Guernsey Financial Services Commission

Pension Arrangements in the Bailiwick

Thematic Review 2017

Foreword

This thematic review formed an important part of our fact-finding regarding the nature and scale of operations of firms providing services to pension and gratuity schemes in advance of the introduction of Pension Regulation and the associated Pension Rules. The thematic review reaffirmed that there is no 'one size fits all' with regard to Pension Providers in the Bailiwick, potentially a reflection of the ongoing maturing and sophistication of the sector.

Pension and gratuity scheme arrangements are of fundamental economic and social importance for long term savings and adequacy of retirement income. Our thematic included a review of transparency of fees and charges to pension members, a crucial element in enabling an assessment of costs, and an area of mixed practice at present. The thematic also reviewed the frequency of bookkeeping and recording of transactions; as in previous thematic reviews the Commission again notes surprise at the low frequency of such records in the Bailiwick.

Throughout the thematic review, we considered what information would be helpful for consumers who may already have pension arrangements or for those who may be considering setting up a pension and a Pensions Helpsheet (Appendix 1) has subsequently been published on the Commission's website.

This report reflects the findings from the thematic review of firms of all impact ratings. We hope the content will be useful to all firms carrying on pension scheme and gratuity scheme business in the Bailiwick.

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November 2017

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I. Scope

Pensions Arrangements in the Bailiwick was selected as the 2017 Fiduciary Supervision Policy and Innovations Division's ("FSPID") Thematic Review, following engagement with stakeholders (including the Guernsey Association of Pension Providers ("GAPP")) regarding the potential for a modern supervisory framework for the provision of pensions.

The Commission issued a Discussion Paper ("DP") on 27 October 2016 seeking feedback in this area and responses to the DP expressed support for the introduction of Pension Scheme regulation.

On 30 June 2017 Section 2 of the Fiduciaries Law was amended to make the formation, management or administration of pension schemes or gratuity schemes and the provision of advice in relation to the same a regulated activity in the Bailiwick. The associated Pension Licensees (Conduct of Business) & Domestic and International Pension Scheme and Gratuity Scheme Rules (No.2) 2017 ("the Pension Rules") have also been introduced.

The purpose of the Thematic Review was not to conduct a critical assessment of the pension sector in the Bailiwick but to enable the Commission to gather information regarding pension providers, assess current practice, the challenges facing firms and to discuss known issues within the sector. Further it enabled FSPID to reflect on crystallised risks recently experienced in the sector and to support the anticipated development of new pension rules. The following areas were covered:

- Retirement Schemes;
- Introducers;
- Risk Appetite, Investment Management and Monitoring;
- Information for members;
- Fees and Charges;
- Bookkeeping and Reconciliations; and
- Complaints.

II. Approach

As in previous years, the Thematic Review consisted of two stages:

1. 51 Full Fiduciary Licensees responded to a questionnaire; and
2. 8 onsite visits.

Questionnaire responses provided an overview of the sector, including a broad understanding of how Licensees' pension arrangements operate.

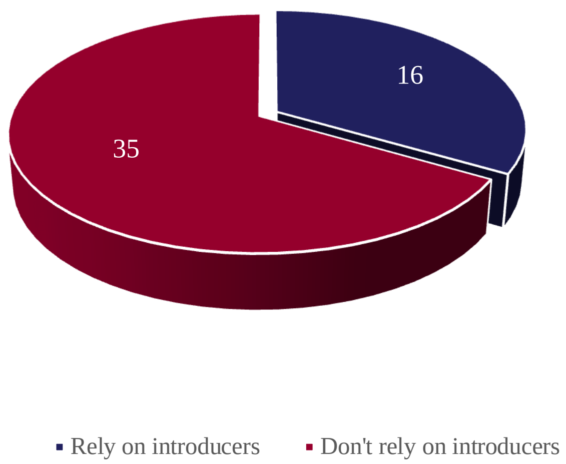
Onsite visits delved into a greater level of detail and provided Licensee specific insights. Visited Licensees represented a cross-section of PRISM impact ratings, size and ownership models.

