SHAPS

Scottish Housing Associations' Pension Scheme

Detailed Guide for Employers - 30 September 2018 Valuation

tpt

Retirement Solutions

Contents

Introduction

This guide provides detailed information about the valuation results for you to discuss with your Management Board and Executive Team and, if your organisation provides ongoing defined benefit (DB) accrual, details on how to undertake consultation with your employees.

The 2018 valuation is the first to take place under the new SHAPS governance structure, which came into effect on 1 December 2017. Under this structure the Scheme Committee (SC) exercises delegated Trustee responsibilities in relation to managing the SHAPS funding and investment strategy for the defined benefit (DB) section. One of the Employer Committee's (EC) responsibilities is to act as the representative body for employers participating in the DB section of SHAPS. The SC therefore consults with the EC on funding and investment related matters.

The consultation process during the valuation has involved robust challenge and scrutiny by the SC, EC and their respective advisers.

The valuation has also been undertaken against a heightened regulatory environment but, despite its involvement in the 2015 valuation, The Pensions Regulator (TPR) confirmed it would not proactively engage with the Trustee during the 2018 valuation process. Instead, TPR informed the Trustee that the valuation would be reviewed through its normal process after the final results are submitted.

As a participating employer in SHAPS, you have been separately informed of the revised deficit contributions and scheme expenses that will apply to your organisation from 1 April 2020. If your organisation continues to provide DB accrual for members, revised future service contributions will apply from 1 April 2020.

Default position

Now that employers have been provided with the valuation results and details of what this means for each organisation, we are aware that you will need to fulfil internal governance requirements and potentially consult with employees if any changes are to be made to member contributions and/or benefits.

If your organisation still provides employees with future pension benefits on a DB basis, then in order to make any changes to the current member contribution rates and/or benefits structures from 1 April 2020 **an "Employer Form of Authority" must be received by TPT Retirement Solutions (TPT) by 31 January 2020**, otherwise the default position will apply.

Under the default position, the existing benefit option(s) will continue and the increase in future service contributions will be met by the employer in full, with the members' contributions being held at the current rate. Any future changes to the contribution rates and/or benefit structures will only be possible in accordance with TPT's agreed timescales for making future changes.

Key valuation assumptions and results of the 30 September 2018 valuation

Essential components of the actuarial valuation are the key actuarial and financial assumptions used to value the benefits provided. After taking advice from the Scheme Actuary, and following consultation with the EC, the following key assumptions have been used for the 2018 valuation.

Assumption	30 September 2015 valuation % p.a.	30 September 2018 valuation % p.a.
Price inflation	RPI- 3.1% CPI- 2.2%	RPI*- 3.35% CPI*- 2.35%
Discount rate -pre-retirement -post-retirement	5.7% 3.1%	3.12%**
Pensionable earnings growth (annual)	3.7%	3.35%***

*The Retail Price Inflation (RPI) rate is now based on a gilt inflation curve, rather than using a single inflation rate. The figure shown is the average for the Scheme. CPI Inflation is RPI Inflation less 1% p.a.

** The discount rate is now a single rate based on the gilt yield curve plus a margin. The margin reduces from an initial rate based on the additional asset return from the current investment strategy, taking into account prudence and the employer covenant rating, to a long-term rate of gilts plus 0.5% p.a. over a fixed period. The figure shown is the average for the Scheme.

*** Earnings growth is based on CPI plus 1% p.a.

In addition to these key financial assumptions, updated mortality projections, supported by SHAPS' own scheme-specific experience have also been used in the assumptions adopted.

