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Briefing paper: The case for consultation on multi-employer pension schemes

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SPENCE

EXECUTIVE SUMMARY

- The recent Wedgwood case has raised the profile and awareness of the problems faced by charities in multi-employer schemes, but distorted the debate as it is not representative of the issues faced.
- Section 75 legislation is complex and ill-suited to last man standing multi-employer pension schemes.
- A pensions 'apartheid' has been created between stand alone and segmented multi-employer schemes, and last man standing multi-employer schemes.
- Members' benefits, the future viability of employers and the tax payer are being placed at risk through employers with weak covenants being forced to continue to build future defined benefit liabilities.
- Pensions legislation is at odds with charity legislation.
- The charity sector is being unfairly forced to fund public sector pension liabilities.
- Recent flexibility added to Section 75 has not impacted multi-employer last man standing schemes.
- Defined benefit pensions are a major barrier to corporate activity within the charitable sector.
- Tender selections are being skewed by pension legislation and pension provision.
- The position will further deteriorate with the introduction of auto-enrolment.
- The current legislation is forcing employers to use uncompetitive pension provision when more competitive options exist.

1. INTRODUCTION

The Wedgwood case has highlighted the significant issues faced by charities as a result of their defined benefit pension provision. Unfortunately, however, the debate has become too narrowly focused on the 'last man standing' issue which has meant that other, arguably more significant, issues have been sidelined. This paper will try to highlight the key issues for charities, why Wedgwood should not necessarily be seen as representative and provide some suggestions about potential ways forward.

The legislation, as it stands, has created a pensions 'apartheid' where actions which are considered the norm by organisations with stand alone pension schemes or segregated multi-employer schemes are unavailable to participants in last man standing multi-employer schemes. This is inequitable and removes the exercise of legitimate choice from numerous organisations who decided to participate in these schemes in the past for legitimate reasons.

Ultimately the only sensible outcome is for the DWP to agree to carry out a comprehensive review of multi-employer pension schemes (as proposed in the Section 75 review published in December 2011). **It is only by means of such a comprehensive review that all the issues can be identified and fully considered, the potential impacts quantified and the combined knowledge and experience of organisations and advisers be brought to bear to reach a sensible way forward which protects charities, pension scheme members and the taxpayer.**

2. WHO IS AFFECTED?

Numerous charities participate in multi-employer defined benefit pension schemes. Organisations have joined these schemes over the past 20+ years on the basis that there was a financial benefit in sharing risk and controlling costs or because at the time it was the only option open to them. It is quite clear however that many organisations were not fully aware of the implications of participation in these schemes. Undoubtedly there was very limited communication of the risks inherent at the time of joining. We now face a very different environment which has highlighted a number of difficulties which the legislation makes it very difficult, if not impossible, for organisations to manage.

The schemes involved include Local Government Pension Schemes ("LGPS"), numerous schemes run by The Pensions Trust and other industry wide schemes. There are approximately 73 LGPS in England, 8 in Wales, 10 in Scotland and 1 in Northern Ireland covering around 2,000-3,000 charities spread across all sectors. For example there are 170+ admission bodies in Strathclyde Pension Fund, the largest UK local government pension scheme. There are around 1,700 charities participating in the Pensions Trust Growth Plan, around 800 across two schemes focused on registered social landlords, 200 across a couple of specific charitable schemes and numerous others across education, leisure and care sectors. There will be some membership overlap in these schemes but it is not unreasonable to assume that there could be 4,000 to 5,000 charities affected.

3. SEGREGATED AND LAST MAN STANDING ARRANGEMENTS

Multi-employer schemes are effectively set up and administered in two ways.

- As a general rule segregated schemes have each organisation participating as a single distinct entity with assets and liabilities allocated specifically to that organisation. The funding, contributions and investments tend to be specifically related to that organisation although there may be some degree of collective approach in some areas to add simplification and/or reduce costs (e.g. collective investment approach). The Pension Protection Fund ("PPF") levy would be based upon the employer covenant of each individual employer and in the event that an organisation was unable to meet its pension liabilities the scheme would contain a partial wind-up rule which would allow members to be eligible for the PPF.

