

DIOCESAN SYNOD

Archbishop's Task Group on Clergy Pensions: a response

1 Summary

The Archbishop's Council has reconvened the Pensions Task Group to review the Clergy Pension Scheme in the light of the recent economic downturn. The resulting analysis highlights a significant funding gap in the pension fund and proposes a number of options for addressing the issues.

2 Recommendations

That the Archbishop's Council be asked to:

- (i) re-negotiate the settlement of 1997 and make more effective use of the Church Commissioner's funds to secure a defined benefit pension scheme for clergy, whilst capping parish contributions at 40%;
- (ii) re-align the provision of Mutual Support by the Commissioners across the church and transfer responsibility for its management to the Archbishops Council and Dioceses;
- (iii) as a minimum, adopt Model I set out in the Task Group's paper if (i) and (ii) fail to prove acceptable.

3 Financial Implications

- 3.1 Clergy across the Church of England currently benefit from a non-contributory, defined benefit pension scheme. This provides a full pension, after 40 yrs service, of £13,093 and a lump sum of £39,279.
- 3.2 Since 1997 this scheme has been funded by DBFs, and, by extension, through Parish Share. Prior to 1997 this responsibility lay with the Church Commissioners who sought to be relieved of the burden for fear it would overwhelm the use of their funds after serious financial difficulties in the late 1980s/early 1990s.
- 3.3 For 2009 the contribution rate is 39.8%. In response to a consultation on clergy pensions two years ago the DBF set a limit on contribution rates at 40%. The current economic crisis has produced a recommendation for a revised, interim contribution rate for the clergy pension scheme of 45% of the national minimum stipend benchmark for the financial year 2010.
- 3.4 Looking ahead, the next valuation, in 2011, is likely to produce a contribution rate of 57% on current projections. It is the un-sustainability of such increases that is forcing a re-think in the long-term strategy.

4 Background

- 4.1 The enclosed summary of the Archbishops' Council consultation paper (Appendix I) provides a full account of the current crisis facing the Pensions Board as a result of the recent turbulence in world stock markets (paras 16-21).

- 4.2 Whilst an interim increase in the contribution rate for 2010 has already been announced – from 39-45% - the Board is already acknowledging that this will be insufficient to take full account of the recent stock market falls, come the re-valuation of the scheme in 2011.
- 4.3 In trying to address the long-term viability of the defined benefit scheme for clergy the Task Group makes two sets of proposals: the first are generic changes that can be undertaken regardless of the nature of the scheme ultimately (paras 68-91); the second are more fundamental changes to the character of the scheme that will inevitably affect the nature of the covenant between clergy and the Church concerning retirement provision (paras 92-125).
- 4.4 The second set (paras 92-125) rehearse more radical changes to the fundamental structure of the scheme by: switching to a defined contribution scheme for future service for all clergy; introducing a hybrid scheme in which employer contributions would be split between a DBS element, at a much reduced level, and a DCS element that would aim to 'top-up' a reduced DBS retirement pension of around 25% of the pensionable stipend (as opposed to the current 2/3).
- 4.5 As the accompanying narrative to each option illustrates, none of the proposals from the Task Group reduces the current level of the contribution rate; all seem to come out at around 42%. It is also clear that none of them totally extinguishes the continuing risk of mounting deficits in the face of stock market fluctuations. As recent history has shown us, it is the existing deficit that has suffered most from the recent downturn in values: rising from 5-19% in two years, whilst the contribution to future benefits has only grown by 4% over the same period.
- 4.6 The Task Group has asked each diocese, through its Synod or Bishop's Council, to debate these issues and forward their comments before the end of October, so that it can advise DRACSC on the way forward.
- 4.7 The Bishop's Council has reviewed the options proposed by the Task Group and concurs with the alternative proposal initially set out by the Chairman of the DBF, Diocesan Secretary and Director of Finance in a letter to the chairman of the task Group in May this year.
- 4.8 This alternative proposal is essentially to undo the settlement of 1997 and make more effective use of the Church Commissioners' funds as a means of meeting the two fundamental principles which should be adhered to in this process: not diluting the clergy pension scheme and not increasing parish contributions beyond 40%.
- 4.9 This would not only solve the clergy pensions issue in a long-term and principled manner but would also enable a realignment of Mutual Support across the Church which could then also be more strategically managed by Archbishops' Council and the Dioceses rather than the semi-autonomous Church Commissioners.
- 4.10 As a second position the Bishop's Council notes that the closest proposal from the Task Group to this position is "Model 1" which as a minimum retains the defined benefit scheme but diluted, at an additional cost to parishes and with no reassurance that this issue will not return in another two years.

