








Pensions roundtable:

FUNDING DEFINED BENEFIT SCHEMES IN THE CHARITY SECTOR

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Roundtable

Panel:

Steve Hitchiner is a partner at pensions consultancy firm Barnett Waddingham

Chris Hawley, is a partner at pensions consultancy firm Barnett Waddingham

Jackie Birch is the legacy fundraising manager at The Salvation Army

Jane Hodson-Lewis is the HR Manager at Aspire Sports and Cultural Trust

Paul Hodgkin is the chair of trustees at Friends Therapeutic Community Trust

Many defined benefit pension schemes are now closed to new accrual and are steadily working towards their 'endgame'. Alongside this, several high-profile cases of failing employers leaving behind underfunded pension schemes has put the future of DB funding into the spotlight.

Against this backdrop, The Pensions Regulator will soon be consulting on a revised funding framework for DB schemes, which is set to focus on long-term funding objectives, requiring little or no reliance on the employer. Schemes have also been urged to start thinking about their journey plan and the actions they can take to help them achieve their goals.

Charity Times, together with Barnett Waddingham, brought together a panel of people responsible for charity pensions to discuss some of these issues and to look at what meeting long-term funding objectives really means in practice.

Revised funding regime

Opening the discussion, Steve Hitchiner, partner at Barnett Waddingham describes how the funding of defined benefit pension schemes is "reaching a tipping point". "Schemes are maturing and they're starting to think about their long-term objectives," he says.

National media coverage of high-profile DB scheme failures hasn't helped in recent years. Carillion and BHS – both examples of failed pension schemes at the hands of financially unstable companies – are just two of the most notable cases and which have highlighted the need for greater DB security.

The government has been quick to respond, though, and in 2018, it published a white paper outlining plans to secure a 'clearer future' for DB funding, whilst criminalising wilful pension scheme neglect through giving The Pensions Regulator (TPR) more powers.

Hitchiner tells the panel a new framework, which will be set out by TPR, is set to be consulted on in due course, and will detail – amongst other things – a requirement for pension schemes to firmly set a 'long-term funding target'.

"We expected the framework some time ago, but political uncertainty has delayed it," he explains. "But the consultation should be expected soon."

The requirement for a long-term




funding target is essentially a way to eliminate some of the pressure from employers and place less risk on investments. Schemes will need to allow for their reliance on investment risk to reduce over time, such that it is largely removed when they are substantially mature, and to have sufficient funding in place to pay the benefits promised on this basis. If there is a shortfall, Employers will be able to pay the requisite contributions needed to correct this over an agreed period.

"The regulator has been quite open about what they see the target looking like," Hitchiner adds. "They have alluded to an assumed investment return of around a quarter to a half a per cent per annum above the risk-free rate of return that you get from lending money to the government. This is quite a low investment return, some might say, but a lot of schemes already have similar funding targets in place."

Additionally, schemes also have a new fast-track option for compliance. This means that schemes that can meet a certain number of criteria regarding their long-term funding targets and funding plans and will then be able to go through 'fast-track compliance', without further questions from TPR.

There will also be a bespoke regime which will allow schemes to veer from the fast-track compliance route, but with greater scrutiny from TPR expected. "In other words, the regulator will ask to see their homework, and satisfy themselves that what they're doing is reasonable," he says.

Long-term objectives

But what exactly does this objective mean for charities in practice and how should charities design a strategy to meet it?

One panellist argues that although the framework is "great in theory", more clarity is required around what 'long-term' and 'funding target' really mean.

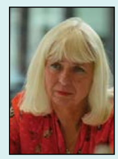
"It sounds good, but in practice, because of the absurdity of the actuarial calculation process, the long-term target is blown out of the water at the next revaluation. A tiny fluctuation in gilt yields or liabilities might have done this, for example.

"So my message to the regulator would be this: if we are going to adopt 'long-term funding targets', we have to have an actuarial valuation process that is locked in for the long term and isn't

Panel:


Nicola Anson is the interim finance director at the young person's charity Engineering UK


Mike Rutherford is the director of finance at the charity Social Interest Group


Karen Mackenzie is the pensions manager at consumer advice charity Which?


Roger Buckley is a trustee of the Retail trust Retirement and Death Benefits Scheme


Mary Daly is the chief financial officer at scientific research charity The Royal Society

Panel:


Richard Purdue is a trustee of The Institute of Materials, Minerals and Mining


Katharine Horler is the chief executive of learning and development charity Adviza


Richard Hunt is the head of lending business development, charities at CAF Bank


Stephen Joyce is the finance director of the Royal Society of Chemistry


Beci Jones is head of finance and operations at Bobath Children's Therapy Centre Wales

susceptible to tiny fluctuations in abstruse, arcane things – things that I don't understand, let alone my trustees."

Many panellists hope charities will receive a little leniency from TPR, given the nature and lifespan of their operations. "We read in the press about commercial businesses that are in serious trouble, and they can simply 'pop out' of being a business if they really need to. But charities have a much longer life expectancy, and – especially for the larger charities, which so many rely upon – this is simply not possible.

"Surely there must be an argument for charities to have a longer recovery plan?"

