Bandwagon

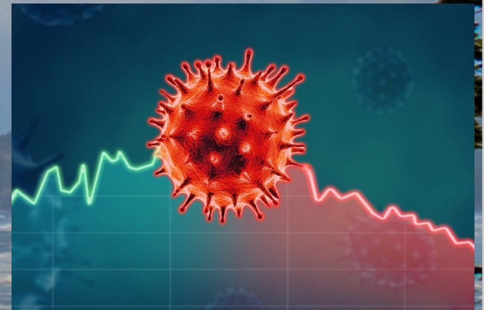
The BWCI Group Newsletter

Quarter 2- 2020

Inside this issue:

- Updated Guernsey Pensions Regulations
- What can COVID -19 teach us about Insurance Risk Management?
- New Guernsey Practice Notes
- COVID 19 – Pension considerations

The impact of COVID - 19



How are you doing?

Island Global Research
IMPACT OF COVID-19 ON EDUCATION
Island Global Research
IMPACT OF COVID-19: LOOKING TO THE FUTURE
Island Global Research
IMPACT OF COVID-19 ON HOUSEHOLD INCOME

Welcome to the second edition of Bandwagon in 2020. We hope that all our readers are staying safe and we will be able to return to more normal times soon as the lockdowns begin to ease.

Island Global Research, part of the BWCI Group, have been monitoring how feelings and perceptions about COVID -19 and the lockdown have been changing over the last few weeks. The back page of this edition provides some interesting insights. For more results from Island Global Research's weekly surveys, please visit:

www.islandglobalresearch.com/Our-Reports

While the implications and consequences of COVID -19 feature prominently in this edition, trustees of pension schemes which fall within the scope of the Guernsey Financial Services Commission's regulatory framework are reminded that new rules have been issued recently and come into effect at the end of the year. The article on page 3 provides an overview of the changes.

Inevitably some of the events that we were looking forward to supporting during 2020 have been affected by the lockdown and social distancing requirements. Sadly the Shakespeare Globe Touring Company has had to cancel their entire tour this year.

The BWCI Mini Soccer Festival has been deferred, but we are hoping that it will still be possible to arrange a tournament later in the year. We are liaising with festival organisers and hope to be able to provide more information in the next edition of Bandwagon.

How to contact us

The majority of our team are working remotely as we continue to adhere to the requirements of the States of Guernsey and Jersey. The best way to contact us is by emailing your usual BWCI contact, or by using the contact form on our website - www.bwcigroup.com

Some of you may have noticed that our email addresses have changed slightly and are now in the form:

First Name.Surname@bwcigroup.com.

However, don't worry if you are still using the old email addresses; your message will still get to us!

Guernsey Pension Regulation training

We have updated our training material for the changes which come into force from 31 December 2020. Our courses can be tailored to the specific needs of an organisation's team working in this area and can be delivered remotely if required.

For further details please contact :

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Updated Guernsey Pensions Regulations

"general principle around the fair treatment of members is being introduced"

Erin Bisson
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Introduction

The Guernsey Financial Services Commission ("GFSC") have released the third version of the pension regulation rules; their official title is the Pension Scheme and Gratuity Scheme Rules and Guidance, 2020 ("the 2020 Rules"). When they come into force on 31 December 2020 they will supersede The Pension Licensees (Conduct of Business) & Domestic and International Pension Scheme and Gratuity Scheme Rules (No. 2) 2017 ("the No. 2 Rules").

Guidance notes have also been added, providing examples of how licensed fiduciaries could demonstrate compliance with the rules. These guidance notes do not form part of the rules and appear in shaded boxes to distinguish the guidance from the rules.

There are a number of differences between the 2020 Rules and the No. 2 Rules. A fundamental change is that all of the conduct of business sections have been consolidated into the new Fiduciary Rules and Guidance. That document replaces and builds on the existing Codes of Practice.

The other changes to the rules fall into three areas:

- New requirements
- Modifications to the existing requirements
- Relaxation of some requirements

New requirements

An overarching general principle around the fair treatment of members is being introduced across all types of pension arrangement. In addition, there are also new requirements for specific types of pension schemes.

