SHAPS Committee Update

January 2017

Welcome to the SHAPS Committee Update. This is a summary of some key items discussed at our meeting on 8 December 2016. You can find extracts of our previous Committee meeting minutes here.

The Committee welcomes your feedback on this update and how we communicate in general. Please let us know your thoughts by emailing shaps@tpt.org.uk.

This edition covers:

- Committee news
- April 2017 changes to contributions
- Changes to the Investment Strategy
- Investment Performance
- 30 September 2016 Funding Update
- Employer Forums – 19/20 April 2017
- Results of the 2016 Financial Assessment
- A review of the Scheme's Retirement Age
- Accounting
- Employer engagement

Committee news

Fiona Nicholl, Ochil View Housing Association retired from the Pensions Committee in December 2016. The Committee wishes to thank Fiona Nicholl for her dedication and commitment to SHAPS and the Committee during her 8 year term of office.

April 2017 changes to contributions - 31 January deadline

The new defined benefit (DB) future service contribution rates and deficit contributions arising from the 30 September 2015 valuation calculations take effect from 1 April 2017.

We urge all employers who continue to offer a DB option for future service to return their Employer Form of Authority by 31 January 2017. This form confirms the employer and member split of the total future service rate.

Where an employer does not confirm this split, the default position will apply. The default position being that the total increase will be met by the employer until such time as TPT receives a completed Form of Authority. Please note that a minimum three month notice period applies to any proposed changes outside the above timetable – a form received in February 2017 will take effect from 1 June 2017.

We will contact all employers prior to 1 April with a reminder of the revised deficit contributions payable.

Please ensure that your Finance Team is aware of the forthcoming changes. You can download the form here. Please then return it to Susan Wardlaw, either by email or by post to the address at the bottom of this update.

Changes to the Investment Strategy

In September the Committee considered a three year de-risking plan to reduce the level of risk within the Scheme's portfolio and agreed two stages. Firstly, an immediate reduction to the Scheme's growth asset allocation from 70% to 65%, this has now been completed. Then, secondly to consider, at the December Committee meeting, updated funding level triggers covering the period to the next valuation.

The Committee has now agreed a new de-risking plan using triggers based on the Scheme funding level. Starting at the current level of 65%, the growth asset allocation will be adjusted when certain "solvency" funding levels are reached. The triggers and adjustments are set out below:

Funding level triggers	'Solvency' Funding level	Growth asset allocation
30 September 2015	40%	70%
30 September 2016	38% (estimated)	65%
Trigger 1	44%	63%
Trigger 2	48%	60%
Trigger 3	52%	57%
Trigger 4	56%	53%
Trigger 5	60%	50%

The 'solvency' funding position relates to the cost of settling the benefits in full with an insurance company. If we translate this to the 'ongoing' funding basis (in other words how we fund the scheme as a going concern), achieving Trigger 1 by September 2018 would be considered on track and Trigger 3 would represent approximately 100% funding

The Committee will keep the de-risking plan under review.

The Committee also agreed to increase the interest rate hedging; to hedge 100% of the Scheme's funded liabilities and therefore reduce the level of risk and volatility.

In order to move towards this target around 25% of the Scheme's physical equity holding (just under 9% of the total assets) will be replaced with 'synthetic equities' exposure. The aim of the 'synthetic equity' strategy is to free up capital by replacing physical equity holdings with a derivative position, backed by cash used for collateral. This does not reduce the expected return on the assets however the freed up capital is used to increase the holding of defensive 'Liability Driven Investment' assets to reduce the volatility of the Scheme's funding position.

This change to the investment strategy has no impact on the 2015 valuation outcome.

Further background will be provided at the April 2017 Employer Forums.

Investment Performance Update

The Committee received the latest investment report (regarding the assets that underpin the defined benefit (DB) structures of the Scheme) for the period to 30 September 2016.

With gilt yields falling in the wake of the EU referendum vote the Scheme's liability values rose sharply (as illustrated by the "liability proxy" return). Strong returns from growth assets combining with even larger returns from liability matching assets the overall Scheme return looks good in isolation. However, the Scheme return is below the liability proxy putting downward pressure on the funding position. A summary of the returns can be found below:

	Quarter ended 30 Sept 2016	12 months ended 30 Sept 2016	5 years ended 30 Sept 2016
Returns	9.5%	28.4%	15.2% p.a.
Benchmark	7.8%	25.5%	14.2% p.a.
Liability Proxy*	10.7%	30.1%	13.8% p.a.

**The 'liability proxy' illustrates how the value of reserves required (i.e. liability value) for an average pension scheme has changed during the periods shown above. The liability proxy cannot however give the complete 'SHAPS' picture as it does not specifically track the movements in the SHAPS' liabilities and takes no account of changing valuation assumptions. It helps us to understand how the Scheme's funding level (i.e. assets divided by liabilities) has moved (e.g. if the liability proxy return is lower than actual asset returns, then the Scheme's funding position will tend to have improved).*

A number of employers offer the defined contribution (DC) section of the Scheme to their members. The table below outlines the performance of the default investment option, the Target Date Fund (TDF) which is monitored by TPT Retirement Solutions.

