Review Body on Senior Salaries

REPORT No. 72

Review of the Parliamentary Contributory Pension Fund 2010

July 2010

Chairman: Bill Cockburn, CBE TD

Cm 7926

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Foreword

Review Body on Senior Salaries

The Review Body on Top Salaries (TSRB) was appointed in May 1971 and renamed the Review Body on Senior Salaries (SSRB) in July 1993, with revised terms of reference. The terms of reference were revised again in 1998 as a consequence of the Government's Comprehensive Spending Review, in 2001 to allow the devolved bodies direct access to the Review Body's advice and in 2007 to add certain NHS managers to the remit.

The terms of reference are:

> *The Review Body on Senior Salaries provides independent advice to the Prime Minister, the Lord Chancellor, the Secretary of State for Defence and the Secretary of State for Health on the remuneration of holders of judicial office; senior civil servants; senior officers of the armed forces; very senior managers in the NHS*[1]*; and other such public appointments as may from time to time be specified.*
>
> *The Review Body also advises the Prime Minister from time to time on the pay and pensions of Members of Parliament and their allowances; on Peers' allowances; and on the pay, pensions and allowances of Ministers and others whose pay is determined by the Ministerial and Other Salaries Act 1975. If asked to do so by the Presiding Officer and the First Minister of the Scottish Parliament jointly; or by the Speaker of the Northern Ireland Assembly; or by the Presiding Officer of the National Assembly for Wales; or by the Mayor of London and the Chair of the Greater London Assembly jointly; the Review Body also from time to time advises those bodies on the pay, pensions and allowances of their members and office holders.*
>
> *In reaching its recommendations, the Review Body is to have regard to the following considerations:*
>
>> *the need to recruit, retain and motivate suitably able and qualified people to exercise their different responsibilities;*
>>
>> *regional/local variations in labour markets and their effects on the recruitment and retention of staff;*
>>
>> *Government policies for improving the public services including the requirement on departments to meet the output targets for the delivery of departmental services;*
>>
>> *the funds available to departments as set out in the Government's departmental expenditure limits;*
>>
>> *the Government's inflation target.*
>
> *In making recommendations, the Review Body shall consider any factors that the Government and other witnesses may draw to its attention. In particular it shall have regard to:*
>
>> *differences in terms and conditions of employment between the public and private sector and between the remit groups, taking account of relative job security and the value of benefits in kind;*

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[1] NHS Very Senior Managers in England are chief executives, executive directors (except medical directors), and other senior managers with board level responsibility who report directly to the chief executive in: Strategic Health Authorities, Special Health Authorities, Primary Care Trusts and Ambulance Trusts.

changes in national pay systems, including flexibility and the reward of success; and job weight in differentiating the remuneration of particular posts;

the need to maintain broad linkage between the remuneration of the three main remit groups, while allowing sufficient flexibility to take account of the circumstances of each group; and

the relevant legal obligations, including anti-discrimination legislation regarding age, gender, race, sexual orientation, religion and belief and disability.

The Review Body may make other recommendations as it sees fit:

to ensure that, as appropriate, the remuneration of the remit groups relates coherently to that of their subordinates, encourages efficiency and effectiveness, and takes account of the different management and organisational structures that may be in place from time to time;

to relate reward to performance where appropriate;

to maintain the confidence of those covered by the Review Body's remit that its recommendations have been properly and fairly determined; and

to ensure that the remuneration of those covered by the remit is consistent with the Government's equal opportunities policy.

The Review Body will take account of the evidence it receives about wider economic considerations and the affordability of its recommendations.

Members of the Review Body are:

Bill Cockburn CBE TD* *Chairman*
Professor Richard Disney*
Martin Fish
Professor David Greenaway
Mike Langley
Professor David Metcalf CBE
Sir Peter North CBE QC*
Christopher Stephens
Bruce Warman*
Paul Williams*

* member of SSRB's Parliamentary sub-committee

Ron Amy OBE FFA, Chairman of the Review Body on Doctors' and Dentists' Remuneration, was co-opted onto the SSRB's Parliamentary sub-committee because of his expertise in pensions and we gratefully acknowledge his assistance.

The Secretariat is provided by the Office of Manpower Economics.

Contents

Summary and recommendations

The Parliamentary Contributory Pension Fund

1. MPs, Ministers in both Houses and parliamentary office holders such as committee chairmen in the Commons and the Lord Speaker in the Lords are members of the Parliamentary Contributory Pension Fund (PCPF). The PCPF is a funded pension scheme which pays a defined benefit pension based on final salary. Members and the Exchequer pay contributions to the PCPF which are used to build up assets to pay pensions at the specified level to members during their retirement.

2. The key features of the PCPF are currently:

Main features of current parliamentary pension scheme	
Normal retirement age	65
Accrual rate	1/40th, 1/50th or 1/60th
Basis of pension	Final salary[2]
Lump sum	By commutation (actuarially neutral)
Member's contribution	11.9% of salary for 1/40th accrual, 7.9% for 1/50th and 5.9% for 1/60th
Exchequer contribution	20.0% of payroll[3]
Possibility for member to buy additional pension	Through additional voluntary contributions (AVCs) either invested on defined contribution basis or via the purchase of 'added years'
Surviving spouse's or partner's pension	5/8ths of member's pension
Death in service	Three months' salary plus lump sum of four times pensionable salary

Reasons for this review

3. In 2007 the Exchequer contribution for future accrual in the PCPF was 18.3% of payroll. We recommended in our last review of parliamentary pay, pensions and allowances[4] that the Exchequer contribution should be capped at 20% and that there should be a major review of the PCPF if it became likely that the cost[5] to the Exchequer would rise above 20%. The Government Actuary began a further valuation of the PCPF as at 1 April 2008 and this eventually showed that, unless member contributions were increased or benefits reduced, the cost would rise to 23.1%. The Government therefore asked us in February 2009 to carry out a fundamental review of the PCPF and to recommend pension arrangements that are sustainable, appropriate to the members' circumstances and fair to both them and the taxpayer.

[2] Based on the MPs' salary. For Ministers and office holders the PCPF in effect provides a career average pension for the Ministerial or other supplement paid in addition to the MP's salary.

[3] This is based on the expected cost for future accrual in 2009-10, i.e. excluding payments to amortise the deficit for past service, based on the assumptions used by the Government Actuary for his 2008 valuation of the PCPF and following changes introduced during 2009 to members' contributions and benefits to reduce the Exchequer contribution from 23.1% of payroll. However, the House of Commons voted on 25 June 2009 to peg the Exchequer contribution at the 2008-09 level, although the necessary changes to achieve that further reduction have not yet been made.

[4] Review Body on Senior Salaries. *Review of parliamentary pay, pensions and allowances.* Cm 7270. TSO, 2007. Available at www.ome.uk.com

[5] Throughout this report, the words 'cost' and 'cost of accrual' are used to refer to the Standard Contribution Rate, based on actuarial assumptions. The 'cost to the Exchequer' refers to the share of the Standard Contribution Rate which is to be paid by the Exchequer. The *actual* cost will depend on the actual demographic and financial experience, and would include any surplus or deficit that arises.

4. In recent years it has frequently been necessary to revise the Exchequer and member contributions and member benefits. This shows the inherent instability in the PCPF as currently constituted. Given the cap on the Exchequer contribution, which the House of Commons voted to reduce, any future increase in the cost of ongoing accrual will have to be borne entirely by the members. Future triennial valuations of the PCPF are likely to reflect high volatility and there is a risk that some members might decide to leave the scheme because of the uncertainty about the level of contributions and benefits.

Objectives of a redesigned scheme

5. Our overriding objective has therefore been to design a scheme which is affordable, sustainable for at least the medium term and provides a reasonable and predictable level of replacement income in retirement. We have been considerably aided in our work by the responses to our consultation in 2009 and we are grateful to all those who submitted evidence.

The wider pensions environment

6. There has been considerable media coverage of the problems faced by both public and private sector pension schemes in recent years. Life expectancy has increased more rapidly than predicted and this has increased costs for all pension schemes. In addition, private sector pensions have been adversely affected by tax changes, stricter financial reporting requirements and stricter rules aimed at protecting members in the event of companies' closure or insolvency. Funded schemes, both private and public, have also had to cope with widely fluctuating asset values. The consequence has been a rapid and widespread movement in the private sector away from defined benefit pension schemes toward defined contribution. Many defined benefit schemes have been closed to new entrants and increasingly they are being closed for future service of existing employees.

7. This has had the advantage for employers of reducing their exposure to risk. Their sole liability is to pay the agreed percentage of salary each month into the employee's chosen fund (or a default fund). For the employee, however, defined contribution schemes mean increased risk and much greater uncertainty about the eventual size of his or her pension. Moreover, some evidence suggests that the cost of providing a given level of retirement income via a defined contribution scheme is higher than via a defined benefit scheme.

8. Meanwhile, in the public sector most large schemes have been revised in recent years, typically raising normal retirement age. In some cases members' contributions have been increased or benefits have been reduced. For some schemes the Government contribution has been capped, for example at 14% of payroll for the schoolteachers' scheme and 20% (from 2012) for civil servants.

The role and remuneration of MPs

9. MPs play a fundamental role in our democracy. Pensions are an important part of their total reward and SSRB takes the value of pensions into account when reviewing pay. We are due to carry out a further review of MPs' pay in the year following the next general election and we shall take account then of any changes in the value of MPs' pensions.

10. Although many MPs perceive their status as insecure because they must stand for re-election at five-yearly or shorter intervals, in fact their job tenure is on average higher than that of workers generally[6]. However, many people change jobs voluntarily while remaining in the same occupation. MPs may gradually lose touch with their previous occupations, making it harder to find new work if they lose their seats. It does not follow, however, that the pension scheme should be used to compensate in some way for that

[6] See paragraph 3.6 below.

risk. The scheme should, though, be designed to fit the typical pattern of MPs' service, and it should take account of the absence of career progression for most MPs, who are all paid the same salary. The scheme also needs to accommodate those MPs whose pay increases temporarily while they are Ministers or office holders but then drops back if they return to the backbenches.

Options for reform of the PCPF

11. The PCPF is unusual among public sector pension schemes in being funded. Most are not funded but 'pay as you go'. We do not think it would be acceptable for the PCPF to cease to be a funded scheme. We therefore considered the following main options: maintaining the PCPF as a final salary scheme with minor adjustments to bring the Exchequer contribution down to the level specified by the Commons; other forms of defined benefit scheme, namely career average revalued earnings or cash balance; a defined contribution scheme; and hybrid schemes combining aspects of both defined contribution and defined benefit. We consider these against the specific characteristics of MPs.

Changes recommended to the PCPF

12. We consider that the best balance between the conflicting pressures of reducing the taxpayer contribution to the PCPF and securing adequate and sustainable pensions for MPs would be achieved by retaining a defined benefit scheme, but based on career average revalued earnings and with a higher retirement age. We propose that this scheme should apply immediately after the next election to all MPs, Ministers and office holders. However, all current MPs would have their service to date preserved and uprated in future by the Retail Prices Index (RPI), with the current normal retirement age of 65.

13. The key features of our recommended revised PCPF are:

Main features of recommended revised parliamentary pension scheme	
Normal retirement age	68
Accrual rate	1/60th, career averaged
Lump sum	By commutation (actuarially neutral)
Member's contribution	5.5%
Initial Exchequer contribution	10.5%[7]
Maximum Exchequer contribution	15.5%[8]
Possibility for member to buy additional pension	Through AVCs on defined contribution basis
Revaluation of career average benefits for active members, deferred pensions and pensions in payment	Lower of RPI and 2.5%
Surviving spouse's or partner's pension	5/8ths of member's pension
Death in service	Three months' salary plus lump sum of four times pensionable salary

[7] This is the expected cost, based on the assumptions used by the Government Actuary's Department (GAD) for its 2008 valuation of the PCPF, and additional assumptions by GAD about the effect of using the lower of RPI and 2.5% as the revaluation rate.

[8] As explained in Chapter 5, we propose two separate caps, of 4% on investment risk and 1% on demographic changes.

14. We also recommend that the Government continue paying an additional contribution of 8.7% of payroll until 2021 as agreed following the 2005 valuation.

Impact of our recommendations

15. Our recommendations would mean that all MPs would start to accrue at 1/60ths and would pay contributions of 5.5% of salary. The Exchequer contribution would initially be 10.5% of payroll but could vary by up to 5% either side of that figure. There are many permutations which make it difficult to compare directly the effect on MPs' pensions but we have asked the Government Actuary to model a number of different examples. Because past service is preserved, the impact of our proposed changes is less for MPs who have been in the House for several terms already. MPs elected at the next election and joining the new scheme will pay lower contributions, as will the Exchequer, and it follows that their pensions will be significantly lower than under the current scheme. However, we believe those pensions will still be significantly better than those that would have been available under a defined contribution scheme with similar contribution rates.

Recommendations

Recommendation 1. We recommend that any review of MPs', ministers' or office holders' pay take into account the value of the accompanying parliamentary pension.

Recommendation 2. We recommend that 1/60th be the single rate of defined benefit accrual available in the PCPF.

Recommendation 3. For simplification, we recommend that the retained benefits restriction be removed from the definition of maximum benefits for all members of the PCPF who join at or after the point of transition.

Recommendation 4. We recommend that for future accrual in the PCPF, the specified normal retirement age should be set at 68.

Recommendation 5. In order to reduce potential volatility in the value of past service liabilities, we recommend that future accrual in the PCPF be on the basis of career average revalued earnings rather than final salary.

Recommendation 6. We recommend that the members' contribution rate be set initially at 5.5% of payroll.

Recommendation 7. We recommend that the career average benefits of active members of the PCPF be uprated by the lower of RPI and 2.5%.

Recommendation 8. We recommend that all 'final salary' accrual up to the point of transition be calculated on the basis of the Final Pensionable Pay of MPs at the point of transition, and thenceforth uprated by RPI.

Recommendation 9. We recommend that the Exchequer continue to pay 8.7% per year for the balance of the original 15 year period, i.e. until 2021. There should be no corresponding reduction in the amount the Exchequer would otherwise pay under our proposed new scheme for future accrual.

Recommendation 10. We recommend that benefits accrued up to the point of transition should continue to be increased by RPI when in payment as well as deferment.

Recommendation 11. For future accrual after the point of transition, however, we recommend that increases to deferred pensions and pensions in payment be made at the lower of RPI and 2.5%, when legislation allows.

Recommendation 12. We recommend that the Trustees of the PCPF and the Government agree with the Government Actuary strategies for valuing the Fund which ensure that as far as possible members do not suffer or gain from short term fluctuations and that measures of real growth are independent of short-term market values, subject to independent certification.

Recommendation 13. We recommend that members not be allowed to purchase added years through additional voluntary contributions, nor to use the 'transfer in' of benefits from other pension schemes to purchase defined benefit entitlement under the PCPF (except in cases where this is required in order to provide the Guaranteed Minimum Pension). A review of existing contracts for the purchase of added years should be undertaken with a view to ceasing these at, or as soon as possible after, the date of transition.

Recommendation 14. We recommend that the Trustees explore the possibility of exploiting economies of scale by enabling members to make additional voluntary contributions through a larger public sector scheme.

Recommendation 15. For administrative simplicity, we recommend that MPs', Ministers' and office holders' salaries be treated in the same way for the purposes of pension.

Recommendation 16. We recommend that the Exchequer should absorb any increases or decreases in the cost of accrual due to investment factors within 4% of payroll of the initial figure.

Recommendation 17. We recommend that the Exchequer should absorb any increases or decreases in the cost of accrual due to demographic (i.e. non-investment) factors within 1% of payroll of the initial figure.

Recommendation 18. We recommend that any increases or decreases in the cost of accrual expressed as a percentage of pensionable payroll arising from changes in the number of active members be excluded from the cap.

Recommendation 19. We recommend that all ancillary benefits in the PCPF based on the value of the member's pension (such as survivors' pensions, ill-health retirement and death-in-service benefits) be modified in line with the recommended changes to the main benefit structure.

Recommendation 20. We recommend that any deficit or surplus which arises from investment performance at subsequent valuations be spread in perpetuity in order to reduce the probability of unnecessarily triggering the cost caps.

