GENERAL SYNOD

Church Commissioners' Funds and Inter-Generational Equity

"Those who cannot remember the past are condemned to repeat it."
By Andreas Whittam Smith, First Church Estates Commissioner

Introduction

1. The stimulus for this note is the production by the Archbishops' Task Groups of ambitious proposals to equip the Church for the future. The Church Commissioners strongly welcome these initiatives and wish to play a full and creative part in their implementation.

2. At the same time, the Church Commissioners understand that financing such proposals, and in particular accelerating their adoption, would be beyond the capacity of the dioceses and that, if the proposals are to be taken forward, the Church Commissioners would have to make available additional funds. This could well draw them into over-distributing for a period. In other words, they would be spending from their funds above the rate that is sustainable over the long-term.

3. The attached note from our Chief Finance Officer provides a briefing on the distribution of the Commissioners' funds. It repays careful reading. The key point to bear in mind is that there is 'good' over-distribution and 'bad' over-distribution.

4. The good version is undertaken for a clear purpose, in response to plans that are evidence based, fully costed and is entered into with the agreement and understanding of all parties. And there are safeguards in place. In addition a successful outcome would have, as a by-product, an increase in the Church's financial strength.

5. 'Bad' over-distribution is what led the Commissioners into a severe crisis in the early 1990s. In November 1990 it was first realised that the Church Commissioners' portfolio could no longer provide sufficient sustainable income to meet their expenditure commitments. Then it was calculated that the Commissioners' pension liabilities were on track to exceed their assets, as well as leaving nothing in respect of the Commissioners' liability for other payments such as bishops' costs, help for cathedrals and support for parishes. Even as late as January 1994, annual expenditure was still exceeding income by £20 million with nothing held back for the benefit of future generations.

6. In response, four major reforms were carried through. A new pension scheme for clergy, funded by the dioceses and administered by the Church of England Pensions Board, was set up and came into operation in 1998 (benefits arising from service prior to 1998 are still the responsibility of the Commissioners).

7. At the same time, the Archbishops' Council was created to 'co-ordinate, promote, aid and further the work and mission of the Church of England'. It took over the Commissioner's previous role in remuneration policy and was also given responsibility for decisions about how to distribute the funds made available by the Commissioners.

8. Thirdly, the Commissioners professionalised their staffing. Externally recruited specialists filled posts previously occupied by generalists developed in-house. In addition governance was improved with the creation of an Audit Committee.

9. The fourth great reform was to require independent actuaries to be appointed to advise the Commissioners on a regular basis how much money could prudently be distributed. This new discipline makes it impossible to over-distribute **without knowing that you are doing it** – unlike what happened in the 1970s and 1980s. Every three years the actuaries carry out a detailed review of the Commissioners' fund and pensions obligations, and they update their findings annually.

10. Consequently, for more than twenty years now, with the benefit of their actuaries' advice, the Commissioners have adopted a rigid policy of distributing only such sums that will enable the value of the endowment to be maintained in real terms through time. In so doing they have observed the principle of *inter-generational equity*.

11. To help Synod members consider whether they would support the Commissioners' in a policy of once again breaking the inter-generational rule, only this time deliberately, for clear purposes and with safeguards, what follows is an account of some of the episodes that created the crisis of the early 1990s together with an analysis of why the current proposals before us are different in nature and should not result in a repetition of past mistakes. As was remarked long ago: "Those who cannot remember the past are condemned to repeat it.

The Commissioners' responsibilities

12. Throughout their history, the Church Commissioners, set up in 1948, and their two predecessor bodies, Queen Anne's Bounty, created in 1704, and the Ecclesiastical Commissioners, founded in 1836, have been concerned with improving clergy stipends (and more recently clergy pensions) and with securing a Christian presence in every community, particularly in areas of growing population.

13. In the 1970s and 1980s the Commissioners fully lived up to these historic duties. For during this period, their assets were growing quickly. That is, until the very end of the 1980s and in the early 1990s when commercial property values collapsed and an unbalanced and carelessly managed investment policy was exposed.

