Paper G2

URC Future Pensions – a document for discussion

Pensions Committee and Finance Committee

Basic information

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Action required	There will be group discussion of the questions in 1.3
Draft resolution(s)	None.

Summary of content

Subject and aim(s)	The purpose of this paper is to facilitate a discussion at Mission Council. This will inform our approach to General Assembly 2021 where we hope a decision in principle will be taken about the future of the two URC pension schemes.
Main points	In June 2020, Mission Council re-affirmed the Church's commitment to provide good pensions to its ministers and staff. Pension costs have risen substantially since 2008 because of low interest rates. Costs will rise further because of the Regulator's requirement for increased prudence. This raises questions about not just affordability but also value for money – for the Church and for the members. Any change would only affect the future accrual of pensions. Pensions already earned from past service are legally protected. Changing pension arrangements would be a complex and costly process, so we are trying to take this one step at a time.
Previous relevant documents	Paper titled 'URC Pension Schemes – facing up to some serious challenges' written for General Assembly 2020 and considered by Mission Council in July 2020.
Consultation has taken place with...	The Integrated Risk Management project group. External consultants who have helped with some financial modelling.

Summary of impact

Financial	None at this stage. Any change to URC pension arrangements would have one off implementation costs, and would affect the ongoing costs to the Church and the benefits to members.
External (e.g. ecumenical)	None.

1. Introduction, including questions for discussion

1.1 In June 2020, Mission Council on behalf of General Assembly passed the following resolution:

The General Assembly, being representative of Local Churches, synods and the whole Church, confirms the Church's commitment to the pensions promises already made, and wishes any consideration of future pension arrangements for the Church's Ministers of Word and Sacraments, Church Related Community Workers, missionaries and staff to keep clearly in mind:

a) The Church's warm gratitude for the commitment, gifts and service of those who work among us and serve in our name;
b) The Church's desire to deal with these people honourably in their retirement;
c) The Church's desire to act as a responsible employer, for the people we employ and for our stipendiary office-holders.

This was by no means the first time that General Assembly, or Mission Council on its behalf, has reaffirmed its commitment to provide good pensions to office-holders and staff in the United Reformed Church. This understanding is the starting point for any discussion about the future of the two URC pension schemes.

1.2 General Assembly has always been the body to take decisions regarding changes to the terms of the Ministers' Pension Fund. General Assembly has also more than once decided that the two URC pension schemes should be kept in line with one another. We assume that both these things are still the case.

Our short-term objective is to enable General Assembly in July 2021 to have an informed discussion about the future of the two URC pension schemes and to make a decision in principle about the future direction of travel. That decision in principle is necessary before we incur significant costs in developing detailed proposals about possible future arrangements.

This paper for Mission Council does not make any recommendation about what future pension arrangements should be. It sets out the issues as we currently understand them and provides estimates of costs and benefits of some alternatives. Its purpose is to facilitate a discussion at Mission Council which will help us prepare the members of General Assembly for its consideration of these matters.

1.3 Questions for consideration at Mission Council:

i) In our view, this issue needs to be considered urgently by General Assembly, though doing so carefully will take a little time. Do you agree? If not, why?
ii) Which parts of this paper do you not adequately understand?
iii) What questions have you got that are not answered by this paper?
iv) Do you have a view on the examples of possible rates of Church and member contributions used in the modelling in section 5.4 and section 6?
v) Do you have any other suggestions about how we should prepare the members of General Assembly for its discussion of these matters?

These questions will be considered in group discussions at Mission Council. Responses from those groups and from individuals are requested **by 31st March.**

2. Some definitions and background information

2.1 Existing URC pension schemes

The United Reformed Church is currently operating two pension schemes. The Ministers' Pension Fund (MPF) covers most ministers and Church Related Community Workers. It is

managed 'in house', albeit through an independent trust company, the URC Ministers' Pensions' Trust Limited (MPT). The URC Final Salary Scheme is mostly for Church House staff plus some at most of the synods, at Westminster College, and at Northern College. This Scheme is managed externally, by TPT Retirement Solutions. The URC is the principal employer.

2.2 Defined Benefit pension schemes

Both the existing pension schemes are Defined Benefit (DB) schemes. This means that the method of calculating the pension payable is pre-determined. The pension payable at retirement is 1/80 for each year of service of final stipend (for the MPF) or the highest salary earned in the final three years of service (for the 'lay' scheme).

The fact that the calculation is pre-determined does not mean that the amount of the pension is known in advance. It depends on the increases in salary / stipend that have taken place prior to retirement. The real value of that pension will, therefore, also depend on what has happened to inflation during that period.

The pension payable is not dependent on the performance of the assets of the scheme. As sponsor or 'employer', the Church is legally obliged to meet the total cost of these pensions, less the member contributions, whatever that cost is. So, all the risks associated with investment performance are carried by the employer.

2.3 Defined Contribution pension schemes

The main alternative to a DB arrangement is a Defined Contribution (DC) pension scheme. Such a scheme would also be managed by a trust company. Here, the levels of contributions by the Church and members are fixed (but may be changed after due notice). These contributions are invested on behalf of the members. At retirement, each member has a pension pot which is used to pay them a pension.

The risks associated with investment performance are transferred to the members. The pension that is payable will depend on that investment performance.

There are, also, potentially significant advantages for the members. There is now considerable flexibility in the operation of DC schemes. There is more personal choice around investment policy than in the increasingly restricted world of maturing DB schemes, and flexibility in terms of how and when the pension pot is used. Also, any residue in the pension pot following the death of a member and their spouse is an asset that passes to their beneficiaries (possibly subject to tax).

2.4 Status of members and role of the Church

Stipendiary ministers and Church Related Community Workers are office holders, not employees. In relation to them and the MPF, the Church is sponsor, rather than employer. However, for pensions purposes this difference has no effect.

3. Why consider the future of the URC pension schemes now?

3.1 Given that we are in the middle of a serious pandemic, which means there is great uncertainty about so many aspects of Church and personal life, it might be reasonable to ask 'why consider the future of our pension schemes now?'

It is our view that there are many compelling reasons for doing so:

a) this matter was last considered by General Assembly in 2012, when some changes were made to reduce costs and thereby avoid the need for a more strategic review;

b) the costs of the current pension schemes have risen significantly since 2012;

c) the costs of the MPF, in particular, are predicted to rise further because the Pensions Regulator (tPR) is expecting pension schemes, and especially those like ours that are approaching maturity, to be valued much more prudently;

d) some of the synod trusts wish to link the funding of the deficit on the Ministers' Pension Fund (MPF) with the closure of that scheme to new accruals; and

e) there are some who think that the flexibility of a defined contribution scheme might deliver better value for members.

