PENSIONS POLICY INSTITUTE
PPI

Financial Security in Retirement

Chris Curry

Pensions Policy Institute

CHASM Annual Conference 2014

18 July 2014

www.pensionspolicyinstitute.org.uk

Financial security in retirement

PENSIONS POLICY INSTITUTE
PPI

- The state pension is being redistributed but will be less generous
- Private pensions will be more widespread, but people will not be saving enough
- The Budget gives freedom and choice over retirement income, but will retirement incomes increase?
- What might change?

The state pension is being redistributed but will be less generous

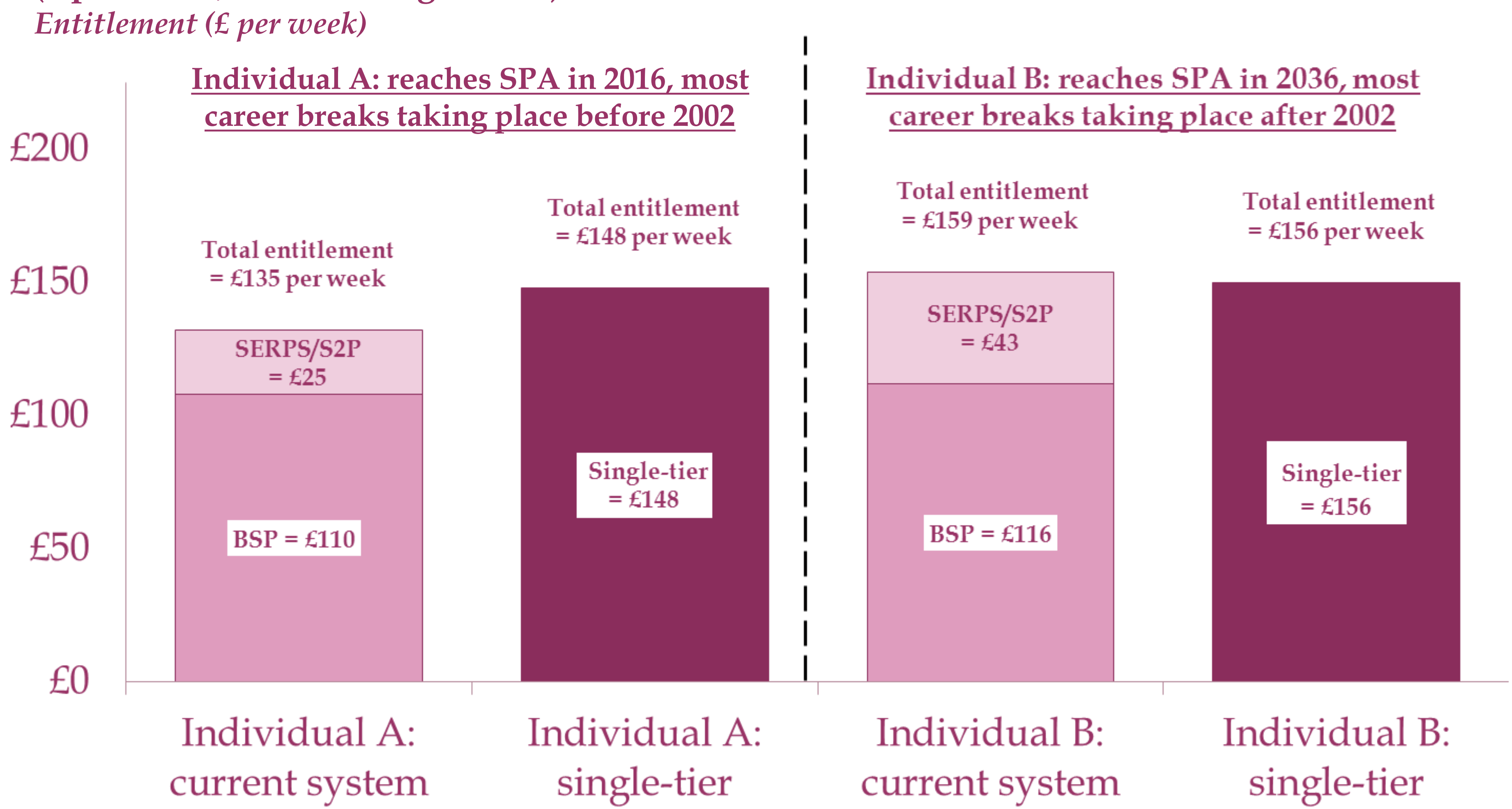
PENSIONS POLICY INSTITUTE
PPI

- The state pension will be a flat rate single tier pension for those reaching SPA from April 2016
- Higher earners will receive lower state pensions than in the current system
- Those with low S2P (older working age women and the self-employed) will do better in the new system
- But younger low income individuals could see lower state pensions in the new system

