

Annual Report

Year to 30 September 2010



Chair's Statement 2010

I am pleased to present this Annual Report on behalf of the Scottish Housing Associations' Pension Scheme Committee. My statement this year considers our latest 'health check' valuation update at 30 September 2010. It also looks back at the actuarial valuation to 30 September 2009 and will focus on the changes in the benefit structure of the Scheme that have been triggered by the funding shortfall identified in the 2009 valuation.

Looking forward, I will also cover some positive measures we are introducing to protect the interests of you, our members, and have some encouraging news in this respect, as we begin a review of the risk posed by individual employers to the Scheme and their ability to meet the future pension liabilities.

Looking back over the last 24 months

This last two years have been challenging for members of the Committee and I would like to thank them all for their support, hard work and commitment in serving the interests of the Scottish Housing Associations' Pension Scheme and our members and employers. The Committee had to: consider and complete the actuarial valuation and review of the benefit structure of the Scheme; take difficult decisions to protect the long-term interests of members and employers; and remain vigilant and react to broader changes affecting the pensions industry and the general economy, in the aftermath of the global 'credit crunch' and ensuing stock market declines.

I also want to take the opportunity to give a special thanks to Ken Tudhope, a member of the Committee, for all his hard work in heading up a review of the management of the Scheme. This involved the use of Barnett Waddingham, a leading firm of independent actuaries and consultants, to ensure that we were receiving value for money from The Pensions Trust, which acts as trustee and administrator for our Scheme. The outcome of the review was confirmation that The Pensions Trust is providing a high quality service to the Scheme and at market competitive rates. This review also led to the Scheme adopting a passive management investment strategy for our global equities, a move which should reduce the risk that our investment returns from equities underperform investment benchmarks.

Further progress on the path to recovery!

Whilst the 2009 valuation results were understandably disappointing when compared to the 2006 results, they did nevertheless show an improvement in the position that I reported for 2008. It is pleasing to be able to report further progress in the recovery in our pension scheme in 2010 as well as another year of 3% membership growth.

The Scheme's key performance indicators for 2009 and 2010 are shown below:

- Membership continued to increase by 3.0% in each of the years 2009 and 2010, to total 7,939 members at 30 September 2010.
- Net assets of the Scheme rose by £29.8million (11.2%) in 2009 and by £40.5million (13.8%) in 2010, to stand at £335.1 million at 30 September 2010.
- Annual contributions receivable increased by 9.5% to £24.1million in 2009 and decreased by 2.2% to £23.6million in 2010.
- We achieved a positive investment return of 10.6% in 2010, a further improvement on the return of 6.6% achieved in 2009 (though these came after a fall of 17.9% in 2008).
- Our latest actuarial valuation 'health check' to 30 September 2010 indicates that the funding level of the Scheme improved further to 67.4%, from 64.8% at the last full actuarial valuation carried out at 30 September 2009.

The worst point in the Scheme's funding shortfall had already occurred by 30 September 2008, when the funding level fell to 63.9% at the height of the global financial crisis. Since then the Scheme's funding position has improved and we have taken small but positive steps forward on the path to recovery in both 2009 and 2010, with improvements in the funding level to 64.8% and then again to 67.4%. Whilst global equity markets, in which the Scheme is heavily invested, have risen quite strongly since 30 September 2010 and will improve the funding position even further if this trend is maintained, recent events in South-East Asia will have set this position back somewhat.

The Actuarial Valuation

As expected, the Scheme's actuarial valuation at 30 September 2009 revealed an increased funding shortfall in the Scheme due to the global financial crisis and ensuing stock market declines. That is, the growth in the value of members' benefits (the liabilities) out-stripped the growth in the assets of the Scheme.

The valuation revealed that costs are continuing to increase. Results of the valuation identified a funding shortfall of £160 million, an increase of £107 million. This means, that as at 30 September 2009 the Scheme had assets covering 64.8% of its liabilities.

As a result, and based on actuarial advice, the Committee has agreed to put in place a recovery plan which aims to eliminate the funding shortfall in the Scheme by 2024. In agreeing the recovery plan, the Committee adopts a level of prudence in its assumption setting process, so as to reduce the likelihood of the funding position deteriorating. However, we cannot guarantee that the Scheme will be immune from future financial storms similar to those we witnessed over the three years to 30 September 2009. For this reason, if changes are made to our recovery plan, it is because they are led by unforeseen real world events, such as the 'credit crunch', rather than a failure to put in place a plan based on prudent assumptions.