- In a last man standing multi-employer scheme the assets and liabilities are pooled with a 'notional' entitlement to a share for each participating employer based upon the liabilities of its membership (or a broad estimate). Funding and investments are pooled and actuarial assumptions will tend to relate to the scheme as a whole, rather than individual participating employers. Employers need to accept an element of cross-subsidy. In the event that an employer becomes insolvent their unpaid liabilities are transferred to an 'orphan pot' for which each other participant has a liability based upon their proportion of the liabilities as a whole. In this way liabilities are passed down to the remaining employers in the scheme until the 'last man standing.' The PPF levy will tend to be based on the scheme as a whole with a reduction in cost given the reduced risk of a call on the PPF as this would only happen should the whole scheme fail.

The 'last man standing' basis effectively means that stronger employers are having to stand guarantor over weaker organisations. These weaker organisations can continue to accrue benefits without consequence as they are effectively being guaranteed by stronger but totally unconnected fellow participants, without the stronger employers having any control over this.

The employer PPF levy is likely to be lower for weaker employers but could be higher for stronger employers.

Charity Trustees are also concerned that this employer cross-subsidy may not be compatible with their duties under charity law which prohibits one charity from standing guarantor over the liabilities of another unconnected charity and that it is at odds with organisations' charitable objectives. Both issues place charity trustees in an untenable position.

Under the current legislation member's benefits are ultimately better protected as they are covered by all employers, not just their employer, and then ultimately the PPF. The benefits are however only covered to the extent that global assets are sufficient, which in many cases they are not. In addition, as liabilities increase as members continue to accrue additional benefits beyond the level of coverage of an organisation's net assets, member's benefits are at increased risk. There is a risk, if this is not properly addressed, that instead of a small number of modest claims on the PPF, the end result is one very large claim as the last man standing is ultimately swamped by "orphan" liabilities.

4. FUNDING BASES

There are a number of actuarial methods used to value scheme liabilities. The main three relevant here are:-

- Statutory Funding ('On-going') basis – This is the methodology used to fund the scheme to a sufficient level to pay benefits as they fall due and is used to calculate scheme contributions. The assumptions used in the calculations are the responsibility of the scheme trustees (or statutory scheme administrators) and will incorporate an element of prudence in to the financial calculations.

- FRS17 – This is the methodology used to assess the pension assets and liabilities for accounting purposes. The assumptions used are the responsibility of the employer trustees/directors based upon guidance from an actuary. It should use a discount rate based upon AA Corporate bonds over a suitable duration and it is a 'best estimate' (so no element of prudence need be included).

- Cessation / Section 75 / Buyout – This is the methodology used to calculate assets and liabilities on exit from the scheme. The discount rate assumptions used tend to be based upon gilt yields.

Triggers for Section 75 debt -

- Organisations can elect to exit on a voluntary basis and settle their cessation debt in full.

- The debt may be triggered on organisational re-structure, such as merger or takeover, where the participating organisation ceases to exist. Frequently organisations are forced to employ convoluted methods to keep the original organisation in existence to avoid triggering the debt.

- Should the organisation become insolvent its liability for a Section 75 debt will be triggered although unlikely to be enough coverage to settle the debt in full. Any balance not met would become 'orphan debt' and re-distributed amongst the remaining employers.

- Ceasing to have 'active' members in the scheme (such as through scheme closure to new entrants or rising employee costs) also triggers a Section 75 debt. In this scenario organisations can be 'held to ransom' by the last employee.

