Bandwagon

The BWCI Group Newsletter

Quarter 1 - 2018

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Guernsey Pocket Pensions

Guernsey Pocket Pensions Guide

We have just launched BWCI's Guernsey Pocket Pensions. We hope that you will find it a useful source of information and answer many of the general questions you have about pensions. It includes information about Guernsey's old age pension and the new secondary pension scheme, as well as a pensions jargon buster and contact details for our subject specialists if you need more information.

https://www.bwcigroup.com/downloads/pocket-pensions/Guernsey-pocket-pensions-2018.pdf

2018 Bursary Applications

BWCI has launched its 2018 undergraduate bursary, which has been specially designed to support local students wishing to study for a degree at university.

While we invite applications from all local students meeting the academic criteria, preference is given to those studying for degrees in maths, economics, or other subjects with some mathematical content.

As well as a student's academic qualifications and achievements, we are interested to know what students would hope to gain from a period of work experience with us.

Application forms can be downloaded from our website: https://www.bwcigroup.com/bursary Short-listed candidates will then be invited to an interview, before the recipient is chosen.

For further details about the bursary scheme please contact our HR Administrator Kayley Bostock at kbostock@bwcigroup.com.

Closing date : Friday 9 February

New Insurance Business Actuarial Guidance

Revised Guidance Notes

Actuarial Requirements and Standards
Applies to all internationally and locally incorporated domestic insurance companies licensed in Guernsey.

Actuarial Valuations
Applies to all Guernsey licensed life assurance companies (i.e. long term insurance).

Background

The Guernsey Financial Services Commission has recently revised two guidance notes relating to actuarial requirements for insurance business. The revisions, which took effect from 1 January 2018, follow changes made to the Institute and Faculty of Actuaries' professional standards, together with the introduction of the Insurance Business (Solvency) Rules 2015 ("the Guernsey solvency regime").

Impact on insurers

The impact of the changes is expected to be minor. We anticipate that compliance statements in some actuarial reports will change after 1 January 2018. In addition, there could potentially be more scrutiny of valuation data.

Copies of the updated guidance notes are available from https://www.gfsc.gg/industry-sectors/insurance/legislation-and-guidance

Key Changes

- Clarification that the same standards must be applied to actuarial work performed by actuaries for both general and long term business, as well as for both domestic and international insurers.
- Compliance with all relevant professional or technical actuarial standards must be stated in any actuarial report.
- Actuarial valuation reports for long term insurance business must include details of the data checks performed.
- The terminology has been updated to reflect the Insurance Business (Solvency) Rules 2015 and the guidance now makes explicit reference to the Prescribed Capital Requirement and Minimum Capital Requirement.
- References to the Institute and Faculty of Actuaries' *Guidance Note GN5 (The Prudential Supervision outside the UK of Long-term Insurance Business)* have been removed, following its withdrawal in July 2017.

What MiFID II means for Pension Schemes

"greater transparency around investment activity and charges"
Carl Stanford

The original Markets in Financial Instruments Directive (MiFID) was implemented in November 2007 to harmonise the regulation of investment services across the EU[1]. However, the 2008 financial crisis exposed some of MIFID's shortcomings in focusing on equities. Combined with the need to keep up with advancements in technology and the requirement for greater transparency in the financial system, the directive was revised and the Markets in Financial Instruments Regulations 2017 introduced. The updated directive and new regulations are collectively referred to as MiFID II.

The extensive reforms came into effect from 3 January 2018 and cover virtually all aspects of financial trading within the EU. Despite the UK being in the process of leaving the EU, UK investment managers must comply, as the new requirements have been incorporated into in the FCA[2] rules.

Objectives

MiFID II's key objectives are:

- transparency
- investor protection.

It also aims to increase market efficiency and regulators' ability to analyse activity of market participants. This is achieved by strengthening existing conditions and introducing new requirements in various areas. In this article we focus on the impact on pension schemes which use the services of EU investment managers.

Impact on Pension Schemes

1 **Bundled external research fees**

Investment managers sometimes outsource investment research to investment banks and brokers. Typically the fee for such advice is bundled with the commission charged on trades placed. Historically such costs have all been accounted for as transactions costs; they would not have been included in a fund's Ongoing Charges Figure (OCF).