Dr Kevin Brown.

Clergy Pensions

Summary of Report from Archbishops' Task Group

Present Scheme (General Summary)

A Defined Benefit, non contributory scheme. On retirement members receive a pension calculated at 1/60 of National Minimum Stipend for each year of pensionable service up to a maximum of 2/3, plus a variable lump sum up to £39k.

The scheme includes Death in Service and Illness benefits, reduced Widows Pension and an Annual Pension Increment of 1.5% above RPI

The fund is managed by the Pensions Board of the C of E and is subject to the oversight/direction of the Pensions Regulator under the provisions of the Pensions Act.

The cost of 39.7% of stipend is borne by the DBF.

Funding

The Scheme funds are reviewed every three years by actuaries appointed by the Pensions Board. The review takes account of, inter alia, the value of the fund's assets, the age profile of members, estimated life expectancy, projected rates of income and capital growth. This produces an assessment of the size of fund required to service the projected pension payment obligations.

The next review is due at the end of 2009. Preliminary evaluation suggests a major deficit in the region of £352m. The Funding Rate is to increase to 45% of stipend from 01/2010 and it is estimated it needs to rise again to 57% from 2011.

The deficit arises because of changes in several of the salient factors, but mostly because of the fall in asset value, and the fall in interest and yield rates during the credit crunch.

Cost Implications

39.7% was considered to be the highest rate affordable by the DBF. We must therefore decide whether or not we wish to go beyond that figure or see major changes in the Scheme, to reduce proposed costs and the ongoing exposure of the DBF to further increases in the future. Changes will inevitably affect the nature of the scheme and probably the pension prospects of the Clergy.

If no changes are made, the DBF **must** pay whatever the Pensions Board deems prudent.

The Archbishops set up the Pension Task Group to look at options to contain costs, and any implications arising from those options.

Task Group Report (summarised)

Most Dioceses feel unable to support the projected rates of contribution and the open ended commitment the current scheme entails. Three alternative options are suggested but each assume the following basic changes:

- Contracting **in** to the State Second Pension. Clergy are presently contracted **out**.
- Reducing the indexed increases to pensions in payment to RPI (currently RPI + 1.5%).
- Increasing pension age to 68, for future service.
- Increasing the accrual period for a full pension to 43 years for future service (currently 40 years).

Model 1

A modified Defined Benefits Scheme.

The existing scheme would contain the standard changes (above) which would reduce the contribution rate to 42% plus 2% extra NIC. Clergy would also pay extra NIC.

There would be no introduction of member's contributions.

This option gives the highest benefits to members but leaves the DBF exposed to further increases in contribution rate if the deficit is not reduced over time.

Model 2

Close the DB Scheme and replace it with a Defined Contribution Scheme.

The DBF would pay a defined amount to each member of clergy, instead of paying into the existing fund. This amount would be invested in a personal pension fund. The pension produced for any individual would depend upon the size of the fund accumulated (years of service plus fund performance) and the rates of annuity at which the pension can be purchased with the fund available at retirement.

NB

- All clergy would have to be transferred to this DC Scheme.
- Earned benefits in the closed DB Scheme would have to be preserved at an estimated ongoing cost to the DBF of 19% of stipend.
- Death in Service and Illness benefits would need to be bought in at an extra cost to the DBF.

The overall projected cost of this model is 22%-23% for the contributions plus 19% for existing benefits = 42%.

Benefits. Limits costs and exposure for the DBF.

Drawbacks Transfers market risks to the individual pensioner.

Model 3

A Hybrid Scheme.

This represents a halfway house between Models 1 & 2. Members would end up with three sources of pension. One from our DB Scheme, one bought with the proceeds of the DC Scheme and a third being the State Second Pension.