Chapter 1

Introduction

Background

1.1 The Parliamentary Contributory Pension Fund (PCPF) has existed since 1964 and been reviewed by the SSRB at intervals since 1970. Membership is open to MPs, Ministers in both Houses of Parliament and parliamentary office holders, e.g. committee chairmen in the Commons, the Lord Speaker and Chairman of Committees in the House of Lords. It is a defined benefit pension scheme based on final salary, meaning that for each year of their service in the scheme members accrue the right to draw a fraction of their final salary in retirement as a pension.[9] It is a funded scheme: both the member and the Exchequer make financial contributions to a fund during the member's period in office as an MP, Minister or other parliamentary office holder to build up assets intended to pay the specified pension to the member during his or her retirement. A summary of the main provisions of the current scheme is at Appendix 1.

1.2 In its 2007 report, the SSRB recommended that if it became likely that the cost to the Exchequer of ongoing accrual in the PCPF would rise above 20% of payroll, then there should be a major review of the Fund. The Government and the House of Commons accepted this recommendation in January 2008. During the Government Actuary's preparation of the latest valuation of the PCPF, it became clear that this 20% figure was likely to be exceeded. The Prime Minister accordingly wrote to the SSRB in February 2009 to ask us to undertake a review of the PCPF, and to recommend appropriate pension arrangements for Members of the House of Commons, Ministers and other parliamentary office holders.

1.3 Our Terms of Reference for this review are:

"To conduct a fundamental review of the pension provision for Members of the House of Commons, Ministers and other Parliamentary office holders, and to recommend to the Leader of the House of Commons pension arrangements for these groups that are sustainable, appropriate to their circumstances, and fair to both them and to the taxpayer.

In reaching its recommendation, the review body is to have regard to:

- *the Government Actuary's valuation of the Parliamentary Contributory Pension Fund as at 1 April 2008 (expected to be completed March 2009);*
- *the recommendation of the Senior Salaries Review Body, as endorsed by a resolution of the House of Commons on 24 January 2008, that the Exchequer contribution to the cost of Parliamentary pensions should in principle be limited to a maximum of 20 per cent of the payroll of scheme members;*
- *interaction with other aspects of the Parliamentary remuneration package and other benefits to which MPs, Ministers and other office holders are entitled;*
- *the special circumstances of Parliamentary life and the uncertainty of the careers of MPs, Ministers and other office holders;*
- *the best balance of contributions and benefits for MPs, Ministers and other office holders of different ages and different patterns of service;*

[9] There is a limit on the benefit that can accrue. Where this limit is reached, members will not accrue additional pension.

- *the value of – and structures (such as defined contribution and career averaging) commonly found in – pension arrangements provided to those in comparable employment in the private sector, and in the rest of the public sector in the context of recent and ongoing reforms;*
- *wider Government policy to encourage the continuation of good pension provision in the UK; and*
- *comparable international experience, where relevant."*

1.4 The full remit given to the SSRB is reproduced at Appendix 2.

Recent history of the Fund

1.5 Every three years, the Government Actuary assesses the cost of the benefits provided by the PCPF and the value of the Fund and recommends what level of contributions should be paid over the next three year period. The Chancellor then has to pay the recommended amount, so effectively the Actuary is deciding the contribution level and is therefore bound by public law considerations. Together, the contributions of the Exchequer and active members to the Fund in a given year should, after allowing for expected returns on investments, cover the cost of the pension and other benefits accruing in that year; this is the cost of ongoing accrual, sometimes termed the *Standard Contribution Rate*. If the assumptions on which the Standard Contribution Rate is calculated are always borne out, then the Fund should never be in deficit or surplus.

1.6 However, if the assumptions on which the Standard Contribution Rate has been calculated in previous years have not been met (e.g. members' life expectancy is revised, or investments have performed other than as expected), then the Fund will be in deficit or surplus with regard to past service liabilities[10]. If there is a deficit, contributions will need to be increased or benefits reduced to amortise the deficit; if the Fund is in surplus, contributions can be reduced or benefits increased.

1.7 The cost of accrual in the PCPF, expressed as a percentage of payroll, has been slowly rising since its inception owing to the improving longevity of members (although other changes, such as increasing the age at which benefits can be taken without being 'discounted' for early payment, have mitigated the effect). The increasing cost of benefits was not so apparent during the 1990s when the Fund was in surplus, allowing the Exchequer to reduce its contributions to below the cost of accrual.

1.8 At the 2002 valuation of the PCPF, however, the Fund was in deficit. The Exchequer contribution to the cost of accrual was 19.3% of payroll, with a further 4.7% of payroll required to amortise the deficit. By the time of the 2005 valuation, the Exchequer contribution to the cost of accrual had gone down to 18.1% (partly due to increased contributions from PCPF members) but the deficit contribution was up to 8.7%, bringing the total Exchequer contribution to 26.8% of payroll.

1.9 Faced with these increasing costs, in 2006 the Government asked the SSRB, as part of its triennial review of parliamentary pay, pensions and allowances, to consider how to fund the PCPF in a way that is fair to both the Exchequer and members, so as to endeavour to ensure that it remained affordable. In its report, the SSRB made several recommendations designed to address the affordability of the PCPF. They were:

"Recommendation 7: We recommend that any increase or decrease in the cost of accrual for MPs in service in the Parliamentary Contributory Pension Fund should be shared equally between the Exchequer and members. We consider the following to be some of the elements excluded from the cost of accrual:

[10] The aggregate cost of providing benefits promised to date.

- *payments to amortise the accumulated deficit identified in the 2005 valuation of the Fund;*
- *changes to allow members with retained benefits to opt for a 1/60th accrual rate (i.e. the consequence of Recommendation 6); and*
- *changes to the assumptions about the investment return on assets.*

Recommendation 8: We recommend that the Exchequer contribution to the cost of accrual of benefits for MPs in service in the Parliamentary Contributory Pension Fund (excluding payments to amortise the accumulated deficit identified in the 2005 valuation of the Fund) should in principle be limited to 20 per cent of the payroll of scheme members.

Recommendation 9: We recommend that if it becomes likely that, unless action is taken, the Exchequer contribution to the cost of accrual of benefits for MPs in service in the Parliamentary Contributory Pension Fund (excluding payments to amortise the accumulated deficit identified in the 2005 valuation of the Fund) would rise above 20 per cent of payroll, then there should be a major review of the Fund."[11]

These recommendations were endorsed by the Commons in a resolution on 24 January 2008.

1.10 In preparing his valuation of the PCPF as it stood at 1 April 2008, the Government Actuary advised that the Exchequer's contribution to the underlying cost was likely to exceed 20% of payroll. When the valuation was published on 31 March 2009, the Government Actuary confirmed that he estimated the underlying cost to the Exchequer to be 23.1% of payroll at 1 April 2008.

1.11 In a Written Ministerial Statement announcing the publication of the valuation, the Government presented its preferred interim measures to keep costs within the 20% cap, pending the outcome of this review. First, it proposed an increase of 1.9% in all member contributions. Secondly, it proposed to extend the 2/3rds salary limit on benefits to MPs over the age of 65 who joined the scheme before 1 June 1989. Currently these MPs are allowed to accrue benefits over the 2/3rds limit at a rate of 1/60th of pensionable pay once they reach the age of 65.

1.12 However, when the proposals were debated on 25 June 2009 the House not only endorsed them but also called on the Leader of the House of Commons to bring forward further proposals such that the total Exchequer contribution could remain at its 2008-09 level. With the contributions necessary to amortise the deficit most recently estimated at 8.5%, this limits the cost of accrual to 18.3%. In a Written Ministerial Statement on 14 September 2009, the Leader indicated that such proposals might include "a further increase in member contribution rates, an increase in pension age, changes to the benefits payable on death, or a combination of all these measures."[12] However, in the event, the Government did not bring forward any additional measures, preferring to await the results of this review.

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[11] Review Body on Senior Salaries. *Review of parliamentary pay, pensions and allowances.* Cm 7270. TSO, 2007. Available at www.ome.uk.com

[12] *Parliamentary Pensions.* Written Ministerial Statement, 14 September 2009. Available at www.publications.parliament.uk

The case for reform

1.13 The cost of the Exchequer contribution to the PCPF is therefore still in excess of the limit agreed by the House and reform is needed to meet the House's own ambitions for reducing the burden on the taxpayer. We welcome the Leader's decision to await the outcome of our review, rather than make piecemeal changes to the scheme to keep the cost within the 18.3% agreed by the House. We believe that a more fundamental reform of the PCPF is the best way to arrive at affordable, sustainable, appropriate and fair pension arrangements for parliamentarians.

1.14 There is a further argument for reform of the PCPF: it has not only become unaffordable to the Exchequer, but will also become unattractive to members (and may already have become so). The cost of ongoing accrual in the PCPF is unlikely to fall in future; one major factor which has been driving the cost increases is increasing longevity, which is a long term trend. The cost cap on the Exchequer contribution (first at 20% of payroll, now 18.3%) means that any future increases in the cost of ongoing accrual in the PCPF would have to be borne entirely by the members, through increased contributions, reduced benefits or a combination of both.

1.15 Furthermore, the Government has fixed its separate contribution intended to pay off the past service deficit at 8.7% of payroll, which was the level of contribution recommended in the 2005 valuation of the PCPF in order to amortise the deficit over 15 years. If the past service deficit were to increase – for example, because of lower than expected investment returns – the members would have to bear the extra cost. Equally, should the deficit decrease, the change would be reflected in the member contribution because the Government has fixed the Exchequer contribution. Triennial valuations of the PCPF are likely to show high volatility, because the Fund's investments are likely to fluctuate in value in the short term. For example, the average return on the scheme's investments from 1 April 2005 to 31 April 2008 was 8.7% a year, but ranged from +24.4% in 2005-06 to -4.0% in 2007-08.

1.16 It is likely, therefore, that following each triennial valuation of the PCPF (if unchanged), the member contributions or benefits will have to be adjusted. These adjustments are likely to be substantial, reflecting the volatility of the PCPF's investment returns. Faced with such volatility affecting their take-home pay at three yearly intervals, some PCPF members might well decide to leave the scheme. Although members might happily accept a temporary reduction in their contributions, they are likely to find large increases in contributions or decreases in benefits unpalatable.

1.17 An alternative, to avoid volatile changes in the members' contributions and benefits, would be to change the investment strategy to de-risk and reduce the volatility of investment returns. However, this would also reduce the expected return on investment and present members with another unattractively large increase in contributions or decrease in benefits and could prompt members to leave the scheme.

Our aim and principles

1.18 In conducting this review, we have sought to recommend pension arrangements which are both sustainable and affordable. By 'sustainable', we mean arrangements which enable members to plan for their retirement with a degree of predictability about:

- their own financial contribution;
- the contribution which the Exchequer will make; and
- the likely benefits in terms of their pensions.

The current situation, where contributions and benefits are changing every three years or more frequently, is not sustainable. Although no pension scheme can be immune from long-term changes in demographic or financial factors, we have sought to recommend arrangements which should not need revising in the medium term.

1.19 In thinking about affordability, we have considered what we believe is an appropriate contribution for the Exchequer to be making to the pensions of parliamentarians, and how to make sure that this contribution is kept at a level which does not place too heavy or unpredictable a burden on the public purse. The cost to the Exchequer should be fair to taxpayers whilst providing for retirement benefits appropriate to the role of an MP. We have looked at pension arrangements for other groups of employees in both the public and private sector, but have taken account of the specific nature of holding office as a parliamentarian and the characteristics – such as age and length of service – of the PCPF members.

Our methods

1.20 We began our review with a consultation[13], which set out the background to our review and invited respondents to answer a number of questions about possible reforms to the PCPF. The launch of the consultation received some coverage in the national media and elicited more general responses from members of the public. In total, we received 52 responses and submissions of evidence: 18 from MPs, nine from groups and individuals with a professional interest in pensions (or MPs' pensions in particular) and employment, and 22 from members of the public. We also received written evidence from the Government, the Conservative Party and the PCPF Trustees.

1.21 We held oral evidence sessions with the Trustees of the PCPF, the pensions staff of the House of Commons and the Government Actuary. We also took oral evidence from the Association of Consulting Actuaries. During the course of the review, we sought expert advice and input where relevant from organisations such as the Association of Consulting Actuaries and the Government Actuary. In particular, we are grateful to the Government Actuary for his co-operation with costing and advising on the different scenarios which we have considered during the course of our review.

[13] Review Body on Senior Salaries. *Review of parliamentary pensions – consultation document*, 2009. Available at www.ome.uk.com

Chapter 2

The wider pensions environment

Pressures on pensions in the public and private sectors

2.1 In our consultation document we noted that there has been widespread revision of pension schemes in both the public and private sectors in recent years. In the public sector the need for reform has largely been driven by rising longevity, which has increased the cost of defined benefit schemes that pay regular, inflation-proofed pensions for as long as pensioners live, as well as pensions to surviving spouses or partners, in many cases. Recent reforms of public sector pensions have typically seen the Exchequer's contribution capped, employee contributions increased and the value of ongoing accrual of employee benefits decreased.

2.2 Longevity is not only increasing and pushing up the cost of accrual now, but it is increasing by more than actuaries assumed it would when calculating the cost of accrual and setting contribution levels in the past. Pensioners are drawing their pensions for longer than was foreseen when they were in employment, meaning that insufficient assets have been built up to pay for their pensions. Many pension funds are therefore facing large (and, all other things being equal, increasing) deficits with regard to past service liabilities.

2.3 The real ongoing cost to employers of funding defined benefit pension provision also increased towards the end of the 1990s, when the Government changed the tax treatment of dividends paid on schemes' equity holdings. Whilst companies paid dividends net of advance corporation tax, pension funds were able to reclaim it. However, these credits were first reduced and then abolished altogether on dividends paid on or after 2 July 1997.

2.4 In the private sector, there are additional factors which have put pressure on defined benefit pension provision. Return-seeking investments are often volatile and it is only to be expected that, at certain points in the financial cycle, the returns will be lower than the long-term average. However, financial reporting requirements (FRS17 and IAS19) and the cost burden of legislation aimed at safeguarding private sector pensions have made it difficult for private companies to take a long term approach to covering their pensions liabilities. Under Part 3 of the Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005[14], defined benefit occupational pension schemes are subject to a statutory funding objective: they must have sufficient and appropriate assets to cover the estimated cost of the benefits which have been accrued by the scheme members to date. In the event of an actuarial valuation of the scheme revealing a shortfall in assets, the trustees must put in place a recovery plan setting out how and over what period the deficit will be recovered. The Pensions Regulator requires that period to be as short as the employer can reasonably afford.

2.5 Put simply, the combination of measures to make companies disclose deficits in pension funds for which the companies are liable and rules intended to protect current and future pensioners in the event of companies' closure or insolvency has had the unintended consequence of making many companies close defined benefit pension schemes (either to new entrants or, increasingly, future accrual).

