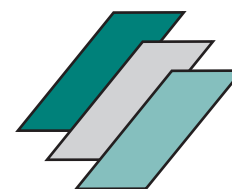


NEWSFLASH:

SFHA Pension Scheme wins UK award –

‘SMALL PENSION
SCHEME OF THE YEAR’



SFHA Pension Scheme

Major Review – Phases 1 & 2
Interim Report No. 2

October 2004

Executive Summary

- This report is second of a series, under the Major Review process
- Phase 1 Consultation completed on time
- Large response confirms success of consultation
- Responses confirm support for Scheme
- Employees and employers wish costs shared fairly
- Consultation results are detailed in this Report
- Committee decisions reflect majority views
- New contribution rates from April 2005 are:

Employee	7%
Employer	14%
Total	21%

- Financial update will check position at 30 September 2004
- Major Review Phase 2 has commenced
- Changes to Committee membership from 1 October 2004
- Pensions context and Government proposals still to be clarified
- Consideration of Asset/Liability Modelling to enhance investment
- SFHA Pension Scheme Award details are given in section 3.1

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1.0 Introduction and Background

1.1 This Interim Report

This report is the second of a series being issued by the Pensions Committee for information of members and employers as part of the Major Review process.

The report is intended to inform members of the background, current position and the proposed process for the second phase of the review.

2.0 Current External Background

Six months on from the first Interim Report there has been no significant change in the external pensions environment.

Pension schemes remain under significant pressure. The combination of taxation changes, increasing longevity and uncertain investment outlook have continued to lead to widespread scheme closures or review of the benefits on offer.

Our scheme therefore continues to operate against an uncertain background and in difficult investment conditions.

3.0 Current Scheme Development

3.1 Pension Scheme of the Year Award

Given this background, it is particularly pleasing to be able to report that the SFHA Pension Scheme has been awarded the title of "Small Scheme of the Year" by Professional Pensions Magazine.

Full details of the award are given on the next page.

Pension Scheme of the Year Award

Each year Professional Pensions Magazine organises a competition entitled “Pension Scheme of the Year”, for different categories of UK pension schemes.

The “Small Scheme” category is for pension schemes of up to £250 million assets. This is a prestigious award, on a competitive basis, judged by a panel of industry experts.

In coming to their decision, the judges took into account the industry-wide nature of the scheme and in particular:

- (i) The management of the scheme – including the quarterly Committee Meetings and review of issues facing the scheme.
- (ii) Communication and Consultation – this incorporated communication to members and employers, such as new member packs, Annual Benefit Statements, the Annual Scheme Review and took into account our recognition that as an industry-wide scheme, all SFHA Pension Scheme stakeholders should be informed and consulted before changes are made, as evidenced by our Major Review process and reports.
- (iii) Customer Service – the high level of customer service offered to members, and guidance and services provided to employers.

A great deal of work goes into the running of the scheme, both by the Committee and by The Pensions Trust, and this award recognises the effort and results achieved.

This gives a clear external verification of the Scheme’s high standards in these areas, and the Committee thanks all who have contributed to this excellent situation.

3.2 Committee Elections and Co-options

Committee members Alison Massie and Ann Scott retired by rotation and chose not to stand again. We thank them for their contribution to the Scheme over many years.

With effect from 1 October 2004, two new members have been elected to the Pensions Committee. The newly elected members are:

Kathryn Miller – Employer Representative
Christine Murphy – Member Representative

Their appointment follows a ballot of Scheme members and employers. Both new members bring a wealth of experience to the Committee.

Kathryn is Finance Director of the Scottish Federation of Housing Associations, a position she has held for four years. Previously, she spent six years as Assistant Director of Corporate Services at Old Town Housing Association. Kathryn qualified as a Chartered Accountant in Ireland and has since become a fellow of the Institute of Chartered Accountants and achieved an MBA.

Christine, who is Deputy Director/Finance Officer of Elderspark Housing Association in Glasgow, has been involved with the Housing Association movement for over 20 years. She is a graduate of the University of Strathclyde and has been a member of the Institute of Chartered Accountants of Scotland since 1980.

In addition to the new elected members, the Committee has also co-opted Sally Inkster to the Committee.

Sally is employed by Orkney Housing Association as Deputy Executive Director. She holds a first class Honours degree from The Open University and is a member of the Chartered Institute of Public Finance Accountants.

This appointment significantly strengthens the Committee links with the Highlands and Islands and Rural Housing Associations.

