

Statutory redundancy pay

July 2005

<http://www.dti.gov.uk/er>

Objective

1. The objective of changing the legislation on statutory redundancy payments is to reduce age discrimination in the workplace, in a way that is consistent with the overall social policy aims of the statutory redundancy scheme. These aims are:

- To ensure that employees who are made redundant receive at least a statutory minimum severance payment that (as noted in *Age Matters*¹) recognises the degree of their past commitment to the employer's business; and
- To promote labour market flexibility (mainly by easing the process of job transition for redundant employees).

Risk assessment

2. The current legislation entitles redundant employees of different ages to different multiples of their years of service in calculating their statutory redundancy payments.² This is direct age discrimination. Not only is this inequitable, but where it cannot be objectively justified, it risks undermining the overarching objective of age discrimination legislation which is to increase choice and participation in the labour

¹ In 2003 the Government launched a consultation, *Equality and Diversity: Age Matters*, seeking views on proposals for outlawing age discrimination. For further details see: <http://www.dti.gov.uk/er/archive.htm>

² The formula for statutory redundancy payments is as follows: to qualify for statutory redundancy payments, employees have to have completed two years' continuous service. For each complete year of continuous service between the ages of 18 and 21, employees receive half a week's pay. For each complete year of continuous service between the ages of 22 and 40, employees receive one week's pay. For each complete year of continuous service between the ages of 41 and 65 employees receive 1½ weeks' pay. However, if employees are over 64, the total amount of the payment received is reduced. There is a cap of twenty years on reckonable service.

market of those who are currently being discriminated against because of their age.

3. The Government considers that direct age discrimination in statutory redundancy payments should be removed as it cannot be objectively justified in terms of the aims of the scheme (see para 1). There is no sound reason why an employee who is, say, 50 years old, should receive more compensation than one who is, say, 25 years old, if each has the same length of service with their employer, and has thus demonstrated the same degree of commitment, at the point when they are made redundant. While older employees sometimes find it harder than younger ones to obtain alternative work following redundancy, this is likely to be due, at least in part, to age discrimination, which the new legislation seeks to address and which we do not believe justifies differential treatment between younger and older employees. Younger employees often have greater financial commitments than older ones – e.g., young families to support, and higher mortgages – but this would not justify weighting the payment calculation in favour of them, as recognition of financial commitments, likewise, falls outside the aims of the redundancy payment scheme.

Options

4. The statutory redundancy payments scheme, introduced in 1965, currently has a number of aspects that discriminate directly on grounds of age. They cannot be justified and so ought to be removed. There are however other aspects of the scheme, that could be said to have an indirect disparate impact on different age groups, but that the Government proposes to keep and (if they do indeed have an indirect disparate impact – which is uncertain in some cases) to justify objectively for the following reasons.

- The two year qualifying period of continuous service: An employee with less than that length of service cannot be said to have demonstrated sufficient commitment to justify payment³;
- The use of length of service as a factor in the payment calculation: This is an obvious proxy for degree of dedication and commitment;
- The use of weekly pay at the time of dismissal (subject to the statutory upper limit) as a factor in the payment calculation: This reflects the position the employee has reached in the employer's business and is the most (and arguably only) administratively convenient figure to use – particularly given that many employers

³ In a survey of employers in 2000/01, 75 per cent thought that the two year length of service requirement was about right; 13 per cent thought it was too long and 10 per cent thought it was too short. Source: IFF Research Ltd (unpublished) *Employers' Redundancy Practices* – copies available on request.

do not keep long-term records that could be used, for instance, to work out a career average rate of pay; and

- The 20 year cap on length of service taken into account in the payment calculation: Its removal would expose employers to the risk of excessive financial burdens in the event of a redundancy situation – which could lead them to have to make even more redundancies or even drive them into insolvency.

5. In order to achieve its objectives in reducing the extent of age discrimination in the workplace and in complying with European law requirements, the Government proposes that provision should be made to:

- Remove the age 18 lower limit on service taken into account for the purposes of qualification and payment calculation under the scheme;
- End the use of age as a factor in the payment calculation;
- Remove the upper age limit on entitlement;
- Repeal the provision under which the amount of payment due is tapered by one twelfth for each month elapsed between the ages of 64 and 65; and
- Revoke the Redundancy Payments Pensions Regulations 1965 SI 1965/1932, which allowed employers to off-set certain pension or lump sum payments against statutory redundancy payments, which no longer serves a useful purpose and which have fallen into disuse.

