

CAP ON PUBLIC SECTOR EXIT PAYMENTS LOCAL GOVERNMENT ASSOCIATION RESPONSE

This response is submitted by the Local Government Association (the LGA), on behalf of local authorities. The LGA is the national voice of local government. We work with councils to support, promote and improve local government. The LGA covers every part of England and Wales and includes county and district councils, metropolitan and unitary councils, London boroughs, Welsh unitary councils (via the Welsh LGA), and fire and national park authorities. The Workforce Team of the LGA offers advice on employment issues and represents local government employer interests to central government, government agencies, trades unions and European institutions.

Our response is based on views expressed by authorities following a consultation that we carried out with councils and fire authorities. This incorporated views of authorities and the various Local Government Pension Scheme funds/fund managers.

Where possible we have answered the specific questions asked in the consultation. However, we feel that there are many other issues that the questions do not address, but which need to be raised and taken account of in the progression of this policy if it is not to cause significant difficulties for employers. In addition some of those points and responses are interlinked and therefore we have organised our response around themes some of which incorporate a number of the consultation questions. This means that not all of the questions have been answered, and when answered not in numerical order.

This proposal raises a number of very complex legal and technical issues in relation to employment and pensions. We have dealt with employment law and general HR management issues first with appropriate reference to related pensions issues but have then dealt with those pensions issues in more detail in a separate section.

Any queries regarding this response should be sent to simon.pannell@local.gov.uk or philip.bundy@local.gov.uk.

The effectiveness of the consultation

However, firstly, we wish to raise our significant concerns about the effectiveness of the government's consultation exercise in this instance.

Issuing a consultation on a policy proposal which has wide-ranging impacts on employers of a substantial part of the economy's workforce and entails analysis of the very complex interplay of various legislative and contractual provisions with less than 28 days to submit a response and, furthermore, in August, appears to show a lack of due care in relation to the development of this policy. It would also appear to be a failure to adhere to the government's own principles in relation to consultation exercises, identified in the consultation paper which are available at:

<https://www.gov.uk/government/publications/consultation-principles-guidance>

Of particular relevance is the following provision:

"Timeframes for consultation should be proportionate and realistic to allow stakeholders sufficient time to provide a considered response and where the consultation spans all or part of a holiday period policy makers should consider what if any impact there may be and take appropriate mitigating action."

We do not consider that the timeframe for this consultation was in any way proportionate or realistic, both due to the very short period allowed for responses and the timing of it, with all the period allowed falling within a holiday period (as defined by the consultation principles). We wish to be informed of the policy maker's considerations on this matter and of the mitigating action that is to be taken.

As you will see from our response below, the consultation exercise that we carried out raised a substantial number of concerns, even in the inadequate period that was allowed. We hope that it is recognised that it is important that there is full engagement with us over these issues and others that will inevitably be raised in the coming weeks, so that they can be given the consideration necessary to ensure that this policy does not lead to negative consequences for the sector.

PART 1: EMPLOYMENT LAW AND HR MANAGEMENT ISSUES

The payments that may be included in the cap

Question 3: Do you agree that the payments listed above should be subject to a cap on exit payments under the terms set out above? If you believe certain payments types should be excluded please provide rationale and examples.

Local authorities have a number of concerns with the payments the government intends to include in the cap.

Annual Leave

For example, including payments for untaken annual leave would seem inappropriate. This should really be seen as falling within the category which is excluded from the cap i.e. remuneration for normal ongoing activities that

are part of employment as if a person has not taken the proportionate amount of their annual leave, the payment effectively represents pay for work they have carried out. Additionally, there is also a legal requirement to pay for untaken annual leave provided by the Working Time Directive and the Working Time Regulations. It is hard to see how complying with this requirement could be said to be disproportionate. In most cases employees who are leaving will be told to take their accrued leave. However, there will be circumstances where this is not desirable. To include such payments in the cap could lead to employees taking their accrued leave in circumstances where the employer would not wish them to do so, due to the impact that it would have on the delivery of the service. This could particularly be the case where employees are leaving and have a limited time to handover to those staff remaining.

