Church of England Funded Pensions Scheme

Consulting you about changes to the scheme

Introduction

1 This document sets out the changes we plan to make to your pension scheme. It tells you:
- why we need to make changes; and
- how those changes will affect you.

By law, we must consult all members of the scheme.

2 We would like to know your opinions on the plans we are putting forward. Our Deployment, Remuneration and Conditions of Service Committee (DRACSC) will carefully consider your comments. We expect to put changes to the scheme rules to the General Synod to approve in July 2007.

Why we want to make changes

3 Pensions have changed a lot over the past few years. Most organisations outside the public sector have decided that they can no longer afford the costs and commitments associated with defined benefit pension schemes (pension schemes which guarantee that pensions will be linked to final salary). A large number of those schemes have now been closed to new members, and a lot of these have stopped providing the same level of benefits to existing members. Changes to benefit structures have been put in place, such as:
- lengthening the time you need to work for an organisation to earn a full pension; and
- increasing pension age.

Although there are still defined benefit pension schemes in the public sector, a range of changes have been introduced to these to limit rising costs.

4 The main reasons we want to make changes to our schemes are as follows.
- People are living longer, so retirement now lasts much longer and pensions are paid over a longer period than a generation ago.
- Average returns from investments have been much lower since the mid-1990s, and are expected to stay low for the next few years.
- Returns from Government bonds have fallen, which has increased the cost of the benefits defined benefit pension schemes have to pay.
- Under new accounting rules, companies must include pension payments in their accounts, and make managers and investors more aware of how much they are spending on pensions.
- By law, pension scheme trustees have to invest much more cautiously when funding defined benefit pension schemes. The Government has put these laws in place to make the schemes more secure, but it means that a higher level of contributions has to be paid into the schemes.

5 These pressures affect our pension scheme, and we have had to consider how to respond to the challenge. In November 2005, we set up a task group to assess the situation. The task group produced a report on 1 March 2006, and a second report on 30 June 2006.

The first report:

- provided background information; and
- identified the most important issues we needed to deal with.

The second report:

- identified options for dealing with the issues identified in the first report; and
- began a consultation process, which ended on 10 November 2006.

You can find the task group's reports on the internet at www.cofe.anglican.org/info/pensions/ or by writing to us at the address shown at the end of this paper.

6 From the report, it is clear that, unless we take action to reduce costs, the contributions which will have to be made to fund existing pension payments will rise to a level that they cannot be afforded. The Pensions Board decided it could not responsibly leave the contribution rate unchanged until the results of the next valuation were known. It decided to increase the contribution rate from 33.8% of the national minimum stipend for the clergy to 39.8%. This means that dioceses and other organisations taking part in the scheme now have to contribute £7,188 a year for each serving member of the clergy, rather than £6,105 a year as before. This adds an extra £9.5 million to yearly spending for the dioceses all together.

7 The second report set out the views of the Pensions Board's advisers on the likely results of the valuation due as at 31 December 2006. They expected that the valuation will show we would need to put up the contribution rate again from 1 April 2008 if we did not change the conditions of the scheme. The task group explored possible ways of limiting costs.

8 We invited dioceses to give us their views on the task group's recommendations. We asked the dioceses to consult a wider range of people before sending a single view through their Bishops' Councils. We also encouraged individual people and other organisations to respond. Some dioceses arranged special meetings to discuss the proposals.

9 DRACSC considered the results of the consultation and made recommendations to us. We put forward a report (paper GS1645) to the February session of the General Synod. You can get a copy of our report on the internet at http://www.cofe.anglican.org/about/gensynod/agendas/gs1645.rtf, or by writing to us at the address shown at the end of this paper.

10 The General Synod approved the recommendations in the report and authorised us to carry out this important consultation with you, our scheme members.

Our recommendations

11 In our report to the General Synod, we said it was encouraging that so many people from around the Church accepted our task group's suggestions. We also said we were aware that many people in the Church, and clergy in particular, were reluctant to have any change in existing benefits, and we share that view. However, we do not think it is in anyone's interest to try to continue with arrangements which dioceses and parishes are not able to fund.

Our task group's consultation exercise showed that people in the church are:

- committed to continuing to provide a defined benefits pension scheme for the clergy (rather than moving to other types of scheme which offer less security to scheme members); and
- willing to find some extra money to do so.

Since 1 January 2007, the dioceses have already been paying much more than they were last year in pension contributions, but there is a limit to how much more they can afford.

12 The changes we suggest aim to maintain the benefits the scheme already provides, while trying to limit the cost. One of the changes we suggest (see paragraph 22) would release money from the Church Commissioners that could be shared between dioceses to help them pay the extra pension contributions.