6. Apart from the removal of the upper age limit on entitlement, these are all proposals that were put forward in *Age Matters*. They received overwhelming support from consultees.

7. It was made clear in *Age Matters* that the decision on the upper age limit would depend, in part, on the decision on the proposed state default retirement age. Now that the latter decision has been taken, the Government has reviewed the issue and decided that the upper limit should not be retained. The rationale previously advanced for it was that, on reaching the normal retirement age for his/her job, or age 65 if lower, an employee could no longer be said to have a legitimate expectation of continued employment. It was, therefore, justified for him/her to be denied entitlement if kept on by the employer and then made redundant.

8. It would, however, be untenable, in the light of the new EU age discrimination requirements, to argue that it was actually to the benefit of employees over retirement age to deny them entitlement to a payment that would be due to younger colleagues in identical circumstances. This is not a case where the reason for dismissal is age, but where the reason for dismissal is redundancy, and so the considerations relating to retirement age do not apply.

9. Changing the calculation so that all age groups are entitled to the same number of weeks of pay for each year of service in calculating statutory entitlements requires a choice of what this number of years should be. At the moment, it ranges from half a year for younger workers to one and a half years for older workers, with the average being around one week. However, if a formula based on one week's pay for each year of service was adopted, this would result in some welfare loss for older workers. This could be addressed, either by levelling up and adopting a formula that results in one and a half years being used or by raising the statutory upper limit for payments (currently standing at £280).

10. The options considered are, therefore, concerned with the statutory upper limit for payments (currently standing at £280 per week) and the multiple used to calculate the number of service year weeks. A "do nothing" option is also considered for comparison purposes.

Costs and benefits

Business sectors affected

11. Table 1 shows the distribution of redundancies by industrial sector and compares this to the distribution of all employees. It is clear that in 2001 proportionally more employees were made redundant in manufacturing. However, the distribution of redundancies by sector is likely to vary from year to year, depending on business conditions.

1. Number of redundancies made last 12 months by Industry sector of employer

	Redundancies (%) (2000/01)	All employees Spring 2001
Manufacturing	46	18
Mining, construction, utilities and agriculture	4	7
Wholesale and retail	18	15
Financial and business services	18	15
Transport and communications	*	7
Public administration	*	8

Source: IFF Research Ltd *Employers' Redundancy Practices* Labour Force Survey *sample size too small

Employees

12. Table 2 and the graph below show estimates of statutory redundancy payments due to employees per year, if they are made redundant. The figures are based on the numbers of employees who said that they had been made redundant⁴ over a one-year period and who had at least two years of service. To estimate statutory payments, we have used information on when employees started work with their employer and their weekly earnings. Estimates have been

⁴ Source: Labour Force Survey, from Summer 2003 to Spring 2004

disaggregated by age, so that some adjustment can be made to take into account the different characteristics of those being made redundant compared with all employees.

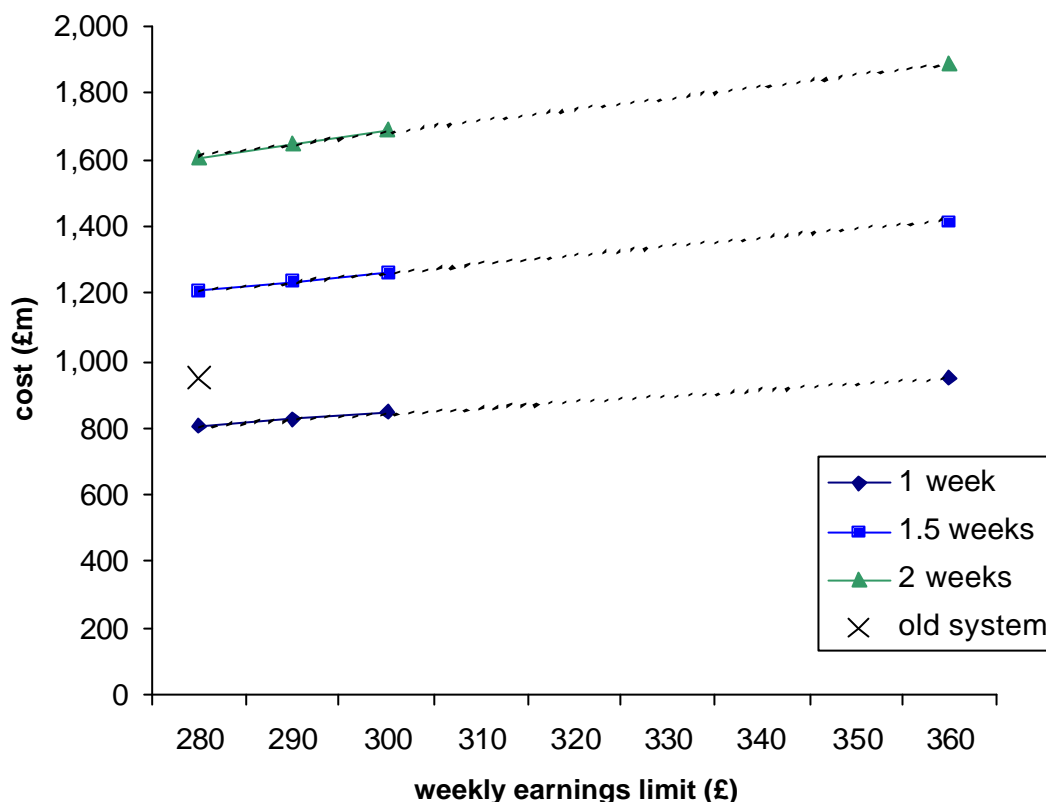
2. Estimates of statutory redundancy payments to employees

