| Summit Group | Dated: |
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| Establishment Committee | 10 July 2019 |
| **Subject:**<br>Draft Public Sector Exit Payment Regulations | |
| **Report of:**<br>Director of Human Resources | **For Information** |
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## Summary

The Small Business Enterprise and Employment Act 2015 includes a provision that allows the Government to introduce regulations to impose a cap on exit payments within the public sector. A 12-week consultation period on the draft Public Sector Exit Payment Regulations 2019 (the 'Regulations') closed on 3 July 2019, this cited that the total cost to the tax-payer of exit payments in the public sector in 2016-2017 was £1.2 billion, with payments at and above £100,000 amounting to £0.2 billion[1].

The government consultation set out the proposed method of implementing a cap of £95,000[2] on exit payments (the cap). The cap will be applied to all forms of exit payments including: redundancy pay, cash lump sums, early access to unreduced pensions and some payments in lieu of notice.

## Recommendation

This report is for information only. Members should note the contents in view of potential implications going forward, particularly with regards to the Fundamental Review.

## Main Report

### Background

1. Exit payments are associated with loss of employment or office, including redundancy. Such arrangements are pivotal to enabling employers to reform, make changes to the workforce and to provide displaced employees' with financial support whilst seeking new employment or to bridge the gap to retirement.

2. The government first introduced powers to place an exit payment cap on the public sector in the Small Business, Enterprise and Employment Act 2015, later amended by the Enterprise Act 2016. However, the required secondary legislation in the form of Regulations were not introduced to implement it, invariably due to other parliamentary priorities.

3. It is the government's intention to implement the exit cap in two stages. The cap will initially capture most public sector employees, including those in local government, before being extended to the rest of the public sector, except for a limited number of exemptions[3]. The draft Regulations apply to public sector authorities and will apply to the 'Common Council of the City of London in its capacity as a local authority or police authority or port health authority'.

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[1] Whole of Government Accounts 2016-17, page 70.

[2] Part 9 (9) of the Enterprise Act 2016 allows for future changes to the level of the cap, however there is no provision for any such increases to be index-linked.

[3] HM Treasury guided by the Office for National Statistics (for National Account purposes) classified which bodies are either in or out of scope of the Regulations. Exemptions include: The Secret Intelligence Service, the Security Service, the Government Communications Headquarters and the Armed Forces.

**Restrictions on exit payments**

4. The Regulations provide that public sector authorities must not make an exit payment that exceeds the exit payment cap of £95k in respect of a 'relevant public sector exit'. A 'relevant public sector exit' occurs when:

   - an employee leaves the employment of a public sector authority listed;
   - an office holder leaves the public sector office listed;
   - a statutory redundancy payment is made to which the person is entitled[4]; or
   - a person who is not entitled to statutory redundancy pay receives a payment of an amount equivalent to the statutory redundancy pay to which the person would have been entitled[5].

5. Exit payments **in scope** are as follows:

   - compensatory payments on dismissal by reason of redundancy, including a statutory redundancy payment;
   - any payments made to reduce or eliminate an actuarial reduction to a pension on early retirement or in respect to the cost of a pension scheme of such a reduction not being made (pension strain costs);
   - any payments made pursuant to an award of compensation under the ACAS arbitration scheme or a settlement or conciliation agreement;
   - severance or ex gratia payments on exit;
   - payments in lieu of notice where this would exceed one quarter of the annual salary[6].

6. Payments **out of scope** are any payment made in respect of:

   - death in service;
   - incapacity as a result of accident, injury or illness and ill health retirement;
   - a service award paid to a member of the judiciary in accordance with the determination of the Lord Chancellor dated 31 March 2006;
   - annual leave due under a contract of employment but not taken;
   - compliance with an order of any court or tribunal following litigation for breach of contract or unfair dismissal;
   - pay in lieu of notice due under a contract of employment that does not exceed one quarter of the relevant person's salary[7].

