Local Government briefing

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Exit payment cap and the Local Government Pension Scheme

<u>What is the exit payment cap?</u>

The public sector exit payment cap is an overall limit to the amount that an employer can pay to an employee, or to a pension scheme in respect of that employee, when they leave their employment.

The cap has been set at a level of £95,000 and unfortunately there is no index-linking of this amount or any mechanism to automatically increase this figure. In effect this means that the value of the cap will decrease each year and more people will be subject to it.

<u>Who is subject to the cap?</u>

The original stated intention from the Conservative party was that the cap was being introduced to "end taxpayer-funded six-figure payoffs for the best paid public sector workers"

Unfortunately, the cap is being introduced in such a way that an employee on a moderate salary with long service could be caught by the cap. There is no automatic exclusion or waiver of the cap for employees who are low or moderate earners.

All public sector employees as well as some private sector workers are within the scope of the cap. A list of the employers affected can be found in Schedule 1 to the regulations which are accessible on the following website: https://www.legislation.gov.uk/ukdsi/2020/9780348210170

<u>What payments are included in the exit payment cap?</u>

Most payments that are made by an employer to an employee in consequence of their employment ending are subject to the cap.

Payments within scope of the cap are:

- Any payment on account of dismissal by reason of redundancy;

- Any payment to reduce or eliminate an actuarial reduction to a pension on early retirement or in respect to the cost to a pension scheme of such a reduction not being made;
- Any payment pursuant to an award of compensation under the ACAS arbitration scheme or a settlement or conciliation agreement;
- Any severance payment or ex gratia payment;
- Any payment in the form of shares or share options;
- Any payment on voluntary exit;
- Any payment in lieu of notice due under a contract of employment;
- Any payment to extinguish any liability to pay money under a fixed term contract;
- Any other payment, whether under a contract of employment or otherwise, in consequence of termination of employment or loss of office.

Will exits agreed before the implementation of the cap be honoured?

Any exits already agreed before the cap comes into force will be paid in full. This includes any that occur during the 21-day period between the regulations being made and coming into force.

If an exit occurs after that point then the cap would apply, even if the terms were agreed beforehand. However, the regulations do include a discretionary waiver where under certain circumstances the cap can be disapplied, for example, if the exit has been delayed for reasons outside of the individual's control.

When did the cap come into force?

The exit payment cap regulations were subject to the affirmative procedure and were approved by both Houses of Parliament. The exit payment cap came into force on 4 November 2020.

How does the cap interact with the Local Government Pension Scheme (LGPS)?

The major impact of the regulations on LGPS members will be for those aged 55 or over who currently qualify for an unreduced pension because of redundancy or efficiency retirement as well as a severance payment.

Currently, if a member is entitled to an unreduced pension, there is a 'pension strain cost' which is payable by the employer to the pension fund. This payment is made to the pension scheme as the pension payable to the member is being paid prior to their normal pension age and does not have the early payment reductions applied to it that normally would be.

This pension strain cost can be a substantial amount of money and despite widespread criticism of this being included within the scope of the cap, it has been. The pension strain cost alone could be at the level of the cap for those with long service.

This causes an issue for the LGPS as currently the rules state that if a member is made redundant or leaves on grounds of efficiency when they are over the age of 55, they must take their unreduced pension and the strain cost must be paid.

Clearly this is a valuable benefit, but it is at odds with the overriding exit cap regulations as there will be numerous instances of the cap being exceed by the pension strain cost alone.

The Ministry of Housing, Communities & Local Government have therefore consulted on changes to reform exit pay in Local Government.

What did MHCLG consult on?

MHCLG consulted on a wider reform of exit pay in local government which included changes to the LGPS regulations that give members flexibility to choose how they receive their redundancy compensation.

The consultation document can be accessed here:
https://www.gov.uk/government/consultations/reforming-local-government-exit-pay

The main proposed changes to exit pay in local government are as follows:

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

For affected members, the proposals will be significant. Currently the member would receive an unreduced pension plus their severance pay. Under the proposals they would receive statutory redundancy pay and one of the following options:

- An immediate actuarially reduced pension calculated using a strain cost reduced by the amount of the statutory redundancy payment and capped at £95k. In this case no severance is payable; or,
- An immediate fully reduced pension (no strain cost to the employer), plus statutory redundancy pay plus severance in excess of statutory redundancy limited to £95k, or,
- A deferred pension (no strain cost to the employer), plus statutory redundancy pay plus severance in excess of statutory redundancy limited to £95k.

In the rare cases where the discretionary redundancy payment would have had a higher value than the strain cost, the member will be entitled to take the unreduced pension plus a cash payment equal to the difference between the strain cost and discretionary redundancy payment.

MHCLG sought views on the following:

- The effect/s that the proposals will have on the regulations which currently govern exit payments (including both redundancy compensation pay and early access to pensions) in local government.
- The impact that the proposals will have on the local government workforce.

It is important to note that at the time of writing (1 February 2021), the only regulations or legislation to be implemented are the £95k exit payment cap regulations. The subject of this separate consultation was the reform of exit payments in Local Government, but these changes have not been introduced.

If a member's total exit package is below £95k, they should be unaffected as these wider reforms are not yet in force.

Several legal challenges, including one from Prospect, have been lodged and these are due to be heard at the end of March 2021. It is highly unlikely that a consultation response from MHCLG or any regulations implementing exit pay reform in Local Government will come into force prior to this hearing.

Unfortunately, due to the rules of the LGPS conflicting with the exit payment cap regulations, we are in a period of legal uncertainty as whatever route an employer follows, they could be subject to challenge.

Prospect submitted a response to the MHCLG consultation and this can be found here: https://library.prospect.org.uk/download/2020/01184