

Restricting exit payments in the public sector

HM Treasury consultation on implementation of regulations

LGA Response

June 2019

Contact:
Naomi Cooke
Head of Workforce
Mobile: 07825144023
Email: Naomi.Cooke@local.gov.uk

Executive Summary

As the leading organisation representing councils, fire authorities and other public sector employers, the Local Government Association (LGA) response to this consultation focuses on the feasibility and consequences of implementing the government's stated policy in the manner set out in HM Treasury's consultation documentation. Our members have different views of the conceptual merits of the proposals but our purpose in this response is to consider the likely consequences of the provisions set out and, where possible, to suggest alternatives to minimise cost and disruption to local government employers and employees once the policy is implemented.

It is important for us to be absolutely clear that we have very serious concerns regarding the consequences of implementing this policy as set out in these consultation documents. We believe the employees in scope to have their exit payments capped are much lower earning than the consultation suggests; that, as drafted, these Regulations present a range of potential legal risks that could increase costs to employers that have not been considered; that there are a number of changes to other legislation – most notably the Regulations governing the Local Government Pension Scheme – that are required before these Regulations can reasonably be applied; and, that the processes outlined to secure exemptions to the cap are overly bureaucratic and challenge the capacity of local government to make decisions in the interests of local taxpayers.

The LGA response to the consultation is divided into two sections, the first outlines the practical difficulties facing employers by the measures set out in these documents and the second lists the technical issues the Regulations, as drafted, instigate. The key issues are listed below.

1. The scope of the cap as set out in this consultation could cover local government workers who have decades of service and earn less than £23,500 a year.
2. The absence of any review of the cap limit or any indexation of the £95,000 figure means that over time, more people with salaries below the UK average will be affected.
3. When originally proposed, the concept of a salary floor was suggested but there is no mention of that in this consultation. The LGA would support amendments to these Regulations to introduce both salary floor and indexation revisions.
4. No implementation period is set out in this consultation. Due to the volume of consequential Regulation changes required and the substantial changes needed to administrative systems we believe a minimum of nine months from the date the Regulations are passed is required for the necessary reforms to the Local Government Pension Scheme to be introduced and the actuaries, payroll providers and others to respond accordingly.
5. The LGA is deeply concerned that the discretionary exemptions process set out in this consultation will prevent democratically elected councillors taking the necessary decisions to reform and manage the local government workforce. The overly bureaucratic process outlined which potentially requires three central government post holders (two civil servants and one Minister) to ratify a full council decision will frustrate employer engagement with employees and inhibit the responsiveness of local authorities to changing situations.

6. We support the mandatory exemption provision for those with whistleblowing and discrimination cases however, the omission of health and safety reporting related cases seems inappropriate and inconsistent, bearing in mind tribunal awards for such cases are also unlimited. Therefore, we would support the extension of the mandatory exemption to cover those cases.
7. More broadly, the discretionary exemption process for other tribunal cases is problematic and we have a number of concerns that the process itself will prejudice an employer's position. In addition, we envisage increased costs resulting from tribunal cases as individuals will be reluctant to accept a settlement when the cap means they could achieve a higher award in tribunal.
8. The absence of a robust Equalities Impact Assessment is a cause for concern and is one of several areas where the LGA is concerned that these Regulations increase legal risks facing councils.
9. As drafted, cash exit payments in local government will potentially increase as a result of these Regulations resulting in increased national insurance costs to councils when the National Insurance (Termination Awards and Sporting Testimonials) Bill comes into force.
10. Currently exit payments in local government are predominantly related to unreduced pension access for those above minimum benefit age and, particularly when compared with the wider public sector, the severance cash payments are low: generally 1.5 weeks per year reflecting the statutory system of accrual and actual weekly pay. As these Regulations will inhibit pension access for some individuals earning considerably below UK average earnings, there will be pressure from trade unions to improve the severance framework in response.
11. Substantial clarification on the impact of the cap on the Local Government Pension Scheme is needed in order to make these Regulations workable. In particular there is no clarity on the application of the cap in a way which provides a 'fair choice' for the member between a reduced pension and the cash alternative referred to in the draft Regulations. Also, there will be disputes due to the differing methods around the calculation of strain payments across the country and resultant inconsistencies in who is capped and to what extent.
12. Excluding outsourced employees from these Regulations, as well as other areas of local government related employment creates a two tier workforce that will be exacerbated by the inclusion of an exemption for TUPE cases but not 'TUPE-like' cases resulting, for example, from government mandated reorganisations. There is significant confusion around coverage in these Regulations which is made worse by the prospect of an iterative process gradually extending the range of organisations covered.

Our full response sets these issues out in detail and we would welcome further engagement with HM Treasury and others to resolve these concerns.

1. About the Local Government Association

- 1.1 The Local Government Association (LGA) is the national voice of local government. We are a politically-led, cross party membership organisation, representing councils from England and Wales.
- 1.2 Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.
- 1.3 The local government workforce is the most occupationally diverse in the public sector. 1.4 million people work in local government, covering 800 different occupations.

2. Background to this submission

- 2.1 The LGA [responded](#) to the original consultation on the introduction of a cap on exit payments in 2015 and set out a list of technical concerns and points for clarification that were necessary for the implementation of the government's intended policy. In responding to this consultation we include a similar technical response – Part Two – that again queries the feasibility of successful implementation of the proposals outlined in the consultation with the regulatory provisions as currently drafted.
- 2.2 For local authorities and the thousands of other public sector employers covered by these Regulations (and an additional number who are unclear whether they are in scope), a range of clarifications, amendments to these draft Regulations and amendments to other legislation, are required before a cap on public sector exit payments can confidently be introduced. We strongly urge HM Treasury to give the necessary consideration to these issues before laying Regulations to enact the exit payment cap.
- 2.3 In addition to the technical issues the consultation provokes, we have a number of policy concerns about what is proposed and the means by which the cap is to be implemented. These are outlined in the first part of this LGA response.

Part One

3. Key areas of concern

- Cap waiver provisions
- Bureaucracy of cap
- Scope of organisations covered by the cap
- Commencement and implementation
- Range of individuals affected by the cap
- Industrial relations
- Legal risks
- Unintended costs to employers resulting from the cap

4. Cap waiver provisions

- 4.1 The consultation documents outline provisions for mandatory relaxation for the cap in specific circumstances. The facility for mandatory relaxation is welcome although we have some queries for clarification of how and when this is intended to operate.
- 4.2 As the organisation representing local authorities we have a particular interest in the discretionary waiver process. It is important that a facility exists for the cap to be waived when circumstances make this the best course of action for the employer, individual and taxpayers. However, the consultation documents do not concur on when and how this waiver can be utilised and potentially necessitate an additional cumbersome and time consuming approval process that challenges the capacity of democratically elected local councillors to make timely and appropriate decisions.

5. Mandatory relaxation of the cap

- 5.1 The LGA has queries for clarification over two of the three proposed mandatory cases for relaxation of the cap.
- 5.2 The exemption for payments arising from applying the TUPE Regulations is clear but it is not explicitly set out that the same applies for 'TUPE-like' transfers that follow the spirit of TUPE such as transfers following the [Cabinet Office Statement of Practice](#) or similar central government instigated transfers that may not explicitly be covered by TUPE.
- 5.3 As the policy intent has historically been to ensure that public sector workers are treated no worse than they would be if TUPE formally applied it is assumed that the exemption would cover these transfers as well but this should be confirmed and set out explicitly.
- 5.4 However, exempting transfers while restricting payments available to non transferring staff could lead to double standards in post transfer reorganisations that distort an employer's capacity to make the appropriate decisions necessary. The discretionary provisions discussed below could assist but this is not clear from the guidance or Directions set out in this consultation.
- 5.5 Transfers and reorganisations are a common feature of local government and clarity over the application of the cap in these circumstances is crucial to its successful and consistent application and for the avoidance of costly legal challenges.
- 5.6 The mandatory exemption for some tribunal scenarios is welcome but its limitation to only two types of tribunal case gives cause for concern.
- 5.7 The mandatory exemption which it is proposed will apply to discrimination and whistleblowing claims is welcome, bearing in mind there is no maximum award limit for those cases, and the important protections that those claims cover. We agree that employees should not in any way feel prejudiced in raising discrimination and whistleblowing issues that could result in then needing to bring a claim. However, the same considerations also apply to health and safety related unfair dismissals, particularly in that employees should not in any way feel their future position is prejudiced if they raise health and safety matters, and therefore we believe such claims should also fall within the mandatory relaxation of the cap.

- 5.8 The absence of indexation of the £95,000 figure means that in time, indeed arguably already, cases that are successfully prosecuted at tribunal, even where a maximum award does apply, could secure awards over £95,000.
- 5.9 Inhibiting an employer's capacity to settle ahead of the legal process will lead to costly legal cases and awards having to be paid by local authorities who could have saved public money by settling, even if that meant making an exit settlement – for example an unreduced pension – that these Regulations cost at more than the cap.
- 5.10 As reflected in 10.3 below, since the £95,000 figure was set out in the Small Business Enterprise and Employment Act 2015 inflation has inevitably meant that the impact of that figure has changed. Failure to provide for regular review or indexation of this figure means its interaction with potential tribunal awards will increasingly mean employers cannot enter into meaningful discussions to settle cases ultimately meaning there will be a rise in tribunal claims pursued.
- 5.11 Statutory payments associated with dismissal have risen in the time since 2015. A basic award may now be up to £15,750 and a compensatory award up to £86,444, giving the potential for awards up to £102,194. Under the draft Regulations, in order for an employee to win this amount of compensation they would need to pursue a case in an employment tribunal with all of the associated time and expense for the employee, employer and taxpayer.
- 5.12 We would therefore urge government to consider redefining this mandatory exemption power to also apply in cases where an employer reasonably believes that an award made by a tribunal might exceed the cap.
- 5.13 In most situations it is clear in the HM Treasury Directions and Small Business Enterprise and Employment Act 2015 that the mandatory relaxation must be authorised by a local authority, fire and rescue authority or Minister of the Crown – the 'Decision Makers'. However, it is not clear how this process is intended to work for employers such as schools (both maintained and academy) or other employers associated with local government and in scope for the Regulations but not directly within the remit of the council. We have sought clarity from MHCLG and DfE but the situation remains uncertain.

6. Discretionary relaxation of the cap

- 6.1 The Regulations and guidance around the discretionary relaxation of the cap need to be precise and transparent so individuals and employers understand the parameters of the exemptions and therefore can plan accordingly.
- 6.2 The intention of the 'undue hardship' exemption seems uncertain given the context of the Regulations and the guidance set out. As stated elsewhere in this response, the scope of these Regulations could include long serving public sector workers earning £24,000 a year, almost 25% below the average full-time UK salary. The lack of indexation of the £95,000 cap figure will lead to this scope expanding in time to cover even lower earning workers. Contrary to the assertion in paragraph 5.4 in the guidance, the LGA can envisage circumstances where individuals in their late 50s with more than 30 years' public service on these sorts of earning levels do face hardship as a result of being compelled to take a reduced pension a decade before they planned to retire.

