

Archbishops' Task Group

Clergy Pensions – The Way Forward

Report No. 2

June 2006

CLERGY PENSIONS – THE WAY FORWARD

Second Report of the Archbishops’ Task Group

Contents

	Paragraphs
Developments since our first report.....	7 - 8
The five questions.....	9 - 19
The central issue.....	20 - 31
The actuaries’ latest assessment.....	32 - 36
Three possible approaches.....	37 - 44
Option A –	45 - 47
Modifying the benefits.....	48 - 67
Possible help from the Commissioners.....	68 - 81
Assessing Option A.....	82 - 84
Option B.....	85 - 112
Option C.....	113 - 124
Retirement housing.....	125 - 131
Conclusion.....	132 - 135
Next steps.....	136 - 141

1. In our report of 1 March we set out the potential challenge facing the Church as a result of recent changes in funding requirements for pension schemes. At a meeting of the Archbishops' Council the following week, the Archbishops invited us to continue to co-ordinate the complex process of assessing options, consulting widely and enabling the Church to take some decisions.
2. This, our second report, brings the story up to date and sets out what seems to us to be a possible way forward though in doing so we have been very conscious that it must be for the wider Church, through all the relevant decision making bodies, to weigh the arguments and come to its own conclusion.
3. We have tried to set out the arguments as clearly and dispassionately as possible. There is much in this report that is necessarily rather dry. But throughout our work we have been mindful that decisions about pensions are not primarily technical. They touch not merely the financial wellbeing of the Church but the personal wellbeing of thousands of serving and retired clergy, together with their families.
4. While all organisations are required to consult scheme members before making changes to pension arrangements, our consultation and decision making processes in the Church are unusually extensive, time consuming and potentially unsettling. It is important, therefore, that the continuing debate be conducted with sensitivity and restraint.
5. One further preliminary word of caution. On a subject as complex as this it is understandable that many people would like simply to be told now what the answer is, or at least what the clear choices are. We have done our best to be clear and simple. The story is, however, still unfolding and will continue to do so over the next few months.
6. A further, very constructive, meeting with the Pensions Regulator a fortnight ago and a meeting of the Pensions Board only last week served to underline just how much fresh thinking all pension trustees now have to do about their increased responsibilities and accountability within the new regulatory framework. While, therefore, the big picture has become clearer, it needs to be understood that much further exploration and discussion will need to continue at national level, in parallel with the Churchwide consultation exercise which we are now launching. To delay this report by several months until more of the details were settled was not a practicable option.

Developments since our first report

7. Over the past four months there has been a wide range of discussions both nationally and within dioceses. The Archbishops' Council, the Board of Governors of the Church Commissioners, the Pensions Board, the Archbishops' Council's Finance Committee and DRACSC have each had discussions in which members of the task group have participated. The Inter-Diocesan Finance Forum has met on two occasions, on one of these solely to discuss pensions issues. The Secretary of the Pensions Board and other staff members are now making a series of presentations to diocesan synods and other gatherings.

8. These months have not simply been about talking and thinking. The story has moved on in a number of important respects

- **On 24 April the Pensions Board decided it had to increase the contribution rate for the clergy pension scheme.** Normally, the rate would have remained unchanged until April 2008, following the December 2006 triennial valuation. But, in the light of the new regulations and the actuaries' advice the Board concluded that the rate should increase from 33.8% to 39.8% from 1 January 2007 (from £6,105 pa to £7,188 pa in cash terms¹). This constitutes a 17.8% increase in pension costs, adding some £9.5m to diocesan budgets.
- **In early May the Pensions Regulator issued his code of practice on the way in which he will approach the new funding rules and has recently issued a guidance note on the use of contingent assets.** In addition we have had further discussions with the Regulator. The big picture remains much as set out in our first report. The Regulator is now going to expect pension trustees to put an even greater emphasis than previously on prudence. He has been at pains to stress that it must, in every case, be for the trustees to determine what is prudent. There is no set formula. This places an even greater responsibility on the Pensions Board than in the past. In assessing liabilities and contribution rates, they are going to have to be more cautious about future investment returns. That means getting more money upfront from those providing the funding rather than counting on all the future investment returns they might reasonably expect. In the long run this new approach should not in itself lead to more expensive pensions. Contribution rates further down the track will be lower than they otherwise would have been. But the more that funding has to be secured upfront, particularly while there are still deficits to pay off, the greater the challenge for all defined benefit pension schemes.
- **On 26 May the Government produced its own White Paper on pension reform, largely reflecting the recommendations of the Turner Commission.** The direct implications for occupational defined benefit arrangements such as the clergy scheme are only limited and technical. But, once implemented, it will significantly affect the context in at least three important respects. First, between 2024 and 2045 the state pension age will increase progressively from 65 to 68. This does not mean that pension age for occupational schemes has to change. But it does mean that, where it is lower, those who retired at the earliest opportunity would have to wait before their state pension became payable. Secondly, the Government intends, in the next Parliament, possibly from 2012, to restore the link between pension increases and earnings inflation. This will halt the erosion of the basic state pension, relative to earnings, which started in 1980. Thirdly, employers will be required to contribute 3% of salary and enrol employees in a personal account for retirement unless employees specifically opt out or there is a more favourable occupational pension scheme.

¹ Annual amounts in this report are shown at 2006/07 levels

- **There has been a good deal of further turbulence in the equity markets since the beginning of May.** This is a timely reminder that pensions decisions should be taken on the basis of long- term judgements rather than simply a snapshot on a particular date. We must avoid being mesmerised by any single set of figures. Indeed the valuation of the Church Administrators' Pension Fund – the first of the Church schemes to be valued under the new funding rules – reflects the new approach of requiring the trustees to test and own a wide range of assumptions. Decisions about the future of the clergy pension scheme should not, therefore, be driven simply by the way the markets perform between now and the triennial valuation at the end of December. What is, however, reasonably clear is that gilt yields at the end of 2005 were at an unusual and, arguably, artificially low level. Since these are a key driver in the calculation of pension liabilities the Pensions Board will consider very carefully with its actuaries what assumption it makes about longer term gilt yields.

The five questions

9. In paragraph 31 of our first report we identified five questions that seemed to us to be the key to finding solutions. **The first was about the link between the Church's commitment to maintaining the present defined benefit scheme (see Annex A) and its affordability. The next three questions were about possible changes to the benefits package to make it less costly. The final question asked whether the Church Commissioners might be able to contribute to the overall solution.**

10. Much of the discussion of the past four months has involved an exploration of these questions. A range of answers has been given. Many have observed that they are difficult questions to answer without further information or without setting them in a much broader context. Nevertheless, they cover the issues that the Church is going to have to address over the next year given the difficult figures that the triennial valuation seems bound to produce.

11. We shall return to the questions later in this report as we identify possible options. But it may be helpful at this point to record what seems to us to be the emerging balance of opinion.

12. In relation to the **commitment to maintaining a defined benefits scheme** we detect a significant shift of mood since the last major consultation on pensions nearly five years ago. At that point, there was a very strong affirmation, across the Church, of the importance of maintaining the defined benefits scheme in its current form, despite the increasing cost.

