Pensions Valuation for Methodist Ministers' Pension Scheme (MMPS)

Basic Information

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Status of Paper	Draft
Action Required	Decision
Draft Resolutions	
Alternative Options	As outlined in the paper

Summary of Content

Subject and Aims	To note the results of the triennial valuation for MMPS and confirm the basis of the assumptions agreed between the Trustee Board and the Finance Sub-Committee (FSC) of the SRC and the ongoing contributions to the Scheme.
Main Points	The triennial valuation has been concluded and the Trustees have discussed and agreed the basis for the assumptions with the FSC. MMPS is showing a lower shortfall in the Scheme at this valuation although there has been an increase in the cost of providing future service benefits. The total Church contribution rate remains at 26.9% from 1 September 2015. The shortfall could reduce by a further £24.2m if pension increases awarded in relation to both past and future service were linked to CPI rather than RPI. A consultation with members would be required before the Conference could decide in 2016.
Background Context	The paper follows agreement between the Trustee Board and the FSC and follows the presentation to the Methodist Council in January 2015.

Summary of Impact

Financial	The shortfall and contribution rates could reduce if the proposed benefit change was agreed and implemented following consultation.

Methodist Ministers' Pension Scheme (MMPS) Valuation Results

Introduction

1. The valuation results for MMPS have been based on the actuarial basis which has been agreed between the Trustee and the Finance Sub-committee (FSC) of the Strategy and Resources Committee (SRC).

2. It has been agreed that the Methodist Council, on behalf of the Conference, will make the decisions required on scheme funding issues. In addition, it will recommend changes to the benefit structure for agreement by the Conference in respect of MMPS.

3. The actuarial valuation is essentially a planning exercise. The output is a level of contributions that is considered likely to be sufficient to meet the future liabilities of the Scheme and, where a shortfall exists, the contributions that are required to meet the funding target.

4. The technical provisions of the Scheme (the past service liabilities) are derived by projecting forward benefit cash flows, for up to 80 years or so, and discounting these to the valuation date with an allowance for anticipated investment returns that are believed to be prudent. This is different to an economic valuation or the price that would need to be paid to secure the liabilities with a third party, both of which would result in higher values.

5. The results of the valuation have 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 proposed basis for 2014. The increase in the future service contribution rate is mainly due to the fall in bond yields.

6. The Church future service contribution rate would increase to 17.1% of standard stipends if the member contribution rate was maintained at the current rate of 9.3% of standard stipend. The current Church total contribution rate is 26.9% of standard stipends, which includes 14% in respect of shortfall contributions.

7. This paper proposes that the Council agrees to recommend to the Conference that the Church contribution rate continues 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.

8. The paper also proposes that the Council agrees to recommend to the Conference 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. This is outlined in more detail from paragraph 27.

The employer's covenant

9. As part of the consideration of the preliminary valuation results, the Trustee must have regard to the strength of the covenant of the Methodist Church.

10. The Trustee had extensive discussions with the FSC and a comprehensive review of the covenant of the Methodist Church has been provided to enable the Trustee to assess the strength of that covenant.

11. The strength of the covenant of the Methodist Church will help determine how prudent the actuarial assumptions need be.

Prudent assumptions

12. Funding assumptions need to be made about the likely course of events.

13. The regulations require that the assumptions overall are chosen prudently. By prudent, the regulations require assumptions which, if the Scheme continues on an ongoing basis, are more likely to overstate than understate the amount of money actually required to meet the cost of the benefits.

14. In particular, the Pensions Regulator expects prudent assumptions to be used for the discount rate and mortality rate used in the calculations.

Assumptions

15. The valuation results have been produced using a set of actuarial assumptions which the Trustee Board has agreed with the FSC.

Assumption	Proposed basis for 2014 valuation	Any change from 2011 valuation basis
Pre Retirement Discount Rate	Gilts + 2.0% = 4.7%	Updated to reflect current market conditions
Post Retirement Discount Rate	Gilts + 1.0% = 3.7%	Updated to reflect current market conditions and current investment strategy
Pensionable Earnings Increases	CPI + 0.75% = 3.25% pa	Updated to reflect current market conditions
Pension Increases	As guaranteed in the Rules, based on RPI increases	Updated to reflect current market conditions
Commutation	An allowance for members to commute 15% of their pensions for a lump sum	No change
Mortality	Most up to date tables and improvement factors	A change to using the most up to date tables
Expenses	2.3%	An increase from 2.0% to reflect increased regulatory fees

16. A copy of the Statement of Funding Principles agreed by the Trustees which will require signature on behalf of the Methodist Council is attached to this paper.