- 6.3 We welcome the slightly broader definition indicated in the guidance that the circumstances constituting undue hardship may not be restricted to the employee alone. However, without clearer guidance there is a danger of confusion and a divergence of circumstances that may be deemed to meet the relevant threshold for this exemption. Given the complexity of the process (discussed further below), we are concerned that there is substantial scope for inconsistency and confusion in this exemption and urge HM Treasury to be clearer over the policy intention of this relaxation provision.
- 6.4 The discretionary exemption category of 'workplace reforms' is described in slightly different ways in the consultation documents which perhaps reflects the lack of precision in the exemption itself. Various descriptions as a provision to accommodate 'urgent' or 'significant' workplace reforms, we are concerned that the stipulation in the guidance to the consultation: that a detailed business case will be required, in the absence of any indication of the criteria that might be used to assess such a case, will cause valid cases to be rejected or returned for resubmission when the criteria, by iteration, becomes clear. Combined with the bureaucracy of the approval process discussed below, the LGA is concerned that any 'urgent' workplace reforms will be frustrated by these Regulations to the detriment of the local taxpayer, employees and the wider public.
- 6.5 The approval process risks introducing a circular process where negotiations with trade unions and staff over workplace reforms are stalled while the potential to access a discretionary exemption is explored only to be reconvened when a decision is taken, presupposing it is possible for a decision to be made before an agreement in principle is reached. This risks exacerbating an already tense industrial relations context that can surround urgent, or significant, workplace reforms. We therefore seek a clear and streamlined process that minimises this risk and any obstruction to local authorities' capacity to introduce workplace reforms.
- 6.6 Particularly in the early stages of these Regulations being implemented, it is likely there will be significant questioning of the timing of agreements and exit dates. The LGA is concerned that agreements with individuals to see through projects or ensure a smooth workplace reconfiguration will be frustrated by these Regulations and instead departure processes will be imbued with uncertainty making employees less flexible about their formal departure day than is beneficial for the employer. The LGA recommends an amendment to introduce an exemption for exits agreed prior to the implementation of the Regulations that have a date of departure within six months of that date.
- 6.7 These Regulations have been pending since 2016 and remain beset by inconsistency and a lack of clarity that is causing a level of confusion and uncertainty in discussions currently in process regarding exits. As set out in section 9 below, it is imperative there is an implementation period of sufficient length for consequential legislative changes and for the correct exit payment discussions to be had with employees.
- 6.8 Given the ongoing reduction in jobs in some local authorities (the local government workforce is three quarters the size it was in 2012), these implementation issues are of significant importance and we urge HM Treasury take appropriate steps to address them.
- 6.9 We recognise and welcome the provision for a discretionary relaxation exemption in other circumstances not explicitly set out in these HM Treasury Directions. There is a concern however, reflected in section 7 below, that without at least some principles to be satisfied by the required business cases, it will be difficult for authorities to submit an appropriate business case to the four levels of clearance required.

- 6.10 Paragraph 5 of the HM Treasury Directions is unclear. This seems to indicate that where an exemption applies, payments are still limited beyond that already set out in the exit provisions set down in legislation. We seek clarity on what that would mean in practice as, for example, having differing levels of pension reduction in light of an exemption would require further complicated changes to Regulations and administrative costs as an employer made an assessment of exactly what level of strain payment is appropriate outside both the current exit provision practice in local government and the explicit limits in these Regulations, in order to mitigate an undue hardship case.
- 6.11 We anticipate that the limitation to relax the cap only 'to the extent necessary' to satisfy the grounds for exemption will expose local authorities to legal risk as there are likely to be differences of view on how far is necessary. This would not be the case if the exemption simply allowed the existing provision to apply – this is simpler and more intuitive and we urge HM Treasury to review this provision accordingly.

7. Bureaucracy of process

- 7.1 As indicated above, the LGA has significant reservations regarding the complexity of these Regulations and the cumbersome approval processes outlined in these consultation documents for the application of exemptions.
- 7.2 At its most extreme, business cases appear to need approval from:
a) full council;
b) the permanent secretary at MHCLG;
c) a Minister of the Crown; and,
d) HM Treasury.
This is time consuming, costly and overly bureaucratic. We cannot see how this is feasibly an efficient and appropriate approach.
- 7.3 Local authorities are democratically elected by the public and they are accountable to them. Repeatedly it has been shown that local government is the most efficient part of the public sector. Requiring three further levels of approval for an exemption reached by a full council decision suggests a level of distrust that the LGA finds disturbing. Providing employers can demonstrate they are following the Regulations and HM Treasury Directions, we don't believe three extra levels of approval are required and would contend this will be seen as a disproportionate level of central government involvement in local workplace decisions.
- 7.4 The range of bodies related to but not directly linked to local authorities' central functions also makes this approval process uncertain for those bodies, like schools, who have significant autonomy in their operations but will be reliant on the local authority to approve an exemption. Even if successful, it is unclear how a school (or similar employer) then navigates the other layers of the approval process, or whether the local authority is presumed to take up that responsibility (an extra obligation on already stretched resource).
- 7.5 The consultation presumes government departments will issue appropriate guidance for these processes but with the volume of regulatory changes required and the lack of implementation period set out in the consultation document; we are deeply concerned that councils, schools, academies and related employers will be left without the necessary provisions to operate these policies.

- 7.6 Academies, many of whom are part of the LGA's Employer Link network, will face particular challenges navigating these Regulations for both teachers and support staff where both DfE and MHCLG may be deemed the appropriate sponsoring department (as support staff are members of the Local Government Pension Scheme) and there is no obvious Decision Maker at a local level. It would seem unnecessarily complicated if different frameworks operated for securing exemptions for different groups of school staff in analogous situations.
- 7.7 It should also be noted that academies are already covered by an obligation to seek approval from the Education Funding Agency (EFA) for any 'special severance payments' that exceed £50,000. It is expected, from the suggested scope of these Regulations, that special severance payments are also covered by this cap, however, it is unclear how these two obligations interact in a qualifying case and whether EFA approval would be needed in addition to any exemption sought from DfE and HM Treasury.
- 7.8 The LGA is further concerned that there may be competing obligations regarding confidentiality and transparency in regard to the reporting requirements set out in these provisions. For councils where very few exits breach the cap and secure an exemption it may prove difficult to protect the anonymity of the individual.
- 7.9 The requirement on individuals to report their exit to other public sector employers is likely to cause confusion as it is not clear exactly which employers are in scope and the bureaucratic process of exemptions may mean the timing of exits is distorted. One risk to employers is the extra effort and expense of undoing an exit payment or even securing sufficient information to assess whether doing so would be financially prudent; another is the potential for a resultant legal challenge from the individual.
- 7.10 This section sets out the case against the approval process both in principle and with regard to the addition of another a layer of bureaucracy in cases where HM Treasury has already indicated that the cap should be relaxed on mandatory or discretionary grounds. Such bureaucracy of process could be avoided by changes in the guidance (and the Directions, where it is indicated below) to reflect the wording of the Regulations namely:
- to allow bodies listed in Regulation 11 to exercise the power to relax the cap in mandatory cases without the need for further approval;
 - to allow bodies listed in Regulation 11 to exercise the power to relax the cap in discretionary cases without the need for further approval. This would require a change in section 4.1 of the Directions which states that HM Treasury consent is required;
 - to specify that only HM Treasury approval is needed if a body named in Regulation 11 (other than a Welsh authority) wishes to relax the cap outside of the circumstances set out in the Directions, removing the requirement for the Principal Accounting Officer and relevant minister approval.

These changes would allow democratically elected and accountable bodies to continue to make transparent decisions that provide good value for the taxpayer. Alternatively, if the intention is that bodies listed in Regulation 11 (other than a Welsh authority) are required to gain approval as set out or implied in the guidance then changes in the Regulations, Directions and guidance are required to make this clear.

8. Organisations in scope for the cap

- 8.1 Some local authorities have expressed unease at the list of organisations included and excluded from the cap. Whilst recognising the aim of excluding resettlement payments from the cap, which are used in the armed forces and security services, it is disproportionate and unnecessary then to exclude those bodies as a whole to achieve that aim. Such payments are not exclusive to the armed forces and security services and the aim could be better achieved by excluding resettlement payments as a category from the cap, which would then enable other analogous public sector workers to share the same provision rather than excluding them purely on the basis of their employer, not the demands of their profession.
- 8.2 As discussed in section 12 below, the omission of an Equalities Impact Assessment (EIA) for these Regulations appears to expose them to risk of legal challenge. The LGA urges government to review this and share the legal basis of the decision to defer an EIA until a decision is taken around a two stage implementation process, which is, apparently, only linked to the organisations deemed in scope, not the policy itself.
- 8.3 The concept of subsequent lists of organisations in scope being published is deeply problematic. Firstly, the descriptions set out in this consultation are not precise and will lead to numerous queries in regard to whether certain deliverers of public services are in or out of scope. We envisage that those queries will turn into legal challenges that will disproportionately affect local government due to the innovation within the sector and the diversity of approaches taken to service provision.
- 8.4 Lack of clarity on the organisations in scope will also frustrate the multiple employment procedure where, according to this consultation, employees are obliged to inform all other public sector employers of an exit payment. On each occasion the employer is going to have to check the list to confirm if the organisation is in scope. Without clarity on types of organisation included and excluded, or at least a comprehensible description of the scope, this is going to be increasingly difficult to do.
- 8.5 All workers outsourced from local government are in effect excluded from these Regulations. This seems counter to the intentions of Fair Deal to protect provisions at the time of transfer as such employees may remain entitled to exit payments, including the early payment of an unreduced pension, that are not available to staff directly employed by the local authority. This certainly seems iniquitous, potentially resulting in additional costs recharged by outsourcing employers as well as legal challenges that will be a further burden on councils.

9. Commencement and implementation timing

- 9.1 The LGA is particularly concerned about the proposed start date for these Regulations. As stated, the cap and associated provisions will come into force the day after the Regulations are made. Given the need for the draft Regulations to be clarified and amended this provides far too little time for employers to change their policies, communications and potentially offers to individuals exiting over this period. As made clear in this consultation response, there are a substantial number of issues to be navigated before determining what exit payment can legitimately be paid to an individual once these Regulations come into force. Employers will need to procure advice from legal advisers, administering authorities and others before they are in a position to proceed with making exit payments. The discretionary exemption for agreements to exit made before the coming into force of the Regulations does not

address this issue, as the parties to the agreement cannot be sure that the discretion will be exercised so as to allow the payment.

- 9.2 Unlike some other sections of the public sector, local government continues to reform its workforces, often resulting in a reduction in staffing levels. To have to put these on hold, and potentially withdraw plans and offers that have been made in order to ensure compliance with Regulations that have not been in a state to be anticipated will be a major challenge for employers and a notable cost. We strongly urge government to allow employers a reasonable period for implementation after the Regulations are made AND the necessary consequential changes to other Regulations (most notably the Local Government Pension Scheme Regulations) have been introduced. Presuming these changes to the LGPS are introduced promptly after these Regulations pass through Parliament, we believe nine months would be an appropriate period. Any delay to changes to the LGPS, however, will necessitate more time. Part Two of this response includes a description of the consequential LGPS regulatory changes and GAD provisions that are required in order to give effect to the exit payment cap Regulations. These should be considered a prerequisite to these Regulations coming into force.

10. Scope of individuals affected by the cap

- 10.1 Although in many parts of the public sector a cap of £95,000 will impact only the very highest earners, the decision to include payments made to a pension scheme as well as those made to individuals means that in local government the effects of the cap will be felt beyond this group. The cap will bite on some long serving, comparatively low paid public sector workers including social workers, school caretakers, environmental health officers, planning officers, assistant finance/HR/IT workers and other basic rate taxpayers who have devoted their working lives to local government service and have made significant contributions to the scheme on the understanding of the benefits to be provided in redundancy situations.

An administrative assistant with 35 years' service at 55 earning £23,500 when she is made redundant could have a combined severance payment and pension strain cost that exceeds £95,000 even though she would actually receive a severance payment of £18,300 and, as a result of contributing to the pension scheme throughout her service, an annual pension of £11,800 (with a lump sum on retirement from the pension scheme of £21,150).

