Bandwagon

The BWCI Group Newsletter

Quarter 3 - 2017

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Action from the 2017 BWCI Mini Soccer

A New Partner

Michael McKay

We are delighted to announce the promotion of Michael McKay to Partner. Michael joined us in 2016 as Deputy Chief Executive of our fiduciary business, bringing with him a wealth of operations experience in accounting and financial services in both Guernsey and the Isle of Man.

Over the last year Michael has taken over responsibility for some of our key clients. In addition, he has led on a number of projects to drive forward the development of our pensions administration business.

In announcing the promotion, BWCI's Managing Partner Diana Simon said:

"Since Michael joined us he has made a significant contribution to the management and development of the fiduciary business and his promotion is a reflection of this."

As well as Michael's promotion, the career progression of a number of other BWCI staff has also been recognised. Further details are provided on the back page of Bandwagon.

Brussels Conference

BWCI's Mike Freer (left) and John Martin

BWCI was very fortunate to be able to secure a slot to speak at the prestigious annual conference of the International Employee Benefits Association (IEBA) which provided us with a fantastic opportunity to spread the word that Guernsey is an ideal location in which to establish and operate international pension plans.

One of our international specialists and BWCI Partner, John Martin, provided an overview of BWCI's knowledge and experience of assisting corporates in many overseas locations in his presentation entitled: '*Global Pension Solutions for Globetrotters*' to an audience of over 75 international delegates from a range of multi-national organisations.

John included some case studies of how BWCI had worked with a wide range of different clients, from those with just a handful of employees in certain jurisdictions, to those with several thousand personnel, often in jurisdictions where local provision was not readily available.

The subsequent discussion focussed on the challenges faced by international compensation and benefits teams in identifying and providing the best pension solutions in different jurisdictions, with differing local social and/or gratuity arrangements.

For further details on international pension plans please contact John Martin at jmartin@bwcigroup.com.

2017 Bursary Student

Fraser Casbolt

We are pleased to announce that Fraser Casbolt has been awarded the 2017 BWCI Bursary.

Fraser, who has just completed his A-Levels in Maths, Economics, Geography and Biology at Elizabeth College, will be working with us for two months over the summer, initially in our trust team. He then hopes to take up his place at St Edmund Hall College, Oxford in October where he plans to continue his studies, reading Economics and Management.

BWCI's bursary is designed to provide local students with the opportunity to gain practical experience across our range of business areas. Each year, for the duration of their undergraduate course, we provide our bursary students with eight weeks of paid work experience.

We hope that the new skills our bursary students develop, in a working environment, will complement their academic studies.

Alison Hawkins, BWCI's Senior HR Manager, said:

"We were very pleased with the calibre of applications for our bursary, and it was a pleasure to interview the short-listed applicants. We are delighted that Fraser accepted our bursary offer, and look forward to introducing him to different aspects of work at BWCI whilst he pursues his academic studies at Oxford".

Outside of studying Fraser likes to blow the cobwebs away and settle the mind cycling.

DC Scheme Investment: Pension Freedoms

"a guaranteed income in retirement is an appropriate part of a good retirement package"
Hannah Gibson

For Channel Islands residents, RATS [1] and RTS [2] have long been options for Defined Contribution ("DC") scheme members who wished to avoid purchasing an annuity in retirement.

This happy state of affairs did not extend to all UK DC members until 6 April 2015, following George Osborne's radical 2014 budget announcement, which leapfrogged the Channel Islands' flexibility, permitting withdrawals up to 100% of a member's pension pot.

The UK pensions industry was taken completely off guard (as were most others) so it has taken time to adapt.

In 2017 we can now consider the trends in DC schemes, based on the results of Pensions Insight's latest DC schemes survey results[3], and reporting from the UK Pensions Regulator.[4] These provide useful insights for both UK and offshore schemes.

DC scheme trustees are responsible for ensuring that both the initial selection and ongoing investment options remain appropriate, so in the UK their immediate considerations were how scheme members might respond to the pensions freedoms, and what action should be taken.

