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Our Ref: LGPS Reforming Local Government Exit Pay Consultation

Your Ref:

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Local Government Finance Stewardship
Ministry of Housing, Communities and Local Government
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By email

9th November 2020

Dear Sir or Madam,

Local Government Pension Scheme: Reforming Local Government Exit Pay

Surrey County Council (Surrey) welcomes the opportunity to respond to the consultation on proposed amendments to the statutory underpin.

Surrey is the Administering Authority for the Surrey Pension Fund (the Fund) as part of the Local Government Pension Scheme (LGPS). The Fund has assets of over £4billion and includes nearly 300 employers.

Surrey has concerns about the latest proposals and it has articulated them in its response the questions posited in the consultation below:

The Fund considers these proposals to be more problematic than the ones that were consulted on twice, which many practitioners criticised as being impractical, and it is surprised that the Ministry of Housing Communities & Local Government (MHCLG) *“is not seeking views or representations on the government’s position regarding exit pay reform”*.

Question 1: Are there any groups of local government employees that would be more adversely affected than others by our proposed action on employer funded early access to pension?

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Members who leave employment aged 55 and over are more affected than other groups - particularly if they would otherwise have had an immediate entitlement to unreduced pension benefits.

These proposals are more regressive than previous iterations as they oblige members who are made redundant to defer or draw a reduced pension, unless their lump sum compensation exceeds their strain cost. The focus on the £95,000 cap is misleading; it would be more accurate to describe these proposals as eviscerating compensation payments with additional penalties for packages exceeding £95,000.

For example, a member with relatively low pay, with 30 years’ service, a £15,000 statutory redundancy payment and a £20,000 strain cost would be forced to take the £15,000 redundancy payment and pay a £5,000 partial strain cost to lower the reductions to their pension. Conversely, a higher earner with 15 years’ service, a £30,000 redundancy payment and a £20,000 strain cost could draw an unreduced pension **and** receive a £10,000 compensation payment. The reason for this stark anomaly is that the redundancy payment must be offset against the strain cost, unless it exceeds the strain cost when the excess can be paid.

The Fund considers that offsetting statutory redundancy payments (which must be paid) against strain costs will have a disproportionate impact on the low paid.

Question 2: What is the most appropriate mechanism or index when considering how the maximum salary might be reviewed on an annual basis?

The Fund considers Average Earnings to be the most appropriate index for reviewing the earnings cap. It reflects average earnings and the real economy.

Question 3: Are there any groups of local government employees that would be more adversely affected than others by our proposed ceiling of 15 months or 66 weeks as the maximum number of months or week’s salary that can be paid as a redundancy payment?

Very few leavers receive any compensation in excess of a statutory redundancy payment unless they are under 55 and leave without an immediate entitlement to unreduced pension benefits. Employers tend to use multiples of the redundancy

ready reckoner to calculate discretionary compensation and it is highly unusual for employers to award more than 66 weeks.

Question 4: Are there any groups of local government employees that would be more adversely affected than others by our proposal to put in place a maximum salary of £80,000 on which an exit payment can be based?

Employees who earn more than £80,000 per annum are adversely affected. However, if the 66 weeks / 15 months limits engage that threshold drops below £80,000 as, otherwise, the £95,000 limit would be breached. If the 66 weeks or 15 months limits apply the pay figure is effectively restricted, which means that employees earning more than £74,848 are potentially adversely affected by the new proposals.

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The Government's has imposed an £80,000 limit on pay for calculating exit payments in local government; however, the Local Government Association has pointed out that it has allowed the civil service to retain its £149,500 limit, which seems to cut across its stated policy aim of "fairness and consistency". Although the Government is intent on imposing an earnings limit, it seems to be conflicted about where that threshold should be set.

If so please provide data/evidence to back up your view?

Please see previous answer.

Question 5: Do you agree with these proposals? If not, how else can the Government's policy objectives on exit pay be delivered for local government workers?

It is not clear to the Fund what the underlying policy intention is. It was originally trailed as means of curtailing payments to high earners; however, respondents to the previous consultations pointed out that the (then) arrangements could adversely affect members earning as little as £23,500 per annum. In response to these observations in previous consultation the Government has instead introduced proposals that will potentially hit anyone who is made redundant, no matter how little they earn.