So surely there must be an argument for charities to have a longer recovery plan?" one panellist argues.

However, as Hitchiner points out, TPR regulates the entire pensions industry, regardless of individual circumstances. "In its guidance, TPR says trustees of charity pension funds should approach employer covenant in the same way. They should think about how much cash is available – now, and in the future – and what the risks are to that cash," he says.

"Many charities do have long-term horizons," he says, "but if I was a trustee of a charity pension fund, I would still look to ask myself the same questions: how much cash is the charity going to generate? Is that cash going to be available to the pension fund, and what are the risks to that cash? What could make the cash suddenly go away?

"These are all really important questions and I don't think they should be any different. However, I think TPR does recognise that charities are not like private companies who need to take risks to deliver profits, and will often take a less aggressive stance."

"Trustees have a responsibility to encourage members not to 'make the mistake'"

Managing liabilities

Over recent years, liability management has become a useful tool to help employers reach their long-term objectives.

Hitchiner recalls that historically members taking a transfer from a DB scheme was unusual. "But in the last three or four years, we've seen an absolute explosion in interest from members in their options under the scheme to either transfer, retire early or explore other flexibilities with their benefits," he adds.

These flexibilities – introduced as part of George Osborne's 'pension freedoms' in 2015 – have subsequently led to the greater use of liability management, which can mean providing more information, or implementing a bulk communication exercise and providing access to advisors.

"I've spoken to a number of trustee boards about liability management over the years, and the views range from, 'these are valuable options that members will be interested in, we should tell everyone', to 'we will avoid highlighting any of these options because they are not in their interests," Hitchiner adds.

One panellist shares his experience of looking to undertake a bulk exercise, although he claims his advisor fears take-up would be very low. "We haven't seen this so-called 'explosion of interest' yet, but if we do, we want to go big and try and shrink the size of the overall pot by having transfer values in place," he says.

Another panellist argues that transfer values could be "the answer to a lot of the issues we have as a sector". "People love the idea that they can now have more flexibility around their pension and take it early to pay off the mortgage and pay off debts," she says. "The scheme – on transfer value basis – would actually benefit from this. Transfer value basis would not be as generous as buy-out basis, so the scheme would profit from everybody wanting to transfer."

But where do employers' responsibilities lie with regards to members' best interests? A trustee on the panel argues that trustees have a responsibility to encourage members not to 'make the mistake'. "It would certainly help the funding of the scheme, but the encouragement to transfer all of your DB benefits is a mistake and personally, I feel like I would have a responsibility to stop a member from doing that.

"But, alternatively, if you provide them with all the information they need, they seek advice and still come to the same decision, well then surely our work is done? It's a very difficult situation, but I certainly like the idea of moving benefits around. Much more than moving benefits away."

Buyouts

For many charities, a long-term funding target is already in sight and they are closing in on the point of buy-out, whereby they can transfer

their pension liabilities to an insurance firm, which will take on the responsibility of meeting them.

But the market has become busy, and due to demand, it can often be difficult for organisations to obtain quotes from insurers. "This has meant that it's become increasingly important for schemes to prepare well for buy-out, and that means making sure the trustees and the employer are working well together, and both understand a common set of objectives," Hitchiner explains.

"It means you've got no legal uncertainty with regards to your benefits, so you'll need to have closed everything down, made sure you've got all your deeds tied up and have drawn up an accurate benefit specification. Your data will need to be in good order too. This is just part of a check list for trustees to go through on the path to buy-out," he adds.

One panellist talks about being extremely close to the point of a buy-out, but whilst also being held back by high admin fees.

"We're about £2 million short of a buy-out," she tells the panel. "And as it stands, we could just carry on making no further contributions and we'd be there in 2030. But we've got £100,000 a year of admin fees to pay.

"This has really highlighted how many costs can be accumulated in the build-up to buy-out and just how necessary it is to build these fees into the projections," she adds.

Preparation is key

Chris Hawley, partner at Barnett Waddingham also emphasises the need for preparation, explaining that due to the popularity of buyouts it can be extremely difficult to get traction in such a competitive market.

"This just highlights the need to prepare," he says. "You must make sure you've done your data and benefit work. These are things you can do years in advance of a transaction. Even if you are talking about a buy-out five years away, you can still get your lawyers to go over your benefit specification and see if there are any skeletons in the closet."

Whilst the idea of a long-term funding target may not be appealing to many charities, it does act as a reminder that working towards the future, setting objectives and careful planning are key to avoiding the devastation caused by DB failures.

"Like everything in life, there's a need for balance," Hitchiner concludes. "What the regulator is saying is that every organisation – regardless of their objectives – must simply plan to be at a point in the future where they are no longer on a bumpy journey.

"You can take some time to get there, and you can invest in some exciting things in the meantime, but at the point at which you're substantially mature, you should aim to be funded on a basis that allows you to avoid risk and volatility.

"Of course, this can be costly, especially for non-profit organisations, but finding the right balance will make it worthwhile in the long-run." ■

Barnett Waddingham is a leading provider of pensions consultancy services to the charity sector. For more information, visit: **barnett-waddingham.co.uk.** To speak to somebody directly, please contact: **steve.hitchiner@barnett-waddingham.co.uk.**