

GENERAL SYNOD**THE CHURCH OF ENGLAND FUNDED PENSIONS SCHEME
(AMENDMENT) RULES 2012****EXPLANATORY MEMORANDUM****Introduction**

1. The Church of England Funded Pensions Scheme (Amendment) Rules 2012 (“the amendment rules”) make changes to the rules of the scheme in two areas:
 - a new rule to incorporate the provisions of the Reorganisation Schemes (Compensation) Rules 2011 made by the Dioceses Commission; and
 - a revised rule to deal with debts that arise under Section 75 of the Pensions Act 1995, following a change in legislation and guidance from the Department for Work and Pensions (DWP).

The Reorganisation Schemes (Compensation) Rules 2011

2. The Dioceses Commission has made rules - the Reorganisation Schemes (Compensation) Rules 2011 (the “Compensation Rules”) - which set out the principles on which compensation is payable to office holders whose posts are abolished under a reorganisation scheme. These rules include provisions relating to pension benefits. The Rules were approved by General Synod in July 2011.
3. The amendment to the rules of the Church of England Funded Pensions Scheme (CEFPS) contained in rule 3 of the amendment rules incorporates the provisions of the Compensation Rules into the CEFPS by inserting a new rule 14.5.

Section 75 of the Pensions Act 1995

4. Section 75 of the Pensions Act 1995 (as amended by the Pensions Act 2004 and Regulations made in 2008) has the effect that an employer participating in a defined benefit scheme cannot “walk away” from its liabilities. The section achieves this by providing that in the following three circumstances, a debt (known as “Section 75 debt”) becomes due from the employer:
 - a. on insolvency of an employer (in which case a debt is due only from the affected employer)
 - b. on an “employment cessation event” (see below) (in which case again a debt is due only from the affected employer);
 - c. at a time designated by the trustees after winding up of the scheme commences (in which case a debt falls due from all entities which were employers immediately before the process leading to winding up commenced).
5. An “employment cessation event” arises if an employer ceases to employ active members of the scheme and at that time another employer continues to do so. This means that, if an employer’s last employee leaves service or dies, the debt will arise.

6. The debt for each employer is calculated as the sum of:
 - a. liabilities in respect of its own employees and former employees; and
 - b. a proportionate share of all “orphan” liabilities. Liabilities are “orphan” if they arose during employment with an entity which is no longer an employer (e.g. an entity which previously employed members of the scheme but no longer does so). Additionally, legislation provides that if a member’s actual employer cannot be identified, the liabilities for that member are treated as orphan.
7. For this purpose, liabilities must be valued on a “buy out” basis, i.e. by reference to the estimated cost of securing liabilities with an insurer. This places a considerably higher value on the liabilities than the basis used by the Trustee to value benefits for the purposes of ongoing contributions.
8. The calculation of the debt for any employer is complex, time consuming and expensive. It is, however, possible for the scheme rules of a multi-employer scheme to apportion the debt differently between employers. One means of doing so is called a “scheme apportionment arrangement” (SAA).
9. The Rules of the CEFPS were amended in 2008 to allow for SAAs. Under those rules, the Pensions Board designated each Responsible Body¹ within the scheme as either “major” or “minor”:
 - “Major” bodies are the diocesan boards of finance and a number of other organisations (such as the Church Commissioners) which could be expected to continue in the scheme on a permanent basis.
 - “Minor” bodies are organisations whose participation in the scheme is less likely to be on a long-term basis. Minor bodies include theological colleges, certain charities and university colleges and will typically only have a very small number of members of the scheme at any time. When a minor body ceases to have active members it pays a nominal debt of £100 with the remainder of the debt being apportioned to the major bodies. This arrangement is a form of SAA and is set out expressly in the Rules governing the CEFPS.
10. Particular features of minor bodies are that:
 - they typically have a very small number of members, meaning that the risk of an “employment cessation event” arising is high;
 - although there is an easement applicable where the Responsible Body re-starts employing members within a limited period, this will often not assist (because it is common for posts not to be filled within this period);
 - the costs of the calculations are often disproportionate to the amount of the debt;
 - the amounts involved can be large in the context of the Responsible Body (particularly for those that are charities).

¹ A ‘responsible body’ is the body responsible for paying contributions in respect of the scheme members for which the body in question is responsible under section 4 of the Pensions Measure 1997.

