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Executive Summary

Retirement income and assets: the implications for retirement income of Government policies to extend working lives

This report is sponsored by The Actuarial Profession, Age UK, Aviva and Partnership.

The PPI is grateful for the support of the following sponsors of this project:

Sponsorship has been given to help fund the research, and does not imply agreement with, or support for, the analysis or findings from the project.

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Published by the Pensions Policy Institute

ISBN 978-1-906284-22-0
www.pensionspolicyinstitute.org.uk

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Introduction

In the UK over the last three decades, life expectancy has increased substantially. In 1981 a 65 year old man could have expected to live for another 14 years on average, to age 79. However in 2011 a 65 year old man can reasonably expect to live for another 21 years, to age 86 on average.

These substantial improvements in life expectancy reflect a complex range of changes in lifestyle, diet, healthcare and patterns of work and economic activity. Improvements in life expectancy could be positive for individuals. However, increased life expectancy also poses significant challenges to individuals, to employers and to the Government. Individuals who live longer may have increasingly long retirements to save for and support, employers who sponsor Defined Benefit schemes face increases in the costs of providing these pensions and the Government may face increased pressure from funding the state pension and benefits for pensioners.

This research examines current patterns of work and retirement in the UK among people over age 50 and considers how these might change in the future. The Government has introduced a range of policies and programmes aimed at extending working lives such as policies aimed at moving people off benefits and into paid work, changes to the age at which people can receive state pension and benefit income, and the removal of legal barriers to working longer. The research looks at international experience of similar policy changes and considers what lessons the UK might learn from them. Finally, the research considers what patterns of work and retirement might mean for income adequacy in retirement.

The proportion of people over age 50 in work has risen over the last few decades in the UK

Employment rates have been increasing for people aged 50 and above in the UK. For example, in 1993, around 64% of men aged 50 to 64 were in work in the UK, by 2011 this had increased to 70%. The proportion of men working beyond the current male State Pension Age of age 65 has also increased. In 1993 around 8% of men over age 65 were in work, by 2011 this had increased to 11%.

The increase in employment rates at older ages has been even more substantial for women. The State Pension Age for women was age 60 until 2010, but is now increasing towards the male State Pension Age of 65 under legislation intended to equalise the male and female State Pension Age at age 65 by 2018.

In 1993, around 57% of women aged 50 to 59 in the UK were in work, by 2011 this had increased to around 72%. The proportion of women working beyond the current women's State Pension Age of age 60 has also increased substantially. In 1993, 23% of women aged between 60 and 64 were in work, by 2011 this had increased to 34%.

The average age of exit from the labour market has been increasing for both men and women. In 1984, the average age of exit from the labour market for men in the UK was age 64, by 2011 this had increased to around age 65 for men. For women, the average age of exit from the labour market was around age 61 in 1984 and increased to age 63 by 2011.

These increases in employment beyond age 50 for both men and women mask considerable differences in employment rates at older ages by occupation, skill level and wealth. Working at age 50 and above is more likely for men, for those with higher wealth, for those with higher education and for the self-employed.

Why do people leave work before reaching State Pension Age?
While the proportions of people working at older ages has increased, many people are compelled to leave work before State Pension Age due to circumstances beyond their control, such as health problems or the need to provide care for a family member.

Health problems are one of the main, non-voluntary reasons for people to leave work before State Pension Age. By the time men and women are aged between 60 and 64, around 30% of them have a disability that limits their ability to work. Age, gender, ethnicity, occupation and location affect both the likelihood of having a work limiting disability and the likelihood of continuing to work while disabled. Work limiting disability is more common among older people in lower wealth quintiles, those with lower levels of education and manual workers who are more likely than those in other occupations to leave work due to health problems.

Providing care can also affect people's ability to work at older ages; in 2008/9, 10% of women and 1% of men aged 50 and older who were not in employment were providing care.

Equally some people choose to leave work voluntarily before reaching their State Pension Age. Men are more likely to retire voluntarily before reaching their State Pension Age than women. In 2008/9, around 29% of men reported that they were retiring voluntarily in the five years before State Pension Age, compared to around 8% of women.

