

**EXPLANATORY MEMORANDUM TO**  
**THE OCCUPATIONAL PENSION SCHEMES (SCHEMES THAT WERE**  
**CONTRACTED-OUT) (NO.2) (AMENDMENT) REGULATIONS 2022**

**2022 No. 158**

**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 Her Majesty.

**2. Purpose of the instrument**

2.1 The purpose of this instrument is to provide a new fixed rate of revaluation of Guaranteed Minimum Pensions (GMP) for those leaving pensionable service for the period 6 April 2022 to 5 April 2027.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Joint Committee on Statutory Instruments*

3.1 None.

**4. Extent and Territorial Application**

4.1 The territorial extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

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

**5. European Convention on Human Rights**

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

**6. Legislative Context**

6.1 Where a member of a contracted out pension scheme leaves that employment before the age the GMP can be taken, the scheme has a statutory duty (under section 16 of the Pension Scheme Act 1993)<sup>1</sup> to revalue the amount of GMP which is due to the member until the GMP may be taken.

**7. Policy background**

*What is being done and why?*

*Guaranteed Minimum Pensions*

7.1 The State Pension used to be made up of two parts: a flat rate basic State Pension and an earnings-related additional State Pension. However, when contracting out was introduced in 1978, many employees were already members of pension schemes provided by their employer. Therefore, between 6 April 1978 and 5 April 1997,

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<sup>1</sup> <https://www.legislation.gov.uk/ukpga/1993/48/contents/enacted>

salary-related occupational pension schemes could ‘contract out’ their members from the earnings related element of the State Pension (the additional State Pension), provided the scheme took on the promise to pay a Guaranteed Minimum Pension (GMP) to each scheme member.

- 7.2 A Guaranteed Minimum Pension is payable for life at age 60 for a woman or 65 for a man and includes survivor benefits which are payable to a widow, widower or surviving civil partner of the member. Contracting out continued to operate until April 2016, but on a different basis and Guaranteed Minimum Pensions did not accrue after 1997.
- 7.3 Where a member of a formerly contracted out pension scheme leaves the scheme before GMP pension age, the scheme must revalue their GMP when it becomes payable.
- 7.4 Although there are three alternative ways of revaluing GMPs, schemes can choose which method to use. Some schemes have chosen to revalue GMPs using the fixed rate method, whereby the GMP is revalued by a fixed rate of revaluation provided for in legislation.

#### Fixed Rate Revaluation

- 7.5 As explained above the Guaranteed Minimum Pension age is set at 60 for a woman and 65 for a man. When a member of a contracted out pension scheme leaves employment before the age the GMP can be taken, the scheme has a statutory duty under section 16 of the Pension Schemes Act 1993 to revalue the amount of Guaranteed Minimum Pension which is due to the member until it may be taken, to protect the buying power of a member’s pension.
- 7.6 Some occupational pension schemes use the fixed rate revaluation method to do this. Under the fixed rate revaluation method, the Department for Work and Pensions (DWP) sets the rate which schemes must use to revalue deferred members’ GMPs each year. Because the rate is fixed in law, the fixed rate method gives pension schemes greater certainty about what their future liabilities will be.
- 7.7 The rate is reviewed and updated as necessary by DWP every five years or so to ensure that it continues to reflect trends in inflation and wage growth. The current rate of fixed rate revaluation is 3.5% per annum. This has been in place since 2017. The next review was therefore carried out in autumn 2021, to come into effect from 6 April 2022.
- 7.8 In line with previous reviews, we have sought advice from the Government Actuary’s Department (GAD) on whether the current rate of revaluation applied to fixed rate revalued GMPs remained appropriate.
- 7.9 GAD indicated that a new fixed rate revaluation rate of between 3% per annum and 3.5% per annum for the period 6 April 2022 to 5 April 2027 is a more appropriate range given current trends in inflation and wage growth. GAD recommended that DWP consult on a specific rate of 3.25%, which they have advised is reasonable as a mid-point of the proposed range.
- 7.10 GAD’s figure is based on projected average earnings increases over the next 7.5 years, without any explicit allowance for the higher pay increases reported over the last year. GAD has reduced the period on which the earnings increases are based from 10 years, as used in their previous review, to 7.5 years. This reflects the fact that many occupational pension schemes have matured and that members with Guaranteed

Minimum Pensions (GMPs) are now much closer to the age at which they will receive them than at the last review five years ago.

- 7.11 The proposed move from 3.5% to 3.25% reflects a long-term reduction in the rate of revaluation applied to fixed rate revaluation GMPs. In the period 1978 to 1988, the rate of fixed rate revaluation was set at 8%. This had fallen to 4.5% in the period 2002 to 2007.

## **8. European Union Withdrawal and Future Relationship**

- 8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act

## **9. Consolidation**

- 9.1 Informal consolidated text of instruments is available to the public free of charge via ‘the National Archive’ website <http://www.legislation.gov.uk/><sup>2</sup>.

## **10. Consultation outcome**

- 10.1 In line with standard practice, we ran a consultation for eight weeks from 23 September 2021 to 18 November 2021. The consultation asked three questions seeking views on the proposed new fixed rate of GMP revaluation for those leaving pensionable service.
- 10.2 There were just two responses to the consultation, one from a private individual, and one from a representative of a pensions industry body.
- 10.3 One respondent argued that this rate was too high, on the grounds that a lower rate of fixed rate revaluation would be in the interests of existing members of money purchase schemes with Guaranteed Minimum Pensions that are subject to Fixed Rate Revaluation, whilst the other respondent had no views as to the proposed rate itself, but expressed a desire to see any change in the rate communicated to pension schemes and their administrators well in advance of 6 April 2022. There was otherwise either agreement or no view expressed.
- 10.4 We have addressed the respondents’ comments in the Government’s response to the consultation, published on GOV.UK on the day this instrument is laid.

## **11. Guidance**

- 11.1 No guidance is required as this instrument does not change existing policy.

## **12. Impact**

- 12.1 There is no, or no significant, impact on business, charities or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 An 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.

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<sup>2</sup> <https://www.legislation.gov.uk/>

### **13. Regulating small business**

- 13.1 The legislation applies to activities that are undertaken by small businesses, as the legislation applies to any occupational scheme that is carrying out fixed rate revaluation.
- 13.2 The Order has a negligible administrative impact on business. It is not possible to mitigate the impact of the requirements on small business without an adverse effect on scheme members.

### **14. Monitoring & review**

- 14.1 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 Guy Opperman at the DWP has made the following statement: “The rate of Fixed Rate Revaluation is reviewed and updated as necessary by DWP every five years to ensure that it continues to reflect trends in inflation and wage growth. I therefore do not consider that a review clause is necessary.”

### **15. Contact**

- 15.1 David Brown at the Department for Work and Pensions, email: david.brown@dwp.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Fiona Frobisher, Deputy Director for Defined Benefit Policy, at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Guy Opperman at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.