SCOTTISH PARLIAMENTARY PENSION SCHEME COMMITTEE

Tuesday 26 February 2008

Session 3

£5.00

Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by RR Donnelley.

CONTENTS

Tuesday 26 February 2008

SCOTTISH PARLIAMENTARY PENSION SCHEME COMMITTEE
2nd Meeting 2008, Session 3

CONVENER

*Alasdair Morgan (South of Scotland) (SNP)

DEPUTY CONVENER

*Peter Peacock (Highlands and Islands) (Lab)

COMMITTEE MEMBERS

*David McLetchie (Edinburgh Pentlands) (Con)
*Hugh O'Donnell (Central Scotland) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Sir John Butterfill MP (Parliamentary Contributory Pension Fund)
Alun Cairns AM (National Assembly for Wales Members' Pension Scheme)
Chad Dawtry (Scottish Public Pensions Agency)
David Lauder (Scottish Public Pensions Agency)
Christine Marr (Scottish Public Pensions Agency)

CLERK TO THE COMMITTEE

David Cullum

SENIOR ASSISTANT CLERKS

Ruth Cooper
Derek Stein

LOCATION

Committee Room 4

Scottish Parliament

Scottish Parliamentary Pension Scheme Committee

Tuesday 26 February 2008

[THE CONVENER *opened the meeting at 15:03*]

Scottish Parliamentary Pension Scheme Inquiry

The Convener (Alasdair Morgan): Ladies and gentlemen, welcome to the second meeting this year of the Scottish Parliamentary Pension Scheme Committee. I remind members and others to switch off their mobile phones.

Agenda item 1 is to take evidence in our Scottish parliamentary pension scheme consultation. I welcome our first witnesses today, who are from the Scottish Public Pensions Agency. Chad Dawtry is the director of policy, strategy and development at the agency, and Christine Marr and David Lauder are policy managers. I thank them for coming to the meeting.

We will move straight to questions.

Hugh O'Donnell (Central Scotland) (LD): Good afternoon. Will Mr Dawtry clarify what the SPPA's principal role is and what its principal functions are in relation to public service pension schemes?

Chad Dawtry (Scottish Public Pensions Agency): Our primary role is pensions administration for the national health service and teachers schemes. We also administer on behalf of the Scottish Parliament and the Northern Ireland Assembly. Our policy remit is regulating the five main schemes in Scotland, not including the civil service scheme of course. We also have an appellant function on behalf of the Scottish ministers.

Hugh O'Donnell: In carrying out those functions, does the SPPA draw on services, for example those of actuaries or legal advisers?

Chad Dawtry: Yes. We use both of those kinds of services. There are three sources of advice for us. The committee might be aware that we draw largely on pensions policy that is developed down south. That is an historical fact. However, when we are taking forward policy developments in Scotland, we take legal advice from the Scottish Government's legal division and actuarial advice that is primarily from the Government Actuary's Department.

The Convener: How can you be sure that legal advice from the Government is not influenced by Government policy and that it relates only to the judgments that you should be making about the pension schemes themselves?

Chad Dawtry: The advice that we get from the Scottish Government is primarily very technical advice about the regulations.

David McLetchie (Edinburgh Pentlands) (Con): Good afternoon. Will you outline for the benefit of the committee the main drivers for pension scheme administrators modifying their rules in recent years, in the way that is now being proposed in relation to the Parliament's scheme?

Chad Dawtry: I will do my best. In 2000, there was a Treasury-led review of public pension schemes, which identified issues around increasing longevity and the need to reform schemes to ensure that they can be paid for in future. After the reforms started, the Finance Act 2004 introduced specific requirements to make changes—there was a lot of discretionary space in there, too. The main drivers are, in effect, longevity and affordability.

David McLetchie: But there have not been governance-type issues, as separate from issues of affordability and the benefits package that the schemes provide.

Chad Dawtry: That has been less of an issue for the public pension schemes, because, of the five schemes that we look after, four are unfunded and one is funded. The funded one is the local government scheme, which has its own governance arrangements.

David McLetchie: Who are the trustees and governors of the local government scheme and how are they elected or selected for that purpose?

Chad Dawtry: There are 11 funds in Scotland, which are administered by 11 administering authorities. I cannot say for certain how the trustees are selected.

David Lauder (Scottish Public Pensions Agency): They are regarded as quasi-trustees. The councillors of the scheme are responsible for the management and investment of the pension funds. They are not trustees in the normal sense of the word, in that the scheme is governed by the scheme regulations—which are imposed, if you will, upon councils—but the councillors have responsibility for the management of the funds.

David McLetchie: I want to focus on recent changes in the law driving changes in the terms of schemes. On the discretions that have been conferred on or taken by trustees of schemes, what sort of things have others been adopting?

David Lauder: Under the Finance Act 2004 there are only a handful of requirements. As you say, the rest of the provisions are permissive options. The act introduces a lifetime allowance and an annual allowance. It increases the minimum pension age from 50 to 55 and pegs the children's pension at 23. Those are the requirements that the act brings in.

In the past, restrictions were imposed by the Inland Revenue to allow the scheme to have tax-exempt status. The scheme could not provide more than 40 years' worth of benefits at age 60 and you could not accrue more than 40 years' service at age 60. There was a limit on the amount of contributions that you could make. You would pay the normal 6 per cent contributions in the local government scheme and there was an overall ceiling of 15 per cent, so if any other options were used, such as additional voluntary contributions or buying added years, you could not pay more than an overall limit of 15 per cent. The Finance Act 2004 removed the Inland Revenue restrictions, so schemes can also remove them, but it is the scheme's choice. Schemes can retain the restrictions, but they would be scheme rather than revenue restrictions.

David McLetchie: Do schemes maintain such restrictions to limit the reciprocal contribution that would come in from an employer?

David Lauder: That would be one reason for limiting contributions.

There has been criticism of the local government scheme. People can join at the age of 16, so at the age of 60 they would have paid 44 years' worth of contributions, but would receive only 40 years' worth of pension benefits. The driver for us was that removing the restrictions because the revenue no longer required them would assist with scheme recruitment and membership, because it would make the scheme more attractive to people.

David McLetchie: I will ask you specifically about the provisions in the schemes that you look after in relation to unmarried partners. What pension rights do unmarried partners of scheme members have? How do those rights compare with those of married partners or civil partners?

David Lauder: Unmarried partners will have the same rights as civil partners or married partners. That provision is being introduced into the new scheme.

David McLetchie: Are the criteria for determining whether people are in an appropriate partnership for the purposes of securing pension benefits consistent across all the schemes?

David Lauder: Yes, I believe so.

David McLetchie: Are they essentially self-certifying, or are any objective criteria applied—without the process being overly intrusive?

David Lauder: I think that people have to provide evidence that the relationship has existed for a period of time.

Chad Dawtry: It is two years.

Christine Marr (Scottish Public Pensions Agency): And that they are interdependent—perhaps that they have a joint bank account.

David McLetchie: So one criterion is the length of the relationship. Let us suppose that people have formed such a relationship and are clearly, to all intents and purposes, committed to one another—they have perhaps bought a house together or have a joint bank account or whatever. If the scheme member died prematurely after they had been together for only six months, nine months, a year or something like that, do your schemes have discretion in relation to people in that situation, or is there an absolute rule that the relationship has to have subsisted for a minimum period of two or three years before the partner benefits?

Chad Dawtry: The rule is based on Treasury guidance, and the period is two years.

David McLetchie: So, as far as you are aware, there is no discretion for a shorter period to be sufficient in the circumstances that I have described.

Chad Dawtry: Not that we are aware of, but we can check that for you.

David McLetchie: That would be helpful, because of the issue about how many rules should be mandatory and how many should be discretionary.

We are, in a sense, playing catch-up. In order to ensure that we have encompassed all the matters that are in the pipeline or are foreseeable, can you advise us whether you are working on further changes to the schemes that you administer to which you might want to draw our attention?

Chad Dawtry: I do not think that there is anything else major. The new Pensions Bill is introducing personal accounts, and we will have to take account of issues around autoenrolment, but I do not think that there is anything else major in the pipeline.

David McLetchie: Finally, we want to consider systems for reviewing our scheme rules in future. How are changes in the rules of SPPA schemes made? What process is involved and who is involved in that process?