Further, in respect of the proposal to include extra leave, although it is probably rare for an employer to offer such extra paid annual leave, this may arise where the employer is being flexible in an attempt to assist the employee with finding another job, for example providing leave to attend an interview. It would seem inappropriate to potentially restrict such a practice as the earlier an employee finds alternative employment the better for both the individual and the state.

Notice pay

Including pay in lieu of notice could also cause problems for employers. Employees are entitled to a period of notice under the terms of their contract or as set out in the Employment Rights Act 1996. Payments in lieu would not be used in local government without good reason. Including the payment in the cap could lead to further problems in relation to potential litigation if the individual concerned effectively receives a reduced compensation payment as a result of being paid damages for breach of contract.

“Special severance payments”

The inclusion of “special severance payments” in the cap could also cause problems for employers as it would greatly affect the willingness of an individual to settle a potential claim or a tribunal claim.

It appears from the consultation document that aside from serious ill health, injury and death compensation, an employee would only be able to receive “special severance” type compensation outside the scope of the cap “following litigation” for breach of contract or unfair dismissal. The true intention around this area needs clarifying.

Precisely when will the proposed exclusion of compensation following litigation apply? Will this be when litigation is pursued to a final judicial decision in an employment tribunal or court, or will this exclusion also incorporate settlement agreements reached following the instigation of litigation, or indeed when there are prospects for litigation.

Further, aside from unfair dismissal, other statutory claims could arise from an employee's exit, such as one for sex discrimination. Therefore it is our view that compensation for such claims should also be outside the scope of the cap.

In any event it is worth noting that in local government, settlement agreements would usually only be used in appropriate circumstances, in accordance with CIPFA, or auditor guidance, generally with the aim of reducing costs to taxpayers by avoiding expensive litigation where there may be uncertain prospects of success. However, the inclusion of special severance payments could mean that an individual will refuse to settle what is likely to be a complex tribunal claim, and so this part of the proposal could effectively increase costs and administrative burdens on councils (although we recognise that the proposal includes a provision whereby the full council (or a meeting of members in fire and rescue authorities) could waive the cap in exceptional circumstances.

Redundancy pay

The consultation paper talks about redundancy pay and it is not clear whether within the policy there is to be a distinction drawn between statutory redundancy pay and additional discretionary or contractual redundancy pay.

There is an obvious argument that statutory redundancy pay is different to any additional redundancy or severance pay granted.

Prioritisation and deemed order of payments

Once the government finally decides on the payments that could be in scope, one of the issues which is also raised in our response to question 11 is the question of what will be the order of priority of payments to be scheduled before the cap is applied, and who will decide that order? Will it be set out in legislation with all of the consequential amendments made to the Employment Rights Act 1996 and the various pensions regulations to qualify the rights to payments? Will it be an employer discretion to apply the cap where it sees fit? Or will it be an employee choice under which, for example, they could choose to forego part of their redundancy payment rather than their pension benefits, or vice versa? Further, could they choose to have the excess deducted from their pension only and not from their LGPS tax-free lump sum? This would involve additional bureaucracy in terms of preparing a wide range of estimates to enable them to make such choices.

The identification of priorities may also be important for the purposes of identifying tax liability for the severance payment. For example, if the cap is breached by £10,000 and the redundancy payment is £40,000, will the £10,000 be deducted from the £30-40,000 end of the redundancy payment (leaving £30,000 RP tax free) or from the £0-10,000 end of the payment meaning that part of the payment (the £30-40,000 end) would be taxable?

Question 1: What other forms of exit costs do you think are relevant in this context?

None were identified.

Question 2: Do you agree that the government should introduce a cap on the value of public sector exit payments on the basis set out above?

