

SSRO

Single Source
Regulations Office

Consultation on revised Incentive Adjustment (Step 3) Guidance

*Supporting the implementation of the
Strategic Defence Review 2025*

Published 1 June 2026



1. Consultation on revised Incentive Adjustment and Reporting Guidance

- 1.1 This consultation document accompanies the publication of updated statutory guidance on the incentive adjustment under the Single Source Contract Regulations 2014 (the Regulations), following amendments made by the Single Source Contract (Amendment) Regulations 2026.

About this consultation

- 1.2 The Single Source Regulations Office (SSRO) is consulting on revisions to the Incentive Adjustment (Step 3) section of its Guidance on the baseline profit rate and its adjustment. The revisions reflect changes to the Regulations governing the incentive adjustment and are intended to support consistent and compliant application in qualifying defence contracts (QDCs).
- 1.3 The revised guidance is being published now to support implementation of the amended Regulations. At the same time, the SSRO is launching a 12-week public consultation on the revised guidance and will consider feedback before issuing a further updated version later in 2026, or earlier if necessary.

What is changing at a glance

Change	Summary
Maximum incentive adjustment for QDCs	The maximum incentive adjustment under step 3 is increasing from 2 percentage points to 10 percentage points for QDCs.
Safeguards for use of the incentive adjustment for QDCs	For QDCs, the amended Regulations introduce statutory requirements that incentives are outcome-based, capable of objective verification (including where judgement is required), and reasonable in the circumstances having regard to potential public benefit.
SSRO opinions	The amended Regulations clarify that the SSRO's opinion function for default pricing method proposals includes the appropriate adjustment under step 3 (as well as steps 2 and 4).

- 1.4 Readers should note that the legislative changes to pricing reflected in this consultation do not affect Qualifying Sub-Contracts for which the existing provisions regarding the application of the incentive adjustment (IA) remain unchanged.

Background and policy context

- 1.5 Under section 17(2) of the Defence Reform Act 2014, the contract profit rate for a qualifying defence contract (or qualifying sub-contract) that is priced using the formula must be calculated by applying a sequence of steps set out in regulation 11. The incentive adjustment (IA) is step 3 in this process.
- 1.6 The IA allows the Secretary of State, at their discretion, to apply an adjustment at step 3 of the contract profit rate calculation to give the contractor a particular financial incentive in relation to the performance of specified provisions of the contract or component.
- 1.7 The legislative framework for incentive adjustments is being amended as part of the MOD's wider review of the regulatory framework. The reforms are presented by the MOD as supporting stronger incentives for performance, improved value for money, and the effective delivery of defence capability.

Summary of legislative changes

- 1.8 The amended Regulations make two linked sets of changes to the step 3 incentive adjustment for QDCs:
 - a. They increase the maximum incentive adjustment from 2 percentage points to 10 percentage points.
 - b. They introduce and strengthen safeguards governing the design and operation of incentive adjustments, including requirements that:
 - i. payment is conditional on achieving a specified outcome;
 - ii. the outcome is capable of objective verification and incentivises performance of the relevant provisions;
 - iii. any element of judgement is capable of determination by a suitably qualified independent person; and
 - iv. the Secretary of State is satisfied the incentive adjustment is reasonable in the circumstances, having regard to potential public benefit.

Purpose and scope of the revised guidance

- 1.9 The revised guidance explains how the MOD and contractors should interpret and apply the updated legislative requirements when deciding whether to offer an incentive adjustment and, if so, how it should be structured and operated. The guidance remains principles-based and recognises that contracting parties may need to exercise judgement when designing incentives for complex defence contracts whilst ensuring that the incentive schemes they design comply with the requirements of the Regulations.

- 1.10 In particular, the new guidance addresses:
- a. how outcomes should be specified (as outcomes to be achieved rather than describing effort or process intended to achieve such outcomes);
 - b. that the outcomes must be capable of objective verification and how that objective verification of the outcomes can be achieved, including where judgement is involved; and
 - c. how reasonableness of the amount of the incentive adjustment should be assessed, having regard to potential public benefit.
- 1.11 Alongside this new guidance, further updates have been made to other SSRO guidance to ensure it remains aligned with the amended Regulations. This includes:
- a. clarifying how existing contract reporting regulations will continue to apply under the new requirements of the incentive adjustment;
 - b. reflecting within Alternative Pricing Guidance Section 9 – Aggregation of components, the increase to 10 percentage points as being the maximum contract level incentive adjustment for QDCs
 - c. updating as necessary references to the maximum IA being 2 percentage points.

Scope of the consultation

- 1.12 This consultation seeks views on whether the revised guidance:
- accurately reflects the updated Regulations for the incentive adjustment (step 3);
 - is clear, workable and proportionate in practice; and
 - supports effective use of incentive adjustments while protecting value for money for the MOD and fair and reasonable prices for contractors.
- 1.13 This consultation does not seek views on the policy decision to change the maximum incentive adjustment or the conditions for its use; it focuses on the associated guidance and how it should be expressed to support implementation.

Consultation questions

- 1.14 Respondents are invited to provide views on the following questions. Please provide explanations and evidence to support your answers alongside suggestions as to how the guidance may be improved.
- **Clarity and interpretation:** To what extent does the revised pricing guidance clearly explain the updated legislative requirements for the step 3 incentive adjustment, including the increased maximum adjustment and the safeguards relating to outcomes, objective verification, and the role of judgement? If you find any aspects are unclear or misleading, please identify them and propose revised wording or additional guidance.
 - **Reasonableness and public benefit:** To what extent does the guidance provide a clear steer for assessing reasonableness and potential public benefit, including where benefits are qualitative, intangible or not readily quantifiable? If you consider improvements are needed, please describe what should change, how and why.

- **Practical application:** Does the guidance support effective, proportionate and operationally realistic use of incentive adjustments in practice? If you consider not, please identify any barriers or risks you foresee and suggest how the guidance could be improved to address them (including examples where helpful).

Next steps

- 1.15 The SSRO will consider all responses received during the 12-week consultation period. Subject to the feedback received, the SSRO may publish an updated version of the guidance later in 2026, or earlier if necessary, to support implementation of the amended Regulations.
- 1.16 The consultation period closes on 24 August 2026. We will take into account all consultation feedback received during this period. Responses received after this date may not be taken into account but will inform subsequent consideration of guidance changes.

How to respond

- 1.17 Please send responses by email or in writing by **completing the consultation response form on our website** and returning it to the SSRO using the contact details below. You may answer any or all of the consultation questions and provide supporting evidence or examples. We aim to publish responses to our consultation to support transparency in our guidance development. **If you are content for your feedback to be published on the SSRO's website please confirm this in your response.**
- By email: consultations@ssro.gov.uk
 - By post: Single Source Regulations Office, G51/G52 100 Parliament Street, London, SW1A 2BQ.
- 1.18 These contact details may also be used if you would like to discuss with the SSRO any aspect of this consultation during the consultation period and prior to responding.