



The Gibraltar Financial Services Commission

Consultation Paper

Regulation of personal pension schemes

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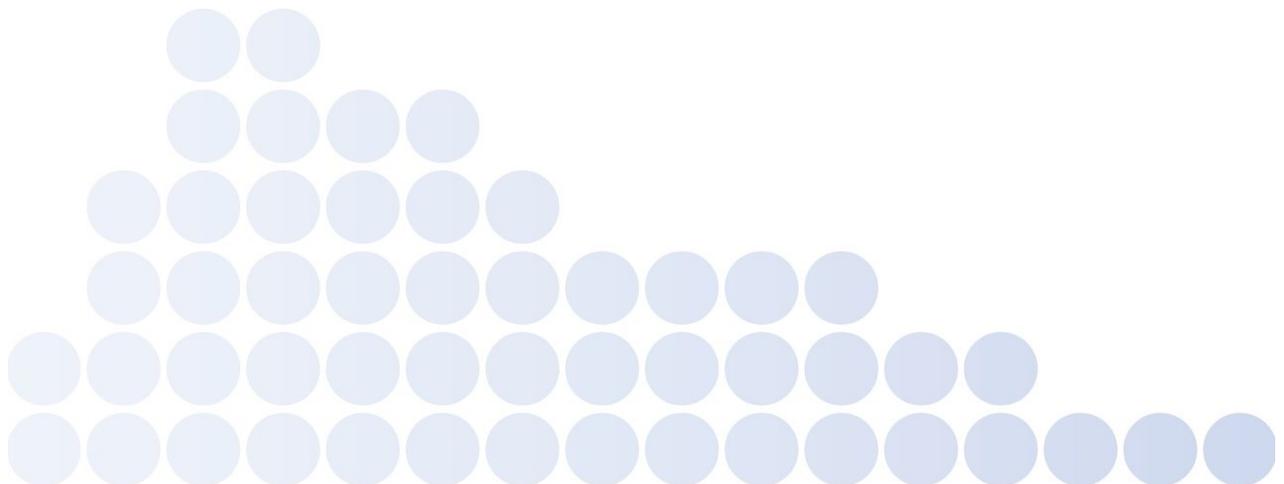


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1. Purpose

The purpose of this Consultation Paper, developed at the request of HM Government of Gibraltar, is to propose our approach to the regulation of personal pension schemes in Gibraltar. It sets out our policy intention and how, at a high-level, we might achieve it in practice. Responses to this consultation will be considered by the Gibraltar Financial Services Commission and HM Government of Gibraltar before finalising the draft legislative proposals.

The scope of this Consultation Paper is personal pension schemes. By this we mean personal pension schemes established in Gibraltar which have been approved by the Income Tax Office (ITO). Such schemes represent individual pension arrangements and are designed as 'defined contribution' schemes. Personal pension schemes include:

- personal pensions for Gibraltar residents;
- QROPS (Qualifying Recognised Overseas Pension Schemes);
- QNUPS (Qualifying Non-UK Pension Schemes); and
- international pension transfers from countries other than the UK.

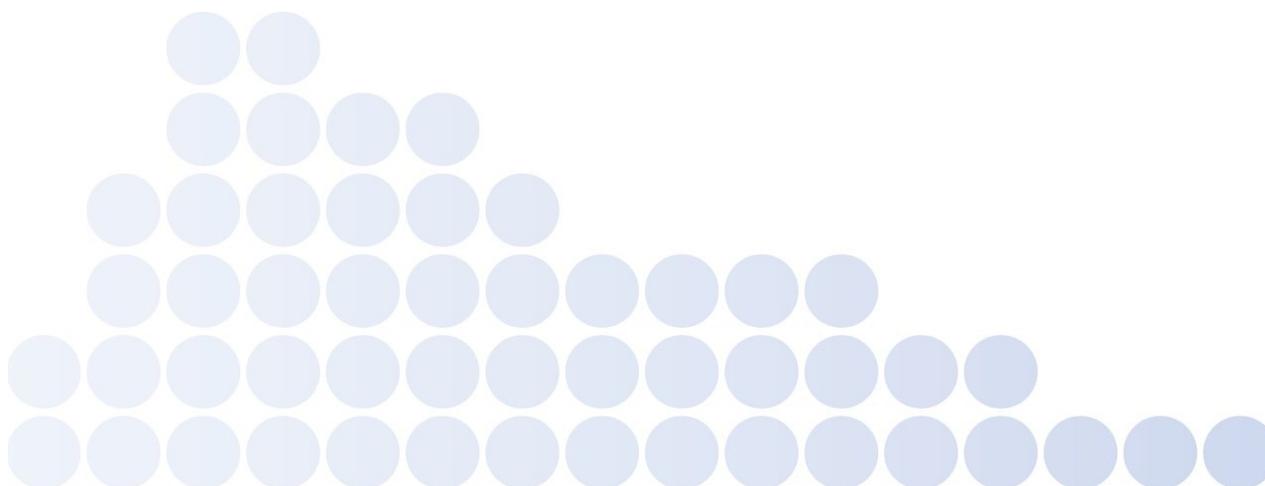
Occupational pension schemes, that is those set up by employers under trust for the benefit of their employees, are out of scope of this Consultation Paper. A separate Consultation Paper covering occupational pension schemes will be published in due course.