15:15

Chad Dawtry: In most cases, the reforms have been taken forward on a tripartite basis, with the Scottish Government, employers and the staff side—the unions—being represented at the table. A feature of post-reform activity has been that that has engendered more interest from stakeholders, so we have on-going tripartite arrangements for the pension schemes for teachers, NHS workers and local government employees.

David McLetchie: So there is a continuous review-type mechanism.

Chad Dawtry: In effect, yes.

Peter Peacock (Highlands and Islands) (Lab): I am interested in early retirement under the scheme—though not personally, I should say—

Hugh O'Donnell: That may be outwith your control.

Peter Peacock: The SPPA administers a number of schemes and regulates others. What are the broad provisions on early retirement in the different schemes that the SPPA administers and advises on, and are they similar? Are they exactly the same in the schemes for teachers, local government employees and members of the Scottish Parliament? Can you give us a wee description of that?

Christine Marr: The provisions are broadly similar, but they are not the same in all the schemes. Most schemes allow for voluntary early retirement, whereby members of the scheme can opt to take their benefits early. In some schemes that is possible from the age of 50, but in other schemes people must be 55. From 2010, the minimum age will be 55 for members of all schemes. Under early retirement, the benefits are actuarially reduced and that reduction is for life. There is a reduction of roughly 5 per cent for each year that is taken early.

Peter Peacock: Does roughly 5 per cent mean 5.1 or 4.8 per cent? Where does the figure lie, or does the level of reduction vary?

Christine Marr: The reduction works out at roughly 5 per cent. In saying roughly, I am rounding up the figure. It might be about 4.7 or 4.9 per cent.

The schemes also provide for members who are made redundant or retired on grounds of efficiency. In that case, the employer must pay the cost of the member's retiring early. However, the amount varies across the different schemes. In the teachers scheme, the employer pays a share of the pension and a lump sum, which we calculate based on actuarial factors. In the local government scheme, the employer is required to pay into the fund a lump sum called a strain-on-the-fund cost. Similarly in the NHS scheme, the cost of the early payment is capitalised and the NHS employer is required to pay a lump sum into the fund.

Peter Peacock: This is quite complex, so let me try to get the issue clear in my mind. If people voluntarily opt for early retirement because they have reached the point in their life—after 2010, they will need to be at least 55—where they just want to do something else with their life, such as travelling the world, they can take early retirement in the knowledge that their pension will be actuarially reduced by, on average, roughly 5 per cent per year for life. If, on the other hand, people are made redundant or if the local authority creates an incentive for them to retire early in order to reduce staff or teacher numbers, they can take early retirement without any actuarial reduction and possibly with an enhancement to their service.

Christine Marr: Their pension would not be actuarially reduced—

Peter Peacock: Would there definitely be no actuarial reduction?

Christine Marr: In the local government scheme, people who are made redundant have a right to their pension—

Peter Peacock: Provided that they have reached the age of 55.

Christine Marr: Yes. In the teachers scheme, the matter is at the employer's discretion. For historical reasons, the teachers scheme seems to be the only one in which there is no such automatic right and it is up to the employer to agree. Because the employer must meet the cost of the early payment, the scheme member does not suffer any penalty. On top of that, the employer could award additional compensation.

Peter Peacock: So the employer might say, "You are 55, but we will give you five years' enhancement and calculate your pension on the basis that you are 60."

Christine Marr: Yes. Obviously, there is a maximum amount that can be awarded.

Peter Peacock: When the decision to retire early is not wholly in the hands of the individual—because of redundancy, or because the employer desires to reduce the workforce and therefore offers an incentive to leave—the employer and not the employee would meet the cost of that.

Christine Marr: Yes, that is correct.

Peter Peacock: Thank you. That is helpful.

You have highlighted schemes for teachers and local government employees. When a decision is made on whether someone can go at 55, does the person have to have a minimum number of years

of service, or is the decision based simply on the person's age?

Christine Marr: To be eligible, the person has only to qualify for benefits. That happens after two years of service.

Peter Peacock: So, in 2010, provided a person has two years of service and is 55, they will be entitled to early retirement in the way that you describe.

Christine Marr: Yes.

Peter Peacock: Are there no other criteria? Is that the only trigger—that a person be aged 55 and have two years of service?

Christine Marr: Yes, as long as the person has qualified for benefits.

Peter Peacock: You have answered my questions so fully that you have probably covered most of the points that I wanted to raise.

The Convener: In that hypothetical example, in which somebody has paid for two years and then retires and becomes entitled to their pension, they do not get that entitlement made up for another five or 10 years of service, do they?

Christine Marr: That would be at the discretion of the employer, but there would be a maximum amount that they could receive as an enhancement.

The Convener: Determined by what?

Christine Marr: Determined by regulations in subordinate legislation, which would set out how much could be paid.

The Convener: Are these special circumstances that affect certain schemes? Is local government affected?

David Lauder: Under the pensions regulations for local government, if somebody goes at age 50—or at age 55 in 2010—when the employer has requested and initiated the retirement, the person would get their accrued benefits, as Christine Marr said. In addition, the employer can, at its discretion, award additional years of service.

There are also separate regulations—the local government discretionary payments regulations. Under those regulations, the employer has the alternative of awarding a lump sum, up to a maximum of 66 weeks' pay, I think. Therefore, if an employer intends to provide compensation, there are two alternatives—additional years of service or a lump sum payment.

The Convener: How often will additional years of service be awarded, as a proportion of the number of early retirements?

Christine Marr: For teachers, most employers will award either one or two years. It is not normally more than that. However, I really do not know about the proportion.

David Lauder: Years ago, the tendency among local authorities was to award the maximum in all cases.

The Convener: That could have been up to 10 years.

David Lauder: Yes. However, in recent years local authorities have become more conscious of the costs of making people redundant. The regulations now require each authority or each employer to publish its policy on discretions. The policy might be to award the maximum in all cases, or to award less than that—for example, 50 per cent.

Peter Peacock: Following up on the question that the convener asked a minute ago, would you be able to find out more, when you get back to your office, about the balance between those who volunteer to go early and those who, for one reason or another, are encouraged or required to go early?

Chad Dawtry: We would not have that information to hand, so it would depend how long you were willing to wait.

Peter Peacock: If it were possible to find that information without colossal effort that would bring the organisation to a halt, it would be interesting to know.

David Lauder: We would have to gather information—

Chad Dawtry: From the local authorities themselves.

Peter Peacock: Maybe we should discuss with the clerks after the meeting whether we need that information and get back to you about it.

Let us move on to the question of retirement through ill health. In our consultation, we asked various questions about ill-health retirement. It is very difficult to judge whether someone's health is sufficiently poor to require them to retire and to leave them unable to fulfil any other occupation. The consultation talks about ill-health retirement options with the level of benefit depending on the severity of the illness. Broadly speaking, what provision do other schemes, such as those for teachers and local government workers and the other schemes in which you are involved, make for that?

Chad Dawtry: I will start off and my colleagues will deal with the specific schemes. The Treasury review of ill health, which took place a few years ago, was concerned with ensuring that ill-health retirement is better targeted as well as with the

introduction of better workplace management of ill health in general. It talked about having gateways to ill-health retirement and setting up two-tier arrangements. In the most severe cases, if someone could not do their own or any other job, they would get upper-tier arrangements, which would differ depending on which scheme they were in. In cases in which a person was unable to do the job that they had done previously but was capable of undertaking other paid employment, they would get lower-tier arrangements and a reduced amount of accrued benefits.

Peter Peacock: Would it be normal for the other schemes of which you are aware to provide for the trustees of the scheme—whoever they are—clear discretion to review someone's case once they had retired, to see whether their condition had changed or become less severe than expected?

Chad Dawtry: That tends not to be a feature of the schemes, primarily because of the administrative difficulties associated with that.

Peter Peacock: So, there tend to be set out in the scheme clear trigger points for making a decision.

Chad Dawtry: Effectively, yes.

Peter Peacock: And once that decision is made, it tends not to be reviewed.

Chad Dawtry: It tends not to be reviewed.

Peter Peacock: Are there circumstances in which it is? Is there any exception to that in the schemes?

Christine Marr: It was not introduced for teachers, but we may introduce it in the future. The two-tier ill-health arrangements have been running only since 1 April 2007 but we will evaluate them after a year. The situation may well have to be reviewed.

