Bandwagon

The BWCI Group Newsletter

Quarter 3 - 2018

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Do you need help?

AVIVA

AVIVA - Ceasing to support DB schemes

Aviva have announced that they will no longer be providing administration and actuarial services to their Defined Benefit pension schemes from 30 June 2019. This affects all of their insured schemes in the UK and the Crown Dependencies.

Aviva have identified a major UK accounting firm as a possible alternative service provider. The proposed firm would be expected to have relevant UK pensions experience. However, their pensions experience in relation to Guernsey, Jersey and the Isle of Man is unclear.

Trustees and employers of the schemes affected now need to give careful consideration to the potential impact on their scheme. For good governance, this should include consideration of alternative providers, as well as Aviva's suggestion. BWCI would be one such provider.

In view of the change being forced upon schemes by Aviva, it may also prove to be an appropriate time to review a company's pension provision more generally, including any defined contribution arrangements.

For example, are any other changes desirable, such as reviewing risk management, investment strategy or considering whether there is a more sustainable approach to pension provision? In this context a specialist advisor, such as BWCI, with expertise in the relevant jurisdictions is likely to be of most assistance.

For further information and advice on this issue please contact:
Michelle Galpin - mgalpin@bwcigroup.com
or John Martin - jmartin@bwcigroup.com

New Chief Executive

Michael McKay

We are delighted to announce the appointment of Michael McKay as Chief Executive of our fiduciary business. Michael, who joined BWCI back in 2016 as Deputy Chief Executive, is taking over the role from Steven Jones, who will continue as a board director.

BWCI's Managing Partner Diana Simon said: *"We would like to congratulate Michael on his appointment and wish him every success in his extended role."*

Since joining BWCI, Michael has played a key role in the growth of our pensions trusteeship and administration business, as well leading a major project to introduce our enhanced pension administration system.

2018 Promotions

We are pleased to announce a total of ten staff promotions from 1 July 2018.

There are four promotions within our pensions administration team; Tia Jones, Ashley Gill and Arnis Zugans have all been successful in completing our initial in-house training programmes to become fully-fledged pensions administrators. This milestone marks the launch of their careers and ongoing development in the world of pensions. In addition, Dan Guilbert becomes an assistant manager, reflecting his depth of knowledge and skills.

Amongst our actuarial staff, we are pleased to announce the promotions of Chris Collier to senior analyst in our pensions actuarial team; Chris Ferry becomes a senior actuarial trainee in our actuarial insurance team reflecting his rapid progress through the actuarial exams. In the same team, Michael Jones becomes an assistant manager, whilst actuarial student Luke Richards becomes an assistant manager within our investment team.

Our insurance administration team has been strengthened with the promotion of Justin Pedersen to assistant manager while, within Island Global Research, Lilyanne Guille becomes an assistant manager.

*Left to right :
Luke Richards, Ashley Gill,
Michael Jones, Lilyanne Guille,
Justin Pedersen, Tia Jones,
Dan Guilbert, Arnis Zugans, Chris Collier,
Chris Ferry was unavailable for the photograph*

Thinking about climate risk yet?

"Those with much shorter time horizons cannot ignore the issues"
Michelle Galpin

The headlines are dominated currently by record-breaking temperatures and out of control wildfires in numerous places around the world. Are we now beginning to see the devastating physical effects of climate change on a daily basis?

Since the 2016 Paris agreement, climate-related issues have moved up many corporate agendas. Just over a year ago the Institute & Faculty of Actuaries issued a risk alert on climate-related risks, encouraging all actuaries to consider how climate change might have an impact on their advice.

An understandable initial reaction was to assume that this risk alert was directed at those members of the profession advising on premiums and reserving for insurance products with an element of cover against extreme weather. The relevance for those advising on pensions was perhaps less obvious, at least until you delve a little deeper.

Types of risk

It is very easy to view climate risk solely in terms of the physical damage to property and infrastructure caused by extreme weather events. However, in a speech back in 2015, Bank of England Governor, Mark Carney, identified climate-related risks as falling into three basic categories: physical, transitional and liability.