13. Now, views seem more divided. We detect three schools of thought. One continues to see the defined benefits scheme as such an integral part of the relationship between the Church and its clergy that retaining it should be a very high priority, almost at any cost. This view emphasises the nature of the Church as a mutual and supportive society of which its clergy and parishioners are vital parts. It is not a commercial organisation with all that implies in terms of the relationship between employers and employees.

14. The second view also reflects a strong wish to maintain a defined benefits scheme if at all possible but is more agnostic over whether it is now achievable without unacceptably distorting the Church's financial commitments. In other words, this view hopes that this exercise will find a way of preserving the defined benefits scheme but is unsure whether it can be done.

15. The third view, noting that 70% of defined benefits schemes outside the public sector have now been closed to new entrants, believes that the Church can no longer expect or afford to swim against the tide. Those who hold this view see a switch to a defined contribution scheme at some point as inevitable and think it would be better to grasp the nettle now and introduce a scheme which comes as close, in its expected benefits, to the present scheme as finances allow.

16. **Our next three questions concerned possible changes to present benefits.** We asked whether changes in entitlement for the future service of existing members of the scheme should be contemplated, whether new clergy should be brought in on less expensive pension arrangements and whether post retirement pension increases should in future be linked to price rather than stipend inflation.

17. Again, unsurprisingly, there has been a range of views. We have not detected significant support for bringing new clergy in on a different basis from existing clergy. Some have suggested that those who enter the stipendiary ministry early and give a lifetime's service to the Church might be put on more generous arrangements than those who enter after a certain age. We think that such an arrangement would, however, be problematic and might lead to claims under age discrimination legislation.

18. The point has also forcefully been made that, even at its present level, the full clergy pension is not large in absolute terms given the responsibility that falls to clergy, at retirement, to house themselves. Nevertheless, the tone of the discussions, particularly in diocesan synods, suggests that clergy accept the need to play their part in finding an overall solution. Certainly many would prefer to see some limited changes to the present benefit arrangements rather than face a move to a defined contribution scheme.

19. **Our final question concerned the Church Commissioners.** Their Board of Governors is prepared to explore ways in which the Commissioners might be able to help meet the challenge of funding clergy pensions, if the rest of the Church concludes that other options, though necessary, are unlikely to be sufficient. As our earlier report stressed, there is no Commissioners' solution which can absolve the wider Church from facing up to some tough decisions. It is also crucial to avoid recreating unacceptable liabilities for the Church Commissioners. Nevertheless, they have identified three possible options that would, at least, be worthy of further exploration, if Commissioners' help were deemed necessary by the wider Church. We return to these later in the report.

The central issue

20. Everything connects to everything else. Since our first report there have been suggestions that the pensions issues need to be addressed in the context of reviewing other issues. Suggestions for what might be brought within a wider review process

have ranged very wide. They include stipends policy, the future of clergy housing, giving levels within the church, the future of stipendiary ministry, how stipendiary clergy are deployed around the Church, redistributing the historic assets of the dioceses and mutual support more generally.

21. It is clearly right that the pensions challenge needs to be faced with an eye to these other important questions and we refer later to other pieces of work that might be pursued in parallel. Pensions arrangements cannot be viewed in isolation. Nevertheless, we would urge caution over assuming one difficult set of problems will become easier to solve if several other sets of problems are added to the mix at the same time. There is a limit to the number of difficult issues that any organisation can manage at one time. This is particularly the case for the Church where consultation and decision-making processes do not make it easy to advance quickly across a broad front, particularly when there is a variety of strongly held views.

22. **We repeat, therefore, the note of urgency in our first report. The clock is ticking.** The Pensions Board will be faced with a new actuarial valuation in around six months. The 6 % points increase in the contribution rate (from 33.8% to 39.8% in effect a 17.8% increase) was an interim measure, while the wider situation was assessed. The Church needs to be clear on the way forward not later than the July 2007 Synod.

23. All that said, we are aware of a strong groundswell of opinion that the **Church should be looking for a durable solution rather than a temporary fix.** The succession of increases in the contribution rate since 1998 has taken its toll. All those responsible bodies funding pensions are looking for some increased predictability and stability.

24. Just as importantly, clergy want to know where they stand. They do not find it helpful to have their pension arrangements constantly called into question. If some changes are now unavoidable clergy would certainly want some reassurance that they were not simply the first instalment of a whole series of further changes. We have much sympathy for this view. It is unreasonable both for funders and for scheme members for pension arrangements to keep changing.

25. One test that needs, therefore, to be applied to any possible solution is how sustainable it is likely to be. Few things in life are certain. Nevertheless, **we think that the Church should set itself the task of finding the solution that has a good prospect of avoiding the need for further significant changes for the foreseeable future.**

26. That being so, **the Church has to ponder whether it is willing and able to commit to go on paying whatever contribution rate the Pensions Board decides it has to set in the light of the actuarial valuation and advice every three years to provide the benefits promised under the scheme.** If dioceses could pay whatever it costs, then the questions of possible changes to the benefits structure and of help from the Church Commissioners would not arise. There would be no need for votes in Synod or any requirement for fresh legislation.

27. From all we have heard many dioceses (and other responsible bodies) are doubtful whether they can realistically go on increasing pension contributions. Even

those dioceses who remain strongly committed to defined benefits and might be willing and able to pay a contribution rate of around 40% have made it clear that they can only meet the increased contributions in 2007 by short term measures such as drawing on reserves. They might, over time, be able to generate sufficient additional income to sustain a contribution rate of 40%. But if the rate were to go much higher they would need some relief, whether on a transitional or permanent basis.

28. Other dioceses have offered a more cautious view. For them, a rate of 39.8% appears to be already at or above the upper limit of what they regard as sustainable. They may be able to meet it in the short run by drawing on reserves but the signals from them are that they want less expensive solutions.

29. **An important question, therefore, is whether there is any reason to believe that, were nothing else done, the contribution rate would peak at around 40% and perhaps, over time reduce.** As we noted earlier, in the long term the more cautious approach required by the new funding rules and the Regulator may well eventually bring contribution rates down. Increased funding upfront is likely to lead to some savings later, even though further improvements in longevity would, over time, continue gradually to push costs in an opposite direction.

30. There are, however, two reasons why this does not provide a reliable escape route. **The first is that investment returns in the future, whether from equities or from gilts, must remain uncertain.** The future may not resemble the past. **Secondly, even if there is a very good chance of the savings materialising, they are likely to be many years away.** Barring spectacular improvements in gilt yields, higher contribution rates are likely to be with us for much of the next decade at least.

31. **As indicated above, the central issue, therefore, that the Church needs to face is whether the policy of simply relying on funding bodies to meet whatever increases in the contribution rate the Pensions Board may require from 2008 is going to be sustainable.** Much of course turns on what the contribution rate is likely to be, so we have attempted to get a further handle on this.

