

Date: April 2009
Our Ref: SHPS/CM1/0409
Direct Line: 0845 608 5252
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Dear

Social Housing Pension Scheme Valuation and Benefits Review

I am writing to you with important information for your organisation on the results of the Social Housing Pension Scheme (SHPS) latest valuation, its impact on contribution rates, and the new choices which the SHPS Pensions Committee is introducing to provide further lower cost options. Please ensure that this correspondence is passed to the appropriate individual within your organisation.

SHPS like most defined benefit schemes has been considerably affected by the current financial crisis and falls in investment markets. We have also needed to take account of current research showing increases in future longevity.

In determining the assumptions for our valuation, in consultation with the Scheme Actuary, HSBC, we have been mindful of:

- The worsened situation in the markets since 30 September 2008, the date of the valuation.
- The strength of the housing association sector's covenant which means that a relatively long-term view can be taken, both of the potential recovery of investment returns and of employers' ability to meet deficits.
- The scrutiny of scheme valuation assumptions by The Pensions Regulator which will take place later in 2009.

The provisional results of the triennial valuation show a deficit of £663 million at 30 September 2008. This means that the funding level of liabilities represented by assets is 69.7%. This is a significant worsening since the last triennial valuation in September 2005 when the deficit was £283 million and liabilities were 82% funded. It is worth mentioning that, on an update of the funding position at March 2007 (the mid-point between valuations), liabilities were then 90% funded. This illustrates the volatility of defined benefit scheme funding.

For future service, based on our actuarial advice, we have been able to maintain contribution rates at close to the levels introduced at the last triennial valuation.

However, our past service deficit has more than doubled and employers will need to fund this deficit over the deficit recovery period. This will necessitate an increase in costs to employers from April 2010 of 3.1% of pensionable payroll at the date of the 2008 valuation to cover past service alone.

We recognise that this is a significant increase and for this reason we have taken full account of the conclusions of the employer consultation carried out extensively last autumn. As a result, we are introducing two new lower cost defined benefit (DB) options (80th final salary and 80th CARE) and also for the first time a defined contribution (DC) option.

There will now be five ongoing options for employers to consider for use for existing and new staff. In any changes made, as when benefit structure choice was first introduced three years ago, all benefits earned up to the date of the change will be maintained and only future service benefits will be affected.

We hope that this extended choice will also enable employers, if they so wish, to use SHPS for auto-enrolment of their staff when this becomes a statutory requirement and Personal Accounts are introduced in 2012.

Some employers with relatively few active members in the SHPS defined benefit scheme have been concerned that, when the last active member leaves service, they may be affected by current legislation requiring payment into the Scheme of the share of the deficit on the 'buy out' basis attributed to that employer.

By giving employers the opportunity to enrol new active members into an option which is appropriate to their financial situation, but still part of SHPS, we hope we have been able to give more scope to reduce the risk of triggering an employer debt on withdrawal.

At our consultation meetings with employers last autumn, there was a strong wish for more predictability of costs. The benefit structure options now offered will give associations and their Boards the ability, after consultation with staff, both to control costs, and, if they so need, to move the burden of risk away from employers towards employees.

The attached document sets out the results of the above considerations in more detail, including the contribution rates which will apply to the different benefit choices. It also initiates the need for each employer to consult with staff and come to decisions on both benefit structure and split of contribution rates by the end of November 2009. We hope this will give adequate time for both the statutory consultation period for employers with 50 or more employees and for appropriate governance decision taking.

A more detailed set of Employer Consultation Guidance Notes and an information sheet for staff will be supplied to you by the middle of May 2009.

Yours sincerely



Colin Small
Chair, SHPS Pensions Committee

Enclosed:

- Appendix to letter dated April 2009
- Annex A – SHPS Surcharge
- SHPS Employer Forums 2009 – Reply Slip

**Social Housing Pension Scheme (SHPS)
Appendix to letter dated April 2009**

1. Review of the Benefit Structure and Associated Funding Requirements

This document contains important information on the results of the SHPS September 2008 valuation, its impact on contribution rates, and the new choices which the SHPS Pensions Committee (the Committee) has decided to introduce to provide further lower cost options.

2. Consultation with Employers

In September 2008, the Committee sent a letter to all employers participating in SHPS seeking their views on a number of issues affecting pensions. A second letter was sent in November 2008 addressing some financial issues.

Both letters included a questionnaire for completion so that the Committee could consider employers' response to the issues.

