Independent Parliamentary Standards Authority

MPs' Pensions

Consultation - January 2012

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Introduction

In October 2011, the Independent Parliamentary Standards Authority (IPSA) was given responsibility for determining a new scheme for MPs' pensions. Earlier that year, in May, we received the powers to set pay. For the first time, therefore, MPs' remuneration will be determined independently and in a transparent manner. Our overall task is to determine what a modern twenty-first century elected representative and legislator needs from the public purse to do the job of being an MP. Our goal is to produce a set of arrangements which is fair, workable and transparent.

We have said that we will involve the public as we take on these responsibilities and this consultation document is the first step in that process.

We have always taken the view that the public interest and public confidence should be paramount in our minds as we conduct our work on MPs' expenses and costs and now on pay and pensions. We believe that if MPs are seen to be protected from the wider reforms to public service pensions and restraint on pay, public confidence in MPs, in Parliament and in the principles of independent regulation would be undermined. We also note that MPs voted for a motion which invited IPSA to raise their pension contributions in line with increases applied to the rest of the public service. We are therefore consulting today on our proposals to increase MPs' pension contributions from 1 April 2012, in common with the increases being levied on others in the public sector. This will be an interim arrangement while we carry out our more comprehensive review.

The MPs' Pension Scheme differs from the other public service schemes. The level of contributions paid and benefits accrued by MPs is high, as is the normal pension age. In recognition of the higher level of contribution we propose that MPs are offered the opportunity to change downwards the basis on which benefits are accrued, which, if taken up, will reduce the benefits to be paid and at the same time reduce the cost of the scheme to the public purse (compared to what it would have been) and to individual MPs.

Back in October 2011, we set out our plans for a long term review of MPs' pay and pensions, with changes to be implemented from 2013. While we are consulting on the interim arrangements to be introduced in April 2012, we are also planning for that larger review now. At the end of this document we set out some more detail about how we will deal with pay and pensions for the remainder of this Parliament.

Details of how to respond to the consultation are on page 9. We look forward to receiving your responses and will carefully consider all of the evidence and feedback we receive as part of this consultation. We will announce our final position in March.

Sir Ian Kennedy

January 2011

The MPs' Pension Scheme

1. The MPs' Pension Scheme is a defined benefit pension scheme for MPs, which provides a pension when an MP has left the House of Commons and reached the age of 65. Unlike many other public service pension schemes, it is a funded scheme, i.e. a scheme with a fund of investments out of which pensions are paid. This fund (the Parliamentary Contributory Pension Fund) receives income from three sources: members' contributions, the Exchequer and investment returns.

2. MPs accrue pension benefits as a proportion of their final salary. The pension received at retirement age is based on the length of pensionable service and the MP's final pensionable salary. For each year of pensionable service an MP will normally receive a pension of either 1/40th, 1/50th or 1/60th of the final pensionable salary, multiplied by the years of service in the Scheme. If MPs choose to accrue at 1/40ths, they pay 11.9% of their gross salary each month; to accrue at 1/50ths they pay 7.9%; and to accrue at 1/60ths, they pay 5.9%. In common with other pension schemes, these contributions are paid from their salaries before tax is assessed. The maximum pension an MP can accrue is two-thirds of the final salary.

Accrual Rate	MP Contribution	Exchequer Contribution[1]	Annual gross cost to MP[2]	Expected annual net cost to MP	Exchequer Contribution to fund
1/60th	5.9%	18%	£3,878.54	£2,327.13	£11,832.84
1/50th	7.9%	20%	£5,193.30	£3,115.98	£13,147.60
1/40th	11.9%	21%	£7,822.82	£4,693.69	£13,804.98

3. Once MPs have joined the Scheme and chosen the basis on which benefits are to accrue (1/40th, 1/50th or 1/60th), they are not able to change their selection. They remain at that level for the remainder of their membership of the pension scheme.

4. Every three years, the Government Actuary undertakes a valuation of the Parliamentary Contributory Pension Fund and sets a "standard contribution rate", which is the amount required to be paid into the fund each year in order to pay for future service costs. This standard contribution rate takes into account various assumptions, including assumed investment returns, the membership of the Scheme and MPs' contribution rates. As the current scheme is a "balance of costs" scheme, the Exchequer is liable for the difference between the MPs' contributions and the standard contribution rate.

