These notes refer to the Pensions Act 2007 (c.22)
which received Royal Assent on 26 July 2007

PENSIONS ACT 2007

EXPLANATORY NOTES

SUMMARY AND BACKGROUND

State Pensions Measures

Additional pension: simplification of accrual rates

Current position

58. Paragraphs 60 – 63 detail how state second pension is to be accrued. In broad terms, for any given tax year, state second pension accrues on the portion of an employee's annual earnings between the annual value of the lower earnings limit and the upper earnings limit for Class 1 National Insurance contributions – called the "surplus earnings factor". This amount is revalued in line with growth in average earnings up to the last full tax year of a contributor's working life. The accumulated surplus earnings factors are then divided by the number of years in the person's working life to produce a "lifetime average" which is multiplied by the relevant accrual rate and divided by 52 to produce a weekly rate of additional pension.

59. People earning, or treated as earning, between the lower earnings limit and the upper earnings limit accrue state second pension on a cumulative basis depending on the level of their earnings. Earnings above the upper earnings limit do not accrue state second pension. The table below sets out the current earnings accrual bands for state second pension that will apply from 2009/2010.

Earnings		***Percentage***
Band 1	Not exceeding low earnings threshold	40
Band 2	Exceeding low earnings threshold but not exceeding upper earnings threshold	10
Band 3	Exceeding upper earnings threshold but not exceeding upper earnings limit	20

Changes

60. Under the provisions of this Act, state second pension will be restructured.

61. The first step will be to merge Bands 2 and 3, so that all earnings exceeding the low earnings threshold (but not exceeding the upper earnings limit) will fall into Band 2 and accrue additional pension at a rate of 10%. This change will have effect for the tax year 2010-11 onwards.

62. In addition, from a date to be determined by the Secretary of State by order, the current 40% accrual band (Band 1) for earnings between the lower earnings limit and the low earnings threshold will be replaced with a weekly flat rate accrual amount of £1.50 (giving an equivalent annual amount of £78.00). This will be accrued by all contributors and people credited into state second pension in respect of each year of contribution.

For a time, the additional earnings-related component of state second pension (accruing at 10%) will remain in place. This component will ultimately be withdrawn by around 2030, leaving a flat-rate benefit.

63. These changes will have an effect on the contracted-out rebate for defined benefit schemes. If a pension scheme member is opted out of state second pension they receive a “rebate” from the Government, delivered through reduced-rate National Insurance contributions, which is based on the amount of state second pension foregone. Therefore changes to state second pension need to be taken into account when calculating the rebate.