The cessation liability will be significantly higher than the liability assessed under either of the other methodologies referred to, given the lower discount rate applied. Schemes need to ensure that on the exit of an employer they minimise the risk that a future shortfall will build up that has to be paid for by other participants. The difficulty is that, whilst the schemes levy cessation costs on a basis equivalent to 'buy-out', they do not actually secure the liabilities for the applicable employer's staff at the point of receiving the additional funding, or indeed subsequently. This means that their cessation payment is pooled within the fund as a whole, improving the global funding position. This provides reduced incentive for employers to settle a debt even if it is affordable. Within LGPS benefits will ultimately never be secured so it is questionable if such a basis should be applied.

Should a cessation basis be applied employers should be given the option to have their staff benefits secured. Within LGPS (or indeed other schemes) there should be a reduction to the 'normal' cessation liability which reflects the fact that liabilities will not actually be secured but will continue to be reliant upon the scheme as a whole.

Schemes have an option to cease accrual of future benefits providing **all** participants agree to this step. Should this happen the cessation debt would not be triggered but the on-going deficit funded over time with a gradual move towards the cessation debt (potentially over 20-30 years) which gives employers much more latitude to fund liabilities and protect member's accrued liabilities. The difficulty for participants in a multi-employer scheme of non-associated employers is that if even one employer wishes the scheme to continue this prevents this happening. In a number of schemes there is a very significant proportion (often in excess of 50%) who wish to cease accrual but are

forced to continue against their will. Again where there is a small number wishing to continue they can effectively hold the other organisations to ransom over the closure terms.

In addition this option would not be available in LGPS as it is hugely unlikely to ever wish to cease future benefit accrual. **The S75 legislation therefore leaves organisations trapped in LGPS.**

It is completely correct that employers should be required to fund the benefit promises they have made to staff. However, it has to be recognised that providing future benefits on a final salary basis has become unaffordable for most small charities. The current legislation creates a ridiculous situation where employers cannot afford to keep building up future final salary benefits, but they can afford to stop building up accrual even less, because it would trigger an immediate demand for a cessation payment. The consequence is that the easiest short term option is to continue to accrue unaffordable benefits rather than trigger the even more unaffordable Section 75 debt. Insolvency seems the inevitable outcome which is not in anyone's interests.

Case study 1

A small charity we worked with had net assets of £400k and an 'on-going' pension liability of £200k in 2008. The exit deficit was around £500k. They could not afford to exit the scheme which meant they needed to continue to participate. Over the subsequent 4 years their net assets have reduced to around £350k and their on-going liability to around £350k which has nearly doubled their contributions which they will now struggle to afford. The exit debt is now in excess of £1m. Should they become insolvent the £1m will be re-distributed to other participants in the LGPS so the majority of the debt will be picked up by council tax payers. Had the organisation been able to cease accruing liabilities in 2008, and continued their funding plan, the on-going deficit would have reduced to around £50k and the exit deficit to around £350k. Continuing to contribute on this basis will continue to reduce the exit cost, or they may fund at an increased level to reduce it more quickly, which better protects members benefits, makes the continued operation of the charity more likely and makes a call on other members of the scheme (and ultimately the taxpayer) much less likely.

Case study 2

A group of 25 charities participate in a multi-employer scheme. The total deficit has increased 3 fold over the 3 year inter-valuation period which has resulted in a three-fold increase in contributions. Five organisations who cannot afford the revised contributions have become insolvent which has increased the orphan debt from 1% to 10% and effectively increased contributions by a further 10% which puts more organisations at risk. The level of asset coverage against liabilities is only around 70% of on-going liabilities and 30% of cessation liabilities. This highlights the risk of a 'domino effect' within many of these schemes and the ultimate risk to the PPF.

Case study 3

A charity wishes to settle its cessation debt in the scheme. The cessation liability is around £2m which is about £1.6m in excess of the on-going liability. The payment of this amount will not secure the benefits of this organisation's staff but will be added to the general fund. In this way the on-going funding rate may improve by 2% and 1% on the cessation basis. The organisation is concerned that its members are no better protected despite the payment of such a substantial sum.

