Professor Sir Ian Kennedy
IPSA
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3 April 2014

Dear Sir Ian

Thank you for your letter of 24 March 2014. I was disappointed to note that IPSA will not be meeting any of the scheme implementation costs. I am, however, grateful for your acknowledgement that IPSA will work with the Trustees to limit implementation costs wherever possible.

The Trustees have been liaising with our administrators about the implementation of the new scheme and they will commence their implementation project in April 2014 and our officials have been in regular communication about drafting details of the new scheme.

As the benefit structure of the new scheme has become clearer, and following extensive meetings with members which have only been possible since the details of the new scheme have become available, the Trustees have some important concerns which I need to raise with you now.

Headline issues

It has been IPSA's stated position since the CARE scheme option was confirmed, that the detailed benefit structure (which was not visible at consultation stage) would follow that of the new Civil service reform scheme where practicable. That was of course drawn out of IPSA's guiding principle to determine MPs' remuneration in the same way as that of other citizens, as far as practicable. It has however come to the Trustees' attention, as details emerge, that there are some areas where there are notable differences between the two schemes for which the Trustees cannot readily see a justification.

The differences fall into two main areas:

Accrual Rate and Contribution Rate

A number of members have understandably focussed on these two headline aspects of the new IPSA scheme. In short, they are struggling to understand why the new IPSA scheme has a substantially higher member contribution rate and a lower accrual rate than that which is to apply in the Civil Service reform scheme (for those on a similar salary to the anticipated post 2015 MPs' salary). You are aware of course that the Trustees pressed IPSA on these two issues during the consultation period and that we supported the 40% (member) 60% (employer) contribution split initially indicated. But that IPSA of course then moved the goalposts on the latter in its final consultation document (to a 46:54% split).

What we would like from IPSA is a short paragraph, which we can then use in communicating with our members, explaining this marked difference on these headline benefit issues between the Civil Service reforms and the new IPSA scheme. Much of that content is contained in various places within IPSA's consultation document, but it would be very useful for the Trustees to have a succinct explanation from IPSA that can be used in this way. It is not for the Trustees to seek to justify IPSA's position on these issues.

As an aside, the Trustees remain concerned that, whilst the driver for the change to the contribution split appears solely to be the anticipated salary rise from 2015, the pay award remains unconfirmed.

Flexibility in pension scheme provision

You will note that the Trustees' October 2013 response to IPSA's consultation included our desire for IPSA to offer flexibility to MPs. You will recall that our representations in our formal responses to IPSA have consistently included requests for flexibility. We had requested a choice of accrual rates, on a cost-neutral basis. We made clear that the continuation of existing flexibilities would not give rise to new complexities or administration costs.

The Trustees have always remained strongly in favour of this flexibility and during discussions with Members since December it has become apparent that MPs are concerned about the high contribution and the lack of flexibility offered by IPSA to pay a lower rate, if they cannot afford to pay the expected 10.53%. Sadly, the Trustees are concerned that the current proposed rigidity may result in some of our colleagues choosing in the future to opt out of the scheme or may even dissuade some from standing for election. I know we have discussed the diversity of MPs and their backgrounds in the past with IPSA. The Trustees believe that to remain committed to encouraging a diversity of MPs, we should be encouraging some flexibility in pension scheme provision.

Unfortunately, in your letter to me of 12 December 2013, which accompanied your final report, you stated that 'this type of flexibility is not available in any other public sector pension scheme'. Whilst this statement is somewhat dubious in itself, (it is my understanding that the LGPS have an option of accrual rates), it is not of itself my point. Rather, the Trustees' recent discussions with members, following the setting of the higher than expected contribution rate in your final report, has been that a provision available in the Civil Service reform scheme could easily be offered to Members - in the absence of any other flexibility – and this would address a number of concerns expressed by my Members.

I am referring here to the "Partnership" option offered to Civil Service members. This is, as I expect you are aware, a DC alternative to the CARE scheme into which employer contributions can be made on an age related basis. The employee can choose whether to make additional contributions and so can set these contributions at an affordable rate. If similar flexibility were offered to MPs, a maximum cap on employer contributions could of course be set by IPSA. The indications from discussions between officials is that IPSA have based many aspects of the pension scheme changes relating to MPs are based on the PCSPS (Principal Civil Service Pension Scheme) reform scheme. Therefore, we believe it is the 'Partnership' arrangement offered in the PCSPS which should be modelled

I know that IPSA will be reviewing salaries following the General Election, but at this point, there is no indication of whether the pay for MPs will rise in line with your proposals. This leaves MPs with a lack of certainty about their future pay and consequently some uncertainty about the ability to afford pension contributions, which are generally higher than others in the public sector earning a salary similar to (or higher than) MPs.

This issue has been raised in discussions with your officials who have suggested offering a DC option now is not viable as IPSA would be required to consult again. However, we do not believe you would necessarily be required to consult to offer a similar facility. We are open to further discussions about this.

As you know, there are some advantages to employers when providing DC schemes, namely lower costs and passing on of risk to the member. There are also general employer duties to help to encourage all people to save for retirement. Although IPSA and MPs do not fall within this conventional 'employer-employee' relationship, I can see no reason why IPSA would not want to provide access to a DC arrangement. We believe the provision of this scheme would stay in line with IPSA's principles of keeping the cost to the taxpayer down and also treating MPs like ordinary citizens.

