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Appendix 2

CONSULTATION ON EXIT PAYMENT CAP

**RESPONSE OF THE ROYAL BOROUGH OF KENSINGTON AND CHELSEA
TO HM TREASURY'S CONSULTATION ON
RESTRICTING EXIT PAYMENTS IN THE PUBLIC SECTOR
PUBLISHED 10 APRIL 2019**

1. Document production details

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2. Responding body

This document is the response of the representative body of the Royal Borough of Kensington & Chelsea to the Government's proposal, issued on 10 April 2019 by HM Treasury, for a cap of £95,000 (before tax) on the total value of exit payments.

The Royal Borough of Kensington & Chelsea covers a combined workforce of approximately 4,000 employees working in London local government.

We do not consider our response should be treated as confidential within the context of the Freedom of Information Act 2000.

3. Response to Consultation Questions

The borough's response to the consultation questions is below:

Question 1: Does draft schedule 1 to the regulations capture the bodies intended? If not, please provide details.

Response: We have no comments on the list of bodies in draft schedule 1.

Question 2: Do you agree with the current list of bodies in scope, for the first round of implementation? If not, please provide reasons.

Response: We have no comments on the proposed list of bodies in scope for the first round of implementation.

Question 3: Do you agree with the exemptions outlined? If not, please provide evidence.

Response: We have no comments on the proposed exemptions.

Question 4: Does the guidance adequately support employers and individuals to apply the draft regulations as they stand? If not, please provide information on how the guidance could be enhanced.

Response: We have no comments on the ability of the guidance to adequately support employers and individuals to apply the draft regulations as they stand.

Question 5: Is the guidance sufficiently clear on how to apply the mandatory and discretionary relaxation of the regulations, especially in the case of whistleblowers?

Response: We have no comments on the clarity of the guidance in this respect.

Question 6: Is there further information or explanation of how the regulations should be applied which you consider should be included in the guidance? If so, please provide details.

Response: In the Local Government Pension Scheme (LGPS) there are other events which can lead to a pension strain cost which are not exits and which therefore are not covered by the proposed regulations. These are:

(a) A situation where deferred benefits are paid prior to normal pension age and all or part of the early payment reductions are waived in accordance with discretionary provisions of the LGPS;

(b) Flexible retirement – providing the member's pay reduction is achieved by changing the employee's current contract.

Although the HM Treasury guidance and proposed payment cap regulations concentrate on specific exits such as redundancy, we think the guidance needs to be clear that payments made under the discretionary provision of the LGPS in respect of deferred members and flexible retirees are not included in the cap.

Question 7: Are there other impacts not covered above which you would highlight in relation to the proposals in this consultation document?

1st response: Our primary concern is the inclusion of the pension strain cost in the exit payment cap. The LGPS pension strain cost for an active scheme member whose employment is terminated on the grounds of redundancy or business efficiency after the age of 55 (and prior to their normal pension age) is not cash paid to the employee as part of the termination of their employment. Neither does it confer a pension on an employee which is higher than the entitlement they have earned in accordance with current LGPS regulations. We are of the view that the inclusion of the pension strain cost would result in the exit payment cap being extended to a much larger group of employees that just the 'high earners' originally envisaged by the Government, and consequently that it contradicts the purpose for which the cap was originally intended. For this reason, we consider that pension strain costs should be excluded from the exit payment cap.

Below we identify examples where employees are not what would be considered 'high earners' in the context of the proposed exit payment cap but whose exit payments would be reduced due to the inclusion of the pension 'strain' cost in the event of the termination of their employment whilst being an active member of the LGPS. We are of the view that this would adversely affect our ability to manage workforce change on a much larger scale than that envisaged by the Government.

(a) The £95,000 cap would be breached in future for someone retiring on grounds of redundancy or business efficiency at age 55 with an accrued annual pension of at least £15,000 and a critical retirement age of 65.

(b) In relation to members with pre-2014 benefits, where there is no cash lump sum redundancy payment, (e.g. efficiency early retirements), the cost of the immediate payment of pension benefits would exceed £95,000 for the following sample members:

- A member with 30 years of LGPS membership and final pay of £52,000

- A member with 20 years of LGPS membership and final pay of £96,000 (for simplicity we've assumed the member is retiring at age 55 on 1 April 2020 with a critical retirement age of 60 for pre-2008 benefits, and that his/her pay over the previous two years under both 2014 and 2008 scheme definitions is the same)

(c) The position becomes more acute when including statutory redundancy payments. Allowing for statutory redundancy payments of 1.5 weeks' pay* for each full year worked up to a maximum of 30 weeks, the total cost of the statutory redundancy payments plus immediate payment of pension benefits would exceed £95,000 for the following sample members:

- A member with 30 years of membership and final pay of £39,000

- A member with 10 years of membership and final pay of £75,000

  *(*This applies to those aged 41 or older. The calculations vary according to the age on redundancy as well as critical retirement age.*

2nd response: The level of the exit payment cap is set at £95,000 but there is no provision for this to be automatically index-linked annually, for example in line with the consumer prices index (CPI). The absence of annual indexation will, we believe, further enhance the negative impacts outlined in our submission because it will have the effect of gradually including a larger proportion of the lower-paid workforce into the remit of the cap.

