

PRIVATE AND CONFIDENTIAL

Date:

Employer
Number::

Dear

Social Housing Pension Scheme (SHPS) 30 September 2014 Triennial Actuarial Valuation and Benefits Review

I am now in a position to provide high level details of the provisional SHPS valuation results following consideration by the SHPS Pensions Committee (the Committee) at its meeting on 10 March 2015. This letter forms the first of two communications you can expect to receive in the coming months. This first letter sets out:

- the valuation results for service accrued to 30 September 2014;
- the proposed changes (following feedback from employers) to the Defined Benefit (DB) structure from 1 April 2016, which may require you to consult with your employees;
- the required future service costs from 1 April 2016 taking account of the proposed changes; and
- some other issues for you to consider.

We expect to issue a second communication in July providing further details for your organisation to consider.

Section 1 – Provisional Valuation results: service accrued to 30 September 2014

As we highlighted at the Employer Forums held last autumn, the triennial valuation has again been undertaken against a challenging backdrop for DB pension schemes like SHPS. At the Employer Forums the Scheme Actuary estimated that the SHPS deficit had increased from £1,035 million to approximately £1,380 million (with a typical tolerance of +/-£130 million) pending a detailed review of the latest SHPS member data.

I can confirm following the detailed review of data the actual deficit as at 30 September 2014 is confirmed as £1,323 million, (which is in the range highlighted by the Scheme Actuary at the Employer Forums).

Whilst SHPS has benefited from investment outperformance (compared to the assumptions made at the 2011 valuation) the liabilities have increased more significantly, largely driven by the continued fall in long-term interest rates which form the basis of the discount rates used to value the liabilities. The lower discount rate environment means that pensions payable in the future (the liabilities) are given a higher value today, resulting in a widening gap between the Scheme's assets and liabilities. In summary, the investment returns achieved and contributions paid have not been sufficient to keep pace with the increase in the liabilities.

The key headline provisional valuation results are:

Valuation	2011 (£m)	2014 (£m)	%change
Assets	2,062	3,123	+51%
Liabilities	3,097	4,446	+44%
(Deficit)	(1,035)	(1,323)	
Funding Level	67%	70%	+3% (net change)

The existing deficit contribution basis will remain in place and it will be necessary to increase deficit contributions, from 1 April 2016, to deal with the newly emerging deficit. The new deficit contributions will be allocated to employers on a 'share of liability' basis, consistent with the basis set at the 2011 valuation.

The additional SHPS deficit contributions, as a whole, amount to £31.69m p.a. These additional contributions will increase at 3% annually and will be payable for a period of 10.5 years. This reduced recovery period means that the final date for deficit payments is capped at 2026.

The Scheme Actuary is currently finalising the valuation, including calculating each employer's share of the additional deficit contributions. We anticipate being able to provide further details of the valuation results, including analysis of the change in the position over the last three years, and your organisation's deficit contribution requirements from 1 April 2016, with our next communication, in July.

Section 2 – Future service defined benefit structures from 1 April 2016

Over the last few months the Committee has consulted employers on proposals to amend the future benefit structure of SHPS, in respect of service from 1 April 2016, with the objective of trying to develop a range of affordable DB benefit options whilst also recognising trends in life expectancy. Further details of the consultation responses will be provided in the next communication.

The Committee has now reviewed the positive feedback received from participating employers and proposes to amend the SHPS benefits structure in respect of service from 1 April 2016, as follows:

From 1 April 2016:

- to increase the Normal Retirement Age (NRA) to age 67; and
- to apply a lower cap of 2.5% (instead of the current cap of 5%) to the revaluation of members' benefits prior to retirement and increases to pensions in payment.

It is important to note that the above changes will **only** impact service from 1 April 2016. Benefits accrued prior to 1 April 2016 will continue to be provided on the existing basis.

Whilst the SHPS Committee is seeking to implement these changes based on the feedback received from employers, it may be necessary for you as a participating employer to formally consult with your employees over the proposed changes, in addition to any plan your organisation has to require members to bear additional contributions.

