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## **HM Treasury Consultation on reforms to public sector exit payments**

### **Response from the Employment Lawyers Association**

**3 May 2016**

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#### **INTRODUCTION**

The Employment Lawyers Association ("ELA") is a non-political group of specialists in the field of employment law and includes those who represent claimants and respondents in courts and employment tribunals. It is not ELA's role to comment on the political or policy merits or otherwise of proposed legislation or regulation, rather it is to make observations from a legal standpoint. Accordingly in this consultation we do not address such issues. ELA's Legislative and Policy Committee consists of experienced solicitors and barristers who meet regularly for a number of purposes including to consider and respond to proposed legislation and regulations.

The Legislative and Policy Committee of ELA set up a sub-committee under the chairmanship of Emma Burrows of Trowers & Hamlins LLP to consider and comment on the consultation paper from HM Treasury Consultation on reforms to public sector exit payments. Its report is set out below. A list of the members of the sub-committee is at the end of this paper.

#### **Question 1: Are there alternative options and approaches to compensation provision reform you think the government should be considering? What alternative approaches would you suggest and why?**

The current rules around redundancy and exit provisions for those working in the Public Sector are not only significantly more generous than the minimum statutory entitlement frequently applied [we acknowledge, correctly, elsewhere, that many private sector employers pay enhanced arrangements and so we should be careful to ensure consistency with the final answer and avoid suggesting that the distinction is between generous public sector arrangements and frugal statutory arrangements in the private sector] within the Private Sector, the rules are not consistent across the Public Sector creating an inequality in treatment and the complexity of the schemes, may create confusion and inconsistency in application.

The proposals, in their current form, are complicated and are likely to cause confusion amongst those affected by them. In some cases, a party seeking to calculate or challenge a payment would need to refer to numerous pieces of legislation to determine the scope and meaning of the proposed rules.

As regards the calculation of payments, in addition to the methodology used under statute, there are differing methodologies used in the Private and Public sector. The ELA would welcome a limit on the number of overall schemes and a more consistent approach so that there is uniformity and transparency across the entire Public employment sector.

The current proposals include setting a maximum salary, capping the number of months' salary, using a multiplier based on years of service and/or tapering; where entitlement changes depending on age this gives rise to potential claims of indirect age discrimination. A system which discriminates based on age can however, be lawful where it falls within a statutory exemption or is otherwise objectively justified.

Redundancy pay schemes which take age into account in determining entitlement, are potentially discriminatory under the Equality Act 2010. The EqA however contains specific exemptions for both the statutory scheme and enhanced redundancy schemes that are similar. Paragraph 13 of Schedule 9 of the EqA exempts enhanced redundancy payments from the prohibition against age discrimination where, albeit more generous, they follow the way the statutory scheme works (section

162 (1) to (3) of the Employment Rights Act 1996. The statutory scheme is often enhanced in the following ways;

- a. Changing the multiplier to a figure above 1.
- b. Increasing the appropriate amount for each year of employment by multiplying it by a figure of more than one.
- c. Raising the cap on a weeks' pay or removing it altogether.

There are certain requirements that must however remain the same;

- a. The age banding.
- b. Multiplier for the age bands must be in proportion to the statutory multiplier (i.e.  $\frac{1}{2}$ , 1,  $1\frac{1}{2}$ ).
- c. The scheme must be limited to qualifying employees as defined.

Having one scheme for all Public Sector staff which follows the statutory scheme or falls within one of the exemptions would not only prevent the potential issue of age discrimination, it would be simple to understand and apply.

Where a proposal does not fall within the statutory exemption, non-exempt schemes must be *objectively justified* (cost can be taken into account but cannot on its own justify discrimination: *Cross v British Airways Plc [2005] IRLR 726*). The guiding principles from case law which have emerged around what can provide objective justification are as follows;

*"Encouraging and rewarding loyalty*

*Encouraging voluntary redundancies amongst older workers and facilitating progression for more junior staff*

*Cushioning older workers against labour market disadvantage*

*Enabling the employer to manage change*

*Maintaining good industrial relations and a contented workforce*

*Operating a commercially viable business*

*Preventing employees receiving a windfall<sup>1</sup>.*

*Kraft Foods UK Ltd. v Hastie UKEAT/0024/10:* EAT held that a cap applied to payments under a redundancy scheme which had the intention of preventing employees from receiving more than they would have earned if they had remained until retirement age was a proportionate means of achieving a legitimate aim.

*Loxley V BAE Land Systems (Munitions and Ordnance) Limited [2008] IRLR 853:* EAT held that a contractual redundancy scheme was potentially justified, payments under the scheme were calculated by reference to age and length of service but tapered down from the age of 57 so those over the age of 60 were entitled to nothing. (The age at which the scheme tapered reflected the pension age and the age at which pension could be accessed).

