

July 2010

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This guide is part of our Pensions and retirement series.



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No selling.
No jargon.

Just the facts
about the State
Second Pension.
Should you be contracted out?

 **Money made clear**[™]
from the Consumer Financial Education Body (CFEB)

MoneyMadeClear™ guides are brought to you by the Consumer Financial Education Body (CFEB). We aim to help you understand financial matters and manage your money better.

Just the facts about the State Second Pension.

Should you be contracted out?

We try to ensure that information in this guide, much of which comes from external sources, is correct at time of print. It is possible that some of it is oversimplified, or may become inaccurate over time, for example because of changes in UK law. You should always check the current position before you take action.

This is general information intended for consumers of UK financial services resident in the UK. It does not take account of individual circumstances. When making decisions about your own circumstances you should consider whether to consult a financial or other professional adviser.

This guide is for you if

You are

an employee, and are contracted out, or are thinking of contracting out, of the State Second Pension (formerly SERPS).

This is important information and:

- could affect the amount of money you get in retirement
- you should review your contracting out decision each year to make sure it is still right for you.

Information in this guide is based on tax law at the time of writing and will be subject to change.

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The State Second Pension

What is the State Second Pension?

Nearly everyone can expect to get a basic State Pension when they reach State Pension age.

You qualify for the State Second Pension (S2P) if you are or have been employed and earning above a certain amount on which you have paid National Insurance contributions (NICs).

You get S2P in addition to the basic State Pension.

Until April 2002, the State Second Pension was called the State Earnings Related Pension Scheme (SERPS).

This guide is *not* for you if:

- you are self-employed as you cannot build up a State Second Pension; or
- you are contracted out through your employer's occupational pension scheme.

What is contracting out?

The government currently allows people to leave S2P. This is known as contracting out.

If you contract out, the government will pay some of your National Insurance contributions (called a rebate) and income tax relief into a personal or stakeholder pension of your choice.

This money is invested to provide benefits at retirement instead of the benefits you would have received from S2P had you remained in the state scheme.

The option to contract out of S2P will be removed from 6 April 2012, but final salary occupational schemes will keep the option.

Are you contracted out?

If you're not sure whether you have contracted out, contact your personal or stakeholder pension provider or call the HMRC Contracted Out Pension Helpline – see *Useful contacts* on Page 12.

If you are a member of an occupational

pension scheme, check with your employer whether the scheme is contracted out. If it is, you cannot contract back in while you remain a member of that scheme.

If you have contracted out

If you are contracted out through a personal or stakeholder pension, you should review your decision now.

Your decision about whether to stay contracted out will depend on, among other things:

- your personal circumstances including how you wish to receive your benefits at retirement; and
- your attitude to investment risk.

How do you decide?

It is important that you compare the differences between being in or out of S2P and understand the risks.

The decision to contract out is likely to be finely balanced in purely financial terms. However, people in older age groups, particularly those closer to retirement, are likely to be financially worse off by contracting out.

By contracting out or staying contracted out, you are accepting the risk that your pension income could be lower than if you had stayed in S2P.

If you don't want to accept this risk, contracting back in is likely to be the best option for you.

You should make sure you review your decision every year. The decision you make this year will not affect past years in which you were contracted out.

The tables on pages 4-7 compare the main differences between being in or out of S2P.

This is an important decision – take time to think about this and your personal priorities.

Key points

- Review your contracting out decision each year to make sure it is still right for you. Get professional financial advice if you're unsure.
- Do this before the end of the tax year on 5 April each year – your decision will affect your pension fund for the current tax year and your benefits at retirement.
- Your decision to stay contracted out will depend on your personal circumstances, such as your attitude to investment risk and the way you want to receive your benefits at retirement.

Key things to think about

This table compares the main differences between being in or out of the State Second Pension. The table is based on current law and government proposals, which could change.