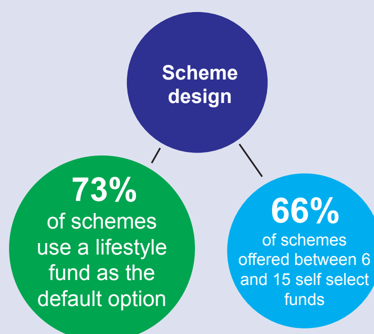
Trustees needed to consider the interaction of:

- changes to options available at retirement
- their scheme's membership profile and member preferences
- market practice and trends

Trustees' main focus initially needed to be on the scheme's default investment strategy, since this was where the vast majority of members' pension pots were invested. Indeed, the latest information from the UK Pensions Regulator reported 92% of members were invested in their scheme's default strategy. This is also consistent with BWCI's experience of schemes in the Crown Dependencies.

Scheme design

A default strategy is there for those members who do not feel they understand, or do not want to be involved in, the investment process. This is frequently for the very good reason that they are not investment experts, or even familiar with investments; a range of self-select funds is available for everyone else.



Source: Pensions Insight

A lifestyle strategy automatically switches a member's investments in accordance with a set of rules, based on a member's period to retirement. The trustees can control the asset classes and the shape of the transition to retirement date. These advantages make lifestyle particularly suitable as a default strategy. But how do the range of new retirement options fit with a default?

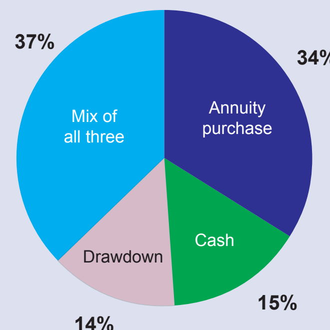
Default strategy retirement target

DC members in the UK have the following retirement options:

1. Purchase an annuity
2. Draw down income from their pension pot
3. Take a cash lump sum
4. A combination of the above three

The breakdown of schemes' default strategy retirement targets show how these options are reflected.

Default Retirement Target Strategies



Source: Pensions Insight

The design of the default investment strategy at retirement needs to reflect what members will want to do in general. For example, those with small pots at retirement may well want to cash them in. However, those with more substantial pots may want something more diversified. A single strategy would have to average these out. A more sophisticated approach would be to have pension pot size guide asset allocation.

Despite the freedoms, responses to the Pensions Insight survey indicated that 71% (34% +37%) of schemes were still targeting annuity purchase for at least a proportion of their default pension pot allocation at retirement. This suggests trustees still consider that a guaranteed income in retirement is an appropriate part of a good retirement package.

Conclusions

DC scheme trustees need to review the investment options in their scheme regularly. If you are a trustee of a DC scheme, here are a few questions to consider:

- When was your scheme's last review?
- Is your default strategy still appropriate?
- Do the self-select funds allow members to target their preferred retirement options?
- What do members think about the investment options?

[1] Retirement Annuity Trust Scheme in Guernsey

[2] Retirement Trust Scheme in Jersey

[3] Published in September 2016 by Pensions Insight in association with J.P.Morgan Asset Management, based on a survey of a sample of 139 UK schemes

[4] The Pensions Regulator's 2016-2017 Scheme return data on 34,500 occupational trust-based schemes

For further details on DC investment reviews please contact Hannah Gibson at hgibson@bwcigroup.com

Guernsey Pension Regulation - Update

"some initial action will be required before the end of September 2017"
Michelle Galpin

In the last edition of Bandwagon we outlined the proposed regulatory framework for pensions in Guernsey which, at that time, had just been announced. We then saw a flurry of activity in June; the States approved the high level framework and the Guernsey Financial Services Commission ("the Commission") published their finalised pension rules. As a result, we now have more clarity about the requirements and the timescales for compliance.

In this article we look at what this new regulatory framework is likely to mean in practice.

What is a gratuity scheme?

This is a retirement benefits scheme that provides a lump sum, rather than a pension at retirement.

Background

The first phase of the implementation of the regulatory framework has already begun, with the extension of the Commission's supervisory remit to include "the formation, management and administration of pension and gratuity schemes". Gratuity schemes are now included in response to feedback received during the consultation on the draft rules.

The requirements came into force on 30 June 2017 and apply to both domestic and international arrangements which are either formed, managed or administered by Guernsey licensed fiduciaries. Table 1 shows which schemes are affected in this first phase.

The second regulatory phase is expected to be introduced by primary legislation in due course. We do not yet know the likely timescale for this, but we anticipate that it could be at least two years away, possibly longer. It is at that stage that the scope of the pensions regulatory framework could potentially be extended to cover a wider range of schemes, rather than just those which fall within the first phase. It is also possible that the regulatory requirements themselves could be extended at that stage.

