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Why the Big Society does not offer a Fair Deal for Charities

The Coalition has a driving ambition: to put more power and opportunities into people's hands. A key part of this is the opening up of public services enabling charities, social enterprises, private companies and employee-owned services to compete to offer people high quality services.

The odds have been mounting against the survival of the British high street for years. Opportunities perhaps for charities, although in the present economic climate many are struggling to come to terms with reducing donations and cuts in local government funding. The latter is such a problem that the Department for Communities and Local Government (DCLG) has just released a new consultation paper which includes clear guidelines for local authorities who are considering cutting funding to local voluntary and community organisations.¹

Funding is only one half of the problem; controlling costs is the other. And none has a potentially greater impact than the "P" word – pensions.

This March saw the publication of the Independent Public Service Pension Commission's Final Report or the Lord Hutton Report, as it is more commonly known.² This Report follows the Interim Report, which was published in October last year.³

The Interim Report stated that evidence presented to the Commission had made it clear that current pension structures, combined with the requirements to provide comparable pensions ("Fair Deal"), were a barrier to non-public service providers, potentially reducing the efficiencies and innovation in public service delivery that could be achieved.⁴

The Commission reported that it had also been suggested that extending access to public service schemes for non-public service employees could be a solution to this problem. But it was not clear that this was a solution either for Government, which has to accept additional liabilities and long-term risk, or for some external organisations, which, depending on the scheme they are

¹ Best value: new draft statutory guidance Consultation April 2011

² Independent Public Services Pensions Commission: First Report 10 March 2011

³ Independent Public Services Pensions Commission: Interim Report 7 October 2010

⁴ Pages 109 - 112 of the Interim Report

entering, may be required to pay a premium or indemnity for entry, take part in deficit recovery plans, or pay large exit charges.

However by the time of the Final Report, the Commission recommended that it is in principle **undesirable for future non-public service workers to have access to public service pension schemes**, given the increased long-term risk this places on the Government and taxpayers (emphasis courtesy of the Report).⁵

Whilst the Commission acknowledged there were clear pros and cons to allowing access to public service schemes, it felt it was inappropriate that the Government, and hence the taxpayer, takes on the risk of liabilities for a workforce it does not control. By allowing external organisations into public service pension schemes, the Government is at risk from the financial consequences of those organisations failing, awarding excessive pay rises, being unable to pay their exit fees when they leave schemes or of them paying insufficient contributions whilst they are in the scheme for the long term liabilities that their members accrue.⁶

But why does the idea appear so novel? After all much of the risk that the Lord Hutton Report is concerned about is simply the risk that every employer who sponsors a final salary scheme runs simply by virtue of the design of such schemes.

Indeed after the Maxwell scandal, the Government established the Pension Law Review Committee, chaired by Professor Goode, to look at the issue of safeguarding pension rights. The result was the publication in 1993 of a Report running into over 1,000 pages over two volumes and containing 218 recommendations.

Most pension professionals realised the writing was on the wall, at least for smaller employers with final salary schemes. The proposed increased regulation and related cost alone was sufficient for many pension advisors, including life offices, to advise their clients to close their final salary schemes and instead move to a defined contribution scheme, usually contract based, where the risks and costs could be more tightly controlled and managed.

The implementation of the Pensions Act 1995, together with increasing volatile investment returns and improved life expectancy, have now resulted in even the largest employers firstly closing their final salary schemes to new entrants, then closing them to future accrual and now looking at ways to reduce the risk to the scheme. Last year the Association of Consulting Actuaries warned that final salary pensions in the private sector which accept new joiners are “all but extinct”. The National Association of Pension Funds reported that 17% of final salary schemes in 2010 were closed completely and added that the decline of final salary schemes had entered “a new phase”, due to increasing longevity and inadequate investment returns.

⁵ Page 119 of the Final Report

⁶ Page 119 of the Final Report

So if such schemes are becoming all but extinct in the private sector, have charities been left behind in the race to shed their final salary pension liabilities?

Perhaps smaller charities lacked the benefit of independent financial advice and/or their trustees lacked the requisite knowledge and experience. Perhaps they had been lulled into a false sense of security based on past experience, unaware of the emerging problems impacting on funding, or perhaps they felt as benevolent employers they should retain such benefits. Maybe it was just too easy to join the LGPS as a community admission body with all matters left to the admissions authority, a form of benign neglect.

