Debrief

SHPS 2020 valuation

The SHPS 2020 valuation results have been published. With a significant increase in contributions due from April 2022, we take a look at what the results might mean for your organisation more widely and the steps you can take to form your response.

It is good that SHPS has retained the same "strong" view of the sector's long-term covenant, but could it have been taken further? TPT may have missed an opportunity to take a fresh look at the funding approach and to make it more bespoke to employers' risk appetite and needs. Looking ahead to the 2023 valuation and with the new DB funding code coming in next year, none of these issues will go away.

This debrief note covers:

- The headline results
- How did we get here?
- Insight and commentary
- Employer questions and considerations
- How Isio can help

Headlines

77%

The value of the deficit has increased by £38 million from £1.522 billion to £1.560 billion – this is despite contributions paid in over the period of £409 million. The funding level is now 77%.

£5.148bn

Total SHPS assets have grown to £5.148 billion with liabilities growing to £6.708 billion as at 30 September 2020.

17%

Annual deficit contributions payable from 1 April 2022 are to increase initially by 17% on average – the actual increase depends on an employers' individual profile (and could be up to 40% or more).

72%

Total deficit contributions payable have gone up by around 72% - allowing for the full recovery plan with no discounting allowance.

5.5%

Annual deficit contributions will increase by 5.5% each year rather than the current 2%.

18 months

The recovery plan will now end at 1 March 2028 – extended by 18 months to further "back end load" additional payments.

51%

The funding level on a solvency basis is 51%.

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The cost of new benefits has risen by around 50%.

Employer contributions towards benefits already built up will rise from April 2022 by 17% on average (for some employers by as much as 40% or more).

Employer contributions commitments overall have risen by around 72%.

The deficit is now around £450m behind the Trustee's funding plan from the last valuation.

Employers have paid in deficit contributions of £405m over 3 years.

How did we get here?

New benefits being built up

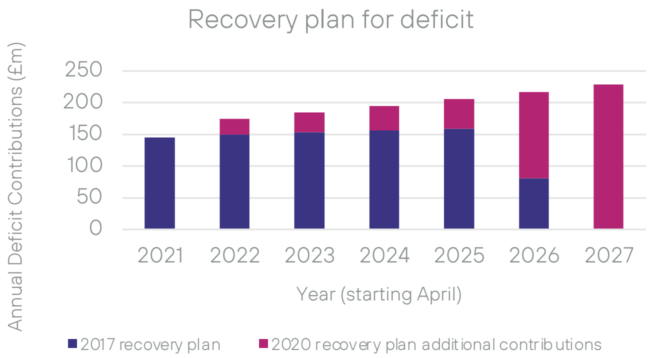
The cost of building up new benefits has risen sharply since 2017, driven by a fall in government bond yields.

The change in cost of new benefits over the years leads to cross-subsidies between employers – some will be winners and others losers. Those now closed to new service are still exposed to the risk from employers who remain open to new benefits.

Benefit type	Final Salary			CARE		
Accrual Rate	60	70	80	60	80	120
Existing Rate (% pensionable salaries)	27.2%	23.4%	20.5%	22.1%	16.7%	11.3%
April 2022 Rate (% pensionable salaries)	41.2%	35.4%	31.1%	33.0%	24.9%	16.8%
Net Change (% pensionable salaries)	14.0%	12.0%	10.6%	10.9%	8.2%	5.5%
% Change	51.5%	51.3%	51.7%	49.3%	49.1%	48.7%

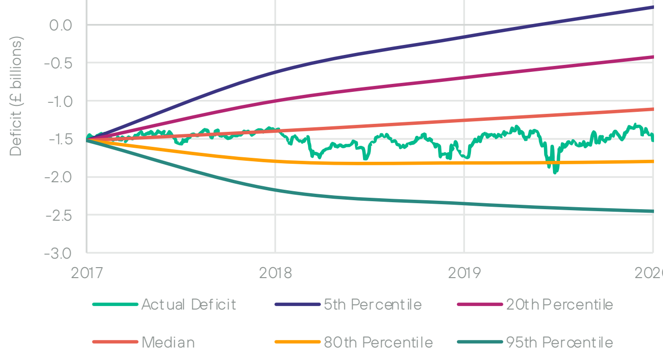
Legacy benefits already built up

The cost of funding benefits already built up has also risen, although the full impact has been delayed until later years.