People in the highest wealth quintile are more than twice as likely to retire voluntarily before reaching their State Pension Age, than people in the middle wealth quintile. Those with a Defined Benefit pension are almost twice as likely to retire voluntarily before their State Pension Age than those with no private pension income.

In order for older workers to be able to engage in employment there needs to be an appetite from employers to recruit and retain older workers and employers need to be able to provide appropriate support to those older people who need it.

Trends and changes within private pensions could affect future work and retirement patterns
Within the private sector, many of the employers who offer Defined Benefit (DB) pensions have closed their schemes to new members, and increasingly to existing members too, as the costs and risks of providing this type of pension have increased. Increasingly employers are offering current employees Defined Contribution (DC) pension schemes. Auto-enrolment into private pensions, which begins in 2012, will also lead to a substantial increase in people saving in DC pensions.

Members of DC schemes may have more incentive to work longer than member of DB schemes, as working longer can lead to increases in income in retirement from a DC scheme and because levels of contribution into DC schemes have tended to be lower than to DB schemes. This could mean that some people may have to work for longer than expected in order to ensure sufficient income during working life and to ensure that they save enough in a pension to ensure they have adequate incomes in retirement.

Some policies aimed at extending working lives could increase income for those who can work longer, but may disadvantage those who cannot
In the future, people may need to work until older ages than they had previously anticipated if they wish to have a comfortable standard of living in retirement. The Government has a range of policies and programmes aimed at extending working lives, including

- policies aimed at moving people off benefits and into paid work;
- changes to the age at which people can receive state pension and benefits income;
- the removal of barriers to working longer, including the removal of legal barriers and efforts to tackle age discrimination in the workplace.

While these policies will encourage and enable some people to work longer, and to take their state and private pension later, there may be negative financial implications for those who cannot work longer because of health problems, or other factors such as caring responsibilities. For those who are unable to work longer, rises to the State Pension Age and changes to the benefit system may result in lower incomes in retirement.

Changes to the benefit system may affect older people in particular. Around a million people who are over age 50 are currently receiving Incapacity Benefits. Over the next few years these people will be phased on to Employment and Support Allowance (ESA) which has a stricter assessment regime. Being found Fit for Work is no guarantee of actually being able to find work. Of those aged 55 and over who were found Fit for Work under the ESA assessment (or had their claim dropped) only around a quarter were in work a year to 16 months later.

A number of other countries have undertaken policy reforms to encourage extending working lives similar to the policies being implemented in the UK. For example:

- Denmark is formally linking increases in State Pension Age to increases in Life Expectancy from 2015. Under current proposals State Pension Age in Denmark is expected to increase to 72 by 2055.
- The USA removed mandatory retirement during the 1970s and 1980s. This has contributed to increases in employment above age 65, which has risen from 11% of people aged 65 and over in 1985 to 17% in 2010.
- New Zealand introduced policies aimed at extending working lives from the early 1990s onwards. New Zealand increased its State Pension Age, removed mandatory retirement on the basis of age and introduced a positive ageing strategy. Although other factors have also played a significant role in increasing participation at older ages including a skills shortage, the increase in the employment rate among older workers increased dramatically. In 1990, 26% of people aged 60 to 64 were in employment in New Zealand. By 2000, this had risen to 46% and by 2010, 70% of people aged 60 to 64 in New Zealand were in employment.

Although the environment and context in the countries where these policies have been implemented differs from that in the UK, there are still some policy conclusions for the UK:

- It is important to have safeguards built into policies designed to encourage working at older ages to help those individuals who cannot work longer.
- Other factors, such as economic changes and changes in pension design, are also likely to be important in determining participation rates at older ages.
- Increases in life expectancy, even if accompanied by increases in working at older ages, are likely to need to be accompanied by increased saving if individuals are to have an adequate income in retirement.

What could future patterns of work and retirement mean for retirement income adequacy?