In the case of those outsourcing public sector services, and in particular, local authority services, perhaps they had no option due to the Fair Deal policy.⁷ This policy applies where a public service is outsourced to be delivered by an independent provider, including private sector businesses and non-profit making organisations such as charities and social enterprises. Whilst the Transfer of Undertakings (Protection of Employment) Regulations 2006 preserves the employment entitlements of transferring staff, the Regulations specifically exclude pension entitlements insofar as they relate to old age, ill health or survivor benefits. Some statutory protection was introduced in the Pensions Act 2004 with a requirement on the transferee to match employee contributions into a scheme up to 6% where the transferring employees were either members of a scheme or were in a waiting period.

However this was nothing like the protection the Government decided was appropriate for transferring public service workers when it announced its Fair Deal policy in 1999. This builds on the TUPE requirements and covers both employee's accrued benefits and future pensions accrual. The Fair Deal policy requires that the new employer should offer transferring staff membership of a pension scheme which is "broadly comparable" to the public service pension scheme which they are leaving. In addition to requiring a broadly comparable pension for future accrual, since 2004 the policy also covers the treatment of previously accrued pension benefits, requiring service credits on a like for like basis.

Although the policy is expressed to be non-statutory, as far as Local Authorities are concerned, as best value contracting authorities they are required to comply with the Best Value Authorities Staff Transfers (Pensions) Direction 2007, which was made under section 101 of the Local Government Act 2003.

At the same time the LGPS introduced Admitted Body Status (ABS) to facilitate public sector outsourcing. This was to provide a methodology to enable charities, social enterprises, private

⁷ Staff transfers from Central Government: a fair deal for staff pensions; Guidance to Departments and Agencies; HM Treasury, 1999 and Fair Deal for staff pensions; procurement of bulk transfer agreements and related issues, HM Treasury, 2004

companies and employee-owned services to comply with the Fair Deal policy. Whilst it was theoretically possible for the transferee to provide “broadly comparable” benefits by providing their own defined benefit or defined contribution schemes, this rarely happens. Existing defined benefit schemes rarely mirror public scheme benefits, necessitating either setting up a new section within the existing scheme or establishing a new scheme, an exercise which, coupled with certification, is both costly and time consuming. Whilst it may also be theoretically possible to provide a defined contribution alternative, the level of contributions would be prohibitively high and accordingly ABS has become the default option.

Whilst at some levels ABS has been a success, certainly for those employees whose pension rights have been protected, for some time there have been a number of perceived problems with the framework.

Primary concerns raised by contractors were the lack of control over costs, investment and funding strategy; asymmetric risk (the contractor is liable for any deficit but cannot benefit from any surplus); accounting issues; distortion of the bidding process owing to some bidders not appreciating the pension risk they were assuming and the cost of providing bonds and indemnities.

These concerns lead to the DCLG working closely with the those involved and the issue of a discussion paper in 2006, then followed by a further consultation document in 2008. In the end, the DCLG chose to leave the current framework in place and instead issued Guidance in December 2009⁸ aimed at Local Authorities, LGPS administering authorities, contractors, actuaries, trade unions and LGPS members. Whilst such Guidance was helpful in highlighting the potential risks and how they may be allocated between the parties, in reality the contractor needs to be fairly sophisticated to understand the issues and also have a deep enough wallet to employ relevant professionals. For many charities that is not possible.

Accordingly it was no surprise that Lord Hutton’s Interim Report found that the Fair Deal policy, coupled with current public service pension structures, created a barrier to the plurality of public service provision, making it difficult to achieve the efficiencies and innovation which new providers can bring to public service delivery.

As a result of these interim findings the Government announced its intention to undertake a review of the Fair Deal policy, reporting in Summer this year.⁹ Responses are requested by 15 June 2011.

⁸ Admitted body status provisions in the Local Government Pension Scheme when services are transferred from a local authority or other scheme employer December 2009

⁹ Consultation on the Fair Deal Policy: treatment of pensions on compulsory transfer of staff from the public sector March 2011

In line with the changes happening in the private sector, and given the Coalition's Big Society policy, it is difficult to make a case for the Fair Deal policy surviving. Who, without some form of compulsion or coercion, would opt to elect into a system which potentially left you with large onerous liabilities over which you had little control (including third party orphan liabilities), with benefits way out of line with the private sector and where you are exposed to increased future liabilities with no upside.

But then, of course, if you are the General Secretary of Unison, the largest public sector union, you may see it differently - "The Government wants to attack our pension schemes to make it cheaper for private companies to tender for work. Cowboy firms will make cheap bids which will destroy high quality public services."

Would you rather be labelled a cowboy or risk being an insolvent charity instead?

My money is with Lord Hutton's Committee, which went on to recommend that future non-service workers should not have access to public service pension schemes notwithstanding that the consultation on the Fair Deal had only just been launched.

And for the same reasons the time has also probably come to also consider whether it is appropriate that charities, as community admission bodies, continue to participate in the LGPS at all.

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