Which pension schemes are most suited for charities?

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Pension analysis: The demise of People Can highlights the difficulties many charities face in funding the defined benefit (DB) pension schemes they offer to employees. Jennie Kreser, partner at Silverman Sherliker, warns charities should avoid DB schemes and switch to regime based schemes instead.

Original news

Homeless charity's pension deficit pushes it into administration

A Liverpool-based homeless charity, People Can, has gone into administration because of pension deficits of an estimated £17 million.

What are the key problems associated with defined benefit schemes?

Generally speaking, DB schemes are 'balance of cost' schemes. This means employers have an open-ended obligation to pick up any shortfall in the funding--that is, the difference between the assets and the liabilities. The benefit is based on an arithmetical formula rather than a simple investment of monies (as defined contribution (DC) schemes are). Therefore, depending on a number of factors--eg how the assets are invested, the volatility of the markets, increasing life expectancy etc--funding can be adversely and significantly affected.

In effect the size of the pension scheme and in particular its deficit could become larger than the business of the employer. This is more prevalent in the charity sector, in which some charities may be running a very tight financial business model in order to keep admin costs to a minimum to ensure maximum benefits to the charitable causes they support.

Are charities at particular risk? How can other charities guard against a similar fate?

I wouldn't say charities are at particular risk per se, except that as non-trading/profit-making entities, their ability to meet the costs of increasing deficits is perhaps more limited.

Charities should avoid DB schemes and, if they have any still open, should consider closing for future accrual. They should monitor investment performance closely and take advice on other risk-reducing measures such as 'buying out' pensioner liabilities.

These other measures may come with an immediate short-term cost, but over the longer term may help to reduce the overall cost of running a pension scheme. Going forward, any new charitable foundation will be facing an auto-enrolment (AE) regime and should adopt an AE scheme. These will almost certainly be DC-based and, while providing a poorer level of pension provision, will allow the charity to control cost and risk.

How do pensions feature in the administration process?

Pensions are all too often something of an afterthought in the charity trustees' agenda when in fact they should be treated far more seriously, as pension fund liabilities can outweigh revenue from fundraising.

As mentioned above, charities are often run with limited overheads (especially smaller charities) and the often clumsy trusteeship set up of their administration does not lend itself to active management of issues outside the main charitable purposes. Again, this is particularly so with smaller charities that may only meet two or three times a year.

What will happen to the DB scheme and how will members be affected?

If eligible, the scheme will fall into the Pension Protection Fund (PPF) regime and members' benefits (called compensation in PPF parlance) will be cut back to the PPF levels. For most, this will mean a maximum of 90% of their accrued benefits, although those in receipt of their pensions will retain 100%. The process of PPF assessment can take over 12 months and this will remain a worrying time for scheme members. However, the situation is far better than it would have been in the past when members risked losing their entire pension.

What should charities and their advisers do next? What lessons should be learned from this case?

Charities should consider their current pension scheme situation carefully. Many outsourced from the public sector at a time when government requirements meant they had to set up mirror image schemes to the public sector's gold-plated and highly expensive schemes. They may not have been allowed to become 'admitted bodies' to the public sector scheme (although this comes with its own challenges). Nowadays, DC alternative arrangements are far more common. They allow costs to be controlled and pass risk generally onto the member rather than the employer charity.

Interviewed by Duncan Wood.

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