

JOHN RALFE CONSULTING

Sir John Baker
c/o The Office of Manpower Economics
Bay 665
66-74 Victoria Street
London SW1 6SW

April 9th 2008

Dear Sir John,

Review of MPs' pay and pensions: Consultation Document

The Review of MPs' pay and pensions is a vital part of restoring public confidence in Parliament and I have pleasure in attaching my response to the Consultation Document.

As an independent pension consultant (see attached CV) my comments focus only on pensions.

It is crucial that the cost of MPs' pensions is properly measured as part of their overall remuneration, before considering a suitable "comparator" or a regular review mechanism. Sadly, the "official" pension cost is grossly understated, thus understating an MP's overall remuneration.

MPs' pensions are the most generous in the UK – an annual benefit of 2.5% of final salary, full inflation protection and early retirement provisions. But the 2005 PCPF Actuarial Valuation ¹ and the 2006/7 Commons Accounts recognise a taxpayer cost of only 18.1% of pensionable salary, after Member contributions. ²

¹ <http://www.publications.parliament.uk/pa/cm200506/cmselect/cmfund/979/97901.htm> Summary

² <http://www.publications.parliament.uk/pa/cm/cmresource/832.pdf>

JOHN RALFE CONSULTING

The total taxpayer cash contribution is 26.8% of salary, 18.1% service cost, plus 8.7% deficit contribution.

The FRS17 cost, used by private sector companies, disclosed in a footnote to the Commons accounts, is 38% of salary, based on the AA bond rate.³

Since MPs' pensions are Government guaranteed, and inflation-linked, the correct discount rate is the index-linked gilt rate, not the AA corporate bond rate. Based on the April 2007 ILG yield the real cost to the taxpayer is around 43% of MPs' salary.

Reported, FRS17 & ILG cost of MP's new pension promises				
<i>% of salary</i>	Reported cost 2006/7	FRS17 cost 2006/7	ILG cost 2007/8	ILG cost + longevity 2007/8
Total cost	27.4%	47.3%	52.3%	59.3%
Member contribution	9.3%	9.3%	9.3%	9.3%
Taxpayer cost	18.1%	38%	43%	50%
MP salary	£61k	£61k	£61k	£61k
MP pension	£11k	£23k	£26k	£30.5k
Total	£72k	£84k	£87k	£91.5k
Real discount rate	3.5%	1.7%	1.2%	1.2%

The longevity assumptions in the PCPF 2005 Valuation are also weak and based on the 1992 Actuarial Tables, with no "cohort" improvement⁴; an assumed life expectancy for a man aged 65 in 2025 of around 86.3 years.

³ ibid page 33

⁴ ibid Appendix E

JOHN RALFE CONSULTING

The guidelines recently announced by The Pensions Regulator for private sector schemes ⁵ require the use of 1992 Tables, with a “long cohort” improvement. This suggests life expectancy for a man aged reaching 65 in 2025 of around 89.4 years.

This extra three-years life expectancy increases the annual cost of MPs’ pensions by around 7% to 50% of salary.

The total annual cost of the Bank of England pension scheme is 41% of salary for 1/60th accrual, based on index-linked gilt rates. ⁶ Scaling this to a 1/40th accrual suggests a total cost of 60%, before Member contributions, similar to my total estimate for MPs’ pensions, also based on index-linked gilts.

Including the real cost of MPs’ pensions means their remuneration is not the official figure of £72,000 (£61,000 pay + £11,000 pension), but £91,500 (£61,000 pay + £30,500 pension), or 27% higher.

The starting point for the Review of MPs’ pay and pensions should reduce MPs’ future pension benefits to the official annual cost of 18% of pensionable salary reducing their overall remuneration to £72,000.

Reducing the annual pension accrual from 1/40th to 1/60th would reduce the total cost by 20% of salary. Moving from Final Salary to Career Average, and capping annual inflation indexation on pensions in payment and in deferral at 2.5%, would save a further 10%. With an unchanged Member contribution of 10% the taxpayer cost would be reduced from 50% to 20% of salary, in line with the official 18% cost.

⁵ <http://www.thepensionsregulator.gov.uk/pdf/LongevityConsultationDocument.pdf>

⁶ <http://www.bankofengland.co.uk/publications/annualreport/2007full.pdf> pages 32 & 91

JOHN RALFE CONSULTING

	Existing annual pension benefits	Proposed annual pension benefits
Annual accrual	1/40th	1/60th
Basis of pension	Final Salary	Career Average
Pension indexation	RPI, with no cap	RPI, capped at 2.5%
Deferral indexation	RPI, with no cap	RPI, capped at 2.5%
Total cost	c 60%	c 30%
Member contribution	c 10%	c 10%
Taxpayer cost	c 50%	c 20%

These changes would also bring MPs' annual pension benefits in line with standard private sector Defined Benefit pensions. Although most have maintained a 1/60th accrual for existing members they have reduced costs by moving from Final Salary to Career Average and imposing an annual 2.5% cap on pension increases and deferrals (introduced by the Pensions Act 2004 and recent Regulations).

Please feel free to contact me if you would like to discuss these comments.

Yours sincerely

John Ralfe

John Ralfe Consulting

JOHN RALFE CONSULTING



John Ralfe is an independent consultant advising company and trustee boards on pensions.

Until December 2002 he was Head of Corporate Finance at Boots and a member of Boots Pension Fund investment committee. He was instrumental in moving the £2.3bn Boots Pension Fund to 100% AAA long dated sterling bonds, followed by a share buyback, described by The Economist in 2006 as a "*landmark*".

He is a vocal contributor to the debates on the economics of company pensions and reform of pension regulation and is a regular contributor to the Financial Times and the BBC Today Programme, as well as appearing on the BBC News at Ten and Channel 4 News. He was also a consultant to the Accounting Standards Board on FRS17 and the International Accounting Standards Board on share options and worked with Harvard Business School to develop Boots Pensions as a Case Study.

Prior to joining Boots he spent 11 years in banking and consulting with Chase Manhattan, Warburgs, Swiss Bank Corporation and Ernst & Young Corporate Finance. He obtained a First in PPE in 1978, from Balliol College, Oxford and also studied economics at King's College, Cambridge.