11. The reason for allowing the Minor Responsible Bodies to participate in the scheme is to ensure that clergy who move out of parochial ministry for a period continue to benefit from scheme membership. However, the existence of the Section 75 debt means that the “price” for this continued scheme membership for the Responsible Body concerned is potentially high. There is therefore a real concern that, if no action is taken, these Responsible Bodies may be unable to continue to participate in the scheme, to the general detriment of the affected clergy and the Church as a whole. There is a further concern that smaller organisations which currently participate in the scheme could be severely affected financially to the extent that they become insolvent as a result of their last / only member leaving, retiring or dying.
12. In general, although the legislation requires a debt to be apportioned, in practice the aim of the SAA (although expressed as an amount of debt) was to apportion liabilities. This was achieved under the current rules of the CEFPS by providing that section 75 debt apportioned to Minor Responsible Bodies was nominal in amount (rule 20.4(i)). The Major Responsible Bodies had apportioned to them both their own share of debt liability and the remainder of the total debt that was not apportioned to the Minor Responsible bodies (rule 20.4(ii)). The scheme apportionment arrangement contained in the rules, by providing for only nominal debt to be apportioned to Minor Responsible Bodies, avoided a number of the difficulties mentioned above in paragraph 11 above. In particular, it meant that, in the case of the CEFPS, there was no need to calculate the actual amount of the debt for each departing employer. Carrying out a full calculation in each case would have entailed considerable cost in actuarial fees and meant that CEFPS would not be able to continue to accommodate the smaller Responsible Bodies.
13. The Department for Work and Pensions (DWP) has, however, recently issued guidance about its interpretation of the way in which the legislation governing SAAs operates. It states that it interprets the legislation as requiring an actual amount of debt to be apportioned. If that interpretation is correct, then the mechanisms inserted into the scheme would not work effectively. There is therefore a risk that an employer might not be discharged from its liability following a cessation event. Additionally, even if the approach of apportioning a debt could work in individual circumstances, the amounts would have to be certified, which would involve significant cost.
14. Although the DWP’s interpretation can be disputed, the legal advice received by the Pensions Board is that it would be unsafe – from the viewpoint of both the Board and the Responsible Bodies - to continue to rely on the arrangements as currently set out in the Rules.
15. However, new regulations came into force at the end of January 2012 which introduce a new method for handling Section 75 debts – “flexible apportionment arrangements” (FAAs). An FAA provides a new way of transferring liabilities between employers that does not involve identifying and apportioning a particular debt. In fact, it provides a mechanism which is much closer to what the Board had sought to achieve with the SAA it had put in place in 2008.
16. The Board’s legal advisers have recommended that the Rules of the CEFPS be amended to allow the use of the new FAA arrangements and that the Board puts in place new arrangements which will qualify as an FAA. A new rule to give effect to that recommendation is set out in rule 4 of the amendment rules. It takes the place of existing rule 20.
17. These new arrangements will be on the same terms as the present arrangements except that the “minor” Responsible Bodies will not be required to pay a nominal amount. The mechanism for dealing with individual cases will be set out in a policy statement from the Board, a draft of which is attached as Appendix 1. This sets out how the apportionment arrangements will be applied in the majority of cases (involving Minor Responsible Bodies); previously, the

mechanism for dealing with cases was set out in the Rules themselves. Other cases will be dealt with in the most appropriate manner depending on circumstances. This would include whatever arrangements are required to deal with the reorganisation of the West Yorkshire dioceses under the Dioceses Commission proposals, if those go ahead (the amalgamation will trigger cessation events in respect of the former dioceses); the current rule is too narrowly drawn to deal with that situation and a rule amendment would have been required in any event.

18. The application of the policy set out in Appendix 1 will require the specific agreement of each Responsible Body participating in the scheme to take on the relevant liabilities of the minor bodies. Responsible Bodies have been asked to give their approval and, at the time of writing, many have already done so. Consent from all Responsible Bodies is not required to make the Rule change, but it will not be possible for the Board to adopt its policy statement until agreements have been received from every body.
19. If any major Responsible Body were to withhold its consent, then it would mean that, on each and every “employer cessation event”, a full actuarial assessment would need to be carried out to calculate the leaving employer’s Section 75 debt. That debt would need to be paid by the departing employer. The cost of carrying out such assessments would be prohibitive. Given the large number of minor responsible bodies, employer cessation events are a frequent occurrence.
20. The likely result of a major body withholding its consent to the new arrangement would be that no new minor Responsible Bodies could be admitted to the scheme and existing minor Responsible Bodies may have to cease participation. The Board would be under a legal obligation to pursue any Responsible Body that ceased participation for the Section 75 debt it owed. This could result in such bodies being forced into insolvency.
21. The Board strongly believes that it is in the best interests of the clergy and the Church as a whole that the minor Responsible Bodies continue to be able to participate in the scheme so that clergy who take up posts with minor bodies can benefit from continuity of pension provision. This proposal gives effect to the intention of the previous arrangements for dealing with Section 75 debt, adjusted in the light of the guidance from the DWP and the new arrangements permitted under recent legislation. It does not represent any change in policy but is the consequence of those external factors.