[1] These figures relate to the relative contributions paid based on the 2008 valuation of the pension fund. The aggregate contribution paid by the Exchequer following that valuation was 20.2% of payroll.
[2] Based on an MP's salary of £65,738

The Supplementary Scheme

5. In addition to the main Scheme there is a Supplementary Scheme for those MPs who serve as a paid Committee Chairman, or other paid office holder in Parliament.[3]

6. The MPs' Scheme and the Supplementary Scheme operate on the same basis and vary only in their accrual basis. In the MPs' Scheme, the final pension is calculated on final salary, while in the Supplementary Scheme it is calculated on career average re-valued earnings. This takes account of the fact that Committee Chairmen and other office holders may be in office for one or more short periods over their career and that they may revert to being backbenchers before they retire. MPs in the Supplementary Scheme accrue benefits and pay contributions at the same rate as they do in the MPs' Scheme. So the Chairman of a Select Committee accruing at $1/40^{\text{ths}}$ in the MPs' Scheme (and paying 11.9% of his or her salary), would pay the same proportion from his or her Chairman's salary and also accrue at $1/40^{\text{ths}}$.

7. The Supplementary Scheme also provides pensions for Ministers, although the rules as they apply to Ministers are set by the Government and not IPSA.

8. The changes we propose in this consultation document will apply equally to MPs' membership of the MPs' Scheme and the Supplementary Scheme, although not to the Ministerial element. For brevity we refer only to the MPs' Scheme.

9. Further details of the current parliamentary pension schemes can be found at http://www.parliament.uk/briefing-papers/SN01844.pdf

[3] The Chairman and Deputy Chairmen of Ways and Means

Changes to public service pensions

10. The Government set out its plans for reforming public service pension schemes in November 2011 in its document "Public Service Pensions: good pensions that last".[4] That document made clear that in the long term, public service pensions will be based on the principles of the Independent Public Service Pensions Commission chaired by Lord Hutton ("the Hutton Review"). The Government set out its preferred design for the public service schemes as follows:
    - based on average earnings across the member's career;
    - accrue at 1/60ths and continue to be index-linked (by reference to earnings while still working and by reference to consumer prices once in payment);
    - come into payment at the same time as the state pension age; and
    - have a fairer balance of contributions between the Government and the member.

11. The Government believes that this approach will ensure that public sector pensions are affordable, sustainable and fairer to lower paid workers than the current system.

12. These new, career average pension schemes are due to be introduced from 2015. In advance of these changes, Lord Hutton acknowledged the need for short-term increases in contribution rates to offset the substantial increases in life expectancy over the last few years. These increases in life expectancy have placed a strain on all pension schemes, both public and private and the Government believes that some of the additional cost should be borne by members.

13. The increases that the Government will apply will be phased in over three years. In April 2012 there will be an average increase of around 1.3% of gross salary. The actual increases will vary by scheme and by salary level. Higher paid workers will see a greater increase of up to 2.4% of gross salary (depending in part on their current level of contributions) while some low-paid workers will see no increase at all this year. Further increases will be applied in later years, raising contributions by an average of 3.2% of gross salary by 2014.

14. The Government has also recently consulted on increases to contributions to the Ministerial Pension Scheme (which is also part of the Parliamentary Contributory Pension Fund). This scheme, which provides pensions for ministers, whips and certain other parliamentary figures,[5] will have similar increases to those applied elsewhere in the public service schemes from April this year. Again, those increases will be tiered by level of responsibility, with Secretaries of State paying the highest increase.

15. On 17 October 2011, the House of Commons debated the subject of MPs' pensions and agreed that MPs should be subject to the same increases as are being applied elsewhere in the public sector. At the end of the debate, in handing the power to establish a pension scheme for MPs to IPSA, it passed the following motion unanimously.

    That this House reasserts its view that the salaries, pensions and expenses scheme for hon. Members ought to be determined independently of this House; accordingly invites the Leader of the House to make an order commencing those provisions of the Constitutional Reform and Governance Act 2010 which transfer responsibility for the 5 pensions of hon. Members to the Independent Parliamentary Standards Authority (IPSA); supports the approach to public service pension reform set out in the Final Report of the Independent Public Service Pensions Commission chaired by Lord Hutton of Furness; believes that IPSA should introduce, by 2015,

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[4] Cm 8214, http://cdn.hm-treasury.gov.uk/pensions_publicservice_021111.pdf

[5] Such as the Leader of the Opposition.

a new pension scheme for hon. Members which is informed by the Commission's findings and their subsequent application to other public service pension schemes; recognises the case for an increase in pension contributions made in Lord Hutton's interim report; and accordingly invites IPSA to increase contribution rates for hon. Members from 1 April 2012 in line with changes in pension contribution rates for other public service schemes.