3.3 Committee Structure and Composition

Nomination Category	Member's Name	Comment	Location
Employee	Jim Wilson	Chairman	Dundee
	Malcolm MacDonald	Deputy Chair	Glasgow
	Christine Murphy	Link to Forums	Glasgow
Employer	Jim Michael	Link to EVH	Glasgow
	Kathryn Miller	Link to SFHA	Edinburgh
	David Molyneaux	Former HA Chair	Aberdeen
Co-opted	Alastair Miller	Actuary, retired	Edinburgh
	Sally Inkster	Rural & Islands	Orkney
	(Third Co-option)*	Pensions Expert	(See below)

* Technical appraisal by the Committee has greatly benefited by the co-option of Alastair Miller, a retired Actuary. To further strengthen its technical expertise, the Committee has formally approved the co-option of a named qualified pensions professional with very relevant experience. Details will be announced when discussion of arrangements is completed.

The Committee and Pensions Trust form a strong and balanced team for effective Scheme management.

3.4 The Pensions Trust Services

- Susan Wardlaw as Scheme Secretary
- Specialist Final Salary Administration Team
- Dedicated Client Manager for Employers
- Monthly meetings between The Pensions Trust Account Executive and Chair of the SFHA Pension Scheme
- Dedicated Major Review Project Team reporting to Major Review Sub-Committee

3.5 Asset/Liability Modelling

The Committee has established a Working Party to consider the future investment strategy of the Scheme. By investment strategy we mean the mix between the main investment asset classes (equities, bonds and property). This review is aimed at ensuring that the investments held under the Scheme are appropriate and match as clearly as possible the liability (future pension payments) profile of the Scheme. Appropriate actuarial advice is being obtained.

3.6 Scheme Growth

Against a challenging background, the Scheme is continuing to increase its membership. Over the year to 30 September 2004, membership has grown by just under 6%. The Scheme now includes over 6,000 members and 200 employers.

4.0 Major Review Phase I

4.1 Consultation Process and Results

Interim Report No. 1 confirmed that a new contribution rate of 21% was required for the Actuary to be able formally to sign off the 2003 three-yearly valuation. This required a 2.8% increase in the combined contribution level for employers and members.

As Phase 1 of the review process, the Committee approved the 21% combined rate but announced their intention to consult with members and employers over the apportionment of the 2.8% increase and to seek information on opinions and attitudes to assist in the second phase of the review.

Legally, the Committee was required to make a decision on the apportionment by 30 September 2004. The Phase 1 consultation process therefore needed to be completed in good time to give the Committee an adequate period to consider the results.

The Phase 1 review period was originally scheduled to finish on 30 July 2004, but to allow further time for feedback this was subsequently extended to 20 August 2004. The consultation process was completed on time in line with this timetable.

The consultation process took a number of forms, including:

(i) Members of the Committee and Pensions Trust employees attended a number of forums to discuss the Major Review. These included the East and West Coast Finance Forums, Rural & Islands Forum, EVH Management Committee Meeting and Senior Officers Forum.

- (ii) Members of the Committee and Scheme Secretary met with the T&G, Unison and GMB Trade Unions.
- (iii) Pensions Trust employees organised employee and employer focus groups to discuss their thoughts on the apportionment and take comments on the future of the Scheme.
- (iv) All active members and participating employers received a Consultation Feedback Form on which to indicate their preference for the apportionment of the increased contributions.

The Committee wishes to record its thanks and appreciation to all those members and employers who participated in the Phase 1 Consultation process.

Feedback from members indicated that support for the scheme and the benefits it offers remains strong. There was also recognition that an increase in the member contribution rate was required to retain this provision. Members, generally, were open to the suggestion of consideration of altering future benefits in the Scheme.

Employers also appreciated that the Scheme provides excellent benefits and is a valuable recruitment and retention tool, but they were conscious that if costs continue to rise the Scheme will become unaffordable to some employers.

Employers also recognised that the Scheme continues to attract new members but confirmed that it is becoming increasingly difficult to encourage younger staff to join the Scheme. Increasing rates may make the Scheme less attractive.

The level of response received to the Consultation Feedback Form was extremely high, with 32% of active members and 48% of employers responding. The full results are set out below.

Response forms were sent to contributing members (ie excluding pensioner and deferred members) and to employers.

Options for split in contributions issued for Consultation	Analysis of Consultation responses:			
	Active Members		Active Employers	
Option 1 – All to employers (employer 15.0%, member 6.0%)	Option 1	320 (25.4%)	Option 1	4 (7.0%)
Option 2 – 2.0% to employers, 0.8% to members (employer 14.2%, member 6.8%)	Option 2	206 (16.3%)	Option 2	6 (8.0%)
Option 3 – 1.8% to employers, 1.0% to members (employer 14.0%, member 7.0%)	Option 3	397 (31.5%)	Option 3	21 (27.0%)
Option 4 – Equally between employers and members (employer 13.6%, member 7.4%)	Option 4	299 (23.7%)	Option 4	36 (48.0%)
Option 5 – 1.0% to employers, 1.8% to members, (employer 13.2%, member 7.8%)	Option 5	19 (1.5%)	Option 5	4 (5.0%)
Option 6 – 0.8% to employers, 2.0% to members, (employer 13.0%, member 8.0%)	Option 6	5 (0.4%)	Option 6	2 (3.0%)
Option 7 – All to members (employer 12.2%, member 8.8%)	Option 7	9 (0.7%)	Option 7	1 (1.0%)
Option 8 – Other	Option 8	6 (0.5%)	Option 8	1 (1.0%)