5. THE WEDGWOOD CASE

The Wedgewood Museum was deemed to be part of the Wedgwood Group and therefore ultimately connected to the Group for pension purposes, having had museum staff participating in the Group pension scheme. Ultimately the Group made pension promises to members of the Scheme and those members have a right to expect those promises to be honored to the maximum extent possible. The money from Wedgwood Museum will ultimately improve some members' pensions or go into the Pension Protection Fund to improve the protection of others who might lose their benefits.

A fundamental point about the Wedgwood case is that there was a direct connection between the museum and the corporate entity. The vast majority of charities who may be impacted by similar issues in other schemes are unconnected. Charities participating in local government or industry wide schemes such as those run by the Pensions Trust are on the hook for orphan liabilities arising through the insolvency of organisations with which the charities have absolutely no connection.

Case study 4

In one multi-employer scheme the orphan liabilities account for 20% of total liabilities which means that £1 in every £5 that charities participating in this scheme pay is to meet the obligations of other unconnected organisations now no longer in existence, and to which their trustees, and indeed donors, may not wish to provide support. As the orphan debt rises, the cost of funding it increases which places more organisations at risk.

A proposal made to exempt charities from the 'last man standing' rule is not a realistic solution and was rightly rejected by the Government on fundamentally sound grounds. Any change will have to be applied consistently to all charities and all schemes. To simply remove the last man standing rule would put member's benefits at risk, fundamentally change the basis of many schemes with associated increased funding costs and risks, open the potential for legal action from members and is likely to result in a significant increase in PPF levies payable by scheme participants.

Unpalatable as it is, the charities concerned have entered in to these arrangements with the scheme and their staff and organisations should not simply have the option to walk away from their obligations. That does not however mean that there shouldn't be a wider range of options available to allow them to manage their liabilities better.

6. SECTION 75 LEGISLATION

The multi-employer sections of this legislation undoubtedly have much more wide ranging implications than were initially intended. The legislation was primarily designed, and subsequently amended, to prevent private companies from restructuring their operations to allow them to effectively abandon their pension liabilities, therefore placing the PPF at greater risk.

The primary way this was addressed was via the introduction of the 'active' member test which meant that if an organisation participating in a multi-employer pension scheme ceased to have active members while other employers in the scheme continued to have active members then the exiting employer would have to settle their Section 75 debt at that point. The legislation does not provide any flexibility on the basis or timing although some schemes have sought to offer some limited flexibility over the payment term.

A review was carried out by the DWP in 2011 with the results published in mid-December [http://www.dwp.gov.uk/consultations/2011/employment-debt.shtml] and whilst it recognised that there was an issue for charities the view expressed was that further consultation on the issue was required.

Given the additional flexibility now offered following the consultation by apportionment and withdrawal arrangements, connected organisations in multi-employer arrangements now have a myriad of options to re-structure their pension arrangements where there is a commercial reason to do so and members interests are protected. This flexibility is not available to unconnected organisations participating in similar multi-employer arrangements.

If a charity had its own single employer pension scheme it could readily manage its risk exposure by closing to new entrants and ceasing future benefit accrual. In these circumstances the Trustee would rightly seek some additional security from the employer such as higher deficit contributions (such as to ensure the on-going or solvency position improved over time) or seek some form of security and the scheme could continue in 'closed' form securing benefits as they fall due and ultimately moving towards wind-up.

Such an option is not open to employers within multi-employer schemes as a single employer closing its section of the scheme to future accrual immediately triggers their Section 75 debt. Unfortunately this means that organisations are forced to continue to accrue additional liabilities, which they patently can't afford, which ultimately puts the organisation, members' benefits and other participating employers at risk.

Within LGPS it should be remembered that the tax payer is standing ultimate guarantor over these liabilities.

7. MEMBER SECURITY

There seems to be a level of concern within Government circles that changes to Section 75 could reduce member benefit security, concerns undoubtedly re-enforced by a proposal to exempt charities from last man standing arrangements, which has rightly been rejected as totally unworkable. However this is a one dimensional look at the issue of member security.

