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EXIT PAYMENT CAP

WHAT ARE EXIT PAYMENTS AND WHY ARE THE GOVERNMENT INTRODUCING THE CAP?

Exit payments are settlements that are paid to employees when they leave an employer. They normally take the form of a lump sum cash payment, or payments in the forms of shares / share options, but for employers participating the LGPS a particular feature is the availability of an unreduced pension on early retirement (i.e. waiving any early retirement reductions that would normally apply).

The cost of exit payments to employers can vary significantly and can be very substantial. The Government has highlighted that employees leaving the public sector workforce in 2016/17 cost the taxpayer £1.2 billion, with payments at and above £100,000 amounting to £0.2 billion.

In response to its concerns over the increasing cost to the taxpayer of financing early retirement packages, the Government first launched a consultation in 2015 about limiting the value of exit payments to a total of £95,000 per employee. It then laid the primary legislation to enable such a cap to be introduced in the public sector via the Small Business Enterprise and Employment Act 2015, which was subsequently amended by the Enterprise Act 2016. This latter Act included some technical details for how the cap should allow for the availability of an unreduced early retirement pension. However, none of these enabling provisions have yet been brought into effect so it is possible they could be amended before the new provisions come into full force.

The Government has therefore issued a further consultation on 10 April 2019 on the introduction of the £95,000 cap. This latest consultation essentially confirms the Government's overall intentions whilst addressing some of the details which need to be resolved prior to implementation.

Under the LGPS regulations members aged 55 and over are entitled to an immediate and unreduced payment of accrued pension where their employment ends on the grounds of redundancy or efficiency. Currently, the employer normally has to pay a "strain cost" to the LGPS in order to "buy out" the reduction in pension benefits which the member would normally face on retiring early, and this strain cost on its own can easily exceed £95,000. Introducing the cap on exit payments would therefore involve some conflict with the LGPS Regulations.

Under the Government's proposals public sector employees would still be able to take early retirement but the extent to which they could take an unreduced early retirement pension would be limited so that the cost of any pension enhancement would be no more than £95,000 less any amounts (cash or other forms of compensation) paid direct to the employee.

WHAT IS INCLUDED WITHIN THE RECENT CONSULTATION?

The key points within the 10 April 2019 consultation are as follows:

- There is no change from the earlier proposal that the maximum exit payment will be £95,000.
- The cap will apply to a wide range of public sector employers, including employees of councils in England and Wales, fire authorities, police forces, academies and maintained schools. There are some limited categories of public servants in Wales which are exempt.
- As discussed, the £95,000 cap will include the value of any early retirement strain payments, and it is envisaged that the ability to take an unreduced early retirement pension will therefore be severely restricted in some cases.
- Certain employers in the LGPS (e.g. Universities and Colleges) appear not to be covered which will mean that members would be treated differently within the LGPS depending on their employer on exit.
- There will be provisions for the cap to be waived in some circumstances. However, the tone of the consultation makes clear that any waiver is expected to be the exception rather than the norm, and that there is a “high bar” for them to be justified (e.g. subject to ratification by the full council in relation to a local authority).

Clearly there will be some details to be ironed out in relation to the LGPS in England and Wales. We expect the MHCLG will run a separate consultation, and which will cover amongst other things the agreement and implementation of an appropriate costing methodology and factors for strain payments for paying pension early.

In any case, at this stage we cannot be sure what the final form of any provisions will be. For example, we understand that there is a proposal from some quarters that for members affected by the cap the focus should move away from the pension being enhanced, and instead the *employee is given the choice of taking the £95,000 in cash or of using part or all of it to buy-back additional pension within the LGPS*.

IMPACT ON ADMINISTERING AUTHORITIES

The consultation introduces some actions / complications for Funds. In particular, in our view:

- There will need to be a clear and consistent LGPS-wide methodology and set of factors for calculating the “early retirement strain cost”. Otherwise public sector employees could end up with markedly different forms of exit packages, albeit still with an overall value of £95,000, simply by virtue of the administrative practice of their particular fund or employer.
- Funds will need to set a clear policy on how the cap on exit payments works in practice. There will need to be a process in place for an employer to be advised as quickly as possible of the potential “early retirement strain cost” in any particular case. Inevitably until the employee’s exit is finalised this will involve working on estimated figures. The employer will then need to confirm to the Fund whether the exit cap needs to be applied in the particular case, and how much by way of residual compensation is available for increasing the member’s pension and this will need to be paid into the Fund as a contribution by the employer or employee. There will then need to be a clear methodology for converting this amount back into pension benefits. The entire process could therefore become very intricate, especially in cases where it is borderline whether the cap will be breached.

- Separate administrative processes will need to observed by the Fund for those employers covered by the cap, and for those not covered by it. The Fund will need to establish and keep a clear record of which employers fall into each category.
- There will be increased administration costs in dealing with such a process and performing the necessary calculations to ensure the cap is not breached. Clearly, the simpler the process can be made, the better.
- Funds will need to consider their communication with employees, and ensure that any right to an unreduced early retirement pension is appropriately qualified.

IMPLICATIONS AND CONSIDERATIONS FOR EMPLOYERS

- The new Regulations will reduce pension costs for affected employers given that the total exit payments made to employees will now be capped.
- These employers will need to have their own procedures on how to exchange information with the Fund in a timely way and communicate appropriately with the affected employees.
- Employers will need to consider whether they will ever consider seeking to waive the exit cap, the circumstances in which they would do so and the procedures which they would need to go through if they did. Consistency from one case to another will be one of the keys to avoiding employment relationship complications.
- There may be pressure over the next few months from some employees to seek exit packages in advance of the new Regulations coming in. This could cause workforce planning issues and unplanned costs for employers in the very short term. It is also possible that employees would press for alternative access to an unreduced pension via ill health so these processes need to be robust in these circumstances.
- The introduction of the cap may cause relationship problems with staff, particularly if they have seen staff exit with large payments in the past. As an example, for a 55 year old with an accrued pension of c.£13,000 per annum the early retirement strain cost could easily be around £100,000 in isolation. If we assume a non-pension redundancy payment of c£20,000, this leaves a balance of £75,000 that can be used for providing the pension enhancement, so only about 75% of the member's pension would be enhanced and the remainder subject to an actuarial reduction. In practice, typically LGPS pensions are much less than this and so the change will only impact a subset of members, but the HR implications of having to deal with a few high-profile cases could be disproportionate.
- Voluntary redundancy exercises would potentially be affected e.g. the higher paid or longer serving employees are most affected by the cap and may not wish to take the option given pension is reduced. This may therefore affect planned workforce reforms and longer term business objectives for the employers.

We would be happy to discuss the above further with the Fund officers, Committee and Board.

Mercer Limited
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