EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY REVALUATION OF EARNINGS FACTORS ORDER 2025

2025 No. 255

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

2.2. Cathy Payne, Deputy Director for State Pensions, at the Department for Work and Pensions confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1. Peyton Robinson at the Department for Work and Pensions email: londoncaxtonhouse.statepensionsenquiries@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. Under section 148 of the Social Security Administration Act 1992[1], the Secretary of State is required, in each tax year, to review the general level of earnings in Great Britain. If it appears to the Secretary of State that earnings factors used in the calculation of additional State Pension[2] (also known as the State Earnings Related Pension Scheme (SERPS) and State Second Pension (S2P)) and Guaranteed Minimum Pensions (GMPs) for previous tax years from 1978/79 have not maintained their value in relation to the general level of earnings, the Secretary of State is required to make an order to increase those earnings factors to make up that fall in their value. This instrument (referred to in this Memorandum as the "Revaluation Order") is being made to fulfil that requirement.

Where does the legislation extend to, and apply?

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

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

[1] https://www.legislation.gov.uk/ukpga/1992/5

[2] Additional State Pension (AP) was introduced from 6 April 1978. It was intended to provide an earnings-related element to the basic State Pension for those without access to an occupational pension scheme.

5. Policy Context

What is being done and why?

5.1. For the purposes of additional State Pension (referenced at paragraph 5.3) and Guaranteed Minimum Pensions (GMPs) (referenced at paragraph 5.10), "earnings factors" represent the amount of earnings on which relevant National Insurance contributions have been paid or treated as paid over a person's working life from 1978/79 onwards. They are derived from earnings upon which primary Class 1 contributions have been paid or treated as paid. For the purpose of additional State Pension only, they are also derived from Class 2 and Class 3 contributions paid[3] between 1978/79 and 2002/03. From 2002/03, carers and disabled people entitled to certain benefits are treated as having a qualifying earnings factor for these purposes.

5.2. Earnings factors derived for each year from 1978/79 are revalued annually in line with the increase 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 a first award of a GMP (i.e. an award as calculated when someone first reaches GMP age – 60 for women and 65 for men) and additional State Pension. Once in payment additional State Pension is up-rated annually in line with the increase in the general level of prices[4]; any GMP accrued from April 1988 to April 1997 is up-rated by occupational pension schemes annually in line with the increase in the general level of prices subject to a cap of 3%[5].

<u>Additional State Pension</u>

5.3. Prior to 6 April 2016, the old State Pension comprised two tiers: the basic and additional State Pension. The additional State Pension was introduced in 1978 and is related to that part of the person's earnings factor which exceeds the level required for the basic State Pension. On 6 April 2016, the old State Pension was replaced by the new State Pension for people reaching State Pension age on or after that date. The new State Pension has no additional earnings-related element and as a result, there can be no further accruals of additional State Pension after 5 April 2016.

5.4. However, new awards of inherited additional State Pension are still possible after that date, payable as part of an old State Pension to a surviving spouse or civil partner who reached State Pension age before 6 April 2016 and whose deceased spouse or civil partner had reached, or would have reached, State Pension age after 6 April 2016[6].

5.5. In those circumstances, the inherited additional State Pension is based on the deceased's earnings factors and flat-rate accrual amounts of State Second Pension (S2P) up to and including 2015/16, revalued to the tax year immediately before the tax year in which they died or, if later, reached State Pension age. This is to ensure that earnings growth beyond 6 April 2016 is reflected in the survivor's inherited

---

[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 person's National Insurance contributions record. See section 22 of the Social Security Contributions and Benefits Act 1992: http://www.legislation.gov.uk/ukpga/1992/4/contents/enacted and section 14 of the Pension Schemes Act 1993: http://www.legislation.gov.uk/ukpga/1993/48.