	Contracting out or staying contracted out of S2P	Contracting in to S2P		Contracting out or staying contracted out of S2P	Contracting in to S2P
How is your pension worked out?	<p>The government pays your rebates into a personal or stakeholder pension of your choice. Personal and stakeholder pensions allow investments into a range of assets including, among other things, the stockmarket.</p> <p>The amount you will get from your contracted-out pension will, in particular, depend on:</p> <ul style="list-style-type: none"> • the amount of the rebates paid in; • how this money is invested and the performance of the underlying investments – for example stockmarket investments; • annuity rates at retirement; and • any charges you pay the pension company for running your fund. <p>Investments can go down as well as up, so you may end up with a smaller pension than you would with S2P.</p>	<p>The amount you will get will depend on the amount of National Insurance contributions you pay and the government’s pension policy.</p> <p>Governments may change pension policy. If that happens, you may end up with more or less S2P than calculations based on current pension policy would suggest.</p>	What happens when you retire?	<p>Most people use their pension fund to buy a lifetime annuity. An annuity is a special type of investment that converts your pension fund into retirement income.</p> <p>The amount of retirement income you get will mainly depend on the size of the fund you invest, but also your age, health and personal circumstances. For more information on this and other options read our Retirement options guide – see <i>Useful contacts</i> on Page 12.</p> <p>The minimum age at which you can take your pension is 55.</p>	<p>The government will pay your S2P at the same time as your basic State Pension.</p>

Key things to think about

	Contracting out or staying contracted out of S2P	Contracting in to S2P		Contracting out or staying contracted out of S2P	Contracting in to S2P
Is there a tax-free lump-sum option?	You can currently take up to 25% of your contracted-out fund as a tax-free lump sum when you retire. This will reduce the amount you have left to buy your annuity.	You cannot take a tax-free lump sum. However, you can defer taking your S2P beyond State Pension age. If you do this, you will have the choice of increasing the amount of your S2P or taking the additional benefits as a taxable lump sum. For further information read the Department for Work and Pensions (DWP) leaflet Deferring your State Pension – see <i>Useful contacts</i> on Page 12.	What happens if you die after you retire?	If you have a spouse or civil partner when you retire, you must currently buy a lifetime annuity that will pay out half the income to your spouse or partner if you die before them. This will change from 2012 when there will no longer be this restriction.	If you have a spouse or civil partner, they may qualify for a portion of your S2P if you die before them. For further information read the DWP leaflet Inheritance of SERPS pension – see <i>Useful contacts</i> on Page 12.
What happens if you die before you retire?	If you have a spouse or civil partner and die before you retire, your contracted-out fund must be used to provide benefits for them. If you don't have a spouse or civil partner, your contracted-out fund can be left as part of your estate.	If you have a spouse or civil partner and die before you start taking your State Pension, they may be eligible for half the S2P you have earned. If you don't have a spouse or civil partner, your S2P benefits are not payable to your estate. For further information read the DWP leaflet Inheritance of SERPS pension – see <i>Useful contacts</i> on Page 12.			

Your questions answered

Question

How will the government's changes to pensions affect me?

Answer

The government has announced plans to consult on increasing the State Pension Age to 66 from 2016.

It also intends to remove the requirement to buy an annuity or alternatively secured pension by April 2011. The full extent of the proposed changes is still to be decided.

Question

How much State Second Pension can I expect to receive?

Answer

If you are contracted out, your pension provider or financial adviser will give you an 'illustration' estimating how much pension income you might get.

This will be based on various assumptions such as inflation and stockmarket growth. If you are in S2P, you can find out how much SERPS/S2P you have earned already and how much you might expect to receive at State Pension age by contacting the State Pension Forecasting Team – see *Useful contacts* on Page 12.

Question

Where can I get advice?

Answer

Advice about whether to contract out or stay contracted out is available from a limited number of advisers. The Association of Independent Financial Advisers (AIFA) website lists the advisers who give advice in this area – see *Useful contacts* on Page 12.

Question

I've made my decision – what now?

Answer

If you decide to change your current position, contact your pension provider or financial adviser. They will tell you what you need to do. Make sure you do this well before 5 April if you want to change things for the current tax year. If you are happy with your current position, you don't need to do anything now. But you should review your decision next year because things may change.

Question

I want to complain about the advice I was given to contract out – what can I do?

Answer

There are a number of pros and cons to contracting out. If you were advised to contract out, your adviser should have taken them into account.

