Aquila Heywood

Reforming Local Government Exit Pay
Response to MHCLG Consultation

November 2020

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Executive Summary

Aquila Heywood the market leader in the provision of pensions administration software for LGPS administrating authorities in England, Northern Ireland, Scotland and Wales. 80 of the 99 LGPS Funds currently use Aquila Heywood's software.

This document is the official Aquila Heywood response to the MHCLG consultation on the reform of exit payments in local government in England and Wales.

Aquila Heywood response to the consultation has focused on the development of pensions administration software and, where known potential, impact on the administration of the Local Government Pension Scheme (LGPS) for our customers. Throughout this document the following terminology is used:

"the Exit Payment Regulations" refers to The Restriction of Public Sector Exit Payments Regulations 2020; and

"the draft LGPS Exit Payments Regulations" refers to The Local Government Pension Scheme (Restriction of Exit Payments) (Early Termination of Employment) (Discretionary Compensation and Exit Payments) (England and Wales) Regulations 2020.

Aquila Heywood recognises that the reform of exit payments will have a substantial impact on software providers as well as the workload for LGPS administering authorities. Proposed legislative changes mean that substantial changes to existing functionality and potential new features may be required to remove ever increased administrative burden for pension funds.

The authorities will want to minimise that impact and, therefore, they will want their systems providers to automate as many of the additional administrative tasks as possible including use of online platforms. Without the development of an automated solution Aquila Heywood believe that there will be substantial impact on the administration of the LGPS. As things stand, a software solution will not be in place for the expected effective dates for the implementation of the legislative

In summary our key points are as follows:

- significant development is required to minimise the impact on Administrators;
- further clarification is required in respect of the draft LGPS Exit Payment Regulations and the draft and GAD guidance;
- the implications of back-dated legislation; and
- concurrent legislative changes.

We would like to expand on these key points in more detail:

Significant development is required to minimise the impact on Administrators.

Based on our interpretation of the draft regulations on the restriction of exit payments in the public sector, Aquila Heywood will be required to make substantial development to pension administration systems. The development spans across early retirement, redundancy calculations and recalculations of these. In addition, changes highlighted in GAD guidance will have implications on database and associated processes. We expect to use of online platforms and take full advantage of the technology available as this is in line with our member and administrator expectations.

See section 4.1 for more detail on the amendments, which will be required to pension administration systems, in order to implement the new pension strain calculations and the restriction on exit payments.

Further clarification in respect of the draft LGPS Exit Payment Regulations and GAD guidance.

The draft LGPS Exit Payments Regulations will need to

- refer to the appropriate statutory guidance;
- specify which LGPS benefits are included in the strain on the fund calculation
- permit actuarial reduction to benefits where a member retires under regulation 30(7) of the LGPS Regulations 2013; and
- permit members to make payments to the pension fund to offset impact of the strain on the fund calculation.

Employers, administering authorities and software suppliers will require guidance where the effective date for the draft Restriction of Public Exit Payments Regulations is earlier than the effective date for the draft LGPS Regulations 2020. If the effective dates are not synchronised, there will be an additional burden on employers and administering authorities.

The LGPS has an extremely complex benefit structure. There are a number of areas where Aquila Heywood believe further clarification on the guidance is required.

There are several ways where members have increased their benefits in the LGPS:

- Added years;
- AVC Service Credits;
- in-house AVCs converted to GAD annuity pension
- ARCs increasing in line with RPI;
- ARCs increasing in line with CPI; and

- APCs.

Please see section 4.1 for detailed comments on the issues surrounding additional member benefits. If the GAD guidance does not specify the treatment of additional benefits, which are funded by the member) then the draft LGPS Regulations 2020 must state what benefits are included in the pension strain calculation.

Implications of back-dated legislation

The effective date for the restriction on exit payments legislation mean that the necessarily software amendments will be delivered after the legislation takes effect.

It is inevitable, however, that LGPS administrators will have to process a large number of manual adjustments in retirement calculations as a result of the restriction on exit payments legislation. Employers will have to supply more information to the administering authority at the point of retirement.

Concurrent Legislative Changes.

There are other changes in the pipeline which will impact on the administration of the LGPS and which will require additional amendments to pensions administration system software. The timing of the other changes will impact on the development schedule for the implementation of the restriction on exit payments in local government legislation.