The Consultation Paper raises a number of questions which we look forward to receiving your responses on by 5pm on Tuesday 14 July 2015. This represents a 6-week consultation period

If you have any further questions or want to send comments directly please contact:

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We will subsequently publish a further document which provides our response to the feedback received and finalises our detailed approach. Excerpts from responses received to this consultation may be published, unless a respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.



2. Executive Summary

2.1 Overall objectives

An important regulatory objective, in terms of personal pension schemes, is to protect the interest of consumers – that is the members of such schemes. In so doing the reputation of Gibraltar is protected and also enhanced as a jurisdiction with an appropriate regulatory regime.

We consider that the risks to members of personal pension schemes are primarily related to:

- the suitability of a pension scheme for the member;
- the appropriateness of the investment decisions taken;
- the security of the underlying assets;
- the effectiveness and efficiency of the administration of the scheme; and
- the value for money of the products and services supplied.

Our overall policy intention is that the regulatory regime mitigates these risks to consumers in a proportionate manner to ensure that regulation provides appropriate protection whilst not impeding the development of the market.

2.2 Current regulatory regime

Personal pension schemes established in Gibraltar are currently structured on a trust basis. The risks to which members of such schemes are exposed are therefore, in large part, a function of the quality of the trustees. However, the exposure to risks is also impacted by the actions of other parties such as pension scheme administrators and financial advisers.

The Financial Services (Investment and Fiduciary Services) Act 1989 captures professional trusteeship as a controlled activity which requires a licence. There are also associated Financial Services (Conduct of Fiduciary Services Business) Regulations 2006.

We have identified that, in order to protect consumers and the reputation of Gibraltar, it is necessary to:

- strengthen regulation as it currently applies to trust-based schemes, for example by being clearer on the duties of those that run personal pension schemes; and
- extend regulation so that it captures other parties engaged in the operation and distribution of personal pension schemes such as administrators and financial advisers.

Furthermore we want to ensure that the regulation does not only cover trust-based schemes but that it also extends to contract-based structures. By taking this approach we are looking to facilitate innovation and support the development of the market.

2.3 Proposed regulatory framework

Our proposed approach is to directly regulate the operation of personal pension schemes. Our intention is to also regulate the provision of financial advice, directly where the adviser is based in Gibraltar; and indirectly, through the operator of the scheme, where the adviser is based in other jurisdictions.

We consider that the benefits of this approach include the following:

- it is a robust and comprehensive approach with the regulation becoming self-contained (i.e. consideration is given to the operation of a scheme as a whole and to the financial advice);
- different scheme structures, for example contract-based, can be more readily accommodated; and
- it will ensure that the reputation of Gibraltar is enhanced in terms of having a robust and fit for

purpose regulatory regime for personal pension schemes.

