EXPLANATORY MEMORANDUM TO

THE PENSIONS ACT 2007 (SUPPLEMENTARY PROVISIONS) (NO.2) ORDER 2009

2009 No. 3094

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 Rebates of National Insurance contributions can be paid for people who contract out of the State Second Pension. Age-related percentages are used to work out the amount of these rebates paid into such a person's contracted-out personal pension scheme. This Order will ensure that those age-related percentages for personal and stakeholder pensions continue to be based on the rates of accrual used for the State Second Pension. From April 2010 there will be only two accrual rates used for the State Second Pension instead of the current three.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

4.1 The State Second Pension currently accrues on three different bands of earnings with different accrual rates applying to each band. These rates and earnings bands are used to calculate the age-related percentages applicable to employees who contract out of the State Second Pension through a personal or a stakeholder pension. Contracting out is the term used when someone gives up all or part of their State Second Pension in return for a rebate of their National Insurance contributions. The rebate is intended to provide benefits broadly the same as the State Second Pension given up.

4.2 From April 2010 there will be only two different rates of accrual for the State Second Pension, rather than the current three. *The Social Security (Reduced Rates of Class 1 Contributions, Rebates and Minimum Contributions) Order 2006,* ("the rebate order") sets out the age-related percentages for contracted-out personal pension schemes. The age-related percentages in that Order are amended so that they reflect the changed accrual rates for State Second Pension from April 2010.

5. Territorial Extent and Application

5.1 This Order extends to England and Wales and Scotland.

6. European Convention on Human Rights

6.1 As the Order is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 Employees building rights in the State Second Pension can decide to leave the State scheme provided they have a suitable private pension arrangement to take its place. This is known as contracting out. One of the ways in which they can do this is by joining an `appropriate personal pension scheme´ – this is the term used to describe a personal pension scheme that can be used by its members to contract out.

7.2 Individuals who contract out through an appropriate personal pension scheme are compensated for the State Second Pension forgone by receiving an annual refund of their National Insurance contributions. This is paid by HM Revenue & Customs direct to the scheme for investment on behalf of the employee.

7.3 Refunds of National Insurance contributions for appropriate personal pensions are calculated as an age-related percentage of earnings between certain levels. These percentages, covering the tax years 2007-2008 to 2011-2012, are set out in *Schedules 2-6 to the Rebate Order*. When a person contracts out, the amount of the refund reflects the amount of State Second Pension forgone. Therefore, the age-related percentages reflect the three bands of earnings on which the State Second Pension accrues at different rates.

7.4 From April 2010 the State Second Pension will accrue at only two different rates. These are:

- earnings exceeding the lower earnings limit (£4,940 in 2009/10) but not the low earnings threshold (£13,900 in 2009/10); and,
- earnings exceeding the low earnings threshold but not exceeding the upper accrual point (£40,040 in 2009/10).

Consequently, for tax years 2010-2011 and 2011-2012 (the final two years covered by the Rebate Order), the age-related percentages will reflect only these two rates of accrual, rather than the current three.

7.5 As the amount of State Second Pension is changed by the reduced number of accrual bands, it is appropriate to change the amount of the refund for those contracted-out through an appropriate personal pension. This Order changes the amount of the refund. People who contract out should therefore get a refund which reflects the State Second Pension they are forgoing.

- Consolidation

7.6 This is the first time the rebate order has been amended. The rebate order is expected to be replaced from April 2012. Consolidation is therefore not appropriate.

8. Consultation outcome

8.1 The changes in this Order stem from the state second pension simplification measures outlined in the White Paper: *Security in retirement: towards a new pensions system (CM 6841*) which set out the Government's proposals for pension reform. However, the high level simplification proposals attracted little comment and detailed proposals were only developed following the outcome of that consultation. This resulted in technical changes to the state second pension accrual which were introduced by the Pensions Act 2007. The supplementary changes provided for in this Order reflect a minor technical aspect of those simplification measures, and it was deemed that the changes would not warrant further public consultation.

8.2 During the passage of the Pension Act 2007, there was a brief debate on the measure in the House of Commons see: http://www.publications.parliament.uk/pa/cm200607/cmpublic/pensions/070130/pm/70130s01.htm. However, the debate mainly focused on future State Pension outcomes rather than the technical aspects of the proposed change. In addition, the changes in that Act were outlined in the House of Commons Library Research Paper 07/05 which can be found at http://www.parliament.uk/commons/lib/research/rp2007/RP07-005.pdf. In the main, the measure attracted little attention and no issues or concerns were raised.

9. Guidance

9.1 The Government will be reminding pension providers of the change in a newsletter to the pensions industry and will also be providing guidance.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

10.3 A full impact assessment has not been prepared for this Order.

11. Regulating small business

11.1 The legislation applies to small business, but the impact is as for all businesses – negligible.

12. Monitoring & review

12.1 The origin of the provisions in this Order is the change to the State Second Pension accrual bands. The rationale for those changes is simplification: this is the first step towards transforming the State Second Pension into a simple, flat rate weekly top-up to the basic State Pension. The changes in this Order are supplementary to, and in consequence of, these simplification measures and are necessary in order to ensure that the rebate percentages continue to be calculated in the same way as the State Second Pension.

13. Contact

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