3.2 It is also important to be clear that, if the Church decides to retain the two existing DB schemes, that does not mean that things will stay as they are. In particular:

i) as the schemes become more mature, tPR and the trustees are likely to require more prudent valuations of the schemes (meaning higher contributions) and more security from the Church against the possibility of future losses on investments (this issue relates mainly to the MPF as the Final Salary Scheme is already valued on a much more prudent basis); and

ii) the costs of managing the MPF in the medium term are likely to increase as work currently done by volunteers has to be transferred to paid professionals.

3.3 But it is also important to recognise that there are uncertainties in the current situation, even from a narrow pensions perspective. The much delayed Pensions Act has just received royal assent. This will provide the general framework for the future. It is, however, for the Pensions Regulator (tPR) to spell out how the legislation is to be applied. The recent thinking of the IRM group, which has been shared with the Church, has been based on the stance of tPR in its 2019 consultation. A definitive new Code of Practice from tPR is not now expected until 2022 at the earliest. There have been some signals during the parliamentary debate of the Pensions bill (now Act) that a few aspects of the approach presented in that 2019 tPR consultation may be slightly modified in the Code of Practice.

Given the level of maturity of the two current URC pension schemes, it would not be realistic to expect a radical change in how these schemes are viewed by tPR or by the schemes' trustees. However, it is possible that there may be more flexibility than we are currently assuming regarding future investment strategy or regarding the timetable to and beyond the 'long term funding objectives' of the two schemes.

4. Enabling Mission Council to have an informed discussion

4.1 Limited scope of the work done so far, reflected in this paper

The cost of developing any new pension arrangements would be high. Our aim up to now has been to do or pay for enough work to enable Mission Council, and then General Assembly, to have an informed discussion but not to do or pay for work that might not be necessary unless and until General Assembly makes a decision in principle about the future. This means that there are many unanswered questions and some of the information provided represents only best estimates at this stage.

4.2 Ministers' Pension Fund (MPF)

The rest of this paper focuses on the MPF and what could replace it. This is mainly to try to simplify what is being presented. It is also on the working assumption, as previously stated, that what is done regarding the MPF and its members will probably be mirrored in what is done with the Final Salary Scheme.

From the perspective of the Church, the MPF is by far the bigger and, therefore, more costly of the two schemes – approximately four times the size – and more like seven times

the size, if the involvement of the other employers in the Final Salary Scheme is ignored. The Final Salary Scheme is already valued on a more prudent basis.

From the perspective of the members, it is unlikely that there will be any significant issues in relation to the pensions of staff which do not apply to the pensions of ministers. The main difference is that stipends, and therefore accruals of pensions, are the same for all ministers whereas the levels of staff salaries, and therefore the pensions earned, are different depending on the job being done.

4.3 Comparing the current DB scheme with a 'good' DC scheme

Again, mainly to simplify what is a very complex matter, the rest of this paper compares the options of either staying with the existing DB schemes or moving completely to one or two new DC schemes with a fixed rate of contribution.

Of course, there are other options.

The Church could decide to stay with the DB scheme but to reduce its future benefits or increase the future level of contributions required from members. It is our view that this would not adequately manage the costs and risks to the Church without reducing the benefits to members to an unacceptable degree.

The DC employer contribution rate could be varied according to age.

The Church could decide to go for a more complex arrangement, such as a reduced DB scheme alongside a new DC scheme, but complexity may well mean more cost.

4.4 Benefits already earned in the existing DB schemes are protected

It is important to emphasise that benefits already earned by members of the DB schemes are protected. Any changes can only apply to pension benefits earned in the future.

5. What might a good Defined Contribution scheme look like?

5.1 Objective

The heading of this section is, clearly, a subjective question. Based on the resolution quoted in 1.1 above, it is assumed that a good DC pension scheme must deliver a reasonable pension to members at a cost that is affordable for the Church.

5.2 What is happening in other denominations?

Our understanding of the current policies of other denominations is as follows:

C of E: Have a relatively new DB arrangement for clergy but not for lay staff who have switched to DC. The employer contributions to the DC scheme are age related, ranging from 8% to 15% plus matching member contributions up to 3%.

Methodist: Have a DB scheme for ministers but have just closed their staff DB scheme to future accrual and are putting a DC plan in place.

Baptist: Closed all DB schemes and only offer DC. Members contribute 8%. The employer contributes 6% to pension and 4% towards life cover.

Congregational Federation: Only offer DC. Employer contribution is 15% for those in service before 2016, but only 2% above the government minimum for those entering service after that.

Church of Scotland: Only offer DC. Contribution rates not available.

Salvation Army: A DB arrangement for officers but DC otherwise. The DC scheme offers a range of options to staff. Essentially, the employer contribution is up to 12% calculated as twice the member contribution up to 6%.

5.3 What is happening elsewhere?

Comparison of the financial circumstances of ministers with those of people in secular employment is not straightforward.

Virtually all DB schemes outside the public sector have closed to accruals since 2008, because of rising costs, and have been replaced by DC schemes.

The Pensions and Lifetime Savings Association (PLSA) is an association of providers which aims to raise standards. It issues Pensions Quality Mark (PQM) accreditation to pension schemes. In relation to contribution levels, its PQM accreditation requires a minimum of 12% of which at least 6% is from the employer. Its PQM Plus accreditation requires a minimum of 15% of which at least 10% is from the employer.

5.4 Contribution levels

The financial modelling reported in 6.3 below was carried out based on a URC DC pension scheme with **employer contributions of 17.5% and member contributions of 7.5%.** The member contributions are set at the current level. The level of employer contributions is, clearly, significantly higher than the PQM Plus minimum rate referred to in 5.3.

Projections are also given in 6.4 below based on **employer contributions of 12.5% and member contributions of 7.5%**.

6. Comparison of benefits for members

6.1 Some 'health warnings'

Any change of pension arrangements would affect each member differently depending, among other things, on their age, marital status, dependents, previous employment and associated pension entitlement, household income, and length of service. This section focuses on three theoretical and simpler individuals. If this exploration of alternative pension arrangements proceeds to the next stage then proposals will be modelled against the actual members of the current DB schemes.

