Storms ahead

David Ainsworth explains the increasing difficulties providing pension schemes have on charities

Do charities have a problem with pensions? Well, yes. For some, at least, pensions problems are serious enough to threaten the charity's very existence.

And the lion's share of the problems come from a single issue: the multi-employer defined benefit scheme.

Several thousand charities, for one reason or another, have found themselves with staff in a multi-employer scheme. Some charities joined a federated scheme. Others enrolled in custom schemes as a way of reducing costs or spreading risk. And perhaps most commonly, charities have found themselves involved in public-sector schemes – most often where they have taken on a local government contract, and been required to join the Local Government Pension Scheme (LGPS).

Multi-employer schemes share the problems of all DB schemes: a high-cost cocktail of falling interest rates, rising inflation and increasing life expectancy, which markets have not kept pace with – leaving most schemes with spiralling payments, and historical deficits.

For individual schemes, the answer is often to close to new members, or even to further accrual, institute a lower-risk defined contribution scheme, and pay down historical deficits.

But it's not so simple if you're in a multi-employer scheme, because you cannot choose by yourself to close the scheme, only withdraw from it.

If a charity wants to withdraw from a multi-employer scheme, they cannot manage down the deficit. Most often, they must pay it immediately.

What's worse is that payments made on this basis – known as a cessation or buyout debt, or a section 75 debt – are usually considerably higher than those identified on a continuance basis. Too high to pay, in many cases.

So charities in multi-employer schemes find themselves in a Catch 22 situation. They cannot easily afford to continue, and they cannot afford to leave.

Charities also know that the choice may one day be taken away. A charity can arrive at a cliff edge, where the last remaining member of staff wishes to retire. Apocryphal stories tell of charity workers left unable to retire without financially destroying the very organisation they have given their lives to.

Charities also face the issue of covenants. Charities in the same scheme may have vastly different financial positions from each other, and certainly from a state-backed entity. And a charity's true viability may not be fully reflected in actuarial calculations. The ability to persuade the public to give you donations, for example, appears nowhere on a balance sheet.

Two further wrinkles make the issue worse in some schemes. One is the problem of accounting equitably for workers who shuttle between employers but remain within the same pension scheme. In LGPS, when a worker transfers, so does their whole historical pension liability. Usually the worker also comes with a substantial payment intended to cover the preceding years. But that only covers any debt on a continuance basis, not a buyout basis. So if the worker leaves or retires, the charity can find itself with a shortfall.

The other is the 'last man standing' arrangement in some schemes, in which orphan debt from failed organisations transfers to the remaining employers.

An extreme example is the Wedgwood Museum, which participated in the Wedgwood Pottery scheme. When the various Wedgwood trading companies went bust in 2009, the charity discovered it was the last man standing. It inherited a debt of £134 million to add to its own rather modest £100,000 shortfall, and had to fundraise millions to save its pottery collection.

Measures are now afoot to try to address this unsustainable state of affairs. Last year the Department for Work and Pensions introduced the Deferred Debt Arrangement (DDA), which means that if a charity stops employing an active member in a scheme, they are no longer required to pay all the debt at once. LGPS schemes, which operate on slightly different rules, are developing similar regulations. In Scotland, legislation has been implemented. In England and Wales, a consultation closes at the end of this month.

DDA could be a great boon. However implementation is at the discretion of each scheme, and uptake so far has been modest.

Such arrangements will avail charities little, if schemes cannot be persuaded to use them.

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