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Retirement income and assets: outlook for the future

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A Discussion Paper by Daniela Silcock, Sean James and John Adams

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Introduction

This is the final report in a series of four, looking at the evolution of needs for income during the course of retirement and the roles different sources of income and assets could play in helping pensioners to meet their needs in retirement. The previous three reports in this series examined the income needs of pensioners and the roles that housing assets, pensions and other financial assets can play in funding retirement. The project has the overall aim of providing independent evidence to inform debate about the role of different types of income and assets in funding retirement.

This report summarises findings from the first three reports and considers how the trends and issues identified in them could combine to produce a picture of possible interactions between needs, income and assets for a future generation of pensioners reaching state pension age in 2030. In addition this report explores the ways that working longer and recent reform proposals for the funding of care and support could potentially impact on retirement income and assets.

Chapter one gives an overview of the main approaches to measuring the income needs of pensioners, explores how pensioners' needs for retirement income vary over time, considers the sources of income which pensioners use in retirement and examines how levels and sources of income tend to change for pensioners during retirement.

Chapter two uses hypothetical case studies to explore how individuals may use income and assets to support retirement in the future.

Chapter three examines the role which state pensions play in providing income to pensioners and explores the potential effects of the Government's state pension reforms on the role that state pensions could play in supporting retirement for pensioners in the future.

Chapter four examines the roles that private pensions and other financial assets play in providing income to pensioners, explores the potential impact of the Government's private pension reforms, and the potential impact of changes already occurring in the private pensions market on the roles that private pensions and other financial assets could play in the future.

Chapter five examines the role which housing assets can play in supporting retirement and explores how the use of housing to support retirement may change in the future.

Summary of Conclusions

Pensioners are likely to have more varied baskets of assets and income in future

Findings from the retirement income and assets project indicate that in future, many pensioners are likely to have a greater variety of income and assets, including housing wealth, available for use in retirement. Reforms to state and private pensions could result in more pensioners receiving income from both private and state pensions in future. Future generations of pensioners may also have access to more housing wealth.

However, changes in the private pensions market which are leading to more pensioners receiving income from DC pensions mean that many of the risks associated with pension saving are being passed from the employer to the employee. The amount that pensioners are likely to receive from their private pension income will depend heavily on employer and individual responses to the Government's private pension reforms and subsequent contribution levels. While more pensioners are likely to receive private pension income in future, some pensioners may receive less income from private pensions than they would have in a pre-reform pensions landscape.

More varied baskets of assets and income in the future will also mean that more people are making decisions for the first time regarding the accumulation of savings and investments in working-life and their use in retirement. Advice and information services will need to be able to support people who are likely to have to make more choices and more complex financial decisions about their retirement savings during their working life, at the point of retirement and during retirement.

Income needs vary during retirement

Needs and spending patterns vary during retirement as a result of changes related to ageing, changes in health, and changes in economic circumstances. The amount of income any pensioner household requires to meet their needs could also depend on their desired standard of living in retirement and the structure and location of their household.

It is not possible to calculate a single level of income that would be suitable for all pensioners to meet their needs or expectations for all of their retirement, however there are some useful calculations of how much income pensioners could require to meet their basic needs, and how much income they might require to achieve a standard of living they would find acceptable (by calculating a 'replacement rate' of working-life income.)

The Government is currently considering how to fund care (adult social services) and support (disability benefits) for adults in the future. Government policy decisions on how care for people will be funded, and where the balance between state and individual funding should lie, will have implications for the amount of money that pensioners will need to spend on their own care in the future.

Moderate to high income pensioners may have trouble meeting replacement rates in future

The hypothetical individual case studies in this paper show that:

- In future, some pensioners with lower incomes may find it easier to meet replacement rates because of reforms to state pensions.
- The shift from DB to DC may mean that more moderate to high income pensioners will find it hard to meet replacement rates from pension income alone in future.
- Pensioners on moderate to high incomes may find it difficult to meet replacement rates from state and private pension income alone in future and may need to supplement pension income with income from other savings and assets.
- The hypothetical pensioners who deferred state and private pensions (while working after SPA) increased their income in retirement from state and private pensions by around 10%.
- The hypothetical median-earning man may have had a more reasonable chance of meeting his replacement rate if he and his employer had contributed 15% of his total salary to his DC pension during his working life. In order to meet his desired replacement rate, he and his employer would have needed to contribute around 5% above average contribution levels.

Moderate to high income pensioners may have to pay less towards their own personal care costs in the future

- Under the Government's 'Partnership Model' for care funding, the hypothetical moderate to high income pensioners were responsible for paying 16% to 33% less towards their own care costs in total (including accommodation costs) than under the current system, if they require care and support.
- Under the Government's 'Comprehensive Model' for care funding, the hypothetical moderate to high income pensioners were responsible for paying 41% less towards their own care costs in total (including accommodation costs) than under the current system. However, some individuals will pay the comprehensive insurance premium but may not actually need care.
- Under current and future models of care and support funding, pensioners on low incomes are not generally expected to cover their own care and support costs although they may be required to pass all of their income over to the state, retaining only enough for the Personal Expenses Allowance.

