TRANSFERS OUT OF THE SOCIAL HOUSING PENSION SCHEME:

SHOULD I STAY OR SHOULD I GO?

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At the last valuation in 2014, there were 472 employers participating in the Social Housing Pension Scheme and it had £3.1 billion of assets and liabilities of £4.4 billion. With the next valuation results due this year and a predicted deficit across the scheme of £1.5-2 billion, many employers will be reviewing what their options are.

One of the options taken by a small number of employers (five at the time of writing) is to transfer their share of the defined benefit assets and liabilities to a new, stand-alone pension scheme. The key reason given for making this change was for the employer to get more control over the management of its pension deficit and, in some cases – such as Genesis and Sanctuary – to achieve efficiencies by bringing together all their defined benefit liabilities into one scheme.

What is driving employers to leave?

A rising deficit has undoubtedly played a part in this. Over the last three valuations, the value of the overall deficit for SHPS has risen by about a third at each one. This is despite increased deficit contributions from employers at each valuation and, following the last valuation, a reduction in the value of benefits.

Where an employer operates a number of defined benefit pension schemes, there will be duplication in time spent administering and, therefore, in the cost of this. Consolidating these will bring efficiencies.

A further factor is that SHPS is a "last man standing" multi-employer scheme – which means that when an employer leaves without paying its liabilities in full, those liabilities (known as orphan liabilities) fall back to the remaining employers.

Cross-subsidy of other employers is also something that has motivated employers to transfer. The way that earlier deficit reduction contributions are calculated means that some employers will be subsidising others. SHPS has address this in more recent tiers of deficit reduction contributions by calculating the contributions based on the employer's share of the total liability.

Why might employers be better staying with SHPS?

So is transfer something that all participating employers should be doing? The short answer to that is no. Transfers out will not be suitable for most employers in SHPS for two reasons.

Firstly, the costs of transferring out and running their own scheme mean that smaller employers would actually see a rise in their costs. One of the benefits of SHPS, as a multi -employer scheme, is that participating employers share the costs of running the scheme with the other employers. These costs will include fees for legal work, administration of the scheme, management of investments and actuarial work. By way of illustration, for the average employer in SHPS with 135 defined benefit members and assets of £7 million in SHPS, their share of the annual costs will be about £12,000 (including the levy payable to the Pension Protection Fund (PPF)). For this sort of employer to have their own scheme, the costs are likely to be around £50,000 plus the PPF levy on top – which on its own is likely to exceed the £12,000 payable to SHPS. This means that transfer is unlikely to be attractive to employers with liabilities less than £20 million – which at the last valuation covered fewer than 10% of employers.

Secondly, an employer transferring to a stand-alone scheme needs to show that it has sufficient financial strength to be able to stand behind the scheme on its own. Again, this is unlikely to be the case for smaller employers. Employers transferring out where their covenant is regarded as weak could actually find that the new scheme requires a higher level of funding and therefore contributions to reflect that weakness.

Whilst employers may be concerned about orphan liabilities, we don't anticipate these ballooning, as there have been only 4 participating employer insolvencies in recent times and SHPS did partially recover the termination debt in each case. Orphan liabilities currently stand at 1.2% of all liabilities. SHPS carries out regular covenant reviews and at the last report (January 2016), 88% of employers were seen as low risk, 3% as medium risk and 9% as higher risk. Higher risk employers are required to stop allowing the build-up of defined benefits

in order to manage this risk. Due to the profile of the scheme, the insolvency of a single employer is unlikely to result in a significant increase in liability for all the other employers. 95% of employers have a liability share that is less than 1% of the total liabilities. 340 out of the approximately 460 employers have a share that is less than 0.3% of the total liabilities and the largest employer has a share wthat is 2.7% of the total liabilities.

It is also important to note that employers leaving will need to pay a settlement figure to cover their share of the orphan liabilities, as these cannot be transferred to the new scheme. We understand that Clarion paid a £1.5 million settlement figure to SHPS as part of its transfer out.

SHPS will also take account of the impact on the overall financial strength of the employers backing SHPS in assessing whether SHPS will agree to a transfer and SHPS may well require a further payment to reflect this additional risk to the remaining employers.

Should you leave the social housing pension scheme?

Summary of the benefits and drawbacks

BENEFITS	DRAWBACKS
More influence over funding strategy	Greater governance requirements
All contributions benefit employer's funding position (no cross-subsidies)	Cost of paying for share of orphan liabilities
No more risk of inheriting orphan liabilities	Potentially higher cost of scheme expenses
Efficiencies where consolidating schemes	Cost and time in managing transfer to new scheme
Not covered by section 75 debt requirements where single employer scheme	No longer benefit from any cross-subsidies
More influence over investment strategy and risk management	Cost of any payment required by SHPS to reflect loss of covenant strength
	Risk that new scheme requires a more cautious funding strategy to reflect weaker covenant

For those employers looking to leave, SHPS has produced a briefing pack and has a standard bulk-transfer process. It's obviously going to be sensible to take some expert advice from appropriate professionals including actuaries to help you weigh up the benefits and drawbacks of leaving in your particular situation.

FOR MORE INFORMATION

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