Individuals spending time out of the work force, but who would have qualified for S2P credits after 2002, may receive less from the single-tier pension

PENSIONS POLICY INSTITUTE

Comparison of the state pension entitlements of two low earning individuals, each spending around half of their working life out of work, one reaching SPA in 2016 and one in 2036 (£ per week, 2013 earnings terms)



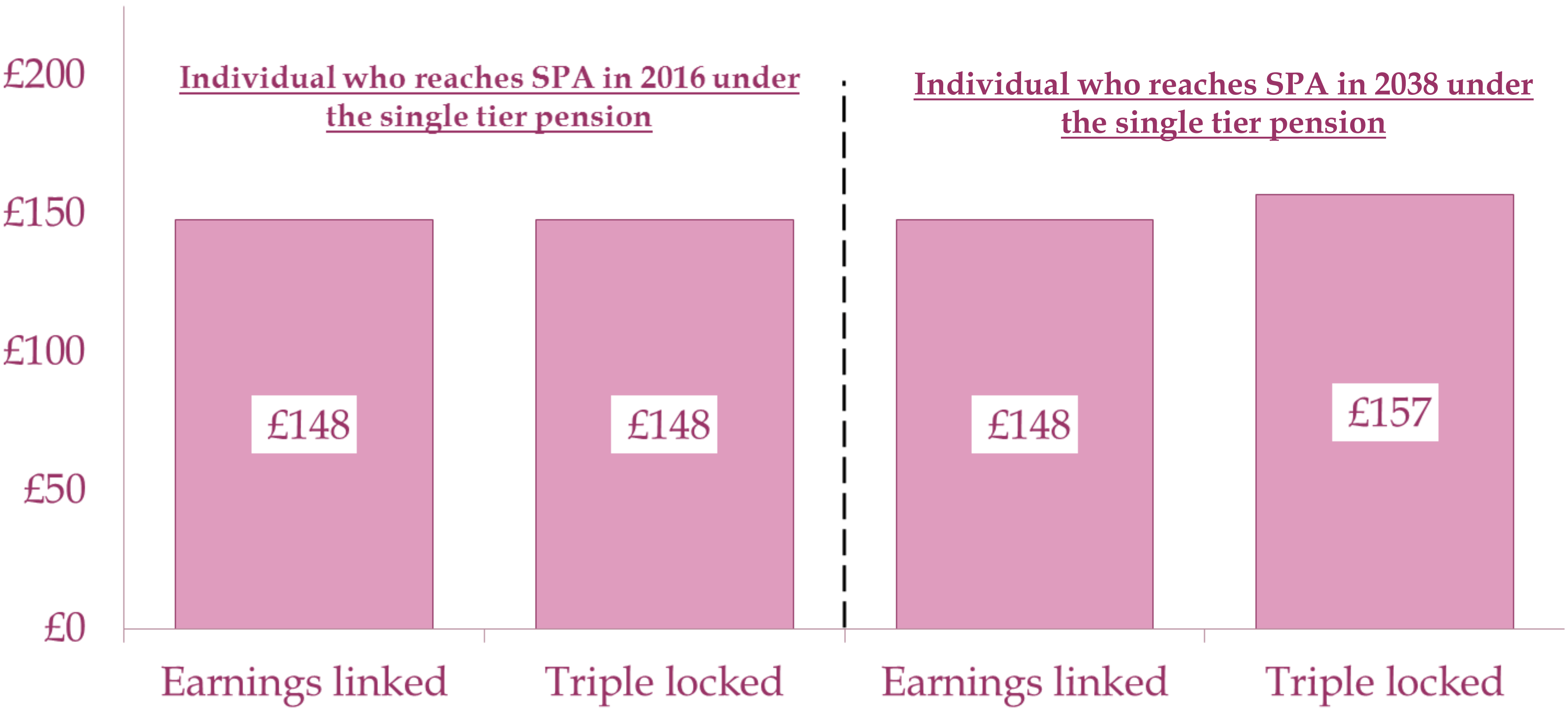
An earnings linked Single Tier pension may result in a lower pension than a triple locked pension