Funding position

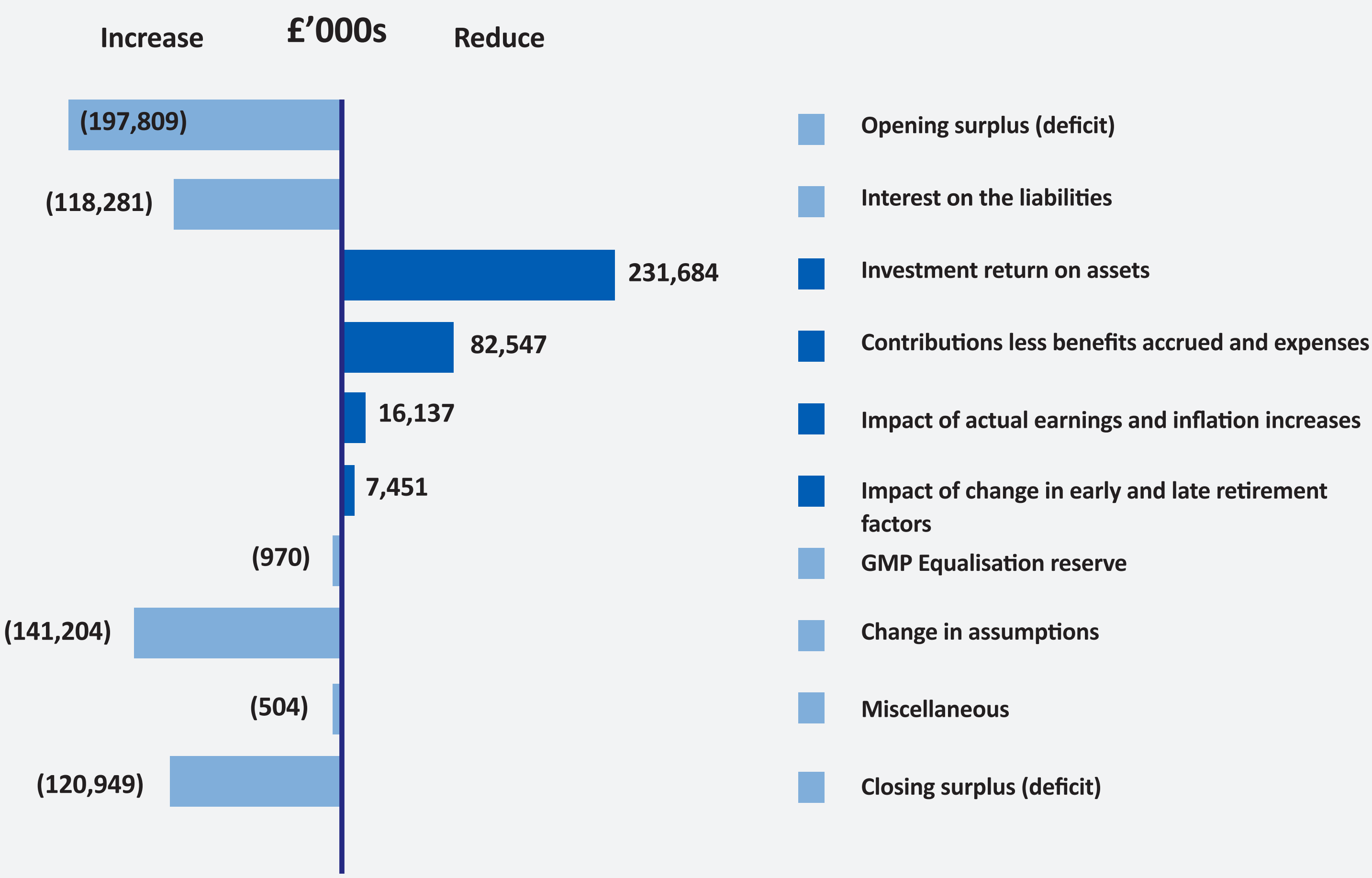
Based on the valuation assumptions adopted, the 2018 valuation results, with the comparative results from 2015, are:

	2015 Valuation £m	2018 Valuation £m
Assets	616	877
Liabilities	814	998
Deficit	-198	-121
Funding level	**76%**	**89%**

The figures in the above table represent the **Technical Provisions** (sometimes referred to as the ongoing funding position) funding level. This assumes SHAPS continues into the future and the employers continue to fund the benefits accrued to 30 September 2018 as they fall due for payment.