Member security in a pension scheme is effectively a combination of the coverage of liabilities in the scheme by assets, plus the strength of the employer(s) backing any shortfall. What therefore also needs to be considered is:-

1. Charities do not tend to have an increasing underlying asset base but run their operation on tight 'not-for-profit' margins maximising the revenue which goes to meet their charitable objectives. However, continued participation in a defined benefit pension scheme means that liabilities continue to accrue, and frequently accrue very rapidly. The security of members' benefits is compromised when the coverage of any pension liabilities is reduced as net assets fall or remain static.

2. Given the tight financial constraints charities face they are less equipped to deal with volatile contributions.

3. The current approach creates a risk interdependency between unconnected organisations which cannot be effectively identified or managed. For example a strong financial organisation is unlikely to be aware of their risk exposure to, and cannot influence the approach of, a weaker organisation.

4. There is huge variability in the basis and level of charity net assets. For example there are multi-employer schemes covering employers in the social housing sector. Many of these employers are considered to have a strong net asset base given their housing stock. However for the majority this 'financial strength' is illusory as the vast majority of the assets are not realisable. In addition many employers participate in these schemes with no, or very little, financial backing and have liabilities hugely in excess of what can be settled either on an on-going or cessation basis, participating in the scheme based upon the 'perceived' financial strength of their fellow participants. Even if this is recognised by employers they are powerless to do anything about it.

In individual or segmented schemes organisations would deal with this by ceasing further accrual of benefits and paying down accrued liabilities. However, this is not an option in last man standing schemes so they are forced to keep accruing further liabilities beyond the level of their asset backing. This actually reduces the level of security for members' accrued benefits relative to the current position.

LGPS have recognised this and would not want many organisations to continue participating but are unable to prevent them from doing so.

8. LGPS TRANSFER ISSUES

A specific issue related to LGPS is that when an organisation is established outwith local government to supply services to local government then it must continue to provide 'broadly comparable' pension benefits under the 'Fair Deal' requirements. The organisation is forced to agree to do this if it wants the contract, and continues in LGPS as an admitted body.

However, unlike most schemes, LGPS does not recognise multiple employers related to specific periods of service and so all past liabilities are transferred to the new employer. These liabilities are transferred to the new employer as if they were 100% funded on an on-going basis, however this is usually only about 40% to 50% funded on an exit basis. There is currently no mechanism open to employers to split past service liabilities or to leave them with the employer with whom they were accrued.

This means that should the organisation subsequently wish to exit the scheme it is not just liable for its cessation debt but that of the Council also. Whilst laudable in its intentions, as currently structured this gives employers, members and the taxpayer anything but a fair deal.

Case study 5

A charitable organisation was established in 2008 to provide services on behalf of a local authority. Of their £11m of on-going pension liabilities 85% related to service with the council prior to their formation in 2008. The on-going funding rate had fallen to 85% which meant that the charity was having to fund 100% of the increased contributions even though only 15% of these liabilities related to their staff's service. The charity could have afforded the approximately £1m to pay the cessation debt for their service however they had an additional £6m cessation debt related to the council benefits. This meant that they were forced to continue in the scheme accruing further liabilities and taking them to a point beyond which they could not afford to exit.

This is an issue likely to affect out-sourced service providers across such sectors as sports & leisure, education and others.

LGPS should be required to segregate service periods on transfer and retain responsibility for contributions, ill-heath / strain on fund costs, and cessation debt for their period of service as is the case in the majority of other schemes. This would not be a significant burden for local authorities as the cessation position is not relevant for them as the scheme will not move to wind-up. However the current position is totally inequitable and restricts the flexibility for affected charities.

In addition, as cessation of the scheme is not likely, the schemes should consider an alternative cessation basis which reflects this and not be permitted to apply the equivalent of a buyout methodology when no buyout will occur.

