Finding a QROPS that fits

In the wake of 'Q-Day', the landscape for QROPS has undergone significant change. Following Guernsey's exit, the remaining jurisdictions are now competing to fill the gap left in the market, but understanding which is the best option for clients depends on a range of factors

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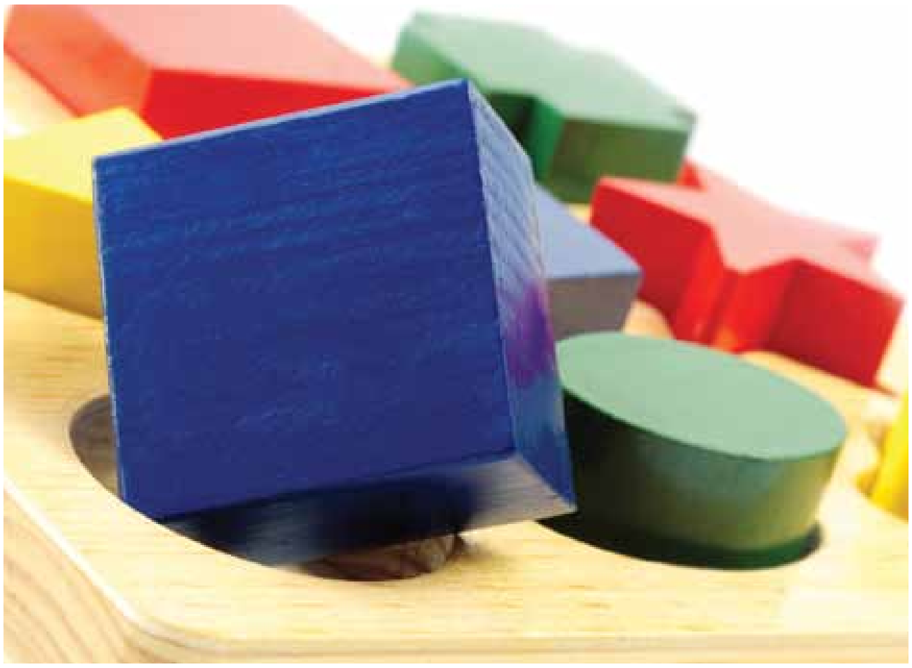
Rex Cowley, principal, Newdawn Consultancy



The cliché, "what a difference a day makes" has never rung as true as it did in April 2012 when HMRC introduced the amended QROPS legislation. We are all familiar with the implications of the legislation for jurisdictions such as Guernsey, Isle of Man and New Zealand, but the real loser in this was that of "choice, simplicity, efficiency and cost".

Pre-April 2012, the market benefited from falling prices due to intense competition, open architecture, highly flexible investment propositions, and good operational efficiency. There was also access to broad technical expertise with multiple product providers and the ability to take pension benefits without the deduction of tax at source (gross income).

Q-Day aftermath

Importantly, all these benefits were available from a single jurisdiction making the adviser's job simpler, and hence why Guernsey commanded over 60% of market share (Source: 'The QROPS Report, 2012').

Since 'Q Day' last year we've seen prices rise, operational efficiency and servicing standards fall, significantly less product and increased complexity as the remaining jurisdictions try to fill the gap left by Guernsey's exit. However, the greater predicament for the market is that there is unfortunately no single jurisdiction which offers the full set of benefits in the way Guernsey or indeed the Isle of Man did, and a week doesn't go by without financial advisers asking for my advice on which jurisdiction is best for their client.

There is no simple answer to this question and it depends on a host of factors which need to be taken into consideration. These include the quality of the product provider, the structure of the product, the jurisdiction and the legislation within the jurisdiction.

This article provides a general *aide memoir* to advisers to assist with comparisons of legislative and jurisdictional points of difference so that these can be matched to the requirements of their clients before considering a provider.

Legislative factors

Understanding what the legislation allows is arguably the most important aspect around the selection of the QROPS jurisdiction, as it dictates the investment environment, when benefits can be taken, the level and type of benefit, and implication from a tax perspective. Table 1 lists some of the main legislative features at jurisdictional level and what is very apparent is that no one jurisdiction provides a significantly better proposition than another in all areas. However, depending on a client's requirements, certain jurisdictional features may prove more desirable given the clients objectives and therefore it is client need that will prescribe the jurisdictions of choice.

Benefit date

All jurisdictions offer international members access to benefits from the age of 55 and provide access prior to this date through ill health provisions with the exception of New Zealand, which also has a hardship clause that can be invoked after five years of non-UK residency at the discretion of the trustees.