Comparing a DB scheme with a DC scheme is comparing an apple with an orange. They are very different. In particular:

- a DB scheme pays a pre-determined pension which is fixed at retirement and then subject to inflation, whereas a DC scheme creates a pension pot for each member which is used to provide them with income during retirement;
- a DB scheme pays a pension to the member and then to their spouse for life, whereas a DC scheme creates a pension pot for each member and it is up to the member to decide how and when to use that pension pot – and when it is gone, it is gone;
- in a DC scheme, the size of the pension pot of a member at retirement is dependent on the performance of the investments and this, in turn, is dependent on the investment choices of the member and on the financial markets;
- this means that the outcomes of a DC scheme can only be estimated; and
- in a DC scheme, there is a lot of flexibility and choice for each member, though there is usually a default arrangement based on a reasonable investment strategy for a typical member.

6.2 Choice of examples and other assumptions

Financial modelling has been carried out for three sample people. All three are people who it is assumed will spend their whole working life in stipendiary ministry, from age 28 to age 68. These may well be the people most affected by any change to URC pension arrangements. These examples therefore exclude the effects on the total income in retirement, which will be different for each individual, of previous or subsequent employment and any pensions earned in those other roles.

The first example is aged 28 with 40 years of service ahead of them.

The second example is aged 43 with 15 years of existing and protected pension entitlement from the existing DB scheme and 25 years of service ahead of them.

The third example is aged 58 with 30 years of existing and protected pension entitlement from the existing DB scheme and 10 years of service ahead of them.

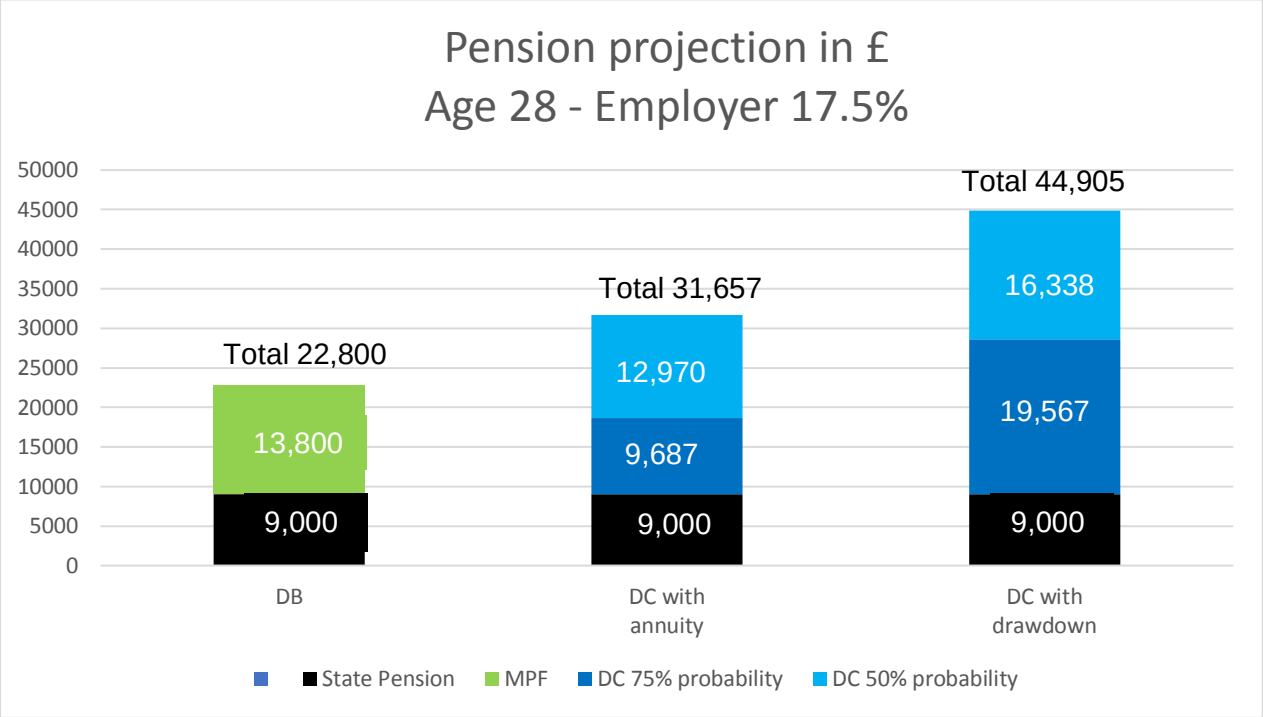
All the figures are expressed in current prices. It is assumed that inflation will have the same effect on stipend levels, on DB pensions in payment, and on DC investment returns which will be reflected in DC pensions. Of course, this may not be true but it is a reasonable working assumption.

The impact of taxation and the option of a tax-free commutation are ignored.

6.3 Comparison of the current Ministers' Pension Fund DB scheme and a DC scheme with 17.5% employer contributions and 7.5% member contributions

6.3.1 Example 1: 28 year old, just entering stipendiary ministry

In the initial financial modelling it was decided, as a 'starter for ten', to set the contribution levels as employer: 17.5% and member: 7.5%. The intention was to provide a generous pension at a cost to the Church at roughly the present level.



This chart shows the estimated income in retirement on three different bases.
In all three cases, the bottom dark rectangle represents the state pension of £9,000.

Existing DB scheme

The left-hand block represents the continuation of the existing DB scheme. The annual pension from the DB scheme at retirement in 40 years' time would be 40/80 of stipend = £13,800 so **total annual income would be £9,000 + £13,800 = £22,800**. So, income before tax in retirement is estimated to be just over 80% of stipend.

Suggested DC scheme with an annuity purchased at retirement
As stated previously, the outcome of a DC scheme can only be estimated.

The central block represents a DC scheme as described above, and assumes that at retirement the member's pension pot will be used to purchase an annuity.

An annuity feels a bit like a pension from a DB scheme in that it is guaranteed at a certain level for life, often increased annually in line with inflation, with a spouse's pension payable. However, in recent years annuities have delivered very poor value for money and are used less often – at least in the early years of retirement.

The reason is that annuities are provided by insurance companies which have to take a very prudent approach to investment policy, as they are carrying all the risks, and they also plan to make a profit.

The dark blue rectangle indicates that there is a 75% chance of receiving an annuity at retirement of at least £9,687 so total annual income including the state pension would be £9,000 + £9,687 = £18,687.

