CLERGY PENSIONS

CONSULTATION PAPER FROM THE ARCHBISHOPS' TASK GROUP

Summary

1. **The Church of England now faces difficult choices over the future of its clergy pension scheme. The Pensions Board has already had to increase from the beginning of 2010 the contributions that dioceses and others have to make to fund the scheme. Unless action is taken, far larger increases look unavoidable from 2011 even if the financial markets recover somewhat before the next formal valuation of the pension fund at the end of 2009.**

2. **All the indications from the dioceses are that the sorts of increases that will be required are unaffordable. The Task Group is clear, therefore, that some significant changes to the present pension scheme will be needed. The objective must be to continue to make adequate provision for our clergy in retirement in a manner that is sustainable in the long term.**

3. **There is no simple solution. It has already been suggested by some that the Church Commissioners should be called on to clear the deficit in the pension fund. This would, in the view of the Task Group be a mistake.**

4. **The historic assets of the Commissioners are already being used to pay for pension benefits earned before the funded scheme was introduced in 1998. To disperse even more of these assets would be to meet today's liabilities at the expense of future generations. It would also reduce immediately the Commissioners' ability to make money available for distribution, especially to the less well resourced dioceses.**

5. **The Task Group's judgement, therefore, is that a solution needs to be found that is consistent with the proportion of their budgets that dioceses are already devoting to pension costs. Currently dioceses have to pay the Pensions Board a contribution of £7,797 for every clergy member of the scheme for whom they are responsible. That represents 39.7% of the national minimum stipend ('the contribution rate'). From January 2010, that will increase to 45% (an annual rate of £8,838) and on present estimates could rise to around 57% (£ 11,195 on current stipend rates) from 2011.**

6. **On the basis of what it has already heard from dioceses the Task Group has concluded that the target contribution rate for any solution should be around 42%, which is itself nearly double what the rate was when the funded scheme was introduced in 1998.**

7. **Much less than this would have an unacceptable impact on the income prospects for clergy in retirement. Much more is unlikely to be affordable without disproportionate damage to other aspects of the Church's mission and ministry.**

8. **At this stage the Task Group has not identified a recommended option. Instead it has worked up three possible models. All other things being equal, all would produce, in total, the same level of retirement income but they differ in terms of where the risk lies that things will turn out differently.**

9. **One option would preserve a modified version of the present defined benefit scheme and would leave most of the future funding risk with those who fund the contributions. One would move all clergy to a defined contribution arrangement for future service where the pension earned largely depends on the size of the pension pot accumulated and they would bear the risk that this will turn out to be less than expected. The third would move them to a hybrid scheme for future service - that is where part of the pension received would be on a defined benefit basis and part would be based on a defined contribution arrangement. Under this option the risk is shared between the clergy and those paying the pension contributions.**

10. **Since each of the three possible approaches needs to cost around 42% they have certain common features. Each would involve :-**

    - **contracting the clergy scheme into the State Second Pension,**
    - **limiting the annual increase in pensionable stipend to price inflation,**
    - **changing the pension age for future service from 65 to 68, and**
    - **moving, for future service, the accrual period for a full pension from 40 to 43 years.**

    These common factors are explained in paragraphs 69 to 91.

11. **None of the possible changes would affect pensions already in payment, nor would they affect pension rights already earned by those still in service. They could, however, potentially affect the amount of pension that existing clergy would receive at the moment of retirement depending on when the person concerned takes retirement and the other market factors explained later in this report.**

12. **The Task Group is seeking comments (sent to the address below) on these possible approaches by the end of October. It will then decide what recommendation to make in November to the Archbishops' Council, which in turn will have to bring a proposal to the General Synod for approval in February 2010.**

13. **After that there will need to be a statutory consultation with all members of the pension scheme with a view to Synod approving any necessary rule changes if possible in July 2010 before the Pensions Board has to set the contribution rate from 2011.**

    Please submit your response to : 'pensionstaskgroup@c-of-e.org.uk' .

Clergy Pensions Task Group
June 2009

Introduction

14. The issues covered in this document are both important and complex. We start by summarising what has happened since we issued a scene-setting note on 5 March. In that we explained the developments that had led the Archbishops in November to re-establish the Task Group and the issues that we were exploring with a view to issuing this further document at the end of June.

15. We then provide some background material before going on to explore whether there are any ways in which the present scheme could be preserved unchanged. Having concluded that there are not, we examine in turn three possible models. We identify what seem to us the key considerations that need to be weighed and we offer a list of pros and cons of each of the models. Finally we explain the process and pose some questions to which we need responses in order to frame a firm recommendation.

Developments since March

16. Since the scene-setting note appeared the markets have remained subdued. The FTSE100 stood, at the end of 2008, at just over 4,400, down from over 6,000 last June. After further falls this year, taking it to a low of 3512 in March, it has recovered somewhat. Over recent weeks it has been close to the end 2008 level but opinion is divided whether this is the beginning of a more sustained, if slow, recovery or simply a temporary rally, with possibly worse to come.

17. Returns on Government securities (gilts) are a key building block in calculating pension liabilities. These have reduced since the last valuation in 2006 and even a small change can make a big difference to the overall calculation. There have been moments in recent months when the returns have fallen further still and the prospects remain uncertain.

18. On 20 April the Pensions Board announced that the amount that dioceses and others have to contribute for each member of the clergy scheme would increase on an interim basis from 39.7% of stipend to 45% from 1 January 2010. The Board's decision reflected a serious deterioration in the funding position of the scheme as at 31 December 2008. By then the funding gap between the scheme's assets and expected liabilities had increased to £352m compared with £175m at the end of 2007 and £141m at the last formal valuation at the end of 2006.

19. Around three-quarters of this deterioration resulted from the fall in share prices and around a quarter from the reduction in yields on Government bonds. The Board noted that these figures would imply a contribution rate of 57% (38% for future service and 19% for the deficit) following the next formal valuation in the absence of any other changes. The interim increase to 45% will itself add £9m per year to the cost of contributions to the clergy pension scheme, which in 2008 amounted to £69.7m.

20. The Pensions Regulator has reaffirmed that pension trustees must continue to adopt a prudent approach to funding requirements. Given the exceptional market circumstances he has signalled that some increased flexibility over recovery plans may be acceptable. The recovery period for the clergy pension scheme, at 15 years,

is already, however, longer than the 10 year trigger used by the Regulator when deciding whether to investigate a scheme's funding arrangements.

21. Reactions within the Church to the scene-setting note and the increase to 45% in the contribution rate have reflected an appreciation of the difficult situation in which the Church of England finds itself. On the one hand there is a widespread recognition of the importance of the pension scheme for the morale of clergy. On the other hand there are serious concerns that a contribution rate of 45% - to say nothing of one that from 2011 could be between 50% and 60% - is simply not affordable without disproportionately damaging reductions in other items of expenditure, including in some cases the number of clergy posts.

Purpose of this document

22. This document is designed to stimulate debate and gather views. We have sought to identify what seem to us to be credible – though difficult – options. We have not yet identified one of these as our favoured option. We stand ready to offer a recommendation but only once we have heard the debate that now needs to take place around the Church.

23. Our expectation is that this debate will not be easy. There is no way forward that does not involve challenges of one kind or another. Those most directly concerned, whether as funders or as beneficiaries, need to wrestle with the issues before choices come to be made. What is clear, however, is that choices cannot be avoided.

24. **As trustees, the Pensions Board cannot continue, responsibly, to pay out benefits at the present levels unless they receive the contributions which they consider necessary in the light of the professional advice of their actuaries.** The General Synod and those responsible for funding the scheme, need, therefore, to decide whether the Church should pay whatever it takes to maintain present levels of benefit or to modify the scheme by reducing benefits in order to reduce costs.

Some key facts

25. As at end 2008 there were some 9,100 members of the clergy pension scheme for whom current contributions were being paid, 1,700 people who were no longer earning pension but will be entitled to some benefits when they reach pension age and 3,800 scheme members or surviving dependants who were receiving pensions (these figures exclude those whose pensions are solely funded by the Church Commissioners). **The market value of the assets of the scheme was £461m, a deficit of £352m against the estimated requirement of £813m**.

