The Church of England Pensions Board

Annual Review 2016

WELCOME

2016 was challenging for the Board and one where we had to make some difficult decisions about the services we offered.

Each year we carry out a valuation of one of the pension schemes for which we act as trustee. At the end of 2015, it was the turn of our largest fund, the Church of England Funded Pensions Scheme. This provides pensions and associated benefits for clergy and others in stipendiary ministry for service from 1 January 1998; benefits arising for service prior to that date are wholly funded by the Church Commissioners.

The valuation was completed during the course of the year and showed good progress towards our objectives. Economic circumstances since the valuation date have however had a substantial negative impact on the scheme's funding position, and the Archbishops' Pensions Task Group, of which I am a member, continues to keep the scheme under close review. 2016 has been very volatile for the fund, and the Board has initiated several measures aimed at increased stability.

Investing the pension funds in an ethical manner is important to us and to the Church as a whole. We are grateful for the advice received from the Ethical Investment Advisory Group over the years. The recent focus has been on climate change and on investment in extractive industries (mining etc), following the launch of a new policy on climate change in 2015. As part of the implementation programme, we played a key role in the development of the Transition Pathway Initiative (TPI); this was a joint initiative by the National Investing Bodies of the Church of England and the Environment Agency Pension Fund. TPI enables us, and others, to make informed judgements about how companies with the biggest impact on climate change are adapting their business models to prepare for the transition to a low carbon economy. The development of TPI was a significant international intervention by the Church investors, and attracted the support of other asset owners and funds that together have over £2 trillion in assets under management. We will now be using TPI analysis to engage with companies. Importantly this initiative delivers on the commitments we made in our climate change policy to play our part in supporting the transition to a low carbon economy.

In the autumn the Board made the decision to close the Manormead Nursing Home; it subsequently closed early in 2017. The Board took this heart-breaking decision with very considerable regret, and after a good deal of soul-searching. But we agreed that we had reached a point where we were unable to staff the home in a way which met the needs of our residents and minimised the risks to them and others.

2017 brings fresh challenges to the Board. On the pensions front we will be looking at the valuation of the Church Workers Pension Fund. This fund operates as a centralised occupational pension scheme for over 300 employers of lay staff connected with the ministry and mission of the Church of England, including diocesan offices, cathedrals, mission agencies and parishes. We will continue to seek to deliver a professional, high quality service to our customers, respecting their needs and the interests of those who fund it.

Jonathan Spencer
Chairman

THE CHURCH OF ENGLAND PENSIONS BOARD AT A GLANCE

The members of the Pensions Board represent a balance of skills and expertise and are drawn from a wide range of constituencies. The majority of members serve on at least one or more of the Board's Committees.

21.2%

total return for all pension assets in 2016

£2.3 bn

funds under management

over 38,000 people rely on us to administer their pension

We provide retirement services for those who have served or worked for the Church

£27.7 m

spent on charitable activities

over 450 employers participate in our pension schemes

over 2,000 retired clergy and their dependants housed

PENSIONS

Over 38,000 people, working for over 450 employers, rely on us to administer their pensions. The majority of these people are stipendiary clergy within the Church of England, the remainder, around one-third, work in parish offices, dioceses, cathedrals and in Church House.

In **delivering pensions administration** for over 38,000 people, we seek to understand our customers' needs and expectations. We seek feedback on our service from all new pensioners. We have also strengthened links with the employers who participate in our funds through regular communication and hosting regional workshops.

Any customers and employers can phone or email one of our experienced pensions administrators based in Westminster. The team receives hundreds of queries each month, ranging from organisations interested in joining the CWPF, to individuals notifying us of a change in either their personal circumstances or that of a member of one of the schemes.

The team can be contacted on 020 7898 1802 or by emailing pensions@churchofengland.org.

During 2016 we completed the actuarial valuation of the largest of pension schemes, the Church of England Funded Pension Scheme (CEFPS). This provides pensions and associated benefits for clergy and others in stipendiary ministry for service from 1 January 1998; benefits for service prior to that date are wholly funded by the Church Commissioners.