If you have concerns about the advice you were given, you should complain first to the firm or adviser you think is responsible. If they cannot resolve the dispute, you may be able to take it to the Financial Ombudsman Service – see *Useful contacts* on Page 12.

Next steps

Step 1

Find out whether you are contracted out by contacting your personal or stakeholder pension provider, asking your employer, or calling the HMRC Contracted Out Pension Helpline – see *Useful contacts* on Page 12.

Step 2

Review your position by comparing the differences between being in or out of the State Second Pension – see pages 4-7.

Step 3

If you decide to change your position, contact your pension provider or financial adviser. They will tell you what you need to do.

Step 4

Review your decision before 5 April each year as your decision will affect your pension fund for the current tax year and your benefits at retirement.

Jargon buster

Some key words and phrases explained.

Annuity rate

The amount of monthly income you get from your pension fund. It depends on several factors, particularly interest rates at the time and the insurance company's estimate of how long you will live.

Basic State Pension

The benefit provided at State Pension age to those with a sufficient National Insurance contribution record.

Contracting out

The facility to leave the State Second Pension – previously SERPS – and build up benefits in a personal or stakeholder pension.

Department for Work and Pensions (DWP)

The government department with overall responsibility for the rules governing pension schemes and the administration of State Pensions.

HMRC

HM Revenue & Customs – responsible for collecting taxes and paying tax credits.

National Insurance contributions (NICs)

You pay these if you are employed or self employed to build up your entitlement to certain social security benefits, including the State Pension. You stop paying NICs at State Retirement age.

State Second Pension (S2P)

An additional State Pension paid on top of the basic State Pension. It used to be called SERPS. Self-employed people cannot build up a State Second Pension.

Useful contacts

Consumer Financial Education Body (CFEB)

To order other Moneymadeclear™ guides or for general information or guidance

Helpline: 0300 500 5000
Typetalk: 1800 1 0300 500 5000

(Calls should cost no more than 01 or 02 UK-wide calls, and are included in inclusive mobile and landline minutes)

Other Moneymadeclear™ guides

- Getting financial advice
- Making a complaint
- Pensions
- Retirement options
- Saving and investing

For more titles, call us or go online
www.moneymadeclear.org.uk

On our Moneymadeclear™ website you can find

- **Comparison tables** to help you compare products like annuities, savings and investments.
- a **Budget calculator** to help you work out your spending.

Call rates may vary – check with your telephone provider.

Contracting out

HMRC

Contracted Out Pension Helpline
0845 915 0150

www.hmrc.gov.uk

To find out if you are contracted out.

Pension enquiries

The Pensions Advisory Service

0845 601 2923

www.pensionsadvisoryservice.org.uk

An independent organisation helping with pension queries.

Pension information and advice

DWP Pension Information Order Line

For booklets about State Pensions including:

- Inheritance of SERPS pension (Reference: SERPSL1)
- Deferring your State Pension

0845 731 3233

Textphone: 0845 604 0210

To get an estimate of your pension

State Pension Forecasting Team

0845 300 0168

Textphone: 0845 3000 169

Typetalk: 1800 1 0845 300 0168

www.direct.gov.uk

For an estimate of your State Pension and to use the State Pension age calculator.

The Pensions Regulator

0870 606 3636

www.thepensionsregulator.gov.uk

Finding an adviser who can give advice about contracting out

The Association of Independent Financial Advisers (AIFA)

www.adviserlists.co.uk/contracting

Finding a financial adviser/planner

Unbiased.co.uk

www.unbiased.co.uk

For independent financial advisers or mortgage brokers in your area.

Personal Finance Society

www.findanadviser.org

For financial advisers in your area.

Institute of Financial Planning

www.financialplanning.org.uk

For help in planning your finances.

Complaints and compensation

Financial Ombudsman Service

South Quay Plaza

183 Marsh Wall

London E14 9SR

0845 080 1800

or 0300 123 9 123

www.financial-ombudsman.org.uk

Financial Services Compensation Scheme (FSCS)

7th Floor, Lloyds Chambers

Portsoken Street

London E1 8BN

020 7892 7300

or 0800 678 1100

www.fscs.org.uk