7. Where an exit payment would exceed the cap, the employer must reduce the exit payments until the cap is satisfied. Where two or more relevant public sector exits occur in respect of the same person within any period of 28 consecutive days, the total amount of the exit payments may not exceed the exit payment cap (subject to any relaxation, as set out below. Noting that, statutory redundancy entitlement under the Employment Rights Act 1996 cannot be reduced.

**Relaxation of the cap**

8. There are circumstances in which the exit payment restrictions <u>must</u> be relaxed – 'mandatory cases' – and circumstances in which they may be relaxed – 'discretionary cases'.

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[4] s135 of the Employment Rights Act (ERA) 1996.

[5] Unless exempted by s159 of the ERA Act 1996.

[6] Implications for individuals with a notice period greater than 3 months i.e. senior staff in the schools.

[7] Under the regulations, 'salary' means the annual value of remuneration that the person was contractually entitled to receive for the salaried employment or office on the date they left. This includes any benefit in kind.

9. The **Mandatory Relaxation** restriction applies:

- as a result of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) applying[8];
- to avoid employment tribunal litigation in relation to a complaint that someone has suffered a detriment or been dismissed as a result of whistleblowing[9];
- to avoid employment tribunal litigation in relation to a complaint of discrimination under the Equality Act 2010 (one of the 9 protected characteristics).

10. It is possible that relaxation of the restrictions in connection with the specified employment tribunal litigation may act as an incentive for some individuals to bring claims in order to maximise compensation and avoid the cap.

11. A **Discretionary Relaxation** may be exercised where it is an appropriate exercise of power on the basis of one or more of the following grounds:

- there are compassionate grounds owing to genuine hardship;
- it is necessary to exit an individual to give effect to (urgent) workplace reforms i.e. to avoid undermining the continuing effectiveness of operational delivery, or where there are special circumstances pertaining to an individual employee or office holder;
- an arrangement to exit was entered into before the Regulations came into force, but the exit was delayed until after that date and the delay was not attributable to the employee or office holder concerned.

12. Any relaxation decision-making business cases, report recommendations and deliberations must be consistent with Data Protection rules. Discretionary relaxation is expected to be granted only in exceptional circumstances which meet the criteria in HM Treasury Directions.

13. However, whether it be a Mandatory or Discretionary Relaxation sought, the draft Regulations and guidance are currently at odds with the guidance issued; these need to be consistent to clarify the required approval steps before the Regulations come into force.

14. At its most extreme, business case proposals[10] appear to need approval from: a) the Common Council; b) the permanent secretary at the Ministry of Housing, Communities and Local Government (MHCLG); c) a Minister of the Crown; and d) HM Treasury. Consequently, the process can undoubtedly be anticipated to be bureaucratic, time consuming and with delays invariably adding to costs.

**Application to the City Corporation**

15. In the first stage of implementation, the schedule to the draft Regulations provide that these will apply to the Common Council of the City Corporation in its capacity as local authority, police authority or port health authority. The regulations also apply to a body corporate established pursuant to an order under section 67 of the Local Government Act

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[8] Employees returning or otherwise transferring to the public sector may also bring their previous employment terms with them. Without corresponding changes to these terms based on previous employment, such individuals may continue to be entitled to exit payments in excess of the cap, introducing an inconsistency with public sector counterparts.

[9] It may also be in public interest to grant a waiver in respect of particular special severance payments used either to settle statutory disputes or claims, or disputes or claims under an individual employment contract.

[10] All decisions should be supported by appropriate evidence, with an explanation of the business interests and a value for money assessment; and should be disclosed in the organisation's annual accounts.

1985. Lastly, the schedule lists specified office holders to whom the cap will apply, including the Commissioner of Police for the City of London.

16. Where a body or office is not cited in the Schedule attached to the Regulations[11], there will be no legal obligation under the regulations to apply the cap to an exit payment. Nevertheless, the government expects commensurate arrangements to be voluntarily applied to demonstrate value for money to the tax-payer. Indeed, this does not stop employers from applying alternative contractual capping arrangements where those provisions go further than the Regulations.