26. These assets in the Church of England Funded Pensions Scheme are designed to meet the costs of pensions earned since 1 January 1998. The costs of all pensions earned before then are borne by the Church Commissioners out of their General Fund. The Commissioners have statutory authority, currently until 2018, to expend capital as well as income to meet these pension liabilities. The latest estimate is that some 39% of the Commissioners' total assets (which are currently valued at £4.3 billion) will be needed to meet the Commissioners' liability, over the coming decades, for pre-1998 service.

27. The amount that the Pensions Board receives each year by way of contributions from the dioceses and other responsible bodies (including the Church Commissioners in relation to the contributions for the pensions of bishops and cathedral clergy) will continue for many years yet to exceed the amount that the Board has to pay out as pension benefits in respect of service from January 1998.

28. This 'immaturity' of the Fund enables the Pensions Board at this stage to invest 100% in equities, which are the asset class expected by actuaries to give the highest financial returns over time. The Board agreed, however, in 2007 that it would begin to reduce its equity holding from 2017, as its annual expenditure on pensions gradually grows.

29. The introduction of new funding arrangements from 1998 was not accompanied by any change to pension benefits. These had been settled by the General Synod in 1980 and phased in during the 1980s. The scheme is non-contributory for its members and provides them, provided they have the requisite years of service, with a full pension of two-thirds of the national minimum stipend. In addition they receive on retirement a tax-free lump sum of three times the pension.

30. Because of historic taxation rules, many pension schemes limit the value of the pension and lump sum combined to two-thirds of final salary. In the case of the clergy scheme, however, the lump sum is payable in addition to the two-thirds pension to take account of the value of the tied housing that clergy received during their active ministry. **The full pension is currently £13,093 per year and the lump sum £39,279.**

31. In addition to their clergy pension, members of the scheme are entitled to the basic State Pension (but not the additional state pension), depending on how many years of National Insurance contributions they have made. The full basic State Pension is currently £4,953 pa for a single person and £7,919 pa for a married couple.

32. Taken together, this means that **an unmarried member of the clergy retiring on a full clergy pension and State Pension is currently in the top 20% of UK retirement incomes**[1]. This is, however, only part of the picture. Clergy are very unusual in having to re-house themselves at retirement following many years in tied housing. **Around a third of retiring clergy find it necessary to access the CHARM scheme operated by the Pensions Board which provides retirement housing on a means-tested basis.**

33. Clergy can retire and take their pension without reduction once they reach 65. Alternatively, they can, if they prefer, remain in office until they reach 70. The accrual rate for pension earned up to the end of 2007 was based on earning a full pension over 37 years. For service since 1 January 2008 the accrual rate is based on earning a full pension over 40 years.

34. Pension at the time of retirement is a function of the number of years of service and the national minimum stipend for the preceding year. Thereafter a person's pension

[1] Pensioners' Income Series 2007/8
http://www.dwp.gov.uk/asd/pensioners_income_arc.asp#PI_Latest

is up-rated on 1 April each year in accordance with the annual increase in the retail prices index (RPI) in the previous September, subject to a maximum of 5% in respect of benefits from service up to the end of 2007 or 3.5% in respect of benefits earned from service after that date.

35. **It is an uncomfortable fact that the costs of the pension scheme introduced by the General Synod in 1980 have been consistently under-estimated.** At that time the Church Commissioners believed that they could afford to take on the increased commitment so long as it was phased in.

36. In the event it became clear in the early 1990s that the Commissioners could no longer sustain these commitments. The capping of their liability through the introduction of the Funded Scheme in 1998 was intended to address the question of sustainability and to ensure that they could continue to provide other forms of financial support to the Church.

37. Since 1998, the dioceses and other responsible bodies have had to meet an ever increasing contribution rate:

1998 – 2003	**21.9%**
2003 – 2005	**29.1%**
2005 – 2006	**33.8%**
2007 - 2009	**39.7%**
2010 – 2011	**45%**
2011 -	**??57%**

38. This escalation in costs has, of course, been paralleled by similar pressures facing all organisations who offer defined benefit (final salary) arrangements. Outside the public sector such arrangements have become increasingly unusual, with 70% of non-public sector schemes now closed to new entrants by 2006. There is also increasing speculation as to the sustainability of present public sector pension arrangements in the medium and longer term given the likely state of the public finances for many years to come.

39. As a result of last year's market turbulence it was recently estimated that some 90% of the 7,800 defined benefit schemes in this country were in deficit, as against 68% 12 months ago. A recent estimate put the deficit of all schemes at the end of May at £179 billion[2].

40. In assessing the upward pressure on pension funds it is important to distinguish between three distinct factors, all of which have played their part since the funded clergy scheme was introduced in 1998: changes in longevity, changes in regulations, and changes in market conditions.

41. The first of these has had a significant effect on earlier valuations and the expectation must be that continued improvements in **life-expectancy** will, in due course, add further pressure to defined benefit schemes even though, at the moment, the actuaries are not advising the need to change the assumptions made following the

[2] Source: Pension Protection Fund 7800 Index

December 2006 valuation. The Board has already built in some assumptions that life-expectancy will continue to increase. But these assumptions will need to be regularly revisited.

42. **Regulatory changes** had their biggest impact at the last valuation following the Pensions Act 2004, the establishment of the new Pensions Regulator and the requirement that pension trustees adopt a ‘prudent’ approach to scheme funding.

43. The most significant of the three factors since 1998 has been **market conditions**. The Funded Pensions Scheme was introduced during what, with hindsight, turned out to be the final phase of a long bull market (the FTSE 100 reached its all time high in 1999).

44. The difficulty that the pension scheme faces now is not simply the result of the market crash of last year. While there have been some good years since 1998, overall the return on investments over the past decade has been less favourable than had been assumed on the basis of long term trends.

45. The Pensions Board now has a difficult judgement to reach about what assumptions it makes about average long term, investment returns. A steady market recovery would help recover some of the ground that has been lost but there is no reason at this point to assume that all the lost ground can be recovered.

Preserving the present scheme unchanged?

46. Before assessing the various options for change it is important to have a clear idea of what would be involved in seeking to preserve the present level of benefits unchanged. It is in principle open to the Church to conclude that the present pension scheme is so important for the well-being and morale of the clergy that it should be given priority over all other categories of expenditure. It is important, however, to be quite clear about what any such decision would involve.

47. As of January 2010 the dioceses and other responsible bodies will be required to pay a contribution rate of 45% of pensionable stipend (the equivalent of around 25% of total remuneration once the value of the housing provided is taken into account). By the end of March 2011 the Pensions Board will have to set a new contribution rate in the light of the formal triennial valuation of the Fund as at the end of December 2009.

48. **If no changes to the benefits were made the dioceses (who sponsor around 96% of scheme members) and other responsible bodies would have to pay <u>whatever</u> the Pensions Board at that point considered prudent.**

49. In the Spring of 2010, the Pensions Board will receive the formal triennial valuation of the scheme as at the end of 2009, reflecting movements in the financial markets during 2009 as well as any changes in other key factors e.g. life expectancy. In the light of this, the Board will be able to consider whether it would be prudent to relax the current assumptions about the length of the deficit recovery period and/or future investment returns (inevitably at some risk for the longer term). At this stage it is impossible to predict whether the contribution rate for the scheme (without changes

to assumptions or to its terms and conditions) will remain at the estimated 2008 year end figure of 57%, or be reduced, or conceivably, be still higher.

50. That will mean making judgements not only about future market conditions but about the underlying strength of the funders' commitment to the scheme and ability to go on financing it in the long term. The Board will also have to check its assumptions about longevity. Crucially it will also have to reach judgements on the basis of what its assets are worth as at 31 December 2009.

51. At this stage it is impossible to predict with certainty what the contribution rate to fund unchanged benefits would be but, as at the end of 2008, **the actuaries' estimate was that 45% could well become 57%.** And, given the volatile state of the equity and bond markets, it is just as possible that the figure will be higher or lower than that.

52. **It is important to be clear, therefore, that if the scheme is left unchanged the Church is likely to be faced with a very substantial additional pensions bill with a contribution rate somewhere between 50% and 60%.**

53. The question, therefore, is whether those who would have to provide the funding regard increases of this kind as affordable and sustainable. To put it another way, can dioceses identify now the ways in which, by a mixture of generating additional income and cutting expenditure elsewhere, they could meet, on an ongoing basis, an increased bill of this size?

