These notes refer to the Child Support, Pensions and Social Security Act 2000 (c.19) which received Royal Assent on 28th July 2000

CHILD SUPPORT, PENSIONS AND SOCIAL SECURITY ACT 2000

EXPLANATORY NOTES

Part II: Pensions

Commentary on Sections

Chapter I: State Pensions

State second pension

Section 31: Calculation

377. *Subsections (1) and (2)* amend subsection (2) of, and insert subsection (3A) into, section 45 of the Contributions and Benefits Act, which sets out the way Additional Pension is calculated. They provide for Additional Pension to be the sum of entitlement accrued under SERPS and entitlement accrued under State Second Pension.

378. *Subsection (3)* introduces Schedule 4 which sets out a new Schedule 4A which is to be inserted into the Contributions and Benefits Act. It sets out the way in which State Second Pension is to be calculated for those contracted-in and those contracted-out.

New Schedule 4A: Additional pension

379. This Schedule sets out the way in which Additional Pension will be calculated under State Second Pension ("the final amount"). There are four Parts to the Schedule:

- Part I sets out the calculation of the final amount;
- Part II sets out the calculation of the yearly amount for someone who is not contracted-out for any part of the year;
- Part III sets out the calculation of the yearly amount (if any) for someone in contracted-out employment for the whole of the year;
- Part IV provides for regulations to be made in particular to provide for the calculations where someone moves between contracted-in and contracted-out employment in the course of a year, and between different types of contracted-out provision within a year.

Part I: The amount

Paragraph 1(1) provides for the amount of Additional Pension under State Second Pension to be calculated by adding together the amounts (if any) for each year since the introduction of State Second Pension, and then dividing by the number of relevant years (that is, the number of years in the working life since 1978, when Additional Pension was introduced).

Sub-paragraphs (2) to (7) set out the method of calculating the number of years in the working life to be used in the calculation of any Additional Pension payable under State Second Pension to widows and widowers, based on their late spouse's contributions. This method is the same as that used under SERPS for those widowed from 6 April 1999 onwards.

Sub-paragraph (8) defines "relevant year" as the number of years in the working life since 1978 by reference to section 44(7) of the Contributions and Benefits Act.
Part II: Surplus earnings factors

Paragraph 2(1) provides for Part II of the Schedule to apply to any year in which a person has a surplus in his earnings factor for the year. There is a surplus where the earnings factor for the year exceeds the Qualifying Earnings Factor (QEF), which is 52 times the weekly Lower Earnings Limit for the year.

Sub-paragraphs (2), (3) and (4) set out how State Second Pension will be calculated for someone who is not contracted-out of the state scheme at any time during the year in question.

First, the surplus earnings factors for the years in question are to be divided into the bands shown in the appropriate table in sub-paragraph (3) or (4). Secondly, the surpluses in each of the bands are to be revalued for each year to ensure that they maintain their value in earnings terms. This revaluation is in line with the increase in national average earnings up to the year before the year in which state pension age is reached (under section 148 of the Administration Act). Thirdly, the revalued surpluses in each band are to be multiplied by the relevant percentage in the tables in sub-paragraphs (3) or (4). Finally, the totals for each band are added together to give the total for the year.

This calculation differs from that used for SERPS by the application of different accrual rates to the surplus in the earnings factor falling within different bands of surplus earnings factors. Under SERPS anyone retiring from 6 April 2009 onwards (Table 2) would have had one accrual rate of 20% on their surplus earnings factor. Under State Second Pension the same person will have an accrual rate of 40% on the surplus in their earnings factor falling within Band 1. Band 1 covers surpluses in the earnings factor which correspond to the amount of earnings between the Qualifying Earnings Factor and the Low Earnings Threshold of £9,500. This band will include those low earners, carers and disabled people with broken work records who are treated as if they had an earnings factor of £9,500 in a qualifying year under section 44A(2) of the Contributions and Benefits Act as inserted by subsection (3) of section 30 above.

Surpluses in a person's earnings factor falling within Band 2 will have an accrual rate of 10%. Band 2 covers twice the amount of surplus falling within Band 1, rounded to the nearest £100. So, if the Qualifying Earnings Factor is £3,432 (52 times the 1999/00 weekly Lower Earnings Limit) and the Low Earnings Threshold is £9,500, the amount of surplus falling within Band 1 will be £6,068. This means that the amount of surplus falling within Band 2 will be £12,136 and the upper limit of Band 2 will be £9,500 + £12,136, rounded to the nearest £100, which is £21,600. Someone earning £21,600 will receive the same amount from State Second Pension as they would have done under SERPS, because the higher accrual rate on the surplus in their earnings factor falling within Band 1 will be entirely offset by the lower accrual rate on the surplus in their earnings factor falling within Band 2. Those earning less than £21,600 will receive more from State Second Pension than they would have done under SERPS.

