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Trust Housing Association
Participation in the Scottish Federation of Housing Associations Pension Scheme

Board Presentation
17 February 2011

Presenter

- David Davison
- Head of Charity / Not-for-profit Practice
- Spence & Partners Limited
- Actuaries & Pension Consultants
- Considerable experience with SFHA, Pension Trust Schemes and 'multi-employer' arrangements

Agenda

- Background on Trust Housing Association ("THA") participation and Scottish Federation for Housing Associations Pension Scheme ("SFHA")
- Discussion of options available
- Comment on recent Employer consultation exercise
- Possible options

Final Salary and CARE benefits

- Final Salary
  - Pension based upon years of service times final salary
  - E.g. 1/60th x 15 years x £20,000 = £5,000 pa pension
- Career Average Revalued Earnings
  - Each years accrual treated in isolation
  - Then revalued to retirement

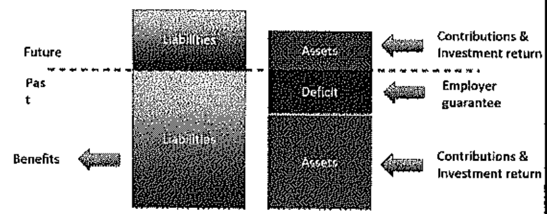
Pension	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5	TOTAL
Year 1	£333.33	x 1.047	x 1.029	x 1.041	x 1.015	= £379.45
Year 2		£363.33	x 1.029	x 1.041	x 1.015	= £395.04
Year 3			£391.66	x 1.041	x 1.015	= £413.84
Year 4				£416.66	x 1.015	= £422.92
Year 5					£440.00	= £440.00
Total pension at the end of Year 5						= £2,051.25

Defined benefit scheme
How is it valued?

- Liabilities = benefits promised to members plus expenses
- Estimate of cost based upon salary, price inflation and life expectancy
- Time value of money

Amount	Term payment	Present value at 5%	Present value at 9%
£100	1	95	92
£100	5	78	65
£100	10	61	42
£100	20	38	18

Defined benefit scheme
How does it work?



Final Salary to CARE

- Impact
  - Lower benefits – nominal for salaries which closely track inflation?
  - Lower cost – small change?
    - Future service
    - Past service the same
    - Small change
  - Avoid cost of large salary fluctuations close to retirement
    - Hutton Report
  - Mixed benefits
  - Communication
  - Lower "barrier to entry"

Background SFHA Pension Scheme

- Multi-employer defined benefit pension scheme, managed by the Pensions Trust
- "Last Man Standing" arrangement
- Reviewed in 2007
  - 100% retained for existing staff
  - 84% for new staff
- Consultancy exercise to review benefit structure in summer 2010

Background

- Extended choice of benefit options to be offered from April 2011
  - Final salary with 60th accrual
  - Career Average Revalued Earnings (CARE) with 60th accrual
  - CARE with 70th accrual
  - Care with 80th Contracted-out
  - Care with 120th Contracted-inWHHA are members of the SFHA Pension Scheme
- Current benefit structure is final salary with 60th accrual
- 'Employer covenant'
- Weaker employers forced to move to 120th accrual

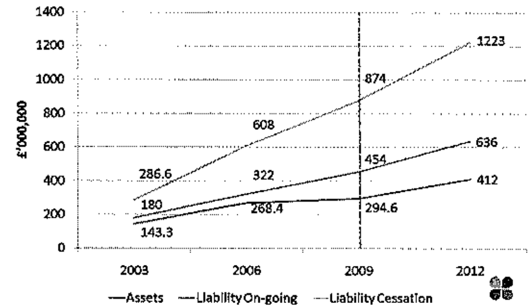
Defined Benefit - risks

- Build assets to pay benefits when due based upon contributions and investment return
- Unknown cost
- Assumes scheme continues
- Lengthening longevity
- Much higher liability on exit/closure

SFHA Pension Scheme

- Most recent actuarial valuation carried out as at 30 September 2009
- Funding basis is weak compared to "prudent" funding valuation basis
- High levels of asset returns assumed
- Adjustment to a more "prudent" funding basis could increase liabilities by more than 10%
- Recent investment changes reflect acceptance of lower returns
- Inconsistent with funding approach