54. **From what we have heard so far from the dioceses there seems to be an emerging view that increases of this magnitude would simply not be affordable without damaging and counter-productive cuts elsewhere**, for example in the number of stipendiary clergy posts.

55. This is something that Bishops' councils, dioceses and other Responsible Bodies need to consider further as part of this consultation process. But we have reached the judgement on the basis of what we have heard so far that **any sustainable solution needs to involve a contribution rate of not more than about 42%.** That is the target figure we have assumed in the models we have developed.

56. There have been some suggestions that instead of passing the full cost on to the dioceses, the Pensions Board might instead look to the **Church Commissioners to help**, for example by transferring capital to the Funded Pensions Scheme to offset the past service deficit or to take on responsibility for meeting the cost of pensions to a later date than the end of 1997.

57. The first thing to say about this suggestion is that, even if it came to command widespread support, it could not be implemented in time for April 2011. The Church Commissioners currently have no powers to help in this way. Primary legislation would be required and the process of taking that through the Synod and subsequently obtaining Parliamentary approval (which in this case would be far from a formality) would probably take two to three years.

58. Secondly, and more fundamentally, however, it would not be a free lunch. If the Commissioners were to take on additional pension liabilities they would immediately have to reduce the amount they made available for distribution for non-pensions purposes, including to the less well resourced dioceses through the Darlow formula. Given that the amount available for distribution from 2011 is already likely to be constrained as a result of last year's fall in asset values this could have serious consequences for those dioceses.

59. Some may consider, however, that reducing distributions could, though regrettable, be a price worth paying in order to sustain something so important for the morale of the clergy, which is itself so important for the wellbeing of the Church of England. We have considered that argument carefully.

60. An important consideration, in our minds, is that the historic assets of the Commissioners are already being used to pay for pension benefits earned before the funded scheme was introduced in 1998. To disperse even more of these assets would to be meeting more of today's liabilities at the expense of future generations.

61. **It would in our view be a mistake to fall back into the old, pre-1998, ways of meeting today's bills with tomorrow's money. To deny to future generations the support for ministry and mission that the permanent endowment is meant to produce would in our view be very hard indeed to justify. There is a question of inter-generational justice here.**

62. When the Board of Governors of the Church Commissioners discussed our scene-setting note recently it did not believe that even more of the Commissioners' funds should be earmarked to meet the costs of clergy pensions. Similarly, **it seems to us that reopening the settlement reached in the 1990s about the relative responsibilities of the Commissioners and the dioceses would be unwise**.

63. There is a separate question to be addressed as to how the money made available by the Church Commissioners for distributions should, from 2011, best be used to meet need and opportunity in parishes and dioceses. But that is the matter of separate consultation. It is quite different from any idea of imposing by legislation additional responsibility for pension funding on the Commissioners. We do not believe that such a course should be pursued.

64. **Our judgement, therefore, is that if a case is to be made for preserving the present benefits unmodified it needs to be on the basis that the dioceses and other responsible bodies are fully aware of the ongoing costs and risks and prepared to meet them, however great they are. From all that we have heard that acceptance of what is in effect an open ended commitment is no longer there. As a result, some significant change to the present scheme is unavoidable.**

Options for change

65. In this and the following sections we explore three possible ways in which the cost of clergy pensions might be contained. We have, in each case, set ourselves the discipline of producing an approach that could produce an overall contribution rate

of around 42%.

66. It seemed to us important to illustrate each of the three possible approaches with cost figures that were roughly equal and were of a kind that the Church would be able to sustain for the longer term not just a year or two.

67. The three approaches we have analysed are:

- **Model 1- A modified defined benefit (DB) scheme**
- **Model 2 A defined <u>contribution</u> (DC) scheme for all future service**
- **Model 3 A <u>hybrid</u> scheme for all future service (ie part DB/part DC).**

68. Before coming to the differences between them we start with describing four common features which we believe are necessary in order to enable the overall costs in each case to be around 42%. They are:

- **contracting into the State Second Pension (S2P);**
- **indexing increases in the pensionable stipend;**
- **increasing the pension age for future service to 68;**
- **increasing, for future service, the accrual period to 43 years for a full pension.**

Contracting in

69. The first of these – **contracting in** – is **the single change that would reduce costs without reducing benefits.** For that reason **we believe, despite its complexity, that it should be an element within whichever way forward is adopted.**

70. The background is that the clergy pension scheme is, like many other occupational pension schemes, contracted out of S2P. When the Government introduced its predecessor - the State Earnings Related Pension Scheme (SERPS) - it allowed organisations that provided their own occupational pension schemes to stay outside the system, given that they, and in many cases their employees too, were already making contributions to fund their own pension arrangements.

71. Thus, typically, the Civil Service pension scheme, and many other public and private sector pension schemes have always been contracted out of SERPS/S2P. Contracting out means that the employer <u>and</u> employee pay lower rates of National Insurance contributions than if they were contracted in. Employees receive pensions benefits from their occupational scheme and are also entitled to the Basic State Pension (the old age pension) but not to the additional State Pension (SERPS and/or S2P).

72. Initially it represented better value for many employers and employees to pay the lower NI contributions that came with contracting out. But, over time and with a higher average age of the scheme's membership, the financial balance of advantage has shifted. Providing the same overall level of pension benefits on a contracted out basis now costs around 2.5% more than doing so on a contracted in basis.

73. How contracting in would work is as follows:

- Dioceses and other responsible bodies would pay additional National Insurance payments (currently around 3.3% of pensionable stipends). In addition the National Insurance rate paid by clergy would increase by 1.5%[3]. It would be for separate consideration at the moment of transition whether dioceses compensated for this by a one-off increase in the stipend. Not to do so would in effect amount to a reduction in pay. As a result of these higher contributions, clergy would become eligible for S2P in respect of future service;

- The contribution rate for the clergy scheme would be reduced to the level necessary to produce a full pension of 50% of the national minimum stipend rather than the present two-thirds. **The prospective clergy pensioner would, however, be no worse off since the new entitlement to S2P would make up the gap;**

- Once accrued, each year of S2P earned increases annually in line with national average earnings until State pension age and then thereafter in line with RPI (without the 3½% cap that applies to the clergy scheme);

- The retired member of the clergy would receive a higher proportion of pension income from the state as they would be eligible to receive benefits from: the clergy scheme, the Basic State Pension and S2P.

74. If the decision is made to contract the clergy scheme into S2P **the change would apply to all pensionable service after the due date.** There would be no scope for individual options or phasing the change in. This does mean that clergy very near to retirement at the point of change would have a third source of pension funding for what may be a very small sum (the minimum period of service to qualify for second State Pension is only one week) but the S2P benefit would be paid as an addition to the Basic State Pension.

75. Nevertheless, despite this and the administrative complexity for the Pensions Board of the transition**, our judgement is that, in the present circumstances it would be irresponsible if the Church failed to take the opportunity of the financial advantage that contracting in represents.**

76. Becoming more reliant on State provision does, of course, carry its own risks in relation to possible future changes in Government policy. Nevertheless, we believe this is a risk worth taking. Indeed, it seems to us that the better view is that this will involve an overall reduction in risks since the Church, largely dependent as it is on voluntary income, will no longer be responsible for providing as large a proportion of the benefits.

77. There is a further potential advantage. Increases in the S2P once in payment are linked to RPI. This would mean that **a significant part of the overall income of clergy pensioners was no longer linked to a <u>capped</u> level of price inflation**.

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[3] This is the overall effect in terms of typical pensionable stipend. NI contributions are levied at different rates on different bands of earnings.