ELA members felt that exit payments are perhaps more vulnerable to being used inconsistently as a reason for departure in which exit payments can be made (such as redundancy, early retirement, retirement in the interests of the efficiency of the service) across the Public sector and clear standardised criteria required for the circumstances in which they are to be applied.

Where the termination of an employee's employment is held to be unfair, an employee's compensation under the ERA 1996 is subject to a cap. A compensatory award which may be awarded for financial loss is essentially capped at a year's salary or sum prescribed by the secondary legislation [currently £78,962] in cases of unfair dismissal. An Employment Tribunal will take into account mitigation and the individual's ability to find other work when assessing a compensatory award. To prevent a windfall particularly for senior employees who are likely to secure well paid employment quickly, it is not uncommon in the Private sector for exit payments to be staggered or paid in instalments, with an express requirement on the employee to take steps to mitigate and find alternative employment. This reflects the actual loss an individual suffers. There are provisions for repayment if a Public sector employee returns to work for the same Public sector employer but no repayment where they have experienced potentially no loss by finding consultancy or work in the Private sector immediately. Consideration should be given to staggered payments/ instalments or other alternatives to prevent windfalls which may include wider repayment agreements.

The rationale for retaining pension tops up in the context of reducing cost and having a more consistent approach to the Private sector experience where many final salary pension schemes are no longer available, is unclear.

Employees are likely to seek to volunteer for redundancy or early retirement before the proposals take effect. In an effort to manage costs, employers may look to delay staff departures until after the proposals take effect.

<sup>1</sup> Extract from Practical Law Company

**Question 2 – Do you agree with the proposed approach of limiting early retirement benefits with reference to the cost for the employer? What alternative approaches would you suggest and why?**

This approach has already been adopted across the National Health Service via a national collective agreement. Employers across the NHS are assessing the impact of this change and the Government may wish to consider the effects of these changes before implementing wider changes. To the extent that such changes reduce the potential for early retirement, it is possible that such changes will make it more difficult for employers to re-profile their workforces.

Limiting early retirement benefits would achieve the Government's aim to modernise terms and conditions of public sector works and deliver maximum value for taxpayers. However, it may be the case that certain public sector pension fund rules or the legislation behind them may require amendment in areas where staff made redundant or permitted to retire on grounds of efficiency are entitled to unreduced early retirement benefits.

The right to early retirement, in particular at age 50, does not stand fairly, on one view, with the delay in state retirement age which is now 67 for those currently aged 50. In a modern workforce an exit for early retirement 17 years before the date of expected retirement seems very early and may not be sustainable.

Alternative approaches suggested to reduce the cost of early retirement benefits:

- Dropping the added years of pensionable service and paying for the unreduced early payment
- Discontinuing the use of defined benefit pension schemes for future hires (but honouring benefits which have accrued to date).
- Using a tariff to allow early retirement at later ages over the next 10 - 15 years.
- Raising the lowest age at which early retirement is allowed under the pension schemes.

### **Question 3 – Do you agree with the proposed options around capping tariff terms? What alternative approaches would you suggest and why?**

We understand that the government is proposing to introduce some, or all, of the tariffs set out at paragraphs 4.12 to 4.15 of the Consultation paper. Clearly, the impact of the reforms will vary considerably depending upon which of the possible tariffs are adopted and in what combination. As such, it is difficult to give a clear view on the impact of the proposed options in the face of numerous possible combinations of caps or restrictions but we would make the following observations:

1. If the government decides to introduce most or all of the proposed tariffs, the exit payment system would be complicated and difficult for employees to understand.
2. The proposed tariffs at paragraphs 4.13, 4.14 and 4.15 are likely to put older employees at a particular disadvantage compared to younger employees on the basis that older employees are more likely to have longer service and/or higher salaries. The proposals are therefore potentially discriminatory on the grounds of age.
3. The proposals at paragraph 4.15 (tapering close to retirement age), together with the proposal to limit early access to pension, may make it more difficult for public sector employers to move on older employees and may therefore reduce job opportunities for younger employers. The effect of these provisions would be to substantially reduce the attractiveness of voluntary redundancy to older employees, particularly since they are likely to have legitimate worries about finding alternative employment which may have a substantial impact on their pension benefits from defined benefit pension schemes.
4. It is not clear how the proposed tariffs would interact with the exit payment cap of £95,000 on public sector exit payments being considered as part of the Enterprise Bill. Introducing these tariffs alongside the cap increases the likelihood of a detrimental impact on older employees.
5. An alternative approach might be to adopt a system based upon the Statutory Redundancy Scheme, as described in Box 2.1, but enhanced in one or several ways. This would have the advantage of being easier to understand and more consistent with private sector employers (who tend to either just pay statutory or calculate payments based upon an enhancement of the terms of the statutory scheme). The proposal could involve increasing or removing the cap on a week's pay for statutory redundancy, increasing the multipliers used and/or increasing the overall figure by multiplying it by more than one.