Peter Peacock: Okay. In thinking about early retirement and ill-health retirement, is there any experience within the schemes of which you are aware that—how can I put this correctly, politely or properly? Is there any relationship that you think exists or might exist between the inability to take early retirement and the ability to take ill-health retirement? Does some relationship exist between the provisions for early retirement and the taking of ill-health retirement?

Chad Dawtry: The quick answer is that we do not have any data on that specific point.

Peter Peacock: So in conversations that you have with other professionals about designing pension schemes, does no one say that if the early retirement provisions are too strict there tend to be more ill-health retirements?

Chad Dawtry: For most of the schemes, the two-tier arrangements have only just kicked in and it might be too early to tell. Anecdotally, in the past there possibly has been a suggestion of that, but it would be hard to found that on evidence.

Peter Peacock: I am grateful for that answer. Clearly, ill-health retirement is significantly more expensive for a scheme than early retirement if the ill-health provisions tend to base someone's pension on earnings to the age of 65—is that correct?

Chad Dawtry: Yes.

Hugh O'Donnell: Do any of the schemes in which you are involved revisit people who have taken ill-health retirement but who have subsequently gone back into similar paid employment? For example, if a teacher who has retired on the ground of ill health were subsequently to return to a supply list, is there a ceiling on their earning capacity and does anyone monitor whether they earn more than they did as a result of taking ill-health retirement and then being available on the supply list?

15:30

Christine Marr: Such a person would not be allowed to go back to teaching—or, rather, they could, but their pension would stop. If a person retired and was on the upper tier of the new two-tier system, their benefits would be enhanced. The criteria for the upper tier is that the person has to be 90 per cent incapacitated and unable to do any work. If that person felt that they had improved and they wanted to take work outwith teaching, they could see their general practitioner and provide us with a certificate. If the GP believed that they were still totally incapacitated, their pension would continue.

Hugh O'Donnell: What would happen in the case of someone taking early retirement as opposed to ill-health retirement?

Christine Marr: A person who takes early retirement can go back to teaching and we give them an earnings limit. Their pension and their earnings from employment must not exceed the salary that they were on with pensions increase added.

Hugh O'Donnell: How is that monitored?

Christine Marr: It is monitored by the SPPA, which writes to the teacher's employer and asks for details of what the teacher has earned.

Peter Peacock: I have reflected on what you said about the ill-health provisions. I was surprised to learn that comparatively little discretion is held or exercised by trustees when a person has retired. In your experience, is it possible fully to

capture in the regulations for a scheme provisions that adequately cover all ill-health retirements? Is there any discussion between professionals about the need to allow trustees more discretion to judge whether a person's ill health continues or whether their health has improved or deteriorated?

Christine Marr: We rely on our medical advisers, who follow the guidance for occupational health physicians. They would recommend to us whether the person satisfied the criteria for the lower or upper tier.

Peter Peacock: To be clear, are those medical advisers different from the advisers to the person who was seeking ill-health retirement? The advisers that you mentioned are independent and they advise you.

Christine Marr: Yes. They are appointed by the SPPA.

Peter Peacock: So their job is to scrutinise the medical evidence from the GP, consultant or whatever.

Chad Dawtry: They take a completely independent view of a case, without any bias. Again, that approach was a Treasury recommendation.

Peter Peacock: Once the medical advice has been agreed by both parties or the trustees have taken their decision on the basis of their own medical advice, that tends to be it. The decision is made once and for all.

Chad Dawtry: That tends to be it. I return to the point that the Treasury review was keenly interested in better workplace management of ill health. The notion is that things should be managed before the trigger points are reached. That is the last stage, in effect. The process should be managed before somebody reaches the stage of being let go.

David Lauder: On the local government side, one of the factors that led to the Treasury's concern about the number of ill-health cases in the past was the fact that the criterion for getting ill-health benefits was simply that the person was permanently incapable of doing their own job. It did not take account of whether they were capable of doing other paid employment. They could walk into that other job the next day, but if they could not do their own job, they would access their pension.

In the two-tier approach, the first tier consists of people who are permanently incapable of doing their own job or any other job. It should be relatively straightforward for occupational health doctors to assess that group. We would not normally expect someone who was assessed as being permanently incapable of doing any work suddenly to improve in the future.

The requirement for the second tier is that the person is permanently incapable of doing their own job but would be capable of doing other paid employment at some future date. We have moved away from the situation in which being unable to do one's own job was the only criteria for getting a pension for life.

The Convener: You mentioned Treasury guidance in connection with ill-health retirement, and with unmarried partners. Would it be possible for us to have a copy of that guidance? We do not have it at the moment.

Chad Dawtry: In respect of ill health, there is a review that we can give you, rather than guidance. The recommendations came out of that review, which we can certainly provide.

The Convener: Okay. You also mentioned guidance in relation to unmarried partners.

Christine Marr: That was to do with the two-year criterion.

The Convener: If we could obtain the source document for that, that would be great.

The various changes that we have discussed have had funding implications. How have the changes to the various schemes for which you are responsible been funded?

Chad Dawtry: There are four unfunded schemes.

The Convener: Clearly, the unfunded ones do not get funded, but what about the funded ones?

Chad Dawtry: The money still has to be found. There has to be long-term affordability and sustainability. The unfunded schemes have moved from an increase in the low pension age, which has effectively generated savings. Changes under the Finance Act 2004 have allowed people to commute up to 25 per cent of their lump sums. Actuarial assumptions may have been made based on how many people will take that up.

The Convener: Is that a benefit?

Chad Dawtry: That is assumed to be a saving, because people buy that out at a rate of £1 for every £12-worth. On the assumption that people live longer than for 12 years after they retire, the scheme saves money. In the case of local government, one of the ways in which changes have been funded is through increasing employee contribution rates.

The Convener: How have they changed?

Chad Dawtry: They have gone up by 0.3 per cent.

The Convener: That is 0.3 per cent from—

Chad Dawtry: In fact, they have gone up by 0.4 per cent, from an average of 5.9 per cent. Under the current scheme, the figure is 6 per cent for most people, and 5 per cent for manual workers. A banded approach will be taken under the new scheme, but it will average out at 6.3 per cent. The average between those figures of 5 per cent and 6 per cent was 5.9 per cent. Hence, there is a 0.4 percentage point increase.

The Convener: To what extent have those changes addressed the other funding issues, such as increased longevity and the poor performance of the stock market?

Chad Dawtry: The stock market is an issue only in relation to local government and the funded scheme—I will return to that in a second—and the other schemes do not have to concern themselves with that so much. As each package of benefits has been agreed, it has been costed by actuaries, and is projected for 50 years. That is where the affordability and sustainability argument is made, and contribution rates are set in line with that. There are triennial or quadrennial valuations, which allow actuaries to check whether the assumptions that they made in the first instance, and the behaviours of people and of the schemes, have been as they expected.

The Convener: So the schemes have a provision built into them for a review of employees' contributions, as a result of the valuations.

Chad Dawtry: Teachers and national health service schemes have introduced potential cost-sharing mechanisms and employers' caps, and there is a commitment to develop a cost-sharing mechanism for the local government scheme. If the valuations show that costs are getting out of kilter, that means in effect that increases in payments for those benefits will be shared between employers and employees. The effect of employers' caps does not apply to local government. Employers' caps go so far—and only so far—for employers and taxpayers, and any additional amount is picked up by the employees themselves.

The Convener: When you say that

"there is a commitment to develop a cost-sharing mechanism",

that means that it has not yet been developed.

Chad Dawtry: That means that a mechanism has not been developed. One of the main reasons is that there are 11 funds in Scotland. The situation is not as straightforward as it would be for an unfunded scheme. The current aim is for that cost-sharing arrangement to be agreed by April 2010, and introduced with effect from April 2011.

The Convener: Is that on the basis of sharing the costs equally between the two partners?

Chad Dawtry: It is to be on the basis of an equitable sharing arrangement. The devil, of course, will be in the detail.

The Convener: As the committee has no further questions, I thank the members of the Scottish Public Pensions Agency for their evidence, which has been helpful, and for coming along.

I welcome our next panel of witnesses: Sir John Butterfill MP, who is the chairman of the trustees of the parliamentary pension scheme at Westminster; and Alun Cairns AM, who is the chairman of the trustees of the National Assembly for Wales pension scheme. Thank you for coming to give us the benefit of your experience.