4.2 New Contribution Rates

Taking into account the feedback from Phase 1 of the Major Review, the Committee unanimously voted for Option 3, taking the employer contribution rate to 14% and the member contribution rate to 7%. This decision was communicated to all active members and employers by letter posted on 30 September 2004.

In making this decision the Committee recognised that the overwhelming majority of members and employers acknowledge the need for the increase to be shared by both members and employers. This was clearly indicated by the majority of both categories who voted for either Option 3 or Option 4 as the way forward. It is also important to remember that employees

receive tax relief on any contributions and this has the effect of mitigating any increase. Even after this increase, the employer rate compares well with other surveyed rates.

The Committee were also particularly cognisant of feedback from all stakeholders of the need to ensure the Scheme remains attractive to new members and that any alterations to the Scheme, which may result from Phase 2, may mean a reduction in members' benefits. It therefore concluded it was reasonable at this stage to apportion more of the increase to the employer (Option 3) rather than a 50:50 split (Option 4).

This also restores the Scheme's original 2:1 employer/employee contribution ratio.

5.0 Pension Protection Fund

At the time of writing, the position regarding the Government's proposed Pension Protection Fund (PPF) is still unclear. The exact content and nature of the Pensions Bill which introduces the PPF, and which is due to come into effect from 6 April 2005, is unknown as many amendments to the Bill continue to be tabled. At the time of writing, the situation has been further confused by the resignation of the Pensions Minister and some commentators are now questioning whether the Bill will make it through Parliament at this time.

The original proposal was for the PPF levy to be raised on a "flat-rate" basis for a short period of time before moving to a risk-based levy, where well run schemes would be expected to pay a lower levy as they would be less likely to claim against the fund.

The Government has now confirmed that it will be 2009 before the risk-based levy is operational. There is also no confirmation, as yet, of how much any initial levy will be, if and when the PPF comes into existence.

6.0 Financial Update at 30 September 2004

The Committee has requested that a Financial Update for the Scheme be provided by the Actuary as at 30 September 2004. This will allow the Committee to assess whether there have been any significant changes to the valuation position reported at 30 September 2003 and enable the Actuary to reconfirm that a combined contribution rate of 21% from April 2005 remains appropriate.

The Financial Update is now in progress and the figures are expected to be available for Committee consideration in mid-November 2004.

7.0 Major Review Phase 2

7.1 Objectives and Scope

In Phase 2 we intend a completely fundamental review of the Scheme's structure and benefits. With changing economic conditions and employer and member expectations, this may result in a pension scheme which differs radically from the present Scheme – or in confirmation that the present arrangements are appropriate for the future.

Owing to the comprehensive nature of the review, a number of Working Parties will be established, consisting of Committee members and Pensions Trust employees. These Working Parties will look at financing implications, communication and publicity, strategy and planning and administration, technical and other issues. Where appropriate, external consultants will be utilised.

The Working Parties will report into the Major Review Sub-Committee which controls the whole Major Review on behalf of the Committee.

7.2 Plans and Timetable

The extensive nature of the review and desire for consultation mean that the earliest planned implementation of any changes to the Scheme as a result of Phase 2 is April 2006. In reality, to allow employers to plan the budgeting process, Phase 2 decisions should be taken by September 2005.

The second phase has started. The scope of the exercise may mean some alterations to this timescale will be required. The overriding priority is that the result is right for the Scheme's future.

We will endeavour to keep all members and employers informed of progress of the review. To this end, we plan to issue a third Interim Report by the end of March 2005.

7.3 Consultation Methods

Further consultation with members and employers will again form a vital part of the Committee planning for Phase 2 of the project. Once again, the Committee will be arranging a series of face-to-face consultation meetings. Consideration is also being given to a range of other consultation methods in order to ensure that the consultation process is as full and effective as possible.

8.0 Conclusion

The pension's context has rarely been so testing. We have an award-winning scheme that has met all challenges to date.

But consideration must now be given to the future direction of the scheme to ensure it continues to meet the needs of all its members and employers.

This second phase of the review process will be our next major task.

With your co-operation, the Committee aims to ensure that the process results in a scheme of which we can continue to be proud and which remains viable in today's increasingly challenging pension environment.

Comments or questions should be addressed to Susan Wardlaw, SFHA Pension Scheme Secretary, at the undernoted address.



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