This feature may prove attractive for the member who is still working and has not reached retirement age, as it provides a form of income protection should economic hardship be encountered such as unemployment.

Retirement age

New Zealand schemes are the only schemes not to have a mandatory date by which benefit must be taken (benefit crystallisation). For many clients this is irrelevant, as benefit will be drawn from retirement which is typically between 60 and 65.

However, for those clients that have no need for income from their plans, this option means they are not forced into a position where income has to be taken, which invariably results in an income tax liability in their country of residence and potentially a withholding tax in the QROPS jurisdiction.

This option also gives advisers the ability to turn on an income stream in later life, if needed by their client, and given current life expectancy this feature could prove very beneficial where phased or portfolio retirement planning is used.

Lump sums

All jurisdictions allow a pension commencement lump sum of 30% of the scheme value. However there are two variances to this which are very noteworthy. First, Maltese schemes are not subject to the 70% rule due to their route of QROPS qualification, and therefore where the scheme secures a prescribed minimum regular income benefit the scheme can make additional lump sum payments to the member from the plan's capital.

This does require a scheme to have a minimum value of circa £500K and upwards in order to secure an income at the prescribed level, but this feature is particularly beneficial where an enhanced income or access to capital is needed.

Taxation of these additional lump sum payments is an important consideration and if structured correctly can prove very efficient, particularly for USA residents.

Second, under a New Zealand scheme, the 30% commencement lump sum is restricted to the tax relieved contributions only and therefore non-tax relieved contributions and growth can be paid in addition to the 30% after five years of non-UK residency.

This means that these schemes can provide a larger total commencement lump sum while ensuring compliance with the QROPS legislation as the 70% rule is strictly applied to UK tax relieved funds.

Regular income benefit

All jurisdictions follow a very similar approach in terms of the level of regular income that can be generated within the first five years of UK non-residency and link benefit payments to the UK Government Actuarial Department (GAD) tables.

However, after five years of UK non-residency, retirement benefit can be calculated on an independent actuarial basis from the Isle of Man, Malta and New Zealand, and it is expected that Gibraltar will follow suit even though the current interpretation limits this to 120% of GAD. This means that the regular income that can be achieved from a scheme is relatively on par across jurisdictions.

Taxation

When it comes to the taxation of regular pension benefits at source, New Zealand offers the simplest solution as there is no withholding tax on the pension benefits. Malta, and to a much lesser extent the Isle of Man, have the ability to pay gross where a double tax treaty (DTA) exists with the members' country of residence.

Without such a treaty, withholding tax can be as high as 35% in Malta and 20% in the Isle of Man. The downside of having to rely on double tax treaties is that if the member moves from one country to another, and the new country of residence is not covered by a DTA, this could invoke a significant withholding tax. Gibraltar, on the other hand, opted for 2.5% tax on all pension distributions, excluding the commencement lump sum.

This means that for a very low rate of tax the

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Table 1: QROPS from a legislative perspective

	Isle of Man	Malta	New Zealand	Gibraltar
What is the maximum PCLS payable?	30% of fund value	30% of fund value	30% of tax relieved funds plus investment growth	30% of fund value
What is the earliest retirement age?	55 unless member has ill health	50, but 55 if UK pension transfer	55 unless member has ill health or financial hardship	55 unless member has ill health
How is the pension income paid/ determined?	In line with UK GAD rates, up to 5 years of non-UK residency and via more flexible actuarial tables if non-UK resident for 5+ tax years	In line with UK GAD rates for regular income but additional withdrawals can be provided where a pension is secured	In line with UK GAD rates up to 5 years of non-UK residency and via more flexible actuarial tables if non-UK resident for 5+ tax years	Non-resident for 5 years or more max is 120% of UK GAD limits (no set min). Non-resident for less than 5 years, 100% of UK GAD (no set min)
Is the pension income subject to tax locally?	Yes, 20% (unless a DTA applies)	Yes, up to 35% (unless a DTA applies)	No	Yes, a withholding tax of 2.5%
Is the death benefit taxed?	Potentially up to 7.5%	No	No	No
Do pension benefits have to be taken by a certain age?	Yes, age 75	Yes, age 70	No	Yes, age 75
Investment architecture	Open	Certain restrictions	Certain restrictions	Open

IA KEY POINTS

Key features of each jurisdiction vary including the date when pension benefits are taken, lump sums, regular income arrangements, taxation, and death benefit.

Jurisdictions also need to have the ability to deliver the service in an efficient and cost effective manner.

The provider's standing, time in the market, systems, processes and people, are also important considerations when choosing the right QROPS.