[4] For example see the Social Security Benefits Up-rating Order 2024: https://www.legislation.gov.uk/uksi/2024/242/made

[5] For example see the Guaranteed Minimum Pensions Increase Order 2024: https://www.legislation.gov.uk/uksi/2024/243/contents/made

[6] Sections 48B and 51 of the Social Security Contributions and Benefits Act 1992: https://www.legislation.gov.uk/ukpga/1992/4/contents

additional State Pension, as it would have been had the new State Pension not been introduced.

Flat rate accruals of additional State Pension

5.6. From 2012/13, accruals of State Second Pension (S2P) on the first band of earnings[7] became flat-rate. Revaluation of the flat-rate amount was formerly made by reference to a separate Order (The Social Security Pensions (Flat Rate Accrual Amount) Order). The last such Order, made in 2015, reset the flat-rate amount at £93.60 for 2015/16.[8] From 6 April 2016, flat-rate amounts are increased by the percentage specified for 2015/16 in the Schedule to the Revaluation Order[9].

Shared additional pension

5.7. Where a pension sharing order has been made by the courts[10] in respect of a person's additional State Pension on divorce or dissolution of a civil partnership, the National Insurance record of the person whose additional State Pension is to be shared (the transferor) is noted with a debit and the record of the person who will benefit (the transferee) is noted with a credit. A state scheme pension debit becomes a weekly deduction from the transferor's State Pension when they reach State Pension age or, if later, when the pension-sharing order takes effect. State scheme pension credits give rise to a weekly State Pension for the transferee which becomes payable when they reach State Pension age or, if later, when the pension-sharing order takes effect.

5.8. Where the sharing order takes effect in a tax year earlier than the tax year before the one in which the person reaches State Pension age, the debit or credit is revalued. For this purpose, the relevant Revaluation Order is the last such order to come into force before the start of the tax year in which the person reaches State Pension age and the debit or credit is increased by the percentage specified in that Order for the year in which the share order took effect[11].

5.9. Additional State Pension is still shareable where either the transferor reached State Pension age before 6 April 2016 or the divorce or dissolution proceedings began before that date[12], and so revaluation is still required for old state scheme debits and credits which have not yet been activated.

Guaranteed Minimum Pension (GMP)

5.10. Between April 1978 and April 1997 employers sponsoring salary-related occupational pension schemes could "contract out" of the State Earnings Related Pension Scheme (SERPS) on condition that they provided members of the scheme with a pension of a statutory minimum (the Guaranteed Minimum Pension (GMP)). In return both the employer and employee paid reduced National Insurance contributions. Earnings

---

[7] In 2015/16, this band covered earnings (or deemed earnings) between £5,824 and £15,300 p.a.

[8] http://www.legislation.gov.uk/uksi/2015/185/contents/made

[9] See Article 2(5) of the Pensions Act 2014 (Consequential and Supplementary Amendments) Order 2016 (S.I. 2016/224): https://www.legislation.gov.uk/uksi/2016/224/made

[10] Or where the parties have entered a qualifying agreement in Scotland that makes provision corresponding to that which could be made by a pension sharing order; see section 48 of the Welfare Reform and Pensions Act 1999: http://www.legislation.gov.uk/ukpga/1999/30/contents

[11] Paragraph 2 of Schedules 8 (credits) and 10 (debits) to the Pensions Act 2014: http://www.legislation.gov.uk/ukpga/2014/19/contents

[12] See section 49 of the Welfare Reform and Pensions Act 1999 and Article 2 of the Pensions Act 2014 (Pension Sharing on Divorce etc.) (Transitional Provision) Order 2016 (S.I. 2016/39): http://www.legislation.gov.uk/uksi/2016/39/contents/made

factors calculated on the basis of Class 1 contributions paid in tax years 1978/79 to 1996/97 are used to calculate the amount of Guaranteed Minimum Pension (GMP) payable for that period.

5.11. Other than where an individual leaves a formerly contracted-out scheme before they reach GMP pensionable age[13] (60 for women, 65 for men), under section 16(1) of the Pension Schemes Act 1993[14] the earnings factors are revalued by the last Revaluation Order to come into force before the tax year in which the person reaches GMP pensionable age.