Employer meetings were also held during October 2008 to assist in gauging the opinions and concerns of employers.

Some main themes emerged:

- The need to control and provide some predictability of pensions costs.
- The need to continue to provide a choice of benefit options and to extend that choice, in particular to introduce a lower-cost option.
- The demand for a defined contribution structure within SHPS.
- A willingness to share some of the pension scheme risks with employees.

The Committee has considered all of the responses, and outlines below the next and final stages of this Benefit Review.

To assist the Benefit Review process, the Committee will be providing a set of Employer Consultation Guidance Notes. It is proposed to issue these Guidance Notes no later than the middle of May 2009. In addition, regional Employer Forums will take place in June 2009 and Account Managers from The Pensions Trust will be available at the Trust's offices in Leeds, for employer specific meetings, during July 2009. Please complete and return the enclosed Employer Forums Reply Slip if you wish to attend.

At this stage we would ask you to liaise with any other pensions contacts within your organisation to ensure that all interested parties receive this information.

3. Benefit Choice

From 2010, each employer within SHPS will have an extended choice of benefit/funding structures. There will be five core benefit options:

- (i) the existing final salary structure with a 1/60th accrual;
- (ii) the existing Career Average Revalued Earnings (CARE) structure with a 1/60th accrual;
- (iii) a new final salary structure with a 1/80th accrual;
- (iv) a new CARE structure with a 1/80th accrual; and
- (v) a new defined contribution structure.

The existing 1/70th final salary structure has not been selected by many employers. Accordingly, this option will continue for those employers which already offer it, but will not be open to new employers.

Employers may offer only one open defined benefit structure at any one time to new members plus, if they wish, the defined contribution option.

Employers may continue to operate different ('live') benefit structures for existing and new employees. If an employer currently operates different structures for its existing members, those structures could be maintained (in the same way as in 2007). Whilst these structures are not open to new entrants, they continue to be 'live' (in that benefit continues to accrue in them).

For example:

If an employer currently operates final salary 60^{ths} accrual for existing members at 1 April 2007 and CARE 60^{ths} for new members (since 1 April 2007), then this same employer could (from 2010) operate these two existing (or alternative) bases for its existing staff in these structures and then operate (say) CARE 80^{ths} for new members.

Its existing members (of either final salary 60^{ths} or CARE 60^{ths}) could elect (if personal finances dictated) to join the CARE 80^{ths} structure for future service, as this is the only (open) option that is offered for new members within that organisation.

As part of the Benefit Review, the opportunity will be taken to implement The Pensions Trust's eBusiness facility. This will permit the submission of monthly contribution data online via the internet. Further details will be included in the Employer Consultation Guidance Notes.

The new final salary and CARE options will come into operation from **April 2010**. The defined contribution option will require significant changes to the IT and administration systems, including the requirement for online submission of data by employers, and so will be introduced from **October 2010**.

Employers intending to adopt the defined contribution option with effect from October 2010 will be able to continue to offer defined benefit options between April and October 2010.

Employers will be required to formally advise their chosen benefit/funding structures, whether final salary, CARE or defined contribution **by no later than 30 November 2009**.

It is stressed that any benefits built up under SHPS before the date of any change cannot be reduced. Such benefits will be retained and safeguarded. We are accordingly only considering potential changes to the benefits to be provided in respect of pensionable service accruing after April 2010 (defined benefit options) or October 2010 (the defined contribution option).

All of the options have been designed to qualify as 'exempt' from the requirement to auto-enrol into Personal Accounts due to be introduced from 2012.

Please note that employers may choose to retain their existing benefit options, in which case confirmation of the employer/member contribution rate split will still be required as the funding requirements of the Scheme have changed.

If an employer elects to operate more than one open benefit structure, then the contribution rate split for each benefit structure will operate in respect of all the employees in that structure (see 'Contribution Rates' below).

In the event that an employer selects a CARE structure for existing employees, then the revaluation of each employee's accrued benefits under the previous final salary structure up to the date of change (April 2010 or later), will continue to be on a final salary basis until they leave service or retire. This will be reflected in any past service deficit contribution.

In the event that an employer selects the defined contribution structure for existing employees, then the revaluation of each employee's accrued benefits under the previous final salary structure up to the date of change (October 2010 or later), will continue to be on a final salary basis until they leave service/retire. This will be reflected in any past service deficit contribution, which would continue to be required.

