

Scottish Voluntary Sector Pension Scheme (SVSPS)

Briefing Paper for Employers June 2009

1. Executive Summary

Key actuarial valuation results

- The funding position of the Scheme has deteriorated to 68.8% as at 30 September 2008 (down from 83% as at 30 September 2005).
- The Scheme deficit has increased to £20.438m as at 30 September 2008 (up from £6.719m as at 30 September 2005).
- The cost of meeting the increased deficit (over a ten year period from the actuarial valuation date) is 6.65% of pensionable earnings (up from 2.7% over a 16.5 year period as at 30 September 2005). From 1 October 2018 to 31 March 2022 the deficit contribution would reduce to 2.7% of pensionable earnings.
- For the 60ths benefit structure the total cost of future benefit accrual (employer and member contributions combined) inclusive of administration expenses and PPF levies is 23.1% (up from 20.0% as at 30 September 2005).
- For the 80ths benefit structure the total cost of future benefit accrual (employer and member contributions combined) inclusive of administration expenses and PPF levies is 17.7% (up from 15.3% as at 30 September 2005).
- As matters stand, if no increases were made to member contributions, the standard employer contribution rate (inclusive of deficit costs) would increase from 15.2% to 22.25% for the 60ths benefit structure, and from 12.0% to 18.35% for the 80ths benefit structure (assuming standard member contributions of 7.5% for 60ths and 6.0% for 80ths). **Please note some employers and members currently pay non-standard rates.**

Consequences of the actuarial valuation results

- The SVSPS Pensions Committee ('the Committee') has considered the actuarial valuation results, the financial strength of participating employers and the 'employer debt' regulations and has taken the difficult decision to close the Scheme to future accrual of benefits from 1 April 2010.
- Members' accrued benefits to 31 March 2010 will continue to be based on the final pensionable earnings at the date they leave employment.
- Employers with 50 or more employees will have to consult with 'affected members' (Scheme members, and employees eligible to join) about the closure. Regardless of the statutory position, consultation is 'best practice' and all employers are recommended to undertake some form of consultation.
- Employers will have to find a replacement scheme for employees' future pension provision.
- A methodology for collecting deficit contributions – to bring the Scheme up to 100% funding over time – has been developed.

- Employer forums will be held in Edinburgh and London in July 2009.

2. Background

- 2.1. As employers will be aware, final salary schemes, such as the SVSPS, are required to be valued at least once every three years.
- 2.2. Provisional figures relevant to the position as at 30 September 2008 are now available and are covered within this paper.
- 2.3. Pension scheme funding regulations require schemes to have sufficient and appropriate assets to cover their 'technical provisions', which are essentially the liabilities in respect of the Scheme members. In arriving at a basis for calculating the 'technical provisions', the trustee is required to adopt 'prudent' assumptions.
- 2.4. Where the actuarial valuation reveals a deficit, a Recovery Plan will need to be implemented. The Recovery Plan will determine how, and over what period, the employers will fund any shortfall. The Pensions Regulator has intimated that deficits should be paid off over a 'relatively short period of time'.

3. Why have the actuarial valuation results worsened since 2005?

- 3.1. Financial markets have not performed very well of late, and the performance achieved by the SVSPS over the three years between the 2005 and 2008 actuarial valuations fell well below what the Scheme Actuary had allowed for in the 2005 actuarial valuation.
- 3.2. The investment return assumption that the Scheme Actuary had assumed in 2005 was 5.87% a year. The actual return was 1.09% a year. This adds £5.805m to the deficit.
- 3.3. Further negative effects have been due to changes in the longevity (mortality) assumption and inflation assumption (and corresponding salary increase assumption).
- 3.4. Longevity Assumption
 - 3.4.1. There has been widespread discussion in the media about people living longer and longer.
 - 3.4.2. This has a profound effect on pension scheme costs. Each year longer that members live, over and above the assumption that has been made by the Scheme Actuary, results in an additional year's pension benefit being paid in respect of all members.

3.4.3. The following table shows the difference in the ages that people are expected to live beyond age 65 at the 2005 actuarial valuation and now at the 2008 actuarial valuation.

Life expectancy in years at 65	2005 Actuarial Valuation	2008 Actuarial Valuation
Male	19.3	22.2
Female	22.2	24.9

Providing a pension for an average of an additional two to three years adds around £4.731m to the deficit. It also means the cost of future pensions is higher.