This research uses two measures of income adequacy in order to test whether pensioners might have enough income in order to meet their needs in retirement:

- The **Minimum Income Standard,** which calculates how much income pensioners require to meet a *minimum acceptable standard of living* (as defined by pensioners in focus groups) is just under £11,000pa (£211pw) for a single pensioner Before Housing Costs (BHC), and around £15,700pa (£303pw) for a couple in 2011. For people who have lived on medium to high incomes during working life, the minimum acceptable standard of living may not seem adequate as it would generally constitute a drop in living standards.
- **Working life replacement rates** which calculate how much income an individual pensioner might need in order to achieve a similar standard of living to the one they had in working life. Replacement rates are generally in the range of 50% to 80% of people's gross working life income. A median-earning man with a weekly income at the point of retirement of around £500pw might need a gross weekly retirement income of around £17,400pa (£335pw) to meet a 67% replacement rate of working life income (and recreate working life living standards). In this analysis, the lowest replacement rates are aligned with the Minimum Income Standard, so that no one has a target income below the Minimum Income Standard.

In order to examine how working longer can affect the adequacy of retirement income, the PPI has modelled the retirement income that individuals aged between 50 and State Pension Age in 2011 might expect to achieve if they continue to work and save at current levels, up until or beyond their State Pension Age.

The analysis assumes that the individuals remain in work, and continue to earn and save at their existing levels until they hit the target level of retirement income. In reality of course, some people may not be able to continue to work and save longer, so the analysis is illustrative of the extent of longer working that may be needed to achieve adequate retirement incomes, rather than a projection of what will actually happen.

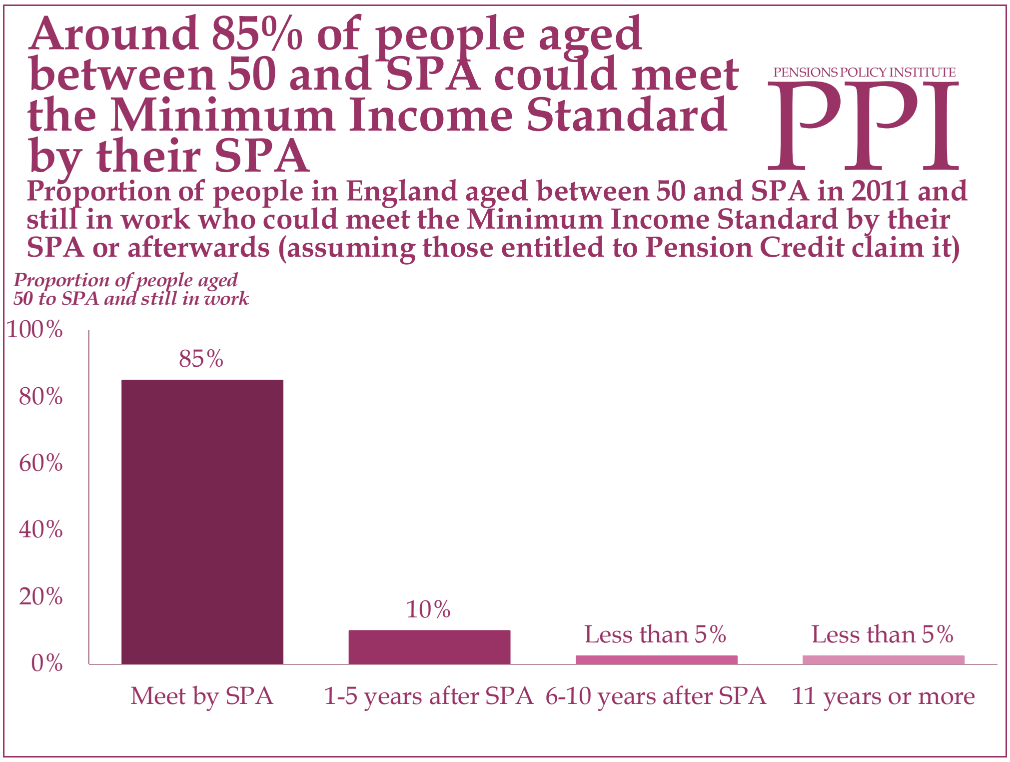
The analysis is based on the English Longitudinal Study of Ageing data set of people still in work aged between 50 and State Pension Age in England. Where individuals are not currently saving in a pension it is assumed that they are automatically enrolled into pension saving at minimum required levels – (which are phased in between 2012 and 2019 to reach 8% minimum total contributions on band earnings by 2019). The following results have been rounded to the nearest 5%. Totals may not sum to 100% because of this rounding.

