XPS Pensions

Briefing

October 2018

Social Housing Pension Scheme (SHPS) valuation results – the wait is over

In brief

- As at 30 September 2017, SHPS was 75% funded with a deficit of over £1.5bn
- Deficit reduction contributions have been restructured; there are immediate winners and losers in the first year, with new contributions falling due from 1 April 2019
- There are to be no changes to benefits from April 2019
- From 1 July 2019 future service costs are increasing by about a third

Next steps

- Employers with exposure to SHPS should review their overall benefit strategy in light of these increased costs
- Employee consultation will be needed in relation to any proposed benefit or contribution changes and will need to be completed ideally by mid-April 2019

SHPS has recently written to participating employers to provide results of the 30 September 2017 valuation, a little over a year after the effective date of the valuation. As trailed, we have seen a bigger deficit reported and a material increase to future service costs, and a revised approach to meeting the larger deficit. This note summarises these results and also considers some options available to employers in respect of future pension provision and employee contributions.

2017 valuation results – past service

The 2014 valuation disclosed a deficit of around £1.3bn and a funding level of 70%. Despite contributions towards the deficit of £350m over the last three years (after allowing for expenses and benefits accrued), employers had been warned that the likely outcome of the valuation was a higher deficit and the results of the 2017 valuation have indeed revealed an increased deficit of £1.5bn. The funding level of 75% is lower than the 79% which was expected had SHPS's experience since 2014 been in line with the assumptions made then. Asset returns have outperformed expectations, but changes in investment markets (primarily gilt yields) mean that they did not keep pace with the increase in liabilities.

	2014 Valuation (£m)	2017 Valuation (£m)
Assets	3,123	4,553
Liabilities	4,446	6,075
Deficit	-1,323	-1,522
Funding level	**70%**	**75%**

SHPS has confirmed the proposed changes to setting deficit reduction contributions so that they are based on each employer's share of the total liabilities. This has been facilitated by its work to attribute assets to each employer so that they can make a full defined benefit (DB) disclosure under FRS102 from 31 March 2019.

There has also been a long-standing understanding that there are winners and losers in SHPS. This started as a result of the approach adopted at the 2005 and 2008 actuarial valuations, when deficit contributions were set by reference to a proportion of payroll. Unsurprisingly, as a result of the 2017 changes there are again winners and losers. However, with a higher deficit being recovered with 2% increases over the period to 2026, it is likely that most employers will see a substantial increase in deficit contributions over this period as a whole.

Revised deficit contributions come into force from 1 April 2019.

Cost of new benefits accruing

SHPS had previously made it known that it was not looking to change benefits at the 2017 valuation and had indicated a likely increase of 30-50% to the total future service cost for each benefit tranche.

What we now know is that contributions are to increase by about a third. The impact on the total cost for each DB section is set out below.

Benefit	60ths final salary	70ths final salary	80ths final salary	60ths CARE	80ths CARE	120th CARE
Existing rate	20.6%	17.7%	15.5%	16.7%	12.6%	8.6%
New 1 July 2019 rate	**27.2%**	**23.4%**	**20.5%**	**22.1%**	**16.7%**	**11.3%**

This means that employers will be considering how to share the increase with members. Those employers that have capped their pension contribution are therefore likely to be passing some or all of this cost on to members, asking them to effectively pay up to an extra 6.6% of salary to keep their pension offering unchanged from 1 July 2019.

Inevitably this may not be affordable to many members, who may well look to either a lower value DB option or the defined contribution (DC) option, in order to protect their take-home pay. Some employers currently offering benefits based on 60ths accrual may note that the revised rate for 80ths is almost identical.

These figures all assume employers have an open SHPS DB section. For employers where this is not the case SHPS has confirmed that the 'closed scheme surcharge' will reduce from the current level of 2.5% of salaries to 1.1%.

SHPS has also slightly increased the fixed administration fees per employer and per DB member.

What do Housing Associations plan to do?

Earlier this year we carried out a survey that asked how Housing Associations might deal with the anticipated increases in costs once the SHPS 2017 valuations results were published.

Full details can be found here:
https://www.xpsgroup.com/media/1249/xps-pensions_housing-report_june-2018.pdf

Our key findings were that:

- **55%** of respondents did not have a policy in place for how they will meet this increase.
- Of those with a policy, around **a third** stated that any cost increase would be met by employees in full. For Final Salary 60ths, this would require employees to pay an extra 6.6% of salary. Other employers will have to bear some or all of the cost increases, and will have to consider whether the cost increases are affordable for them and/or their employees.
- Only **3%** said that they would **definitely not** be reviewing their SHPS pension offering once the results were published. **Over half** of respondents said they would consider closing some or all of their DB section(s) to future accrual. Now that the results have been published there will be a lot of activity at board level over the coming months as employers consider what action, if any, they need to take by 30 April 2019.

Actions required

Employers should review their overall benefit strategy in light of these increased costs (both for new benefits and, for many, higher deficit contributions). Many will not find it possible to increase member contributions yet further. Providing a lower level of pension could be considered, e.g. moving to CARE benefits instead of Final Salary benefits or reducing the accrual rate instead.

Providing DC pensions for new employees is becoming increasingly common, as is ceasing DB accrual for all employees. In the case of the latter, care is needed not to trigger a 'section 75' debt, although in most cases this is easy to avoid, either via the use of SHPS DC for future accrual, or the new option of a deferred debt arrangement (talk to us or see our briefing note on this subject). In reviewing their pension strategy, employers will not just be looking at immediate costs, but also the risk of further cost increases at subsequent valuations.

How can XPS Pensions help you?

XPS's specialist housing team has vast experience of working with employers to identify and implement the optimal pension strategy for your own circumstances.

For further information

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