SCOTTISH EPISCOPAL CHURCH PENSION FUND

2013 Consultation with Serving and Prospective Members

Foreword

This consultation document represents a further step in a staged process undertaken within the Scottish Episcopal Church over the last 18 months. It follows upon the results of the triennial valuation of the Scottish Episcopal Church Pension Fund as at 31 December 2011, debate at General Synod 2012, a consultation in the autumn of 2012 with serving members of the Pension Fund and church ‘employers’ such as vestries and dioceses, and further discussion at General Synod 2013 in the light of that consultation.

General Synod 2013 agreed that, subject to this current consultation, alterations should be made to the Pension Fund rules which will affect the age at which pension can be drawn and the level of pensionable stipend/salary on which pension is based. These alterations are considered to be a necessary means to reducing the overall cost of providing future benefits under the Pension Scheme. They stem from the desire of the provincial Standing Committee to provide fair and proper pension for clergy and staff on retirement by maintaining defined benefit (final salary) provision, provided such provision can be afforded and sustained into the future.

The detail of the proposed changes on which members and prospective members of the Scheme are being consulted is set out in the pages which follow. **The consultation formally commences on 26 August 2013. The closing date for responses to this consultation is 31 October 2013. Information about how to respond is set out in section 7 below.** Following the end of the consultation, the provincial Standing Committee will consider the responses and make a final decision which will be notified thereafter to members and prospective members.

I commend the proposals contained in this document.

David Palmer
Convener, Standing Committee
August 2013

1. Introduction

1.1 General Synod 2012 received a report on the triennial valuation of the Scottish Episcopal Church Pension Fund (referred to in this document as ‘the Pension Fund’, ‘the Fund’ or ‘the Scheme’) as at 31st December 2011. That report outlined the increased cost of providing future benefits under the Scheme in its present structure. General Synod 2012 asked the provincial Standing Committee to undertake a consultation on the affordability of current benefit provision and on possible changes to the Scheme.

1.2 In October 2012, a Consultation Paper (referred to in this document as ‘the 2012 Consultation Paper’) was issued on behalf of Standing Committee. The 2012 Consultation Paper emphasised Standing Committee’s desire and commitment to provide fair and proper pension provision for clergy and staff in retirement and its intention to maintain defined benefit (final salary) pension provision, provided that such provision could be afforded and sustained into the future. It made clear that, unless the Church were in a position to make greater contributions to the Fund in future, some changes to the benefit structure would be needed. The 2012 Consultation Paper consulted on a number of possible changes to the benefit structure.

1.3 The 2012 Consultation Paper was sent to stipendiary clergy and salaried staff as serving members of the Scheme as well as to diocesan and vestry secretaries as ‘employers’. A copy of that 2012 Consultation Paper is available at:-

http://www.vestryresources.scotland.anglican.org/wp-content/uploads/Pensions-Consultation-2012.pdf

It sets out much of the factual background to the issues in question.

1.4 A report on the consultation was provided to General Synod 2013. A copy of that report is available at:-

http://www.vestryresources.scotland.anglican.org/wp-content/uploads/Pensions-Consultation-Report-to-General-Synod-2013.pdf

Synod agreed the proposals contained in the report that certain alterations needed to be made to the rules of the Pension Fund with effect from 1 January 2014, subject to statutory consultation with members. This document undertakes that statutory consultation.

1.5 By way of explanation, the contribution rate payable in respect of the Scheme is based on a percentage (currently 34.9%) of stipend/salary. The rest of this document for convenience refers simply to stipend but for staff members of the Scheme since the contribution rate is in fact based on salary reference to 'stipend' should be read accordingly.

2 Proposed Changes to the Pension Fund Rules

2.1 General Synod 2013 agreed, subject to this current consultation, the following changes to the Pension Fund rules with effect from 1 January 2014: –

- **That normal retirement age in relation to future pensionable service should be 67**
- **That, in relation to future pensionable service, increases in future pensionable stipend/salary should be determined by the provincial Standing Committee subject in all cases to a maximum of not more than the increase in the Retail Prices Index.**

3 Reasons for the Proposed Changes

3.1 Key features of the most recent triennial valuation of the Pension Fund (undertaken as at 31st December 2011) were that the deficit in the Fund in relation to past liabilities had been reduced to £3m, as compared with a deficit of £8.8m at the end of 2008, but that the cost of providing future benefits for members had increased materially from 26% of stipend in 2008 to 32.2% at the end of 2011. Given that there had been a reduction in the deficit it was possible to retain the total overall contribution rate of 34.9% of stipend. However, the change in composition of this overall contribution rate was significant:

	2008 valuation	**2011 valuation**
Future benefit accrual	26.0%	32.2%
Deficit contribution	8.9%	2.7%
Total contribution	**34.9%**	**34.9%**

More background information regarding this is set out in Appendix A to this document.