78. As will be apparent from the above figures, however, this is not a panacea. To achieve a contribution rate of around 42% three other changes would be required, each of them adversely affecting benefit levels. **None of these would affect pensions already in payment, nor would they prejudice the statutory protection for pension rights already earned by those still in service. They could, however, potentially affect the amount of pension that existing clergy would receive at the moment of retirement depending on when the person concerned takes retirement and the other market factors explained later in this report.**

Indexing increases in the pensionable stipend

79. It is open to the Archbishops' Council, as the Central Stipends Authority, to adopt **a new policy in relation to future increases in the national minimum stipend (NMS) which is the current link to pensions at the point of retirement**. At the moment the Pensions Board assumes, on the basis of past long-term experience, that in the long run the national minimum stipend will rise by an average of 1.5% above RPI. There have, of course, been individual years when the NMS has increased by much less than that. But, over the long run, earnings have, for the clergy as for others, tended to rise faster than price inflation.

80. In order to constrain the otherwise very large prospective increases in the pension costs it would be open to the Archbishops' Council to decide that it intended to ensure, over time, that the year on year increases in the national minimum stipend only tracked increases in RPI.

81. This new policy, which we are recommending as a standard change for all the models, would mean that the increase in any one year would normally be the same as RPI. There might be years when, for particular reasons, the NMS would rise by less than the RPI figure. Certainly, if high levels of inflation were to establish themselves again, the Church could not write a blank cheque in advance that it would match RPI however high it went.

82. But **it does seem to us reasonable that, as a contribution to containing pension costs, the NMS should increase in line with RPI rather than the present assumption of RPI plus 1.5%. Each 0.5% of stipend above RPI costs around 3% on the contribution rate, so a reduction to RPI would save 9%.**

83. **We suggest however that the Church should retain the option of increasing the NMS by more than RPI but that this opportunity should only be exercised if it was clear that the financial position of the pension fund had improved sufficiently for the additional cost implications to be acceptable.**

84. We have considered whether it would be better to make the link to CPI (which excludes the effect of changes in the mortgage rate) rather than RPI but the latter, for all its imperfections, is the inflation index used for all other pension purposes and the advice from the actuaries is that it would introduce anomalies and complexities to use two different indices for different pensions related purposes

85. There are two important additional points to be made about this proposal:

- although the law requires pensions **in payment** to be protected by indexation by RPI up to a maximum of 2.5%, members of defined benefit schemes have no statutory entitlement to any annual uplift to their earnings while they are accruing pension. That is why other organisations faced with burgeoning pensions deficits have felt it necessary to cap annual increases in pensionable earnings – for example Marks and Spencer announced in January that the annual increase in employees' pensionable pay in their defined benefits scheme would, from October, be just 1%;

- **a policy to limit the increase in the national minimum stipend for pension purposes does not necessarily mean that the stipend of assistant curates has to be constrained by the same amount nor mean that actual stipends in payment have to be similarly constrained**. It would be possible for the present linkage between the NMS and regional stipend benchmarks to be broken. In any event, the actual amount that each diocese pays is a matter for its own discretion. In effect, therefore, there is likely over time to be a growing gap between the level of actual stipend and pensionable stipend, and a reduction in the value of the full pension as a percentage of actual stipends in payment (quite apart from the changes resulting from contracting in to S2P) .

Increasing the pension age for future service to 68

86. The two other changes which we propose are related though, in principle, separable. State Pension Age (SPA) is the age from which state pensions are payable. It is 65 for those who will reach age 65 before 6th April 2024 (and earlier for women born before 1956).

87. SPA has increased for anyone attaining age 65 after 6th April 2024 and has increased to age 68 for anybody who will attain age 68 after 5th April 2046. It is on a sliding scale between 65 and 68 for anybody due to attain age 65 between 6th April 2024 and 5th April 2046.

88. It is open to the Church to decide now, as part of this wider package of changes, to move the pension age, **for future service**, from 65 to 68 in one go and this is one of the common features to all the options that we are recommending. **Existing clergy would, of course, still be able to retire at 65 and take, without abatement, the pension that they had earned before the date of the change**. But all service earned **after** the date of change would assume a pension age of 68, so if a member of the clergy decided to retire before 68 there would be some reduction for early payment in respect of that period of service.

89. **What this means is that the immediate impact would be very small on clergy who have already earned most of their pension but would steadily grow over time.** The saving for every year on the pension age beyond 65 is 0.8% on the contribution rate, so moving from 65 to 68 would save about 2.4%.

Increasing the accrual period to 43 years

90. All service up to the end of 2007 is calculated on the basis of a full pension being earned over 37 years. From that date the accrual has been based on a full pension

being earned over 40 years. Increasing the pension age to 68 for future service would be a logical moment for increasing the accrual period for future service by a further three years to 43. This would also save an additional 2.4% on the contribution rate and is another standard change which we are recommending should be common to all the options considered later in this report.

91. Again, this would make no difference to service already earned. So the effect of the change on existing clergy would be very small at first but would grow over time.

Models for consideration

Model 1: Defined benefit scheme

92. Having set out the changes we recommend which are common to all the options for the future, we now turn to the models themselves. Model 1 would involve the retention of the present DB scheme but modified to take account of the standard changes. The actuaries' advice is that model 1 would, on the basis of present figures, produce an overall contribution rate of **42%**, made up of 22% for future service, 17% for past service and 3% for the additional National Insurance contribution for contracting in payable by the employers. If dioceses were to compensate clergy for their own additional NI contributions that would increase costs and on a grossed up basis would be the equivalent of a 44.1 % contribution rate.

93. We have considered and rejected a number of other possible modifications to the present scheme.

94. One would be a further reduction in the annual uplift to pensions post retirement. For benefits earned up to the end of 2007 that is linked to RPI to a maximum of 5% pa. For benefits earned since then it has been linked to RPI subject to a maximum of 3.5%. It would be possible to reduce this to the statutory minimum of 2.5% pa in respect of future benefits. However, this is a change which would impact disproportionately on pensions in payment accrued in the future at a time of some uncertainty over future inflation rates and we do not favour it.

95. The second possibility we have rejected would be to introduce mandatory contributions from individual clergy. These would, without offsetting compensation, amount to a net pay cut and would, therefore, in practice, at least initially, have to be quite small, certainly far less than would be required to make a significant difference to the funding gap. In addition, although pension contributions are tax deductable, National Insurance contributions remain payable on total pay.

96. A third possibility that has been suggested is that the present differentials in pensions benefits as between incumbents, deans, bishops etc should be abolished. In financial terms the impact that these make on the present funding gap is negligible. We have not, therefore, devoted time to studying this possibility in any detail. In the case of models that moved either in whole or in part away from a defined benefit structure the question of differentials could more easily be re-examined.

97. Although Model 1 would involve some significant changes to the rules of the Funded Pensions Scheme and spread the risk more between the Church and the State

it would still be recognisably a similar defined benefits scheme to what we have now.

Model 2: Defined contribution scheme

98. The second model that we offer for consideration is very different. **It would involve all pension earned after the day of change to be on a defined contribution basis.**

99. The consultation exercise in 2006 revealed very few dioceses at that point which were willing to support a move away from a defined benefits scheme for the clergy. A straw poll at the Inter-Diocesan Finance Forum in April suggested, however, that there was now a greater willingness to explore this option.

100. The seemingly inexorable increases in the contribution rate and the fact that so many other organisations outside the public sector have had to move away from final salary schemes inevitably raise the fundamental question whether the Church of England can continue to **guarantee** benefits at a particular level.

101. In assessing alternatives to defined benefit schemes it is important to be clear that, other things being equal, **similar sums of money invested in any well-designed pension scheme will tend to produce similar benefit levels**. One of the reasons for the poor reputation of defined contribution schemes in recent years is that many employers have taken advantage of the transition to reduce substantially their own level of pension contributions.

102. **The key characteristic of defined contribution schemes is not that they necessarily produce smaller pensions but that, compared with defined benefits schemes, they completely transfer the risk from the organisation to the individual.** What a defined contribution scheme guarantees is the amount of money that is being set aside with a view to building up a pension.

103. At the point of retirement the size of the pension, part of which would be accessible as a lump sum, will depend on two things which are unknowable at the outset:

    (a) what size of pensions pot the contributions will have produced by retirement in the light of investment returns over the intervening years; and

    (b) what the annuity rates are at the point when the person retiring needs to convert the pensions pot into a guaranteed stream of retirement income.