	Quarter 30 Sept 2016	12 months ended 30 Sept 2016	Since inception 28 Feb 2013
Returns: TDF 2014-16	4.12%	12.26%	6.18% p.a.
Returns: TDF 2026-28	6.85%	23.32%	9.68% p.a.
Returns: TDF 2035-37	7.15%	23.13%	9.74% p.a.
Returns: TDF 2044-46	7.35%	22.90%	9.48% p.a.

You can view more information on the performance of the Target Date Fund or the self-select funds here.

Members can also download the SHAPS DC member guide for more information on the SHAPS DC scheme.

Results of the 2016 Financial Assessment

The assessment measures the income and balance sheet strength of the employers using two Key Performance Indicators (KPIs): ‘Affordability KPI’ and ‘Balance Sheet KPI’. The 2016 assessment is now complete and the results are below:

Risk Rating	Higher	Medium	Low	Total
2015 (employers)	18	2	132	152
2016 (employers)	17	0	133	150

Overall since the 2015 assessment, the **‘Affordability KPI’** has reduced by 17%. However a degree of volatility is expected with this measure year on year. Nevertheless, the score comfortably remains above the Scheme’s low risk threshold. The **‘Balance Sheet KPI’** has improved marginally by 2%.

A new ‘Forecasting KPI’ was introduced this year. Whilst this KPI is not used to determine the risk ranking, it will be used to inform opinion on the strength of employers and the covenant they offer to the Scheme into the future.

30 September 2016 Funding Update

The Actuary will provide the Committee with the 2016 funding update in March 2017. The outcome will be communicated to in the April Committee Update and presented at the April 2017 forums.

Employer Forums – Save the date – 19/20 April 2017

The next forums will be held on 19/20 April in Glasgow and Edinburgh respectively. Invitations and the details of the topics, location and timing will be issued shortly. In the meantime, please ask any representatives of your organisation who may wish to attend the forum to hold the date.

A review of the Scheme's Retirement Age

During March 2016 the Committee sought employer views on the future benefits and in particular whether the Committee should investigate raising the Normal Retirement Age (NRA) from age 65. We received feedback from 44 of the 85 employers offering defined benefit (DB) accrual, 26 were in favour of continuing with an NRA of age 65 and 18 were either not in favour or requested a more detailed consideration.

Of those who wished to consider a change to the NRA in more detail, 10 suggested increasing the NRA by one year to age 66; and 8 thought that it would be helpful to have a change in line with State Pension Age (SPA) or the ages set for other schemes in the sector (for example LGPS).

The Committee commissioned actuarial advice on the impact of changing the Scheme's NRA for future service and considered the report at its December meeting. A change in NRA could be undertaken to introduce more affordable defined benefit options however it is the Committee's view that the Scheme already offers a sufficiently large cost range. The total future service rates for the current benefit options (for an employer closed to new entrants) ranges from 13.1% of earnings (CARE 120ths) to 27.1% (Final Salary 60ths) (these rates include member and employer contributions and the death in service benefit).

A single year change in the NRA (from age 65 to age 66) would reduce the Final Salary 1/60th future service contribution rate from 27.1% to 25.9% which is very similar to maintaining an NRA 65 and moving to CARE 1/60th (future service contribution rate of 25.8%).

SHAPS also provides a defined contribution option which provides complete flexibility for employers.

Another significant factor to consider was that under the current arrangement SHAPS is an 'automatic enrolment qualifying scheme'. The actuarial advice highlighted a risk, either at the next valuation or at a time in the future, that a change to the NRA for CARE 1/120th could bring the cost of accrual below the current total cost of accruals threshold to be eligible as a qualifying scheme (currently 11% of pensionable earnings).

Some employers had indicated an interest in matching the Scheme's NRA to SPA. However the current range of SPAs would result in a significant administrative burden and additional costs for managing the Scheme. It would also complicate the communication and understanding of the Scheme's benefits further and may be considered discriminatory, if only indirectly.

Based on the advice received, the Committee agreed that at this stage, it would not pursue increasing the Scheme's Normal Retirement Age.

Further background will be provided at the April 2017 Employer Forums.

Accounting

Housing associations are obliged to produce financial statements which comply with the Housing Statement of Recommended Practice (also known as Housing SORP).

TPT has been in dialogue with representatives of the Housing SORP Working Party, a body that has been recognised by the Financial Reporting Council (FRC) for the purpose of producing the Housing SORP. TPT is scheduled to have an update meeting with the Working Party in January and will communicate the outcome to all participating employers, outlining any actions you may need to take.

Employer feedback

Over 2016 TPT Retirement Solutions has been working to improve the written communications and contact we have with employers. Part of this work has involved a survey, where we asked our employers for their views on the service we provide. We would like to thank employers for completing TPT's annual survey which has provided TPT with a number of areas for development over the coming year.

Further information

We want to make sure that our communications are sent to the right people within your organisation. If someone else in your organisation wishes to receive these updates, please send their contact details to shaps@tpt.org.uk with 'SHAPS Committee Update' as the subject heading and we will be pleased to add them to the mailing list.

If you require any further information or if you have any queries relating to SHAPS, please contact me by email to susan.wardlaw@tpt.org.uk or calling on 0131 718 6662.

Scottish Housing Associations' Pension Scheme
TPT Retirement Solutions, 9-10 St Andrew Square,
Edinburgh, EH2 2AF

Tel: 0131 718 6662

Email: enquiries@tpt.org.uk

Visit: www.shaps.org.uk

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Retirement Solutions