Industry Update

FOR FINANCIAL ADVISORS ONLY

Welcome to our 'Industry Update' our new briefing document for pension industry professionals.

In our November 2014 edition you will find insightful commentary on how Self-Invested Pension products continue to form an integral part of many pension portfolios and we also look at some of the current popular investment choices.

We have also invited Joe Beashel of Matheson to outline some of the key legislation changes coming from Europe and Ian Mitchell from Eighty 20 Focus to provide us with his thoughts on exit strategies for company directors.

Gerard Keane – Managing Director

Self-Invested Pension arrangements (sometimes referred to as Self-Administered or Self-Directed Pensions) are rapidly increasing in popularity and should form an essential part of every Independent Financial Advisors ('Advisors') recommendation.

Self-Invested Pensions have long been popular amongst experienced investors. Transparent fee structures, investment choice and ease of access have led to a growth in popularity. More and more clients with the help of their Advisors are discovering that they need to take a more active interest in managing and growing their retirement funds.

Following a recent review of our clients we asked what had drawn them to Self-Invested Pensions. Below are the top four answers:

- Control of their investment decision
- Transparent fees (invoiced in advance of deduction)
- Property
- Service

In the UK last year the SIPP Market grew by 14% in the number of contracts sold and almost 20% in assets under management. It is more difficult to get exact numbers for the Irish Market but the leading providers in this area have indicated that the market here is growing at a similar rate, admittedly from a smaller base.

Self-invested pensions are not a viable alternative for everyone but they do suit certain clients. It provides clients and Advisors with the flexibility that is required to execute their financial plans in full without the need to compromise on investment due to the constraints of the traditional pension contracts. We believe 'Self-Invested Pensions' should mean 'Self-Invested Pensions' and should only be constrained by the Revenue rules on investing and not by the investment criteria of your provider. Advisors should be presenting Self-Invested Pensions as one of a number of options to their clients.

In this issue we focus on the topical investments driving the growth in this area. We have outlined below some of the investment options currently proving very popular with clients.

Residential & Commercial Property

In the last year we have experienced a resurgence in Advisors and their clients' expressing a preference to invest in both commercial and residential property. This is not that much of a surprise, with a PWC report published earlier this year indicating that Ireland is fast becoming one of the 'hottest' places for European property investment.

The report which included an investor survey, identified that Dublin's real estate market as being transformed from a no go location amongst investors only two years ago to being one of the more popular in Europe. It is now seen as a prime location for investment with both domestic and international investors attracted by both pricing levels and Ireland's improving economic outlook.

A Self-Invested Pension allows an individual to purchase and maintain a property investment using their pension funds. The pension holder sources their own property investment with the guidance of their Advisor and their Self-Invested Pension purchases the asset. The property is then held on the balance sheet of the

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individuals pension, be it an ARF, PRSA, SIPP, PRB or SSAPS. The purchase costs and legal fees are deducted from the pension fund, as are any running/maintenance costs for the property. Any rental income generated from the leasing of the property goes back into the pension scheme gross of tax. Along with the annual yield generated by way of rental income, there is great scope for capital appreciation in selection of the right property with no CGT applicable. On retirement property assets can be transferred across to a post retirement ARF or Vested PRSA.

The majority of investments into property in the last couple of years have not utilised mortgage finance but borrowing is still allowed and available to Self-Invested Pension investors. The average Loan to Value that we have seen is between 50%-60%.

Discretionary Fund Managers

Over the last couple of years we have seen a growth in the provision of 'multi-asset' funds, real return and absolute return funds within life company fund ranges. However it is in the area of more niche discretionary fund managers that we have seen the real growth over the last five years. There are a number of reasons for this and when asked there was a very strong consensus between clients as to why they were following this route. Some of the reasons were as follows:

- Clients believed that they were given a better initial insight into how their money was being managed along with regular meetings and updates from their Advisor and/or Fund Manager(s).
- Larger clients viewed discretionary funds as more transparent in relation to charges.
- Due to their personal service approach, clients felt that they built a much stronger trust based relationship with their Advisor and Fund Managers.
- Following the downturn in 2007, clients who have made the switch to discretionary fund management believe that they now have influence and control of their investments in tandem with their Advisor and that they can now hold their fund manager to account for its performance.