[14] *The occupational pension schemes (scheme funding) regulations 2005.* SI2005/3377. TSO, 2005. Available at www.opsi.gov.uk

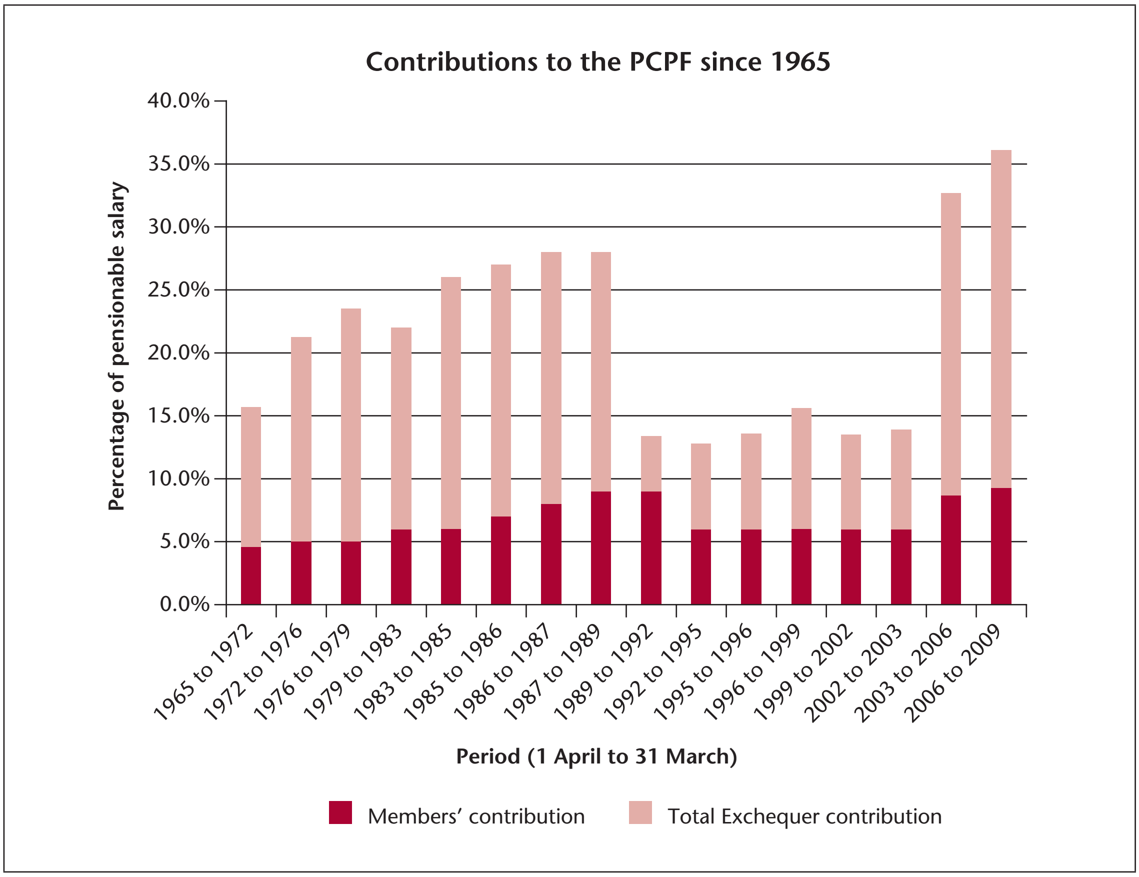
2.6 Defined contribution pension schemes do not present any such problems for employers. In a defined contribution scheme, the employer typically pays a specified proportion of an employee's salary into a fund. The employee usually also makes contributions and the total amount is invested to produce a sum of money which the employee must use to buy a pension for their retirement. From the employer's perspective, a defined contribution scheme has the advantage that the employer's sole liability is to pay the agreed percentage of salary each month. From an employee's point of view, the arrangement carries two major risks compared to a defined benefit scheme: first, the return on the money invested up to retirement is uncertain, depending on the return on assets and the skill of the fund manager – usually an insurance company – who makes a charge for managing the fund. Secondly, the pension provided can vary widely depending on the state of the economy and market expectations at the point where the pension is arranged. The same increases in longevity that have pushed up the cost of defined benefit schemes have affected the amount of pension that can be purchased for each £1,000 of 'funds' available under a defined contribution arrangement. Thus while beneficiaries of a defined benefit pension can be confident that, subject to remaining in employment, the ongoing viability of the employer and continued payments into the scheme, they will achieve a known rate of income replacement on retirement, employees in defined contribution schemes have no such certainty.

2.7 To illustrate the uncertainty of defined contribution schemes, the Association of Consulting Actuaries in its written evidence to us cited the example published by *Money Management* magazine of a man contributing £200 per month for 20 years in an average with-profits policy. In January 1996 the fund would have been worth £287,413 at maturity and would have bought a single life annuity escalating by 3% a year of £22,706. In January 2006 the maturing fund would have been worth only £121,452 and would have bought an annuity of only £4,964 (resulting from a combination of increasing longevity, and hence less advantageous pension conversion rates, and poor investment returns). Since then investment returns have fallen even further – in July 2008 the fund value at retirement would have been only £107,984 – but annuity rates had improved slightly and the fund would have bought a pension of £5,097. So the value of the pension obtained for a given level of saving had fallen by over 77% in cash terms within 12 years.

Pressures on pensions, as they apply to the PCPF

2.8 The PCPF is subject to the effects of increasing longevity along with all other defined benefit pension schemes: the cost of accrual is increasing.

2.9 In contrast to most other public sector schemes, the PCPF is a funded scheme, meaning that pensions are paid out of a fund of assets; most public sector pension schemes are unfunded and pay pensions out of general government revenue. In an unfunded scheme, although costs of paying pensions will increase with longevity, there is no explicit deficit of assets to cover past service liabilities because there is no defined pot of assets earmarked to meet those liabilities. The government treats the contributions of active scheme members and their employers as tax revenues and simply pays pensions out of tax receipts as they fall due. However, the PCPF, as stated above, is a funded scheme. The Fund is currently in deficit with regard to its past service liabilities. At the most recent valuation of the PCPF, as at March 2008, the deficit stood at £50.9 million. Most if not all of that deficit can probably be attributed to reduced contributions paid by both the Exchequer and members during the 1990s when the scheme was in surplus. (However, it is problematic to infer a simple cause and effect relationship: had the assumptions about demographic and investment factors made at that time subsequently been borne out, there would have been no deficit.)



2.10 Deficits can also arise from lower than expected investment returns. The Pensions Act 2004 requires private companies' occupational pension funds to be valued by reference to the market value of the assets; such valuations will reflect the short-term volatility of the markets. As discussed in paragraph 2.4, if there is a shortfall of assets to liabilities, then the trustees must put in place a recovery plan to make good the shortfall over a period to be agreed between the employer and trustees, which the Pensions Regulator requires to be as quickly as the employer can reasonably afford. A key motive underpinning this 'funding regime' is to ensure that the pension scheme members are protected as far as is possible in the event of the company becoming insolvent.

2.11 The latest triennial valuation of the PCPF has also used a market value approach to valuing the Fund's assets. The PCPF is largely invested in equities (67% at 31 March 2008), and one would expect a market value approach to valuing the assets to reflect the volatility of financial markets. However, without the driving rationale of protecting members from the effect of company insolvency, it is not necessarily the most appropriate approach for the assets to be valued at a single point in time every three years, rather than over a longer period which more accurately reflects the medium to long term performance of the investments. Nevertheless, the approach must follow public law requirements on process, including determination of all relevant stakeholders' objectives. Therefore a move away from the approach adopted by private sector schemes may well need agreement and acceptance by those stakeholders before it can happen.

2.12 The PCPF is subject to the pressures from longevity increasing, and at a faster rate than was assumed in previous valuations, which are pushing up the cost of accrual and contributing to the size of the past service deficit. However, it is debatable whether the PCPF should be subject to the pressures on pension schemes that arise from financial reporting and legal measures designed to avoid problems which are not relevant to the PCPF or its members.

Recent changes in pension provision

2.13 Most public sector pension schemes have been reformed in recent years to address affordability and sustainability. The Office for National Statistics' Occupational Pensions Schemes Survey 2008 notes that:

"A new pension scheme was established in 2005 for the Armed Forces, replacing the 1975 defined benefit scheme. New schemes for the police and firefighters were introduced on 6 April 2006; for teachers on 1 January 2007; for the civil service on 30 July 2007; and for local authority employees (England and Wales) and the NHS on 1 April 2008. There will be a new scheme for local authority employees in Scotland from 1 April 2009."[15]

2.14 Many public sector schemes have reduced the benefits payable to members: for example, the Civil Service, Teachers' and NHS pension schemes have all increased normal retirement age from 60 to 65 for new entrants. Several schemes have also introduced caps on the Exchequer contribution in order to protect against further increases in the cost of benefits: the Civil Service schemes, including Nuvos, have a cap of 20%, and the Teachers' pension scheme has a cap of 14%. The Teachers' and NHS pension schemes have also introduced cost-sharing, whereby additional increases in the cost of accrual are to be shared 50:50 between the employer and employee. A summary of the provisions of major public sector pension schemes and recent changes to them is given at Appendix 3.

2.15 In the private sector, many companies have changed the terms of their defined benefit schemes, closed them to new entrants or, more radically, closed them for future service of existing members too. In 2008, 39% of active members of private sector defined benefit schemes saw contribution rates increase; 18% of active members of such schemes saw their schemes close to new entrants. The closure of private sector defined benefit schemes has been one of the most striking trends in the last decade: in 2000, 4.1 million employees were members of open private sector defined benefit schemes; in 2008, the figure was 1.1 million[16].

2.16 Where employers have closed defined benefit pension schemes to new entrants or future service, they have often replaced them with defined contribution schemes – either an occupational pension scheme or a group personal pension (GPP).

2.17 Many employers have not only changed the nature of the occupational pension scheme but have reduced their contribution at the same time. In 2008, the average employer contribution to an open private sector defined benefit scheme was 14.6%, but only 6% to an open private sector defined contribution scheme[17]. Employee contributions are also lower on average in defined contribution schemes than in defined benefit schemes: 5.1% for an open private sector defined benefit schemes in comparison to 3.0% for an open private sector defined contribution schemes.

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15 Office for National Statistics. *Occupational Pension Schemes Survey 2008*, p.3. Available at http://www.statistics.gov.uk/downloads/theme_population/Occ-Pension-2008/OPSS_Annual_Report_2008.pdf

16 Office for National Statistics. *Occupational Pension Schemes Survey 2008*, table 8.1, p.54; figure 2.5, p.10. Available at http://www.statistics.gov.uk/downloads/theme_population/Occ-Pension-2008/OPSS_Annual_Report_2008.pdf

17 Office for National Statistics. *Occupational Pension Schemes Survey 2008*, pp. 20-21. Available at http://www.statistics.gov.uk/downloads/theme_population/Occ-Pension-2008/OPSS_Annual_Report_2008.pdf; note that defined contribution schemes in this survey do not include Group Personal Pensions or stakeholder pensions.

2.18 Although private sector defined benefit pension schemes are closing, most private sector employees in open occupational pension schemes are still in defined benefit schemes rather than defined contribution schemes. In 2008, there were 1.1 million active members of open private sector defined benefit schemes and 1.0 million active members of open private sector defined contribution schemes[18]. However, open private sector defined benefit schemes are expected to continue to decline rapidly over the next few years.

Different pension designs: advantages and disadvantages

Defined contribution pensions

2.19 The motivation in the private sector to move from defined benefit provision to defined contribution provision is, in general terms, a shifting of the risk from the employer to the employee as described in paragraphs 2.6 and 2.7 above. From an employer's point of view, as long as the pension is adequate to cover its recruitment and retention needs, then this transfer of risk to the employee makes financial sense.

2.20 From the employee's point of view, a defined contribution pension can allow a welcome degree of flexibility: the employee usually has a greater degree of choice over how much to pay into his or her pension, has more choice over where to invest the contributions and often has options regarding the type of pension to purchase – for example in respect of 'inflation-proofing' and provision for dependants. Younger members, for example, may wish to focus on saving for a deposit on a property before they start investing in their pension. Some members may decide that, because of their personal circumstances, they are prepared to bear a high degree of risk on their pension investments in exchange for a potentially higher return. Other members, including one of the respondents to our consultation, place a value on being able to choose an ethical investment option. This kind of flexibility is easier to accommodate in a defined contribution scheme.

2.21 However, defined contribution schemes arguably put too much of the risk and responsibility onto employees, without enough professional input. Individual employees will seldom have the necessary information to make optimal decisions about the investment of their pension contributions; indeed, evidence points to:

"a widespread lack of knowledge and understanding about pensions and investment choice. Coupled with this, UK consumers (and women in particular) are generally found to be risk averse […]. In keeping with this, consumers have been found to focus more on minimising financial losses than maximising financial gains, even when making decisions about long-term investments such as a pension […]."[19]

2.22 As pension investments near the point at which they have to be cashed in, the tendency would be to invest them in less risky funds. One would expect a rational individual to move his or her pension investments out of equities, for example, and into bonds or gilts in the five years or so preceding retirement. This reduces the likely return on investment – the Association of Consulting Actuaries estimate that collective investment arrangements which avoid making this switch to low-risk investments can give efficiency savings of up to 10% in the long term[20].

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18 Office for National Statistics. *Occupational Pension Schemes Survey 2008*, table 2.6, p.10. Available at http://www.statistics.gov.uk/downloads/theme_population/Occ-Pension-2008/OPSS_Annual_Report_2008.pdf. Again, these figures do not include Group Personal Pensions or Stakeholder pensions.

19 Sharon Collard. *Individual investment behaviour: a brief review of research*. Personal Finance Research Centre, University of Bristol, 2009: p.21. Available at http://www.padeliveryauthority.org.uk/documents/report_v7_final.pdf

20 Supplementary evidence provided to the SSRB from the Association of Consulting Actuaries, 13 November 2009.

2.23 As noted above, a defined contribution pension pot is generally used to buy an annuity at the point at which the employee retires. The market for annuities will rise and fall, but often individuals do not have a choice about when to purchase their annuity and may have to buy at the bottom of the market. The insurer who sells the annuity will also be seeking to make a profit, further reducing the benefit to the individual buying the annuity. The insurers who provide the annuity will also have an incentive to adopt a more cautious investment strategy which will ultimately lead to a lower return on the investment (although this may in part be balanced out by the incentive to adopt an aggressive strategy in order to compete in the marketplace), and a higher cost of keeping capital reserves sufficient to meet solvency requirements imposed on them by financial regulators.

Defined benefit pensions

2.24 Defined benefit pension schemes avoid many of the inefficiencies in defined contribution schemes outlined above. A study from the United States' National Institute on Retirement Security found that 'a defined benefit (DB) pension can deliver the same retirement income at 46% lower cost than an individual defined contribution (DC) account.'[21] Although there are some differences between the American and UK pension markets which make direct comparisons difficult, the same general efficiency factors related to investment and annuity purchase are at work. The Association of Consulting Actuaries considers that the overall conclusions about the relative efficiency of collective pension arrangements under professional investment management (such as are found in defined benefit schemes) compared with individual defined contribution accounts apply similarly to the UK.

2.25 In general, defined benefit pensions also attract higher contributions from employees, encouraging people to invest for their own retirement. As noted in paragraph 2.17 above, in 2008 the average employee contribution to an open private sector defined benefit scheme was 5.1% compared with 3% for open private sector defined contribution schemes. Employee contribution levels in public sector defined benefit schemes vary, but new entrants contribute between 3.5% (Civil Service) and 9.5% (Police) depending on the scheme. (The exception is the Armed Forces, who have a non-contributory pension.)[22]

2.26 However, defined benefit schemes have been judged by many private companies to be unsustainable because of the level of risk and volatility in cost which the employer has to bear. Not only do employers have to meet any shortfall in predicted investment returns: they also have to meet the cost of any increases in longevity, which as already described, has been increasing dramatically in the last twenty years, outstripping actuarial predictions. The liabilities of pension funds have consequently increased and many are now in deficit. To the extent that longevity is not accurately predicted by the actuaries when calculating the ongoing cost of accrual and the required contributions, companies with a defined benefit pension scheme give a hostage to fortune.

2.27 The question of investment risk is more complex: the long-term performance of investments is relatively predictable; the main difficulty in managing the investment risk is the short-term volatility of the fund. Over the long term, periods of low investment return should be balanced out by periods of higher return, and the contributions to the fund should not have to vary dramatically in order to compensate for variations in investment return. However, during periods of high investment return when a pension

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21 Beth Almeida and William B. Fornia. *A better bang for the buck: the economic efficiencies of pensions*. National Institute on Retirement Security, 2008. Available at http://www.nirsonline.org/index.php?option=com_content&task=view&id=121&Itemid=48

22 Office for National Statistics. *Occupational Pension Schemes Survey 2008*. Available at http://www.statistics.gov.uk/downloads/theme_population/Occ-Pension-2008/OPSS_Annual_Report_2008.pdf

fund is in surplus, employers may take a contributions 'holiday', as happened in the PCPF during the 1990s. Such an approach was, at that time, required by UK tax law. However, such contribution holidays could mean that funds had no or reduced buffers to fall back on in periods of low investment return.

2.28 Furthermore, legal requirements on private sector pension funds mean that they have to take a market value approach to valuing their pension fund assets and put in place recovery plans to make good any shortfall through increased contributions. These requirements are well-motivated, aimed at ensuring that companies' pension funds are able to cover their liabilities in case of insolvency. However, in practice they make it very difficult for companies to take the long-term approach to managing pension liabilities and fund assets which is required to make defined benefit schemes viable.