Defined benefit ("DB") pension schemes will need to have an actuarial valuation at least once every 3 years. In practice this may have little impact, since most occupational pension schemes' trust deed and rules will specify a requirement for a valuation within this timescale anyway. However, unlike the position in the UK, the requirement does not specify a timeframe for completing the valuation; the UK deadline is 15 months after the valuation date, including agreement with the sponsoring employer over the rate and timing of any contributions required.

A change to the requirements for defined contribution ("DC") schemes will see members informed if there is a reasonable likelihood that the value of their account will be exhausted by member borne charges before retirement age. Clearly assessing this will be subjective, since it will depend on the both the rate of return achieved on the funds and the expenses. However, it should help to highlight to members the impact of fees and charges on their pension savings – we may see members looking to consolidate a number of small pension pots to take advantage of economies of scale.

Changes to existing requirements

Benefit statements

Members of DB schemes will now need to be provided with an annual benefit statement; previously these only had to be provided on request. The statements should include benefit illustrations to assist members with their retirement planning.

Service providers

More detailed records on the terms of appointment of service providers will need to be kept, including their terms and regulatory status.

Transfers

The governance around transfer values is being updated. Licensees must not impose unreasonable conditions on members wishing to transfer to another arrangement; the 21 day limit for providing transfer value quotations is being replaced with a requirement for it to be provided as soon as reasonably practicable. Only transfer values in excess of £50,000 will require a transfer analysis report before the transfer can take place; the limit has been updated from £30,000, bringing it into line with the triviality limit. It is now also the responsibility of the transferring licensee to obtain this report if the receiving trustee or administrator is not regulated by the GFSC.

Some relaxations

The requirement for a governance committee has been relaxed, as long as a scheme can demonstrate good governance. In addition, members no longer need to be provided with details of the complaints procedure every year. Instead they just need to be informed of any changes to the procedure.

The requirement to produce a statement of investment principles no longer applies to member-directed schemes.

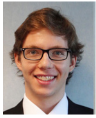
Next steps

We have provided an overview of the key changes. Trustees and other pension providers will now need to take an in depth look at their existing processes and procedures to check if there are any areas where changes need to be made to remain compliant with the forthcoming rule changes.

How we can help

BWCI is offering a "gap analysis" service to highlight the areas where changes may need to be made. We can also provide generic or bespoke training in this area for pensions administration staff.

What can COVID-19 teach us about Insurance Risk Management?



"it is always better to identify your weaknesses in a stress test than in reality!"

Michael Jones
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Introduction

COVID-19 has dominated the news since late February 2020. We are all aware of the effect it has had on our lives already: I write this piece from my home a few weeks into Guernsey's lock down. In such a rapidly developing situation it would be irresponsible of us to attempt to draw conclusions regarding COVID-19's impact on the insurance industry specifically. Nevertheless, while insurers prepare for the oncoming claims, it may be useful to consider what the pandemic can teach us about risk management in the context of Solvency II, how insurers could plan for similar outbreaks in the future, and whether any lessons we learn could be expanded to help insurers plan for other extreme events.

Pandemics in the Standard Formula

As part of the Solvency II standard formula, insurers must consider their exposure to pandemic scenarios. The Solvency II regulations[1] specify two considerations for pandemic shocks.

The first is for life insurers and is specified as an increase of "0.15 percentage points to the mortality rates (expressed as percentages) which are used in the calculation of technical provisions" [2] .

The difference sounds small and indeed in the mortality curves looks fairly small as illustrated in the graphs below. But to put this in context, if we were to follow a group of 100,000 people over the next ten years, the increased mortality rates would result in about 1,500 more deaths.

The second way pandemics are included in the standard formula is for insurers with health exposure, e.g. medical expense lines. This stress is defined with reference to the loss in own funds equal in value to 0.0075% of the total affected income protection exposure and 40% of the total medical expenses exposure (on a per country basis).