Stipends

14. During the 1950s and 1960s the Church had tangled with clergy deployment and remuneration issues. The Commissioners, providing as they did in those days some 75 per cent of the total, had a ringside seat. The Church Assembly commissioned a report entitled 'Partners in Ministry'. It recommended the creation of a "more equitable structure for remuneration"; it envisaged the creation of a Central Stipends Authority (CSA) and identified the Commissioners for this unenviable role.

15. Reassured that uniformity of payment was the aim, the Board of Governors duly agreed. No reservations with regard to affordability or the possible impact on pension costs were recorded. From 1 January 1973, the Commissioners, as CSA, would be responsible for establishing a recommended stipend range, campaigning to ensure clergy were not paid below it, persuading dioceses to pay their share, and – significantly – making their own

contribution, which added nearly £1m to their £15m stipends bill in the first year of the new arrangements.

16. In the early 1970s many clergy were still paid below the lower end of the recommended range. Worse still, rampant inflation, with the cost of living rising by 19.1 per cent in 1974, 24.9 per cent in 1975 and 15.1 per cent in 1976, undermined the value of stipend increases, decimated the value of parishioners' giving and spurred the Government into producing a White Paper on the control of incomes.

17. And so, despite recognising that "the main responsibility for providing stipend increases must . . . fall on church members", and despite the Government urging employers to increase salaries by no more than 5 per cent, the Commissioners soon agreed a 13 per cent uplift for clergy (of which they would pay a quarter). But as pension provisions rose with stipends, there would also be a double whammy effect. Even so, the following year the Commissioners would also commit to generous aspirations for higher pensions.

Pensions

18. A compulsory pension scheme for clergy had been established in 1927. By the early 1950s pensions had become a pressing issue. In 1953, the matter was raised with the Commissioners and they considered a new scheme under which they would take over the responsibilities of the Clergy Pensions Board with the corresponding assets. With their greater resources, the Commissioners would seek to improve the pension package and, significantly, the scheme would now become non-contributory. The Board "resolved that the proposed scheme be accepted in general principle... and [agreed that] £300,000 per annum be allocated for increasing pensions".

19. Thus the Commissioners had taken on a long-term legal liability that was difficult to evaluate. Shortly, further improvements to the pension package – all entirely reasonable and overdue – were made. Subsequent Measures would reduce the pensionable age from 70 to 65, give all clergy a full service pension equalling about half their stipend and entitle clergy widows to one-third of their husband's pension. All of these would increase the burden on the Commissioners on a recurring basis. But the next major pension reform, and much the biggest contribution to the Commissioners' later strife, would come in 1980.

20. In April 1979 the Pensions Board sought to persuade the Commissioners that the time was ripe to set out new policy objectives for clergy pensions. The Commissioners replied that, in view of the likely limitations on "moneys available for pensions in 1980 because of the continued demand for money to help dioceses in the 'catching-up' operation for stipends…a false impression could be given if specified pension objectives were made known".

21. However it wasn't long before the Commissioners felt "able to announce that, in the light of some slightly more favourable estimates for their future income that had recently come to hand, it seemed likely that they would be able to provide sufficient additional income in 1981-1982 to enable pension levels to be increased that year marginally above 50 per cent of the minimum stipend... and [that it may] also be found possible in 1982-1983 and subsequent years to provide sufficient additional income."

22. Finally, in November 1980, the Commissioners and the Pensions Board jointly published a report entitled 'The Pensions of the Full Time Ministry'. It was a "general statement of policy" and introduced a set of aspirations rather than commitments. Its only assurance was that pensions benefits would be further improved "as and when resources are available". However, the Pensions Board chair would later tell a Parliamentary Select Committee that this concept of affordability was not scientifically considered: "there was no valuation of liabilities on a traditional actuarial assessment".

23. The aspirations were generous. The two bodies would work towards the provision of a pension equal to two thirds of the minimum stipend, seek to make two thirds of the pension available to widows and, in the longer term, increase the full service lump sum to three times pension "as rapidly as finances permit". Thereafter there would be similar improvements in the retirement benefits of deaconesses and licensed lay workers.