In summary, the regulatory framework we propose is as follows:

Market participant	Proposed high-level regulatory approach
Schemes established in Gibraltar	Directly regulate the operation of the scheme (covering trustees, corporate entities, administrators, etc.).
Financial advisers based in Gibraltar	Ensure subject to conduct of business regulation in respect of personal pension schemes.
Financial advisers based in other jurisdictions	Utilise binding fundamental regulatory rules – and develop guidance – to require the <u>operators of the scheme</u> to take appropriate responsibility for the source of its business. To include: <ul style="list-style-type: none"> • due diligence on the financial adviser; • due diligence on the assets allowed into the scheme, in particular non-standard investments; • assessment of the suitability of high-risk and speculative investments for retail investors; and • acceptance of non-advised business and “insistent clients”.

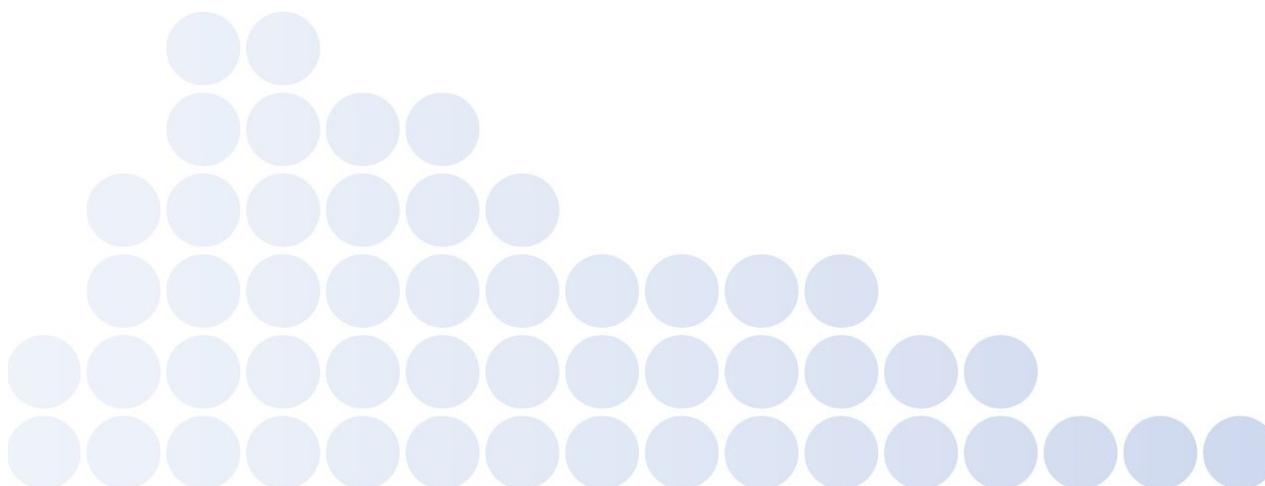
In the main body of this Consultation Paper we expand further on these proposals and also cover a number of related matters, including:

- the governance of contract-based schemes;
- the outsourcing of the administration of schemes established in Gibraltar; and
- the Legislative Reform Programme.

2.4 Next steps

Please send us any comments you have by 5pm on Tuesday 14 July 2015.

We will consider your feedback as we develop a final policy statement and the draft legislation. We intend to publish the policy statement and consult on the draft legislation after the summer.



3. Approach to the regulation of personal pension schemes

3.1 Background

The market for personal pension schemes, such as QROPS, continues to grow and develop. This provides opportunities for Gibraltar as a major international financial services centre.

The regulatory objectives of the Financial Services Commission are set by statute and include the protection of consumers and the protection of the good reputation of Gibraltar. In carrying out our functions we are mindful of the need to operate in a manner which is consistent with the principles of good regulation including: to facilitate innovation; to maintain competitiveness; and to minimise the adverse effects of regulation.

Furthermore the providers of personal pension schemes in Gibraltar appear to have a strong focus on building long-term relationships with their customers. Such providers are therefore supportive of regulatory and taxation policies which support this objective. It is important that customers have confidence that they are saving into durable products that are capable of delivering good outcomes.

In a rapidly developing market it is important that the regulatory regime remains fit for purpose and responsive to the changing environment. This includes the requirement to incorporate into regulation any European Union Directives.

Our approach to the regulation of personal pension schemes is to support the market in delivering good outcomes for customers, intervening only as necessary where the market appears unlikely to do so unaided. We are committed to risk-based regulation with a proportionate approach that is mindful of burdens on business. Also, given the growth in this market, we need to ensure that our regulatory approach is capable of tackling both current and future challenges in the market landscape.

