

Pension Consultation with members of Methodist Ministers' Pension Scheme (MMPS)

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Status of Paper	Final
Action Required	Decision
Resolution/s	As contained in the paper

Summary of Content and Impact

Subject and Aims	To consider the recommendations of the Finance Sub Committee (FSC) of the Strategy and Resources Committee following the consultation with MMPS members concerning a change to increases to pensions in payment awarded in relation to both past and future service to be linked to the Consumer Price Index (CPI) rather than Retail Price Index (RPI).
Main Points	<p>The 2014 triennial valuation has been concluded and MMPS was showing a shortfall in the Scheme of £40 million, however the 2015 funding update showed that the shortfall had increased to £53.1 million if pension increases continued to be based on the RPI. If this situation continued the total contribution rate would be close to 50% of stipends.</p> <p>The shortfall could reduce by approximately £24 million if pension increases awarded in relation to both past and future service were linked to the annual rate of the CPI rather than the RPI.</p> <p>A consultation with members took place to gain views on the change to CPI with a reduction in both Church and member contribution rates. The majority of members who responded were supportive of the changes. The FSC is recommending that pension increases awarded in relation to both past and future service are linked to the annual rate of the CPI once the results of the 2017 actuarial valuation are known ie from 1 September 2018. There is no recommendation regarding the reduction in contributions at this stage because of the worsening funding position.</p>
Background Context and Relevant Documents	The results of the 2014 Actuarial Valuation were considered by (MC/15/32).
Consultations	A consultation with all members of MMPS took place between 5 November 2015 and 4 February 2016.
Impact	The shortfall would reduce if it was agreed to link the pension increases to CPI rather than RPI from 1 September 2018.

Background

1. The results of the 2014 MMPS Actuarial Valuation revealed a reduction in the shortfall from £58.4m in 2011 to £40.0m in 2014. However, there was an increase in the total future service contribution rate from 22.2% of standard stipend in 2011 to 26.4% of standard stipend on the agreed basis for 2014. The increase in the future service contribution rate is mainly due to the fall in bond yields.
2. The Conference agreed that the total Church contribution rate should continue at the rate of 26.9% of standard stipend, this being 17.1% in respect of the future service contribution rate and 9.8% in respect of shortfall contributions. In addition, £1 million per annum continues to be paid from the Pension Reserve Fund until the end of the recovery period. The end of the recovery period remained unchanged at 31 December 2020.
3. The issue of affordability of Church contributions for some circuits was discussed by the Trustee with the Finance Sub-Committee and a recommendation to consider future contributions was made to the Methodist Council.
4. One option considered by the Methodist Council was to link future pension increases awarded in relation to both past and future service to the Consumer Price Index (CPI) rather than the Retail Price Index (RPI). Due to the differences in how the indexes work CPI is, on average, around 0.75% to 1% per annum lower than RPI which would result in lower expected increases to pensions in payment.
5. Based on the September 2014 valuation, the impact on the shortfall if pension increases were linked to CPI rather than RPI would be to reduce it from £40m to £15.8m, reducing the shortfall contributions to 4.3% of standard stipend (from 9.8%) and reducing the recovery period to three years. The effect on the total future service rate would be to reduce it from 26.4% of standard stipends to 25.8% of standard stipend.
6. If pension increases awarded in relation to both past and future service were linked to CPI rather than RPI the total Church rate could reduce from the current rate of 26.9% of standard stipends to 20.8% of standard stipends (if the member contribution rate remained at 9.3% of standard stipends). This is based on the results of the 2014 Actuarial Valuation.
7. Alternatively, the member contribution rate could also reduce in a proportionate way, for example, the total Church contribution rate could be 22.8% of standard stipends and the member contribution rate could be 7.3% of standard stipend. Again this is based on the results of the 2014 Actuarial Valuation.
8. A history of RPI and CPI rates for each January since 2008 is shown in the table below:-

Year	RPI annual rate %	CPI annual rate %
2016	1.3	0.3
2015	1.1	0.3
2014	2.8	1.9
2013	3.3	2.7
2012	3.9	3.6
2011	5.1	4.0
2010	3.7	3.5
2009	0.1	3.0

2008	4.1	2.2
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9. The Council recognised the importance of the Church continuing to provide a defined benefit pension scheme for ministers. It considered the balance between the long-term affordability of the scheme for the Church and the level of benefits that are provided. It agreed that this potential change should be consulted upon whilst the Church can control the timescales and have a full consultation without the outcome being driven by the needs of a valuation.
10. The 2015 Conference agreed to consult with members over a change to the benefit structure to link future pension increases awarded in relation to both past and future service to CPI rather than RPI.
11. A letter and consultation document was sent to all members of MMPS on 5 November 2015 with a closing date for responses to the consultation of 4 February 2016. A copy of the letter and document is attached as appendix 1.