The valuation provided a snapshot of the funding position of the scheme at 31 December 2015. In doing this the trustees had to make assumptions regarding the assets and liabilities of the fund. The actuarial valuation for the CEFPS showed that the scheme had a deficit of £236 million but a recovery plan is in place to bring the scheme back to full funding.

The benefits structure is linked to the National Minimum Stipend (NMS), with the amount of pension earned related to the length of service carried out. The scheme rules provide for increases at the rate of the change in the Retail Prices Index, subject to a maximum rate increase.

The **Church Workers Pensions Fund (CWPF)** is our most complex scheme. It provides a service to employers linked to the ministry and mission of the Church of England. As parishes and organisations look for pension schemes for their employees, an increasing number have joined this particular scheme; there are currently around 450 employers participating in the scheme, some with only one or two employees in a parish, and others with several hundred.

The scheme has two sections – a defined benefits section and the "Pension Builder" section. Pension Builder comprises two hybrid sub-sections where the level of contributions is chosen by the employer. Under *Pensions Builder Classic* the contributions provide an amount of pension payable at the member's normal pension age. *Pensions Builder 2014* provides a lump sum that members use to provide benefits at retirement. Bonuses are added from time to time, depending on the investment return earned by the fund and the financial position of the sub-sections

We are currently undertaking an actuarial valuation of the CWPF, looking at the funding position of the scheme. We will complete the valuation by the end of March 2018 but the key results will be provided to participating employers during 2017. The last valuation (as at 31 December 2013) showed the defined benefit section had a deficit of £12.9 million; and the pension builder section had a small surplus. Throughout the process we will be working closely with the employers participating in the scheme in an open and transparent manner to reach funding solutions that protect beneficiaries' interests.

The **Church Administrators Pension Fund (CAPF)** provides pensions for the staff of the National Church Institutions. They are mostly based in Church House and in the offices of the Archbishops of Canterbury and York.

The fund has two sections – a defined benefits section which closed to new entrants in 2006, and a defined contributions section. The defined benefits section was amended in 2010 so that it is on a career average earnings basis for future service, rather than a final salary basis. Both sections are non-contributory by the employee although defined benefit members pay towards the cost of benefits for dependants. Pension increases are linked to changes in the Retail Price Index.

The last valuation was carried out as at 31 December 2014. The difference between the scheme's assets and its liabilities for the defined benefit section was a deficit of £25.1 million.

INVESTMENTS

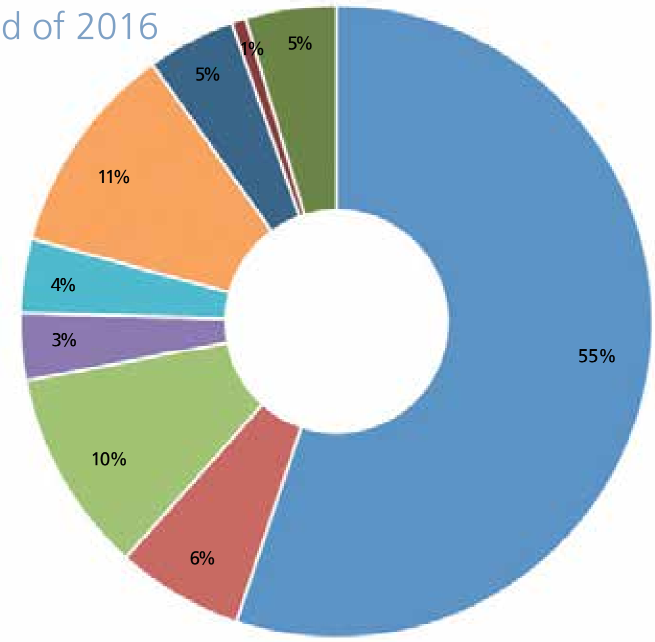
Most of the assets of the pension schemes are pooled for investment purposes to allow the smaller schemes to access economies of scale and investment opportunities which might not be available to them otherwise. We manage funds in excess of £2.3 billion.