Schemes affected

Both defined contribution and defined benefit occupational arrangements are potentially affected. In addition retirement annuity trust schemes ("RATS"), either established as an employer sponsored arrangement or on an individual basis, are within scope. In particular, any occupational scheme or RATS where a fiduciary licensee has some involvement, either as a trustee or an administrator (or both) will need to comply with the new requirements (see Table 1).

In a change from the consultation draft, the scope of the Commission's remit now more explicitly includes schemes where insurance intermediaries are involved.

What does this mean in practice?

The Commission's rules impose immediate requirements on fiduciary licensees and some initial action will be required before the end of September 2017. Full compliance is required by 30 September 2018.

Table 2 highlights some of the main questions that will need to be considered by schemes that fall within the scope of this first phase of the regulatory framework.

Inevitably the new requirements will generate some questions as they are being implemented and we are in the process of seeking clarification on a number of detailed requirements.

Transitional Arrangements

While the Commission's rules are already in force, there is a two stage transition period, before full compliance will be required, as follows:

Stage	Compliance Requirement
1	Licensees to have conducted an assessment of their internal controls to identify and plan for compliance. **Deadline: 30 September 2017**
2	Licensees to ensure full compliance. **Deadline: 30 September 2018**

While licensees have 15 months to put in place all of the necessary processes and procedures to be able to demonstrate compliance, the initial 3 month deadline for identifying and planning what is required means that work towards compliance will effectively need to begin immediately.

If either your scheme's trustees or administrator are affected, they will need to carry out a preliminary scheme audit and gap analysis to identify any areas where changes may need to be made or where further investigations may be required.

Conclusions

We welcome the introduction of a formal regulatory framework for pensions in Guernsey. As well as supporting Guernsey's international pensions industry, the new requirements should help to raise the profile of pensions within Guernsey, promote good scheme governance and ultimately enhance members' outcomes at retirement.

If you would like any assistance with identifying whether your scheme may be affected, or what action may be required, please contact your usual BWCI advisor or email Michelle Galpin at mgalpin@bwcigroup.com.

Table 1 - Is your scheme affected?

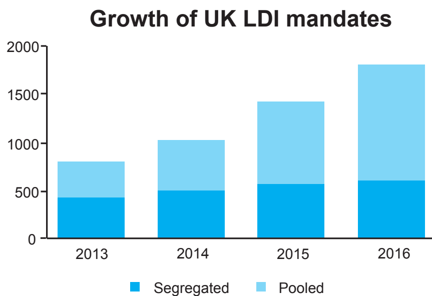
		Type of Trustee		
		Guernsey Licensed Fiduciary	Mixture of Licensed and Lay Trustees	All Lay Trustees
Type of Administrator	Guernsey licensed fiduciary	Yes	Yes	Yes
	Out-sourced to non-licensed provider	Yes	Yes	No
	In-house administrator (unless a Guernsey licensee)	Yes	Yes	No

Table 2 - How does your scheme measure up?

Area	Preliminary compliance questions
Governance procedures	■ Are internal controls robust? ■ How are conflicts of interest managed? ■ What tax-reporting procedures are in place? ■ Is your data complete and accurate? ■ When did you last audit the data? ■ Do you need a governance committee?
Documentation	■ Are scheme documents complete and up to date? ■ Are all documents stored safely? ■ Are documents made readily available to members?
Members and Beneficiaries	■ Are they treated fairly? ■ Are they given clear and transparent information? ■ Does the scheme have a formal complaints procedure?
Charges (DC Schemes only)	■ Are member charges reasonable? ■ Are member charges transparent?
Benefits	■ How regularly do you provide benefit statements? ■ Are they clear and accurate? ■ Is the prescribed information on the benefit statements?
Contributions	■ Does the scheme have a contribution schedule? ■ Are reasonable safeguards to monitor payment of contributions in place?
Transfers	■ Are transfers processed promptly?
Investment	■ Does the scheme have a clear statement of investment principles? ■ Is any employer self-investment limited to 5%?

Time to Consider LDI?

"it is now much more cost-effective and simpler for schemes to adopt LDI"
Carl Stanford



Source: KPMG's 2017 LDI survey

Liability Driven Investment ("LDI") is an investment approach that can help trustees of defined benefit pension schemes to reduce funding volatility. It does this by reducing the risk that asset and liability values change at different rates, or even move in different directions. Depending on how it is structured, LDI may also provide an opportunity to improve the funding position.