3.2 Two particular issues bear on this situation:-

3.2.1 Given the inherent uncertainties in forecasting future costs, the 2.7% margin currently being used for deficit funding leaves very little room for manoeuvre if conditions deteriorate.

3.2.2 The ability of the Church to fund contributions is not limitless and the 2012 Consultation confirmed that most church 'employers' considered that an overall contribution rate of 35% was the maximum level which congregations could reasonably afford.

3.3 Advice from the pensions advisers to the Church is to the effect that, given a range of potential funding scenarios for the future, it would be appropriate to seek to ensure a 'cushion' equivalent to 7% of stipend between the cost of contribution needed to fund future service and the perceived maximum level of contribution affordable by the Church.

3.4 In essence, in the light both of the increased cost of providing future benefits and of the ability of the Church to fund such benefits, General Synod 2013 supported the need to take measures to reduce some of the cost of future benefits (accrued benefits would be unaffected). That in turn implies a reduction in some of those future benefits themselves. The changes now being proposed received the broad support of the members and church 'employers' who responded to the 2012 Consultation.

4. Normal Retirement Age

4.1 It is proposed to alter normal retirement age for pension purposes from 65 to 67. The concept of 'normal retirement age' for pension fund purposes needs to be distinguished from actual retirement age and indeed canonical retirement age. At present, the Canons of the Church provide that, subject to some provision for extension, stipendiary office will not normally be held after the age of 70. The 'normal retirement age' for pension purposes is 65. In other words, pension can be drawn from age 65 without reduction (early retirement prior to age 65 entails actuarial reduction of the pension receivable).

4.2 Extending normal retirement age for pension purposes from 65 to 67 reduces the contribution rate payable because pension would not become payable until later.

4.3 It is important to emphasise that any change to normal retirement age for pension purposes will have effect only in relation to pension accrued from the date that a change in normal retirement age is made (proposed as

1 January 2014). A move of the normal retirement age for pension purposes to 67 would mean that existing clergy would still be able to retire at 65 and take, without actuarial reduction, the pension that they had earned before 1 January 2014 but all service earned after that date would assume a pension age of 67. Consequently, if a member of the Scheme decided to retire before 67 there would be some reduction for early payment in respect of the period of service from 1 January 2014 onwards. The immediate impact on clergy who have already earned most of their pension would be small. The impact would steadily grow over time.

4.4 Consideration of retirement age needs to be seen also in the wider context of state pension provision. The already agreed increase in state pension age to 68 for both younger men and women is likely to result in an increasing trend towards later retirement ages.

5. Future Pensionable Stipend

5.1 The amount of pension paid under the Scheme is linked to the level of standard stipend. The proposed alteration will for the future create a notional ‘pensionable stipend’ to be used to calculate the actual pension payable. At present, that ‘pensionable stipend’ is in fact ‘standard stipend’ (as agreed annually by the Church). Current policy is that standard stipend is tied to the Church of England national stipend benchmark. Current assumptions for pension purposes are that stipend will grow at the rate of Retail Price inflation plus 1% per annum. A saving of approximately 3% in the contribution rate would be achieved if future changes in pensionable stipend are limited to just Retail Price inflation.

5.2 It is important to emphasise that alteration to future pensionable stipend referred to above would not affect the actual amount of stipend paid; nor would it limit the factor by which standard stipend might in fact change each year. It would, however, mean that the stipend upon which pension is payable would be a notional pensionable stipend and not actual standard stipend. Accordingly, if actual stipend increases at a rate in excess of the growth rate applicable to pensionable stipend, the level of pension which would be paid on the basis of that notional pensionable stipend would be less than the amount of pension currently payable on the basis of standard stipend. An illustration is included in Appendix B but it should be emphasised that it is difficult to assess the effect of such a possible change because it requires assumptions to be made regarding both future stipend growth and rates of inflation, potentially over a very long period into the future. Slight changes in assumptions can, therefore, produce very different outcomes.

5.3 The precise figure of pensionable stipend would be agreed annually, by the provincial Standing Committee on behalf of the Church. Similar principles would apply to salaried staff members and their respective employers (eg Dioceses) would be required to provide information annually about staff salary increases in order to enable Standing Committee to agree the figures for pensionable salary.

