Exit Pay Cap Regulations

The Regulations came into force on 4 November 2020 but the draft LGPS Regulations and Compensation Regulations are still being consulted on (concluding on 18 December 2020. NOTE: The policy position consultation concluded on 9 November 2020). The LGPS Regulations and Compensation Regulations will not be amended until early 2021 so we have a period of several months where there is conflict between two sets of regulations.

The Current Position:

For those over the age of 55 and members of the LGPS being made redundant:

Where the total exit pay sum is less than £95k –no change to their exit package.

- Employer pays full strain cost.
- Employee receives both statutory and occupational redundancy payment.

Where total exit pay sum is more than £95k – the cap comes into force.

a) Employer should consider if any elements of the exit package could be reduced to bring the total sum under £95k, e.g. not paying occupational redundancy payment.
   i. If yes – pay revised exit package.
   ii. If no - Employer should consider whether a Waiver applies
b) If waiver does not apply or application is unsuccessful this is where the legal challenges may arise.

Exit Pay is Capped and No Waiver

Current LGPS Regs (10) state that the employee is entitled to an unreduced pension. A separate and unrelated paragraph in the Regs (68) state that the employing authority will be asked to pay for any strain costs. The payment of an unreduced pension is not expressly directly linked to the payment of the strain costs. However, most administering authorities will not pay an unreduced pension without the strain costs being met.

The LGPS Regs do not currently permit partial payment of strain costs – it's an all or nothing situation. This means that if the full strain costs can not be paid, the administering authority will not pay an unreduced pension.

This will give rise to the employee challenging the decision of the administering authority to only pay a reduced pension, when the Regs indicate the employee should be in receipt of an unreduced pension.

Sitting along side this is the provision in the LGPS Regs (8) that permit the employing authority to make a strain costs cash alternative payment to the employee in the event that the strain costs will not be paid to the pension fund. Because we are in an 'all or nothing' situation with paying strain costs, this gives rise to the option for employers to pay a cash alternative equal to the amount of strain costs that they could pay under the Pay Cap Regulations.

However, employing authorities are being advised not to pay this cash alternative until any challenge regarding the payment of a reduced pension is concluded. This is for several reasons:

- If they successfully challenge the reduced pension and the administering authority has to pay an unreduced pension:
  - You will need to recover the payment that you have made to the employee – which could be time consuming and costly, OR

  - You could end up paying twice, OR
  - You can’t pay strain costs so the pension fund has a deficit that has to be funded through the employer contribution rates which are calculated across all employing authorities in the pension fund. This would cause tension between employing authorities as others have to pick up the cost of your redundancy exit.
- If they lose the challenge and have to accept a reduced pension:
  - They may wish to divert the cash alternative payment to the pension fund to minimise the reduction in the pension. If the sum has been paid to them, it will have been subjected to tax and NI contributions so it is worth more when paid directly to the pension scheme.

The Impact of the Proposed Changes to the LGPS Regulations and the Compensation Regulations

When the proposed reforms become law there are a number of key impacts on all those being made redundant or leaving on efficiency grounds who are over the age of 55. The purpose of the further reforms is in part to provide the employee with the choice about whether they take their pension and if so, what level of reduction to pension benefits will occur.

The options will be:

1. to fund an unreduced pension through surrendering redundancy payments and making a top up if needed,
2. to draw a slightly reduced pension by surrendering discretionary redundancy payments but taking statutory redundancy payments,
3. to draw a fully reduced by taking all redundancy benefits and not topping up the strain costs, OR
4. to defer drawing down the pension and taking all redundancy benefits.

In order to minimise any reduction in pension benefits, statutory redundancy will need to be surrendered to reduce pension strain costs. In addition, where discretionary redundancy payments are less than the Net Pension Strain Costs (PSC less statutory redundancy pay) no discretionary redundancy payment will be made.

The Government Actuary’s Department (GAD) has issued guidance where it assumes members would seek an unreduced pension. The guidance indicates that based on redundancies made between 2013 – 2016, 86% of LGPS members will be affected by these additional reforms. The average salary of those affected is £28.7K with an average age at point of redundancy of 59 and average length of service of 17.9 years. The average size of loss in the value of exit payments is £13.2K which is approximately 35% of the exit package. The younger a member is or the higher the salary, the bigger the impact.

Accessing an Unreduced Pension

Pension Strain less than £95k

To secure an unreduced pension where the pension strain cost is less than £95k, any statutory redundancy pay must be surrendered to reduce the pension strain costs accordingly and where the employer is paying pension strain costs the employees entitlement to any discretionary redundancy pay will be lost in most circumstances.

Example:

A	B	C	D	E	F	G	H	I	J
Emp'ee	Age	Service	Salary	Pension Strain	Statutory Redundancy	Discretionary Redundancy	Current Value	Post Reform Cash paid to empee	Post Reform Total Value & % change
1	59	19	39K	39K	15K	8K	62K	0	39K – 37%
2	61	31	41K	21K	16K	19K	56K	14K	35K – 37.5%
3	65	7	20K	2K	4K	2K	8K	4K	6K – 25%
4	67	23	34K	0	16K	13K	29K	29K	29K – 0%

Column I: If Pension Strain – Statutory Redundancy – Discretionary Redundancy is more than zero – no cash payment made.

Individual 2: 21K – 16K results in a net pension strain cost of 5K. Discretionary Redundancy is greater than the net pension strain costs so the balance is paid as a Cash sum.

Individual 3: Net strain cost is -2K so the balance of the statutory redundancy is added to the discretionary redundancy resulting in a cash payment of 4K.

Individual 4: there is no strain cost so full statutory and discretionary redundancy are payable.

Pension Strain more than £95K

Where the pension strain costs exceed £95K the employee will have their exit pay capped and will have the option of making an additional payment to the pension scheme to secure an unreduced pension.

Example:

A	B	C	D	E	F	G	H	I	J
Emp'ee	Age	Service	Salary	Pension Strain	Statutory Redundancy	Discretionary Redundancy	Current Value	Post Reform Cash paid to empee	Post Reform Total Value & % change
5	55	25	80K	182K	15K	47K	244K	0	95K – 61%

Employer will pay 80K strain costs (95K cap level less Statutory Redundancy).

Employee will surrender 15K Statutory Redundancy and would need to make a payment of 87K to secure an unreduced pension.

For some worked examples setting out the cost implications of choices 2, 3 and 4 that employees over the age of 55 will have please see the following document.

[link to worked examples document that currently appears in the 15 Oct briefing note on website]

For details of waivers and our original briefing note please see below – 15 October 2020