Feedback from within the NHS, which has already introduced some of these changes suggests that:

1. The application of a combined salary cap of £80,000 for use in calculating contractual redundancy payments when combined with the proposed statutory public sector redundancy cap of £95K are likely to have a significant impact on the value of redundancy payments available to senior NHS managers.
2. It might be seen as simpler and fairer to leave the tariff as it is and lower the earnings ceiling.
3. A combined approach of capping the tariff and reducing the number of months' salary that can be used when calculating redundancy payments may be unnecessary and that one or other measure might be sufficient.

### **Question 4 - Do you agree that the Government has established the correct scope for the implementation of this policy? Are there other factors the government should take into account with regards to scope?**

The ELA suggests that the following factors should be considered:

- **The complexity of the public sector**

The limiting and control of public spending is critical to support a challenging economy. It is proposed that the new policy on public sector exit compensation terms curb public spending and deliver savings. In general, there are two limbs to the application of the policy. It applies to the major public sector workforce (as outlined in the Scope) and those who are under existing public sector compensation schemes and other exit arrangements.

The major workforce is defined as the existing and future employees working in the NHS, Civil Service, Teachers, Local Government, Police Officers and the Judiciary.

However, the public sector comprises a diverse range of organisations that extends beyond the major workforce identified by the government. These organisations can include arms-length bodies, such as Non-Departmental Public Bodies, 'Quangos' and Executive Agencies.

Other regulations, notably the Public Sector Exit Payment Regulations 2016 apply to a wide range of employees employed by those bodies within the public sector (as set out on the list prepared by the Officer of National Statistics) save where excluded. The ELA suggests that consistency in legislation should be encouraged and that the scope of any new arrangements should be consistent with other legislation.

- **Statutory Schemes**

It is the intention of the government to establish new public sector compensation schemes to reflect the reforms to redundancy and exit payments.

The current statutory schemes for compensation payments apply to civil servants, local government workers, teachers, fire and rescue workers, and members of the police forces. The government proposes that the new scheme will also apply to "NHS workers" despite there being no existing statutory scheme for this category of employees.

The statutory scheme underpins the main principles for the expenditure that should be adopted for compensation schemes and exit arrangements.

However, a public sector organisation that does not employ the above categories of employees and who are not governed by any statutory scheme will have more flexibility in their redundancy and exit payments.

If there is no statutory scheme in place, this may lead to many public sector organisations being out of scope. Furthermore, inconsistencies may continue across the wider public sector where no scheme or policy exists to govern the exit payments.

**Question 5 - Are there other impacts not covered in the above which you would highlight in relation to the proposals in this consultation document?**

The ELA suggests the following needs consideration:

- **Potential blocking effect on organisational change and restructuring**

*NHS, local authority and other public sector organisations have been, and are likely in the future to be, subject to significant and large-scale structural changes. Exit payments are important to employers' abilities to implement workforce reforms and to respond to new circumstances. They provide important support for employees as they seek new employment particularly in circumstances where, as may be the case in the NHS and other public sector organisations, their skills and experience may be role or sector specific.*

- **The effect on workplace relations and partnership working**

Generally speaking, public sector employers prefer to work in partnership or constructively with staff side and union representatives to address change and update working

arrangements and operational agreements. A combination of an increasing burden of new legislation and regulations on the one hand and diminishing benefits and protection on the other is likely to start to limit the future opportunities for working together locally and nationally, in partnership, to address organisational change and industrial relations issues. Strong concerns have been expressed by a number of public sector contacts over the potentially negative impact of what is perceived to be an increased reliance on legislation rather than agreement.

A number of public sector contacts have also expressed the view that the limits themselves and the process of introducing successive sets or new limits may contribute to a general deterioration in staff morale.

- **Parallel reduction in the value of voluntary arrangements**

The consultation refers to voluntary redundancy arrangements that run alongside compulsory redundancy provisions. Such arrangements are in practice likely to be reduced alongside compulsory redundancy provision. The Civil Service Scheme referred to in Box 2A provides a higher level of payment in circumstances of voluntary redundancy than compulsory. In the NHS the reverse applies with Mutually Agreed Resignation Schemes (“MARS”) offering only a proportion of any compulsory redundancy scheme.

A corresponding reduction in the value of the MARS is likely to reduce the take up of schemes with staff preferring to remain in employment and/or to await compulsory redundancy at the higher (albeit now reduced) rates. A combined, across the board, reduction in both redundancy and MARS arrangements may have the counter-intuitive effect of increasing the cost of reorganisations and headcount reductions by increasing the number of compulsory redundancies that are required. Further work may be necessary if the effect of this is to be considered fully.