17. There are a number of areas which sit largely or wholly outside the City Corporation's capacity as a local authority or police authority or port health authority. These generally include functions that are funded by City's Cash and Bridge House Estates. There are also areas of the service that support the City Corporation in both its local authority and non-local authority capacities as well as some areas that are more difficult to classify, e.g. Hampstead Heath, City's Court function and the cemetery.

**Voluntary extension of the pay gap**

18. Should the draft Regulations come into force in their current form, the City Corporation will need to decide whether to voluntarily extend the cap, or a variation of it, to all employees. The advantage is that there will be consistency of treatment across the organisation, but voluntary application is likely to be resisted by staff, the trade unions and could be open to legal challenge. Further detailed work will be needed to define in clear terms which parts of the Corporation fall under the statutory regulations.

**LGPS pension implications**

19. The Local Government Pension Scheme (LGPS) provides benefits to members who are aged 55 or over, should they be removed from the scheme on grounds of redundancy and efficiency retirement. These members are currently entitled to their retirement benefits (i.e. pension and lump sum where applicable) immediately, with no actuarial reduction for early payment with the cost of this increased benefit fully funded for by the employer at the time of the retirement (i.e. pension strain cost[12] where applicable).

20. The position for the LGPS is that paragraph 5 of Schedule 6 to the Enterprise Act 2016 amends the Local Government Pension Scheme Regulations 2013 to allow:

    - partial reduction of a member's pension benefits where otherwise the exit payment cap would be breached; and
    - a scheme member to pay a charge to buy out some or all of that reduction

21. These changes do not come into effect until HM Treasury issue a commencement order. The effect of the exit payment Regulations on the LGPS is dependent on whether they are enacted before or after the LGPS regulations changes come into force (as set out in the Enterprise Act).

22. If the LGPS regulations were unchanged where an exit payment in scope including pension strain cost exceeds the cap, it is unclear whether the pension could be paid under regulation 30(7)(b) of the LGPS Regulations 2013 if the strain cost referred to in

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[11] Any newly created public sector body will not be in scope of the regulations until it is added to the Schedule within the Regulations. It is the responsibility of the named body to notify HM Treasury of new additions or changes to existing categories to update the Regulations.

[12] Strain costs are calculated as the difference between the value of the benefits the member would have received under the normal course of providing benefits from the Pensions Fund, and the value of the benefits provided as a result of un-reduced early retirement due to redundancy.

regulation 68(2) cannot be paid in full. It is the Local Government Association's (LGA)[13] understanding that the intention is for the member to receive a fully reduced pension in this circumstance, plus the cash alternative of the strain cost (up to the maximum allowed by the cap). Changes to the LGPS regulations would be required to introduce the option for a member who is made redundant or leaves on the grounds of business efficiency at age 55 or over to defer payment of their pension.

23. However, if the LGPS Regulations were amended to allow partial reduction. The LGA's interpretation is that if an exit payment includes pension strain cost and would exceed the cap, then the member's benefits would be reduced to such a level that the exit payment cap is not breached. The member would have the option of paying extra to buy-out some or all of the reduction.

24. The proposed regulation changes do not introduce the option to defer payment of pension benefits in the event of a LGPS member who is over age 55 being made redundant or leaving on the grounds of business efficiency. As the regulations currently stand, a LGPS member whose exit payment has been capped would be forced to accept a reduced pension.

25. If the option to defer payment of LGPS benefits on redundancy or retirement on business efficiency grounds at age 55 or over is introduced, the LGA advise then a member who exercises the option to defer could be paid the cash alternative to the pension strain cost (up to the maximum allowed by the exit payment cap).