For the pension schemes we operate a **Return Seeking Pool** and a **Liability Matching Pool**.

A new asset allocation was agreed for the Return Seeking Pool, which saw a reduced allocation to public traded equities, and within that allocation, a restructuring to remove the bias to the UK market. We increased our exposure to investments that rely more on contractual income and that are less liquid; these include infrastructure and private debt. This move was made to increase the diversity of the assets and reduce the volatility of the Pool's valuation.

The Return Seeking Pool is managed by 16 managers, with day to day responsibility for nine asset classes.

Return Seeking Pool
Asset Mix at end of 2016



55%	Global developed marketing equities	11%	Property
6%	Emerging market equities	5%	Infrastructure
10%	Small cap equities	1%	Cash
3%	Private loans	5%	GTAA hedge funds
4%	Emerging market debt		

Our top five equity investments at 31 December 2016 were in Apple, Alphabet, Exxon Mobil, Microsoft and Wells Fargo.

Managing risk in the investment portfolio is important to us and we have taken several steps to mitigate risk during 2016.

The implementation of a **Liability-driven investment** (LDI) framework for the clergy pension scheme was completed in 2016. The objective of pension scheme investing is to ensure that there are sufficient funds to pay the scheme's liabilities. LDI puts this at the centre of the investment using a range of instruments, such as Gilts, bonds, swaps and repos, to construct an investment strategy that closely matches the behaviour of the pension liabilities.

As part of the implementation, the broadly based index linked Gilt portfolio in the Liability Matching Pool was sold in May 2016 and the proceeds were distributed to the pension schemes invested in the Pool. The Clergy Fund's share of the proceeds were used to buy two very long-dated Index Linked Gilts, which boosted the Scheme's inflation and interest protection; whereas the share of the proceeds for the CWPF and CAPF was invested in a pooled fund tracking the FTSE Over 5-year Index Linked Gilt Index, managed by Blackrock.

The Fund's Return Seeking Pool returned 19% over 2016, and the Liability Matching Pool 11.2%, in a volatile year for returns.

	1 year % pa	**3 years % pa**	**5 years % pa**	**10 years % pa**
Return Seeking Pool	19.0	9.7	11.7	5.2
Pool benchmark (consolidation of manager benchmarks)	*21.4*	*10.5*	*11.8*	*6.1*
*Liability Matching Pool**	*11.2*	*9.8*	*5.7*	*5.8*
RPI + 3% comparator	5.5	4.8	5.7	5.8

**Corporate bonds only from 5 May 2016*

It is disappointing that collectively our fund managers missed their consolidated benchmark in 2016, but markets tend to perform very strongly, as they did in 2016, when riskier stocks do well. For 2016 this was profit-free internet companies, and oil and commodity stocks. Institutional quality fund managers and their strategies tend to be exposed to less risky stocks, and, as one would expect, those used by the Board are generally like this. The flip-side is that we expect our managers to outperform falling or less strongly performing markets.

Index Linked Gilts posted very strong returns over the year, with the FTSE Over 5-Year Index Linked Gilt index appreciating by 27.4% in 2016. The Index Linked Gilts held within the Liability Matching Pool from January to April 2016 returned 3.8%, and for the CAPF and CWPF, 22.5% when invested in the pooled index-linked Gilt fund from May to December, making a return for the year of 27.2%. For the Clergy Fund the results were even better, with the long-dated issues held from May to December making a return of 40.6%, which contributed to a return of 45.9% for the year.

ETHICAL INVESTMENT

We are committed to active engagement with companies we invest in, consistent with our ethical investment policies.

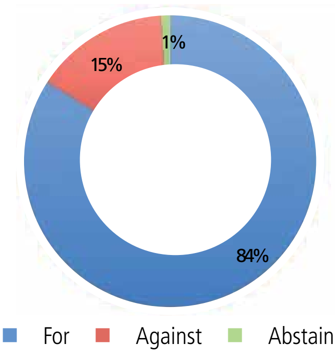
In 2016 the **Ethical Investment Advisory Group (EIAG)** continued to develop a new ethical policy on the extractive industries which the Board will consider in 2017. No new recommendations for ethical exclusions were made in 2016.