I will start with one or two questions on governance. What are the main responsibilities and roles of the trustees of your pension schemes?

Sir John Butterfill MP (Parliamentary Contributory Pension Fund): Our main duty is a fiduciary duty to protect the interests of our beneficiaries. We have a secondary duty to consult the scheme sponsor—which, in our case, is the Treasury—and take account of its concerns. In exercising those duties, we have to manage the finances as well as they can be managed, and ensure that the scheme is administered properly.

The Convener: Does that fiduciary duty extend to getting as good a deal for your members as possible?

Sir John Butterfill: The duty is to ensure that the money is well invested and that the members get a decent return, although that is fixed in our case as a percentage of the retirement salary. However, we are also conscious of the fact that we are the custodians of public funds and therefore must ensure, if we can, that there is no wastage of the money that is used to provide the scheme benefits.

Alun Cairns AM (National Assembly for Wales Members' Pension Scheme): I concur with what Sir John has said. I add that we have to act within pensions law, which we take for granted, and ensure through appropriate training that each trustee understands their responsibilities, which Sir John has outlined, so that they can carry them out.

The Convener: In carrying out those responsibilities, what support, advice and training has been available to you? How big a job is it for the trustees?

Sir John Butterfill: In our case, it is quite a large scheme. We look after what was nearly £400 million but which is now, with the changes in the stock market, probably nearer to £350 million. We have to ensure that those whom we employ and the trustees themselves manage that money

professionally, so we have a policy, which we have had for some time, that trustees should undertake training and sit the examinations that the Pensions Management Institute sets. All our trustees go through a training programme when they are appointed and, once they have qualified, are expected to undertake continuing professional development by keeping up with legislation and other trends within the pensions world. They are expected to attend a number of pensions seminars of one sort or another, whether those are on the legal side, the investment side or relating to implementation of legislation. It is expected that all our trustees will have and use such areas of expertise.

15:45

When we started this process, all our trustees sat the examinations: happily, all of them passed. I was rather relieved, as I could not take the exam on the same day as the others, but as they all passed first there was no pressure on the chairman. We regard this as a professional job. In a scheme of this size, we also appoint external advisers, such as an external investment adviser, external lawyers, and external fund managers. We have different fund managers for different areas of investment; for example, we have one set of managers who deal exclusively with bonds, another group who manage hedge funds, a fund of funds manager, equities managers and property managers. We review their performance individually against benchmarks that we and our investment advisers have set.

In addition, we have our own specialist pensions lawyers—they are a division of a larger law firm—and we review their performance periodically. All of those people are subject to review about every three or four years, so they might or might not be reappointed.

The Convener: I will come to Mr Cairns in a minute. It strikes me that the task of your trustees is quite onerous. Do the whips give you an easy time in relation to some of the other potential duties that you might have?

Sir John Butterfill: No, not particularly. It is a very onerous task, and has become much more so in recent years. The Government has been fairly prolific in its legislation on pensions, so we need to keep up to speed on the law. As legislators ourselves, we are conscious that if we do not set an example in scheme fund management, we are letting down Parliament as a whole.

The Convener: Mr Cairns has a younger and smaller scheme. Are the issues relating to that scheme different, or just the same?

Alun Cairns: The issues are different, although the principles are the same, if that makes sense. For example, the latest estimate—which is some three months old—of the fund is that it is in the region of £10 million. Having been formed as a team of trustees in 1999, we had obligations, as we talked about in response to the earlier question. We took the decision that a pooled fund would be the most sensible way of investing. We needed actuarial advice—we considered the potential cost of going out to tender, and the Government actuary acted as a broad adviser on that. We deemed that at that time the Government actuaries would be best value, and could give us advice as we needed it. The formal advice that we get to date comes from the Government actuaries, who not only act as actuaries, but have given us broad guidance in relation to our plan and our strategy.

We have legal advisers—a Cardiff-based law firm that provides specialist pensions advice—who redraft rules; for example, in relation to the latest pensions act. We have fund managers; Baillie Gifford, an Edinburgh-based fund manager, was appointed based on the broad principles that we agreed in discussions with our legal advisers and the Government actuaries. In addition, we have one dedicated member of staff in the fees office who works full time on the Assembly's pension scheme, and we have part-time support from the head of the fees office and from an assistant within the fees office, which is broadly the equivalent of having two full-time members of staff to carry out administrative roles and responsibilities.

The Convener: You mentioned dealing with the recent changes. What sort of consultation do you undertake of your members—paying members and members who are receiving, or deferred members who might be receiving, pensions—when you make such changes?

Alun Cairns: At the outset in 1999, the make-up of the trustees was based on the principle of there being one trustee per party group, with the Deputy Presiding Officer. Members have moved on, changed roles, become ministers and so on, so the make-up of the trustees has moved away slightly from what it was. Until recently, the need to look after the interests of pensioner members was also met by members retiring and losing elections. Our governance has changed so that the rules are now agreed by the Assembly Commission rather than in an Assembly plenary session, and the commission has expressed a desire to go back to the original formal arrangements in which there was one trustee per party group plus the Deputy Presiding Officer. That is, of course, in order, but we must look after the interests of pensioner members. We have therefore drafted rule changes to allow for an election among pensioner members so that there is an additional trustee to look after

their interests. I hope that those changes will be agreed shortly.

The Convener: Is it assumed that people from a party group or pensioners will somehow undertake soundings on changes within the group that they represent?

Alun Cairns: Yes. That has generally been how we have worked. We should bear in mind that the changes relating to the Pensions Act 2004 tended to apply to newly elected Assembly members, rather than to existing members. We have not had to take difficult decisions that would mean that members could find themselves at risk of losing out on the potential benefits that were originally laid out.

Sir John Butterfill: We have not only serving members of Parliament on our board of trustees—we also have at least one pensioner trustee at any given time. Recently, we agreed to take a trustee from the recently formed association of former members of Parliament so that it would be represented, but we have made it clear to them that they are not meant to represent any one particular body of opinion; rather, they have a general overall fiduciary responsibility to the fund. People who come from a different perspective enhance our debates. Of course, the terms of the scheme have not changed—it provides the same benefits that it has always provided. Any major changes to our scheme would require statutory action by order under the Parliamentary and other Pensions Act 1987, by whose terms we are governed. We have had to amend that act from time to time—in fact, it needed to be amended following the passing of the Pensions Act 2004. We would go through that process and then proposals could be debated in the House of Commons.

The Convener: What process is followed when the trustees decide that a change is required? Do you go to the Leader of the House of Commons and say, "Look, we need some time for this statutory instrument"?

Sir John Butterfill: Yes. Normally, we would consult the Leader of the House of Commons on changes that we think are necessary, and we would work on that through the Cabinet Office and with the Treasury, if necessary. On reaching agreement, our lawyers would then be involved with the Government's lawyers in producing an amendment to be put forward by way of an order.

Alun Cairns: Before the Government of Wales Act 2006, which separated the Executive from the Assembly, our pension trustees effectively decided on changes to the rules, based on consultation with each party grouping and supported by the House Committee. Any rule changes would then be presented to the full Assembly to be voted on. That gave the trustees significant autonomy to act as they thought fit. However, the request to change the membership of the trustees in order to look after the interests of pensioner trustees has come from the Assembly Commission. We would need to present our argument to the Assembly Commission, which would accept or reject it. In theory there is probably no difference, but in practice there is, because parties tend to be far more strongly represented on the commission than in the Assembly.

The Convener: Is there any evidence so far that the change has influenced decisions relating to pensions?

Alun Cairns: I can give you only one example. There was a wish to amend the membership of the trustees to bring it more up to date and to ensure that the majority of trustees are current members of the Assembly. Arguably, that is unnecessary, but there will now be a minor rule change to accommodate the request.

Hugh O'Donnell: For clarity, how many members of Parliament and Assembly members are trustees?

Sir John Butterfill: Our trustee board includes about eight members.

Alun Cairns: Four of our trustees are members.

Hugh O'Donnell: Could you tell us in more detail how they were elected or appointed? Was that done within the party system or by an open ballot? How did they come to be there? Were they appointed?

Sir John Butterfill: We proceed through the usual channels. I put the names forward, although it is possible for members to lobby for someone else to be appointed. The Association of Former Members of Parliament lobbied hard to be allowed to put someone forward. We were happy with the name that it put forward and were pleased to accept its request. An order to that effect duly went through.