Revaluation Period and Increase

5.12. Revaluations are calculated by reference to the change in the general level of earnings in Great Britain over the period of 12 months up to the end of September[15]. This allows sufficient time for the resulting Order to be made before the beginning of the tax year in which it is to apply.

5.13. During the period between September 2023 and September 2024, the Office for National Statistics' Average Weekly Earnings statistics showed a year-on-year increase (non-seasonally adjusted, including bonuses, including arrears) in average earnings in Great Britain of 4.5 per cent.

5.14. The Revaluation Order accordingly provides for earnings factors for 2024/25 and earlier tax years to be increased by cumulative percentages which reflect this increase and in addition, the increases provided for by previous Orders under section 148[16].

What was the previous policy, how is this different?

5.15. This instrument fulfils a statutory requirement in Great Britain. Each tax year, the Secretary of State is required to review the general level of earnings. The revaluation process has been in place since 1979. There was no previous policy.

6. Legislative and Legal Context

How has the law changed?

6.1. The Social Security Revaluation of Earnings Factors Order is an annual order which fulfils a statutory duty on the Secretary of State. Section 148 of the Social Security Administration Act 1992 requires the Secretary of State to review changes in the general level of earnings each year and, if on review the Secretary of State concludes that the earnings factors for past years have not maintained their value in relation to the general level of earnings, to make an Order to increase those earnings factors to make up the fall in their value. The revaluation process has been in place since 1979 and is based on cumulative earnings growth since then.

[13] Where individuals leave before GMP pensionable age, a scheme may choose to revalue the GMP by a fixed rate, as provided by section 16(2) and (3) of the Pension Schemes Act 1993. The fixed rate method is based on an actuarial estimate of future earnings increases which is reviewed periodically and updated as appropriate based on advice by the Government Actuary's Department.

[14] http://www.legislation.gov.uk/ukpga/1993/48

[15] Under section 148(2)(a) Social Security Administration Act 1992, revaluations are calculated since the end of the period taken into account for the last review or such other date as the Secretary of State may determine. The last review took as its end date 30 September 2023: https://www.legislation.gov.uk/ukpga/1992/5/contents

[16] And where relevant, section 21 of the Social Security Pensions Act 1975, which preceded section 148: https://www.legislation.gov.uk/ukpga/1975/60/contents

7. Consultation

Summary of consultation outcome and methodology

7.1. There is no statutory duty on the Secretary of State to consult on this instrument. The Department does not consider informal consultation is appropriate in this case, as this is a technical order which gives effect to a statutory requirement, the terms of which are specified in primary legislation.

8. Applicable Guidance

8.1. Information and guidance on the additional State Pension is published by the Department on Gov.UK[17].

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 it delivers a pre-existing statutory requirement to maintain the value of additional State Pension and Guaranteed Minimum Pension (GMP) entitlements relative to earnings growth.

Impact on businesses, charities and voluntary bodies

9.2. There is no new or significant impact on business, charities or voluntary bodies as pension schemes are already required to calculate GMPs and revalued earnings factors are part of their usual activities.

9.3. The legislation does impact small or micro businesses.

9.4. The legislation applies to formerly contracted-out occupational pension schemes but has negligible administrative impact on them. The revaluation of GMPs not yet in payment is a long-standing requirement. Removing small businesses (that is, small schemes) from this requirement would adversely affect scheme members because their pensions would not be protected from the effects of inflation.

9.5. There is no, or no significant, impact on the public sector. The benefit expenditure associated with revaluation has not been separately identified but is included within the Government's expenditure plans.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1. There are no plans to monitor the effect of this instrument. There is a statutory requirement to ensure the additional State Pension and GMPs maintain their value relative to earnings growth.

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.

---

[17] https://www.gov.uk/additional-state-pension

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").