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Employer Consultation Document



September 2011

Social Housing Pension Scheme



Administered by
The Pensions Trust

Employer Consultation Document



Introduction

This document contains important information on issues being considered by the Social Housing Pension Scheme (SHPS) Pensions Committee (the Committee) in conjunction with the 30 September 2011 triennial actuarial valuation. It provides information on possible further developments of the SHPS benefit structures.

It is recommended that you read the content of this document in advance of attending the Employer Forums scheduled for October/November 2011.

Against the backdrop of this review are wider pension issues, for example the ongoing debate concerning public sector pensions, continued longevity improvements and issues of funding and investment. In addition, all employers will need to address issues concerned with the auto-enrolment requirement stemming from the Work Place Pension Reforms which will be phased in from October 2012 onwards. All of these issues are set against the ongoing challenges that employers in the social housing sector currently face.

Scheme funding position

The funding position is formally assessed every three years and the Scheme Actuary is required to provide a 'roll forward' funding update every year. In addition, the Committee commissions a formal interim valuation mid way through the triennial valuation period.

The last triennial and interim funding position can be summarised as follows:

Date	30 September 2008	31 March 2010
Type of valuation	Triennial valuation	Interim valuation
Assets	£1,527m	£1,915m
Liabilities	£2,190m	£2,534m
Deficit	(£663m)	(£619m)
Technical provisions ongoing funding level	69.7%	76%

The next triennial valuation will be undertaken as at 30 September 2011. The triennial valuation assumptions will be based on financial markets at the valuation date and the outlook for future inflation, interest rates and mortality. The Committee will take professional advice when setting the assumptions. The triennial valuation results are expected to be available in Spring 2012 and will be communicated to participating employers in due course. We would expect that any changes to contributions will not be implemented until 1 April 2013.

Membership

SHPS has continued to experience overall membership growth. As at 31 March 2011 membership had grown to 61,648 members comprising 23,380 active contributing members, 27,154 deferred members and 11,114 pensioners.

As at 31 March 2011 the total market value of the assets was just under £2.2 billion.

Development of the SHPS benefit structures

It is worth recalling how the SHPS defined benefit (DB) structures have been developed in recent times, as well as the launch of the defined contribution (DC) structure. In summary:

	Pre 2007	Added from April 2007	Added from April 2010	Added from October 2010
Benefit	FS 1/60th	FS 1/70th CARE 1/60th	FS 1/80th CARE 1/80th	Defined contribution
Overall employer/ member contribution split	Fixed by SHPS	Determined by employer, subject to employer paying 50% of cost	50% employer requirement relaxed	3% minimum employer contribution
	Age related	Flat rate or age related		3% minimum member contribution

Key: FS = Final Salary

CARE = Career Averaged Revalued Earnings

The increased range of options and flexibility has been developed following consultation with and feedback from participating employers. We believe it has given greater flexibility to employers to help them manage their pension budget and assist them in managing their longer-term pension liabilities.

Benefit considerations

One of the outcomes of the last benefit review was that the Committee agreed to consider a 'Wish List' of feedback received from organisations. This has been considered as detailed below.

More recently we also agreed to consult employers on the decision taken in February 2011 not to amend the rules to retain Retail Prices Index (RPI) as the measure for increasing pensions in payment. As a result of this decision, Consumer Prices Index (CPI) has applied since April 2011. We undertook this consultation via the letter dated 27 May 2011 circulated to all employers. We received very little feedback regarding the prospect of augmenting benefits to reinstate the link with RPI for increases to pensions in payment. We have therefore concluded that the decision should not be revisited.

Possible future changes to the SHPS benefit structures

The Committee has considered the previous 'Wish List' feedback along with other proposals resulting from more recent developments. The considerations in the remainder of this document can be grouped into four sections:

Section 1 – Possible changes to the benefits provided by the Scheme that the Committee would like to receive employer feedback on (proposals 1 to 4 inclusive).

Section 2 – Possible changes that the Committee has considered and decided to discount **but** may decide to revisit in light of the actuarial valuation results due to be received during Spring 2012 (proposals 5 to 7 inclusive).

Section 3 – Possible change that the Committee has considered but decided to discount unless an overwhelming number of employers request the Committee to reconsider (proposal 8).

Section 4 – Some changes we intend to implement, probably from April 2013 (proposals 9 and 10).

