HYMANS ROBERTSON

Private & Confidential
Consultation on Exit Payment Cap
Workforce, Pay & Pensions Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

12 June 2019

Dear Sir

Restricting exit payments in the public sector – Hymans Robertson response

Hymans Robertson LLP is pleased to provide its response to HM Treasury's "Restricting exit payments in the public sector: consultation on implementation of regulations" published 10 April 2019. We are responding in our capacity as a firm of pension professionals, actively working in the public sector, particularly advising on the Local Government Pension Scheme (LGPS).

The Annex to this letter sets out our formal response to the proposals 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. Alongside our actuaries there is a team of 15 consultants providing investment advice and a team providing benefit and governance advice to our LGPS clients.

Our long history of working with local authorities means that we have developed a real understanding of the pressures they face, not least in the compliance with LGPS Regulations and the implications of long term benefit costs including early retirements.

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

Yours sincerely

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Annex – Our response

Question 1

Does draft schedule 1 to the regulations capture the bodies intended (described in section 2.1 above)? If not, please provide details.

In general, we believe the schedule captures the bodies intended, as described in section 2.1. Specifically, in relation to employers participating in the LGPS, we appreciate the exclusion of further and higher education establishments along with housing management companies, given they are no longer considered to be under the umbrella of the public sector.

We do have some concern that any newly created public sector body will not be covered by the cap until it is added to the Schedule. While the expectation is that they would voluntarily restrict exit payments there is no guarantee this would be the case, leading to the possibility of a two-tier situation arising. It would be preferable if, as a consequence of their formation, any new public-sector body is automatically added to the schedule within any legal documentation setting them up.

Question 2

Do you agree with the current list of bodies in scope, for the first round of implementation? If not, please provide reasons.

For Local Government purposes it would appear that the relevant organisations set out in Part 1 to schedule 2 to the Local Government Pension Scheme Regulations 2014 have been included in the first phase, along with a small number of those organisations included within Part 2 of that Schedule. We do wonder, however, if explicit reference is required in order to capture entities falling within paragraphs 5 and 6 of Part 2 of Schedule 2, namely:-

5. An entity connected with a body listed in paragraphs 1 to 5 of Part 1 of this Schedule where "connected with" has the same meaning as in section 212(6) of the Local Government and Public Involvement in Health Act 2007.

6. A company under the control of a body listed in paragraphs 6 to 24 of Part 1 of this Schedule where "under the control" has the same meaning as in section 68 or, as the case may be, 73 of the Local Government and Housing Act 1989 (except that any direction given by the Secretary of State must be disregarded, and any references to a local authority treated as references to such a body).

Question 3

Do you agree with the exemptions outlined? If not, please provide evidence.

Stated exemptions

As previously stated, we appreciate that further and higher education establishments and housing management companies are no longer considered to be public sector, so thereby exempt from the cap. We make no explicit comment on the other organisations that are planned to be exempt from the cap, given they have no direct involvement in the LGPS.

We agree with the principle behind the specific Fire Scheme lump sum exemption, as this would not increase the actuarial value of a firefighter's pension as a result.

Inclusion of early retirement strain

We are still concerned, however, with the desire to include pension strain as part of the exit cap where an individual's employment ceases on the grounds of redundancy or business efficiency aged 55 or over, for the reasons set out in our response to the original HM Treasury consultation in 2015. Our concerns seem particularly relevant given that the draft Regulations confirm the exit cap would remain at £95k even though regulation 153A(9) of the Small Business, Enterprise and Employment Act 2015 allows Regulations to change the level of the cap.