The proposals have changed dramatically and the Fund notes that the latest iteration is titled "Reforming Local Government Exit Pay". As the title implies, this proposal focuses on reducing exit payments across the board and probably ought to have been the subject a separate consultation.

The proposals concerning relaxing the cap are complicated and unwieldy. In particular, the proposal to refer a case approved by the full council to not only the Secretary of State for Housing Communities and Local Government but also, possibly, a Treasury minister.
The requirement to offset compensation payments against the strain cost unless they exceed the strain cost, when the excess compensation can be paid, means that most members who are made redundant will be forced to draw a reduced pension or defer their pension benefits. This is because the redundancy payment, which must

be paid, is offset against the strain cost even if the whole package is within the £95,000 cap. This provision is regressive, and it will have a disproportionate impact on low paid workers, many whom are women who work part-time.

One of the principle justifications offered for these proposals is that when someone is made redundant aged 55 or over *"… it sends the signal that their working life is over. In the modern world of work people have good reasons for wanting to work longer and someone made redundant in their late 50s may still look forward to a satisfying career for many years to come".* This is a very positive take on discouraging members aged 55 and over from drawing their pensions; however, it is predicated on the availability of employment opportunities for this cohort of workers.

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Question 6: Do you agree that the further option identified at paragraph 4.8 should be offered?

The proposal to offer members aged 55 and over the option to defer their pension benefits and draw a redundancy / compensation payment instead of an unreduced pension appears to be a natural concomitant to the change in policy. The proposals appear to be designed to encourage members to take lump sum compensation. It should be noted that lump sum compensation can have potential tax implications, as compensation payments above £30,000 attract Income Tax. A lower rate taxpayer leaving mid-way through the year could find themselves paying upper rate tax on part of their package. Employees receiving anything approaching a £95,000 compensation payment would be looking at a substantial upper rate tax charge.

Question 7: Are there any groups of local government employees that would be more adversely affected than others by our proposals?

There are groups of employers such as universities, sixth form colleges and certain admitted bodies who are not covered by these proposals. The employees of local government employers who are covered by these proposals are adversely affected in comparison to the ones who are not.

All members who are affected by these proposals will lose out in comparison to the existing provisions. However, the impact of the loss will vary depending on whether it is weighed in absolute or relative terms, with. high earners tending to lose the most in absolute terms. However, the relative losers are likely to be low earners who will see their termination packages significantly eroded by these proposals.

As respondents to earlier consultations pointed out, these measures are unlikely to affect very high earners because they are likely to have input into; their remuneration package, their reason for and timing of leaving, the prospect of an Employment Tribunal, the possibility of a waiver. It is unfortunate that a measure originally promoted as being targeted at high earners is now likely to have a big impact on median and (particularly) low earners.

Although it is the only progressive measure put forward, the proposal to allow members whose compensation payments exceed their strain cost to benefit from the difference is potentially indirectly age discriminatory because it favours older members within the over 55 demographic. This is because (1) older members tend

to have more service and bigger redundancy payments and (2) actuarial reductions fall away as they approach retirement and the strain costs diminish.

This policy started out as a £95,000 cap on high earners' exit payments in 2015 and has subsequently morphed into something much harsher as the £95,000 cap, has not been index linked and the policy intention appears to have moved from a cap on high earners to a general levelling down of exit payments. Again, as noted in responses to previous consultations, these proposals reduce the options for employers to take measures designed to ensure that work forces are restructured efficiently, which could result in an ageing workforce and increased costs.

The net effect is that members appear to be being incentivised, and in some cases forced, to draw lump sum compensation with an actuarially reduced/deferred pension instead of an unreduced pension.

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How would you mitigate the impact on these employees?

The Government could mitigate the impact by incorporating feedback from previous consultations in its revised proposals.

Question 8: From a local government perspective, are there any impacts not covered at Section 5 (impact analysis) which you would highlight in relation to the proposals and /or process above?

These proposals seem to be predicated on the notion that early retirements/redundancies are just additional costs. In normal circumstances potential early retirements are supported by a comprehensive business case that shows the potential net savings to the organisation.

The direct and indirect costs in paragraph 5.6 focus on savings and the perceived benefits to local government without pausing to consider the arguments of previous consultation responses. It is more efficient and effective to restructure work forces consensually and these proposals could hamper employer flexibility in this area.

