

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. These are separate to the Basic State Pension. 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 because 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. From 2012, both S2P are set to rise in line with the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) as in the past. Since, generally speaking, the CPI is lower than RPI we expect increases to be smaller going forwards thereby reducing the cost to the government. However, we are expecting protected future increases in the Basic State Pension.

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.

The Government has plans in place to remove the Contracting-out option from 6 April 2012, after which you will automatically be contracted back in to the State scheme. However, between now and April 2012 you will continue to have the option to contract-out. At that time, any benefits that you have built up from these rebates will remain within your pension plan.

WHAT SHOULD YOU DO NOW?

As a general rule, our advice is that you should remain in or opt back into S2P particularly if you are likely to rely upon your State Pension in retirement. Doing so may help to reduce the risk that your final pension will fall in value, with more of the risk lying with the Government. From April 2012, the Government has decided to take away the option and you will be contracted back into the State scheme automatically, regardless of whether you choose to do so now or not.

You should be aware that there are no guarantees as to the level of pension you will actually receive when you retire, even if you contract back into the State scheme. The government is liable to make changes and, particularly when retirement is a long way off, it is impossible to know what these might be.

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 employee's and the employer's National Insurance Contributions, together with an age related top-up, to the Appropriate Personal Pension Scheme (APPS).

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 Protected Rights Benefits, which will become available on retirement at any time from age 55 to 75.

Unlike the benefits from the main personal pension scheme, the Protected Rights Fund must provide a pension for a qualifying spouse on the death of the policyholder. However from April 2012, it is intended that this restriction will also be removed and that the benefits available will be the same as from the rest of your pension.

Changes from 6 April 2012

Under the current plans, you will be contracted back into the State scheme from April 2012, where you will accrue extra State pension for each year you pay National Insurance contributions over £4,940 a year (based on 2009/2010 earnings).

This change should not affect the way in which you or your employer make payments to your pension, nor the benefits built up from any previous contracted-out rebates.

Our regulator, the Financial Services Authority (FSA), has updated their guide on this subject to include additional information on both contracting-out and the planned changes in 2012. I have included a copy of their guide, "The State Second Pension - should you be contracted out?" with this letter. You can also find further details from the FSA on this topic at their website at www.moneymadeclear.org.uk

If you have any concerns, or would like to discuss this matter further, please contact Nick Matthews for assistance.