PENSIONS POLICY INSTITUTE

PPI

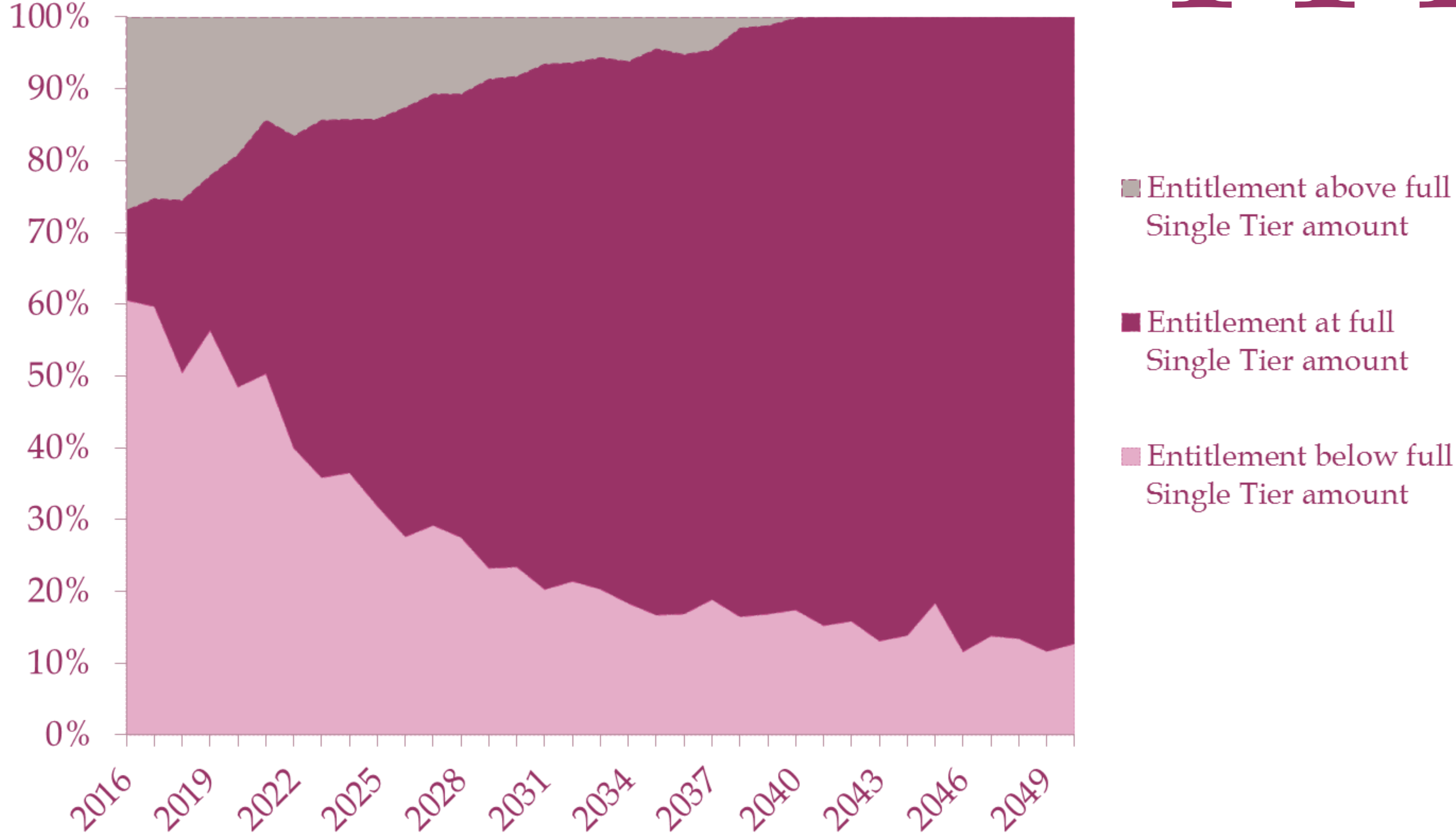
Comparison of the outcome of the state single tier pension entitlement of an individual reaching SPA in 2038 if the pension is triple locked from 2015 compared to an earnings linked single tier pension (£ per week, 2013 earnings terms)

Entitlement (£ per week)



Level of entitlement for proportion of individuals reaching SPA in each year

PENSIONS POLICY INSTITUTE
PPI



Source: DWP estimates of level of entitlement to single-tier ***(based on the modelling and economic assumptions in the October 2013 Pensions Bill Impact Assessment)***

Private pensions will be more widespread, but people will not be saving enough

PENSIONS POLICY INSTITUTE
PPI

- Automatic enrolment has been very successful so far
- But not everyone is saving
- Savings levels are low – and lower than needed for an adequate retirement income
- Lower earners may need to save relatively less compared to higher earners (if they work and save in most years), but affordability issues remain

Who is saving under automatic enrolment?