3rd response: If the regulations prevent an exit payment being made (because the pension strain cost exceeds the cap and the pension scheme rules do not allow partial reduction, for example) then a cash payment, not exceeding the cap must be paid to the individual. In our view this presents some difficulties for the operation of the LGPS for the following reasons:

Paragraph 5 of Schedule 6 to the Enterprise Act 2016 amends the Local Government Pension Scheme Regulations 2013 to allow a partial reduction of a member's pension benefits where otherwise the exit payment cap would be breached, and to allow a scheme member to pay a charge to buy out some or all of that reduction.

These changes do not come into effect until HM Treasury issues a commencement order. The effect of the exit payment regulations on the LGPS is dependent on whether they are enacted before or after the LGPS regulations changes come into force, as set out in the Enterprise Act. There are two possible scenarios in this situation:

- **Scenario 1 – the LGPS Regulations are unchanged**
  If an exit payment includes pension strain cost and would exceed the cap, it is unclear whether the pension could be paid under regulation 30(7)(b) of the LGPS Regulations 2013 if the strain cost referred to in regulation 68(2) cannot be paid in full. It is our understanding that the intention is for the member to receive a fully reduced pension in this circumstance, plus the cash alternative of the strain cost (up to the maximum allowed by the cap). Changes to the LGPS regulations would be required to introduce the option for a member who is made redundant or leaves on the grounds of business efficiency at age 55 or over to defer payment of their pension.

- **Scenario 2 – the LGPS Regulations are amended to allow partial reduction**
  If an exit payment includes pension strain cost and would exceed the cap, then the member's benefits would be reduced to such a level that the exit payment cap is not breached. 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 LGPS member who is over age 55 being made redundant or leaving on the grounds of business efficiency. As regulation 6 of the exit payment cap currently stands, a LGPS member whose exit payment has been capped would be forced to accept a reduced pension.

If the option to defer payment of LGPS benefits on redundancy or retirement on business efficiency grounds at age 55 or over is introduced, then a member who exercises the option to defer could be paid the cash alternative to the pension strain cost (up to the maximum allowed by the exit payment cap).

To implement partial reduction in the LGPS, guidance from the Government Actuary's Department (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 in a members' benefits, the method and calculation for buying out the reduction – particularly the calculation which would be involved in working out the reduction to apply 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. It is likely that changes to the LGPS regulations and new statutory guidance would be required to effect this change.

The Regulations do not specify how to calculate the strain cost related to the early payment of a pension on an unreduced basis. The LGPS Regulations state that this strain cost is to be 'calculated by an actuary appointed by the administering authority' and the Guidance says that it 'may be the amount as calculated by the scheme actuary'. Currently, the method of strain cost calculation is formulated locally based on the demographic make-up of the LGPS members in an administering authority. Demographic differences across the country mean that strain cost and the implications for the exit cap could differ widely for LGPS members in different geographical areas, even if they are similar in other respects such as age, salary level and length of pension scheme membership.

If there is no change to the current position, then the calculation of the strain cost element of an exit payment will differ between LGPS administering authorities. The benefit of this approach is that the strain cost reflects the best estimate of the cost of paying the pension early, based on actuarial assumptions and the demographics of members participating in the LGPS in a particular administering authority. The main disadvantage is that a member may be affected by the cap based on the calculation adopted by one administering authority who would not be affected had the strain cost been calculated by another administering authority. An alternative would be for GAD to introduce a standard method of calculating pension strain cost in the LGPS. This would have the advantage that the application of the exit payment cap would be equitable and consistent across the entire scheme.

4th response: In 2015, when the exit payments cap was previously proposed, an equalities impact assessment was conducted by the Government. In our view that assessment was inadequate because it failed to identify that in local government many more people than just 'high earners' will be impacted and therefore there is likely to be a disproportionate impact on women who represent on average 60% of the local government workforce in lower-paid and mid-range occupations. Consequently, we consider it to be inappropriate that the Government has not produced an updated equalities impact assessment to accompany its revised 2019 proposals for the exit payments cap and has instead decided only to do so if the two-stage implementation process proceeds. This has disadvantaged respondents to the proposals because it is not clear whether an updated equalities impact assessment would provide any assurances to respondents that the revised proposals have satisfactorily addressed these concerns.

Question 8: Are you able to provide information and data in relation to the impacts set out above?

Response: Relevant data is included in our response to question 7.