It does not transfer all the future risk of pensions fund performance to the employee, but seeks to give a compromise which limits the downsides to both parties.

The DB scheme would remain open but be reduced to provide 25% of pensionable stipend plus Death in Service and Illness benefits. **Costs 13% + 2% + increased NIC 3% for contracting in to Second State Pension.**

A DC Scheme would be opened at a contribution rate by the DBF of 7%.

Past Service costs would be 17%.

Total cost to DBF 42%. (Members would also incur higher NIC rates for the contracting in to SSP.)

Decision Required

1. What sort of pension provision do we want to give to our clergy?
2. How much are we prepared to pay for it?
3. Who bears the cost of risk, Diocese or Clergy and what part should the State play?

Risks:

- The present scheme is open ended; the risk is all with the DBF.
- Effect on clergy morale.
- Complexity that would arise from Model 3.

Process

We must advise the Pensions Board of our views by 31st October on the following:

1. Do we agree with the target rate of 42%?
2. Which Model do we prefer?
3. Do we have any variants in one or other of the Models to propose?
4. Any other proposals and comments.

CJF 2/9/09

Mr Andrew Britton
Chairman of the Pension Task Group
Archbishop's Council
Church Commissioner's
Church House
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15th May 2009

Dear Mr Britton,

Re: The Allocation of Church Commissioners' Funds 2011-13

We are writing to you as Chairman of the Funded Pension Scheme and Archbishop's Council's Finance Committee in response to your request that we do so following the consultation exercise held by Church Commissioners last week. We hope the following is a clear articulation of what we believe is the most strategic use of the Commissioners' funds, in economic and spiritual terms, and demonstrates that our proposal is one designed to benefit the whole Church and not simply a partisan view of a better-off diocese.

1. As we reported at the meeting we have two grave concerns for the Church within the context of financial strategy.
2. The first is that our congregations are disengaging from the concept of a universal Church and moving towards greater congregationalism driven, in part, by the reduction in clergy; but equally by the unending sense of retrenchment of the Church away from them and their needs. Financially this is reflected in an increasing level of "won't pay", often amongst the most financially wealthy churches.
3. Fifty years ago the Church was provided "free" to congregations, now it is something that is paid for. This is a fundamental shift in relationship, from a culture of 'charity' to pay-as-you-go. Generosity and common purpose have been elbowed out by a more calculating spirit. Whilst there is, long term, mission strength in our new position there is also a deep sense of betrayal amongst many at the swiftness and manner in which this change has come about. Our financial strategy must overcome this spiritual issue before we can hope to move to a financially self-sustaining Church. Our diocese is therefore focussing its efforts on rebuilding a sense of belonging and togetherness with our parishes which is essential to heal the wounds of the past decades.
4. Our other, and possibly greater, long term concern is that the clergy are beginning to sense betrayal too. In the last pension round there was a lot of concern expressed regarding the security of the pension scheme, compounding an already growing unease about the reliability of generally understood assurances that "the Church" would look after them when their active ministry ended. This sense of anxiety has grown subsequently, mainly around retirement housing.