- 10.2 For this reason the LGA would propose that the Regulations are amended to include an earnings 'floor' to ensure that those basic rate taxpayers with moderate incomes and who could not be described by any measure as 'highly paid' are not caught by it.
- 10.3 The LGA is also concerned that the cap will, over time, cause more and more individuals to be affected. It is evident that in the absence of indexation or any provision for review of the cap the £95,000 figure is already leading to an incremental increase in coverage. To demonstrate, the Small Business Enterprise and Employment Act set the figure for the cap: £95,000, in March 2015. To set the cap today at the equivalent to £95,000 in 2015 the limit would be around £105,000. Conversely, £95,000 today is closer to £87,000 in 2015.
- 10.4 The omission of any indexation or review of the cap in these Regulations, coupled with the lack of an earnings 'floor', means that over time more lower paid staff will be caught by its provision. This will be increasingly perceived as unfair by those staff and will reduce the ability of employers to secure voluntary redundancies – slowing up the

restructuring process and potentially causing extra costs resulting from the need to develop assessment criteria and processes to manage compulsory redundancy situations that would otherwise have been avoided – and increase the pressure to improve the severance cash provisions of the local government redundancy scheme.

11. Industrial relations

- 11.1 For several decades, since the 1970s, local government redundancy provisions have included a right to an unreduced pension for those at or above minimum benefit age (currently 55) and, in comparison with other areas of the public sector, modest severance payments usually based on the statutory redundancy scheme.
- 11.2 Employers have discretion over the non-pension redundancy compensation scheme they have (subject to the limits in the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006, however, the majority of local authorities adopt a low multiple to the statutory formula and use actual pay instead of the capped pay in the statutory scheme. This is why the illustrations in this consultation response are based on a presumed redundancy payment calculation of **actual pay * statutory weeks * 1.5** as this reflects the most common formula used.
- 11.3 The decision to include pension strain payments in the exit payment cap cuts across severance payment provisions and is likely to lead to pressure on councils to improve their payment formula to closer match other areas of the public sector. This would reflect the government's stated intention in its 2016 consultation on public sector exit payments reform to ensure greater consistency across the public sector although to do so is likely to more than exceed any savings achieved through the cap as the suggestion in government's response to that consultation was a maximum of three weeks per year of service, more than double the current formula used in some circumstances.
- 11.4 Local authorities, academies and other employers in scope of these Regulations will be faced with the challenge of seeking to plan and implement workforce reform in the context of uncertainty over what exit offers they can make and what agreements, individual and collective, can reasonably be made. This will lengthen, and make more fraught, redundancy exercises that remain a common feature of the local government landscape despite local government employment being at its lowest figure since ONS records began in 1999.
- 11.5 The confusion over the waiver process and legal limitations will also frustrate opportunities for mutually agreed departures. This means some staff will be more inclined to resort to the legal process and pursue Employment Tribunal claims instead of reaching a settlement that would ultimately demonstrate value for money for the taxpayer. Instead both employer and employee will be faced with an uncertain, time consuming and potentially costly legal process.
- 11.6 Such mutually agreed departures will be further discouraged by a continuation of a pension scheme which denies choice to individuals faced with a reduced pension. LGA would propose that it made clear that all public service pension schemes should offer the ability for employees who are capped to choose a 'package' that best meets their situation at the time of their exit.

12 Legal uncertainty

- 12.1 The LGA is very concerned at the lack of Equalities Impact Assessment (EIA) for these Regulations and the proposal that one would only be undertaken if a two stage implementation approach is adopted.
- 12.2 The consultation document makes reference to an EIA conducted “in the previous consultation, ahead of legislation on the policy.” The only text relating to equalities impacts in the webpage referred to is this:

“In terms of impacts on groups protected under equalities legislation, using data from the Labour Force Survey (LFS) , it is possible to break down the working age population by whether they work in the private or public sector – and by age, gender, ethnicity, religion, disability and marital status. To assess the potential impact of this policy, statistics for the total population and the total UK workforce are compared to the statistics for public sector workers. The LFS, however, cannot be used to estimate the proportion of the public sector workforce according to sexual orientation, gender reassignment status, pregnancy or maternity status – and therefore cannot estimate the impact of this policy on these groups. As a consequence of the way exit payments are calculated, among a population of high paid individuals those that are long-serving, and in turn more likely to be older, are relatively more likely to be affected.”

We are concerned that this assessment, dating from 2015, may not meet obligations under the Public Sector Equality Duty 2010 and therefore these Regulations are at risk of legal challenge causing confusion and potential additional costs for local authorities.

- 12.3 We have some specific concerns regarding the equalities impact of these Regulations that we do not believe have been adequately considered in any previous consultations and are not covered at all in this one. Even if the impact assessment above is deemed adequate, we contend that the failure to index the £95,000 figure has meant that, four years on, the coverage of the cap has expanded. As drafted, the cap will limit the exit terms of some local government workers earning less than £24,000 a year – considerably less than the average UK full time employee. We do not believe this has been properly considered in terms of who is impacted and to what degree.
- 12.4 The exclusion from scope of outsourced workers could also have a differing impact on employees by gender. We know from data produced for the gender pay gap assessments that the pattern of outsourcing has a significant impact on the gender pay gap of local authorities. There is also likely to be a different impact of the exit payment cap depending on outsourcing patterns; again, it is not clear that this has been considered in the development of this policy.
- 12.5 As discussed in section 8, local authorities consider it disproportionate that the armed forces and security services are exempt as a whole rather than exempting the categories of payments that specifically relate to the special features of their employments such as resettlement payments. Those exempted parts of the public sector, it is suggested, are younger and more male than other workforces, such as local government, that are in scope.
- 12.6 The suggestion that if the cap prevents an individual receiving the pension to which they would previously have been entitled, they should receive cash to the value of £95,000 may also give rise to age discrimination risk. This would be a cash

payment, so not a pension payment; neither covered by the exemption in the age discrimination for pension provisions, nor the statutory redundancy age provision exemption. We are concerned this exposes councils to a legal risk around age discrimination.

- 12.7 The potential exemption for settlements to avert tribunal awards for discrimination and whistleblowing only is a concern as there is a potential for challenge about the assessments made by councils in regard to the merits of cases and on what basis an authority is judging they would lose a case. We are also concerned that putting a case to full council on this basis may ultimately prejudice a case if it is subsequently pursued.
- 12.8 Given recent legal judgments we strongly urge government to seek and share relevant legal advice relating to these Regulations before local authorities and others are put in the position of having to implement legislation that is subsequently successfully challenged in the courts.

13. Unintended costs of implementing the cap

- 13.1 Government announced its intention, in 2016, to align the income tax and employer national insurance contribution rules, so that payments which qualify for the £30,000 tax exemption would be subject to both income tax and employer NICs on amounts in excess of £30,000. This, we understand, will affect exits from April 2020.
- 13.2 One option indicated in this consultation is for capped exit payments that prevent unreduced pension access (because they are insufficient to cover the strain cost), to have that balance paid as cash instead. To illustrate the impact of this:

Female aged 55, earning £40,000 with 35 years' service

Current exit benefits:

Immediate payment of an unreduced pension of £20,082 and a lump sum from her pension entitlement of £36,000

Severance cash payment, including statutory redundancy of £31,154 (based on a presumption of the redundancy provision offered by the local authority of actual pay x statutory weeks x 1.5)

Under the forthcoming National Insurance Bill, in this example, the council would be liable to pay national insurance on £1,154 of this payment amounting to approximately £159.

If local government employers are obliged to pay increased severance instead of providing access to an unreduced pension due to the cap, in this instance the council would be liable to pay NI on £65,000 rather than £1,154 amounting to £8,970 – an additional cost of exit of £8,811. There will also be additional tax payable by the employee that will reduce the severance they ultimately receive.

- 13.3 The consultation documents are silent on whether these national insurance payments are included in the calculation of £95,000 or excluded. It is therefore possible that, in the above example, the £8,970 should be counted as part of the payment and therefore the individual would receive a severance payment of £86,030 rather than £95,000.

- 13.4 The lack of clarity on the interaction of these Regulations with the proposed application of employer national insurance contributions to exit payments may erode the employer savings envisioned from this policy.
- 13.5 Due to the inclusion of pension strain costs in the calculation of the cap and the consequent necessity for partial reductions to pensions from the LGPS, there will be additional costs from administering authorities and their actuarial advisers that will be passed on to employers.
- 13.6 The complexity of the bureaucracy surrounding these Regulations will almost inevitably cause delay and uncertainty to the exit process which is likely to make individuals less confident in the process and be more demanding of assurances. As the exemption processes are uncertain but will undoubtedly take time, the additional uncertainty is liable to make the exit process more fraught, take more time and as such incur more cost as exits are delayed.
- 13.7 The ability of public sector employers to recruit to senior posts and retain skilled and knowledgeable senior employees has already been eroded due to the negative impact of pension taxation. The protection offered by public sector pension schemes in the event of redundancy or ill health is an advantage that serves to encourage talented individuals to join or remain in the public sector. The removal of some or all of that protection may tip the balance in favour of moving to a higher-paid private sector position for some senior employees, adding to the problem of retention caused in part by pension taxation.
- 13.8 As indicated in section 8 above, local authorities are concerned that the reduction in availability of unreduced pension access for exiting employees with long service will lead to pressure on employers to increase the cash payments that are paid on exit to longer serving staff, including those who would not hit the cap.
- 13.9 The limitations of the exemptions for the full range of tribunal claims and the absence of indexation for the £95,000 figure will mean that an increasing volume of cases go to litigation instead of being settled as individuals know that it will be difficult or impossible for employers to offer as much in a compensation settlement as they may secure through a tribunal claim. Even when this turns out not to be the case, legal costs for employers may result in increased overall cost (in addition to additional costs on the tribunal system from increased cases).

Part Two

This second part of the LGA response to the consultation is split into sections which examine the contents of the consultation documents and consider the possible impacts that the proposed Regulations will have on local government employers and members of the Local Government Pension Scheme (LGPS).

14. Draft Regulations

14.1 There are many inconsistencies and errors in the numbering of the draft Regulations. It is vital that consistent numbering is introduced in the final version. Only those errors and inconsistencies which impact on the meaning or operation of the draft Regulations are listed in this section. Also included are comments on the content of the draft Regulations, with particular emphasis on the impact on the LGPS. Issues that arise in the introductory text or in multiple places in the Regulations are set out in 14.2, with the following paragraphs covering technical issues identified in the draft Regulations in order.

14.2 'and' in the *Small Business, Enterprise and Employment Act 2015* is spelt incorrectly in the first line.

These Regulations are '*Coming into force in accordance with regulation 1(2)*'. This wording should be changed to be consistent with the numbering of regulation 1, or regulation 1 must be re-numbered to include subsections (1) and (2).

Regulations 2, 3 and 10 refer to Part 1 and/or Part 2 of the Schedule. Annex B, which is a draft version of the Schedule, is not split into Parts 1 and 2. A change in these Regulations or the Schedule is required to ensure the Regulations have effect.

14.3 Regulation 1

The introduction of an exit payment cap will require significant changes to processes followed and correspondence issued by both public sector employers and pension administrators. It is our expectation that the final version of the Regulations, guidance and HMT Directions will differ markedly from the versions included in the consultation documents.

We do not consider that an implementation date of the day after final regulations are laid would allow sufficient time for employers and pension administrators to make essential changes to their processes and documentation, and to communicate the changes to employees and pension scheme members. In particular software providers will be reticent to make changes to systems used to calculate pensions until regulations are in force. Such changes could then take several months to implement resulting in calculations having to be done manually, potentially leading to delays in and inaccuracy of pension benefits. A reasonable implementation period as requested in section 9 would ensure that the cap can be correctly and consistently applied across those public sector bodies who are in scope.

Such an implementation window would also allow a significant number of exits agreed before these Regulations come into force to proceed without the need for HM Treasury approval.

14.4 **Regulation 4**

Regulation 4(a) does not require that individual exit payments listed in regulation 6(1) are aggregated. The draft Regulations would appear to permit the sum of exit payments related to a single relevant public sector exit to exceed the cap as long as each individual exit payment is below the threshold, subject to the exceptions set out below.

The total of all exit payments must not exceed the cap under regulation 4(b), but this applies only to a person with multiple relevant public sector exits in a 28-day period.

Regulation 8(b) requires that exit payments other than a relevant redundancy payment are reduced if the '*total of the exit payments in respect of the exit would exceed the cap*', but only in respect of an individual who is entitled to a relevant redundancy payment.