The last couple of years or so have seen a much greater take up of LDI. According to a KPMG report published recently, total UK pension scheme exposure to LDI rose to an estimated £908 billion over 2016, an increase of more than 23% over the year.

This move towards LDI solutions has been influenced by the injection of new products into the market, most notably pooled leveraged LDI funds. However, LDI is still often perceived as only being practical for large schemes; unfamiliarity with the latest developments in LDI solutions now available means that some trustees and employers are not yet aware of the potential benefits of an LDI approach.

In this article we explain how LDI funds work and why they are potentially such a valuable risk reduction tool for trustees.

How liabilities are valued

Understanding the factors that can influence a pension scheme's valuation result are central to getting to grips with LDI.

The three main factors influencing the value placed on scheme liabilities are:

- **Interest rates** – if expectations of interest rates **rise**, expected investment returns rise and the so the present value of liabilities **falls**
- **Inflation** – if expectations of future inflation **rise**, expected benefit increases rise and the present value of liabilities **rises**
- **Longevity** - if longevity **increases**, benefits are expected to be paid for longer and the present value of liabilities **rises**

Changes in interest rates and inflation expectations can result in significant changes in a pension scheme's funding position. For example, a 0.5%pa fall in expected interest rates can result in an increase in liabilities of more than 15% for schemes with long durations (30+ years).

Unrewarded risks

Interest rate and inflationary risks are unrewarded risks. Trustees do not expect their scheme to benefit from taking these risks in the long term, so their reduction or removal is therefore considered beneficial.

How to reduce liability risks

Pension schemes can manage liability risks by investing in assets which change in value in line with the value of their liabilities.

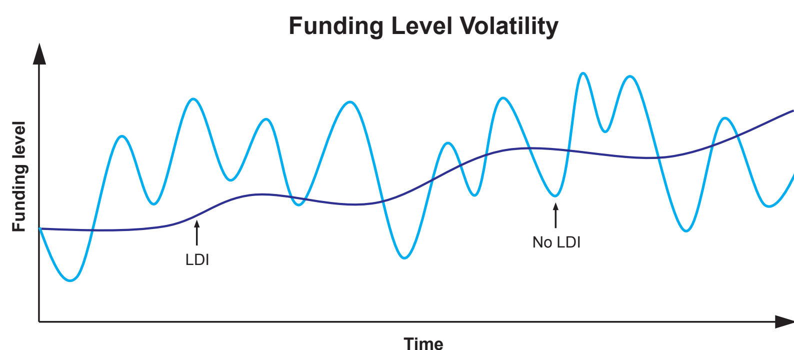
Traditionally, bonds have been used to implement an asset/liability matching strategy. However this approach can place significant capital demands on schemes, particularly if the target is full hedging. A further issue is that a bond-based approach could result in a poor match for the longest-dated cashflows. As a result, many pension schemes using just bonds are unable to hedge their liabilities to the desired extent, and instead retain this as a funding risk.

LDI funds

Historically, LDI was only available to large pension schemes using bespoke arrangements tailored to their liabilities. However, the evolution of off-the-shelf LDI funds means that it is now much more cost-effective and simpler for smaller schemes to adopt LDI.

Due to the gearing involved, an LDI fund initially only requires some of a pension scheme's assets to be used (typically one third) to largely eliminate exposure to funding risks from movements in interest rates and inflation expectations. This now makes highly effective liability hedging possible for many more schemes. The remaining assets can then be allocated to return-seeking growth assets, such as equities and property.

The graph illustrates how a scheme's funding level might progress with an LDI strategy in place, compared to the same scheme without LDI.



For further details on LDI funds please contact Carl Stanford at cstanford@bwcigroup.com

Using LDI funds

The simplest approach requires schemes to select a combination of real and fixed, short and long duration LDI funds to replicate the liability profile of their scheme. It is these low governance, low cost LDI solutions that are becoming increasingly popular with trustees.

To increase LDI coverage investors simply purchase additional units; conversely units are sold to reduce or remove hedging. The value of the LDI funds is the value of the units held.

How LDI funds work

An LDI fund is usually invested in a cash fund and derivatives. The cash amount fluctuates as money is posted to and from the derivatives. The changes in the value of the LDI fund, as a result of changes in interest rates and/or inflation, would be expected to reflect movements in the hedged liabilities.