On a recent visit to the UK we met the second largest Self Invested Pension Provider in the UK, James Hay. We discussed their rapidly expanding business, the requirement for technology, the ever increasing regulatory demands and the UK pensions market, as their market is a number of years ahead of Ireland. It is interesting to see over 70% of company directors and professionals in the UK have a Self-Invested Pension (SIP). The market has in light of legislative changes moved away from the traditional insurance based model to the Self-Invested model.

MiFID II and IMD II will be enacted in the coming year. If the introduction of RDR in the UK is to be mirrored, the impact on the Irish insurance market will be dramatic. Advisors should ensure they are kept well informed of any potential legislative changes that may impact their business.

Newcourt Retirement Fund Managers Limited and Newcourt Pensioneer Trustees Limited have been providing Self-Invested Pension solutions for over 20 years.

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REGULATORY UPDATE - MIFID II & AIFMD

Joe Beashel
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The development of financial services legislation at European level and its transposition into Irish continues to present opportunities and challenges in Irish financial legislation services. This note provides a brief overview of recent regulatory developments with consequences for investment funds and investment firms respectively. An analysis is provided of the changes to the Irish regulatory market likely to be ushered in by the implementation of the Markets in Financial Instruments Directive II ("MiFID II"). Further, a short summary of the key provisions of the Alternative Investment Fund Managers Directive (the "AIFMD") is provided which came into effect on 1 July 2011 and was transposed in Ireland on 16 July 2013.

MiFID II

The aim of MiFID II is to introduce new post-financial crisis conduct of business requirements and seek to improve the transparency, stability and regulation of the financial markets. MiFID II aims to tighten rules on the derivative markets to curb speculative investment and protect investor's interests. The changes reflect fears that speculative commodity trading has affected the price of staple goods. MiFID II also introduces a new category of trading venue called organised trading facilities ("OTF") for non-equity instruments. It aims to push the trading of standardised derivatives onto visible regulated venues such as a multilateral trading facility.

MiFID II will also extend the scope of the original directive to cover more firms. For example a wider range of commodities firms will be covered than is the case at present and certain data providers will fall within the scope of the regulation for the first time.

MiFID II will also introduce consumer protection rules governing the distribution of insurance-based investment products by amending the Insurance Mediation Directive 2002/92/EC. A Recital to MiFID II explains that this amendment is being made in order to deliver consistent protection for retail clients and ensure a level playing field between similar products. MiFID II defines an insurance-based investment product as "an insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations". This indicates that an insurance based investment product for these purposes would need to include an investment component that is expected to provide a variable rate of return. This would be likely to cover investment based insurance products such as unit-linked and index-linked contracts, fixed index annuities and variable annuities.

The European Securities and Markets Authority ("ESMA") will have powers under the MiFID II to prohibit or limit the marketing and distribution of certain types of financial instruments in particular circumstances, and the European Banking Authority may have similar powers in relation to structured deposits.

The conduct of business requirements are modified in order to grant additional protection to investors. The rules for investment advice are improved both when advice is provided on an independent basis and in the long term. Advisors declaring themselves as independent will need to match the client's profile and interests against a broad array of products available in the market and say whether they will provide the client with a periodic assessment of the suitability of advised products.

In a fundamental development, it is also proposed to permit third country firms (i.e. non-EEA firms) that wish to provide cross-border investment services across the EEA to do so on the basis of a "passport". Under the proposals, the passport will be exercised either:

- By establishing an EEA branch which will be mandatory if the intention is to deal with retail clients and professional clients within the meaning of Section II of Annex II to the Directive (clients who request to be treated as professional clients) and gaining authorisation for the branch; or
- By becoming licensed by an EEA competent authority to provide services from outside the EEA on a cross-border basis (this is possible where the firm only intends to provide services to professional clients within the meaning of Section I of Annex II to the Directive (deemed professional clients) and eligible counterparties).

In the second case the non-EEA firm must pass an equivalency test to be devised by the Commission. It is also envisaged that persons within the EEA will be able to receive services cross border from non-EEA firms that are not authorised in the EEA where the person in the EEA requests services from the non-EEA firm at their "own exclusive initiative", i.e. on an unsolicited basis. The proposed new regime for non-EEA firms will inevitably lead to a re-write of the cross-border business "safe harbour" in Regulation 8 of the MiFID Regulations and the introduction of a formal "unsolicited business" exemption.

ESMA is now faced with the challenge of translating the MiFID II requirements into practically applicable rules and regulations. The process began prior to MiFID II's publication in the Official Journal on 12 June 2014.