Of course, I do not expect the vast majority of MPs to consider joining a DC scheme and, as you know, the Trustees have not supported this as a vehicle for providing the main scheme benefits. However, there are certain MPs for whom this will suit their circumstances better and this could be provided at no extra, and in all likelihood a lower, cost to the tax payer. We do not believe that this added flexibility would give rise to new complexities or administration hurdles as much of the set up and administration would be done by an external insurance company and would therefore be very easy to provide and to manage.

<u>Further issues of detail</u>

There are in addition some other matters which have come out of discussions to date around the final benefit structure of the new IPSA scheme. Whilst these have been raised with our officials, I felt it appropriate to draw them to your attention whilst writing.

<u>Age 75 Issue</u>

The current PCPF Rules require MPs to cease serving before they are able to take their pension. The exception to this rule is that when a serving MP reaches age 75, they are presented with the option to draw a tax free lump sum from the scheme before they turn 75 and acquire a 'pensioner' status and they would no longer make contributions. Most of the remaining pension becomes a preserved pension and is not paid until they stand down. The scheme rules allow this flexibility because of the tax implication of payments to those aged over 75. Protection of accrued benefits for Members means this arrangement will continue for past service. IPSA are not permitting the same flexibility in their new scheme rules so serving Members approaching the age of 75 will not be able to draw their lump sum in this way. This poses problems for those Members if they continue in service beyond age 75 without taking their benefits because of serious tax implications.

We request that IPSA mirror the existing flexibility in the new scheme. Several MPs do remain in service past the age of 75, yet this is probably not a likely occurrence in the Civil Service. In this instance, there appears to be a cause for IPSA to adopt a different approach for MPs. Many of my colleagues in the House are above the age of 75 and I would not like to see Members in the future being restricted from continuing in service beyond 75 due to this inflexibility. To enable Members to remain in service until the next General Election, rather than stand down mid-term, it makes sense to adapt the scheme rules so that Members in this category are not forced to stand down between elections.

If legislation changes in future and the age 75 tax restrictions are removed then the Trustees believe it would be appropriate for IPSA to change their rules at that time as then Members would not need the flexibility that is being requested now.

Structure of the new IPSA scheme

As you know we have had some concerns on the drafting of the new scheme and the style. Initial discussions have progressed well and have addressed some legal concerns with the proposals, principally about: (i) ensuring accrued rights are not affected (a principle to which I am grateful that IPSA is committed); and (ii) avoiding any inadvertent changes arising by seeking to replace seemingly archaic language in the existing rules with simplified, modern drafting. I note that your recent letter anticipates that the Cabinet Office will adopt a similar structure and style to the drafting of the 2015 reforms to the MCS scheme but it is not yet clear that this will in fact materialise.

The Trustees expect that IPSA will ensure that these legal concerns are adequately addressed in the new scheme rules. Whilst our officials and lawyers will be reviewing the rules, I am sure you will agree that primary responsibility for the rules sits with IPSA and I would welcome reassurance that IPSA will be ensuring that this will be done.

Increases to pensions in deferment and in payment

To date, pensions payable by the PCPF have been increased in deferment and once in payment in line with the statutory provisions affecting public sector pension schemes under the Pensions (Increase) Act 1971. That legislation applies to official pensions provided by the PCPF. In broad terms, increases apply by reference to uncapped (now CPI) inflation. Our understanding is that IPSA is taking advice as to whether that legislation applies to the CARE benefits to be accrued from 2015 or whether IPSA itself will be able to set the inflation measure (which I understand IPSA intends to be CPI). The issue is more complex than the headline inflation measure, as the 1971 Act sets out in detail for example the manner and timing at which the increases are to apply. We would welcome clarity on this issue so that our officials and lawyers can consider it further.

AVC scheme
I note your comments in your letter dated 24 March about the AVC scheme and the ongoing discussions. This does of course require engagement with the Cabinet Office. I trust our respective lawyers can work together to reach a conclusion soon.

Cost cap valuations
As you state, further information on IPSA's intended approach is yet to come. However, in addition to the detail of the mechanism, three particular points need to be flushed out, in relation both to the IPSA scheme and the MCS scheme, being:

a. The consequences of a cost cap valuation breaching the limits (up or down). Whilst a default applies in the PCSPS, it may be appropriate for the PCPF to differ from the PCSPS here given that the legal framework of the PCPF, which empowers the IPSA and MCS respectively to make future service changes by way of a new scheme following consultation, differs from the PCSPS structure. That structure lends itself to having no prescribed default in the PCPF, which would have the advantage of enabling the IPSA, through the existing consultation framework, to consider what revisions (if any) to implement in respect of future benefit design. IPSA could then, as it has done in setting the benefit design of the new scheme, consider the position in the context of MPs' remuneration as a whole;

b. seeking to ensure that the PCPF's operational expenses do not form part of the cost cap valuations, particularly in light of the fact that the proposed structure of the IPSA reforms could result in significant increases to the administrative cost of operating the PCPF. In the proposed mechanism for the PCSPS, I understand that changes to scheme administration costs are intended to be outside of the cap mechanism and we would expect the same principle to apply to the Fund; and

c. How members will benefit in the event of the costs (within the cap mechanism) falling.

We would welcome early engagement with IPSA on all of the points raised in this letter. Although, these are important issues, I am confident they will not delay your efforts to proceed with your timetable for the new scheme. I look forward to hearing from you.

Yours sincerely

Brian H Donohoe MP
Chairman of Trustees