Briefing Note: Reform of local government exit pay

- **This Briefing Note is relevant for Councils, Police and Fire Authorities, Academies and some Colleges. We do not expect Admission Bodies to be affected by this change to Regulations.**
- Our examples in this Briefing Note suggest that the reforms may significantly reduce the value of exit packages for English & Welsh LGPS members working for the affected employers (not just high earners) who are made redundant from age 55. Employees will face difficult choices between pension and cash.
- Any employers that are considering early retirement and redundancy exercises should consider these impending reforms. Some of these changes, regarding the "£95k cap" (see page 6 onwards), are expected to come into force in early November. However further uncertainty is created by the gap between the legislation on the £95k cap and the changes required to LGPS Regulation in order to accommodate it.
- The wider exit payment reform proposals being consulted on at the moment (see page 2 onwards) will affect members taking early retirement for redundancy/business efficiency reasons, regardless of the size of their exit package. There is much uncertainty about the timing, member communications and practical processes of all these.

On 7 September 2020, MHCLG published a consultation on restricting exit payments in local government in England and Wales. The consultation goes wider than delivering the government's previously stated aim of ensuring that no public sector workers will receive a 6-figure severance package; these proposals will affect all local government workers who are retiring from age 55 on redundancy or efficiency grounds. Our 60 Second Summary provides further detail about the consultation.

The purpose of this Briefing Note is to explore some worked examples to demonstrate the 'before and after' impact of the reforms on employees, and the new options that will be available post reform. The examples are illustrative only and are based on our current understanding of the government's intentions as set out in the consultation document. The scenarios shown should not be relied upon for retirement planning and may not reflect the reality of legislation and/or GAD guidance when they are finalised.

Note on legislation quoted and expressions used

The Compensation Regulations referred to are The Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006 available here. NB these regulations are due to be replaced following the end of this consultation.

The Restriction of Public Sector Exit Payments Regulations 2020 Introduce the £95k cap and can be found here**.** These regulations come into force 21 days after they're 'made' which at the time of writing is expected to be mid-October 2020, thus implying an effective date of early November 2020.

Pension Strain refers to the additional cost of paying LGPS benefits before Normal Pension Age with no (or with a lesser) reduction. For the purposes of this reform, this strain needs to be calculated by GAD: we have reviewed their draft factors and guidance and these appear to give pension strain amounts not too dissimilar to the amounts we see for most funds at present.

Statutory Redundancy Payment refers to the minimum redundancy amount that must be paid under the Employment Rights Act 1996

Discretionary Compensation refers to any payment made under the replacement to the Compensation Regulations that is in excess of the statutory redundancy limit.

Exit payment reform

Who is affected?

English & Welsh employers covered in an as-yet-to-be published set of updated compensation regulations. Based on the current (out of date) Compensation Regulations that will be;

- Council workers
- Police and fire civilians
- Academies (possibly)
- FE and HE colleges (possibly)

What does it mean?

Currently a worker retiring from the LGPS on redundancy grounds from age 55 will typically get;

- Immediate payment of LGPS benefits unreduced
- Statutory redundancy payment
- Discretionary compensation (decided by their employer based on limits within the Compensation Regulations)

Paying benefits early and unreduced creates a pension strain that the employer must pay.

The proposal is that from now on an employee aged 55 or over would not be able to get both an unreduced pension and redundancy payment (whether statutory or discretionary). This is because:

- In order to receive an unreduced pension, the member must make a payment towards the pension strain, equal to their statutory redundancy payment, thus in effect giving up their SRP (although technically the SRP must be paid).
- The proposals explicitly state that if pension is being paid immediately but not fully reduced then the employer may not arrange for any discretionary compensation.

Example 1 (typical case where discretionary compensation < strain cost)

Full strain cost = £50k

Statutory redundancy = £5k

Discretionary compensation = £10k

Existing regulations

	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary compensation	Value of package to member
	Full unreduced pension	£50k	£5k	£10k	£65k

New regulations

Options available to member	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary compensation	Value of package to member
A	Full unreduced pension	£45k	Member receives £5k but must contribute £5k of own money to top up the strain cost to the full £50k	0	£50k
B	Pension paid with some reduction	£45k	£5k	0	£50k
C	Pension paid with full reduction	0	£5k	£10k	£15k
D	Deferred Pension	0	£5k	£10k	£15k

Comment on example 1: options A and B are clearly more valuable than options C and D. Nonetheless members who desire immediate access to cash may find C and D attractive.