The actuaries' latest assessment

32. Earlier this month we received a revised assessment from the Pensions Board's actuaries in the light of the Regulator's Code of Practice and current market conditions. A copy of the letter is attached as Annex B. **Overall it paints a picture that, while less apocalyptic than a few months ago, is still sombre.**

33. The Regulator has still set 'trigger points' that will cause it to scrutinise closely the funding plans of all schemes whose financial position does not meet certain tests. It seems likely that the clergy scheme, like the many other defined benefit schemes currently in deficit, will be subject to this scrutiny once the Pensions Board has reached decisions on a new contribution rate next year in the light of the forthcoming triennial valuation. But the Regulator has helpfully signalled somewhat more flexibility over its likely approach to the assumptions made about the extra investment return normally associated with equity investments and suitable periods for clearing deficits. Provided trustees are satisfied with the strength of the covenant from those who provide the funds they may, therefore, not have to frontload the funding requirement by as much as initially seemed likely.

34. The figures in the actuaries' letter are at this stage merely illustrative, pending the triennial review at the end of this year. Moreover, it will be the Pensions Board, rather than the actuaries, who will have to reach a view on prudence. **Nevertheless there is now some prospect that, instead of being faced with a contribution rate from 2008 of somewhere between 46% and 57% if the pension benefits remain at present, we could be looking at something around 43.5% (£7,856 per scheme member per year), if nothing else changed.**

35. This would still represent a huge, and possibly for many dioceses an unaffordable, additional increase from the 33.8% currently being paid and the 39.8% that will be payable from January 2007. We also need to think about what we would do in the event the figures are somewhat worse than this (the chances of their being substantially better barring a sharp recovery in gilt yields or equity market prices appears to be low).

36. It is important to stress that these contribution rates are, of course, a percentage of the national minimum stipend (and most clergy are paid around 10% more than this level). When making comparisons with other pension schemes the fairer comparison is to look at the contribution rate as a percentage of the total remuneration package, including the notional cost of providing clergy with free housing. On that basis the present 33.8% contribution rate is the equivalent of just over a 17% contribution rate in other schemes and 39.8% the equivalent of around 21%. This does not, however, alter the fact that each additional 1% on the contribution rate costs dioceses more than £1.5m a year on their budgets in total.

Three possible approaches

37. We have taken to heart the demands for an analysis that does not take too narrow a view nor rule out in advance any possible solution, however radical. We have, therefore, identified what seem to us to be the three big picture solutions. The first of these retains the main features of present arrangements and is the one that we have worked up in most detail. **It is the approach that we recommend.** We have described the two other, much more radical approaches, only in broad outline at this stage. Both would need to be worked through in much more detail than we have had the time to do in preparing this report before the Church could reach a decision on them.

38. Depending on decisions taken following consultation on this report, the first half of next year, 2007, will need to be spent agreeing a detailed implementation plan. The more radical the changes, the longer the implementation process is likely to be, though there is no option but to deal with the consequences of the actuarial valuation once it is available next spring. We describe the three approaches in the remaining sections of this report. They can be summarised as follows.

39. **Option A is the approach that we recommend.** It would involve some additional contributions, some changes to the benefit package and possibly some help from the Church Commissioners. Although it is the least radical of the three options, it involves significant and difficult decisions, including a vote by the General Synod to modify the present pension benefits. It might also involve the approval of fresh legislation by General Synod and Parliament to change the powers of the Church Commissioners.

40. In our view, this is the approach to go for provided:
- the Church still wants to preserve a defined benefits scheme for the clergy if at all possible;
 - responsible bodies are prepared to pay something more than the present 33.8% and accept that this rate might vary over time;
 - the clergy are prepared to accept some modification in present benefits, so long as the basic structure of the scheme is largely retained;
 - the Church is willing, if it proves necessary, to accept some help from the Church Commissioners, and the consequence that would entail;
 - there is a disinclination to change the present underlying distribution of responsibilities and risks in relation to pensions.

41. **Option B would involve the Church deciding, as many other organisations have already done, that the risk of the guarantees involved in providing a defined benefits scheme was no longer acceptable.** A move to **defined contributions** for future service would be the approach to go for if the Church is unwilling to go for option A and is not attracted to option C and:

- sees predictability and sustainability of pensions costs as the top priorities;
- is not prepared to see the proportion of its overall expenditure devoted to pensions continue to rise;
- is prepared to contemplate radical changes in the clergy remuneration arrangements more generally; and
- does not think it desirable to use Church Commissioners' help to preserve a defined benefits scheme.

42. **Option C would seek to guarantee the long-term security of the defined benefits scheme by reversing the decision reached in the 1990s to create a funded scheme separate from the Church Commissioners' fund.**

43. All the present assets and liabilities of the funded scheme (for clergy) would be transferred, by legislation, to the Church Commissioners who would once again become totally responsible for clergy pensions. Dioceses would continue to contribute, but direct to the Commissioners' rather than the Pensions Board's funded scheme. The strength of their asset base should enable the Commissioners to set less cautious assumptions – and therefore a lower contribution rate – than would otherwise be the case. The Commissioners' fund would also absorb the effects of deficits and surpluses via its long term distributions rather than through adjustments to the pensions contributions. A key uncertainty about this option, however, is whether it would be achievable without subjecting part or all of the Commissioners' fund to regulation as a pension fund and what the impact of such regulation would be.

44. This would be the approach to go for if the Church:
- regards the maintenance of a defined benefits arrangement for the clergy as its most important financial priority;
 - is prepared, as a result to accept that the clergy pensions commitment should, indefinitely, have first call on the Commissioners' fund;
 - believes that the advantages of having one large fund outweigh the inevitable risks of having "all the eggs in one basket";
 - is satisfied that the change would, at worst, have no adverse impact on the overall financial ecology of the Church including, crucially, the flow of current giving from Church members to parishes and parishes to dioceses; and
 - is satisfied, once they have been further explored, that the regulatory consequences would be acceptable.

Option A

45. Many in the Church would clearly like to preserve the defined benefits scheme in largely its present form if possible. So, the first assessment has to be whether there is a credible and achievable package of measures that has a reasonable chance of doing so, not just for the short term but, all being well, for the foreseeable future.

46. **A package of this kind would, we think, involve a three-pronged approach:**

- **a commitment from the dioceses etc to a significantly higher level of contributions, for the time being, than the current rate of 33.8%;**
- **willingness from the clergy to accept some reduction in benefits in order to preserve the funded scheme largely as it is at present; and**
- **readiness by the Church Commissioners to help if called on to do so.**

47. Since the potential cost to the dioceses would be heavily influenced by the extent of the relief from the other two elements it is to those that we turn first.

Modifying the benefits

48. In considering possible reductions in the cost of the scheme it is important to keep in mind that **reduced costs in the long term can only come about through reduced benefits**. Some are likely to be less unpalatable than others but none of them will be welcome to the clergy. We advance the possibility, not because it is very appealing, but because, as part of a wider package to safeguard the main features of the scheme, it may be less bad than the alternatives.