Risk- and cost-sharing arrangements

2.29 The difference between defined contribution and defined benefit pension schemes can thus be characterised in terms of where the risk lies: in a defined contribution scheme the greater share of the risk lies with the employee; in a defined benefit scheme, the greater share of the risk lies with the employer. There are, however, ways of sharing the risk between employee and employer.

2.30 Several public sector schemes have chosen to share risk by capping the employer's contribution. If the cost of accrual goes up beyond the cap, then the employees have to bear the excess cost either through increased contributions or reduced benefits. The Civil Service scheme has also agreed to share 50:50 the cost of any increases in the cost of accrual up to the cap.

2.31 There are also ways of apportioning the cost of different types of risk. A cash balance scheme, for example, guarantees a return on investment for the employee's pension contributions but then the employee buys an annuity with that investment at the point of retirement. The investment risk is borne by the employer, the annuitisation cost and longevity risk by the employee.

2.32 It can be argued that, if risk is going to be shared between employees and employer, the longevity risk is more appropriately borne by the employees: after all, financially, as a group it is the employees who get the benefit of the extra years of pension. It is possible to deal with longevity risk directly and assign it to the employees by linking retirement age to longevity. This would not mean that members' actual retirement age would have to increase, but that taking their pension before the retirement age specified in the scheme would entail an actuarial reduction. This removes a significant element of the longevity risk from the employer, because the average number of years for which a pensioner can draw a full pension is kept constant and the pensions of those who retire before the specified normal retirement age can be actuarially reduced to reflect both the reduction in length of time over which contributions are paid and the longer period over which the pensions are expected to be drawn.

Adequacy of pension arrangements

2.33 In the future, income in retirement will be determined much more by individual pension provision than state provision. The Government stated in 1998 that, while presently 40% of pension income came from private sources, it wanted to increase this to 60% by 2050.[23] State support, where it exists, is increasingly focussed on income-tested benefits rather than universal support. As a consequence:

[23] Quoted in James Banks, Carl Emmerson and Zoë Oldfield. *Preparing for retirement: the pension arrangements and retirement expectations of those approaching State Pension Age in England*. Institute for Fiscal Studies, 2005. Available at http://www.ifs.org.uk/wps/wp0513.pdf

"If private provision fails to provide 'adequate' resources then either there will be further costs to future taxpayers through additional welfare payments for future generations of pensioners, or else future generations of pensioners will have higher rates of poverty (and possibly inequality) than their predecessors."[24]

2.34 It is therefore of concern to everyone in society that occupational pension provision should allow and encourage employees to ensure that, with their employers, they set aside adequate resources for their own retirement. There is justifiable concern that wholesale adoption of defined contribution schemes will not meet this goal.

2.35 In principle, a defined contribution scheme, suitably designed and with appropriate governance, attracting sufficient contributions from employees and employers, should be able to provide an adequate income for its members in retirement. However, analysis of the 2002 results of the English Longitudinal Study of Ageing shows that, for people aged between 50 and State Pension Age contributing to a defined contribution pension fund, the median value of their fund was just £16,250. Although the mean value was higher, at around £35,500, the analysis showed that different sources of retirement wealth tended to have an additive effect rather than a compensatory one; that is, those with small pension pots do not tend to have other sources of wealth to make up for it. Survey data from the UK indicates that most people feel that they need more than half of their current income to achieve a comfortable retirement[25]. Modelling by the Department of Work and Pensions indicates that, even with the reforms to the state pension in the Pensions Act 2007, a median earner retiring in 2055 can expect to receive from the state 32% of what he or she earned at the end of working life. To top this up to give an income of half a median salary of £25,816[26] would require an annuity costing approximately £95,000[27].

2.36 The evidence suggests, therefore, that defined contribution schemes in general may not produce levels of income that their members regard as adequate in retirement. Given the inherent extra cost of such schemes (as discussed at paragraphs 2.21 to 2.24), it may be that both members and employers are unwilling to contribute enough to guarantee a sufficiently high level of income replacement in retirement from a wholly defined contribution scheme.

2.37 Based on evidence submitted by the Association of Consulting Actuaries, defined benefit schemes do offer a more efficient way of providing retirement income than defined contribution schemes. Furthermore, they appear to encourage people to contribute more to their own pensions, as the average employee contribution to a defined benefit scheme is higher than to a defined contribution scheme, even within the private sector. We believe that there is a strong case, therefore, for retaining at least elements of a defined benefit scheme where the outcome in terms of retirement income can be improved at no additional cost to the employer.

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24 James Banks, Carl Emmerson and Zoë Oldfield. *Preparing for retirement: the pension arrangements and retirement expectations of those approaching State Pension Age in England*. Institute for Fiscal Studies, 2005. Available at http://www.ifs.org.uk/wps/wp0513.pdf

25 *Retirement savings in the UK: The State of the Nation's Savings 2007/2008*, ABI Insurance Market Study no.4. Association of British Insurers, 2007. Cited in: Sharon Collard. *Individual investment behaviour: a brief review of research*. Personal Finance Research Centre, University of Bristol, 2009: p.19

26 Office for National Statistics, *Annual Survey of Hours and Earnings 2009*. Available at http://www.statistics.gov.uk/StatBase/Product.asp?vlnk=15313

27 Watson Wyatt's Technology and Administration Solutions 'Annuity Desk' estimate the purchase price of an annuity of £4,646.88 pa for a single life, male aged 65, with a 3% escalation, to be £94,630.

2.38 Defined contribution schemes also have a role to play in offering flexibility to the employee in terms of investment choices and levels. For employers, they have a role in limiting the company's exposure to longevity and investment risk and the consequent impact of the pension scheme on the balance sheet (although there are risk-sharing or 'hybrid' schemes – such as cash balance schemes – which can also do much to address this problem). However, it is not clear that defined contribution schemes alone will provide adequate occupational pension provision for large numbers of the UK's workforce. Furthermore, there may be beneficial interactions between defined benefit and defined contribution schemes: for example, research from the US suggests that the typically risk-averse investment behaviour of defined contribution scheme members may be mitigated if the member has a defined benefit plan in addition, providing a degree of security[28].

[28] Cori E. Uccello *401(k) investment decisions and social security reform.* Center for Retirement Research working paper 2000-04. Boston College, 2000. Available at http://dcollections.bc.edu/R/?func=dbin-jump-full&object_id=87538&local_base=GENOI

Chapter 3

Context – the role and remuneration of MPs

Introduction

3.1 The matters to which our terms of reference for this review require us to have regard include:

- interaction with other aspects of the parliamentary remuneration package and other benefits to which MPs, Ministers and other office holders are entitled;
- the special circumstances of parliamentary life and the uncertainty of the careers of MPs, Ministers and other office holders;
- the best balance of contributions and benefits for MPs, Ministers and other office holders of different ages and patterns of service.

The role of MPs

3.2 There are currently 646 MPs and at the time of the latest valuation 634 were active members of the PCPF. There is no official job description for MPs. They are largely free to do the job as they wish and, as we pointed out in our *Review of parliamentary pay, pensions and allowances*[29] in 2007, there is much variation. For example, many MPs see the job as full-time but some continue outside occupations alongside their role as MPs. Some MPs give greater weight to their work as legislators and others to their constituency casework. The volume of that casework may vary depending on the nature of the constituency and whether it is in England or a part of the UK with a devolved parliament or assembly.

3.3 When we were taking evidence for our 2007 Review, some MPs described their role as being akin to running a small business employing several staff and running a constituency office, with the responsibilities that entails. We do not entirely accept this analogy since the MP is paid a salary and has staff and office costs met by the House. There is none of the risk of running a small business. (There is of course the risk of not being re-elected, discussed later in this chapter.) Nevertheless, this is clearly an important and demanding role, and a fundamental part of our constitutional democracy. It is essential that the total reward is sufficient to recruit and retain people of suitable quality for this role.

3.4 MPs vary by background, previous careers and time spent in the Commons. This variety makes it difficult to design systems suitable for them all. In the case of pensions, someone who becomes an MP at age 55 after a career in the private sector is likely to have different pension expectations and needs from someone who becomes an MP at, say, 30 without having accrued much or any pension entitlement. The average age of MPs just after the 2005 election was 51, a year higher than in 2001, but the youngest was 25 and the oldest 80. The relatively high average age of members adds to the cost of the pension scheme, because the contributions paid by members and the Exchequer are invested for a shorter period before pensions are drawn than in schemes where the membership is younger.

[29] Review Body on Senior Salaries. *Review of parliamentary pay, pensions and allowances.* Cm 7270. TSO, 2007. Available at www.ome.uk.com

Job tenure and security

3.5 Of course the chief factor which distinguishes MPs from the vast majority of the working population is that they are elected to office rather than appointed to a job or self-employed. MPs understandably tend to focus on that fact and many perceive their positions as precarious compared to 'normal' work. However, the evidence does not entirely support that perception. Only 50 incumbent MPs (around 8%) were defeated in the 2005 election. According to evidence from the Government Actuary's Department (GAD), the mean length of service (excluding transfers in and added years) of active PCPF members at the time of the latest valuation in 2008 was 12.2 years, while the mean length of service (again excluding transfers and added years) of those who left at the last election in 2005 was 14.4 years.

3.6 According to the Office for National Statistics Labour Force Survey, the median length of stay in a job in the UK in 2008 was 4 years 10 months and less than 30% of the working population had been in the same job for more than 10 years[30], which would suggest that MPs' job security is not below average. However, this comparison is arguably misleading since many of those in the wider economy who change jobs will do so voluntarily, and even those who lose their jobs may well find employment in the same occupations. This option is not realistically available to MPs. Moreover, many MPs argue that they lose touch with their previous occupations while serving as MPs and therefore have particular difficulties finding new work if they lose their seats. These problems have been set out in a report, *Life after losing or leaving – The experience of former Members of Parliament*, by Theakston, Gouge and Honeyman[31].

3.7 At present the uncertainty of parliamentary tenure is compensated, at least to some extent, by the Resettlement Grant which is payable to all MPs who leave the Commons at a General Election (whether or not that departure is involuntary). Resettlement Grant is between 50% and 100% of annual salary, depending on an MP's age and length of service. In our 2007 report we recommended that the grant be paid only to MPs who lose their seats at a General Election or whose seats disappear as a result of boundary changes (i.e. not to those who retire or resign) and at the rate of one month's salary for each year of service as an MP up to a maximum of nine months' salary. However, the House of Commons did not accept that proposal.

3.8 The Committee on Standards in Public Life[32] recommended that Resettlement Grant should be payable at the rate we had proposed to MPs who lose their seats at a general election, because of deselection or boundary changes, but in addition that those who stand down voluntarily should be paid for eight weeks from the date of the election. However, the Independent Parliamentary Standards Authority in its consultation document[33] questions whether there should be any payment for MPs leaving Parliament [sic], either voluntarily or otherwise. (It should be noted that a significant number of MPs are appointed to the House of Lords on leaving the Commons.)

3.9 For the purposes of this review, we set aside the question of whether there should be some form of resettlement grant for some or all MPs leaving the Commons. We are clear that the pension scheme should not be used to compensate for any uncertainty of tenure, although the scheme should be designed taking account of the characteristics of parliamentary service and we have tried to do so, despite the wide variety of MPs as described above.

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30 Information supplied by the Office for National Statistics, Labour Force Assessment Branch.

31 K. Theakston, E. Gouge & V Honeyman. *Life after losing or leaving: the experience of former members of parliament*. School of Politics and International Studies, University of Leeds, 2007. Available at http://www.epolitix.com/Resources/epolitix/Forum%20Microsites/Association%20of%20Former%20Members%20of%20Parliament/life%20after%20parliament.pdf

32 Committee on Standards in Public Life. *MPs' expenses and allowances: supporting parliament, safeguarding the taxpayer: report*. Cm 7724. TSO 2009. Available at http://www.public-standards.gov.uk/Library/MP_expenses_exec_summary.pdf

33 Independent Parliamentary Standards Authority. *MPs' expenses: a consultation*. TSO, 2010. Available at http://mpexpensesconsultation.org.uk/wp-content/themes/ipsa/ipsa-mps-expenses-a-consultation.pdf

The MP's remuneration package

3.10 The other main peculiarity of service as an MP, apart from the need to stand for election at intervals of five years or less, is the spot salary. All backbench MPs are paid the same salary, currently £64,766, regardless of the length of time they have been in the House. Ministers and certain office holders are paid supplements and are able to accrue, in effect, a career average pension[34] on those supplements, rather than the final salary pension accrued on the basic MP's salary. This somewhat unusual arrangement reflects the fact that many MPs will serve as Ministers or office holders for a period before reverting to the backbenches. A purely final salary arrangement would benefit Ministers who retired while in office and penalise those who returned to the backbenches before retirement.

3.11 The spot salary is something MPs have chosen for themselves. Since MPs have set their own pay until 2008, albeit after SSRB recommendations, they could have made different arrangements but have not done so, and during our last review most of the MPs who commented on this issue argued for continuation of the spot rate salary so that all backbench MPs are paid the same.

3.12 The MPs' pension is almost certainly the next largest item after salary in MPs' total reward. We received mixed evidence from MPs themselves and others about the importance of the MPs' pension in recruiting and retaining MPs. Some of those who gave evidence said that any significant deterioration in the pension would be a deterrent to becoming or remaining an MP, while others suggested that the potential financial rewards were irrelevant to the decision to seek to become an MP. The job had its own attractions.

3.13 We recognise that there are other benefits such as subsidised facilities and free parking in the Palace of Westminster, as well as what we described in our 2007 report as "non-financial attractions of the job, such as the opportunity to serve the public, influence, the prospect of higher political office and the status and cachet of being one of an exclusive group of elected representatives". Against that, MPs argue that they work very long hours and are busy even during the 22 or so weeks each year when the House is not sitting.

3.14 The advice we received from actuaries when preparing our 2007 report was that the MPs' pension was worth 22% of salary for an MP of average age (then 54 – the average age of MPs of course increases each year after a general election before tending to fall back at the next election). We took account of that pension value when comparing MPs' total reward with that of comparable occupations and, if our recommendations for changes to the PCPF are accepted, we shall need to consider the revised value of the pension when carrying out the review of MPs' pay after the next election, as mandated by the House of Commons resolution of 3 July 2008.

Recommendation 1: We recommend that any review of MPs', ministers' or office holders' pay take into account the value of the accompanying parliamentary pension.

Pensions and benefits in comparable senior roles

3.15 In Chapter 2 we discussed the wider pensions environment and trends in the provision of public and private sector pensions. Appendix 3 contains a summary of the principal provisions of the main public sector pension schemes. This shows that most schemes open to new entrants (other than those for uniformed services) have a normal

[34] In a defined benefit career average scheme, benefits payable in retirement are based on a fraction of the member's aggregate pensionable earnings over his or her entire career.

retirement age of 65 and two large schemes (NHS and schoolteachers) have capped the employer contribution at 14.2% and 14% respectively while the employer contribution to the civil service schemes will be capped at 20% from April 2012. However, schemes for the uniformed services, judiciary and local government workers currently have no employer cap.

3.16 In the private sector, there has been a strong trend away from defined benefit schemes toward defined contribution. For example, the Association of Consulting Actuaries' 2009 survey found that 87% of defined benefit schemes were now closed to new entrants[35]. A study[36] carried out for the Review Body on Doctors' and Dentists' Remuneration and us found that, where employers have implemented defined contribution schemes, employer contributions for employees paid at around the same level as MPs are typically in the range 6.5% to 10%. The Watson Wyatt 2008 pension plan design survey found that the median employer contribution was 8% of salary (based on employees paying the maximum matching contributions)[37].

International comparisons

3.17 Our terms of reference require us to have regard to 'comparable international experience, where relevant'. We obtained information on the pensions of parliamentarians in the following countries:

Canada
France
Germany
Ireland
Italy
Netherlands
New Zealand
Northern Ireland
Norway
Scotland
Spain
Wales

3.18 Analysis of this information is difficult because the nature of pension provision differs significantly between countries. Unsurprisingly, pension provision for parliamentarians in Northern Ireland, Scotland and Wales is quite closely aligned with the PCPF. Elsewhere, there is a very wide range of practice. For example, in Spain there is no separate, additional pension scheme for members of parliament but they receive accelerated accrual in the normal, state pension scheme. In Germany members of parliament are not eligible for the normal state pension and have a separate scheme instead. Other countries have supplementary schemes for MPs. We set out some features of schemes in selected countries in the table below but it is difficult to draw any conclusion about those schemes in the absence of more information, for example about the tax system and total reward (do employee contributions attract tax relief? are pensions taxed in the same way as earnings? how generous is the base pay?) and any universal pension provision in the country concerned. However, it is clear from the information that defined benefit schemes are the most common type of arrangement, with only New Zealand having a defined contribution scheme.