The light blue rectangle indicates that there is a 50% chance of receiving an annuity at retirement of at least £22,657 (£9,687 + £12,970), so **total annual income including the state pension would be £9,000 + £22,657 + £31,657.**

Suggested DC scheme with drawdown used after retirement
The right-hand block represents a DC scheme as described above, and assumes that the member will use drawdown to provide income in retirement.

Drawdown is commonly used by members of DC schemes. Here, each member decides on the amount of cash to be taken from their investment pot to provide income in retirement – this decision is usually made annually. The rest of the pension pot remains invested. The decisions of each member will depend on such things as other income, housing costs, state of health, and lifestyle choices.

For the purpose of this modelling, it is assumed that the drawdown will be managed to deliver a pension for life fixed at retirement, increased annually by inflation, and followed by half a pension to a surviving spouse for the rest of their lifetime. These assumptions make the results more comparable with the current DB scheme.

The dark blue rectangle indicates that there is a 75% chance of delivering a pension at retirement of £19,567, so total annual income including the state pension would be £9,000 + £19,567 = £28,567.

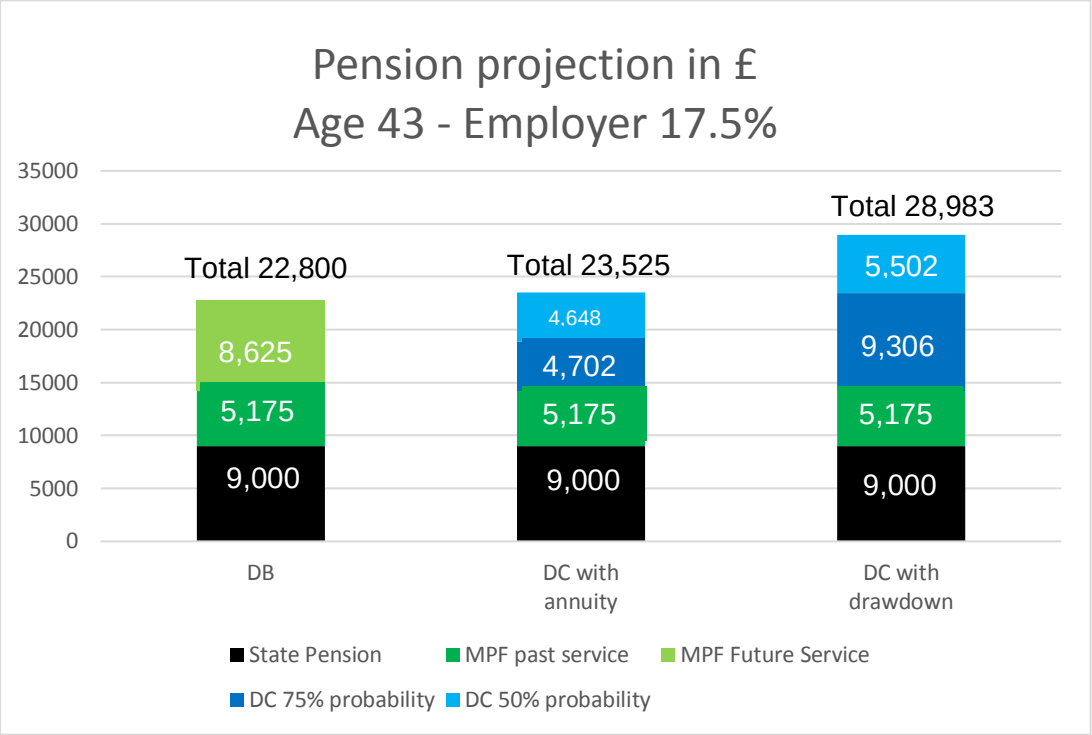
The light blue rectangle indicates that there is a 50% chance of delivering a pension at retirement of £35,905 (£19,567 + £16,338**), so total annual income including the state pension would be £9,000 + £35,905 = £44,905.**

6.3.2 Example 2: 43 year old, with 15 years of past service

The chart is on the next page.

As before, the dark rectangle at the bottom of all three columns represents the state pension of £9,000. Now there is a dark green rectangle above this in all three columns which represents the pension payable from the DB scheme for the past 15 years. The value of this defined pension is fixed at 15/80 of stipend = £5,175.

Existing DB scheme
Again, the left-hand block represents the continuation of the current DB scheme and shows the total pension payable at retirement after 40 years' service of £13,800 (£5,175 + £8,625) and that the **total annual income including state pension would be £9,000 + £13,800 = £22,800.**



Suggested DB scheme with an annuity purchased at retirement
The central block represents a DC scheme, as described above, and assumes that the member's pension pot will be used to purchase an annuity at retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annuity at retirement of at least £4,702 resulting in total annual income including the state pension and the DB pension of £9,000 + £5,175 + £4,702 = £18,877.