Transitional risks are beginning to emerge, as the consequences of government policies and other behavioural changes to minimise the impact of climate change. A recent example is the policy shift away from purely petrol and diesel vehicles in the UK by 2040.

Liability risk relates to the financial and reputational impact arising from potential future legal actions against organisations whose historical actions (or lack of action) may have exacerbated a climate-related issue.

Impact on pension schemes.

Those with longer term investment horizons such as pension schemes, and particularly defined contribution schemes, are most at risk of the financial implications of climate change.

However, investors with much shorter time horizons cannot ignore the issues, since they could also be affected if markets price in climate-related risks more quickly. Clearly all pension trustees will need to think about the extent to which their investment portfolio could be adversely affected by the impact of climate change. But what about other areas?

Employer risk

The direct impact on the sustainability of the sponsoring employer needs to be considered. Could it affect a sponsor's ability to fund the scheme? How well could its business model adapt to changes in government policy driven by climate change? For example, if your sponsoring employer is already part of the electric car industry, it is probably better placed than one that would struggle to adapt to a lower carbon world.

Longevity risk

What are the implications for mortality projections? It is well-known that heat waves and severe cold snaps result in a higher than average number of deaths over the period. However, there are also expected to be some health benefits as a result of actions taken to limit climate change; less pollution and better air quality is expected to reduce the numbers of deaths, particularly from respiratory-related diseases. Quite how these two opposing effects offset each other remains to be seen, but many expect the overall impact of climate change to have a limited impact on life expectancy.

What should trustees do?

A good place to start is to think about what climate-related risks might affect either the scheme's investment portfolio or the strength of the sponsoring employer's covenant. Any risks and any mitigations should be included within the scheme's risk register.

The scheme's statement of investment principles may also need to be reviewed and updated to reflect any changes in approach or strategy.

Trustee checklist

The UK Sustainable Investment and Finance Association (UKSIF) has identified five risks in the transition to a low carbon economy. They have produced a helpful checklist for pension scheme trustees to consider the risks to their scheme.

Further details can be found at: http://uksif.org/resources/a-checklist-for-pension-trustees/

Risks identified by the UKSIF	
Political	Action from policy makers to reduce greenhouse gas emissions, impacting the value of high-carbon assets
Legal	Litigation claims brought against companies for failing to mitigate against climate change or disclose material financial risks
Technology	New technologies affecting the competitiveness of certain organisations
Market	Shifts in supply and demand for products and services as the market increasingly takes account of climate risks and opportunities
Reputational	Climate change has been identified as a potential source of reputational risk tied to changing customer or community perceptions of an organisation

DC schemes - time for a service?

"Early and targeted action"
Luke Richards

With the increasing regulatory requirements for Defined Contribution (DC) pension schemes, it is easy for trustees to lose sight of one of their key objectives:

"Is our scheme providing good member outcomes?"

There are a number of different aspects to consider. Most trustees will already be reviewing the performance of the investments, but many have yet to consider the choices made by members and whether these are appropriate. The good news is that there are now tools available which can give trustees a complete overview of their scheme and can help identify any issues.

Monitoring default options

Trustees should monitor the ongoing appropriateness of members' investment options as part of good governance. According to Pension Insight's latest UK DC scheme survey results[1], a majority of schemes have over 90% of their members invested in a scheme's default arrangement, with 62% of schemes using a lifestyle strategy as the default arrangement.

The high take up of the default option is a feature of local schemes too. The survey statistics underline the importance of selecting and ensuring the ongoing suitability of the default arrangement, where the majority of a scheme's membership is likely to have invested their retirement savings.

It is particularly important that the default arrangement is reviewed regularly to check if it is meeting its objectives. A key part of this is considering how the investment performance compares to the trustees' targets. Where a lifestyle strategy is used, this is normally assessed by considering the performance of the individual funds that make up the strategy.

However, it is also possible to measure the performance of the lifestyle strategy as a whole. This can be used as a performance check against objectives and as an indication of the returns achieved by members.