This paper draws on the first three reports in this series and summarises their findings regarding the roles which state and private pensions, other savings and assets, and housing play in providing income to pensioners and how these roles may change in the future.

Pensioners are likely to receive more income from state pension in the future

From 2010 and beyond pensioners are likely to receive more income from state pensions than they currently do as a result of the Government's state pension reforms. This will increase the importance of income from state pensions for many pensioners, though more significantly for certain groups, such as women, carers, the disabled and very low earners.

More pensioners are likely to receive income from private pensions in the future

According to the Government auto-enrolment could lead to the proportion of people with private pension savings rising from around 40% of the working age population today (around 14 million people) to around 21 million people, or roughly 60% of the UK working-age population once the Government's reforms are fully implemented. This could result in the proportion of pensioners receiving income from private pensions rising as successive cohorts reach State Pension Age (SPA). However it is difficult to estimate exactly how private pension contributions and the proportions of income pensioners receive from private pensions may change in the future. Future contributions to private pension saving will depend on how employers and individuals respond to the reforms. PPI analysis indicates total annual pension contributions could increase or decrease by £10 billion in 2050 (in 2006/7 earnings terms) depending on how employers respond to the reforms.

Income from private pensions will also be affected by changes occurring in the private pensions market

Though work-based pension provision has traditionally been supplied in the form of Defined Benefit (DB) schemes, the last two decades have seen an acceleration in the trend for private sector DB schemes to close, either to new members or to new and existing members, and for employers to offer membership in Defined Contribution (DC) schemes instead. If current trends continue, then active membership in private sector DB schemes could reduce from 2.5 million today, to around 1.5 million active members by 2050. The trend for DB schemes to be replaced by DC schemes is more prevalent in the private sector than in the public sector where the predominant form of pension provision remains DB pension schemes.

There are likely to be more savers in DC pensions in the future

There are an estimated 5 million people saving in DC pensions today. By 2020 there could be around 15 million people saving in a DC pension, and by 2050 there could be around 17 million people saving in a DC pension. The amount held within DC pension funds could grow from around £600 billion today to between £700 billion and £900 billion (2009 earnings terms) by 2050, depending on how employers and individuals respond to the private pension reforms.

A rise in DC pension savers means that in the future the retirement products market will face a greater number of new customers. In future, the annuity and retirement products market will need to hold and manage a larger proportion of people's wealth in retirement than it does today.

In future there may be more scope for pensioners to use housing wealth to help support retirement

- Housing wealth is one of the largest assets held by UK households. Around 40% of UK households' £9,000bn net wealth is held as housing wealth.
- Home ownership has increased amongst older people. If this trend continues, around 80% of people over State Pension Age could be owner-occupiers within the next few decades.
- The value of housing wealth owned by people over State Pension Age could increase by around 40% from £907bn in 2009 to £1,274bn in 2030 (in 2009 earnings terms).
- The number of pensioner households with medium or high value houses who could release their housing wealth in order to support their retirement could increase by a third, from 3.9 million households in 2009 to 5.2 million households in 2030.
- There could be a 40% increase in the value of housing wealth that pensioners could release to support retirement from £251bn of housing wealth in 2009, rising to £359bn in 2030 (in 2009 earnings terms).
- However there are attitudinal and cost barriers to accessing housing wealth which may mean that not all available housing equity is used to support retirement.

Chapter one: do pensioners have sufficient income to meet their needs?

This chapter draws on the results of the first report in the series,[1] and gives an overview of the main approaches to measuring the income needs of pensioners. This chapter explores how pensioners' needs for retirement income vary over time, considers the sources of income which pensioners use in retirement and examines how levels and sources of income tend to change for pensioners during retirement.

Measurements of income needs in retirement can be based on basic need assessments or desired income levels

A calculation of pensioners' income needs can be approached by examining the level of income pensioners require in order to satisfy their basic needs. Calculations can also be approached by exploring how much income pensioners require in order to achieve a standard of living that they would find acceptable. For many people in retirement, satisfaction with income is related to whether they are able to achieve the same (or a similar) standard of living to the one which they experienced during their working life.[2]

Box 1: some pensioners can replicate working-life living standards with a 'desired replacement rate' of income in retirement

The majority of people feel that in order to be satisfied with their level of income in retirement, their income will need to provide them with a standard of living similar to the standard they experienced in their working life. Most pensioners can achieve a similar standard of living with an income in retirement of between 50% and 80% (gross) of their working life income.[3]

