

Briefing

The Social Housing Pension Scheme – key issues and considerations for housing associations

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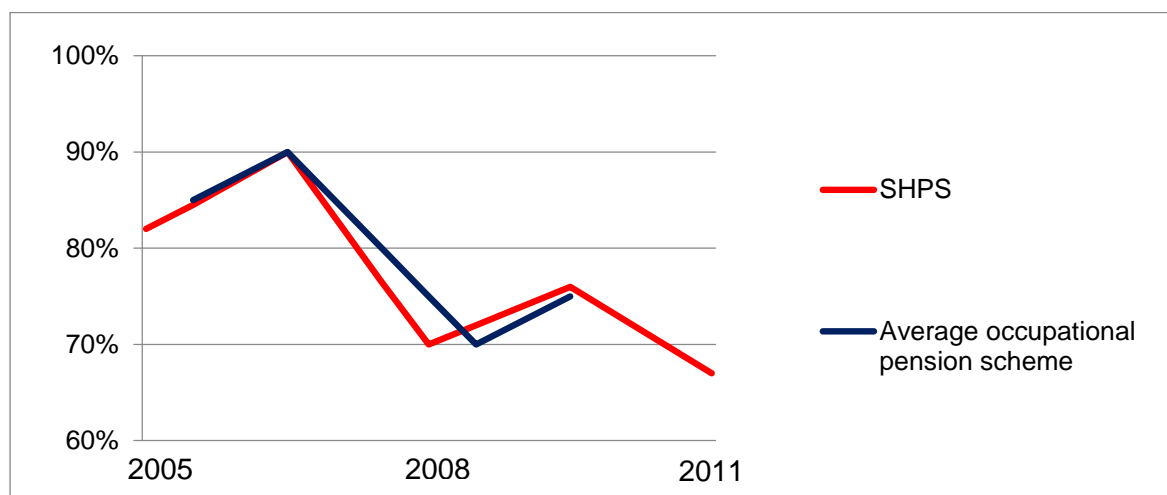
1.0 Introduction

1.1 This short paper covers the Social Housing Pension Scheme (SHPS) and sets out:

- the funding of SHPS, including a brief explanation of the deterioration of the funding position
- a comparison with other defined benefit pension schemes that are seen in the social housing sector and beyond and
- some issues that participating employers should consider.

2.0 SHPS funding position

2.1 The chart below shows how the funding level in SHPS has changed compared to defined benefit pension schemes as a whole, based on available information. It can be seen that both funding levels have moved in very similar ways.



2.2 The deterioration since 2008 has been caused by low asset growth, and a fall in government bond yields which has led to a higher assessment of the liabilities.

2.3 The factors above have affected all defined benefit pension schemes, and SHPS is not alone in reporting the deterioration of its funding position over the past few years.

2.4 The assumptions adopted by the Scheme Actuary were broadly in line with the assumptions one would expect to see for a defined benefit pension scheme with a reasonably strong employer.

2.5 However, market conditions have continued to deteriorate since September 2011 and therefore an increase in the deficit at the 2014 valuation is likely if markets remain as they are currently, despite the deficit contributions paid since.

3.0 Contribution requirements

- 3.1 The method of allocating the deficit was changed for the 2011 valuation and is a move away from the “multi-employer” approach to that adopted for a stand-alone scheme.
- 3.2 However, the decision to adopt this methodology will have created “winners” and “losers”, and some employers will have seen a disproportionate increase in required payments.
- 3.3 The period of the Recovery Plans for the past three valuations is 15 years. This compares with an average recovery plan in defined benefit pension schemes of 8 years⁽¹⁾, therefore deficit contributions within SHPS are comparably lower.
- 3.4 The table below illustrates the total future service costs for SHPS and the average occupational pension scheme in 2011:

Comparison of 2011 future service costs (employer plus employee)		
Benefit option	SHPS	Average occupational pension scheme ⁽²⁾
Average Final Salary	15.7% p.a.	19.2% p.a.
Average CARE	13.4% p.a.	16.9% p.a.

- 3.5 Total future service contributions have also increased due to the deterioration in market conditions. The total cost now varies by benefit tier but range from 14.0% p.a. (80th CARE) to 19.4% p.a. (60th Final Salary).
- 3.6 SHPS has also introduced a 120th CARE option for future service, with a total future service contribution rate of 9.7% p.a., reflecting the lower level of benefit payable.
- 3.7 The level of employee contributions can be chosen by employers. Average employee contributions in the private sector equalled 4.9% of payroll in 2011⁽²⁾.
- 3.8 In addition, SHPS has already announced that future service contributions for Final Salary sections are likely to increase in 2016 as a result of the increase in the earnings growth assumption in 3 years time.