How many people aged between 50 and State Pension Age in 2011 might be able to meet a Minimum Income Standard of retirement income?

Meeting the Minimum Income Standard will be easier for people than meeting a target replacement rate of working life income using only state pension and benefits and private pension income:

- **The vast majority, around 85%, of those aged between 50 and State Pension Age in 2011 and still in work might have sufficient state and private pension income to meet the Minimum Income Standard by their State Pension Age** assuming that everyone continues to work and save until their State Pension Age and that those who are entitled to means-tested benefits claim them.
- Means-tested benefits can play an important role in helping those on low incomes during working life achieve minimum acceptable standards of living in retirement. Some of those who don't meet the Minimum Income Standard are not eligible for means-tested benefits as their savings are too high.
- **Around 10% of those aged between 50 and State Pension Age in 2011 and still in work** will only be able to meet the Minimum Income Standard if they continue to work and save for a further one to five years after State Pension Age.
- **Around 5% of those aged between 50 and State Pension Age in 2011 and still in work** might need to work for six years or more after their State Pension Age in order to meet the Minimum Income Standard.

Chart A[1]



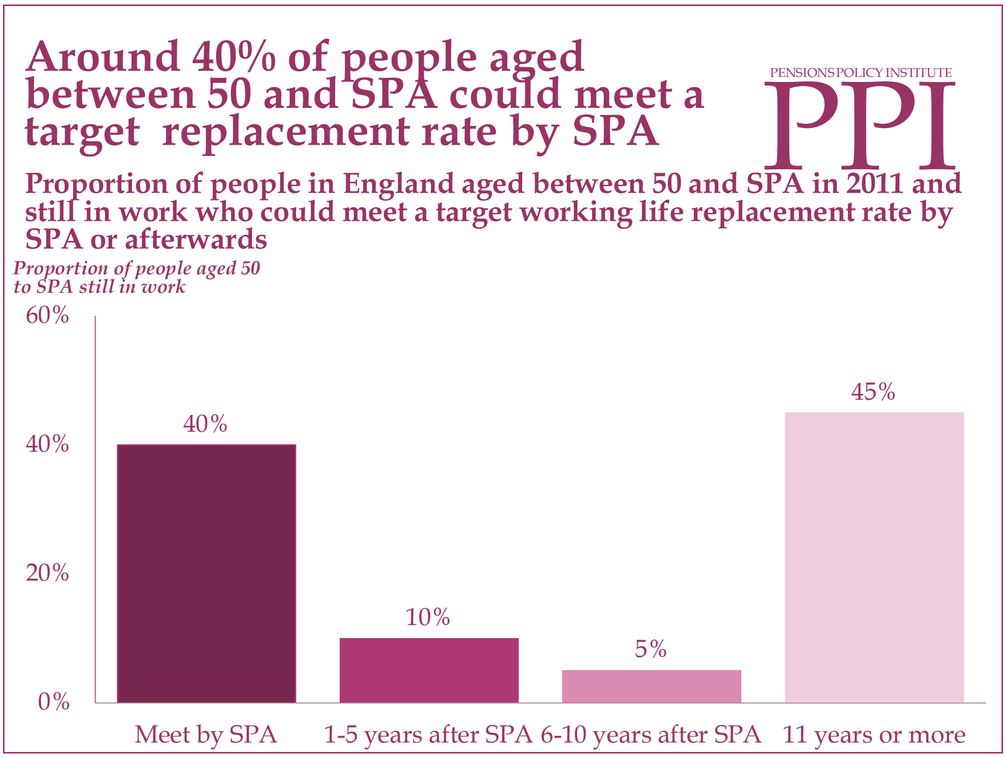
[1] PPI Dynamic Model – numbers may not sum to 100% due to rounding

How many people aged between age 50 and State Pension Age in 2011 might be able to meet a target replacement rate of retirement income?