4. Contribution Rates

(i) Past Service Deficit Contributions

The provisional results of the actuarial valuation reveal that the Scheme had a deficit of £663 million as at 30 September 2008. The deficit at the previous valuation in 2005 was £283 million. Further details regarding the valuation will be included in the Employer Consultation Guidance Notes.

Following consultation with employers (in November 2008) on financial issues and, notably, on the treatment of deficit recoveries in future, there was very substantial support for defining in value terms the deficits attributable to each employer. This has been accepted by the Committee and it has been decided to relate the past service deficit rate as a value equal to 7.5% of the pensionable payroll for each employer at 30 September 2008 (the valuation date), increasing by 4.7% per annum. The 4.7% increase allowance is the future earnings increase assumption used by the Scheme Actuary in the valuation.

The existing past service deficit contribution rate of 4.4% of pensionable salaries will continue to be payable by the organisations participating in the Scheme at the date of the previous valuation (i.e. 30 September 2005) until 30 September 2020, in line with the current arrangements. (This will continue to be collected until March 2010 based on actual pensionable salaries, and thereafter on the above basis.)

An additional past service deficit contribution will be required to fund the increase in deficit identified at this valuation. This is assessed at 3.1% of notional pensionable salaries (pensionable salaries at 30 September 2008) and will be payable as from 1 April 2010, **in addition to the existing 4.4%**.

If the valuation assumptions are borne out in the future, this contribution will eliminate the deficit over 13.5 years, by 30 September 2023. SHPS will be drafting an actuarial valuation recovery plan to reflect this.

This past service deficit contribution rate of 7.5% of pensionable salaries will be payable by the organisations participating in the Scheme at the date of the previous valuation (i.e. 30 September 2005).

Those organisations who have joined SHPS since 1 October 2005 and are in the transitional period before payment of past service deficit contributions is required, will be contacted separately.

Some employers have asked for advice on whether the multi-employer exemption which most employers exercise from full implementation of the accounting standard FRS 17 will be affected by the above. Having consulted a leading firm of auditors in the housing association sector, our view is that the proposed change in methodology for calculating deficit contributions from April 2010 does not alter the substance of the previous calculation and does not in itself necessitate any change in the basis of pension accounting within the financial statements of sponsoring employers. The decision as to whether to take the exemption available remains a matter for employers to agree with

their own auditors. The SHPS website's advice on FRS 17 and accounting for pensions will in due course be updated on these lines.

(ii) Benefit Structure Contribution Rates

The contribution rates, expressed as a percentage of pensionable salaries, required to fund the total past and future service costs of the existing benefit structures, are set out below:

| Benefit Option | Contribution Rate | | |
|---|--|--|---------|
| | Future service expressed as a % of Actual Pensionable Salary | Past service expressed as a % of Notional Pensionable Salary * | Total % |
| Final salary benefit structure on a 1/60 th accrual | 17.8 | 7.5 | 25.3 |
| <i>Current rate</i> | 17.6 | 4.4 | 22.0 |
| Final salary benefit structure on a 1/70 th accrual | 15.4 | 7.5 | 22.9 |
| <i>Current rate</i> | 15.3 | 4.4 | 19.7 |
| Career average (CARE) benefit structure on a 1/60 th accrual | 14.9 | 7.5 | 22.4 |
| <i>Current rate</i> | 14.1 | 4.4 | 18.5 |
| Final salary benefit structure on a 1/80 th accrual | 13.5 | 7.5 | 21.0 |
| Career average (CARE) benefit structure on a 1/80 th accrual | 11.9 | 7.5 | 19.4 |
| Defined Contribution (minimum) | 6.0 | 7.5 | 13.5 |

**Notional Pensionable Salary is Pensionable Salary as at 30 September 2008 indexed annually in line with the salary growth assumption in the valuation.*

These rates will be payable from 1 April 2010, except for defined contribution future service which will commence from 1 October 2010.

For employers choosing the defined contribution structure, the past service deficit contribution of 7.5% will only be payable by those employers who currently offer one of the defined benefit structures.

For defined benefit structures, employers, in consultation with their staff, will determine the split of the total contribution rate between members and the employer. The requirement for the employer to meet at least 50% of the contribution will be removed from 2010. Age related contributions can be maintained or introduced if employers, in consultation with their staff, so determine.