Alun Cairns: Until recently, the party groups decided who should be appointed. Broadly, that is still the case, although who the trustees should be is now agreed with the commission, on a cross-party basis.

Hugh O'Donnell: You are responsible for schemes of different sizes and scales. What expenses do the trustees incur in managing the fund?

Sir John Butterfill: Ours are pretty significant, but they are reasonable as a proportion of the funds that we manage. We regularly make comparisons with external schemes to ensure both that we are not overspending and that we are not failing to cover matters that we should. For

example, I have joined PensionChair, an organisation comprising the chairmen of trustees of most of the major pension funds in the United Kingdom. We meet regularly to discuss current topics and how we are dealing with them.

PensionChair also provides a consultancy, so that if a member of the organisation has a problem and wants to know how other people are dealing with it, it can be put out on a named or anonymous basis to the whole membership of PensionChair, which will respond. That is a helpful means of consultation that enables us to know that we are not out of step with what is happening elsewhere. It may also help us to discover problems that we did not know we had, because when an issue is raised we have to ask ourselves what we are doing about it, which is useful. We have an arrangement with PensionChair that allows another senior trustee or, on occasion, our head of pensions to go to meetings in my place when I am unable to attend.

Hugh O'Donnell: Is the cost incurred a matter of public record?

Sir John Butterfill: Yes. Everything is set out in our annual report and accounts.

16:00

Alun Cairns: Although I am not familiar with the detail of the parliamentary scheme, it is fair to say that our costs are significantly lower, because of the make-up of our scheme. I mentioned the two full-time equivalent staff in the fees office who are employed by the scheme. There are also the costs of our expert advisers. Whenever the Government actuary joins us to give us broad advice, the standard costs apply. Actuarial costs are significant in the scheme of things, because our general costs are quite low. Whenever actuaries provide a review or a service, the cost that is incurred is significant in comparison with our other costs. We also pay for legal advice from our lawyers. As a result, we tend to manage and to invite actuaries and lawyers only to trustee meetings at which they are needed. However, we have at least one meeting a year at which everyone is present, to ensure that any adviser who wants to can bring something to our attention.

The other cost is from training. We have not followed the professional qualifications that Sir John Butterfill spoke about, but we asked the actuaries and our legal advisers to provide as they saw fit bespoke training that was needed.

Hugh O'Donnell: I move on to trustees' responsibilities. What decisions do trustees make about investment policy? Are those decisions founded entirely on the professional advice that is given, or are trustees at liberty to put that to one side if they do not want to go down that road?

You will be aware of all sorts of funding fluctuations in recent years that have had an impact on the viability of funds. If they have had an impact on your funds, how have they been handled?

Sir John Butterfill: We have professional investment advisers in addition to fund managers. They advise us on the level of funding that is required, although we use the Government Actuary's Department too, by statute. We do not slavishly follow the advice that is given. For example, as a fund becomes more mature—when it has more pensioner members than active members—it is normal for the character of the investment portfolio to change. If members are predominantly active, a fund probably invests more in equities or property. As a scheme becomes more mature, the proportion of bonds and more secure investments gradually increases.

I suppose that we are in an unusual position, because we probably have a better guarantee than most external employers' schemes, so we can be a little more adventurous than we might be if we ran an equivalent fund in the private sector. However, we must agree all of that. We agree our investment strategy with the Leader of the House and the Treasury. Some years ago, the Treasury pushed us quite hard to go much more heavily into bonds, but we resisted that. We accepted that we needed to alter the portfolio to an extent, as the scheme became more mature, but when bonds were at an all-time expensive level and equities were on the floor, we did not think that it was a good idea to sell equities to buy bonds. We said that we would examine that over three years, but we did little about it. That proved to be a good decision, because the equity market improved and the bond market did not. We have that ability, but we must justify our decisions to the scheme's sponsor.

Alun Cairns: Obviously, when our scheme was formed, it started with a zero balance, so a pooled fund was the most effective and efficient form of investment. Now that we have reached £10 million, many more options are available. The pooled fund that we used is one reason why our costs were low—that relates to the previous question.

Because of the pooled fund, we have not used independent financial advisers, although we have considered that. We were approached by some people and some others were not absolutely satisfied with the investment performance over a certain period, so we looked a lot more closely at the performance of the fund vis-à-vis the rest of the market. Consideration is still being given to calling on external advice, but until now we have been using the Government actuaries to tell us

whether our decision to stay with the fund is justified.

We have decided to hold a lot more in cash than we normally would because the market has been somewhat turbulent of late. It was intended to invest that cash in various vehicles depending on the advice that we received, but the market then became even more turbulent after the sub-prime mortgage crisis in the United States. We are still considering the sort of advice we need, and we are probably still holding more cash than we need. The decision is actively being considered at the moment.

Hugh O'Donnell: Thank you.

Peter Peacock: Mr Cairns, you indicated that you depend on the Government actuaries. I am less clear about the system in London, Sir John. Am I right that, although you take advice from Government actuaries, you also have your own completely independent actuaries? If so, why have you taken that approach?

Sir John Butterfill: We have not. By statute, our only actuary is the Government Actuary's Department. Some of our investment advisers also have in-house actuarial expertise, which they may draw on in the investment advice that they give, but actuarial approval has to come from the Government actuary.

There was a time when that was set in stone, but in the new climate we could decide to go outside for actuarial advice. That would need an order to go through the House, and we would have to be pretty unsatisfied with the Government actuary's performance. It has not always been as good as we would have liked and on occasion we have criticised it. On balance, we see no real need to change at the moment, although we could if we wanted to.

Hugh O'Donnell: This is perhaps a hardball question: of the major issues that you have faced in carrying out your responsibilities as trustees, what has been the one that has come out of left field and caused unanticipated difficulty?

Sir John Butterfill: I cannot think of one, although we have recently had to deal with all sorts of changes. For example, the introduction of civil partnerships has required rule changes and adaptation, which have involved additional costs and will do so on an on-going basis. For example, death-in-service benefits now apply to civil partners whereas they previously applied only to spouses.

We are currently dealing with the question of ill-health retirement, which I heard your previous witnesses speak about. We are unhappy with the present system, which is all or nothing—someone is either fit or not—and we intend to move to a system in which the requirements for granting full early retirement are somewhat tougher but there are probably one or possibly two stages below that. We are in consultation on that with the Leader of the House.

The Leader of the House agrees with our proposals, and the Government actuary estimates that it will save us about 0.4 per cent in the wages bill, which is not inconsiderable. It will probably enable us to deal with another problem that has beset us: retained benefits. That has been a contentious issue. The Government legislated on retained benefits in the Finance Act 2004, and retained benefits are no longer a statutory requirement. However, to abandon the retained benefits regime would have a significant cost for our scheme. The Government Actuary's Department reckons that the cost would probably be about 0.4 or 0.5 per cent—about the same as the expected savings on the changes in relation to early retirement. The Government is offering a trade-off: if we go ahead with one change it will accept the other. In the long term it will do well out of the deal, because retained benefits will fall away over the years and we will not need to operate a retained benefits regime in future.

We have had many problems with guaranteed minimum pensions, on which we were given wrong advice by HM Revenue and Customs, the national insurance contributions office, the Government's lawyers and our lawyers. There is a mess, which we are sorting out. Of course, the GMP regime has been changed by the Government, so the same problems should not arise in future. However, I flag the issue up for the committee's careful consideration in relation to the Scottish parliamentary pension scheme.

Alun Cairns: I think that it was the Auditor General for Wales who recommended early that we follow the parliamentary scheme as closely as possible, for administrative purposes and for simplicity. Since then, we have largely been pragmatic; when there has been a need for changes in the pension rules we have made them.

An example that comes to mind is what happened when the widow of a late member became a member of the Assembly, so a beneficiary of the scheme became a contributor. The pension rules did not allow that and needed to be changed. Those are unique circumstances—they might not be unique, because there is another husband-and-wife partnership in the Assembly. In such unusual circumstances, which we would not come across every day, we try to leave as much discretion as possible to the trustees. Because ours is not a standard scheme, the lawyers often say that their advice to us is different from the advice that they would give to trustees of another pension scheme. In the

example that I gave, we used as much discretion as possible to accommodate the situation sensibly, so that there were no particular advantages or costs for anyone. We approached the problem in a pragmatic way, which made sense for the taxpayer and the individual.