SFHA Funding position



SFHA Funding position

- Asset values increased by @10% from 2006-2009
  - Due to contributions as investment return -1.6% p.a.
- Liabilities grew by 40%+ on an on-going basis
  - Deficit £53.5m (83.4%) to £160.1m (64.8%)
- Cessation position
  - £339m (33.7%) at 2006
  - Estimate £580m (34%) at 2009
- Even if 100% funded on-going cessation deficit likely to be in excess of £350m – and it's not
- More prudent assumptions could add a further 10%-15% to contributions

SFHA Strength of Funding Basis

- Funding basis can be benchmarked against other measures
- Pensions Regulator benchmarks
  - PPF Basis (S179) 100% +
  - Also look at FRS 17 100% +
- "Strength" of ongoing basis
  - 75% of PPF Basis
  - Approx 80% of FRS 17
  - 52% of estimated buyout cost

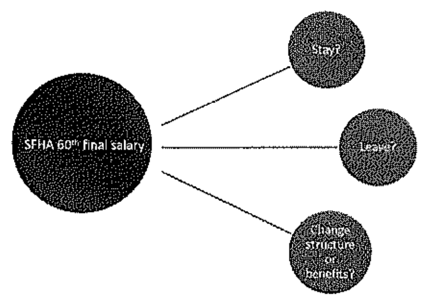
SFHA Funding position

- Cessation
  - Voluntary exit – full payment
  - Re-structure
  - Insolvency – multi-employer coverage
  - Inadvertent e.g. No active members – likely through rising employee costs?
  - Scheme closure
- Increasing cessation debt
- Employers standing over guarantee
  - Future deficit
- Approval of funding plan with tPR?
- Future position?

Key issues

- Considerable worsening of SFHA Pension Scheme funding position
- Poor investment returns
- Employers Consultation may not have been sufficiently wide-ranging
- Statutory Consultation timescale too short
- Pensions Committee has rejected defined contribution arrangement (unlike SHPS)
- Although additional benefit options, it is very difficult to make decisions on the information provided
- The introduction of NEST from 2012 exposes THA to further financial risk

Options



Stay in scheme

- Continued participation exposes THA to significant financial risks
- Contribution levels are likely to continue to rise in the future
- Increasing contribution rates may result in fewer members joining the SFHA Pension Scheme
- Decreasing active membership could impact on the liabilities
- Requirement for security
- Impact of RPI/CPI
- Growth Plan membership?

Leave the SFHA Pension Scheme

- If THA leave the SFHA Pension Scheme, buy-out debt must be paid to the Scheme
- £18,092,007 at 30 September 2009
- Includes "orphan" liabilities
- Amount of debt is volatile and is likely to increase over time
- Growth plan debt at 30 September 2009 was £46,347.86

Ceasing participation

- Cease participation in the SFHA Pension Fund and provide all future pension entitlement with a defined contribution arrangement
- Major step given financial and HR implications
- Is cessation cost affordable?
- If the SFHA Pension Scheme were closed, the cost could be spread over time
  - E.g. Scottish Voluntary Sector Pension Scheme closed to future accrual in March 2010.

Limiting new members

- Closure to new entrants
  - Limits the growth of further pension liabilities
  - Incurs an additional charge, currently 3.5% on contributions
  - Need to ensure that at least one employee remains in the SFHA Pension Scheme to avoid triggering exit debt
  - Revises basis of deficit payment
- Could limit the eligibility of new members
  - Exact terms of participation in the SFHA Pension Scheme would need reviewing

Employer consultation

- Revised contribution rates proposed

Benefit option	Joint contribution rate	Employer contribution rate
Final salary 60th	29.6%	20.0% (inc 10.4%)
CARE 60th	27.5%	19.0% (inc 10.4%)
CARE 70th	25.3%	17.8% (inc 10.4%)
CARE 80th	23.6%	17.0% (inc 10.4%)
CARE 120th	19.8%	15.1% (inc 10.4%)