Surpluses in a person's earnings factor falling within Band 3 will have an accrual rate of 20%, that is the same as under SERPS. Band 3 covers surpluses in the earnings factor which correspond to earnings which are above the surplus falling within Band 2 but not exceeding the Upper Earnings Limit.

Someone reaching state pension age before 6 April 2009 would have had an accrual rate higher than 20% under SERPS. This is because of the changes made in the Social Security Act 1986, which reduced the accrual rate in SERPS in stages from 25% to 20% for those retiring between 2000/01 and 2009/10 (in respect of accruals from

1988/89). There will be similar transitional arrangements in the State Second Pension and Table 1 shows the accrual rate for those retiring before 6 April 2009. Someone reaching state pension age before then will have accrual rates which give an extra 1% on the surplus in their earnings factor falling within Band 1, 0.25% on the surplus in their earnings factor falling within Band 2, and 0.5% on the surplus in their earnings factor falling within Band 3 for each year by which the year in which they reach state pension age is earlier than 2009/10. For instance, someone reaching state pension age in the year beginning 6 April 2008 would have accrual rates of: 41% on the surplus in their earnings factor falling within Band 1 (twice what it would have been under SERPS); 10.25% on any surplus falling within Band 2 (half what it would have been under SERPS); and 20.5% on any surplus falling within Band 3 (the same as it would have been under SERPS).

Sub-paragraph (5) will enable regulations to be made to bring in Stage 2 of the State Second Pension for people with a significant part of their working life ahead of them. All those coming within the scope of Stage 2 will earn entitlement to State Second Pension as if they had an earnings factor of £9,500, regardless of their actual earnings. This means that low earners, carers and long-term disabled people with broken work records will continue to be deemed to have an earnings factor of £9,500. However, those earning more than £9,500 will only earn entitlement to State Second Pension on the surplus in their earnings factor falling within Band 1, that is the amount between the prevailing annual Lower Earnings Limit (the Qualifying Earnings Factor) and the Low Earnings Threshold (the deemed earnings factor under new section 44A, which is £9,500 or the prevailing level at the time Stage 2 is introduced). This will only apply to entitlement accrued after the "second appointed year", which will be the year in which Stage 2 is introduced. Any entitlement accrued under Stage 1 will be preserved. It is intended that Stage 2 will not be brought in until stakeholder pension schemes have established themselves.

Sub-paragraphs (6), (7) and (8) define "the value of N", "LET", "QEF" and "2QEF", and also the "final relevant year".
Part III: Contracted-out employment etc

Paragraph 3: Introduction

380. Paragraph 3 provides for Part III, and not Part II, of the Schedule to apply to any year throughout which the person is contracted-out of the state scheme and in an occupational or personal pension scheme.

Paragraph 4: The amount

381. This paragraph provides for calculation of the amount for that year (for the purposes of the calculation in paragraph 1) under State Second Pension for someone in contracted-out employment (amount C) to be the amount of additional pension they would have received if they had not been contracted-out of State Second Pension (amount A) less the amount of pension they are deemed to receive in respect of their contracted-out National Insurance rebate (amount B).

Paragraph 5: Amount A

382. Amount A is the amount a person would have received from State Second Pension if they had not been contracted-out. The calculation is the same as that in Part II with one exception - there is no provision to move to a flat-rate scheme as in the second stage of State Second Pension. This is because those who are contracted-out will continue to receive earnings-related rebates, and their top-up (if any) will be based on the earnings-related first stage of State Second Pension.

Paragraph 6: Amount B (first case)

383. Amount B (first case) applies to those who are contracted-out by an occupational salary-related, or money purchase scheme, including an employer's occupational-based stakeholder pension scheme. It is the amount of contracted-out second pension which a person is treated as receiving in respect of their National Insurance rebate.