Another issue that has crossed our desks, although it has not done so for some time, which could have blown up into a large debate, is ethical investments. The issue raises the question of what is ethical. We go by the statement of investor principles, which says that we must act in the best interests of members, with an eye on ethical issues—I paraphrase loosely, but I can send members the statement. I am thankful that we have not got down to debating which companies we would expect the pooled fund to invest in.

David McLetchie: New pensions legislation has driven a number of rule changes in recent years, some of which related to governance and some to a desire to liberalise or simplify the complex rules that govern pension schemes, tax relief and so on. To what extent have funding and affordability issues driven change? Sir John Butterfill talked about changes to ill-health retirement benefits, which I presume are being driven less by the rules than by questions about affordability. Have other benefits in your scheme given rise to similar concern about affordability or justifiability?

Sir John Butterfill: Yes. Trustees have been conscious of their duty to the public in the administration of funds. We have considered at our own instigation early retirement and the public sector transfer club, which was imposing a heavy burden on our scheme, because people could transfer in from, for example, modestly paid local authority employment and get the years that they had worked expressed as payments into our scheme. The cost to the scheme was considerable.

16:15

We have now abandoned that, for two reasons. One was the cost. The other was that we thought that it was inequitable for the people who were transferring in from the private sector to get only what the transferred sum of money would buy, whereas those who transferred in from the public sector were getting a huge increase in the total value of their pension pot. The two are now on a par, which I think is morally and ethically correct. We have been considering that, and we have also considered ways to protect the public purse. We would constantly seek to do that.

I will make a recommendation to the committee, although it is more difficult with a small scheme. I will start with some background. When I first became a trustee, there was no professional pensions expertise in the fees office and the whole scheme was managed by civil servants in that office. They were very good, although they did not have any pensions qualifications. They were doing the administration of the scheme, as well as examining how it was run. We outsourced the administration, which I think was a good thing to do. That has not proved any more expensive. In fact, according to our analysis, we saved money by outsourcing the scheme's administration, compared with what we were paying to members of the fees office.

I have insisted that we have professionally qualified pensions people in the residual area of the pensions department in the fees office. I suggest that that is very important. Unless you have a pensions professional, like our head of pensions, who attends all the trustees meetings, you will not always know the right questions to ask of those to whom you have outsourced administration, investment advice, legal advice or whatever. To have a really well-qualified person in that field is very important. I think that, in the long term, it saves money.

Alun Cairns: The rule changes that we made as the result of the most recent pensions legislation were broadly cost neutral. For example, the enhancement of the death-in-service benefit, which was because of a rule change, was financed by drawbacks or withdrawal of enhancements elsewhere. To the taxpayer, those changes were broadly neutral.

There was, however, a cost in one area, when the scheme's accrual rate changed from fiftieths to fortieths. That was borne by members of the Assembly. The choice was given to each individual member. Some members are running on the scheme of fiftieths; some are running on the scheme of fortieths. From my recollection, the vast majority of AMs are on the scheme of fortieths.

David McLetchie: Can members elect either to go on to a fortieths funding basis or to remain on a fiftieths basis?

Alun Cairns: Yes.

David McLetchie: In your scheme, that change was fully funded by members by their electing to pay higher contributions.

Alun Cairns: Yes.

David McLetchie: So there was no additional cost to the public purse; the cost was borne by contributing members. Was that the same at the House of Commons, Sir John?

Sir John Butterfill: Yes. Initially, the Government actuary calculated that it might cost a little more than a 10 per cent contribution from members in total, but his view now is that the cost is more than covered. The reason for the element

of uncertainty was that we did not know how many members would opt for the higher contribution level and the improved accrual rate. We also did not know how many would be affected by retained benefits and would therefore be unable to benefit from a higher accrual rate because they were already up against the limits imposed by the retained benefits regime. Indeed, it is important that you are aware, as far as you can be, of the extent to which your members have retained benefits, otherwise they might contribute to a scheme from which they are unable to benefit, and they might seek to sue you.

When we made the change to the one fortieth accrual rate, we sent round a questionnaire that included a question on whether members had retained benefits and, if so, whether they realised that that might affect their eligibility. We also said that they must take independent advice. I think that we sent out five such notices to our members, and the response rate was only 50 per cent. Some of them have since taken us to the pensions ombudsman for not telling them that they should not have taken up the different accrual rate. They have lost, but it shows that you have to be careful to ask all the questions when you make such a change. You must ensure that members are aware of the consequences and, most important, that you tell them that they must take independent advice. You must never give advice. You can tell them of the dangers and pitfalls that lurk, but you must then tell people to take their own advice. It is unlawful to give advice.

David McLetchie: Do you have a panel of advisers as an information service?

Sir John Butterfill: No, and you must not. If you do, you influence the advice that members are given. You can give them the address of the Association of Independent Financial Advisers and say that it can recommend someone who might be suitable for their case.

Alun Cairns: The change was far more manageable in our scheme. With only 60 Assembly members—although there were some changes because of elections—it was easy to contact each individual member, make available the figures that would allow for a calculation to be made, and suggest that they seek independent advice.

David McLetchie: Is there an official member of staff in the Assembly, as Sir John has in the House of Commons, who is a pensions adviser to the trustees and who liaises with members, extracts information and explains what happens?

Alun Cairns: Yes. Someone works in the fees office full time on pension matters. He has come from the industry, and he advises the trustees. He is also a sounding board for members should they have factual questions on the transfer in, the processes and so on.

David McLetchie: So he does not provide advice about the desirability of courses of action; he provides clear information and explains how the system works, perhaps relative to what people had in previous employment.

Alun Cairns: Yes.

David McLetchie: You both mentioned changes to your schemes based on the establishment of civil partnerships. What rules do you have on informal partnerships—unmarried partners, whether they are heterosexual or homosexual? What benefits does an unmarried partner have, how do they qualify for them, and how is that verified or established?

Sir John Butterfill: Partners do not qualify unless they are in a civil partnership. Once they are in a civil partnership, they qualify.

Alun Cairns: Our rules are different. This was one of the early rule changes that the trustees brought about as a result of requests from members. It was felt that people in same-sex partnerships were disadvantaged because of how the rules were originally written, so amendments were made. I cannot remember the exact wording, but I can arrange for it to be forwarded to the clerk. It was the best stab that we could make, based on industry practice for people in relationships.

David McLetchie: Whether they were same-sex relationships or heterosexual relationships.

Alun Cairns: Yes.

David McLetchie: For clarification, Sir John, can you confirm that to benefit from the House of Commons scheme a person must be married or in a civil partnership?

Sir John Butterfill: I will double check whether there is any way in which any part of the benefits can accrue to a partner in an informal relationship. I do not think that there is, but I will come back to the committee on that. The great difficulty is establishing criteria for such relationships.

David McLetchie: I explored with the previous witnesses the objectivity that applies in determining the criteria in such cases. It would help us if you could come back to the committee on that.

Sir John Butterfill: I will do so.

Alun Cairns: The issue brings us back to my point about the trustees having significant discretion to make judgments, according to the criteria that have been set.

Peter Peacock: Further to David McLetchie's questions, does the option of paying a higher

contribution in order to go to a one fortieth accrual rate endure for members throughout their life in the scheme, or do you end the option of having a one fiftieth accrual rate? Do members continue to have a choice?

Sir John Butterfill: On joining, our members must elect. Their election is irrevocable.

Peter Peacock: Do they continue to have the right to elect in future sessions of Parliament?

Sir John Butterfill: No, they make a once-and-for-all election. They cannot change.

Peter Peacock: I understand. If I were to join the Westminster scheme in 10 years' time—I am not planning to do so—would I be allowed to elect for fortieths or fiftieths?

Sir John Butterfill: You would.

Discussion is going on with the Government, in the context of retained benefits, about whether we can allow people who elected for fortieths under a misapprehension to change. When those people were forced to make their election, the Government's stated intention was to legislate on retained benefits. It was well known in tax and accountancy circles that the Government was intending to change the law—it did so in the Finance Act 2004.

Some people who had retained benefits were advised that because the regime was going to be abolished, they might as well go for fortieths. The Government altered the law omissively, but did not alter the rules of our scheme. Many people think that they were unfairly brought into a regime from which they cannot profit. Following a recommendation from the Review Body on Senior Salaries—the senior salaries review body—in its most recent report, that people ought to be able to change, the Government is considering whether they can change and, if so, on what terms.