MiFID II prohibits the use of bundled fees. Instead, it requires separate charges for external research and trade execution. While this is not expected to change the overall level of fees, the OCF for some funds will increase as managers make an explicit charge for these services. Other managers have taken the decision to absorb the costs of external research so some schemes may actually see a reduction in overall fees.

2 **Legal Entity Identifier**

MiFID II broadens transaction reporting obligations to include all investments traded in the EU, including non EU derivatives that relate to an EU[1] security or index. The data to be recorded includes identifiers for the underlying buyer and seller, as well as a timestamp of the transaction.
This is designed to help increase market supervision and prevent market abuse.
The Legal Entity Identifier (LEI), a unique 20-character code, is required for pension schemes that use the services of a financial institution subject to MiFID II reporting.

From now on, investment managers will not be able to execute trades on behalf of pension schemes that have not yet obtained an LEI. Schemes can check if they have an LEI on the global register of LEI holders (www.gleif.org). The International Stock Exchange (TISE) have an LEI service to obtain, renew and maintain LEIs. Further details can be found at http://www.tisegroup.com/lei-service/
Pension schemes can apply directly or through their investment manager.

3 **Additional disclosure and reporting**

Under MiFID II, investment firms now have a duty to take sufficient steps to obtain the best results when executing client orders. Firms also have to report to clients, on a more stringent basis, about the quality of their execution, including complex and granular reporting of investment costs and charges both in percentage and cash terms.

In addition, investment firms must now provide quarterly investment performance reporting and notify clients within 24 hours if their portfolio falls by 10% in a reporting period. Further reporting is required after subsequent falls of 10%.

4 **Investment Management Agreements**

The new requirements relating to disclosure and best execution are likely to require changes to existing investment manager agreements. The onus is on investment managers to ensure compliance.

Conclusion

While investment managers have chosen different approaches to implementing the MiFID II changes, from an investor's perspective, they should create greater transparency around investment activity and charges. This is expected to improve pension scheme member protection and make it easier to compare fees between managers, and carry out value for member assessments.

Pension schemes which have not yet considered the implications of MiFID II may wish to ask their investment managers about the approach taken and schedule a fee review in their business plan for 2018.

MiFID II
Impact on Pension Schemes

- Unbundling of investment fees
- Legal Entity Identifier (LEI) needed
- Best results on execution of trades
- Increased client reporting
  - Cost and charges
  - Portfolio movements

[1] As well as Iceland, Lichtenstein and Norway, as members of the European Economic Area

[2] Financial Conduct Authority

Guernsey Pensions Regulation - Gap analysis

"The Rules are marginally less onerous for DB schemes than for DC schemes"
Erin Bisson

Last year saw the States approve the introduction of a pensions regulatory framework. As part of this process, the Guernsey Financial Services Commission ("the Commission") published The Pension Licensees (Conduct of Business) & Domestic and International Pension Scheme and Gratuity Scheme Rules 2017 ("the Rules"). These came into force on 30 June 2017 and **full compliance is required by 30 September 2018**.

As an interim step, licensees had to conduct a "gap analysis" by 30 September 2017, to identify any gaps in compliance with the new requirements. We have completed this analysis on behalf a number of our clients, as well as for schemes where we have licensee obligations. The results of this analysis highlighted some interesting patterns.

Key areas

We analysed schemes' compliance into ten key areas:

- Compliance
- Contributions
- Investment
- Benefits
- Members and beneficiaries
- Transfers
- Service providers
- DC charges
- Documentation
- Governance

There results were coded with a traffic light approach to identify the areas for immediate action easily:

Action required

Action recommended

No action required

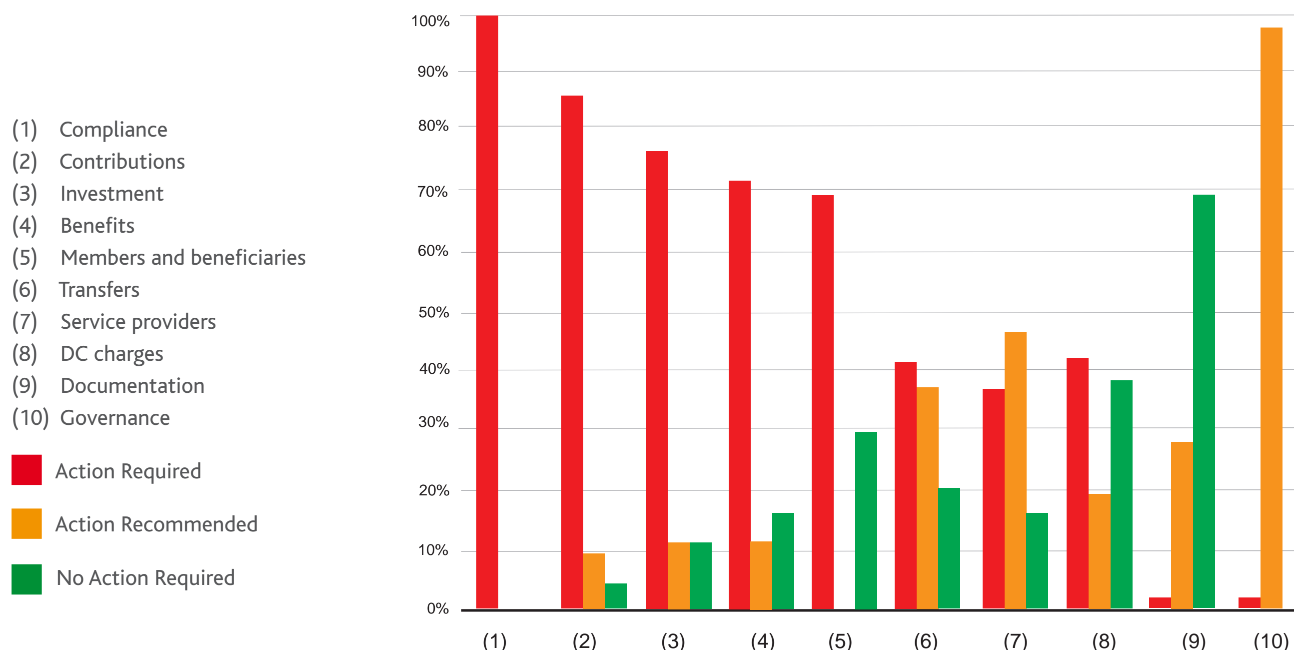
Compliance

Some of the regulatory requirements are new, such as filing a compliance return. Consequently this was a gap identified in all schemes. In due course the return will need to be submitted electronically, through the Commission's website. At this point those responsible for schemes affected need to recognise that the return is a new requirement and include it in their business plan for the year.

Contributions

The Rules require that a contribution schedule is in place. This will set out when contributions are due, together with the amount. While a contribution schedule has been a statutory requirement for UK and Isle of Man schemes for a number of years, our analysis showed that many Guernsey schemes do not yet have a formal contribution schedule.

Figure 1
Compliance by Category



Those schemes which already have a schedule in place will still need to take some action. In particular, they will have to review their processes to ensure contributions are paid in line with the schedule and that action is taken in the event of non-compliance.

Governance

The Rules stipulate that schemes must have a governance committee unless it is decided that it is not required. This is something that should be considered soon, ideally at the next trustees' meeting. Trustees should ensure that if they are not going to put a governance committee in place, they document clearly the reasons for their decision.

Documentation

We found that generally most schemes were compliant with the Rules surrounding documentation requirements and were storing and maintaining their documentation appropriately.

Investment

Investment was another area where most schemes currently appear to meet or almost satisfy the requirements.

Generally some documentation was in place around the scheme's investments; however it was not always fully compliant with the new requirements. We found that some schemes had a fully compliant statement of investment principles ("SIP"). However, while others had a SIP, it did cover all of the points required in the Rules. We also found that some schemes had investment documentation and guidance, but not a formal SIP.

Transfers

Most schemes had set procedures for dealing with requests from members to transfer their benefits, although many did not have timescales as tight as those specified within the Rules.

