Appendix 2

This is the advice circulated to the Chamberlain given by AON Hewitt on the government proposals.

Dear all

Following its announcement on 23 May 2015, the Government has published a consultation on proposals to cap the total cost of exit payments to public sector workers to £95,000. The consultation document can be found here: https://www.gov.uk/government/consultations/consultation-on-a-public-sector-exit-payment-cap/consultation-on-a-public-sector-exit-payment-cap

Scope

Of most immediate interest (and possibly concern) to administering authorities and local authorities is the **proposal that the cap will cover pension strain payments due on redundancy early retirement**. Section 1.2 sets out that payments in scope include the "*monetary value of any extra leave, allowances or other benefits granted as part of the exit process which are not payments in relation to employment*". The consultation goes on to clarify in Section 3.1 that exit payments include the cost of "*early access to unreduced pension"*. Compensation payments in respect of death or injury, serious ill health and ill health retirements would be excluded from any cap.

Core Proposals

- A cap of £95,000 on the total value of exit payments (before tax) to employees in the public sector.
- A cap covering all forms of exit payments including cash lump sums, the cost of early payment of pension benefits and other non-financial benefits such as additional paid leave.
- A cap applying to all types of arrangement including formal redundancy schemes, collective agreements and contractual arrangements.

Where different payments are made, they would be aggregated for the purpose of comparison with the cap.

Pension Aspects

The proposals are that employees would retain the option to take early retirement on an unreduced pension (where available) but that the cost to the employer should not exceed the cap. If lump sum redundancy payments are also made, the total cost of both the pension and lump sum payment should not exceed the cap. The consultation acknowledges that in the Local Government Pension Scheme there is an entitlement to an unreduced pension for employees over age 55 who leave employment on redundancy or business efficiency grounds, but concludes that local government pensions should be within the scope of the cap. If this proposal goes ahead, then there would need to be a change in the LGPS Regulations to deal with cases where provision of immediate unreduced pension benefits would breach the £95,000 limit.

Implications for the LGPS / local authorities

Factors used to calculate early retirement strain costs vary by Fund, usually according to the funding strategy adopted (and hence the funding assumptions, primarily the discount rate and longevity improvement assumptions). If the proposed changes are made, it may well lead to increased scrutiny of the factors in use across the country and the accusations of a "postcode lottery" in relation to early retirements.

Using the factors for one of our administering authority clients, the £95,000 cap would be breached in future for someone retiring at age 55 with an accrued pension of around £15,000 and a critical retirement age of 65.
In relation to members with pre-2014 benefits, where there is no cash lump sum redundancy payment, (e.g. efficiency early retirements), the cost of the immediate payment of pension benefits would exceed £95,000 for the following sample members:

- A member with 30 years of membership and final pay of £52,000
- A member with 10 years of membership and final pay of £96,000

(for simplicity we've assumed the member is retiring at age 55 on 1 April 2016 with a critical retirement age of 60 for pre 2008 benefits, and that his/her pay over the previous two years under both 2014 and 2008 scheme definitions is the same)

The position becomes more difficult once you build in an allowance for redundancy payments. Allowing for statutory redundancy payments of 1.5 weeks' pay* for each full year worked up to a maximum of 30 weeks, the total cost of the statutory redundancy payments plus immediate payment of pension benefits would exceed £95,000 for the following sample members:

- A member with 30 years of membership and final pay of £39,000
- A member with 10 years of membership and final pay of £75,000

*This applies to those aged 41 or older

The calculations vary according to the age on redundancy as well as critical retirement age. In general, the higher the age on redundancy the lower the strain payment and the higher the critical retirement age the higher the strain payment but it is the relationship between the two (i.e. the number of years early the pension is being paid) which has the greatest effect on the calculations.

Next Steps

The consultation closes on 27 August. The Government will consider the consultation responses and decide how best to achieve the stated aim of capping the total value of exit payments made to individuals leaving public sector employment. The intention is to introduce clauses to the Enterprise Bill to give effect to the cap. The effective date of any changes is not yet known but given the relatively short consultation period it is possible that implementation is being considered for April 2016. This could therefore have a material effect on local authorities' short-term plans and, in particular, their approach to achieving required cost savings.

Final Comments

Whilst redundancy payments are principally an employer rather than an administering authority issue, we would strongly suggest that administering authorities alert their public sector employers to these proposals (noting that some exemptions are being considered and the devolved administrations will need to determine if and how they take forward similar arrangements for bodies for whose employment and remuneration practices they are responsible). There are other uncertainties over exactly which employers will be affected. For example, HMT has recently classified Universities as private sector for Fair Deal purposes, so does this mean they will not be covered by these proposals?

It is proposed that waivers may be granted in exceptional circumstances and, for local authorities, approved by Full Council or meeting of members in the case of fire and rescue authorities. Further, authorities would be required to publish a policy on when exceptions might be made and disclose any exceptions in their annual Statement of Accounts.

It is not clear if or how this new consultation relates to that carried out by the Coalition Government in 2014 concerning the repayment of exit payments made to high earning public sector workers (those earning more than £100,000) who return to the public sector within 12 months. The then Government's response suggested that those proposals would be taken forward using powers to be set out in the Small Business Enterprise and Employment Bill, no later than April 2016. It may be that if exit payments are to be capped as is now being proposed, it is considered that there will be no need to claw back any payments to high earners re-joining the public sector. The previous consultation can be found here:

https://www.gov.uk/government/consultations/recovery-of-public-sector-exit-payments

There are no draft regulations included within the consultation and the LGPS Regulations will need to be amended if the proposals are taken forward. It is not yet clear what form any amendments might take, and whether employers would have to use whatever of the £95k is left after any lump sum redundancy or other exit payments to waive some or all of the actuarial reduction on early retirement (and indeed on the extent to which the employee has to draw their pension benefit if made redundant over age 55) or to what extent there would be flexibility for employers and employees to agree the best combination of exit payments within a £95k limit on a case by case basis. Clearly the more flexibility is permitted, the higher the costs associated with redundancy exercises, particularly if large scale downsizing is required.

I hope this is a helpful summary. Do get in touch if you would like more information or to get a better understanding of how this might affect your Fund or your employers.