The majority of the authorities that responded to us expressed concerns with the introduction of the cap, particularly in the light of the payments to be included in it, although many recognise the overall aim of offering value to money to the taxpayer. As a point of principle several authorities also felt that the national application of such a cap conflicts with the policy of devolution of responsibilities to local councils who are run by democratically elected councillors and are able to take their own decisions based on financial circumstances and the business case.

Notwithstanding the conflict with devolution principles, authorities have questioned the necessity of applying the cap to local government, which already operates within a transparent framework including published policies and whereby an exit payment of over £100,000 has to be approved by full council. It could be that further assessment of the impact of such policies in local government be undertaken in local government before application of additional mandatory rules are necessary.

Authorities already manage exit payments very tightly, with the number of instances of payments exceeding the proposed £95,000 cap being low, particularly when compared with other parts of the public sector taking into account the number of employees employed.

Furthermore, the years referred to as evidence for the policy are those where major cuts to funding had taken place, resulting in major restructuring of authorities, including senior management teams, which were more likely to be made up of long-serving and older employees. Such decisions were made to create efficiency savings, i.e. the costs of termination will be fully recovered in longer term savings in order to balance budgets.

Question 4: Are there further payments that the government should include?

None were identified.

Question 5: Do you agree that a cap on exit payments should be set at £95,000? If you think an alternative level would be more appropriate, please provide evidence and analysis to support your proposal.

The majority of councils offered no support for setting the cap at this level if all of the payments are included as proposed, particularly strain on fund costs.

The consultation document asks for evidence and analysis to support alternative proposals, however, local authorities are not in a position to supply such data, particularly in the very short timescales involved. There is little evidence in the consultation document for setting the cap at £95,000 without taking any other factors into account such as efficiency savings achieved. It is accepted it would fit with statements made in relation to headlines around “six figure pay-outs” although such headlines usually fail to have the in depth analysis which the government requires into the reasons behind such payments.

The consensus among the respondents to our consultation exercise felt that the policy as drafted with a cap set at £95,000, which includes strain on fund costs, unjustifiably penalises older, longer serving, junior to middle ranking employees in local authorities. Most respondents felt that it was not the intention of the government to target such employees in this way and that this policy as it stands misses the mark of what many felt was believed to be the target of high earners. One authority suggested that this would be more fairly achieved if strain on fund costs were removed and the cap could potentially be reduced.

This is particularly the case as those employees who will more likely bear the brunt of this policy will be penalised due to having been long-serving members of the Local Government Pension Scheme. The factors that are taken into account in calculating redundancy payments in local government are in practice relatively modest and result in reasonable redundancy payments. Some authorities pay only statutory redundancy pay, without enhancing the number of weeks' pay. The reason why this policy would bite would be, in the vast majority of cases, due to the fact that an employee had been a long-serving employee and contributor to the LGPS. It is the benefits that they (and their employer through the provisions of the scheme) have funded that would result in them losing out as a result of this policy.

The consensus among authorities was that this policy, particularly including the strain on fund cost in the cap, would erode the ability of employers to manage their workforce reduction programmes, which are continuing, in an efficient and effective way. This will be exacerbated by the potential for the change in the tax treatment of termination payments and the increase in pension age, which will increase strain on fund costs.

The impact of this policy will be felt in a number of ways. There is likely to be an increase in the number of employees who are currently eligible for early retirement seeking to leave now under voluntary redundancy arrangements, prior to introduction of the cap. This could place employers in a difficult position in that this could result in a drain of knowledge and talent, but on the other hand to refuse requests for voluntary redundancy could lead to further compulsory redundancies.

In the future, should the policy be implemented as it stands, there will be fewer volunteers for redundancy, bearing in mind that even if the cap might not actually 'bite', many employees would not be able to establish whether the

impact of the strain on fund pension payment would mean the cap would or would not 'bite'. This will have a negative effect on the efficacy of restructuring programmes. Instead of receiving requests from volunteers to leave, employers will have to make compulsory redundancies involving full consultation and notice periods.. This may well mean that any savings in a cap will be eroded, if not eliminated. Also, although allowing an employee who has an entitlement to an unreduced pension to volunteer for redundancy, as opposed to compulsorily dismissing an employee who doesn't, may have marginal financial implications, the positive effect of being able to reduce the number of compulsory redundancies on morale and service delivery should not be overlooked.