Assets

17. The assets of the Scheme had a market value of £384.0m as at 31 August 2014. On the valuation basis the Scheme was 90.6% funded as at 1 September 2014.

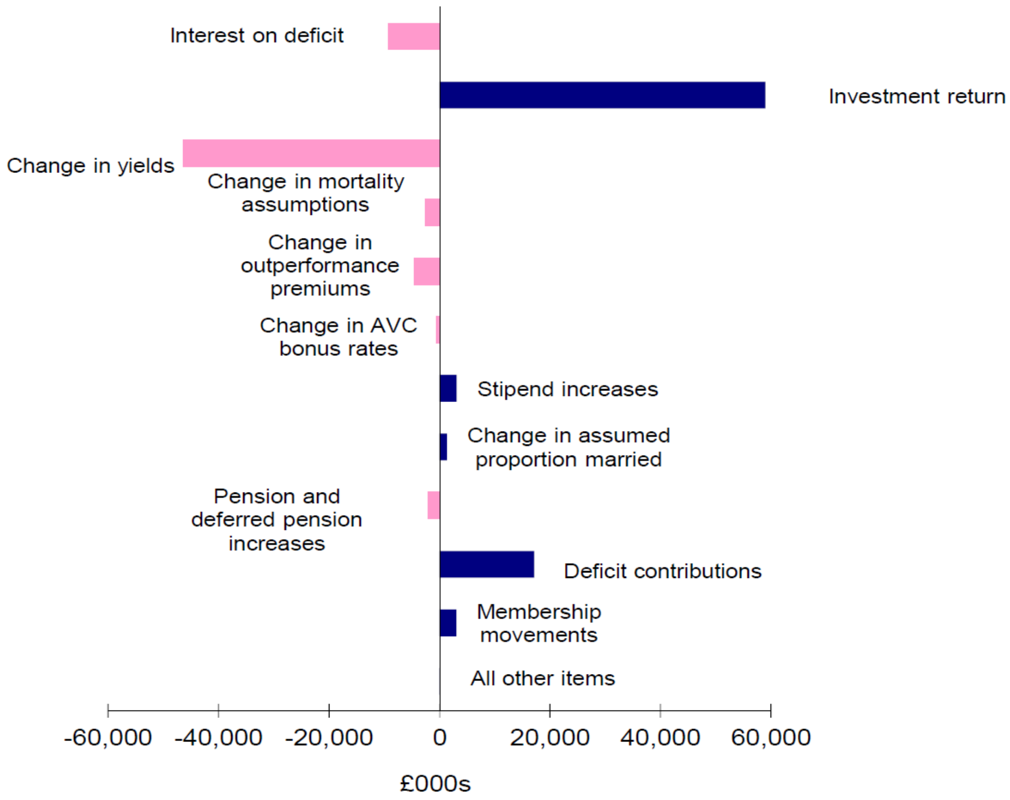
Results

18. The results of the actuarial valuation compared to the previous valuation in 2011:

	2014	2011
Technical provisions (liabilities)	£424.0m	£355.9m
Market value of assets	£384.0m	£297.5m
Past service shortfall (£'m)	£40m	£58.4m
Funding ratio	90.6%	83.6%
Total future service contribution rate (% standard stipend)	26.4%	22.2%

Change in funding position

19. The valuation carried out as at 1 September 2011 revealed a shortfall of £58.4m. The position has improved as the shortfall has fallen to £40.0m, and the graph below shows the main factors to the change in funding level position over the three years to 1 September 2014:



20. Although the change in yields had significantly increased the value placed on the liabilities under the Scheme, this was offset by the better than expected investment return. In addition the deficit contributions paid in the three years to 1 September 2014 helped reduce the shortfall to £40m.

Membership

21. The Membership profile as at 31 August 2014 is shown in the table below. For comparison, figures as at 31 August 2011 are shown in brackets.

Active	1,518	(1,610)

Deferred	306	(220)
Pensioners	2,646	(2,583)
Total	4,470	(4,413)

Recovery plan

22. The valuation results have revealed a shortfall of £40m and the recovery plan to eliminate this shortfall will need to be agreed with the Methodist Council and the Conference.