3.5. Inflation assumption

3.5.1. Although inflation is low at present, this was not the case at the actuarial valuation date and inflation had been increasing during the three years since the last actuarial valuation. The Scheme Actuary has used a long-term assumption of 3.2% for the 2008 actuarial valuation (up from 2.5% in 2005).

3.5.2. Whilst the increase in the inflation assumption is only 0.7%, this also feeds through to the increase in the assumption used for predicting salary increases – which is inflation **plus** 1.0% for five years from April 2010, then inflation plus 1.5%.

3.5.3. The change to both the inflation assumption and the salary increase assumption adds around £6.241m to the deficit. It also means the cost of future pensions is higher.

3.6. On the positive side, there have been more early leavers than expected, resulting in a funding gain of £1.897m. Changes in the financial assumptions regarding future investment returns have also improved the position by £2.951m.

4. Closing the Scheme to future accrual of benefits

4.1. Market conditions have deteriorated since the actuarial valuation date, with a further drop in asset values.

4.2. As matters stand, the additional contribution requirement for the 60ths benefit structure is 7.05% of pensionable earnings and 6.35% for the 80ths benefit structure. This could be split between employers and members. While some employers will be able to bear this increase in contributions (most likely if it is shared with members, and by switching from 60ths to 80ths), many employers will not.

4.3. The Committee considered various alternative benefit structures, but noted that the history of recent increases in contribution rates may be repeated indefinitely.

If lower cost defined benefit (DB) benefit structures are introduced – the 80ths benefit structure was introduced less than two years ago – it is possible that cost increases could quickly render them unsustainable.

4.4. The table below summarises the Scheme’s recent contribution history:

Actuarial valuation date / (contribution increase date)	Total standard contribution as a % of pensionable earnings	Standard Employer Contribution	Member Contribution
60ths			
2002 (April 2004)	18.0	12.0	6.0
2005 (October 2007)	22.7	15.2	7.5
2008 (April 2010)	29.75	22.25	7.5
80ths			
2005 (October 2007)	18.0	12.0	6.0
2008 (April 2010)	24.35	18.35	6.0

4.5. For those employers who feel they could afford to continue to offer the Scheme, it should be noted that the Scheme is immature. Each year of benefit accrual adds significantly to the emerging liabilities which employers will ultimately have to pay for.

4.5.1. As each year passes, active members build up an estimated £4m of liabilities on an ongoing basis (significantly more if calculated on a debt on withdrawal calculation basis) within the Scheme.

4.5.2. These liabilities are notionally allocated to each participating employer, ready to be totted up in the event of that employer ceasing to participate. The build up of significant additional liabilities would mean even greater pressure on participating employers in the event of a future market downturn.

4.6. It is unlikely that many SVSPS employers would have sufficient resources to meet the required debt should they cease to participate in the Scheme. The ‘covenant’ (the ability to meet the cost of providing the promised benefits) of participating employers is not especially strong overall, as a number of organisations are reliant on funding and do not own assets like property, or have large reserves that can be called upon to support the Scheme.

4.7. There is a growing school of thought that organisations which do not have physical assets such as property or significant unrestricted reserves which can be earmarked for pension purposes if necessary, shouldn’t be participating in a

DB scheme. The debt on withdrawal regulations make it very difficult to justify including these organisations in a multi-employer DB scheme.

4.8. The issue of debt on withdrawal is a concern for stronger employers, as they will pick up the residual costs for members whose employers have left the Scheme unable to pay their debt on withdrawal in full.

4.8.1. Since September 2005, 14 employers have withdrawn from the Scheme. Five employers paid their debt in full; two are paying by instalments; five cases are still under discussion. A little over £1m could not be recovered in respect of two withdrawing employers.

4.9. If an individual employer closes the Scheme to new members, then a 'withdrawal debt' is payable when the employer's last active member leaves service. Employers have been advised individually, in the letter issued with this mailing, of their estimated withdrawal debt as at 30 September 2008.

4.10. The Committee wrote to all participating employers in June 2008 to say that a Defined Contribution (DC) benefit structure would be added to the Scheme's benefit structures from 2010. The intention was to provide a means for employers who could no longer support defined benefit provision to continue to have active members in the Scheme and so avoid a debt on withdrawal.

4.11. It is more cost-effective for many employers to make their own DC arrangements for future service provision (through either The Pensions Trust or another provider), as a significant extra layer of cost is added when a DC arrangement is included in an existing DB scheme. The only reason to have done this would have been if some DB provision was continuing, to avoid debt triggers.

