

## **Factsheet - abolition of contracting out on a defined contribution basis**

At the moment some pension schemes are set up to provide a pension which replaces all, or part, of the additional State Pension. This includes some company, stakeholder and personal pension schemes. When you join one of these pension schemes, you are said to be 'contracted out' of the additional State Pension.

### **Changes to your defined contribution contracted-out pension scheme**

It is intended that from 6 April 2012 you will no longer be able to contract out of the additional State Pension (also known as the State Second Pension) on a defined contribution (money purchase) basis. Instead you will automatically be brought back into the additional State Pension and begin to build up entitlements from this time.

### **Why is contracting out on a defined contribution basis being abolished?**

The National Insurance rebates an individual currently gets if they are contracted out are intended to provide benefits broadly the same as those given up in the additional State Pension. However, because benefits from defined contribution schemes can vary, it is very difficult to predict with any degree of certainty what you will get. Due to this uncertainty and the difficult judgements that individuals currently have to make about whether they would be better off in the additional State Pension or contracted-out, the Government has decided to abolish contracting out on a defined contribution basis.

### **How much additional State Pension will I get once I am back in the State system?**

It is intended that from 6 April 2012, instead of receiving rebates of your National Insurance contributions you will begin to build up entitlement to the additional State Pension. For every year that you pay National Insurance on earnings over £4,940 a year (based on 2009/10 earnings) you'll get an extra £1.60 a week on your State Pension when you come to claim it.

### **I thought the Government was encouraging people to save in private pensions – why are you stopping me doing so?**

You will still be able to save in a defined contribution company pension, personal pension or stakeholder pension. All this change will do is remove the option for people to use this type of pension arrangement to contract out of (leave) the additional State Pension.

### **What do I need to do?**

- It is important for you to read this factsheet to understand how the abolition of contracting out on a defined contribution basis will affect you. If you are in a personal or stakeholder pension scheme read section A. If you are in an occupational pension scheme read section B.
- Your pension scheme administrator or employer should contact you nearer the date of abolition in order to explain how your scheme will operate in future.
- You should continue to review your pension position each year as you may be better off opting back into the State system prior to the abolition date.

## **Section A**

### **Q&A for employees in a contracted-out personal pension scheme or a contracted-out stakeholder pension scheme**

#### **What does it mean for me?**

- It is planned that from 6 April 2012, you will no longer be able to use a personal or stakeholder pension in place of (to contract out of) the additional State Pension.
- The Government will no longer make National Insurance rebate payments into your pension scheme in respect of earnings paid in tax years beyond the 6 April 2012.
- You can continue to pay your personal contribution into your scheme as usual.
- The changes will not affect any past or future entitlement you have to the Basic State Pension.

#### **Will my rate of National Insurance contributions change as a result of abolition?**

No. However, the Government will no longer pay a rebate of National Insurance contributions into your personal or stakeholder pension.

#### **What will happen to the National Insurance rebates that have already been paid into contracted-out personal and stakeholder pension schemes?**

At the moment the rebates together with any investment return are known as “protected rights”. There are currently restrictions on how protected rights can be used. This is because they are intended to be used to provide benefits in place of the additional State Pension. However, it is intended that from 6 April 2012 these restrictions will no longer apply.

#### **I have a rebate only pension scheme, what will happen to it in the future?**

A ‘Rebate-only Pension’ is one where the only contributions paid into it are the end-of-year rebates of National Insurance contributions paid by the Government direct to the pension scheme. Following abolition, these rebates will no longer be made in respect of any earnings paid in tax years beyond the intended abolition date of 6 April 2012. However, rebates already paid will remain in the scheme to provide benefits in place of the additional State Pension for the time you were contracted out. If you wish you can transfer these rights to another pension scheme if the new scheme is prepared to accept them.

#### **Can I make payments into my personal or stakeholder pension scheme after the abolition date? Will I still get tax relief?**

You will still be able to continue to make payments into your personal or stakeholder pension, but you will no longer receive a rebate of your National Insurance contributions. Tax relief will still be available on any of your own payments that you continue to make.

**Where can I go to find out more about my contracted-out personal/stakeholder scheme?**

**HMRC**

Contracted-Out Pensions Helpline - 08459150150

National Insurance Helpline - 08453021479

Pension Schemes Helpline - 0845 600 2622

[www.hmrc.gov.uk](http://www.hmrc.gov.uk)

**The Pensions Advisory Service**

Pension Helpline – 0845 6012923

[www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)

## **Section B**

### **Q&A for employees in a contracted-out defined contribution occupational pension scheme**

#### **What does this mean for me?**

- As you are contracted out, you and your employer currently pay lower National Insurance contributions. The difference between this amount and the full rate payable is paid into your pension scheme by your employer. This amount is known as the 'minimum payment'. However, following abolition this will no longer be possible as you and your employer will pay the full standard rate of National Insurance contributions. The higher National Insurance contributions will go towards building up your entitlement to the additional State Pension. Any additional contributions paid into the pension scheme by you and your employer will continue to be invested on your behalf and used to provide benefits when you retire.
- The changes will not affect any past or future entitlement you have to the Basic State Pension.

#### **What will happen to the National Insurance rebates that have already been paid into my employer's scheme?**

At the moment the rebates together with any investment return are known as "protected rights". There are currently restrictions on how protected rights can be used. This is because they are intended to be used to provide benefits in place of the additional State Pension. However, following abolition, these restrictions will no longer apply.

#### **Can I still pay into my employer's pension scheme?**

Yes. Any contributions that you and your employer currently pay into the scheme can continue to be made.

#### **Does my employer still have to run a pension scheme?**

Although no employer currently has to run a pension scheme (they do this on a voluntary basis for the benefit of their employees), these changes will **not** mean your employer has to stop running a scheme.

#### **Where can I go to find out more about my contracted-out occupational scheme?**

##### **HMRC**

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