For the defined contribution structure and in anticipation of the introduction of Personal Accounts in 2012, the minimum contribution rate for the defined contribution option has been set at 6% (3% member and 3% employer). The minimum member contribution will rise to 5% from 2012 to comply with the Personal Accounts requirements. The employer contribution rate for the defined contribution option will not be phased in, but will be set at a minimum of 3% from October 2010. Please note that the contribution rate is to be based on pensionable salary and that it is not intended to adopt the 'banded earnings' approach for the defined contribution structure which will apply to the State Personal Accounts scheme.

Both employers and employees may pay more than the 3% minimum, for example, employers may wish to match employees contributions up to a certain level, or contribute at a multiple (such as 2:1) of employee contributions, as determined in consultation with their staff.

The approach to member and employer charges for the defined contribution structure are being finalised, but are likely to be in three parts:

- A one-off set-up fee, payable by the employer.
- An annual administration fee per member, payable by the employer, which will include the cost of life assurance.
- An annual management charge (expressed as a percentage), deducted from the employee's fund.

The defined contribution structure does not provide an ill-health pension, so employers should consider whether they need separate Permanent Health Insurance or income replacement insurance.

(iii) Surcharges

At present, employers not offering SHPS to new employees pay a surcharge to recognise that the average age of their members will increase more quickly than for an employer continuing to offer SHPS to new employees. This surcharge is currently 3% of pensionable salaries.

This practice will be amended under the new arrangements effective from 1 April 2010. The Actuary has confirmed that the base rate of the surcharge can be maintained at 3% of pensionable salaries. It has been decided that a discounted rate of surcharge will apply in certain circumstances, as shown in the flowchart in Annex A. The rate and discount will be reviewed at the next valuation in 2011.

5. Consultation with Employees

Consultation is required in 2009 if employers are going to change the accrual rate and/or the member contribution rate with effect from 2010.

Prior to any consultation, it is important for employers to carefully assess their own position, and particularly their obligation, in relation to an organisation's Terms and Conditions of Employment and to legislation. Proposed changes to an organisation's benefit and/or funding arrangements must have due regard to any provisions in contracts of employment relating thereto, and particularly the need for members' consent to any changes. There may also be obligations in relation to the conduct of the consultation process. In these matters an employer may wish to take legal advice.

The Pensions Act 2004 requires employers to consult with employees on any proposed changes to their pension scheme. These changes may relate to the benefits provided and/or to the level of contributions to be made by the employees. Prior to the consultation each employer will need to determine, in accordance with their own procedures, the benefit/funding approach proposed to be pursued with employees in terms of the benefits and funding options to be considered.

The statutory requirement to consult has been phased in and employers with 50 or more employees are now required to undertake consultation on significant changes for a period of 60 days before the changes are introduced.

Consultation remains good practice however for all employers, and whatever the statutory position on consultation there is likely to be a legal duty on employers to consult as part of the 'duty of mutual trust and confidence'. All employers are therefore recommended to undertake some form of appropriate consultation.

The Committee cannot undertake the consultation work on behalf of employers. Nor are we, or The Pensions Trust, able to give advice. It is therefore necessary for employers to set in place a consultation process in line with their own established procedures. As appropriate, the process may involve trade unions, works councils and staff representative groups.

It will be a matter for each employer to set its own timetable. However, in general it is suggested that the consultation process be undertaken to allow time for employers to approve, under their normal governance procedures, their final benefit and funding structures by the required date of 30 November 2009. It is also strongly recommended that employers take advice from their own employment solicitors on any consultation and proposed amendments to staff Terms and Conditions.

A telephone helpline and a series of regional seminars, together with other support mechanisms, will also be provided to assist employers (Board members and relevant staff).

It is important that members are aware of the developments within SHPS arising from this Benefit Review. This will be undertaken for active members by means of a member leaflet. Whilst the obligation to consult with their employees rests with the employer, the Committee is producing an information leaflet which will give all active members a uniform perspective on the Benefit Review and related developments within SHPS. The members' leaflet is due to be issued before the end of May 2009. A copy of the leaflet will be circulated to employers with their Employer Consultation Guidance Notes a few days before it is issued to members. It is also proposed to send a short separate letter to deferred members and pensioners to provide assurance that their positions are not affected by the Benefit Review.

6. Future Considerations

The Committee considered, but decided against the introduction of a CARE structure with a 1/100th or 1/120th accrual rate at this time, on the basis of cost. These options would be on a contracted-in basis, requiring higher National Insurance contributions from both the employer and employee. However, the Committee may reconsider these options at a later date if there is a clear case for their consideration.