Analysing the questionnaire responses and onsite visit findings allowed the Commission to identify a spread of good practice as well as areas for attention and key themes for pension providers.

III. Key Findings: Introducers

FSPID defined introducers as '*a person who introduces a member of an International Personal Retirement Scheme or a Domestic Personal Retirement Scheme to a Trustee or Administrator'*. Prior to the completion of the Thematic Review introducers had been seen as a typical source of business for pension providers.

Having assessed the questionnaire responses in relation to introducers, FSPID concluded the following:



- 35 of the 51 firms surveyed (**68.62%**) do not rely on introducers for the source of members.
- 16 of the 16 firms surveyed (**100%**) using introducers undertook due diligence or suitability checks in respect of all of the introducers relied upon.
- 11 of the 16 firms surveyed (**68.75%**) who rely on introducers carry out ongoing monitoring of those introducers, of these, 1 firm (**9.09%**) stated that they had ceased relations with new introducers since January 2012.
- 9 of the 16 firms surveyed (**56.25%**) who rely on introducers stated that introducer fees are paid on a commission basis.

FSPID were interested to note that 16 of the 51 firms responding to the thematic questionnaire relied on introducers as their key source of business. Further analysis revealed that the firms using introducers are generally those conducting international pensions business. In some cases firms indicated that they do not rely upon introducers however FSPID understood from previous engagement with those firms that they had used introducers in the past indicating that there may have been a change in approach towards introducers by those firms. Notwithstanding this, it was encouraging to learn that all of those Licensees who do use introducers undertake due diligence. In many instances the introducers can be unregulated and therefore it is reassuring to note that Licensees are carrying out their own assessment. Under rule 5.1.2 of the Pension Rules a Licensee has an obligation to ensure that any Service Provider (which includes introducers) appointed by it are assessed on appointment and periodically reviewed thereafter to ensure their suitability and competence.

Nine Licensees responded that introducer fees are paid by them on a commission basis. The Pension Rules make it a requirement under rule 10.12 that any *member borne charges* be reasonable in the circumstances. Therefore, the nine Licensees who reported paying fees on a commission basis will need to ensure that they are acting in compliance with this rule. FSPID would also expect that the member is aware of the basis upon which the fees are charged.

CASE STUDY:

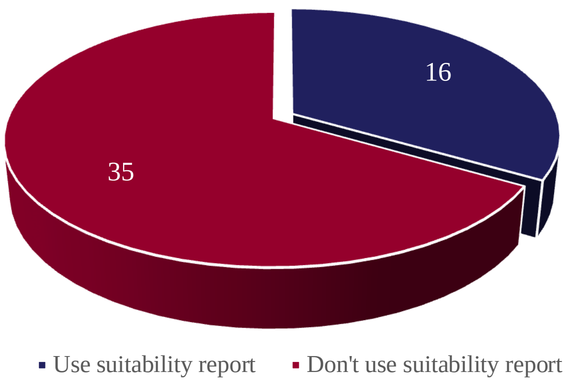
An example of good practice observed during the onsite visits related to the initial and ongoing review of the suitability of introducers. Through the ongoing monitoring of introducers of members to pension schemes some Firms have identified introducers that they are no longer willing to accept new business from. Further, the early identification of an unsuitable introducer may also prevent losses being incurred through inappropriate investments where the financial adviser has also been appointed to make, select and direct investment decisions.

IV. Key Findings: Risk Appetite, Investment Management and Monitoring

Investment performance is one of the main sources of pension complaints that Licensees report to the Commission, FSPID have found that there is often a misunderstanding by members regarding who has responsibility for reviewing and making investment decisions. The introduction of the Pension Rules should help address this issue. Under rule 10.15, Licensees must ensure that there is a written statement of principles governing decisions about investments, which Licensees must monitor. This written statement must cover, to the extent they apply:

(a) The kinds of investments to be held;
(b) The balance between different kinds of investments;
(c) Levels of risk;
(d) Expected returns on investments; and
(e) The liquidity and realisation of investments.