	£280 limit	£290 limit	£300 limit	£360 limit
Existing system	£950m			
1 week	£800m	£830m	£840m	£950m
1.5 weeks	£1,210m	£1,240m	£1,270m	£1,420m
2 weeks	£1,610m	£1,650m	£1,690m	£1,890m

13. The table gives estimates for the existing system, based on a statutory limit of £280 for a week's pay.⁵ The table also gives estimates of various options with different statutory limits and different number of weeks' pay for each year of service. The graph below allows estimates to be made of the payments that would be due under other options.

⁵ The minimum payment is currently calculated as follows: half a week's pay for each year of service between the ages of 18 and 21, one week's pay for each year of service between 22 and 40, and one-and-a-half week's pay between 41 and 65, in all cases with weekly pay subject to a maximum of £280 and the number of years of service to a maximum of 20.

Estimates of annual statutory redundancy payments to employees



14. If the minimum statutory redundancy payment is set at one week's pay per year of service whatever age that service occurred at, there will be the following effects:

- Employees with two years of service below the age of 20 will have the right to a redundancy payment of one week's pay or a maximum of £280 per year of service for the first time. According to the Labour Force Survey, this would affect a negligible number of people.
- Employees aged between 20 and 22 will see their statutory redundancy pay double.
- Employees aged between 23 and 41 will gain if they have been working for their employer since they were 21 or younger.
- Employees aged between 42 and 63 will see their entitlement fall, since their entitlement for service at ages 42 and over will fall from one-and-a-half to one week.
- Employees aged 64 will no longer see their entitlement reduced by a twelfth every month till they are 65, but this will

be offset by the fact they will only get one week's pay instead of one-and-a-half per year of service.

- Employers aged 65 and above will have the right to statutory redundancy payments for the first time. However, if it is decided to have a default retirement age and/or to allow firms to set their own mandatory retirement ages (that they will have to justify), then some employers might make use of the DRA/EJRA provisions to retire their staff instead of making them redundant to avoid paying redundancy pay. However, our "planned retirement" approach aims to ensure that this does not happen. According to the Labour Force Survey, a negligible number of people say they are made redundant at age 65 and over. This is likely to benefit between about 1,700 and 7,700 employees by about £2.4 million to £10.4 million each year (based on a formula of one weeks pay per year of service and a limit of £280).⁶

Impact on employers

15. Any changes to statutory redundancy payments could have an impact on employers, depending on their circumstances:

- Those who pay the statutory minimum will in theory have to pay a different amount to their employees.
- This might not be the case for those who are unable to make redundancy payments either in part or in full because of insolvency. In which case the Exchequer may have to pay part or all of the payments due.
- Those who currently pay over the new statutory minimum will not be directly affected, but may increase their payment anyway.

16. Evidence suggests that a substantial number of employers (maybe 50 per cent) pay over the statutory minimum.⁷

⁶ The numbers benefiting depends on whether the redundancy rate for those aged 65 and over is the same as it is today (about 0.5 per cent) or the same as other age groups (about 2.4 per cent). With the legislative change it is likely that the redundancy rate could rise towards the latter.

