Housing briefing, June 2021
Scanning the horizon for SHPS

The 2020 valuation results for the Social Housing Pension Scheme (SHPS) were expected by May, but as June turns to July we are still waiting.

With this latest 3-yearly funding assessment likely to have a significant impact on the sector's pension provision, we take a look at:

- Possible reasons behind the delay
- The likely results
- A roadmap to implementation

Why the delay?

No doubt the Scheme and Employer Committees have been involved in frequent and robust discussions since 30 September 2020 (and before).

However, it is common for pension scheme trustees and employers to take several months to agree valuation outcomes. This timeframe can be drawn-out if the results are challenging, particularly when it is a £5bn sector-wide pension scheme affecting over 350 employers across England and Wales.

We can speculate on the reasons for the delay, but suspect that the main reasons are:

1st possible reason for delay – A much bigger deficit

If assumptions made as part of the 2017 valuation were borne out in practice, then we estimate that the 2020 deficit would be around £1.1bn – or perhaps £0.9bn if we allow for bulk transfers over the period.

It will surprise no one that a £0.9bn deficit is unlikely to be the outcome this time round, and this means that a new deficit recovery plan is needed.

This new deficit payment plan can be designed in different ways taking account of factors such as:

- Length of deficit recovery plan
- Size of deficit payments
- Approach to sharing the deficit

There is a delicate balance here as different employers joined SHPS at different times, and some employers closed defined benefit (DB) sections years ago with others continuing to support future DB benefit accrual (and new entrants). Having employers with a wide range of liability profiles means that the outcome for individual employers can be sensitive to the design of a new deficit recovery plan.

Key to setting the prudent margin and the length of the recovery plan is the strength of the employer covenant. There has been recent criticism from market commentators that the SHPS funding plan is too prudent and does not reflect the collective covenant strength of the employers.

2nd possible reason for delay – DB Funding Code

Last year the Pensions Regulator consulted on changes to its DB Funding Code. This year we had a new Pension Schemes Act which lays the ground for the new Code. Next steps are consultations on both secondary legislation (to bring provisions of the Act into force) and fine-tuning of the DB Funding Code.

The direction of travel for the new Code is to have a long-term objective (met by a long-term funding and investment strategy) that minimises any future reliance on sponsors once the scheme is significantly mature. In other words, well-funded (closed) pension schemes are to invest cautiously.

However, SHPS is a large scheme, open to benefit accrual and new entrants, and has a sizeable deficit – so is far from being in the Regulator's preferred position. To close this gap would take a lot of money and a long-term continuation of deficit payments.

Although the new Code is not expected to be in place until late 2022, the Scheme Committee is likely to already be considering the Regulator's views on long-term objectives so this aspect will have an impact on the 2020 valuation results.

3rd possible reason for delay – a review of historical benefit changes

When the DB Accounting Tool was released in May, TPT drew attention to a review of benefit changes which identified that some past rule changes may not have been carried out in accordance with governing documentation. Subject to legal views, a possible outcome could be a retrospective uplift in scheme liabilities – with a very early estimate suggesting this could be in the region of 0.05% for SHPS.

Neither the accounting liabilities at 31 March 2021 nor the 2020 funding valuation have incorporated this potential adjustment. TPT have suggested the legal process could take at least two years, but have also confirmed that this will not delay the outcome of the 2020 funding valuation.

The likely results – past and future service

1. Past service deficit

As outlined earlier, the existing deficit payment plan (currently payable until September 2026) is unlikely to be enough to pay off the new deficit so overall amounts are likely to have to increase, or the payment plan extended, or a combination of the two. Employers will have to allow for this new schedule of payments in their business plans.

2. Cost of future service benefits

The total cost of Final Salary and CARE benefits as a percentage of payroll is likely to increase significantly. For employers continuing to support future DB accrual this will mean that decisions will be needed (and potentially staff consultation), such as: whether to continue supporting the same benefit level (e.g. 1/60th Final Salary, 1/80th CARE, etc), how to share the cost increases with staff and whether to close DB to new entrants and/or all future accrual.

A roadmap to implementation

Although white smoke is still yet to emanate from TPT offices, plans can still be put in place for review.

1 April 2022 is the scheduled date when revised contributions towards the past service deficit and future benefits are likely to be implemented.

We have suggested a 5-step plan to carry out a review, design pension changes, carry out a consultation and implement any pension changes by 1 April 2022, noting the usual requirement to inform TPT of the outcome of any consultation by 31 January 2022 for these to be implemented by 1 April 2022.

Step	Timescales	Task
1	Jul to Sep 2021	Review pension strategy and develop options via the executive team (including Board 'refresher' training)
2	Sep to Oct 2021	Board to agree proposals
3	Oct to Dec 2021	Minimum 60-day consultation with staff
4	31 Jan 2022	Board to make final decisions, with any changes to be sent to TPT by 31 Jan 2022
5	1 Apr 2022	Pension changes implemented

However, any changes do not have to be aligned with the contribution changes on 1 April 2022. For example, 1 July 2022 could be the date proposed by the individual employer for implementing changes to benefits and/or contributions for its staff. However, in this scenario, there would be an interim three-month period where the employer accepts the full increase in future costs of benefits that are likely to come in from April 2022, until pension changes have been consulted on and decisions ratified.

An advantage of a delay is that it provides time for an extra 3 months of planning. In this scenario, the rest of 2021 could be used to review strategy and design any pension changes – with consultation on proposed changes taking place in the first quarter of 2022, rather than the last quarter of 2021.

If this is giving you déjà vu, the Scheme Committee delayed the increase in the cost of future benefits by 3 months during the last valuation cycle (albeit with deficit contributions increasing from April 2019), but there is no guarantee that any further delay in announcing the valuation results will lead to this happening again following this valuation.

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