HYMANS ROBERTSON

**Private & Confidential**

Exit Pay Consultation
Local Government Workforce and Pay Team,
Ministry of Housing, Communities and Local Government
Fry Building
2 Marsham Street
London
SW1P 4DF

2 November 2020

Dear Sir/Madam

## Local Government Pension Scheme (England and Wales)

**Reforming Local Government exit pay**

Hymans Robertson LLP is pleased to provide its response to MHCLG's consultation on the above topic. The Annex to this letter sets out our formal response to the questions set out in the consultation.

**About Hymans Robertson LLP**

Hymans Robertson has grown up with the LGPS. The firm was founded to provide advice to the LGPS in 1921, just as the first funds were being created. Whilst our business has developed over the decades, working with the public sector remains at the heart of what we do.

We have a specialist public sector actuarial team, which employs over 60 people exclusively advising on the LGPS. Alongside our actuaries there is a team of governance, administration and project consultants providing advice to our LGPS clients on benefits matters such as these, plus a team of 15 investment consultants.

We believe that we are well placed, therefore, to respond to the questions posed by MHCLG in this latest consultation paper.

Yours faithfully

Ian Colvin
Head of Benefits Consulting
For and on behalf of Hymans Robertson LLP
DDI (0)141 566 7923
ian.colvin@hymans.co.uk

Douglas Green
Partner
For and on behalf of Hymans Robertson LLP
DDI (0)141 566 7690
douglas.green@hymans.co.uk

## Annex 1

**1. Are there any groups of local government employees that would be more adversely affected than others by our proposed action on employer funded early access to pension?**
**- If so, please provide data/evidence to back up your views?**
**- How would you mitigate the impact on these employees?**

- *Members with entitlement to unreduced early retirement pension will be forced in effect to choose between taking that pension and taking their redundancy pay (statutory and discretionary top up);*
- *This will have greatest impact on lower paid local government employees being made to take early retirement, where the required trade-off between pension and cash means a higher relative reduction in their income.*
- *As pension strain is linked to length of service, the financial detriment will be proportionately larger for long-serving employees.*

The Government's stated policy intention is seeking to restrict the level of exit payments paid to local government employees. The approach being taken to introduce the exit payment cap in line with HM Treasury regulations, along with wider local government reform to the discretionary compensation provisions, is intended to achieve this aim.

The greatest impact of these proposals will be felt by those taking early retirement pension from the LGPS aged 55 and above, particularly where any pension strain is materially greater than their redundancy pay. Historically these members have been entitled to the immediate payment of unreduced pension benefits from the scheme in additional to statutory redundancy pay and any discretionary lump sum top up their employer chose to pay. These reforms would significantly reduce the overall cost of such exit packages.

We have set out an example at the end of this Annex to demonstrate the sorts of impact this might have.

While our example shows a reduction in the overall cost of the exit package from £65k to £50k where a full or partially reduced pension is taken, the overall cost of the exit package drops significantly to £15k where the member decides to take a fully reduced pension or chooses to defer the pension instead. The disparity between the value of the reformed exit package depending on the decisions relating to any LGPS pension does appear significant for those aged 55 and above.

We can therefore surmise that the impact would be relatively greatest on the lowest paid, where the proposals in effect require a trade-off between cash and pension and will have a high impact on the member's post-retirement income one way or the other.

We recognise that any steps to mitigate the impact the £95,000 cap would be directly contrary to the Government's policy intentions. We also feel that some other measures that have been mooted elsewhere, such as only exempting those below a certain salary, would introduce cliff edges, further confusion and might, in themselves to discriminatory.

However, as we argue elsewhere, we do believe that one way to mitigate the impact on those who are below the cap, is to remove the requirement to reduce pension strain by the statutory redundancy amount.

**2. What is the most appropriate mechanism or index when considering how the maximum salary might be reviewed on an annual basis?**

- *On the grounds of fairness we believe an earnings indexation would be the most appropriate.*

It is important that there is a suitable mechanism put in place to ensure the proposed maximum salary is available to be indexed, thereby ensuring these changes affect only those initially intended to be affected, and ensuring the Government meets its overarching requirement of fairness. Any such mechanism should, therefore, seek to reduce the risk of the threshold being eroded over time and impacting those employees that the threshold was never intended to affect.

The two main indexation options available to Government would appear to be increasing the threshold in line with increases in the Consumer Prices Index (CPI) or increases in line with average earnings.

Given that the threshold is in effect a salary cap for the purposes of assessing lump sum compensation packages we believe the most appropriate and fairest form of indexation would be the use of increases in average earnings.