⁷ The current mean statutory minimum redundancy payment (based on the Labour Force Survey) is estimated at about £2,200. The Family Resources Survey 2002-03, suggests a median actual redundancy payment of £5,000, based on a sample size of 452. A report by IFF Research Ltd. for the Department of Trade and Industry in 2001 found that 48% of employers made some improvement to the statutory entitlement for at least one employee made redundant. Of these, 77% offered an improvement to all employees, and 23% to just some of their employees. The sample size was 1,085. The 2002 Survey on redundancy by the CIPD found that 72% of employers paid redundancy compensation above the statutory minimum. The CIPD report was based on a sample size of 563, but was heavily biased towards larger firms, which according to the IFF report, are more likely to pay redundancy pay above the statutory minimum.

17. Normally, statutory redundancy payments are paid by employers direct to redundant employees. However, if employers fail to do so⁸ the Insolvency Service (IS) pays employees from the National Insurance Fund on employers' behalf. In 2003/04, the IS spent about £120 million on statutory redundancy payments. This is about 13 per cent of our estimate of the total amount due to employees of around £920 million.

18. Based on this information and what we know about the proportion of employers who pay over the statutory minimum, employers will probably have to bear between 43.5 and 87 per cent of the changes to the scheme.

19. Table 3 shows how much this will cost or benefit employers for different options each year. A positive sign indicates that employers will gain and a negative sign indicates that they will lose. The cost to employers of lifting the age limit of 65 will lie between £1 million and £9.5 million each year (based on one week's pay per year of service and a limit of £280 for a week's pay).⁹

3. Impact on employers of various options compared with doing nothing

	Low (43.5 per cent)			High (87 per cent)		
	1 week	1.5 weeks	2 weeks	1 week	1.5 weeks	2 weeks
£280	+£61m	-£115m	-£288m	+£123m	-£227m	-£577m
£290	+£53m	-£127m	-£306m	+£105m	-£253m	-£612m
£300	+£44m	-£139m	-£323m	+£89m	-£279m	-£646m
£360	£0m	-£206m	-£412m	£0m	-£412m	-£823m

20. Most employers, even those who have a redundancy agreement, may not incur any additional costs in becoming aware of the legislation, as they would probably do so on an 'as needs' basis, whatever the formula.

21. It may be that some employers have automated payroll systems that include paying statutory minimum redundancy payments and that these would need changing. We do not have any information on the extent of these systems, nor what the cost would be of updating these systems.

22. Employers and unions have also highlighted to us that there may be extra costs in negotiating agreements over the statutory minimum, due to lack of familiarity of the new system. We do not have any evidence on the extent contractual redundancy agreements that set out how much above the statutory minimum employers would pay.¹⁰ It is

⁸ For instance, due to insolvency or financial difficulty.

⁹ This is included in the costs in Table 3 and is calculated as 43.5% x £2.4m to 87% x £10.4m.

¹⁰ Although informal consultation with employers have shown us that they do exist and case studies suggest that this is not unusual. For evidence of the latter see IDS Studies Plus Personnel policy and practice (2001) *Managing redundancy* Income Data Services Ltd.

likely, however, that some employers and unions or staff representative who have contractual arrangements in place or who have established some precedent for what is an acceptable improvement on the statutory minimum, will have to renegotiate in the light of the new formula. We do not attempt to quantify this.

Exchequer

23. The Insolvency Service pays employees where employers are insolvent or otherwise unable to pay statutory redundancy pay. Table 4 shows estimates of costs to the IS of different options, based on past patterns of claims.

4. Estimates of statutory redundancy payments to be paid by the Exchequer compared with existing system

	£280 limit	£290 limit	£300 limit	£360 limit
1 week	-£18m	-£16m	-£13m	£0m
1.5 weeks	+£34m	+£38m	+£41m	+£61m
2 weeks	+£86m	+£91m	+£96m	+£122m

24. In addition, the statutory limit is also applied to other payments such as unpaid wages, notice pay and outstanding holiday pay. We have estimated this by taking the amount paid out in 2003/04 and increasing this by the percentage change to statutory redundancy payments resulting from changes to the limit. The amount paid in 2003/04 for payments excluding statutory redundancy payments was about £119 million. The impact of changes to these as a result of changes to the formula for statutory redundancies are in Table 5.

5. Estimates of increase payments by the Exchequer for other categories (not including statutory minimums)

	£280 limit	£290 limit	£300 limit	£360 limit
Comparison with 2004/05	£0m	£3.0m	£6.0m	£21.4m

25. The computer system used to process these payments will need to be reprogrammed in light of the changes in the scheme. It is estimated that this will cost up to £100,000. This is an implementation cost.

