Scottish Episcopal Church Pension Fund
Reduction in contribution rate
Pensionable Stipend and Pensionable Salary

Standing Committee is seeking General Synod's approval to three changes relating to the SEC Pension Fund. The proposed changes are all possible due to the positive news emerging from the recent Actuarial Valuation. One change recommended is a reduction in the contribution rate from 2025 and the other two concern the setting of Pensionable Stipend. The Pensionable Stipend changes relate to the agreement of Pensionable Stipend from 1 July 2024 and the provision of greater discretion to Standing Committee than it currently has in the setting of future rates of Pensionable Stipend and Pensionable Salary. The following motions, which are endorsed by the Pension Fund Trustees, will be proposed to Synod detailing the proposed changes:

Motion 11 That, with effect from 1 January 2025, the contribution rate in relation to serving clerical and staff members of the Scottish Episcopal Church Pension Fund be reduced from 32.2% to 22% of Standard Stipend and Salary respectively.

Motion 12 That Pensionable Stipend for the period 1 July 2024 to 30 June 2025 be increased by 7.8% to £32,988, in line with Standard Stipend for 2024.

Motion 13 That, notwithstanding the general principle that increases in future Pensionable Stipend/Salary be limited to a maximum of not more than the increase in the Retail Prices Index, Standing Committee be permitted to agree increases in excess of the Retail Prices Index if it is of the view, after consultation with the Pension Fund Trustees and having obtained appropriate professional advice, that such an increase is appropriate and affordable.

Further information regarding the proposed changes is provided below together with answers to questions Synod members may have about them. The proposed changes have no impact on pensions currently being paid to SEC pensioners or future increases to those pensions.

Bridget Campbell, Convener, Standing Committee
Sarah Whitley, Chair, Pension Fund Trustees

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Background information

1 What are the responsibilities of Church and Pension Fund Trustees?

As the ‘employer’ the Church is responsible for agreeing what benefits are provided to the scheme members. The Church in this context is deemed to be the General Synod (with Standing Committee acting on its behalf and liaising with the Pension Fund Trustees). The Pension Fund Trustees are independent of the General Synod and are responsible for administering the scheme in such a way to provide the agreed benefits.

2 What type of pension fund is it?

The Scottish Episcopal Church Pension Fund is a defined benefit pension scheme with benefits based on final Pensionable Stipend or Salary. This is a type of pension scheme often referred to as a final salary scheme. Membership of the scheme is open to both serving stipendiary clergy and provincial and diocesan staff. All contributions to the scheme are paid by the ‘employer’ (charges / dioceses / province.)

Actuarial Valuation

3 How do the Pension Fund Trustees assess whether there are sufficient assets to pay all future pensions?

The Trustees receive annual actuarial reports which estimate the Fund’s liabilities, the funding level and the ongoing contribution rate. A more detailed valuation is undertaken every three years. The triennial Actuarial Valuation is typically used as the basis for determining contribution rates, with annual reports to monitor progress. The Actuarial Valuation as at 31 December 2023 is underway and the Scheme Actuary has delivered his preliminary results.

4 How does the Scheme Actuary estimate if there are sufficient assets to pay future pension and what the contribution rate should be?

Pensions being earned today start being paid when each member retires and end when the member or their surviving dependant dies. The Fund’s liabilities therefore stretch over many decades. The purpose of the Actuarial Valuation is to estimate how much money the Fund needs to hold now, and what contributions are required in the future, to pay the pensions promised to the members. The Actuarial Valuation is therefore based on a number of assumptions which are discussed and agreed with the Pension Fund Trustees and the Standing Committee on behalf of the General Synod. Pensions legislation requires that the assumptions are based on prudent principles. The assumptions relate to issues such as investment returns, inflation, future stipend and salary increases, mortality rates, retirement age, pension increases, and the proportion of members married or in civil partnerships.