Our proposed changes

16. When considering whether to increase MPs' contributions to the pension scheme, we have taken into account several factors, including the following.

    - Most public sector workers will see their pension contributions increase by between 0.6% and 2.4% this year, with an average increase of 1.3% of gross salary.
    - The motion passed by the House of Commons on 17 October 2011, which invited IPSA to increase the contributions in line with the rest of the public service schemes from April 2012, without any increase in benefit.
    - The difficulty of comparing even seemingly similar pension schemes, given their varying accrual and contribution rates, lumps sums available, pension ages and other features.
    - MPs already pay high contributions, for commensurately high benefits. These contributions are in most cases higher than those paid by other public sector workers.
    - Further increases to the rates (particularly to the highest rate of 11.9%) could make the Scheme unattractive to MPs, leading some to opt-out of membership entirely.

17. There is an argument that these two final factors in particular should influence IPSA to delay any increase in MPs' contributions until we have conducted the fundamental reform of the pension scheme, which we referred to in the Introduction. However, this must be set against the potential impact on public confidence in MPs and in Parliament if MPs were not subject to similar increases in contribution rates to the rest of the public service schemes. Moreover it should be recognised that MPs voted in favour of inviting IPSA to increase contribution rates from April 2012.

18. One of IPSA's fundamental principles is that MPs should, as far as possible, be treated in the same manner as ordinary citizens. We have accordingly decided that it is fair that MPs, like the majority of other public sector workers, should pay more for their pensions this year. MPs at all levels of benefits will see an increase of contributions from 1 April. The changes will only apply to service from this date.

19. We recognise that there are specific circumstances which apply to the MPs' Scheme which do not apply to other public service schemes, including the current high level of contributions and benefits. These circumstances may, in our view, lead some MPs to conclude that they do not wish to remain members of the Scheme (at their current level of contributions) once the increase has been applied. We therefore consider below whether it would be appropriate to introduce a further change to the Scheme which would allow MPs currently accruing benefits in the highest benefits levels to switch to a lower level and therefore pay a commensurately lower contribution while receiving lower benefits. They would be allowed a limited period of time in which to exercise this option.

Increasing Contributions

20. In considering what increase should apply to MPs, we have examined the increase being applied to members of the other public service schemes. In most of the other public service schemes, the increases in contribution rates are tiered, so that lower-paid workers will pay a smaller increase than those who earn more. In the largest scheme, for NHS workers, workers earning the same amount as MPs[6] will be in the top tier of increases and will pay an additional 2.4% of salary. Similarly, in the Ministerial Scheme, it has been proposed that Secretaries of State in the House of Commons (who earn a ministerial salary of £68,827, in addition to their MP salary) will also have an increase of 2.4% applied.

21. However, workers in other schemes will pay smaller increases this year, and some local government workers will have no increase at all for 2012 (although the local government scheme may make savings in other areas and have a new scheme in place by 2014).

22. We recognise that there are several factors particular to the MPs' scheme, including the current high level of contributions (and benefits) and the higher normal pension age of 65. We, therefore, propose to apply a slightly lower increase than that being applied to similarly paid workers (who by and large pay lower contributions and have a lower normal pension age). That said, we propose that MPs pay a higher increase than the average increase paid in other public service schemes.

23. We propose that MPs should pay 1.85% more for their pensions from 1 April 2012. This equates to a yearly increase of £1,216.15 gross and £729.69 net of higher rate income tax.

Accrual Rate	**MPs' Contributions**	
	2011/12	**2012/13**
1/60th	5.9%	7.75%
1/50th	7.9%	9.75%
1/40th	11.9%	13.75%

24. Preliminary advice from the Government Actuary is that increasing MPs' contribution rates by 1.85% will allow the taxpayers' contribution to MPs' pensions to be reduced, from what it would otherwise have been, by approximately 1.4% or £700,000.[7]

25. We have examined whether MPs should also have differing rates of increase applied, as is the case in other schemes. However, as all MPs earn the same amount for their service as MPs, the

[6] All MPs earn £65,738 a year their service as an MP. A small number of MPs earn additional amounts of service as Committee Chairmen or other positions within the House of Commons.