49. We have considered a number of possible ways of modifying the present benefit structure and have had the advantage of advice from DRACSC. We have also looked again at the options considered by the Financial Issues Working Group in

2001/2 (GS 1434 and 1467). In principle, there is a very wide range of possible changes that could be made to the scheme. We have, however, excluded from consideration those which would either fundamentally affect the value of the pension (for example by abolishing the lump sum) or would contribute too little financial relief to be worthwhile (for example abolishing or reducing pension differentials).

50. This has left us with a shortlist of four possible changes:

- **change the basis for all future post retirement pension increases;**
- **extend from 37 to 40 years the period of service required for a full pension, for future service;**
- increase the pension age for future service to more than 65;
- introduce a compulsory pensions contribution for each member of the clergy.

51. **Our own judgement is that any credible package is likely to need to include the first two of these changes, which we describe in more detail below.** It may well be sensible to increase the pension age from 65 as the state retirement age increases progressively from 2024. But it seems to us that that is a change that it might be prudent to keep in reserve until then to deal with that gradual increase in costs that will come through over time if longevity continues gradually to improve. A decision on that is not necessary immediately.

52. One important point to note is that if the pension age were to increase at some later date, the change would apply to **future service** from that point only. Thus, clergy who already had years of existing service would still have the right to retire at 65 and draw, unabated, the pension earned up to the date of the change. It would only be in respect of the future service period after the change that there would be some reduction in their pension if they decided to leave “early” at 65. They would, of course, have the option of making additional contributions to mitigate the reduction or to work on until the new pension age (at which point their pension from service before the date of change might be payable at an enhanced level).

53. We also do **not** recommend the option of compulsory pensions contributions for each member of the clergy, even though every 1% would save 1% on the contribution rate. While each 1% would cost only about £16 per month at current stipend rates this would in effect amount to a compulsory pay cut. If the Church were to compensate clergy by increasing their stipends to offset the increased contribution we would have done nothing to solve the underlying financial problem. Indeed, given that National Insurance would be payable on the increased stipend by both the employer and the clergy, the net financial impact would be negative.

54. **We do, however, strongly believe that the first two changes are a necessary part of any package under option A. They both have the advantage of leaving unchanged the current level of full service pension to which a member of the clergy is entitled on the day of retirement.**

55. The present link between post-retirement pension increases and stipend increases is extremely unusual in occupational pension schemes. Although it is a

discretionary link, it has always been maintained as a matter of policy. Indeed we are not aware of any occupational pension scheme that has to give increases related to earnings rather than price inflation (although some have the discretion to do so, which they may or may not exercise).

56. It may be objected that breaking the link, as a matter of practice, would be an odd thing to do just at the moment that the Government has announced the restoration of the earnings link for the state pension. The two sorts of pension are, however, very different. The state pension, which of course the clergy will continue to receive, is primarily designed to provide a basic level of income. Occupational schemes are designed to provide a standard of living over and above that. Linking rises in that part of a pensioner's income to price inflation rather than earnings inflation is the norm in occupational schemes and is, in our view, entirely reasonable.

57. The clergy scheme is, in fact, already written only to guarantee pension increases in line with limited price inflation (that is RPI subject to a maximum of 5%, with the Government introduced option now to reduce that to 2.5% in respect of benefits from future service). The link to stipend increases reflects a policy decision of the General Synod and the scheme is currently funded on that basis. Each year the Pensions Board and the Church Commissioners have to decide, as a matter of discretion, whether to continue to follow the policy recommended by the Synod.

58. It would be open to them, at any time, to decide that the increase was no longer affordable. Nevertheless, it seems to us unreasonable to leave the Pensions Board and the Church Commissioners to have to take the initiative in moving away from the policy of the Synod. **If the Church favours Option A we recommend, therefore, that the Synod should decide, not later than July 2007, to establish a new policy that all future post-retirement pension increases should reflect what is guaranteed by the scheme, namely LPI (i.e. RPI up to 2.5% in respect of benefits from service after the change is implemented).**

59. **This change would reduce the pension contribution rate by about 2.5% (£451 pa). In addition it would reduce the pensions liabilities of the Church Commissioners by a capital value of around £180m. Other things being equal, this would enable the Commissioners to increase their annual distributions for non pensions purposes by about £4.4 m.**

60. **It would be for separate consideration how that additional money should be distributed. To the extent that some or all of it was allocated selectively to the least well-resourced dioceses it could help them meet the burden of additional pension contributions.**

61. There are two possible variants to this proposed new basis of uprating pensions in payment. We do not recommend either of them since one would defer the full saving for many years and the other would reduce the saving. The first would be to make this change only for pensions not yet started. Thus existing pensioners would continue to have their pensions uprated in relation to stipends. The second variant would be to maintain a policy of discretionary payments but link them to RPI, where this exceeded 2.5%, rather than to earnings.

62. Excluding pensions already started would eliminate any saving to the Church Commissioners and all but eliminate the immediate saving in the contribution rate. Moreover, we do not believe that there is any reason of principle for distinguishing between pensions already started and those that are not.

63. In relation to capping post-retirement pension increases at **2.5%** it is certainly the case that there can be no guarantee of the present period of very low inflation continuing indefinitely. But in the event that it were to increase or even return to the levels of earlier decades (though that is unlikely) the Government would almost certainly require pension schemes, including ours, once again to provide for a higher level of price inflation. And even if the Government didn't, it would be open to the Church, at that point and at a cost, to review its policy, whether by introducing additional discretionary payments or by increasing the level of guarantee. Attached as Annex C is a history of pension increases compared with RPI since the funded scheme was introduced in 1998.

64. **We also recommend that, for all future service, the accrual period for full pension should increase from 37 to 40 years .** An immediate change from 37 to 40 years would save around **2.2% (£397 pa) on the future service contribution rate.** The saving would be less initially if the change were to be phased in over a number of years. Again, the change would need to apply to all future service rather than merely to new scheme members, otherwise the cost benefit would be tiny for many years. We recommend a 12 month notice period between the decision to make the change and its implementation.

65. We recognise that this change would be unwelcome to many. Nevertheless, all service before the date of change would be “banked” at 37 years accrual. So the net effect for those close to retirement would be small. Some would, no doubt, be willing and able to work on a little closer to the compulsory retirement age of 70. There would, of course, be those who, as now, could still not achieve full pension before retirement age. But it would be possible to give the opportunity for additional voluntary contributions to increase the total pension payable. An illustration of how this change would affect clergy in various positions is attached as Annex D.

66. These two changes, taken together, would reduce the contribution rate by around **4.7% (£848 per scheme member per year in cash terms).** **On the basis of the projections provided by the Pensions Board’s actuaries and, if the Board reaches a judgement that it is justified to assume both some credit for equity outperformance and that the payback period for the deficit should remain at 15 years, this could result in a total contribution rate of around 39 % (around £7,043 pa in cash terms).** Like all figures at this stage these must of course be taken as provisional pending the results of the triennial review.