**3. Are there any groups of local government employees that would be more adversely affected than others by our proposed ceiling of 15 months or 66 weeks as the maximum number of months' or weeks salary that can be paid as a redundancy payment?**
**- If so, please provide data/evidence to back up your views?**
**- How would you mitigate the impact on these employees?**

- *We are not aware of any groups which would be more adversely affected than others, apart from those specifically designed to be in scope.*

We appreciate the overriding policy intention is to restrict the amount paid out to local government employees by way of exit payments, while ensuring any reforms meet the key principles of fairness, modernity and flexibility and ensure greater consistency across workforces. Reducing the maximum number of weeks' pay used in the calculation of lump sum compensation from 104 weeks to 66 weeks is one mechanism by which these aims can be achieved.

Our expectation is that the vast majority of employers currently do not offer exit packages up to the current 104 weeks maximum, with many likely offering significantly less. As a result, we believe the reduction of the ceiling to 66 weeks' pay alone should not have a material impact for many employees, although of course, anyone whose employer currently offers more than 66 weeks' pay would be affected, as is the intention.

**4. Are there any groups of local government employees that would be more adversely affected than others by our proposal to put in place a maximum salary of £80,000 on which an exit payment can be based?**
**- If so, please provide data/evidence to back up your views?**
**- How would you mitigate the impact on these employees?**

- *We are not aware of any groups which would be more adversely affected than others.*

We have always understood that a key element of this reform exercise was to limit the amount of compensation paid out to higher earners within the public sector where they are made redundant or retired on the grounds of business efficiency. The introduction of a salary cap on which such exit payments can be assessed is clearly one means by which the Government can achieve this policy intention.

**5. Do you agree with these proposals? If not, how else can the Government's policy objectives on exit pay be delivered for local government workers?**

- *The manner of communication of the wider reform proposals has not reflected well on MHCLG.*
- *It is disappointing that the exit payment cap of £95,000 will be brought into place before this consultation is even concluded, let alone in a constructive manner with these proposals.*
- *The inclusion of the statutory redundancy payment is punitive to the lowest paid, for whom the payment might well be an immediate financial lifeline on being made redundant. We would rather see the statutory redundancy payment element removed from the final changes.*
- *We believe Funds should be left to determine their own procedures for collecting pension strain costs from employers rather than the imposition of standardised amounts.*
- *We would prefer to see employers and administering authorities allowed to continue current practice whereby strain costs can be remitted to Funds over an agreed number of years.*
- *There are issues around TUPE transfers where members and their employers may see unexpected reductions in benefit or increases in cost.*

The Government has set out a clear policy expectation that exit payments across the public sector should be reformed in order that they are affordable, continue to provide appropriate protection to affected employees and are exercised consistently across workforces. The Government has also confirmed that pension strain is to be included within the overall cost assessment. To this end the proposals set out within the consultation document would appear to deliver on these overriding policy intentions.

We have, however, set out specific observations on the proposals below.

## The introduction of the exit payment cap

Legislation introducing the £95,000 exit payment cap is already in place and will come into force before this consultation exercise has been concluded. The scheme is required to be amended, therefore, in order to comply with the cap for those employers included within the schedule to the Restriction of Public Sector Exit Payments Regulations 2020.

Overall the proposals appear to achieve that aim. However, it is disappointing that these proposals have not been organised to take effect in a constructive manner with the £95,000 cap – the resulting collision of contradictory legislation from 4 November 2020 (the £95,000 cap restricting early retirement pensions while the LGPS Regulations prescribe full payment of pension) has led to much uncertainty and confusion. Ironically, this will have led to greater consultancy and legal fees being paid by councils to address a matter which was intended to reduce public sector expenditure.

## The introduction of wider exit payment reforms

Unless an employer has a particularly generous discretionary compensation policy in place we do not expect the proposed reforms to have any significant impact on those employees aged under 55, for whom the compensation arrangements will remain largely unchanged, save for the introduction of the maximum 66 weeks' pay ceiling.

The greatest impact will be felt by those aged 55 and above, who will see the overall value of their compensation and retirement packages reduced in the event of early retirement. This was, however, one of the overriding principles behind the reform proposals and so any perceived loss in the overall value of the exit package is to be expected.

Overall whilst we appreciate the aims of the wider exit pay reform proposals and believe they will achieve the wider aims of the reforms, we are very disappointed that the consultation is so unclear on these crucial wider issues. We are far from alone in not having appreciated the intended trade-off between redundancy pay and early retirement pension on initial reading of the proposals, and the package was still being presented as largely focussed on the £95,000 cap; whereas far more local government workers will be affected by these wider reforms. Furthermore, the publication of these proposals, and beginning of the fixed consultation period, without the draft Regulations until much later, has been very unhelpful to funds and employers.

We would strongly urge MHCLG and other Government departments to reflect upon the negative reaction these proposals have had in terms of their lack of clear communication and consequent ill-feeling among the local government community as a whole. This is regardless of the proposals themselves: the manner of communication itself has, in our experience, reflected badly on MHCLG.