At this point it is worth stressing that any definitive decisions will not be taken until consultation with employers is complete and the Committee has agreed the results of the 30 September 2011 actuarial valuation.

Section 1 – Possible changes the Committee would like to receive feedback on

Proposal 1 – CARE 120ths benefit structure

Whilst SHPS now offers a range of benefit structures we have been asked to consider the possibility of introducing a further CARE structure – possibly at the 120ths accrual level. If this structure was introduced it would retain the same ancillary benefits (i.e. survivors'/children's benefits, revaluation in deferment etc) associated with the other CARE DB structures.

The joint future service rate for such a benefit is expected to be around 10%.

A CARE 120ths benefit structure would not be contracted-out of the State Second Pension (S2P) and therefore members and employers would pay higher National Insurance Contributions, as they do for the DC structure.

The overall risk of providing such a level of defined benefit would be reduced for future service compared to the liabilities emerging from the current DB structures that SHPS provides. However, employers would still bear the same types of DB funding risks and, if they were to cease participation in SHPS, the same Section 75 withdrawal risk. Like the other SHPS DB structures, from a member's point of view it would not be necessary to buy an annuity at retirement as, unlike the DC structure, pensions would be paid by SHPS rather than bought from an insurance company. Consequently, a lower accrual CARE benefit structure may provide better value for money for members than the equivalent contributions would provide in the DC structure. In addition, introducing a lower accrual CARE benefit structure as an alternative to the DC structure means that the investment risk is not transferred to members.

Employers that have already taken the decision to adopt the DC structure may not wish to consider another DB structure. However, for employers keen to continue to offer a less costly DB scheme, CARE 120ths would also provide a qualifying scheme for auto-enrolment purposes.

We would be interested to hear the views of employers on the possibility of introducing a further DB lower accrual structure. We would also be interested to hear whether employers would be prepared to introduce this structure for auto-enrolment purposes. Please respond via the enclosed Employer Feedback Questionnaire.

Proposal 2 – More than one 'open' DB structure

At the moment an employer can only offer new recruits one 'open' DB structure for SHPS membership. In the past some employers have expressed an interest in offering more than one DB structure.

Extending the number of 'open' options an employer can offer its new recruits would give an employer greater flexibility to tailor its HR benefits package. It would also give members more flexibility, for example as they earn more to pay more in return for increased benefits. This could be attractive to younger staff or employees who progress through the organisation as they have more disposable income.

If SHPS were to permit further DB options there would need to be the expectation that the employer would offer **all** its 'open' DB structures to all members and prospective members, rather than just selected groups. This would be necessary in order to limit selection issues against SHPS (i.e. only the higher paid and older staff being offered the opportunity to join the higher accrual structures).

Having too many options could prove onerous from the HR perspective. If many employees choose a higher-cost option an employer could find its long-term liabilities increasing further than expected.

We would be interested to hear whether:

- a) the current one 'open' DB restriction gives employers any difficulty; and**
- b) employers would wish to be able to offer more than one 'open' DB structure.**

Please respond via the enclosed Employer Feedback Questionnaire.

Proposal 3 – Changing the index used to revalue deferred benefits and the CARE benefit

At the moment RPI is used to revalue deferred benefits, and accrued CARE benefits. It would be possible to base increases for future service on CPI rather than RPI.

As already highlighted, since April 2011, pensions in payment under SHPS have been linked to CPI, rather than RPI.

Adopting CPI as the index for revaluation is likely to reduce liabilities and costs over the long-term, given that CPI has historically been less than RPI. This change will have the effect of reducing the future service cost. Any immediate savings in costs will need to be weighed against the likely longer-term impact on members' benefits.

On a cautionary note, it is possible that the composition of CPI might be changed in the future to include elements of housing costs that are not included at the moment; this would reduce any savings that CPI might bring.

Adopting CPI would be equitable to all members as all future benefits would be increased using the same index. Adopting CPI would, however, be a change to the CARE benefit model and would probably lead to lower benefits being provided.

We would be interested to hear whether employers (who would need to consult with their staff over such a change) would support changing the index used for revaluing future benefits from RPI to CPI. Please respond via the enclosed Employer Feedback Questionnaire.

