



Contracting Out of the State Second Pension

Questions & Answers

These notes are for people who are deciding whether to stay contracted-out of the State Second Pension scheme using a personal pension from Windsor Life. Our annual statement letters encourage policyholders to review their decision often. While we do not give regulated financial advice on this matter, we provide as much factual information as we can to help our customers make their own informed choice. You can also ring us on 0870 887 3333 for any factual, non-advice questions, but please read this document first as it may already answer your question. Alternatively, customers may wish to talk to their Independent Financial Adviser (IFA) to consult on their personal circumstances before choosing. If you do not have a financial adviser, you can find details of the IFAs in your area at www.ifap.org.uk or ring 0800 085 3250.

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Q 1. What is the State Second Pension?

The State Second Pension, usually written as **S2P**, is an earnings-related state pension scheme that replaced the State Earnings Related Pension Scheme (SERPS) from 6th April 2002.

In each year of membership it builds up benefits that depend on your average earnings over the period of your membership.

People who meet the eligibility rules are automatically members of S2P, unless they choose to opt out. They can do this by actively contracting-out, which means they build up a pension in a personal pension scheme instead, or by being a member of a company pension scheme that is itself contracted-out. These notes are for people who have contracted-out of S2P using a personal pension from Windsor Life.

If you have a Contracted-out Personal Pension (COPP) but your last Annual Statement shows that we received no NI rebate for your pension. This may be for various reasons, for example:

- o Your earnings for each of the tax years may be below the minimum earnings limit;
- o You are, or may have been, a member of a contracted-out occupational pension scheme with your employer;
- o There has been a delay in your employer filing tax returns with the IR, which means that they have been unable to calculate the contributions; or
- o Your employment may not qualify for payment of contributions.
- o You have contracted back in to S2P

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Q. Am I eligible to rejoin the State Second Pension?

- o If you have a Contracted-out Personal Pension (COPP), which is receiving your National Insurance (NI) rebate, you are automatically eligible to rejoin the State Second Pension (S2P).
- o You will also be a member of S2P if you are not earning but are now receiving one of the following benefits:
 - o Invalid Care Allowance;
 - o Child Benefit (where the child is under 6);



- o Long-Term Incapacity Benefit;
- o Severe Disablement Allowance:
- o You are also entitled to membership of S2P if you receive home responsibility protection because you are caring for a sick or disabled person.

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Q. What benefits would the State Second Pension give me?

The following table shows the earning bands for the 2007/08 tax year and the percentage that you can build up of those earnings bands. It also shows the comparative percentage used to build up benefits under the previous arrangement, the State Earnings Related Pension Scheme (SERPS).

For those retiring after 5th April 2009 the Department for Work and Pensions (DWP) calculates your benefit as follows:

Table 1

Earnings		S2P earned	SERPS earned
£34,840	Upper Earnings Limit (UEL) **		
	Band 3 earnings	20%	20%
£30,000	Second Earnings Threshold (SET) *		
	Band 2 earnings	10%	
£13,000	Low Earnings Threshold (LET) *		
	Band 1 earnings	40%	
£4,524	Lower Earnings Limit (LEL) *		

* This level will usually increase each year in line with earnings.

** This level will usually increase each year in line with prices.

It may be easier to give an example assuming there are no changes to these bands that you are a member of S2P for your full working lifetime, and there are no changes to the percentage rates:

1. Your average lifetime earnings are £35,000 each year after adjustment for inflation. Spread this over the 3 earnings bands as shown;
 - Band 1 - £13,000 - £4,524 = £8,476.00 x 40% = **£3,390.40**
 - Band 2 - £30,000 - £13,000 = £17,000.00 x 10% = **£1,700.00**
 - Band 3 - £34,840 - £30,000 = £4,840.00 x 20% = **£968.00**
2. Add together the final figures, which means a S2P benefit of **£6,058.40 each year**



Notes:

- The DWP adjusts each band separately in line with the rise in national average earnings from the year in question up to the tax year before the individual reaches State Retirement Age. The last year stays untouched.
- For those retiring sooner than 6th April 2009, the DWP adjusts the calculation to take account of the higher percentage rate used under SERPS. This means the people who fall into this category will be no worse off because of the change to S2P.
- For most people this is in addition to the basic State Pension.

The pension provided continues for life and increases each year in line with the increase in the Retail Prices Index (RPI). Following your death, your widow, widower or legal civil partner would receive **50%** of your S2P benefit for the rest of their life.