In the remainder of this document it is assumed that the policy intent is for the aggregated exit payments related to an individual exit (or multiple exits which occur within a 28-day period) to be measured against the cap, and that this policy intent will be delivered in the final regulations.

14.5 **Regulation 5**

In order to comply with regulation 5, all parties must know about other relevant public sector exits that occur within a 28-day period. Under regulation 10 an individual who receives an exit payment is required to supply all other relevant public sector authorities by which they are employed with information about that public sector exit, but only **after the exit has occurred**. The information the individual is required to share is not sufficient to determine the sequence in which exits are treated as having occurred under regulation 5. Employers have suggested that a GDPR-compliant mechanism to share information about relevant public sector exits would be more efficient and would allow the Regulations to operate more effectively.

Under regulation 5(b)(iv) the order that exit payments are treated as having been paid can be determined by the relevant Minister if this cannot be established based on the provisions of regulations 5(a) and 5(b)(i) to (iii). 'Relevant Minister' is defined as a Minister of the Crown in regulation 3, but there is no requirement for this to be a specific minister. If the intention is that the minister associated with that employer should make the determination, then this should be explicitly stated in the Regulations or in the Schedule.

14.6 **Regulation 6**

Regulation 6 lists payments which are exit payments under the Regulations, but does not specify that the total of these payments should be measured against the cap. This issue is covered in more detail in section 14.4.

Defining pension strain costs as exit payments for the purpose of these Regulations is problematic in relation to LGPS members who are over age 55. The LGPS is administered locally by 88 administering authorities across England and Wales and the methodology and factors used to calculate strain cost are different at administering authority level and can differ at employer level. Without a change to a standard method of calculating strain cost, the impact of the cap on LGPS members would vary based on geographical location. This issue is covered in more detail in section 20.6.

The order in which exit payments should be capped is not specified in the Regulations, other than the fact that a statutory redundancy payment cannot be capped – if the total exit cost exceeds the cap then one or more exit payments other than the statutory

redundancy payment must be reduced. Based on the guidance document it is assumed that the policy intent is that all other exit payments should be capped before pension strain cost, so that an individual's pension entitlements are only affected if all other exit payments (other than statutory redundancy pay) have been reduced to zero, however the Regulations do not make this clear.

The term 'severance payment' appears in regulation 6(1)(d) and for clarity we recommend that a definition of this term is included in regulation 3.

Regulation 6(1)(i) confirms that the cap applies to any payment made to a person or '*in respect of that person to another person in consequence of termination of employment or loss of office*'. The Finance (No. 2) Act 2017 will amend the Income Tax (Earnings and Pensions) Act 2003 in making employer National Insurance contributions payable on any part of a termination payment which exceeds £30,000 from 6 April 2020. Consideration must be given to whether employer National Insurance contributions will constitute an exit payment for the purpose of these Regulations. If they do, then an iterative calculation will be required in cases where the exit payment is capped – the exit payment amount would determine the level of employer National Insurance payable, and the employer National Insurance payable would affect the calculation of the total exit payment. Detailed guidance on the operation of this calculation should be provided to ensure a uniform approach.

14.7 **Regulation 7**

The word 'service' is not required in regulation 7(e) and may cause confusion; we recommend that it is removed.

Additional clarity is needed in regulation 7(g) to specify whether:

- pay in lieu of notice is only excluded if it is less than a quarter of the member's annual salary, or
- in cases where the pay in lieu of notice is more than a quarter of the member's annual salary, the pay in lieu of notice up to a quarter of the individual's annual salary is excluded, but the remainder of the payment is an exit payment for the purpose of these Regulations.
- It also needs to be clarified whether the exemption applies wherever there is a right to notice under the contract – not just in cases where there is a specific pay in lieu of notice clause / right in the contract of employment.

14.8 **Regulation 9**

Regulation 9 will only have an effect if pension scheme rules are not amended to allow partial reductions in the event that the exit payment is capped. The possible effects on the LGPS are considered in section 20.

It is assumed that advice has been taken on the potential equality issues (as set out in section 12.6) of any cash payment made to an individual instead of a pension strain payment made to a pension scheme as such a payment would only be made to an individual who is over age 55. It would be helpful for guidance to include reference to such advice.

Further information about the status of a cash payment as an alternative to a pension strain cost payment is needed. It is vital that employers know whether this payment is a termination payment and therefore whether tax and (from April 2020) employer National Insurance should be deducted from the excess over £30,000.

Regulation 9 does not specify the arrangements for the payment. It would be helpful if guidance clarifies that the payment must be made to the individual or, at the request of the individual, to the relevant public service pension scheme. This small change would allow flexibility on the use of this payment, allowing it to be used to purchase extra pension in the LGPS. This option is discussed in more detail in section 20.

14.9 **Regulation 10**

Regulation 10 needs re-numbering as it currently includes 10(2) but no 10(1).

The individual must provide specific information to other public sector bodies that they are employed by about an exit payment to which they are entitled. The Regulations do not specify how, when and by whom the individual is to be given the information concerning the exit payment that they are required to divulge, nor how they will find out about the requirement to inform. We believe that additional detail is required in this regulation to set out the employer responsibility to provide information to the exiting employee.

Further guidance is needed on the requirement to inform in cases where the cap has been relaxed in accordance with the Directions or with HM Treasury consent.

Local government employers have questioned how the individual will know which bodies are in scope of the cap and have recommended a centrally maintained list which is regularly updated and available online.

The earliest date that an individual is required by the Regulations to share information about a relevant public sector exit is the day that the exit occurs. In the case of multiple relevant public sector exits within a 28-day period, particularly if exits occur on the same day, earlier disclosure would be essential to avoid employers inadvertently breaching the cap.

Regulations or statutory guidance could be used to widen the requirement to inform; with individuals having the responsibility to divulge basic information about other public sector employment at the early stages of an exit and the introduction of a GDPR-compliant mechanism for public sector employers to share information to ensure the cap is not breached, in addition to the existing requirement for the individual to disclose the information set out in regulation 10(2) after the exit has occurred.

Consideration should also be given to the inclusion in the Regulations of a specific obligation on the employer to request information from the exiting employee about other relevant public sector exits before any exit payment is paid or agreed to ensure that the cap is not breached.

Section 4.4 of the draft guidance mentions sanctions on an organisation which makes a payment that exceeds the cap, or on the sponsoring department. Local government employers have queried whether there will be any consequences for individuals who do not comply with the requirement to inform laid down in regulation 10.

14.10 **Regulations 11 and 12**

We did not identify any issues with the Regulations covering relaxation of the exit payment cap. However, there are many significant contradictions between the wording of the Regulations and the draft statutory guidance on the topic of the approval process which are covered in detail in section 19.

14.11 Regulation 13

Regulation 13(1) requires that records are kept by the person who exercises the power to relax the exit payment cap under section 153C(1) of the Small Business Enterprise and Employment Act 2015. Regulation 13(3) requires that the 'relevant public sector authority' must publish information about the occasions when the exit payment cap has been relaxed.

The 'relevant public sector authority' in some cases will not be the 'person exercising the power' under section 153C(1) and it would seem consistent that the 'person exercising the power' is obliged both to record and publish information about relaxation of the cap.

The approval process is considered in section 19. It is likely that, in some cases, a business case approved by '*a person who exercises the power in section 153C(1)*' may relate to an exit that does not actually occur. Guidance should be clear that the power has not been exercised where the employee moves to a new post, decides to retire voluntarily or on health grounds or simply remains in employment. This will serve to ensure that events recorded under regulation 13(1) are actual exits, not just advance approvals of exits which in the event do not occur.

To ensure transparency across the public sector, regulation 13(3) should be more specific in stating when and in what form the specified information about occasions when the exit payment cap is relaxed should be published.

15. Small Business, Enterprise and Employment Act 2015

15.1 The Regulations are made in exercise of the powers conferred on HM Treasury by the Small Business, Enterprise and Employment Act 2015. Areas of concern that we have identified in that Act are set out below.

15.2 Section 153A(1) of the Small Business, Enterprise and Employment Act 2015 sets the exit payment limit at £95,000 and 153A(9) allows for the substitution of '*a different amount for the amount for the time being specified in subsection (1)*'. There is no indication as to when or if that amount will be reviewed. Inflation will erode the real value of the cap over time, meaning more long-serving employees on low and moderate incomes being affected by the exit payment cap in future years. As set out in Section 10, the LGA firmly believes that the cap should be index-linked, or subject to regular review. Appendix 1 provides estimates of which employees, based on salary and length of service, may be affected by the cap.

15.3 Section 153C(1) of the Small Business, Enterprise and Employment Act 2015 states that '*A Minister of the Crown may relax any restriction imposed by regulations made by the Treasury under section 153A*'. Based on this wording, any Minister of the Crown may exercise the power to relax the exit payment cap, there is no requirement for the minister to be associated with the employer. Unless this was the policy intent, changes to the Schedule or the Regulations are needed to clarify the relaxation process. Our views on the consultation documents' description of the approval process are set out in section 19.

16. Annex B

- 16.1 It is our understanding that Annex B is a draft version of the Schedule referred to in the Regulations. Further information must be included in the Schedule, the Regulations or the guidance to explain the purpose of this document.
- 16.2 The Regulations refer to Parts 1 and 2 of the Schedule. The Schedule is not separated into parts and a change is required in the Regulations or in the Schedule to correct this inconsistency.
- 16.3 Clarity is needed on the purpose of this document, particularly in the relevance of the government department listed next to the body or office. The intention may be that the 'Minister of the Crown' who has powers under draft regulation 5(b)(iv) and 153C(1) of the Small Business, Enterprise and Employment Act 2015 may only exercise them in respect of employers with which they are linked in the Schedule. This needs to be clearly stated in order to have effect.
- 16.4 Further changes are needed if the document is intended to specify which government department has responsibilities under these Regulations – Fire and Rescue authorities appear both in the MHCLG and Home Office lists, for example.
- 16.5 Local authorities have questioned who would be the Decision Maker in relation to exit payments made to employees of maintained schools. Such a payment would be funded by a local authority, but these schools are listed in the DfE section of the Schedule. What further information is required is dependent on the confirmed purpose of this document.

17. Draft Guidance

- 17.1 There are terms used in the draft guidance including 'responsible authority', 'responsible body', 'delegated authority' and 'sponsoring department' which are not defined. These terms should be defined or replaced with terms that are defined in regulation 3, as appropriate.
- 17.2 Section 2 of the draft guidance includes the government's expectation that '*bodies not in the proposed scope of these regulations will come forward with their own, commensurate cap on exit payments*'. Based on the draft Regulations it is difficult to see how such a voluntary arrangement could have any meaningful effect. Public sector bodies outside the scope of the cap could introduce rules which impose an upper limit on the level of cash payment made in relation to an exit. In practice, in the majority of cases, the cap would only be breached where the exit payment includes pension strain cost. Any voluntary arrangement to cap exit payments would not affect the member's right to an unreduced LGPS pension on redundancy or efficiency retirement over age 55. Under regulation 4(b) a relevant public sector authority could not consider an exit payment made by an employer not in scope of the Regulations in assessing the level of exit payment due. There is no 'requirement to inform' imposed on an individual if an exit does not fall within the scope of these Regulations, or if their ongoing employment is not with a relevant public sector authority. As such any 'commensurate' arrangement would relate to the cash payment made in respect of an individual exit and would not amend a person's rights under the LGPS.
- 17.3 In section 3.1 it is stated that '*HM Treasury's expectation is that an exit payment should be considered to have been received in full on the date the recipient's employment ended, or that person ceased to hold office*'. To add clarity, particularly in the operation

of the cap as it applies to multiple exits, and to be consistent with regulations 4 and 5, we believe that treating an exit payment as being received on the date the person left employment should be mandated, not merely an expectation. Communicating the rules to employees will be a challenging task which will only be made more difficult if employers are applying different rules concerning when an exit payment is considered to have been paid.