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[35] Association of Consulting Actuaries. *Report 1: 2009 ACA Pension trends survey results*. Available at www.aca.org.uk

[36] Towers Watson. *Research into total reward offered by comparator sectors*. Office of Manpower Economics. 2010. Available at www.ome.uk.com

[37] *Watson Wyatt Pension Plan Design Survey*. Watson Wyatt (now Towers Watson), 2008.

Table 3.1: **Information on pensions for members of parliament in selected countries**

Country	Government contribution rate	MP contribution rate	Accrual rate	Normal retirement age
Canada	Variable. Expressed as multiple of MP contribution. In 2008 multiple was 3.65 times.	7%	3% up to maximum of sessional indemnity	55
France	31.4% in first 15 years, 15.7% thereafter	15.7% in first 15 years, 7.85% thereafter	Pension payable depends on number of mandates: ranges from €19,115 p.a. after 5 years to €71,680 after 22.5 years.	60
Germany	Full cost – pay as you go system	Nil	2.5%	67 for those born after 1963, but reduced by one year for each year of service between nine and 18 years
Ireland	Not known	6%	1/40th – max half salary, plus 3/40th lump sum, max 1.5 times salary	50 (65 for new entrants)
Italy	Not known	8.6%	4% per year subject to minimum of 5 years and maximum of 60% of salary	Normally 65
Netherlands	Not known	6% in 2009	2%	65
New Zealand	Up to 20%, conditional on member contribution	Up to 8%	Variable – MPs choose a fund in which to invest contributions.	No set age
Northern Ireland	23.3% including 2.9% to amortise deficit	11.5% for 1/40th, 6% for 1/50th	1/40th or 1/50th, max 2/3 of salary	65 but members with more than 15 years' service may be able to retire earlier with unreduced benefits

Country	Government contribution rate	MP contribution rate	Accrual rate	Normal retirement age
Norway	Not known	2%	66% of salary after 12 years' service	65 or when age plus service = 75
Scotland	21% including 0.2% to amortise deficit	11% for 1/40th, 6% for 1/50th	1/40th or 1/50th, max 2/3 of salary	65
Spain	10%	Nil	MPs who serve 11 years receive maximum state pension. MPs who serve 9-10 years receive 90% of state pension. 7-8 years = 80% of state pension. Service below 7 years counts towards state pension.	65 or 60 if 40 years' social security contributions
Wales	23.8%	10% for 1/40th, 6% for 1/50th	1/40th or 1/50th, max 2/3 of salary	65 from 2007

Chapter 4

Options for reform of the PCPF

Current PCPF structure and benefits

4.1 The PCPF is a contracted-out, defined benefit, final salary, funded pension scheme with an accrual rate of 1/40th if members contribute 11.9% of their pensionable salary towards the cost, 1/50th if they contribute 7.9% or 1/60th if they contribute 5.9%. It provides for full benefits to be payable from a normal retirement age of 65, although it also accommodates early or late retirement. All MPs who have taken their seats are eligible to contribute towards a pension based on their salary as an MP. MPs who are appointed as Ministers or hold other parliamentary office (such as Chairs of certain Select Committees) receive salary supplements whilst in office. They accrue additional pension on those supplements through a defined benefit, career average top-up. All PCPF pensions are subject to an overall maximum; the precise determination of the overall maximum for each individual is somewhat complex, but it is usually subject to an overarching maximum pension of two thirds of salary (which may, in certain cases be 'capped'). That limit can include benefits accrued from all registered pension schemes prior to becoming a member of the PCPF. Appendix 1 gives an overview of the provisions of the PCPF for MPs and office holders.

4.2 As explained earlier, resolutions passed in the House of Commons have called for the Exchequer contribution to be limited to 18.3% of payroll[38] (leaving aside the additional, temporary contribution of 8.7% to amortise over 15 years the deficit identified in the 2005 valuation). The current arrangements are considered to have a cost to the Exchequer of 20.2% payroll but, as already indicated, the Leader of the House is awaiting the outcome of our review before bringing forward further proposals for reducing costs[39].

Issues to be addressed by reform

Cost

4.3 The cost to the Exchequer of the PCPF has therefore reached a level that the House itself considers to be too high. The scheme also looks generous when compared with some other public sector schemes (such as the Teachers' and NHS schemes, which have a cap of 14% on the employer contribution) and with the average levels of contributions by private sector employers, although it is by no means the most generous public sector scheme. As discussed in Chapter 2, most private sector schemes now offer a much lower level of benefits, on a defined contribution basis.

4.4 However, simple comparison of the costs of schemes can be misleading and is not appropriate. MPs, like judges, have a particular age profile which has an impact on pension costs, and they should therefore arguably be compared with people of similar age profile in jobs of similar weight, rather than with the entire working population. In our 2007 report[40] we argued that for pay purposes MPs should be compared with other public sector workers and we identified six specific comparators: a headteacher, police chief superintendent, colonel or equivalent in the armed forces, senior civil servant (pay band 1), 2nd tier county council official and an HR director or equivalent in an

[38] Hansard, 25 June 2009, Col 1017

[39] Hansard, 15 December 2009, Col 118WS

[40] Review Body on Senior Salaries. *Review of parliamentary pay, pensions and allowances.* Cm 7270. TSO, 2007. Available at www.ome.uk.com

NHS trust.

Volatility

4.5 The main driver of the increasing cost of accrual in the PCPF over the long term is the increasing longevity of its members, but the overall cost of accrual is not the only issue which needs to be addressed. As discussed in paragraphs 1.14 – 1.17, the cap on the Exchequer contribution (including the fixed contribution to paying off the deficit) means that the cost for members of the pension scheme will tend to vary substantially or the benefits will have to be amended to contain the cost after each triennial valuation. This is unsatisfactory from the point of view of members who are trying to plan both their current monthly income and expenses and for their retirement. Although over the long term one would expect costs both to rise and fall, there is a risk that a sharp rise in contributions (or a reduction in benefits) following a valuation could prompt a large number of members, especially younger members, to leave the scheme. This could lead to a further upward spiral in the cost of accrual. Ideally, therefore, we should seek to remove the short-term volatility from active members' experience of the pension fund.

Past service deficit

4.6 The Exchequer has committed to paying off the past service deficit (identified at the 2005 valuation) at a rate of 8.7% of payroll over 15 years. The liabilities in respect of past service are large (£418.1m at 1 April 2008) and are sensitive to a variety of assumptions including the longevity of members, the rate of return on investment and the final salary of members still accruing benefits (i.e. the rate of salary increase). This fluctuating level of liability is difficult to manage and should ideally be stabilised as much as possible. The problem is particularly acute because the Exchequer's approach of fixing its contribution at 8.7% means that fluctuations in the size of the past service deficit would henceforth be borne entirely by the PCPF members, reflected in either their take-home pay or pension benefits.

Areas of inequity

4.7 Reform of the PCPF also presents the opportunity to address areas of inequity in the scheme. The SSRB has previously expressed the view that the treatment of 'retained benefits' (i.e. benefits accrued in another pension scheme before joining the PCPF) is unfair. Members are limited to a pension from the PCPF of, broadly, the greater of:

- 2/3rds of final salary, including any benefits which they accrued before joining the scheme;
- 1/60th of final salary for each year of accrual up to 40 years (regardless of the level of contributions actually made).

4.8 Until 2009, there were only two rates of accrual: 1/40th and 1/50th. This meant that some members with retained benefits were paying the 1/50th (or 1/40th) accrual rate when they were only able to benefit from 1/60th accrual. Those members were in effect subsidising other members without retained benefits and we therefore recommended in 2007 that members with retained benefits should be allowed to opt for a 1/60th accrual rate at a reduced contribution rate to be calculated by GAD. With the implementation of that recommendation, members with retained benefits can pay lower contributions to reflect the fact that they will benefit only from 1/60th accrual. However, there remains an element of inequity in that members who have been prudent in saving for a pension before joining the PCPF are treated differently from members who have not, in that the former may in effect be unable to accrue at the higher 1/40th and 1/50th rates. This is because their retained benefits from previous activity will be counted against the limit on pensions under the PCPF of 2/3rds of final salary when they come to retire.

4.9 A further area of inequity, common to all defined benefit pension schemes, is the cross-subsidy between younger and older members. The younger a member is, the longer the pension scheme has to build up sufficient assets to provide the benefits at retirement. The longer the scheme has to grow the assets through investment, the lower the initial contribution is estimated to need to be. The cost of accrual in a given year is therefore calculated to be less for a younger member than an older member. However, PCPF members all have the same contribution rates meaning that younger members are effectively subsidising older members. Whilst this might be acceptable in occupations where people tended to stay in the same job for the whole of their working life, it is more obviously unfair when job tenure is shorter and people often change jobs several times during their working life.

4.10 Under a defined contribution arrangement, all members could receive the same contribution from their employer, regardless of age. However, this would create unequal outcomes in terms of retirement income for older and younger members, which could arguably be considered just as inequitable as the cross-subsidy in a defined benefit scheme. Moreover, as explained in paragraphs 2.6 – 2.7 above, the actual size of the pension obtained for a given level of contributions can vary substantially over time, leading to a further source of inequity.

Pros and cons of options for reform

4.11 In response to our consultation, we received a range of views about how the PCPF should be reformed. There was no consensus, although almost all respondents were agreed that the current arrangements are unsustainable. Many also recognised the benefits of risk-sharing schemes and forms of pension provision which combine aspects of defined benefit and defined contribution schemes. Defined contribution and defined benefit are often presented as the only options, but variations and combinations of both are possible. We discuss below how the different options for the future of the PCPF do (and do not) address the case for reform which we have outlined.

4.12 In considering each option, it is important to remember that within any pension scheme structure there are a number of variables which can be adjusted to shape the overall balance of costs and benefits. The most obvious of the variables are the contribution rates of the employee and employer, but other variables include the specified normal retirement age, favourable early retirement terms, lump sums on retirement and survivors' pensions (e.g. pensions paid to widows and widowers).

Minimal changes

4.13 One option for reform is to make minimal changes to the scheme to bring the cost of ongoing accrual down to 18.3%, in line with the House of Commons resolution passed on 25 June 2009. However, this is unlikely to be sustainable for long while the underlying problems of the volatility of valuations, increasing cost from rising longevity and vulnerability to fluctuations in the past service deficit remain unaddressed.

Career average

4.14 Currently the PCPF is a final salary scheme for MPs, meaning that the benefits which MP members accrue are expressed in terms of a fraction of final salary. An alternative basis for defined benefit schemes is 'career average revalued earnings' (CARE), meaning that the benefits which members accrue are expressed in terms of a fraction of the members' aggregate pensionable earnings over their entire careers, revalued from the point of accrual in line with an index. For workers whose earnings peak at the end of their career, accruing at the rate of 1/60th in a final salary scheme can be worth considerably more than accruing 1/60ths in a career average scheme. However, MPs do not have a normal 'career structure' and pay progression: they do not receive increments or performance pay so all MPs receive the same salary unless they become Ministers or office-holders.

Unless there is a large increase in all MPs' salaries during an MP's career, moving to a career average scheme is unlikely to have a great impact on the member's retirement income or the estimated cost of the scheme.

4.15 Nonetheless, actuarial calculations show that there would be a small cost-reduction for future accrual by moving from a final salary scheme to a CARE scheme if the revaluation index chosen for uprating CARE benefits was lower than the rate of growth of MPs' salaries. In a career average CARE scheme, each year's accrual (e.g. 1/60th of salary) is uprated at a given rate (usually related to the movement in the RPI) from the time of accrual to the point of retirement. Salaries are usually assumed to grow faster than price inflation; indeed, in the 2008 valuation of the PCPF, the Government Actuary assumed a real rate of salary growth of 1.5% per annum.

4.16 Moving to a career average scheme would also protect the past service liabilities from one source of volatility. At every valuation, the Government Actuary must make an assumption about what the final salary of currently accruing members will be; if that assumption turns out to have been wrong, then it will have a negative or positive impact on the funding level of the PCPF. For example, if MPs were to receive a large salary increase, this would inflate the past service liabilities in respect of MPs still in office because whatever fraction of final salary they have already accrued as pension would now be worth much more.

4.17 The PCPF already has an element of CARE within it. MPs who are appointed as Ministers or hold other parliamentary office (such as Chairmen of certain Select and Standing Committees) receive salary supplements whilst in office. They accrue additional pension on those supplements through a career average top-up. This makes sense because their period of highest earnings (as a Minister or office holder) may not coincide with their final years as an MP; in a final salary scheme, no account would be taken of any intervening years of higher earnings and contributions. Moving to a career average scheme would therefore enable the PCPF to be simplified so that the pensions for Ministers and office holders can be dealt with in the same way as pensions for MPs.

Cash balance

4.18 A cash balance scheme splits the risk between the employee and employer. Typically, the employer credits a percentage of salary to a member's account each period; this accumulates over time and is available at retirement to purchase an annuity on terms applicable at the time of purchase, or, subject to restrictions, to take as a lump sum. The returns added to the account each period will usually be linked to an index such as RPI + x%, with the rate of return being guaranteed by the employer. The investment risk is therefore borne by the employer and the longevity risk is borne by the employee.

4.19 A cash balance scheme would have the advantage of protecting the Exchequer from the cost of increasing longevity. However, the requirement to purchase an annuity can be viewed as an inefficient method of converting savings into retirement income. Furthermore, individuals purchasing annuities are subject to all the volatility of the annuities market; in contrast, a defined benefit scheme which pays out benefits over the longer term will bear the cost of longevity, but not of fluctuations in annuity rates attributable to other factors.

4.20 The Exchequer would still be exposed to investment risk in a cash balance scheme, as it would be undertaking to provide a guaranteed rate of return to the scheme members. The problem of the volatility of investment returns would therefore remain, unless the scheme reduced the assumed return on investment from its current level which relies heavily on the high allocation to volatile, return-seeking assets. However, it can be argued that the alternative, of leaving it to individual employees to manage their own investments, presents equally unacceptable risks as well as being less efficient.

Defined contribution

4.21 The current PCPF could be closed and replaced with a defined contribution pension scheme. The main advantage of such a move would be to remove all risk for the Exchequer in terms of the cost of ongoing accrual, although there would still be a considerable legacy of liabilities for past service.

4.22 A defined contribution scheme would also give members the freedom to manage their own savings and investments. For example, we mentioned earlier one respondent to our consultation who noted that it was a disadvantage of the current arrangements that he could not choose to invest in 'ethical' assets. Defined contribution schemes give greater flexibility in terms of allowing members to choose how much to save for their retirement and to fit this in with other calls upon their salary at different points in their career. For example, members may wish to put considerably more of their salary towards their pension when they have a period of high earnings as an office holder or Minister.

4.23 A defined contribution scheme could also be designed to address any issues of inequity in the PCPF. If all members receive the same employer contribution, then in one sense all members receive the same benefit. However, as noted above, there would be an inequity in outcome because younger members have longer to invest their contributions before drawing on them in retirement. Some defined contribution schemes are therefore designed with tiered employer contribution rates, meaning that employers contribute more to the pensions of older members.

4.24 The disadvantages of a defined contribution arrangement for parliamentarians are the same as for all other employees. The higher cost and lower efficiency of defined contribution schemes in comparison with defined benefit schemes (discussed at paragraphs 2.21 – 2.23) mean that, if contributions to each are the same, the likely retirement income for a member of a defined contribution scheme will be much lower than for a member of a defined benefit scheme. Retirement income is also much less predictable under a defined contribution scheme, because it will depend both on the level of the individual's fund and on the annuity market at the time of retirement.

4.25 Ultimately, the risk of inadequate pension provision will be borne by society as a whole if large numbers of pensioners have to rely on state provision of services and benefits because they have no or inadequate occupational pensions. However, it could be argued that this concern is not highly relevant to the pensions of parliamentarians: those people most likely to end up qualifying for means-tested benefits in retirement are those currently in low-paid employment, and at present the MPs' salary puts them at around the 95th percentile of earnings. Under a defined contribution arrangement, the cost of providing a pension which keeps parliamentarians from depending on state provision in retirement would not therefore be great, expressed as a percentage of payroll; however, the cost is likely to be greater for everyone, and give greater insecurity for members, than a defined benefit arrangement.

