GENERAL SYNOD

DRAFT DIOCESAN STIPENDS FUNDS (AMENDMENT) MEASURE

EXPLANATORY MEMORANDUM

BACKGROUND

1. The Diocesan Stipends Funds Measure 1953 imposes strict restrictions on what a diocesan board of finance ('DBF') may do with the diocesan stipends fund. In particular, the fund must be allocated as between income and capital accounts, and the Measure specifies the purposes for which each account may be used. The capital account may not be used for payment of stipends.

2. The effect of these statutory restrictions is that dioceses are compelled to accumulate capital gains of the diocesan stipends fund in the capital account, and only income returns may be used for payment of stipends out of the income account. In an environment where income returns are low, this may have the unintended consequence that the value of the capital account increases while the annual sum from the income account which is available for payment of stipends is decreasing. Alternatively, it could encourage trustees to adopt an investment policy which would increase income in the short term, but at the expense of eroding the capital and reducing income over the longer term.

3. DBFs are charitable companies, registered with the Charity Commission. Other charities, finding themselves in the position described above, would have applied to the Charity Commission for an order under section 105 of the Charities Act 2011 enabling them to invest and spend on a "total return" basis. Such an order enables a charity – subject to safeguards set out in the Order – to spend some of its accumulated capital gains as well as income. This has enabled charities with a long-term time horizon better to balance the needs of current and future beneficiaries. The Commission's guidance,[1] issued in 2001, explains this more fully:

    > *"Under the total return approach, the nature of the investment return is irrelevant; it is solely the level of the [total] return that matters. This means that trustees are allowed to invest in a way that generates the best overall return regardless of whether the return comes from dividends, interest or capital gains.*
    >
    > *The trustees can then allocate as income whatever portion of the total return they consider appropriate. The balance remaining is carried forward as unapplied total return and is invested as capital. It is important to note that the total return approach requires trustees to be even-handed between present and future beneficiaries when making decisions.*

[1] Operational Guidance note 83

Using the total return approach, trustees can focus on investments that are expected to give the best performance in terms of their overall return rather than on investments that will give the "right" balance of capital and income under the standard rules."

4. Since the coming into force of the Trusts (Capital and Income) Act 2013, charity trustees have been able to pass a resolution under new section 104A of the Charities Act 2011, to enable a permanent endowment to be invested on a total return basis, if they think that such a resolution is in the interests of the charity. If such a resolution is passed, trustees will be able to determine the balance between sums to be spent and the sums to be retained for further investment by looking across the whole investment return rather than at the technical classification of receipts as capital or income.

5. If they follow this approach, trustees need to determine a "base level" for the endowment, which cannot be applied and which will therefore be preserved, and to decide whether this base level will be fixed or varied over time in line with a predetermined policy. The initial base level is usually defined as the original value of the endowment adjusted by an inflationary factor. If the original value of the endowment is unknown, the Charity Commission's guidance makes clear it is permissible to make a reasonable estimate. How far back in time it is reasonable to go in making this estimate will depend on factors such as the amounts involved and the state of the records.

6. The difference between the initial base level, calculated as described in paragraph 5, and the actual value of the fund as at the date of the resolution is known as the "unapplied total return" and can be allocated either to investment or for application for charitable purposes. If the fund has made significant capital gains in the past, the new flexibility in relation to the unapplied total return may provide a charity with a source of extra funds to distribute.

7. Neither of these approaches – seeking an order from the Charity Commission or passing a resolution under the 2013 Act - is available to DBFs in respect of their diocesan stipends funds, because the legislative constraints under the 1953 Measure on the uses of the capital and income accounts involve a statutory restriction, preventing investment on a total return basis. Therefore legislation is needed to enable DBFs to exercise the same range of investment powers, in relation to diocesan stipends funds, that is available to other charities. The total value of all diocesan stipends funds, as at December 2012, was a little over £1 billion, so this flexibility is potentially very valuable. Annex 1 sets out an example of how a total return resolution might apply in relation to a diocesan stipends fund.

8. The purpose of the draft Measure is therefore to enable DBFs to allocate returns on their investment, whether those returns are capital gains or income, to either the income account or the capital account. They would continue (like other charities which adopt a total return approach to investment) to be subject, as a matter of law, to the fiduciary obligation to balance the interests of present and future beneficiaries of the fund, and therefore to balance

allocating returns to the capital account for investment with allocating returns to the income account to fund current stipends. This is emphasised in the Regulations on this matter that apply to all charities in respect of permanent endowments which make it clear that trustees must make decisions in a way which does not adversely affect a charity's ability to further its aims now and in the future.

9. The draft Measure achieves this by enabling a DBF to pass a resolution under section 104A of the Charities Act 2011. A resolution under that section attracts the provisions of regulations under section 104B. A copy of the current Charity Commission regulations appears as Annex 2 to this Memorandum.