Employers may be aware that there have been some changes regarding the Limited Price Indexation (LPI) requirements. This is the requirement to increase pensions in deferment and pensions in payment each year by the rise in Retail Price Index (RPI) subject to a limit of 5%. The law recently changed to permit this limit to be decreased to 2.5%. The Committee have not had the opportunity to consult with employers regarding this change, or to consider in detail the impact on SHPS benefits. Accordingly, any possible change to LPI has not been addressed as part of this Benefit Review, but will be considered in future.

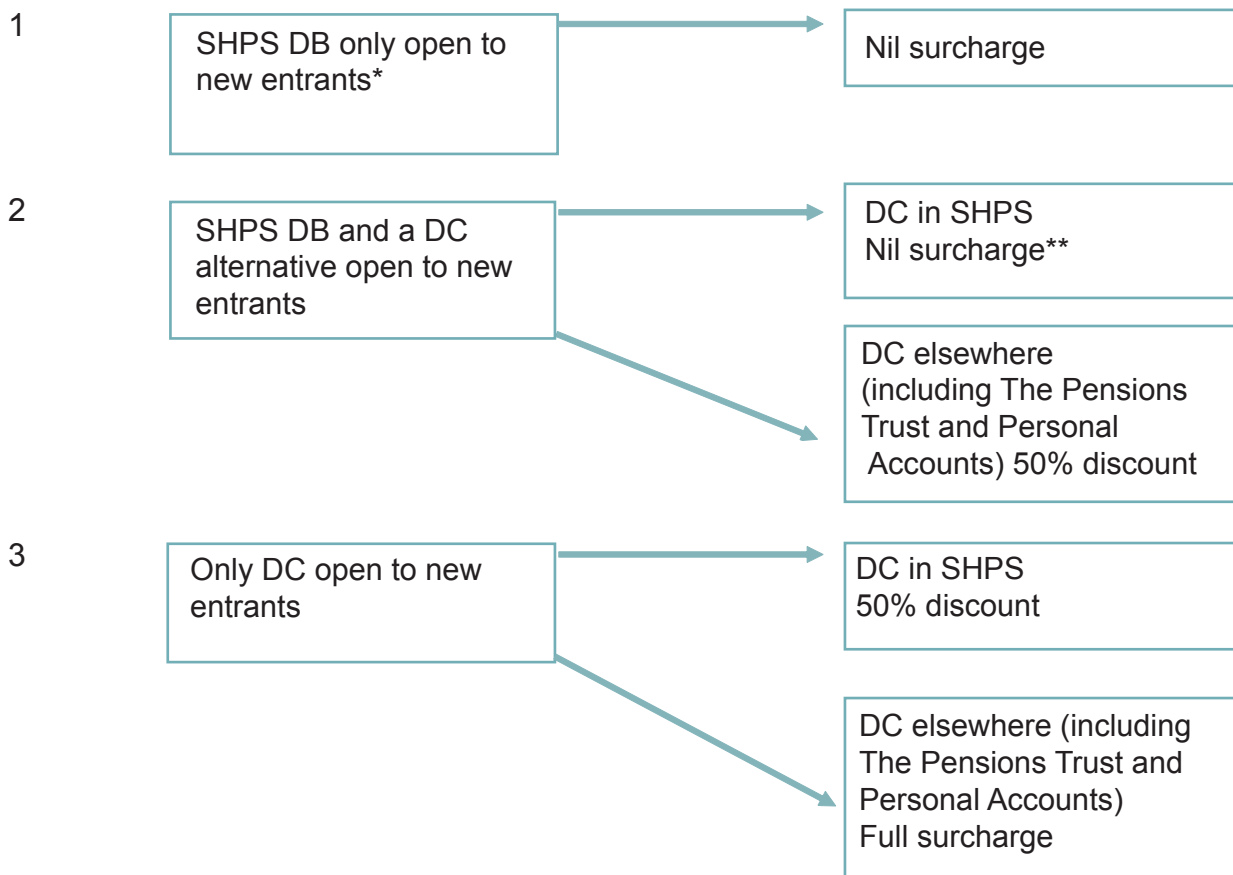
Any queries relating to the Benefit Review should in the first instance be addressed to:

Janet Hennessey
Scheme Adviser
SHPS at The Pensions Trust
Verity House
6 Canal Wharf
Leeds
LS11 5BQ