We would argue that cost of living increases will mean that over time more members will be affected by the cap. The key issue here is that many council (and other) employees will be caught by this cap on early retirement simply by virtue of having a reasonable length of service, and not due to them receiving a particularly large salary or exit remuneration package. We feel that the inclusion of early retirement pension strain will unduly affect a large number of employees whom the general public would never consider to be "fat cats". On a very simplified basis, some examples of LGPS members who will or will not be caught by these proposals are as follows, noting that in all four cases the member's LGPS pension would be a similar amount (broadly £15,000 p.a.):

Member	A	B	C	D
Salary	£30,000	£45,000	£90,000	£150,000
Exit age	55	55	60	64
Service	30 years	20 years	10 years	6 years
Early retirement pension strain*	£112,000	£112,000	£58,000	£12,000
Scope for other exit remuneration**	Nil	Nil	£37,000	£83,000
Limit member's pension? ***	Y	Y	N	N

*The strain cost is calculated differently in different Funds; for simplicity we have used the actual current strain factors in place for a typical Fund.

**The shortfall of the early retirement strain vs the proposed £95,000 cap

***If the early retirement strain exceeds the proposed £95,000 cap, then there should be scope for the member's pension to be deferred and/or reduced, under the current proposals: see "Interaction with LGPS Regulations" below.

It can be seen from the above that some counter-intuitive situations will arise: members with lower salaries will be caught by these proposals whereas much higher paid members will not, depending on the early retirement age and length of service. Observers will be surprised to see that four individuals on the same pension will be affected very differently from how the proposals are being put forward, i.e. that **very highly paid staff could escape the impact whilst much lower paid staff could be caught.**

Interaction with LGPS Regulations

If funding strain is to be included as currently set out then we believe further amendments to the LGPS should be considered, in addition to those already provided for within paragraph 5 of Schedule 6 to the Enterprise Act 2016. We appreciate that this would fall to MHCLG to take forward, but we believe consideration should be given to enable the scheme member to choose to defer payment of an immediate, possibly reduced, pension where employment is terminated on the grounds of redundancy or business efficiency rather than having a permanent reduction to their retirement benefits imposed on them.

Any further changes to the LGPS Regulations would of course need to be drafted in such a way as to apply only to those individuals who are impacted by the exit cap – i.e. we would not expect individuals employed by further or higher education establishments or housing management companies to be worse off as a result of changes to the scheme rules aimed specifically at those who are affected.

Question 4

Does the guidance adequately support employers and individuals to apply the draft regulations as they stand? If not, please provide information on how the guidance could be enhanced.

We are concerned that there are several instances where the wording of the draft Regulations, Guidance and Directions appears to be contradictory. For the application of the exit cap to work effectively it is important that any ambiguity or uncertainty is cleared up ahead of the exit cap being introduced.

Examples include:-

- The option to exercise a discretion on account of workplace reforms requires clarification between the wording of the HMT Directions ("workplace reform") and the supporting Guidance ("urgent workplace reform") and what this means.
- Relaxing the cap – clarity is required when certain types of approval are required. Specifically for local government in England the guidance suggests approval would be required from the sponsoring Department (e.g. MHCLG) and HM Treasury, although this is not reflected in the draft Regulations or the HM Treasury Direction.
- Recording and reporting – there is no specific requirement within the draft Regulations for employers to record instances where an exit payment is capped, although the guidance makes a recommendation they do so. We see no reason why this can't be mandated in the Regulations themselves.

Additional comments regarding the Regulations, Guidance and Directions are set out below: -

New employers

We believe it is inconsistent that any newly created public sector body set up as part of a machinery of government change is not automatically covered by the cap until included in Schedule 1. While this might only be a procedural issue, we do wonder if it introduces the risk of an individual moving from an employer covered by the cap to one where they are not as a means of circumventing the cap and gaining an advantage over others.

Pension strain

As we have previously stated, pension strain isn't about receiving a bigger pension, as suggested in the guidance, but a consequence of receiving the accrued pension for longer. So while individuals may be receiving a pension for longer, for many who may be impacted by the cap this will not be any sort of windfall.

Looking specifically at the calculation of the strain cost, the draft Regulations themselves do not specify how this is to be done. Within the LGPS strain costs are calculated by each Fund's appointed actuary. This has the advantage of accounting for specific demographic and funding approach differences that exist across funds, resulting in different factors being used by different funds.

The guidance suggests, however, that for the purposes of the exit cap, strain costs should be calculated by the scheme actuary.

