GENERAL SYNOD

CLERGY PENSIONS

Update from the Archbishops' Task Group[1]

Summary

The wider context remains very uncertain, with continuing volatility in financial markets and no detailed proposals yet from the Government for reform of the state pension and the State Second Pension.

Against that background the Task Group's view is that the aim-though at this stage it cannot be more than that- should be to manage the consequences of the forthcoming actuarial valuation of the clergy pension scheme without making further changes to benefits. In particular it does not believe that further work is needed at this stage on the radical options of introducing a hybrid scheme or moving to a defined contribution basis.

Nevertheless, the valuation at the end of 2012 seems bound to show a larger deficit than last time, even though the Pensions Board's investments have performed well. The increased deficit is the result of the current level of UK gilt yields, by which the liabilities of pension funds have to be calculated; low gilt yields (the lowest for 300 years) are currently increasing the value of liabilities for pension funds.

The Pensions Board has done some early thinking with the support of the scheme actuary on how any increased pension deficit might best be managed. Barring further substantial deterioration, initial indications are that a way through which avoided further changes to the current scheme could involve a combination of measures. They would include some changes to the financial assumptions used, an increase in the length of the recovery plan and some increase in the contribution rate paid by dioceses. Depending on the size of the- hopefully small- increase in contributions needed, consideration might need to be given, on affordability grounds, to some stipend restraint.

The Pensions Board – working with the Church Commissioners - has also begun a programme of closer engagement with dioceses, with workshops taking place in each region before Christmas. The Board will continue to work closely with dioceses and other funders throughout the valuation period, with the detailed report expected from the actuary in May/June 2013.

[1] The members of the Pensions Task Group are: Andrew Britton, Chair of the Archbishops Council's Finance Committee, Andreas Whittam-Smith, First Church Commissioner and Jonathan Spencer, Chair of the Church of England Pensions Board. The Group is supported by William Fittall, General Secretary of the Archbishops Council, Andrew Brown, Secretary and CEO of the Church Commissioners and Bernadette Kenny, CEO of the Church of England Pensions Board.

Background

1. In February 2012 the Chairs of The Archbishops' Council's Finance Committee and the Remuneration and Conditions of Service Committee submitted reports on clergy pensions and remuneration to the General Synod (GS Misc 1010).

2. The first report – by the Pensions Task Group and presented to the Council in November 2011- provided an overview of the challenges facing the Clergy Pension Scheme and summarised options for possible hybrid pension schemes. The Task Group's advice, endorsed by the Council, was to maintain the present arrangements. This was based on the conclusion that there was no reason at that stage to believe that the scheme was unsustainable in the long term though significant risks lay ahead over the next few years given difficult market conditions.

3. The second report – by the Remuneration and Conditions of Service Committee – assessed the value of the current clergy remuneration package. The report made no recommendation for substantial change but did identify some possible options that the Committee continues to consider and will report to the Council as appropriate.

4. The Council asked the Task Group to keep the funding position of the scheme under close review and to report back in September 2012 in good time before the next valuation date of 31 December 2012. The Archbishops Council considered its update at their September meeting. It noted the conclusions summarised above, endorsed the Task group's advice that changes to the scheme should if possible be avoided and invited the Group to submit this update to the Synod.

Developments in the funding position since November 2011

5. The biggest risk to the current scheme remains volatility in the financial climate. The combinations of poor economic growth – or in many cases mild recession – across much of the developed world plus big anxieties about the consequences of a possible Eurozone break-up makes the world scene at least as gloomy as 9 months ago. Significantly the flight to safety continues with the price of what are perceived as safe Government bonds – UK, German, US – reaching even more abnormally inflated levels.

6. These high prices (and the associated low level of yields) – particularly in the case of the UK with the potential for a further round of quantitative easing before Christmas – look unsustainable in the long term. So - for so long as UK Government bonds remains at these levels - there will be a seriously distorting effect on the calculation of pension liabilities.