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Q. Is it likely to change again in the future?

- No one can be sure whether or not future UK Governments will change the S2P scheme. This Government has announced it intends to change S2P around the same time as it reintroduces the link between the basic state pension and earnings. Their aim is to do this around 2012. We show the planned changes for S2P in the following table:

Table 2

Earnings		S2P earned (post 2012)	S2P earned (current)
£34,840	Upper Earnings Limit (UEL) **		
	Band 3 earnings		20%
£30,000	Second Earnings Threshold (SET) *		
	Band 2 earnings	Flat Rate Benefit based on LET earnings. (Government to confirm the rate)	10%
£13,000	Low Earnings Threshold (LET) *		
	Band 1 earnings		40%
£4,524	Lower Earnings Limit (LEL) *		

This change will not apply to those then aged **45 or older**. They will continue to build rights under S2P on all 3 earnings bands.

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Q 2. What is contracting-out?

- o People who meet the eligibility rules are automatically members of S2P, unless they choose to opt out. They can do this by contracting-out, which means they build up a similar pension in a private scheme instead. These notes are for people already contracted-out of S2P using a personal pension from Windsor Life.
- o It works by the Government paying a part of your normal National Insurance contributions into your personal pension, known as **rebates**. The Government works out the rebate and reviews it every 5 years. The Government Actuarial Department (GAD) has reviewed the rates for the next 5 years and has published its report. **These rebates are intended to give roughly the same benefits from a personal pension as you may have built up in the Second State Pension. (please see the table of risks in Question 3)**

These rebates depend on your age and increase as shown in the following table. However, there is a rebate cap which for this tax year is 43.

Table 3: National Insurance rebates for 2007 - 2012

Age	Band 1 earnings £4,524 - £13,000	Band 2 earnings £13,001 - £30,000	Band 3 earnings £30,001 - £34,840
15	9.4%	2.35%	4.7%
20	10.0%	2.5%	5.0%
25	10.8%	2.7%	5.4%
30	11.6%	2.9%	5.8%
35	12.6%	3.15%	6.3%
40	14.0%	3.5%	7.0%
45	14.8%	3.7%	7.4%
50	14.8%	3.7%	7.4%
55	14.8%	3.7%	7.4%
60	14.8%	3.7%	7.4%

- o The rebates build up in your personal pension in a fund known as **protected rights**. You can use this fund between the ages of 50 (age 55 from 2010) and 75 to buy an annuity, or pension income, payable for the rest of your life. You may ask for up to 25% of your fund to be paid as a tax-free cash lump sum (called the pension commencement lump sum).
- o The decision to contract-out is not final. You should see contracting-out as an annual decision, and you can decide each tax year whether it is in your best interests to stay contracted-out. We strongly suggest you reconsider each year whether to remain contracted-out based on your personal circumstances.

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Q 3. What do I need to think about when deciding whether to stay contracted-out?

- There is no formula to work out whether to stay out or opt back into the State Second Pension (S2P). It's a personal decision based on your own circumstances and attitudes.
- There are several factors to consider and the following table lists the main ones and how they might affect your decision:

Your Age:	Government rebates increase with age but it caps the amount paid after age 55 (see table 3 in Question 2).
Your Marital Status at retirement date:	The Government works out your National Insurance (NI) rebates based on you having a pension that includes a 50% widow, widower's or legal civil partner's pension benefit. This is true even if unmarried at your retirement date. If you stay contracted-out and are not married or a partner in an in-force civil partnership at your retirement, you can choose to exchange the fund in your COPP to buy a single person's pension giving you a higher benefit.
Your Attitude To Risk:	There are several risks to weigh up when deciding whether to stay contracted-out: <ul style="list-style-type: none">• The fund you will eventually have to buy your contracted-out pension depends on investment performance. The better the fund performance the more you will have at the end to buy your pension benefit. We cannot guarantee investment returns and markets can go down as well as up.• When you retire, you may use your fund to buy a lifetime annuity, or pension income, payable for the rest of your life. It is impossible to predict, with any certainty, the cost of buying your pension. This is because annuity