Under rule 10.16 of the Pension Rules, three investment approaches are described: member directed, Licensee directed and third party directed. Each of these approaches have different characteristics and it is important that Licensees are familiar with the Rules regarding this area.

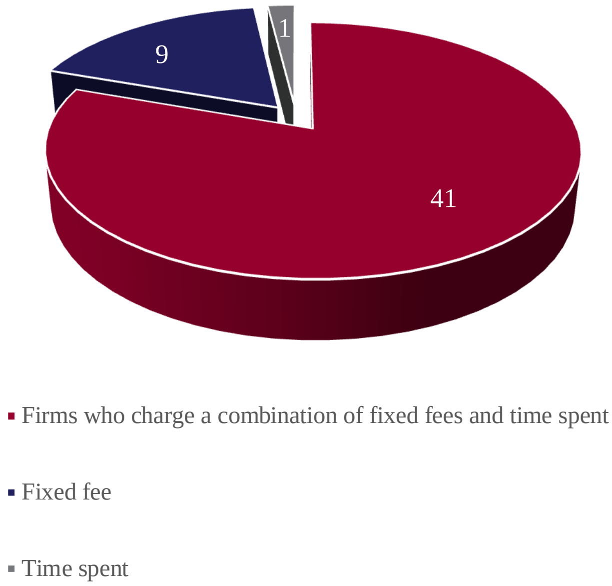


· 35 of the 51 firms surveyed (**68.62%**) do not use suitability reports for all members.
· 19 of the 30 firms surveyed (**63.33%**) who permit Members to appoint Investment Managers undertake due diligence or suitability checks on the Investment Manager.
· 33 of the 51 firms surveyed (**64.70%**) do not retain responsibility for the investment management of the assets held in all retirement schemes.

The questionnaire responses indicated that generally the suitability of investments are managed on a case-by-case basis rather than being governed by a suitability report. Licensees generally confirmed that where the product is a Guernsey resident RATS ("Retirement Annuity Trust Schemes"), a suitability report is often received at the outset from a financial advisor or the licensee requests the client to complete their own suitability questionnaire. However, in the case of an occupational scheme suitability reports are less common, as expected. Several Licensees noted that they do not provide financial or investment advice to such clients and therefore did not provide suitability reports. The Commission considers that the use of suitability reports can be a helpful tool for trustees for ensuring the selected investments are appropriate and in-line with the member's risk appetite and personal circumstances. However, the Commission notes that suitability reports are not necessary for all circumstances.

V. Key Findings: Fees & Charges

One of the key sources of member complaints that Licensees report to the Commission is in the area of fees and charges, particularly where members do not understand the rationale for certain fees. As noted above, under rule 10.12 of the Pension Rules, there is a requirement for Licensees to be transparent on member borne charges and a statement of the actual or anticipated fees or charges will need to be provided to the member upon joining a Pension Scheme or Gratuity Scheme.



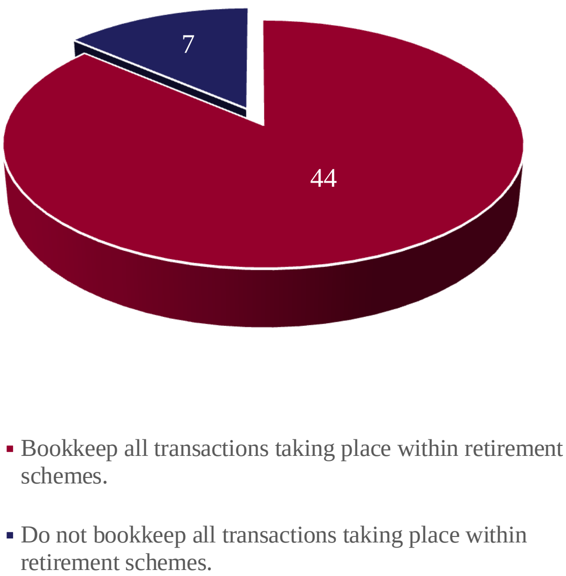
- 41 of the 51 firms surveyed (**80.39%**) charge fees on a combination of fixed fee and time spent basis. 9 of the 51 firms surveyed (**17.65%**) charge fees on a purely fixed fee basis and 1 of the 51 firms surveyed (**1.96%**) charge fees purely on a time spent basis.
- 12 of the 51 firms surveyed (**23.52%**) gave an example of the type of fees that may be received by the introducer of a member to a retirement scheme.
- 45 of the 51 firms surveyed (**88.23%**) do not receive any payments of retrocessions or commissions in respect of the services they provide to retirement schemes.
- 39 of the 51 firms surveyed (**76.47%**) do not pay any retrocessions or commissions in respect of retirement schemes.