Over the past year we have established, jointly with the Church Commissioners, an engagement team. The decision to establish an in-house team and to strengthen engagement capacity reflected the increased importance of engagement in the application of our ethical investment policies. The Engagement Team now oversee the voting of our shares in companies, the screening of our investments against our ethical policies and the engagement with companies within which we have holdings.

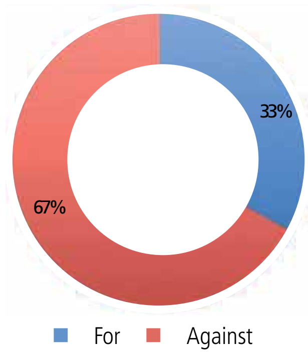
We continue to exclude from our direct investments companies involved in indiscriminate weaponry, conventional weaponry, pornography, tobacco, gambling, non-military firearms, high interest rate lending, human embryonic cloning, and extraction of thermal coal and production of oil from oil sands, subject to revenue thresholds. We continue to maintain restrictions in the alcohol sector.

In line with commitments under the UK Stewardship Code we have continued to **vote** our shareholdings in 2,219 company meetings, comprising 28,783 individual resolutions. In 2016 our voting and interventions at Annual General Meetings focussed on: executive remuneration, climate change and board diversity.

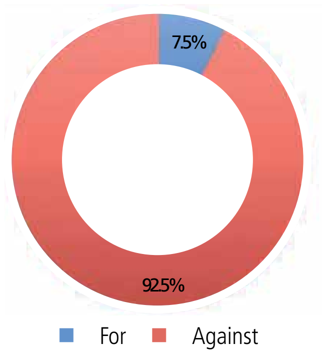
Voting for / against directors of UK companies



Voting for/against UK remuneration reports and policies



Voting for/against US remuneration reports on policies (say-on-pay only)



During 2016, in line with the National Investing Bodies' executive remuneration policy, we continued to vote against the majority of remuneration reports and publicly called upon company remuneration committees to exercise better judgement when recommending reports to shareholders. A number of high profile advisory votes went against board recommendations and we expect executive remuneration to remain the most prominent issue in the 2017 voting season.

During the year, the engagement team continued to meet company representatives on a range of issues of concern. These issues included human rights, climate change, tailings dams, risks around reporting on joint ventures within extractive companies, promotion of responsible alcohol consumption and community health and safety and environmental concerns around mining activity.

Over the past year we have continued to support the **Mining and Faith Reflections Initiative**. This initiative is the result of a group of eight mining company CEOs reaching out to the Catholic, Anglican and Methodist Churches for an honest and open dialogue about the social licence to operate of their sector. This is a high level and different style of engagement that enables difficult issues to be raised and addressed in a forum with companies.

The **Transition Pathway Initiative (TPI)** is an asset owner-led initiative, supported by asset managers and owners with over £2 trillion of assets under management. It assesses how companies are preparing for the transition to a low-carbon economy through a public and transparent online tool developed with the London School of Economics Grantham Research Institute.

We, together with the other Church of England National Investing Bodies, have led the initiative with the UK Environment Agency Pensions Fund, and with data and analysis provide by the London School of Economics and FTSE Russell. It was launched at the London Stock Exchange in January 2017, with preparation having taken place throughout 2016.

The initiative came about as a result of the National Investing Bodies' climate change policy, which committed us to engage more intensively with companies on climate change and assess whether they are taking seriously their responsibilities to assist with the transition to a low-carbon economy.

Assessments from the TPI produced by the London School of Economics will be used to support our engagement with companies over the coming year and provide a clear and transparent basis upon which to report progress of engagement to trustees and beneficiaries. The TPI also provides a basis to be able to assess the exposure to transition risk within our portfolio and to better inform our decision-making and monitoring of our fund managers.