Differences between DB and DC schemes

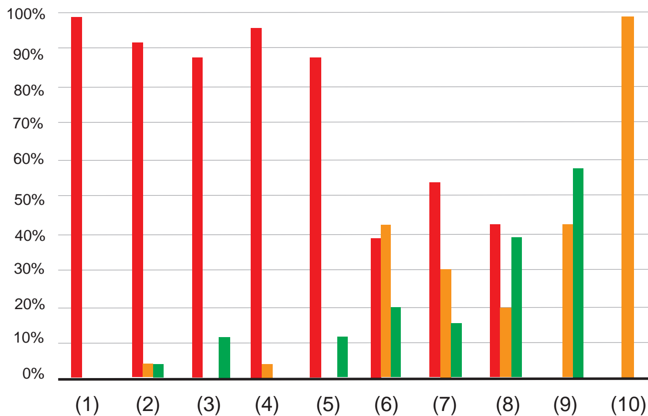
Of the schemes we analysed there was a notable difference between the levels of compliance within defined benefit ("DB") and defined contribution ("DC") schemes. This is unsurprising since the Rules are marginally less onerous for DB schemes than for DC schemes. For example, DB schemes only need to provide information to members on request, whereas DC schemes are required to provide annual benefit statements automatically.

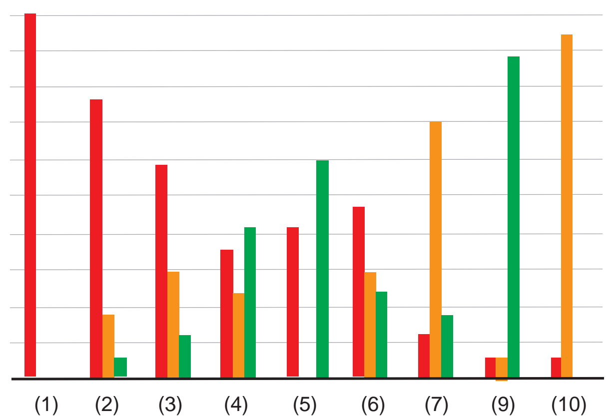
We also found that more DB schemes had SIPs in place (some of which were already fully compliant).

Summary

Figure 1 shows how schemes faired against the new requirements and where some action is required or recommended, with respect to each of the key areas. Figures 2 and 3 show the results separately for DC and DB schemes respectively.

The charts show that there is a considerable amount of work to be done by schemes over the next few months to become fully compliant.





IFRS 17 – "Hard to Digest?"

"Early engagement with auditors should result in a smoother journey towards implementation"
Graydon Bennett

Jargon Buster

BBA : Building Block Approach

CSM : Contractual Service Margin

IFRS : International Financial Reporting Standards

PAA : Premium Allocation Approach

Following our previous article on insurance accounting, the International Accounting Standard Board ("IASB") has at long last issued the final version of IFRS17: Insurance Contracts – a standard 20 years in the making.

The publication provides some welcome clarity and sounds the starting gun for what will require detailed preparation to achieve a successful implementation on 1 January 2021.

Insurers will be required to make choices which will have material implications for their financial results. Early engagement with auditors should result in a smoother journey towards implementation and will assist insurers in making the best choices for their business.

IFRS17 is extensive and demands more than a page to describe its requirements and potential impact fully. Nevertheless, there are a few aspects of the new standard which we highlight in this "digest" below.

Building Block Approach and the CSM

For most contracts, IFRS17 mandates the use of the Building Block Approach ("BBA") to value insurance contracts. The BBA requires that the entity calculate a discounted best estimate of fulfilment cash flows and a risk adjustment (which are analogous to, but may well differ from, the Solvency II best estimate liability and risk margin respectively), as well as a contractual service margin ("CSM") defined as "the unearned profit the entity will recognise as it provides insurance services in the future".

The CSM is designed to eliminate any initial profit recognition and is released as profit over the life of the contract as the risk runs off. The details relevant to the calculation of the CSM are outside the scope of this article, but it is worth mentioning that adjustments in respect of interest accretion, cash flow changes, and others will need to be calculated at every reporting period until the policy has run off.

Premium Allocation Approach

While the BBA is the default approach under IFRS17, an alternative methodology is permitted in certain cases. The Premium Allocation Approach ("PAA") will be of particular interest to general insurers writing yearly renewable contracts and insurers writing group protection policies.

This simplification applies only to the unexpired portion of the contract, or the "liability for remaining coverage", and replaces the complicated calculation of the CSM with a liability that is broadly determined as premiums received less associated acquisition costs.

The liability for incurred claims, however, does not benefit from any simplification and is thus determined as the discounted best estimate of fulfilment cash flows plus a risk adjustment to account for uncertainty.

