Local Government Pension Scheme Regulations

Consultation Response

August 2016

Introduction

About Charity Finance Group

Charity Finance Group (CFG) was founded in 1987. It is the charity that works to improve the financial leadership of charities, promote best practice, inspire change and help organisations to make the most out of their money so they can deliver the biggest possible impact for beneficiaries.

CFG has over 1350 members and they manage £21 billion in charitable income. Its members work at the heart of the strategic development of their organisations, and are at the forefront of delivering a sustainable and efficient charity sector.

CFG hosts a regular Pensions Forum which brings together charity experts, lawyers and charities to discuss the impact of LGPS regulations – as well as other pensions policy and regulatory changes - on their organisations. This response draws on the evidence collated in these meetings in addition to research carried out for our flagship publication, *Navigating the Charity Pensions Maze*.

For more information on this response please contact Anjelica Finnegan, Senior Policy and Public Affairs Officer, on 020 7871 5480 or anjelica.finnegan@cfg.org.uk

Motivation for responding to the consultation

CFG welcomes this consultation on the proposed changes to the scheme regulations. Our consultation response focuses on the Fair Deal proposals – specifically issues pertaining to admitted body status.

The charity sector currently accounts for **£6.7bn** of local government contacts and there are estimated to be between **2,000-3,0000 charities** admitted into the LGPS. For over a decade, CFG has been working with charities on a range of pensions issues. Over this time charities have highlighted two key challenges:

1) Past service liabilities
2) Cessation debt

CFG urges DCLG to use this opportunity to mandate all funds to **identify and allocate past service liabilities between employers** and to **address the inequitable methodology** currently used to calculate cessation debts for admitted bodies in the LGPS.

Comments on the 'Fair Deal' proposals

1) Past Service Liabilities

The challenge

The LGPS typically requires charities, as admitted bodies, to agree to take on past service liabilities accrued under a former contract or by the local authority itself. Any such past service liabilities typically far outweigh the future service benefits that the employer can accrue over the term of the contract.

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.

This should not only be of concern for charities, but also local authorities. Contracts represent an effective way for charities to deliver their charitable objectives whilst also providing a vital source of income. For local authorities, the proximity of charities to the local community means they are well-placed to play a pivotal role in shaping and delivering public services at the local level.

It is therefore important for both charities and local government to ensure that charities are not prohibited to take on contracts by inequitable pension risk sharing.

Recommendation

1) Reflecting most other large multiemployer schemes, liabilities should be segregated so that they remain with the employer who accrued them. Each employer will therefore only be responsible for liabilities accrued over the period of the contract.

2) Local Contracting Authorities need requisite capabilities to contract transparently and therefore improve understanding of the risks being passed onto suppliers.

Case study: The Lothian Pension Fund

The issue of past service liabilities has been recognised by the Lothian Pension Fund which, in 2015, took legal advice on its policies for admitted bodies and altered its funding policy.

Lothian Pension Fund Policy pre 2015

Liabilities accrued by staff during their employment with the local authority (or previous contractor) were passed on to the new employer.

Any exit payment (due when a charity ceased to participate in the LGPS) was calculated on a higher cessation basis taking into account all historic liabilities, not just those accrued by the charity over the course of the contract.

Lothian Pension Fund Policy post 2015

For reasons of "fairness" the fund addressed the issue of past service liabilities.

The new policy sets out that exit payments will be calculated on an on-going basis for both staff that have been transferred under TUPE and any new staff that join the charity and are enrolled in the LGPS.

2) Cessation debt

The challenge

Regulations 64(1)(b) states that an employer will exit the LGPS when the contract comes to an end or it ceases to have active members in the Fund if earlier. At this point it will be the Administering Authority's decision whether to calculate an exit payment on an ongoing or a cessation basis. If the latter, the charity can be faced with a significant bill at a time when it is in a poorer position to pay it – typically because the charity has just finished/lost a contract.

As it currently stands admitted bodies – including charities – are required to pay a cessation debt calculated on a gilts basis. This approach is inappropriate given that the aim is not to secure the benefits through an annuity.

Through CFG's pension forum we have seen evidence of charities choosing not to take on public service contracts due to the financial threat posed by joining the LGPS. This means that local authorities are not able to benefit from the high quality services that charities can provide and the added social value that they offer to local people and communities.

Recommendations

1) CFG proposes a more realistic scheme-orientated approach (previously proposed by Spence & Partners) which takes into account the discount rate applied in the LGPS on-going funding valuation plus a discontinuance margin.

2) CFG recommends that organisations should be able to cease to accrue liabilities without automatically triggering a cessation debt - the funding should subsequently be adjusted to reflect the closed basis of the scheme.

This would be in line with recommendations made by PwC in their 2015 paper, *Deficit Management in the LGPS*. The paper argues that employers should be able to: a) continue to pay contributions for a defined amount of time after their last active employee has left; b) allow employers to pay their cessation debt over a longer period of time.

Allowing for a more reasonable repayment periods will enable charities to meet their repayments on the understanding that sever debt repayment periods (such as we see now) that lead to insolvency only generate greater liabilities.

Regulations have recently been amended to allow funds to spread payments out. The mechanism to allow charities to suspend the liability for 3 years does exist for those organisations that are likely to have one or more active members contributing to the fund within three years. This welcome addition to the regulations benefits charities where a contact ends but outsourcing work is a regular business recurrence, or when a contract is still in place but the transferred employees have left. This indicates that flexibilities can be built in.

Through adopting these recommendations the LGPS will be more likely to recoup the funds owed (to at least an on-going funding basis). This will protect members' pensions and ensure that charities are able to continue providing high quality services to people and communities.