67. A more prudent approach on investment returns and the payback period would mean a higher rate and would take costs to a level that most dioceses would regard as unaffordable. Some may argue that, in that case, the benefits package should be further curtailed. We recommend against that. **The present pension scheme should not be subject to death by a thousand cuts.** In our view it should either be preserved broadly as it is, subject to the two changes we have recommended (plus possibly, at a later date, some increase in the pension age), or a much more radical approach should be adopted (see Options B and C). The way of providing some

further relief for responsible bodies would not be to make additional changes to the benefits but to bring the Church Commissioners into play.

Possible help from the Commissioners

68. We have identified two possible ways in which, in the context of Option A, the Church Commissioners could help, if the proposed benefit changes proved insufficient to deliver a contribution rate that dioceses regarded as acceptable. Both have advantages and downsides. The Board of Governors of the Church Commissioners has authorised detailed exploration of both of them, though without endorsing either at this stage. The Pensions Board has also had a preliminary discussion of both, without, in the absence of further work, coming to a firm conclusion. The two approaches are quite different from each other.

69. The **first** would build on the Regulator's approach to "contingent assets". This would involve the Church Commissioners agreeing to provide a guarantee to the funded scheme, up to a specified level. It would not necessarily involve, at the outset, any transfer of funds (though in the attached letter – Annex B - the Pensions Board's actuary mentions as one possibility the placing of some Commissioners' funds into an escrow account). What it would do would be to enable the Pensions Board to take a more even handed (less cautious) view of future investment returns and perhaps also of the deficit payback period.

70. As a result the Board would be able to submit to the Regulator a funding plan that included a lower contribution rate than would otherwise be the case. The Board would have the assurance that, if the investment returns in their funding plan didn't come through as expected and the responsible bodies in the last resort could not meet their obligations, the pension fund had an agreed level of Commissioners' resources to fall back on.

71. The main advantage of this approach is that it would leave underlying responsibilities where they currently belong and provide some flexibility as the impact of the new funding rules worked through. It would also avoid crystallising a problem at a time in investment markets that many believe is atypical.

72. The immaturity of the funded scheme (which in 2005 received around £55m per year and paid out only £8m) means that the Pensions Board may well be able to take a bolder view of some of the funding requirements than the Regulator would permit for more mature schemes. A guarantee from the Church Commissioners would reinforce this. If the Pensions Board maintains its current investment policy and equity investment returns achieve the levels expected (rather than those assumed for scheme funding purposes under the new regulations), the financial position of the fund will steadily improve and it should never be necessary to call in the guarantee.

73. The downside is that the Commissioners would no longer have unfettered control of all their assets. Even though the guarantee could be a floating one rather than tied to particular assets, there would be some impact on their asset allocation and, depending on how those assets are held, investment performance and therefore potentially on the amount of distribution to the Church although at present the extent of that impact is unclear. In addition, there is a question whether any form of guarantee would tend to blur the responsibilities of the dioceses, the Pensions Board

and the Commissioners. What is clear is that if the contingent asset were, at some point, transferred to the Funded scheme (in whole or in part) distributions from the Commissioners' fund would have to be reduced.

74. The third complication is being clear about what impact, in practice, a guarantee would have on the contribution rate. By its nature its effect would be indirect, since it would not immediately put any additional money into the funded scheme. What it would represent would be a strengthening of the Church's covenant with the scheme, thereby enabling the Pensions Board to be less demanding over the upfront funding required from dioceses. Before any decision could be taken on this option the Pensions Board and the Church Commissioners would need to be clearer over what the effect was likely to be and would need to test out that evaluation with the Pensions Regulator.

75. The **second** possible approach, which would also merit serious consideration if Commissioners' help were deemed to be required, would be more radical. It would involve the Commissioners taking over from the Pensions Board the liabilities and the assets of the funded scheme, including the deficit up to a certain date. In other words, instead of being responsible only for pensions earned up until the end of 1997, the Commissioners would be responsible for pensions earned up to a more recent date, say the end of 2006 or 2007.

76. The responsible bodies would continue to make contributions to the funded scheme but only in relation to future service. The contribution rate would not, therefore, have to include an element for paying off the present past service deficit. The Commissioners would, in effect, be covering the deficit between the liabilities of the scheme from 1998 to, say, 2006/7 and the assets that they would receive from the Pensions Board.

77. Since this deficit would be spread across the Commissioners' asset base and would not attract the new funding requirements, which the Regulator is required to oversee, the impact of the deficit would be much reduced. For example, a deficit of £125m as set out in the actuary's February report would probably reduce the Commissioners' non-pensions expenditure by only around £3m per year, though this would be a permanent reduction and would increase in line with average earnings. Where such a cut in distributions would fall would be a matter for discussion.

78. Moreover, if the change were accompanied by the proposed breaking of the link between post retirement pension increases and stipends (which reduces the Commissioners' pension liabilities by around £180m, or £4.4m per year in terms of their non-pensions distributions) there would be no net reduction in distributions at all. Overall the Commissioners would be able at least to maintain, or slightly increase, the current level of distributions they make to the Church.

79. This approach, however, also has its downsides. The decision reached by General Synod and Parliament in the 1990s was that the Commissioners should become in part a closed pension fund, with their pension liabilities being paid out over the coming decades. Parliament was prepared to let the Church Commissioners use some of their capital to meet this need, to avoid unacceptable financial consequences for the Church. To ask the General Synod and Parliament to give the Commissioners fresh, albeit still time-limited, pension liabilities would require careful justification.

There would certainly be those who would worry that it established a precedent for yet further Commissioners' involvement in a few years' time if this new package proved unsustainable.

80. A third complication is that this option would involve the transfer of funds from a regulated to an unregulated scheme. Consultations with lawyers, actuaries and the Pensions Regulator have not yet revealed this to be an insuperable obstacle. If the Pensions Board, the Commissioners, the General Synod and Parliament were all persuaded that, overall, this arrangement both satisfactorily preserved the rights of existing members of the scheme and was in the interests of clergy and the Church more generally, the different regulatory position of the two funds ought not to be an obstacle. It is, moreover, relevant that the Commissioners' fund currently provides more than double cover for its existing pension commitments.

81. What both options have in common is that they would require fresh primary legislation with the risks and uncertainties associated with having to seek Synodical and Parliamentary approval to the necessary measure. Our view, therefore, is that further contingency work should be done to work through the practicalities of both approaches, were one or other of them to prove a necessary ingredient for Option A to work. But the better outcome would be if the two proposed benefit changes and increased diocesan contributions proved sufficient to meet the need, leaving the Commissioners' present capacity to support the Church unaffected.

Assessing Option A.

82. We recommend Option A. Taken together, the package would, in our judgement, be likely to preserve the defined benefits scheme for the foreseeable future without the need for radical change. The fact that the Pensions Board was now having to take a more cautious approach in setting the contribution rate would also reduce the risk of future shocks.

83. If the contribution rate can be kept within acceptable limits without having to seek new powers for the Commissioners to give guarantees or assume the past service deficit, that would be the best outcome. Nevertheless, the contingency work needs to be done now on the two possibilities identified in case one or other proves to be required as part of the package.

84. Others may, however, take a different view from us of the risks and pain involved in Option A. In that case more radical options will be needed. We turn now to Options B and C.

