Exit payment reforms

Key points to note

- The Government is in the process of introducing a series of reforms to the exit payments payable to an individual where they exit a public sector employment.
- Such reforms will apply to employers listed as public sector by The Office for National Statistics
- These reforms are intended to achieve better value for the public purse and to increase consistency in treatment across the different parts of the public sector.
- The reforms will have impacts on the LGPS, particularly where a member is 55 or over and is made redundant. Currently such members would become entitled to the immediate payment of their full retirement pension and this would usually involve the payment of a strain cost by their employer.
- The implementation timescales for the reforms have been subject to change in recent months, but currently the secretariat expect that the reforms will become effective in stages in the first half of 2017. Further detail is outlined in the body of the report.

Summary

- Under **exit payment recovery**, where an individual with a salary of more than £80,000 leaves a public sector employment and re-joins the public sector within 12 months, they may be required to pay back some or all of the exit payments they received from their former employer.
- Under the **exit payment cap**, where an individual leaves a public sector employment, the total exit payments that their employer can make in respect of that exit will be capped at £95k. This cap includes the strain cost payable in respect of an LGPS pension coming into payment early.
- The Government consulted earlier this year on making **further reforms** to how public sector exit payments are calculated. The Government responded to its consultation in September 2016 and that response sets out certain guidelines within which it expects individual departments to make reforms. Departments have until the end of December 2016 to make initial proposals for reform and then must implement the changes by the end of June 2017.

Exit payment recovery

1. The primary legislation that provides for the introduction of exit payment recovery is contained in the Small Business, Enterprise and Employment Act 2015.

2. Under exit payment recovery, where an individual with a salary of more than £80,000 leaves a public sector employment and re-joins the public sector within 12 months, they may be required to pay back some or all of the exit payments paid in respect of that exit by their former employer.

3. Any LGPS strain cost paid by the individual's former employer in respect of the cost of putting a redundancy pension into payment will count toward the total amount that the individual has to pay back to their employer.

4. Under draft regulations the Government consulted on earlier this year, the repayment amount will be calculated by reference to the individual's salary at leaving their prior employment, tapered by the gap between the two public sector employments (see the example below).

5. The regulations that would bring exit payment recovery into effect are affirmative and must therefore be passed by resolutions of both Houses of Parliament in order to come into force. The secretariat understand that the Government hope that the regulations will pass through Parliament before the end of the year in order to become effective early in 2017.

6. We also understand that the Government do not plan for the recovery regulations to apply retrospectively – i.e. the regulations will only apply for exits happening from a specified future date onwards.

<u>Example</u>
A 56 year old individual working full time with an annual salary of £85,000 is made redundant from public sector employer A. After the deduction of the income tax and NICs paid by the individual over the final year of their employment, their pay is £56,626.

The member receives a £25,000 redundancy payment from their employer and the employer pays a £70,000 strain cost to the member's LGPS pension fund in respect of the cost of putting the member' pension into payment early. The member's exit payments total £95,000.

150 days later, the individual returns to full time employment with public sector employer B. As 150 days have passed since the member left their prior employment, the amount they must pay back to their employer is calculate as follows:

A – total exit payments
B – member's actual final pay after income tax and NIC deductions
C – days between leaving former employer and joining new employer
D – 365
E – total amount to be recovered

A – (B x (C / D) = **E**

£95,000 – (£56,626 x (150/365)) = **£71,729.04**

Exit payment cap

7. The primary legislation that provides for the introduction of an exit payment cap is contained in the Enterprise Act 2016.

8. Under the exit payment cap, where an individual leaves a public sector employment, the total exit payments that their employer can make in respect of that exit will be capped at £95k.

9. The exit payments that count towards the cap will include the strain cost payable in respect of an LGPS pension coming into payment early - for instance, where a scheme member aged 55 or over is made redundant and has an entitlement to the immediate payment of an unreduced pension.

10. To achieve the effective introduction of the cap, amendments to the LGPS Regulations 2013 are required. Schedule 6 of the Enterprise Act 2016 includes a number of proposed amendments which will become effective when the cap comes into force.

11. After the introduction of the cap, where the payment of an LGPS strain payment would cause the cap to be breached, the amount that the employer will be able to pay to the pension fund will be limited. In such cases, the individual's retirement pension would by default be put into payment at a reduced rate to reflect the reduced amount that their employer has paid to the pension fund.

12. However, the expected changes to the LGPS Regulations 2013 will allow members the option to make up the gap in the strain cost where the £95k cap would mean that the individual's employer would be unable to fund the cost entirely themselves.

13. Additionally, an individual will be able to ask their employer to prioritise the payment of a certain type of 'exit payment' if they, for example, would prefer to receive payment of an unreduced pension instead of their full redundancy payment (see the example below).

14. However the envisaged changes would not allow for a member aged 55 or over to opt to defer their pension and take the full amount exit payment as cash.

15. Under the Act, HM Treasury have the power to make regulations to increase the cap from the current level in the future.