3.2 Market landscape for personal pension schemes

The market has seen significant growth in recent years and the current number of schemes registered with the ITO is as follows:

- QROPS – 44;
- QNUPS – 4; and
- Personal pension schemes – 9.

Source: ITO (May 2015).

The future growth of the QROPS/QNUPS market is dependent on a number of factors in particular the regulation applied by Her Majesty's Revenue & Customs (HMRC), specifically the extent to which the flexibilities that came into force in the UK in April 2015 are extended to non-UK pension schemes.

Currently all personal pension schemes in Gibraltar are trust-based. This is seen to be a barrier to some international pension transfers where the potential transfer is from a country such as France where the financial adviser and the customer are unfamiliar with trust type structures. In such a situation only contract-based schemes are likely to be acceptable to the customer. We understand that those jurisdictions which currently permit contract-based schemes are attracting a significant amount of such transfers. However we are receiving mixed messages on how big a market this is in practice.

Furthermore the growth of the market is dependent upon a number of factors, for example: the reputation of the jurisdiction; the robustness of the regulation; and the taxation regime.

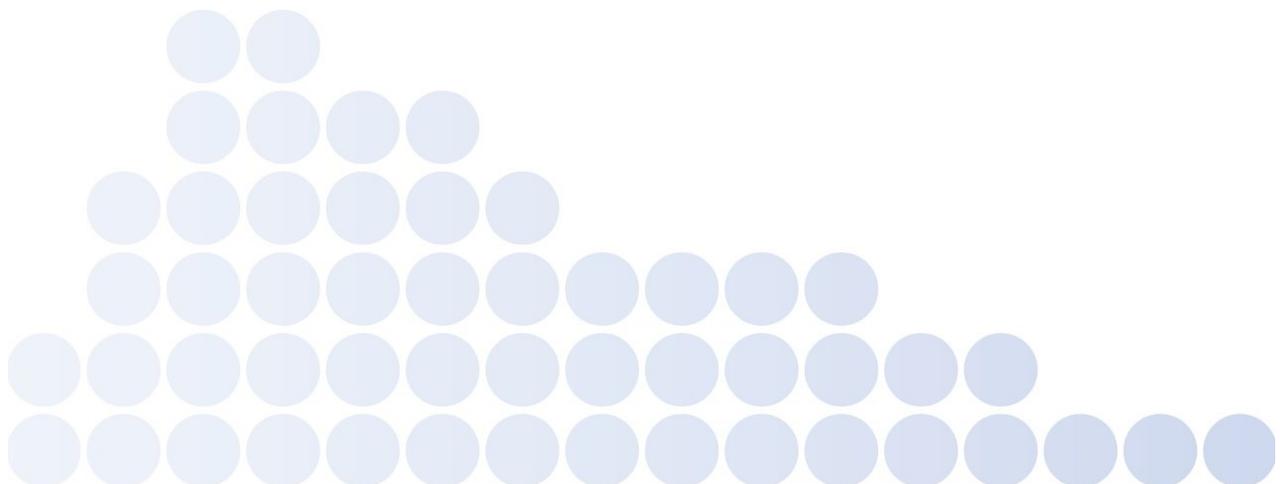
3.3 Risks to members

Consideration of the regulatory approach requires, in the first instance, a clear understanding of the risks to customers that we might wish to mitigate.

We have therefore analysed the market, and tried to identify the principal risks to members of personal pension

schemes. We consider these are primarily related to the following five aspects:

- the suitability of a pension scheme for the member;
- the appropriateness of the investment decisions taken;
- the security of the underlying assets;
- the effectiveness and efficiency of the administration of the scheme; and
- the value for money of the products and services supplied.



4. Proposed regulatory approach

4.1 Operation of personal pension schemes established in Gibraltar

Our proposed approach is to directly regulate the operation of personal pension schemes.

Operating a personal pension scheme would become a regulated activity. The regulated activity would also extend to establishing a scheme and winding up a scheme.

The operator would be responsible to the members for managing and administering the assets of the scheme (together with income and the benefits payable) in accordance with legislation. In practice, an operator of a trust-based scheme would consist of some combination of the scheme trustee and the scheme administrator. This might be a single entity or two separate companies (e.g. a trustee and an administrator).