How has the funding position changed from 2015?

The deficit has reduced by £77m, from £198m (in 2015) to £121m (in 2018). The reasons for the change in the funding position since the last valuation in 2015 are shown in the chart below:



Interest on the liabilities

At each valuation, a present value is placed on the future liabilities. This involves projecting the expected future benefit payments and then discounting the payments back to the valuation date. At each subsequent valuation, as the term to the future payment date is three years shorter, a shorter discounting period is applied. Whilst SHAPS continues to have a deficit, the interest element on the liabilities will continue to have a negative impact.

Investment return on assets

The investment performance has been strong and this has helped to reduce the deficit. The assets returned £231m compared to the estimated return on assets assumed in the 2015 valuation of £96m; a positive outperformance of £135m.

Over recent years, steps have been taken to diversify the SHAPS growth assets (providing access to a number of additional sources of return) and increase the proportion of assets that directly match the liabilities. Overall, this has helped to reduce risk and should deliver a more stable funding outcome. An investment strategy review will also now be undertaken to closely align the funding and investment strategy approaches.

Contributions received less benefits accrued and expenses

Deficit contributions paid by employers have also helped to reduce the deficit. The net value over the period amounted to £82.5m.

Impact of actual earnings and inflation increases

Actual earnings growth and inflation were lower than assumed in the 2015 valuation, resulting in a positive gain of £16m.

Changes in valuation assumptions

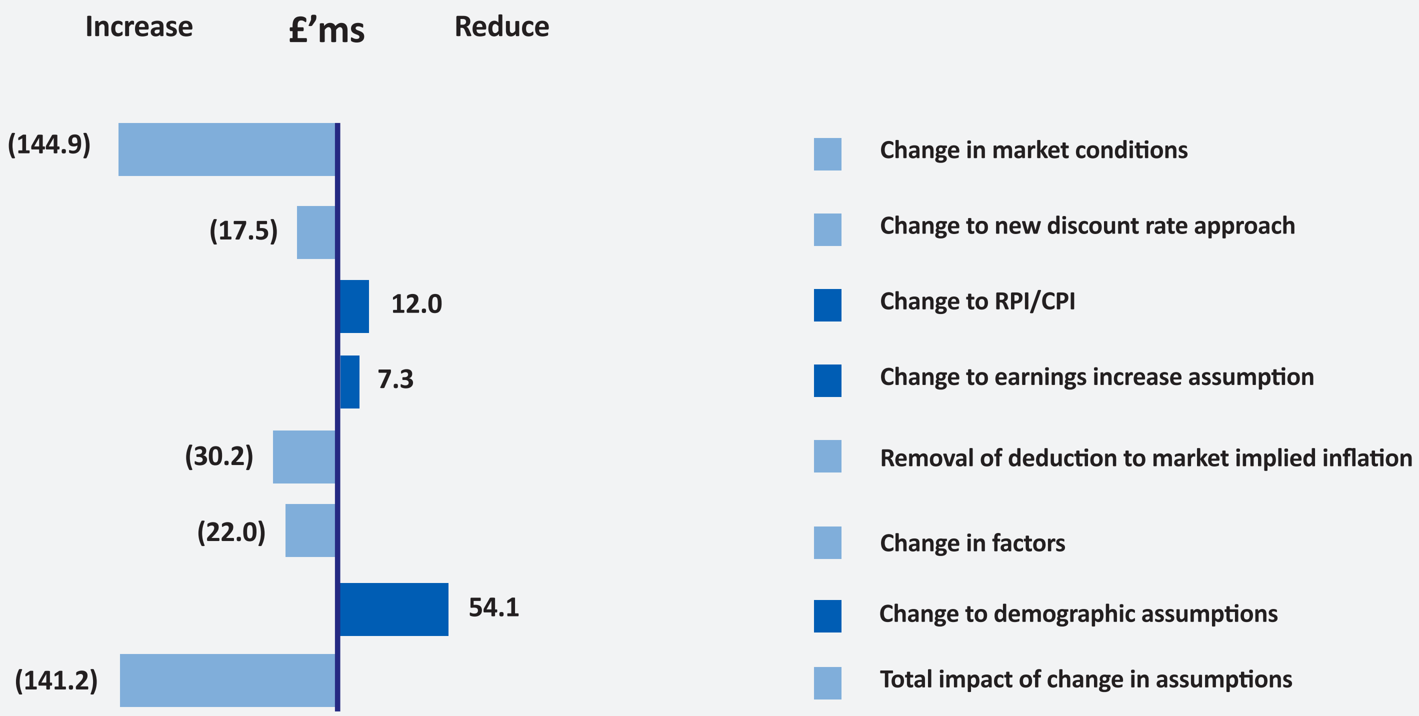
From the reconciliation chart overleaf, you will note that the change in valuation assumptions item represents a significant negative impact of £141m. At each valuation the assumptions are reviewed based on market conditions, scheme-specific experience and the outlook for future investment returns.

