Summary
- The total charity DB deficit level in the UK stands at £1.7 billion, according to the *UK Civil Society Almanac 2016*, compiled by NCVO.
- It is common practice that when staff already in the LGPS are transferred over to a charity, that charity takes on responsibilities for historic liabilities. The 'new' Fair Deal failed to extend to the LGPS. This is placing huge pressure on charities and threatening their existence.
- The charity industry has argued that local authorities should be asked to retain risk related to pension liabilities.
- Non-associated multi-employer DB schemes are still significant challenges for charities. The deficit caused in these schemes is preventing them from taking steps to ensure their financial sustainability.

Passing the buck?

Adam Cadle outlines the LGPS-charity problem and the ramifications of this on charities' future sustainability

Like all other parts of the economy, charities' pension funds are faced with falls in equities, bond yields and rising life expectancy. It comes as no surprise therefore that the total charity DB deficit level in the UK stands at £1.7 billion, according to the *UK Civil Society Almanac 2016*, compiled by NCVO.

For CFG senior policy and public affairs officer Anjelica Finnegan: "The collapse of Tata Steel and the BHS deficit show that pension policy is broken and provides challenges for all sectors."

"It is widely recognised that government needs to commit to serious reform," she adds. "The trend among charities has been to close DB schemes in favour of DC schemes. However, there are some unique challenges that charities face that businesses don't. For example, for many charities much of their income is restricted and so can only spend their funds as determined by the restriction as opposed to core costs, such as paying down deficits. This therefore can prevent charities from closing their DB schemes."

A major threat

One major issue is threatening the very existence of charities however – the LGPS-charity problem. Many charities become admitted bodies in the LGPS when they take on public-service contracts that involve a TUPE arrangement. If staff from a local authority are transferred to a charity under TUPE regulations, the charity is required to offer them a broadly comparable pension arrangement. It is common practice that when staff already in the LGPS are transferred over to a charity, that charity takes on responsibilities for historic liabilities.

GJH pensions director and pensions manager at The Children's Society Gareth Hopkins warns that "in real terms, this translates to a lot of money and risk, which charities are not considering; let alone pricing into their bids".

"The 'new' Fair Deal published in October 2013 applied to central government departments, such as the Principal Civil Service Pension Scheme; the Teachers' Pension Scheme; and the NHS Scheme – basically, anyone and everyone apart from local authorities like the LGPS. Why the revised Fair Deal was not extended to local government is anyone's guess," he adds.

Updated legislation incorporating the LGPS has been drafted but it could well take years before it is published.

"LGPS has a supposed inability where they can't allocate different liabilities to different employers under the same agreement," Spence & Partners director David Davison states.

"For many charities there is also a growing recognition that councils have adeptly transferred historic past service liabilities in millions of pounds to them, due to LGPS inability to segregate service between employers and without making employers aware of the impact. This has been hugely expensive for charities. DCLG and LGPS continue to try to ignore this issue and sweep it under the carpet."

The gravity of the situation is exemplified by the transfer of liabilities that can occur either on an ongoing basis or through cessation. Davison emphasises that organisations must enter public service contracts with their eyes open.

"Liabilities can be transferred at the start and worked out on an ongoing basis, on the basis that the contract continues," he explains. "However when it comes to the end of a contract, you can move to a point where you have a cessation liability and these could be about 50 per cent higher. Yet often the majority of those liabilities relate to liabilities that were built up by the council or a previous supplier. This is patently completely unfair."

Davison describes a charity in the education sector with an outsourcing contract for three years from 2014, with current assets of £1.6 million, ongoing liabilities of £2 million, so an ongoing deficit of £400,000 but a cessation deficit of £1.4 million.

Furthermore he speaks of a charity that transferred in the six staff from the Principal Civil Service Scheme with large benefits. "It is supposedly fully funded on a transfer value basis but only on an ongoing basis. The charity now has in excess of £600,000 of a deficit, which is now close to crystallising as all but two of the members have left and the agreement is a closed one, so no-one else can be added," Davison explains.

"Pension risk relating to TUPE is huge, and must not be underestimated," Hopkins argues. "There are ways and means of mitigating pension risk. In danger of over-simplification, local authorities should be asked to retain all risk related to pension liabilities, and this should be reflected in the commercial contract."

A change in practice by one local government pension scheme, Lothian Pension Fund, has reflected a recognition of the unfairness of the issue. This fund recognised that applying a cessation debt to an employer who has transferred in from a local authority is unfair and has therefore accepted that exit payments in these circumstances should be calculated on an ongoing basis for both transferred-in staff and any new staff that join the charity and are enrolled into the LGPS.

"Clearly this represents a significant change and one which surely must have implications for other administering authorities, as if there is an acceptance in this fund that the prior approach is inequitable, it must be, de facto, inequitable in all similar funds," Davison states.

"It is common practice that when staff already in the LGPS are transferred over to a charity, that charity takes on responsibilities for historic pension liabilities"

The battle goes on

The buck doesn't stop here for charities however, with two other major issues potentially affecting their welfare. Non-associated multi-employer defined benefit schemes are still significant challenges for the sector.

"The way that these schemes operate means that charities are faced with the Hobson choice of continuing to accrue unaffordable liabilities or trigger a cessation (Section 75) debt that requires immediate payment they cannot afford to pay," Finnegan accentuates.

"The deficits caused by these schemes, which were historically marketed as a safe and sensible option for charities, is preventing them from taking steps to ensure their financial sustainability. This means that charities are forced to close, which has a knock on effect for other organisations remaining in the scheme and ultimately, for the employees that have their pensions with these schemes."

The DWP has recognised that the S75 rule needs reforming and has run a consultation on the matter, but the government has yet to act in 12 months since the consultation closed. In the meantime, charities have been forced to close that could otherwise have remained open, had they been able to exit their multi-employer pension scheme more flexibly.

Staying strong

Charity pension schemes within the LGPS currently find themselves in somewhat of a dark tunnel where liabilities are concerned. It would not be at all surprising if the Charity Commission is taking rather a dim view on how certain charities are exposing their organisations to great levels of pension risk under TUPE arrangements. "One may even argue it is illegal," Hopkins states.

"A cynic might say that local authorities are offloading pension liabilities as part of a rather grandeur de-risking attempt. However I suspect the real reason is far more simplistic – the local authorities, themselves, don't understand pension risk. It is important charities gain pension and legal advice before committing to a particular contract and charities should be prepared to walk away. Some charities seem to loathe this approach due to reputational risk, which is nonsense.

"Charities need to make a stand – until the third sector collectively refuses to take on pension risk, local authorities will continue to pass on these liabilities as business as usual," he concludes.

Written by Adam Cadle