26. The LGA advise that in order to implement partial reduction in the LGPS, guidance from the Government Actuary's Department (GAD) on partial reductions and on the cost of buying out those reductions would be required. Detailed information concerning the method of calculating the partial reduction in a members' benefits, the method and calculation for buying out the reduction – particularly the calculation which would be involved in working out the reduction to apply where some but not all of the reduction has been bought out, and the deadline that applies to an election to make such a payment would be required. It is likely that changes to the LGPS regulations and new statutory guidance would be required to effect this change.

27. The Regulations do not specify a uniform way to calculate the pension strain cost related to the early payment of a pension on an unreduced basis, these are currently set locally by each administering authority. See Financial Implications below.

28. It should be noted that the City Corporation private sector employers carrying out public sector work via TUPE arrangements will not be party to this legislation.

29. There may also be occasions where the employer offering reduced early retirement on unreduced pension may make a contribution to the individual's pension that 'buys out' some or all of the reduction in pension benefits which the individual would normally face on retiring early. The size of the additional employer contribution or 'top up' is determined by the individual's earnings, how close they are to retirement and their accrued pension rights. These provisions are however not currently applied at the City Corporation.

**Compliance, record keeping and reporting**

30. The relevant public sector employer is responsible for ensuring compliance with the cap in accordance with the HM Treasury Directions. Any payment that exceeds the cap and is not compliant with the relaxation directions is considered to be a payment beyond the

[13] LGA Workforce Bulletin on Exit payments cap; represents the views of the LGA Secretariat and should not be treated as a complete and authoritative statement of the law, readers to seek their own legal advice.

organisation's legal competence[14], which may result in sanctions[15] on the organisation or, if appropriate, sponsoring department by HM Treasury.

31. Whole of Government Accounts returns may request information relating to the exit payment cap, or any exit payments made by the relevant body, for later publication. Public sector employers are expected to cooperate in providing such information.

32. Where the cap is relaxed in accordance with the separate HM Treasury Directions, the responsible body 'Decision Maker'[16] must be keep records for a minimum of 3 years about: when, to whom, the amount including type of exit payments and why the power was exercised.

33. The relevant authority must also publish in their annual accounts where exercising the relaxation power: the amounts and types of exit payments made, the dates and the reasons why the power was exercised.

34. An employee with multiple employments in the public sector who receives an exit payment in respect of one employment is required, as soon as is reasonably practicable, to inform all other public sector authorities (or those responsible for paying them as an office holder) by whom he or she is employed about that exit payment in writing. Specifically, the amount and type of exit payment, who will be paying it and the date they left employment or ceased to hold office to which the exit payment relates.

35. Authorities will be required to publish a policy on the limited circumstances in which they would consider the granting of an exception.

**Implementation**

36. The government's consultation closes on 3 July 2019, however no proposed implementation date has been announced apart from the statement that intention is for the reforms to be introduced 'without further delay'.

37. The Chief Secretary to the Treasury has also alluded to the cap being brought in later this year, meaning it could therefore apply to some public sector employees as early as October 2019.

**Likely practical impact of the pay cap**

38. The inclusion of pension strain in calculating the pay cap means that individuals over the age of 55 but under normal retirement age who are in the LGPS will be disproportionately affected. The nearer the age of 55, the higher the salary and the longer an individual's membership of the LGPS, are all factors that make it more likely that the pay cap will apply. For example, an individual who is aged 55, earning a relatively modest £40,000 per year with 35 years' service (and LGPS membership) would incur a pension strain charge for the City Corporation of @£73,000. The occupational redundancy payments under the City Corporation would be approximately £31,000, bringing the total to £104,000 and exceeding the payment cap by £9,000.

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[14] Payments in excess of the cap must be accompanied by a value for money assessment on whether to pursue civil repayment through the courts. This assessment must be agreed by the relevant Accounting Officer in line with their Accounting Officer responsibilities.

[15] Sanctions may also be imposed on the employer (or, if appropriate the sponsoring department) by HM Treasury.