6. Overall Effect of the Proposed Changes

6.1 This paper consults on the proposed combination of moving to a normal retirement age of 67 and limiting future pensionable stipend growth to no more than the Retail Prices Index. This combination of options appeared to be the most favourable in the light of the 2012 Consultation. **It is important to emphasise that it is the combination of both changes which is needed to achieve the desired reduction in the cost of future accrual. Neither change on its own produces a sufficient saving.**

6.2 An upwards adjustment to pensionable retirement age is similar to the kind of changes being experienced by the population at large in relation to state retirement age. Also, while accepting that average stipend increases over the years have generally exceeded the rate of inflation, the experience of the last five years has been different, with stipend increases being at less than the rate of Retail Price inflation. Some illustrations are set out in Appendix B. It is recognised, however, that this combination carries a degree of uncertainty because of the difficulty in being able to determine the likely pattern of stipend increases for the future in relation to inflation. If stipend increased at a rate the same as, or less than, the rate of Retail Prices, then there would be no differential between actual stipend and pensionable stipend. Consequently, provided stipends increased only at that level, the level of pension ultimately receivable would not be reduced (as compared with pension receivable on the current basis) by this factor in the combination. It would, of course, be affected if stipend increased at a rate greater than Retail Price inflation. Other options, previously considered in the 2012 Consultation, such as a reduction in the accrual rate (which would necessarily have resulted in a reduction in the pension ultimately receivable (as compared with pension receivable on the current basis)), have not been pursued further.

6.3 It should be emphasised that the changes consulted on in this document would apply only to pensionable service after 1 January 2014. Benefits earned in relation to pensionable service up to the point of change would remain intact. It is also the case that these changes would not affect pensions in payment or the rates by which such pensions would increase. The changes could, however, potentially affect the amount of pension that existing clergy would receive in retirement depending on when the individual concerned takes retirement and other factors explained in this document.

7. Responding to the Consultation

7.1 This document is being sent to all active members of the Scheme (ie stipendiary clergy and church staff who are members of the Scheme) and to those who are prospective members because they are due to take up stipendiary/salaried appointments in the Church.

If you wish to make a response to this consultation please provide your name and address when doing so since only comments from members or prospective members can be considered.

7.2 Responses to this consultation are invited by not later than 31 October 2013. Responses may be submitted by email to PensionsConsultation@scotland.anglican.org or by post to:-

The Secretary General
General Synod Office
21 Grosvenor Crescent
Edinburgh
EH12 5EE

8. Future Process

8.1 Following the response date of 31 October 2013, the responses will be considered and the provincial Standing Committee will make a final decision on the adoption of the changes. It is expected that members will be notified of the decision around the middle of November 2013, with any changes actually taking effect from 1 January 2014.

Please note that in the light of the above timetable, it is expected that the sending of annual benefit statements to members (which normally takes place in September/October each year) will be deferred until after a final decision has been taken on the benefit changes.

9. Conclusion

9.1 Whilst the Standing Committee would in an ideal world prefer to be able maintain benefits at their current level, heed must be taken of the financial realities. Standing Committee believes that the changes proposed in this document are essential in order to meet the aspiration to maintain defined benefit pension provision in a manner that is capable of being afforded by the Church and of being sustained into the future.

The Standing Committee expresses its thanks, in advance, to all those able to consider this document and make a response.

David Palmer
Convener, Standing Committee

August 2013

APPENDIX A

Background and Further Information regarding the Scottish Episcopal Church Pension Fund

History

The Pension Fund is an amalgamation of all the previous pension arrangements in the Scottish Episcopal Church. The Aged and Infirm Clergy Fund, Scottish Episcopal Church Widows and Orphans Fund (SECWOF) and Cash Retirement Benefit Fund (CRBF), and part of the Widows' and Orphans Supplementary Fund (WOSF) were amalgamated to form the Scottish Episcopal Church Pension Fund in January 1988. The new scheme provided improved future pension benefits for clergy and upgraded all past service (both serving and deferred) in line with the new benefit structure.

Benefit Structure

The basic benefit structure of the Scottish Episcopal Church Pension Fund is:

- Accrual rate of 1/80th pensionable stipend for each year of service subject to a maximum of 42 years
- The Scheme is contracted in to the State Second Pension (formerly known as SERPS): Members accrue additional State Pension related to earnings from part of their National Insurance contributions (unless individually opted out)
- Death in service benefit of three times stipend (increased from twice stipend in 2000)
- Two thirds widowed spouses'/civil partners' pensions (increased from one half in 2000)
- Statutory increases to deferred pensions prior to retirement
- Normal retirement age 65
- Guaranteed increases to pensions in payment
- Staff members were admitted on same terms from 1993-4 when the existing staff pension scheme with Clerical Medical was wound up.