Response to the Consultation

12. There were 174 responses to the consultation by either email or letter. A summary of the responses to whether the index used to calculate pension increases be changed from RPI to CPI is given below

Should the index used to calculate pension increases be changed from RPI to CPI?		
For	Against	Neutral (comments only)
112 (64%)	42 (24%)	20 (12%)

13. The FSC noted their appreciation for all the responses received and the time and soul searching from ministers.
14. A number of alternative suggestions were made during the consultation and these are summarised in paragraph 27, together with the consideration given by the FSC.

Implications of a deterioration in the funding level since the 2014 valuation

15. The Scheme Actuary made the Trustee Board aware of the funding implications of the possible change to CPI pension increases following the annual funding update as at 1 September 2015. The preliminary results of the funding update show that the Scheme's funding position had worsened since 1 September 2014.
16. The past service shortfall had increased from £40m as at 1 September 2014 to £53.1m as at 1 September 2015 if RPI increases continued.
17. If the Conference decided to amend the benefit structure with effect from 1 September 2016 then members would expect to see an immediate reduction in their contribution rate, but this would not now be affordable based on the updated funding position.
18. A comparison of the funding position as at 1 September 2014 and 1 September 2015 is given below.

	Position if pension increase continue in line with RPI		Position if pension increase changes to CPI from 1.9.2016	
Valuation date	1.9.2014	1.9.2015	1.9.2014	1.9.2015

Shortfall	(£40.0m)	(£53.1m)	(£15.8m)	(£27.0m)
Church Contributions	26.9%	40.1%	22.4%	24.7%
Member Contributions	9.3%	9.3%	7.7%	8.6%
Total Contributions	36.2%	49.4%	30.1%	33.3%

19. **The Actuary advised that a full valuation would be required to re-assess the contribution requirements.** A formal valuation would need to be carried out as at 1 September 2015 in order for there to be time for this to be formalised and implemented with effect from 1 September 2016. A new Statement of Funding Principles, Recovery Plan and Schedule of Contributions would be required which was agreed with the Conference.
20. An alternative would be to delay any benefit change until 1 September 2018 then the contribution calculations could be incorporated into the next formal valuation as at 1 September 2017. This would avoid the need for an out-of-cycle valuation but it would mean that a further two years' of RPI pension increases would be granted in the meantime.
21. The Actuary advised that if RPI exceeds CPI by 0.7% between 2016 and 2018 then current pensions in payment could become around 1.4% higher than they would have been had CPI pension increases been applied. This difference has an estimated financial impact of around £3.7m (the ultimate impact will depend on the actual difference between RPI and CPI).
22. The following options were available

Option	Impact on Scheme
1) Do nothing – pension increases remain linked to RPI	No changes to the Scheme benefits and hence no changes to the valuation requirements. Contributions would next be reviewed at the formal valuation due as at 1 September 2017.
2) 2016 change – pension increases become linked to CPI with effect from 1 September 2016	The lower expected pension increases are implemented immediately. There are two options for reviewing the contribution requirements: a) A formal valuation is undertaken as at 1 September 2015 and the expected reduction in contributions is implemented with effect from 1 September 2016; or b) A formal valuation is not undertaken until 1 September 2017 (in line with the current triennial cycle). In this case the expected reduction in contributions could not be implemented until 2018.
3) 2018 change – pension increases become linked to CPI with effect from 1 September 2018	The lower pension increases are not implemented until 2018. This delay in implementation has an expected cost of around £3.7m relative to option 2. A formal valuation would be undertaken as at 1 September 2017 in line with the current triennial valuation cycle and the expected reduction in contributions implemented in 2018.
4) Choose one of the alternative suggestions (as noted in paragraph 28)	This option would need to be assessed from a funding and contribution requirement perspective by the Actuary. If any change is agreed for 2018 this could form part of the formal valuation undertaken as at 1