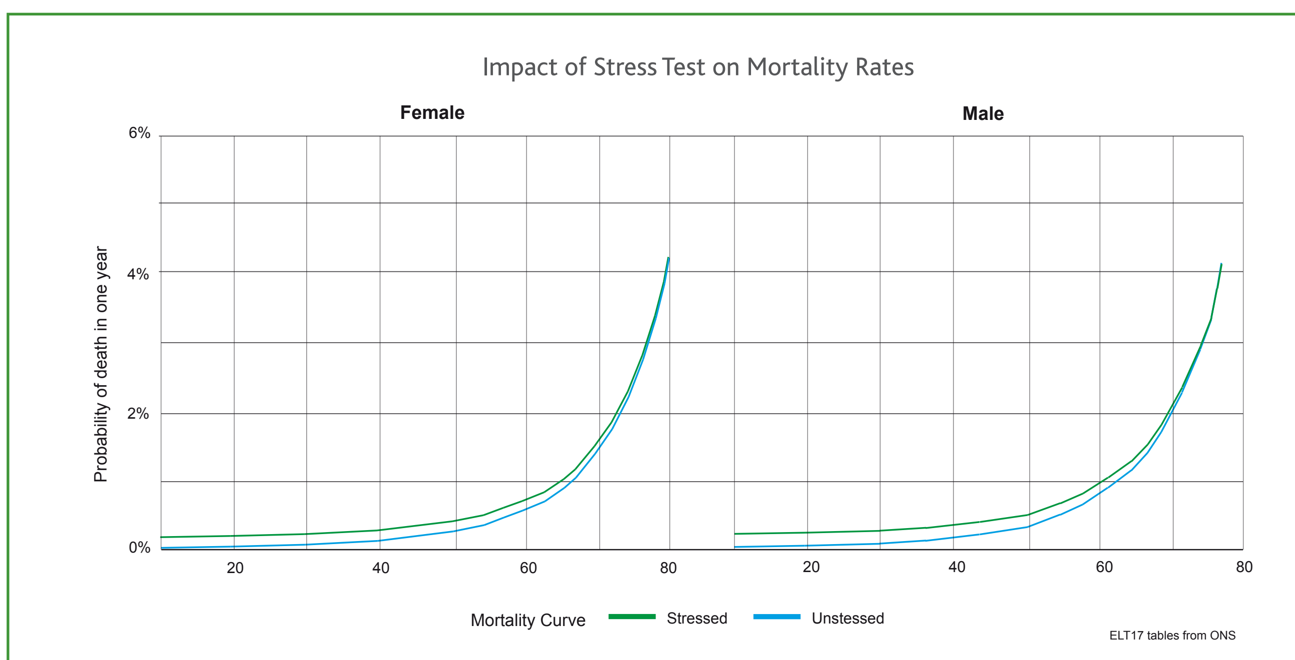
This leaves a gap: The standard formula only considers the direct impact of pandemics on claims, and so only considers those lines of insurance that cover life or medical risks. However, experience over recent months tells us it should be clear that an insurer that does not write medical business is not insulated against the effects of a pandemic.

So how should an insurer plan for a pandemic event? The answer is in the ORSA [3].

ORSA: The perfect tool for risk management

If not considered properly, the ORSA could be viewed as a needlessly expensive additional requirement put on insurers. If used to its full potential, however, it is a powerful tool in risk management.

At its heart, the ORSA allows insurers to ask "what if" questions in an explicitly quantitative way. It is precisely the place to consider how particular scenarios could lead to adverse experience. It is also a useful framework to plan management actions and predict their effectiveness. After all, it is always better to identify your weaknesses in a stress test than in reality!



[1] EU Commission Delegated Regulation 2015/35
[2] Delegated Regulation 2015/35 Article 143
[3] Own Risk and Solvency Assessment

Example

Let's look at what might happen in practice to a small insurer that writes motor business, travel insurance and property insurance. Under the standard formula, this insurer has no exposure to pandemic risks, but the truth is likely to be drastically different.

The first impact is likely to be through the investment markets. Betweeen late February 2020 and late March, over the same period, the price of oil had fallen by about half, before briefly going negative. On 9 March, the S&P500 dropped 7% leading to a fifteen minute halt in trading across the US; the first since December 2008. Changes in asset values alone are likely to impact the insurer significantly.