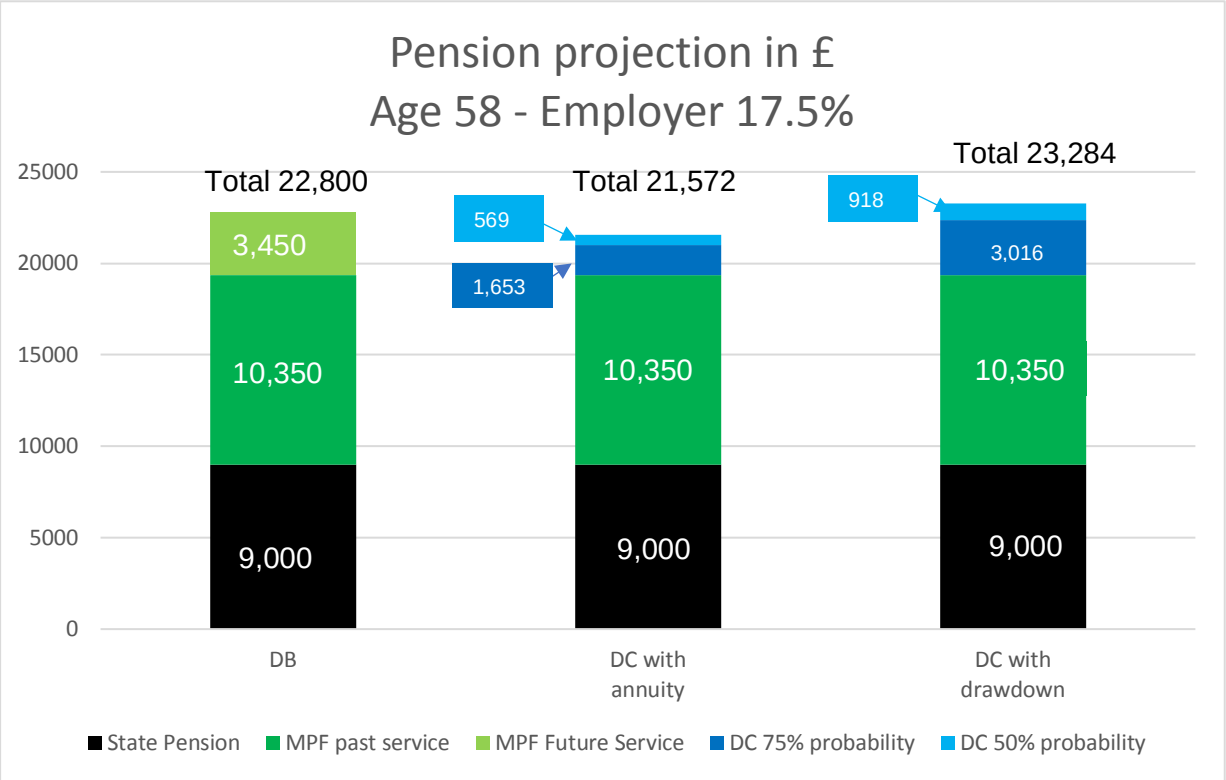
The light blue rectangle indicates that there is a 50% chance of receiving an annuity at retirement of at least £9,350 (£4,702 + £4,648) meaning **total annual income including the state pension and the DB pension would be £9,000 + £5,175 + £9,350 = £23,525.**

Suggested DC scheme with drawdown used after retirement
The right-hand block represents a DC scheme as described above, and assumes that the member will use drawdown to provide income in retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annual pension at retirement of at least £9,306 meaning that total annual income including the state pension and the DB pension would be £9,000 + £5,175 + £9,306 = £23,481.

The light blue rectangle indicates that there is a 50% chance of receiving an annual pension at retirement of at least £14,808 (£9,306 + £5,502) meaning that **total annual income including the state pension and the DB pension would be £9,000 + £5,175 + £14,808 = £28,983.**

6.3.3 Example 3: 58 year old, with 30 years of past service



Once again, the dark rectangle at the bottom of all three columns represents the state pension of £9,000. The dark green rectangle above this in all three columns represents the pension payable from the DB scheme for the past 30 years. The value of this defined pension is fixed at 30/80 of stipend = £10,350.

Existing DB scheme
Again, the left-hand block represents the continuation of the current DB scheme and shows the total pension payable at retirement after 40 years' service of £13,800 (£10,350 + £3,450) and that the **total annual income including the state pension would be £9,000 + £13,800 = £22,800.**

Suggested DB scheme with an annuity purchased at retirement
The central block represents a DC scheme, as described above, and assumes that the member's pension pot will be used to purchase an annuity at retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annuity at retirement of at least £1,653 resulting in total annual income including the state pension and the DB pension of £9,000 + £10,350 + £1,653 = £21,003.

The light blue rectangle indicates that there is a 50% chance of receiving an annuity at retirement of at least £2,222 (£1,653 + £569) meaning **total annual income including the state pension and the DB pension would be £9,000 + £10,350 + £2,222 = £21,572.**

Suggested DC scheme with drawdown used after retirement
The right-hand block represents a DC scheme as described above, and assumes that the member will use drawdown to provide income in retirement.

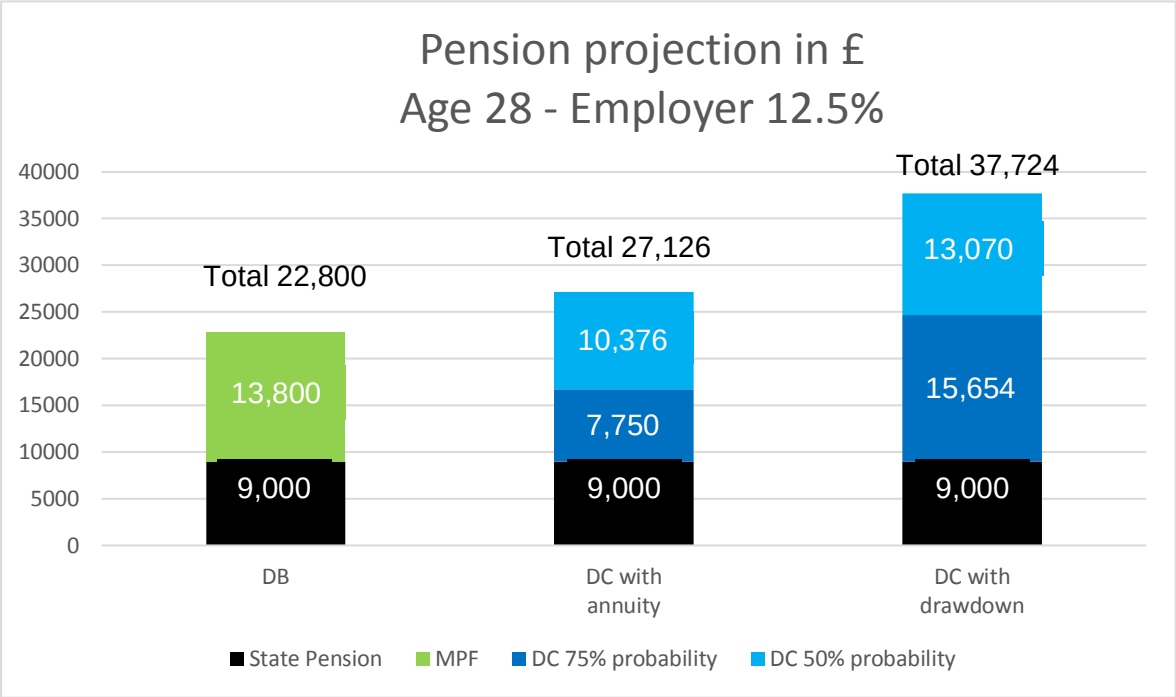
The dark blue rectangle indicates that there is a 75% chance of receiving an annual pension at retirement of at least £3,016 meaning that total annual income including the state pension and the DB pension would be £9,000 + £10,350 + £3,016 = £22,366.