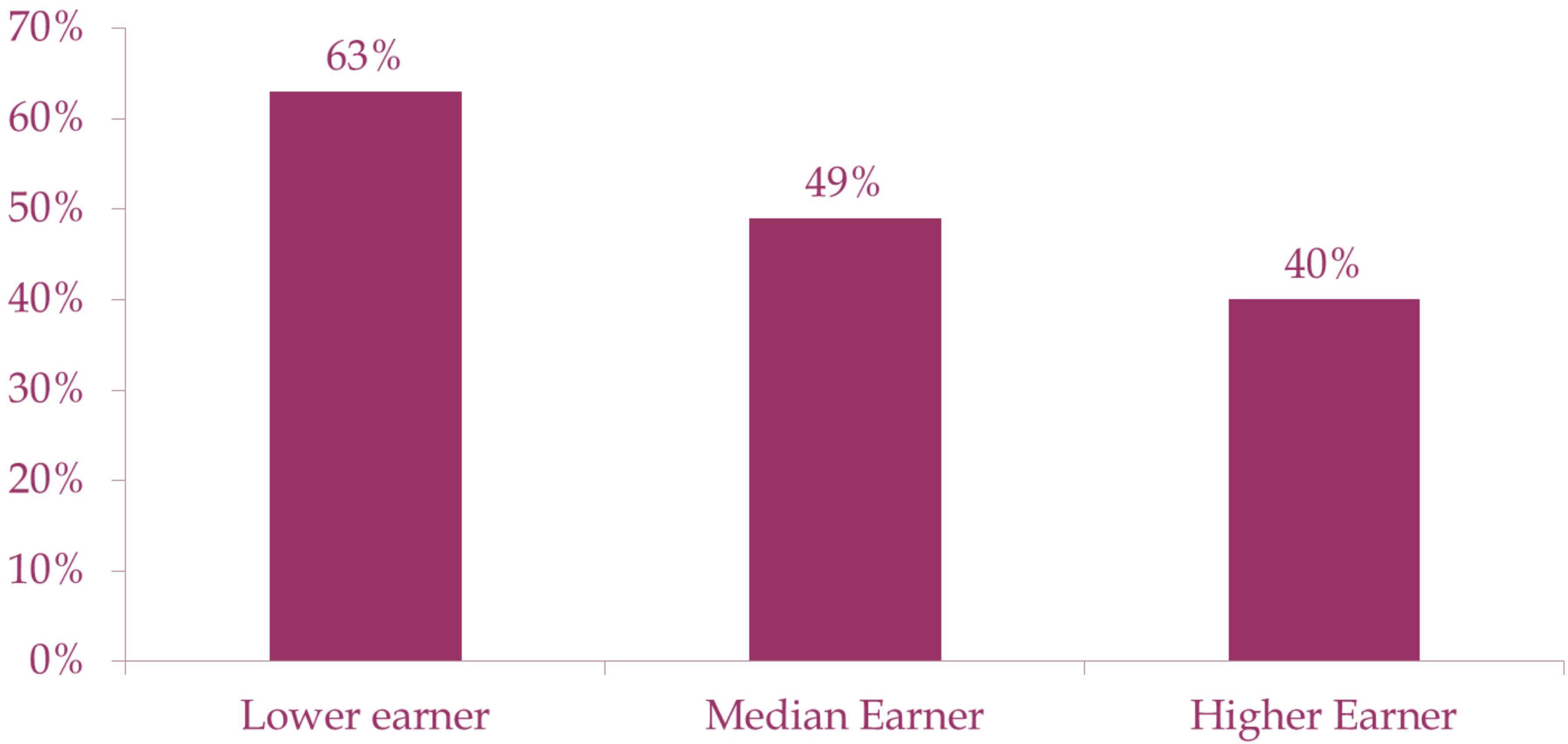
PENSIONS POLICY INSTITUTE
PPI

- 90% of those automatically enrolled are saving
- Comprehensive data is not yet available, but there are patterns emerging regarding who is more likely to opt out:
    - Those in older age groups
    - Women
    - Tentative correlation between those enrolled at higher contribution levels and opt-outs
    - "Financial constraints" - the main reason for opt-outs
- 3.5 million people have been automatically enrolled, but 4.2 million people have not

The probability of achieving the target replacement income varies by earnings level

