EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSIONS (REVALUATION) ORDER 2010

2010 No. 2861

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

2. Purpose of the instrument

This instrument sets out the percentages by which preserved pensions are to be revalued in final salary occupational pension schemes.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

The Secretary of State is required by law to lay an Order each year which sets out the minimum required level of revaluation for pension rights (excluding guaranteed minimum pensions) of people who were early leavers from final salary occupational pension schemes on or after 1 January 1986 where the accrued rights have been left in the scheme.

5. Territorial Extent and Application

This instrument applies to Great Britain.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

7.1 Sections 83 to 86 of, and Schedule 3 to, the Pension Schemes Act 1993 provide for preserved pension rights to be revalued. The revaluation provisions, first introduced in the Social Security Act 1985, are designed to protect early leavers from the effects of inflation. The requirement applies to rights of members who leave pensionable service on or after 1 January 1986 where there is at least a year between the date of leaving and the member attaining their scheme's normal pension age.

7.2 The Order sets out the revaluation required (over and above guaranteed minimum pension rights) for people who will reach their scheme's normal pension age in 2011.

7.3 For preserved pension based on pensionable service carried out before 6 April 2009, the increase must be at least in line with the increase in the general level of prices over the whole period of deferment or 5% compound per annum whichever is the lower. The Pensions Act 2008 reduced the 5% 'cap' to 2.5% compound per annum for pension based on service from 6 April 2009, though schemes may continue to use the higher cap under scheme rules.

7.4 The primary legislation (in particular, paragraph 2 of Schedule 3 to the Pension Schemes Act 1993) requires the Secretary of State to form a judgment of the general increase in prices over the relevant inflation reference periods (ending on the latest 30 September) in making the Order. The Secretary of State considers the Consumer Prices Index (CPI) to be the most appropriate measure of inflation for the latest 12 month inflation reference period. The judgment of inflation already made for the purposes of previous annual orders, based on the Retail Prices Index (RPI) measure of inflation, will not change however. This means that the revaluation percentage for the one-year period is based exclusively on CPI whereas the percentages for longer periods are based on RPI for all but the last 12 months of the relevant period.

7.5 People who left pensionable employment on or after 1 January 1991 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 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.

7.6 An example of revaluation follows. A person leaves an employment in 1997. When he leaves, the pension rights he has accrued in his occupational pension scheme are preserved within the scheme. At the time he leaves in 1997 the value of his pension is £30 per week. In 2011, the person reaches the normal pension age of his 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 who ceased pensionable service in 1997 the appropriate percentage is 39.4%. (No revaluation applies for part years, so the revaluation period starts from 1 January 1998.) The original amount of the pension, £30, will therefore be uplifted by this percentage to give a new pension entitlement of £41.82.

Consolidation

7.7 The Order has effect for the 12 months commencing 1 January 2011. It will be replaced by a new Order to take effect for the following calendar year. There is therefore no need for consolidation.

8. Consultation outcome

As explained above, primary legislation requires the Secretary of State to make an Order each year, coming into force on 1 January, based on his judgment of the increase in the general level of prices up to the immediately preceding 30 September. As there is no scope for consultation to affect the outcome of this annual Order, no consultation is undertaken. The Order does not amend other legislation.

9. Guidance

The latest revaluation Order comes into effect from 1 January each year and all occupational pension schemes have procedures in place to implement the relevant revaluation increases. No guidance is therefore necessary.

10. Impact

A full impact assessment is not required for this instrument as it amends an existing regulatory regime by a pre-determined formula. However, a draft impact assessment of the Government's decision to use the CPI rather than the RPI as the best measure of inflation for indexation and revaluation of private sector occupational pensions will be published in conjunction with a public consultation paper covering proposals for legislation in connection with this decision. This will be available online at: http://www.dwp.gov.uk/consultations/

11. Regulating small business

11.1 The Order applies to all final salary occupational pension schemes in amending an existing regulatory regime by a pre-determined formula.

11.2 It is not possible to minimise the impact of the requirements on firms employing up to 20 people without an adverse effect on scheme members.

12. Monitoring & review

This Order will be replaced in 12 months' time, as the primary legislation requires, by a new Order reflecting updated inflation figures.

13. Contact

Tim Found at the Department for Work and Pensions Tel: 020 7449 7375 or email: tim.found@dwp.gsi.gov.uk can answer any queries regarding the instrument.