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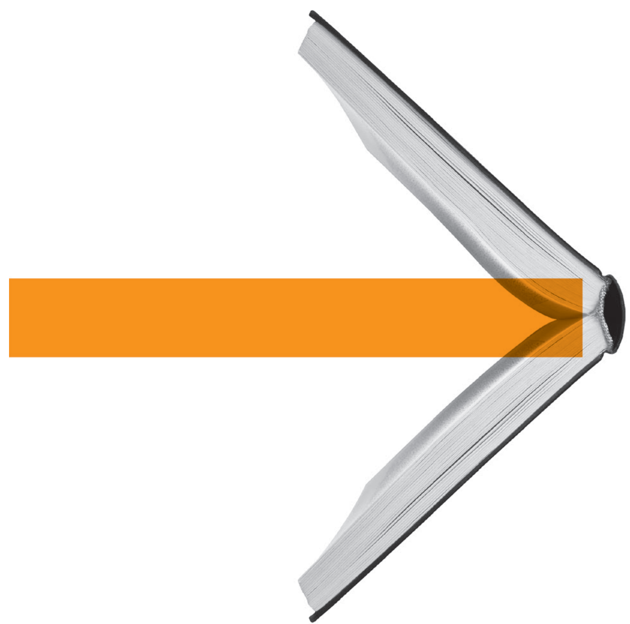
Thinking caps on

The potential implications of capping public sector exit payments



Introduction

Last month, the Government published its Response to consultation regarding public sector exit payments. Despite a "significant number" of the 4,000 or so respondents reportedly being against a blanket cap on such payments, it is clear that government proposals will be proceeded with, with a view to clamping down on large exit payments in the public sector.

Although April 2016 is likely to be the earliest date these changes come into effect, a more realistic time frame may be October 2016, to allow for Parliamentary process of the Enterprise Bill, which will provide the vehicle by which ministers may impose legal limits on the ability of public sector organisations to make exit payments in excess of £95,000. Payments relating to accrued but untaken annual leave will not be taken into account in applying the cap and payments falling below the threshold will be unaffected.

Full details of exactly what sort of payments will be covered by the new regime will be set out in separate regulations, which will only be made after the Bill has been approved by both Houses of Parliament. However, a whole host of payments could, potentially, be in scope, including redundancy payments, pay in lieu of notice, sums paid to settle potential tribunal claims and payments involved in providing unreduced benefits under pension schemes.

Food for thought...

With so much uncertainty at present, establishing coherent strategies and advice is difficult. Even so, it is clear in principle that a cap will be introduced in some shape or form in the not too distant future and will take precedence over current legal or contractual rights. What is more, the mere fact these changes are in the offing, is already starting to impact staffing considerations within the sector and crucial pension decisions.

In light of this we have signposted below some areas employers may wish to reflect upon even before the detailed regulations are available. Employers should bear in mind also that the cap on exit payments is not the only change to which they will need to adapt. Within the next few weeks we are also expecting the Government to publish regulations aimed at recovering exit payments from individuals earning over £100,000 who leave the public sector and then return to work for in the same sub-sector within 12 months. Those regulations are expected to take effect by April 2016 (at the latest).

Key areas of focus for public sector employers

Staff retention:
Almost inevitably, employers will be receiving enquiries from staff now as to whether they can be released early, prior to the implementation of a cap. Others, anticipating departures, will be addressing their minds to whether postponing such terminations might be a legitimate cost-saving step.

How will employers respond? Careful consideration will need to be given to each of the above options, both of which carry important staffing, employment relations and financial responsibilities.

There will surely be short term staff-incentive issues for employers but they may also need to consider their long-standing reliance upon notice provisions, allowing employers a cushion from sudden departures of senior personnel. These are also likely to be affected by the cap once employees can no longer rely upon provision operating equally. Employment contracts and what employers "promise" by way of notice will need review.