- 17.4 There is disagreement between the guidance and the Regulations concerning offering a cash payment as an alternative to a pension strain cost. In regulation 9, such a payment **must** be made if pension scheme rules do not allow partial reduction, the exit payment includes pension strain cost and would breach the cap. In section 4.1 of the guidance, such a payment **may** be made.
- 17.5 Section 4.2 opens '*When calculating whether an individual's exit payment should be subject to the £95,000 cap, employers must take into account all payments related to exit received by the individual within a 28 day period*'. A change is needed to make it clear that only exit payments made by public sector employers in scope of these Regulations must be taken into account. A further change is required to correct the fact that the 28-day period relates to the dates the exits occur, not the dates on which any exit payment is received by the individual.
- 17.6 Section 4.4 confirms that '*The relevant public sector authority is responsible for ensuring any exit payment made by their authority does not exceed the public sector exit payment cap*', and that they (or the sponsoring department) may face sanctions if a payment exceeding the cap is made which is not compliant with the Directions. The guidance does not provide any information about what steps an employer must take to find out about other relevant public sector exits; we believe guidance on this subject would be welcomed by employers. A payment could be made which exceeds the cap because an individual does not disclose the information they are required to under regulation 10. Local authorities have asked for additional information on what form sanctions on employers who make payments which exceed the cap may take, and on whether there will be any sanctions on individuals if the cap has been breached as a direct result of their failure to disclose the relevant information.
- 17.7 In section 4.5 of the guidance, it is stated that '*The reasons for exercising a power to relax the cap should relate directly to a relaxation category*' but this is contradicted in section 5.1 '*The Minister of the Crown or a delegated authority can relax the cap outside of the circumstances outlined in HMT directions only with HMT consent*'. This discrepancy must be removed in the final version of the guidance.
- 17.8 There are further contradictions on the rules surrounding relaxation of the cap in the content of section 5 of the guidance and the Directions and Regulations, and these are covered in section 19 below.

18. HM Treasury Directions

- 18.1 In this section we address the issues identified in the content of and omissions from the HM Treasury Directions. The significant differences between the relaxation process as set out in the Regulations and Directions, and that in the guidance are covered in section 19 below.
- 18.2 As noted in section 5.2, we believe that other movements of staff that are not covered by TUPE, but that follow the spirit of TUPE such as central government instigated transfers, should be exempted from the cap.

- 18.3 The cap must be relaxed when the Decision Maker believes that an Employment Tribunal (ET) would award compensation to the individual under whistleblowing or discrimination legislation. Although this exemption is welcome, its inclusion does raise questions for employers and Decision Makers – particularly in deciding the appropriate level of exit payment to be made in the absence of an ET award – which are considered further in sections 18.4 and 19.11.
- 18.4 The guidance is silent on the relaxation process where the employer does not have delegated power to relax the cap, and relaxation is on mandatory grounds. Further information is needed to ensure the relaxation process is transparent and applied equitably across the public sector. Guidance should be available which sets out what information is needed by the Minister of the Crown to relax the cap on mandatory grounds under section 3 of the Directions. If the cap is being relaxed in accordance with 3.2 of the Directions, clarity is needed on who sets the level of payment to be made. Is the Decision Maker responsible only for deciding only to relax the cap, or are they also responsible for deciding the level of payment exceeding the cap that should be made?
- 18.5 Further guidance on discretionary relaxation on the basis of 4(a) of the Directions is required. The Directions refer to discretionary exercise of the power where *'not exercising the power would cause undue hardship'*, section 5.4A of the guidance where *'there are compassionate grounds due to genuine hardship'* and section 4.5 includes the term *'personal hardship'*. We recommend that the difference in wording is corrected to avoid confusion.
- 18.6 In section 5.4A of the guidance it states that *'there are few, if any, circumstances where the operation of the cap should lead to genuine hardship'* and that in deciding whether to relax the cap *'the circumstances that may be considered are not limited to the employee's own circumstances and it may be appropriate to consider the position of family members'*. As set out in 6.3 of this document, we believe further guidance is needed to apply this exemption equitably. In those cases where HM Treasury approval is required before the cap can be relaxed, a business case must be submitted. The relaxation of the cap due to an individual's caring responsibilities is a compassionate decision, and not one that could easily be supported by the information that would normally be included in a business case. Additional detail on the circumstances in which HM Treasury envisions relaxation of the cap on the grounds of avoiding undue hardship would be appropriate, and guidance on the type of information that should be included in a business case to support such a decision would be welcomed.
- 18.7 Section 4.3 of the guidance confirms the requirement under regulation 13(1) for the Decision Maker to keep a record of each occasion that the power to relax the cap is exercised. The reason why the power was exercised must be recorded and this should *'refer to the guidance and be sufficiently detailed to enable HM Treasury to assess if it has been appropriately applied'*. The reference here should be to the Directions as opposed to the guidance. Inconsistencies in the description of the approval process is considered in more detail in section 19. If the wording of the draft guidance is correct, then all decisions to relax the cap (other than on mandatory grounds) must be approved by HM Treasury. It seems incongruous to record detailed information *'to enable HMT to assess if [the power] has been appropriately applied'* when HM Treasury approval must already have been sought before the power to relax was exercised. It is likely that details about decisions need to be recorded for purposes of transparency and review of the operation of the cap, but the correct reason for recording should be referenced in the guidance.

- 18.8 Section 4.5 refers to the 'mandatory HMT directions', where the reference should be to the Directions, including both the mandatory and discretionary exercise of the power. It is suggested in Section 4.5 that 'personal hardship' would be considered a sufficient explanation for exercising the cap in relation to disclosure under regulation 13(2). This does not appear to be compatible with the assertion that '*there are few, if any, circumstances where the operation of the cap should lead to genuine hardship*'.
- 18.9 Paragraph 6.4 of this document sets out our views on the inconsistent wording concerning the discretionary relaxation of the cap to facilitate workforce reforms. Section 5.2 of the guidance confirms that the power to relax the cap may be exercised '*in very exceptional circumstances, in respect of a group of employees*'. The example given of redundancies occurring as a result of specific workforce reforms is far from exceptional in nature. In accordance with Section 5.4A of the guidance, in '*exceptional circumstances the restrictions could be relaxed to give effect to urgent workplace reforms*'. We encourage the publication of further guidance on the criteria that must be satisfied before the cap can be relaxed in respect of an individual or group in order to facilitate workforce reform.
- 18.10 Changes to the provision to relax the cap in cases where an exit was agreed before the Regulations came into force are needed to avoid an unnecessary prolonged approval process in specific circumstances and section 5.4C of the guidance should be expanded to ensure the power to relax the restrictions is not misused.
- 18.11 Our recommendation for a prolonged implementation period is laid out in section 9 of this document. The frequency of the need to relax the exit payment cap in cases where an agreement to exit was made before the Regulations came into force will depend on the length of that implementation period.
- 18.12 Without a firm definition of 'agreement to exit' there is the potential for confusion and the risk of legal challenge should the exit cap be applied. The definition must set out whether a verbal agreement could be considered as an agreement for the purpose of complying with the Directions, or whether the agreement must be in written form.
- 18.13 The guidance only permits discretionary relaxation of the cap under 4(c) of the Directions if the individual's exit date is delayed. If an agreement to exit is made before the Regulations come into force, but the planned exit date is after the (currently unknown) date that the Regulations come into force and there is no change in that exit date, then this would not satisfy the wording of the Directions. An application could be made to relax the cap outside of the circumstances set out in the Directions, which may involve a more protracted approval process.
- 18.14 Further guidance is needed to cover cases where the cap is relaxed in accordance with the Directions or with HM Treasury consent, and the individual subsequently exits from another relevant public sector authority within 28 days. As the Regulations stand, the individual would be required to inform the other employer about the first exit under regulation 10, but what action the second employer takes in response to that disclosure is not clear. For example, if part of an exit payment '*relates to a complaint that an employment tribunal has the jurisdiction to consider*' under whistleblowing or discrimination legislation and therefore the cap has been relaxed, but the individual's exit payment also included a statutory redundancy payment and pension strain cost, is the second employer required to disregard the whole of the exit payment for the purposes of applying the cap? Or take account of the statutory redundancy pay and strain cost, but disregard any payments made that fall under the circumstances in which mandatory relaxation applies? Any guidance would need to state clearly the

approach to take in cases where relaxation has applied on mandatory or discretionary grounds, and with HM Treasury consent.

19. The approval process

- 19.1 There are significant differences between the approval process required by the draft Regulations and the Directions, and the guidance. The approval process outlined in the guidance is substantially more onerous and in part contradicts the other consultation documents; there are also contradictions within the guidance on this topic. The LGA supports the use of statutory guidance to assist employers and LGPS administering authorities in complying with new or amended regulations by providing a level of detail that it is not possible to include in legislation. In its current form this guidance, particularly those parts that relate to the approval process, serves only to confuse and introduce contradiction where the primary purpose should be to add clarity. There are also significant omissions from the guidance concerning the approval process in particular circumstances. The approval process is considered in this section with emphasis on those areas of disparity in the consultation documents.
- 19.2 Table 1 shows the approval needed before specific bodies can relax the exit payment cap based on the draft Regulations and the Directions.
- 19.3 According to the draft guidance a body, other than a Welsh authority, listed in regulation 11 must gain approval multiple times before they are permitted to exercise the power to relax the cap. Table 2 sets out the approval needed before the exit payment cap can be relaxed, according to the guidance.
- 19.4 Concerns have been raised regarding the delegation of power to relax the cap to a local authority, in respect of the ability of councils '*to ensure decisions are made in a reasonable and timely fashion*' if such a decision can only be made by the full council. In some organisations full council meetings occur every three months, which may not be frequent enough to make decisions concerning the relaxation of the cap to facilitate urgent workforce reform. Local authorities have asked whether decisions can be delegated to a subcommittee which meets more frequently and could be more easily convened to consider urgent cases.
- 19.5 Full council meetings are open to the public and it is possible that the information the council will consider in order to make a decision about the relaxation of the cap could be used to identify the individual concerned. Without proper exceptions being in place to exclude members of the public from that part of the meeting this could contravene data protection rules, particularly if a decision is being made under 4(a) of the Directions and the individual's personal and family circumstances are being scrutinised.
- 19.6 The implication of section 5.1 of the guidance is that a body listed in regulation 11 must obtain consent of the Principal Accounting Officer and the relevant minister in order to relax the cap on mandatory grounds. This is not reflected in the wording of the Regulations or the Directions and so changes are required to ensure consistency.

Table 1: The power to relax restrictions on exit payments – based on draft Regulations and Directions

Employer ¹ making the exit payment	Decision Maker	Grounds for relaxation	Consent of HM Treasury required?
Local authority in England	Full council of that authority	Mandatory	No
A fire and rescue authority	The fire and rescue authority		
The Greater London Authority	The London Assembly	Discretionary	Yes
Any other public sector body covered by the Regulations, other than a devolved Welsh authority	Minister of the Crown	Mandatory	No
		Discretionary	No
All of the above	As above	Outside of circumstances outlined in HMT Directions	Yes
A devolved Welsh authority	Welsh Ministers	All – HMT Directions do not apply	No

¹ or a body responsible for determining the remuneration payable to the holder of a public sector office listed in Schedule 1.