5 What are the preliminary results of the Actuarial Valuation?

The preliminary results of the Actuarial Valuation of the SEC Pension Fund as at 31 December 2023 provide some good news for those contributing to the costs of pensions (mainly charges) and scheme beneficiaries – they indicate that there is a surplus of £4.6m in relation to past service and that it will be possible to reduce the contribution rate from 2025.

The ***surplus*** of £4.6m relates to the costs of providing pensions that have already been earned. Effectively, based on current assumptions, it is estimated that the Fund has £4.6m more than needed to pay the pensions that current and future pensioners are entitled to in the future. (The Fund has been in surplus for some time – at the last Actuarial Valuation the surplus was estimated at £5.6m.)

The ***future service contribution rate*** is the estimated cost of accruing future benefits for serving members of the Fund and is used to calculate the contributions that ‘employers’ are required to pay for current clergy and staff. It is estimated that a contribution rate of 21.7% is required – a reduction from the current rate of 32.2%. (The 2020 Actuarial Valuation indicated that a contribution rate of 41% was required – General Synod 2021 however accepted a joint proposal from the Trustees and Standing Committee to effectively use part of the then past service surplus to subsidise the contribution rate and leave it unchanged at 32.2%.)

6 Why the big change since the last Actuarial Valuation?

The big change since the last Actuarial Valuation is the reduction in the future service contribution rate. The yield on UK government bonds (gilts) is an important factor in the calculation of future pension liabilities in the Actuarial Valuation. When gilt yields rise, the cost of providing pension reduces, and conversely falling gilt yields increase those costs. Over the last 25 years gilt yields gradually fell reaching all-time lows at the end of 2020. Gilt yields have increased since the 2020 Actuarial Valuation. The impact of this is most marked in the reduction in the future service contribution rate from 41% (2020) to 21.7% (2023).

7 Is this likely to be a permanent reduction in the contribution rate?

It is not possible to say whether the reduction will be permanent. As mentioned previously, contribution rates are reviewed every three years in the light of the results of each Actuarial Valuation. Experience has shown the sensitivity of the contribution rate to fluctuating gilt yields, but there are other factors such as mortality, interest rates, inflation and investment returns that affect the funding position.

As noted above, gilt yields fell to historically low levels following the financial crash of 2008 and have since increased to what some may consider to be more ‘normal’ rates. It is hoped that this may reduce the likelihood of a future increase in the pension contribution rate.

Standing Committee recognises that once a reduction in contribution rate is agreed it may create difficulties to increase it again. With this in mind, and recognising the inherent uncertainty in economic trends and future Valuation results, it recommends a contribution rate of 22% rather than the minimum rate of 21.7% suggested by the Actuarial Valuation. It is hoped that this slightly higher rate, combined with the Fund surplus, will help reduce the possibility of the need for a future rate increase and provide a degree of flexibility in the setting of Pensionable Stipend and Pensionable Salary.

8 Could the surplus be used in any other way?

We are fortunate that Actuarial Valuations have reported a surplus on the Pension Fund since 2014 and that the surplus is now £4.6m. The surplus has benefited both ‘employers’ (mainly charges) and scheme beneficiaries. As previously noted, the availability of the surplus prevented a contribution increase or reduction in benefits following the 2021 Valuation. The Standing Committee proposes that the surplus is used to fund increases in Pensionable Stipend (see below). Pensioners have also benefited from the surplus – it was used to fund discretionary increases for all pensioners in 2023, ensuring that the value of pensions was not eroded during a period of high inflation.

Pensionable Stipend

9 What is Pensionable Stipend and how does it relate to Standard Stipend?

Pensionable Stipend is used in the calculation of initial pensions paid to clergy retiring from active service. The pension paid from retirement is based on the number of years’ service and the Pensionable Stipend at the date of retirement.

