EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSIONS (REVALUATION) ORDER 2022

2022 No. 1229

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 This instrument sets out the minimum required level of revaluation for pension rights (excluding Guaranteed Minimum Pensions) of people who were early leavers from defined benefit final salary occupational pension schemes, on or after 1 January 1986, where the accrued rights have been left in the scheme. This is referred to as an individual's preserved pension. The instrument is also used for the purpose of providing the minimum amount by which pensions in payment, that were accrued in private sector defined benefit schemes, must be increased for one year.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is Great Britain.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is Great Britain.

4.3 The Department for Communities in Northern Ireland will be producing its own legislation replicating the effect of this Order for Northern Ireland.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 The Secretary of State is required by law to make[1] and lay an Order each year which sets out the minimum required level of revaluation for preserved pensions in final salary occupational pension schemes, for members who reach their scheme's normal pension age during the following calendar year (in the case of this Order between 1 January 2023 and 31 December 2023).

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[1] Sections 83 and 84 of, and paragraph 2 of Schedule 3 to, the Pension Schemes Act 1993 https://www.legislation.gov.uk/ukpga/1993/48/contents

6.2 Under sections 51 and 51ZA of the Pensions Act 1995 the Order is also used for the purpose of providing the minimum amount by which pensions in payment, accrued in private sector defined benefit schemes, must be increased for one year.

7. Policy background

What is being done and why?

7.1 In a final salary scheme, if a person has been a member of the scheme for at least 2 years before they leave the scheme, they become what is known as a 'deferred member' of the scheme. Deferred members of a final salary scheme receive a measure of protection against the effects of inflation from the date they leave that scheme until pension age. Deferred members of other types of defined benefit schemes generally receive any increases they would have received as if they had remained active members of the scheme.

7.2 The member's accrued rights remaining in the scheme are known as a preserved pension. Due to inflation, that pension is likely to have lost value by the time that it is put into payment. Revaluation provisions, which were introduced for those who left schemes after 1 January 1986, are designed to provide a measure of protection against inflation where there is at least one full year between the member leaving the scheme and the member reaching the normal pension age.

7.3 This Order sets out the revaluation required (for that part of a pension in excess of the Guaranteed Minimum Pension rights) for people who will reach their scheme's normal pension age in 2023.

7.4 Pensions based on pensionable service before 6 April 2009 must be increased at least in line with the increase in the general level of prices over the whole period of deferment or 5 per cent compound per annum, whichever is lower. The Pensions Act 2008[2] reduced the 5 per cent compound per annum to 2.5 per cent compound per annum for pensions based on service from 6 April 2009, though schemes may continue to use the higher cap under scheme rules. The Order provides for both rates.

7.5 The primary legislation[3] requires the Secretary of State to form a judgement of the general increase in prices over the relevant inflation reference periods (ending on the 30 September) in making the Order. Since 2010, the Secretary of State has considered the Consumer Price Index (CPI)[4] to be the most appropriate measure of inflation and CPI has again been used for the last 12 months' inflation reference period. The judgement of inflation already made for the purposes of annual Orders up to and including the 2009 Order, which were based on the Retail Prices Index (RPI) measure of inflation, will not change. This means that the revaluation percentages for periods in the last thirteen years are based exclusively on CPI whereas the percentages for longer periods are based on RPI for all but the last thirteen years of the relevant period.

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[2] Pensions Act 2008 https://www.legislation.gov.uk/ukpga/2008/30/contents

[3] Sections 83 and 84 of, and paragraph 2 of Schedule 3 to, the Pension Schemes Act 1993 https://www.legislation.gov.uk/ukpga/1993/48/contents

[4] Consumer price inflation, UK - Office for National Statistics

7.6 Legislation requires people who left pensionable service on or after 1 January 1991 to have all preserved rights revalued, including pre-1986 service. Similarly, those people with all their pensionable service falling on, or after, 1 January 1985 will have all of their preserved rights revalued. People who left between 1 January 1986 and 31 December 1990 have a right to a revaluation only of the rights accrued from pensionable service on or after 1 January 1985.