	<p>rates will depend on interest rates in the future, and on improving life expectancy. Other alternatives may be available to you.</p> <ul style="list-style-type: none">• Security of state benefits – the Government may change state retirement benefits in the future.
Your Degree of Control:	Contracted-out pensions put you in more direct control of your pension. You can choose which funds to invest in, when to draw benefits between ages 50 (age 55 from 2010) and 75, and you can top-up the Government NI rebates with tax-efficient contributions of your own. You can choose to take up to 25% of the fund as tax-free cash, known as the pension commencement lump sum. If you decide to contract back in to S2P, then you keep this degree of control over the personal pension benefits you have built up so far. However, you will lose it for the State Second Pension benefits you build up in future.
Your Choice of Retirement Age:	State Retirement Age (SRA) is changing for women. Those of you born after 5 th March 1955 will have a retirement age of 65. For those born before 6 th April 1950 it will remain as 60. Women born between these dates will have a sliding scale SRA depending on their birth date. If this applies to you, by remaining contracted-in to S2P you will restrict your choice of when to retire and take the benefits.



Your Salary:	Comparison between S2P rebates and S2P benefits depends on your earnings. There are different rates for building up S2P for each band of earnings. People who earn between £4,524 and £13,000 a year get their S2P topped up by the Government as if they were earning £13,000.
Life Expectancy:	You may have a pessimistic view of dying before State Retirement Age. If you are unmarried, or not in a civil partnership, at the time of your death before retirement, your fund would be returned to your estate. However, if you remain in S2P there is no lump sum if not married or not in a civil partnership. It is designed to give only a spouse's or civil partner's benefit of 50% of your entitlement.
Plans for Emigration:	If you are considering moving abroad when you retire, you will need to consider any restrictions that may apply depending on the country you eventually move to. In particular, any increases in your State Pension benefit, called indexation, will not apply to you if you are living outside of the European Union in one of the following countries: <ul style="list-style-type: none">• Canada• Australia• New Zealand• South Africa
State Pension Promises:	You may have a cynical attitude to past and current Government promises on State Pension provision. The value of the previous State Scheme, called the State Earnings Related Pension Scheme (SERPS), is much less than when originally brought in. The value of its replacement, S2P, could also be changed in the future.

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Q 4. Why have you stopped showing pivotal ages on annual statements?

- As you can see from the list of factors in question 3, there is no easy answer to the question of whether you should stay contracted-out. Pivotal ages are too limited because they only look at the decision by your age and gender, and there is a risk that people could choose inappropriately unless they consider other factors too. Many other providers are also changing the way they disclose this information and are moving away from calculating pivotal ages.

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Q 5. If I am happy to stay contracted-out with WL what do I need to do?

- You don't need to do anything. Every year we automatically claim the National Insurance rebate on your behalf from the Government. You will see the value of the rebate received on the unit statement that we will send you each year.
- We strongly suggest you reconsider each year whether to remain contracted-out based on your personal circumstances.

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Q 6. If I have decided that I want to contract back in to the Government scheme, how do I go about it?

- Contracting-out is a decision that applies individually to each tax year. Any decision to contract back in to the State Second Pension should be recorded by completing HM Revenue and Customs (HMRC) Form CA1543. You may download this form by going to our website www.windsor-life.com or, if you prefer, ask us to send you a copy. Whichever way you obtain the form, please complete Section 4 and return it to us so we can complete our sections and forward it to HMRC for registration. If you contract back in then the fund you have built up so far will remain invested with us until your chosen retirement date. You will start building State Second Pension benefits in future following your decision to contract back in.

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Q 7. Where can I find out more?

- o By going to the website www.gad.gov.uk you can find out more about how the Government works out the rebate figures. It also shows you other assumptions they use when calculating whether a contracted-out personal pension would give equivalent benefits to the State Second Pension
- o The industry's regulator, the Financial Services Authority (FSA) website www.fsa.gov.uk has a guide called **Contracting-out of SERPS**.
- o The Pension Service – part of The Department of Work and Pensions – has a booklet called **Contracted-out pensions: Your Guide**. You can download it from their website www.thepensionsservice.gov.uk.

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IMPORTANT NOTES

- o WLA is authorised and regulated by the FSA. We do not give advice, therefore nothing in this document forms financial advice or a recommendation from us for any individual to contract-out or remain contracted-out of the State Second Pension. If you do wish to consult on your personal circumstances before deciding, you should consult an independent professional adviser. Please note that this would be at your own expense.
- o We base this document on our understanding of current UK law and UK Government practice, which may change in the future.