384. A person in a contracted-out occupational scheme receives a rebate which is calculated to reflect the cost of providing benefits of an actuarial value equivalent to that of the state benefit given up. Currently, under SERPS, the benefit given up is 20% of their lifetime earnings for someone who reaches state pension age on or after 6 April 2009. (Those reaching state pension age before 6 April 2009 have a higher accrual rate as described above, which is reflected in the amount of their rebate.)

385. Under State Second Pension a person in a contracted-out occupational scheme will continue to receive a rebate calculated on this basis.

386. Therefore, amount B (the amount to be deducted from what the person would have got if they had not been contracted-out of the state scheme) is 20% (or 20+N% for someone retiring before 6 April 2009) of the "assumed surplus" in their earnings factor for the year. The "assumed surplus" is defined in *sub-paragraph (2)* of paragraph 8 as the surplus there would have been if the person had not been contracted-out. In effect, this is their earnings between the Lower and Upper Earnings Limits for the year. The assumed surplus is then revalued in the same way as the surplus in amount A, to ensure that the amount B for each year also maintains its value relative to average earnings up to state pension age.

387. As *paragraph 8(3)* makes clear, there is to be no boost to the amount of the Low Earnings Threshold when calculating amount B. So where actual earnings are between the annual Lower Earnings Limit and the Low Earnings Threshold, the rebate will be calculated on the basis of the actual earnings.

388. For all those earning less than the upper limit of Band 2 (£21,600 in 1999/00 terms) there will be a surplus when amount B (first case) is deducted from amount A. This is because State Second Pension is more generous than SERPS for those earning less than the upper limit of Band 2. Those earning below the Low Earnings Threshold benefit from the boost to that threshold, and moderate earners continue to benefit from the increased accrual rate on their Band 1 earnings until earnings reach the upper limit of Band 2. The surplus of amount A over amount B represents the extra a person would have received if they had remained in an earnings-related State Second Pension scheme. The surplus will be paid as a top-up to the state pension when the person reaches state pension age.

Paragraph 7: Amount B (second case)

389. Amount B (second case) applies to those who are contracted-out by an appropriate personal pension, including a non-occupational stakeholder pension scheme. It is the amount of contracted-out second pension which a person is treated as receiving in respect of their National Insurance rebate.

390. For those contracted-out into appropriate personal pension schemes, including stakeholder personal pension schemes, the amount of rebate paid to their scheme will be increased when State Second Pension is introduced to reflect the 3 part accrual rate in State Second Pension itself. This is reflected in Table 5 (for those reaching state pension age before 6 April 2009) and in Table 6 (for those reaching state pension age on or after 6 April 2009).

391. This means that for all those earning at or above the Low Earnings Threshold, amount B (the revalued assumed surplus) will be the same as amount A (the revalued surplus calculated as if the person had been contracted-in). Where earnings are above the annual Lower Earnings Limit, but below the Low Earnings Threshold, for the year there will

be a surplus when amount B (second case) is deducted from amount A. This surplus represents the extra a person would have received in State Second Pension from the low earner's boost. The surplus will be paid as a top-up to the state pension when the person reaches state pension age.

Paragraph 8: Interpretation

392. This paragraph defines "salary related contracted-out scheme", "money purchase contracted-out scheme", "appropriate personal pension scheme", "assumed surplus", "N", "LET", "QEF", "2QEF" and "final relevant year".

Part IV: Other cases

393. **Paragraph 9** provides for regulations to be made for calculating the amount of any State Second Pension in a year for those cases not covered by Parts II or III. In the main these will be cases where the person's circumstances change during the course of the year. For instance, a person may move between contracted-in and contracted-out employment during the year. Or they may move between different categories of contracted-out employment, such as from employment with a personal pension scheme to one with an occupational pension scheme.

394. In such cases it will be necessary to apportion the amounts calculated according to amounts of employment in each circumstance. The guiding principle for these regulations will be to provide a top-up from the state scheme if the person contracted-out would have received more from State Second Pension than the amount they are treated as receiving in respect of their National Insurance rebate.

395. Paragraph 9 also provides for regulations to be made in "such other cases as the Secretary of State thinks fit". This provision will be used to prescribe how the provisions regarding the Contribution Equivalent Premium and the restoration of state scheme rights will operate under, and interact with, the State Second Pension provisions. These are the provisions which deal with the necessary calculations for those who are contracted back into the State scheme because, for instance, their contracted-out employment terminates after less than 2 years. As above, this power is to be used to ensure that no one loses out because they had a period in contracted-out, rather than contracted-in, employment.