- The remedy for the McCloud judgement - Software suppliers are already facing extremely tight deadlines to implement the remedies for the McCloud across multiple public service pension schemes.

  There will be pressure on software suppliers to implement the restriction on exit payment changes as soon as possible. Inevitably, there will be a conflict in demand between the implementation of the McCloud judgement remedy and the implementation of the restriction on exit payments.

- Cost Cap Mechanism - Prior to the McCloud judgement, there were discussions about changing the benefit structure as a result of the cost valuations. The proposed changes included changes to the accrual rates of the CARE schemes.

It would assist all stakeholders if the timescales for these items were reviewed and a sensible timeline agreed which ensure solutions can be developed in a timely manner. At the current time, it is difficult to see how solutions to all these changes can be implemented in the timeframes proposed.

We look forward to receiving MHCLGs response to our consultation response.

1 Basic Information

Name	Dave Friend
Position	Benefit Calculation Technical Consultant
Organisation	Aquila Heywood
Address	Hamilton House, Church Street, Altrincham, Cheshire WA14 4DR
Email	David.friend@aquilaheywood.co.uk
Telephone numbers	D: 0161 613 4259 M: 07828 308066

2 Proposals for reforms to exit payments in local government

2.1 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?

- If so, please provide data/evidence to back up your views?

- How would you mitigate the impact on these employees?

Aquila Heywood have no comment from a software system perspective.

2.2 Question 2

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

An index based on average earnings should be used to review the maximum salary figure on an annual basis. For example, the earnings factors, which are used in the calculation of a member's GMP, are revalued by reference to an average earnings index.

2.3 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 weeks salary that can be paid as a redundancy payment?

- If so, please provide data/evidence to back up your views?

- How would you mitigate the impact on these employees?

Aquila Heywood have no comment from a software system perspective.

2.4 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?

- If so, please provide data/evidence to back up your views?

- How would you mitigate the impact on these employees?

Aquila Heywood have no comment from a software system perspective.

2.5 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?

The proposals do meet the policy objectives but, in our view, there are serious challenges with the proposals.

The essential problem is the exit cost cap proposals are complex in themselves before they are combined with the LGPS benefit structure which is far from simple. It is extremely difficult to offer an alternative which meets the policy intent, is better than the proposal and is easy for members to follow.

The proposals are far from simple. It will be difficult for many members to understand the each of the options available. See section 4.1 on the draft GAD guidance for a more detailed explanation on the difficulties faced when implementing the proposals.

Inevitably, the proposals will lengthen the process from an initial quotation to the payment of benefits to the member. The member has more options in addition to the usual conversion of part of the pension to increase the lump sum.

It will place an additional administrative burden on administering authorities. The calculations have to be processed by the administering authority as they have the systems in place to generate the strain on the fund cost. Administering authorities will require more information from the employers and they will have to supply more calculations to the member together an explanation on the choices available to the member.

The proposals will require significant new calculations to pension administration systems. The calculation of exit payments and redundancy compensation payments are not typically a part of pension system calculations. It will take substantial development work to incorporate those calculations into retirement calculations.

If these calculations are not incorporated into the pension administration systems, then administering authorities will have to develop resources outside of their pension administration systems and the manually input the results into the retirement calculations. This approach would increase the risk of human error.

2.6 Question 6

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

Aquila Heywood have no comment from a software system perspective.

2.7 Question 7

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

Aquila Heywood have no comment from a software system perspective.

3 Impact Analysis

3.1 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?

Aquila Heywood have no comment on this question from a software system perspective.

3.2 Question 9

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

Aquila Heywood have no comment on this question from a software system perspective.

3.3 Question 10

Would any transitional arrangements be useful in helping to smooth the introduction of these arrangements?

Regulation 15 of the draft LGPS Exit Payments Regulations provides transitional arrangements. These will assist the administration in the six months following the effective date of the LGPS Exit Payments Regulations 2020.

There is a period where the Public Sector Exit Payments Regulations 2020 become effective on 4 November 2020 and the unknown effective date for the LGPS Exit Payments Regulations. AH assume that as the employer and the member had already agreed the terms of the member’s exit payments that these will be honoured.

3.4 Question 11

Is there any other information specific to the proposals set out in this consultation, which is not covered above which may be relevant to these reforms?