RETIREMENT HOUSING

Through our various housing options, we assist around 25% of the retiring clergy with housing in retirement.

In **delivering our housing services**, we seek to understand our customers' needs and expectations. We seek feedback from everyone who moves into one of our properties and team members spend an increasing amount of time out of the office visiting our customers to discuss their housing options and any issues or concerns they may have.

Retiring clergy, and those already in our properties, can phone or email the housing team based in Westminster. The team receives hundreds of queries each month, ranging from retiring clergy looking for housing or to move to one of our supported housing communities, to individuals notifying us of a change in their personal circumstances.

The team can be contacted on 020 7898 1824 or by emailing housing@churchofengland.org.

The **CHARM** (Church's Housing Assistance for the Retired Ministry) scheme is designed to assist retiring clergy who have not been able to make their own provision to find somewhere to live in retirement. Two options are available to customers – shared ownership and a rented housing. Around 2,100 retired clergy households and their dependants are housed in one of these two options, or in the mortgage scheme which closed in 2008.

The wider Church of England contributes to the running of the CHARM scheme through "Vote 5" of the Archbishops' Council budget. The total contribution for 2016 was £4.36 million.

We currently house around 100 clergy households through the **shared ownership** option. We buy a property in partnership with the retiring household; we contribute up to 75% of the property cost, with rent paid on the share we own.

It is not unusual for the retired household to buy additional equity in the property, or even to buy out our share entirely.

During the year we assisted another seven households through the shared ownership option.

The majority of our customers choose to **rent** property from us at an affordable rent. 1,333 retired clergy households and their dependants were renting from us at the end of 2016.

Retiring clergy, subject to eligibility criteria, can choose a property from our extensive portfolio up to five years before they intend to retire and "reserve" it for retirement. A list of available properties is distributed at regular intervals to those looking for their retirement home.

During 2016, we added a further 75 properties to the portfolio at a cost of £16.1 million.

Until 2008, we granted equity sharing **mortgages** to retiring clergy. At the end of the year there were 775 loans outstanding.

We wanted to ensure that our customers are able to report issues with their properties when they happen, 24 hours a day, seven days a week, and we therefore outsourced our repairs helpline and service to Sanctuary Housing a few years ago. As well as responding to these calls, we spent over £2.6 million in planned and major works during the course of the year to improve our portfolio of properties and keep them in good order.

In addition to our CHARM property options, we provide supported **housing**. This is for retired clergy and their dependants who wish to live as independently as possible with access to a range of support services.

Each of our seven supported living communities provide somewhere to live where the liturgical and spiritual life of the Church of England is central. The communities not only provide residents with a self-contained flat, but also include dining facilities, meeting spaces, libraries, a chapel with regular services led by local clergy and by the residents, and communal grounds.

In the autumn of 2016 we took the decision to close our only nursing home at Hindhead, Surrey, because increasing difficulties with recruiting and retaining qualified nursing and care staff meant we could no longer guarantee the long-term safety of the people in our care. But we made sure that every resident could be safe and well cared for at another home of their choice.

THE CHURCH OF ENGLAND PENSIONS BOARD

The members of the Pensions Board represent a balance of skills and expertise and are drawn from a wide range of constituencies. The majority of members serve on at least one of more of the Board's committees.

Appointed Members

Dr Jonathan Spencer CB (Chair)
Jeremy Clack FIA
Canon David Froude ACIB
Roger Mountford

Elected by the House of Laity

Jane Bisson
Roger Boulton FIA
Canon Nicolete Fisher
Alan Fletcher ACII
Canon Emma Osborne
Brian Wilson FIA

Member Nominated Board Members

The Revd Fr Paul Benfield
Ian Boothroyd
The Revd Paul Boughton ACA
The Revd Nigel Bourne
Ian Clark
Maggie Rodger
The Revd Canon David Stanton
The Rt Revd Alan Wilson

Employer Nominated Board Members

Richard Hubbard
Canon Sandra Newton