Option B

85. The radical approach adopted by many other organisations has been to close their defined benefit schemes. In principle there are two reasons why organisations choose to offer the alternative of a **defined contribution scheme** ('DC' or 'money purchase' schemes as they are sometimes called).

86. One is from a conviction that offering defined contribution schemes provides the member with more flexibility, particularly as, in the course of a working life, they are now likely to move between employers more frequently than was once the case.

87. The second reason is to gain more control and predictability for the employer over costs and avoid much of the complexity and regulatory burden of providing defined benefit schemes. This second reason has been by far the more powerful driver in the substantial shift from defined benefit to defined contribution schemes over recent years.

88. Many companies that have switched to defined contribution schemes have sought to extract a double advantage. By their nature, defined contribution arrangements mean that the employer's costs are capped. It is the contributions that are guaranteed. The benefits depend on investment returns over the period for which the contributions are made and annuity rates at the point of retirement. But there has been a second gain for many employers as a result of setting their contribution rates much lower than they were previously paying for defined benefit schemes.

89. The recent Government White Paper quotes a 2004 survey that revealed that the average employer contribution to defined benefit (DB) schemes was 19% (n.b. the 33.8% for the clergy is really just over 17% when applied to the total value of the remuneration package) whereas the average employer contribution to DC schemes was 9%.

90. This raises an important point about the current perception of DC schemes. They are widely seen as less generous than DB schemes. But this is largely because contribution rates have been so relatively low. As the Government White Paper says "DB schemes are not necessarily better than DC schemes." Provided contributions are at a high enough level and provided the investments are well managed, DC schemes can provide very good pensions.

91. They do, however, suffer the disadvantage that the funds generally have to be used to buy an annuity at retirement and there is the additional uncertainty of market conditions at the time. As a result, a DC scheme is generally somewhat more expensive than a DB scheme that provides the same benefits.

92. The rate payable into a DC scheme could be set with the aim of producing a pension comparable to that available from the current scheme using even-handed estimates about future investment returns. **What DC schemes cannot by definition do is provide the same level of security to the member as DB schemes. At the heart of the move from DB to DC is the transfer of risk from the funder to the beneficiary.** In the case of the Church what this would mean is the transfer of risk from the dioceses and others who are responsible for the funding to the clergy themselves.

93. All previous consultations have revealed that this is a shift the clergy themselves would view with some trepidation. Moreover, given the lifelong vocation involved in a call to the ordained stipendiary ministry, the added flexibility of DC schemes for those who move between employers would not be so relevant.

94. We share these reservations about moving to DC arrangements for the clergy. Unlike employees more generally (including lay employees of the Church), stipendiary clergy do not receive salaries, nor are they generally free to buy and live in their own properties. They receive a stipend and housing that, together, are designed to liberate them for ministry in a particular location.

95. On retirement they currently receive, after 37 years' service (we suggest this should be raised to 40), a lump sum of around £36,000 and an annual pension of around £12,000 in addition to the state pension. They are responsible for housing themselves, although discretionary help is provided for those who cannot afford to do so (around a third of all retired clergy have accessed either the rental or equity share sections of the Church's Housing Assistance for Retired Ministry - CHARM – scheme although demand for assistance has reduced slightly in recent years).

96. To remove the guarantee from the pension would be a significant step that would need to be weighed very carefully in relation to clergy morale. Nevertheless, the fact is that, outside the public sector, DB schemes are disappearing. There is a potential awkwardness if clergy come to be seen as insulated from the pension uncertainties that apply to most parishioners. Like private companies and other parts of the voluntary sector we do not have access to taxpayers' funding. Indeed, it has already been decided that new salaried staff joining the National Church Institutions after 1 July 2006 should be admitted to a DC scheme.

97. So we have tried to think through what would need to be done if the majority opinion in the Church were that the costs and risks to funders of maintaining the present clergy scheme were now becoming prohibitive. If so, what are the issues that would arise and how would the transition be made?

98. One possible approach would be to place all new clergy onto the new DC scheme but allow existing clergy to continue to serve out their time as members of the old scheme. This is what many companies have done. Where staff turnover is reasonably high it can mean that the employer secures some financial relief within a relatively short period. But turnover amongst stipendiary clergy is relatively low, at under 3% per year. This compares, for example, with staff turnover of 10 - 15% pa in secular employment.

99. What that means is that the financial relief would be a very long time coming if the change were confined to new ordinands. Moreover contribution rates for schemes that are closed to new members are higher than those for open schemes because the membership gets steadily older and a more cautious investment policy is required as the liabilities mature.

100. In our view, therefore, **if the Church were to pursue Option B, it would need to consider very seriously the case for moving all future service onto a defined contribution basis, including the future service of existing clergy.** A number of companies have adopted this approach. **It seems to us that such a radical move would need to be accompanied by four things.**

101. **First, the Church would need to commit itself to an adequate level of contributions.** The intention would be that, using reasonable (best estimate) assumptions about the future, the clergy could expect a reasonable level of pension even if they chose not to make additional contributions of their own. Using even-handed assumptions, the Pensions Board's actuaries have estimated that a contribution rate of 43% (£7,765 p.a.) would have a 50:50 chance of producing pension benefits comparable to those available via the current scheme. Their letter is setting out their assumptions is attached as Annex E.

102. Contributions at these levels would be far higher than those for DC schemes elsewhere. Before settling the figure the Church would, however, have to assess carefully what continuing payments were going to be needed, for a significant period, to honour the entitlements under the DB scheme up to the date of the changeover which are protected by law.

103. This brings us to the second point. **The Church would be confronted with the choice between either paying high contribution rates to the new scheme, while continuing to make contributions for perhaps a decade or more to clear the deficit on the DB scheme, or setting lower contribution rates for the new scheme in order to contain overall pension costs.**

104. The downsides of the latter are obvious. The difficulty with the former is affordability since much of the very increase in overall pension costs that Option B would be designed to avoid would probably still have to be met for the foreseeable future. A solution would be for the Church Commissioners (see paras 75-80) to be given power by legislation to take over the assets and liabilities of the (defined benefits) funded scheme, leaving the Pensions Board to operate the new DC scheme without the overhang of any deficit from the previous DB scheme.

105. One point to remind ourselves of if this approach were to be pursued is that the additional liabilities accepted by the Commissioners would probably reduce their ability to distribute for non pensions expenditure by around £3m per year. One way of mitigating this would be if, in addition to pursuing Option B, it were decided to break the link with stipends for post retirement increases due under the closed Commissioners' scheme (see para 59 above).

106. **Thirdly, careful work would be needed on the design of the scheme.** One important issue would be whether to make it purely DC or to make it a hybrid between DB and DC. The advantage of the latter is that it guarantees certain benefits but makes others subject to the success of the investments. It does, however, somewhat erode the advantage to funders in that they do not secure a guaranteed cap to their costs.

107. **Fourthly, it seems to us that a change as radical as closing the present defined benefit scheme for clergy would probably need to be accompanied by a wider look at future remuneration and housing arrangements.** Such a significant transfer of risk to a group of people who do not receive normal salaries and are not able generally to get on the housing ladder (except perhaps where they have the income of a working spouse or have benefited from a legacy) would raise some important questions about the underlying "deal" between the Church and its stipendiary clergy.

