



New Zealand – Financial Markets Conduct Bill

Comments on the draft

Introduction

Our representations are concerned with clause 113 of the above draft Bill where with effect from its implementation date membership of New Zealand Superannuation Schemes will become subject to the “New Zealand criteria”. This sets out that in general terms, membership of New Zealand pension schemes will become restricted to persons who are “normally living in New Zealand”.

This restriction, over and above the current legislation, will rule New Zealand out of the Market for QROPS and also the market for QNUPS. Both of these markets are of significant size and it should be remembered that most jurisdictions (along with their regulators) that view themselves as a Financial Centre are very actively trying to attract this business.

About us

Brooklands Pensions is a group of Pension Companies that have operations in UK, Guernsey, Isle of Man, New Zealand and Dubai in the United Arab Emirates. We operate a wide variety of UK and International Schemes including UK SIPP as well as International QROPS and QNUPS.

We have a unique position in the market place in that we operate in the UK as well as International and therefore our UK Pension knowledge brings a unique understanding of the legislation along with experience of interaction with the UK HMRC (Her Majesty’s Revenue and Customs).

Brooklands Pensions are Pension Providers and not advisers and therefore we have worked closely with regulators and HMRC to ensure the schemes we operate are on a long term basis as we do not wish any of our schemes to jeopardise our reputation for the other products that we operate. We also operate in the jurisdictions that stand to benefit from New Zealand’s proposed effective withdrawal from this market place and can provide an insight to their reaction on the New Zealand announcement.

On a personal level and academically I am a Financial Economist and have over 20 years’ experience of pension administration management within most pension products and this includes a significant number of years spent on UK Schemes as well as international ones.

I have been involved with transfers to overseas schemes prior to April 2006 and understand HMRC reasoning behind the introduction of QROPS along with the HMRC activity and changes on QROPS since this date. I am also aware of HMRC areas of concerns regarding abuse and how they are expecting these schemes to operate.

QROPS Legislation

Legislation for QROPS was introduced by HMRC in April 2006 and was brought in to simplify the HMRC's pre 2006 method of dealing with overseas transfers as well as bringing them up to date with European legislation on portability of pensions and the DTAs that the UK had in place.

In simple terms, jurisdictions which qualify for QROPS broadly fall under the following 3 bases:

- 1) Are established in a Member State of the European Union, Norway, Liechtenstein or Iceland, or
- 2) Are established in a country or territory with which the UK has a Double Taxation Agreement (DTA) that contains exchange of information and non-discrimination provisions - it is necessary also that tax relief is not available to the member on contributions, or
- 3) If neither of the above then: satisfy the requirement that, at the time of the transfer, the rules of the scheme provide that:
 - at least 70% of the funds transferred will be designated for the purpose of providing the member with an income for life,
 - the pension benefits (and any associated lump sum) payable to the member are not payable before the member reaches normal minimum pension age unless the ill-health condition is met, and
 - membership of the scheme is open to persons resident in the country or territory in which it is established.

A DTA between the UK and New Zealand was introduced in 1984 and New Zealand qualifies under basis 2 above. Malta qualifies under basis 1. Guernsey and Isle of Man qualify under basis 3. It should be noted that ONLY basis 3 has any HMRC restriction on lump sums and bases 1 and 2 would only be restricted by reference to their 'local' regulations.

The legislation (Finance Act 2004 schedule 34 and SI 2006/206) which defines the above three bases (that includes New Zealand under basis 2) has been around since 2006 and was reused to define QNUPS in 2010. HMRC have therefore been telling us for quite a while exactly what they consider acceptable as features of an Offshore Pension Scheme. New Zealand has throughout satisfied these requirements. HMRC had also accepted New Zealand as a jurisdiction to receive transfers prior to 2006.

If HMRC wanted to exclude New Zealand from the main market place then they have had plenty of opportunities to do so. It is not like HMRC to ignore what they find unacceptable and we only have to look recently at Hong Kong to see that they take swift and decisive action when they do not like something – including changing UK legislation.