7. This is because a pension fund deficit is not like a loan or mortgage which can predictably be paid off over a period. The value of the assets in a pension scheme and the size of the liabilities to be met can ***both*** go up and down in the light of market conditions. So, even if contributions have been increased to cover any previous deficit, this can be more than wiped out by a fall in share prices (which decreases the value of the assets) or a reduction in the gilt yields (which increases the size of the liabilities).

8. The Pensions Board's assets have performed well over the 3 year period since the last valuation at the end of 2009. The Board is nearing the end of its strategy to diversify

assets away from (largely) holdings in UK equity classes. Over the three years to the end of September 2012, the Board's pension scheme assets returned 7.1% p.a. and over the nine years to that date, 7.0% p.a.. During the period since the scheme's last valuation, however, liabilities have been extremely volatile.

9. At its best, the deficit shrank faster than expected from £262m (December 2009) to £172m (April 2010). At its worst, the adverse market conditions took it to £507m (November 2011). At the last annual report (December 2011) the scheme deficit was an estimated £484m. It has since fallen back somewhat, but the Board still expects the December 2012 valuation to show an increased deficit above the December 2009 level.

Proposals for changes to state pension arrangements

10. We have yet to see any detail of the Government's proposals for fundamental change in state pension provision (including the State Second Pension, which we opted into in 2010 in order to improve affordability to the Church of the overall clergy scheme). This was expected in the spring but has now been put back to an unspecified date this autumn.

11. We remain of the view that fundamental change to the Clergy scheme - which in any event we do not favour unless and until it becomes clear that present arrangements are unsustainable – would be unwise until we are clear about the implications of the state arrangements. What is finally decided by the Government will be of major significance for clergy incomes in retirement. Current arrangements assume payment of the State Second Pension. If this was to change the clergy scheme would in any event need to be looked at again.

Next steps

12. The Pensions Board is very conscious of the need to balance the financial pressures on funders with the obligation to protect the interest of future pensioners. They will begin their detailed work once they have received the actuary's initial report, which they expect in May/June of 2013. In advance of that – and in the absence of the actual valuation figure – such thinking as they have done of necessity comes with a heavy health warning.

13. The Board expects to review a number of possible mechanisms for mitigating the effect of any increased deficit. These might include: some modest change in the assumptions used to value the liabilities that determine the calculation of the deficit; an increase in the length of the current recovery plan (this will have reduced to 9 years by the end of 2012); an assessment of the scope to assume some positive move in gilt yields over the life time of the recovery plan. The Board will also take external advice on the strength of the employers' covenant (dioceses, other smaller funders and the Church Commissioners) and their ability to meet future financial commitments. The Board has concluded already that it does not, however, need any emergency increase in contributions in advance of its consideration of the final valuation results.

14. The Task Group remains of the view that we should if at all possible avoid further changes to the present benefit structure. Any such modifications to the defined benefit scheme would make only a very small impact on the contribution rate. It has reviewed

the case for managing cost pressures through the introduction of member contributions but these would not be National Insurance efficient. If some clergy 'contribution' were required as part of a package of measures including higher diocesan contributions and an extended recovery period this would be better achieved indirectly through further stipend restraint.

15. RACSC has been commissioned to do some further work on stipend restraint. They are also continuing to examine the scope for increased flexibility (mixing retirement and part time working) at the end of a normal working life. We note, however, that changes here are unlikely to ease pressure on the funds (indeed there is a risk that some changes would add to them).

Timetable

16. The major milestones for the valuation process are:
    - 31 December 2012 – the date at which the deficit is valued;
    - May/June 2013 – the detailed initial results will be presented to the Board by the scheme actuary.
    - July/November 2013 – an informal consultation with employers on the valuation assumptions (for these purposes, the Task Group will act on behalf of the Archbishops' Council);
    - November/January 2014 – the Board sets its assumptions;
    - January/March – the Board agrees the deficit recovery plan and signs off the final plan no later than 31 March 2014.
    - Thereafter any changes in contributions would come into effect in accordance with the recovery plan, and not before 2014 at the earliest.

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31 October 2012

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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