16. The secretariat understand that the Government intend to undertake another consultation on the regulations that will govern the exit payment cap and that this is planned to take place in early 2017. It is understood that the cap will come into force soon after this period of consultation.

17. The regulations that would bring the exit payment cap into effect are subject to the affirmative resolution procedure and must therefore be passed by resolutions of both Houses of Parliament in order to come into force. We understand that the Government do not plan for the cap regulations to apply retrospectively – i.e. the regulations will only apply for exits happening from a specified future date onwards.

<u>Example</u>
A 58 year old employee of a district council is informed that they are to be made redundant from their post. The individual's redundancy payment will total £35,000 (including a statutory redundancy component of £14,370) and the LGPS pension fund has informed the employer that the strain cost that would be payable to fund the payment of the individual's full retirement pension totals £85,000.

Overall, the employee's exit payments would come to £120,000, exceeding the cap by £25,000. The individual does not plan on going back to work and wants to maximise the total retirement pension they receive. They ask their employer to reduce their redundancy payment in order that their employer can put more money towards the LGPS strain cost.

The statutory component cannot be foregone so the individual must still be paid their £14,370 statutory redundancy payment. After accounting for this, the amount available to the employer to fund the individual's pension within the cap is £80,630 (£95,000 - £14,370).

As this is less than the total amount needed to fund the individual's strain cost (£85,000), the individual is given the opportunity to pay the remaining £4,370 directly to the pension fund in order to avoid having their retirement pension reduced. If they choose not to, the pension they receive will be put into payment with actuarial reductions applied.

Further reforms to the calculation of exit payments

18. In February 2016, the Government consulted on further proposals to reform exit payments across the public sector with the stated aim of making public sector exit compensation terms 'fairer, more modern and more consistent'.

19. In September 2016, the Government responded to the consultation to announce that it planned to proceed with the reforms and would ask individual departments to come forward with proposals for reforms that fit within certain public sector-wide guidelines.

20. Specifically, individual departments have been asked to ensure their proposals fall within the following criteria:
    a. a maximum tariff for calculating exit payments of three weeks' pay per year of service. Employers could apply tariff rates below these limits
    b. a ceiling of 15 months on the maximum number of months' salary that can be paid as a redundancy payment.
    c. a maximum salary on which an exit payment can be based. As a starting point the government will expect this to align with the existing NHS scheme salary limit of £80,000.
    d. a taper on the amount of lump sum compensation an individual is entitled to receive as they get closer to their normal pension age
    e. action to limit or end employer-funded early access to pension within exit packages.

21. The government will consider the case for transitional protection for those with exits formally agreed on terms that applied before new workforce exit compensation arrangements come into effect.
22. In the September 2016 consultation response the Government confirmed that they expects departments to produce packages consistent with the framework above and consult on these where appropriate.

23. The government will expect departments to produce proposals within three months of the publication of the response (i.e. by 26 December 2016) and to have completed negotiations and made the necessary amendments to exit arrangements within nine months of the publication of the government

response (i.e. by 26 June 2017). Given that compensation arrangements and employer-funded early access to pension are both contained within statutory instruments for the LGPS this will be a challenging timetable.

Examples

Example 1 £25,000 10 years service					
Pre reform	Age	Redundancy	Deferred Pension	Immediate Pensions	Total Cost
	less than 55	£14,400	£4,300	£0	£14,400
	at age 55	£14,400		£4,300	£45,200
Post reform					
	less than 55	£14,400	£4,300	£0	£14,400
	at age 55	£14,400		£2,500	£14,400
	or	£0		£3,500	£14,400
	or	£14,000	£4,300		£14,400
Example 2 £100,000 30 years service					
Pre reform	Age	Redundancy	Deferred Pension	Immediate Pensions	Total Cost
	less than 55	£51,900	£42,300	£0	£51,900
	at age 55	£51,900		£42,300	£153,100
Post reform					
	less than 55	£62,500	£42,300	£0	£62,500
	at age 55	£62,500		£28,900	£62,500
	or	£0		£36,900	£62,500
	or	£62,500	£42,300		£62,500

The chart at the end of this paper provides some estimated figures demonstrating how exit packages would differ from current packages under the new framework. The chart contains examples for members of different age and service profiles. Cells highlighted yellow indicate where a CER payment alone would breach the £95k cap, those highlighted orange indicate where the CER plus the CRM breach £95k..

In the chart the following terms are used:

- Cost of Early Release (CER) – this refers to the LGPS strain payment payable by an employer under the current system where an individual aged 55 or over is made redundant. The estimates in the document are for a male aged 55 years old and have been supplied by an actuarial firm.
- Common Redundancy Maximum (CRM) – this refers to the redundancy payment paid by local government employers under the current system. In the document, the figures assume that the calculations are done on actual pay and use double the statutory minimum weeks.
- Proposed Maximum Payment (PMP) – this refers to our estimate of the maximum payment which employers will be allowed to make under the new system. Calculations of the figures are based on a maximum salary of £80,000, three weeks' pay per year of employment and a total limit set at 15 months' pay.