As can be seen above, schemes that qualify on Basis 1 or 2 have a significant advantage over schemes that qualify on basis 3. Guernsey and Isle of Man providers know this and this is why they have campaigned with HMRC over the last few years to get HMRC to shut New Zealand down.

Although HMRC have received significant pressure from other jurisdictions, they have not excluded New Zealand with a change of legislation but they have sought to influence the New Zealand authorities on practices that they do not wish to see. New Zealand is far from unique in receiving this HMRC attention. Please see the examples in the QROPS history below.

QROPS History

Most jurisdictions that have registered QROPS have had HMRC attention at some point in time.

In reality HMRC will review any jurisdiction where the boundaries are being pressed or where a provider has not taken full account of the local requirements. Our understanding with some of these is as follows:

Guernsey – were the subject of a HMRC review where some providers were allowing full cash from the QROPS and where further transfers were being made to non-QROPS schemes with higher cash entitlements. Guernsey self-regulated the issue and no action was taken by HMRC;

Isle of Man - where new legislation has been written to exploit the maximum possible lump sum from their category of membership, HMRC spent in the region of 9 months reviewing the acceptability of this with the Isle of Man Authorities. This review was instigated because of one provider's marketing material and HMRC concluded the new legislation to be acceptable;

Gibraltar - HMRC spent over 2 years reviewing the acceptability of this jurisdiction with the Gibraltar Authorities;

Hong Kong – this was initially a scheme with a fictitious employment that had its registration removed and HMRC have been clear that they do not like fictitious employments. HMRC have also been clear that they do not wish UK residents to benefit from being in a QROPS and recently the UK Government made a change to UK legislation which ensures that UK residents cannot benefit from being within a Hong Kong QROPS;

Singapore – here a provider did not register the scheme with the local regulators which are a necessary condition of obtaining QROPS registration. The Singapore Authorities stated to HMRC that they do not regulate and would not register any of their local schemes, which led to a block removal of Singapore QROPS as effectively none would be able to fulfil the basic requirements for QROPS registration;

Latvia - The Service Personnel and Veterans Agency (SPVA), which administers pensions on behalf of the Ministry of Defence brought the issue of a scheme in Latvia to the HMRC's attention as the scheme was allowing full cash out for UK residents. HMRC removed the registration of the scheme in question.

As can be seen from the above list, HMRC have reviewed many jurisdictions, but not all HMRC review's end in schemes or jurisdictions being struck off and in most cases a simple change of legislation has allowed the jurisdiction to continue and thrive in this ever increasing market place. HMRC will always continue to monitor and review both schemes and jurisdictions for what they perceive as abuse, but abuse is not dependent on residency but on how the schemes operate in practice.

Market Size and QNUPS

It is estimated that approximately 7,000 individuals are transferring out to QROPS each year. Based on the book of schemes that we hold across all related products, the average size is just under £100,000 where we understand that this average for schemes only in Guernsey and Isle of Man would be in the region of £150,000. Even if we use the lower average, we can see that the QROPS market size would be in the region of £700 m.

QNUPS is a further type of Pension Scheme (again introduced by HMRC) which provides significant benefits for a client regarding UK Inheritance Tax and these clients may still be resident in the UK. QNUPS are funded by way of new contributions and most will have fund values over £1m. If 300 clients a year (a very conservative estimate) take up a QNUPS, this would be an additional £300 m of funds. HMRC introduced QNUPS in February 2010 and the market has been very active. Unfortunately New Zealand will not be that attractive to this market unless the tax on funds is also removed for these.

The reality is therefore that New Zealand would be giving up on an industry that is easily worth over £1bn per year in funds to be invested.

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BROOKLANDS PENSIONS is a global brand of UK and International Pension Schemes under the name of Brooklands and has a suitably authorised and regulated trustee company in each jurisdiction.

About the QROPS Market Place

Guernsey, Isle of Man and Malta are not regulated as well as New Zealand is currently, but Guernsey and the Isle of Man have a vibrant QROPS (and QNUPS) industry which HMRC in the main are satisfied with. Malta is a relative new comer but benefits from being within Europe and therefore qualifies under basis 1.

Guernsey and Isle of Man providers are overjoyed with New Zealand's proposals to in effect pull out of this market place and are delighted that the prolonged pressure that they brought to bear on HMRC has delivered the result that they were after.