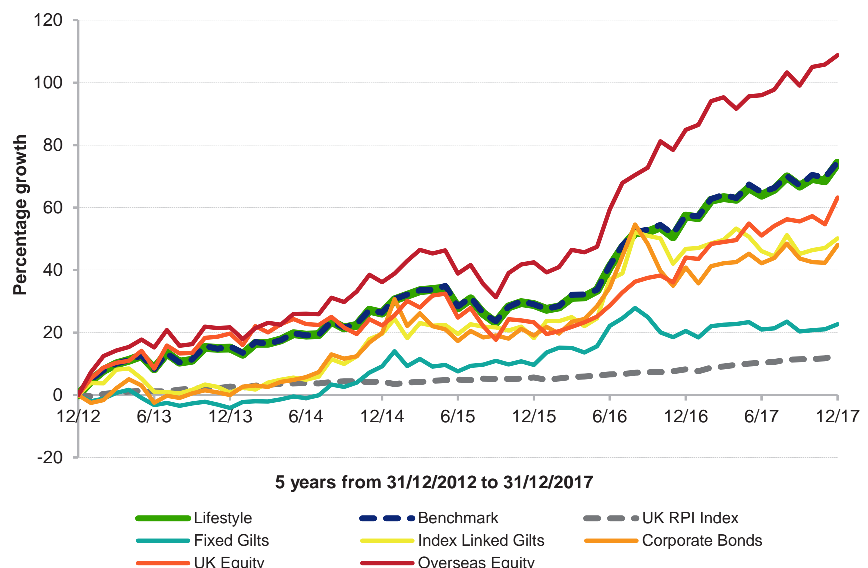
As an example of investment monitoring in practice, Chart 1 shows BWCI's Blue Riband's default lifestyle strategy performance during the growth phase over the 5 years to 31 December 2017. The performance is shown relative to the weighted benchmarks of the funds, the UK RPI Index and the funds comprising the current strategy.

In this particular case, over the 5 year period the lifestyle strategy returned 74.2%, which is 61.5% over RPI. The graph shows that the lifestyle strategy provided returns which were higher than all asset classes (other than overseas equities), but with reduced volatility. The chart also shows that the lifestyle strategy tracked its benchmark, meeting the performance objective set by the trustee.

Review of member choices

Whilst most members are usually in their scheme's default investment strategy, the proportion of members who choose to select their own investment options can vary considerably between schemes. For this latter group, it is important that the funds selected by members remain appropriate for their changing needs over their period of scheme membership.

A review of member choices can help trustees identify any areas where members who opt to select their own investment strategy appear to have been making poor investment choices, such as taking a high level of capital risk relative to their period to retirement. This is done by allocating each member's current investment strategy a risk rating, depending on the mix of investment funds chosen.