The main calculations of the level of income that would be required to meet basic needs tend to conclude that a single pensioner needs around £130 per week (after housing costs) in 2009 earning terms.[4] Calculations of what a median-earning pensioner might need to achieve an adequate standard of living in retirement (based on expectations) tend to conclude that they would need around £280 per week[5] in 2009 earnings terms.[6]

Income needs vary between households and during retirement

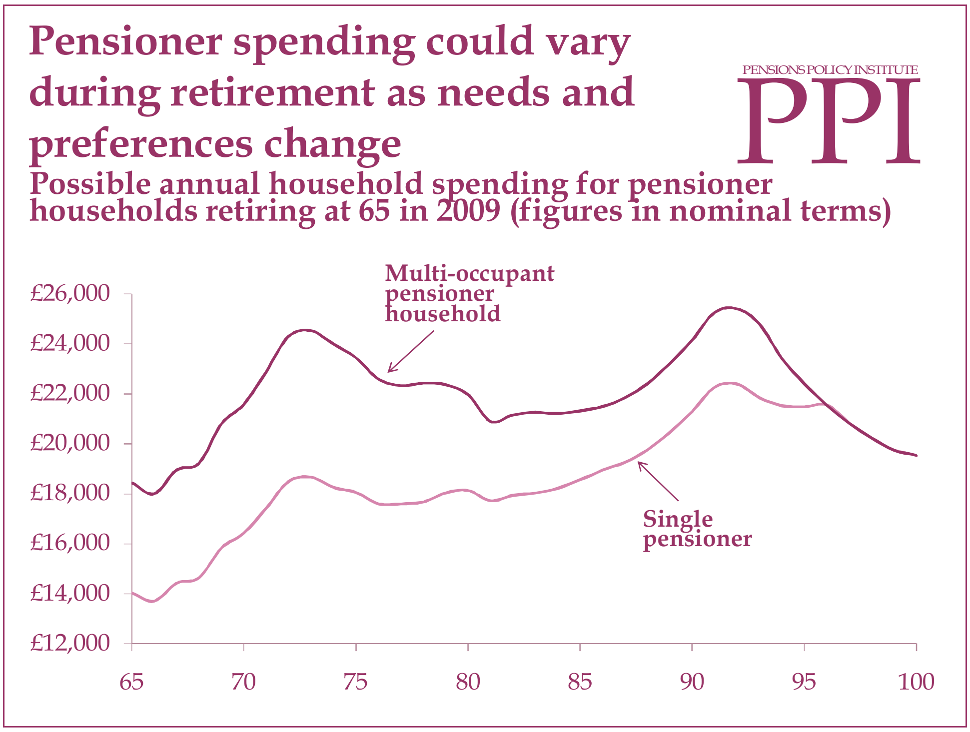
It is not possible to calculate a single level of income that would be suitable for all pensioners to meet their needs or expectations throughout their whole retirement, though minimum and desired income measures

[1] PPI (2009a)
[2] Pensions Commission (2004)
[3] Pensions Commission (2004)
[4] Based on Guarantee Credit 2009 rates, JRF (2009) and ONS & DWP (2009)
[5] Before housing costs
[6] Calculations based on Pensions Commission (2004)

can provide a useful guide. The level of income required by any pensioner may be dependent on their desired standard of living in retirement, the structure and location of their household and their health needs.

Spending can vary during retirement due to a combination of needs, expectations and spending preferences (Chart 1). A typical pensioner might spend more on recreation and leisure in early retirement, decrease spending around age 75 as they become less mobile, increase spending once again around the age of 85 as a result of disability or health needs and then decrease spending in their 90s as mobility is reduced to a very minimal level.[7] Any individual pensioner's needs and expectations may be for lower spending than depicted in Chart 1 or for higher spending if, for instance, they acquire disabilities as they age.

Chart 1[8]



It is possible that pensioner households who receive the average level of income for their age group could find it difficult to meet both of the spending peaks in early and later retirement. Some low to moderate income pensioners may be able to meet spending preferences in early retirement depending on their retirement provision, however pensioners' income tends to decrease during retirement.[9] Even higher income pensioners may not be able to meet all of their spending preferences

[7] PPI (2009a)
[8] Life Trust, cebr (2008), data assumes 2.5% inflation (altered from original data which assumed 2.3%)
[9] See PPI (2009a) for modelling of pension incomes and relation to desired income in retirement

solely from pension income if they aim to have a standard of living similar to the one which they experienced in their working life.