Changes we suggest

13 The changes affect two benefits our pension scheme provides. We would like you to give us your views on changes to:

- the length of service you need to do to earn a full pension; and
- yearly increases to your pension benefits.

The length of service you need to do to earn a full pension

14 We work out benefits in the scheme based on the national minimum stipend for the clergy (known as the NMS) in the year that has just passed. The full basic pension at age 65 is two-thirds of the NMS, and the full lump sum is three times the rate of the full basic pension.

15 In 2006/2007, the full service pension was £12,040 a year, and the lump sum was £36,120. By 'full service', we mean 37 years. If you retire with less than full service, you will only get a percentage of the full pension. For example, if you retire at age 65 after paying into your pension for 22 years, you would get $\frac{22}{37}$ of the full pension and lump sum.

16 We suggest extending full service from 37 years to 40 years. This would mean that, instead of each year counting as $\frac{1}{37}$ of the full benefit, it would count as $\frac{1}{40}$.

17 **This change would only apply to years of service you complete after 1 January 2008** (the date we expect the change to take place). So, if you have already completed five years'

service by 1 January 2008, this would still count as $\frac{5}{37}$ of the full benefit. **This change would not affect the pensions that are already being paid.**

18 In Appendix 1 there is a table which shows the effect this change will have on your pension based on a range of periods of service before and after 1 January 2008. There are also two examples with calculations to show the effect the change may have.

19 You can see from the examples in Appendix 1 that, the nearer you are to age 65, the less the change will affect your overall benefits. This is because there is a shorter period of service that will be counted at the lower rate.

20 We work out certain benefits under the pension scheme based on the service you would have done in the future (for example, if you retire early because you are ill, or when we work out your husband's or wife's pension if you die before you retire). For these benefits, the extra service we credit to your pension will also be based on 40ths instead of 37ths.

Yearly increases to your pensions payments

21 At the moment, the rules of the scheme say that yearly pension payments must go up in line with the retail price index (RPI), up to a limit of 5% a year. However, in the past the General Synod has aimed for pensions to go up, as far as possible, in line with increases to the national minimum stipend, and this has always been achieved.

22 We can no longer afford to increase pension payments in line with increases to stipends. It would also not be acceptable for the Pensions Board, as the scheme trustee, to continue to increase pension payments by more than that stated in the scheme rules at a time when the scheme is in debt. We suggest that:

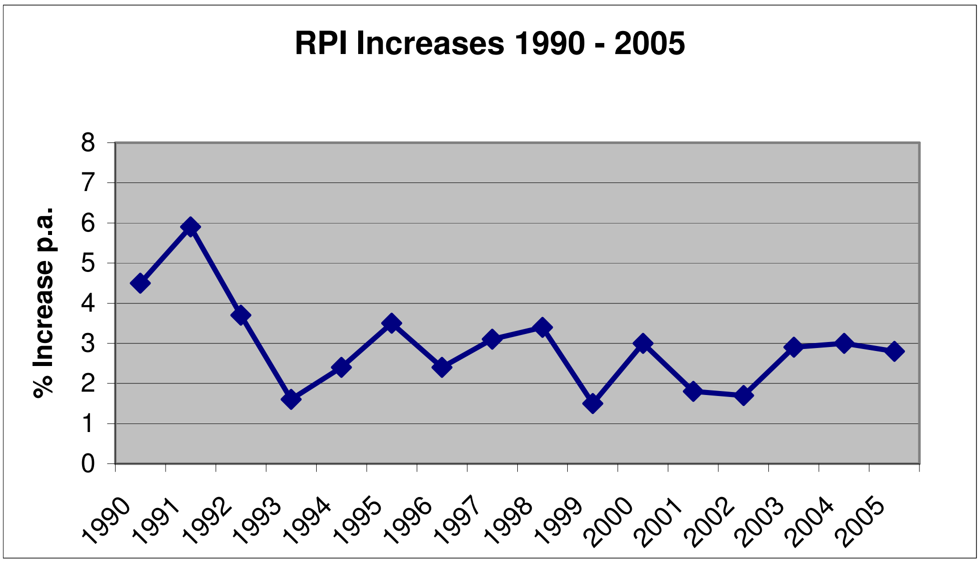
- we should not continue to increase pension payments in line with increases in the national minimum stipend; and
- all future pension increases, from 1 April 2008, should be in line with increases in the retail price index up to a maximum figure.

23 This change would also apply to people who joined the scheme before 1998. The change would slightly reduce the pension payments the Church Commissioners make and allow them to provide more non-pension financial support to the Church.

24 Government regulations now allow for pension increases to be limited to increases in the retail price index up to 2.5% a year. (This used to be 5%.) Our task group had recommended that we apply this lower level of increase to pensions paid on service completed after the date of the change. When we consulted people about this, there was a lot of support for removing the link with stipends described above, but many people did not want us to limit increases to as little as 2.5%. DRACSC considered this issue carefully, and recommended that we should only reduce the limit on increases from 5% to 3.5%.