Hybrid schemes

4.26 There are a variety of pension scheme designs which combine aspects of defined benefit and defined contribution provision. For example, a 'sequential' hybrid scheme offers its members a defined contribution pension up to a certain age, and then a defined benefit pension thereafter. A 'combination' hybrid scheme offers members a defined benefit pension on the first portion of their salary, and a defined contribution pension on any amount above that level. All members have the security of a defined benefit pension up to a certain level, but the higher earners additionally have defined contribution provision.

4.27 Hybrid schemes such as these are designed to distribute guarantees and risks in pension provision amongst a workforce according to variables such as age and salary level. However, parliamentarians are an unusually homogeneous group in age and income and there would consequently be little benefit in providing a 'sequential' or 'combination' hybrid scheme for them. For example, restricting the portion of salary on which a defined benefit pension is based would be no different in practice from reducing the rate of accrual, because most MPs are on the same salary. We therefore see no advantage in 'sequential' or 'combination' hybrid schemes for MPs.

Chapter 5

Changes recommended to the PCPF

5.1 Having considered the evidence and arguments relevant to the options for reform of the PCPF, we recommend that the PCPF retain a core of defined benefit provision, but with changes to make it affordable and sustainable for both members and the Exchequer. In particular, we have sought to reduce the volatility which in recent years has meant almost annual adjustments to PCPF contribution rates and benefits.

5.2 We believe that our recommendations achieve the aims outlined in Chapter 4 of reducing the cost of accrual, limiting the impact of investment volatility, reducing and stabilising the past service deficit and removing areas of inequity within the scheme. Furthermore we have sought to give members more flexibility in pension provision and responded to changes in society with respect to pension provision and retirement age. We have maintained the value of benefits accrued based on service and salary to date and ensured that, in the future, MPs who leave Parliament will continue to do so with a pension which contributes adequately towards their retirement income. Whilst no pension scheme can be entirely future-proof, we have recommended arrangements which should not need revision for at least the next ten to fifteen years, giving members greater security and confidence about their expected contributions and benefits than at present.

What type of scheme?

5.3 The simplest solution would have been for us to recommend the closure of the final salary scheme, and its replacement by a defined contribution scheme. Many private sector employers have closed their defined benefit pension schemes, either for new entrants or for all future service. Such a change would give absolute clarity over the costs of the pension scheme and leave the Exchequer free from any potential liability to fund a future deficit. We are not, however, aware of any significant defined contribution schemes in the public sector. Most are still final salary although the new Civil Service scheme, Nuvos, is career average and there is also a Partnership option which is defined contribution (see Appendix 3). Moreover, as we have already indicated in Chapter 2, we see disadvantages for individual members in a move from defined benefit to defined contribution pensions. As the information provided by the Association of Consulting Actuaries shows (see paragraph 2.7 above), defined contribution schemes contain two elements of risk over which members have no control. One is the investment performance of the fund while it is being built up and the other is the level of the annuity which the fund will buy at retirement. Both of these are liable to vary widely – in the example given by the Association of Consulting Actuaries the value of pension bought for a given level of saving fell by 77% in cash terms over 12 years. We are also persuaded by the argument advanced by the Association of Consulting Actuaries in their evidence that defined contribution schemes are a less cost-efficient way of providing pension benefits than defined benefit schemes.

5.4 We believe that it is possible to offer defined benefit pension provision which retains the key advantages of defined benefit schemes – the security for the employee of having predictable benefits and the overall efficiency of operation – without asking employers to sign a blank cheque. Our recommendations below set out the architecture of a scheme which significantly reduces the taxpayers' contribution to parliamentarians' pensions and places limits on that contribution for the future, whilst providing parliamentarians with the security of a core of defined benefit pension provision. We have also protected the pension benefits which members have already accrued. More broadly, and following our terms of reference, we see our recommendations as contributing to 'wider Government policy to encourage the continuation of good pension provision in the UK'.

5.5 We therefore propose that MPs, Ministers and other parliamentary office holders should, from the date of the next election, cease to accrue pension under the current final salary scheme, although past service would be protected as described below. Future service from the beginning of the next Parliament should be under a CARE scheme with the following main characteristics:

Table 5.1: **Main features of proposed new parliamentary pension scheme**

Normal retirement age	68
Accrual rate	1/60th, career averaged
Lump sum	By commutation (actuarially neutral)
Member's contribution	5.5%
Exchequer contribution	10.5%[41]
Maximum Exchequer contribution	15.5%[42]
Possibility for member to buy additional pension	Through AVCs on defined contribution basis
Revaluation of career average benefits for active members, deferred pensions and pensions in payment	Lower of RPI and 2.5%

In the following paragraphs we set out the reasoning behind each element of the overall design outlined above.

The accrual rate

5.6 The PCPF currently offers members the opportunity of accruing 1/40ths (with an 11.9% member contribution), 1/50ths (with a 7.9% member contribution) or 1/60ths (with a 5.9% member contribution). It is the higher rates of accrual open to members (1/40th and 1/50th) which make the PCPF look generous in comparison to other public sector schemes. Of the final salary schemes, only the judges' scheme currently has such a high rate of accrual (1/40th), the judges' age profile being very unusual. The Civil Service Nuvos scheme has an accrual rate of 2.3% (approximately 1/43rd) but it is a career average scheme.

5.7 However, the PCPF accrual rate of 1/40th is not necessarily as generous as it appears at first sight, because a significant part of the cost is borne by members via the higher contribution of 11.9% of salary (compared to 5.9% for 1/60th accrual). Nonetheless, it does have an impact on the Exchequer in terms of risk. The greater the benefits promised by the scheme, the greater the risk the Exchequer takes on in guaranteeing those benefits should the assumptions about the cost of accrual and return on investments turn out to have been optimistic. Lowering the overall rate of accrual would therefore reduce the risk of a sizeable deficit emerging in the future.

5.8 Furthermore, at present some members who opt for the higher rates of accrual (1/40th and 1/50th) do not receive all the benefits they have paid for, because of the impact of maximum benefit limits which restrict the pension that members can draw from the PCPF to 2/3rds of their final salary minus any retained benefits (that is, pension benefits accrued before joining the PCPF). However, the maximum benefits limits allow benefits accrued at 1/60th final salary to be taken in full, regardless of retained benefits.

41 This is the expected cost, based on the assumptions used by GAD for its 2008 valuation of the PCPF, and additional assumptions by GAD about the effect of using the lower of RPI and 2.5% as the revaluation rate.

42 As explained below, we propose two separate caps, of 4% on investment risk and 1% on demographic changes.

5.9 Introducing a single rate of accrual would also help to eliminate one element of cross-subsidy in the PCPF as it currently operates. Because most of the cost of accrual above 1/60th is paid for by the members' contributions, cross-subsidy between members at different accrual rates is relatively minor in terms of the cost of ongoing accrual. However, hitherto the Exchequer has borne the full cost of meeting any past service liabilities[43], so when the fund is in deficit with regard to its past service liabilities those members who have accrued pensions at higher rates receive a greater benefit from the Exchequer guarantee. In effect, members on lower rates of accrual currently subsidise those on higher rates of accrual.

5.10 In terms of the absolute level of accrual, accrual at 1/60th puts the PCPF in line with most other public sector defined benefit schemes. In the private sector, 1/60th is also the most common rate of accrual in open defined benefit schemes (and those closed to new entrants). Overall, there are 1.7 million active members of private sector defined benefit schemes with accrual rates of 1/60th or better[44].

Recommendation 2: We recommend that 1/60th be the single rate of defined benefit accrual available in the PCPF.

Recommendation 3: For simplification, we recommend that the retained benefits restriction be removed from the definition of maximum benefits for all members of the PCPF who join at or after the point of transition.

Normal retirement age

5.11 Many pension schemes have responded to the increase in longevity by increasing the specified normal retirement age. Public sector schemes including the PCPF now all have a specified normal retirement age of 65 for new entrants, with the exception of the uniformed services who have lower ages and judges, most of whom must retire at 70. It is important to understand that the specified normal retirement age in a pension scheme is the age at which pensions can be taken unreduced – members can retire earlier than the specified normal retirement age, but their pensions would usually be reduced to reflect the fact that they will be drawn for a longer period.

5.12 There is a growing acceptance that people will have to work for longer in order to provide for their increasingly long retirements. The Government has introduced legislation to increase the state retirement age gradually from 2024 so that by 2046 it will be 68.

5.13 Increasing specified normal retirement age substantially reduces the cost of pension provision. The Government Actuary has calculated that increasing the specified normal retirement age of the PCPF by 1 year reduces the cost of accrual by approximately 1% of payroll. It would be possible to adjust the retirement age in parallel with improvements in longevity, such that the cost of accrual is not increased by improved longevity. Indeed, in their oral and written evidence, the PCPF Trustees advocated the use of retirement age as the prime lever to control increases in the cost of accrual from longevity, both at this current reform and at future valuations.

5.14 We believe that, given the pressures on the PCPF from rising longevity and the need to reduce costs, specified normal retirement age should be increased in line with wider trends in society.

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[43] The Exchequer has now fixed its contribution to amortising the past service deficit at 8.7% of payroll, but the logic – of greater benefit from the Exchequer guarantee for members who have accrued at a higher rate – still holds.

[44] Office for National Statistics. *Occupational Pension Schemes Survey 2008*, table 4.1, p.30. Available at http://www.statistics.gov.uk/downloads/theme_population/Occ-Pension-2008/OPSS_Annual_Report_2008.pdf

Recommendation 4: We recommend that for future accrual in the PCPF, the specified normal retirement age should be set at 68.

5.15 If longevity improves in line with GAD's best estimate assumptions, raising normal retirement age to 68 now will mean that it should not need to be adjusted again for at least the next ten to fifteen years. Although we do not propose phasing in the change, current members of the PCPF will not experience it as a sudden increase to retirement age because the change will apply only to future accrual. All pension benefits accrued up to the point of change will be payable (unreduced) from the original retirement age. Where members have accrued benefits which are payable at different retirement ages, an actuarial reduction can be applied to those benefits which members wish to take before the specified normal retirement age. Likewise, if a deferred member wishes to take some of their benefits after the retirement age relevant to their accrual, the benefits would be augmented to reflect the shorter period for which they will be payable.

5.16 It is worth noting that for parliamentarians, and MPs in particular, changing the retirement age of the scheme is unlikely to have a direct impact on the age at which they retire. MPs nearly always retire by deciding not to stand at a further election or by standing but not being re-elected. The date of their retirement is therefore subject to the timing of an election and the voters' choice, not a personal choice or the terms of their pension. In July 2009, there were already 94 MPs over the age of 65. It could be argued that raising the retirement age by three years will encourage MPs in their early 60s to stand for one more parliamentary term than they would otherwise have done. A rise in the actual retirement age of MPs would reflect or foreshadow the trend in the population as a whole.

5.17 In adopting an immediate change to the PCPF's retirement age for future accrual, parliamentarians would be showing leadership with respect to the scheduled increases in national state pension age. They would also be leading the way for changes which may have to be made to pension provision more widely to relieve the pressure from rising longevity – whether that pressure is currently being borne by employers through the cost of defined benefit schemes, or by members through the diminishing retirement income from defined contribution schemes.

Moving to career average revalued earnings (CARE) instead of final salary

5.18 One of our aims in this review is to minimise the scope for deficits to arise in the fund with respect to past service liabilities. As discussed in paragraphs 4.14 – 4.17, in a final salary scheme deficits can arise from salaries rising faster than was assumed when originally estimating the cost of accrual. A career average scheme removes this potential cause of deficit. The employer is protected from the large increases in the cost of past service liabilities which would arise under a final salary scheme if employees receive a large salary increase.

5.19 This last point is particularly relevant to parliamentarians. As Sir John Baker's *Review of Parliamentary Pay and Pensions*[45] noted, governments are often reluctant to propose increases to MPs' and Ministers' salaries, and MPs themselves decline to vote to increase their own pay, even when the increase has been independently recommended, as happened in 2008. For these and other reasons, over a period of time, the pay of MPs and Ministers has therefore fallen behind that of comparator groups. Attempts to rectify this situation are made even more difficult in a final salary scheme, where any sudden increases in salaries (to 'catch up' with comparator groups, for example) are also reflected in an increase in the size of the liability for the past service of active members.

[45] Sir John Baker. *Review of Parliamentary Pay and Pensions*. Cm 7416. TSO, 2008. Available at http://www.ome.uk.com

We believe that a career average scheme would therefore have an advantage in enabling decisions about parliamentarians' salaries to be taken based on the evidence and arguments concerning appropriate salary levels, without having to take into account the consequences for the pension fund's liabilities for past service.

5.20 Final salary schemes particularly benefit those workers whose pay rises during their careers, and especially those who receive significant increases in the years immediately preceding retirement. Such people have pensions that are higher relative to the contributions paid during their working lives than those who have had no or little pay progression during their careers. In practice, therefore, most final salary schemes involve a cross-subsidy from those with little or no pay progression to those whose earnings increase significantly. However, MPs are unusual in that all MPs other than Ministers and certain office holders are paid the same amount. For this reason, the difference between a final salary and a CARE scheme will be much less for MPs than for many other occupations where there is typically more pay progression, whether through promotion or performance or service-related increments.

Recommendation 5: In order to reduce potential volatility in the value of past service liabilities, we recommend that future accrual in the PCPF be on the basis of career average revalued earnings rather than final salary.

The member contribution rate

5.21 The current member contribution rate for accrual at 1/60th is 5.9% of payroll. Actuarial estimates indicate that there will be a small saving in the cost of accrual from moving to benefits based on revalued career average earnings rather than final salary (that is, if the revaluation rate is lower than the assumed rate of salary growth). We recommend sharing this saving between members and the Exchequer, reducing the members' contribution by 0.4% of payroll.

Recommendation 6: We recommend that the members' contribution rate be set initially at 5.5% of payroll.

Revaluing of accrued benefits

5.22 Once benefits have been accrued in a CARE scheme, they are revalued, usually by an index such as RPI, until the point at which the pension is taken. At present, because MPs do not experience individual salary growth during their careers, their benefits are effectively already on a career average basis, albeit revalued in line with the growth in an MPs' basic salary while they are still an MP and by RPI thereafter. Moving from a final salary scheme to a career average scheme does not therefore necessarily reduce the cost of accrual as substantially for MPs as would be expected for other groups of employees who experience significant salary growth with career progression. However, the Government Actuary currently uses an assumption of RPI + 1.5% for growth in MPs' basic salary, so any revaluation index below this would reduce the cost of accrual.

5.23 We have considered what index to recommend for revaluing career average accrual in the PCPF. Revaluing by RPI would preserve the purchasing power of the accrued career average benefits, and is estimated to reduce the cost of accrual at 1/60th by approximately 2% of payroll (compared with final salary benefits).

5.24 However, unrestricted index-linking of accrued benefits would leave the PCPF open to potentially large and destabilising increases in costs during a period of high inflation. The Government's inflation target is for 2% consumer price inflation over the longer term and Parliament has passed legislation which sets the minimum revaluation rate for deferred benefits in defined benefit schemes at RPI capped at 2.5% (i.e. the lower of RPI or 2.5%). We believe MPs should apply such a provision for revaluing the career average benefits of active members. Revaluing accrued career average benefits by the lower of 2.5% and RPI also has the benefit of reducing the cost of accrual.

Recommendation 7: We recommend that the career average benefits of active members of the PCPF be uprated by the lower of RPI and 2.5%.

Past service and transition

5.25 Members who have accrued benefits under the current arrangements have accrued 'final salary' benefits. Normally, this 'final salary' would be the member's salary at the point at which he or she ceases to be an MP. However, as discussed above, this leaves the scope for large past service deficits to arise in the PCPF if there is an increase to MPs' salaries.

Recommendation 8: We recommend that all 'final salary' accrual up to the point of transition be calculated on the basis of the Final Pensionable Pay of MPs at the point of transition, and thenceforth uprated by RPI.