Table 2: QROPS jurisdictions from an operating perspective

	Isle of Man	Malta	New Zealand	Gibraltar
Moody country credit rating	AA+	A–	AA	NA
EU member	No	Yes	No	Yes (not full)
EEA participant	Yes	Yes	No	Yes
OECD white list	Yes	Yes	Yes	Yes
Dedicated pension regulator	Yes	Yes	Yes	Yes
Tax authority	Treasury, income tax division	Malta Inland Revenue	New Zealand Inland Revenue	Gibraltar Income Tax Office
Financial services regulator	Insurance and Pension Authority	Malta Financial Services Authority	New Zealand Financial Markets Authority	Gibraltar Financial Services Commission
Compensation scheme*	Cash in pensions plus policy holder protection on life contracts	Yes, but pensions excluded	Yes, subject to client classification	Yes, but pensions excluded
Ombudsman	Yes	No	Yes	No
Economic risk	Very low	Moderate	Moderate	Very low
Political risk	Very low	Low	Very low	Very low
Financial risk	Very low	Moderate	Low	Very low
Double tax treaties	13	60	37	0
Affinity to personal pensions	High	Moderate historic focus on occupational plans with legislation evolving	High	Moderate with evolving legislation
Depth of labour market	Moderate	Constrained	Good	Constrained

* Compensation schemes are complex and while they exist they are subject to limitations and exclusions which can apply at client and product level, which may or may not protect pension assets in a QROPS.

** This rating is based on the size of the trust industry and access to skills and expertise.

Risk criteria source: AMR, Sept '11. Credit ratings source: 2012 Moody's Investors Service

complexity that DTAs bring can be mitigated.

Death benefit

Most jurisdiction do not apply any withholding tax to death benefit payments. However, under certain circumstances, an Isle of Man scheme could be liable to levy a 7.5% charge on the death benefit.

Investment architecture

Isle of Man and Gibraltar offer the Guernsey-style investment environment of open architecture investing, whereas Malta and New Zealand are more restricted due to their legislation. Maltese schemes have to appoint an investment manager, and the underlying assets have to meet diversification rules. If a financial adviser is appointed as an investment manager to a Maltese scheme, and they are based in the EU, then the financial adviser has to be licensed in accordance with MiFID and not the IMD, as investment management is a defined activity which requires legislation and regulation.

It is also questionable if an adviser who is not licensed to deal in securities, irrespective of their location, can be appointed, which means that appointing a third party discretionary investment manager to manage the assets will pose the least risk to the trustees and adviser. New Zealand, on the other hand, has rules that require a minimum number of investors per investment type or security. So theoretically this allows total open architecture, but practically it does not. Hence the appointment of a fund manager to run the assets of the scheme is the prudent route for the trustee.

Operating environment

When selecting a jurisdiction, it's not just about the pension legislation. It's also about the jurisdictions' ability to deliver the service and their commitment both politically and economically to the proposition, the levels of expertise, experience and depth of the labour market available to deliver the service in an efficient and cost effective way.

Other factors such as investor protection, dispute mediation and international standing are also key points to look at. Then there is the provider and its standing, time in the market, systems, processes and people. 2012 saw both a Maltese and New Zealand scheme being removed from HMRC's list because of administrative issues.

This is unforgivable when holding out to be a pension administrator, given the importance of these products to individuals. Table 2 provides an interesting set of comparatives to consider from a jurisdictional operating perspective.

What can be gleaned from the above is that it's about the jurisdiction of 'relevance', that is, relevance to the client's needs and no longer simply a jurisdiction of 'choice' that Guernsey was.

If it is gross paying, low cost and simplicity that the client wants, or the ability to defer taking income, New Zealand seems to win out but the investment choice is restricted.

If it is the ability to secure an income and draw down on the capital quicker via an additional withdrawal option, then Malta looks like the place to be, but costs are high, investment architecture is limited and there is a reliance on DTAs to avoid withholding tax.

Where a client is very mobile, and hence DTAs are restrictive in terms of the client's residency, and where investment flexibility is a key driver, Gibraltar looks like a smart EU option.

Get what you need

When it comes to years of experience, access to expertise, systems and people, together with well-established investor protection and the presence of an ombudsman to protect client interests, the Isle of Man and New Zealand are equally matched.

The words of the Rolling Stones 1969 hit sums up the market, "You can't always get what you want… but you can get what you need". Therefore it's vital for advisers to be able to identify and prioritise a client's key requirements and objectives so as to best match them with a jurisdiction, knowing that compromise is now almost certainly unavoidable.