If the LGPS retained its current position the early retirement strain cost will vary from one fund to the next, due to different factors being used by different funds. This raises the prospect of two members in identical circumstances in separate LGPS funds, where one is caught by the cap and one isn't. The different factors could be due to different actuarial advice, or to the factors having been set at different times in the past.

While the "obvious" answer might be to adopt a single set of strain factors across the LGPS in order to ensure consistency across the scheme, the fact there are significant demographic differences across the funds means that some employers could overpay strain cost and as a result reduce their contributions while others could be underpaying, leading to an increase in employer contributions.

It is possible that a single set of factors could be used only for the purposes of applying the cap with local factors being used to calculate the actual strain cost. However, this would result in duplication, complexity and could lead to challenge if it results in a member's exit payment is over £95,000 on a single factor basis but less on the locally determined basis.

If factors were only to be made consistent across public sector employers, a different inconsistency would then arise between public sector and non-public sector employees retiring in identical circumstances. Either way, **these proposals including early retirement pension strain will give rise to inconsistencies.**

There is also the discrepancy between treatment of early retirements in the unfunded schemes and the LGPS; it is crucial to ensure similar treatment throughout the public sector, and that LGPS members are not in a worse position than their NHS/civil servant/teacher counterparts.

Pay in lieu of notice

There is the risk of confusion where the pay in lieu of notice is exempt from the cap where it is less than a quarter of the person's salary.

Order of priority

The draft Regulations don't as suggested, prescribe an order of priority where an individual receives one or more exit payment in respect of a single event (e.g. statutory and/or enhanced redundancy, pay in lieu of notice, pension strain, etc.). We believe both the Regulations and guidance need attention to rectify this.

LGPS

For the cap to work effectively in local government, specific amendments are required to the LGPS Regulations. It is unclear, however, what would happen between the enforcement of these Regulations and any changes being made to the LGPS. There is a risk of conflict between two separate statutory instruments which could lead to potential unfair dismissal claims if an individual is adversely impacted by any delay in changes to the LGPS.

For example, the LGPS requires an individual to receive the immediate payment of unreduced pension on redundancy/efficiency retirement, but these proposed Regulations say they can't. It is unclear how an employer could make a payment of up to £95k as an alternative.

Employers not covered by the cap

We are not sure how likely it is that public sector authorities not currently impacted by the cap will voluntarily adopt commensurate arrangements.

Exceeding the cap

The assumption is that employers would cap contractual redundancy lump sums (i.e. any discretionary element over and above the statutory amount) and allow individuals to receive payment of their pension top up payment in full (capped at £95k) in circumstances where the pension strain exceeded the cap. We believe there should be greater flexibility for individuals to choose whether they defer payment of their pension and receive a cash alternative or suffer an appropriate reduction to their pension, rather than have a solution imposed on them.

Compliance

No specific comment on this element of the guidance.

Transparency

No specific comment on this element of the guidance, as it seems to fit in with the current reporting requirement relating to exit payments paid during a financial year.

Individual responsibilities

We appreciate the requirement for employees to notify public sector employers where they have been impacted by the exit cap, but have concerns where an employer could be subject to sanction where they are not informed by an individual but subsequently end up making an exit payment or exit payments that ultimately exceed the £95k cap. We wonder if stronger sanction is required for individuals who fail to inform, rather than punishing an employer and leaving it to them to decide what steps to take in recovery of any payments made.

Relaxation of the Cap

For local government we would need to see what guidance MHCLG proposes in this area to know how effective it may be. At this stage it is unclear how this will link, if at all, to the need set out in the proposed guidance for local government employers to also obtain HM Treasury approval in all discretionary cases.

If HMT approval is required for all cases of discretionary exceptions then we wonder if they are resourced to receive potentially significant numbers of requests across the full breadth of central and local government, particularly given the continuing effects of austerity measures in recent years.

Scope of relaxation powers

We do have a slight concern that the need to sign off each discretionary exemption could introduce unwanted bureaucracy and delay, particularly in cases of hardship or urgent workplace reforms. The guidance itself also doesn't provide much detail on the process to be followed, timescales, etc. which we think might be expected to be included.