At inception the Scheme was designed to provide a combined benefit of Scottish Episcopal Church Pension, State Pension and SERPS equivalent to stipend after service of 40 years.

Recent Valuations

The initial contribution rate in 1988 was 9% of stipend, but this rose to 11% in 1992 (1990 valuation results), then 13% in 1995 (1993 valuation), and 14% for clergy and 15.8% for staff members in 1998 (1996 valuation), but reduced to 12% for all members from 1 January 2001 following the 1999 valuation.

The 1999 valuation recorded a healthy surplus of £6.3m. Good investment returns and other factors had outweighed the negative impact of benefit improvements, tax changes, and revised assumptions. Mortality assumptions had been changed in recognition of the trend towards greater longevity and investment return assumptions were more cautious than in previous valuations. Although the underlying rate for future service was 22.8%, the funding position was so strong that a contribution holiday would have been possible at this time, but a modest reduction in the rate was approved. Legislation required pension schemes to maintain a minimum level of funding, but did not permit overfunding.

The Clergy Personnel Commission had recommended changes to benefits for widows and in 2000 the widowed spouse's pension increased to 2/3rds, and the death in service lump sum to three times salary or stipend. The cost implications of these changes were considered reasonable and factored into the 1999 valuation assumptions.

By 2002 the position had deteriorated and the valuation showed a deficit of £1.2m. Poor investment returns had resulted in a past service deficit, and the full future service contribution rate of 22.2% therefore had to be met from contributions. The contribution rate including contribution adjustment to make good the deficit was 25.3% for the period 2004-2017 (this predated the legislation on Recovery Plans). The funding position improved by 2005 to a modest surplus of around £400K, but with the ongoing contribution rate of 25.4% the overall contribution rate was unchanged.

The 2008 valuation showed a material deterioration in the position of the Fund in relation to past service with the result that there was a shortfall of £8.8million. That deficit arose almost exclusively as a result of falls in the Fund asset values – in common with the experience of many pension funds at the time. The cost of future benefit accrual was calculated at 26% of stipend. A Recovery Plan, designed to pay off the deficit over a 15 year period, was put in place with the approval of General Synod and comprised a new contribution rate from the beginning of 2009 of 34.9% of stipend (26% for future service and 8.9% towards the deficit) and a cash injection from the General Synod of £2 million.

2011 Valuation

The background for the 2011 valuation was the 15 year Recovery Plan referred to above.

The injection of the £2m lump sum from General Synod funds in February 2010 and higher than expected investment returns had resulted in a reduction in the deficit from £8.8m to £3m as at the end of 2011. However, the future service contribution rate had risen from 26% to 32.2%, mainly as a consequence of historically low gilt yields. Gilt yields are used in the actuarial valuation process to estimate the value of the liabilities. Gilt yield is the annual return on the market price of a Government Bond. In the current financial climate investors have been favouring traditionally safe investments such as bonds. The greater demand for Government stock has forced prices up, thus reducing the return on the investment.

The improvement in the past service funding position meant that progress with the Recovery Plan was ahead of schedule and that it would be possible to continue without increasing the contribution rate and still eliminate the deficit within the remainder of the 15 year period. The revised Recovery Plan resulting from the 2011 valuation was therefore on the basis of a future service contribution rate of 32.2% and a deficit contribution of 2.7%.

Following the 2008 valuation the Trustees adopted an investment strategy designed to reduce the risk of volatility in the Fund value over time. This involves a gradual increase in the proportion of fixed interest investments whenever the Fund value rises above agreed trigger points. The strategy is beneficial in reducing the probability of major loss of Fund value, but has the unavoidable impact of reducing the assumptions for future growth as the proportion of fixed interest investments to growth investments in the portfolio increases. This in turn increases the value of the liabilities, pushing up the contribution rate, so further risk reduction in the portfolio has to be weighed against the impact on the contribution rate. The Trustees will implement further risk reduction only when the funding level permits and it is affordable to do so. Since implementation, the strategy had been successful in protecting the value of the Fund during turbulence in the world markets, and losses had not been as marked as might otherwise have been expected.

APPENDIX B

Pensions Illustrations

Providing meaningful illustrations of the likely impact of the various options for change can be difficult. In some cases such illustrations involve estimates of potential rates of inflation and stipend increases over more than 40 years. What follows in the table below are illustrations of the likely impact for seven examples with a range of ages and existing periods of service. In all cases the potential future pension is expressed as a percentage of the equivalent pensions calculated using the existing scheme rules.