The light blue rectangle indicates that there is a 50% chance of receiving an annual pension at retirement of at least £3,934 (£3,016 + £918) meaning that **total annual income including the DB pension and the state pension would be £9,000 + £10,350 + £3,934 = £23,284.**

6.4 Comparison of the current Ministers' Pension Fund DB scheme and a DC scheme with 12.5% employer contributions and 7.5% member contributions

6.4.1 Example 1: 28 year old, just entering stipendiary ministry

The results of the initial financial modelling were more generous than expected and at a significantly higher cost to the Church than expected. So, a second set of figures is provided, with the employer contribution reduced from 17.5% to 12.5%. This is still above the level for PQM Plus accreditation.



Again, this chart shows the estimated income in retirement on three different bases. In all three cases, the bottom dark rectangle represents the state pension of £9,000.

Existing DB scheme

The left-hand block represents the continuation of the existing DB scheme. The annual pension from the DB scheme at retirement in 40 years' time would be 40/80 of stipend = £13,800 so **total annual income including the state pension would be £9,000 + £13,800 = £22,800.**

Suggested DC scheme with an annuity purchased at retirement

As stated before, the outcome of a DC scheme can only be estimated.

The central block represents a DC scheme as described above, and assumes that at retirement the member's pension pot will be used to purchase an annuity.

The dark blue rectangle indicates that there is a 75% chance of receiving an annuity at retirement of at least £7,750 so total annual income including the state pension would be £9,000 + £7,750 = £16,750.

The light blue rectangle indicates that there is a 50% chance of receiving an annuity at retirement of at least £18,126 (£7,750 + £10,376), so **total annual income including the state pension would be £9,000 + £18,126 = £27,126.**

Suggested DC scheme with drawdown used after retirement
The right-hand block represents a DC scheme as described above, and assumes that the member will use drawdown to provide income in retirement.

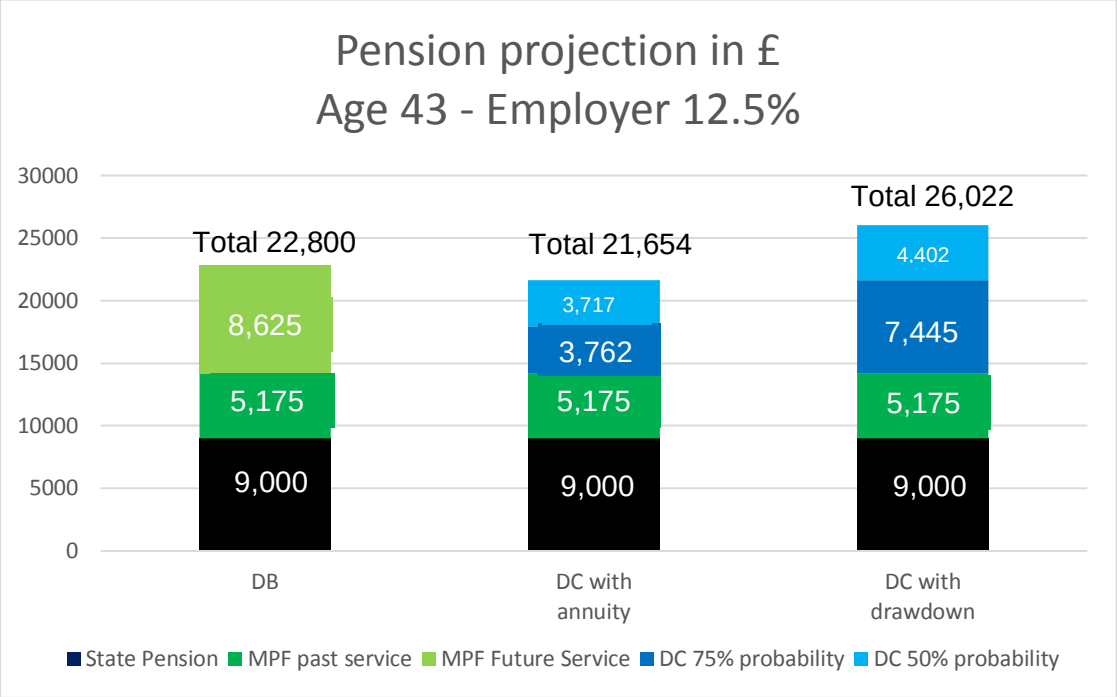
The dark blue rectangle indicates that there is a 75% chance of receiving a pension at retirement of £15,654, so total annual income including the state pension would be £9,000 + £15,654 = £24,654.

The light blue rectangle indicates that there is a 50% chance of receiving a pension at retirement of £28,724 (£15,654 + £13,070), so **total annual income including the state pension would be £9,000 + £28,724 = £37,724.**

6.4.2 Example 2: 43 year old, with 15 years of past service
The chart is on the next page.

As before, the dark rectangle at the bottom of all three columns represents the state pension of £9,000. Now there is a dark green rectangle above this in all three columns which represents the pension payable from the DB scheme for the past 15 years. The value of this defined pension is fixed at 15/80 of stipend = £5,175.

Existing DB scheme
Again, the left-hand block represents the continuation of the current DB scheme and shows the total pension payable at retirement after 40 years' service of £13,800 (£5,175 + £8,625) and that the **total annual income including state pension would be £9,000 + £13,800 = £22,800.**



Suggested DB scheme with an annuity purchased at retirement
The central block represents a DC scheme, as described above, and assumes that the member's pension pot will be used to purchase an annuity at retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annuity at retirement of at least £3,762 resulting in total annual income including the state pension and the DB pension of £9,000 + £5,175 + £3,762 = £17,937.