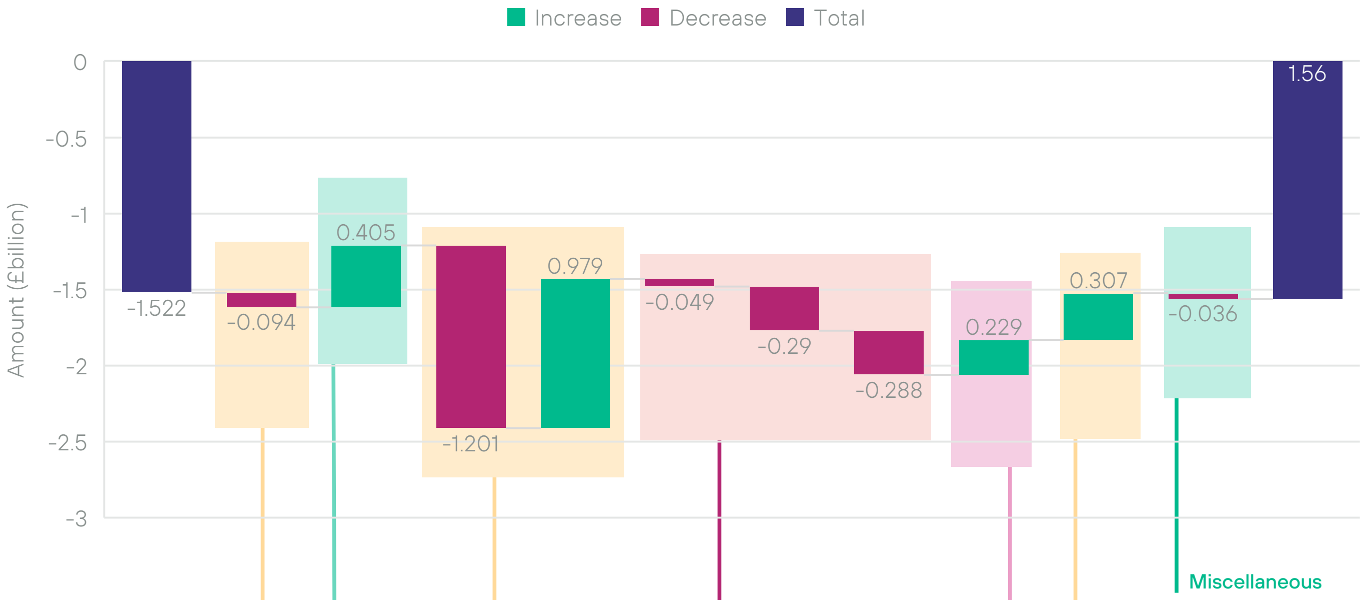
Progress against funding plan

Had the funding level progressed in line with the Trustee's plan at 2017, the deficit at 30 September 2020 would have been around £1.1 billion. This compares to the actual deficit at that date of £1.56 billion. This is a poor outcome but there was broadly a 25% chance it could have been worse.



The funding level is volatile. Had the valuation date been at 31 March 2020, for example, when markets were hit by the start of the pandemic, the deficit would have been nearer £2bn and contributions would have increased by closer to 50% (compared with 17%) from 1 April 2022. This assumes the same approach as taken at 30 September 2020.

2017 to 2020 Summary



Interest on deficit
As the scheme was in deficit in 2017, interest on that deficit has further reduced the funding level.

Employer contributions
SHPS employers have been contributing considerably to the deficit from the last valuation.

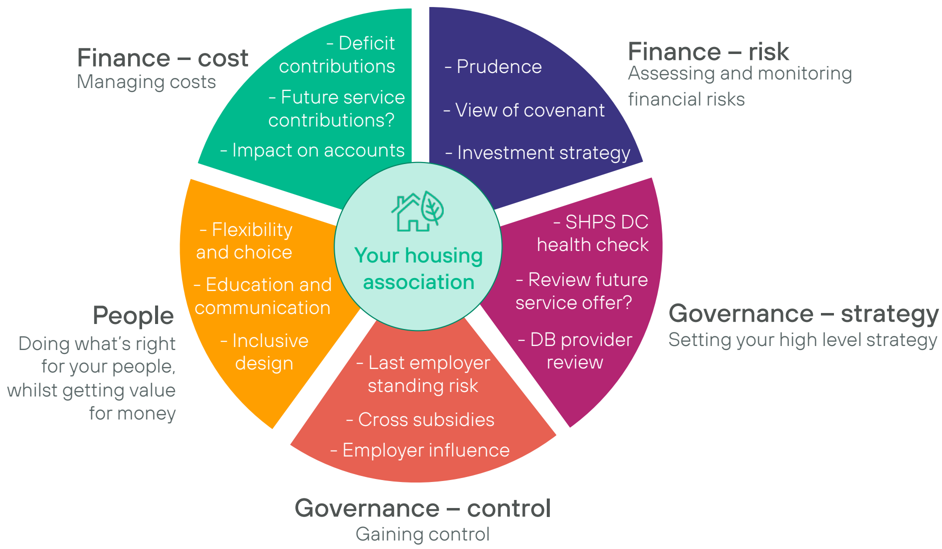
Hedging
SHPS is well hedged but not fully matched, leading to a loss of £222m.