Aquila Heywood have no comment on this question from a software system perspective.

4 Next Steps

4.1 Question 12

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

Aquila Heywood has the following comments.

The Exit Payments Regulations

Regulation 4(b) states that the restriction on exit payment applies where a member has two or more public sector exits within 28 consecutive days. That will make it very easy for potentially affected members to avoid the restrictions on exit payments at little or no cost to themselves. Any such member will have to wait less than a month for the additional benefits which will have either slightly less actuarial reductions applied or receive a slightly smaller actuarial increase.

The draft LGPS Exit Payments Regulations

Aquila Heywood have several comments on the draft LGS Exit Payments Regulations.

Aquila Heywood have assumed that the LGPS Exit Payments Regulations will only apply to members whose exit from the LGPS occurred after the effective date for those regulations.

Regulation 1(4) includes a definition for the Local Government Pension Scheme Regulations 2013. The examples in the GAD guidance include members' benefits which accrued before 1 April 2014 (i.e. the commencement date for the CARE scheme). Regulation 1(4) does not contain a reference to the Local Government Pension Scheme Regulations (Transitional Provisions, Savings and Amendments) 2014 ("the 2014 Transitional Provisions").

If the restrictions on LGPS exit payments, following an exit, are to include benefits which accrued before 1 April 2014, there should be a reference to either the earlier regulations or the 2014 Transitional Provisions.

Regulation 5 makes several amendments to the LGPS Regulations 2013 by inserting references to regulation 10 of the LGS Exit Payments Regulations.

There is no amendment to regulation 33 (Election for lump sum instead of pension) of the LGPS Regulations 2013. Aquila Heywood understand that it is permissible for members to convert part of their pension to increase the lump sum and then use the funds to avoid the reduction in full or part to pension.

Regulation 5(4(c) replaces the reference to an actuary appointed by the administering authority with guidance which is issued by the Secretary of State – i.e. GAD guidance. There will not be many instances but guidance will be used to calculate the strain on the fund for a member's benefits where the member is within the scope of the Schedule to the Public Sector Exit Payments Regulations but are outside of the scope of the Schedule to the draft LGPS Exit Payments Regulations. Regulation 68(2) does not allow for this possibility after the amendment in regulation 5(4)(c) of the draft LGPS Exit Payment Regulations 2020.

Implementation in Pension Administration Systems

The restriction of exit payments in local government will require substantial changes to pension administration systems and the retirement processes where a member voluntarily retires, is made redundant or leaves due to the efficiency of business. As administering authorities currently calculate the strain on fund costs, the burden of additional administration will fall on them.

Implementation of the restriction in exit payments in pension administration systems may involve:

- provision of more information by employers in respect of other exit payments to enable the calculation of statutory redundancy;
- the calculation of Statutory Redundancy Payments by pension administration systems;
- the ability to differentiate between different types of employers in benefit calculations. There are four categories of employers. Those that are subject to both pieces of legislation; those that are subject to the general restriction on exit payments but not the new LGPS legislation; those that subject to the new LGPS legislation but not the restriction on exit payments legislation and those employers are not subject to either piece of legislation. The expectation is that most employers will fall into the first two categories.;
- the calculation of the new pension strain calculation;
- the update of early retirement calculations from active and deferred pensioner statuses;
- the update of redundancy and in the efficiency of the business retirements from active status;
- the update of benefit calculation documentation;
- amendments to data available to members via online solutions;
- the recording of exit payments, Statutory Redundancy Payments the new pension strain calculation and cases where the restrictions on exit payments were relaxed; and

- a substantial testing effort by both software suppliers and administrators.

Draft GAD Guidance: Additional Member Benefits

This section will apply where the definition of the pension (which is used in the strain on the fund calculation) is not specified in the draft LGPS Exit Payments Regulations.

Paragraph 1.14 refers to enhanced early retirement factors which are to be used in the calculation of the pension strain for pre 2014 final salary benefits. There is a reference to an additional pension purchased by an employee under regulation 16 (of the LGPS Regulations 2013). Those benefits are an additional CARE benefit and therefore are not related to pre 2014 final salary benefits.

Paragraph 2.8 refers to Table 2 from Appendix B which lists the enhanced strain factors for early payment of pre 2014 benefits factors after age 55. The factors cover the usual range from 0 to 13 years. There is no reference to age 60 where the member attains CRA between age 55 and 60 as applies when a member retires voluntarily between those dates.