All contributions made on behalf of clergy are related to Standard Stipend (with appropriate adjustments for part-time clergy) rather than actual stipend paid. Contributions are calculated as a percentage of Standard Stipend. Benefits paid (ie pensions in retirement) are calculated with reference to Pensionable Stipend. (Similarly, contributions for staff members are based on actual salaries and their benefits are calculated on Pensionable Salary.)

Changes in Standard Stipend are effective from 1 January each year. Changes in Pensionable Stipend are effective from the following 1 July. Until 2014 Pensionable Stipend always increased at the same rate as Standard Stipend, the Pensionable Stipend from 1 July being set at the same as the Standard Stipend rate effective from the preceding January. (The principles relating to changes in Pensionable Salary are broadly similar but different reference dates apply. This is explained below.)

10 Why did things change in 2014?

The Actuarial Valuation as at 31 December 2011, undertaken during 2012, indicated that the costs of future pension provision were increasing. Given that it was thought that there was no scope to increase the contribution rate beyond the then rate of 34.9% advice was sought on what steps could be taken to reduce the costs of future pension provision. Following consultation with serving members and those responsible for paying the contributions (charges / dioceses) two changes were agreed by General Synod in 2013:

> “That, subject to statutory consultation with members and due consideration by the Standing Committee of responses to such consultation, the Standing Committee request the Pension Fund Trustees to alter the Rules of the Scottish Episcopal Church Pension Fund with effect from 1 January 2014 as follows:-

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

The first of the changes effectively results in two years' more pension contribution and two years' less pension for members of the scheme and therefore helps to keep the contribution rate down. The second is to guard against high rates of inflation significantly increasing the costs of providing future pensions beyond what the Fund could afford. The combination of the two changes means that there is no need to increase the contribution rate.

11 How were the 2014 changes reflected in the Pension Fund rules and practice?

The operation of the Pension Fund is governed by its Trust Deed and Rules. The change in normal retirement age from 1 January 2014 was formally reflected in the Trust Deed and Rules. Given the complexities involved in the change agreed in relation to Pensionable Stipend the Trust Deed and Rules were amended to simply provide that Pensionable Stipend be "increased with effect from 1 July each year by such amount (if any) as the Church shall decide." To ensure that the terms of the General Synod motion were observed the Standing Committee adopted a practice note stipulating that increases in Pensionable Stipend would be limited to RPI but also allowing for the possibility of increases in excess of RPI:

- If Standing Committee of the view, after consultation with Pension Fund Trustees, that an increase in excess of RPI is appropriate and affordable it should seek General Synod agreement.

12 What effect has the change had on Pensionable Stipend since 2014?

Since 2014 there have been two years where increases in Standard Stipend have exceeded RPI and the cap on Pensionable Stipend increases was applied. There were however subsequent years where RPI exceeded increases in Standard Stipend allowing Pensionable Stipend to catch up with Standard Stipend. In all years other than 2015/16 and 2016/17 Pensionable Stipend has been the same as Standard Stipend.

13 What is the issue now?

The immediate issue is that on 1 January 2024 Standard Stipend increased by 7.8% to £32,988. The relevant rate of RPI for increases in Pensionable Stipend (December 2023) was 5.2%. If the RPI cap were applied it would limit Pensionable Stipend from July 2024 to £32,191. Any clergy retiring from July 2024 to June 2025 would therefore receive an initial pension based on a Pensionable Stipend that is lower than Standard Stipend.

In the medium to longer term there is a possibility that any gap between Standard Stipend and Pensionable Stipend will increase if the RPI cap continues to be applied. General Synod 2021 committed the SEC to above inflation increases in Standard

Stipend until such time as Standard Stipend was restored to its 2006 level adjusted for inflation since then. Although different measures of inflation are applied and different reference dates used, the application of the currently agreed stipend policy and the RPI cap could result in a widening gap between Standard Stipend and Pensionable stipend.

14 What is the proposed solution?

To address the immediate issue Standing Committee is seeking General Synod's approval to increase Pensionable Stipend effective from 1 July 2024 by 7.8% to £32,988, in line with the current rate of Standard Stipend.