24. Synod was supportive. Its debate was rightly full of compassion for retired clergy and their families – speaker after speaker identifying unfairness and urging redress – but there was no mention of affordability until the then First Church Estates Commissioner, Sir Ronald Harris, was called to speak in debate on one of a series of amendments.

25. He made clear that these were, after all, only aspirations and that the Commissioners would enable them to be met "as and when the financial situation permits". This did nothing to dampen Synod's enthusiasm for the report. Nor did the fact that two other Commissioners expressed personal views that the proposals were not generous enough (one of them also bemoaning Anglican caution).

26. Once Synod had voted overwhelmingly in favour of these aspirations, the Commissioners gave the whole thing a head start. Having enjoyed the fruits of a decision by Shell and Unilever to pay out their arrears of dividends in 1979, the Commissioners had £800,000 to apply to the bringing forward of the effective date for the pension improvements. The aspirations were immediately viewed as duties and a new permanent burden (however worthwhile) had been accepted.

27. A report commissioned by Archbishop George Carey in 1993 after the crisis described the 1980 pensions vote as "a major factor" in the Commissioners seeking to increase the income generated from their investments to the detriment of their capital value. Indeed those taking part in the various discussions during 1979 and 1980 had not focussed on the fact that the cost of non-contributory pensions paid by the Commissioners had already (before this latest initiative had taken effect) risen from £1m at the end of the 1950s to £14.4m in 1980.

28. Realists might further have wondered where that figure would head in the coming decade and beyond. In fact by 1990 pensions would cost the Commissioners £53m per annum; the pensions' outgo, which had represented 24% of their income in 1980, would virtually double in the following decade.

Over reliance on commercial property development

29. Over reliance from the 1970s onwards, yes, but in the immediate post-war period, the Commissioners were exceptionally well placed as far as property development was concerned. Bomb damage had created many cleared sites and the Commissioners had a full ration of them, especially in central London. Until 1951, redevelopment was

virtually impossible because of materials shortages and a strict licensing system. These restrictions were progressively lifted between 1953 and 1959. The consequence was that during the twenty years since 1939, a massive shortage of offices and retail space had developed. There was huge supressed demand.

30. The Commissioners had the sites and they had the funds. They lacked only the expertise, but that could be acquired by forming partnerships with experienced developers. They were in a midst of a never-to-be-repeated property boom when great personal fortunes were made. The First Commissioner of the time was moved to tell the Archbishop of Canterbury of an embarrassment of riches. Geoffrey Fisher replied that 'it is really very difficult to take in these vast sums'. By 1961 the Commissioners had some 20 joint ventures with developers.

31. By the 1970s when inflation began to take hold, the Commissioners persuaded themselves that in an unsettling age of rising prices, property, and property development with its enhanced returns, offered them the best protection there was. The deliberate aim was to protect stipends from the effects of a sharply increasing cost of living. And wanting to invest as heavily as possible in what they believed were inflation proof assets, they let slip their old rule of ploughing back into the endowment a proportion of the surplus earned each year.

32. The Commissioners really began to go wrong, however, when they moved beyond developing their own sites and moved beyond using their own money. Rather than partnering with entrepreneurs to develop their inherited real estate, they began to develop new sites. They invested heavily in funding the development of new shopping centres, for instance, starting with St Enoch's in Glasgow. In 1985 came the Metrocentre in Gateshead. Then followed Tower Ramparts in Ipswich a further project in Cheltenham, the Marlowes Centre in Hemel Hempstead and other developments in Maidenhead, Sutton Coldfield, Banbury, and Birmingham.

33. The Metrocentre has been a success. But cost overruns and the weakness of some of the Commissioners' partners dented the prospects of many of the others. The Commissioners still retain a sizeable investment in a huge development project at Ashford in Kent that was started at the same time, but they have hung on not because it has been a success. Rather, it fell so far short of what was expected that only prolonged nursing has given the Commissioners any hope of receiving a return.

34. At the same time the Commissioners ventured into the US property market. In 1982, a US company was formed to act as the vehicle. By January 1984, it had properties in California, Texas, Florida, the northeast, the mid-east and North Carolina. In 1986 its investment ceiling was raised to $230 million, which was used up by February 1989. By the end of 1996 the Commissioners sold it all but with little to show for what they had done.