- Move from 2/3 employer, 1/3 employee split
- Rates are payable on pensionable salary from 1 April 2011
- Past service fully paid by employer
- future service cost split 50/50 between employer and employee

Past service cost

- 10.4% over 15 years
  - From 5.3% over 12 years from 30/9/06 to 31/3/11
- If closed to new entrants based on higher of salary at Sept 2009 / salary at point of closure
- Contribution increases at 4.5% per annum regardless of payroll
- If no payroll increase rise to 19.2% effective
- If 3% pa payroll increase rise to 12.7% effective
- Equivalent to @14.4% level

Past service cost

- Spread over each employer based on salary roll
- Doesn't take account of liability which each employer has built up
- Considerations if next valuation is on the same basis
  - Any increase in salary roll will increase deficit contributions
  - Incentive to minimise salary roll which is pensionable
- Basis is unsustainable in the longer term and may well change to reflect each employer's liability
  - Then no reason not to recognise under FRS 17

Commentary on CARE 120th proposal

- CARE 120th benefit basis is contracted-in.
  - Employer and employees pay higher national insurance contributions (3.7%/1.6% band earnings)
  - Employer pays majority of the NI pension contributions
  - In exchange for higher NI contributions, employees are eligible for S2P state pension
- 'Higher risk employers' forced to move
- The Pensions Committee comments that member benefits from CARE 120th are likely to be higher than from a DC option set at Pension Quality Mark.
- Is this the case?

24

Impact of NEST

- Contribution rate to SFHA Scheme may be a barrier to entry (existing and new)
- NEST contribution basis starts 2012 at 1% employer 1% employee rising to 3%/5%
- Promotion may result in additional take up of pension provision (inc SFHA) and further cost to employer
- How might NEST be integrated into existing pension provision

25

Conclusions

- THA - limited resources and access to future funding
- Open to the following risks
  - Rising contribution rates
  - The number of members requiring benefits may significantly increase (accelerating growth of liabilities)
  - The number of members requiring benefits may significantly decrease (past service liabilities spread over smaller salary roll)
  - The status of THA changes in the future, triggering exit debt
  - Full accounting disclosure

26

Pension costs

Benefit option	Employer deficit reduction contributions	Employer future service cost	Employee future service cost	Difference in future service cost (employer)	Difference in future service cost (employee)
FS 60th Pre	5.3%	10.1%	7.7%		
FS 60th	10.4%	9.6%	9.6%	-	-
CARE 60th	10.4%	8.5%	8.5%	1%	1.1%
CARE 70th	10.4%	7.5%	7.5%	2.2%	2.1%
CARE 80th	10.4%	6.6%	6.6%	3.0%	3.0%
CARE 120th*	10.4%	4.7%	4.7%	4.9%	4.9%
CARE 120th + NI*	10.4%	7.4%	5.9%	2.2%	3.7%
Care 120th + NI* + 2/2 DC	10.4%	9.4%	7.9%	0.2%	1.7%

*NI assumed to be 2.7% employer and 1.2% employee total salary to account for B/E

27

CARE plus 'top hat' DC

- Care 1/120th
- Contracted-in so state benefits on top
- Attractive for lower earners
- Additional scheme to take extra contributions outside Pensions Trust
- Limit accrual and no C'out subsidy
- Matched contributions / Employee choice
- Same or additional cost
- Additional fixed cost
- NEST vehicle

28

Options

- Do nothing, accept future build up of liabilities
  - Consider investment and governance
- Consider a move to CARE section of SFHA Pension Scheme
- Limit numbers of staff who are eligible for Scheme membership
- Cease to admit new entrants
- Transfer accrued benefits to LGPS, SHPS or alternative
- Cease participation in the Scheme and pay cessation debt
- Scheme closure as a whole to allow spreading of cessation cost

29

Next steps

- Need to fully understand financial position to make informed decisions
  - HR Implications
  - Future risks
  - Contribution affordability – now and in the future
- Legal implications?
- Communicate with scheme within timescales
- Need to be able to communicate impact of change to staff
  - Contributions / net pay
  - Benefits
- Briefings / Illustrations
- Comparison model

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Questions?