9. SAMPLE IMPACTS

Merger / Incorporation / Reconstruction

It has been highlighted consistently in charity research that defined benefit pensions are the major barrier to corporate activity within the sector (e.g. Capacitybuilders research in 2010). Charity trustees operating organisations without defined benefit pension liabilities are, not surprisingly, reluctant to become engaged with organisations that have, especially when no mechanism exists to limit the future growth of these liabilities.

Indeed there is considerable concern amongst trustees about the personal and trustee liabilities that such a decision would entail.

Case Study 6

A group of three charities in the voluntary sector wished to merge to streamline their regional operations and create an additional 20% yearly increase in available funding for projects. Two of the three organisations had defined benefit pension schemes (one within LGPS) and one had defined contribution provision. The organisations did not have the level of net assets necessary to settle the Section 75 debts. The legislation would not allow the cessation of future accrual within the DB schemes. The closure of the organisations to create a new entity would trigger the Section 75 debt and make two organisations insolvent. The trustees of the organisation without the DB liabilities were not prepared to accept these liabilities as it was worsening their financial position, creating an open-ended and growing liability. This was effectively creating a Newco which was insolvent from the outset and was therefore contrary to their trustee duties. Had the charities been able to limit their future liabilities by ceasing future accrual and paying down the accrued debt the merger could have taken place but was eventually abandoned purely based upon the DB pensions issue.

Tenders / Grants

There is a difficult issue evolving within the charitable sector in relation to organisations with defined benefit pension schemes competing for tenders and/or grant funding. Many of these organisations were forced to implement defined benefit pension schemes in order to compete for services. However, as scheme contribution costs have risen the organisations now find themselves uncompetitive on price when tendering for work or losing grant funding because the funder is concerned that too much of the payment will be directed to funding pension costs.

Losing these contracts or funding can lead to insolvencies which means that ultimate pension liabilities must be picked up by the scheme and therefore mostly by the local authority. Authorities seem totally unaware that the potential saving made in service costs needs to be offset by the potential increased expenditure on pension funding.

The ability to limit the growth of liabilities would make organisations more competitive in pricing work, more likely to retain it and therefore more likely to be able to continue funding pension contributions and thereby more greatly protecting members accrued benefits.

Case study 7

A small charity grew as it picked up contracts from local government. As part of the process it was required to provide defined benefit pensions for staff within LGPS. LGPS costs continue to rise. When re-tendering for work the level of pension costs makes the charity uncompetitive with organisations not providing benefits of this type and the local authority awards the service to another organisation. Gradually as each contract is lost the number participating in the scheme fall and the proportionate cost increases driving the organisation inevitably towards insolvency. Once the organisation becomes insolvent their liabilities become orphan within the LGPS scheme and as the local authority is responsible for the majority of the scheme liabilities they ultimately pick up the cost.

10. PENSION ACCOUNTING – FRS17 / IAS19

The position with disclosure of pension liabilities in charity accounts is highly variable.

Where the body is a member of a "multi-employer" scheme then the position is considered in details in Section 38 of Practice Note 22 – *'The Auditors' consideration of FRS17 'Retirement Benefits' – Defined Benefits Schemes* which states:-

Where more than one employer participates in a defined benefit scheme, it is known as a 'multi-employer scheme.' In some cases the scheme assets are not clearly allocated to specific employers and it may be difficult to identify the share of the underlying assets and liabilities attributable to each participant on a consistent and reasonable basis. In such circumstances, FRS17 requires the contributions to be accounted for as if the scheme were a defined contribution scheme, provided that there is disclosure in the financial statements of:

a) the fact that the scheme is a defined benefit scheme but that the reporting entity is unable to identify its share of the scheme assets and liabilities; and

b) any available information about the existence of a surplus or deficit in the scheme and the implications of that surplus or deficit for the reporting entity.

c) the quantity and quality of other available relevant audit evidence.

The crucial element therefore appears to be whether the body is able to separately identify their share of the scheme assets and liabilities. Clearly if their specific details cannot be identified then the accounts will reflect contributions as if they were to a money purchase arrangement and should include the additional information specified above.