104. Under the Church Workers scheme there have already, for a long time, been a significant number of lay staff within the Church who are on defined contribution arrangements. In addition, since July 2006 all staff joining the National Church Institutions have been offered a defined contributions scheme, the old DB scheme having been closed to new members.

105. In the case of the clergy there are, however, three particular considerations that need to be weighed in considering a possible switch to a defined contribution scheme:

- **Because of the relatively slow turnover among the clergy simply introducing a defined contribution scheme for new entrants only and leaving existing clergy within the present scheme would make relatively little impact on overall costs unless, at the same time, some significant modifications were made to the DB scheme**;

- **The cost of the past service deficit for the DB scheme would still have to be met**. Since this is, without changes to the DB scheme, set to consume about a third of overall contributions the amount of money available for DC contributions would be necessarily constrained;

- **A wholesale transfer of risk is inevitably a more sensitive subject in relation to a group of people who, during their working lives, are paid only around £20,000 per annum and are expected to house themselves in retirement after many years of living in tied housing.**

106. At this stage we have seen our task as being to identify what a defined contribution arrangement for the clergy might look like if it were concluded that it was the right way forward. For the purposes of clarity we have assumed in this model, as with model 3, that **the new arrangements would apply for all future service, including that of existing clergy, after the date of the change and not merely to new clergy.**

107. We have also assumed, as for the NCI staff scheme, that a clergy defined contribution scheme would be based on an age-related contribution scale. That is not a forgone conclusion but it is the normal arrangement in many DC schemes.

108. An illustrative scale would be a 9% contribution for anyone under 30, 12% for those in their 30s, 15% for those in their 40s, 18% for those in their 50s and 22% for those above 60. Overall, this would produce an average contribution rate of somewhere between 17% and 18%. Lower contributions for younger scheme members reflect the fact that there is longer for the contributions to accumulate and the resulting investments to grow.

109. In addition, the dioceses and other funding bodies would need to meet insurance costs of around 5% to cover the cost of death in service and ill-health benefits which, in a defined benefit scheme, are subsumed within the overall contribution rate. We have assumed with this, as under models 1 and 3, that present levels of death in service and ill-health benefits would be retained.

110. The latter are, however, already the subject of a separate review by a group chaired by the Bishop of Warrington. It remains to be seen what their report, expected over the summer, will recommend but if it were to lead to any changes it might be sensible to subsume them into the wider package of changes that the Synod will need to settle next year.

111. A defined contribution scheme would need to be contracted into S2P so that there would, both for the Church and for the clergy, be the same increased NI costs as under model 1.

112. In terms of inflation protection, members would be free to choose the level of increase that will apply when they buy their annuity at retirement. Typical policies would have no increases, increases at a fixed rate (e.g. 3% p.a.) or increases in line with RPI. The choice affects the initial amount of pension received.

113. A significant issue with a move to defined contribution arrangements for existing serving clergy would be what to do in relation to **benefits already earned** and banked under the present defined benefits scheme. By law existing benefits would, of course, have to be preserved and the Church would continue to have to pay the necessary deficit payments for past service.

114. For existing members of the clergy the statutory requirement would mean that benefits earned would be frozen at the moment of transition and up-rated thereafter up to pension age in line with the lesser of 5% per annum or RPI for service up to 5 April 2009 (when the relevant pension legislation changed) and the lesser of RPI and 2.5% for service thereafter.

115. At pension age they would become payable as normal along with whatever had, by then, been earned under the defined contribution scheme. **Pensioners would, therefore, at that stage, have four sources of income: their preserved benefits under the present defined benefit scheme; whatever had been earned under the DC scheme; the Basic State Pension; and S2P.**

116. Another issue for the Pensions Board as the trustee of the scheme is whether it would be comfortable to maintain the existing investment strategy for the then closed defined benefit scheme or whether a more cautious approach was required. In the event that the Board did decide that it should, for example, reduce the level of equity investments more rapidly, this could add approximately 3% to the overall cost but final decisions on this will not be made until the formal valuation takes place next year.

117. Overall, the actuaries estimate that the total cost of Model 2 would be the equivalent of a **42%** contribution rate (or 45% if the Pensions Board decided on a change in investment strategy for the closed DB scheme). If investment returns matched expectations, the overall income in retirement for the retired member of clergy would be very similar to model 1.

118. But everything would depend on actual investment returns and annuity rates at retirement. For those nearing retirement at the moment of transition to the new scheme the impact would be relatively limited since by far the greater part of their pension would have been earned under the old arrangements. For those with many years still to serve the uncertainties would inevitably be greater.

Model 3: Hybrid scheme

119. A third approach, which in some respects would represent a halfway house between models 1 and 2, would be to move to a hybrid option for all future service. As with the two previous models, it would involve all the common factors described earlier in the report. **However the contributions from dioceses and responsible bodies to the Pensions Board would buy pension benefits some of which were guaranteed and some of which were ultimately dependent on investment performance.**

120. From the point of view of the dioceses the advantage of a hybrid scheme compared with a defined benefits scheme is that it transfers **some** of the future funding risk to the individual member of the pension scheme. For the latter, the advantage is that, compared with a defined contributions scheme, it does **not** transfer **all** of the risk. For both, the advantage in comparison with a DC scheme is that by keeping the DB scheme open the possible additional costs (estimated at some 3%) of the more cautious investment strategy necessitated by a closed DB scheme are avoided.

121. The actuaries have produced for us an illustrative hybrid scheme which would involve a future service contribution rate for the defined benefit element of 13%. This would aim to produce a defined benefit retirement pension of **25%** of the pensionable stipend at age 68 after 43 years service (in contrast to the present two-thirds or the 50% under model 1). There would also be an additional insurance cost of around 2% in order to sustain current death in service and ill-health benefits.

122. The employers would pay the additional National Insurance contributions of 3% in order to qualify clergy for S2P. In addition there would be defined contributions. There would need to be a decision whether these should be age related or on a flat rate basis. Either way we have estimated that the average cost to the employers per scheme member would be around 7%.

123. **The potential advantage of model 3 over the other two models is that it involves the greatest sharing of risk between the dioceses, the individuals and the state.** In contrast with option 2 it avoids the irrevocable step of closing the defined benefit scheme. It also keeps open the possibility that the balance between the defined benefit and defined contribution elements could be adjusted in the light of experience and the financial position of the scheme. Within an overall fixed cost to the employers, at each formal valuation of the scheme, an assessment would be made about how much is needed to fund the guaranteed defined benefit element. In the event that this increased, a lower contribution would be put into the defined contribution section. Conversely if the amount needed for the defined benefit element dropped, more would be put into the defined contribution section.

124. Since members would continue to be accruing service under the defined benefit scheme, albeit at a slower rate, past service benefits would continue to be linked to pensionable stipend: in contrast to model 2 there would be no need to freeze benefits at the moment of transition. However dioceses and other funding bodies would retain the risk that the cost of the guaranteed element of the pension would tend to increase over time.

125. Taking into account the need to pay 17% contributions to eliminate the past service deficit, the overall cost of Model 3 would be **42%.**

Choices or set menu?

126. At present, all stipendiary clergy are automatically enrolled in the Funded Pensions Scheme unless they exercise their statutory right to opt out (which hardly any do given the attractiveness of the scheme). We have set out three possible models for change in terms which imply that, once the Church has made a decision as between

these – or some variant of them – the new arrangements will then apply for the future service of everyone.

127. It has, however, been suggested to us that there might be advantage in moving away from a set menu to a more à la carte approach. There are, in fact, two rather important limitations which cannot be ignored:

- In a situation in which the big challenge is how best to get the numbers to add up there is a potential difficulty in any set of options which enables individuals to cherry-pick arrangements in a way that is potentially most advantageous to them;

- The clergy pension scheme has a large number of members and administering it is, as a result, a substantial undertaking. Greater choice means greater complexity which, in turn, means increased administrative costs. Given all the other upward cost pressures on the scheme we do not think this is a moment for incurring avoidable expenditure

128. Although, therefore, we are open to further representations on the point, our inclination at this stage is that the central issue is which of the possible models to adopt – or, indeed, as some have advocated whether to maintain the existing system unmodified and simply pay what it costs – rather than to provide a menu of options from which clergy will, in future, be able to choose.