There are issues about how can such a cap be managed in practice, across the wider public sector, particularly given the varying degrees of contractual and statutory entitlements to redundancy payments and pension benefits. There needs to be careful consideration of this issue, if for example, the policy is not to result in additional costs to public sector employers in terms of fighting claims for breach of contract.

Whatever the level of any cap, it would need to be subject to an appropriate indexing mechanism to maintain its current value otherwise the policy would begin to impact on more lower earning long-serving employees.

The policy could also have further impact on the ability to recruit and retain skills and knowledge in the public sector. Authorities are already seeing difficulties recruiting in professions such as IT and legal, as they are failing to compete with the private sector. These difficulties can be more acute in London and the South East.

Scope

Question 8: Do you agree that the government has established the correct scope for the implementation of this policy?

The exclusion of publicly funded bodies on the basis that they are operating on a commercial basis begs the question of if these proposals are bad for business then will they not be bad for the public sector which operates on an increasingly commercial footing within a complex labour market? The government's proposals to exclude banks and other publicly funded bodies where some of the largest exit payments are made cannot be supported.

Also, as with the government's proposal to implement a system of recovery of exit payments, if a public sector worker returns to the same part of the public sector, the legislation will have to be clear as to not only which bodies it does not apply to but absolutely explicit as to the bodies it does apply to and to have a maintained list of bodies. This would have to include all the companies that local authorities have set up, if they are to be included.

Ex-public sector employees working in the private sector

Question 9: How do you think the government should approach the question of employees who are subject to different capping and recovery provisions under TUPE rules following a transfer to (or from) the private sector and whether there should be consistency with public sector employees in general?

If implementing rules in relation to staff transferred to and from the private sector it will be necessary for great clarity as to how they would apply, particularly whether there would be any time limits put in place over which the policy would apply.

It seems logical that an employee transferred into the public sector should be covered by the rules as they work in the public sector whose money is being paid out as a termination payment. Although of course given the impact of TUPE it may not be as simple as that.

Employees who work in the private sector, but on contracts delivering public services procured and paid for out of public money likewise have their wages paid and termination payments paid indirectly from the public purse. Arguably based on a public money argument the same rules could and should apply to all staff on such contracts, not merely those who may have transferred from the public sector. However, it would be difficult to see how the public purse would benefit and money saved put to public use as it would be more likely to simply increase private profits made out of public money unless caps could be placed on profits to be made on such contracts.

Even if caps could be applied to staff transferred out, it must be acknowledged that structures and businesses change. Someone transferred out of public sector employment might spend very little time working on the previous public sector contract and move onto another role within the private sector employer so how would a cap apply to them?

Waiver

Question 10: Do you agree with the proposed approach for waivers to the cap on exit payments?

Although the introduction of a waiver seems in some respects to run counter to the objective of the policy, the ability to apply the waiver would provide important flexibility.

In local government, payments made in the circumstances envisaged in the consultation document have for some considerable time been made in accordance with government guidelines in an open and transparent way. Although there is currently no explicit cap, authorities in maintaining their discretionary policies must have regard to the extent to which the exercise of their discretionary powers (in accordance with the policy), unless properly limited, could lead to a serious loss of confidence in the public service. They must also be satisfied that the policy is workable, affordable and reasonable having regard to the foreseeable costs.

Alternatively, payments have been made as legitimate settlements in respect of litigation against the authority, taking into account an assessment of the prospects of success and the likely level of compensation payable. It is important that the ability to make such payments is retained. In this context though matters of confidentiality are often important and one authority has suggested that in some cases it might be appropriate to allow delegation of discussion of such matters from Full Council to a smaller committee.