Consideration of consultation responses by the Finance Sub-Committee (FSC)

23. The FSC met on 10 February 2016 and 29 February 2016 to discuss the responses to the consultation, the implications of the deterioration in the funding level and the alternative suggestions made.
24. The deterioration in the funding level was an important consideration as the actuary would need to complete a formal valuation to enable the Trustees to agree to a reduction in contribution rates. Any reduction in contributions rate from 2016 would be much lower than originally expected. As a result the FSC would not recommend that an additional formal valuation be undertaken as the affordability of contribution rates by circuits would not be addressed.
25. The FSC recognised that the change to pension increases in line with CPI is unlikely to eliminate the shortfall in isolation, and that a further Recovery Plan would need to be put in place following the 2017 valuation.
26. The FSC noted that 174 responses had been received, of which the majority were supportive of the changes. The FSC went through each of the 174 responses on a page by page basis.
27. The FSC recognised the importance of providing a defined benefit pension scheme for the ministers. The Church is working hard to keep the defined benefit scheme open during difficult financial and economic conditions as well as dealing with the financial impact of members living longer than previously expected.
28. A number of alternative suggestions were made by members of MMPS and each one was considered by the FSC. The following table shows a summary of each of the alternative suggestions, together with the consideration of the FSC.

	Alternative suggestions	Details	FSC consideration
1	Accept the change to CPI but set a minimum Increase each year	To move to CPI but have a minimum increase level of, say, 0.5%.	To be considered as part of the 2017 valuation. Any minimum increase would be at the Trustee's discretion and only apply if the Scheme's funding position could support such an increase. Year by year application is already permitted by the Scheme's Rules.
2	Close the MMPS to new entrants	To close the current final salary scheme to new entrants as the scheme is not sustainable and membership is in decline	The FSC recognised that the covenant applies to all ministers, including future ministers and that closing the Scheme to new entrants would not reflect that covenant. It would also still leave the deficit to cover.
3	Phase in the change over three years	To phase in the change over a period of three year. Year one - 66% RPI 34% CPI, year two - 50% of RPI and CPI, year three - 34% RPI and 66% CPI. Year four would then be 100% CPI	As the recommendation is to delay any change to CPI for two years further phasing would not be recommended.

4	Use an average of RPI and CPI	To pay an increase that was an average of RPI and CPI	The rules determine that a single index to be used so that would be either RPI or CPI. Any other increase or an average of these is unlikely to be agreed by HMRC
5	To establish a hardship fund	A hardship fund set up for ministers for whom the reduction will cause significant hardship	There are already a number of financial support funds in place. The FSPD would be highlighted in the consultation response sent to all MMPS members
6	Joining the Church of England Pension Scheme	Either have unpaid ministers so no pension is awarded or join the Church of England Pension Scheme	It is very unlikely that Methodist ministers could join the Church of England Pension Scheme. The suggestion of unpaid ministers is outside the scope of this consultation.
7	Increasing pensions in line with increases given to stipends	Use the same increase for pensions in payment as the CAC uses in assessing percentage increase for stipends. Presently use AWEI+CPI /2 but that is reviewed very three years	The rules allow for a single index to be used so that would be either RPI or CPI. Any other increase is unlikely to be agreed by HMRC.
8	Use the Pensions Reserve Fund	To pay for the shortfall with the Pensions Reserve Fund or a levy on the District Advance Fund	The Pension Reserve Fund (PRF) is already being used to support MMPS and the use of the PRF is already considered at each valuation. The distribution to District Advance Funds is already reduced due to the PRF levy.
9	Wait until the end of the five year plan and then review	The current five year plan appears to be achieving what it set out to do, so it should run its course, and only at the end of that five year period consider any further proposals for change if they are considered to be necessary.	The Recovery Plan is considered at every valuation. The expectation is that MMPS may need to look beyond 2020 to fully fund the Scheme, given present market trends.
10	Continue to contribute at the current rate and having a two-tier approach	Allow ministers to contribute at the higher rate and continue to have increases in line with RPI. A lower contribution rate could be introduced for ministers that elect CPI based increases	Although the FSC appreciate the sentiment the effect of such a two-tier system on the scheme funding would be minimal as it would only apply to a limited number of active ministers.
11	Circuit contributions to be based on membership rather than ministers	To move to a situation where future service contributions are collected from Circuit in the current way but the costs to reduce the deficit are charged to the circuits based on Church membership (or similar) as part of the circuit assessment so that the burden is more evenly spread and the costs not just on the circuits that maintain or increase their staffing levels	Circuit contributions are based on the number of active ministers that Circuit has. Church membership varies by number but also by income so may not be a fair approach. The data collection and calculation costs are prohibitive