To help limit the possibility of a widening gap between Standard Stipend and Pensionable Stipend Standing Committee is seeking General Synod's approval for discretion to increase Pensionable Stipend by more than RPI when required, and deemed affordable, to maintain parity, as far as possible, with Standard Stipend.

15 Is the suggested solution affordable?

Specific actuarial advice on the proposed increase of 7.8% in Pensionable Stipend from 1 July 2024 has been obtained. It suggests that the discretionary element of the increase (the difference between RPI (5.2%) and the proposed increase of 7.8%) adds about 0.35% to the contribution rate in terms of future service and reduces the surplus by approximately £260,000. The Actuarial Valuation assumes that the proposed increase is implemented and therefore both the surplus of £4.6m and the future contribution rate of 21.7% referred to above already reflect its impact.

It is not possible at this stage to quantify the costs of similar above RPI increases in the future. Standing Committee would however liaise with the Pension Fund Trustees and obtain specific advice from the Scheme Actuary should it wish to exercise its discretion and increase Pensionable Stipend by more than RPI in any future year. Standing Committee would only make such discretionary increases if it was satisfied that they were affordable.

16 Why is Standing Committee proposing these changes?

Standing Committee recognises the need to balance the costs of pension provision borne by employers with the benefits provided to members of the pension scheme. Indeed, the effective reduction in the benefits payable to scheme members from 2014 was prompted by the need to maintain benefits to members as far as possible but within a given cost limit. Given the changes in circumstances since 2014, and, in particular, the welcome news that a reduction in contribution rate will be possible following the recent Actuarial Valuation, Standing Committee considers it appropriate to seek to limit any further reduction in member benefits by implementing the changes it has suggested. It notes that, notwithstanding the proposed change, it will be possible to reduce the contribution rate and the costs borne by employers.

Generally, Standing Committee has been able to agree Pensionable Stipend each year several months in advance of the 1 July implementation date which is helpful to anyone considering retirement later in the year and seeking pension forecasts. From a practical point of view, delaying any decisions on discretionary increases to Pensionable Stipend to General Synod each year will hinder the provision of pension forecasts – hence the reason for asking Synod to grant Standing Committee discretion for the future.

17 Would the contribution rate be lower if the proposed changes were rejected?

Yes. There is a cost implication to the proposed 7.8% increase in Pensionable Stipend this year and the possibility of increases in excess of RPI in future years. The Actuary has advised that the proposed 7.8% increase in Pensionable Stipend effectively adds 0.35% to the required contribution rate (compared with a capped increase in Pensionable Stipend). The cost implication of the proposed change for this year is therefore not considered to be material and is already reflected in the results of the Actuarial Valuation.

18 What has changed since 2014?

The changes in benefits agreed following the 2011 Valuation have helped improve the Fund's position, as intended. As detailed above the methodology used in Actuarial Valuations depends on a number of assumptions and economic factors, some of which have changed since 2011. The most significant change has been the change in gilt yields outlined above.

19 What about Pensionable Salaries?

Clergy pensions are related to Pensionable Stipends. Staff pensions are related to Pensionable Salaries. The issues outlined above relating to Pensionable Stipends are reflected in very similar issues with Pensionable Salaries. The timing of changes in salary and Pensionable Salary are different to equivalent stipend changes. Consequently the reference dates for RPI are also different. The general principle that a gap could develop between salary and Pensionable Salary is however this same. (Similar to the position for stipends, such a gap did exist from 2015-2017. Since then Pensionable Salary has been equal to Actual Salary.) The 2024 increase in Pensionable Salary is not due to be agreed until September based on RPI to July – hence there is no specific proposal for Synod's consideration. In seeking Synod's approval to greater discretion in the setting of Pensionable Stipend Standing Committee is seeking the same discretion with regard to Pensionable Salary.