[16] The person who exercises the power under s153C(1) of the Small Business, Enterprise and Employment Act or under regulation 11(b), 11(c) or 11(d) of the Regulations; the full council of a local authority (Court of Common Council, City Corporation) in respect of exit payments made by local government bodies for which it has responsibility.

39. Over the past three years, there were five termination payments made across the City Corporation which would have exceeded the cap, had it been in place. In all five cases this involved the early payment of pension thereby incurring a pension strain charge.

40. It is now imperative ahead of the government consultation closing that due consideration is given to the impact on pension strain costs for any future redundancy and efficiency retirement exits for those pension members aged 55 and over.

**Security implications**

41. None.

**Financial implications**

42. The calculation of the strain is based on costs at each individual Pension Fund in the LGPS as determined in the Triennial valuation. Therefore, the cost of exit will differ on a like for like basis from Fund to Fund. It is, therefore, difficult to apply fairly a fixed cap of £95,000 to pension benefits when the strain costs vary between Funds. This could leave the LGPS and the administrating authorities exposed to the risk of challenge and complaint from scheme members.

43. Further guidance is required, however, a universal strain calculation is being considered at a national level and if agreed would be applied to all Funds.

44. Financial implications may include the costs associated with:

- amendments to the software systems;
- increased volume of redundancy estimates;
- additional work due to manual calculations and checking of calculation;
- increased turnaround times and backlogs;
- risk of error and challenge;
- formal complaints against: a) employer; b) pension administration; and/or c) LGPS.

45. For the LGPS member the issue here will be more around the ability to remove the mandatory payment of pension benefits from age 55, permitting scheme members to defer the pension payment to a later date. This would allow payment of redundancy and other statutory payments up to the cap amount and for scheme members to receive pension benefits on a later date of their choosing with a reduced reduction or no reduction at all. However, some people may not be able to afford to do this and could be left without work with limited career options.

**Public sector equality duty**

46. The government commented on the equality impact of the Regulations back in 2015 and has proposed to undertake a full Equality Impact Assessment (EIA) if the second stage of implementation is adopted. This does give rise to concern about the likelihood of legal challenges not having been appropriately assessed.

**Resourcing implications**

47. For employers' voluntary redundancy exercises may not produce the desired outcome and mandatory redundancy exercises may then become necessary.

48. The Pensions Office may receive increased numbers of estimates (voluntary then later mandatory); and if the calculations for the strain are manual, this may require further staff to process successfully.

49. However, it is currently difficult to know how to judge the effect of the legislation without having the necessary pension scheme regulations in place. Certainly, if the legislation was implemented today, the LGPS benefits must under current regulation (which is statutory) be paid in full, irrespective of cost or cost cap, the employer must pay that cost.

**Conclusion**

50. Supplementary guidance to the Regulations is provided for the relevant public sector employers to be used in conjunction with the separate mandatory HM Treasury Directions (which must be followed if relaxing the £95,000 cap). Where there is any discrepancy between the Regulations and the guidance, the Regulations prevail. The Regulations take precedence over any existing contractual agreements, regulations and other exit schemes where they make more generous provision than allowed by these regulations, unless these arrangements are exempt in the regulations. However, in saying this the draft Regulations and associated references presently contain many significant contradictions and inconsistences which need to be resolved before the Regulations come into effect.

51. Exit payments can be important to employers' ability to reform and react to new circumstances, whilst providing support for employees as they find new employment or as a bridge until retirement age. However, public sector employers have a responsibility to demonstrate that they are using public money efficiently and responsibly, and to ensure that pay and terms are always proportionate, justifiable and fair to the taxpayers who fund them.

52. The government will consider the consultation responses and decide on how best to achieve its aims. Once the outcome of the government's consultation is known, a further Establishment Committee report will be prepared.

**Background paper**

Restricting exit payments in the public sector, LGA published consultation response https://www.local.gov.uk/our-support/workforce-and-hr-support.

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