129. There is, however, one possible variant which, while it would not leave choice with the individual, would involve some combination of the above models and is worth mentioning in case there is any interest in pursuing it. That would be to have different pension arrangements for new clergy from those available to existing members of the scheme.

130. **It must be stressed however that, given the size of the deficit and the relatively slow turnover among the clergy, leaving the present arrangements unchanged for existing members does not offer a solution to the present funding challenge. The question is simply whether it might be thought reasonable to make a greater transfer of risk in the case of those being admitted to the scheme than to those already in it.**

Considerations to be weighed

131. A document of this kind, discussing as it must, questions of cost and risk, inevitably runs the risk of sounding cautious and negative. **It is important, therefore, that in the forthcoming consultation process there be no uncertainty or equivocation over the Church's continued commitment to providing a fair deal for its clergy both during their working lives and in retirement.**

132. Just as the Church continues to have a duty to ensure that clergy are satisfactorily housed and remunerated during their working lives so that they can minister without anxiety and distraction, so it has the responsibility to help them prepare for a retirement in which they will have adequate resources to house and care for themselves.

133. At the same time, we must try and find a solution that is also fair to those who have to raise funds to finance the pension scheme alongside all the other financial commitments (both inside and outside the Church) which they have to meet.

134. It is important to keep in mind one of the inevitable paradoxes in relation to possible pension changes. **Since, by law, any changes cannot take away what has already been earned, it follows that those who have already earned most of their pension will, in practice, be least affected by any changes that affect the pension they may earn in their final years of service.** Yet it is precisely those who are nearest to retirement for whom pensions issues loom largest and for whom even relatively small changes can assume disproportionate importance.

135. It will, therefore, be important in the forthcoming consultations to approach the issues with an eye to the interests of those still early in their ministry who may be least concerned about their eventual pensions but will potentially be much more affected by the decisions than their colleagues who are already approaching retirement..

136. Thirdly, **it will be important to try to discern what is both in the interests of the clergy and of the Church more generally**. This is a challenge facing the whole Church and it calls for a whole Church solution. The underlying dilemma is that every additional pound spent on clergy pensions is a pound that cannot be spent on clergy stipends, housing costs, training new ordinands, maintaining our church buildings or all the other myriad and necessary costs incurred in sustaining the ministry and mission of the Church of England to our nation.

137. There are, therefore, difficult questions of priorities to be faced. Our expectation is that members of the Church will continue to want to see the need to provide adequate retirement incomes for clergy as a high priority. Nevertheless, there is a choice to be made over whether the ever-increasing proportion of the Church's budget being devoted to pension costs can be sustained without unbalancing the way in which the Church uses resources of which it has stewardship.

138. In parallel to questions of priorities and affordability comes the need to assess risk. Pension schemes are by their very nature bound up with the long term assessment and management of risk. Actuarial assumptions and regulations about prudency are all about trying to handle risk responsibly but they do not bring certainty. Pensions deficits and (in happier times) surpluses are themselves shifting sands.

139. **At the heart of the decisions that the Church has to take lie, therefore, questions about how much risk should be borne and who - as between the Church as a whole, members of the pension scheme and the State - should bear it.**

140. These include:

- What are the risks of devoting ever more money to clergy pensions in order to sustain commitments that may in fact be too onerous in the long term?
- What are the risks to clergy morale of reducing the pension benefits earned in future?

- If some significant change has to be made, what should the relative balance of risk be in future between members of the clergy and the wider Church?

141. Each of the three models described above involves striking that balance of risk at a different point. There needs to be a serious debate about what would be reasonable. And, to the extent that it is judged that there should be any transfer of risk between the Church and individuals it will be necessary to consider how best to provide ongoing support to help clergy manage their financial affairs prudently.

142. **Perhaps the most difficult consideration of all concerns the weight to be attached to the exceptional circumstances in which this consultation exercise is being launched**. By common consent the credit crunch which started in August 2007 and escalated into a systemic threat to the international financial system in the autumn of 2008 is unlike anything that has been witnessed for some decades. It is too soon yet to know what the consequences are going to be over the next few years.

143. **Against that background it is, therefore, particularly difficult to judge whether the sudden and massive ballooning in pension fund deficits should be seen as the final death-knell for a model of pension provision that was already becoming increasingly expensive and risky for employers or whether this is simply a particularly violent storm which, if it can be ridden out, will eventually give way to calmer waters.**

144. If the latter is the better view then this is the moment for taking action which stops short of being irreversible. If the former view is correct then this is the moment of crisis that provides the opportunity for doing now what will sooner or later become unavoidable in any event.

145. Given the difficulty of the decisions it would be tempting to think of reasons for delay. The clock is, however, ticking. The Pensions Board will receive the formal triennial actuarial evaluation next spring and in the normal course of events would set a new contribution rate effective from April 2011, in the autumn of 2010 – and in any event not later than March 2011.

146. By then the Church has either to decide to pay however much it costs or to have agreed on changes that will bring the costs down. If the Church concludes that it cannot meet the full costs but at the same time is unable to decide how to reduce them it will fall to the trustees of the Pensions Board to take whatever action is necessary to act in the best interests of members.

147. If the Church and the Pensions Board are unable to reach agreement on a contribution rate that will adequately pay for the benefits, then the Regulator may step in and enforce a solution – either directing that additional contributions be paid or reducing the benefits.

148. So, in summary, it seems to us that the pros and cons of the three models we have identified are as follows:

- **Model 1** has the great advantage for the clergy that, while it involves many sacrifices, it retains much of the present scheme and provides certainty over

retirement benefits. At a time of uncertainty it also avoids the irrevocable step of abandoning a defined benefit approach. As against that it leaves the wider Church with a financial risk that it has continuously underestimated up to now. It may be that in years to come 42% or thereabouts will prove to have been the high-water mark of expense. But, at the same time, there is the inevitable risk that at some point the Church will once again have to decide whether to pay more, cut benefits further or move to a hybrid or DC approach

- **Model 2** has the great advantage for the Church of controlling future pension costs. It also means that clergy will no longer face the prospect of recurrent debate about the sustainability of the present scheme. As against that it would in practice be an irreversible step. The question inevitably arises whether now is the moment of opportunity for taking a difficult step that some see as inevitable at some point or is this an abnormal moment when it would be better to give the DB approach one last chance? For the clergy it also means a significant transfer of risk whilst for those who finance the scheme, the risk is removed. For those whose pensions are already largely earned the impact would be small. But for those in early or mid service their retirement income would be largely dependent on market conditions over the coming years.

- **Model 3** has the advantage of being the model that shares the risk most widely as between the Church, the individual and the state. It represents something of a half way house between models 1 and 2. Clergy would face increased risk compared with now but those funding the scheme would see some of their risk removed. But the move away from DB would be neither complete nor irreversible. By its nature it is the most complex of the three models with clergy in future receiving their retirement income in four elements rather than the present two (although in all the models it moves to three).

Process

149. We are committed to trying to facilitate an orderly process by which the Church as a whole can now seek to grapple with the difficult choices that it faces. We are asking bishop's councils, other 'responsible bodies' (that is those who make pension contributions for clergy) and anyone else who wishes to respond to let us have **by 31 October** their answers to the following questions:

(1) Do you agree that the target contribution rate from 2011 (including for paying the past service deficit) should be around 42%?

Yes **No**

Comments:

(2) Of the three possible models do you prefer:

Model 1

Model 2
Model 3

Comments:

(3) Are there any variants to one or other of the three options for change models that you would wish to propose?

(4) Do you have any other proposals or comments?

150. Members of the Task Group and the staff who have supported us stand ready to visit dioceses to give presentations and answer questions. Requests should be sent to Shaun Farrell at shaun.farrell@c-of-e.org.uk (020 7898 1807). Submissions or queries on this consultation document should be emailed to pensionstaskgroup@c-of-e.org.uk.

151. After the end of October we will prepare recommendations with a view to the Archbishops' Council submitting a package of proposals for debate in the February 2010 Synod. Depending on decisions there, we would then envisage a formal, statutory, consultation with members of the clergy pension scheme.