Isle of Man recently changed its domestic legislation to make it as attractive as it could be based on the way it qualifies for QROPS status.

Guernsey has also recently changed its legislation to make it more attractive as a jurisdiction for QROPS.

Malta has even more recently changed legislation to do likewise and is also offering Financial Sector business owner's tax incentives to move their operations to Malta.

Guernsey and Isle of Man trustees in particular have been very vocal over the last few years against New Zealand and have lobbied hard with HMRC to have New Zealand shut down as a QROPS jurisdiction. They understand the size of the market place and they also understand what a threat New Zealand could be to their QROPS Finance Industry if New Zealand were to try to make their schemes attractive and therefore decided to compete with them.

If New Zealand did decide to compete for this market, then due to the basis under which they qualify, they could easily become the main player which would include holding funds on a long term basis. This is something that Guernsey and Isle of Man providers are extremely concerned about.

Opportunity

As shown above, the opportunity runs to an amount of £1bn per year (every year) for investment. I am sure that tax on profits and wages alone from looking after this would be a significant contribution to the New Zealand economy.

Unlike institutional funds, pension monies tend to be 'sticky money' and once invested there is not much movement in this and therefore represents a great foundation for long term funds under management. New Zealand are currently not receiving much of the long term investment monies but would need to only make small legislative changes to do so in the future.

Having a QROPS and QNUPS industry is getting to be almost a prerequisite to be a main Financial Centre. We are seeing a surge in other related finance activities within QROPS jurisdictions due in main to the publicity and reassurance that these products bring to a jurisdiction.

HMRC and the issues

Residency - The issues are not to do with residency of the clients. The only stipulation regarding this is that the schemes are open to 'local' members. 99% of the members of Guernsey and Isle of Man QROPS are not 'locals'. They have both had previous HMRC attention and where necessary have made changes to their legislation to satisfy HMRC. Whilst ruling out international members may have solved 99% of their problem it would not have dealt with the underlying fundamental problem and this is the same for New Zealand.

HMRC have been clear that they do not want UK residents benefiting from being in a QROPS and members who are still within completion of 5 complete consecutive tax years out of the UK have to be treated differently. For example if someone becomes a New Zealand resident but has not completed their 5 complete consecutive tax years out of the UK

they cannot benefit from the added flexibility that the New Zealand Scheme brings and if they do then HMRC will have an issue with this – even though they are New Zealand resident. Some of the HMRC attention that New Zealand has attracted has been due to providers being lax on the 5 tax year requirement.

Maximum 30% lump sum – This is a myth and as can be shown by an understanding of UK legislation that it only relates to schemes that qualify under basis 3. Even then it only relates to 30% of the original transfer value and the Isle of Man has changed its legislation to maximise the lump sum at 30% of the original transfer value and 100% of the investment growth. Isle of Man has been pushing some aggressive marketing material which shows a 75% lump sum (with small print stating that the client needs exceptional growth).

This was the reason for the HMRC review of the new Isle of Man legislation and whilst they did not like the marketing material the technicalities fit within UK legislation. HMRC do not regulate the marketing material of offshore providers and therefore would not take action on this - this is purely down to the Isle of Man regulators.

If Isle of Man can actively promote 75% lump sums at retirement when they qualify under basis 3 then there cannot be a problem with New Zealand allowing up to 100% when the basis under which they qualify has no restriction in this area.

Provision of retirement benefits – HMRC and the Pensions Regulator have a history of dealing with what they deem to be “pension liberation”. Over the years there have been many UK schemes which have sought to take the tax relieved monies and get them back to the member before they reach an age when they can take retirement benefits. HMRC have always seen pension schemes as being for clients to take benefits after they reach a certain age which is now 55 (used to be 50) or in the event of serious ill health – which can also be seen as being within the definition for basis 3 of the legislation.