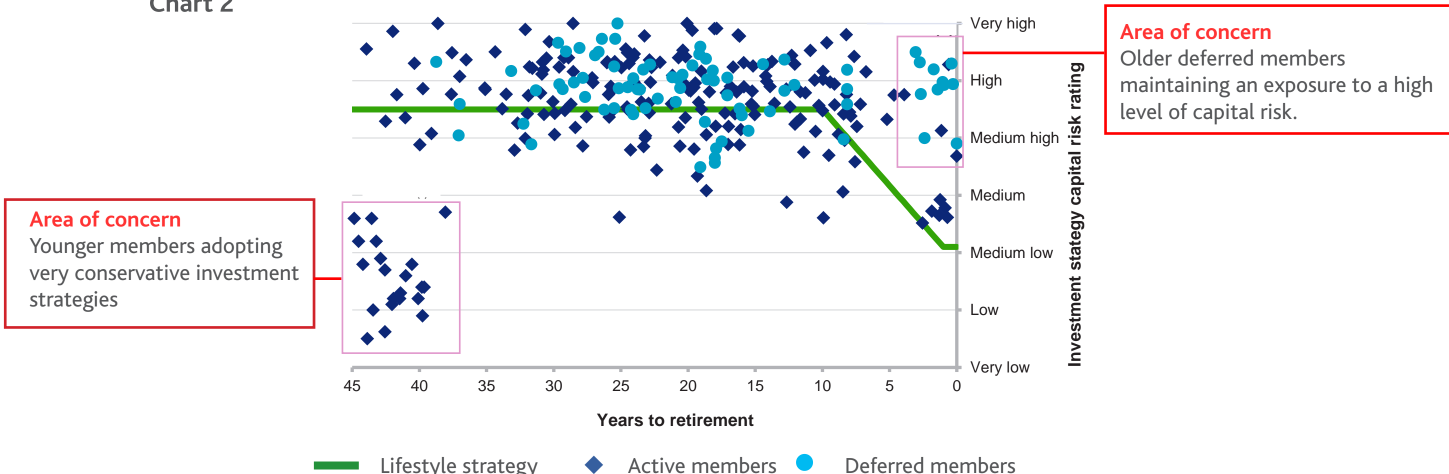


For further details on the tools to monitor DC Schemes, please contact:
investmentservices@bwcigroup.com

[1] Published in DC Landscape: Defined Contribution Pension Plans in the UK an analysis (May 2018) by Pensions Insight in association with Legal & General Investment Management.

Chart 2 shows what the output might look like for a typical scheme. A standard lifestyle strategy (green line) has been included as a benchmark of the expected level of capital risk at each period to retirement. In this example there are two potential areas of concern that may warrant further investigation.

Chart 2



The very low capital risk strategy chosen by members with 40 or so years to retirement suggests that they are invested in low risk/low return funds and could indicate a lack of investment knowledge. In contrast, the high capital risk strategy, predominately amongst deferred members who are within 5 years of retirement, could indicate that they may have not reviewed their investment strategy since leaving service. Armed with this knowledge, trustees can decide how best to address these issues. This could include reviewing communications to target them more effectively.

Projecting retirement benefits

It can be difficult for trustees to understand how a member's particular investment decisions could impact on their retirement outcome, or whether current contributions are likely to be adequate. A projection of members' benefits can help. Chart 3 shows members' projected retirement benefits, relative to their period to retirement.

In this example:

- Younger members have a wide range of projected outcomes for both lifestyle strategy and self-select options
- The projected outcomes are generally poorer for self-select than lifestyle strategy members
- Older self-select members have a larger spread of outcomes than older lifestyle strategy members

In light of these results, the trustees may decide to try to improve member engagement to encourage greater awareness of the need for retirement planning.

Chart 3

Conclusion

Good governance is not a static process; trustees need to consider outcomes for all members on an ongoing basis. Regular monitoring of the default arrangement is particularly important, as it is generally where most members are invested.

The additional reporting options illustrated are powerful tools to enable trustees to track if their scheme is on course to achieve good member outcomes and, where this is not the case, to target action to achieve this. The exercise can be repeated over time to measure the effectiveness of any change and can include other member options such as the level of take up for member contributions by age. Early and targeted action by trustees is more likely achieve better outcomes for all stakeholders involved.

Brexit Round-Up

"Brexit presents an opportunity"

Graydon Bennett

It is difficult to avoid discussions of the UK's impending withdrawal from the EU, and this article must be prefaced with an apology to all readers who feel that they have read more than enough about Brexit over the last 2 years since the results of the referendum were announced. Here we take a different tack, and look at the potential impact of Brexit on insurance companies in countries outside the UK.

Just to clarify, unless specified otherwise, the terms 'insurance' and 'insurer' include reinsurance and reinsurer, respectively.

Rather than trying to make any grand predictions about the terms of the final withdrawal agreement, or whether there will be any transitional arrangements, we consider the current regulatory landscape and highlight some significant changes potentially looming on the horizon.

The Crown Dependencies

While the Crown Dependencies currently enjoy some benefits as a consequence of the UK's membership of the EU, they have never been part of the EU in their own right. Moreover, they are not subject to UK or EU insurance regulations, notably the Solvency II Directive.

Back in 2015 Guernsey developed its own risk-based solvency regime for insurance companies which, from a quantitative perspective, bears some resemblance to Solvency II. However, at the time of publication, Guernsey has elected not to petition the European Commission for recognition of Solvency II equivalence.

Jersey retains a simpler solvency regime; we are not aware of any intention to pursue Solvency II equivalence in Jersey.

The Isle of Man appears to be pursuing a different approach, as it implements a revised insurance solvency regime and makes significant updates to its corporate governance codes for insurers. Indeed, the Isle of Man appears to be seeking closer alignment with EU regulations and has indicated its intention to petition for Solvency II equivalence in the future.