If an LDI fund becomes large, relative to the hedged liabilities, a dividend is paid to unit holders. Alternatively, if an LDI fund reduces, relative to hedged liabilities, the percentage of hedged liabilities is reduced. At this point investors would have the option either to purchase additional units to retain the same level of liability hedging, or to opt for the lower level of hedging.

LDI example

We consider the implications of adopting LDI funds using an illustrative scheme, which is 75% funded, with assets of £24m and liabilities of £32m. The effect on the funding level is considered after an immediate 0.5%pa reduction to expected interest rates and separately a 0.5%pa increase in inflationary expectations. Three investment strategies are considered:

- 100% equities
- 33% matching bonds
- 33% LDI funds

and the results are illustrated in the charts below.

In the lower interest rate or higher inflation scenario, the funding level reduced significantly for both non-LDI strategies; it remained unchanged for the LDI funds strategy under both scenarios. In addition, while the bond and LDI funds strategies have the same allocation to matching assets (£8m) the leveraged nature of the LDI funds enabled a higher level of protection.

Governance

The governance associated with an LDI approach would normally fall on the trustees. However the pooled approach offered by LDI funds means that these obligations fall on the fund manager instead. This is a service that is wrapped up in the product, which is a key benefit for trustees.

Conclusion

The courses of future interest rates and inflation are uncertain; they are unlikely to be smooth. LDI funds provide trustees with the tool to largely eliminate interest rate and inflation risks and reduce funding volatility, whilst also investing for growth.

Trustees could chose initially to start slowly, perhaps by just hedging a percentage of the liabilities, rather than all of them. An LDI hedging strategy could be phased over time, perhaps in response to changes in interest rates or improvements in the funding level.

LDI could also be used to replace the matching provided by an existing bond portfolio and, in doing so, enable an increased allocation to growth assets.

The starting point for determining an appropriate level of LDI investment is often for trustees to assess their scheme's sensitivity to movements in interest rates and inflation. Armed with this information they can then consider if any risk retained is consistent with their risk appetite and objectives and those of the sponsoring employer.

BWCI Promotions

From left to right:
Back row: Jessica Sumner, Jason Hart, Zoe Domaille, Andrew Barker
Front row: Michael McKay, Philippa Bonnick, Amber Buckingham, Samantha Bisson, Katarzyna Gryzcka, Fiona McDonald, Dan Moyles

In addition to Michael McKay's promotion to Partner, we have announced a further ten staff promotions in six of our business and support teams.

Half of these promotions are within our pensions administration team; Andrew Barker, Samantha Bisson and Katarzyna Gryzcka, have all become senior administrators, reflecting their depth of knowledge and experience in pensions administration. In addition, Zoe Domaille and Dan Moyles have earnt their stripes, moving up from trainee to full administrator level.

Within our actuarial pensions team, we are pleased to announce the promotions of Jessica Sumner and Amber Buckingham to senior actuarial trainees as they progress through the actuarial exams. In our investment consulting team Philippa Bonnick becomes a senior analyst.

Our compliance function has been strengthened with the promotion of Jason Hart to senior compliance and insurance management officer. Finally, Fiona McDonald becomes an assistant manager in our trust administration team.

The Partners would like to thank all staff for their hard work and commitment to BWCI, and congratulate everyone on their career progression.

Everton Champions Again!

After a weekend of action-packed football, the team from Everton came out on top once again, winning the 2017 BWCI Mini Soccer Festival against Southampton in a repeat of last year's final. However unlike last year, which had to be decided on penalties, this year Everton triumphed 1-0 to take the BWCI Shield home again.

The BWCI Plate final saw an all Jersey affair, with St Paul's beating Jersey Wanderers, also with a score line of 1-0.

Festival chairman, Martyn Banton said: *"The BWCI festival has established an enviable reputation, which is evident in the continued high number of entries each year".*

BWCI Managing Partner, Diana Simon said: *"We are delighted to be able to support this community event and we would like to take this opportunity to thank Martyn and his team for all their hard work, not only during the festival, but also throughout the year which makes everything run so smoothly."*

Future Jersey

Jersey's Chief Minister, Senator Ian Gorst

We were delighted to have the opportunity of sponsoring the Jersey Chamber of Commerce lunch when Chief Minister, Senator Ian Gorst, launched "Future Jersey". The document sets out the vision for Jersey over the next 20 years and how progress against the long-term social, environmental and economic targets will be measured.

Further details and the facility to provide feedback on the proposals are available at www.shapingourfuture.gov.je

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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