- **Potential blocking effect on developing staff and “new blood”**

Concerns have been expressed in relation to the ability of organisations effectively to move staff on and create space for the next generation of more senior staff and leaders. The current arrangements provide for succession planning and a healthy turnover. This is particularly likely to be the case in settings with existing “no compulsory redundancy” agreements. Such agreements themselves would require either the negotiation or imposition of alternative arrangements. These processes themselves would in turn be likely to lead to disruption through the loss of good will and, potentially, industrial action.

- **Obstacles to future recruitment**

In practice, recruitment in all sectors is based on the balance of the overall level of pay and benefits available. A reduction in the level of protection offered by exit payment arrangements may lead to a reduced pool of suitable applicants, their loss to the private sector or a corresponding upward pressure in relation to pay or notice periods. Further work may be necessary if the effect of this is to be considered fully.

- **Reduced savings arising out of other changes**

Corresponding proposals to levy employer National Insurance contributions on the value of severance payments over £30,000 will increase the cost of such payments and reduce the saving to the public purse. Further work may be necessary if the effect of this is to be considered fully.

- **Loss of specialist knowledge and experience**

A lower cap and tariff, and for some employees a period within which they have to stay out of the public sector for up to a year as a result of repayment arrangements, may lead to the loss

of certain professionals and their skills and experience from the public sector entirely. Those with clinical expertise may find that in the intervening year their knowledge and expertise has become outdated, limiting their opportunities for re-employment or leading to a permanent move to the private sector or overseas. Further work may be necessary if the risks of this are to be understood fully.

**Question 6 - Are you able to provide any further information and data in relation to impacts which may be relevant to the government in setting out the above?**

- The ELA believes that there is insufficient data or information to determine whether or not the impacts identified above will be blocks to the implementation of the reforms. Further work may therefore be required in this area to minimise the risk of unforeseen and/or unintended consequences
- Redundancy and exit payments are a bridge for employees finding new employment and a financial cushion to offset the loss of employment and rights. There is no data to show how long it takes for a public sector employee to find new employment with another public sector employer and whether the claw back of compensation will impact a successful job search.
- The policy underpinning the use of public sector exit payments needs to be consistent across the wider public sector. The data provided by the BBC reporting on the use of gagging orders, <sup>1</sup>suggest that there were enhanced pay-outs totalling £226.7m from 2010-2015, but this report provided no insight into the circumstances of the leavers.. Generally, exit payments are based on voluntary or compulsory redundancy, mutually agreed terms and retirement. Further intelligence is needed to breakdown the elements of public sector exit payments and the leaver's circumstances to further understand the social impacts on groups.
- It is noted that the government has given assurance in the consultation that pension schemes remain unaffected by the reforms and will not be in breach of the Public Service Pension Act 2013. The ELA's experience suggests the limit on pension top ups and/or the tapering provision may impact on pensions.
- The proposal to reduce pensions top ups in exit arrangements may impact succession planning for early retirement. There may be less of an incentive for older employees to move on to create room for the younger generation. Further data is required to consider whether the reduction in pension top ups will have this impact on succession planning. In addition, there should be more data surrounding the circumstances on the use of pension top ups to inform the strategy for succession planning.
- There will be a change in the landscape for exit payments. The pace of implementation and degree to which more transparency and accountability will be required may affect the responses of staff and employers. The restraint and reduction in the flexibility of exit payments could affect operations and industrial relations. However, further information is needed to consider whether any of these factors could affect the management of the workforce and/or future attempts at change in organisations or across sectors.
- The government needs to obtain intelligence on the wider practice of exit payments and how the changes to exit payments could stifle organisational change and restructuring.

**Question 7 - Are you able to provide information and data in relation to redundancy provision in the wider economy which could be used to inform the government's response to this consultation?**

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<sup>1</sup> <http://www.bbc.co.uk/news/uk-35946263>

Our experience is that redundancy provisions vary significantly in the wider economy. Our experience is that many organisations (especially smaller organisations) apply statutory minimum redundancy terms only. For larger organisations which provide for more generous terms this tends to be based on the use of the statutory formula but with the actual week's pay rather than the capped week's pay. This may be as a result of the introduction of age discrimination legislation and the specific exemption for redundancy payments based on the statutory formula or a formula which mirrors the statutory formula. Our experience is that some organisations (especially those which were once public or quasi-public sector but have moved into the private sector – for example, the defence sector) have retained much more generous redundancy terms (up to 104 weeks' pay in some cases) linked to pension arrangements. A point to note is that many private sector organisations which apply more generous redundancy terms do so on a discretionary basis and are careful to ensure that such enhanced terms do not become contractual. Some organisations use additional discretionary payments to encourage voluntary redundancy – these vary from increasing the number of weeks' pay for each year of service to providing a fixed additional lump sum.

### **ELA Sub-committee**

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