REGULATORY UPDATE - MIFID II & AIFMD CONTINUED

AIFMD

AIFMD applies to Alternative Investment Fund Managers ("AIFM") based inside or outside of the European Union which are involved in managing EU-based funds or who wish to market funds to professional investors in the EU. The AIFMD was transposed in Ireland on 22 July 2013 and Ireland was the first country to accept applications for authorisation as an AIFM. Notably, Ireland offers somewhat of a ready-made solution to many of the issues arising from the AIFMD's introduction. A self-managed qualifying investor alternative investment fund ("QIAIF") may apply for authorisation as an AIFM and may delegate its investment management functions to either an EU or non-EU investment manager.

The AIFMD requires that any fund manager who is regularly involved in the management of AIFs within the EU is subject to authorisation or registration with a competent authority within the EU. The AIFMD provides that each Alternative Investment Fund ("AIF") must have a single AIFM, which is responsible for ensuring compliance with the AIFMD. The legislation itself is broad and essentially all AIFMs fall within the scope of the AIFMD with the exception of managers located outside of the EU who manage non-EU funds that are not marketed to EU investors. The AIFMD creates harmonised requirements for both the structure and the operation of AIFMs and in turn permits AIFMs to avail of a passport to market AIFs to professional investors across the EU and to manage AIFs domiciled outside of the AIFM's home member state.

There are a number of significant provisions set out by the AIFMD. Some of the most noteworthy aspects of the AIFMD include:

- As regards marketing provisions, an AIFM can only market an AIF to investors within the EU if the AIFM is authorised by a relevant EU regulator or is compliant with national private placement regimes. The AIFMD provides a framework for marketing to professional investors and no passport exists for marketing to retail investors.
- Under the AIFMD, each AIF managed by an AIFM must have a single depositary appointed to it. This depositary may be an EU credit institution, an EU investment company or a UCITS depositary. However the depositary may not be an AIFM. It is required that the registered office or branch of the depositary of an EU AIF must be in the AIF's home Member State. In situations where the depositary is established in a third country there is a requirement that co-operation and information exchange agreements are in place between the supervisor of the depositary, the regulator of the AIFM and the regulator in each Member State where the AIF is to be marketed. Regulation and supervision to the same effect as that under the EU must be in place.
- It is required that the AIFM sets a maximum level of leverage for each of the AIFs it manages. The levels set must be reasonable and this must be demonstrable to its regulator. The maximum level of leverage set must be complied with and the risks of the leverage employed by the AIFM are subject to assessment by the regulator.
- The AIFMD requires that where any functions of the AIFM are delegated, the regulator must be notified. The delegation structure must be objectively justifiable and any delegated services must be reviewed by the AIFM. Where the AIFM wishes to delegate any risk management or portfolio management functions it is required to do so only to regulated entities and any such delegations are subject to prior authorisation by the regulator. The AIFMD seeks to combat 'letter box entities' and conflicts of interest are strictly monitored. Any delegate must be sufficiently experienced, have sufficient resources and hold a good reputation.
- Valuation functions may be carried out either by the AIFM or an appointed external valuation agent. The AIFMD requires both competence and independence for any personnel who perform valuation. Prior to the AIFMD, responsibility for the valuation procedures and AIF's resided with the board of directors of that AIF. The board can retain this responsibility under the AIFMD as a self-managed AIF or where an external entity is appointed as AIFM, that entity will assume the responsibility for this function.
- The marketing passport is automatically available to all EU AIFMs managing EU AIFs. This passport does not however become available to non-EU AIFs until at least two years after transposition to national law, in the case of Ireland around July 2015. Where a non-EU manager intends to avail of the passport they will have to apply for authorisation from their member state of reference ("MSR"). The MSR should be where the AIFM intends to develop effective marketing.

This note is for information purposes only and does not constitute legal advice.

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EXIT STRATEGIES FOR SENIOR CORPORATE PERSONNEL

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Back in the day it was easy – fund up the Defined Benefit scheme, give them a high pensionable salary, an inflation protected benefit in retirement with a decent spouse's pension attaching and, after saying a few suitable words at the leaving do, wish them on their way.

But it's much more complicated than that now for corporate employers – of both the quoted and professional partnership owned varieties.

Actually it was quite complex then too if you wanted to ensure that your most senior personnel were able to retire in a manner and style that suited the needs of both the organisation and the individual; but these days it's a real minefield. And nobody ever starts planning for it in time.

So where do the main pension problems lie?