Effectively, this means that the pensions of existing MPs are treated as if the MP ceased to be an MP at the point of transition to the career average scheme, and then rejoined the scheme after the transition on a career average basis. Responses to our consultation indicated that a major concern for MPs is to protect benefits which they have already accrued, and we believe that our recommendations achieve this.

5.26 Because 2/3rds of salary at the point of transition uprated by RPI may turn out to be worth slightly less than 2/3rds of eventual final salary (which, in part, determines the maximum that can be accrued under the scheme), the possibility arises that active members who have ceased contributions because they had accrued the maximum pension of 2/3rds of final salary are now able to accrue further benefits. If members wish to do this, they should be able to do so; however, any member in this position who does not wish to recommence contributions and accrual should still be considered an active member of the scheme for the purposes of ancillary benefits.

Past service deficit

5.27 De-linking active members' past service 'final salary' accrual from their individual eventual final salary and linking it instead to salary at the point of transition uprated thenceforth by RPI also reduces the past service deficit in the PCPF. The Government Actuary estimates that the cost of paying off the past service deficit should fall from 8.5% of payroll per year to 6.2% of payroll per year for 15 years (based on the 2008 valuation, and ignoring any other post-valuation events). However, the Government indicated after the latest (2008) valuation (which found that the cost of paying off the past service deficit had fallen from 8.7% to 8.5%) that it was willing to pay 8.7% for 15 years, as envisaged in 2006, but no more than that amount. On current expectations and assuming our other proposals are implemented, this should still be sufficient to amortise the past service deficit.

5.28 Any payments in excess of 8.7% per year until 2021 required to meet past service deficits identified at future valuations should be subject to the new cost-capping arrangements and funded accordingly.

Recommendation 9: We recommend that the Exchequer continue to pay 8.7% per year for the balance of the original 15 year period, i.e. until 2021. There should be no corresponding reduction in the amount the Exchequer would otherwise pay under our proposed new scheme for future accrual.

Increases to deferred pensions and pensions in payment

5.29 Many members have made plans for their retirements on the basis of the pension benefits which they have already accrued. We believe that as far as possible the current terms of the PCPF should be respected for all past service.

5.30 For future accrual, we recommend that increases to deferred pensions and pensions in payment should be at the same rate as the revaluation of career average benefits of active members, i.e. the lower of RPI and 2.5%.

5.31 However, we are aware that currently public service pensions (including the PCPF's) are increased under the provisions of the Pensions (Increase) Act 1971 and Section 59 of the Social Security Pensions Act 1975. The latter provides for public service pensions to be increased at the same rate as the additional pension provided under the State Earnings Related Pension Scheme, which is based on the September-to-September increase in RPI. Implementing this recommendation would therefore require revision of primary legislation. In the rest of this report and in our cost calculations, we have assumed that, for future accrual increases to deferred pensions and pensions in payment will be at lower of RPI and 2.5%. However, because of the legislative context, we recognise that the Government may wish to implement this recommendation separately and in due course.

Recommendation 10: We recommend that benefits accrued up to the point of transition should continue to be increased by RPI when in payment as well as deferment.

Recommendation 11: For future accrual after the point of transition, however, we recommend that increases to deferred pensions and pensions in payment be made at the lower of RPI and 2.5%, when legislation allows.

Reducing the impact of the volatility of the PCPF

5.32 As discussed in paragraph 4.5, one of our aims in this review is to remove the short-term volatility of investment performance from the members' experience of the scheme, or at least to reduce its effects. One way to do this is to ensure that there is sufficient 'headroom' between the current cost of accrual and the cap on the Exchequer contribution so that at least some of the volatility in investment performance is absorbed by the Exchequer. At present, the Exchequer's share of the cost of accrual is so close to the cap that any increases in costs due to below target investment performance or increased longevity have to be borne entirely by members. The effects of better than expected investment performance are shared equally between the Exchequer and members, but still reflect the same degree of volatility.

5.33 A further way to reduce the impact of investment volatility would be to take a medium- to long-term approach to valuing the Fund and managing the funding level, rather than using triennial mark-to-market valuations (which are likely to display high volatility) and amortising any deficits as quickly as possible. As discussed in paragraph 2.10, the approach of requiring the employer to make additional payments to amortise any deficit as quickly as possible is motivated by the need to protect private sector pension scheme members in the event of the employer's insolvency. However, if the risk of the employer becoming insolvent is unlikely to materialise, the disadvantages of valuing the fund and requiring rapid remedial action for any deficit every three years may outweigh the benefits.

Recommendation 12: We recommend that the Trustees of the PCPF and the Government agree with the Government Actuary strategies for valuing the Fund which ensure that as far as possible members do not suffer or gain from short-term fluctuations and that measures of real growth are independent of short-term market values, subject to independent certification.

Additional voluntary contributions (AVCs)

5.34 At the last valuation of the PCPF, Members were paying, on average, a contribution of 9.1% of payroll towards their pension. Implementing a single rate of 1/60th accrual with a member contribution of 5.5% would mean that most members will pay less in pension contributions than they do currently. We do not wish to discourage members from saving for their retirements and recommend that an additional retirement savings vehicle be made available to members who wish to make additional pension contributions.

5.35 Having recommended arrangements which we believe provide an appropriate level of security for members, balanced against an acceptable level of risk for the Exchequer, we are not in favour of allowing members to purchase additional benefits which would further increase the liability of the Exchequer (such as the purchase of added years).

5.36 We therefore recommend that members be enabled to make AVCs to a defined contribution pension. There is already a facility in the PCPF for this and it should continue. However, it may be possible to achieve economies of scale and potentially to reduce administration costs through joining in with a larger scheme. The Civil Service Partnership scheme, for example, makes a variety of investment funds available to its members through established pension providers.

5.37 A defined contribution option for AVCs not only gives members flexibility in terms of how much to invest and when, but also the opportunity to determine the 'shape' of emerging benefits according to their personal circumstances. Members can make a choice about the type of annuity which they want to purchase, for example taking into account whether they want a pension which continues to be paid to the member's partner after the member's death.

Recommendation 13: We recommend that members not be allowed to purchase added years through additional voluntary contributions, nor to use the 'transfer in' of benefits from other pension schemes to purchase defined benefit entitlement under the PCPF (except in cases where this is required in order to provide the Guaranteed Minimum Pension). A review of existing contracts for the purchase of added years should be undertaken with a view to ceasing these at, or as soon as possible after, the date of transition.

Recommendation 14: We recommend that the Trustees explore the possibility of exploiting economies of scale by enabling members to make additional voluntary contributions through a larger public sector scheme.

Bringing Ministers and office holders and backbench MPs into the same system

5.38 Currently, Ministers and office holders have the equivalent of a career average pension on the salary which they receive by virtue of their Ministerial role or office. This pension is calculated separately to the pension which they receive by virtue of having been an MP. This arrangement makes sense because it would be unfair (and highly arbitrary) to apply a final salary scheme to Ministers since those who retired while still Ministers would benefit enormously compared to those who return to the back benches before retiring. A career average scheme is much fairer for such people.

Recommendation 15: For administrative simplicity, we recommend that MPs', Ministers' and office holders' salaries be treated in the same way for the purposes of pension.

However, we recommend that, for all members joining the PCPF after the point of transition, the maximum benefits payable to a member who has served as a Minister or office holder should be increased proportionately, such that the limit is equal to 2/3rds of the revalued career average earnings.

Reducing the cap on employer contributions

5.39 The reforms which we have proposed to the PCPF would reduce the Exchequer contribution to ongoing accrual to below the cap of 18.3% which was agreed by the House. Other public sector pension schemes also have caps on the Exchequer contribution: currently, approximately 14% of payroll for the Teachers' and NHS schemes, and 20% of payroll for the Civil Service.

5.40 It is fair to say that such caps on other schemes have been set in the expectation that they will be breached at a subsequent valuation, and that cost-reducing measures will have to be invoked. However, as we have discussed previously, having undertaken a wholesale review of the PCPF we wish to avoid the need for members' contributions and benefits to be adjusted following each valuation. Rather, we wish to put in place arrangements which are reasonable and affordable, and likely to remain so for at least the next ten to fifteen years. We nonetheless favour setting a cap on the Exchequer contribution, in line with several major public sector schemes, to ensure that the Exchequer guarantee is not open-ended.

5.41 The cost of accrual in the PCPF will alter according to both demographic and investment factors. The demographic factors include, for example, the age profile of the members and their expected longevity. The investment elements will include the past performance of investments and any adjustments that are made to the assumed future performance of investments taking account of the wider economic environment. We propose to deal with these factors separately in capping the Exchequer contribution.

5.42 Increases and decreases in the estimated cost of accrual due to investment performance should, in the long run, balance out. Although investment performance may be volatile in the short term, it is relatively stable in the long term; and in considering pension funds, we believe that it is appropriate to plan for the long term. The cap should therefore be set at a level which can withstand the likely short-term volatility of investment performance. In addition, we will recommend that deficits or surpluses which arise due to changes in the investment performance be spread in perpetuity in order to reduce the impact of that volatility.

Recommendation 16: We recommend that the Exchequer should absorb any increases or decreases in the cost of accrual due to investment factors within 4% of payroll of the initial figure.

Any cost increase due to investment factors which takes the recommended Exchequer contribution to more than 4% above the initial figure should be borne by members through increased contributions, reduced benefits or an increased normal retirement age; likewise, any cost decrease due to investment performance which takes the recommended Exchequer contribution to more than 4% lower than the initial figure should be to the benefit of either the members (through reduced contributions, increased benefits or a reduced retirement age) or the Fund as a whole (through carrying the surplus forward). That is, we advocate putting a floor on the Exchequer contribution, as well as a ceiling.

5.43 Demographic factors, while significant, display much lower volatility than financial factors and we expect this to continue to be the case. Many of the demographic changes which affect the cost of accrual – e.g. longevity, the ages at which MPs actually retire, size and age distribution of membership – are the result of longer-term trends or policy decisions. Changes in the demographic factors are therefore less likely to result in short-term changes to the demographic assumptions used to calculate the cost of accrual. Moreover, an increase in costs as a result of increased longevity, for example, will mean that members are receiving pensions for longer, and benefiting directly. This is in contrast with a fall in investment returns, which increases scheme costs without benefiting members. We therefore think that it is right that members should bear more of the risk from an increase in costs resulting from a change in demographic factors.

Recommendation 17: We recommend that the Exchequer should absorb any increases or decreases in the cost of accrual due to demographic (i.e. non-investment) factors within 1% of payroll of the initial figure.

5.44 Any cost increase due to demographic factors which takes the recommended Exchequer contribution to more than 1% above the initial figure should be borne by members through increased contributions, reduced benefits or an increased normal retirement age; likewise, any cost decrease due to investment factors which takes the recommended Exchequer contribution to more than 1% lower than the initial figure should be to the benefit of members, either through reduced contributions, increased benefits or a reduced retirement age. The best estimate of the Government Actuary is that this cap is unlikely to be breached in the next ten or fifteen years.

5.45 We note that one scenario under which demographic factors could cause the cost of accrual to rise is if the size of the membership reduces. Although neither the cost of ongoing accrual nor the cost of amortising any deficit would necessarily increase, the cost of amortising any deficit in the scheme would increase when expressed as a percentage of current payroll – but only because the denominator, current payroll, has decreased. It would seem unfair to reduce the Exchequer's contribution towards members' previously accrued benefits simply because the current payroll has decreased.

Recommendation 18: We recommend that any increases or decreases in the cost of accrual expressed as a percentage of pensionable payroll arising from changes in the number of active members be excluded from the cap.

5.46 The Government Actuary has estimated that, based on the 2008 valuation of the PCPF, the Exchequer contribution to ongoing accrual in the PCPF would be approximately 10.5% following implementation of our recommendations. Applying our recommended caps gives an upper limit to the Exchequer contribution of 15.5% of payroll and a lower limit of 5.5% of payroll.

Ancillary benefits

Recommendation 19: We recommend that all ancillary benefits in the PCPF based on the value of the member's pension (such as survivors' pensions, ill-health retirement and death-in-service benefits) be modified in line with the recommended changes to the main benefit structure.

Cost of our proposed scheme

5.47 Following the last valuation of the current scheme as at 1 April 2008 the Government Actuary estimated the underlying cost to the Exchequer for future accrual at 23.1% of payroll, with an additional 8.5% to amortise the past service deficit. The House of Commons had already agreed in January 2008 to limit the Exchequer cost to 20% of payroll and the Leader of the House proposed a package of measures, including an increase in the member's contribution for 1/40th accrual from 10% to 11.9% and from 6% to 7.9% for 1/50th accrual, in order to reduce the Exchequer contribution to 20%. In June 2009 the Commons voted to reduce the Exchequer contribution back to the 2008-09 level but the Government has not yet brought forward proposals to achieve that reduction, preferring to await our proposals from this review.

5.48 The Government Actuary has estimated that the cumulative effect of our proposed changes would enable the contributions to fund future accrual to be set at the levels in Table 5.1 above, namely 10.5% for the Exchequer and 5.5% for members. Our proposed system of symmetrical floors and caps on the Exchequer contribution means that the maximum Exchequer contribution would be 15.5%. We would favour measures to reduce the probability that either the cap or floor is breached unnecessarily due to short-term market volatility. The Government Actuary advises that it is unlikely that the Exchequer cost will rise above 15.5% in the next ten to fifteen years if deficits and surpluses due to investment performance are spread in perpetuity.

Recommendation 20: We recommend that any deficit or surplus which arises from investment performance at subsequent valuations be spread in perpetuity in order to reduce the probability of unnecessarily triggering the cost caps.

In addition, as explained in paragraph 5.27 we recommend that the Exchequer maintain the payment to amortise the past service deficit at 8.7% until 2021.

5.49 For members, the cost of accrual at 1/60th will drop from 5.9% of salary to 5.5%, albeit on a CARE basis. We set out in Chapter 6 some examples of the effects of our proposed new scheme for both existing and new members. Those who wish to will be able to make AVCs, as at present, on a defined contribution basis.

5.50 It should be noted that the actuarial calculations on which we have relied to make our recommendations used the projected unit method and actuarial assumptions consistent with the 2008 valuation of the Fund. If the actuarial approach to the PCPF should change, the structure of the scheme may need to be revisited. Likewise, we have assumed that the current investment strategy will continue; if there were to be a change in investment strategy and a consequent change in the assumed investment return, then the structure of the PCPF would most likely need to be revisited. The Leader of the House is already required to approve a Statement of Investment Principles and we would expect the Exchequer to be consulted on any proposed change to the investment strategy.

Pension and total reward

5.51 Under the House of Commons' resolution of 3 July 2008, we are due to conduct a review of MPs' salaries in the first year of a new Parliament. When reviewing the pay of any of our remit groups, we look at total reward, including the value of pensions. When we reviewed MPs' pay, pensions and allowances in 2007, we were advised that the PCPF was worth approximately 22% of salary for those accruing at 1/40th and 20% for those accruing at 1/50th (before taking account of the restriction for maximum benefits) and we took this and the value of pensions of comparator occupations into account in recommending the level of the MPs' salary. (The 1/60th option was not introduced until 2009.) Assuming our recommendations in this report are accepted, we shall of course consider the change in value of the pension in our next review of MPs' pay. This does not mean we shall necessarily make a simple arithmetic adjustment. Our recommendation on pay will, in accordance with the Commons resolution, be 'consistent with public sector pay policy' and 'reflect an assessment of the appropriate salary at that time relative to jobs of similar weight elsewhere in the public sector'. That assessment must include pension provision.

Chapter 6

Impact of recommendations

Impact on members

6.1 If our recommendations are implemented, members who remain in the PCPF will see their contributions reduced to 5.5% of salary. This will be a bigger reduction for some members than others, as not all members pay for the same rate of accrual at the moment. Members will also be able to make AVCs into a defined contribution scheme should they wish to.

6.2 The precise impact of the recommended changes on members' benefits will depend on a number of factors, including members' own investment choices. However, we asked the Government Actuary to project the likely pensions, based on a set of assumptions, of a member of the PCPF a) under the current arrangements, and b) if our recommendations were implemented at the next election. We assumed that a member pays 11.9% for 1/40th accrual under the current arrangements, and under our recommended arrangements pays 5.5% for 1/60th accrual and uses the balance (11.9 – 5.5 = 6.4%) to purchase AVCs on a defined contribution basis[46].