Proposal 4 – Implementation of a minimum employer DB contribution rate

Since April 2010 employers have been fully able to set the contribution rate for their employees. Historically, employers typically paid 2/3rds of the overall costs of providing SHPS DB benefits.

Some organisations have taken steps to increase member contribution rates to such an extent that the member is now paying a greater proportion of the overall cost than the employer. We believe this approach will deter lower paid staff from joining and will increasingly result in only higher paid staff being willing to pay these higher member contribution rates.

Traditionally SHPS has benefited from the inflow of younger staff. To combat possible selection issues there could be an argument for introducing a minimum employer contribution rate. This would ensure that the employer continues to pay an appropriate share of the overall cost so that the SHPS DB structures remain attractive to staff.

We would be interested to hear employers' views on reinstating a minimum employer contribution rate. Please respond via the enclosed Employer Feedback Questionnaire.

Section 2 – Possible changes the Committee has considered and decided to discount at this stage **but may revisit once the 30 September 2011 actuarial valuation results have been received.**

Proposal 5 – Rates of pension increase

Currently pensions in payment increase annually up to the maximum of 5% per annum. Since April 2005, legislation has provided that pension schemes can limit increases to 2.5%. When the change in legislation was introduced the UK was experiencing lower rates of inflation than now.

Changing the future pension increase rate would reduce future liabilities and costs, as pensions built up after this change would be subject to lower expected increases. Past service would retain the 5% limit.

Proposal 6 – Reducing the rate of revaluation of future deferred and CARE benefits

Since April 2009 legislation has provided that increases to pensions in deferment (and the revaluation of CARE benefits for active members) can be reduced from a maximum of 5% p.a. to 2.5% p.a. (Please note: The Scheme rules currently link the increases to RPI.)

Any change to the basis could only apply in respect of the future accrual of benefits only. Past service benefits would retain the 5% limit. Any change would reduce future costs and limit liabilities.

Any immediate savings in costs will need to be weighed against the likely longer-term impact on members' benefits. Adopting the lower maximum of 2.5% would reduce member benefits and arguably undermine the whole CARE concept where revaluation is a key determinant in the overall Scheme design and emerging benefit.

It is reasonable to assume that some members will have opted to join the CARE structure or switched from a final salary structure in the knowledge that the 5% limit applied. Any reduction in the rate of revaluation will be seen as a material detriment, particularly in view of current higher rates of inflation.

Proposal 7 – Increasing the Normal Retirement Age (NRA)

The current SHPS NRA is age 65. Prior to 2002 the NRA was also age 65 but members could retire from age 60 with no actuarial reduction to any of their benefits. Now, any member with pre 2002 benefits can retire on or after age 60 with no actuarial reduction to their pre 2002 benefits.

With ongoing improvements in life expectancy the Government plans to link NRA under public sector pensions to changes in the State Pension Age (SPA). This raises the question whether we should look to increase the NRA for SHPS as this will reduce the cost of providing future service DB benefits as pensions will be paid for a shorter period.

Current legal advice confirms that it is not possible to link a member's NRA to their SPA. However, this is expected to change to facilitate public sector pension reforms. It would however, be possible to increase NRA generally under SHPS to say 66, 67 or 68. It would only be possible to apply this in respect of future service and members would have to retain the right to take their earlier NRA benefits without actuarial reduction.

Apart from the public sector there appears to be currently no real trend of pension schemes increasing their NRA for future service. This might simply reflect the fact that there are now only a limited number of DB schemes providing future accrual of benefits.

Given the requirement to protect existing benefits, changing the NRA is likely to be more of an issue for younger members.

Please note: NRA is not an issue for the DC structure as each member selects their own retirement date.

The Committee does not intend to take any of the proposals in Section 2 (which would require you to consult with staff) forward at this stage. However, once the initial results of the triennial valuation are known, the Committee may revisit these points and then seek your views on whether these issues should be considered further. Any feedback you wish to provide in the meantime will be considered.

Section 3 – Possible change considered by the Committee but discounted at this stage

Proposal 8 – Introduction of a Government Actuary's Department (GAD) certified Local Government Pension Scheme (LGPS)-comparable structure

A small number of organisations have raised the idea of SHPS developing a structure that would qualify as a GAD certified structure. This potentially could be used by those organisations that have a requirement to provide benefits broadly equivalent to the public sector when public sector staff are compulsorily transferred to non-public sector employers. For example, if SHPS had a GAD structure it could avoid an employer potentially having to seek admitted body status to the LGPS.