Economy

26. Changes to statutory redundancy payments are essentially changes to transfers between different sectors of the economy (individuals, firms and the Exchequer). Therefore there will be no direct impact on the economy, with the exception of implementation costs. There may, however, be indirect effects, in so far as the policy aids the transition of different groups back into work, or promotes a sense of security and commitment while employed. Given that the changes to the scheme are relatively marginal, and that many employers pay over

the statutory minimum, we do not expect the changes to have a significant effect on the economy.

Equity and fairness

27. Revising the formula used to calculate statutory redundancy payments, so that it does not depend on age, will mean that workers are not discriminated on the basis of age in this area. Options that increase the number of weeks pay per year of service that redundancy pay is based on will benefit all workers. However, although lower paid workers would see the same proportional increase as higher paid workers, their absolute increase would be lower. Options that increase the statutory limit will benefit those who earn over that limit.

Small Firm Impact Test

28. The legislation will impact on all firms. Small workplaces are much less likely to say that they have made redundancies in the last year.¹¹ It is likely that small employers will be less affected by any changes to the legislation.

Competition Assessment

29. The legislation applies to all firms. We have applied the Competition Filter and have concluded that there will be negligible impact on competition (see Annex).

Enforcement and sanctions

30. Enforcement will be, as is currently the case, through the tribunal system. We do not envisage an increase in the number of claims made to Employment Tribunals as a result of this legislation.

Consultation

31. The Department of Trade and Industry has consulted both formally and informally, on changes to the statutory redundancy payments scheme. In the formal consultation in 2003, it asked a number of questions about the age-based elements of the scheme, as well as the retention of length of service as a factor in the payment calculation and the retention of the 20 year limit. The responses broadly showed support for removing the age-based elements of the scheme and support for the retention of using length of service as a factor and for the 20 year limit. Informal consultation has shown some concern from

¹¹ Source: Tables 32 and 17 of IFF Research (unpublished) *Employers' Redundancy Practices* Department of Trade and Industry. Of workplaces with 5-24 and 25-99 employees, 4 and 16 per cent, respectively, said that they had made redundancies in the last 12 months, compared with 37 and 50 per cent for those with 100-499 and 500 and over employees, respectively.

business about removing the limit of 65 years, which was not asked about in the formal consultation.¹²

Monitoring and review

32. Monitoring will be required to check on the impact of the new rules on employers and on employees. The DTI undertook a survey in 2000/01 which asked about employers' redundancy practices, looked at the demographics of employees who were made redundant and sought views of the statutory scheme. We envisage repeating this survey three to five years after the new legislation is in place. Statistics will also be collected on an annual basis from the IS to monitor the number of claims made where employers have been unable to pay the statutory minimum. The Department will also monitor on a quarterly basis the number of claims to Employment Tribunals that are related to redundancy payments.

Summary and recommendation

33. This RIA considers a number of options for changing the formula used to calculate statutory minimum redundancy payments. The impact on firms, employers and the Exchequer are summarised for three of the options only for the sake of clarity in Table 5.

5. Summary of costs and benefits of changes to the formulae for statutory minimum redundancy payments compared with doing nothing

		Annual benefits (£m)	Annual Costs (£m)	Implementation Costs (£m)
£280 limit 1 week	Firms	£61-123m		
	Individuals		£150m	
	Exchequer	£18m		£0.1m
£280 limit 2 weeks	Firms		£288-577m	
	Individuals	£660m		
	Exchequer		£86m	£0.1m
£360 limit 1 week	Firms	£0m	£0m	
	Individuals	£0m	£0m	
	Exchequer	£0m	£21m	£0.1m

¹² For details of the formal consultation in 2003, called *Equality and Diversity: Age matters*, and the results of the consultation see <http://www.dti.gov.uk/er/archive.htm>. Key results of the 2003 consultation with respect to statutory redundancies are given Chapter 7.

Competition Filter

Competition Filter	
Question	Answer
1. In the market(s) affected by the new regulation, does any firm have more than 10% market share?	No
2. In the market(s) affected by the new regulation, does any firm have more than 20% market share?	No
3. In the market(s) affected by the new regulation, do the largest three firms together have at least 50% market share?	No
4. Would the costs of the regulation affect some firms substantially more than others?	No
5. Is the regulation likely to affect the market structure, changing the number or size of firms?	No
6. Would the regulation lead to a higher set-up costs for new or potential firms that existing firms do not have to meet?	No
7. Would the regulation lead to higher ongoing costs for new or potential firms that existing firms do not have to meet?	No
8. Is the sector characterised by rapid technological change?	Not relevant
9. Would the regulation restrict the ability of firms to choose the price, quality, range or location of their products?	No

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