Experience and benefit updates
Negative inflation experience, falls resulting from one-off RPI reform announcements and the improvement in commutation terms have added to the funding deficit. An improvement in benefits at the same time as contribution rises, sends perhaps a mixed message to employers

Employer bulk transfer exits
10 employers leaving has reduced the deficit at a scheme wide level, but that deficit is now shared by fewer employers.
A small gain will have been seen through payment of S75 debts on liabilities left behind and covenant protection premiums.

Changes to assumption setting
There will be some other changes allowed for by the Trustee, for example the impact of Covid-19 on longevity.

Wider pensions strategy – areas to consider



Employer Flexibility and Choice - trends in DB and DC pensions funding and governance options

Click here to re-listen to any part of this discussion from our May webinar:

04:20 - 10:55
Katy Taylor, Housing Lead at Isio - introducing key themes we're seeing across pensions funding and governance for housing.

10:55 - 38:08
Stuart Evans, Trustee of the Enplan pension scheme platform and Ian Johnson, CFO, Metropolitan Thames Valley Housing - discussing options for Trust based funding both within SHPS and outside on platforms.

Trust based funding and governance – what does it mean?

Look back at thoughts from our discussion with the Pensions Regulator and the Regulator of Social Housing on the impact of the new DB funding code coming in 2022: click here.

Isio Insight

Is a different approach possible?

Whilst the fact that SHPS is a pooled multi-employer arrangement may bring some benefits, this also presents challenges for employers. Fundamentally, employers are unable to manage their own risk exposure and lack the flexibility to run exercises which could gain absolute value.

Sector asset backing is strong

Isio has been working with the National Housing Federation (NHF), in discussion with the Regulator of Social Housing (RSH), Welsh Government and the Pensions Regulator (TPR), to raise the profile of the housing sector's unique covenant. The sector's strong asset base, 30 year business planning and regulated nature of the sector provides support to the scheme that is more than adequate overall. There is a case to say that there is significant scope for reduced prudence levels within SHPS and other schemes.

A missed opportunity?

So why have contributions gone up again? The simple answer is that less is now expected from asset returns and the gap needs filling by employer contributions at some point if markets don't improve. The SHPS Trustee - in discussion with TPR and the employer committee – has taken a view that these are required now rather than relying further on the long term employer covenant and market performance. It is helpful for employers that contribution increases are "back end loaded", but they could arguably be lower still for some employers, if not all.

Bespoke funding plans

Despite all this - and this is where it gets interesting – in a multi employer scheme, it is the stronger employers who require prudence to protect themselves from the weaker employers, rather than necessarily the trustee protecting the scheme as a whole. This creates a natural tension for strong employers. They might prefer a direct and bespoke approach to managing their pensions funding challenge and, as long as SHPS continues to take the same funding approach to all employers, this is only possible outside of SHPS in a single-employer scheme. Smaller employers may also gain from transferring if only to access better insurance pricing and to obtain DC freedom. Any employer looking at exit as an option (for control, flexibility or settlement) needs to weigh this up against the efficiencies of being in a multi-employer scheme.

Looking ahead

Looking ahead to the 2023 valuation, none of these issues will go away. In fact, although things have got worse this time from market conditions largely, next time they could get worse because of regulatory pressures and the new DB funding code. We will continue to work with the sector and individual housing associations to find the right solution for each organisation.

The impact will depend on a housing association's individual profile.

The impact will depend on whether you continue to offer DB new accrual as well as other factors such as the maturity of your participation and size of membership.

Questions for employers:

The decisions you need to make and how you make them will depend on what your obligations in SHPS are and what your objectives are. Planning the route through to your preferred position will naturally follow.

You may ask the following questions for each part of your participation:

DB past service

- What has caused the change in deficit allocated to your organisation?
- Is the pace of funding appropriate?
- What is the level of risk being taken in the investment strategy?
- What are the alternatives?
- Is there a way to offer a member options exercise?
- Can you use your balance sheet more effectively?

DB future service

- How does the contribution rate compare to staff in other pension schemes?
- Is the benefit valued by staff?
- Will you pass any contribution increases to your staff?
- Does the cost to employers meet your inclusivity objectives?

DC offer

- Are your staff getting value for money from their pension scheme?
- Are you comfortable with the degree of flexibility offered to staff in relation to investment options and retirement choices?
- Are you happy with the governance structure and quality of engagement with you and your staff?

How Isio can help

We can help you and your organisation to consider the **impact on projected costs over the short, medium and long term and** get from where you are now to where you want to be.

Our SHPS 2020 valuation modules are designed to offer in depth, tailored analysis of your organisation's participation, in order to inform decision making and strategy:

SHPS DB review module

- This component will set out analysis and insight in a report specific to your organisation.
- There is an additional section if you are still accruing DB benefits for future service.

Full scope and pricing available on request

SHPS DC review module

- This report will set out a comparison of key features of the SHPS DC section against current best market practice to assess the value being provided to your staff.

Full scope and pricing available on request

Please contact us for more information or if you would like to speak through any of the issues here in the context of your organisation.

Contact us

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