152. The aim will be to complete that in time for the Synod to make any necessary rule changes in July 2010. Given the complexity of the issues, it is conceivable that more time will be needed and that final decisions will fall to the new Synod to take at its inaugural meeting in November 2010, though it will if possible be better for all concerned if decisions can be taken in the lifetime of this Synod.

Andrew Britton Jonathan Spencer Andreas Whittam Smith

30 June 2009
Church House Westminster

A Supplement to this document on Benefit Illustrations has been issued.

CLERGY PENSIONS

TASK GROUP REPORT SUPPLEMENT

BENEFIT ILLUSTRATIONS

Introduction

This document supplements the Consultation Paper issued by the Clergy Pensions Task Group on 30 June 2009 and should be read in conjunction with that document http://www.cofe.anglican.org/info/pensions2009/consultation.doc

It is designed to provide sample illustrations of the impact of the modifications proposed in the consultation document on clergy at different ages and lengths of service and to assist Responsible Bodies in responding to the questions set out in the Task Group report.

By way of reminder, current estimates suggest that the cost of the scheme, in its present form, could rise to around 57% of the pensionable stipend if the financial position of the scheme at 31 December 2009 (when the next formal valuation takes place) is similar to the position as at end of 2008.

For ease of reference, the modifications proposed, in order to bring the cost of the scheme down to an affordable level (currently assumed to be 42%) are:-

- Capping future increases in the pensionable stipend to RPI
- Increasing, for future service, the normal pension age from 65 to 68
- Increasing, for future service, the period required for a full service from 40 to 43 years
- Contracting the pension scheme back into the Second State Pension.

Each illustration is shown on the basis of the 3 options for the future structure of the scheme i.e.

Option 1 - Retaining the existing defined benefit structure

Option 2 - Closing the defined benefit scheme to future accrual and introducing defined contribution arrangements for future service

Option 3 - Introducing a hybrid arrangement with part of the pension coming from a defined benefit scheme and part from a defined contribution arrangement

It should be noted that, as options 2 and 3 include a defined contribution element, the final pension received will be partly dependent on investment market returns during the period of service concerned. For this reason the pension received cannot be guaranteed. Illustrations have been provided on the basis on 3 different rates of investment return i.e. Medium (6% p.a.), High (7.5% p.a.) and Low (4.5% p.a.).

In addition to what is shown here, all pensioners who have made the necessary national insurance contributions will continue to be eligible for the basic state pension which is currently £95.25 per week (£4,953 p.a.)

Each illustration shows for comparison purposes what the pension entitlement would be under the current arrangements unchanged. A key assumption we have to make is the rate at which the pensionable stipend (currently the National Minimum Stipend) increases in the future. Scheme members have no entitlement to any particular level of stipend increase. The NMS is determined annually by the Archbishops' Council consulting with the dioceses. In the illustrations two scenarios are provided. The first assumes that RPI inflation will be 3% each year and the NMS will increase in line with it, the second that NMS increases are at 1.5% above RPI of 3% each year (the current basis on which the pension contribution is calculated by the Pension Board's actuaries). Figures are shown for age 65 (the current normal retirement age) and for age 68.

All the options provide for the pension scheme to be contracted back into the State Second Pension shown in these illustrations as "Additional State Pension".

Four illustrations have been provided to cover a range of different circumstances:-

Example 1 – a clergy person fairly close to retirement (aged 60)

Example 2 – a clergy person (aged 50) in mid-career

Example 3 – a clergy person in the early part of their career (aged 30)

Example 4 – a newly ordained clergy person (aged 45)

The detailed assumptions which underpin these calculations are set out in **Appendix 1**. The figures included in this document are for illustration purposes only and should not be taken by any scheme member as a precise indication of the benefits they might receive.

Any queries relating to these illustrations should be sent to the dedicated Task Group e-mail address below:-

pensionstaskgroup@c-of-e.org.uk

Pensions Task Group
August 2009

Example 1

Ordained at 30 years old, 60 at date of change, 30 years existing service, 5 years potential service to age 65, 8 years to age 68.

State pension age is 65 years exactly.

Existing Pension Scheme (unchanged)		Age 65	Age 68
(a) Pensionable stipend increases in line with RPI	Church pension	£12,173 p.a.	£13,093 p.a.
	Lump Sum	£36,519	£39,280
(b) Pensionable stipend increases in line with RPI +1.5%	Church pension	£13,114 p.a.	£14,749 p.a.
	Lump Sum	£39,342	£44,248

Option 1 – Revised DB Scheme	Age 65	Age 68
Church pension	£11,473 p.a.	£12,363 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,945 p.a.	£13,011p.a.
Lump Sum	£35,560	£38,917

Option 2 – DC Scheme		
(i) Medium investment assumption (6% p.a.)	Age 65	Age 68
Church pension	£11,402 p.a.	£12,066 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,874 p.a.	£12,714 p.a.
Lump Sum	£35,560	£38,917
(ii) High investment assumption (7.5% p.a.)	Age 65	Age 68
Church pension	£11,440 p.a.	£12,181 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,912 p.a.	£12,829 p.a.
Lump Sum	£35,560	£38,917
(iii) Low investment assumption (4.5% p.a.)	Age 65	Age 68
Church pension	£11,364 p.a.	£11,959 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,836 p.a.	£12,607 p.a.
Lump Sum	£35,560	£38,917

Option 3 – Hybrid scheme (part DB, part DC)		
(i) Medium investment assumption (6% p.a.)		
	Age 65	Age 68
Church pension (DB)	£11,005 p.a.	£11,450 p.a.
Additional Church pension (DC)	£379 p.a.	£685 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,856 p.a.	£12,783 p.a.
Lump Sum	£35,560	£38,917
(ii) High investment assumption (7.5% p.a.)		
	Age 65	Age 68
Church pension (DB)	£11,005 p.a.	£11,451 p.a.
Additional Church pension (DC)	£393 p.a.	£726 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,870 p.a.	£12,825 p.a.
Lump Sum	£35,560	£38,917
(iii) Low investment assumption (4.5% p.a.)		
	Age 65	Age 68
Church pension (DB)	£11,005 p.a.	£11,450 p.a.
Additional Church pension (DC)	£365p.a.	£646 p.a.
Additional State pension	£472 p.a.	£648 p.a.
Total pension	£11,842 p.a.	£12,744 p.a.
Lump Sum	£35,560	£38,917

Example 2

Ordained at 25 years old, 50 at date of change, 25 years service, with 15 years potential service at 65, 18 years to age 68.

State pension age is 66 years exactly.

Existing Pension Scheme (unchanged)		Age 65	Age 68
(a) Pensionable stipend increases in line with RPI	Church pension	£13,093 p.a.	£13,093 p.a.
	Lump Sum	£36,280	£39,280
(b) Pensionable stipend increases in line with RPI +1.5%	Church pension	£16,369 p.a.	£17,117 p.a.
	Lump Sum	£49,109	£51,352

Option 1 – Revised DB Scheme	Age 65	Age 68
Church pension	£10,421 p.a.	£11,723 p.a.
Additional State pension	£1,170 p.a.	£1,600 p.a.
Total pension	£11,591 p.a.	£13,323p.a.
Lump Sum	£37,464	£39,280

Option 2 – DC Scheme		
(i) Medium investment assumption (6% p.a.)	Age 65	Age 68
Church pension	£11,347 p.a.	£12,329 p.a.
Additional State pension	£1,170 p.a.	£1,600 p.a.
Total pension	£12,517 p.a.	£13,929 p.a.
Lump Sum	£37,464	£39,290
(ii) High investment assumption (7.5% p.a.)	Age 65	Age 68
Church pension	£11,707 p.a.	£12,940 p.a.
Additional State pension	£1,170 p.a.	£1,601 p.a.
Total pension	£12,877 p.a.	£14,541 p.a.
Lump Sum	£37,464	£39,280
(iii) Low investment assumption (4.5% p.a.)	Age 65	Age 68
Church pension	£11,031 p.a.	£11,806 p.a.
Additional State pension	£1,170 p.a.	£1,601 p.a.
Total pension	£12,201 p.a.	£13,407 p.a.
Lump Sum	£37,464	£39,280