Alun Cairns: The situation for members of our scheme is similar to the situation in Westminster. There is a one-off decision. However, if someone made a decision when all the facts were not available, I am sure that the trustees would have discretion to consider their case. For administrative purposes, as well as for every other purpose, and to maintain low running costs of the scheme, it was deemed that there should be a one-off decision.

Peter Peacock: Thank you. I will move on.

The witnesses heard from the previous panel some of the evidence on early retirement. Mr Cairns, you mentioned that your advisers acknowledge that to be a parliamentarian is to be in an occupation that is different from many occupations, because we are not in control of our destiny. There are a variety of reasons why a parliamentarian might leave the Parliament: they might be deselected, they might lose their seat, they might lose ranking in a regional list, or the Boundary Commission for Scotland might do away with their seat altogether. In such circumstances, parliamentarians find that they are no longer employed.

I think that I am correct in saying that both the Westminster and the Welsh schemes have maintained the 15-year qualification period before a person can take their pension. Did you consider alternative approaches, for example reducing the number of years? A 54-year-old member who transferred their teachers pension into the scheme but then lost their seat after 14 years' service might feel a bit aggrieved that they could not access their own money because they failed to qualify by one year. Did you consider the qualification criteria? Why did you stick with the criteria that you have? Will you continue to maintain them?

16:30

Sir John Butterfill: No, I do not think that there is any suggestion of our making any changes. Indeed, we have toughened up our scheme. One of the ways in which we have made savings comes into effect from next year. We have made it that, if somebody takes early retirement, before the age of 65, they will suffer a diminution in their pension. Previously, provided that they could satisfy the 15-year rule and the rule of 80, people could retire without penalty at the age of 60. To reduce the costs of the scheme and to make it fairer in relation to what most people outside the public sector are having to put up with, members will now suffer a diminution if they go before the age of 65. We have done that by creating a gradient. People will not suddenly fall off the edge as from next year: the change will be phased in over a certain period. I cannot remember how long it is, but I think that the phase-in of the new arrangements will take five or six years. There will certainly be a diminution of some sort if people retire before 65, as from next year.

The Convener: If there is going to be a diminution of that kind, particularly if it is eventually to be actuarially based, is there any reason to have a requirement for a minimum number of years' service? Effectively, people will get only what they and their employers have paid for during their period of service.

Sir John Butterfill: No, that is not quite right. There will still be an element of benefit, certainly during the transitional period.

The Convener: But once the transitional period is over, and the diminution is actuarially based, will

the argument for the 15-year period fall away somewhat?

Sir John Butterfill: We might consider that when we are faced with that situation but, at the moment, we are not inclined to do so.

Peter Peacock: When you reviewed your scheme in Wales, Mr Cairns, were there similar considerations to those that Sir John has outlined?

Alun Cairns: It is fair to say that the 15-year rule is under consideration. The broad principle that we try to apply with this sort of change is that there should be as much flexibility as possible for members, but at no disadvantage or cost to the taxpayer. If something can be justified actuarially, with absolutely no cost to the fund, as trustees we generally support it in principle. Clearly, however, it must come under the pensions acts and regulations.

Peter Peacock: Some members may choose to change their lifestyle and opt for early retirement, but are most cases of early retirement at Westminster and in the Welsh Assembly due to boundary changes, the loss of seats or deselection by one's party? Can both of you give me a feel for that balance? What gives rise to most early retirement requests?

Sir John Butterfill: I think that it is about 50:50. We do not have a list system, so members do not face the same risk of being deselected by their party, unless they do something extremely naughty. [*Laughter.*]

The Convener: We will not ask you to go into that.

Hugh O'Donnell: We will not ask for examples.

Peter Peacock: We move on quickly to Mr Cairns.

Alun Cairns: Bearing in mind the fact that we have had only three elections, the general reason why people take early retirement is that they have lost their seat. However, some members have taken early retirement because the experience has not quite lived up to their expectations, or they have had something else more interesting to do.

Peter Peacock: I will move on to the subject of ill-health retirement. Sir John, you referred to the difficulties around this area, and you have said that you are seeking to review the arrangements. Could you expand on your thinking, and on what gives rise to it? Ill health is a difficult area to make judgments on.

Sir John Butterfill: At the moment, the trustees are bound by a rule that says that, if somebody can show that they are no longer well enough in whatever way to continue as a member of Parliament and that they are not likely to have much earning potential outside, they can receive a full pension up to what they would receive if they stayed an MP until they were 65. I would not say that there has been substantial abuse, but we think that the scheme has been extremely generous in some cases in which medical advisers have been unduly lenient in interpreting the rules.

We should bear in mind the fact that there are blind members of Parliament—indeed, we had a blind Home Secretary until not long ago—and several who are in wheelchairs but who continue to work. I think that the level of disability needs to be graduated in terms of eligibility for early retirement due to ill health.

We would not in any way want to resile from paying a pension when somebody was clearly totally incapable of working in the future—because of some terrible brain damage or other disability, for example. We would not find paying in such cases a problem. People with terminal and degenerative illnesses are not an issue for the pension scheme. Other areas are much greyer, and we will certainly look for a change in the rules to enable us to be more flexible in our interpretation. We will need to do that in a way that is defensible. Otherwise, all that we will do is open up a legal nightmare for ourselves and possible references to the pensions ombudsman or the courts.

We will want to establish some criteria, but we may have one or even two tiers below the full element. Someone who, because of their disability, could work but could not possibly earn as much as they were earning as an MP would be in one category; somebody who could earn a bit but not quite as much would be in another category; and somebody who could not earn at all would be in the full category. We are discussing that idea with the Cabinet Office.

Peter Peacock: Are you seeking to gain for the trustees discretion to allocate people to the different categories, based on medical advice and in a defensible way?

Sir John Butterfill: The criteria would have to be defensible.

Peter Peacock: Indeed, but we are discussing essentially a discretion that the trustees would exercise on a case-by-case basis, subject to medical advice.

Sir John Butterfill: That is correct.

Peter Peacock: Mr Cairns, will you outline the situation in Wales?

Alun Cairns: We have our own medical advisers, whom we commission to conduct assessments. They advise us on the criterion of ill health and whether somebody is sufficiently ill not to be able to do their job as an Assembly member—that is the definition that we use. Our

advisers usually come back with a suggestion of a review in three years, five years and then five or 10 years thereafter, and we have always followed their suggestions. In one case, when the advice was that there was no need for a review, the decision was taken still to have a review in three years and then five years. We have been through some reviews, and each has come back stating that the person involved was not sufficiently well to do their job as an Assembly member.

Peter Peacock: I want to develop the point further. Sir John, you referred earlier to the degree of leniency or toughness of the medical advice that you receive. It is clearly of greater cost to the pension scheme when somebody retires on the ground of ill health than when they opt for early retirement. However, is there any relationship between those two factors? This might be a spurious contention but, depending on how tough the early retirement provision is, might you see a greater incidence of more lenient medical advice?

Sir John Butterfill: No, I do not think so. We have our own advisers and have indicated to them that the rules should be interpreted firmly. With medics, there is always a danger that they are sympathetic to the person who comes to see them, and that is not what they are being asked to do.

Peter Peacock: If it is one's own GP, that is fair enough, but I take the point that you make.

Sir John Butterfill: We make it clear to them that they are being asked to exercise their professional judgment. For example, if there was a three-tier system, we would ask them into which tier they would allocate the person concerned. It is easier for us to defend the decision in the event of a challenge if we can say that the category into which the people fall and, therefore, the level of support that they will get are determined by independent medical advice that we have taken. The decision must be defensible.

Peter Peacock: Do you have any thoughts on those points, Mr Cairns?

Alun Cairns: No. The trustees have discussed the matter, but have not yet decided on any clear way forward if we want to bring about any changes. We are reasonably satisfied with the system that is in place at the moment, but it is always subject to potential review.

Peter Peacock: Thank you. That covers my points well.

The Convener: We will move on to the senior salaries review body's recommendations. The previous witnesses talked about cost sharing. What discussions have the witnesses had on that and how might it work out in future?

Sir John Butterfill: We have not had any formal discussions with the Government yet, but the SSRB suggested that we might consider alternatives to the present arrangements and determine how they could work.