Devolved administrations

24. The reforms referred to in this document apply to public sector employers in England.

25. The Government have stated that it will be up to the devolved administrations in Wales, Scotland and Northern Ireland to determine if and how they want to take forward similar arrangements in relation to workforces in their jurisdictions.

26. Nevertheless, as the LGPS in England and Wales is one pension scheme with one set of regulations, the implementation of the changes referred to in this document may mean that some Welsh employers will be impacted by the reforms as a consequence of changes to the scheme's governing regulations.

Matters for consideration

27. Under the cap proposals members aged 55 and over would not have the choice to defer their pension while taking a maximum cash exit payment. Should this flexibility be available under a further reformed arrangement?

28. The further reform proposals ask for either cash or strain cost to be available to the member (limited to the amount of the redundancy payment). In the majority of cases a member who gives up the cash in lieu of strain will still suffer a reduction in pension. Should this be addressed by seeking to increase redundancy payments for all members or by requesting an ability for employers to pay a 'top up' strain cost up to the £95k cap?

29. Should the members ability to meet the strain cost themselves be extended beyond redundancy to all those who choose to take their pension from aged 55 onwards?

November 2016

Comparing Cost of Early Release (CER) with Common Redundancy Maximum (CRM) and Proposed Maximum Payment (PMP)

	CER	CRM	PMP	CER	CRM	PMP	CER	CRM	PMP	CER	CRM	PMP	CER	CRM	PMP
Pay	£10,000			£15,000			£20,000			£25,000			£30,000		
Service Yrs 2	£2,864	£1,154	£1,154	£4,295	£1,731	£1,731	£5,727	£2,308	£2,308	£7,159	£2,885	£2,885	£8,591	£3,462	£3,462
5	£6,334	£2,885	£2,885	£9,501	£4,327	£4,327	£12,668	£5,769	£5,769	£15,835	£7,212	£7,212	£19,002	£8,654	£8,654
10	£11,235	£5,769	£5,769	£16,852	£8,654	£8,654	£22,470	£11,538	£11,538	£28,087	£14,423	£14,423	£33,704	£17,308	£17,308
15	£14,561	£8,462	£8,654	£21,841	£12,692	£12,981	£29,122	£16,923	£17,308	£36,402	£21,154	£21,635	£43,682	£25,385	£25,962
20	£15,563	£10,385	£11,538	£23,344	£15,577	£17,308	£31,126	£20,769	£23,077	£38,907	£25,962	£28,846	£46,688	£31,154	£34,615
25	£17,904	£10,385	£12,500	£26,857	£15,577	£18,750	£35,809	£20,769	£25,000	£44,761	£25,962	£31,250	£53,713	£31,154	£37,500
30	£20,246	£10,385	£12,500	£30,369	£15,577	£18,750	£40,492	£20,769	£25,000	£50,615	£25,962	£31,250	£60,738	£31,154	£37,500
35	£22,588	£10,385	£12,500	£33,881	£15,577	£18,750	£45,175	£20,769	£25,000	£56,469	£25,962	£31,250	£67,763	£31,154	£37,500

	CER	CRM	PMP	CER	CRM	PMP	CER	CRM	PMP	CER	CRM	PMP	CER	CRM	PMP
Service Yrs / Pay	£35,000			£50,000			£75,000			£100,000			£150,000		
2	£11,454	£4,038	£4,038	£14,318	£5,769	£5,769	£21,477	£8,654	£8,654	£28,636	£11,538	£9,231	£42,954	£17,308	£9,231
5	£25,336	£10,096	£10,096	£31,670	£14,423	£14,423	£47,505	£21,635	£21,635	£63,340	£28,846	£23,077	£95,010	£43,269	£23,077
10	£44,939	£20,192	£20,192	£56,174	£28,846	£28,846	£84,261	£43,269	£43,269	£112,348	£57,692	£46,154	£168,521	£86,538	£46,154
15	£58,243	£29,615	£30,288	£72,804	£42,308	£43,269	£109,206	£63,462	£64,904	£145,608	£84,615	£69,231	£218,412	£126,923	£69,231
20	£62,251	£36,346	£40,385	£77,814	£51,923	£57,692	£116,721	£77,885	£86,538	£155,628	£103,846	£92,308	£233,442	£155,769	£92,308
25	£71,618	£36,346	£43,750	£89,522	£51,923	£62,500	£134,283	£77,885	£93,750	£179,044	£103,846	£95,000	£268,566	£155,769	£95,000
30	£80,984	£36,346	£43,750	£101,230	£51,923	£62,500	£151,845	£77,885	£93,750	£202,460	£103,846	£95,000	£303,690	£155,769	£95,000
35	£90,350	£36,346	£43,750	£112,938	£51,923	£62,500	£169,407	£77,885	£93,750	£225,876	£103,846	£95,000	£338,814	£155,769	£95,000