CASE STUDY:

An example of good practice observed during the onsite visits related to the disclosure to members by a Licensee of the member borne charges applicable to a pension scheme at the establishment of the pension scheme and for the ongoing services provided. The information provided to the member included a comprehensive and clear statement regarding commissions payable to third parties.

VI. Key Findings: Bookkeeping & Reconciliations

Bookkeeping and reconciliations are a fundamental element of the trustee's responsibility, ensuring that a Licensee can demonstrate the movement of funds to a member upon request. FSPID's findings on this subject were broadly in line with the findings from the 2016 Thematic Review of client money.



- 44 of the 51 firms surveyed (**86.27%**) bookkeep all transactions which take place within retirement schemes, leaving 7 of 51 (**13.73%**) who bookkeep infrequently.
- 32 of the 44 firms surveyed (**72.72%**) bookkeep on a variable timescale, depending on a particular scheme, of which:
- 1 of the 44 firms surveyed (**2.27%**) bookkeeps weekly.
- 5 of the 44 firms surveyed (**11.36%**) bookkeep monthly.
- 2 of the 44 firms surveyed (**4.54%**) bookkeep quarterly.
- 4 of the 44 firms surveyed (**9.09%**) bookkeep annually.

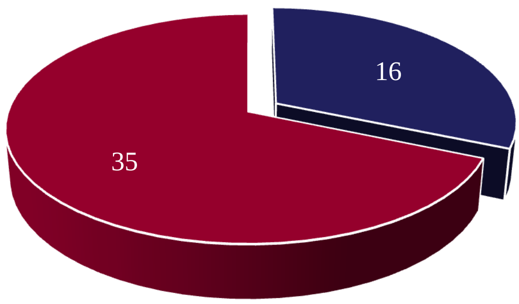
- 47 of the 51 firms surveyed (**92.15%**) reconcile all transactions taking place within retirement schemes, of which:
  - 1 of the 47 firms surveyed (**2.12%**) reconcile all transactions upon receipt of bank statements.
  - 1 of the 47 firms surveyed (**2.12%**) reconcile weekly.
  - 11 of the 47 firms surveyed (**23.40%**) reconcile monthly.
  - 9 of the 47 firms surveyed (**19.14%**) reconcile quarterly.
  - 4 of the 47 firms surveyed (**8.51%**) reconcile annually.
- 21 of the 47 firms surveyed (**44.68%**) reconcile transactions on a variable basis, depending on a particular scheme.

AREA FOR IMPROVEMENT:

The findings of this Thematic Review coupled with the findings of the 2016 Client Money Thematic Review indicate that in some instances firms are not carrying out bookkeeping in a timely manner, or in the case of this Thematic that firms are not bookkeeping all transactions. The Commission would like to remind firms that they should be mindful of the Codes of Practice for Trust Service Providers ("TSPs") and in particular that TSPs should, (so far as appropriate for the TSP's functions and for at least the periods required by any applicable law) keep and preserve appropriate records of trust business including accounts, tax records and minutes of meetings.

VII. Key Findings: Complaints

The retail nature of pensions means that they are the area where FSPID receive the most complaints from members of the general public. It is therefore interesting to note that only 16 Licensees of the 51 firms surveyed (**31.37%**) report having received a complaint in the year ending January 2017. Under rule 7.1.1 of the Pension Rules, every Licensee must have a written procedure for the effective consideration and fair and proper handling of any complaints relating to the Licensees' pension scheme business and gratuity scheme business. Furthermore, rule 7.2.1 requires Licensees to notify the Commission of any complaint which remains unresolved for longer than 3 months from the date of the Licensee becoming aware of it and any complaint which is considered to be significant.



