Consultation on the exit cap

September 2020

MHCLG has now released its consultation on how the exit payment cap should be dealt with by Local Government employers. The consultation lasts for 9 weeks and closes on 9 November 2020. The consultation goes further than expected at this stage in that it contains proposals for wider reform of redundancy payments beyond just the £95K cap.

The consultation doesn't contain any draft regulations, just proposals, so we assume there will be a further consultation in due course when draft regulations are published and we believe there will be a further consultation on GAD guidance for calculating strain costs, although time is now tight to get this in place by the end of 2020. As the consultation covers a mix of employment and pension matters, administering authorities will need to ensure that it is drawn to the attention of scheme employers.

Who is affected?

The consultation applies to LGPS funds and public-sector employers in England, but the position for funds and public-sector employers in Wales is slightly less clear. Our understanding is that any changes made to the Local Government Pension Scheme Regulations 2013 and/or the Local Government (Early Termination of Employment) (Discretionary Compensation) Regulations 2006 will apply equally to both English and Welsh funds/employers. However, it is possible that the £95k cap may not apply in the same way to Welsh employers as the decision is devolved. This requires clarification.

What are the proposals?

On the **employment side**, the proposals are that the Local Government (Early Termination of Employment) (Discretionary Compensation) Regulations will be updated so that:

- redundancy payment calculations will be limited to a maximum of three weeks' pay for every year of service, with an overall maximum of 15 months/66 weeks' pay,
- the maximum salary to be used in the calculation of redundancy pay should be £80,000, with that limit to be reviewed on an annual basis (e.g. increased by CPI).

On the **pension side**, as expected the proposals allow for more flexibility around the payment of pensions in redundancy situations so that the overall £95,000 cap on exit payments for public sector employers can be applied. Further:

- if the employer is paying **any** amount of pension strain cost as a result of paying pension benefits early, the redundancy payment made to the member cannot include any element of discretionary redundancy pay (unless the discretionary redundancy pay is higher than the strain cost in which case the difference can be paid).
- as well as limiting the strain cost to 95k, the strain cost must also be reduced by any amount of statutory redundancy pay, and this appears to be the case even if the strain cost plus other exit payments are below the 95k cap. The pension must then be actuarially reduced until the strain cost reaches the permissible level. Alternatively, the member can 'buy out' the reduction if they wish so they can still receive an unreduced pension although no details are given in the consultation about how this would work. Our understanding is that this might be achieved by using some of their redundancy pay to do this although it is unclear whether statutory redundancy pay can be given up in this circumstance.

There are some exceptions and some options for the member. In particular, there are some circumstances in which the 95k cap may be waived, although as stated above we believe that this is a devolved issue for Welsh authorities.

Alternative options for the member are:

- taking the discretionary redundancy payment instead and receive an immediate fully actuarially reduced pension (using standard early retirement factors)

- taking the discretionary redundancy payment and defer taking their pension (which would presumably then become subject to the same rules as any other deferred pension although this isn't clear in the consultation).

Under both these options, no strain cost payment would be required from the employer, and the member essentially forgoes any value of the strain cost above the amount of the redundancy payment they receive.

Initial thoughts/questions

This consultation is higher level than we had anticipated. Whilst the proposals do appear to meet the Government's previously stated policy requirements while still giving members the flexibility to receive their pension payments from 55* if they wish, the administration involved will be significantly increased to ensure that the correct payments are made and, as always, the devil will be in the detail of the draft regulations.

**We also note that in response to a recent parliamentary question, John Glen, the Treasury minister, confirmed that the announcement made in 2014, that government would increase the minimum pension age to 57 from 2028, would be legislated for in due course.*

- The proposals to amend the Local Government Pension Scheme Regulations 2013 go further than was expected, and it's clear that in order for the process to work effectively there will need to be lots more communication and information sharing between employers and administering authorities to ensure that members are given the correct figures and options.
- Further, if the new changes and flexibilities for members on redundancy are translated into LGPS Regulations, then they may also apply to members employed by employers not subject to the £95k cap, although this is not clear in the consultation and our initial expectations were that there would be no changes for those employed by employers not subject to the Cap.
- The consultation doesn't appear to address non-redundancy exits where a pension strain cost is involved (e.g. a member retiring early where the employer agrees to waive any early retirement reductions). Given that the pension strain cost is likely to be the only exit payment that counts for the £95k cap in this scenario, fewer members will be affected, but we assume that there will be similar restrictions on the level of pension that can be taken to ensure that the strain cost remains under the cap. However, this is another area that requires clarification.
- It's not clear whether the salary limit refers to basic pay only or whether it also includes any allowances/bonuses etc., and it's also not clear how that limit would apply to any part-timers (i.e. is the £80k limit actual pay or the FTE?).
- The consultation also does not clarify what is meant by discretionary redundancy pay.
- Finally, given the interaction between the employer's role and the administering authority's role, it's not clear who would be responsible for providing the member with these choices and obtaining the decision, so if this is not covered by regulations or statutory guidance employers and administering authorities will need to review their procedures and will collectively need to ensure that all parties know who is responsible for providing what information.

Our conclusion is that the consultation raises as many questions as it answers and it is really important for administering authorities and employers alike to respond to ensure that as many of the uncertainties are resolved as possible before Regulations are laid.

If you would like to discuss any of the above or need help with your response to this consultation, please get in touch with one of us or your usual Aon consultant.

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