Sources:

- (1) The Pensions Regulator's Orange Book (June 2012)
(2) ONS Occupational Pension Schemes Survey 2011

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	SHPS	LGPS	Typical single employer occupational DB pension scheme
Benefit structure	Benefit options, including Final Salary, CARE and DC option. DB eligibility dependent on risk assessment of employer	Currently 1/60ths Final Salary benefit, but changing to 1/49 th CARE from 1 April 2014. 50% benefit and contribution option to be made available	Typically one type of benefit (e.g. 1/80ths CARE) in relation to future service
Investment	Assets of the scheme are managed in aggregate. Individual employers are not actively engaged in investment decisions	Assets of the scheme are managed in aggregate. Individual employers are not actively engaged in investment decisions	Trustees responsible for investment strategy, taking into account risk assessment of employer and usually seeking employer input into any decisions
Employer cost – past service	Communicated to employers without negotiation – 15 year recovery plan with annual increases between 3% and 4.7%	Communicated to employers without input but with scope for negotiation. Recovery periods depend on type of employer	Depends on affordability to the employer. Recovery periods average 8 years and non-cash alternatives are becoming increasingly used
Employer cost – future service	Communicated to employers without negotiation – total (employer + employee) annual cost of 1/60 th Final Salary benefit is 19.4% of pensionable earnings	Communicated to employers without negotiation. Annual cost is typically 14-19% of pensionable earnings	Employer and Trustees engage in negotiations at triennial actuarial valuations to agree
Employee cost	Employers have flexibility in how future service costs are shared between employer and employee	Fixed salary-related contributions with no employer flexibility	Employees pay contributions as prescribed under Trust Deed and Rules. Usually a fixed percentage of pay
Administration and associated costs	Costs shared among all participating employers (0.9% p.a. of pensionable payroll at the 2011 valuation)	Administered locally through regional pension funds and costs shared among all participating employers in each LGPS (typically 0.5% p.a. of pensionable payroll)	Costs met by employer with no sharing (either directly or through the scheme) - typically 3-5% p.a. ⁽¹⁾ of pensionable payroll)
Departicipation cost	Linked to the cost of buying out benefits with an insurance company and payable immediately on the last active member leaving. Not triggered if DC actives remain	Broadly equivalent to the cost of buying out benefits with an insurance company and payable immediately on the last active member leaving. Alternative payment approaches are starting to be seen	Linked to the cost of buying out benefits with an insurance company on the last active member leaving, but with specific mitigation options available
Closed employer loading	2.5% p.a. employer loading to reflect increasing age of existing members over time	Increase in contributions to reflect increasing age of existing members over time	Dependent on negotiations between employer and trustees

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4.0 Other issues

- 4.1 As SHPS is a multi-employer scheme, the administrative expenses payable by each participant are relatively low compared to those payable for a typical private sector occupational defined benefit pension scheme.
- 4.2 SHPS provides regular advice and updates to its participating employers and employees.
- 4.3 It is a “last man standing” scheme, which means that if any participating employer fails to honour its commitment to fund the benefits it has built up, then the outstanding cost will be borne by the remaining participants.
- 4.4 SHPS is unusual in that it offers employers the choice of a range of future DB benefit options that members can receive and contributions that they pay. This gives employers some level of flexibility as to the costs they incur.
- 4.5 However, in order to reduce the amount of administration required the individual participants in the scheme have no control over the assumptions adopted for the valuation, the terms over which any deficit is repaid and the investment strategy of the scheme. This is true for most industry-wide pension arrangements.
- 4.6 For those employers that have closed the SHPS defined benefit (DB) structure to new entrants (or operate alternative open pension arrangements alongside SHPS), a closed employer loading is payable. From 1 April 2013, the current 3% p.a. loading will be reduced to 2.5% p.a. and the 1.5% p.a. “reduced employer loading” will be removed. This will lead to a net increase in the employer DB contribution of 1% p.a. for employers who have a closed DB scheme but have active members in the SHPS DC section.
- 4.7 In the private sector, membership of DB private sector pension schemes (Final Salary and CARE) has fallen considerably, with an increase from 9% of pension schemes closed to future accrual in 2003, to 37% in 2011⁽¹⁾. In the housing sector, the majority of employees still have access to defined benefit pension arrangements.

5.0 What should a SHPS participating employer be considering?

- 5.1 An Employer Form of Authority must be sent to the Pensions Trust by 31 January 2013 if you wish to change your future pension provision under SHPS. This should be based on considerations regarding:
 - the affordability of each option
 - the contractual obligations of your employee
 - consultation with employees in advance of the 31 January deadline if changes are being made to benefits and / or contributions with effect from 1 April 2013
 - the overall remuneration package of your employees

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- the impact on recruitment, retention and staff expectations
- alternative pension offerings and trends in the sector
- the deparicipation debts payable if active membership is ceased in both DB and DC sections
- the obligations under the up-coming auto enrolment regulations
- the annual allowance and lifetime tax implications for senior employees and
- whether SHPS's financial risk assessment allows you to provide defined benefit pensions going forward.

5.2 The National Housing Federation and KPMG are working together in relation to pensions provision and will continue to keep participants informed of changes in pensions provision in the sector.