## Inclusion of statutory redundancy payments

The current proposal suggests that the pension strain cost be reduced by the statutory redundancy payment, as well as any additional discretionary compensation that might be payable to the employee. We believe there is a risk that the inclusion of the statutory redundancy payment is punitive to the lowest paid, for whom the payment might well be an immediate financial lifeline on being made redundant.

We would rather see the statutory redundancy payment element removed from the final changes, resulting in all those being made redundant eligible to receive both statutory redundancy payments and unreduced pensions, where they are under the exit payment cap, but no additional discretionary lump sum compensation. We believe this is consistent with the Government's aim of ensuring no six-figure exit payments are made to public sector workers but is fairer to lower paid workers.

### Application

There had been some confusion regarding which scheme employers might actually be subject to the wider exit payment reforms. The schedule to the draft "Local Government Pension Scheme (Restriction of Exit Payments) (Early Termination of Employment) (Discretionary Compensation and Exit Payments) (England and Wales) Regulations 2020" seeks to clarify the extent to which the wider exit payment reform impacts LGPS scheme employers, in particular confirming that the reforms do not impact further and higher education establishments.

In terms of the employers covered by the wider exit pay reform proposals we believe the correct approach has been taken in updating the schedule to the draft Regulations.

### Member choice

Scheme members are already presented with a number of choices regarding the manner in which they wish to receive retirement benefits from the scheme, specifically around conversion of pension to lump sum. The introduction of the exit payment cap, together with wider exit pay reforms, looks set to add considerably to the choices scheme members will have to make.

These choices could have lifelong financial implications. This element of choice comes with certain risks, for example;

- Obtaining independent financial advice can be expensive, and the costs may not be proportionate to the payments in question for many members. A lack of advice may lead to members making decisions which they later come to regret. In some cases this may lead to appeals against LGPS funds on the grounds of insufficient or misleading communications;
- There is an increased opportunity for pension scammers, who may seek to mislead members into taking redundancy cash with a promise to "liberate" their pension afterwards;
- There is also an incentive for unscrupulous employers to try and pressure members to make the decision that is cheapest for them, which would typically be taking the exit payment and fully reducing or deferring pension.

### Requirement for payment of strain cost

We understand that pension strain must now be paid in full by the employer* before retirement benefits can be put into payment – albeit this requirement is not clear from the consultation, another example where communication could have been better in this exercise.

However, such strain payments will presumably be on the basis of standardised GAD factors (which are draft only at time of writing and came three weeks after this consultation began, a further example where funds and employers were left without full information to consider these proposals properly). If these factors must be used in the case of early retirements from public sector employers, this gives rise to various issues:

- Regardless of the GAD assessed amount, different Funds have different investment and funding strategies which mean the true cost to the employer is higher or lower than this standardised amount: such shortfalls or excesses will simply have to be met by the employer at a later stage, and it is unclear why the fund may not charge the employer the fund-specific amount for funding purposes, whilst still using the GAD factors for £95,000 cap and redundancy pay trade-off benefit purposes.
- If the employer does not pay the strain cost, or delays doing so, the member is presumably left without their pension, through no fault of their own.
- What is the intention where redundancy occurs due to the failure of the employer, or while there are disagreements about recovery of a failing employer? Again, there is the risk that employees are left without LGPS benefits in such circumstances outside their control.
- The draft Exit Payment Regulations permit a member to elect the day before they leave to pay all (or some) outstanding strain cost and receive an unreduced (or partially reduced) pension. However, this payment need not be made until 1 month after the date of leaving. This could result in a scenario where a pension is put into payment unreduced on the expectation that the pension strain will be paid by the member but the pension strain is never paid. Presumably then the pension in payment would be reduced. In these circumstances can MHCLG confirm whether or not this would be an unauthorised payment under paragraph 2(3)(b) of schedule 28 to the Finance Act 2004.
- Fund administrators will already have fund-specific early retirement strain cost factors in operation which are appropriate to the fund's investment and funding strategies: even if standardised factors are imposed on public sector employer cases, it adds to the complexity and resource to run a second set of fund-specific factors for other employers. As a consequence it appears that funds will in effect be forced to apply factors to all employers which are perhaps not appropriate to their fund's strategies.

*NB in cases where the £95,000 cap is breached it is also proposed that the member may pay in their own money to bolster their early retirement pension. It should not be underestimated how much additional complication and delay this principle will add to early retirement processes within LGPS Funds.

### Potential for undue pressure from employers

Our example set out in the annex to our response gives an indication of the potential for significant cost differences to employers, depending on the options taken by employees. The example demonstrates a total employer cost ranging from £50k down to £15k, depending on whether the individual elects to receive pension and no/reduced lump sum compensation or whether they take a full reduction to their pension or elect to defer their pension and receive lump sum compensation only.