[7] The reduction in the Exchequer contribution is smaller than 1.85% because the total scheme payroll includes also includes ministers, and because MPs who have reached the maximum benefit limits no longer pay contributions.

only basis on which to apply such a variation would be according to the current contribution level. These contribution rates were chosen at the time of the last pensions choices exercise in 2009. We do not consider that it would be fair to apply differing percentage increases to MPs on the basis of these past personal financial decisions, made in different circumstances and for different reasons. Accordingly we propose to apply the same rate increase to all MPs.

Flexibility to move to a lower benefits level

26. The MPs' Scheme is a relatively high-benefit scheme in comparison to most other public service schemes. The high benefits available make it expensive both to the taxpayer and to MPs. These costs increase as the accruals rate increases, as the table on page 3 shows.

27. It has been put to us that to increase MPs' contribution rates by 1.85% as we propose, will make the scheme unaffordable for some MPs. Some MPs may, therefore, feel that they have no option but to drop out of the Scheme entirely, rather than pay the increased rate. We believe that all MPs should have adequate and appropriate pension provision and are concerned that any MPs would find the higher rates to be unaffordable.

28. A further consideration is that it is more expensive for the Exchequer to support MPs in the $1/40^{ths}$ benefit level than at the lower levels. If significant numbers of MPs change benefits levels, the Exchequer's share of the contribution will fall accordingly. For example, preliminary advice from the Government Actuary indicates that if 25% of MPs in the top tier ($1/40^{ths}$) moved to second tier ($1/50^{ths}$), the taxpayers' contribution would fall by approximately 0.5% of the MPs' payroll.

29. We therefore propose that out of consideration of fairness, to mitigate the risk of MPs leaving the Scheme, and to allow for the possibility of a reduced Exchequer contribution, we will offer MPs the flexibility to opt to accrue benefits at a lower tier for future service. This means that MPs will be able to make a new choice about their future pension accrual and drop their contributions (and consequently their benefits) to a lower level.

30. This is illustrated by the following example.

    An MP is currently accruing at $1/40^{ths}$ and paying 11.9% of her salary in contributions. Her contribution is due to increase to 13.75% from 1 April. She would instead prefer to accrue at $1/50^{ths}$ and opt to move down a tier. She will now pay 9.75% for future service. This rate is made up of 7.9% plus the increase of 1.85%.

31. It is right that MPs have a sufficient period to make this important choice and we will work with the Trustees of the pension fund and with others to ensure that MPs have sufficient information to make an informed choice quickly.

32. We have not decided whether MPs who move tiers should be able to backdate the choice to 1 April 2012, when the new contribution rates will take effect, or whether all MPs who choose to move tiers should instead do so at a future date, such as 1 July 2012. We will explore this further with the Trustees of the Pension Fund and their administrators during the consultation period.

How to respond to this Consultation

33. In this Consultation, we have set out our proposals to increase MPs' pension contribution rates by 1.85% and to allow MPs to switch to a lower benefits tier for future pension accrual, dropping their contributions (and consequently their benefits) to a lower level. **We now invite your views on these proposals.**

34. The consultation runs from 8 February to 29 February 2012. Please ensure that you send your response before the closing date as responses received after 29 February 2012 may not be considered.

35. Responses should be sent by email to **mpspensions@parliamentarystandards.org.uk**. Please include in the subject line "Consultation Response." Responses should be in plain or rich text format, with as little use of colour or logos as possible. If you do not have access to email, you may send your response to:

    MPs' Pensions Consultation Responses,
    Independent Parliamentary Standards Authority,
    7th Floor, Portland House,
    Bressenden Place,
    London SW1E 5BH

36. You may wish to note that responses will be published in full, including your name unless you indicate otherwise when submitting the response. If you do not wish your response to be published, either in full or anonymously, please state this clearly.

37. If you require a hard copy of the consultation document please email **mpspensions@parliamentarystandards.org.uk** or write to IPSA at the address above.

The future for MPs' Pay and Pensions

38. For most people, the issues of pay and pensions are inextricably linked. The same is true for MPs, with the pension scheme providing a significant element of the remuneration package available.

39. MPs' pay and pensions were last subject to a thorough review in 2008 and 2009. We believe that the time is right for a root and branch review of MPs' remuneration. We have started this work in earnest and are planning to consult taxpayers, MPs, the Government and other interested parties in due course.

