INSPIRING FINANCIAL LEADERSHIP

The Pension Manifesto

This document sets out the key charity pension asks that CFG will be making in the run up to the next General Election and beyond.

Key asks:

A. **The considerations of charities as employers must be included when developing all aspects of pension policy as charities face unique financial challenges and there are specific regulatory and statutory requirements for the financial management of charities.**

B. **Recognition that pensions are one of the central risks to the long-term sustainability of the charity sector and a commitment to review key issues (in particular with respect to auto-enrolment and multi-employer schemes) to secure future sustainability.**

C. **Adoption of specific proposals, as set out below, on:**

   1) Multi-employer schemes;

   2) The Pensions Regulator and Covenant Assessment;

   3) Local Government Pension Schemes;

   4) The Pensions Trust;

   5) Auto-enrolment;

   6) Access to guidance and advice; and

   7) The PPF levy.

If you have any questions or comments please contact the policy team on policy@cfg.org.uk; or on 020 7871 5476

Charity Finance Group's vision is to inspire the development of a financially confident, dynamic and trustworthy charity sector. CFG works with finance managers to enable them to give the essential leadership on finance strategy and management that their charities need; promoting best practice in charity finance, driving up standards, campaigning for a better operating environment and ensuring every pound given to charity works harder. CFG has more than 2,200 members, and collectively our members are responsible for the management of over £19bn in charitable funds.

1. Multi-employer schemes:

Why it's important:

The opportunity to pool risk and share administration costs through the use of multi-employer schemes was appealing for the sector and considered 'best practice' particularly for smaller charities. However, at the time charities entered into these non-sectionalised schemes, the implications of the long-term risks posed were not fully understood by most charities or advisers. There are also specific issues associated with Growth Plan 3 which are dealt with in section 3, The Pensions Trust.

The Pension Problems:

i. Governance of multi-employer schemes: In a non-sectionalised multi-employer scheme, the balance of power lays with the scheme trustees. Any employer voice is only one of many which can mean that opinions may not be given the weight they deserve. This dissipation is *prima facie* a situation which can lead to poor governance and accountability. Lack of accountability can lead to higher costs to the employers and ultimately increased risk to the scheme as a whole.

ii. If a charity wishes to cease future accrual in a multi-employer scheme, i.e. stop accruing further pension liabilities such as by offering their staff alternative DC arrangements, it will trigger a (often unaffordable) cessation 'section 75' debt which would need immediate payment. As a result charities can be trapped into building up an ever increasing liability. In single employer schemes, ceasing future accrual does not automatically trigger a section 75 debt and the liability (calculated on a less onerous basis than the section 75 liability) can be managed over time on an on-going basis.

iii. If a charity in a multi-employer scheme can no longer meet its liability to the scheme through insolvency, the liability is picked up by the remaining members. These 'orphan debts' create additional burdens for the remaining charities.

The Solution:

- A wholesale review of the governance arrangements of multi-employer schemes should be undertaken and the option to allow employers to segregate their liabilities within a scheme through negotiation with the trustee should be explored. This would put the balance of power in multi-employer schemes on a par with single employer Defined Benefit Schemes.
- Government should enable organisations to close their schemes to future accrual without triggering the cessation debt. Details of this proposal, requiring the amendment of secondary legislation are laid out here.
- The Pension Protection Fund should continue to work with the sector to understand the challenges multi-employer schemes present. CFG is happy to work with the Pensions Regulator to assist in its review and quantification of the potential impact of systemic risk in multi-employer schemes of the current governance arrangements, cessation debt requirements and increasing orphan debt.

2. The Pensions Regulator and Covenant Assessment

Why it's important:

Covenant assessment determines the long-term cash requirements of charities to their DB pension fund. Whilst this is absolutely critical for single employer schemes it's also important to multi-employer schemes.

The Pensions Problem:

Charities are markedly different from profit making entities. The DB code of practice contains a new 'sustainable' growth objective which has given us cause for concern. We are worried that the objective, when applied to charities, would result in misleading focus on financial growth. The lack of understanding of how charity finance works by pension advisors and pension trustees makes it more difficult to establish constructive relationships with the sponsoring charity.