Operation of the scheme will involve, in practice, various regulated activities, e.g. arranging deals in investments, dealing in investments, arranging safeguarding of assets. For any given scheme, the trustees and the administrator will need to understand the regulated activities that they are carrying out and will need to be licensed accordingly. At one extreme, a trustee might not need to be licensed in this regard if they are bare trustees (i.e. only holding the assets). At the other extreme, an administrator might not need to be licensed if they are only carrying out basic administration (e.g. maintaining records, paying over contributions for investment, paying out benefits).

There is a question around whether, as well as licensing the operator of a personal pension scheme, each individual scheme that the operator establishes should also be licensed. We are of the view that only the operator needs be licensed. This is because, by directly regulating the operator as a whole, we have the appropriate regulatory oversight of all their activities including the establishment and launch of new schemes.

4.2 Financial advisers based in Gibraltar – conduct of business

As well as those who operate personal pension schemes, we fully recognise the importance of considering financial advisers who advise on personal pension schemes (and also advise, as appropriate, on decisions that individuals make in respect of their occupational pension scheme provision).

Our objective is to ensure that such financial advisers based in Gibraltar are licensed and subject to conduct of business regulation. It seems to us that the way to achieve this would be to define the rights under a personal pension scheme to be a specific type of regulated investment. In this way the regulated activity of “advising on investments” would then encompass personal pension schemes.

4.3 Financial advisers based in other jurisdictions

We recognise that many financial advisers are based in jurisdictions which are outside our regulatory reach in terms of conduct of business regulation.

We strongly believe however, that the operators of personal pension schemes – in the interests of protecting their customers and their own reputations – have important responsibilities in relation to all those that provide financial advice. Our intention is to utilise binding fundamental regulatory rules – and develop appropriate guidance – to require the operators of the scheme to take appropriate responsibility for the source of its business. We anticipate this covering a range of aspects:

- due diligence on the financial adviser;
- due diligence on the assets allowed into the scheme, in particular non-standard investments;
- assessment of the suitability of high-risk and speculative investments for retail investors; and
- acceptance of non-advised business and “insistent clients”.

(a) Due diligence on the financial adviser

We accept that operators of personal pension schemes are not responsible for the advice given by financial advisers. However we would expect operators to have procedures and controls in place that enable them to gather and analyse management information that will enable them to identify possible instances of financial crime and customer detriment. Such instances should then be addressed in an appropriate way, for example by contacting the customer to confirm the position or by contacting the adviser and requesting clarification.

Examples of good practice by operators of personal pension schemes include:

- confirming, both initially and on an ongoing basis, that the financial adviser is licensed and regulated as appropriate (i.e. customers resident in regulated jurisdictions receive advice from a financial adviser that is regulated to provide such advice);
- having terms of business agreements that govern the relationship and clarify the responsibilities of the financial adviser;
- understanding the nature of the financial adviser's work to establish the type of company, their business objectives, the types of customers they deal with, the levels of business they conduct and expect to write, the types of investment they recommend, and where else they place business;
- being able to identify irregular investments, such as unusually large transactions, or higher risk investments to enable the operator to detect the need to conduct further relevant checks;
- identifying risks that the products and services supplied to the customer do not represent value for money in terms of costs and charges;
- conducting independent verification checks on customers to ensure the information that operators are being supplied with is authentic; and
- having a set of benchmarks with the purpose of setting minimum standards the operator is prepared to accept, identifying those instances that would lead an operator to decline the proposed business.

(b) Due diligence on the assets

Operators of personal pension schemes should ensure that they conduct and retain appropriate and sufficient due diligence on the investments, for example in relation to assessing that assets allowed into a scheme are appropriate. In particular, we consider it to be imperative that operators have adequate procedures in place to assess any non-standard investments.

Our expectation is that a due diligence process on investments would entail:

- correctly establishing and understanding the nature and structure of an investment;
- ensuring that an investment is genuine and not a scam, or linked to fraudulent activity or money laundering;
- ensuring that an investment is safe and secure (i.e. custody of assets is through a reputable arrangement and any contractual arrangements are correctly drawn up and legally enforceable);
- ensuring that an investment can be independently valued both at point of purchase and subsequently;
- ensuring that an investment is not impaired; and

- ensuring that the investment is regulated by an acceptable regulator and is covered by a compensation scheme.