23. At the previous valuation, a shortfall of £58.4m was revealed. The current contributions being paid to eliminate this shortfall are contributions of 14.0% of standard stipends to 31 December 2020 together with £1m p.a. from the Pension Reserve Fund.

24. The Finance Sub-Committee recommends that the Council agrees that there should be no change to the expected end of the recovery plan of 31 December 2020. In order that there is no change to the expected end of the recovery plan, shortfall contributions of 9.8% of standard stipends will be required in addition to the future service contributions.

25. In addition to the shortfall contributions the payment of £1 million per annum from the Pension Reserve Fund will continue until the end of the recovery plan.

Contributions

26. If the Recovery Plan is agreed by the Council and the Conference then the total Church contribution will remain unchanged at 26.9% of standard stipends. The member contribution rate would also remain unchanged at 9.3% of standard stipend.

Future Contributions – alternative option from 1 September 2016

27. The Methodist Council may wish to recommend that the Conference consults with members throughout 2015/2016 regarding a possible change to pension benefits to reduce the employer contribution rate (and possibly the member contribution rate) from 1 September 2016.

28. Any change to members' benefits would be subject to consultation with members and therefore any change would need to be agreed at the 2016 Conference once responses have been received and considered.

29. One option considered by the FSC 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.

30. The effect on the shortfall if pension increases were linked to CPI rather than RPI would be to reduce the shortfall from £40m to £15.8m, reducing the shortfall contributions to 4.3% of standard stipends (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 stipends.

31. 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. Alternatively, the member contribution rate could also reduce,

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.

32. The table below shows the previous contribution rates:-

Period from	Church rate % standard stipend	Member rate % standard stipend
01.09.1988 – 31.08.2003	10.0	6.0
01.09.2003 – 31.08.2006	13.5	6.0
01.09.2006 – 31.08.2009	17.0	7.0
01.09.2009 – 31.08.2010	22.0	9.0
01.09.2010 – 31.08.2012	25.6	9.0
01.09.2012 – 31.08.2013	26.6	9.0
01.09.2013 – 31.08.2014	26.9	9.3

33. The current pension increase is based on the RPI for January each year. Pensions earned before 31 August 2006 are based on RPI but capped at 5% per annum, and pensions earned after 1 September 2006 are based on RPI but capped at 2.5% per annum..

34. A history of RPI and CPI annual rates for each January since 2008 is shown in the table below:-

Year	RPI annual rate %	CPI annual rate %
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

Solvency position

35. The Actuaries also reviewed the position if the Scheme were discontinued on the valuation date with all members treated as having left service and the Scheme assets used to buy immediate and deferred annuities from an insurance company.

36. The solvency estimate provides an indication of the extent to which the Trustee is reliant on the Church to stand behind the Scheme.

37. The solvency position as at 1 September 2014 and compared to 1 September 2011 is as follows:

	2014	2011
Shortfall	£138.4m	£187.5m
Funding level	73.5%	61%

Next Steps

38. To finalise the valuation a formal report will be produced by the Actuary together with other documentation, detailed below, which will require signature on behalf of the Methodist Council.
    - Statement of funding principles
    - Recovery plan
    - Schedule of contributions

39. A copy of the Statement of Funding Principles, the Recovery Plan and the Schedule of Contributions agreed by the Trustees are attached to this paper.

*****RESOLUTIONS**

32/1. The Council agrees, on behalf of the Conference, to the Statement of Funding Principles, including the assumptions proposed by the Trustee of MMPS as the basis of the Actuarial Valuation and authorises it to be signed on its behalf.

32/2. The Council agrees to the Recovery Plan and recommends to the Conference that a contribution of £1 million per annum from 1 September 2015 continue to be made from the Pension Reserve Fund to MMPS for the duration of the recovery period ie a further 6 years.

32/3. The Council agrees to the Schedule of Contributions and recommends to the Conference to retain the existing Church contribution rate of 26.9% of standard stipends from 1 September 2015.

32/4. The Council recommends to the Conference that a consultation be initiated with members on a change to benefits to link the pension increases awarded in relation to both past and future service to the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) from 1 September 2016.

[Note: This would be subject to further consideration at the 2016 Conference if, subject to consultation with members, it was subsequently agreed.]