Option 3 – Hybrid scheme (part DB, part DC)		
(i) Medium investment assumption (6% p.a.)		
	Age 65	Age 68
Church pension (DB)	£9,297 p.a.	£9,667 p.a.
Additional Church pension (DC)	£1,291 p.a.	£1,752 p.a.
Additional State pension	£1,170 p.a.	£1,601 p.a.
Total pension	£11,758 p.a.	£13,020 p.a.
Lump Sum	£37,464	£39,280
(ii) High investment assumption (7.5% p.a.)		
	Age 65	Age 68
Church pension (DB)	£9,297 p.a.	£9,667 p.a.
Additional Church pension (DC)	£1,448 p.a.	£2,015 p.a.
Additional State pension	£1,170 p.a.	£1,601 p.a.
Total pension	£11,915 p.a.	£13,283 p.a.
Lump Sum	£37,464	£39,280
(iii) Low investment assumption (4.5% p.a.)		
	Age 65	Age 68
Church pension (DB)	£9,297 p.a.	£9,667 p.a.
Additional Church pension (DC)	£1,154 p.a.	£1,528 p.a.
Additional State pension	£1,170 p.a.	£1,601 p.a.
Total pension	£11,621 p.a.	£12,796 p.a.
Lump Sum	£37,464	£39,280

Example 3

28 at ordination, now 30 (2 years service at point of change), with 35 years potential service to age 65, 38 years to age 68.

State pension age is 68 years exactly.

Existing Pension Scheme (unchanged)		Age 65	Age 68
(a) Pensionable stipend increases in line with RPI	Church pension	£12,111 p.a.	£13,093 p.a.
	Lump Sum	£36,334	£39,280
(b) Pensionable stipend increases in line with RPI +1.5%	Church pension	£20,394 p.a.	£23,054 p.a.
	Lump Sum	£61,182	£69,164

Option 1 – Revised DB Scheme	Age 65	Age 68
Church pension	£7,208 p.a.	£9,333 p.a.
Additional State pension	£2,926 p.a.	£3,806 p.a.
Total pension	£10,134 p.a.	£13,139 p.a.
Lump Sum	£29,619	£36,676

Option 2 – DC Scheme		
(i) Medium investment assumption (6% p.a.)	Age 65	Age 68
Church pension	£7,014 p.a.	£8,516 p.a.
Additional State pension	£2,926 p.a.	£3,806 p.a.
Total pension	£9,940 p.a.	£12,322 p.a.
Lump Sum	£29,619	£36,676
(ii) High investment assumption (7.5% p.a.)	Age 65	Age 68
Church pension	£9,336 p.a.	£11,748 p.a.
Additional State pension	£2,926 p.a.	£3,806 p.a.
Total pension	£12,262 p.a.	£15,554 p.a.
Lump Sum	£29,619	£36,676
(iii) Low investment assumption (4.5% p.a.)	Age 65	Age 68
Church pension	£5,337 p.a.	£6,250 p.a.
Additional State pension	£2,926 p.a.	£3,806 p.a.
Total pension	£8,263 p.a.	£10,056 p.a.
Lump Sum	£29,619	£36,676

Option 3 – Hybrid scheme (part DB, part DC)		
(i) Medium investment assumption(6% p.a.)	Age 65	Age 68
Church pension (DB)	£3,932 p.a.	£4,994 p.a.
Additional Church pension (DC)	£3,444 p.a.	£4,259 p.a.
Additional State pension	£2,925 p.a.	£3,806 p.a.
Total pension	£10,301 p.a.	£13,059 p.a.
Lump Sum	£29,619	£36,676
(ii) High investment assumption (7.5% p.a.)	Age 65	Age 68
Church pension (DB)	£3,932 p.a.	£4,994 p.a.
Additional Church pension (DC)	£4,559 p.a.	£5,801 p.a.
Additional State pension	£2,925 p.a.	£3,806 p.a.
Total Pension	£11,416 p.a.	£14,601 p.a.
Lump Sum	£29,619	£36,676
(iii) Low investment assumption (4.5% p.a.)	Age 65	Age 68
Church pension (DB)	£3,932 p.a.	£4,994 p.a.
Additional Church pension (DC)	£2,644 p.a.	£3,187 p.a.
Additional State pension	£2,925 p.a.	£3,806 p.a.
Total pension	£9,501 p.a.	£11,987 p.a.
Lump Sum	£29,619	£36,676

Example 4

New entrant, 45 years old at 1st January 2011, with 20 years potential service to 65, 23 years to age 68.

State Pension Age is 66 years exactly.

Existing Pension Scheme (unchanged)		Age 65	Age 68
(a) Pensionable stipend increases in line with RPI	Church pension	£6,546 p.a.	£7,528 p.a.
	Lump Sum	£19,640	£22,586
(b) Pensionable stipend increases in line with RPI +1.5%	Church pension	£8,817 p.a.	£10,603 p.a.
	Lump Sum	£26,452	£31,809

Option 1 – Revised DB Scheme	Age 65	Age 68
Church pension	£3,745 p.a.	£5,252 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£5,401 p.a.	£7,478 p.a.
Lump Sum	£15,803	£21,010

Option 2 – DC Scheme		
(i) Medium investment assumption (6% p.a.)	Age 65	Age 68
Church pension	£3,428 p.a.	£4,486 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£5,084 p.a.	£6,712 p.a.
Lump Sum	£15,803	£21,010
(ii) High investment assumption (7.5% p.a.)	Age 65	Age 68
Church pension	£4,080 p.a.	£5,507 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£5,736 p.a.	£7,733 p.a.
Lump Sum	£15,803	£21,010
(iii) Low investment assumption (4.5% p.a.)	Age 65	Age 68
Church pension	£2,882 p.a.	£3,654 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£4,538 p.a.	£5,880 p.a.
Lump Sum	£15,803	£21,010

Option 3 – Hybrid scheme (part DB, part DC)		
(i) Medium investment assumption (6% p.a.)		
	Age 65	Age 68
Church pension (DB)	£1,872 p.a.	£2,626 p.a.
Additional Church pension (DC)	£1,771 p.a.	£2,311 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£5,299 p.a.	£7,163 p.a.
Lump Sum	£15,803	£21,010
(ii) High investment assumption (7.5% p.a.)		
	Age 65	Age 68
Church pension (DB)	£1,872 p.a.	£2,626 p.a.
Additional Church pension (DC)	£2,064 p.a.	£2,765 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£5,592 p.a.	£7,617 p.a.
Lump Sum	£15,803	£21,010
(iii) Low investment assumption (4.5% p.a.)		
	Age 65	Age 68
Church pension (DB)	£1,872 p.a.	£2,626 p.a.
Additional Church pension (DC)	£1,526p.a.	£1,943 p.a.
Additional State pension	£1,656 p.a.	£2,226 p.a.
Total pension	£5,054 p.a.	£6,795 p.a.
Lump Sum	£15,803	£21,010

Annex 1

Detailed assumptions

1. All amounts shown are in today's money terms i.e. the projected pensions at retirement have been 'rolled back' to the current date at the assumed rate of inflation (3%). These illustrations which assume that pensionable stipends increase by an average of 1.5% above RPI do therefore show pensions and lump sums which, even in today's money terms, are considerably higher than present levels.

2. The additional (second) State pension is payable from State Pension Age. For younger members this is likely to be higher than age 65.

3. The current pensionable stipend is £19,640 p.a.

4. Benefits payable at 68 but which are taken at 65 have been reduced for early payment by the current early retirement factor.

5. The pensions available from the defined contribution elements of options 2 and 3 are not guaranteed; they will depend on the investment returns achieved up to retirement and the annuity terms available when a member retires.

6. The defined contribution benefits have been converted into pension at retirement using a discount rate commonly used in the annuity market. The pension benefits then payable are assumed to rise annually in line with RPI up to 2.5% p.a. (the commonly available option).

7. To provide a consistent and simple basis of comparison, the lump sum illustrations in options 1 - 3 are based on what would be payable under the current defined benefit scheme as modified (option 1). In practice under options 2 and 3 retiring clergy would be able to exercise some choice over the amount of lump sum taken; the smaller the lump sum taken, the larger the continuing pension.

8. The additional State second pension is assumed to increase at 4.5% p.a. in line with current Government policy (which is that increases should be linked to average earnings).