10. If a diocese has made significant capital gains on its diocesan stipends fund capital account, adopting a total return approach offers the potential to release additional funds for distribution in line with the permitted purposes of the fund. This could enable the diocese to have more stipendiary clergy than it would otherwise be able to afford and / or enable money from other sources (such as parish share) which would have been needed to meet stipend costs to be used for other purposes to further mission and ministry within the diocese.

11. The principle of the draft Measure was considered at the Inter-Diocesan Finance Forum in February 2014, and met with unanimous approval.

12. It is the intention of the Archbishops' Council to issue guidance about the use of the new power by DBFs. This is likely to reflect the guidance already provided by the Charity Commission, but with some tailoring to reflect the particular needs of DBFs. The guidance will make it clear that the decision about whether or not to take advantage of the new powers will rest with individual DBFs and should be made after taking appropriate professional advice.

NOTES ON CLAUSES

Clause 1 (Amendment of Diocesan Stipends Fund Measure 1953)

Clause 1 inserts new section 5A into the Diocesan Stipends Measure 1953.

Subsection (1) of the new section enables a DBF to make a total return resolution under section 104A of the Charities Act 2011 in relation to the capital account of its diocesan stipends fund- that fund being the equivalent of the "permanent endowment" referred to in section 104A since it is not available for expenditure on stipends but must be invested in accordance with section 4 of the Measure. As noted above, passing a resolution under section 104A automatically attracts the provisions of regulations made under section 104B.

Subsection (2) provides that where a DBF has passed a total return resolution, decisions relating to the "unapplied total return" are decisions about whether funds should be allocated to the capital account or the income account. This clarifies a point

that would otherwise be somewhat obscure in the application of the Charity Commission regulations, which refer to allocation of unapplied total return to the "trust for investment" and the "trust for application".

Subsection (3) defines the "unapplied total return" for the purposes of the new section (and, therefore, also for the purposes of the Charity Commission regulations in their application to diocesan stipends funds).

Subsection (4) provides that regulations made under section 104B of the Charities Act 2011 have effect with such modifications as may be necessary. The principal modifications are that, as noted above, references to the "trust for investment" and the "trust for application" should be read as references to the capital account and the income account of the diocesan stipends fund, and that references to the "unapplied total return" in those regulations are references to the unapplied total return as defined in subsection (3).

Clause 2 (Short title, commencement and extent)

This clause provides for the Measure to come into force at the end of two months beginning with the date on which it receives Royal Assent. It extends to the provinces of York and Canterbury, excluding the Channel Islands and the Isle of Man. This reflects the extent of the Diocesan Stipends Funds Measure 1953.

The Legal Office
Church House
Westminster

October 2014

ANNEX 1

EXAMPLE OF HOW A TOTAL RETURN APPROACH MIGHT WORK FOR DSF CAPITAL ACCOUNTS

The earliest valuation of a diocese's DSF capital account balance that can be found is at the start of 1990 when the assets were valued at £20 million. (Only partial figures are available as at 1 April 1978 when the ownership of glebe assets was transferred to the DBF).

As at the end of 2013 the assets were valued at just over £49 million. The average return over that period was 8% p.a. – equally split between capital and income. In comparison to an average return of 7.9% p.a. from the average pension fund, 8.5% p.a. from UK equities and 7.2% p.a. from UK commercial property.

The trustees agree that it is reasonable for them to set the base value of the endowment as the valuation at the start of 1990 increased in line with the RPI index (average annual increase 2.8% p.a.) to preserve its "real" value. In the example this would result in the base value of the DSF capital account endowment being just under £38 million and an unapplied total return of just over £11 million.

This enables the DBF trustees to consider, with the assistance of advice from suitably qualified persons, questions such as:

- Whether they should alter investment policy so that asset allocation and investment selection policies do not have to deliver an average income yield of 4% to enable their expenditure requirements to continue to be met. Over time this could, if the investment policy had been appropriately designed and barring unforeseen events, offer the prospect of achieving higher returns from the investments, enabling a higher cash distribution from the fund towards the diocese's stipends bill than would have been the case under the previous investment policy.

- Whether the DBF can release a portion of the unapplied total return over several years to enable additional stipendiary clergy to be engaged and / or meet a greater proportion of the diocese's stipends bill releasing money from the parish share for other diocesan priorities.

As a result the DBF might:

- Change its investment policy to one which over the next 10 years might achieve an annual total return of 1% more than its original policy. In today's money terms at its 4% distribution rate this would potentially enable it to distribute an additional £0.2 million p.a. at the end of the period.

- Decide to release 20% of its unapplied total return over the next ten years: equivalent to additional stipends support of £0.23 million p.a. in today's money terms. The diocese consults on whether the additional money available in the DBF budget should be used to enable additional stipendiary clergy to be engaged or for other purposes within the diocese.