PENSIONS POLICY INSTITUTE
PPI

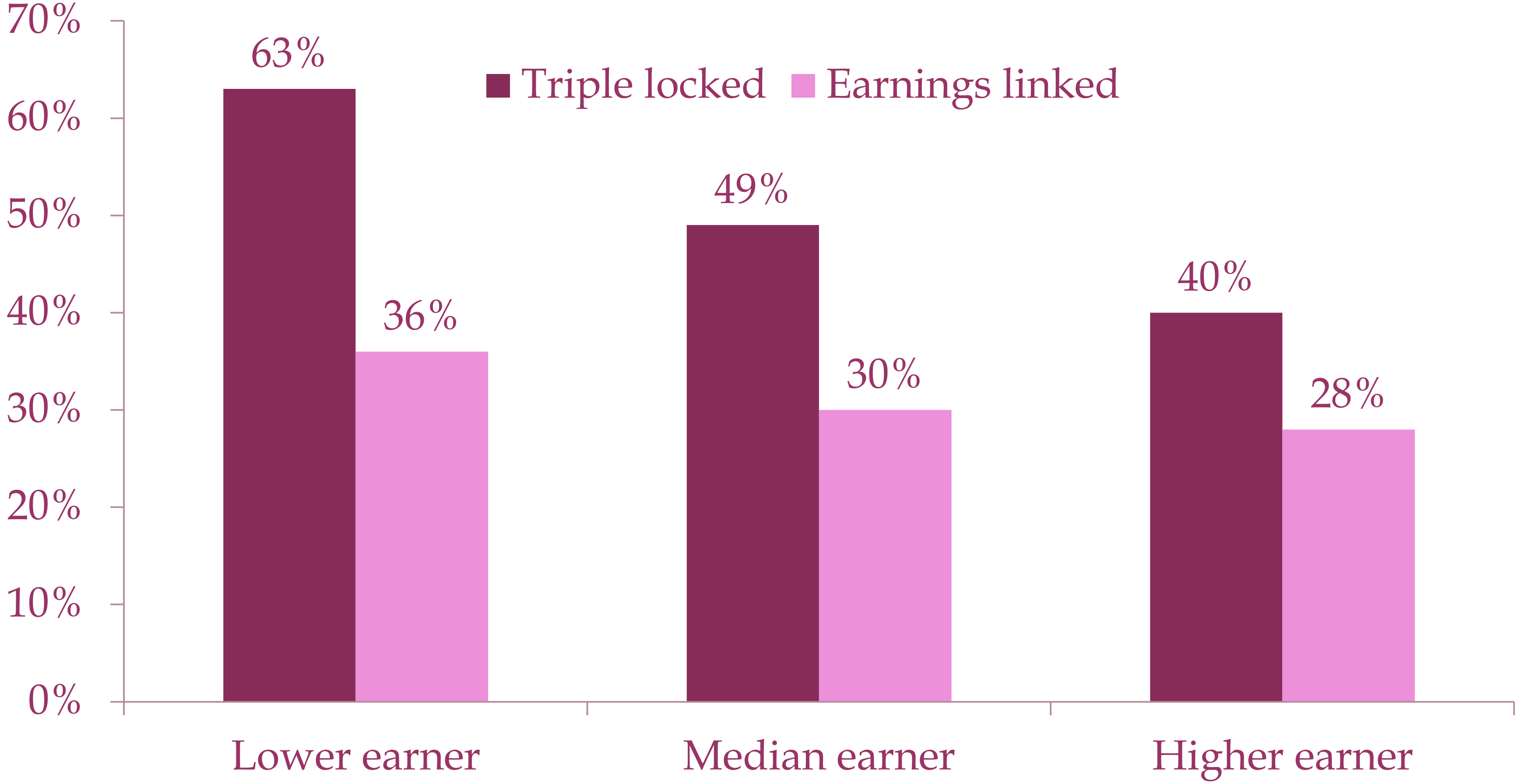
Probability of achieving the target replacement income with income from private and state pensions for different individuals, if starting to save at age 22, retire at SPA follow a traditional lifestyle investment approach and contributing at the minimum total 8% of band earnings



Adequacy is much harder to achieve if the single-tier state pension is not triple locked but earnings linked

PENSIONS POLICY INSTITUTE
PPI

Probability of achieving the target relacement income for different individuals with income from private and state pensions, if they start saving at age 22, retire at SPA, follow a traditional lifestyle investment approach and contribute at 8% of band earnings, under different indexation rules for the single-tier state pension