Mandatory relaxation

Generally, we agree with the circumstances where a mandatory relaxation would apply.

On TUPE, however, we do wonder if this exclusion could mean an individual who is outsourced being better off financially than an individual remaining employed by a public sector employer. Additionally, we wonder if TUPE could be abused as a means of circumventing the cap.

Discretionary relaxation

We agree that employers should have the option available to them to relax the application of the cap, particularly on grounds of hardship or where an arrangement had been already agreed ahead of the cap being introduced.

The option to exercise a discretion on account of workplace reforms does, however, require clarification between the wording of the HMT Directions ("workplace reform") and the supporting Guidance ("urgent workplace reform") and what this means.

We believe that what constitutes urgent workplace reform should be clearly defined, rather than be open to interpretation. We assume that if not achieved via this guidance it would be up to each Government Department to set this out in supplementary guidance.

Question 5

Is the guidance sufficiently clear on how to apply the mandatory and discretionary relaxation of the regulations, especially in the case of whistleblowers?

In principle the discretionary waiver option is welcome, but in practice there is the danger that it may be applied only for those individuals for whom the government intends to be impacted by the exit cap. As a result the cap would be implemented for those lower-paid individuals whose early retirement strain cost is the only reason they breach the cap (without being considered "undeserving" in any commonly accepted sense).

In order for the guidance to provide the necessary detail employers require it would be helpful if more specific detail were included around specific elements such as:

- the actual process to be followed when considering mandatory or discretionary relaxations;
- what is expected to be included within any business case for discretionary relaxation.

As previously stated it is also unclear with local authorities whether they would need to seek HM Treasury approval in each case, or is this a Full Council responsibility or a MHCLG responsibility.

Question 6

Is there further information or explanation of how the regulations should be applied which you consider should be included in the guidance? If so, please provide details.

Please see our responses previously given to Question 5 above.

Question 7

Are there other impacts not covered above which you would highlight in relation to the proposals in this consultation document?

As stated in our response to question 3 above we are concerned at the lack of any indexation of the exit cap, either from 2015 to date or once it has eventually come in to effect. While we appreciate the underlying policy intention to restrict excessive payouts in public sector, as we set out in our response to the 2015 consultation dated 27 August 2015, and again above, we believe the cap as currently intended to be implemented will impact even moderate earners with long service, rather than the higher earners we believe are the intended target of the cap. If the level of the cap is not indexed appropriately then it will increasingly impact those earners who would not be regarded as the intended audience for this measure. This in turn could increase difficulties for public sector bodies to manage their workforces and introduce necessary changes to the delivery of services.

From an LGPS perspective it is also imperative that the timing of these draft Regulations and associated guidance and Directions work together with any changes required to the LGPS Regulations, in order to prevent any inconsistencies and reduce the risk of future unfair dismissal claims as a result.

As we have stated, in particular in our answer to Question 3, we have concerns that the inclusion of pension strain costs as proposed would have an adverse impact on moderate earners, for whom we believe this measure is not the intended audience. As we stated in our response to the original consultation in 2015 , if the government's aim is to restrict unduly generous packages, we would suggest it is necessary to apply a separate test for the early retirement strain cost element. This could be achieved by:

a) applying a cap only to those on pensionable pay above a certain level, or

b) applying a two-tier cap, one for the discretionary non-pension element and the other including the early retirement strain cost. The second cap could be set in such a way as to reduce the likelihood that those earning below a certain pay level would be affected. For instance, our broad analysis suggests that if the relevant pay level was to be, say £90,000, then this would require the second combined cap to be set at something like three times the proposed level, or

c) keep the cap at its proposed level, but restrict its application to only discretionary elements of the exit package. Any non-discretionary elements would sit outside the cap e.g. such as the right under LGPS Regulations to access unreduced pension benefits if retirement is compulsory.

Question 8

Are you able to provide information and data in relation to the impacts set out above?

We have outlined some sample figures in our response to Question 3, regarding the impact of including early retirement pension strain within the £95,000 cap. We would be happy to provide more details, for instance covering further examples and historic data, if that was required.