Table 2: The power to relax restrictions on exit payments – based on draft guidance

Employer ² making the exit payment	Grounds for relaxation	Approval process
Local authority in England, A fire and rescue authority or The Greater London Authority	Mandatory	<ol style="list-style-type: none"> 1) Decision to relax made by full council, FRA or the London Assembly 2) Business case submitted to Principal Accounting Officer ³ 3) Business case submitted to relevant minister ³
	Discretionary	<ol style="list-style-type: none"> 1) Decision to relax made by full council, FRA or the London Assembly 2) Business case submitted to Principal Accounting Officer 3) Business case submitted to relevant minister 4) Business case submitted to HM Treasury for approval
	Outside of circumstances outlined in HMT Directions	<ol style="list-style-type: none"> 1) Decision to relax made by full council, FRA or the London Assembly 2) Business case submitted to Principal Accounting Officer 3) Business case submitted to relevant minister 4) Business case submitted to HM Treasury for approval
Any other public sector body covered by the Regulations, other than a devolved Welsh authority	All	Other than confirming that HM Treasury approval is not required in mandatory cases, the guidance is silent on the approval process for bodies not named in regulation 11.
A devolved Welsh authority	All	Decision made by Welsh Ministers

² or a body responsible for determining the remuneration payable to the holder of a public sector office listed in Schedule 1.

³ The requirement for the Principal Accounting Officer and relevant minister to approve relaxation of the cap on mandatory grounds is implied but not explicitly stated in the draft guidance. Further clarity is needed.

19.7 Section 5.1 of the guidance sets out the process for approval if a delegated authority decides to exercise the power to relax the cap in accordance with section 4 of the Directions – on discretionary grounds. For a local authority this involves gaining approval from at least four bodies:

- i) the full council of the local authority
- ii) the Principal Accounting Officer of the sponsoring department
- iii) the relevant minister
- iv) HM Treasury

This contradicts the Regulations and Directions under which only approval of the full council and HM Treasury is required in such a case.

19.8 Section 5.1 of the guidance also describes the approval process a body listed in regulation 11 must follow if the cap is to be relaxed outside of the circumstances outlined in the Directions. Approval would need to be gained from the bodies listed in i) to iv) above. The Regulations and Directions do not require approval by the Principal Accounting Officer nor the relevant minister in such a case. Change is needed to align the information contained in the consultation documents.

19.9 The discrepancies in the content of the draft Regulations, Directions and guidance must be removed if the approval process to relax the cap is to operate effectively. Section 7 in Part One sets out our recommended amendments.

19.10 The guidance is silent on the approval process for bodies which are in scope of the cap, but which are not listed in regulation 11 and detailed guidance on the approval process must be produced for these bodies before the Regulations come into force. It is possible that the approval process set out in 5.1 of the guidance also applies to bodies not listed in regulation 11, but if this is the case then this begs the question as to why any non-Welsh bodies are listed in regulation 11 if the approval process is exactly the same for those bodies which are listed as it is for those which are not? In the absence of guidance covering the approval process to be followed by bodies not listed in regulation 11, it is difficult to predict what issues may arise. The following two paragraphs include areas that should be covered by the guidance.

19.11 The Decision Maker in respect of an exit payment made by a body not listed in regulation 11 is a Minister of the Crown. We would welcome guidance on what information the Minister will require if the cap is to be relaxed on mandatory grounds. If the relaxation is under 3.2 of the Directions (Employment tribunal claims: discrimination and whistleblowing), clarity is needed on whether the Decision Maker only makes the decision to relax the cap, or if they are also responsible for setting the level of exit payment payable. Such a payment is likely to form part of a settlement agreement and the guidance must set out at what stage of negotiations approval of the Minister of the Crown should be sought by the employer. Negotiating a settlement the cost of which exceeds the cap is time wasted if the Minister subsequently decides that the power to relax the cap should not be exercised.

19.12 Guidance should cover the responsibilities of the employer when the cost of an exit would exceed the cap. Is the employer required to refer all such cases to the Minister of the Crown to decide whether the cap should be relaxed? Or is the employer (not listed in regulation 11) responsible for making an initial decision on whether they believe that relaxation of the cap would be appropriate in a particular case? Employers are unlikely to welcome writing a business cases for consideration by the Decision Maker if they do not support relaxation of the cap on that occasion.

- 19.13 It is difficult to envision how a process which involves gaining approval from four different bodies will result in decisions being *'made in a reasonable and timely fashion'*. Local government employers have raised concerns about the length of time that such a process will take and have recommended an online system or the provision of a suite of standard template documents which set out the information that must be supplied to enable the Minister of the Crown and HM Treasury to make a decision.
- 19.14 This section highlights the issues identified in the approval process for relaxing the exit payment cap and we recognise that the actual process may differ from that described in the draft guidance. It is our expectation that approval will need to be obtained from HM Treasury and/or a Minister of the Crown in certain circumstances and we would welcome additional detail in the guidance about the exact status of the approval - see below.
- 19.15 In order to process retirements in a timely fashion, it is likely that approval will be sought in advance of the proposed exit date. Many factors determine the cost of an exit, including but not limited to:
- final pay
 - actual pay
 - maximum weekly pay used to calculate statutory redundancy
 - actuarial factors used to calculate early retirement strain cost
 - leaving date.

The longer the period between seeking approval and the exit date, the more likely it is that one or more of the factors which determine the exit cost will change. If the cost does change after approval has been given, must a further application to relax the cap be submitted based on the revised cost? As an alternative we would support the introduction of a level of 'tolerance', which would mean that approval does not need to be sought more than once for the same exit except if there has been a substantial change in cost.

20. The Local Government Pension Scheme (LGPS) Regulations

- 20.1 The Local Government Pension Scheme Regulations 2013 (LGPS2013) do not currently allow for the operation of the exit payment cap. What changes are made to the LGPS regulations will determine the impact of the exit payment cap on exiting LGPS members. Under LGPS2013 regulation 2(3) *'The Secretary of State may, after consultation with the Government Actuary's Department, issue actuarial guidance to administering authorities'*. Such actuarial guidance will be required to implement the exit payment cap fully. This section provides further information about LGPS regulation changes that could be used to enable the operation of the exit payment cap, and the supporting actuarial guidance that would be required.
- 20.2 If changes to the LGPS regulations are made after the introduction of the exit payment restriction regulations come into force then there is a danger that LGPS members would be treated differently based on the date of their exits. Changes in the LGPS regulations which take effect at the same time as the exit payment cap comes into effect would mean equitable treatment for scheme members.
- 20.3 Under LGPS2013 regulation 68(2), an administering authority may require an employer to make a payment to the pension fund in respect of the strain cost that arises when an employee retires before their normal pension age with unreduced

benefits. It is not compulsory for such a payment to be made and some administering authorities use alternative methods to cover the pension strain cost. Local arrangements are in place whereby some employers pay an increased contribution rate based on the expectation of a certain number of redundancies and retirements on the grounds of business efficiency in a period and do not make strain cost payments related to individual exits.

- 20.4 A decision is needed as to whether such arrangements can continue when the exit payment cap is introduced. Can a 'notional' strain cost which is not directly paid by the employer to the pension fund be included in the calculation of the exit payment, or must that cost be paid to the pension fund at the point of exit in order to comply with the Regulations? A change may be needed in LGPS2013 regulation 68(2) depending on this decision.
- 20.5 The method of calculating pension strain cost is currently set locally by each administering authority and is based on the demographics of their membership and actuarial assumptions which may include future pay growth, pension increase rate and discount rate. Continuing with this local definition of strain cost would result in the exit payment cap having different results for individuals who participate in the LGPS in different administering authorities, despite being similar in all other respects such as age, length of LGPS membership and salary.
- 20.6 The introduction of a standard pension strain cost calculation across the LGPS in England and Wales would result in the exit payment cap being applied consistently and equitably. Changes would be required to LGPS2013 regulation 68(2) specifying that the pension strain cost must be calculated 'in accordance with actuarial guidance issued by the Secretary of State' instead of 'as calculated by an actuary appointed by the administering authority'. A standard strain cost calculation is therefore vital to the effective operation of the cap whatever decision is made concerning changes to the LGPS regulations.
- 20.7 Introducing a standard strain cost is necessary but will lead to another potential issue. The cost of paying a LGPS pension early must be recorded in an employer's accounts. The method of calculating that cost for accounting purposes may be very different from the standard pension strain cost calculated by the administering authority. This could potentially result in an exit cost in excess of £95k showing in accounts for someone who was not capped or alternatively a cost of less than £95k for someone who was.
- 20.8 This could lead to legal challenge, with employers being accused of breaching the cap 'by stealth' if the exit cost for accounting purposes exceeds the strain cost used in the calculation of the exit payment, or members challenging the cap that has been applied in respect of their exit if the cost for accounting purposes is less than the strain cost.
- 20.9 Actuarial guidance issued by the Government Actuary's Department (GAD) is essential if a universal strain cost calculation across the LGPS is to be introduced. Under current local arrangements, a change in strain cost calculation would affect only the employer cost related to an exit, the level of pension benefits payable to the LGPS member would not be affected. A change in strain cost calculation where the cap has already been applied would affect the pension benefits payable to a scheme member. Factors issued by GAD are regularly reviewed, and often new factors take effect on the day that they are published. Careful thought should be given to the implementation period when new factors to calculate pension strain cost are introduced to ensure that the LGPS benefits payable in respect of an exit that has already been agreed are not adversely affected.

- 20.10 The LGPS regulations have changed over time and a member's pension on retirement can include up to four 'tranches' which are payable without reduction at different dates. Actuarial guidance on strain cost calculation must include the appropriate detail to ensure that the cost reflects the various protected retirement ages and tapered protections that may apply.
- 20.11 Actuarial guidance must set out how any divorce debits or Scheme Pays debits relating to an Annual Allowance (AA) tax charge that arose in a year other than the final year are factored in to the strain cost calculation.
- 20.12 The examples in Appendix 1 demonstrate that employees on relatively modest salaries may be affected by the exit payment cap, but consideration should also be given to the particular pension issues that arise in relation to high income individuals. A complex iterative calculation is currently required when a member chooses to meet pension tax charges by receiving a reduced pension:

- If a member's benefits are measured against the tapered AA, then the level of pension paid may change the member's adjusted income which determines the AA tax charge payable for the final year
- If the tax charge is met by the pension scheme, with the member receiving a reduced pension in exchange, AA debit affects the value of benefits crystallising, which in turn determines the amount of lifetime allowance (LTA) tax payable. If the member chooses to meet the LTA charge by receiving a reduced pension, this will reduce the amount of pension paid, changing the member's adjusted income for the year and therefore changing the AA tax charge due.

Introducing the additional element of a capped exit payment will add further complexity to this calculation. Actuarial guidance must set out the basis of the interaction between pension tax charges and the exit payment cap. We believe that the provision of a calculator would be welcomed by pension administrators and high income individuals who are keen to understand their options.

- 20.13 In order to bring LGPS2013 regulations in line with the exit cap a number of options are available as follows:

Option 1 - No change in LGPS Regulations but apply the exit cap Regulations as overriding legislation

- 20.14 If the LGPS regulations are unchanged, it is unclear whether the implementation of the exit payment cap would change a LGPS member's statutory right to an unreduced pension if they are made redundant or retire on business efficiency grounds at age 55 or over. The exit cap restriction could limit the amount that an employer must pay to the pension fund under LGPS2013 regulation 68(2). However it is not clear whether any such underpayment would affect the member's right under LGPS2013 regulation 30(7): *that member is entitled to and must take immediate payment of...retirement pension relating to that active member's pension account payable under these Regulations, without reduction.*
- 20.15 The implementation of the exit payment cap would have a detrimental effect on the benefits payable to some LGPS members. There is a significant risk that expensive and time-consuming litigation is more likely if no changes are made to the LGPS regulations.

