EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY REVALUATION OF EARNINGS FACTORS ORDER 2014

2014 No. 367

THE SOCIAL SECURITY PENSIONS (LOW EARNINGS THRESHOLD) ORDER 2014

2014 No. 368

THE SOCIAL SECURITY PENSIONS (FLAT RATE ACCRUAL AMOUNT) ORDER 2014

2014 No. 369

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 Instruments

2.1 The Social Security Revaluation of Earnings Factors Order ('the Revaluation Order') is made each year to revalue historic earnings factors in line with the movement in average earnings.

2.2 The Social Security Pensions (Low Earnings Threshold) Order ('the LET Order') is made each year to set the low earnings threshold for additional state pension.

2.3 The Social Security Pensions (Flat Rate Accrual Amount) Order ("the FRAA Revaluation Order") provides for the annual flat rate accrual amount to be increased in line with average earnings. The FRAA was introduced from April 2012.

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

None.

4. Legislative Context

4.1 When entitlement to additional state pension (SERPS/State Second Pension) is calculated the earnings on which it is based need to be revalued in line with earnings growth. The percentages set out in the Revaluation Order will be used for revaluing earnings factors for additional state pensions in tax years 2013/14 and earlier tax years.

4.2 The low earnings threshold was first used when State Second Pension was introduced in 2002. The Secretary of State is required to make an annual order increasing the low earnings threshold if he concludes that the general level of earnings has increased since the last review. This yearly LET Order is being made to effect the annual up-rating of the low earnings threshold for 2014/15.

4.3 The FRAA was introduced from April 2012 in SI 2011/2953[1] and the initial rate was set in SI 2012/189[2]. The FRAA Revaluation Order is being made to set the value of the FRAA from 6 April 2014.

---

[1] The Social Security Pensions (Flat Rate Introduction Year) Order 2011 at http://www.legislation.gov.uk/uksi/2011/2953/pdfs/uksi_20112953_en.pdf

[2] The Social Security Pensions (Flat Rate Accrual Amount) Order 2012 at http://www.legislation.gov.uk/uksi/2012/189/pdfs/uksi_20120189_en.pdf

5. Territorial Extent and Application

These instruments apply to Great Britain. Equivalent provision in relation to Northern Ireland will be made by statutory rule.

6. European Convention on Human Rights

As these instruments are subject to the negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

The Revaluation of Earnings Factors Order

7.1 Earnings factors are the formulae for converting flat-rate and earnings-related National Insurance contributions into entitlement to flat rate and earnings-related benefits, and for calculating earnings-related entitlement over a person's working life. They are derived from earnings upon which primary Class 1 contributions are paid, or treated as paid, and from Class 2 and Class 3 contributions paid[3]. For years from 2002/03 onwards additional pension accrues on primary Class 1 contributions only. Carers and disabled people entitled to certain benefits are treated as having an earnings factor for these purposes.

7.2 Each year the earnings factors derived in each previous year since the additional state pension was introduced in 1978/79 are revalued in line with the movement in average earnings. This annual revaluation exercise allows earnings factors derived from historic earnings to be restated at current values as part of the calculation of new pensioners' entitlement to additional pension under both the State Earnings-Related Pension Scheme (SERPS) and the State Second Pension. Earnings factors are also used to calculate the Guaranteed Minimum Pension for early leavers and retired persons in contracted-out salary-related pension schemes.

7.3 Revaluations have been calculated by reference to the change in earnings over the period of 12 months up to the end of September. This allows sufficient time for the resulting Order to be made before the beginning of the tax year in which it is to apply.

7.4 During the period between September 2012 and September 2013, the Office for National Statistics' Average Weekly Earnings statistic September year-on-year change (non-seasonally adjusted, including bonuses)[4] showed that average earnings in Great Britain increased by 0.9 %.

7.5 The Revaluation Order therefore provides for earnings factors for 2013/14 to be increased and for earnings factors for earlier tax years to also be increased by percentages which reflect, in addition, the increases provided for by previous Orders. The Order also makes provision for the rounding of earnings factors to the nearest whole pound for the purpose of calculating the additional pension element of any long-term benefit.

