

What you need to know about...

CONTRACTING OUT

Everyone pays National Insurance to build up their entitlement to the Basic State pension. Employed people also build up a separate state pension, called the second state pension (S2P, formerly SERPS), which is based on their earnings between certain bands. Contracting out refers to the ability to redirect certain National Insurance contributions into a separate pension pot, usually using a personal pension.

What happens when you contract out?

Instead of paying National Insurance contributions to the State scheme, you can redirect your payments to your own pension. Instead of providing a State-backed pension, related to your earnings, your contributions will go towards building up a fund, from which you will buy a pension income at retirement.

When you contract out you make a decision for that tax year. If you do not change this decision, you will remain contracted out until you reverse it. You may have taken the decision to contract out years ago, when your circumstances were very different, and you should therefore take the time to review your decisions.

What risks are there with contracting out?

With the State scheme you will be guaranteed a set level of pension according to your own circumstances. Of course, this is subject to future changes in legislation.

If you contract out of the State scheme you take all the risk, as your fund may not be large enough to pay the same income you would have received from the state scheme.

What do the experts think is the best thing to do?

This very much depends on your own personal circumstances. However, the Financial Services Authority recently commissioned independent analysis, which showed that:

'consumers are likely to be financially worse off by contracting out or staying contracted out...'

The State Second Pension - should you be contracted out? Nov 2006

This advice may change in future tax years, but the general advice for the moment is to contract back in to the state scheme. By contracting out you assume all the investment risk, not the State.

How do I contract back in?

Contact your pension provider or your financial adviser, who will give you a form to complete.

Can I get a forecast of my S2P?

Call the Pension Service on 0845 3000168, or ask your adviser for a BR19 form.

Continued overleaf...

Call today for independent financial advice on this, or any other issue on

01206 266882 or email advice@woodruff-fp.co.uk

Comparison of contracting in and out of S2P

	Contracting out to a personal pension	Contracting in to the State scheme
Growth of the pension	Part of your National Insurance is diverted to a personal pension plan, under your control.	This will depend on your earnings during your working life.
What are the risks?	<ul style="list-style-type: none"> ▪ The fund may not grow as quickly as you like ▪ The charges may be high ▪ Annuity rates may be low at retirement 	Your entitlement depends on whether future Governments change their policy.
Retirement	Usually you would buy an annuity at retirement. The income depends on the size of the fund, your age and sex.	You will receive your pension at the same time as your Basic State pension.
Death before retirement	If you are married your fund will be used to provide income for them; otherwise your fund can be left in your estate.	Your spouse may be eligible to receive half your benefits; otherwise your fund will be lost.
Death after retirement	Your spouse will receive half the income to which you were entitled.	Your spouse may be eligible to receive half your benefits.
Tax-free lump sum?	You can now take up to 25% of your fund as a tax-free lump sum. This will reduce your pension income.	There is no lump sum available. You can choose to defer your benefits, which will increase your income, or can be taken as a <i>taxable</i> lump sum.

As independent financial advisers we can help you to analyse your pensions to work out the best options for you. The contracting out decision should be taken with other related matters, so that you work towards your long-term retirement goals.

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