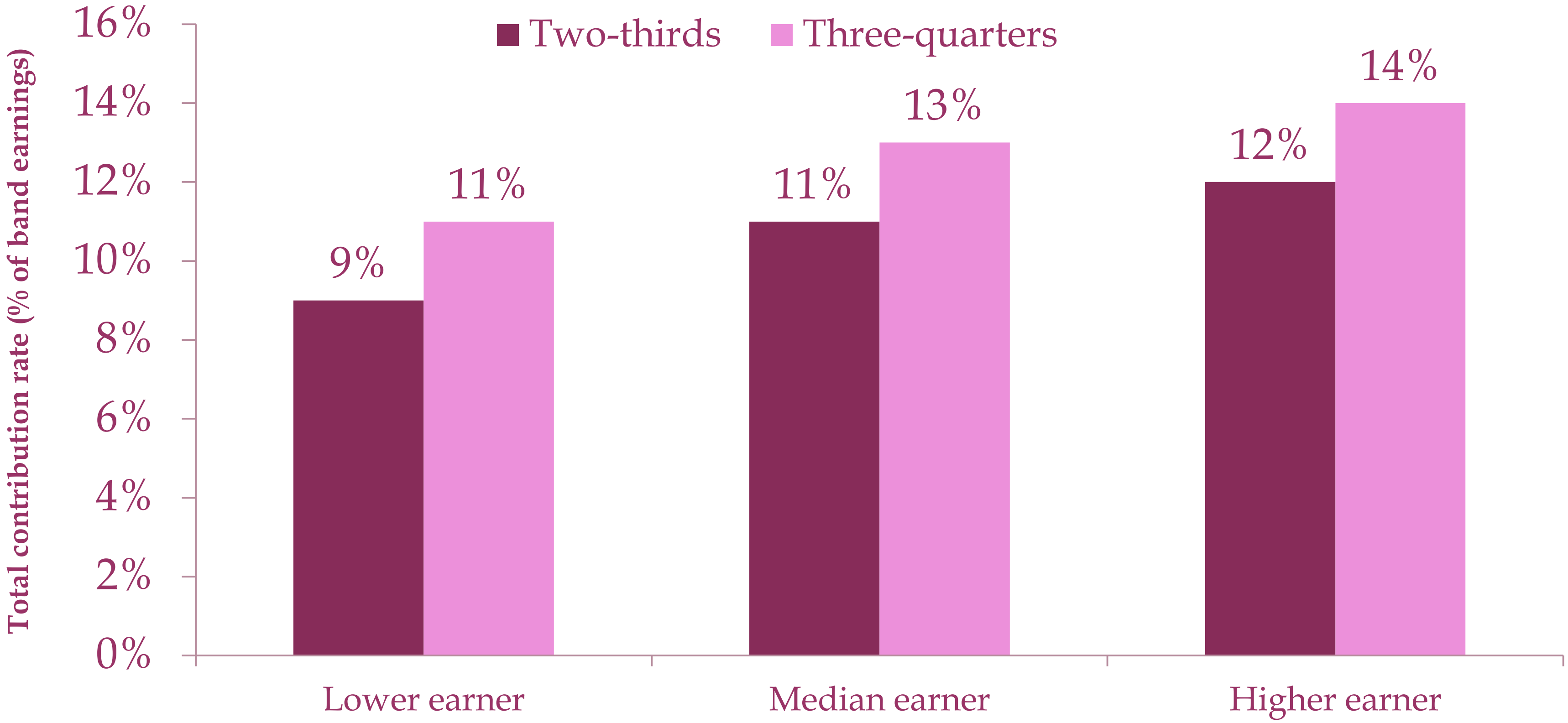


The required contribution rate for a good chance of reaching a target replacement income increases with earnings

