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Reform of local government exit pay

- Our examples in this Briefing Note suggest that the reforms may significantly reduce the value of exit packages for all English & Welsh LGPS members (not just high earners) who are made redundant from age 55. Employees will face difficult choices between pension and cash.
- Funds should urgently contact employers and HR departments to ensure that the impending reforms are reflected in potential early retirement and redundancy exercises. The implementation date is uncertain but may be before the end of this year, with further uncertainty created by the gap between the legislation on the £95k cap and the changes required to LGPS Regulation in order to accommodate it.
- Actuarial guidance from GAD, including standardised early retirement strain factors, needs to be built into software administration systems to feed into employee option packages.

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.

BREAKING NEWS

- **The £95k cap element of the changes is expected to come into force mid-October 2020: LGA have asked for urgent clarification from Government on transitional aspects, and the lack of necessary changes to LGPS regulations to accommodate this.**
- **The Government Actuary's Department (GAD) has issued draft factors and instructions showing how the exit reforms (including the £95k cap) will be calculated and applied.**

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 appears to be 29 September 2020, thus implying an effective date of mid-October 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)
- FT 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.

127

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 > strain cost)

Full strain cost = £10k

Statutory redundancy = £5k

Discretionary compensation = £15k

Existing regulations

	Pension payable	Pension strain paid by the employer	Statutory redundancy	Discretionary compensation	Value of package to member
	Full unreduced pension	£10k	£5k	£15k	£30k

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)	Value of package to member
A	Full unreduced pension	£5k	Member receives £5k but must contribute £5k of own money to top up the strain cost	0	£5k	£15k
B	Pension paid with some reduction	£5k	£5k	0	£5k	£15k
C	Pension paid with full reduction	0	£5k	£15k	0	£20k
D	Deferred Pension	0	£5k	£15k	0	£20k

Comment on example 2: taking full or partially reduced pension under options A or B is financially detrimental to the member. Options C and D are more attractive in terms of overall value and immediate access to cash.

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 FT 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.

Conclusion

There is no question that these changes will increase the complexity of the redundancy process for members, employers and LGPS funds, and the situation has not been helped by the disjointed way that the legislation is being brought forward. Of particular concern is the fact that the £95k cap is likely to be on the statute books (mid-October?) well before the changes needed to the LGPS and Compensation Regulations required for it to take effect in the LGPS. We urge MHCLG to issue formal guidance on how LGPS funds should deal with this situation; LGA have also made a similar request.

As ever, we will be keeping a close eye on the situation and continuing to issue communications as things develop. In the meantime, if you wish to discuss the matter further please speak to your usual Hymans' contact.

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