Housing briefing, August 2022

This briefing covers three areas:

- The Scottish Housing Associations' Pension Scheme (SHAPS)
- Changes to National Insurance contributions from July 2022
- Value for money in DC schemes.

The Scottish Housing Associations' Pension Scheme (SHAPS)

Around 140 housing associations participate in the Defined Benefit (DB) and Defined Contribution (DC) sections of SHAPS.

In 2015, the funding position was a concern. At that time, the funding level stood at 76% and the funding deficit at around £200m. Since then, all DB employers have been paying deficit recovery contributions – currently around £32m pa – to restore the funding to 100%.

Every three years, an actuarial valuation is carried out for the DB section to estimate how much is needed today to pay all the pensions promised to members. The estimate rests on a number of assumptions, including the Scheme's future investment returns, how long its members are expected to live and inflation.

The SHAPS Employer Committee (EC) – with First Actuarial providing advice – has recently been negotiating the 30 September 2021 actuarial valuation with the Trustee.

Improvement in the funding level of the DB section

The EC has communicated some good news – deficit contributions will cease earlier than expected, on 30 September 2022. That said, there is always variability in the funding levels of DB schemes, and the EC has stressed that there is no guarantee that further deficits will not arise at future valuations.

Nevertheless, this is welcome news at a time when there are so many other calls on employers' resources in the sector.

Action: Boards should ensure that their finance teams are aware that deficit contributions will be ceasing and that budgets may need to be updated. Organisations also need to be aware of future risks, such as the possibility that deficit payments may need to resume following the next valuation.

Possible changes to DB benefits earned in the future

Although the DB section is expected to have enough money to pay for benefits already earned, the 2021 valuation results show that higher contributions are needed to fund DB benefits earned in the future.

For example, the total cost of new benefits in the Career Average Revalued Earnings (CARE) 80th section is expected to **increase from 23.7% to around 31% of salaries,** according to the EC. These cost increases are significant and may present affordability challenges for both employers and employees.

The EC is consulting on whether to make future benefit structures more affordable. For example, by changing the way that pensions increase before retirement, the EC estimates that, with some reasonable changes to future indexation, the cost of the CARE 80th section can be kept at **around 26%** (rather than 31%).

> **Action**: Employers with employees still earning benefits in the DB section had until 22 July to respond to the consultation. Consider responding if you haven't already done so, as your views are likely to be taken into account even at this late stage.

Scheme benefit review

The SHAPS Trustee has been reviewing whether DB benefits have been paid in line with the Scheme's legal documentation. This initial review is now complete, and the Trustee has received legal advice that there is uncertainty about how to calculate some member benefits. The Trustee is going to court to obtain clarity on the calculation.

The Trustee will be arguing in court that benefit calculations should be applied in the same way they are now. However, if the court rules against the Trustee, additional liabilities will be created, and these will need to be met by employers. The Scheme Actuary for SHAPS has estimated these **additional liabilities at around £40m** as at 30 September 2021. This is around 3.2% of the c£1.2bn of total liabilities in the DB section.

Employers will need to make sure their interests are protected. It is the role of the EC to do this on their behalf, and we would encourage you to contact the EC to provide your feedback on this potential additional liability. This collaborative approach is likely to be most effective. In our view, any attempt to form new groups runs the risk of fragmenting the employers' response.

The Trustee aims to give the EC a copy of the proposed court documents by the end of the year, with a three-month period for employers to provide any comments if they wish. The Trustee has stated that, in their opinion, there is no requirement for employers to take independent legal advice. TPT will present the case that the status quo should apply.

The Trustee expects to be able to share court documents with employers in Q4 2022, with court proceedings and judgment expected in the second half of 2024.

> **Action**: Employers should follow developments in this area, and appropriate time should be made available in committee/board meetings to explain this potential risk. Employers should provide feedback to the EC at the appropriate time.

Consider salary sacrifice for more efficient pension savings

From April 2022, National Insurance (NI) contributions increased for most workers. Although some of this increase was subsequently reversed by further changes coming into effect from July 2022, many workers will be paying higher levels of NI than they were a year ago.

Salary sacrifice, or salary exchange, is a way to increase take-home pay at this challenging time of significant rises in the cost of living.

Salary sacrifice allows pension contributions to be paid more tax efficiently, generating NI savings for both employees and employers. Read First Actuarial's salary sacrifice briefing for more information. This table shows the impact on an employee earning £30,000 and contributing 5% to their pension.

	Not using salary sacrifice	Using salary sacrifice
Pre-sacrifice salary	£30,000	£30,000
Salary sacrificed (5%)	-	(£1,500)
Post-sacrifice salary	**£30,000**	**£28,500**
Pension contribution (5%)	(£1,500)	-
Income Tax	(£3,186)	(£3,186)
National Insurance	(£2,309)	(£2,111)
Take-home pay	**£23,005**	**£23,203**

The above figures are based on tax and NI rates applying from July 2022.

In the above example, employees would receive nearly **£200 a year more** in take-home pay. Employers would also save, paying **£225 less** in NI employer contributions. Employers can choose to share some or all of their saving with employees if they wish.

Action: Employers should consider salary sacrifice to help employees increase their take-home pay and offset some of their cost-of-living pressures.

Value for money in DC schemes

This spring, Government responded to a range of consultations relating to DC pension scheme investments, as well as launching two further consultations.

Government responses included the charge cap reform consultation. The charge cap is a limit placed on the management fees that can be charged to members in DC auto-enrolment schemes. It is currently set at 0.75% of a member's funds.

One issue identified was that performance-based investment fees, which are only paid to investment managers if they produce strong returns, were included within the cap. This meant that such investments were not always viable for DC funds, despite their useful role in diversifying investment portfolios. Government therefore proposed excluding performance-based investment fees from the cap.

The response to the consultation was 'mixed', with the main concern being that members still need protection from paying excessive fees for poorly performing investments. Government concluded that they would not make any change to the inclusion of performance-based fees in the charge cap at present.

Over summer 2021, the Department for Work and Pensions (DWP) issued a separate call for evidence about greater consolidation of the DC pension market, citing better member outcomes through economies of scale. Government has now responded to this consultation, saying that they will "not be introducing any new regulatory requirements with the sole purpose of consolidating the market in 2022. However, we will work closely with TPR [The Pensions Regulator] to monitor the impact of the value for members' assessment, which will start to be produced this year".

Government also said: "Our focus will continue to be on creating, with TPR and the FCA [Financial Conduct Authority], a value for money framework for occupational and workplace pension schemes…that brings about consistent, informative, member-focussed value metrics that will enable comparison and encourage competition on overall value."

The DWP held two further consultations in the spring. One concerns employer-related investments. The other includes a proposal to require DC schemes with over £100m in assets to disclose their asset allocation publicly in the annual Chair's Statement. A key aim of the latter is to encourage value for money for members through diversification and illiquid investments, as well as promote transparency. Both consultations have now closed and responses are expected later this year.

Action: Consider whether your DC scheme continues to provide value for money for employees.

How First Actuarial can help you

To discuss this briefing or any area of pensions, please contact your usual First Actuarial consultant or any of our nationwide housing specialists:

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