6.3 The situation is complicated somewhat by our recommendations setting a normal retirement age of 68 for new accrual, so we show benefits that can be taken at age 65 and 68 both separately and taken together at age 65, with an appropriate actuarial reduction applied.

Existing members

6.4 We asked the Government Actuary to make calculations for a variety of members, including current active members and members who enter Parliament at the next election. For active members, we looked at the extant cohorts of MPs who entered Parliament at each of the last four elections and who are still in Parliament. For individuals with the average age of each extant cohort, we considered what pension they could expect if they i) stayed the median length of time of their extant cohort (using actuarial assumptions about tenure[47]); and ii) stayed until age 65.

Table 6.1: **Characteristics of extant cohorts**

Year of General Election at which member entered the scheme	Average age of cohort at joining	Median year expected to leave Parliament
1992	41	2014
1997	43	2018
2001	42	2022
2005	42	2022

46 As we have noted in our report, the outcome of a defined contribution scheme is difficult to predict. The Government Actuary has used a mid-way assumption of 3% investment returns in excess of price inflation and net of expense charges, and assumed an annuity rate of 22.5 (based on the current cost of a 68 year old buying an annuity from an insurance company with similar characteristics to the PCPF pension, but with a 3% escalation rather than limited price indexation).

47 In carrying out his valuations, the Government Actuary assumes that there is 20% turnover of MPs younger than 63 at each election, and 80% turnover of MPs aged 63 and over. Elections are assumed to take place every four years.

Table 6.2: **Pensions that an extant member of average age could expect if he or she left at the median predicted year (£)**

Year of General Election at which member entered the scheme	PCPF Pension (old[47] basis) – NRA 65 (1)	Past service up to 2010 on old basis – NRA 65 (2)	Future service after 2010 on new basis – NRA 68 (3)	Additional pension in respect of AVC contributions – from age 68 (4)	PCPF pension (new basis) including AVC pension – combination of NRA 65 and NRA 68 Sum of (2) to (4)	PCPF pension (new basis) including AVC pension – if all benefits are taken at age 65
1992	31,451	23,734	3,805	812	28,352	27,594
1997	31,914	17,038	7,470	1,650	26,157	24,662
2001	32,709	11,615	10,582	2,590	24,788	22,627
2005	25,217	6,225	9,790	2,750	18,765	16,708

Table 6.3: **Pensions that an extant member of average age could expect if he or she left at age 65 (£)**

Year of General Election at which member entered the scheme	PCPF Pension (old[48] basis) – NRA 65 (1)	Past service up to 2010 on old basis – NRA 65 (2)	Future service after 2010 on new basis – NRA 68 (3)	Additional pension in respect of AVC contributions – from age 68 (4)	PCPF pension (new basis) including AVC pension – combination of NRA 65 and NRA 68 Sum of (2) to (4)	PCPF pension (new basis) including AVC pension – if all benefits are taken at age 65
1992	35,621	23,734	5,822	1,201	30,757	29,605
1997	34,002	17,038	8,488	1,842	27,368	25,674
2001	36,917	11,615	12,599	2,978	27,193	24,638
2005	37,240	6,225	15,612	3,950	25,787	22,579

New members

6.5 We also asked the Government Actuary to model the effects of our recommendations on members who entered Parliament and joined the PCPF at the next election. We took the cases of members aged 35, 45 and 55 who each stayed for the median length of time predicted by the actuarial assumptions of turnover.

[48] This is described as 'old basis' with regard to accrual; uprating of accrued benefits from 2010 onwards would, however, be by RPI rather than final salary.

Table 6.4: **Characteristics of new joiner examples**

Age at joining in 2010	Median age expected to leave Parliament	Median year expected to leave Parliament
35	51	2026
45	61	2026
55	63	2018

Table 6.5: **Pensions that a 2010 new joiner could expect if he or she left at the median predicted year (£)**

Age at joining in 2010	PCPF Pension (old[48] basis) – NRA 65 (1)	Past service up to 2010 on old basis – NRA 65 (2)	Future service after 2010 on new basis – NRA 68 (3)	Additional pension in respect of AVC contributions – from age 68 (4)	PCPF pension (new basis) including AVC pension – combination of NRA 65 and NRA 68 Sum of (2) to (4)	PCPF pension (new basis) including AVC pension – if all benefits are taken at age 65
35	21,118	–	10,763	4,263	15,026	12,561
45	24,437	–	13,076	3,670	16,746	14,000
55	12,581	–	7,326	1,675	9,000	7,524

6.6 One of our recommended changes that is not illustrated in these case studies is the change to increases to pensions in payment. On the old basis, and for service up to 2010 on the old basis, pensions in payment will increase in line with RPI, whereas benefits accrued after 2010 will be increased in line with the lower of RPI and 2.5%. The Government Actuary advises that, using the assumptions for RPI and capped RPI which have been used in the costings, it is estimated that ten years after the pension comes into payment, a pension increased in line with the lower of RPI and 2.5% would be at a level of around 90% of a pension increased in line with RPI. This calculation is, of course, highly sensitive to the assumed level of price inflation.

Impact on employer contributions

6.7 The Government Actuary estimates that following implementation of our recommendations, the cost of ongoing accrual in the PCPF should fall to 16% of payroll. The members would contribute 5.5% of payroll, meaning that the Exchequer contribution would initially be 10.5% of payroll. Although at future valuations it could fluctuate within 5% either side of that level, it could not fall lower than the member contribution. Furthermore, implementing our recommendations would reduce the size of the past service deficit by approximately £14m. This would reduce the contributions necessary to amortise the deficit from 8.5% of payroll over 15 years (as calculated in the 2008 valuation) to 6.2% over 15 years.

6.8 We have recommended capping the Exchequer contribution at 15.5% of payroll, and setting a floor of 5.5% of payroll. (It should be remembered, however, that this is the overall ceiling and floor: the 4% cap for investment risk and 1% cap for demographic risk operate independently, rather than cumulatively.) The current cap on the Exchequer contribution is 18.3% of payroll, so our recommendations would reduce the potential exposure of the Exchequer, as well as reducing the initial cost.

Appendix 1

Main features of the PCPF

	Members of Parliament	Office Holders
Normal Retirement Age	65 years	65 years
Pensionable Salary	MPs' salary	Salary received as an office holder. For those who joined the scheme after 1989, the combined MP and office holder salary that can reckon for pension purposes is limited to the statutory pensions earnings cap, £123,600 per annum for 2009-10.
Final Pensionable Salary	Actual Salary due in last 12 months before service ends.	Not applicable but calculated using accrued service credit converted to pension with reference to the actual MPs' salary in last 12 months before service as an office holder ends.
Member contributions	A member may chose to contribute at the rate of: 11.9% Higher rate (increased from 10% w.e.f. 1 April 2009) of Pensionable Salary (for 1/40th accrual), 7.9% Middle rate (increased from 6% w.e.f. 1 April 2009) of Pensionable Salary for (1/50th accrual) or 5.9% Lower rate (for 1/60th accrual).[49]	As for MPs.
Normal retirement pension	1/40th of Final Pensionable Salary per year of pensionable service for period in which a member has contributed at the higher rate. 1/50th of Final Pensionable Salary per year of pensionable service for period in which a member has contributed at the middle rate. 1/60th of Final Pensionable Salary per year of pensionable service for period in which a member has contributed at the lower rate.	Career average scheme, otherwise the same as for MPs.
Maximum pension	Calculated in accordance with GAD guidance on the application of the scheme regulations, which broadly reflect the Inland Revenue rules applicable before 6 April 2006.	Broadly as for MPs, but applying a supplementary maximum for the additional earnings whilst the member is an office holder.

[49] Agreed by the House on 25 June 2009.

	Members of Parliament	Office Holders
Increases to pension in payment	Pension benefits are increased in line with any increase in RPI.	As for MPs.
Normal retirement lump sum	Members have the option to exchange part of their pension for a lump sum.	As for MPs.
Early retirement	Members can currently draw their pension on leaving service without reduction at any age on or after age 60, if the member's age plus service as an MP totals 80. This only applies to service up to the 2010 general election. Otherwise, members can draw the pension at any time after age 50 (55 from 6 April 2010), but at a level reduced for its payment before age 65.	Benefits earned as an office holder can be drawn without any reduction for early payment at the same time as any benefits accrued as an MP, but service as an office holder whilst not serving as an MP does not count towards the qualifying period for early payment.
Ill-health retirement	Two tiers of ill-health pension are payable dependant on certain criteria laid out in the regulations. Higher Tier – paid to those who cannot undertake any form of work now or in the future. Pension is paid immediately, based on the service that the member would have accrued had they continued to serve as an MP until age 65. (There is no reduction for early payment and no minimum age requirement.) Lower Tier – paid to those who cannot undertake the duties of an MP. Pension is paid immediately, based on accrued service only, and without reduction for early payment. Both levels of pension now subject to review by the Trustees.	Pension is paid immediately, based on accrued service only, and without reduction for early payment.
Withdrawal benefits	A deferred pension payable from age 65 or anytime after age 50 (55 from 6 April 2010), but at a level reduced for its payment before age 65. Rule of 80 also applies (see above). If the member has less than 2 years' service, they can opt for a refund of contributions. A dependant's pension of 5/8ths of member's pension revalued to the date of death is payable on death before retirement.	As for MPs except Rule of 80 does not apply.

	Members of Parliament	Office Holders
Qualifications for dependant's pensions	Spouse for all service, and civil partner if member was entitled to a pension based on service on or after 6 April 1988. Also qualifying unmarried partner if member did not leave service before 3 November 2004.	As for MPs.
Death in service lump sum	4 x salary in payment.	As for MPs.
Death in service dependant's pension	5/8ths of a member's Upper Tier ill-health pension entitlement (pension ceases if the dependant remarries or cohabits and the member left service before 3 November 2004). A temporary pension at the rate of Pensionable Salary is payable for 3 months after death. Children's pensions are also payable subject to certain criteria being met.	As for MPs although the temporary pension is not payable.
Death after retirement	5/8ths of member's pension before any reduction made for commutation to lump sum at retirement (pension ceases if the widow(er) or partner remarries and member left service before 3 November 2004). If the member dies within 5 years of retirement, the dependant's pension is payable at the rate of the member's pension for the remainder of the 5 years. If the member dies outside that period, a temporary pension at the rate of the member's pension is payable for 3 months after the member's death. Children's pensions are also payable subject to certain criteria being met.	As for MPs although the temporary pension is not payable.
Additional benefits	Additional contributions can be paid to increase benefits by means of: – purchasing added years of service at rates determined by the actuary; – contributing to the AVCs scheme with funds to be invested with an insurance company and used to purchase extra benefits on retirement.	Office holders may contribute to the Additional Voluntary Contributions scheme, but are not able to purchase added years of service (except in relation to service as an MP).
Contracted-out status	Contracted out of the State Second Pension.	As for MPs.

It should be noted that the benefits of the scheme are subject to variation from the above if the member remains in post after age 75.

Appendix 2

Remit letter from the Prime Minister

10 DOWNING STREET
LONDON SW1A 2AA

THE PRIME MINISTER

13 February 2009

Dear Mr Cockburn

The Government is committed to providing public service pension schemes that are affordable and sustainable in the long-term, consistent with the principle of fairness for all taxpayers and between generations. To achieve this, we have already undertaken a programme of reforms that have included mechanisms such as cost sharing and capping, as well as measures such as increases in pension age.

The last review of Parliamentary pay, pensions and allowances by the Senior Salaries Review Body (SSRB) was published in January 2008. It included a recommendation that there should be a major review of the Parliamentary pension arrangements if it became likely that, unless action was taken, the Exchequer share of the cost of accruing pension benefits would rise above 20 per cent of payroll. The House of Commons endorsed this recommendation in principle on 24 January 2008.

I understand that the Government Actuary's Department has advised that it anticipates that the cost of accruing benefits is indeed likely to rise above 20 per cent of payroll. This effectively triggers the need for the review. I am grateful to you for agreeing that the SSRB should undertake this task, as announced, and I attach the terms of reference. I trust that in the course of its review the SSRB will consider the full range of options for reducing the Exchequer contribution, including, but not restricted to, increases in the pension age, changes in the provisions for retirement on the grounds of ill health, increases in member contributions, changes in the accrual rate, changes in the maximum level of benefits that can be built up and the merits of defined-contribution structures.

I look forward to receiving your recommendations.

Yours sincerely

Gordon Brown

Mr Bill Cockburn CBE TD

Appendix 3

Features of major public sector pension schemes and changes to them

Employer	Scheme	Employer rate	Normal Retirement Age	Cap on employer contributions?	Employee rate	Accrual	Lump Sum	Revaluation of deferred pensions and pensions in payment	Revaluation for CARE schemes (if applicable)
Police	2006 NPPS	c. 19%	55	no	9.5%	1/70th	4 x pension	RPI	
	1987 PPS	c. 26%		no	11.0%	1/60th – first 20 yrs; 2/60th thereafter	by commutation (depending on age)	RPI	
Armed Forces	2005 AFPS	c. 27%	55	no	0.0%	1/70th	3 x pension	RPI	
	1975 AFPS	c. 25%	55	no	0.0%	varies depending on career point	3 x pension	RPI	
Firefighters	2006 FPS	14.2%	60	no	8.5%	1/60th	commutation at 12:1 ratio	RPI	
	1992 FPS	26.5%			11.0%	1/60th – first 20 yrs; 2/60th thereafter	by commutation (depending on age)	RPI	
NHS	2008 scheme	14.0%	65	14.2% in 2012 (31/3/08 valuation); 14.0% in 2016 (31/3/12 valuation)	£0 – 20.7K, 5%; £20.7 – 68.4K, 6.5%; £68.4K – 107.8K, 7.5%; >£107.8K 8.5%.	1/60th	commutation at 12:1 ratio	RPI	GP and dental practitioner scheme (run in parallel with NHS scheme), RPI + 1.5%
	1995 scheme	14.0%	60			1/80th	3 x pension	RPI	

Employer	Scheme	Employer rate	Normal Retirement Age	Cap on employer contributions?	Employee rate	Accrual	Lump Sum	Revaluation of deferred pensions and pensions in payment	Revaluation for CARE schemes (if applicable)
Judges	1993 scheme	32.2%		no	1.8% paid from net salary	1/40th	2.25 x annual pension	RPI	
	1981 scheme			no	1.8% or 2.4% paid from net salary	accrual is non-uniform but equivalent to either 1/40th or 1/30th	2 x pension		
Teachers	post 2007	14.1%	65	14.0% (2008 valuation) from date to be agreed by the Secretary of State	6.4%	1/60th	commutation at 12:1 ratio	RPI	
	pre 2007	14.1%	60		6.4%	1/80th	3 x pension and option of commutation at 12:1 ratio	RPI	
Civil Service	Partnership	age related: from 3% under 21 to 12.5% at 46+, plus up to 3% matching employee contribution	n/a (must buy annuity by age 75)	n/a	at employee's discretion	defined contribution	up to 25% of pot may be taken as lump sum between ages 55 and 75	depends on annuity chosen	

Employer	Scheme	Employer rate	Normal Retirement Age	Cap on employer contributions?	Employee rate	Accrual	Lump Sum	Revaluation of deferred pensions and pensions in payment	Revaluation for CARE schemes (if applicable)
Civil Service *(continued)*	Nuvos	£0 – 20.5K, 16.7%; £20.5K – 42K, 18.8%; £42K – 72K, 21.8%; >£72K, 24.3%.	65	20% from April 2012 (31/3/10 valuation). Current average employer contribution is 18.9%	3.5%	2.3% of annual salary	commutation at 12:1 ratio	RPI	RPI
	Premium		60		3.5%	1/60th	commutation at 12:1 ratio	RPI	
	Classic		60		1.5%	1/80th	3 x pension	RPI	
Local Government	LGPS	varies by employer as administered by LA and some schemes funded (notional rate approx. 13%)	65 (transitional protection for certain members with 'Rule of 85' for early retirement)	No cap set (still to be further discussions)	£0 – 12.6K, 5.5%; £12.6K – 14.7K, 5.8%; £14.7K – 18.9K, 5.9%; £18.9K – 31.5K, 6.5%; £31.5K – 42K, 6.8%; £42K – 78.7K, 7.2%; >£78.7K, 7.5%.	1/60th	commutation at 12:1 ratio	RPI	

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