The 2018 results also include an allowance for:

- the expected impact of equalising the Scheme's Guaranteed Minimum Pension (GMP) liabilities. This is the minimum level of pension the Scheme has to pay to a member and arises as a result of the Scheme being contracted out of the State Second Pension before 6 April 1997. GMPs for male and female members now need to be equalised following a recent court ruling; and
- changes to the factors that are applied to members' pensions when they retire before or after their normal retirement age or covert any of their pension to cash.

Looking ahead, expectations for future investment returns have reduced which increases the current value placed on liabilities (if investment returns are lower, the discount rate is lower and SHAPS will need more money earlier to pay benefits over the lifetime of the members). The SC has introduced additional prudence in the investment return assumption – the change to new discount rate approach- which is expected to help reduce the likelihood of investment volatility in the future.

Changes to the discount rate assumptions as a result of changes in market conditions account for the majority of the impact as highlighted below:



Contribution requirements

The future total DB contributions required comprise of:

- revised deficit contributions payable under the new recovery plan from 1 April 2020;
- expenses contributions based on membership at 30 September 2018, payable from 1 April 2020;
- revised future service rates from 1 April 2020, if DB accrual is being provided; and
- revised open employer discount rates from 1 April 2020, if appropriate (see page 10).

Allocation of deficit costs

The EC has agreed to maintain the current approach to allocate the deficit contributions based on each employer's full share of the total liabilities.

New recovery plan

Following consultation between the SC and the EC, a new recovery plan to recover the deficit of £121m, based on a full share of liabilities approach, has been agreed. This means that the total deficit contributions due to the Scheme from 1 April 2020 has not increased however each employer's share will change to reflect their new liability profile at 30 September 2018.

New Recovery Plan	End of Recovery Plan	Contributions due from 1 April 2020	Increase rate (p.a)
Share of liabilities	30 September 2022	£31.1m	3%

In addition to the Recovery Plan contributions, a Contingent Funding Agreement (CFA) has been agreed between the SC and EC. The CFA is designed to ensure that deficit contributions continue to 31 March 2023 if, based on a funding assessment at 30 September 2021, it appears that these deficit contributions will be required.

The assessment of the funding position at 30 September 2021 will take into account the deficit contributions payable to 30 September 2022:

- if the results show no deficit is identified then deficit contributions will cease from 30 September 2022.
- if the results show the deficit has not been cleared then the deficit contributions will continue until 31 March 2023 as follows:
  - If the deficit is more than £5m, deficit contributions equal to those payable from 1 April 2022 will be payable from 1 October 2022 until 31 March 2023; or
  - If the deficit is between £0m and £5m, deficit contributions equal to 50% of the deficit contribution from 1 April 2022 will be payable from 1 October 2022 until 31 March 2023.

The assessment of the funding position will be carried out by the Scheme Actuary and the results will be communicated to employers by 31 March 2022.