However this is not always the case. Increasingly companies participating in multi-employer funds are having their share of assets and liabilities specifically itemised and in these circumstances it would appear that full disclosure will be necessary.

Auditors are increasingly uncomfortable with organisations not disclosing as it raises a question if the accounts are a 'true and fair' representation of the financial position.

The significant variation also means it is difficult for lenders, funders, other organisations, grant makers and tenderers to clearly and consistently identify a realistic financial assessment. The disclosure position should be much more clear-cut and consistent for all concerned.

Case study 8

The following example considers two identical social housing organisations with the same net assets and pension deficit. One participates in LGPS and therefore discloses its pension liabilities on its balance sheet, deducting any deficit from net assets. The other participates in the Social Housing Pension Scheme (SHPS) which does not provide accounting disclosures using the exemption above and therefore will show a better balance sheet position. In a competitive position the latter organisation will appear stronger even though the reality is it is not. Tenderers are unfortunately not sophisticated enough to recognise this level of detail.

The major audit firms are very uncomfortable with this anomaly as it means questions if organisations are making a 'true and fair' representation of their financial position and could as a result be misleading for funders, sponsors or service providers.

Uncompetitive future benefit provision

Should organisations wish to cease accrual some schemes offer the option to provide future service on a defined contribution basis within the current scheme. However, this means that employers are forced to use the in-house defined contribution option when this may not be the most suitable or competitive solution for them or their staff.

There is also a concern that such an arrangement can effectively ring-fence the defined contribution assets and liabilities from the defined benefit assets and liabilities. In addition employers may be forced to use these schemes where the contributions required are in excess of those the employer wishes to pay or indeed where the employer no longer wishes to provide group pension benefits.

Auto-enrolment

From 2012-2017 employers will be required to enroll all staff in a designated pension scheme. It is frequently the case that organisations have large numbers of staff who are 'un-pensioned'. Adding these staff to a defined benefit arrangement would not be viable for the vast majority of charity employers. They therefore need to find alternative arrangements which are affordable and meet their specific requirements. Such options are considerably constrained by the lack of flexibility imposed by multi-employer last man standing arrangements.

Case study 9

If we take an organisation with 350 staff and a total payroll of £6.5m. They have 100 people participating in their existing LGPS arrangement at a funding percentage of 22% giving an employer contribution cost of around £620k based upon an average salary of £28k. This means that 250 staff are un-pensioned and the applicable salary roll is £3.75m. Should under auto-enrolment all these staff join the LGPS Scheme that would be an additional contribution cost of £825k. Should the organisation decide not to use the LGPS as the default scheme then it would be likely that the scheme would be deemed to be closed for new entrants which would result in an increased funding cost likely to be in the range of £50k-£100k. However using a DC auto-enrolment alternative the potential minimum contributions would fall to £150k-£200k.

Many organisations would wish to amend their pension arrangements to meet their budgetary requirements and to provide a scheme which more equitably shares the contribution spend across a greater number of staff but are unable to do so.

11. CONCLUSIONS

The current legislation is ill-suited for charitable organisations (and indeed non-charitable organisations) participating in multi-employer last man standing pension schemes. The issue is exacerbated where organisations are unconnected.

It cannot be in anyone's interests, neither members, employers, schemes or the taxpayer, for organisations to continue to build liabilities which they cannot afford.

To as great an extent as possible the legislation needs to be consistently applied across stand-alone, segmented and last man standing arrangements.

Any changes need to ensure that members' benefits and the PPF are fully considered and protected in any amendments.

Change is necessary to provide charities with the necessary flexibility to manage their pension liabilities, to reduce their impact on genuine corporate activity and to reduce the risk exposure of charity trustees.

There is the need for a comprehensive review which considers these issues and any others identified, quantifies their impact, takes representation from all affected parties and considers what options might exist for change and improvement.