12	Wait until the next valuation	To move to CPI if the next valuation requires contributions to increase – if on track with recovery plan remain with RPI	The suggestion to wait to the next valuation is to be recommended. Based on the funding update in 2015 it appears unlikely that the Scheme will be on track with the recovery plan but this will be reviewed as part of the 2017 valuation.
13	Change to CPI increase for future service only	To change increases for service from 1 September 2016 to CPI to a maximum of 2.5% p.a.	The change to CPI for future service would only have a minimal impact on the scheme funding and levels of contribution rates.
14	Accept change but reverse change when conditions improve	To accept the change but monitor and if the funding position improves to revert back to RPI	To be considered at each valuation. Any increase above CPI would be discretionary and only apply if the Scheme's funding position could support such an increase
15	Any reduction in contributions applied to circuit contributions only	The whole reduction to be set against circuit contributions as the church contribution has proportionally increased to a much greater extent	The FSC consider it reasonable that any reduction in contributions rates be proportionately applied between the Circuits and active ministers. The impact of a reduction in contribution rates would be much greater for Circuits due to the current split of contributions.
16	Change to CPI but do not reduce contributions	To move to CPI but maintain the existing contributions to continue to reduce the shortfall	To be considered as part of the 2017 valuation. Based on the funding update in 2015 it appears unlikely that the contribution rates will reduce as much as originally expected.
17	Wider mission considerations	To consider the wider mission – any change should enhance and enrich the mission of God.	Agreed.

Recommendation of the Finance Sub-Committee (FSC) to the Methodist Council

29. The recommendation of the FSC would be to move to CPI as the index used to calculate pension increases after the 2017 actuarial valuation ie from 1 September 2018. Pension increases would continue to be based on the increase in line with RPI for the next two years and contribution rates would be maintained at their current rates until the outcome of the 2017 actuarial valuation was known.
30. Any reduction in contribution rates from 1 September 2018 would be evaluated after the 2017 valuation as the change in economic conditions since the 2014 valuation does not allow for the flexibility that was previously expected. If future market and economic conditions allowed for a review of contributions then the aim would be to reduce contributions in proportion to the current contribution rates.
31. The FSC also recommends that consideration be given to providing minimum increases on a purely discretionary basis but recognised that this would be subject to consultation with the actuary and agreement between the Trustee and the Conference.

32. The FSC recognised the financial implications of continuing to use RPI as the index for pension increases for the next two years; currently estimated as a cost of £3.7m. In view of this the FSC recommends that the Conference consider using the Pension Reserve Fund as a possible avenue to cover the cost of the financial impact of pension increase continuing to be based on increase in line with RPI for the next two years. This could form part of the 2017 valuation funding negotiations.
33. It was noted that both legal and actuarial advice had been provided which confirmed that a second consultation will not be required. The 2015 consultation can introduce changes from 2018, provided that the decision is made at the 2016 Conference and communicated to all MMPS members after the 2016 Conference.

*****RESOLUTIONS**

46/1. The Methodist Council notes the summary of responses to the consultation and recommends to the Conference the following:

- that increases to pensions payment in relation to both past and future service be linked to the Consumer Price Index rather than the Retail Price Index with effect from 1 September 2018.
- that any reduction in contributions rates from 1 September 2018 be evaluated as part of the 2017 actuarial valuation with the aim of reducing contributions in proportion to the current contribution rates if the funding position could support such a reduction in contribution rates.
- that consideration be given to awarding discretionary increases on or after 1 September 2018 if the funding position could support such an increase and subject to consultation with the MMPS actuary and agreement between the Trustee and the Conference.
- that consideration be given to using the Pension Reserve Fund to cover the cost of the financial impact of continuing using Retail Price Index for pension increases awarded on 1 September 2016 and 1 September 2017.