Malta

Malta already enjoys all the rights and privileges of a full member state of the EU, including the application of Solvency II. A key benefit of Solvency II is the passporting rights granted to EU insurance companies. Passporting allows an insurer licenced in one EU member state to write business in any other member state, without the need for authorisation from each separate local regulator.

For Maltese insurers writing policies into the UK under existing passporting rights, Brexit presents an opportunity to review their business plan and risk assessments in anticipation of the potential loss of passporting rights into the UK. Possible solutions for affected insurers include redomiciliation or the establishment of a branch in the UK, or another British jurisdiction such as Gibraltar.

The Bank of England has indicated that EU insurers will retain passporting rights into the UK during the transitional period from March 2019. At the date of publication, no similar assurance has been provided by the European Commission for UK insurers passporting into the EU. However with aspects of the Brexit proposals currently being challenged and tweaked so frequently, this may well change.

Gibraltar

As a British Overseas Territory, Gibraltar will follow the UK when the latter leaves the EU. A number of insurance companies domiciled in Gibraltar currently make use of passporting rights to write business into other EU member states. Therefore, Gibraltar effectively faces the converse of the Maltese problem.

In the absence of any guarantee of transitional arrangements from the European Commission, there is the risk that Gibraltar insurers will not be able to honour policies written in the EU after Brexit.

As with Malta, a redomiciliation may be necessary to maintain an insurer's business strategy. Malta, along with Ireland and Luxembourg, are strong contenders to welcome Gibraltar insurers. For logistical and operational reasons, redomiciliation across the Spanish border may also be worthy of consideration. While subject to Spanish regulations and tax laws, Gibraltar companies moving across the border should notice less operational impact, particularly with respect to local staff.

Conclusions

The final terms of the UK's withdrawal from the EU are far from settled and it remains to be seen whether the European Commission will extend passporting rights to UK insurers during any transition or implementation period. While the main repercussions of Brexit will be felt by the UK and EU member states, third countries will not be immune from the indirect impacts. Despite Brexit fatigue, insurers would be prudent to keep one eye on the debate for a little while longer at least and plan their strategies to deal with a range of outcomes of the negotiations.

Life interests and family trusts

"sometimes the structure is more complex"
Amber Buckingham

Many individuals will ultimately receive an income which is guaranteed to be payable for the remainder of their life. Most commonly this is in the form of a pension, whether it be an annuity purchased from an insurance company, or a pension payable from a defined benefit pension scheme.

Placing a value on future income streams is a key part of the actuarial calculations required to quantify the financial health of a pension scheme. However, there are other circumstances in which similar techniques can be used to value an income stream. One such situation is when an individual needs to be compensated financially for the loss of a life interest in a property.

What is a Life Interest?

The right to a life interest is usually created in a will and is designed to give a person the benefit of a property for the rest of their life. This benefit can either take the form of the right to live in the property rent-free, or the right to receive the rental income from the property, if it is rented out to another party.

A common example of a life interest is when a surviving spouse or partner has the right to remain in a property for the rest of their life, before it is passed on to the next generation. However, sometimes the structure is more complex and two or more people may each have a life interest.

Valuing a life interest

A life interest has a value and, with the agreement of all parties involved, it can be exchanged for an immediate capital payment. In practice, this is often done when the property is sold; part of the sale proceeds go to the life interest holder, and the balance, known as the reversionary interest, is paid to the vendor.

In financial terms, the right to live in a property can be thought of as the cost of renting an equivalent property over the same period.

The actual value of the future rental income payments cannot be known with certainty in advance. This is because it is impossible to know at the point the life interest needs to be valued how long the life interest holder will live and at the level of rental income.

In many ways, this is no different from placing a value on future pension payments. Therefore a life interest can be valued by applying the same actuarial techniques used for valuing pension incomes. The information required includes the market value and rental income of the property when the life interest is to be valued. Sufficient information to be able to estimate the life expectancy of the life interest holder(s) is also needed.