The solution:

The Pensions Regulator should work with CFG and the wider sector to produce guidance on the application of the new statutory objective to charities and other not-for-profits for pension trustees. This guidance would consider the diversity of this sector, and the implications of charity accounting regulation with detailed financial case studies.

3. The Pension Protection Fund

Why it's important:

Many charities participating in a Defined Benefit pension schemes, contribute an annual levy payment to the Pension Protection fund. Acting as a 'lifeboat' for Defined Benefit schemes when the employer is insolvent and the scheme hasn't enough assets to pay for benefits in full, this fund serves as an essential mechanism to protect members of pension schemes.

The Pensions problem:

i. The levy can pose a significant cash call on employers, already struggling to manage pension costs

ii. A recent change to the way in which the levy is calculated has resulted in the assessment of increased risk for many charities and thus a higher levy payment. Whilst the sector was not party to the details of risk assessment criteria applied to the setting of the levy by D&B it took some comfort in being generally considered to be lower risk. Whilst we understand the rationale for a more focused approach to risk, the transitional arrangements may be devastating for some charities and needs to be made more sophisticated.

iii. We are concerned that Experian, who are now undertaking the process for the PPF have limited information on the sector's financial profile. The impact analysis provided as part of the consultation process only covers a proportion of the not for profit universe.

The solution:

We urge the PPF to continue to engage with the charity sector as the new levy system evolves. PPF and Experian need to work with the sector to improve Experian's data and the experience of the sector. Transitional arrangements need to be sufficiently sophisticated to enable charities to adjust to significant increases in their levy payments.

4. Local Government Pension Schemes

Why it's important:

Charities are well placed to deliver a number of key public services. Equitable pension risk sharing arrangements for public service delivery are required for charities to play this role to their full potential and with maximum benefit to their beneficiaries.

The Pension problem:

Public service delivery contracts arrangements can require charities to be members of the Local Government Pension Schemes (LGPS). This has the effect of outsourcing the risk for past deficits to the charity, often making the contract punitive. Organisations can be unaware of these risks until after they have committed to a contract and therefore responsible for the liabilities. This has the consequence of acting as a barrier to the delivery of services by charities that are more aware of the risk transfer**.**

The solution:

Government should commit to reviewing options to make contracting arrangements more equitable for those best placed to deliver quality public services.

- Local Contracting Authorities need requisite capabilities to contract transparently and therefore improve understanding of the risks being passed onto suppliers. Consideration should be given to segmenting liabilities based upon the service period; each organisation should only be responsible for the service period of its employees and the continued salary link on their past service liabilities.
- Change methodology to create more flexibility on exit in line with our proposals for MES schemes generally and to establish a fairer exit methodology that is consistent and transparent and not based upon the current section 75 gilt based cessation approach.
- The Government should commit to active engagement between LGPS and charitable admitted bodies to highlight issues and seek workable solutions.

5. The Pensions Trust

Why it's important:

The Pensions Trust has grown over the years, providing pension schemes of various types, to charities and not-for profits. They are most likely the largest provider of multi-employer schemes to the charitable sector with their 'Growth Plan'. The running of their schemes has a significant bearing on the landscape of charity pensions.

The Pensions problem:

i. Significant legislative uncertainty over the last few years on the status of the 'growth plans' of the Pensions Trust's pension schemes has caused considerable confusion over the fact and extent of any liability which exists and to which organisations it applies. Charities who thought that in Growth Plan 3 they had low risk membership of a DC scheme have now found themselves liable for contributions to the deficits under Growth Plans 1 & 2. New legislation in place from 1st July, provides further clarity on these issues, however, there is still room for improvement.

ii. Many of CFG's membership have reported experiencing poor levels of communication with the Pensions Trust. Particular problems surround the arrangements set up to cap the liability issues under GP3 through the introduction of GP4. Charities have expressed skepticism over their appropriateness, since they limit flexibility. Many feel these changes were not sufficiently consulted on.