- Received complaints relating to pension schemes in the 12 month period to 31 January 2017.
- Received no complaints relating to pension schemes in the 12 month period to 31 January 2017.

- 5 of the 16 firms surveyed (**31.25%**) received complaints relating to poor investment performance.
- 4 of the 16 firms surveyed (**25%**) received complaints relating to poor service.
- 3 of the 16 firms surveyed (**18.75%**) received complaints relating to the level of fees being charged.
- 2 of the 16 firms surveyed (**12.5%**) received complaints relating to delays in completing transactions.
- 8 of the 16 firms surveyed (**50%**) notified their insurers in respect of a complaint received.
- All of the firms surveyed (**100%**) have a policy or procedure in place for dealing with complaints in respect of retirement schemes.

The largest source of complaints appears to be around poor investment performance. The new Pension Rules address this to an extent by requiring Licensees to ensure (as per rule 10.15) that there is a written statement of investment principles in place for Pension Schemes or Gratuity Schemes. However, it should be noted that the statement of investment principles identifies responsibilities but will not address poor performance.

POINT OF NOTE:

During the course of the 2017 Thematic Review the Commission observed that following receipt of a complaint most firms provided communication of their complaints procedure to members in a clear and timely fashion. The communications included drawing attention to the existence of the Channel Islands Financial Ombudsman. It should be noted that under the new Pension Rules reviews of complaints must be undertaken by a suitably competent officer of the firm, who is independent of the circumstances giving rise to the complaint. Whilst reviews of complaints may have been undertaken by an officer of the firm who was independent of the circumstances, this was not always evident from the files reviewed during the onsite visits to firms as part of the Thematic Review.

Appendix 1 – Pensions Helpsheet

Guernsey Financial Services Commission

PENSIONS HELPSHEET

1 WHY HAVE A PENSION?

Pensions are effectively a long term savings plan. Pensions are a good way of saving for your retirement.

2 WHO, WHAT, HOW?

Make sure you clearly understand who is responsible for what in relation to pensions. There are several different types of schemes operating in the Bailiwick, each with different qualities and will suit different circumstances. The terminology involved in pensions can be complicated and legalistic. If you are unsure what is meant, or what it means for you, make sure you ask.

3 CHARGES

Knowing what service you receive for your money is important. You should be provided information on the fees and charges associated with your pension. These should not come as a surprise to you. Similarly, you should be aware of any charges paid to third parties by your provider in relation to your pension.

4 INFORMATION FROM PENSION PROVIDER

Your pension provider should provide you with certain information regarding your pension. For example, clear information about the scheme on at least an annual basis.

5 VALUE OF INVESTMENT

Remember that the value of investments can go down as well as up. This means that the value of your pension can fall. You need to be clear on whose responsibility it is to monitor your investments, provide relevant information and take investment decisions.

6 TRANSFERS

If you are considering the transfer of an existing pension to another scheme, ensure that the potential benefits of this transfer outweigh the loss of any advantages offered by an existing scheme. Your pension provider should also process any transfers promptly and accurately, avoiding unreasonable delays.

7 MAKING A COMPLAINT

If you are unhappy with the service which a firm is providing you, the first thing to do is to make a complaint to the firm. If your issue remains unresolved, you can contact the Channel Islands Financial Ombudsman who may be able to assist - www.ci-fo.org

8 THE ROLE OF THE GFSC

The role of the GFSC is limited to the regulation and supervision of licensed firms. The GFSC will not be able to compensate an individual for any monies lost or act as a mediation service.

9 SPOTTING A SCAM

Pension scams are becoming increasingly more sophisticated and it is important that consumers are aware of the potential. If you are suspicious that there is a scam operating in the Bailiwick, contact the Guernsey Police or the GFSC.

10 IF IT LOOKS TOO GOOD TO BE TRUE...

...it probably is!

Further information can be found at https://www.gfsc.gg/consumers/pensions/basics