On 11 March 2020, the Bank of England cut UK base rates of interest to 0.25%; shortly after on 15 March, the Federal Reserve cut US base rates to 0%. The Bank of England cut the base rate again on 19 March to 0.1%. Such attempts at economic stimulus from central banks are one of their key tools. As such, when an insurer is thinking about disaster scenarios, it should factor in interest rate cuts as part of its modelling. Indeed, the insurer could take a view as to whether the standard formula's parameters need to be adjusted. For example, under a pandemic, does the insurer really think that the risk correlations of the standard formula will still hold?

As the pandemic spreads, we have seen that restrictions could be placed on the day-to-day running of the insurer. As staff begin to self-isolate, expenses are likely to increase as preparations are made for remote work. If staff are adjusting to remote work for the first time, productivity is likely to be affected, which could impact all areas of the insurer's business from claims handling to product development to compliance. Eventually some staff could get sick, leading to a complete loss in productivity over some elements of the business.

The same forces affecting the insurer's employees will also affect its customers. Many people will look to cancel previously planned travel and are unlikely to book any new travel, at least for a while. This is going to result in abnormal claims experience under the travel insurance policy. The insurer could see a dramatic short term rise in claims and then have them tail off completely. Similarly, some policyholders may think that being stuck inside is the perfect time to tackle that DIY project that they have been putting off. The insurer could see increased claims on their home property policies!

A hurried approach to implementing remote working may also lead to reduced information security during the time of transition. This would increase the probability of data breaches under GDPR and also data loss through malicious action. Employees not used to remote working may not follow best practice security, leading to intrusions or ransomware attacks being more successful than they would have been otherwise.

Due to the global nature of pandemics, if any functions are outsourced to providers in other countries, it is quite possible that such operational diversification will not add any extra value. Worse, the insurer may have limited ability to mitigate service disruptions from their outsourced providers through having no control over the provider's reaction, coupled with limited in-house experience to bring the function back in-house. Claims handling, audit and actuarial support could disappear with limited notice.

As the pandemic worsens, it is possble that key people within the insurer are taken ill, leading to temporary or permanent loss of operational knowledge.

While what we have discussed so far has been negative for the insurer, the pandemic could also affect certain areas in a more positive way. The insurer could potentially experience reduced claims under their motor policies as people reduce their travel. Depending on the order of events, the insurer may be able to apply pandemic-exclusions to some of their travel business. However, denying claims when policyholders are trying to escape affected countries comes with reputational risk.

A major disaster is likely to touch every part of the insurer's business, and the ORSA is the perfect place to test out the insurer's response plan.

Conclusion

The ORSA process is most effective when insurers start with a story. From the prompt of a global pandemic, we have covered impacts on market risk, expenses, underwriting risk, implications on new business and reputation. Building the narrative from a simple first idea helps the insurer explore possible scenarios with realistic management reactions.

Once the story has been constructed, detailed calculations can be carried out, including counterfactual investigations: "What if staff were already used to remote work?", "What if we had diversified our investments into less affected categories?" and so on. Indeed, it is exactly this type of detailed scenario testing that regulators have been requesting from insurers.

A global pandemic such as COVID-19 affects all aspects of life, and therefore, impacts all parts of an insurer's business. It is not as neatly specified as the standard formula may imply, and so a more holistic view of the full impact on an insurer may be assessed through the ORSA. Scenario testing is a powerful tool to simulate the stress event in a controlled manner so you prepare your company in case you experience it in reality.

The lessons we learn from COVID-19 need not be limited to the impact of pandemics. What we are experiencing can inform risk plans for any catastrophic event, from localised war, to global supply chain disruption. The insights on market reaction we gain from COVID-19 should help us to refine our models for market crashes or catastrophic climate disruption. The latter especially is ripe for exploration in a narrative-based ORSA scenario. BWCI would be happy to help insurers get the most out of their ORSA using this narrative framework.