35. Borrowing by the Commissioners themselves to fund development projects came later in the story. The Commissioners were in danger of breaking what was then considered good practice for endowments - you can spend your income but not your capital. So instead they would borrow. In February 1988, a £150 million floating rate loan was negotiated with NatWest, which was soon increased to £250 million. Then further borrowings from other sources took the total level of borrowing to £518m by 1990.

Lessons to learn

With the benefit of hindsight it can be seen that the Assets Committee of the Church Commissioners, which has an exclusive power in the management of the fund, made three mistakes of principle.

- Until 1974, the Commissioners had been careful not to compromise the future by over-distributing. But in 1974 the Assets Committee noted in its report on money available to the Board that in view of the needs created by high inflation the 'customary transfer to capital for permanent reinvestment' could not be made that year. From then onwards, over-distribution became a habit and the additional spending was targeted on recurring costs (stipends, pensions etc.), which could not be cut back when things turned sour.
- An over concentration of assets was allowed to develop. Commercial property came to represent 38% of the Commissioners' total assets and this asset class was itself made up of a small number of large schemes.
- The decision to borrow exacerbated the risks. Moreover the floating rate of interest, which started at 5 per cent, quickly doubled to 10 per cent. Indeed, the £52m the Commissioners were spending on loan repayments in 1991 was almost as much as they were spending on stipends (£63m) and pensions (£58m).

The Church Commissioners in 2015

36. The position of the Church Commissioners today is very different from that which pertained as recently as the mid-1990s. By careful investment (the Commissioners have achieved investment returns in excess of its target return of RPI plus 5 per cent consistently over the last twenty years) and by the adoption of a prudent distribution regime, informed by independent actuarial advice, the Commissioners presided over as investment portfolio at the end of 2013 of £6.1 billion. Of this, 34 per cent is required, according to the actuaries, to meet the pension obligation the Commissioners still retain for clergy pensions earned prior to 1998. The 2014 outturn will be higher still.

37. The Commissioners operate a highly diversified investment portfolio that has shown itself to be resilient during the recent economic turmoil, and has been able to maintain its level of distribution to the Church, in particular its support for poorer dioceses and more recently for mission and development opportunities.

38. The Commissioners are not encumbered with any borrowing and have been growing the value of the portfolio at a rate faster than simply maintaining the real value of the endowment – indeed **had they only managed to increase it in line with inflation the fund would stand at £2.9 billion, less than half its current value**. As a consequence it has been able to increase its distribution in real terms – in other words, the expenditure on support to the Church is greater than would otherwise have been the case had it merely kept pace with inflation.

39. There is therefore scope for the Commissioners to contemplate some additional 'pump priming' type expenditure over and above its current support for the Church, even over a number of years, but only if the expenditure is to be non-recurring. The analysis suggests that without this additional spend to support diocesan growth plans, the Church will simply continue to decline and so there is an imperative to act. It could even be argued of

course that failure to ‘invest’ at this time will mean there would be no Church in future on which the Commissioners on-going support could be spent.

40. It is important to remember, however, that such expenditure will have a knock-on effect on the amount the Church Commissioners can afford to distribute on an on going basis. As Ian Theodoreson’s note makes clear, expenditure of capital now means that there will be less available for future generations. For every pound over-distributed now there would be a net reduction in what is available for distribution to the Church **in perpetuity**.

Summary

41. Over-distributing without knowing it or without understanding the consequences is a sure road to disaster. Over-distributing knowingly and with precautions in place is a legitimate strategy. I would welcome comment from Synod on the proposal and on the precautions I shall outline in the debate. The wisdom of Synod members both on the principle and the safeguards will be important in getting this right.

Andreas Whittam Smith
10th January 2015

How the Church Commissioners' funds may be distributed -Annex

1. The Church Commissioners manage an investment portfolio of just over £6 billion (as at 31 December 2013). The primary call upon those funds is to meet the Church's pension obligation for clergy service up to December 1997, and against which they have authority bestowed upon them by the Pensions Measure to draw down capital to meet those obligations. That approval is subject to renewal by a new Measure every seven years.

