

In the UK, the State provides two forms of retirement income. These are the basic State pension and the State second pension (S2P).

**Basic State pension:** The basic State pension can be claimed when an individual reaches the State pension retirement age. Currently this age is 65 for men and 60 for women. However, this is due to change. By 2020, the State retirement age for women will be 65 too. This change will be phased in gradually starting in 2010. The State Pension retirement age for both men and women will increase from 65 to 68 between 2024 and 2046.

To qualify for the pension, individuals need to have built up sufficient qualifying years. Each qualifying year is defined as a full tax year in which sufficient earnings have arisen and for which one has made national insurance contributions (NICs). Currently men need to have 44 qualifying years to qualify for the full basic State pension. For women reaching retirement before 2010 the requirement is usually 39 years. Under certain circumstances women can qualify for the basic State pension on the basis of NICs made by their husband.

People who have 25% of the qualifying years can claim the minimum basic State pension, and for those without this minimum of qualifying years, a basic State pension can only be claimed after the age of 80.

Finally, people can choose to defer the date at which they receive the State pension. By doing this, a commensurately higher weekly pension can be obtained later.

**State second pension (S2P):** Like the basic State pension scheme, the pension payable under the S2P is related to the NICs made by an individual and is an earnings-related scheme. This scheme replaced the State Earnings Related Pension Scheme (SERPS) in April 2002. Under S2P the additional pension entitlement was enhanced for low to moderate income earners compared with the SERPS arrangement and also extended entitlement rights to carers and to those suffering longterm illness and/or disability who were not able to build up SERPS pension entitlements because they had little or no earnings.

The idea behind S2P, and the original idea behind SERPS too, is that it should act as a top-up to the basic State pension. Entitlement to a S2P pension increases as the earnings of the individual rise (hence it is earnings related) up to a maximum that is set by the Treasury.

**Contracting out:** Entitlement to a SERPS pension has been complicated by the issue of contracting out. Back in April 1988 the government gave people the opportunity to opt out of the SERPS arrangement. Instead they could opt to pay their SERPS NICs into either an occupational pension scheme or into a personal pension plan (PPP).

If an individual has chosen to opt out of SERPS and is therefore opted out of the S2P arrangements too, because they are a member of their employer's contracted out occupational pension scheme, they will pay lower NICs as a result, but will be entitled to a lower S2P too. This is because the additional pension will come via the occupational pension scheme of which the individual is a member.

Those individuals that opted out of SERPS and are therefore also opted out of S2P, via a PPP, do not pay lower NICs as a result. Instead the Inland Revenue will pay an annual national insurance rebate into the opted out PPP accordingly. Once again, opting out of the S2P will automatically lead to a lower entitlement to the additional State pension.

The Pensions Commission: Significant changes to State scheme provision were proposed by the government appointed, Pensions Commission in 2005 and 2006. Please see the "*The Pension Commission's proposals – a new pension settlement for the 21st century?*" in the *Investment Tutor* Topical Articles area.

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Contact us at Aviva Investors Global Services Limited, No. 1 Poultry, London EC2R 8EJ.  
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