Retirement Age

An increase in retirement age is difficult to illustrate. At present, retirement at 65 is possible – if an individual works beyond this age their starting pension is higher than it would have been at 65 both due to the accrual of further years (up to a maximum of 42 years' service) and to further increases in standard stipend (pensionable stipend) used as the basis for calculating starting pension. This contrasts with taking a pension at 65 and receiving annual increases on it in retirement. Increases to pensions in payment are governed by specific rules and are likely to be different to increases in standard stipend / pensionable stipend.

As explained at section 4.3 if the retirement age were to be increased it would still be possible to retire early at 65 – any pension earned before the date of change would be unaffected but the pension earned after the change would be subject to an actuarial reduction. Such reductions can be significant. At present the reduction applied when retiring five years early is approximately 40% - and that for retiring two years early is almost 10%.

Pensionable Stipend

Illustrating changes in the relationship between standard stipend and pensionable stipend is even more difficult. Such comparisons depend on a number of factors:

- Rate of inflation
- Any caps placed on pensionable stipend when the Retail Prices Index (RPI) is running at a high level
- Rates of actual stipend increase

The longer the period for which such comparisons are provided the greater the uncertainty.

At one extreme if inflation throughout the period was relatively modest and actual increases in standard stipend were never any greater than inflation then the proposed change in assumption regarding pensionable stipend would have no impact on actual pension received. (The undertaking to limit future increases in pensionable stipend would however allow different assumptions to be used in the actuarial valuations which would result in lower rates of pension contribution.)

If however standard stipend increases at a rate greater than inflation (and therefore greater than pensionable stipend) there would be an impact on future pension. The greater the difference and the longer the period the more significant the impact.

The illustrations which follow assume a rate of RPI of 1.75%.

For purposes of illustration, standard stipend increases of 1.75%, 2.25% and 2.75% have been assumed.

(The key factor in considering the impact of any change to definition of pensionable stipend is the difference between the rate of RPI and the actual increase in standard stipend. In periods of very high inflation it might be necessary to further limit increases in pensionable stipend – thus, assuming that standard stipend increases were roughly keeping pace with inflation, further increasing the difference between standard stipend and pensionable stipend and increasing the impact on future pensions.)

Whilst historic trends are not always an indicator of future patterns and historically the rate at which stipend has increased compared to inflation has fluctuated over the years. The following table provides details of how stipend increases have compared with the Retail Prices over various periods. Generally, increases have been in excess of RPI, but the experience over the last five years has been different, with increases being at less than the rate of inflation.

	RPI	**Stipend**	**Stipend minus RPI**
Average over			
45 years	6.4%	7.4%	1.0%
35 years	5.3%	7.0%	1.7%
25 years	3.6%	5.0%	1.4%
15 years	2.9%	3.9%	1.0%
5 years	3.5%	2.2%	(1.3%)

Proposed combination

The proposed change is to increase Normal Retirement Age to 67 and limit increases in pensionable stipend to no more than RPI. Illustrating the impact of this therefore involves the same uncertainty involved in assumptions relating to increases in RPI and standard stipend. Two sets of illustrations are provided. One assumes an individual chooses to retire early at 65 and therefore suffers an actuarial reduction of two years in respect of future service pension. The other assumes retiring at 67 and compares this with the initial pension that would be earned under the current rules if an individual chose to retire at 67.

Illustrations of impact of proposed alteration to Rules

(Increase Normal Retirement Age to 67 and limit annual increases in Pensionable Stipend to no more than RPI)

The table indicates the percentage of pension calculated under the current rules that would be available to a number of example individuals if the proposed changes were implemented. (An RPI rate of 1.75% has been assumed.)

Example individuals	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Age at date of change	25	40	40	50	50	60	60
Years of service prior to change	-	5	10	10	25	10	20
Early Retirement at 65							
Stipend increase of 1.75% (RPI)	90.3%	91.9%	93.1%	94.2%	96.4%	96.8%	98.1%
Stipend increase of 2.25% (RPI + 0.5%)	74.2%	83.2%	85.6%	90.3%	94.0%	96.0%	97.6%
Stipend increase of 2.75% (RPI + 1%)	61.1%	75.6%	79.1%	86.8%	91.7%	95.3%	97.2%
Retirement at 67 *(Comparison with current pension if retiring at 67)*							
Stipend increase of 1.75% (RPI)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Stipend increase of 2.25% (RPI + 0.5%)	81.4%	89.5%	91.0%	95.0%	96.8%	98.6%	99.1%
Stipend increase of 2.75% (RPI + 1%)	66.3%	80.4%	83.1%	90.4%	93.8%	97.3%	98.3%