Example 2: less common case where discretionary compensation > pension strain cost (net of statutory redundancy)

Full strain cost = £15k, Statutory redundancy = £5k, Discretionary compensation = £13k

Existing regulations

	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary compensation	Value of package to member
	Full unreduced pension	£15k	£5k	£13k	£33k

New regulations

Options available to member	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary Compensation	Payment to member (Discretionary compensation less strain cost (net of Statutory Redundancy))	Value of package to member
A	Full unreduced pension	£10k	Member receives £5k but must contribute £5k of own money to top up the strain cost	0	£3k (£13k less (£15k less £5k))	£18k
B	Pension paid with some reduction	£10k	£5k	0	£3k (£13k less (£15k less £5k))	£18k
C	Pension paid with full reduction	0	£5k	£13k	0	£18k
D	Deferred Pension	0	£5k	£13k	0	£18k

Comment on example 2: member is worse off than currently, but equally so under all options: unlike example 1, the protection of the high discretionary element balances out across all four. In options A and B the member is receiving an extra payment to give them parity with a member who is receiving the full value of statutory and discretionary redundancy pay.

The £95k Cap

Who is affected?

English & Welsh employers covered in the Schedule to the Restriction of Public Sector Exit Payment Cap Regulations 2020, essentially all public service employees. In the LGPS world this will include

- Council workers
- Police and fire civilians
- Academies

But not FE and HE colleges, or admission bodies.

What does it mean?

Public sector redundancy packages should be limited as follows;

- A maximum of three weeks' pay per year of service;
- A maximum of 15 months of pay on the amount of a redundancy payment;
- A maximum salary of £80,000 on which an exit payment can be based;
- A £95k cap on the total of all forms of compensation, including redundancy payments, pension strain, compromise agreements and special severance payments.

LGPS staff are especially affected because the £95k cap includes pension strain caused by releasing pension benefits early on redundancy – this means not just high earners are affected.

Example 3 (Cap exceeded and MHCLG restrictions applied)

Full strain cost = £150k

Statutory redundancy = £15k

Discretionary compensation = £30k

Existing regulations

Options available to member	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary compensation	Value of package to member
	Full unreduced pension	£150k	£15k	£30k	£195k

New regulations

Options available to member	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary compensation	Value of package to member	*Additional payment by member to ensure no pension reduction
A	Full unreduced pension	£80k	Member receives £15k but must contribute £15k of own money to top up the strain cost	0	£95k	£55,000
B	Pension paid with some reductions	£80k	£15k	0	£95k	0
C	Pension paid with full reductions	0	£15k	£30k	£45k	0
D	Deferred Pension	0	£15k	£30k	£45k	0

*There will be practical issues around how the employer and fund can be sure that the member's share of pension strain has been recovered before benefits are put into payment.

Comment on example 3 – the cap has a big impact on what the member receives:

- Option A – due to the cap the member has to pay a total of £70k from their own money (of which £15k comes from SRP) to get an unreduced pension
- Option B – the cap again bites and, in the absence of their own money, the member receives a partially reduced pension plus SRP
- Options C and D – less valuable than options A and B but may appeal to members who desire immediate access to higher cash
- The member could choose a hybrid of A and B in which they pay some of the outstanding strain cost but not all of it. Benefits would be reduced based on the proportion of the strain cost they pay. The more they pay the lower the reductions they will receive.

Conclusion

There is no question that these changes will increase the complexity of the redundancy process for members, employers and LGPS funds. If you are an employer covered by these proposed changes, and are considering an early retirement or redundancy exercise, we suggest close communication with your LGPS Fund to understand how this may impact on your employees. However, due to the uncertainties surrounding the updates required to Regulations, it may be some time before LGPS Funds have a clear picture.

We will keep you informed as this situation develops. In the meantime please contact Julie West to understand more (Julie.West@hymans.co.uk). You may also wish to join our LinkedIn group focused on employers within the LGPS to keep abreast of the latest and most important developments affecting such employers: click here to sign up.