- Well, the introduction of and subsequent swingeing reductions to what is known as the Standard Fund Threshold (SFT) hasn't helped much for starters.
- The SFT, beyond which pension contributions are ineffective for tax relief purposes, was introduced in December 2005. It has stood at €2.3 million since 7 December 2010, and has been reduced as and from 1 January 2014 to €2 million.
- Then there's the issue of the reduction in tax free cash available from a pension scheme. That used to be a very attractive benefit for senior executives in that a sum of up to 1.5 times their final total emoluments (subject to some benefit averaging) was available, albeit at a cost to their ongoing pension. Now they are restricted to €200,000, with potential for a further €300,000 subject to tax leakage of 20%.

So to make their exit arrangements a little more palatable senior people are now exploring the potential benefits, where applicable, of one or all of the following:

- Defined Contribution pension schemes, with their potentially more flexible post-retirement benefit constructs. (This applies to executives of both independent shareholder and partner practice owned corporates.)
- Long-Term Incentive Plan (LTIP) share based compensation arrangements. (This is not normally applicable to executives in partner practice owned corporates.)
- Company sponsored executive savings plans. (This applies to both categories of corporate.)
- Attractive termination payments. (This may be more difficult to justify in the instance of partner practice owned corporate structures.)
- 'OwnCo' consulting agreements set up to provide post service earning opportunities. (This may also be more difficult to justify in the instance of partner owned structures.)

Like I said, it's a minefield; and invariably some key strategic arrangements get left until the last minute – which is, of course, always a recipe for getting things wrong!

Exiting from a key executive role is a complicated process for both the employer and the executive, even if the succession plan is carefully crafted and the right messages are delivered both internally and to the market; and companies would be well served by allocating both time and budget to ensuring that the transition is project managed efficiently and correctly.

Amongst a raft of ideas currently doing the rounds are those of

- 'Staggering' post retirement income drawdown by virtue of creating multiple PRSA contracts, each of which can be vested at different times in order to phase in tax free cash whilst delaying the need for implementation of the deemed distribution requirement in the non-vested contracts. This is an interesting and useful concept, but does carry with it the risk that access to tax free cash may be more restricted in the future than it is now, thus potentially costing the executive dearly.
- Transferring pension assets outside of Ireland (an in vogue destination at the moment is Malta) in order to make use of what may appear to be more favourable tax regimes. Again, this initially attractive idea may carry significant risk to the executive, particularly in the light of the current state of flux within EU itself, and anyone considering such a move should consult an international tax expert to obtain in depth advice about the jurisdiction under consideration.
- A variation of this is to consider transferring pension assets to UK and there is some merit in considering this in depth, again in conjunction with a qualified tax expert.

However, every good strategic idea in this area does carry with it the potential to create risk for the employer and should be approached prudently and with attention to detail.

For instance, the significant benefits of purchasing some time bound input from a consultant who, having previously held a senior role within the company, knows the business inside out can often be immense, but not if the arrangement creates risk to the organisation by contravening Revenue regulations and

EXIT STRATEGIES FOR SENIOR CORPORATE PERSONNEL CONTINUED

practice guidelines. So great care is needed in ensuring that the process is both substantive and carefully implemented.

Similarly there may be benefit for both executive and organisation in having an executive retire from a stand-alone company sponsored self-administered pension scheme, rather than from the larger occupational arrangement, but, again, not if the executive then seeks to flout the restrictions placed upon such schemes by EU law, Irish Revenue or the Pension Regulator; and so, again, much attention needs to be paid to process detail.

Inevitably the process around senior retirements is made up of a significant number of moving parts – any of which could, and sometimes does, derail the process badly. So it helps to do three things well:

1. Approach the process with a time horizon of at least 18 months. This will allow time and space for a all relevant information to be gathered up, a plan formulated and 'stress tested' several times by relevant stakeholders, and all required legal and financial aspects of the process to be fully implemented.
2. Appoint an external project manager to work with company HR, the organisation's pensions' consultant and any other stakeholders and external Advisors.
3. Budget resources to provide the retiring executive and her or his spouse with high quality pre-retirement coaching. This for many executives is one of the most stressful times of their life, and if time is taken to explore every facet and option fully organisational risk will be minimised and the process will flow more smoothly for all concerned.

Ian Mitchell is Managing Director of Eighty20 Focus Limited and is a Fellow of the Institute of Leadership and Management and an AC accredited coach. He delivers strategic coaching and consulting programmes to senior executives, top teams, SME owner managers and financial sector practitioners.

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