

Benefact

News on pensions and other
business risks in the Charities
and Not-for-Profit sector



Our experience working with charity and not-for-profit organisations stretches back to the foundation of the firm in 1989, and we have a significant number of clients in this sector.

This is indicative of the culture and values of Barnett Waddingham and our ability to provide a cost-effective service.

Our expertise extends across a wide range of areas, including advice to organisations participating in multi-employer pension arrangements, such as those operated by the Pensions Trust, and advice to charities on the investment of charitable funds. This is in addition to our extensive capabilities in providing services to defined benefit (DB) and defined contribution (DC) pension arrangements operated by organisations in the sector.



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DC Governance and Hybrid Trust Based Arrangements

The DC landscape has seen significant change in recent years. 'Automatic Enrolment' has compelled many employers to provide DC pensions for the first time, or to extend provision to new groups of employees. In addition, increased flexibility for members accessing their DC benefits has added further complexity.

The potential for outcomes that fall short of a member's expectations has always been a concern for DC, due to the inherent risk and volatility, but these changes have exacerbated this and a more robust governance framework is now required.

The Minimum Governance Requirements, introduced in 2015, and The Pension Regulator's (TPR) revised DC Code are positive developments that should be welcomed, but inevitably mean that governing and administering a DC scheme is much more involved than it used to be. This trend is only going to continue, with regulations relating to the analysis and publication of DC costs and charges coming into effect for scheme years ending after 5 April 2018.

It is common within the Charity and NFP sector to use "Hybrid" arrangements, where DC pensions are provided through the same scheme as legacy DB pensions. These schemes are looked after by a group of trustees specifically appointed for this purpose, hence they are often referred to as 'self-administered', although the day-to-day administration is typically delegated to a third party.

Using a self-administered scheme for DC provision creates challenges from a governance perspective, as they do not typically enjoy the economies of scale needed for the latest investment options and communication technologies to be cost effective.

Indeed, in many cases these arrangements are closed to new employees, such that governance resources are being further stretched across multiple arrangements.

Charities sponsoring these arrangements therefore have a dilemma. Should they use this opportunity to review the arrangements (in conjunction with the trustees) to ensure they continue to be fit for purpose? Or should they consider whether alternative arrangements are better placed to meet the needs of their members?

We consider below some of the key challenges and solutions.

Should the flexibilities be offered?

Legislation now allows members to take DC benefits as a lump sum or series of lump sums, rather than using the fund to buy an annuity at retirement.

However, if schemes want to offer these flexibilities there will be additional administration work required and a potential risk in being responsible for overseeing benefits during retirement. Members can always access these flexibilities by transferring to another arrangement, but there is a risk to the member that an unsuitable option will be picked and also the potential that the trustees are perceived to be steering members towards annuity purchase by offering that solution and nothing else.



Governing and administering a DC scheme is much more involved than it used to be

Are investment strategies fit for purpose?

One knock on effect of the flexibilities is that designing a suitable default investment arrangement has become much harder. How do you provide for a typical situation, when there is no standard way of drawing benefits?

The starting point for all schemes is to review the existing strategy and this is now a requirement every three years as set out in the Minimum Governance Requirements.

For many schemes, annuity purchase would have been the default before, but this is unlikely to be the way most members will access benefits going forwards. This has led to an increase in 'intermediate' strategies designed to fit a variety of potential outcomes.

In addition to the default, wider investment options should also be considered for suitability. It's common to see members who, as a result of historical decisions, are invested in cash funds when they are many years from retirement or equity funds when close to drawing benefits. The former may limit the potential for long-term growth, and the latter may introduce an undesired degree of volatility. Whilst there could be good reasons for such choices, it is important to educate members as to the risks involved on making their own choices and the importance of reviewing their decisions on a regular basis.