2. Current actuarial estimates show that around a third of the Commissioners' capital is required to meet their pension obligations. Thus around £2 billion of the £6 billion will be spent out over time to meet those liabilities, and so the fund will be a third smaller in about 60 years' time when the pension obligation will have been all but extinguished (if the estimates are correct).

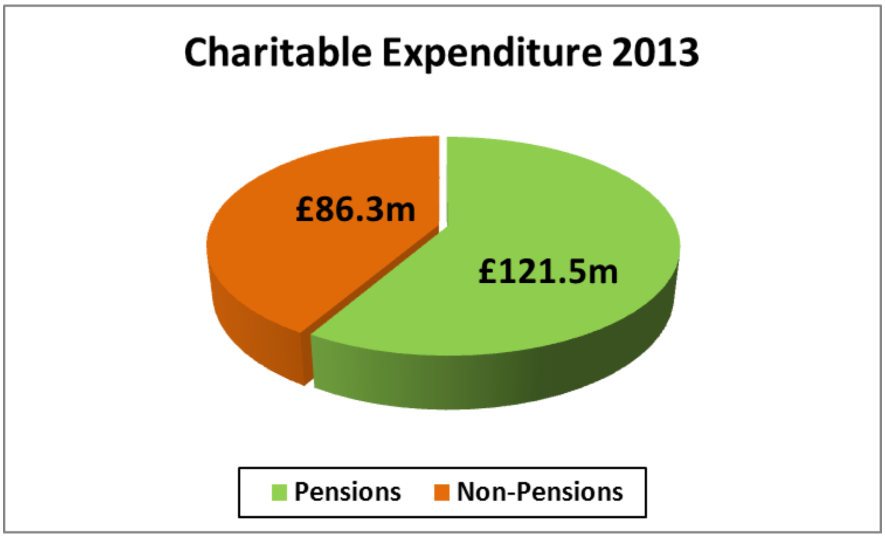
3. There will **not** be any increase in money available for non-pension purposes once the pension liabilities have been met because the actuaries take into account this draw down when advising how much can be made available to meet non-pension expenditure i.e. they assume that element of the fund is fully spent out already.

Non-pension spend

4. The capital not tied up in pensions is available, *in perpetuity*, to meet the costs of the 'living Church'. These include statutory costs such as supporting bishops' ministry and certain cathedral grants, with the largest amount being spent to make 'additional provision for the cure of souls'. This money is distributed by the Council by way of formula based grants to poorer dioceses (the Darlow monies) and increasingly through more targeted grants in support of mission and growth initiatives.

5. In 2013 the total Church Commissioners spend was just under £208 million, of which £121.5 million was on pensions. The £208 million constituted approximately 15% of the Church of England's total spend.

6. Of the £208 million £97 million was met from income and the balance was drawn down from capital. Of the £86 million spent on non-pension costs, 47% was spent supporting dioceses, 36% on bishops' ministry and a further 11% supporting cathedral ministry.

