



Association of British Insurers



About this fact sheet

This fact sheet is published by the Association of British Insurers (ABI) and the Association of Independent Financial Advisers (AIFA) - see note on page 4. It contains important information for people who are currently contracted-out of the State Second Pension (S2P) through either a personal pension or a stakeholder pension. This information can help you decide whether you want to stay contracted-out or rejoin S2P.

Pensions and contracting-out: important information

It is very important that you read this fact sheet and decide whether or not to stay contracted out for this and future years. Remember:

- you should review your decision to stay contracted-out each year; and
- your circumstances may have changed since you took out your pension plan.

It is particularly important to review your decision if you are a woman aged 54 or over or a man aged 60 or over. The Government has decided to limit the 'rebates' (see 'And what's contracting-out?', on page 2) paid to these age groups. Because of the way the age-related rebate works for these age groups, your pension from contracting-out is very unlikely to match the S2P you are giving up.



So, what's the State Second Pension?

Almost everyone qualifies for the basic State Pension. Many people also qualify for an additional State Pension. This additional pension used to be known as SERPS (the State Earnings-Related Pension Scheme). In April 2002, SERPS was reformed and replaced by S2P (the State Second Pension).

How do I qualify?

In general, employees build up entitlement to S2P by paying National Insurance Contributions. The amount of S2P you earn for any one year depends on:

- your earnings in that year (and, as a result, the amount of National Insurance Contributions you pay);
- the growth in National Average Earnings in the period up to your State Pension Age; and
- the rules for paying S2P when you reach State Pension Age (these may not be the same as the current rules).

There are also special rules which provide some S2P for people who are full-time carers or who have long-term disabilities.

And what's contracting-out?

If you are an employee and building up S2P, you can choose to contract-out of it. This means that the Government will make payments to your own private pension instead. These payments are called rebates. Each year that you choose to contract-out, you will give up some or all of your S2P. Your rebates will then be invested to provide an alternative, private pension. This will not affect your basic State Pension. (If you earn less than £12,100 a year, you will continue to earn some S2P. If you earn more than £12,100, you will give up all your S2P. Either way, the issues you need to consider are the same.)

How much pension will I get?

The pension you get from contracting-out will depend on the amount paid into your fund and on:

- how much your investments earn;
- the amount your pension provider charges you for investing your fund; and
- the cost of buying a pension income (including whether you have to buy a pension income for your husband or wife) when you come to retire.

When working out the amount of rebate paid into your private pension fund, the Government has made assumptions about each of these things. Of course, no-one can predict the future with confidence, but if these assumptions turn out to be correct, your private pension will be worth about the same amount as the S2P you have given up. The Government describes this as setting the rebates at a neutral level. In practice your private pension may turn out to be more or less than the S2P you have given up - there are no guarantees.



So, how do I decide?

The decision you have to make now is about the future. For past years in which you have contracted-out of the state scheme, you cannot contract back in. But you can choose whether to stay contracted-out this tax year and in the future. The decision to contract-out is one you should consider each year.

Will I gain financially?

You might have based your decision to contract-out on the expectation that it would give you a bigger pension than staying in the state scheme. While this may have been a reasonable expectation in the past, it is less clear now. Remember, the Government sets rebates at a neutral level, and the pension they produce will depend on things that cannot be predicted. You should not assume that you will gain financially by staying contracted-out.

Your decision about whether or not to stay contracted-out depends on a number of things, including your attitude to different types of risk.

If you choose to stay contracted-out:

You are taking two risks. One is that your investments might not perform as well as you expect and as was assumed when working out the rebates. The other is that the cost of buying a pension income might be higher by the time you come to retire than was assumed when working out the rebates. Either risk might mean that you end up with a smaller private pension than you would have got from S2P.

If you die before you start taking your private pension, your fund will be used to buy a pension income for your husband or wife. If you do not have a husband or wife, your fund will either go to a person you have named in writing or become part of your estate.

If you are married when you retire, you must buy a pension which will allow your husband or wife to continue receiving half the income if you die before them.

Under current rules, you can take your private pension at the age of 60, or later if you choose. In general, the earlier you take your pension, the less you will get each year.

The Government is changing the way in which you can take the pension earned through contracting-out. This means that from April 2006 you will be able to take your private pension from the age of 50 (rising to 55 by 2010) and take up to a quarter of your fund as a tax-free lump sum.

If you choose to contract back in:

You are taking the risk that future governments may change the rules relating to S2P. If they change the rules, you might end up with less S2P than you expect.

If you die before you start taking your pension, your husband or wife may be eligible for half the S2P you have earned. If you do not have a husband or wife, there is no fund to be paid to your estate.

Your husband or wife may qualify for a portion of your S2P if you die before them.

You will not be able to receive a weekly pension until State Pension Age, or later if you choose. State Pension Age is currently 65 for men and 60 for women. For women born after 6 April 1955, State Pension Age is 65, and for those born between 6 April 1950 and 6 April 1955 it is between 60 and 65.

Further information and help

Read more about S2P and contracting-out

You can get the Government's guide 'Contracted-out pensions: your guide (PM7)' from The Pension Service. You can also find useful information on State Pensions in general in the guide 'State Pensions - your guide (PM2)'. You can view both on The Pension Service website (www.thepensionsservice.gov.uk) or order copies by phoning 08457 31 32 33.

You can read the Financial Services Authority's guide 'Contracting-out of the State Second Pension' on their website (www.fsa.gov.uk/consumer/pdfs/contracting_out.pdf) or order copies by phoning 0845 606 1234.

Help with reviewing your position

If you have an independent financial adviser (IFA), you should speak to them. To support this fact sheet, we are giving IFAs more detailed information to help them answer your questions.

If you do not have an IFA, you can contact your pension provider using the phone number on the covering letter sent with this fact sheet.

If you've already decided

If after reading this fact sheet you decide that you want to contract back in to S2P, you should contact your pension provider as soon as possible.

If you decide that you want to stay contracted-out, you don't need to do anything - you will stay contracted-out until you choose to contract back in.



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ABI is the trade organisation representing around 400 insurance companies which, between them, account for over 94% of the business of UK insurance companies. AIFA represents 70% of independent financial advisers (IFAs). An important role of both organisations is to define and promote best practice for the industry.

This fact sheet is published by the ABI and the AIFA. It outlines our understanding of the rules governing contracting-out. However, it is not a full statement of the law and does not claim to give advice on the matters discussed. The Financial Services Authority (FSA) commented on it before we published it.