New Guernsey Practice Notes

"Pensions in payment can be trivially commuted"

Debra Smith
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New Guernsey Practice Notes

Following collaboration with BWCI, the States of Guernsey Revenue Service have made available updated versions of the Practice Notes for approved pension arrangements. These Practice Notes summarise the tax approval requirements of Occupational Pension Schemes approved under section 150 of the Guernsey Income Tax Law and Retirement Annuity Trust Schemes ("RATS") approved under section 157A of the Guernsey Income Tax Law. There are several key changes from the previous edition of the Practice Notes.

Definitions

- Dependant
  The definition of a "dependant" has been widened and brought closer into line with the definitions applicable in Jersey and the UK.

- Member contribution
  A definition of "Member Contribution" has been added, reflecting the requirements for tax relief on contributions that were previously elsewhere on the Revenue Service website. In particular:
  - a monetary payment (and specifically not a transfer of funds from another pension scheme) must actually be made to the scheme by the member for tax relief to be obtained
  - contributions which derive from funds withdrawn from an approved scheme are not eligible for tax relief; and
  - in specie contributions (ie transferring the ownership of an asset) are not allowable for the purposes of claiming tax relief or utilising the carry forward provisions.

Tax relief on contributions

The contributions section has been updated to reflect:

- the 2018 reduction in the monetary cap on member contributions that are eligible for tax relief from £50,000 pa to £35,000 pa;
- the tapering of tax allowances for high earners that was introduced in 2018 and revised in 2019. Currently, individuals with taxable income which exceeds £100,000 pa have various tax allowances and deductions withdrawn gradually at a rate of £1 for every £5 that the individual's taxable income exceeds £100,000; and
- the interaction of the high earners' tapering of tax relief on pension contributions with the ability to carry forward prior years' unused tax reliefs.

Trivial commutation

- Before benefits have commenced
  The trivial commutation section has been updated to reflect the latest requirements, which are:
  - an increase in the triviality limit from £30,000 to £50,000;
  - a change in the applicable income tax charge on trivial payments; and
  - removal of the requirement to aggregate fund values across all approved arrangements or to seek prior approval from the Director of the Revenue Service before trivially commuting benefits not yet in payment.

- After benefits have commenced
  A new section has been added covering trivial commutation of pensions in payment. Pensions in payment can be trivially commuted if:
  - the fund value is no more than £50,000; or
  - the fund value exceeds £50,000 but is no more than £100,000 and the beneficiary has guaranteed minimum aggregate retirement income for the remainder of their life of at least £20,000 pa. Depending on the form of guaranteed retirement income, prior approval may be required from the Director of the Revenue Service. Guaranteed retirement income could be met from any of the following:

    (i) defined benefit pension scheme pension income in payment;

    (ii) annuity income in payment for life from an insurance company;

    (iii) State old age pension income in payment for life from any country; and/or

    (iv) other income subject to prior Director approval

Further information

The full Practice Notes can be accessed via our website at https://www.bwcigroup.com/Publications/GuernseyPracticeNotes

If you have any questions on the application of these Practice Notes to your pension scheme, please contact your usual consultant or Debra Smith.

COVID 19 – Pension considerations

"buying equities at discounted prices is one of the few silver linings"

Mark Colton
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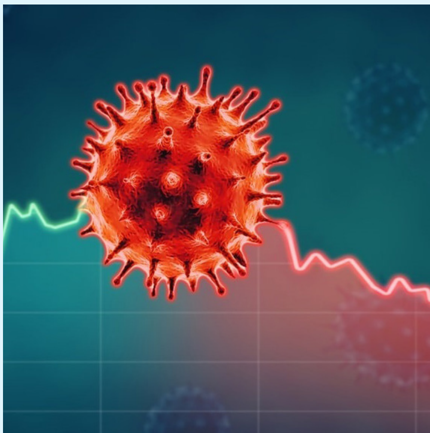
Big Economic Unknowns Remain

- the speed of development of a vaccine, its subsequent production and adequate distribution;
- the number of lockdowns required to ensure health services are not overwhelmed;
- whether there will there be sufficient supply of reagents to allow adequate levels of testing;
- employer failures and resulting unemployment levels



Market crash: the same, but different

Financial markets have been predictably volatile over the last few months following the gradual realisation that there was the potential for the COVID 19 pandemic to be devastating, not only from a health perspective, but also due to the economic consequences.

