

EXPLANATORY MEMORANDUM TO
THE SOCIAL SECURITY REVALUATION OF EARNINGS FACTORS
ORDER 2010

2010 No. 470

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 Order is made each year to ensure that the earnings factors used in the calculation of additional State Pension maintain their value in line with the movement in average earnings. (Further information is given in section 7.)

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 needs to be revalued in line with earnings growth. The percentages set out in this Order will be used for revaluating earnings factors for additional State Pensions in tax years 2009/10.

4.2 As is normal practice, this Order is laid at the same time as The Social Security Pensions (Low Earnings Threshold) Order 2010 for which a separate explanatory memorandum has been produced.

5. **Territorial Extent and Application**

This instrument applies to Great Britain. Equivalent provision in relation to Northern Ireland will be made by statutory rule.

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**

7.1 Additional State Pension was introduced from April 1978 and was normally referred to as the State Earnings Related Pension Scheme (SERPS). In April 2002 the Government reformed SERPS with the introduction of State Second Pension. The additional pension is a combination of both SERPS and State

Second Pension and is paid with the basic State Pension at State Pension age¹, although it can be paid on its own if there is no basic State Pension payable.

7.2 Entitlement to additional State Pension is based on earnings on which National Insurance contributions (NICs) have been paid, or treated as paid, in each tax year from 1978/79, known as earnings factors.

7.3 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 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 paid². For years from 2002/03 onwards additional pension accrues on primary Class 1 contributions and carers and disabled people entitled to certain benefits are treated as having an earnings factor for these purposes.

7.4 For any given tax year, additional State Pension accrues on the portion of an employee's annual earnings between the annual value of the Lower Earnings Limit (£4,940 in 09/10) and the Upper Accrual Point (£40,040 in 09/10) – called the “surplus earnings factor”. This amount is revalued in line with growth in average earnings.

7.5 Each year the earnings factors derived in each previous year since 1978/79 are revalued in line with the movement in average earnings as set out in the annual Revaluation of Earnings Factors Order, up to the last full tax year of a contributor's working life.

7.6 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 SERPS and the State Second Pension.

7.7 Earnings factors are also used to calculate the Guaranteed Minimum Pension (“GMP”) for early leavers and retired persons in contracted-out salary-related schemes. The GMP is the equivalent of SERPS for contracted-out pension schemes.

7.8 Revaluations of earnings factors have been calculated by reference to the movement of earnings over the period of 12 months from September-September, allowing time for the resulting Order to be made before the beginning of the tax year in which it is to apply.

¹ Currently, the State Pension age is 65 for men and 60 for women born before 6 April 1950. For women born after 5 April 1950 and before 6 April 1955, the State Pension age will increase gradually to 65 between 2010 and 2020. From 6 April 2020 the State Pension age will be 65 for both men and women but will then increase to 68 between 2024 and 2046.

² Primary Class 1 NICs are payable on all earnings paid in an earnings period which exceed the Primary Threshold. Class 2 contributions are payable by self-employed earners and along with Class 3 can be paid on a voluntary basis.

7.9 During the period between September 2008 and September 2009, the Office for National Statistics' September whole economy (non-seasonally adjusted) index showed that average earnings in Great Britain increased by 1.2 % (including bonuses and arrears). This Order therefore provides for earnings factors for 2009/10 to be increased by that percentage and for earnings factors for earlier tax years to 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.

Consolidation

7.10 The Social Security Revaluation of Earnings Factors Order is made each year and is appropriate to people reaching State Pension age in that tax year. As the instrument does not amend another instrument, the question of consolidation does not arise.

8. Consultation

Consultation on this order is not appropriate.

9. Guidance

9.1 Leaflets and guidance will be up-dated to reflect the new figures in due course.

9.2 An information notice will be issued to the financial press. The figures will also be published on the Department for Work and Pensions website.

10. Impact

10.1 This instrument has no new impact on the costs of business, charities and voluntary bodies.

10.2 The impact on the public sector is negligible.

10.3 A full impact assessment has not been prepared for this instrument.

11. Regulating small business

This instrument has no new impact on the costs of small business.

12. Monitoring and review

The Social Security Revaluation of Earnings Factors Order is made each year.

13. Contact

Dave Annison at the Department for Work and Pensions Tel: 020 4497145 or e-mail: dave.annison@dwp.gsi.gov.uk can answer any queries regarding the instrument.