Guernsey Financial Services Commission

Industry Seminar – 6 December 2013

Fiduciary Supervision and Policy Division Presentation: Managing Risks at the Frontier

Fiona Crocker, Deputy Director

Thank you Philip and Audrey

Good afternoon

I bring to a close this seminar on risk management with the results of our review this year of a section of fiduciaries who less than 6 years ago were at new frontier with pensions.

The results of our focus on pensions are relevant to share with all fiduciaries exploring new opportunities because its highlights some of the issues to be dealt with. However that review has also helped shape an initiative we will take next year to see if any revisions can be made to the retirement annuity scheme rules to provide a better pension product for islanders. There will be more news on that towards the end of my presentation.

We visited a cross-section of those fiduciaries that administer pensions for at least a couple of hundred members rather than focus exclusively on the niche players. It covered local pension schemes as well as those established for non-Guernsey members as Qualified Recognised Overseas Pension Schemes prior to April 2012 when this market was closed by HMRC.

So did this review show that those we visited had an effective governance framework, the resources and the controls in place to manage and mitigate the risks in their operations?

We saw some very positive developments.

Substantial books of former Qrops business remain. Data we saw indicated a long life cycle with many members due to start drawing a pension in 10 to 15 years' time. If managed and administered well there is steady income stream for those fiduciaries for many years.

We saw a fiduciary which had very good MI on the current health of its business but it was a surprise to see at 2 fiduciaries a lack of MI about scheme membership for budgeting and planning purposes such as number of cases not proceeding, cases transferring out, and the number of members drawing pensions.

We also saw directors at one fiduciary tending to report verbally at board meetings on their areas of responsibility which gave their colleagues little time to consider or question that information.

Since Guernsey closed to new Qrops some fiduciaries have been exploring pension opportunities in Gibraltar and Malta either establishing subsidiary trust companies or entering into joint venture. Yet some of these fiduciaries were without up to date business plans.

In one case the plan was so old it pre-dated the 2006 UK Finance Act which created Qrops. In fact it had been produced as part of its fiduciary licence application. Business plans are not just for licence or funding applications but are important for the ongoing management of a licensee for setting and clarifying the licensee's goals and objectives, how they will be achieved, determining the resources required, as well as a means of measuring performance.

The growth in Qrops business put pressure on staff resources. We heard of shortages of staff experienced in administering pensions. So we were encouraged to find a fiduciary where more than half of its staff were studying for or held professional qualifications such as the Step and ICA diplomas, the MSc in CG or ACCA.

Here it had managed to encourage its staff to take exams at a time when there was a salary premium on those with relevant pension experience –never mind holding a qualification. At this licensee 80% of its senior management held relevant professional qualifications as set out on the GTA's training matrix.

Unfortunately elsewhere we came across pension managers and teams who held no relevant qualifications.

So in today's challenging environment, which fiduciary is better placed to move into a new area?

Elsewhere we saw a fiduciary run well-attended in-house training session on technical issues at 8am every other Friday. Breakfast was provided as an incentive to attend.

We may well include training as one of our thematic topics for next year.

We saw during the review pension administration streamlined effectively to increase efficiencies. In areas of client take on we found generally that procedures were followed, communication with new members was timely and files were organised.

This may be because there were already clear AML/CFT requirements for all fiduciaries to comply with when on boarding new clients. However we did see cases where sloppy practices had crept in with members being accepted before all internal checks had been completed and signed off, or where open source adverse material collected by the fiduciary about the member had not been assessed prior to a member being accepted.

Pensions might generally be considered to be at the lower end of financial crime risk than other products and services but it cannot be assumed that they are immune. Care still needs to be taken especially with personal pensions. Please ensure you risk assess pension members properly.

There is an explicit regulatory requirement for trustees to ensure that Guernsey resident members have received actuarial advice on transfers out of final salary schemes. It was therefore encouraging to see fiduciaries ensuring that both local and non-local members had received this advice before transferring out of such arrangements.

Whilst it is widely recognised that there should be advice for those transferring out of these schemes, one fiduciary was accepting into its Qrops as recently 2012 non-local members from final salary schemes without establishing if they had had that advice. That fiduciary has introduced procedures now – but much of that non-local market has gone.

When Guernsey closed to new Qrops business we saw fiduciaries had very sensibly used the lull to revise policies and procedures and review member files.

However we found cases where it was evident that procedures were still being drafted at the height of the market or if procedures did exist they were in effect notes that were passed around staff and adapted each time an activity passed into new hands.

We saw cases where the fiduciary was exposed to legislative and regulatory risk because it had failed to fully identify the range of requirements that apply to pensions. It had not recognised that as trustee of a RAT it was required under the Rats Rules to be satisfied that the scheme was suitable for the Guernsey resident members.

It had not checked that interest was being charged and paid on the loans it made to members in accordance with the conditions imposed by Income Tax when approving the scheme.

Under the Codes of Practice for TSPs fiduciaries should understand and discharge fiduciary and other duties. If requirements such as the Rats Rules, Codes of Practice, the conditions imposed by Income Tax, or HMRC's rules are overlooked then there is a greater risk of losing any subsequent claim that the pension or its investment wasn't suitable for the member or of incurring a tax penalty for the member because the pension wasn't administered properly.

Generally the review produced mixed results. It was disappointing to find the deficiencies I have highlighted when the Code of Corporate Governance contains guidance on all these areas. See principles 2.3; 4.1 and 5.2 for planning, strategy and risk management; and principles 2.1 and 2.2 for director duties regarding operating within all relevant legislation. As Philip said earlier please read the code and act upon it.

This brings to a close what I wanted to say on the review. I turn now to a new project for next year.

I referred to at the start, of a proposal which is to revisit and revise the Rats Rules with the aims of bringing down the costs of a pension for islanders and at the same time give those with the wherewithal to manage their own pension investment, the opportunity to do so. We want to do this without any accompanying reduction in protection for those who need it.
We think a large number of islanders want to make provision for their old age. The 2013 annual return indicates that more than 2,000 islanders took out a pension administered by a licensed fiduciary over the preceding year. Although fiduciaries have tried to bring the costs

down with the development of multi-member Rats we have all heard about the informal arrangements that exist in Guernsey amongst friends and neighbours to act as trustee of each other's Rats on a "pro bono" basis. Such arrangements might not fall within the scope of the proposed CI ombudsman scheme.

We think the aims can be achieved because we saw during our pension review the development of schemes for non-Guernsey members, which although subject to the same trust law and same income tax requirements as local Rats, offered greater flexibility to members to direct investment of their pensions.

We therefore intend to issue a consultation paper in January 2014 asking what changes could be made to the Rats Rules to bring down pension costs and open up these schemes to enable members who have the relevant expertise to make their own investment decisions.

We will be consulting on the costs of establishing, managing and administering a pension, whether there are opportunities for self-invest pensions and if so if there should be eligibility requirements for members; custody arrangements and types of assets that can held within single and multi-member schemes; and also amending the Rules to explicitly include retirement annuity contracts known as RACS.

We hope that consultation will reach wider than the fiduciary sector to other stakeholders. If you have a question you want asked within that consultation please send it to us.

So on that note I look forward to next year and to hearing from you on how the Rats Rules could be changed for the better.

Thank you and Seasons Greetings