iii. As with Multi-Employer Schemes generally, CFG members are also concerned that the effectiveness of the governance arrangements of the Pensions Trust, whilst compliant from a regulatory perspective, do not give sufficient oversight of the executive managing the scheme compared to a single employer scheme. The nature of the MES means that the voice of individual companies at an operational level can be diminished in communication with the scheme Trustees. CFG members feel the Pensions Trust Board Mandate does not give sufficient recognition to the importance of the sponsoring employer's sustainability which underpins the success of the schemes. [1]

The solution:

- CFG urges The Pension Trust to work with relevant parties, such as the Pensions Regulator to review the effectiveness of its governance arrangements. Effective arrangements would enable risks in relation to the schemes and ongoing financial sustainability of sponsoring employers to be placed at the heart of the Pension Trusts strategic development.
- The Pensions Trust should continue to improve its communications with scheme sponsoring employers.

6. Auto-enrolment

Why it's important:

Auto-enrolment shifts the onus of pension provision squarely upon the employer for the first time. This poses a new set of challenges for charities, many of which are still struggling with the impact of a tough economic environment over the last few years. We all absolutely want to see people being encouraged to save for their retirement but we also need to ensure that there are sustainable jobs available for them during their working lives.

The Pensions Problem:

i. Awareness and capacity: the majority of charities are small and are yet to reach their staging date. Many smaller charities will not have the knowledge or resources to engage effectively in the auto-enrolment process and for many this will be the first time they will have enrolled any of their employees into a pension scheme. Recent

[1] http://www.thepensionstrust.org.uk/NR/rdonlyres/EC0FCEF6-0A17-4881-9E63-A8323D5F4656/0/TPTBoardMandate1013FINALVERSION.pdf

NEST research into auto-enrolment[2] reflects the concern that there are gaps in knowledge, experience and preparedness amongst smaller employers.

ii. By the time auto-enrolment hits the smallest employers, it is possible that there will be little flexibility in the market left for them and thus the choice of suitable provision will be severely limited. Many pension providers will not view smaller schemes as profitable clients, and may have already reached full capacity with larger schemes. This could leave many smaller charities in a position where they have little choice over which pension provider they recruit. This may result in many smaller charities being forced to accept low value schemes with high administration costs.

iii. Payment is automatically being taken as part of auto-enrolment. Of course employees can claim this payment back from the pension provider; there is a concern however that this has a knock on effect on the relationship between employee and employer and ultimately on the employees' cash flow. Charities as responsible employers are likely to be concerned about this impact on their staff.

The solution:

- Government need to monitor, through relevant research and consultation with stakeholders, the impact that auto-enrolment has on smaller entities, including charities.
- Government must consider introducing additional measures to mitigate the impact of auto-enrolment on the smallest employers, including the ability to defer staging dates and registration.
- Government should monitor and implement measures to address where necessary, fair market offerings for qualifying schemes.
- Government need to ensure that their communications strategy concerning auto-enrolment with the smallest employers covers small charities.

7. Access to guidance and advice:

Why it's important:

As CFG's flagship publication *Navigating the Pension Maze* demonstrates, the pensions landscape is hugely complex and requires sound advice and expertise for employers so they can be equipped to manage pension risk proactively. Tailored advice is extremely expensive compared to the income of the vast majority of charities. Unless charities can successfully manage their risks the PPF will suffer an increasing financial burden from failed schemes.

The social impact of key charities becoming insolvent is also concerning. For the sector to thrive and effectively meet the needs of its beneficiaries, it requires financial sustainability, the flexibility to undertake mergers and restructures to maximise resources. Again, relevant expert advice is critical to affecting this.

[2] http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/news/Quiet-welcome-press-release.html

The Pensions problem:

i. Access to tailored advice is expensive and many charities lack the resources to explore the available pension scheme options

ii. The legislative framework of pensions makes mergers and restructures particularly challenging.

The solution:

- Government should commit to finding innovative ways of funding interventions to increase the capability of charities to understand and manage their pension commitments.
- Government should support and/ or fund the issuance of low cost guidance and advice over the next two – three years to enable sustainable business models to be developed and adopted by smaller affected charities.
- Government should commit to reviewing the impact that the pension's legislative framework has on charities' ability to restructure.