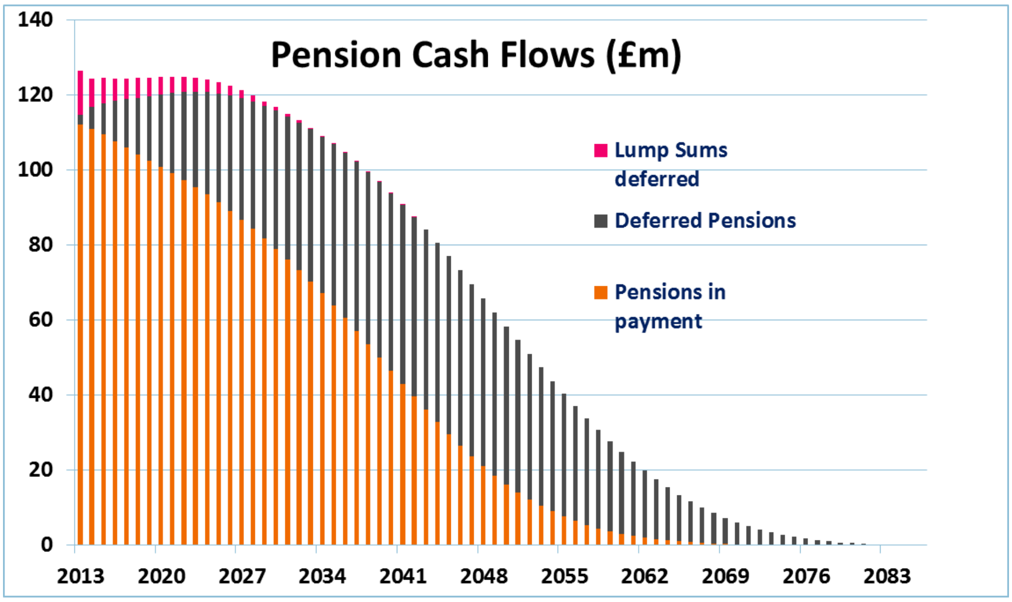


Calculating the monies available for non-pension spending

7. The amount the Church Commissioners make available in any triennium is determined by the annual general meeting, in the light of recommendations made by the Assets Committee and the Board, based on actuarial advice. The first call on the Church Commissioners' funds is for pensions; therefore the actuaries assess how much of the fund needs to be set aside to meet that obligation.

8. The actuaries then consider the level of funds that remain which form the permanent endowment and calculate how much can be distributed now bearing in mind the need to ensure 'inter-generational equity'. This is a general principle of charity law that trustees should not bias their funding to either benefit or discriminate against today's beneficiaries compared to the generations to come.

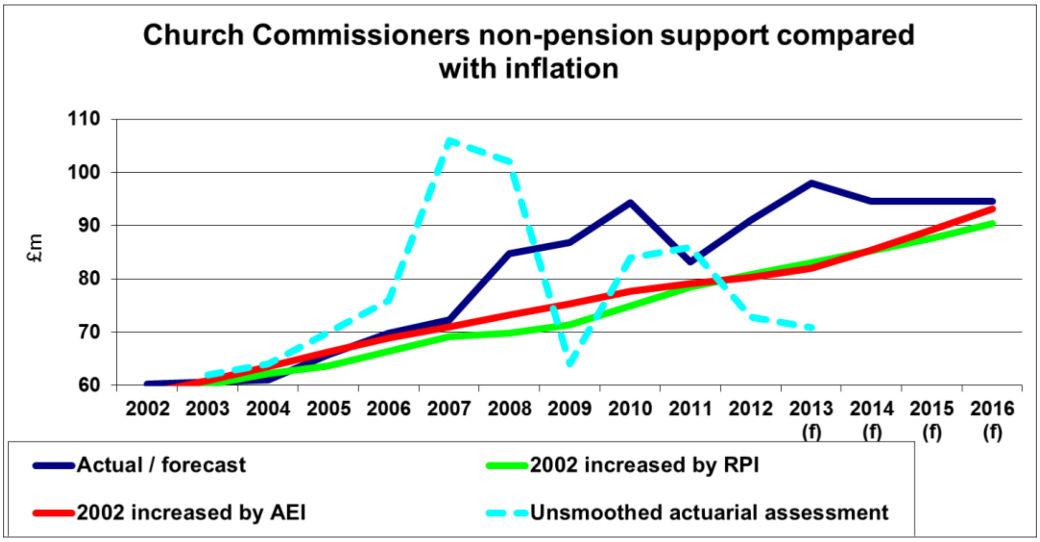
9. At present the cash flow for pension payments is at its peak, and will continue at this level for the next ten years or so. Thereafter the payments will decline steadily (see graph below) though are unlikely to fall below £50 million a year until after 2050. As already noted the actuaries in effect treat the Commissioners' fund as two separate buckets and assess the amounts available for distribution on non-pension expenditure separately from the pension cash flows.



Smoothing

10. After the initial actuarial calculations a smoothing mechanism is applied. The effect of this is to moderate the increase in distributions when investment returns are good and moderate the need to rein back when returns are poor, given the Church's limited ability to absorb year to year fluctuations in central funding in view of its high level of relatively fixed costs.