The two key reasons for the increase in the funding shortfall in the three years to 30 September 2009 were: poor investment returns, due to the global financial crisis, which contributed £75.5million to the shortfall; and changes in the longevity assumptions, to reflect the fact that people and our members are living longer, which added a further £19.5million to the funding shortfall.

Hindsight is wonderful, or is it?

This latest financial turbulence has had an impact on our Scheme, but pensions are long-term investments and short-term financial storms can be overcome and pass. Over the next few years, the outlook for financial markets and for our funding level appears 'choppy', but in the longer-term we expect recovery in financial markets and continuing recovery in our funding level. We remain of the view that our Scheme should focus on the long-term and that the most appropriate investment strategy for the Scheme is to invest a large percentage of its assets in equities (company shares).

Over long periods of time the investment returns from equities have been shown in the past to outstrip those from safer investments that pay interest, such as government bonds. This means the contributions required from employers and members, to fund members future pensions, is likely to be lower over the long haul for a pension scheme that invests heavily in equities, compared with one that invests heavily in bonds.

However, there is a downside and this is that there will be periods when equities underperform and fall in value – the volatility risk – and this can lead to a funding shortfall in the Scheme such as we are experiencing currently. If we invested less in equities and more in bonds, to reduce risk, higher contributions would be required from employers and members. This is because we would strip out the expected higher investment returns from equities that are required to fund the average member's pension which will become due in about 20 years time.

The Committee are constantly looking at ways of reducing the Scheme's exposure to risk which arises from the choice of investments. Indeed, as I mentioned earlier, the Committee have already taken action in this area by requesting that the Trustee adopt a passive management investment strategy for our global equities, a move which should reduce the risk that our investment returns from equities underperform investment benchmarks. Over the next few months we will give this area further consideration, especially more diversification of our growth assets and protection against inflation and interest rate risk.

Now to the wondrous benefit of hindsight. Hindsight is only of benefit if it provides lessons that improve the decisions we have to make today about our future.

Some members and employers have looked at the increase in the funding shortfall that occurred over the three years to 30 September 2009 and concluded that in 2006 the Scheme's investment strategy of investing heavily in equities should not have been adopted. They also question continuation of this current investment strategy today.

Further, some employers believe that if the Scheme had been offering defined contribution (DC) pensions then employers would not now be faced with increased contributions to fund the increased funding shortfall which has arisen due to the stock market declines that occurred in the three years to 2009. These are valid issues for members and employers to raise and I think it only fair that I address these issues, as Chair.

In 2006 the overwhelming consensus was that the global financial system was in great shape and perhaps no voice echoes the sentiments of that time more clearly than that of the then Chancellor of the Exchequer, Gordon Brown, with his repeated assertion 'no more boom and bust'. Investment advice at that time was that investments in equities and property were appropriate and were expected to rise in value in the years ahead.

However, had the Committee had a maverick view and also the conviction to propose change to its investment strategy and go against the investment consensus that prevailed at that time, then it would have had to have consulted with its employers prior to doing so. It would also have had to explain to employers that the consequence of this decision would be that the funding shortfall at that time would increase and also require to be funded by additional contributions by members and employers. It would have had to convince employers to pay more at that time and invest more in bonds to avoid the future risk of stock markets declining.

Today, as then, we face the same question that also requires a similar decision. By adopting a long-term approach and investment strategy that seeks the higher long-term return from shares, we benefit from lower contributions being required to fund expected future pension liabilities, but run the risk equities will fall in value periodically and require additional contributions to make up the shortfall. What should we do? We remain of the view that our Scheme should focus on the long-term and that the most appropriate investment strategy for the Scheme is to invest a large percentage of its assets in equities, given the relative immaturity of the Scheme in terms of its future pension liabilities. Our view is based on advice that it is appropriate provided by the Scheme's investment advisers, Mercers Investment Consulting, a leading global provider of investment advice.