108. There would certainly be those who argue that, if clergy had to bear this level of risk, they should be given more scope and freedom to manage their own affairs, perhaps through receiving a salary, from which they could decide how much to contribute to their pension.

109. **It is important to be clear that there are no simple solutions here that would not either cost more money or change some fundamental features in our**

present ministry arrangements and the remuneration arrangements which support them.

110. In theory the one substantial source of capital that the Church could access would be if it decided to move away from the provision of parsonage housing and over time sell off the existing stock. A historic and radical move of that kind would, however, inevitably require a wide measure of consensus across the Church and we are very doubtful ourselves whether such a consensus would be forthcoming.

111. Parsonages continue to play an indispensable role in enabling the Church to sustain its ministry in every community in the land. There are many parts of the country where property prices would deter or effectively prevent clergy from serving if they were required to pay their own way, even if they had been moved to a more normal salary arrangement. There is a separate question over housing for clergy in retirement that we explore in more detail in paras 125-131.

112. Option B would mean that, after a transitional period, the Church was no longer at the mercy of fluctuating contribution rates. Costs would be predictable and under control. It is the approach adopted now by many organisations outside the public sector. Nevertheless as it will be apparent from the foregoing we have a number of reservations about Option B. There would be some substantial issues to address, including about possible assistance from the Church Commissioners and about the future of the remuneration package more generally. If a decision in principle were taken to go for Option B, there would have to be a good deal of further detailed planning before the new arrangements could come into operation.

Option C

113. Like Option B, option C would be radical but, like Option A, it would maintain the defined benefits arrangement. It would seek to entrench the defined benefits scheme by bringing the strength of the Church Commissioners' asset base into play as, in effect, its permanent guarantor.

114. The rationale for such a move would be that the Church attached such a high priority to the maintenance of a defined benefits scheme for the clergy that it was prepared, with Parliament's agreement, to make it for all time the first call on the Commissioners' resources. This would mean reversing the decision reached in the 1990s to phase out the Commissioners' pension liabilities over the coming decades. Instead the Commissioners would once again be given the ongoing responsibility for all clergy pensions albeit with external funding for future benefit accrual.

115. It is important to underline that this would not be a return to the "bad old days" when the Commissioners operated an **unfunded** non-contributory pension scheme out of their general funds. It became clear in the early 1990s that that was unsustainable and, despite the Commissioners' excellent investment record over the past decade, it would be unthinkable to attempt to return to such a situation (not least because it would involve a very large and immediate cut in the Commissioners' non-pensions distributions).

116. **An essential ingredient in Option C would be that the contributions that responsible bodies had made to the funded scheme since 1998 would transfer from the Pensions Board's funded scheme to the Commissioners' fund. In addition future contributions would be made to the Commissioners' fund, rather than a scheme run by the Board, to cover the full cost of the benefits promised by the scheme. The size of these contributions would need to be reassessed on a regular basis in the light of actuarial advice in the normal way.** But the contributions would cover the cost of the current year's service only. Once paid, they would not have to be topped up to make good any deficit (nor would there be any reduction of contributions if there was a surplus).

117. A key aim of Option C would be to reduce the volatility in contribution rates because surpluses and deficits would be corrected over a far longer timescale than is possible in the separate funded scheme. The correction would be achieved via the Commissioners' non-pensions distributions. The opportunity to do this is unique to the Church and only exists because the Church has the benefit of the separate Commissioners' fund.

118. The prospect of removing much of the present volatility in contribution rates has obvious appeal. Moreover, it is possible (though much would turn on the effect of any regulatory requirements) that the contribution rate for the next decade or more could be significantly lower than would otherwise be the case, primarily because it would not have to include an element for the past service deficit. **Why then have we recommended Option A rather than Option C?**

119. In the first place, **there are a number of important risks and uncertainties that we have not been able fully to assess in the time available.** Legislation would, of course, be required to give the Commissioners power to take on these substantial additional responsibilities. Both the existing scheme trustees and Parliament would, no doubt, want to be satisfied that the new arrangements provided sufficient safeguards for pensions scheme members. Since the normal way now of providing such safeguards is through oversight by the Pensions Regulator there is a real possibility that the Commissioners would have to become subject to its oversight.

120. If so, it would be essential that the Commissioners were not required to divide their fund in two, between a pensions and a non pensions part or follow the more prudent approach required by the new scheme funding regulations. That would cost the Church an unacceptably large amount of money and negate the benefits of adopting this course. Assuming the fund could be kept intact there would still be the question of how any oversight would work in practice and in particular what the cost would be of the regulatory consequences that would follow.

121. We intend to do further work over the coming months with others, including lawyers, actuaries and the Regulator to assess these risks further. Option C would only be a serious possibility if the assessment were positive. If this were to prove positive there would still be a number of other issues that the Church would need to weigh before committing itself to option C.

122. These include whether the Church was content for the Commissioners' enhanced pension commitments to have first charge on their funds, with other

financial needs, including supporting the less well resourced dioceses, having a lower priority; whether the necessary changes in the Commissioners' purposes and ethos and possible consequential adjustments to their governance were acceptable; and whether the overall impact on the financial ecology of the Church, including sustaining and enhancing current giving levels was likely to be positive.

123. The Board of Governors of the Church Commissioners have signalled their willingness for us to expose this option, in a preliminary way, though on the clear understanding that they themselves had reached no view on the merits of such a radical change and would need time to clarify and weigh the attendant risks very carefully if the option were regarded by others as a serious possibility. This option has not yet been considered by the Pensions Board.

124. As will be apparent, **our own instinct at this stage is to approach Option C with some caution.** It raises some deep questions about what the Church Commissioners and their historic assets are for, questions in which Parliament as well as the General Synod would have a legitimate interest. We intend to explore the potential regulatory issues further, but at this stage believe that Option A offers a more promising way forward.

Retirement housing

125. The issue of retirement housing has been raised regularly during the discussions that have taken place so far and it is clear that this is regarded as an essential ingredient in any retirement package. As indicated in paragraph 95 above, around one third of all retired clergy have received housing assistance via the Pensions Board's CHARM scheme.

126. The 'rental' section of the scheme is currently subsidised to the tune of £3m pa principally because the occupation charge which residents are required to pay is limited to 30% of their gross income (25% for cases prior to 2003). Before 2005 this subsidy was met by the Church Commissioners. It was agreed that from 2005 it should become a charge on the dioceses through Vote 5 of the Archbishops' Council's budget in order to release additional parish ministry support for the least resourced dioceses.

127. Most of the capital for the CHARM scheme is provided by the Church Commissioners in the form of a commercial loan facility to the Pensions Board. Money is lent to borrowers under the equity sharing mortgage section of the scheme on identical terms. The current borrowing limit is £125,000 per property.