The introduction of enhanced early retirement calculations, for use in the pension strain calculation only, will mean administering authorities and employers will experience difficulties communicating the differences between the early retirement factors between the pension strain and the retirement calculations. The differences are greater the further the member is away from the retirement age.

Paragraph 2.13 states that the pension strain should include any additional pensions which was purchased by the employer. It would assist implementation if the final GAD guidance stated that, where the employer entered into a shared cost arrangement with the member, that only that proportion of the additional based on the employer's contributions is included in the pension strain calculation.

Paragraph 4.5 states that the calculation of the pension strain in respect of final salary benefits includes transferred in pensions but excludes additional pension purchased by the member. Is the reference to "additional pension" in this section a reference to Additional Regular Contribution contracts which commenced between 1 April 2008 and 31 March 2014? The treatment of ARCs will need to match the treatment of additional pensions which were purchased under regulation 16 or awarded under regulation 31. Like APCs, additional pensions (which the member purchased under the 2008 Scheme could be funded by the member, the employer and under a shared-cost arrangement.

There will be very few active members who will have added years contracts. Nevertheless, they are a member funded benefit. They should be excluded from the final salary benefit's pension strain calculation on that pension. Any actuarial reduction, which is applied to added years' benefits, will cover the early payment of those benefits.

If APCs (which were purchased under regulation 16) are excluded from the pension strain calculation, does this principle extends to other member-funded additional benefits?

There is a typographical error in the table in paragraph 4.11 The definition of $ERF_{table\ 1}$ refers to the "Factor for pre-2014 pension. It should refer to the post-2014 pension as per the following line which is taken from paragraph 4.10 under the sub-heading, "The cost of immediate unreduced pension":

Reduced pension: $[P_{pre\ 2014} \times (1 – ERF_{table\ 2}) + [P_{post\ 2014} \times (1 – ERF_{table\ 1})]$

Examples

Note, the examples provided use intermediate figures rounded to 2 decimal places. The benefit calculations, which are processed on pension administration systems are based on intermediate amounts rounded to at least 5 decimal places for accuracy.

In the calculation of immediately reduced benefits appears to be based on the factors from Table 2 for the pre 2014 final salary benefits. Paragraph 2.8 of the draft GAD guidance states:

> *"The enhanced early retirement factors set out in Appendix B table 2 should be used in the calculation of the pension strain only"*

The calculation should use the standard retirement factors when calculating the actuarial reduction factors when calculating the immediately reduced pre 2014 final salary benefits. The calculations in paragraph 6.26 appear to use the factors from Table 2 instead of those from Table 1 in Appendix B in the calculation of the immediate reduced benefits.

There is an error in the calculation of the Part B pension in Example 4. It is calculated as £6909 instead of £6900 (i.e. £69,000 * 6 years * 1/60).

Pre 2014 Member Funded Final Salary Benefits

The draft GAD guidance makes no reference to in-house AVC benefits. The member can use an in-house AVC fund to purchase an additional pension based on annuity factors provided by GAD. The factors will include an element which is based on the member's age when the in-house AVC pension commences. Members also have the option to take part or all of the in-house AVC fund as cash when the main scheme benefits are crystallised. Aquila Heywood believe that any benefits, which are derived from the in-house AVC funds should be excluded from the pension strain calculation.

The draft guidance does not refer to Pensions Increase applied to a member's benefits. On the basis, that the pension strain calculation is based on the pre-conversion benefits. Aquila Heywood assume any that Pensions Increase, which is applied to final salary benefits due to a previous year's pay, is included in the revised pension strain calculation. The assumption is that the same principle will apply where a PI Review date occurs between the date of retirement and the BCE date: i.e. the pension strain calculation is based on the benefits as at the Date of Retirement.

The Retirement Process

The restriction on exit payments will elongate the retirement process for early retirements and redundancies. The members will have more options available. Even though the pension strain calculations are based on pre-conversion benefits, the maximum tax-free cash lump sum the member can receive will be affected by whichever option the member eventually elects to receive. This will put a premium on clear and concise communications between all stakeholders.

It would be useful if there was guidance that explained the different options, which are available to a member, according to the type of employer. There are four possibilities and it would assist members if there was clear and concise guidance regarding their options.