PENSIONS POLICY INSTITUTE

PPI

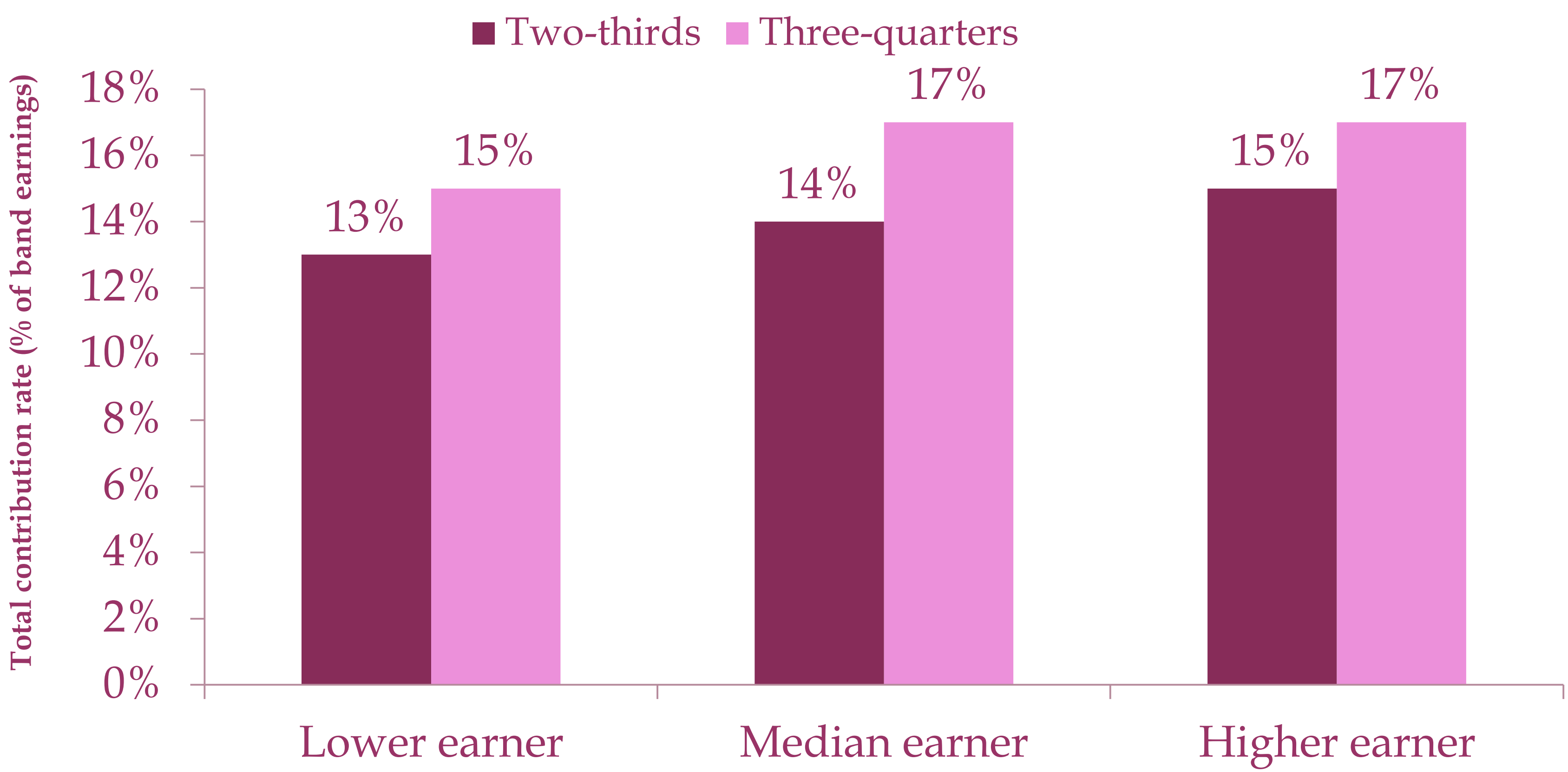
Contribution rates needed for different individuals to reach a 66% or 75% probability of achieving their target replacement income, if they start saving at age 22, retire at SPA and follow a traditional lifestyle investment approach. Single-tier state pension triple locked