As described in the proposal, care would have to be taken with drafting any such waiver policy as by definition foreseeing the exceptional circumstances in which a waiver may be necessary may be problematic. It is recommended that legislative provisions regarding the waiver are not set out in such a way as to make use of it effectively impossible.

In local government there is a further complication in relation to school settings where the relevant governing body has powers to take such decisions. The legislation will have to clarify how a waiver applies in such settings.

Other issues

Question 11: Are there other impacts not covered above which you would highlight in relation to the proposals in this consultation document?

There are a number of additional specific points which need to be considered, and clarified or addresses in the formulation of the policy.

a. Date of implementation

Determining the implementation date is obviously important in order to allow employers to plan and prepare for the new rules, but it will also be essential to co-ordinate the introduction of legislation with consequential amendments to other legislation such as the Employment Rights Act 1996 and the various public sector pensions regulations.

b. Transitional provisions

Local authorities are continually restructuring and striving for efficiency savings. These programmes vary in complexity. Some occur quickly and some are implemented over a longer time period. Authorities will be making decisions and striking deals with employees now which could ultimately be affected by the new policy. The legislation introducing the policy will have to deal with such cases and therefore will need to include specific transitional provisions. It would seem only fair to establish that deals made prior to the implementation of the policy remain valid and not subject to the cap, otherwise this could have a major impact on the ability to conduct restructures while there remains uncertainty.

c. The prioritisation/deemed order of payments

We have mentioned this previously and it is particularly important in relation to the liability to make statutory payments and to satisfy contractual entitlements, and the complexities created if there is to be any incorporation of pension strain payments into the cap. It may also impact on the ability to identify tax liability on payments. In terms of this, will the order of priority be:

- (i) set out in legislation?
- (ii) be established as an employer discretion?
- (iii) be established as an employee discretion?

d. Clarification as to the exact application of the cap to employees

There are a variety of employment contracts in the public sector involving different levels of hours and status. Indeed many employees have multiple contracts; that is more than one concurrent employment contract with either the same or with different public sector employers. However, there will need to be clarification as to whether:

- (i) the policy applies per employee, contract or per employer; and
- (ii) in the case of TUPE transferred employees whether it is per employer (if relevant) or per funder, as under Fair Deal arrangements the transferor employer may fund any strain on fund pension exit costs.

Such clarification will by its nature indicate whether exits will be dealt with as one off incidents or whether there may be any link to future exit payments arising from termination of another contract (whether that be in existence at the time of the termination of the first contract or where the employee subsequently finds new employment).

Please note, as it appears that the policy is to be applied across the board regardless of salary level, it is assumed that it applies equally to part-timers and not on a pro-rata basis.

e. Clarification as to relationship to any other policy

The government is also introducing a policy on the reclaiming of exit payments where high earners return to the same part of the public sector. There will need to be clarity as to any relationship between the policies. For example, how would the cap work for an employee who has had an exit payment capped but who then finds new employment and has to repay a significant proportion of the payment?

f. Discrimination

As the government recognises this policy by its very nature has the potential to have discriminatory effects and these must be considered

much more closely as employers cannot be put in a position where they are fighting costly discrimination claims as a result of government policy.

PART 2: PUBLIC SECTOR PENSIONS ISSUES

This pensions part of the LGA's response does not refer directly to the questions posed. In summary the response covers:

1. The clarification required in order to ensure primary and secondary legislative changes comply with policy objectives.
2. The necessary balance between primary legislation for those elements covering all pension schemes and secondary legislation to amend individual schemes in an appropriate and workable manner.
3. The scope of changes necessary at the scheme level.

This response covers the major schemes operated by Local Government including the Local Government Pension Scheme (LGPS), Teachers Pension Scheme (TPS) and Firefighters Pension Scheme (FPS).

Clarification of policy

The following areas of policy are not absolutely clear in the consultation document and in our view will require confirmation in order to ensure an effective implementation of policy objectives.