40. Our approach will be influenced by our fundamental principles, including that MPs should, as far as possible, be treated in the same manner as ordinary citizens. We will also be guided by our belief that it is right that MPs' overall remuneration is sufficient to attract candidates to elected office, but also that it must be acceptable to the public and command its confidence.

41. Public sector workers will have limited pay increases for the next few years and will move to a Hutton-style career average pension scheme by 2015. We believe that these principles should be reflected in our approach to MPs' remuneration.

42. We will therefore:
    - keep MPs' pay at its 2010 level in 2012/13;
    - consult on a proposal to apply a 1% increase to MPs' pay in both 2013 and 2014; and
    - conduct a thorough review of pay and pensions, announcing the way forward by the end of 2013.

43. We have already said that we will consider a variety of pension scheme designs for MPs as we conduct our review and, in doing so, we will have due regard to the principles of the Hutton Review.

44. We will set out more detailed plans for our review of MPs' pay and pensions over the next few months.

Glossary

This glossary is taken from the Glossary page of The Pension Advisory Service[8] http://www.pensionsadvisoryservice.org.uk/glossary.aspx

Accrual Rate

The factor used to calculate benefits in a defined benefit scheme. For example, a scheme with an accrual rate of $1/60^{th}$, will provide $1/60^{th}$ of pensionable salary for each year of pensionable service.

Actuarial Valuation

An assessment of a defined benefit scheme's ability to meet its liabilities. Carried out by the scheme actuary at least once every three years.

Actuary

The individual appointed by the trustees of an occupational pension scheme to carry out valuations and advise on funding matters.

Annuity

A policy that provides an income in retirement.

Career Average Re-valued Earnings - CARE - Scheme

A type of defined benefit scheme that calculates retirement benefits using the average of re-valued pensionable salaries over the member's pensionable service.

Consumer Price Index - CPI

Used by pension schemes to calculate pension increases. CPI measures the average changes month-to-month in prices of consumer goods and services purchased in the UK.

Defined Benefit - DB - Scheme

An occupational pension scheme that provides benefits based on accrual rate, pensionable service and pensionable salary.

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[8] The Pensions Advisory Service (TPAS) is an independent voluntary organisation that is grant-aided by the Department for Work and Pensions (DWP). TPAS provides information and guidance to members of the public on all pension matters, covering state, company, personal and stakeholder schemes. The TPAS website receives two million visits a year.

TPAS also help any member of the public who has a problem, complaint or dispute with their occupational or private pension arrangement. The TPAS helpline number is 0845 601 2923.

Defined Contribution - DC - Scheme

A scheme that provides retirement benefits based on the build up of a 'pot' of money, accumulated through the investment of contributions paid by both the employee and the employer.

Final Salary Scheme

An occupational pension scheme that provides benefits based on accrual rate, pensionable service and pensionable salary.

Government Actuary's Department - GAD

A government department that provides actuarial advice and guidance to the government and public sector schemes.

Hybrid Scheme

An occupational pension scheme that calculates retirement benefits as some combination of two alternatives, defined benefit scheme or defined contribution scheme.

Money Purchase Scheme

A scheme that provides retirement benefits based on the build up of a 'pot' of money, accumulated through the investment of contributions paid by both the employee and the employer.

Pension Increases

The increments applied to a pension in payment.

Pensionable Salary

Earnings used to calculate retirement benefits in a defined benefit scheme.

Pensionable Service

Length of qualifying time in a defined benefit scheme used to calculate retirement benefits.

Public Sector Scheme

An occupational pension scheme set up by the government to benefit those in government funded employment, i.e. teachers, police, civil servants.

Revaluation

The increase, normally in line with inflation, of a deferred pension between the date the member leaves service and their normal retirement age.

Salary-Related Scheme

An occupational pension scheme that provides benefits based on accrual rate, pensionable service and pensionable salary.

Schedule Of Contributions

Produced by the scheme actuary, it shows the trustees of a defined benefit scheme how much the employer and employees will contribute.

Scheme Actuary

The individual appointed by the trustees of an occupational pension scheme to carry out valuations and advise on funding matters.

Tax Relief

Incentive given to those contributing to pension schemes. The government pays 20% (non-earners and basic rate tax payers) or 40% (higher rate tax payers) of a member's gross contribution.