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Pension shortfalls threaten 'chain reaction' of charity failures

Charity workers' pensions, and vital services on which millions depend, at risk, experts warn

By Richard Evans

Tens of thousands of charity workers could see the value of their pensions fall by a third as a result of spiralling pension scheme deficits, experts have warned.

The cost of final salary pension schemes could force some charities to fold, jeopardising the jobs of hundreds of thousands of workers and vital services on which millions of people depend.

Even worse, the failure of one charity could make it more likely that others go bust, thanks to the unusual way in which many charities pool their pension funds.

The risk was highlighted last week when a charity that promoted peace in Northern Ireland was forced to close, apparently because of its pension deficit.

Charities, especially smaller ones, often have their pension plans run by "multi-employer" schemes. But these schemes operate on a "last man standing" basis, which means that, when one employer fails, the remaining ones have to take on its obligations.

As a result, a failure at one charity makes the scheme slightly riskier for all the remaining members. Should another fail, the risk is further increased and at some stage there is the chance of a "chain reaction" of failures.

"There will be a ripple effect through the not-for-profit sector from charities going bust," said Patrick Bloomfield, a partner at Hymans Robertson, the actuary. "A number of charities participate in 'last man standing' group schemes, so the other charities pick up the pension burden of other charities that go bust.

"In these schemes, charities' pension funds all benefit together or all struggle together. At the moment they are struggling. Although the number of failures has been tiny so far, each one adds a painful bit of marginal cost."

One charity that belonged to a multi-employer pension scheme went bust last year. People Can, which employed 300 people and helped victims of domestic abuse, ex-offenders and the homeless, belonged to the Social Housing Pension Scheme, a multi-employer arrangement.

Malcolm McLean of Barnett Waddingham, the actuary, said: "I fear People Can will not be the last charity brought down by the weight of its pension scheme." However, Sarah Smart, who chairs the Pensions Trust, to which the Social Housing Pension Scheme belongs, said the failure was not caused by a problem with the charity's pension scheme.

On Thursday the Spirit of Enniskillen Trust, set up in 1989 following an IRA bombing in Enniskillen, announced that it would be wound up. It also belonged to a multi-employer scheme.

According to Mr Bloomfield one of the largest "last man standing" schemes relates to social housing organisations. It is part of the Pensions Trust, which specialises in charitable pension schemes, and has 62,200 members and 683 employers. Its last accounts showed £3.6bn of pension liabilities and only £2.3bn of assets.

He pointed out that while charities faced the same problems with funding final salary pensions as conventional profit-making companies, their difficulties were exacerbated by the fact that they had no profits or shareholders to use as sources of extra money to plug pension deficits.

They have also seen **donations** and grants from the Government fall as a result of the economic downturn. Mr McLean said: "In the present economic climate it is very likely that charities will be seeing a drop in their income and will not have the necessary spare money to meet the demands of their pensions and will need to give up on their schemes – if not go out of business altogether.

"In a multi-employer arrangement all employers are responsible collectively for the pension liabilities of the members and you can end up with a situation where the last man standing is saddled with all the pension liabilities. However, an individual employer cannot just walk away."

In February three charity umbrella groups warned the Government that the situation was "unsustainable". In a letter to the pensions minister, Steve Webb, they said: "As charities fail, there is a domino effect on others in the same pension scheme. This situation is simply unsustainable."

Some of the ways in which charities have run their schemes up to now make the task of balancing the books harder, Mr Bloomfield said.

"Charities were a few years behind the private sector in cutting final salary benefits, partly because they tried to stick with these schemes to compete with councils for staff," he said.

"Many charity pension schemes also kept more of their assets invested for long-term growth than private-sector schemes. A decade of stock market underperformance has led to significant deficits and steep increases in the need for additional cash to be paid into their schemes."

If a charity does fail, the statutory backup of the Pension Protection Fund (PPF) would be expected to step in and pay the pensions promised. However, there are limits on the amount that the PPF will pay and on the annual increases. The overall effect of these restrictions is to cut the value of a pension by around a third, Mr Bloomfield calculated.

But he said charities did have some advantages. They are normally debt-free and have built up cash reserves. This money may not be enough to plug pension fund shortfalls but should give them the breathing space to tackle the problem.

Mr Bloomfield concluded: "There is a significant risk that some charities won't be able to cope with the burden of their pension scheme deficit. This is putting charity jobs and vital charitable work at risk, to the detriment of the vulnerable parts of society who tend to suffer most when the economy is struggling."

Ms Smart said: "Some charities have already failed and we are preparing ourselves for more, although we do not believe we have reached a tipping point where there will be a chain reaction of failures."

But she added that final salary schemes needed lots of attention, especially multi-employer schemes. Because of a technicality in the rules, a charity's accounts don't have to treat one of these schemes in the same way as it would a stand-alone scheme. "This could lead to any underfunding problem not being properly appreciated," Ms Smart said.

She pointed out another problem: if a charity closes its final salary scheme it can immediately have to meet a large debt to the multi-employer pension scheme. This can encourage employers to keep schemes open when they can't really afford to, although there is a way around this problem if they switch to a defined contribution section within the same scheme, if one is available.

But Ms Smart said: "The real difficulty is the economic situation – charities are squeezed on funding at a time when pension schemes need more money."

Jennie Kreser, head of pension law at Silverman Sherliker, the solicitors, said: "Sadly, many small employers, including charities, went into final salary schemes when they really should have been advised not to.

"These schemes are excellent, of course, but were never really suitable for small employers such as those with fewer than 100 staff. When times were good, no one thought much about deficits. More and more of these small companies and smaller charities will probably find themselves having to negotiate with the PPF in the coming years."