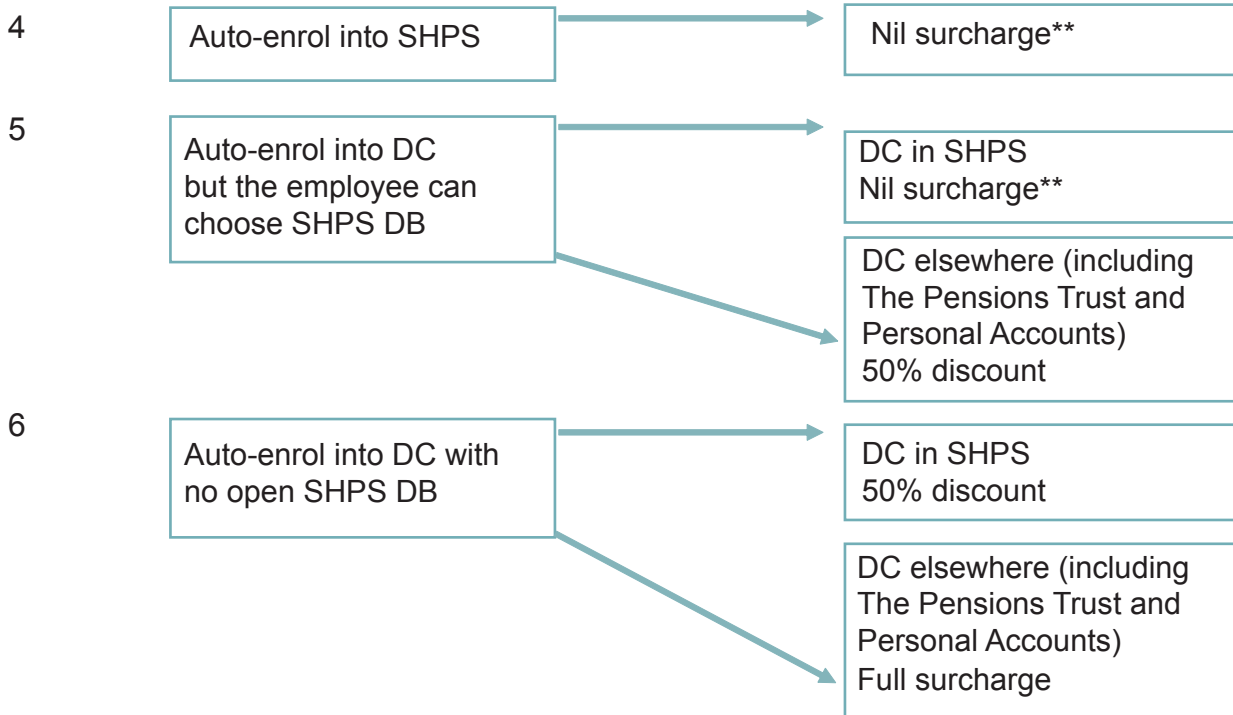
Email: janet.hennessey@shps.org.uk

SHPS Surcharge

Current



On auto-enrolment, either with or prior to Personal Accounts



Closure to future defined benefit accrual will crystallise s75 debt on employer.

* If an employer offers both LGPS and SHPS DB the surcharge with a 50% discount will apply.

** If a surcharge is not applied initially, the Committee reserves the right to apply one at a later date.

SHPS Employer Forums 2009

Reply Slip

Please reserve place(s) at the Forum on:

Wednesday 3 June 2009 (AM) - Birmingham

Wednesday 3 June 2009 (PM) - Birmingham

Thursday 11 June 2009 (AM) - London

Thursday 11 June 2009 (PM) - London

Monday 15 June 2009 (AM) - Leeds

Monday 15 June 2009 (PM) - Leeds

Monday 22 June 2009 (AM) - Bristol

Monday 22 June 2009 (PM) - Bristol

A buffet lunch will be provided at each Forum:

Do you have any dietary requirements?
If yes, please give details

Yes

No

Do you require any specific facilities for a disability?
If yes, please specify

Yes

No

Your details

| | |
|----------------------------------|--|
| Name and position of attendee(s) | |
| Organisation Name | |
| Contact Address | |
| Telephone | |
| Email | |

Please return your completed form to:

Pamela Land

The Pensions Trust, Verity House, 6 Canal Wharf, Leeds LS11 5BQ
or Fax to 0871 429 1312