Turning to the view of some employers that the Scheme should be offering a DC option as an alternative to the defined benefit (DB) options we currently offer, such as final salary or career averaged revalued earnings (CARE), I would ask members and employers to consider what would have happened if this had occurred in 2006.

If DC funds had been largely invested in equities in 2006, then they would have suffered from the same stock market declines as has been experienced by the DB pensions currently offered by the Scheme. However, the fundamental difference is that the employer would no longer have any legal responsibility for putting right the funding shortfall. Instead, the staff member would have to increase their own contributions significantly, with no additional contributions from their employer; or, more likely, accept a significantly smaller pension when they retire. Due to the scale of this transfer of risks from the employers to members, the Committee is clear that the introduction of a DC option would represent a fundamental change in the existing benefit structure of the Scheme.

The benefit review

As you know, the Committee acts as 'quasi trustee' for the Scheme, under powers delegated to it by the trustee, Verity Trustees Limited. In addition, it has a role, on behalf of employers, to agree the benefit structure with the Trustee. During late 2009 and throughout 2010, the Committee was kept very busy in undertaking these roles as it managed the actuarial valuation (its Trustee role) and the benefit review (its employer role). In carrying out their duties, Committee members have to carefully consider potential conflicts of interest that may arise when making decisions and take account of the best interests of members, employers and of the purpose of the Scheme, which is to offer the highest quality pensions possible to the Scottish housing association sector.

The Committee has consulted with employers and has decided to extend the Scheme's benefit options to address concerns raised by employers regarding both the affordability of the existing pension benefit options currently offered and also the risks they face from pension liabilities continuing to increase in future years. The benefit options offered by the Scheme will be extended from 1 April 2011 to incorporate two additional DB options. These are the CARE 80th contracted-out option and a CARE 120th contracted-in option. The two additional options are being offered in direct response to a consultation exercise that the

Committee undertook with employers in June and July 2010. Feedback from the consultation exercise suggested a number of employers felt that we needed to provide more options to them. This arose out of concern over both increasing costs and the growing business risk of offering what is seen by some to be 'gold-plated' DB pension options.

The risk of increasing costs was seen by some employers as being all the greater because of the introduction of new pension regulations from 2012. These regulations will make it obligatory for employers to automatically enrol staff into pension arrangements, in some cases as early as 2012. Auto-enrolment is likely to increase rates of membership among employer organisations (something we welcome), but this does not come without cost implications. For many employers, auto-enrolment into the existing final salary, or CARE benefit options, would prove very costly and the new benefit offering will give employers more opportunity to manage their pension costs.

We wrote to employers in September 2010 setting out the range of benefit options that would be available to them from April 2011 and, if you are an active member of the Scheme, your employer will have consulted with you on its proposed benefit option and contribution levels during the period 1 November 2010 to 28 February 2011. You should note your accrued benefit, including any benefits you currently receive as a pensioner, or that you have deferred from previous membership of the Scheme, will not be affected by these changes.

During our consultation exercise (and since), some employers have expressed the view that a DC option should be set up within the Scheme. Indeed, the Committee carefully considered whether offering DC was appropriate within the Scheme's structure of benefits. This would represent a significant departure from the Scheme's more traditional DB choices. Under DB structures, if the investment performance of the Scheme is poor, or life expectancy increases, for example, the employers bear the risk of this and, whilst member contributions might rise, ultimately employers are required to stand behind the 'pensions promise' and meet the shortfall. Under DC structures, this risk is all borne by the scheme members themselves. Where DC is introduced, this prospect must be considered and understood by employers and their members.

The introduction of DC does not eliminate risk, as some seem might think. If we introduced DC at some future point, the risk would all pass to members for future benefits. This is the risk that investments don't perform well and that the cost of providing benefits at retirement might fluctuate. However, employers would still bear the risk that comes with funding existing benefits that have accrued prior to any change.

Whilst some employers are keen to pass on this future risk to their staff, the Committee did not receive sufficient support to warrant its introduction at this time. In addition, it has further concerns about governance and cross-subsidy being required from the DB options of the Scheme. Should it introduce DC in the future, the Committee would have to be satisfied that it had sufficient support from employers, to the extent that they would be prepared to meet the costs of its introduction and necessary ongoing governance and management. It would be unfair that the burden of cost should be met by the employers (and you, their members) who do not wish to see such a change. The Committee would also want the employers themselves to ensure that they and their members of staff fully understand the implications of DC both for the existing DB benefits and of the transfer of future risk to members.