Fewer people will be able to meet a target replacement rate of working life income that would allow them to replicate working life living standards by their State Pension Age, using only state pension and benefit income and private pension income:

- **Around 40% of those aged between 50 and State Pension Age in 2011** and still in work might have sufficient state and private pension income to meet a target working life replacement rate by their State Pension Age.
- **Around 10% of those aged between 50 and State Pension Age in 2011 and still in work** may be able to meet their target replacement rate if they continue to work and save for a further one to five years after State Pension Age.
- **Around 5% of those aged between 50 and State Pension Age in 2011 and still in work** may be able to meet their target replacement rate if they continue to work and save for a further six to ten years after State Pension Age.
- **Around 45% of those aged between 50 and State Pension Age in 2011 and still in work, might need to work and save for 11 or more years** after their State Pension Age in order to meet a target replacement rate of working life income.

Chart B[2]



[2] PPI Dynamic Model – numbers may not sum to 100% due to rounding

People with certain characteristics may be more or less likely to be able to meet a target replacement rate by State Pension Age from state and private pension income:

- Those in the lower income quartile may be more able to meet a target replacement rate of working life income by State Pension Age, as state pension and benefit levels can be close to or above their target replacement rate levels.
- Single women and people in couples are more likely to meet a target replacement rate than single men. For single women this is because they are more likely to have low incomes than single men, and couples can benefit from pooling incomes.
- People with Defined Benefit pension savings might find it easier to meet a target replacement rate in retirement, as historically DB pensions have been more generous than Defined Contribution pensions.
- Contributing more to a Defined Contribution pension could mean that people do not need to work as long to meet a replacement rate of working life income which would allow them to replicate working life living standards.

Further modelling analysis explored the impact of working longer and not working longer on 3 hypothetical individuals who have different income levels and saving histories during their working life. The modelling analysis illustrated that:

- Leaving work before State Pension Age can result in lower income both before and after State Pension Age.
- Shopping around and purchasing an enhanced annuity (for example an annuity offered to individuals with a medical condition that pays a higher annual pension in recognition that life expectancy is shorter than average) could increase income in retirement for people with health problems.
- Disability benefits can play an important role in meeting income needs for those who have to leave work early due to health problems.
- Remaining in work until State Pension Age can help to maintain living standards up until retirement.
- A high earner, contributing at average levels of salary into a Defined Contribution pension may need to work beyond State Pension Age in order to meet and sustain his target income during retirement.
- Working after State Pension Age can increase net income as a result of tax treatment.

The analysis explored how changes in behaviour in response to a rise in State Pension Age can affect income both before and after retirement:

- As expected, a rise in State Pension Age could reduce income for those who cannot work longer.
- But a rise in State Pension Age could result in higher income both before and after retirement for those who can work longer.

Acknowledgements and Contact Details

The Pensions Policy Institute is grateful for input from many people in support of this paper, in particular:

John Adams
Stephen Balchin
Nicholas Barr
Jim Boyd
Christopher Brooks
Thomas Q. Christensen
Niki Cleal
Rowena Crawford
Maritha Lightbourne
Katy Litt
Stephen McNair
John N. Migliaccio
Ian Owen
Susan St. John
Paul Shelley
Sandra Timmermann
David Yeandle OBE

Editing decisions remained with the authors who take responsibility for any remaining errors.

The Pensions Policy Institute is an educational charity promoting the study of retirement income provision through research, analysis, discussion and publication. The PPI takes an independent view across the entire pensions system.

The PPI is funded by donations, grants and benefits-in-kind from a range of organisations, as well as being commissioned for research projects. To learn more about the PPI, see: www.pensionspolicyinstitute.org.uk

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The PPI is grateful for the continuing support of its Platinum and Gold members:

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This paper uses data from the English Longitudinal Study of Ageing (ELSA). The data were made available through the UK Data Archive (UKDA). ELSA was developed by a team of researchers based at the National Centre for Social Research, University College London and the Institute for Fiscal Studies. The data were collected by the National Centre for Social Research. The funding is provided by the National Institute of Aging in the United States, and a consortium of UK government departments co-ordinated by the Office for National Statistics. The developers and funders of ELSA and the Archive do not bear any responsibility for the analyses or interpretations presented here

The Nuffield Foundation is an endowed charitable trust that aims to improve social well-being in the widest sense. It funds research and innovation in education and social policy and also works to build capacity in education, science and social science research. The Nuffield Foundation has funded the development of the PPI models.

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Published by
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www.pensionspolicyinstitute.org.uk
ISBN 978-1-906284-22-0