

The Financial Services Authority (FSA) is the independent watchdog set up by government to regulate financial services and protect your rights.

We produce a range of user-friendly factsheets and booklets which are available from our website and helpline.

If, after reading this factsheet, you have any general queries, our helpline will try to clarify things for you.

We can tell you if a firm is authorised and help you if you have a complaint and don't know who to contact. But as the regulator, we can't recommend firms or advisers, or tell you whether a particular product or investment is right for you.

If you would like this factsheet in Braille, large print or audio format, please call our Consumer Helpline on 0845 606 1234 or Minicom/Textphone on 08457 300 104 (call rates may vary).

To help us maintain and improve our service, we may record or monitor calls.

Our website, www.moneymadeclear.fsa.gov.uk, aims to help you understand financial services and get a fair deal.

Use the site to:

- shop around with our comparative tables – including mortgages, pensions and ISAs;
- check a firm is authorised by the FSA, or is the agent of an authorised firm. If they are not authorised you will not have access to complaints procedures and compensation schemes if things go wrong;
- order any of our wide range of consumer publications;
- report any misleading financial advertising;
- see explanations of financial products in plain English;
- read recent alerts that we have issued.

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May 2007

FSA Factsheet

The State Second Pension – should you be contracted out?



This is important information that could affect the amount of money you get in retirement.

It is for you if you are an employee and are contracted out, or are thinking of contracting out, of the State Second Pension.

This information is *not* for you if you are:

- a member of your employer's occupational pension scheme which is contracted out – see page 7; or
- self-employed, as you cannot build up a 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 will also qualify for the State Second Pension (S2P) if you are employed and earning above a certain level on which you have paid National Insurance contributions. S2P is paid in addition to the basic pension. Until April 2002, the second pension was called the State Earnings Related Pension Scheme (SERPS).

What is contracting out?

The government 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.

How do I find out if I'm contracted out?

If you have a personal or stakeholder pension, you can check whether you are contracted out by contacting your pension provider. Or you can check with HM Revenue and Customs (HMRC) by calling its contracted-out helpline on 0845 915 0150 (call rates may vary).

- **Review your contracting-out decision each year** to make sure it is still right for you.
- Make sure you do this before the end of the tax year (5 April 2008) – your decision will affect your pension fund for the current tax year and your benefits at retirement.
- If you are unsure whether you are contracted out, check with your pension provider or HM Revenue and Customs (HMRC).

I am contracted out – what should I do?

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

How do I decide?

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

Independent analysis that has been completed for us suggests that for many people, the decision to contract out or stay contracted out during 2007/08 is likely to be finely balanced in purely financial terms. However, older age groups, particularly those closer to retirement, are likely to be financially worse off by contracting out. This position may change in future years.

Different decisions will be appropriate for different people and your own decision will depend upon other factors such as your personal circumstances, how you wish to receive your benefits at retirement and your attitude to investment risk. You may wish to contact your pension provider for further information or seek financial advice to help you make your decision – see page 6.

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 table on pages 4 and 5 compares the main differences between being in and out of S2P. **Please take time to think about this and your own personal priorities.**

This table compares the main differences between being in and 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

How does your pension grow?

The government pays your rebates into a personal or stakeholder pension of your choice. Personal and stakeholder pensions invest in, among other things, the stockmarket.

The amount you will get from your contracted-out pension will, in particular, depend on:

- the amount of the rebates paid in;
- how this money is invested and how the stockmarket changes;
- annuity rates at retirement; and
- any charges you pay the pension company for running your fund.

Investments can go down as well as up, so you may end up with a smaller pension than you would with S2P.

The amount you will get from your S2P will depend on the amount of National Insurance contributions you pay and the government's pension policy.

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.

What happens when you retire?

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. The amount of retirement income you get will, in particular, depend on your age, health and personal circumstances. For more information on this and other options, read the **FSA guide to pensions 3: Annuities and other retirement options**. To get a copy, see *Useful contacts* on page 7. The minimum age at which you can take your pension is going up from 50 to 55 by 2010. Pension providers can raise the age at any time between April 2006 and April 2010. Make sure you check this with your pension provider.

The government will pay your S2P at the same time as your basic State Pension. You can currently claim your State Pension at age 65 for men, and 60 for women. By 2020, the pension age for women will be 65, the same as for men.

The government has proposed further increases to the pension age, so that by 2046, the pension age for both men and women will be 68.

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 Department for Work and Pensions (DWP) leaflet, **Inheritance of SERPS pension**. To get a copy, see *Useful contacts* on page 7.

What happens if you die after you retire?

If you have a spouse or civil partner when you retire, you will have to buy a lifetime annuity that will pay out half the income to your spouse or partner if you die before them.

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**. To get a copy, see *Useful contacts* on page 7.

Is there a tax-free lump-sum option?

You are able to 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 now 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 DWP leaflet, **Your guide to State Pension Deferral**. To get a copy, see *Useful contacts* on page 7.

Will the government's proposed pension changes affect me?

The government has proposed some changes to S2P and contracting out. If they go ahead, you will no longer be able to contract out through a personal or stakeholder pension from around 2012.

The pension age will also increase so that by 2046, you won't be able to take your State Pension until the age of 68.

These proposals have not yet been approved by Parliament, so they could change.

What pension can I expect to receive?

If you are contracted out, your pension provider or financial adviser will give you an 'illustration' estimating how much pension income you might get 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 DWP. See *Useful contacts* on page 7.

I've made my decision – what now?

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 2008 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.

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

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 (FOS).

Where can I get help and advice?

Advice is available from a limited number of advisers. The Association of Independent Financial Advisers' (AIFA) website lists the advisers who can give advice in this area.

See *Useful contacts* on page 7.

You can get more information about pensions from the leaflets listed in *Useful contacts* on page 7.

Useful contacts

0845 numbers will be charged at the local rate based on current charges from BT landlines. Charges for calls from mobile phones and other networks may vary.

Pension Forecasting Team

For a forecast of your SERPS/S2P pension

Tel: 0845 3000 168

Textphone: 0845 3000 169

www.thepensionservice.gov.uk

DWP Pensions Information Line

DWP leaflets that may help you

■ *Inheritance of SERPS pension*

■ *Your guide to State Pension Deferral*

■ *Contracted-out pensions – Your guide*

Tel: 0845 7313 233

Textphone: 0845 604 0210

www.thepensionservice.gov.uk

For information about occupational pensions

To find out whether your occupational pension scheme is contracted out, contact your employer. For further information about occupational pension schemes, see

■ *Occupational pensions – your guide*

Tel: 0845 7313 233

Textphone: 0845 604 0210

www.thepensionservice.gov.uk

The Association of Independent Financial Advisers (AIFA)

For advisers who can give advice about contracting out

Tel: 020 7628 1287

www.aifa.net/consumer-area/

FSA guides

■ *FSA guide to pensions 3: Annuities and other retirement options*

■ *The State Second Pension (formerly SERPS) – were you wrongly advised to contract out?*

Tel: 0845 606 1234

Minicom/Textphone: 08457 300 104

www.moneymadeclear.fsa.gov.uk

Financial Ombudsman Service

For disputes you cannot resolve with the firm

Tel: 0845 080 1800

www.financial-ombudsman.org.uk

Our website and publications aim to give you general information to help you make financial decisions. It is not advice, nor can it take account of your own particular circumstances. For advice with a view to making decisions about your own circumstances you should consult a financial or other professional adviser.