Option 2 – Change LGPS regulations to incorporate the cap and provide the member with choice

- 20.16 Provisions already exist in the LGPS Regulations that could be utilised to facilitate the operation of the exit payment cap, without requiring substantial regulation changes.
- 20.17 Regulation 9 allows a cash payment to be made as an alternative to pension strain cost, if the total of the pension strain cost and other exit payments would exceed the cap. There is no requirement in regulation 9 for that cash payment to be made to the individual. The cash payment could be used by the employer to award additional annual pension to the member under LGPS2013 regulation 31(1)(b).
- 20.18 As set out in section 11, the LGA is firmly in favour of member choice and believes that a LGPS member should not be forced to receive an actuarially reduced pension. We therefore recommend changes to LGPS2013 regulation 30 together with the introduction of guidance to ensure that:
- where a full strain cost can be made an unreduced pension is paid as is now the case
 - where a full strain cost cannot be made the member has the choice of an immediate reduced pension or a deferred pension
 - where an immediate reduced pension is chosen the member has the choice of taking a cash payment under regulation 9 or asking their employer to use the restricted strain cost to make up some of the reduction in pension
 - where a deferred pension is chosen the member has the choice of taking a cash payment under regulation 9 or asking their employer to use the restricted strain cost to provide extra deferred pension, and
 - a member can redirect their statutory redundancy payment to the LGPS in order to purchase additional pension.
- 20.19 In the above scenarios a member may choose an immediate pension and the use of the restricted strain cost for extra pension. The question then arises if they should be able to purchase any further additional pension to make up the remaining reduction to their pension and if so on what basis? As LGPS2013 regulation 16 permits an active member to pay a lump sum to purchase additional pension, the member may use this option as a means of closing the gap, but only if they make the payment prior to leaving. Should consideration be given to allowing a person to purchase additional pension for a limited period after ceasing to be an active scheme member, and if so what safeguards should be put into place to stop the member ‘recycling’ their LGPS lump sum to buy extra pension?
- 20.20 The main advantage of this approach (beyond the introduction of choice) is that only limited changes to LGPS regulations together with the introduction of actuarial guidance would be required to facilitate the implementation of the exit payment cap. The introduction of a standard strain cost calculation to apply across the LGPS, as set out in section 20.5 is recommended to ensure the cap is applied fairly and consistently.
- 20.21 There is the further option of commencing the changes to LGPS regulations as set out in Schedule 6 of the Enterprise Act 2016. Paragraph 5 of Schedule 6 makes amendments to the LGPS Regulations 2013 that would allow the payment of partially reduced pension benefits in cases where the pension strain cost element of an exit payment is capped and provide for the member to purchase all or part of the reduction. However there are several issues with these regulations that would either require further amendments or, more importantly, do not provide the member with any

choice. The draft Regulations do not bring Schedule 6 into force, further commencement regulations would be required to do so. This section looks at what additional changes to LGPS rules would be required if such commencement regulations were laid.

20.22 Schedule 6 would introduce an alternative LGPS2013 regulation 30(7)(b) in cases where the cap has been applied: *'any other pension relating to that employment payable under these Regulations...'*. This regulation has been changed since the Enterprise Act 2016 was written and *'that employment'* would need to be replaced by *'that active member's pension account'* to ensure that the provision applies only to active scheme members, as intended.

20.23 A further change to LGPS2013 regulation 30(7) would be needed to introduce the option for a member to defer payment of a **reduced** pension if they are made redundant or leave on the grounds of business efficiency. Under the current rules, a member is not forced to take a reduced pension. We believe the same choice should be open to an individual who is made redundant or leaves on business efficiency grounds at age 55 or over and whose pension benefits, as a result of the exit payment cap, would be subject to actuarial reduction.

20.24 If the LGPS regulations are changed to allow partial reduction, then actuarial guidance will be required to inform administering authorities how that partial reduction will be applied to a member's LGPS benefits if they are subject to the cap.

LGPS member benefits can be made up of up to six different elements, different in structure and payable without reduction from different dates. The actuarial guidance must set out the partial reduction that will apply to all 'tranches' of a member's LGPS retirement benefits, taking into account the various protections and normal pension ages. The effect of a member's election to receive a reduced pension in exchange for tax-free cash will also need to be considered. The guidance should also cover divorce debits, annual allowance and lifetime allowance debits. If partial reduction is not applied proportionately across a member's benefits then the introduction of exit payment restrictions is likely to lead to members having to consider multiple complex and potentially confusing options on retirement as well as significant additional administrative complexity.

20.25 If the LGPS regulations are changed to allow partial reduction, then a standard pension strain cost calculation is essential. If partial reductions to LGPS benefits are permitted, then a standard method of calculating those partial reductions must be introduced, as set out in the previous paragraph. If strain cost calculations are not standardised, then the cost of paying the partially reduced pension may still exceed the cap, based on a local definition of strain cost.

20.26 Regulation 68A(2) allows the member to pay extra to the pension fund to 'buy-out' some or all of the partial reduction that would otherwise apply to their pension benefits. Such a provision must include reference to the necessary actuarial guidance to cover the cost of buying out a partial reduction, but should also address other considerations concerning the process:

- imposing a time limit on when an election to pay extra to buy-out a partial reduction can be made – for example allowing such an election up to 28 days after the exit occurs, or such a longer period as the employer allows.
- the retirement benefits of LGPS members who joined the scheme before 1 April 2008 include an automatic tax-free lump sum and all members have the option of receiving a reduced pension in exchange for providing or increasing a tax-free lump sum on retirement. There is a risk that members

will use their tax-free lump sum to fund buying-out the reduction to their pension, which would contravene the 'recycling' rules in Paragraph 3A, Schedule 29 of the Finance Act 2004. In addition to a time limit, consideration should also be given to allowing an election to buy-out pension reduction only before a member's benefit crystallisation event to avoid the misuse of the lump sum in this way.

- whether the option to buy-out the reduction is open to all members or just those who choose immediate payment. If the option to buy-out the reduction is open to those who choose to defer payment, then further actuarial guidance will be required to demonstrate how a partial reduction changes over time. It is our view that a partial reduction and the option to pay extra to buy-out a reduction should only be available to members who take immediate payment of their LGPS benefits on exit.

20.27 Appendix 2 provides a comparison of the estimated benefits payable on redundancy:

- under current LGPS rules
- if the exit payment is capped and a cash alternative payment is made
- if the exit payment is capped and the available cash is used to purchase additional pension
- if the LGPS is amended to allow partial reduction.

21. Further LGPS regulation amendments

21.1 In this section further amendments to the LGPS regulations which would simplify the operation of the exit payment cap are considered.

21.2 An employer may award additional pension to an employee who leaves on the grounds of redundancy or business efficiency under LGPS2013 regulation 31(1)(b) within six months of the individual's leaving date. The cost of doing so would form part of the exit payment under regulation 6(1)(i). The effective operation of the exit payment cap, particularly for an employee who is entitled to immediate payment of their pension benefits or who exits from multiple public sector employers within a 28-day period, would be significantly hampered by the award of additional pension more than 28 days after the individual's leaving date.

21.3 Regulation 7(f) specifies that '*any payment made in compliance with an order of any court or tribunal*' is not an exit payment for the purpose of these Regulations, and the Directions prescribe that the exit payment cap must be relaxed when the payment relates to a complaint that an employment tribunal could consider under discrimination or whistleblowing legislation.

21.4 This would require changes in LGPS2013 regulation 31(1) which:

- allow an employer to award additional pension to a member who leaves on the grounds of redundancy or business efficiency within **28 days** of the date the member's employment ended, instead of the current six months and
- allow the 28-day time limit to be extended if that additional pension is awarded in compliance with an order of any court or tribunal, or falls within the definition of a payment under 3.2 of the Directions.

21.5 Regulations 83(4), (5), (6) and (7) of the Local Government Pension Scheme Regulations 1997 set out the options for a LGPS member who is paying extra to purchase added years of membership and is made redundant. Under current

provisions, within three months of leaving (or such a longer period as the employer allows) they can pay a lump sum to the pension fund, as calculated by an actuary appointed by the administering authority, which represents the capital value of the unpaid contributions.

- 21.6 Making a lump sum payment to complete an added years contract will change the strain cost related to the early payment of a member's LGPS benefits. In most cases the strain cost will increase because a larger pension is being paid early. There are circumstances where such a payment would result in lower strain cost because the additional years of membership purchased serve to reduce the age at which the member satisfies the 85-year rule.
- 21.7 Any lump sum payment made for this purpose would affect the total cost of an exit and therefore the operation of the exit payment cap. This necessitates a change in the LGPS regulations so that, for example, any such election must be made within 28 days of leaving employment (or such a longer period as the employer allows). The introduction of central actuarial guidance on the calculation of the cost of completing added years contracts would be more efficient for administering authorities and would reduce costs.

22. Other considerations related to the LGPS

- 22.1 The exit payment cap will not apply on all occasions when a strain cost arises in the LGPS. A strain cost may arise when a scheme member takes 'flexible retirement' – the member reduces their working hours or grade and elects to receive their pension immediately with their employer's consent – but in general the exit payment regulations would not apply because there has not been a 'relevant public sector exit'. An agreement to flexible retirement can include a stipulation that 'full' retirement will occur within a specified period, but that period is likely to be years and not months.
- 22.2 The LGPS regulations allow deferred benefits to be paid early, and for the employer to waive the early payment reduction that would otherwise have applied, leading to pension strain cost. In general such a cost would not constitute an exit payment for the purpose of these Regulations as it is not directly associated with the member's exit from their employment.
- 22.3 It is possible for a settlement agreement to include an agreement to release deferred benefits at a future date, and for the employer to waive the early payment reduction. For example, an employee is made redundant at age 54, a severance payment is paid, and it is agreed that the pension will come into payment unreduced at age 55. It would appear that the strain cost related to the early release of the pension in such a case should be included in the total exit payment by virtue of regulation 6(1)(i). This would be relatively easy to administer if the retirement occurs only a short time after the exit. But the position is more complex if the individual has multiple exits within a 28-day period, or if the retirement occurs years after the agreement was entered into. It is our assumption that the employer would be required to retain a record of the exit payment (severance) made at the time of the exit and that this should be added to the strain cost when the deferred pension is paid early in order to ensure that the total cost does not exceed the cap.
- 22.4 The employers in scope of the exit payment cap do not include admission bodies. It is common for an employer to enter into an admission agreement with an administering authority when a local authority outsources a service or function. The intention of TUPE arrangements is that transferring staff are not disadvantaged and retain the same terms and conditions of employment with the new employer. The

implementation of the exit payment cap within the public sector will mean that some employees are better off after transferring to a body not covered by the Regulations. There is a risk that contractors are less likely to bid for local authority contracts, or that the cost of such contracts increase as contractors pass increased exit payments back to the local authority.

- 22.5 The MHCLG consultation 'Local Government Pension Scheme: Fair Deal – strengthening pension protection' closed in April 2019. The consultation included the possible introduction of 'deemed employers' status in the LGPS. Under the proposals, when an employee is compulsorily transferred to a service provider the original employer remains the scheme employer for pension purposes – the deemed employer – and the service provider becomes the employer for all other purposes. It is our understanding that an employee in this position would not be subject to the exit payment cap because their employer is not a 'relevant public sector employer'. The expectation is that the service provider is not exposed to any pension risk under such an arrangement. It is possible for an agreement between the service provider and the deemed employer to cover the pension responsibilities in more detail, and that could involve the deemed employer retaining responsibility for paying pension strain costs. This could lead to the incongruous situation with the employer having to pay more in relation to the exit of a 'deemed' employee than they have to for an actual employee if the full cost of that exit would exceed the cap.
- 22.6 LGPS administering authorities have voiced concerns about whether they will have any statutory duty to check that the exit payment restrictions are being correctly applied. If a strain cost exceeds the cap, or if it would be reasonable to assume that the strain cost plus other exit payments would exceed the cap, does the pension administering authority need to see proof of HM Treasury (or a body listed in regulation 11) approval to relax the cap? Does the LGPS administering authority have any responsibility to check whether an employer is in scope of the Regulations, or to inform employers if they are aware that an individual has had multiple exits within a 28-day period?