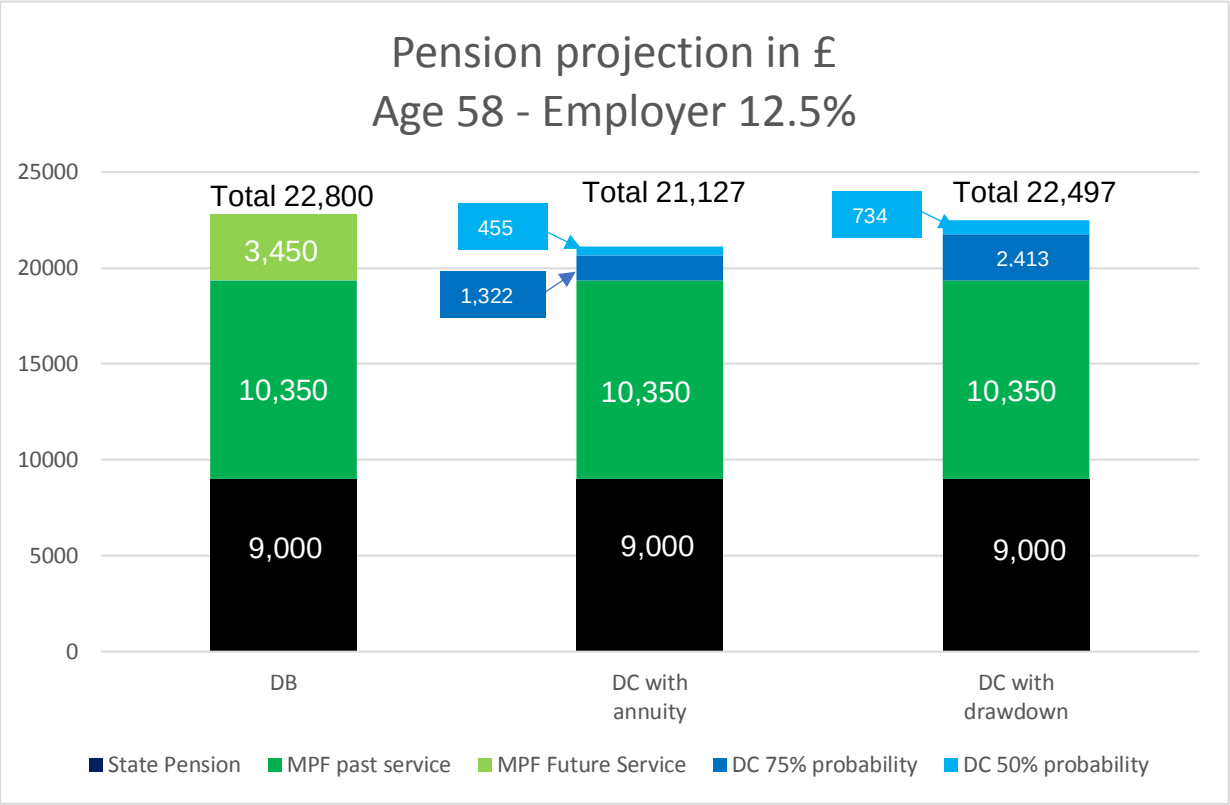
The light blue rectangle indicates that there is a 50% chance of receiving an annuity at retirement of at least £7,479 (£3,762 + £3,717) meaning **total annual income including the state pension and the DB pension would be £9,000 + £5,175 + £7,479 = £21,654.**

Suggested DC scheme with drawdown used after retirement
The right-hand block represents a DC scheme as described above, and assumes that the member will use drawdown to provide income in retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annual pension at retirement of at least £7,445 meaning that total annual income including the state pension and the DB pension would be £9,000 + £5,175 + £7,445 = £21,620.

The light blue rectangle indicates that there is a 50% chance of receiving an annual pension at retirement of at least £11,847 (£7,445 + £4,402) meaning that **total annual income including the state pension and the DB pension would be £9,000 + £5,175 + £11,847 = £26,022.**

6.4.3 Example 3: 58 year old, with 30 years of past service



Once again, the dark rectangle at the bottom of all three columns represents the state pension of £9,000. The dark green rectangle above this in all three columns represents the pension payable from the DB scheme for the past 30 years. The value of this defined pension is fixed at 30/80 of stipend = £10,350.

Existing DB scheme
Again, the left-hand block represents the continuation of the current DB scheme and shows the total pension payable at retirement after 40 years' service of £10,350 + £3,450 = £13,800 and that the **total annual income including the state pension would be £9,000 + £13,800 = £22,800.**

Suggested DB scheme with an annuity purchased at retirement
The central block represents a DC scheme, as described above, and assumes that the member's pension pot will be used to purchase an annuity at retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annuity at retirement of at least £1,322 resulting in total annual income including the state pension and the DB pension of £9,000 + £10,350 + £1,322 = £20,672.

The light blue rectangle indicates that there is a 50% chance of receiving an annuity at retirement of at least £1,777 (£1,322 + £455) meaning **total annual income including the state pension and the DB pension would be £9,000 + £10,350 + £1,777 = £21,127.**

Suggested DC scheme with drawdown used after retirement
The right-hand block represents a DC scheme as described above, and assumes that the member will use drawdown to provide income in retirement.

The dark blue rectangle indicates that there is a 75% chance of receiving an annual pension at retirement of at least £2,413 meaning that total annual income including the state pension and the DB pension would be £9,000 + £10,350 + £2,413 = £21,763.

The light blue rectangle indicates that there is a 50% chance of receiving an annual pension at retirement of at least £3,147 (£2,413 + £734) meaning that **total annual income including the DB pension and the state pension would be £9,000 + £10,350 + £3,147 = £22,497.**

6.5 Observations, other assumptions and other options

It is important to re-state that the above projections are just examples not recommendations, and they are only estimates of what might happen.

In DB pension schemes, like the current URC schemes, a year of service at age 30 earns the same pension accrual as a year of service at age 60. The same pension contributions are paid for both years. However, the contributions paid at age 30 are invested for 38 years up to retirement whereas those at age 60 are only invested for 8 years. So, the real cost of the pension accrual at age 60 is much higher than the cost of the accrual at age 30. The rate of contribution payable, which is the same at all ages, is a calculated average. In a DC pension scheme, the pension contributions are invested on behalf of the members. If the same contribution rate is used at all ages then younger members are likely to get a much better return on the sums invested than older members. This is the reason why some DC pension schemes have variable contribution rates depending on age.

The modelling indicates that younger members are likely to benefit most from a move from the current DB scheme to the suggested DC scheme. This is because their pension pot will be invested for longer with a higher proportion of growth assets than in the DB scheme, and so the returns will be greater.

For older members moving from the current DB scheme to the suggested DC scheme, there is a greater risk that the change will have a negative impact on their future accrual of pension. However, any such negative impact will be over a shorter period of time with a larger promised pension coming from the DB scheme based on past service. So, there is comparatively little effect on total income at retirement.

The modelling assumes a typical approach to investment strategy. In broad terms, this means investing in equities until 15 years from retirement and then moving towards a position at retirement age of 50% diversified growth funds, 25% medium term corporate bonds, and 25% cash. The default arrangement in a DC scheme would be likely to be something like this. For comparison, the MPF is expected to have no more than 20% of its funds invested in growth assets when it reaches its Long Term Funding Objective in around 2030.