The Committee has considered the idea of developing a GAD structure but, given the great uncertainty about the future of the LGPS and the current 'Fair Deal' provisions following the publication of the Hutton Report into public sector pensions, the Committee has decided to discount the idea of developing a GAD type structure at this point.

When further clarity around this issue emerges, and provided there is significant support from employers, the Committee may reconsider this idea at some point in the future.

Section 4 – Changes we intend to implement, probably from April 2013

Proposal 9 – Maternity leave

Under SHPS DB structures no contributions are paid by either the member or the employer during the first 26 weeks of maternity leave but full benefit accrual is maintained based on pre-maternity leave earnings levels. This is a generous provision compared to most UK schemes and harks back to when maternity leave periods were not as generous as they are now. The overall cost of DB maternity provision is met by SHPS as a whole. This essentially means employers that experience high levels of maternity leave are subsidised by those that experience low levels of maternity leave.

The DC structure requires that during paid maternity leave, the member pays contributions based on the earnings she actually receives and the employer pays the balance so that the total contributions paid are based on pre-maternity leave earnings rather than the earnings actually received.

Bringing the DB and DC maternity leave provisions into line will simplify scheme administration and all maternity leave members and employers will be treated equally.

We intend that the DB maternity leave provisions will be brought into line with the DC provisions for all periods of maternity leave commencing on or after 1 April 2013.

Proposal 10 – DC structure – Extension of fund options

When the DC structure was launched, from October 2010, a range of eight fund options, one of which is a 'Socially Responsible Investment' fund, were offered. The Pensions Trust has recently launched a further ethical fund known as the Diversified Ethical Fund following a survey of the UK charity sector. The new fund invests across a range of asset classes including a mix of UK and overseas equities as well as UK and overseas bonds and gilts, selecting securities on a screened basis with the ultimate aim of: investing in companies that make a positive contribution to society; using influence as an investor to encourage best practice management of social and responsibility issues; and avoiding investing in companies that are harmful.

The Committee has the opportunity to incorporate the new Diversified Ethical Fund within the range of SHPS DC fund options.

We intend to add the Diversified Ethical Fund to the range of SHPS DC fund options from 1 April 2013.

Requirement to consult with employees

Employers will be aware that the Pensions Act 2004 imposes an obligation on employers to consult with staff on specified proposals to change their pension scheme.

Changes to the maximum rate of pension increase, the rate of revaluation increases, the index used for revaluation and a change to the NRA are all examples of issues that will require employers to consult with members and prospective members. We will provide guidance regarding the formal consultation requirements in the next round of consultation materials issued to employers.

Adjusting ancillary benefits such as the rate of pension increase and the rate or method of revaluing benefits could be regarded as 'tinkering around the edges' from a cost and risk perspective. As SHPS already provides a range of cost and benefit structures, as well as the ability to set the rate that members contribute, employers may deem it more appropriate to introduce one of the existing lower cost alternatives, or support the introduction of the lower rate CARE 120ths structure described above; both of which also require consultation with members, rather than adjust the ancillary benefits. Avoiding changes to the ancillary benefits would have the advantage of preserving the main elements of the current benefit structure. It would also avoid additional administration complexities, for example, having different rates of revaluation or pension increases for different periods of SHPS service.

We would be interested to receive feedback from employers on the requirements to consult with staff over changes to SHPS and what experiences can be learned from previous exercises. Please respond via the enclosed Employer Feedback Questionnaire.

Next steps

The Committee's role in this review is twofold; to act as a conduit for employers' views as to the future of SHPS, and to keep members informed about developments relating to this review once any decisions have been made.

The enclosed questionnaire is available for employers to express their initial responses and we would welcome any other written feedback from employers. The completed questionnaire, and any other feedback received as a result of this consultation, is not a binding agreement on any employer. It will, together with other feedback received from the forthcoming Employer Forums, provide the Committee with some insight into employers' current thinking in relation to the future of SHPS and the issues they face.

We believe it is very important that your organisation is represented at the forthcoming Employer Forums in October/November 2011 to which employers have already been invited.

Any queries on the content of this document or the enclosed questionnaire should in the first instance be directed to the Customer Relations Team at The Pensions Trust on Tel: 0113 394 2501.

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