128. Whilst the limit presents less of a problem on the mortgage section, where borrowers put in their own funds to boost the total purchase funds available, it does place a restriction on the Board in relation to the properties it buys to provide accommodation under the 'rental' section of the scheme. As house prices have risen, the standard of housing available under the scheme has inevitably declined, as has the number of areas where property can be acquired.

129. Raising the borrowing limit would obviously help improve the situation in one respect but, if occupation charges continue to be capped on the basis of income, the cost of the additional loan interest will feed straight through to the scheme subsidy

and the amount which will need to be raised via Vote 5. The Church Commissioners will also need to be concerned from an investment risk perspective about the proportion of their assets tied up indirectly in residential property.

130. Following calls in *Generosity & Sacrifice* for exploration of ways in which clergy might be helped to acquire property earlier in their ministries, the Archbishops' Council and the Pensions Board collaborated to produce a handbook of sources of assistance. This included details of buy-to-let mortgage products available from three lenders who, following negotiations, were prepared to offer preferential terms to clergy. It is too soon to tell what take-up will be under these schemes but they should enable more clergy to acquire a foothold in property and in the long term reduce the number that need assistance via CHARM.

131. It might be possible to do more work to explore other investment options so that clergy can make earlier provision for their retirement property needs (some kind of property bond has been one such suggestion). **It needs to be recognised however that this would inevitably involve additional expenditure for the Church.** There is no obvious source of spare cash to finance this.

Conclusion

132. **Our recommended approach, option A,** will not be easy to deliver, It will certainly involve some increased financial burden for dioceses and some reduction in benefits for clergy. If exceptional help were needed from the Church Commissioners, whether by contingent guarantee or transfer from the Board of some assets and liabilities, primary legislation would also be required.

133. Nevertheless, **we think it gets the overall priorities right, should be deliverable and provides a good chance of sustaining the present scheme for the foreseeable future. It also has the advantage that it avoids any irrevocable step at this point.**

134. We have attempted to set out the arguments as clearly as we can. It must now be for the wider Church, including, crucially, those responsible for funding pensions, to judge whether the proposed risks inherent in Option A are acceptable and, in particular, whether the implied levels of funding and risks of future changes are tolerable. If not, the Church will need to make a choice: should the clergy come more into line with current practice elsewhere outside the public sector and have a defined contributions scheme, as per option B? Or is maintaining the defined benefits scheme so important that provided the regulatory issues could be satisfactorily solved, the Church would, want to go down the radical route of Option C (with or without any accompanying modifications to the benefits payable)?

135. **In the case of Option A it ought to be possible to make the necessary changes in the course of 2007 (though if legislation were needed to give the Church Commissioners additional powers that could probably not be enacted until 2008).** If Option A is rejected, Options B and C would need to be further explored. The necessary preparatory work would inevitably take longer. The implications of this lead-time for the Pensions Board's approach to the actuarial valuation would need to be further considered. As a matter of law, the Pensions

Board has no option but to set a fresh contribution rate within 15 months of the triennial valuation in December 2006 (i.e. by 31 March 2008).

Next steps

136. This report is being widely distributed within the Church and comments are invited by no later than 10 November 2006. The Archbishops' Task Group will continue to co-ordinate the exercise. Submissions should be sent to pensionstaskgroup@c-of-e.org.uk.

137. We would ask those responding to answer the following questions:

- (1) Do you agree that the policy of simply relying on the dioceses and other funding bodies to meet whatever increase in the contribution rate is required to sustain present arrangements unchanged will not be sustainable from 2008?**
- (2) If you answered Yes to (1), do you agree that Option A should be pursued?**
- (3) If you answered Yes to (2), are there any particular points you want to register in relation to the individual elements of Option A?**
- (4) If you answered Yes to (1) but do not favour Option A, or if the wider Church were to reject Option A, what views do you want to register at this stage on Options B and C?**

138. There are many other questions of detail that arise (including whether the scheme should continue to be contracted out of the Second State Pension). But, at this stage, we have sought to keep the questions simple and at a high level. Question 3 and 4 provides an opportunity for respondents to go into as much detail as they would wish.

139. To prevent a long document becoming even longer we have also refrained from saying anything here about deployment issues and the Church's vision for the future of its stipendiary ministry more generally. We welcome the fact that the bishops meeting devoted time to considering these issues on 7 June. Further work is being undertaken in this area by the Ministry Division.

140. We have also refrained from re-opening at this point the whole issue of clergy remuneration that was comprehensively addressed in the **Generosity & Sacrifice** report. **We do suggest, however, that at the present stage it makes little sense for the Church to make any concerted effort to start implementing stipend aspiration 3 (a stipend of £20,000 pa at 2001 prices).** Most dioceses had in fact already ruled this out on the grounds of affordability before the latest pension developments took place. The Church will need to return to its longer term approach to stipend policy once the decisions needed now in relation to pensions have been taken.

141. While this report is out for consultation we shall, on a contingency basis, continue to do work, in consultation with actuaries, lawyers and the Pensions

Regulator, on how the various possibilities canvassed in this report might be implemented. If it is achievable we would hope that the General Synod might, at the end of February, have a debate to determine the broad direction of travel, so that it can then take more detailed decisions next July.

Allan Bridgewater
Michael Chamberlain
Andreas Whittam Smith

30 June 2006.

FUNDED CLERGY PENSION SCHEME

Current Benefit Structure as at 1 April 2006

Full service pension = 2/3rd National Minimum Stipend in previous year
(37 years service) = £12,389

Full service lump sum = 3 x pension
= £37,167

Widow(er)s pension = 2/3rd of member's pension
= £8,259

Pension contribution rate

Future service	29.3%
Past service deficit	<u>4.5%</u>
	33.8%

Annex C

ANNUAL PENSION INCREASES COMPARED WITH RPI

Year	Pension Increase* %	RPI
1998	3.8	3.6
1999	4.2	3.2
2000	4.2	1.1
2001	4.2	3.3
2002	3.0	1.7
2003	3.0	1.7
2004	3.0	2.8
2005	3.1	3.1
2006	2.9	2.7
Average	3.48	2.57

*Pensions currently increase in line with increase in National Minimum Stipend in previous calendar year.

PROPOSAL – INCREASE FULL PENSION ACCRUAL PERIOD FROM
37 TO 40 YEARS

Illustrations

Clergy person A

Prospective service to age 65 = 37 years

Service up to date of change = 30 years

Service after date of change = 7 years

Pension @ 65 = 30 x 2.703% = 81.09%
 7 x 2.5% = 17.50%
 98.59%

Extra years needed to achieve full pension = 7 months

Clergy person B

Prospective service to age 65 = 37 years

Service up to date of change = 20 years

Service after date of change = 17 years

Pension @ 65 = 20 x 2.703% = 54.06%
 17 x 2.5% = 42.50%
 96.56%

Extra years needed to achieve full pension = 1 year 5 months

Clergy person C

Prospective service to age 65 = 37 years

Service up to date of change = 10 years

Service after date of change = 27 years

Pension @ 65 = 10 x 2.703% = 27.03%

$$27 \times 2.5\% = \frac{67.50\%}{94.53\%}$$

Extra years needed to achieve full pension = 2 years 3 months