It is this area that has led to the main HMRC attention for New Zealand. Most pension transfers that go to QROPS in New Zealand now are cashed straight out by clients signing declarations that they never intend to be New Zealand residents. These effective cash-outs are being taken by clients who have never been New Zealand residents. This seems quite a stretching of the actual Kiwisaver regulations which is concerned with permanent emigration from New Zealand and this is further being stretched as being the justification used by Superannuation Schemes when they are not subject to this legislation. It is our understanding that this Kiwisaver legislation was intended to allow clients who leave employment and New Zealand permanently, to cash out and take their accumulated pension pot with them and was not intended to apply to Superannuation Schemes where the legislation is based on the principle of a primary purpose of retirement provision.

An easy fix

The current draft legislation requires more work especially surrounding transitional arrangements and the treatment of current non New Zealand residents within New Zealand Schemes. Going forward, it will also need close supervision to ensure all providers are abiding by the new legislation and all schemes are only being used by New Zealand residents.

I would therefore suggest that there is an easier fix for this and would suggest consideration of the following changes / clarifications:

- 1) A initial clarification that only members of Kiwisaver schemes can opt to take full benefits out by way of permanent emigration from New Zealand and that this legislation does not apply to Superannuation Schemes. Superannuation Schemes are currently relying on this part of the Kiwisaver legislation to allow clients full cash out at any age just by completing a declaration that they will never go to New Zealand. This would in itself cut out 95% of the QROPS early cash outs and solve the problem without impacting on New Zealand resident members.
- 2) I would suggest some additional clarification to the principle based legislation and guidance associated with Superannuation Schemes with a statement that benefits are to be taken at a normal retirement age of 65 or

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later or on an early retirement basis from age 50 with the trustees' discretion and make this on a phased approach (say over 3 payments of 40%; 30% and a final 30%). Benefits taken before this would need to be justified on a serious ill health basis – (in the UK this is usually defined a life expectancy of less than 1 year.) – Early payment for 'financial hardship could still be included and this could even just be for someone who is "normally living in New Zealand".

- 3) Pension providers also require closer supervision and this would also need to be done even if the draft goes ahead as it is proposed (For the 5 year rule and for the new rule of New Zealand resident only members). The FMA should make it clear that if providers wish to apply for QROPS registration with HMRC then they need to understand the regulations and importance of the 5 complete tax years outside of the UK and if their actions bring the jurisdiction into disrepute then the FMA will take action.

The above three actions should go most of the way to allaying HMRC concerns. If New Zealand also decided that they wished to go after the QROPS / QNUP Market then they would need the following change:

- 4) The main change that is required to make New Zealand a long term attractive proposition would be to continue with the removal of the tax on funds. Currently this is the main advantage that Guernsey and Isle of Man has over New Zealand and is the reason that New Zealand is not attracting pension funds on a long term basis. If New Zealand do continue to take this forward then they will quickly become the jurisdiction of choice for QROPS and QNUPS.

Submission Conclusion

The main HMRC issues concern providers being lax on the 5 tax years outside the UK rule, and providers using the Kiwisaver legislation around 'permanent emigration from New Zealand' to allow non-New Zealand residents who have not emigrated to sign a declaration and obtain payment of full benefits from Superannuation Schemes at ages which are well before retirement benefits would usually be taken.

Disallowing Non-New Zealand residents from joining New Zealand Superannuation Schemes will not in itself stop the abuse of New Zealand QROPS by New Zealand residents (especially of the 5 tax year rule) and will require on-going close supervision of providers. Therefore the proposed legislation will not fulfil the objective of removing HMRC concerns.

The proposed legislation will also require considerable work around transitional arrangements (which have been omitted) and current members of the New Zealand schemes who are not New Zealand residents.

Furthermore, abandoning this market will damage New Zealand's aspiration of becoming a Financial Centre. It will also be handing a significant financial market place (£1bn per year in funds to be invested) to the likes of Guernsey, Isle of Man and Malta. (It is ironic that Guernsey and Isle of Man have been instrumental in bringing prolonged HMRC attention on New Zealand in the first place.)

The changes we propose could easily be introduced and would not only satisfy HMRC but would also then provide a significant leg up for New Zealand to take to the world stage as a Financial Centre.

I would therefore urge that you reconsider the drafting of the legislation and would be willing to offer any assistance that you may require.

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