The Fund is of a view that the policy is poorly conceived. Early retirement costs are counter intuitive because the percentage reductions to annual pensions shrink as life expectancy increases; this is because early retirement is treated as a fixed overpayment and it can be recovered if life expectancy increases. As life expectancy is lower in local government than the public sector as-a-whole the early retirement costs would increase if local government specific factors were used. The imposition of generic factors by the Treasury serves to reduce the costs artificially, thereby delivering precisely the outcome that the Government sought to avoid and leaving pension funds in deficit.

The Treasury appears to view early retirement costs as standalone additional expenditure as opposed to one element of a costed business case. So far from saving money, this policy is likely to lose money and make it much harder to restructure workforces.

These proposals could make it more challenging to manage workforces if it results in a higher likelihood of employees resisting redundancy/early retirement. It is important to note that members who retire with unreduced pensions aged 55 and over will have a significantly smaller incomes in retirement than they would have enjoyed had they worked to normal retirement age.

These measures could encourage an ageing, highly paid work force that presents a challenge for succession planning.

The proposals mean that employees could be more likely to resist redundancy/early retirement, and this could generate additional costs for smaller employers who may not have the internal human resources / legal services capacity of larger organisations. Even for larger organisations this could lead to unwelcome additional costs.

The efficacy of these proposals needs to be judged in the round, not solely on the headline costs. The perceived saving for each early retirement needs to be weighed against increased numbers of appeals (IDRP), Employment Tribunals (ET) and, occasionally, Employment Appeals Tribunals (EAT) and - most importantly - the lost efficiency savings.

It appears that the Government has identified potential savings that practitioners think are unlikely to be realised in practice. Moreover, the long-term costs of having an increasingly aged and inflexible workforce are likely to be considerable.

Question 9: Are these transparency arrangements suitably robust? If not, how could the current arrangements be improved?

The Fund understands the Government's concern about the immediate re-employment of high earners, but, contends that this has largely been reduced due to the advent of flexible retirement. Flexible retirement facilitates the retention of key skills and less experienced officers being mentored into key positions. Any IR35 employees are usually recruited from agencies in order to acquire specialist skills that are not available within the organisation.

The Fund no longer uses the discretion to abate re-employed pensioners because it is not cost effective. The Fund understands that the funds who persevere with abatement have found that the cost of administering the scheme outweighs the overpayments recovered, without considering the costs of internal disputes from members. The Fund is aware that the biennial National Insurance data matching exercise run by Internal Audit uncovered significant overpayments when it was first introduced but the matches have dwindled in both number and the size of the overpayments over time. Although big overpayments were discovered in the first two or three exercises the latest ones mainly flag-up existing cases and false matches that take a lot of time to investigate. The few cases that are uncovered tend to be small overpayments as they should not be more than two years old.

Although this is not the intended locus of this question, it is important to note that these proposals depart significantly from the ones considered in previous

consultations and the Fund is surprised that the government *“is not seeking views or representations on the government’s position regarding exit pay reform”*.
The Fund believes that the Government should consult on the new package because, amongst other things, it has a much bigger impact on low earners than the original proposals.

Question 10: Would any transitional arrangements be useful in helping to smooth the introduction of these arrangements.

A transitional period would be helpful because it would enable employers to carry out carefully considered strategic restructures that realise genuine savings.

Question 11: Is there any other information specific to the proposals set in this consultation which may be relevant to the reforms.

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These proposals go further than previous iterations and they have moved from restricting the packages of high earners to a general reduction in the potential compensation package available for redundancy and early retirement, regardless of the member’s earnings. This is a major shift in both content and underlying philosophy and, in the Fund’s opinion, merits a separate consultation.

The rationale behind the proposals appears to be to save money and yet the way the way it has been structured has the (unintentional) consequence of frustrating considered early retirements that would deliver measurable savings.

Question 12: Would you recommend anything else to be addressed as part of this consultation?

The Fund believes that the proposals have changed significantly from previous iterations and that the new elements should be consulted upon properly.

The Fund is disappointed that each subsequent iteration of this proposal does not appear to have incorporated sensible observations contained in the responses to previous consultations and instead progressively moved away from the original policy intention, which was to curtail the exit payments of high earners.

On the 4th November, in the middle of a consultation, the £95,000 exit cap was enacted without any of the supporting or amending legislation required. This has forced practitioners to try to navigate a course between two competing tranches of legislation.

Yours sincerely

Anna D’Alessandro

Director of Corporate Finance
Surrey County Council

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