Although the approach to allocating the deficit on a full share of liabilities basis has not changed some employers will see an increase to their deficit contributions and some will see a decrease. Reasons may include:

- Any transfer of engagements or restructures that have taken place.
- Changes to an employer's membership (for example transfers out, death of a member).
- Increasing liabilities for employers open to DB as their members continue to build up new benefits.
- Salary growth experience that is higher or lower than the Scheme average between valuations.
- The size of any employer's membership and liabilities in the Scheme – for example, an employer with larger liability will see less impact as a result of a small number of membership changes compared to an employer with a smaller liability.
- The maturity of individual employer's membership- for example, an employer with more mature membership will see their liability reduce over time as members take tax free cash on retirement and as pensioner members pass away but an employer with immature members with a number of years before retirement will see their liability increase.

Changes in the data or employment histories for individual members can also have an impact. This is particularly relevant for an employer with a very small membership where one individual (who may no longer be an active member) represents a large share of the liability.

Scheme expenses

Employers pay expenses to meet the cost of running SHAPS, which includes the costs of trusteeship, scheme governance, communications, administration, actuarial and legal advice plus the annual Pension Protection Fund levy payable by SHAPS.

From 1 April 2020, scheme expenses will continue to be payable based on your share of liabilities in the Scheme. The expenses will be fixed for the period 1 April 2020 to 31 March 2023.

Future service contribution rates

The future service contribution rate is calculated at each valuation and reflects the estimated cost of new benefits being earned by active DB members. The table below shows the existing contribution rates for each of the DB structures, together with the new rates **that will now be applied from 1 April 2020:**

Benefit	60ths final salary	60ths CARE	70ths CARE	80ths CARE	120ths CARE
Existing 'closed' employer rate	27.1%	25.8%	22.1%	19.4%	13.1%
Existing 'open' employer discount	2.0%	2.0%	1.7%	1.5%	1.0%
Existing 'open' employer rate	25.1%	23.8%	20.4%	17.9%	12.1%
New 'closed' employer 1 April 2020 rate	**32.8%**	**31.7%**	**27.1%**	**23.7%**	**15.8%**
New 'open' employer discount	0.4%	0.7%	0.6%	0.5%	0.4%
New 'open' employer rate	**32.4%**	**31.0%**	**26.5%**	**23.2%**	**15.4%**

Open employer discount (if applicable)

Where an employer has enrolled new members into the DB sections between 1 October 2015 and 30 September 2018 the 'open employer' discount will apply.

The requirement for members to pay a maximum of 50% of the total open employer contribution rate has been removed from 1 April 2020. Employers can now determine, following consultation with their employees, how the total future service contribution cost will be allocated between the employer and member.

Guidance on staff consultation

If you have active DB members in SHAPS you may be required to consult with employees affected by the changes in the future service contribution rates.

1. Each employer can choose how they share the total future service contribution rate between the employer and members. However, employers are encouraged to carefully consider how the increase in cost should be shared with members and not simply pass the full increase on to members via the member contribution rate.
2. Please use the Employer Form of Authority to confirm any changes to your existing rates or changes of DB structure.
3. Changes can be made from the 1st of any month with a minimum of two months' notice.
4. For changes to take effect from 1 April 2020, completed Forms of Authority are required by 31 January 2020. Forms received after this date will be effective within a two month timescale, so may take effect from 1 May or 1 June or later as agreed with TPT. Please see the section below on the default position.
5. Employers are required to cover any costs incurred as a result of a benefit change. These relate to the employer introducing the defined contribution (DC) section, updating their rules around DC contributions, or making a change to their DB structures.

You may be required by overarching legislation to consult with employees affected by changes or may need to do so in line with your organisation's own requirements or recognised best practice.

Under legislation, the types of changes – known as listed changes- that trigger the requirement to provide information and consult employees include:

- Increasing member contributions.
- Reducing the rate of accrual of benefits (e.g. CARE 1/60ths to 1/80ths).
- Changing the basis of future accrual (e.g. from final salary to CARE).
- Closing DB to new members.
- Stopping future accrual.

We have produced sample consultation material which is available on the SHAPS website.