Onerous Contracts

The new standard requires onerous contracts to be identified at initial recognition (i.e. the earlier of the start of coverage and premium receipt) and any loss to be recognised immediately.

By contrast, any unearned profit for profitable contracts will be recognised as a liability to be released as insurance services are provided. Unlike the current onerous contracts test, IFRS17 will not permit profitable contracts to offset unprofitable contracts and therefore the entire loss attributable to an onerous contract must recognised at initial recognition.

Unit of Account

The level of granularity required is also prescribed by the new standard. The primary requirement is to identify portfolios, which are defined as groups of contracts exposed to similar risks and managed together.

The portfolios must then be divided into groups comprising contracts issued within the same 12-month period. However, because of the onerous contracts test, these groups must also be sub-divided according to their expected profitability.

The increased level of granularity will doubtless have an impact on data system requirements and processes, as well as on financial results themselves. Users of financial statements will need to understand the implications of the grouping requirement, and this is one area where agreement with auditors will be essential.

Actuarial Support

IFRS17 will require a collaborative approach across a company's finance, actuarial and support functions.

The new standard brings with it not only a change in calculation methodology, but also an increase in disclosure requirements. Entities will be required to reconcile the opening and closing CSM balances for each group of contracts and will likely look to their actuarial functions to assist with this and other analyses.

Lastly, the requirement for retrospective application of the standard is likely to be a challenge for most insurers, although some simplifications are permitted. Nevertheless, the volume of data and complexity of the calculations required are expected to be tremendous. Insurers would be wise to start planning sooner rather than later.

Conclusion

While implementation is still around three years away, we now have a clear view of what the new standard will mean. Insurers will need to start considering the issues raised by IFRS17 and begin making plans for implementation. Early engagement with auditors and close collaboration with other stakeholders including actuaries will be vital to a smooth transition.

Guernsey Secondary Pension Update

"a significant part of the individual's retirement funds would be expected to come from investment returns"
Lindsay Jefferies

Back in February 2016 the States agreed, in principle, to the introduction of a secondary pension scheme in Guernsey and Alderney. This is expected to be phased in over 7 years, beginning in 2020.

While the original proposals were put forward by the Social Security Department, following the changes made to the structure of the States later that year, the secondary pension scheme is being taken forward by the Committee *for* Employment & Social Security. As well as work on the practical details to deliver the secondary pension scheme, the Committee was also tasked with looking at its wider economic implications.

BWCI and IGR were delighted to have been selected to work with the Committee to project the economic impact on individuals and households, employers, the government and the wider economy under a range of different scenarios. The Committee has just published the results.

Encouraging Retirement Savings

All employees paying social security contributions would be automatically enrolled into a secondary pension. While anyone who does not wish to participate may opt out, they would need to take action in order to do so. Automatic enrolment has been very successful in the UK in boosting the numbers saving for retirement.

In Guernsey and Alderney, assuming that 20% of eligible employees choose to opt-out, it is projected that around 16,000 people could begin saving for their retirement for the first time in 2020.

Additional retirement income

One of the principal objectives of a secondary pension is to improve the level of income in retirement; the impact on lower earners will be key to achieving this. The report illustrates that the additional retirement income from the secondary pension, for a lower quartile earner, could potentially double what they could expect to receive relative to just relying on the old age pension alone.

The long term employee contribution rate will be 6.5% of earnings. This would be supplemented by a further 3.5% from their employer. As illustrated in the green bars in the chart below, as well as the benefit of tax relief on those contributions, a significant part of the individual's retirement funds would be expected to come from investment returns earned over the period to retirement.

The "Pension at retirement" bar represents the total income in retirement. The lighter section highlights that up to 30% of this could be exchanged for a lump sum at retirement.