25 **This change would apply only to benefits paid in respect of service completed after the date the change comes into force (which we expect to be 1 January 2008). Benefits paid on service completed before that date (including those from before 1998) would continue to increase by up to 5%**.

26 The graph below shows that, over the 10 years between 1995 and 2005 (for October the first year to September the next), there were only two years when the RPI increased by more than 3.5%. Both times this happened, the increase was 3.6%. In the final months of 2006, inflation went up which meant the RPI went above 3.5% and the consumer price index (CPI) (a measure of the cost of living, which does not include housing costs) went above its 2% target level. As a result, the Bank of England has put up interest rates twice to reduce the effect of inflation the cost of living. Based on the past ten years, limiting pension increases to 3.5% should give pensioners reasonable protection over the long-term against rises in the cost of living.



27 In Appendix 2, you can find some examples of the effect the changes we suggest would have.

The Pensions Regulator

28 Our pension scheme is regulated by the Pensions Regulator, which can take over running schemes if the scheme's trustees, employers or professional advisers have failed in their duties (including the duty to consult people about changes to their scheme). You can contact the Pensions Regulator at:
Napier House
Trafalgar Place
Brighton
East Sussex
BN1 4DW.

Conclusion

29 The changes we have suggested aim to maintain the benefits we provide as far as possible, while at the same time trying to limit costs. However, even with the savings we would make from putting these changes in place, dioceses and parishes would still have to pay around £1200 extra a year for each member (compared to the cost in 2006). We think the changes we have suggested are a sensible and fair way of dealing with the pressures on the Church.

30 We invite your comments on these changes, in particular the issues we set out in paragraph 13. Please send us your comments using the response sheet enclosed no later than **31 May 2007**, to:

The Secretary to the Deployment Remuneration and Conditions of Service Committee
Church House
Great Smith Street
London
SW1P 3AZ

31 For general enquiries on pensions, please ring 020 7898 1802 or email pensionenquiries@c-of-e.org.uk

12 March 2007

Illustrations of the effect on benefits of a change in accrual rate

Service up to 31/12/2007	Service after 1/1/2008	Existing Basis		Proposed Basis		Additional service required to maintain benefits at current level	
		Pension	Lump Sum	Pension	Lump Sum	Years	Days
10	10	6508	19524	6264	18792	0	296
10	15	8135	24405	7769	23307	1	79
10	20	9762	29286	9274	27822	1	227
10	25	11389	34168	10779	32337	2	10
10	30	12040	36120	12040	36120	0	0
15	10	8135	24405	7891	23673	0	296
15	15	9762	29286	9396	28188	1	79
15	20	11389	34168	10901	32703	1	227
15	25	12040	36120	12040	36120	0	0
20	10	9762	29286	9518	28554	0	296
20	15	11389	34168	11023	33069	1	79
20	20	12040	36120	12040	36120	0	0
25	10	11389	34168	11145	33435	0	296
25	15	12040	36120	12040	36120	0	0
30	10	12040	36120	12040	36120	0	0
37	0	12040	36120	12040	36120	0	0

Notes

1 Table shows the pension and lump sum payable at age 65 for a variety of service periods before and after the proposed implementation date

2 Final two columns show the additional service period that would be required in order to receive the same level of pension and lump sum as if the accrual rate had not changed

3 Pension and lump sums used in the illustrations are 2006/7 rates (full pension £12040, full lump sum £36,120)

Worked Examples

Example 1

Full pension rate (2006/2007): £12,040
Full lump sum (2006/2007): £36,120

Date the Revd A began pensionable service: 1 January 1978
Date the Revd A will retire (at age 65): 31 December 2013

Date the change takes effect which increases the length of service needed to earn a full pension: 1 January 2008

Service the Revd A will have worked by the date he wants to retire (31 December 2013): 36 years

How we work out pension if we do not introduce the change
If we do not introduce the change, the Revd A will have worked 36 years of the 37 years he needs to work to get his full pension. His yearly pension would be:

$\frac{36}{37} x £12,040 = £11,714$. (This is less than the full pension shown above because he would need to work one more year to be entitled to their full pension.)

His lump sum would be £35,142.

How we work out pension if we do introduce the change
If we do change the pension rate, the Revd A will have worked for 30 years at the current rate, and 6 years at the new rate. His service would be worked out as follows.

From 1 January 1978 to 31 December 2007: 30 years (at the current pension rate)
From 1 January 2008 to 31 December 2013: 6 years (at the new pension rate)
Total service: **36 years**

We work out his pension as follows.