Employers were asked to select the pension benefit options they wished to provide to both their existing staff and any new employees from 1 April 2011. Employers were asked to respond by 28 February 2011. Based on these 158 responses, employers will be offering the following benefit options:

Number of Employers	Benefit Options available
102	Final salary for all staff
5	Final salary for all staff plus CARE 60th or CARE 70th
4	Final salary for all staff plus CARE 80th or CARE 120th
15	Final salary for existing members only plus a CARE 60th or 70th for new staff and/or existing members
13	Final salary for existing members only plus a CARE 80th or 120th for new staff and/or existing members
8	CARE 60th or CARE 70th for all staff
3	CARE 80th for all staff
8	CARE 120th for all staff

Whilst we are aware that a number of employers will be reviewing the pension benefit options they offer staff during the coming year, it is pleasing to report that the three original benefit options that existed before the recent changes (final salary 60ths, CARE 60ths and CARE 70ths) continue to receive overwhelming support from the majority of our employers (82%).

Further, although the CARE 120ths benefit option affords the greatest opportunity to minimise risk when selected for all staff (for those individual employers who are concerned about their build-up of potential future liabilities and the risk inherent in the above DB pension options), a small minority of employers selected this option (5%).

Protecting the Scheme

The strength of the employer covenant plays a key role in ensuring the long-term viability of the Scheme. Monitoring the employer covenant involves assessing the financial strength of employers and also their willingness to continue supporting the benefit options provided by the Scheme. The employer covenant is assessed for both individual employers and also all employers participating in the Scheme collectively. The purpose of the assessment is to ensure that individual employers have the ability to meet their future pension liabilities and that members receive their pensions when they retire.

Our assessment of the employer covenant is that it is strong and, therefore, that employers collectively have the ability to meet their future pension liabilities. The employers participating in the Scheme are overwhelmingly Registered Social Landlords who own housing assets and also belong to a sector that is strongly regulated to ensure their financial strength is maintained.

The strength of the Scheme's employer covenant allows it to invest heavily in equities, which should reduce the contributions required by members and employers to fund future pension liabilities, in comparison with an investment strategy heavily invested in bonds. If our assessment of the employers covenant was that it was weak, or deteriorating, then we would be likely, amongst other measures, to adopt a more conservative investment strategy. This would have the effect of increasing the funding shortfall and increasing the contributions required from members and employers. We will continue to monitor the employer covenant and introduce protective measures, as required, to ensure that the strength of the employer covenant is maintained. Any action we take to ensure that the strength of the employer covenant is maintained will be taken in the best interests of our members and employers collectively.

More recently, the Committee commissioned PwC, a firm of international chartered accountants and experts in this field, to advise it on the introduction of an appropriate employer covenant assessment framework to protect the Scheme by identifying 'higher risk' employers. Their work included testing their assessment framework on a large sample of 50 employers participating in the Scheme. The aim of these tests was to ensure that for individual employers identified as 'higher risk', this categorisation appears appropriate.

Their work in respect of this representative sample of employers has given us very good news in terms of the ability of the employers surveyed to support the Scheme by passing the robust financial tests that are being set. If our investigation of the remaining employers brings up similar results, then we would expect that our view of the ability of the employers as a *whole* to support the Scheme will be positive when we review it again as part of the next valuation in 2012 with only a small minority of employers expected to be assessed as 'higher risk'.