Section 3 – Valuation results: future service defined benefit costs from 1 April 2016

Taking account of the above changes in Section 2, the Scheme Actuary calculates the revised future service costs (with the existing basis shown for comparison) will be as follows from 1 April 2016. Please note that all figures exclude the allowance for scheme expenses (including Pension Protection Fund levies) for ease of comparison – see below for more information

Benefit	60ths final salary	70ths final salary	80ths final salary	60ths CARE	80ths CARE	120ths CARE
Existing rates (excluding scheme expenses of 0.9%)	18.5%	16.0%	13.9%	17.2%	13.1%	8.8%
Equivalent 2014 rates assuming no changes to benefits (excluding scheme expenses)	23.7%	20.4%	17.9%	20.8%	15.7%	10.6%
net change	+5.2%	+4.4%	+4.0%	+3.6%	+2.6%	+1.8%
New 2014 rates taking account of benefit changes (excluding scheme expenses)	20.6%	17.7%	15.5%	16.7%	12.6%	8.6%
net change	+2.1%	+1.7%	+1.6%	-0.5%	-0.5%	-0.2%

Scheme expenses

Currently for employers with active DB members an expense allowance of 0.9% of salary roll is collected as part of the future service rate (in addition to the 'existing rates' shown above). Where a DB employer adopts the Defined Contribution (DC) structure for all its DB members a fixed £ amount expense charge is payable based on the employer's DB payroll at the point of change to the DC structure.

The Committee has considered different ways of allocating scheme expenses based on the changing profile of the SHPS membership. I can confirm that (from April 2016) scheme expenses will be allocated across all participating employers with a SHPS DB liability in line with each employer's number of overall DB members. Please note this is all DB members, not just active members. It is felt that this is a fairer way of allocating expenses going forward. Details will be confirmed in our next communication.

Closed employer surcharge

Where an employer has closed all the SHPS DB structures to new entrants a 2.5% 'closed employer surcharge' is currently payable, in addition to the existing future service DB contributions, to reflect the ageing membership profile of the closed group. The 2.5% rate has been reviewed by the Scheme Actuary and whilst a small increase has been proposed, I can confirm that the same rate will continue to apply from 1 April 2016.

Section 4 – Other considerations

Accelerated deficit contributions

In response to feedback from participating employers I can confirm that the Committee has agreed to facilitate the payment of advanced deficit repair contributions from April 2016, if not before. The basis, which we believe will be welcomed by some employers, will be confirmed in due course.

Cessation of contracting out

As you are probably aware, the option to contract out of the state second pension system is coming to an end from April 2016. As a result the current national insurance saving that both employers and members receive as members of the DB sections (except the 120th section which is not contracted out) will cease to apply. Consequently, you may need to take account of this statutory change when assessing your future plans. The current national insurance savings are:

National insurance reduction	Employer rate	Member rate
* Reduction on earnings between the lower earnings level (£5,824 2015/16) and the upper accrual point (£40,040)	3.4%*	1.4%*

Consultation with employees

The change in NRA and the reduction in the cap to 2.5% on future revaluation and pension increases, together with any increase in member contributions you implement, will be regarded as a 'listed change' per the Occupational and Personal Pension Scheme (Consultation by Employers and Miscellaneous Amendment) Regulations 2006. You may therefore have a statutory obligation to consult with your employees, as well as any obligation under any internal procedures or governance arrangements. We will provide further detail and support in our next communication.

Next steps

The Committee is mindful of the likely issues and challenges that employers will face over the coming months as they consider their response to the valuation results.

We will in due course provide a detailed guidance document which will provide more information on the valuation results and both the revised past service deficit and future service costs requirements. Feedback on the proposed benefit review changes will also be provided. The document will help you in your discussions with Boards and members alike. We anticipate that the guidance document will be available by the end of July 2015, together with confirmation of the increased deficit contribution requirements.

Further information

If you require any further information at this stage, please do not hesitate to contact Gary Bradley, SHPS Scheme Manager at The Pensions Trust on 0113 394 2723 or via email at: gary.bradley@thepensionstrust.org.uk.

Finally, may I take the opportunity to thank you for participating in the Employer Forums and for your helpful feedback in relation to the proposed SHPS changes; this has helped the Committee formulate its response to the valuation results.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Colin Small', is written over a light blue rectangular background.

Colin Small
Chair, SHPS Pensions Committee