4.12. Simultaneously closing a multi-employer scheme to accrual doesn't trigger a withdrawal debt, but employers are still obliged to fund past service benefits.

4.13. The Committee noted that, as time has gone by, provision of a DB scheme has become less important for recruitment and retention.

4.14. As outlined in 4.10 above, the Committee hoped to include a DC benefit structure within the Scheme to reduce the likelihood of debts being triggered. However, in the light of the cost increases outlined in the provisional actuarial valuation results, the rate at which additional liabilities are building up in the Scheme and the ability of the Scheme's participating employers to pay in full any debt on withdrawal, the Committee has, with great regret, decided that the Scheme should close to future accrual of benefits from 1 April 2010.

5. Issues arising from closure to accrual

5.1. When the Scheme closes to future accrual, the Rules require that members' benefits will be calculated using their service to the date of closure and their final pensionable earnings at their eventual date of leaving, retirement or death. Liabilities will therefore continue to increase in line with members' earnings.

5.2. Closing the Scheme to future accrual of benefits will create an issue for employers who have issued contracts of employment that refer specifically to

membership of a DB or final salary pension scheme. However, it is not expected that many employers have such contracts and the Committee needs to consider its responsibilities for the Scheme as a whole.

- 5.2.1. It is possible to change contracts of employment, though legal advice and consultation will be required.
- 5.2.2. It may be possible to apply for membership of the Local Government Pension Scheme provided the organisation has an acceptable covenant, or a guarantor, and can meet the administering authority's criteria for 'admitted body status'.
- 5.3. Closing a pension scheme to future accrual is a listed change and employers with 50 or more employees will have to consult with their 'affected members' (current active members of SVSPS, and any employees' eligible to join but who have not done so). Regardless of the statutory position, consultation is 'best practice' and all employers are recommended to undertake some form of consultation. Guidance on consultation is included elsewhere in this mailing – please see the documents 'Questions & Answers for Employers' and the 'Consultation Template'.
- 5.4. Employers will have to find a replacement scheme for employees' future pension provision. A budget for employer contributions to this new arrangement will have to take account of the requirement for contributions to the SVSPS over a period of years to pay off the deficit.

6. Treatment of past service deficit

- 6.1. In tandem with taking the difficult decision to close the Scheme to future accrual, the Committee has had to consider how past service deficit payments should be calculated and collected.
- 6.2. The Committee has decided, on advice from the Scheme Actuary, to split the deficit by pensionable salary roll as at the actuarial valuation date. Scheme expenses will also be shared among participating employers. Please refer to the covering letter for your organisation's contribution for the year starting from April 2010.
- 6.3. Deficit contributions – both the amount, and the length of time over which they will be payable – will be reassessed every three years as part of the Scheme Actuary's valuation.
- 6.4. Eleven employers did not have any active members as at the actuarial valuation date and are consequently not paying anything towards the past service deficit. The Committee has agreed, following actuarial advice, that it is equitable for these employers to pay their share of the deficit based on the share of the liabilities they have accrued in the past.

7. Summary

- 7.1. The results of the 2008 actuarial valuation have presented a real challenge to the Committee to come up with a structure going forward that will be acceptable to participating employers and their members and, at the same time, adopt a set of assumptions that will not invoke the unwanted attention of The Pensions Regulator.
- 7.2. In reaching its decision to close the Scheme to future accrual of benefits from 1 April 2010, the Committee considered that future DB provision was unsustainable due to:
- the increases to contribution rates;
 - the prospect of further cost increases in future years;
 - the rate at which liabilities are building up in the Scheme each year;
 - the relatively weak covenant of a number of participating employers, and the threat this poses to stronger employers in the Scheme; and
 - the effects of the Debt on Employer regulations which apply when an individual employer withdraws from the Scheme.

The Committee also considered the concession within the debt on employer regulations which permits accrual to cease simultaneously for all participating employers in a multi-employer scheme without triggering debts on withdrawal.

- 7.3. As no further DB provision would be made within the Scheme, taking into account the cost implications and particularly bearing in mind the provisions of the debt on employer regulations, the Committee considered that it was not desirable to introduce a DC benefit structure within the Scheme.
- 7.4. The Committee recognises the practical difficulties that closing the SVSPS will impose on employers. Regional forums have been arranged in Edinburgh and London in July 2009 to provide more information and to give employers an opportunity to air their views. More details are enclosed with this mailing.