Impact on tax revenue

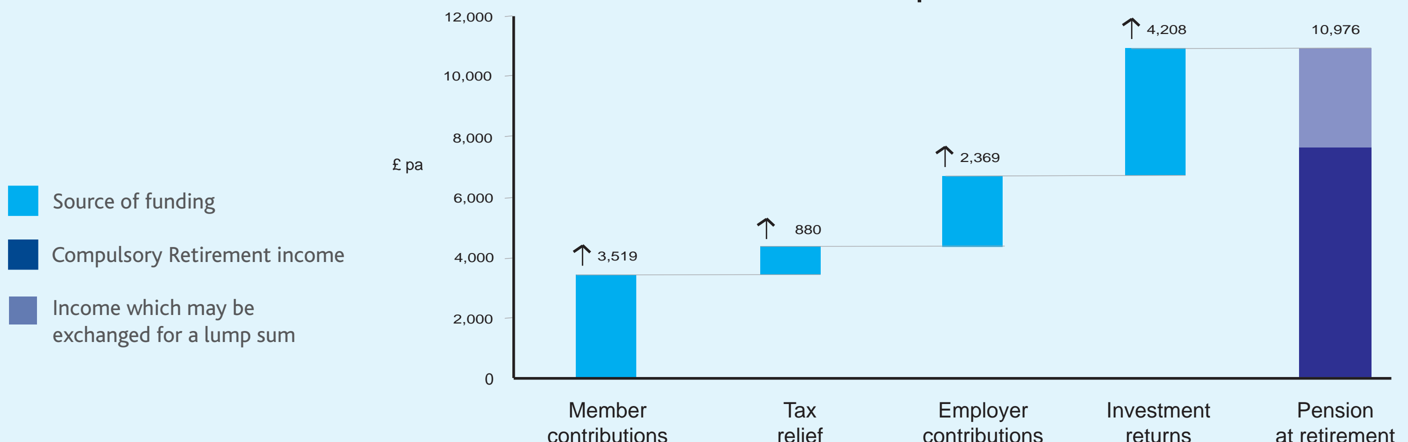
From the government's perspective, there is expected to be a reduction in personal income tax revenue of the order of 1.5% by the time the secondary pension scheme is fully phased -in.

However, in response to this Deputy Gavin St Pier, President of the Policy & Resources Committee, said:

"This will need to be planned for by the States through the discipline of the Medium Term Financial Plan. But it is in the best interests of the community as a whole that we do so"

Next stage

We are expecting an update about the implementation of the secondary pension proposals to be published in the fourth quarter of 2018. Further details about the secondary pension scheme and a copy of the report can be found at: https://www.gov.gg/secondarypensions



Almost 900 years' experience

Every year we mark the long service of our staff with a lunch for our "10 year club". This year we welcomed the two latest members of staff to notch up 10 years with BWCI. They are Hannah Gibson in our Investment team and Maria Le Lère. They joined the other 43 staff and partners, which is over 35% of all staff. Between them they have 889 years of service, reflecting our wealth of experience across our business.

We also marked other notable service milestones; Fiona MacDonald in our Pensions Administration Team has just passed the 25 year mark. Paula Ogier and Julie Le Sauvage in our Secretarial Team have each completed 30 years. Finally, Mark Leadbeater in our Insurance Actuarial Team has completed a remarkable 35 years.

Staff Update

Back row: Erin Bisson and Jason Hart
Front row: Bernadette Benstead and Aaron Laine

Mike Perrett

Promotions
We are delighted to announce several promotions with effect from 1 January 2018; Erin Bisson, becomes a manager in our Pensions Actuarial Team. Erin, who qualified as an actuary in 2016, quickly progressed to assistant manager. Erin's latest promotion recognises her hard work and commitment to BWCI, as well as her excellent team leadership skills.

Jason Hart becomes an assistant manager in our Compliance Team. Jason who joined us, as a compliance and insurance officer, in 2016 was promoted to a senior compliance officer the following year. Jason's strong work ethic is reflected in his latest promotion to assistant manager.

Within our Pensions Administration Team, Bernadette Benstead and Aaron Laine have both successfully completed their training and become employee benefits administrators.

Mike Perrett Retires
We have just marked the retirement of Michael Perrett, who had been with BWCI for almost 20 years. Mike joined us back in 1998 to strengthen the management of our pensions and benefits team. He made "BWCI history" in 2003 when, as an accountant, he was the first non-actuary to become a partner of the BWCI Group.

Over the last two decades Mike has served in a number of roles with us, including a period as the Partner responsible for our Jersey Office when we first established our base there. Most recently, Mike has served as a professional trustee for some significant international pension plans.

We would like to acknowledge Mike's contribution to BWCI and wish him a happy and healthy retirement.

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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