Stock markets started to tumble in late February. Market crashes prompt very similar concerns, no matter their cause. And one thing that they have in common is how the latest one is different from all the others. Spanish Flu, with its heavy death toll, wrought havoc following on the heels of the First World War.

To unpick the implications of the COVID-19 market impacts, we might ask:

- what happened to markets in the first quarter of 2020?
- what can we sensibly conclude about COVID-19's ultimate economic impact?
- what does it mean for pension schemes?

What's happened to markets?

- Most markets fell in the first quarter of 2020. Broad-based equity benchmark indices fell between 16% and 25%, with the UK performing worse than global equities.
- A benchmark long-dated bond index, popular with pension plans, fell around 5%.
- A cash benchmark rose 0.1%.
- Historical "safe haven" investments, such as fixed interest gilts, rose about 7% in value, as did the dollar price of gold.

But how did your scheme's own investment managers perform? Now is a good time to check if the promised outperformance of active management paid off, and whether tracking funds actually tracked.

COVID-19's ultimate economic impact?

The country which has progressed furthest with COVID-19 is China. It has seen a 6.8% GDP downturn (the worst since the 1970s). Its progress towards business as usual was marred by significant upward revisions to its numbers for deaths and infections, but it seems to have turned the corner. The UK is projected to have a worse hit to GDP, and the OBR[1] estimates net debt remaining at about £260bn (10% of GDP) into 2024-2025: this to alleviate the stresses from an almost warlike state of disruption.

Impact on pension schemes

Regulators have been quick off the blocks to alert trustees to a wide range of considerations, but in particular to:

- protect members from scammers
- protect defined benefit ("DB") schemes from transfers out strains
- review the robustness of scheme strategy and governance structures, particularly around investments

Not every company is suffering from lockdowns (think Amazon and Zoom) but a significant proportion are. Maintaining pension contributions may be difficult for employers, which is a cruel twist, since buying equities at discounted prices is one of the few silver linings for pension plans in the current environment.

DB scheme trustees may not want to wait up to 3 years for the next formal actuarial valuation to review funding levels; they need to be pro-active in assessing the impact to the employer covenant. They may also want to review their asset liability projections and opportunities for the significant protection to funding levels offered by leveraged LDI[2] funds. Even small DB schemes can now benefit from these. Consequently, we expect that reviews of investment strategies and funding levels will be high up on trustees' to do lists.

DB scheme members with liquidity concerns may wonder about transferring pension benefits or taking benefits early. For most people, exiting a DB scheme is a poor idea: these schemes are referred to as "gold-plated" for a reason. However, exceptions to this general rule abound, which is why careful consideration of individual circumstances is essential.

Defined contribution ("DC") scheme members generally find themselves invested in their scheme's default option. Some members choose the funds themselves, but they are assumed to know what they are doing. The good news is that very many scheme trustees use a form of "lifestyle" as their default option. This is an automated facility which moves members' investments as they approach retirement from higher growth, higher risk equities to bonds and cash, which are more suitable for retirement benefit provision.

Therefore those members hardest hit are likely be 10 years or more from retirement. That is a long time is the context of previous market recoveries, and contributions are now buying equities at much reduced prices.

There are clearly opportunities and potential actions that trustees may wish to consider further, and your usual BWCI contact will be ready to discuss these in more detail.