As noted on the previous page, this could give rise to the risk that employers seek to influence the decisions taken by employees, with the potential that pressure is placed on them to choose the least costly option to the employer.

To reduce the risk of coercion by scheme employers we would prefer to see employers and administering authorities allowed to continue current practice whereby strain costs can be remitted to funds over an agreed period (usually no more than 3 years).

### TUPE transfers

There is a lack of clarity over how the proposals will take effect TUPE situations. Our understanding is that the requirement to automatically provide unreduced benefits on redundancy only seems to be removed for certain employers (as set out in the separate HM Treasury Regulations). This may cause an issue with TUPE-transferred employees within admission bodies and could result in windfall gains in certain circumstances. For example;

- Members made redundant immediately before a TUPE transfer from a local authority to a private sector contractor would be subject to the restrictions and reductions to LGPS benefits, while
- Members made redundant the day after the same TUPE transfer would apparently not suffer restrictions or reductions to LGPS benefits, and the contractor would be obliged by LGPS Regulations to bear a potentially much greater cost than the local authority.

On the flip side, there appears to be a risk that someone historically transferred out and now brought back in-house could lose the right to unreduced benefits, and may also have the exit payment cap applied, notwithstanding the grandfathering of employment rights which TUPE is typically viewed to confer on such staff.

**6. Do you agree that the further option identified at paragraph 4.8 should be offered?**

- Yes we agree that giving members the option to defer their benefits should be offered if it means they avoid losing their immediate redundancy pay.

If the Government wishes to include pension strain in any reform of public sector exit payments then it is important that employees are given the necessary flexibility over how they receive benefits. Immediate financial pressures (e.g. mortgage repayments, etc.) may result in some employees preferring immediate receipt of lump sum amounts over the longer-term benefit that may be gained from the immediate receipt of a reduced ongoing pension.

By enabling those aged 55 and above to defer their pension and receive lump sum compensation instead would also be fair and equitable when comparing the choices of those aged under 55 who would only be entitled to receive lump sum payments.

We note that the draft regulations 4(4) and 5(3)(b) of "Local Government Pension Scheme (Restriction of Exit Payments) (Early Termination of Employment) (Discretionary Compensation and Exit Payments) (England and Wales) Regulations 2020" seek to close any possible loophole by which an employee could elect to defer benefits on redundancy or business efficiency retirement only to later claim them and seek the scheme employer to waive any subsequent early retirement reductions.

**7. Are there any groups of local government employees that would be more adversely affected than others by our proposals?**

Please see our response to question 1 above.

**8. From a local government perspective, are there any impacts not covered at Section 5 (Impact Analysis), which you would highlight in relation to the proposals and/or process above?**

No, we believe all the necessary impacts have been covered.

**9. Are these transparency arrangements suitably robust? If not, how could the current arrangements be improved?**

We believe the exiting transparency arrangements are suitable as a means for local authorities to manage the changes proposed as part of this consultation. We are not aware of any specific reason linked to these proposals that would require additional reporting or disclosure to be required at such point as the reforms are implemented.

**10. Would any transitional arrangements be useful in helping to smooth the introduction of these arrangements?**

- *The proposed transitional arrangements should ensure a smooth transition*
- *However there was no such transition in introducing the £95,000 cap, which will by itself have caused many problems for local government employers and the LGPS Funds.*

We are aware of the Government's desire not to include a long lead in time for the introduction of these proposed changes, to ensure the current provisions are not open to abuse.

However, we also note the lack of transitional measures, and indeed the highly unsatisfactory collision of regulations, brought about by the introduction of the £95,000 cap on 4 November 2020. This places local authorities and LGPS funds in an impossible situation where in effect they will have to choose which set of regulations (exit payment cap or LGPS early retirement) they are obliged to break on the early retirement of a member with a suitably high package value. It is inevitable that administering authorities will face legal challenge whichever option they take, which will be time consuming, expensive and detrimental to the service they can offer to LGPS members and employers. Given that the Small Business, Enterprise and Employment Act 2015, that gives rise to the Exit Cap is 5 years old it is difficult to see any reason to rush through these changes now.

**11. Is there any other information specific to the proposals set out in this consultation, which is not covered above which may be relevant to these reforms?**

We are not aware of anything specific to these proposals not covered within the consultation, beyond any specific points raised in response to the previous questions.

**12. Would you recommend anything else to be addressed as part of this consultation?**

It is also disappointing that the proposals will mean changes to LGPS Fund administration in a timetable which cannot be accommodated by the administration software, thus leading to an extended period of manual calculations to be carried out by already stretched pension teams.

We would urge MHCLG to reconsider the various other issues impacting on LGPS administration (McCloud, GMP equalisation etc) and stagger these requirements accordingly.

HYMANS ROBERTSON

### Example (typical case where discretionary compensation < pension 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.