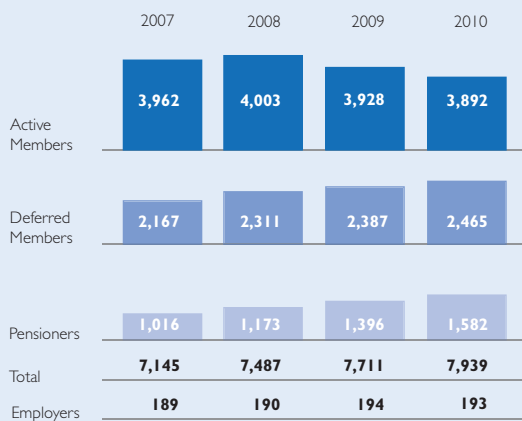
Where employers pose too high a risk to the Scheme (and thus to the Scheme's ability to meet your pension), it is the intention of the Committee that these 'higher risk' employers move their staff to the CARE 120ths pension benefit option for future service, unless they can offer adequate security to the Scheme to cover their pension liabilities. We are looking to them to reduce significantly their future build-up of pension liabilities, in the interests of all employers and members. Employers that are not prepared to reduce their build up of pension liabilities may not be permitted to continue to participate in the Scheme.



Membership news

It is particularly pleasing to report that membership of our pension scheme increased by 3.0% during the year. I wish to take this opportunity to extend a warm welcome to our new members.

Membership



I have been able to report three pieces of very good news in this report:

1. the Scheme's funding position is recovering;
2. the preliminary results of the independent employer covenant assessment exercise we have carried out shows that the sampled employers collectively have the financial strength to meet their pension liabilities; and
3. the majority of employers (70%) have responded to the benefit review by continuing to provide the final salary 60ths benefit option for all their existing and new staff; and employers collectively have also responded overwhelmingly in support for the principle of offering the highest quality of pensions possible to their staff.

The provision of decent pensions for our members remains a key priority of the Committee and with the continued support of employers our final salary and CARE schemes remain open to new members, while many other final salary and CARE schemes in the UK have closed to new members, or indeed, closed even to existing members.

As some of you will be aware, the Independent Public Service Pensions Report, Chaired by Lord Hutton, has just been issued. Its key recommendations are that:

- the core design of public sector pensions should be based on DB pensions, rather than DC pensions;
- that CARE pensions should be introduced that deliver members with adequate levels of income in retirement that are defined;
- that members should make additional contributions more reflective of the value of the pension benefit they receive; and
- pension retirement ages should generally increase in line with the State Pension age.

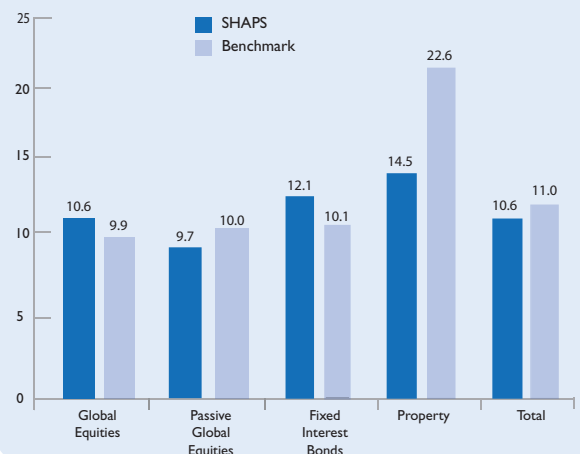
We have received representation from employers suggesting the Committee is 'behind the curve' in terms of it agreeing changes to the Scheme's benefit structure in line with the radical changes being proposed for public sector pensions. The proposed implementation timescale for the above changes is by 2015, following consultation between the government and the unions. Our proposed time scale for change is – now! The Committee has already delivered a benefit structure that meets the essential criteria of the above proposals for its employers and also meets the Committee's objective of providing decent pensions to its members.

The independent Pensions Commission has proposed 'the deal' as being fair to both employee members and the public purse, represented by taxpayers, with Lord Hutton stating 'I believe this is a balanced deal that will ensure public service workers continue to have good pensions and taxpayers can have confidence that costs are controlled.' The Committee hopes that its employers, representing the social housing sector, and who are similarly conscious of the cost of pensions for the public purse and their tenants, can reach a similar fair deal and continue to support offering decent pensions to their employees, our members.

I would like to thank the staff of The Pensions Trust for their dedication in ensuring another year of successful growth for the Scheme. Also a special thanks to our employers and members for their support. Finally, during this challenging time for pensions, members can be assured that protection of your Scheme and the provision of decent pensions for our members remain the key priorities of the Committee.