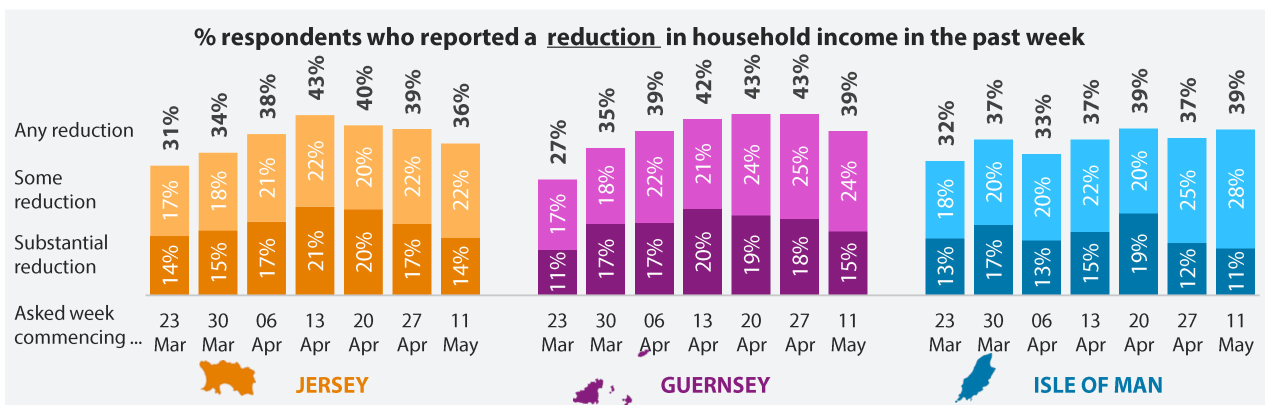
[1] Office for Budget Responsibility
[2] Liability Driven Investment

IMPACT OF COVID-19 ON HOUSEHOLD INCOME

(RESPONSES FROM 23 MARCH – 17 MAY)

Since 23 March 2020, we have asked respondents in Jersey, Guernsey and the Isle of Man whether COVID-19 has had a direct impact on their household income.

- The majority of survey respondents told us that COVID-19 has had no or minimal direct impact on their household income. Around 5% said their household income had increased.
- More than a third of survey respondents have experienced some reduction, or a substantial reduction, in household income in the past week. In the latest survey, the percentage of respondents who had experienced any (i.e. some or substantial) reduction in their income was: 36% in Jersey, 39% in Guernsey and 39% in the Isle of Man.



Sub-group analysis helps to identify the characteristics of those more likely to have experienced a loss of income.

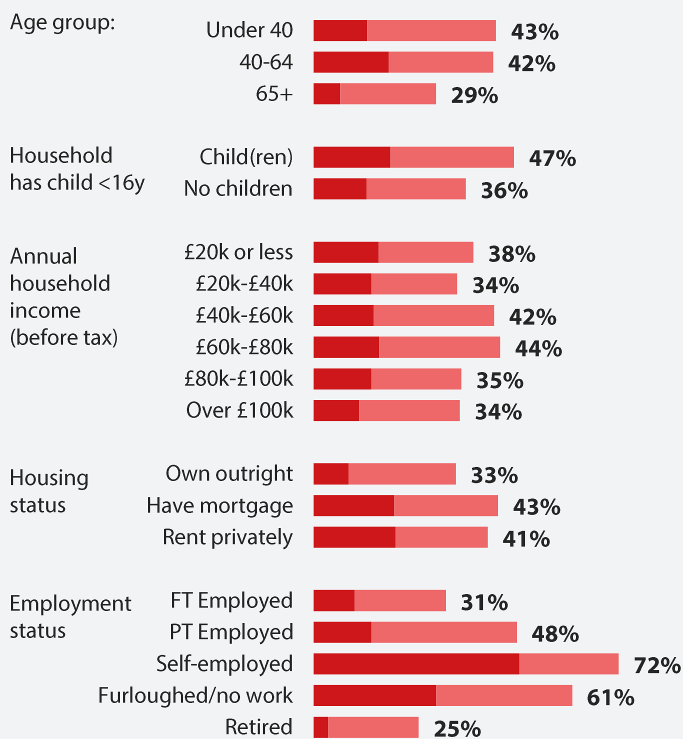
In the latest survey, 38% of respondents across the three islands reported a loss of household income past week.

Those more likely to have experienced a loss of household income are:

- aged under 65,
- in a household that has one or more children under 16 years,
- live in a private rented property,
- self-employed, furloughed/not working due to COVID-19, or part-time employed.

LEARN MORE: Island Global Research has been regularly running surveys to track the impact of COVID-19 on islanders in Jersey, Guernsey and Isle of Man.
www.islandglobalresearch.com/news

The latest survey was completed by 1560 residents in the Crown Dependencies. (601 Guernsey, 555 Jersey, and 404 Isle of Man).



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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