7.7 The following example shows how revaluation works: A person leaves employment that is relevant to the pension scheme in April 1997. When they leave, the pension rights they have accrued in their occupational pension scheme are preserved within the scheme. At the time they leave in 1997 the value of their pension is £30 per week. In May 2023, the person reaches the normal pension age of their former scheme and is therefore entitled to a pension. Before the pension is put into payment, the scheme will revalue it using the appropriate percentage from the Order. For a person whose pension is subject to the higher revaluation rate and has been deferred for 26 years the appropriate percentage is 99.3 per cent. (No revaluation applies for part years.) The original amount of the pension, £30, will therefore be uplifted by this percentage to give a new pension entitlement of £59.79 per week.

7.8 Legislation[5] also sets out the minimum amount by which private sector defined benefit pensions in payment must be increased each year. This provides a measure of protection against inflation for members who are in receipt of their pensions, as inflation can erode the value of their pensions over time. Indexation provisions were introduced in 1997.

7.9 As a minimum, pensions put into payment before 6 April 2005 must be increased by the increase in the general level of prices with a cap of 5 per cent. Pensions taken on or after 6 April 2005 must, as a minimum, be increased by the increase in the general level of prices with a cap of 5 per cent where the rights were accrued between 6 April 1997 and 5 April 2005 and a cap of 2.5 per cent where the pension rights were accrued on or after 6 April 2005. The figures to be used for indexation are those given for the one-year revaluation period in the annual Revaluation Order. Schemes can choose to pay a higher level of indexation than the statutory minimum.

7.10 The CPI figure for the year to 30 September 2022 was 10.1 per cent. [6]

7.11 With the rate of inflation being higher than the revaluation caps, the revaluation rate will be 2.5 per cent or 5 per cent where relevant. Similarly, the indexation rate derived from this order will be 2.5 per cent, or 5 per cent where relevant.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.[7]

[5] Sections 51 and 51ZA of the Pensions Act 1995 https://www.legislation.gov.uk/ukpga/1995/26/contents

[6] Consumer price inflation, UK - Office for National Statistics

[7] European Union (Withdrawal) Act 2018 https://www.legislation.gov.uk/ukpga/2018/16/contents

9. Consolidation

9.1 The Order applies to the 12 months commencing 1 January 2023. It will be followed by a new Order which will apply to the next calendar year. There is therefore no need for consolidation.

10. Consultation outcome

10.1 Primary legislation requires the Secretary of State to make an Order each year, coming into force on 1 January, based on their judgement of the increase in the general level of prices up to the immediately preceding 30 September.

10.2 A consultation is not required because there is no scope for a consultation to influence the outcome of this annual Order. The Order does not amend other legislation.

11. Guidance

11.1 If applicable, occupational pension schemes have procedures in place to implement the revaluation and indexation increases. The Occupational Pensions (Revaluation) Order 2022, coming into effect from 1 January each year, provides schemes with the necessary percentages to use to calculate deferred pensions for members reaching the scheme's normal pension age in that year and the necessary percentage for indexing pensions in payment where relevant. Therefore, no further guidance is required.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A full Impact Assessment has not been prepared for this instrument because there is no new impact on pension schemes in the private sector, as they are already required by law to provide protection against inflation.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses as the Order applies to all final salary occupational pension schemes.

13.2 The Order has a negligible administrative impact on business. It is not possible to mitigate the impact of the requirements on small business without an adverse effect on scheme members.

14. Monitoring & review

14.1 A further Order will be made in 12 months' time, as the primary legislation requires a new Order annually to reflect updated inflation figures.

15. Contact

15.1 Molly Adcock at the Department for work and Pensions email: molly.adcock@dwp.gov.uk can be contacted with any queries regarding the instrument.

15.2 Fiona Frobisher, Deputy Director for Defined Benefit Pensions Policy, at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.3 Laura Trott at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.