Bernadette Kenny
Chief Executive
Church of England Pensions Board
29 Great Smith Street
London, SW1P 3PS

June 2012

Draft Policy Statement

Section 75 Debts

This statement sets out the Policy of the Board to manage debts which may arise from Responsible Bodies under Section 75 or 75A of the Pensions Act 1995 (“**S75 Debts**”).

- 1 The Board has designated each existing Responsible Body as either a “Major Responsible Body” (“**Major RB**”) or a “Minor Responsible Body” (“**Minor RB**”). Any new entity admitted as a Responsible Body will be designated as a Major RB or a Minor RB on admission.
- 2 The Board’s policy is that Minor RBs should not be exposed to S75 Debts as this would be likely in practice to make their continued participation in the Scheme difficult.
- 3 If an event occurs which would otherwise give rise to a S75 Debt from a Minor RB, the Board intends the following:
 - (a) The Board will enter into an arrangement which is a “flexible apportionment arrangement” (“**FAA**”) in consequence of which all liabilities of the relevant Minor RB will be transferred to one or more Major RBs as described at (5) below.
 - (b) The Board does not expect to levy any charge on the relevant Minor RB in connection with the FAA but reserves the right to do so (ie to require the Minor RB to meet part or all of the S75 Debt) in exceptional circumstances.
 - (c) However, the Board can only enter into an FAA if certain conditions are met at the relevant time. In particular:
 - The relevant Minor RB stops employing (or being responsible for) active members of the Scheme and does not give the Trustees a “period of grace” notice under regulation 6A of the Occupational Pension Schemes (Employer Debt) Regulations 2005;
 - The Board must be satisfied at that time that the “funding test” set out in legislation will be met;
 - the Scheme is not in an assessment period (for the purposes of entry to the Pension Protection Fund) or being wound up at that time;
 - the Trustees are satisfied that an assessment period is unlikely to begin in relation to the Scheme within the next 12 months;
 - the consent of all Responsible Bodies affected by the FAA is obtained (see further section (7) below).

The Board will consider at any time when a S75 Debt would otherwise arise from a Minor RB whether these tests are met and, only if they are, will the Board enter into an FAA which has the effect described above. For the avoidance of doubt, if these conditions are not met at

the relevant time, the S75 Debt due from the Minor RB will be calculated as its “liability share” in accordance with legislation.

- 4 Liabilities will be apportioned as follows:
 - 4.1 Where a Member leaves service with a Minor RB and immediately enters service with a Major RB, the liabilities in respect of that member will be apportioned to the relevant Major RBS.
 - 4.2 In all other case, the liabilities which would otherwise have been attributable to the Minor RB will be apportioned on a pro rata basis (by reference to their other liabilities to the Scheme) to all the major RBs. Any S75 Debt which becomes payable from a Major RB will be modified accordingly.
- 5 In the event that it is held by a competent Court or regulatory body that a S75 Debt arises from a person which is not a Responsible Body, paragraph 4.2 will be applied as if that person were a Minor RB.
- 6 It is a condition of an FAA that consent is obtained from both the entity whose debt is apportioned and the person to whom it is apportioned. In effect, this requires the consent of all Responsible Bodies. The Board will not implement the arrangements described in this Policy until such consent has been obtained.
- 7 The Board recognises that circumstances may arise where it is appropriate to enter into alternative arrangements for the management of S75 Debt. In particular, where two or more Responsible Bodies are merged, or where one Responsible Body takes over the business of another, it may be appropriate to enter into alternative arrangements so that the merged/ new/ replacement Responsible Body undertakes the liabilities of the outgoing Responsible Body (Bodies). The Board will consider proposals for such arrangements on a case by case basis. The Board will only enter into such arrangements if all applicable statutory conditions are met and must take account of the effect (if any) that such arrangements would have on other Responsible Bodies.
- 8 The Board will record the terms of each arrangement which it enters into for the purposes of managing S75 Debt (whether in line with Clauses 3 to 6 of this Policy or otherwise) in its minutes or in a formal agreement with the relevant Responsible Bodies.
- 9 The Board may vary its Policy at any time.

**Published by the General Synod of the Church of England
and on sale at the Church House Bookshop**

31 Great Smith Street, London SW1P 3BN

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