

Pensions bulletin – September 2020

Consultation on reforming local government exit pay

Background

In 2015, the government announced plans to cap the amount paid by public sector employers to “exiting” employees at £95k (the £95k cap). This was followed by an announcement that individual government departments would be expected to develop their own plans for further reform to public sector exit payments.

On 10 April 2019 HM Treasury (HMT) launched a consultation on the draft regulations, guidance and directions to implement the cap, which we encouraged you to respond to last year. On 21 July 2020, HMT published the Government’s response to the [consultation](#). This was followed by draft [regulations](#) with further guidance and HMT directions expected.

In addition to the £95k cap, the Ministry of Housing, Communities and Local Government (MHCLG) has launched a consultation on changes to the [Local Government Pension Scheme \(LGPS\) and Discretionary Compensation Regulations](#). The consultation covers the required changes to implement both the £95k cap and the further reforms to exit payments in Local Government.

The following is written from the perspective of the proposals in the MHCLG consultation being in place, and this being at the same time as the, £95k cap. However; it has come to light that the £95k cap, **may in fact come into force much earlier than the changes MHCLG are proposing in their consultation.**

The Local Government Association have set out in a [parliamentary briefing](#) the major issue that the mismatched timing presents both for councils and for employees.

Who is covered by the £95k cap?

The new £95k cap affects all public sector employers “capped employers” and their staff, as defined in the [HMT regulations](#).

Who is covered by the proposed changes to the compensation regulations?

The MHCLG proposals would affect Local Government employers “reform employers” and their staff. We are expecting clarification on exactly which type of employers will be classed as reform employers when draft regulations are published. Some employers will be both capped and reform employers whilst others may fall into one or neither category. We therefore recommend that all public sector employers [respond to the consultation](#).

What is covered by the further reform proposals in the MHCLG consultation?

The MHCLG proposals will limit the payments made to, or in relation to, employees of reform employers in the following way:

- The actual pay used in **severance calculations** will be **limited to £80,000**
- The **maximum severance** (including statutory redundancy pay) will be **limited to 3 weeks’ pay per year of service or 15 months’ pay**, whichever is the lower

- The amount available for any pension strain cost (the payment by the employer to cover the cost of early release of pension) will be reduced by the statutory redundancy payment, **meaning a reduction to pension benefits** would apply in relation to the statutory redundancy payment **unless** the member chooses to make up the reduction in strain cost themselves from their own resources.
- **No discretionary severance** (i.e. that over and above statutory redundancy pay) will be payable if the member receives an immediate pension and the employer pays a strain cost. In cases where the value of the discretionary severance payment exceeds the strain cost (as reduced by the statutory redundancy pay), the excess would be payable to them.

What is covered in the £95k cap?

The exit payment cap limits the payments made to, or in relation to, employees of capped employers, when they are made redundant or have their employment terminated for reasons of business efficiency, to a total of £95,000 with no provision for this to be increased in the future. This includes:

- redundancy payments (including statutory redundancy payments)
- severance payments
- other payments made as a consequence of terminating the employment.

Importantly this also includes **pension strain cost** which is the payment an employer must make when immediate payment of unreduced LGPS benefits is made as a result of the termination.

Though the statutory redundancy payment is included as an exit payment under the cap, this cannot be reduced. If the cap is exceeded, other elements will need to be reduced.

What isn't covered in the £95k cap?

The cap does not cover payments related to:

- death in service or ill health retirement
- pay in lieu of holiday
- payments made in compliance with an order made by a court or tribunal
- payments in lieu of notice that do not exceed a quarter of a person's salary.

How is the LGPS affected by these proposals?

The changes will impact LGPS benefits available to **members aged 55 or over** when their employment ends on the grounds of **redundancy** or **business efficiency**, who are entitled to both immediate payment of unreduced benefits as well as a severance payment. At the moment, members would be awarded both the severance payment and immediate payment of unreduced LGPS benefits, at a cost to their employer, with no restriction on the value of the overall package. Neither the member nor the employer have a choice over the immediate payment of the unreduced LGPS benefits, in these circumstances.

These changes introduce a cap on the total value of the package and restrictions over what benefits can be included together within that package, including:

- **Pension strain costs** must be counted towards the **£95k cap**;
- The value of the strain cost will be determined using standardised actuarial factors, rather than fund-specific factors already in place – this **may impact future valuation results** for employers;
- The amount of strain cost that can be paid by the employer will be reduced by the value of any statutory redundancy pay – this will **impact the amount of pension a member could receive**;
- **Restrictions** on the payment of both pension strain costs and discretionary redundancy payments;
- Members aged 55 or over will no longer be **required** to take immediate payment of LGPS benefits when made redundant.

The actual impact of these changes will depend on which categories the employer falls under (capped, reform or both). If both apply then these changes mean that, generally speaking, an:

- **employee** can only receive immediate payment of fully unreduced pension benefits if they make an additional payment (equivalent to their statutory redundancy payment) towards the strain cost.
- **employer** cannot pay both pension strain costs and discretionary redundancy pay. A choice will need to be made between a combination of statutory redundancy pay plus:
 - pension strain cost; or
 - discretionary redundancy pay.

Employees will therefore have the following options:

- have a **fully unreduced pension** paid immediately alongside the statutory redundancy payment **but** only if the employee tops up the strain cost, which will have been reduced by the value of their statutory redundancy pay;
- have a **partially reduced pension** (i.e. not reduced due to early payment, **but** reduced on account of the statutory redundancy payment reducing the strain cost) paid immediately alongside the statutory redundancy payment;
- have a **fully reduced pension** paid immediately alongside the statutory redundancy payment **plus** any entitlement to a discretionary redundancy payment and discretionary additional lump sum payment;
- **defer the pension** to normal pension age (i.e. not take it immediately) and have the statutory redundancy payment plus any entitlement to a discretionary redundancy payment and discretionary additional lump sum payment.

The above assumes the employer is both a capped and reform employer, the exact impact on members will depend on whether they fit under both or either definitions.

When will this take effect?

The consultation doesn't say, but we understand that the intention is for both the £95k cap and the changes proposed in the MHCLG consultation to be in place by **no later than the start of 2021**. Whilst we understand that it was not intended for the changes proposed in the MHCLG consultation to be backdated, there is potential for the regulations introducing the £95k cap to take effect before LGPS changes can be made. The uncertainty over implementation dates and the lack of detail in relation to the operation of the LGPS changes proposed will potentially **disrupt workforce planning discussions** currently underway that might not come into effect until after the exit cap restrictions and reforms proposed in the MHCLG consultation are introduced.

What else is not confirmed yet?

We're still awaiting the actuarial methodology and factors underpinning the standardised approach for calculating the strain cost, and calculating the reduction in pension if the member wishes to take statutory redundancy pay (SRP). Who is classed as a reform employer is also still to be confirmed.

What do I need to do?

- **Liaise with HR colleagues immediately** to make sure that they are aware:
 - of the potential issues should the £95k cap be introduced from an earlier date than the LGPS changes being proposed in the MHCLG consultation, and
 - that any potential early retirement packages being prepared are suitably caveated. In particular, retirement quotes issued this calendar year where the retirement may not occur until after the proposed LGPS and compensation reforms take effect may be invalidated, with the benefits requiring revision.
- Read and understand the [consultation](#) before considering whether to respond.

The **closing date** for responses to the consultation is **Monday 9 November 2020**. We intend to respond to this consultation and will share this with you ahead of the deadline.

[Respond to consultation](#)