It is important that you consider any listed change carefully. You may have a statutory obligation to consult. For example, if you have 50 or more employees then you must consult with 'affected members' and/or their representatives. An 'affected member' is a current member of SHAPS plus all employees who are eligible to join SHAPS if they wish to do so. As well as the possible statutory obligation to consult, there may be obligations under internal procedures or governance arrangements relating to employees' Terms and Conditions of Employment. Please take legal advice if you are in any doubt as to your obligations.

Where statutory consultation is being undertaken, it must begin and end on the dates specified in the information you provide to affected members and the process must last at least 60 days. The DWP expects the employer and those consulted to work together in a spirit of co-operation. At the end of the 60-day period, the employer must consider any comments before deciding whether to proceed with a change to future pension provision. If no comments are received by the end of the period, the consultation will be regarded as complete.

Member options

Where an employer is moving members between benefit structures and a member decides to take a different option to the default position, the individual member should complete a Transfer to New Benefit Structure (SHAPS) form. This is available on the SHAPS DB website or by contacting TPT's administration team at **enquiries@tpt.org.uk** or **0113 394 2552**.

Please note where a member takes the above action they are treated as a leaver in respect of benefits accrued to the date of change, meaning that the salary link to any benefits accrued on a final salary basis is broken.

Default position

Where an Employer Form of Authority is received after 31 January 2020 or where no form is received a default position will apply. **Under the default position, the existing benefit option(s) will continue and the increase in overall contributions will be met by the employer in full, with the members' contributions being held at the current rate(s).**

Help and further assistance

Questions and queries

Employers with any questions relating to the SHAPS valuation should contact the TPT Employer Relations Team on **0113 394 2754** or via email **employerrelations@tpt.org.uk.**

Please note: The Scheme Committee, Employer Committee and TPT are not authorised to give advice to employers on the selection of their benefit structures and specific funding arrangements. In these matters, it is recommended that employers should source their own independent professional advice.

Valuation presentations

TPT may be able to assist in presenting information about the SHAPS valuation direct to your senior managers and/or Board members.

This might include historic funding levels, the journey to SHAPS current valuation, actions to address any deficit and updates on governance and structure. It is designed to give your organisation's most senior people a broader understanding of pensions, and how your scheme can benefit the business and the people in it. TPT will be able to answer their questions face-to-face, and can also present to your staff members, giving them up-to-date information about SHAPS.

If you would like more information about the support we can provide and associated costs, please contact the Employer Relationship Team at **employerrelations@tpt.org.uk**.

Affordability Appeals

IIf you are concerned that your organisation is not able to afford the full level of deficit contributions, you can follow the affordability appeals process. Full details will be provided upon request but in summary there are three stages to this process:

- Provision of financial evidence by the employer to set out why contributions are not affordable.
- Review of that financial evidence by the Trustee (SC) and/or its adviser.
- Decision made by the Trustee (SC).

This process must be followed in order for the SC to consider an appeal.

It is important to note that the proposal should specify the outcome being sought and any concessions granted will need to be paid back, plus interest.

If you would like more information about the Affordability Appeals process, please in the first instance contact the Employer Relationship Team at **employerrelations@tpt.org.uk**.

Please note that TPT need to be notified of any intent to submit an affordability appeal **by 30 November 2019** in order to guarantee that any concession, if agreed, can be applied from 1 April 2020. You will also need to provide supporting financial evidence and the rationale to TPT by 31 December 2019.

Managing your SHAPS membership

For questions and queries about:

- SHAPS debt and deficit
- Withdrawal from SHAPS
- Employer mergers and incorporations
- General scheme information
- Member or board presentations

TPT's Employer Relations Team will be able to help.

Visit **www.tpt.org.uk/schemes/shaps-db**

Email **Employerrelations@tpt.org.uk**

Call **0113 394 2754**

TPT Retirement Solutions, Verity House, 6 Canal Wharf, Leeds, LS11 5PQ
Tel: 0113 394 2754 **Email:** employerrelations@tpt.org.uk **www.tpt.org.uk**

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