There are all sorts of graduations in how alternatives might be implemented. One of the SSRB's suggestions was that we could consider moving in the future to a lifetime average salary pension scheme, as some of the civil service schemes have done. That would not make a big difference to our scheme—or to yours, I suspect—because, although we are told that we have a final salary scheme, we actually have a basic salary scheme. That is not well understood. Whether they have been ministers or not, members retire on a percentage of the salary of the humblest back bencher.

If a member who has been a minister made additional contributions while they were a minister, that is reflected in a formula that, in effect, buys additional years for the additional contributions that they have made, so they get to their full entitlement earlier, but they do not get a larger-than-full pension. Even the Chancellor of the Exchequer eventually gets a pension that is based on the salary of a back bencher. The only way in which that can be enhanced under the present rules of our scheme is if the member continues after the age of 65 and resumes making contributions. If a member gets to the maximum level before the age of 65, contributions have to cease but, uniquely in our scheme, if they continue after 65, they can resume making contributions without limit. It is not common—not many members do it—but it is technically possible.

The point that I am making is that, as shown by the graph that you probably saw in the SSRB's report, a lifetime average salary scheme is fairly flat and would not make a big difference to our existing arrangements, so we do not think that it is much of a runner. The other possibility would be for us to close the scheme to new entrants and move to a defined contribution scheme for new members. We are prepared to consider that. It is not as attractive as it first appears because there are significant costs in moving to a DC scheme. You run out of new active members, so your run-off is greater and therefore your contributions to service those who are in the old scheme actually increase. There is a cost in moving to a DC scheme that is quite separate from the administrative costs.

16:45

The other problem in moving to a DC scheme is that it creates two classes of members, with benefits of different values. Depending on what the Government, the employer and the individual

contribute, the SSRB might say that those in a DC scheme have a less attractive scheme, so they should get a higher salary. The SSRB currently states that it takes all the benefits into account in deciding what members' salaries should be. Therefore, you might get a two-tier salary arrangement, which would be difficult administratively and which could be quite expensive and lead to resentment.

The only other possibility is to put a cap on contributions. The Government has suggested that it might be interested in pursuing an arrangement whereby there was a cap on its contribution of 20 per cent of salary, and if members wanted something better than that would buy, they would have to increase their contributions. Similarly, if scheme benefits were enhanced, that could be done only at a cost to members and not at a cost to the sponsor.

We could look at such things. In the private sector, a cap is becoming increasingly common, although it generally operates on the basis that, if costs rise, they will be shared between the sponsor and the members and beneficiaries, which is usually done in proportion to their existing contributions. In our case, the ratio would be, roughly, 20:10, if the Government got to 20 per cent—it is not at 20 per cent at the moment. The Government's nominal contributions are above that, but that is only to make up for the deficit arising out of the contributions holidays that it took over a period of 14 or 15 years. Instead of making up the deficit in one lump sum, the Government is making it up over 15 years again.

Alun Cairns: I have not looked at the SSRB report in detail, although in the next few days an independent commission is due to report on Assembly members' salaries, as a result of the change in powers that we inherited last May. The commission has not sought evidence from me, as the chairman of the trustees, although I hoped that it would if it intended to report on the Assembly members' pension scheme. Obviously, I will look with interest at what comments—if any—the commission comes out with.

When you consider the scale of our scheme as it stands and the broad principle that any additional changes, such as when we moved from fiftieths to fortieths, should be borne by members, it can be seen that it has no additional cost to the taxpayer and that it achieves the greatest flexibility. We would consider any changes that were called for by Assembly members or members of the public in line with that approach.

The Convener: The final thing that I want to cover, since we are dealing with it as well, is the resettlement grant. The SSRB made certain recommendations for changes to that for members who stand down at elections. Do you think that the proposals are fair, sensible and workable?

Sir John Butterfill: I do not think that the Government is likely to implement them, but I am not sure.

The Convener: Is that because they probably would not work or because they are not fair?

Sir John Butterfill: I think that the Government thinks the uncertainties that exist in the profession in which we are engaged are bad enough to warrant some form of resettlement grant.

The Convener: What is the position in Wales, Mr Cairns?

Alun Cairns: The position in Wales is similar to the position in the House of Commons. There is a scale for the size of the resettlement grant—it depends on how long someone has been a member. There have been no changes thus far on that issue, although the independent commission may well comment on it. The commission is conducting a two-stage review. The first stage is looking at the responsibilities of an Assembly member vis-à-vis the role of a member of the Westminster Parliament. We are currently paid 76 or 76.5 per cent of what a member of the Westminster Parliament is paid. Members of the Northern Ireland Assembly are paid 82 per cent of the Westminster salary, and there have been reports that that might go up to 84 per cent.

The second stage will make recommendations on allowances and, I suspect—as I said, I have not been called to give evidence, although I hoped that the commission would ask me for evidence—pension contributions, benefits and resettlement grants.

The Convener: Sir John, you talked about the nominal 20 per cent that the Treasury was or was not paying. Is the nominal figure based on the actuarial valuation of what should be paid, or is that just a historical figure?

Sir John Butterfill: The figure was somewhat under 18 per cent, which was what the Government actuary recommended as being the appropriate contribution for the sponsor. At each revaluation, the Government actuary says what he thinks the contributions ought to be. However, the fact is that successive Governments did not make those contributions, partly because the scheme was initially overfunded, but also because tax legislation at the time—although we are not, strictly speaking, affected by it—did not allow for the overfunding of schemes. Therefore, employers had to stop making contributions once schemes reached a certain level, which I think was 105 per cent.

Those contributions stopped, therefore, under the last Conservative Government, and the

contribution reduction continued for some years under that Government. The present Government continued the reduction, although the justification for it had fallen away, in that the scheme was no longer in surplus; in fact, the contributions should have been made, but were not. The present deficit is about £49 million, which is more than wholly accounted for by the failure of the Government to make the recommended contributions.

The Convener: Thank you. My colleagues have no further questions, so I thank Sir John Butterfill and Alun Cairns for giving evidence. Their evidence was succinct and will be very helpful to us in our deliberations. I hope that they have enjoyed their brief trip up to Scotland and that we will see them again.

Sir John Butterfill: Thank you, convener—it was too brief.

The Convener: We agreed at our previous meeting to take in private our consideration of the evidence.

16:52

Meeting continued in private until 17:09.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice at the Document Supply Centre.

No proofs of the *Official Report* can be supplied. Members who want to suggest corrections for the archive edition should mark them clearly in the daily edition, and send it to the Official Report, Scottish Parliament, Edinburgh EH99 1SP. Suggested corrections in any other form cannot be accepted.

The deadline for corrections to this edition is:

Monday 10 March 2008

PRICES AND SUBSCRIPTION RATES

OFFICIAL REPORT daily editions

Single copies: £5.00
Meetings of the Parliament annual subscriptions: £350.00

The archive edition of the *Official Report* of meetings of the Parliament, written answers and public meetings of committees will be published on CD-ROM.

WRITTEN ANSWERS TO PARLIAMENTARY QUESTIONS weekly compilation

Single copies: £3.75
Annual subscriptions: £150.00

Standing orders will be accepted at Document Supply.

Published in Edinburgh by RR Donnelley and available from:

Blackwell's Bookshop

53 South Bridge
Edinburgh EH1 1YS
0131 622 8222

Blackwell's Bookshops:
243-244 High Holborn
London WC1 7DZ
Tel 020 7831 9501

All trade orders for Scottish Parliament documents should be placed through Blackwell's Edinburgh.

Blackwell's Scottish Parliament Documentation Helpline may be able to assist with additional information on publications of or about the Scottish Parliament, their availability and cost:

Telephone orders and inquiries
0131 622 8283 or
0131 622 8258

Fax orders
0131 557 8149

E-mail orders
business.edinburgh@blackwell.co.uk

Subscriptions & Standing Orders
business.edinburgh@blackwell.co.uk

Scottish Parliament

RNID Typetalk calls welcome on
18001 0131 348 5000
Textphone 0845 270 0152

sp.info@scottish.parliament.uk

All documents are available on the Scottish Parliament website at:

www.scottish.parliament.uk

Accredited Agents
(see Yellow Pages)

and through good booksellers

Printed in Scotland by RR Donnelley