In our view it is not the place of Government to dictate to charities the form of pension provision for their staff on a future service basis to a greater extent than to other organisations. We do not believe that the existing inequity was ever the intention of the Government or the legislation, but it is the situation that many small charities are struggling to manage. The legislation must be changed to place charities on the same footing as other SMEs in terms of the options available to manage their pension arrangements. To be clear, we are not arguing for preferential treatment for charities, but for a level playing field which recognises the nature of the pension schemes that many participate in.

12. SAMPLE PROPOSALS

Based upon the above conclusions I believe that there would be a number of steps possible which would improve the position while not jeopardising schemes or member security.

- The 'active' member test could be amended such that the full Section 75 debt is not immediately and automatically triggered. This would permit organisations within multi-employer schemes to negotiate an exit arrangement with the Trustees, or a statutory body, in a similar format to that available within a single employer scheme. Such a move would mean that employers need not continue to accrue unaffordable liabilities, putting other organisations at risk and reducing member security. The move to a 'closed' basis would not compromise employees' accrued benefits or limit their entitlement to last man standing coverage. Indeed, properly structured this could improve members' benefit security, relative to the current position. Such a move is far from radical but merely an extension of the approach currently adopted should a multi-employer scheme close to all participants.

- Employers could be given the option to seek to segregate their liabilities within a scheme through negotiation with the trustee, subject to settlement of any orphan debt, possibly via the use of an additional settlement premium and/or the provision of security. Such a move could significantly improve short term funding for many schemes. This process could allow employers to put longer term funding plans in place with the aim of ultimately buying out benefits - something which is relatively unattractive to these schemes at present given any additional funding is frequently not targeted at specific employers. It could also encourage the use of lower risk asset classes linked to increased funding, all of which would also be in members' interests.

- LGPS should be forced to segregate service periods on transfer and retain responsibility for contributions, ill-heath / strain on fund costs, and cessation debt for their period of service as is the case in the majority of other schemes. This would improve member security and would not be a significant burden for local authorities as the cessation position is not relevant for them as the scheme will not move to wind-up. In addition, as cessation of the scheme is not likely, the schemes should consider an alternative cessation basis which reflects this and not be permitted to apply the equivalent of a buyout methodology when no buyout will occur.

Many schemes (such as LGPS) already recognise the issues here and would be keen to see mechanisms in place which offer them more flexibility to limit liabilities for weaker employers and encourage stronger employers wishing to exit to settle debts in a more certain and controlled fashion.

These proposals are a practical application of legislation which already exists for stand alone and segmented schemes and which can be implemented without compromising member security.

There is clear demand for change now from both schemes and employers, and the Government needs to move to address this.

About the author

David Davison (*BA, ACII, DipPFS)* is a Director and owner of Spence & Partners Limited and Dalriada Trustees Limited. He has 25 years experience in the pensions industry and advises on all aspects of pensions in the third-sector. David has considerably in excess of 100 charity clients in numerous multi-employer and individual pension schemes.

David regularly presents to representatives of charities and not for profit organisations and their trustee boards to give a better insight into the pension options available to them and how to communicate those choices and decisions to all relevant stakeholders.

David's knowledge of the sector has been identified in the numerous articles and comments he has provided to publications serving the charity and not for profit sectors. David has a regular blog on the website of leading charity publication Civil Society and most frequently has commented on the issues and implications surrounding participation in multi-employer schemes.

David is a Chartered Insurance Practitioner and was involved in the development of the Chartered Insurance Institute specialist pension qualification, G60 and subsequently acted as an examiner and scrutineer. David has acted as Chair of a local charity and has experience with charitable fund raising and giving.

About Charity Finance Group

Charity Finance Group is the charity that champions best practice in finance management in the voluntary sector. CFG has more than 1,800 members, all senior finance professionals working in the charity sector and responsible for the management of over £19bn in charitable funds. We campaign for a better operating environment for charities and challenge regulation which hampers effective use of charity funds. We work directly with finance professionals to drive up standards and ensure that every pound given to charity works harder.