

April 2016: The End of Contracting Out

On 6 April 2016 the state pension will change as part of Government state pension reforms. This change will affect defined benefit pension schemes that have “contracted out” of the current state second pension. These are statutory changes legislated in the Pensions Act 2014¹.

What is a “contracted out” scheme?

The current state pension is made up of two parts: the **basic state pension** and the **state second pension**. The state second pension was originally introduced in 1978 called State Earnings Related Pension Scheme (SERPS); it became the state second pension (often referred to as S2P) in 2002.

Many defined benefit occupational pension schemes are contracted out of the state second pension scheme. Members of a contracted out scheme don't build up benefits in the state second pension, instead they accrue a minimum level of benefits within their employer's pension scheme. As a result of 'contracting out' employers and active scheme members pay slightly lower ('discounted') National Insurance² (NI) contributions on earnings between certain levels; 3.4% lower than standard for employers and 1.4% lower than standard for active scheme members. NI contributions are a percentage of the employee's earnings.

What happens to the state pension in April 2016?

The current basic state pension and second state pension will be abolished and replaced by a single-tier state pension³, which means the end of contracting-out for defined benefit schemes. As a consequence, employers and scheme members of a contracted out scheme will pay the standard National Insurance contributions; which translates as an increase over what is currently paid.

The affect on occupational pension schemes

Some employers can amend their pension schemes to offset the NI increases by amending the scheme benefits or changing the pension scheme contribution rates. This power does not extend to public service pension schemes and therefore will not apply to the **Research Councils' Pension Scheme** (RCPS). It is important to note that schemes are not permitted to remain contracted out after 6 April 2016.

If you are an active member of the **RCPS** it means your NI contribution rate will go up by 1.4% from 10.6% to 12% effective from 6 April 2016. Your employer will see their related NI contributions rate increase by 3.4% from 6 April 2016.

¹ Pension Act 2014: <http://www.legislation.gov.uk/ukpga/2014/19>

² National Insurance: <https://www.gov.uk/national-insurance>

³ New single state pension: <https://www.gov.uk/new-state-pension>

Can you give me some more detail about the NI increases?

Active members of the RCPS currently pay a discounted NI contribution of 10.6% on earnings between £672 per month and £3,337 per month. Earnings between £468 per month and £672 per month attract an NI rebate of 1.4%, which also ceases in April 2016. Only the NI contributions paid with regard to these earnings bands will change from April 2016.

Earnings between £3,337 and £3,532 per month attract an NI contribution of 12%. This is not changing.

For earnings above £3,532 per month (known as the upper earnings limit) there is a standard NI contribution rate of 2%. This is regardless of whether a scheme is currently contracted in or out, and is not changing.

In the Chancellor's Summer Budget 2015 he announced that the upper earnings limit will increase to £3,584 per month in 2016-17.

Further information about NI rates and earnings limits is available on Gov.uk:

<https://www.gov.uk/national-insurance/how-much-you-pay>

<https://www.gov.uk/guidance/rates-and-thresholds-for-employers-2015-to-2016>

The following tables illustrate how much more employees will pay in NI contributions from April 2016:

Annual Earnings	£16,000.00	£17,000.00	£20,000.00	£22,000.00	£25,000.00	£28,000.00	£30,000.00	£33,000.00	£35,000.00	£37,000.00	£39,000.00	£40,044.00
Monthly Earnings	£1,333.33	£1,416.67	£1,666.67	£1,833.33	£2,083.33	£2,333.33	£2,500.00	£2,750.00	£2,916.67	£3,083.33	£3,250.00	£3,337.00
Employees Extra NI per month	£11.86	£13.03	£16.53	£18.86	£22.36	£25.86	£28.20	£31.70	£34.03	£36.36	£38.70	£39.91

Earnings below £672 per month do not pay NI contributions.

Earnings between £3,337 and £3,532 per month pay the standard NI contribution rate of 12%

Earnings currently above £3,532 per month pay the standard NI contribution rate of 2%.