(c) Assessment of the suitability of high-risk and speculative investments

The likes of an Unregulated Collective Investment Scheme (UCIS) is a high-risk and speculative investment which we believe is unlikely to be a suitable investment in a personal pension scheme for the majority of retail customers.

Our starting point is that the only type of customers for which such an investment might be suitable are sophisticated investors (who have extensive investment experience and knowledge of complex instruments) and those high net worth individuals (having investable net assets of more than £250,000 or having an annual income of more than £100,000) who have the appropriate capacity for loss.

We do however accept that operators of personal pension schemes are not responsible for the advice given by financial advisers. We also recognise there can be challenges for operators in independently verifying that the customer is in fact a sophisticated investor or a high net worth individual. It seems to us that one possible approach would be for the operator to obtain written confirmation from the financial adviser that they have formally assessed the customer as being a sophisticated investor or high net worth individual (with the capacity for loss) and that the financial adviser has produced evidence to this effect.

(d) Acceptance of non-advised business and “insistent clients”

We have some concerns about investment in personal pension schemes which is transacted direct without financial advice (that is, execution only) though we do recognise that there may be occasions when non-advised business might be appropriate. We are particularly concerned where these practices relate to non-standard investments but identify that there are increased risks to customers with all business of this type.

We have identified two particular scenarios:

- there is no financial adviser involved and the customer just wishes to deal directly with the operator of the scheme on a non-advised execution only basis; and
- there is a financial adviser involved but they have determined the customer to be a so-called insistent client who wishes to transact on an execution only basis.

In the first instance, we think that all such non-advised business should be restricted to sophisticated investors and high net worth individuals. We do however believe that in all circumstances it is inappropriate to accept an insistent client and, at the same time, remunerate the financial adviser for the business.

4.4 Governance of contract-based schemes

We are aware of the view, expressed by some, that – in the absence of trustees – the governance of contract-based schemes is potentially not as strong as trust-based schemes.

However, our view is that the existence of binding fundamental regulatory rules, such as the requirement to treat customers fairly, is capable of supporting an outcome for customers that is similar regardless of whether the scheme is trust-based or contract-based. We therefore intend to rely on such rules rather than impose additional regulatory requirements on contract-based schemes.

4.5 Outsourcing of the administration of personal pension schemes established in Gibraltar

We are frequently asked about the outsourcing of administration in respect of personal pension schemes, and thought it appropriate to include a discussion of the matter as part of this consultation. The question we address here is the extent to which a Gibraltar-based personal pension scheme is permitted to carry on some

administration functions in other jurisdictions.

There are a number of aspects to the question of administration – in particular the tax dimension for QROPS, and the regulatory approach to outsourcing.

- (a) HMRC publish Guidance in the form of a Registered Pension Schemes Manual (latest version April 2014). Within the Manual there is section on QROPS (ref: RPSM13104060) which considers the country of establishment of overseas pension schemes: “Normally, a scheme will be treated as established in the country where its ... main administration is carried out ... The scheme’s location of main administration is where the scheme’s decisions are made. In the case of a trust-based scheme, that would normally be determined by reference to where the scheme trustees are resident as that is where the decision-making responsibilities in respect of the scheme will lie”.

HMRC refers to “main administration” as being where the scheme’s decisions are made. So, from a tax perspective, where other less consequential administration functions – i.e. day-to-day administration such as back-office operations or the processing of data – are carried out are not relevant in terms of defining the country of establishment.

- (b) We set out formal guidance in February 2012 on outsourcing generally which states: “Many firms outsource some of their systems and controls and/or processing outside of Gibraltar. It is important that outsourcing does not result in reduced standards or requirements being applied. Firms cannot contract out of their regulatory responsibilities, and therefore remain responsible for systems of control in relation to the activities outsourced. In all instances of outsourcing it is the delegating firm that bears the ultimate responsibility for the duties undertaken in its name”.

It is our intention, in due course, to set out regulatory requirements in respect of outsourcing. This will include the ability for us to inspect directly the organisations through which the outsourcing is performed.

