Financial Security in Retirement

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Financial security in retirement

• 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

- 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

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)

Entitlement (£ per week)

<table>
<thead>
<tr>
<th>Entitlement (£ per week)</th>
<th>Individual A: reaches SPA in 2016, most career breaks taking place before 2002</th>
<th>Individual B: reaches SPA in 2036, most career breaks taking place after 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total entitlement</td>
<td>£148 per week</td>
<td>£159 per week</td>
</tr>
<tr>
<td>Single-tier</td>
<td>£148</td>
<td>£156</td>
</tr>
<tr>
<td>BSP</td>
<td>£110</td>
<td>£116</td>
</tr>
<tr>
<td>SERPS/S2P</td>
<td>£25</td>
<td>£43</td>
</tr>
</tbody>
</table>

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

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)

<table>
<thead>
<tr>
<th>Entitlement (£ per week)</th>
<th>Individual who reaches SPA in 2016 under the single tier pension</th>
<th>Individual who reaches SPA in 2038 under the single tier pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings linked</td>
<td>£148</td>
<td>£148</td>
</tr>
<tr>
<td>Triple locked</td>
<td>£148</td>
<td>£148</td>
</tr>
<tr>
<td>Earnings linked</td>
<td>£148</td>
<td>£157</td>
</tr>
<tr>
<td>Triple locked</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Level of entitlement for proportion of individuals reaching SPA in each year

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

• 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?

- 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.

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.

- **Lower earner**: 63%
- **Median earner**: 49%
- **Higher earner**: 40%
Adequacy is much harder to achieve if the single-tier state pension is not triple locked but earnings linked.

Probability of achieving the target replacement 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

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

<table>
<thead>
<tr>
<th></th>
<th>Two-thirds</th>
<th>Three-quarters</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lower earner</strong></td>
<td>9%</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Median earner</strong></td>
<td>11%</td>
<td>13%</td>
</tr>
<tr>
<td><strong>Higher earner</strong></td>
<td>12%</td>
<td>14%</td>
</tr>
</tbody>
</table>

The required contribution rate for a good chance of reaching a target replacement income increases with earnings.
Lower indexation of the state pension increases the required contribution rate

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

![Graph](image_url)

- **Lower earner**
  - Two-thirds: 13%
  - Three-quarters: 15%

- **Median earner**
  - Two-thirds: 14%
  - Three-quarters: 17%

- **Higher earner**
  - Two-thirds: 15%
  - Three-quarters: 17%
Different contribution patterns affect the necessary contribution rate to have a two-thirds chance of achieving a target replacement income.

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?

• How will individuals respond?
• What help do they need?
• Will they be able to obtain help?
Will the Budget changes increase retirement incomes?

- 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?

• 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?

- 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?

• 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