

**The STATE EARNINGS RELATED PENSION SCHEME (SERPS)**  
**The STATE SECOND PENSION (S2P)**

From 6 April 2002 the government introduced the State Second Pension to replace the State Earnings Related Pension Scheme. As an employee you have the option of contracting-into or out of the State Second Pension. It is very important that you read this note.

Successive governments have become concerned at the growing number of people who are in retirement by comparison to the working population. State pension benefits are paid from employees' National Insurance Contributions. The ever-growing retired population is causing a relentlessly growing state pension bill and steps have been taken, and will continue to be taken, by governments in order to reduce this growing burden.

Contracting-out is the term for opting out of the State Second Pension, (S2P) whereby an individual sets up their own private arrangement. By contracting-out, employers and employees achieve a rebate from their national insurance contributions. These rebates are paid into an Appropriate Personal Pension or Stakeholder Scheme (APPS) and provide the possibility of achieving a larger pension at retirement than may be available by remaining within the S2P arrangement. It will cease from 6 April 2012.

For your information, a history of appropriate personal pension schemes is shown below: -

	6 <sup>th</sup> April 2009	£	£	£
Lower earnings limit	95	412	4,940	
National Insurance Contributions start	110	476	5,715	
Upper earnings limit	844	3,656	43,875	
	6 <sup>th</sup> April 2002			
	S2P introduced.			
	6 April 2001			
	Contracting out with a stakeholder pension available			
	6 April 1999			
	Age related rebates were increased. Rebates ranged from 3.8% to 9% of Middle Band earnings, with the employee's share remaining at 1.6%.			
	6 April 1997			
	Age related rebates were introduced ranging from 3.4% to 9% of Middle Band earnings. The employee's share of the rebate was reduced to a level 1.6%.			
	6 April 1996			
	The age from which protected rights pensions could be taken was equalised at age 60 for both men and women.			
	6 April 1993			
	The amount of rebate was reduced to 4.8% of band earnings (split 3% employer and 1.8% employee). The 2% incentive ceased and was replaced by an extra 1% paid to contracted-out members aged 30 or over at the beginning of the tax year.			
	6 April 1987			
	APPS were introduced by the Social Security Act of 1986. Personal pensions started on the 1 July 1988 but contracting-out of State Earnings Retirement Pension Scheme (SERPS - the predecessor to S2P) could be backdated to 6 April 1987. The amount of rebate was initially 5.8% of Middle Band earnings (*). This was split 3.8% employer and 2% employee. A 2% incentive was paid except to members who had been in a contracted-out occupational scheme for two or more years, and had left the scheme voluntarily after the 5 April 1988 without leaving the employment.			

(\*) Middle Band earnings are earnings between the upper and lower earnings limits for S2P.

## **WHAT SHOULD YOU DO NOW?**

**Our over-riding advice is that you should remain or opt back into S2P if you will be dependent upon S2P as your only source of income in retirement, or in addition to the basic old age pension.**

### **What Contracting-Out Actually Means**

Full rate National Insurance Contributions continue to be paid by both the employee and the employer. However, the National Insurance Contributions Office (NICO) will pay a rebate of part of the employees and the employers National Insurance Contributions, together with an age related top-up, to the appropriate personal pension scheme after the NICO has received the employer's end of year tax return, which gives details of the employee's earnings on which Primary Class 1 National Insurance Contributions have been paid. As this form is not submitted until after the end of the tax year, rebate payments will be paid after the end of the tax year to which they relate. As an example, this means that rebates for the 2003/2004 tax year will not be paid until after April 2004.

Basic rate Income Tax is added by NICO to the employee's share of the rebate that is paid into the APPS. No higher rate Income Tax relief is available.

### **Protected Rights Benefits**

The appropriate personal pension or stakeholder scheme will provide what are called Protected Rights Benefits, which will become available on retirement at any time from age 50 to 75. The minimum age reduced to 50 as from 6 April 2006 – A-Day – and will increase to age 55 with effect from 6 April 2010.

Unlike the benefits from the main personal pension scheme, on death before retirement the Protected Rights Fund must provide a pension for a qualifying spouse. Where there is no qualifying spouse the fund can be paid as a lump sum and, depending on how the Plan has been set up, it could be paid as follows: -

- To your legal personal representative.
- To your nominated beneficiaries (who need not be dependants).
- At the discretion of the scheme administrator.
- If your policy is the subject of a trust on death, to the trustees for the benefits of dependants and/or others.

There were significant changes made to pension legislation under the Finance Act 2004 and these changes came into effect on 6 April 2006 – A-Day. Up to that date, no tax-free cash could be taken from the Protected Rights Fund but, after A-Day, up to 25% of the accumulated fund can be taken as tax-free cash (now known as the Pension Commencement Lump Sum (PCLS)). In addition, it is no longer necessary for pensions purchased by Protected Rights Benefits to increase on an annual basis at pre-set levels.

The rules relating to protected Rights and contracting out will change as at 6 April 2012.

Our Regulator, the Financial Services Authority (FSA), has updated their leaflet on this subject and you can obtain a copy of "The State Second Pension – should you be contracted out?" from their website at <http://www.fsa.gov.uk>