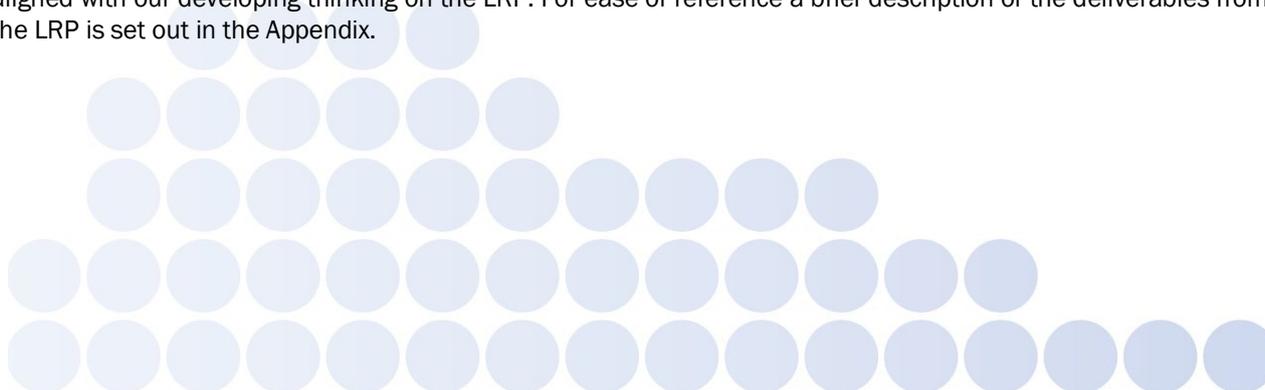
So, from a regulatory perspective, the matter of importance is that outsourcing does not result in any reduction in standards. And, as per the proposals in this paper, we intend to impose regulatory control over the actions of the administrators of personal pension schemes. For trust-based schemes we would expect the trustees to be resident in Gibraltar and, for contract-based schemes, we would expect the registered office and the directors to be based in Gibraltar.

We conclude that for a personal pension scheme, provided that decisions related to the scheme are made in Gibraltar, then other administrative functions can be performed in other jurisdictions as long as this does not result in reduced standards or requirements being applied.

4.6 Legislative Reform Programme (LRP)

Details of the LRP were published on 27 January 2015. In this paper we are not consulting on the wider LRP but rather only on those aspects which we believe are particularly pertinent to the changes we want to make to the regulation of personal pension schemes.

We are of course though progressing the thinking on the regulation of personal pension schemes in parallel with the LRP. It will therefore be important that any legislative change in respect of personal pension schemes is aligned with our developing thinking on the LRP. For ease of reference a brief description of the deliverables from the LRP is set out in the Appendix.