Lower indexation of the state pension increases the required contribution rate

PENSIONS POLICY INSTITUTE
PPI

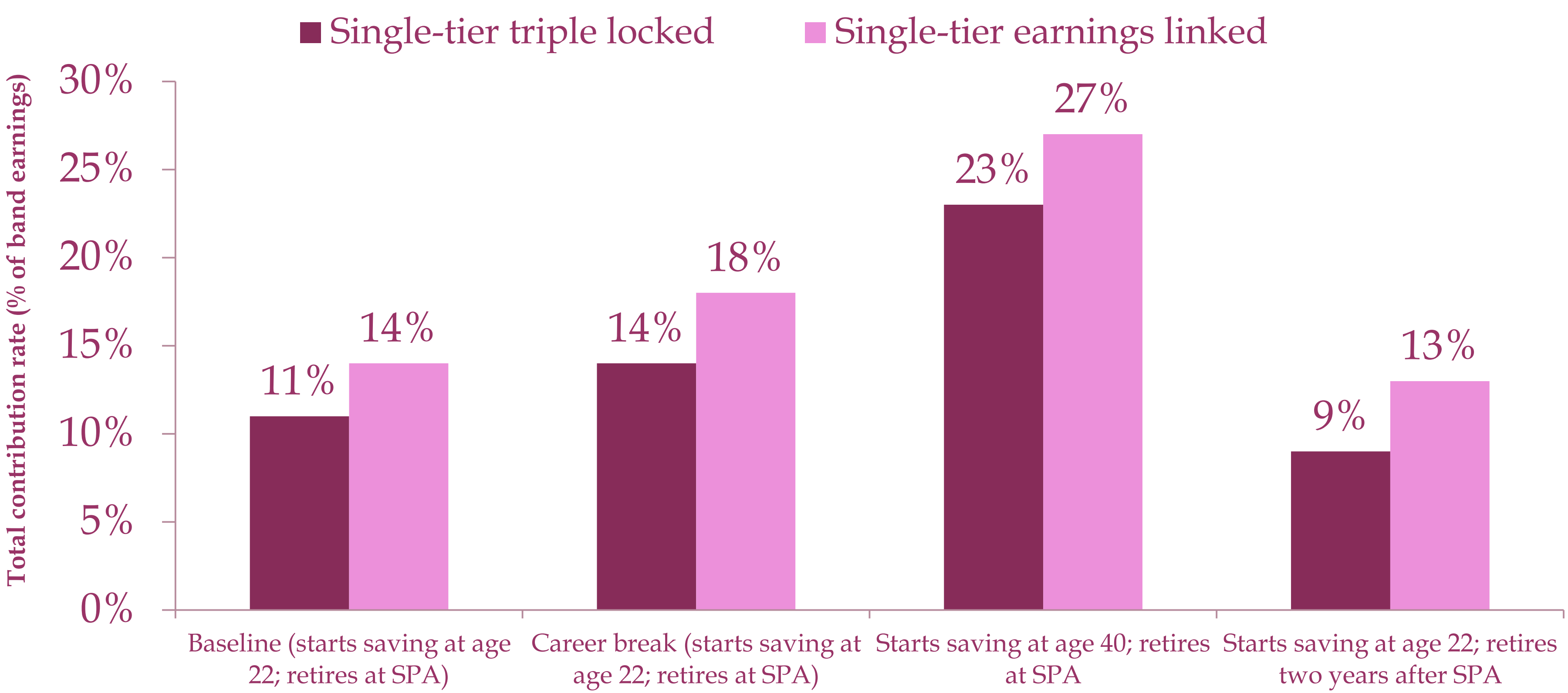
Contribution rates needed for different individuals to reach a 66% or 75% probability of achieving their target replacement income, if they start saving at age 22, retire at SPA and follow a traditional lifestyle investment approach. Single-tier state pension earnings linked



Different contribution patterns affect the necessary contribution rate to have a two-thirds chance of achieving a target replacement income

PENSIONS POLICY INSTITUTE PPI

Contribution rates needed for a median earner to reach a 66% probability of achieving their target replacement income with income from private and state pensions, if they follow a lifestyle investment approach, under different contribution scenarios and mechanisms to uprate the single-tier state pension



The Budget gives freedom and choice over retirement income, but will retirement incomes increase?

PENSIONS POLICY INSTITUTE
PPI

- How will individuals respond?
- What help do they need?
- Will they be able to obtain help?

Will the Budget changes increase retirement incomes?

PENSIONS POLICY INSTITUTE
PPI

- Impact depends on individual responses
- How many will take cash, how many will invest, how many will still buy an annuity?
- What would they have done in the current regime?

Will the Budget changes increase retirement incomes?

PENSIONS POLICY INSTITUTE
PPI

- What will people invest in?
- Will investments do “better” than annuities?
- What are the costs associated with investment?
- How much wealth will pass down generations?
- Is higher income the only consideration?

Are people financially capable?

PENSIONS POLICY INSTITUTE

- Not many of them are
- A lot rides on the "Guidance Guarantee"
- But is a one-off intervention enough?
- What is the default if people "do nothing"?

What might change further?

PENSIONS POLICY INSTITUTE

PPI

- A lot rests on the indexation of the single tier state pension
- Many individuals may need to contribute more than the legal minimum and a number of strategies could be considered
  - Information and advice
  - Incentives – tax relief
  - Reduce the earnings threshold / pay contributions on all earnings
  - Increasing minimum contribution rates
  - Collective Defined Contribution
  - Auto-escalation
  - Compulsion?
- On average people will work for longer