11. Were the Church Commissioners to be distributing funds on an unsmoothed basis the amount available for distribution in 2013 would have been £88.1 million versus the actual amount made available of £94.6 million. The graph below shows how the actual level of distributions has compared with the unsmoothed and how the Church Commissioners have been able consistently to distribute funds in excess of inflation. (The fluctuations in actual expenditure arise because the allocation of discretionary grants depends on activity at diocesan level and unspent amounts are carried over into subsequent years.)



Scope to increase distributions

12. The actuarial assessment is based on certain assumptions and these are subject to alteration as and when the world is seen to have changed in some way. For example, the Commissioners' Assets Committee has been discussing whether the assumption used for future earnings growth ought now to be closer to that used for price inflation. If it was (and assuming all other assumptions stay the same), the Commissioners' fund could sustain a higher amount of non-pensions distributions without being seen to be 'over distributing'. Equally, unforeseen increases in longevity could over time increase the long term cost of the pension obligation and reduce the amount available for non-pensions distributions.

13. The method of calculation adopted by the Commissioners is ultimately a matter for them to decide, so long as it can be reconciled with their fiduciary responsibilities. In principle it would be open to them, within the law, to make a 'special' one-off[1] distribution on the grounds that this would help promote the growth of the Church.

14. The nub of the case for such a distribution would have to be that the present approach to inter-generational equity needed to be modified since, in the absence of substantial additional distributions, the very institution that the charity existed to serve would be gravely weakened and the purpose of the charity therefore frustrated.

15. The aim would be to generate growth within the Church by increasing the level and effectiveness of mission and ministry, thereby avoiding a situation in which, within

[1] 'one-off' would not mean in one year or one triennium but over a defined number of years

forty years the Church of England might have the same distributable national endowment in real terms yet very few members.

16. Such a one-off distribution would in principle be possible without the need for further legislation (though legislation would be needed if new types of distribution - for example for clergy or lay training- were to be envisaged). This is because, in addition to their statutory power to spend capital to meet their pension liabilities, the Commissioners have the benefit of a Charity Commission order, which allows them to manage their funds on a ‘total return’ basis. The effect of that is to give them power to apply a substantial proportion of the capital of their fund for their other purposes.

17. Of the £6.1 billion in the fund at the end of 2013 the value of the original endowment in today's terms was calculated as being £2.9 billion. Any over-distribution would need to come from the unapplied total return, which is the other £3.2 billion.

18. However, before agreeing to make exceptional distributions, the Commissioners would need to be satisfied (after taking legal advice) that it would be consistent with their fiduciary duty as regards inter-generational equity. The Commissioners would also need to take advice from their actuaries on the long term impact and potential risks of any special distribution.

19. It would be important to be clear that any ‘over-distribution’ would have a permanent impact on what was available for distribution subsequently. The figures would need to be validated by the actuaries at the time but, in round numbers, for every additional £100m spent the annual amount available for distributions would reduce by of the order of £2m for ever <u>(and historically this reduction would have been greater at nearer to £3m per annum)</u>.

20. This would be the case even if, as intended, the distributions helped to generate growth and greater financial resilience, since the Commissioners’ fund is closed to new contributions. While the scale of future investment returns would influence the precise numbers the reality is that ‘over- distribution’ would, like the spending out of capital for pensions, produce an irreversible reduction in the size of the historic endowment.

21. The justification would be that it had helped to generate growth in church membership and local financial sustainability, thereby reducing the need for support from national funds in the long term. The risk would be that instead of having a substantial endowment and few members the Church might have neither.

22. There would be important questions to address over:

- The scale of the money released (if a special distribution is to be made it has to be sufficient to make a difference)
- For what purposes it was to be used and;
- How to distribute funding in such a way as to avoid a 'boom and bust' culture or to create dependency. The profile and purpose of the spending would need to be shaped to avoid long-term operational funding commitments and to build long-term sustainability.

23. Any such distribution would need to be tightly governed, in particular to ensure the additional monies are being properly directed towards the change programme and are not being mopped up by 'business as usual' activity.

Ian Theodoreson

February 2015