Members of a DC scheme may choose to take more risks with their investments or may choose to be more prudent.

The three examples are only that and they are somewhat artificial in order to make comparisons easier. The member of a DC scheme has considerable flexibility. For example, a member may choose to receive a smaller annual income and then take out lump sums from time to time to meet particular spending needs. Similarly, it would be possible to convert from a drawdown arrangement to an annuity at any time after retirement. This would almost certainly reduce future income but it would deliver certainty and remove the need for any active involvement in investment decisions from that point on. Some members of DC schemes may choose to do this at age 75 when the tax rules change.

6.7 Issues that have not yet been addressed

Other benefits

The current DB schemes provide for benefits to be paid on the death of a member in service and for death before normal retirement age for those who have left service. They also provide for pensions to be paid to members who have to retire early on the grounds of ill health.

If the Church moves to DC pension arrangements, and wants to continue to provide benefits for death in service and for those retiring early on the grounds of ill health, then these benefits will have to be provided separately from the DC scheme(s). It is currently being assumed that such benefits would be provided in a way that gives members of the DC scheme(s) roughly the same financial protection as they receive from the existing DB schemes.

Support for members

It has hopefully been made clear that the members of a DC pension scheme have a lot more personal responsibility for, as well as flexibility in, the way they plan for retirement and then plan their income during retirement. The Church will want to ensure that members of any such scheme are well informed. This issue is likely to be addressed primarily through the choice of a governance model that ensures the necessary information is provided. The Church will also want to encourage members to take appropriate independent and regular financial advice during their working lives and, especially, just before retirement and during retirement.

7. Comparison of costs for the Church as sponsor or employer

7.1 Costs of continuing with the current DB scheme

The actual cost of a DB scheme will only be known when the last beneficiary has died. In the meantime, we have to focus on the annual contributions, which are the best current estimate of those costs. The level of these contributions is increasing partly because of persistent low interest rates and increased longevity, and partly because the Regulator is expecting a more prudent approach to funding.

The figures below are all based on the actual costs in 2020. The number of paid stipends is going down each year, meaning that the total costs are also reducing. However, the total of contributions from local churches to the Ministry and Mission Fund is also reducing. So, it makes sense to focus on the current actual numbers.

Future service contributions	Percentage of stipend %	Total cost £
Pensionable stipends in 2020 (approx.)		9,440,000
2020 ministers at 2010 contribution rate	12.35	1,166,000
(This rate followed the 2008 financial crisis and the subsequent change to benefits.)		
Actual contributions in 2020	**21.95**	**2,072,000**
(Percentage from 2018 valuation, cost from Chief Finance Officer)		
2020 ministers at estimated 2022 rate	31.0	2,926,000

(This rate was estimated by the MPF actuary in June 2020. The increase is partly due to low interest rates and partly due to the increased prudence expected by the Regulator.)

2020 ministers at estimated 2030 rate	38.2	3,606,000

(This rate was estimated by the actuary in June 2020. It assumes that the assets of the MPF will have been substantially de-risked by 2030.)

The issue here is not just about affordability, although that is clearly significant. If DC schemes are free to invest in growth assets and DB schemes are more restricted then there is an increasingly important issue of value for money – certainly for the employer and possibly for the members also.

7.2 Risks that further deficit funding will be required

For many, the biggest concern about the DB scheme, especially given the current discussions focused on dealing with the expected significant deficit on the MPF in 2021, is the risk that the planned level of employer contributions may prove to be inadequate resulting in further deficits which would then require additional funding.

Moving to a DC scheme would not remove or reduce the risks associated with the pensions that have already been earned. However, it would stop adding to the potential problem.

The trustee of the MPF is increasingly concerned to ensure that the Church is able to meet any such challenges in the future and may well ask the Church for stronger guarantees against such eventualities.

7.3 Costs of moving to the DC scheme suggested above with a 17.5% employer contribution rate

The following figures are all rough estimates at this stage, either because they are dependent on the contribution level which has yet to be decided, or because we do not yet have enough information.

One-off costs of setting up the new DC scheme

A very rough estimate of these one-off costs is £50,000 to £100,000.

Costs of operating the suggested DC scheme alongside the DB scheme

Employer contributions	Percentage of stipend %		Total cost £
2020 ministers	17.5		1,652,000
Governance costs (assuming the use of a managing trust) (Investment management fees are borne by the members.)			20,000
Death in service benefits	1.0	(approx..)	120,000
Ill health early retirement	5.0	(approx..)	500,000
Ongoing in-house administration of URC pension schemes (Admin costs in 2019 MPF accounts = £340k.) (Assumed no significant increase in hours required in house.)			400,000
Estimated total annual costs			**2,692,000**

7.4 Costs of moving to the DC scheme suggested above with a 12.5% employer contribution rate

The following figures are all rough estimates at this stage, either because they are dependent on the contribution level which has yet to be decided, or because we do not yet have enough information.

One-off costs of setting up the new DC scheme

A very rough estimate of these one-off costs is £50,000 to £100,000.

Costs of operating the suggested DC scheme alongside the DB scheme

Employer contributions	Percentage of stipend %	Total cost £
2020 ministers	12.5	1,180,000
Governance costs (assuming the use of a managing trust) (Investment management fees are borne by the members.)		20,000
Death in service benefits	1.0	120,000
Ill health early retirement	5.0	500,000
Ongoing in-house administration of URC pension schemes (Admin costs in 2019 MPF accounts = £340k.) (Assumed no significant increase in hours required in house.)		400,000
Estimated total annual costs		**2,220,000**

7.5 Observations

This paper is intended to facilitate a discussion and it does not make a recommendation.

Some of the figures in 7.3 and 7.4 are rough estimates at the moment and these need to be refined before any decisions are taken.

It will be noted that the calculations show that, with a DC employer contribution rate of 17.5%, the estimated annual cost of moving to a DC scheme is about £600k above the current cost of the existing DB scheme (excluding deficit funding), but £200k less than that cost is expected to be from 2022. With an employer contribution rate of 12.5%, the estimated annual cost of the DC scheme is just above the current cost of the DB scheme.

The questions for members of Mission Council are set out in 1.3 above. The most important of these is how can we best prepare the members of General Assembly for the discussions that will be needed in July, given that many of them will not have had as much exposure to these pensions issues over the last couple of years as members of Mission Council.