30 years at the current rate:

$$\frac{30}{37} x £12,040 = £9762.$$

6 years at the new rate: $\frac{6}{40}$ x £12,040 = £1,806.

The total pension the Revd A would receive is:

30 years at the current rate (£9,762) plus six years at the new rate (£1,806), which is **£11,568**.

His lump sum would be **£34,704.**

Shortfall in pension when the new rate is used: £11,714 - £11,568 = £146.
Shortfall in lump sum when the new rate is used: £35,142 - £34,704 = £438.
So, if the new rate comes into force on 1 January 2008, the Revd A would need to work an extra 178 days to receive the pension and lump sum that would have applied had the rate not changed.

If the rate did not change, this member would have been entitled to the full pension after an extra one year's service. If the rate did change, he would need to work an extra one year and 207 days to receive the full pension.

Example 2

Full pension rate (2006/2007): £12,040
Full lump sum (2006/2007): £36,120

Date the Revd B began pensionable service: 1 January 1997
Date the Revd B will retire (at age 65): 31 December 2027

Date the change of accrual rate takes effect which increases the length of service needed to earn a full pension: 1 January 2008

Service the Revd B will have worked by the date she wants to retire: 31 years

How we work out pension if we do not introduce the change
If we do not introduce the change, the Revd B will have worked 31 years by the date she wants to retire.

Her pension would be:

$\frac{31}{37} x £12,040 = £10,087.$ (This is less than the full pension because she will not have worked the full 37 years by the time she retires.)

Her lump sum would be: £30,261

How we work out pension if we do not introduce the change
If we do introduce the change, the Revd B will have worked for 11 years at the current rate and 20 years at the new rate (31 years altogether). We would work out her pension as follows.

11 years at the current rate:

$$\frac{11}{37} x £12,040 = £3579$$

20 years at the new rate:

$$\frac{20}{40} \text{ x } £12,040 = £6,020$$

The total pension the Revd B would receive is:

11 years at the current rate (£3,579) plus 20 years at the new rate (£6,020), which is **£9,599**.

Her lump sum would be **£28,797.**

Shortfall in pension when we use the new rate: £10,087 - £9,599 = £488.
Shortfall in lump sum when we use the new rate: £30,261 - £28,797 = £1,464

So, if the new rate comes into force on 1 January 2008, the Revd B would need to work an extra one year and 227 days to receive the same pension and lump sum she would have received had the rate not changed.

If she worked until age 70, under the current rate her pension would be **£11,714** (lump sum £35,142). If the new rate came into force, her pension at age 70 would be **£11,104** (lump sum £33,312).

Pension Increase Examples

1. Illustration of a full service pension for someone who retired in 1997 showing actual amounts and illustrations of what would have applied if increases had been in line with RPI over the last 10 years.

	Actual Pension	Stipend-linked increase %	RPI Increase %	Pension increased in line with RPI	Pension increased in line with RPI up to 3.5%
1997	8833				
1998	9173	3.8	3.6	9151	9142
1999	9560	4.2	3.2	9444	9435
2000	9960	4.2	1.1	9548	9538
2001	10380	4.2	3.3	9863	9853
2002	10693	3.0	1.7	10030	10021
2003	11013	3.0	1.7	10201	10191
2004	11346	3.0	2.8	10487	10476
2005	11686	3.0	3.1	10812	10801
2006	12040	3.0	2.7	11104	11093
2007	12400	3.0	3.6	11503	11481

Note: In 2005 and 2007, pensions in payment moved ahead of full service pension as RPI was greater than the stipend-linked increase

2. Illustrations of future full service pensions assuming various rates of inflation

	Pension increased at RPI	Pension increased at RPI plus 1%	Pension increased at 3.5% pa	Pension increased at RPI plus 1%	Pension increased at 3.5% pa	Pension increased at RPI plus 1%
RPI	**3%**		**4%**		**5%**	
2007	12400	12400	12400	12400	12400	12400
2008	12772	12896	12834	13020	12834	13144
2009	13155	13412	13283	13671	13283	13933
2010	13550	13948	13748	14355	13748	14769
2011	13956	14506	14229	15072	14229	15655
2012	14375	15086	14727	15826	14727	16594
2013	14806	15690	15243	16617	15243	17590
2014	15250	16318	15776	17448	15776	18645
2015	15708	16970	16328	18320	16328	19764
2016	16179	17649	16900	19236	16900	20950
2017	16665	18355	17491	20198	17491	22207
2018	17164	19089	18104	21208	18104	23539

Note: Table shows pension rates based on various levels of inflation (RPI). The current assumption is that stipend increases will be at the rate of 1% over RPI.
For each level of inflation included in the table, the right hand column shows what the pension would be if the current arrangements were continued, and
the left hand column what they would be if the proposed change was made.