Considering alternative arrangements

TPR has made little secret of its view that scale is beneficial in running a DC scheme and that consolidation of the market is a desirable outcome. Many smaller self-administered schemes have been transitioning benefits to alternative arrangements with a centralised governance function, whether it be a master trust or contract-based arrangement. These can offer many benefits for both employers and employees in comparison with a self-administered scheme, but there can also be disadvantages and some specific challenges to address.

Particular issues to consider include:

- Hybrid schemes often allow members to use their DC benefits to take tax-free cash entitlements arising from their DB benefits, which is typically beneficial from the member's perspective.
- Even if members have DC benefits only, they may have a protected entitlement to take a tax-free cash lump sum greater than the standard 25% of fund value.
- Under the existing scheme members may benefit from having costs such as administration paid for by the employer.
- Some investment options can carry valuable guarantees.

In most instances these issues can be addressed, but if a change is to be made it is vital that it is planned and implemented with care, including communication with members. With the right approach, it can be possible to protect existing entitlements whilst offering members access to increased governance oversight and functionality.

Socially Responsible Investment

In November 2017, we hosted a joint seminar with BMO Asset Management on the topic of “Incorporating Environmental, Social and Governance factors into investment strategies”. Partner, and Head of Charity Investment, Neil Davies spoke to a group of senior trustee and charity representatives on how to set investment objectives, think about different styles of investment managers, recent market trends, and the compromises that might have to be made to implement the right approach for your circumstances.

We are also currently working on incorporating Socially Responsible Investment (SRI) more explicitly within our investment manager research approach and improving our reporting to trustees on SRI issues, including within our quarterly monitoring.

For more information on how we can assist you with this, please feel free to get in touch.



DB Pensions: General Data Protection Regulation

In our previous Benefact newsletter we highlighted that the General Data Protection Regulation (GDPR) will be replacing the Data Protection Act from 25 May 2018, with significant implications for those in the Charity and not-for-profit sector.

However, the requirements also introduce additional responsibilities for anyone who is a trustee of a pension scheme. This relates to any personal data that is held about pension scheme members. The main areas where pension scheme trustees should be taking action are:

- Drawing up a list of everyone (both trustees and advisers) who process data for the scheme ('data processors'), such as actuaries, lawyers, auditors, annuity providers etc. Past as well as present trustees and data processors need to be considered. You need to ascertain what data they hold and what their legal basis is for holding that data.
- Reviewing your contracts or service agreements with all the scheme's data processors to ensure they comply with GDPR.

- Putting in place a formal data protection policy and keeping sufficient records to be able to demonstrate compliance with GDPR.
- Ensuring that data processors are able to notify the Information Commissioners Office within 72 hours of becoming aware of any data breach.
- Ensuring you have communicated to members what data you hold, what it is used for and who you share it with.

We expect many charities will have devoted a significant amount of time investigating the impact of GDPR, in particular around how donors' data is used. Trustees of charity pension schemes may therefore be able to draw on this internal resource to help them meet their requirements. However, if any trustees do need further assistance we would be happy to help.

DB pensions: Non-Associated Multi-Employer Scheme Debt Changes

The government has issued a response to its earlier consultation on proposed changes to the employer debt regulations, to help employers that participate in non-associated multi-employer schemes (often called NAMES). These arrangements are commonly used within the Charity and NFP sector. The government has also issued updated regulations to reflect the consultation and these regulations are effective from 6 April 2018.

As explained in our July 2017 Benefact, under the current regulations, an employer participating in a multi-employer pension arrangement must pay a 'withdrawal debt' at the point it stops having employees who are active members of the scheme.

... The proposed changes would allow employers participating in a multi-employer pension scheme to defer the requirement to pay this debt subject to certain conditions.

The conditions include the pension scheme trustees' consent being required before a debt can be deferred, and trustees being able to terminate the arrangement at any time if they believe the financial strength of the employer will materially worsen.

Has the government made any changes from the original consultation?

The government has not changed the requirement for trustee consent before a debt can be deferred.