5. Into this context the CEPB has put dioceses on notice of a rise in pension contribution rates to 45%, and potentially almost 60% - rather close to the two-thirds payment in retirement. Simply, and honestly, this is unsupportable by our congregations; it will exacerbate the sense of betrayal and of “the centre” dumping costs on parishes; thereby forcing the question of defined contribution pensions. This in turn will compound the sense of betrayal felt by our clergy.
6. We are, therefore, of the certain opinion that we can neither ask our parishes to pay more to fund clergy pensions, nor can we seek any fundamental change to the pension scheme for clergy. To do otherwise would be disastrous for the life of the Church. This double position forms the most important strategic objective for the National Church in its use of funds.
7. Having posited this problem we are aware that the solutions are not easy. However, it is clear to us that one particular option represents an opportunity to re-invigorate the Church and would offer the greatest act of faithfulness to the clergy and congregations within the Church.
8. We propose that the Church Commissioners take on full responsibility for clergy pensions, permanently. In making this suggestion we are conscious that such a proposal has previously been suggested, but never before in the context of the realistic alternative being the loss of a defined benefit scheme for clergy.
9. We have within the Church family a ready formed fund which the entire pension liability of the Church would make up somewhere around 50% of its value (less if we assume we are in a long-term market low). This is not dissimilar to the level of funds allocated in 1997 to pensions. As others have noted, the total exposure of the Commissioners will decline as the proportion of each new pension for which they are responsible diminishes.
10. The sharp decline in the level of funds taken up by the pension liabilities between 1997 and 2007 is testament to the fact that the Church Commissioners investment policy is more than capable of managing clergy pensions without additional funding. If we were to remove Mission and Ministry Grants altogether, then this analysis is indisputable, even with the latest valuations. With declining clergy numbers and shorter average service it is hard to see a significant change to this ability in the future.
11. We are aware of the three main counter-arguments to this proposition: the impact on Mission and Ministry allocations; the risk of the Commissioners falling within regulatory requirements which restrict its investment policy; and the issue of addressing clergy in need as a *raison d’etre* for the Commissioners. Taking these in turn.
12. To ensure the security of Commissioners’ funds to pay pensions we are proposing that the Commissioners cease all Mission and Ministry funding. If there is a simultaneous cessation in the payment of pension contributions by dioceses we believe the vast majority, including those in receipt of Mission and Ministry funding, will be better off. This will primarily be due to the structural difference in funding a new versus a mature pension scheme and the longer term view which the Commissioners will be able to make.
13. There may of course be a residual Mission and Ministry grant requirement for some dioceses. We believe this could be addressed through a reasonable request by Archbishop’s Council for mutual support from those dioceses (such as ours) that would benefit from the proposed change to fund those who have suffered. Such funding would be helpful in re-building a sense of common purpose across the Church.
14. The effect of our proposal will, therefore, be to move decisions on Mission and Ministry funding away from the Church Commissioners to the dioceses and Archbishop’s Council, thereby aligning policy making and finance more appropriately. This would resolve a long-

standing concern expressed by Commissioners of accountability and their inability to direct and hold dioceses responsible for the use of mission funding for its intended purposes.

15. As regards the regulation of Commissioners funds, we are aware of the risk to earnings that excessive regulation may bring (although even the most pessimistic of investment returns, based on gilt yields, would afford considerable comfort against present commitments). However, we are also aware that the Pensions Regulator is now committed to ensuring that defined benefit schemes are given all reasonable latitude to ensure their survival. As the survival of such an important scheme as the clergy's may depend on a request that an over-funded scheme be permitted to pursue a more enlightened and historically successful investment policy, we are convinced that the Commissioners will receive a very fair and sensible hearing. If the necessary latitude requires further assurance from DBFs then we are sure this can be arranged.
16. Finally as regards the obligation of the Commissioners to help clergy in need. With welcome moves on equalisation of stipends and improvements to housing there is without doubt no greater clergy constituency in need than those in retirement. The clergy package represents a reasonable living by modern standards. The clergy retirement package does not.
17. To reiterate, our proposal is that the Commissioners take on full responsibility for clergy pensions and cease mission and ministry funding. We note that the following will be needed before a clearer understanding of the impact of our proposal on DBFs, Archbishop's Council and the Commissioners can be understood:
 1. A comparative table of the nett impact on DBFs and Cathedrals (two separate tables) of the cessation of pension payments at 40%, 45% and 57% less mission and ministry grants received.
 2. A table for what donations into a mutual support fund would be needed and from which DBFs to ensure no DBF losses out from this change.
 3. A conversation with the Pensions Regulator on the minimum regulation they would insist for the Church Commissioner's funds if it were to accept full responsibility and how this minimum may be achieved (e.g. assurances from DBFs of assets etc).

We believe that this information should then be shared fully with all DBFs so that they can better understand exactly what our proposal will mean, rather than obtuse references to cuts in grants and the impact of regulation on fund management that have met such suggestions to date.

We believe that if this can be achieved it will be a wonderful act of faithfulness to our clergy and congregations, a statement of the unity and common purpose of the Church and genuinely invigorating to clergy and congregations who will feel that a burden is lifted from them.

We trust you will be sympathetic to our position.

The Revd Christopher Finlay
Chair, Gloucester DBF

Dr Kevin Brown
Diocesan Secretary

Benjamin Preece Smith
Director of Finance