1. That the policy applies only to public sector employers within schemes (for example that non-public sector employers in the LGPS and TPS will not be subject to the cap).
2. Whether the policy is to be applied based on who the actual employer is at the time of the event or the employer on which the exit payment cost falls (e.g. where a contractor may pass such costs back to the contracting body, such as a local authority).
3. What if any exit payments may be given up to avoid, as far as is possible, any reduction to pension benefits (for example TPS allows the choice of redundancy or strain cost will this be allowed in LGPS).
4. Whether pension scheme members (aged 55 or over) will be allowed the choice of:
 - a) taking an immediate actuarially reduced pension on redundancy (to bring the cost within the cap), or
 - b) taking an unreduced pension from a later date (when the strain cost equals the cap figure)?

5. Whether events other than exit which result in a pension strain cost are caught by the cap.
6. Clarification of the interaction between the cap and the annual allowance scheme pays option.

Balance of legislation

In setting out our response on legislation the following assumptions have been made with regard to the above policy questions:

- The cap applies at employer not scheme level
- The cap applies in respect of the employer meeting the strain cost (who may not be the employer with whom the contract of employment sits)
- Statutory exit payments may not be given up in lieu of strain cost
- Members may choose to defer or transfer out their benefits on redundancy
- All events resulting in an employer strain cost are caught by the cap

Primary legislation should contain enough detail to ensure the general policy objective is met while providing enough flexibility for scheme regulations to deal with a number of different scenarios, in particular the primary legislation should:

1. Define that the cap applies only to 'public sector' employers within schemes and list or refer to a list of those employers.
2. Determine that the employer for the purposes of the cap is the one which meets the strain cost.
3. List the statutory exit payments that may not be given up in order to maximise the amount available for pension strain cost.
4. Define that the cap applies to all events resulting in a pension strain cost.

If number 4 is not included then there are a number of scenarios that could result in the cap being avoided where there is a strain cost before or after leaving as a result of flexible retirement, additional pension being granted by the employer or deferred pension being brought into payment with any actuarial reduction waived in whole or in part.

Other issues could then be dealt with by changes to schemes via secondary legislation.

Changes to schemes

Secondary legislation would be required to deal with the following issues in order to effectively implement the policy objectives:

1. The Local Government Pension Scheme (LGPS) regulations would need to differentiate between England and Wales as the consultation refers only to English employers while the scheme regulations cover both countries.
2. An obligation on Scheme Managers in all schemes to calculate the correct level of the cap available for pension strain would need to be included. This obligation would set out the options available to the employer/member with regard to any other payments which may be forgone in order to maximise the strain cost.
3. In calculating 2 above the regulations would need to oblige Scheme Managers to take into account strain payments from concurrent or previous employments (and in the LGPS across more than one fund).
4. Where the cap applies to multiple employments (For LGPS both within and across funds) scheme regulations will need to determine how the cap is shared between the employments.
5. In order to provide an equitable outcome for scheme members regulations will need to prescribe the methodology used to calculate strain costs for the purposes of the cap. For the LGPS a methodology would be needed for use by all funds while for the Fire Fighters Pension Scheme (FPS) a methodology would be needed to determine the capital value of the annual strain cost.
6. Regulations would need to determine which other events (apart from redundancy) resulting in a strain cost would be caught by the cap: for example LGPS regulations would need to cover:
 - a. flexible retirement
 - b. augmentation of pension
 - c. shared cost Employer discretion to 'turn on' the 85 rule
 - d. early payment of benefits on compassionate grounds (with no actuarial reduction)
 - e. early payment of benefits with any actuarial reduction waived by the employer (in whole or in part).

Other schemes will have similar events which will also need to be brought inside the cap if avoidance of the policy is to be prevented.

7. Regulations would need to include a methodology for dealing with the interaction of the cap and the annual allowance scheme pays provision as a result of breaching HMRC's annual allowance.

8. Amendments would be required to remove the mandatory taking of benefits on redundancy.

Sarah Messenger
Head of Workforce
Local Government Association

27 August 2015