EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSIONS (REVALUATION) ORDER 2024

2024 No. 1174

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. Declaration

2.1 Emma Reynolds, Minister for Pensions at the Department for Work and Pensions, HM Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Sam Hainsworth, Deputy Director of Defined Benefit Pensions Policy at the Department for Work and Pensions, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Gabrielle Park at the Department for Work and Pensions, email: Gabrielle.e.Park@dwp.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 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 accrued rights have been left in the scheme. This is referred to as an individual's preserved pension.

4.2 The instrument is also used for the purpose of providing the minimum amount that pensions in payment, accrued in private sector defined benefit schemes, must be increased for one year.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England, Scotland and Wales.

4.4 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England, Scotland and Wales.

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

5. Policy Context

What is being done and why?

Revaluation

5.1 In a final salary occupational pension scheme, if a person has been a member of the scheme for at least two years when they leave the scheme (or less if stated in scheme rules), they become what is known as a 'deferred member' of the scheme. Deferred members of a final salary scheme generally receive a measure of protection against the effects of inflation on their pension from the date they leave that scheme until normal 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.

5.2 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.

5.3 Revaluation of rights that were accrued before 6th April 2009 must be increased at least in line with the general level of inflation up to a cap of 5 per cent. The Pension Act 2008[1] reduced this cap to 2.5 per cent for rights that are accrued from 6th April 2009. However, many schemes chose to keep the 5 per cent cap. The Order provides for both rates.

5.4 The Pension Schemes Act 1993[2] requires the Secretary of State to form a judgement of the general increase in prices over the relevant inflation reference periods (ending on 30 September) in making the Order. Since 2010, the Secretary of State has considered the Consumer Price Index (CPI) to be the most appropriate measure of inflation, and the CPI has again been used for the last 12 months' inflation reference period. The Retail Prices Index (RPI) was used as the measure of inflation for the purposes of the annual orders up to and including the 2009 Order. At the time, RPI was the Government's preferred measure of inflation. The RPI, as the measure of inflation, used for revaluation up to and including 2009 will not change. This means that the revaluation percentages for periods in the last 15 years are based on the CPI. For members whose service includes periods more than 15 years ago, their percentage will be based on the CPI for the last 15 years and the RPI for years before that.

5.5 Legislation requires people who left pensionable service on or after 1 January 1991 to have all preserved rights revalued, including pre-1986 service. Pensionable service is the period of service in a defined benefit scheme used to calculate a member's pension or other benefits. Similarly, those people who left pensionable service between 1 January 1986 and 31 December 1990 where all their pensionable service falls on or after 1 January 1985 will have all their preserved rights revalued. People with pre-1985 service who left pensionable service 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.

[1] https://www.legislation.gov.uk/ukpga/2008/30/contents
[2] https://www.legislation.gov.uk/ukpga/1993/48/contents

5.6 This Order sets out the revaluation required (for that part of a pension more than the Guaranteed Minimum Pension rights) for people who will reach their scheme's normal pension age in 2025.

5.7 The Revaluation Order includes a table that sets out the higher revaluation percentages and lower revaluation percentages cumulatively, for each year of leaving a scheme from 1986 onwards.

5.8 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. When they left in 1997, the value of their pension was £30 per week. They reach the scheme's normal pension age in May 2025, and therefore become entitled to a pension. Before the pension is put into payment, the scheme is required to revalue it using the appropriate percentage from this Order. For someone whose pension is subject to the higher revaluation rate and has been deferred for 28 years (1997- 2025), the appropriate percentage is 116.2 per cent, meaning that the original £30 would have been uplifted to £64.86 per week. No revaluation applies to part years.

Indexation

5.9 The Pensions Act 1995[3] requires the Secretary of State to set the statutory minimum indexation increases for private sector defined benefit occupational pensions in payment. Occupational pensions in payment that were built up between 1997 and 2005 are required to be increased by the rate of inflation as a minimum, but capped at 5 per cent. Pension rights accrued after April 2005 are capped at 2.5 per cent. 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. Although schemes must provide at least the statutory minimum, schemes can choose to provide more generous increases. Indexation provisions were introduced in 1997 (except for existing Guaranteed Minimum Pension rights).

5.10 This Order therefore also sets out the minimum amount by which pensions in payment, accrued in private sector defined benefit schemes, must be increased for the following calendar year. The figures to be used for indexation are those given for the one-year revaluation period in the Order.

The Order

5.11 The Consumer Price Index (CPI) figure for the year to 30 September 2024 was 1.7 per cent[4].

5.12 With the rate of inflation, as measured by CPI for the year to 30 September 2024, being lower than the revaluation caps, the revaluation rate for the following calendar year will be 1.7 per cent where relevant.

5.13 Similarly, the indexation rate derived from this Order will be 1.7 per cent where relevant.

What was the previous policy, how is this different?

5.14 This is an annual order setting out the minimum required levels of revaluation and indexation that must be applied. The policy is unchanged.

[3] https://www.legislation.gov.uk/ukpga/1995/26/contents
[4] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/september2024

5.15 The Secretary of State is required by the Pension Schemes Act 1993 and the Pensions Act 1995 to make and lay an Order each year which sets the minimum required levels of revaluation and indexation. The legislation prescribes how those rates are to be determined.

6. Legislative and Legal Context

How has the law changed?

6.1 The Secretary of State is required by the Pensions Act 1993 to make and lay an Order each year which sets out the minimum required level of revaluation for preserved pensions in final salary occupational pension schemes. The Order applies to members who reach their scheme's normal pension age during the following calendar year (in the case of this Order between 1 January 2025 and 31 December 2025).

6.2 Under sections 51[5] and 51ZA[6] 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.

6.3 The Order does not change the legal requirement that preserved pensions in final salary occupational pension schemes must be revalued. The Order simply sets out the minimum required level of revaluation on the relevant preserved rights which must be applied to members who reach their scheme's normal pension age during the following calendar year. The Order also sets out the required minimum level of indexation for one year for members of private sector defined benefit schemes.

Why was this approach taken to change the law?

6.4 The law has not been changed. The Order fulfils the Secretary of State's obligation to make and lay an annual Order setting out the minimum required levels of revaluation and indexation, to ensure that members have an element of protection against the effects of inflation on their pension rights.

7. Consultation

Summary of consultation outcome and methodology

7.1 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 preceding 30 September. Therefore, there is not a requirement for a consultation to take place.

8. Applicable Guidance

8.1 If applicable, occupational pension schemes have procedures in place to implement the revaluation and indexation increases. The Occupational Pensions (Revaluation) Order, 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.

[5] https://www.legislation.gov.uk/ukpga/1995/26/section/51
[6] https://www.legislation.gov.uk/ukpga/1995/26/section/51ZA

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 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.

Impact on businesses, charities and voluntary bodies

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

9.3 There is no, or no significant, impact on small or micro businesses.

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

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The Secretary of State is required to make a new Order in 12 months' time which will supersede this Order.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

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

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").