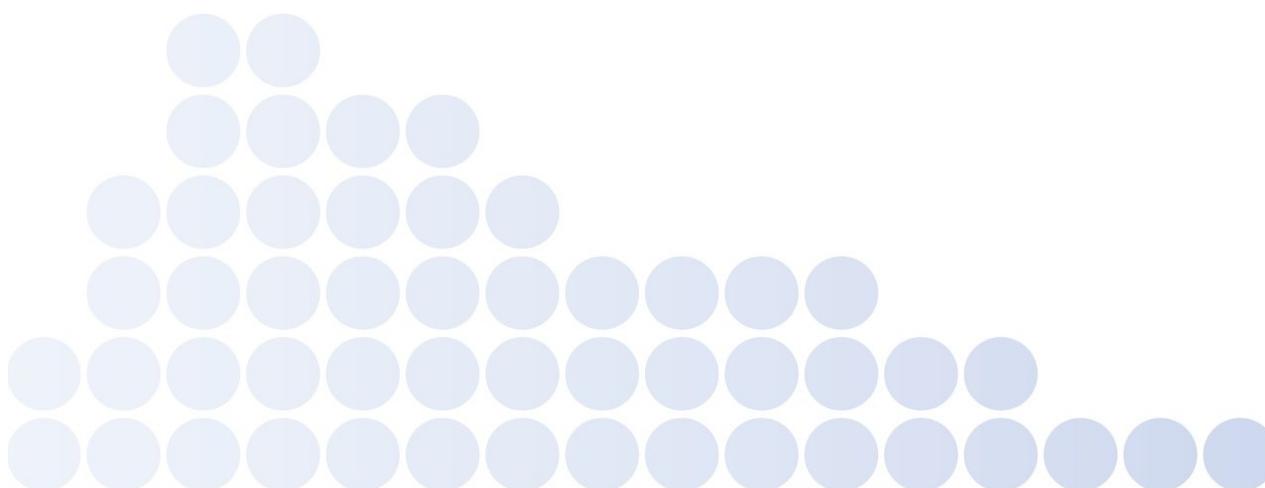
5. Conclusion

We believe that the package of measures outlined above, comprising a number of regulatory changes and associated guidance together with the Handbook delivered by the LRP, is capable of delivering a robust regulatory regime for personal pension schemes which is fit for purpose.

At this stage we are consulting on the high-level principles. We will share in due course our thinking on the more detailed aspects that would flow from such principles (such as capital requirements, regulatory fees, and reporting requirements).

We recognise that this paper covers a number of fundamental matters across a fairly broad range of issues, and accept that not every reader will have an interest in every aspect of this consultation. So please do restrict your response to just particular matters of interest if you feel this is appropriate.

We look forward to receiving your responses to our consultation. Please send them to us by 5pm on Tuesday 14 July 2015.



Appendix

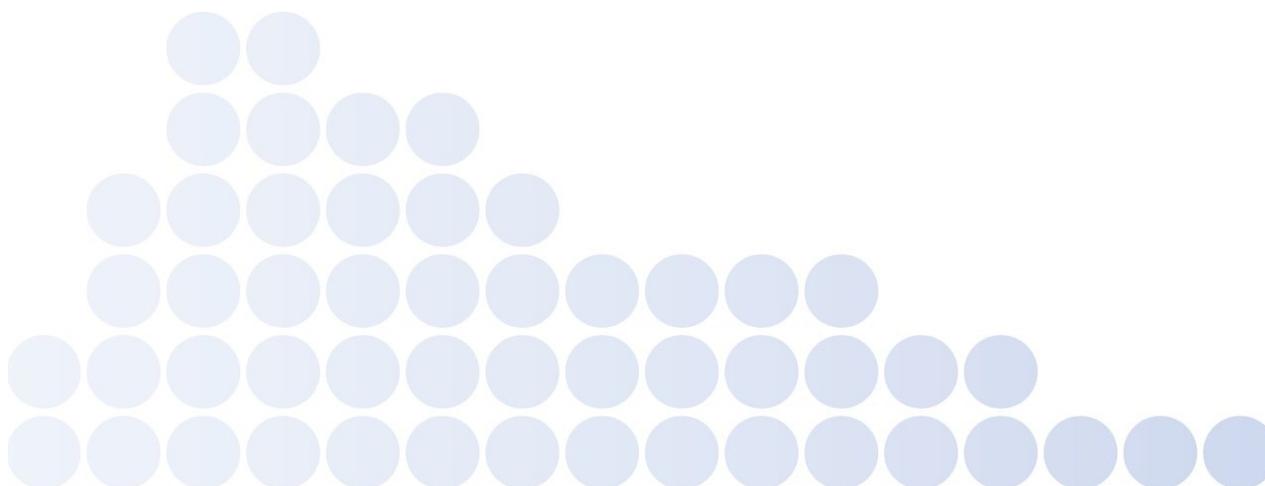
Legislative Reform Programme (LRP)

The LRP will deliver a Financial and Professional Services Regulatory Handbook many aspects of which will apply across a wide range of financial and professional services firms.

The Regulatory Handbook will cover inter alia:

- fundamental rules (for example, that firms should treat customers fairly);
- ethical requirements;
- requirements in respect of Individually Regulated Persons;
- general conduct of business (including marketing, information to clients, and disclosure);
- conduct specific to intermediation (for example, giving investment advice);
- requirements regarding systems and controls;
- corporate governance and risk management, including outsourcing;
- prudential requirements, including capital adequacy and solvency;
- handling of client assets;
- client protection, including complaints handling and compensation schemes; and
- regulatory engagement (including authorisation, supervision, enforcement, reporting requirements, fees).

The Regulatory Handbook will be supported by non-mandatory Guidance.



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