Family Trusts

A life interest in a property is just one example of where actuarial advice is required to place a value on a future income stream. Another area, where we are receiving an increasing number of requests, is in connection with the winding up of family trusts.

Often, the trust's rules will entitle several beneficiaries to an income payable for life. Typically the trust will have been set up many years previously, when interest rates were considerably higher than they are now. As a consequence, the level of income generated by the trust's assets may have fallen to such a level that it is no longer financially viable to operate the trust and still pay the beneficiaries the sort of level of income they had enjoyed in the past.

These cost pressures are prompting some trustees to look at how to distribute the remaining trust assets fairly between the beneficiaries so that the trust can then be wound up. A fair allocation of the trust's assets will depend on the life expectancies of the beneficiaries and any specific requirements of the trust.

The income of each beneficiary is likely to depend on how many are alive at a particular point in time and whether they have any heirs who would continue to benefit from the trust after their death. Therefore a bespoke model needs to be developed to reflect the provisions of an individual trust. This model can then be used to illustrate the sensitivity to each beneficiary's share of the trust's assets to changes in the modelling assumptions.

Life interests and family trusts are just two examples of where actuarial advice may be required outside of the more traditional areas of actuarial work in pensions and insurance.

BWCI has considerable experience in providing bespoke advice as an expert actuarial adviser in relation to life interests and family trusts and are able to provide certification of the allocation of the assets in a variety of scenarios.

For further details, please contact :
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Amber Buckingham - abuckingham@bwcigroup.com

Our new actuary

Michael Jones

We are delighted to announce that Michael Jones, an assistant manager in our insurance actuarial team, has passed all of the exams required to qualify as an actuary.

Michael joined BWCI in 2013, after graduating with a degree in theoretical physics from the University of Durham.

BWCI's student coordinator Matt Stanbury said:

"The actuarial exams are particularly challenging as they cover a wide range of skills, including solving practical problems and communicating the solutions clearly. Michael has been a model student and has made rapid progress with his studies passing the 15 exams required to qualify in excellent time. We congratulate him on this achievement."

2018 Bursary Student

Bella Ogier

We are pleased to announce that Bella Ogier has been awarded the 2018 BWCI Bursary, which will provide both financial support and practical work experience for the duration of her university course. Bella hopes to take up her place at the University of Durham to study for a degree in Natural Sciences (Maths and Physics) in October.

Bella has just completed her A Levels in Maths, Further Maths, Physics and Chemistry at Guernsey's Ladies' College and will be working with us during her summer vacations. We aim to provide our bursary students with a wide range of experience in different departments and Bella's first placement is in our trust team.

2018 Mini Soccer Festival

Everton Toffees - 2018 BWCI Shield winners

2018 BWCI Mini Soccer Results	
BWCI Shield Winners	: Everton Toffees
Runners up	: St Pauls
BWCI Plate Winners	: Bodyline St Martins
Runners up	: GFA Aztec Lions

The first weekend of the school holidays saw 21 mini soccer teams take part in the 2018 BWCI Mini Soccer Festival. This year we welcomed two academy teams from Everton, and a third from Bristol City. They were joined by another UK team and festival stalwarts, Braunton FC.

Following the group stages, the top 16 teams proceeded to the knockout competitions for the BWCI Shield and BWCI Plate. The leading Channel Island team was Jersey's St Paul's. They ended the 9 match group stage having scored an impressive 32 goals, while conceding just 3. Their winning run continued until they took on the Everton Toffees in the final. After a very close match, the Everton team finally triumphed 2-1.

The BWCI Plate final was an all Guernsey affair, which ultimately had to be settled on penalties, with Bodyline St Martins edging out GFA Aztec Lions.

Festival Chairman, Martyn Banton said:

"It's clear that the fantastic reputation of the festival ensures that the event continues to not only be one of the highlights of the Guernsey sporting calendar, but also attracts interest from outside of the island"

BWCI would like to thank Martyn and his team for all their hard work, not only over the festival weekend, but also over the many months of preparation to make sure everything runs so smoothly.

Readers are reminded that nothing stated in the newsletter should be treated as an authoritative statement of the law on any aspect, or in any specific case and action should not be taken as a result of the newsletter. We will be pleased to answer questions on its contents.

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