---

[3] Class 1 National Insurance contributions are paid by employed earners. Class 2 are paid by the Self-employed. Class 3 National Insurance contributions are voluntary contributions to make up gaps in a persons National Insurance contributions record.

[4] See table 6 NSAsect monthly growth ibia in EARN02: Average weekly earnings by sector at http://www.ons.gov.uk/ons/datasets-and-tables/index.html

The Low Earnings Threshold Order

7.6 The State Earnings-Related Pension Scheme (SERPS) was reformed with the introduction of the State Second Pension from 6 April 2002. An important aim of the reform was that additional resources should be targeted on low earners. Additionally, carers and some long-term disabled people unable to maintain a full work record due to their caring responsibilities and disabilities could build additional pension entitlement for the first time.

7.7 The following groups are treated as if they had earnings at the low earnings threshold (LET) for State Second Pension purposes:

- Qualifying carers.
- Qualifying disabled people.

7.8 Employees with earnings between the annual National Insurance lower earnings limit (LEL), the level at which a person's earnings become relevant for National Insurance purposes and the LET are, for the years until 2011/2012, treated for additional pension purposes as having earned at the higher LET level. From April 2012, earnings between the LEL and the LET, or those treated as having earnings at the LET accumulate accruals at the relevant flat rate.

7.9 The LET is £15,000 for the 2013/14 tax year. Each year the Secretary of State is obliged to review the level of average earnings and, where he sees fit, set the LET for the following year accordingly by Order.

7.10 Average earnings in Great Britain increased by 0.9 % (see paragraph 7.4). This means that, with rounding, the threshold is increased to £15,100 for the 2014/15 tax year. The level of this threshold is set by the LET Order.

The FRAA Revaluation Order

7.11 Since 2002 the earnings-related part of the state pension - the additional state pension - effectively builds up at a flat rate for employees with annual earnings below the low earnings threshold. People with earnings below the threshold, carers and people with long term health conditions are credited with earnings at this level for the purposes of calculating their entitlement to the additional State Pension. For people with earnings above this level entitlement is based on the level of their earnings. So, when calculating a person's entitlement earnings are split into two bands i.e. earnings at or above the low earnings threshold.

7.12 When calculating additional state pension entitlement there are two further factors that make it difficult to determine a person's future entitlement. The first is the fact that there is no fixed period over which entitlement can build up. Entitlement is based on the number of years in a person's working life since 1978 so differs for each successive group of pensioners. Secondly, entitlement builds up at different rates depending on the period covered and, since 2002, the amount a person earns. Earnings in the first band, until April 2012 build up at four times the rate of earnings in the second band - 40 and 10 per cent respectively.

7.13 Measures introduced in the Pensions Act 2007 to reform the state pension system sought to replace, from April 2012 entitlement in the first earnings band with a single cash amount, the flat rate accrual amount. This was intended to fix the pension accrued by those with earnings in that band making it easier for a person to determine their future state pension entitlement.

7.14 The flat rate accrual amount was introduced from the start of the 2012/13 tax year and initially set at £88.40.

7.15 Each year the Secretary of State is obliged to review the level of average earnings and, where he sees fit, set the FRAA for the following year accordingly by Order.

7.16 Average earnings in Great Britain increased by 0.9 % (see paragraph 7.4). This means that, the current annual FRAA of £91 will be revalued and rounded to the nearest pound to give a new annual FRAA for April 2014 of £92. This amount is set by the FRAA Order. The weekly flat-rate amount will be £1.77, rounded to the nearest penny.

Consolidation

7.17 As these instruments do not amend other instruments the question of consolidation does not arise.

8. Consultation outcome

Consultation on these Orders is not appropriate.

9. Guidance

Leaflets, guidance and information on our websites will be up-dated to reflect the new figures as part of the yearly leaflet review covering the annual uprating in April.

10. Impact

10.1 These instruments have no impact on business or civil society.

10.2 The impact on the public sector is negligible.

10.3 An impact assessment has not been produced for these instruments.

11. Regulating small business

These instruments have no new impact on the costs of small business.

12. Monitoring and review

The position is subject to review each tax year.

13. Contact

Angela Relf at the Department for Work and Pensions Tel: 020 7449 5997 or e-mail: angela.relf@dwp.gsi.gov.uk can answer any queries regarding these instruments.