However, the requirement for a 'funding test' has been removed. This required confirmation that all the employers of the scheme, including the deferred employer, were reasonably likely to fund the scheme going forwards.

The 'funding test' has now been replaced with a requirement that should be easier to meet. The trustees now need to be satisfied that the strength of the support provided to the scheme by the deferred employer is not likely to weaken materially within twelve months from when the arrangement is expected to take effect.

The trustees still have the power to end the arrangement, although the circumstances when this power can be exercised now has to be considered with materiality in mind. In other cases, the employer and the trustees could reach mutual agreement to end the deferral agreement. Importantly, ending the agreement will not trigger the debt calculation in all circumstances.

Will the changes help?

The changes are an improvement on the original proposals, and make it more likely that the arrangements will be used.

However, from an employer's perspective, the debt is still only being deferred rather than removed. The requirement for trustee consent to use the arrangement still remains a barrier, but one that trustees may feel more comfortable giving due to the removal of the funding test. The power for trustees to bring the arrangement to an end also continues to reduce the attractiveness of this option for employers, as they are potentially passing the power to trigger a very material payment to a third party.

TPT Retirement Solutions Growth Plan: Valuation as at 30 September 2017

The Growth Plan (GP) is a large multi-employer pension arrangement aimed at employers in the Charity and not-for-profit sector.

The GP includes various sections, or 'Series', three of which operate on a DB basis. This means that regular valuations are needed to consider the extent to which the assets of the GP are expected to be sufficient to pay the pensions built up and, if they are not, the additional contributions that must be paid by employers who are still participating in the GP as a consequence. The last valuation of the GP was carried out as at 30 September 2014 and revealed a deficit of £176.5m. Additional contributions are currently being paid to address the deficit in relation to benefits in Series 1 and Series 2 of the GP. However, a new valuation of the GP as at 30 September 2017 is currently underway, and the contributions will be reviewed as part of this.

The financial position of the GP is unlikely to have deteriorated significantly since the previous 2014 valuation, and therefore all else being equal similar levels of additional contributions are likely to be required (although the specific impact can vary from one employer to another). However, although the rate of employer departures has slowed considerably over the last few years, TPT continues to plan for there to be fewer employers participating in the GP in future. In light of this, it is possible that TPT will look to fund the GP on a more cautious basis. In particular, there has been speculation that TPT will seek to fund the GP on a basis that anticipates securing liabilities with an insurance company at some point in the relatively near future. The deficit on this basis is considerably higher than that used to assess the deficit contributions at the last valuation.

A new Employer Committee has been established with effect from 1 October 2017, which represents employers in the GP.

The responsibilities of the Employer Committee include consulting with TPT on the valuation assumptions, the future funding strategy and the resulting contribution requirements. This process is currently underway, and TPT will provide updates when they are available.

There continue to be options for employers in the GP who are thinking of exiting the arrangement, in particular for those employers with Series 3 benefits. If you would like further advice and assistance regarding the potential implications of the GP valuation, or to discuss the GP more generally, we would be happy to help.



The Growth Plan is a large multi-employer pension arrangement aimed at employers in the Charity and not-for-profit sector

How we can help

Our expertise in the Charity and not-for-profit sector extends across a wide of range of areas.

We provide a full range of services in relation to DB and DC pension arrangements sponsored by organisations in the sector. This includes actuarial, investment and administration services to pension fund trustees, as well as actuarial advice to employers sponsoring these arrangements.

Specifically within this sector, we have at least 75 clients who we advise in relation to their DB pension scheme and at least 20 clients who we advise in relation to their DC arrangements. We have also advised at least 20 organisations in the sector who participate in multi-employer arrangements operated by TPT Retirement Solutions.

In addition to our pension related services, we have also advised 10 charities on the investment of trust assets.



Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch with Steve Hitchiner, Partner and Head of Charities and Not-for-Profit sector, via the following:

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