Reduced pension entitlement:
Once in place, the cap will limit entitlement to unreduced pension benefits where the cost of providing those benefits (when aggregated with any other payments caught by the cap) exceeds £95,000. The general model adopted by the Bill is that benefits will still be payable, but will be subject to reduction to the extent that the employer is prevented by the cap from paying the full cost of waiving the reduction, unless the employee is willing – and can afford – to pay a potentially expensive top-up.

This creates a particularly difficult issue in relation to the Local Government Pension Scheme (LGPS), where at present, employees who are members of the LGPS and who are aged over 55 are obliged to take their pension if their employment ends on grounds of redundancy or business efficiency. Under the amendments to the LGPS contained in the Bill, as currently drafted, this obligation to take pension will remain in place, though it may be that lobbying as the Bill proceeds through the legislative process will result in it being changed into an employee option.

If this aspect of the Bill is not changed, some employees may face long-term financial hardship, since the reduction will affect the level of their retirement pension for the remainder of their lives. Employees who are potentially affected may need to start thinking now how they might adjust to what could be significantly altered financial circumstances on retirement. For employers, also, this could potentially have a significant effect on levels of take-up of voluntary redundancy packages by older employees, with a knock-on effect for employers' workforce planning.

There is less information currently available on what changes may be made to the other main public sector schemes. Ideally, employers will want full flexibility to negotiate with employees over the application of the £95,000, so that exiting employees can (for example) choose to buy out just part of the pension reduction, and take the remainder as a cash payment. At present, schemes such as the Teachers' Pension Scheme or NHS Pension Scheme tend to take a very "binary" approach – ie. benefits are payable either with full reduction or with no reduction: there is no scope to take a more tailored approach.

Employers should also note that the cost of providing unreduced benefits for even quite modest earners with long service can be very substantial. Therefore, although the policy aim of the cap is primarily to avoid substantial cash pay-outs to high earners, the actual scope is likely to be much wider.

Potential for claims
Imposing a statutory cap will limit employer exposure to claims by staff alleging breach of contract (which would otherwise arise). Even so, severance payments and ex gratia payments are often used in the sector as a means of compromising potential claims with individuals - for example claims for unfair dismissal, discrimination, and other statutory claims. Furthermore, assessing the appropriate level for such payments is often made by reference to the potential compensation that would be available were individuals to pursue their claims in an Employment Tribunal or other civil court. As such, these payments can be a cost effective way of dealing with such matters, without incurring significant expense in defending litigation, particularly if the prospects of success are weak.

Once the cap is applied to such payments, individuals may be less inclined to enter into settlement agreements and be more willing to litigate, given that no cap will then apply to their compensation. Employers will need to be prepared for such a change –and also the increased costs which litigation could bring.

Depending upon how it applies, the cap could also pose potential discrimination risks for employers (on grounds of age), of which employers should at least be aware. For example, unless this is specifically addressed in the regulations, a cap will disadvantage older, longer serving employees who are not necessarily high earners.

Employment relations
Many organisations have policies in place for circumstances such as redundancy, which have been collectively agreed with their trade unions. There may be knock-on consequences for such collective agreements once a cap is imposed, impacting on general industrial relations. It may also result in less volunteers for redundancy, thereby affecting morale, service delivery and workforce planning.

Inherited issues
The Government has acknowledged that a potential issue may arise where individuals have transferred contractual entitlements under the Transfer of Undertaking (Protection of Employment) Regulations and which might enable those individuals to avoid the cap, placing them in a better position than colleagues. At present, the Government has no plans to address this issue, specifically. As a result (and unless or until they opt to do so) public sector employers need to be alert to the fact that employees falling into this category may need to be treated preferentially as their exit payments may not be subject to the cap

Huw Rolant Jones
Partner

Tel: +44 29 2047 7483
huwrolantjones@eversheds.com

Shirley Hall
Partner

Tel: +44 191 241 6176
shirleyhall@eversheds.com

Gary Delderfield
Partner

Tel: +44 121 232 1786
garydelderfield@eversheds.com

eversheds.com
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