Malcolm MacDonald
Chair
25 March 2011

Scheme Investment Performance



Fund Statement - For the year ended 30 September 2010

	2010 £'000	2009 £'000
Contributions paid by members and employers	23,603	24,122
Group and individual transfers in	-	80
Total money in	23,603	24,202
Benefits paid (pension and lump sums)	(10,179)	(9,290)
Payments to leavers	(710)	(1,103)
Administrative costs	(726)	(759)
Specific expenses	(114)	(94)
Pension Protection Fund	(115)	(78)
Total money out	(11,844)	(11,324)
Net new money available for investment	11,759	12,878
Return on investments		
Investment income and gains	29,989	17,737
Investment management expenses	(1,184)	(881)
Net returns on investments	28,805	16,856
Net (decrease)/increase in the Fund during the year	40,564	29,734
Fund summary		
At the beginning of the Scheme year	294,568	264,834
At the end of the Scheme year	335,132	294,568

Net Asset Statement at 30 September 2010

	2010 £'000	2009 £'000
Global Equities	122,476	222,753
Passive Global Equities	131,001	-
Fixed Interest Bonds	57,802	50,422
Property	20,832	17,828
Total Investments	332,111	291,003
Other Assets	3,021	3,565
Net Assets at end of Scheme year	335,132	294,568

The Scottish Housing Associations' Pension Scheme is part of The Pensions Trust and this statement summarises the transactions of the Scheme and its proportionate share of expenses, investment returns and investments. The figures shown in the statement have been extracted from the audited accounts of The Pensions Trust, which were approved at a meeting of the Trustee on 18 January 2011. The summary report is not intended to be a formal financial statement according with the terms of the SORP (Statement of Recommended Practice) for Pension Schemes. The full Report & Accounts of The Pensions Trust and the Scheme are available on request.

Benefits of the Scheme

As a contributing member of the Scottish Housing Associations' Pension Scheme you benefit from the following:

- A pension payable from retirement for the rest of your life, related to your final pensionable earnings at retirement or (for some members) your average earnings in employment.
- Retirement age of 65, with the option to take early retirement.
- On retiring you may be able to take all or part of your pension whilst continuing to work and if you wish you can continue to accrue further pension benefits (conditions apply).
- An immediate pension if you retire due to ill-health (in defined circumstances).
- The option to exchange some pension for a tax-free lump sum on retirement; you may choose the amount (within limits) that best suits your needs.
- Annual pension increases in retirement.
- Life Assurance (of three times your pensionable earnings) if you die whilst contributing to the Scheme (not applicable once contributions cease).
- Partner's and/or children's pensions if you die before or after retirement.
- Lump sum payment to your nominee(s) if you die after leaving the Scheme but before you start to receive your pension, or if you die within five years of commencement of your pension.

Your Feedback

We welcome members' feedback. If you have any questions, comments or ideas of how we could improve the Annual Report in future; please contact Susan Wardlaw at The Pensions Trust, Conference House, 152 Morrison Street, Edinburgh EH3 8EB or email shaps@thepensionstrust.org.uk

The Scottish Housing Associations' Pension Scheme Committee Members

The Committee meets at least four times a year to monitor the Scheme. It has responsibility for the successful management and operation of the Scheme in the interests of all members.

The Committee includes:

- Five individuals elected by members.
- Five individuals elected by employers.
- Up to three co-opted members.

The Committee members are currently:

Malcolm MacDonald, Govanhill Housing Association
Christine Murphy, Elderspark Housing Association
Sally Inkster, Orkney Housing Association
Ken Tudhope, Atrium Homes
Ahsan Khan, Loreburn Housing Association
Fiona Nicholl, Ochil View Housing Association
Sean O'Drisceoil, Tighean Innse Gall
Margaret Bradley, formerly
North Glasgow Housing Association
Duncan McNaught, West of Scotland Housing Association

The Scheme Secretary is Susan Wardlaw, who is based at The Pensions Trust's Edinburgh office.

Electronic Annual Report

In considering our responsibility to the environment, together with reducing Scheme costs we are giving employers and members the opportunity to receive future Annual Reports electronically. If you wish to take up this option please email the details noted below to shaps@thepensionstrust.org.uk

- Name or Organisation Name
- Membership or Employer Number
- Date of Birth (if you don't have your member number)
- Your preferred email address