23. Other considerations affecting the operation of the cap

- 23.1 Paragraph 19.15 of this document concerns approval where the cost of an exit changes after that approval has been given. Consideration should also be given to the position where an exit payment has been capped and a backdated payment is made, or where the cost of an uncapped exit increases as a result of a backdated payment, to the extent that the cap would be breached. Such a payment is likely to increase pension strain cost, but could also increase other exit payments such as non-contractual pay in lieu of notice.
- 23.2 Public service pension schemes are currently awaiting the final outcome of the McCloud case which concerns the transitional protections given to older scheme members as part of pension reforms introduced in 2014/2015. If the government is not given leave to appeal the Court of Appeal decision in the Supreme Court, or if that appeal upholds the Court of Appeal decision then an Employment Tribunal will be tasked with formulating appropriate remedies for those scheme members not covered by the transitional protections.
- 23.3 Valuations of public service pension schemes performed in 2018 found that schemes were cheaper than expected, to the extent that the cost fell outside the specified margins of the employer cost cap. This would normally have led to scheme reform to increase costs, but the process has been paused pending the McCloud outcome. If

the Supreme Court finds in favour of the government then the cost cap process will resume, with increases to member benefits, including past members likely.

23.4 If the exit payment cap is introduced before the final McCloud ruling and/or before schemes are reformed following the breach of the cost 'floor' then backdated changes to member benefits are likely once those processes are finalised. Employers and LGPS administering authorities will require detailed guidance on the approach to take in respect of exits where:

- the cap was applied, but the cost of that exit increases as a result of a backdated payment, scheme changes or other remedy
- the exit cost did not exceed the cap, but would exceed the cap as a result of a backdated payment, scheme changes or other remedy
- approval was given to relax the cap, but that cost increases as a result of a backdated payment, scheme changes or other remedy.

23.5 Consideration should be given to the level of complexity that will result from the introduction of exit payment restrictions. As the examples in Appendix 1 demonstrate, far from affecting only the highest earners, the cost of the exit of a public sector worker on a relatively modest salary may exceed the cap, meaning these Regulations having effect more frequently than has been anticipated. Employers and pension administrators will have to devote significant resources to explaining multiple complex options to scheme members. Steps should be taken to limit this additional administrative burden. The list below includes decisions that an individual subject to the cap may have to take before their retirement, some of which could be removed if changes are introduced in the Regulations:

- whether to apply the cap to cash payments or pension benefits
- if pension benefits would be partially reduced, whether to claim that pension immediately or defer payment to a later date
- whether to apply that partial reduction to their pension or lump sum
- whether to pay extra to buy-out some or all of the partial reduction
- whether to opt for a reduced pension in exchange for tax-free cash, and if so how much

Higher earners may also need to consider:

- whether to pay an annual allowance tax charge directly to HMRC or to take the 'Scheme pays' option
- whether to opt for a reduced pension or reduced lump sum in order to pay a lifetime allowance tax charge

Both of these considerations may affect the pension strain cost and therefore impact on the level of benefits payable. If we assume that each of these options each have two possible outcomes, there are over 100 different benefit packages that could be paid depending on the options taken.

23.6 LGPS administering authorities will have the daunting task of trying to communicate and explain a vast range of options to members. It is also likely that they will be under pressure to fulfil the role of pension advisers in response to queries raised by members who are perplexed by the complex options open to them. The LGA is firmly in favour of changes in the Regulations and guidance before they come into force to remove some of that complexity by:

- prescribing that other exit payments (with the exception of statutory redundancy pay) are capped before pension strain cost
- applying the partial reduction proportionately across member benefits, not offering member choice and
- not permitting buy-out of a partial reduction unless the member elects for immediate payment of their benefits.

24. Firefighter Pensions

- 24.1 As with the LGPS, there will be amendments and guidance required in relation to the Firefighters' Pension Schemes in order to apply the cap as set out in this consultation.
- 24.2 In FPS2006 & FPS2015, FRAs can allow firefighters to retire from age 55 with an unreduced pension under Part 3, Paragraph 6 (FPS2006) and regulation 62 (FPS2015) - Authority Initiated Early Retirement (AIER).
- 24.3 The Fire and Rescue Authority (FRA) is required to pay the difference between the unreduced and reduced pension into the Firefighters' Pension Scheme (FPS) notional pension fund for each year the pension is in payment. This payment is deemed as an employer payment to facilitate early exit and would have to be measured under the cap.
- 24.4 While often the key reason for an AIER is fitness related, for FRAs who allow an AIER for reasons other than fitness, changes to the FPS Regulations and new statutory guidance would be required in the following areas:

- a. to measure the annual cost to the Fire Authority against the £95k cap

The FPS Regulations state that the cost to the FRA to allow early retirement with an unreduced pension is made by an annual payment to the notional pension fund representing the difference between the unreduced and reduced pension that would be paid to the member.

The Regulations do not specify how to measure this annual cost of early retirement against the cap of £95k.

Guidance would be needed from the Home Office on how to measure the annual payment against the cap. An alternative would be for Home Office to allow the early retirement cost to be paid as a capital cost on exit rather than annually.

- b. amendment to the pension regulations to allow partial reduction

If, on measurement, the early retirement cost would exceed the cap, then the Regulations would need to be changed to consider:

- how the member's benefits would be reduced to such a level that the exit payment cap is not breached.
- whether the member would have the option of paying extra to buy-out some or all of the reduction.

The proposed regulation changes do not introduce the option to defer payment of pension benefits in the event of a FPS member who is over age 55 being made redundant or leaving on the grounds of business efficiency. As the Regulations

currently stand, an FPS member whose exit payment has been capped would be forced to accept a reduced pension.

In order to implement partial reduction in the FPS, guidance from GAD on partial reductions and on the cost of buying out those reductions would be required. Detailed information concerning the method of calculating the partial reduction to benefits, the method and calculation for buying out the reduction – particularly the calculation to work out the applicable reduction where some but not all of the reduction has been bought out – and the deadline that applies to an election to make such a payment, would be required.

Appendix 1: Examples of exit payments in the LGPS

The examples in this section aim to demonstrate the salary level at which the exit payment cap would 'bite' in respect of the exits of LGPS members with different amounts of pensionable service.

The basis for calculating pension strain cost is set locally. The LGA supports the introduction of a standard method of strain cost to apply across all LGPS administering authorities (see section 20.6). In the absence of a standard calculation, the following examples have been based on our best estimate of the methodology that would be employed in that standard calculation.

The estimated figures in Tables 3 to 5 are based on:

- the exit of a female scheme member at age 55 on 31 March 2019
- statutory redundancy pay based on a maximum weekly pay of £525
- severance payment of statutory weeks x actual weekly pay x 1.5

Table 3: Pension strain cost plus severance payment

Length of service (years)	Annual salary which yields total exit cost of £95,000	Unreduced LGPS benefits		Severance payment
		Annual pension	Tax-free lump sum	
35	£ 23,500	£ 11,798	£ 21,150	£ 18,306
30	£ 25,500	£ 11,208	£ 18,168	£ 19,845
25	£ 27,900	£ 10,520	£ 14,649	£ 21,749
20	£ 30,700	£ 9,657	£ 10,362	£ 23,895
15	£ 34,600	£ 8,721	£ 5,190	£ 21,945
10	£ 46,300	£ 8,582	£ 0	£ 20,025
5	£ 81,300	£ 8,296	£ 0	£ 17,584

Table 4: Pension strain cost plus statutory redundancy payment

Length of service (years)	Annual salary which yields total exit cost of £95,000	Unreduced LGPS benefits		Statutory redundancy payment
		Annual pension	Tax-free lump sum	
35	£ 25,100	£ 12,601	£ 22,590	£ 13,041
30	£ 27,400	£ 12,044	£ 19,524	£ 14,175
25	£ 30,700	£ 11,576	£ 16,119	£ 14,175
20	£ 34,900	£ 10,977	£ 11,778	£ 14,175
15	£ 39,500	£ 9,956	£ 5,925	£ 11,550
10	£ 53,800	£ 9,973	£ 0	£ 7,875
5	£ 95,600	£ 9,755	£ 0	£ 3,938

Table 5: Pension strain cost only

Length of service (years)	Annual salary which yields total exit cost of £95,000	Unreduced LGPS benefits	
		Annual pension	Tax-free lump sum
35	£ 29,100	£ 14,609	£ 26,190
30	£ 32,200	£ 14,154	£ 22,944
25	£ 36,100	£ 13,612	£ 18,954
20	£ 41,000	£ 12,897	£ 13,839
15	£ 44,900	£ 11,317	£ 6,735
10	£ 58,700	£ 10,882	£ 0
5	£ 99,700	£ 10,173	£ 0

The figures in the tables above are based on membership of the LGPS only. An individual's career path is likely to involve movements across a number of employers and sectors. The figures in Table 6 represent the exit cost related to the exit of a member who leaves local government employment after five years, but who has transferred pension benefits from another pension arrangements to the LGPS. The purpose of this section is to demonstrate the relatively low level of pension income an individual may be entitled to and still be affected by the exit payment cap. The figures in this section are based on:

- the exit of a female scheme member at age 55 on 31 March 2019
- annual salary of roughly the national average £30,000
- severance payment of statutory weeks x actual weekly pay x 1.5

Table 6: Exit payment cap based on level of pension

Annual pension	Other payments due on exit	Exit cost
£ 10,170	n/a	£ 95,000
£ 9,749	Statutory redundancy payment £ 3,938	£ 95,000
£ 9,476	Severance payment £ 6,491	£ 95,000

Appendix 2 – Partial reduction and additional pension

The aim of the following examples is to demonstrate the results for a LGPS member if their exit payment is capped and the scheme has or has not been amended to allow partial reduction.

Actuarial guidance which covers partial reduction has not been produced and so assumptions have been made about how a partial reduction may be calculated in order to produce this comparison.

A severance payment based on actual weekly pay x statutory weeks x 1.5 is assumed to be payable under the current employer policy.

The member:

- Female
- Age 55
- 35 years' LGPS membership
- Annual salary of £ 40,000

Table 7: LGPS benefits and severance payable under current rules

Annual pension (paid immediately)	£ 20,082
Lump sum (paid immediately)	£ 36,000
Severance (including statutory redundancy pay)	£ 31,154 *
Pension strain cost	£ 130,651

Option 1

- LGPS Regulations not amended to permit partial reduction and
- Full early payment reductions apply.

Table 8: Cash alternative of strain cost (subject to £95,000 limit) paid to the member

Reduced annual pension (paid immediately)	£ 14,114
Reduced lump sum (paid immediately)	£ 31,968
Severance (including statutory redundancy pay)	£ 31,154 *
Available pension strain cost	£ 63,846 *

* We expect that tax will be deducted from the excess over £30,000. These amounts may also be subject to employer national insurance deductions from April 2020.

Option 2

Tables 9, 10 and 11 provide estimates of the payments due to a LGPS member based on the assumption that the LGPS Regulations are amended to permit partial reductions, and member choice is introduced which enables a member to elect whether to receive a reduced pension.

Table 9: LGPS benefits fully reduced, available strain cost used by employer to award additional pension

	Reduced	Additional pension awarded	Total
Annual pension	£ 14,114	£ 3,292	£ 17,406
Reduced lump sum			£ 31,968
Statutory redundancy payment			£ 14,175

Pension strain cost (used to purchase additional pension) £ 80,825

Table 10: Member elects for deferred benefits, cash alternative of strain cost (subject to £95,000 limit) paid to the member

Statutory redundancy payment	£ 14,175 #
Available pension strain cost (paid to member)	£ 80,825 #

Deferred LGPS benefits payable from Normal Pension Age (67) or earlier on a reduced basis:

Annual pension	£ 20,082
Lump sum	£ 36,000

We expect that tax will be deducted from the excess over £30,000. These amounts may also be subject to employer national insurance deductions from April 2020.

Table 11: Partial reduction introduced in the LGPS

Partially reduced annual pension	£ 17,806 ^
Partially reduced lump sum	£ 34,462 ^
Statutory redundancy payment	£ 14,175

Pension strain cost (used to partially fund early payment cost) £ 80,825

^ Scheme member has the option to pay extra to buy-out the reduction.