The need for care could substantially affect pensioners' needs for income

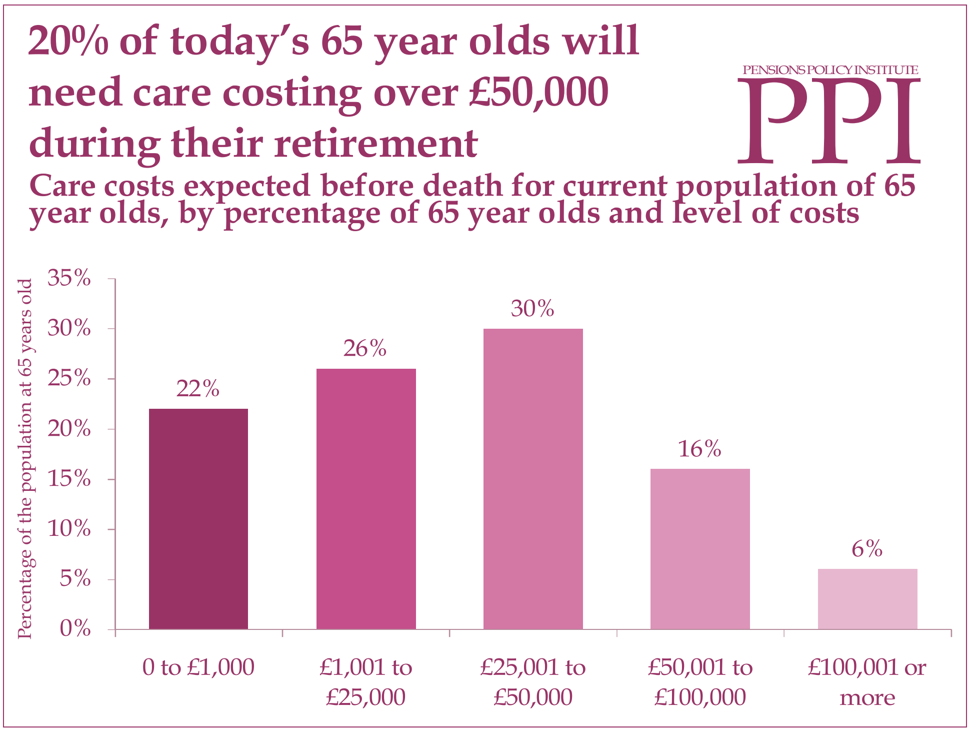
As pensioners age they are more likely to acquire disabilities; by the age of 90, around 80% of people have a moderate or a severe disability.[10] Acquiring disabilities is associated with increases in living costs. People with disabilities could incur costs in several different areas of expenditure for example they may need to spend more on personal care, personal goods, support in the home, transport, mobility aids and modifications to the home.[11]

The second peak in income needs depicted in Chart 1 is related to the need for spending on health as pensioners' age. However the figures in Chart 1 represent an average for pensioner spending. Spending needs in later retirement may be lower for some pensioners and higher for other pensioners, especially those who acquire more severe disabilities as they age. The costs of acquiring a disability could increase the need for weekly income by around £50 to £250 for a single pensioner (depending on type and severity level of disability) and by around £25 to £150 for a pensioner couple.[12] It is difficult to say what proportion of the extra costs associated with acquiring a disability will fall to individuals, households or to the state, as care and support can be provided in different proportions from a combination of sources including Local Authorities, NHS services, state benefits, community services and family members.

The need for care, whether it is provided to a pensioner in their own home or in a residential home, could result in a substantial increase in income needs. The Government estimates that the average 65 year old will need care that costs over £30,000 during their retirement, and that around 20% of today's 65 year olds will need care costing over £50,000 during their retirement (Chart 2). Pensioners who enter residential care homes will generally incur the greatest care costs at around £12,500 per year on average for care[13] plus around £14,000 per year for the cost of accommodation.[14] The average stay in a care home is 2 years.[15]

[10] Kellard *et. al.* (2006)
[11] Age Concern (2005)
[12] Zaidi and Burchardt (2005) and PPI calculations, 2008 figures, see PPI (2009a) for a more detailed discussion
[13] HM Government (2009a)
[14] Forder and Fernandez (2009) p. 20, Table 13. Forder and Fernandez derived figure by subtracting costs of care from overall residential home charges.
[15] HM Government (2009a)

Chart 2[16]



Some pensioners may need to fund their own personal care

The NHS provides most health care free at the point of use and under the current social care system some pensioners with disabilities are eligible to receive care and support from the state through disability benefits. However, some pensioners with disabilities may need to fund some or all of their own personal care which could involve, for example, help with physical tasks such as eating and bathing or support in the home with domestic tasks, for example, cooking, cleaning and laundry. Personal care can be provided in pensioners' own homes or in residential care homes.

People with different types of health problems, or who live in different areas of the UK, are entitled to different levels of funding for care and support from their local authority. Local Authorities are responsible for setting eligibility criteria in the light of local priorities and national guidance, however there is no national eligibility criteria. Charging systems also differ between the four countries of the UK. In Scotland, personal care is free for older people.

In some cases, people must pay for the costs of personal care from their own assets and income, including the equity in their home unless, or until, the value of their total wealth is less than £23,000. In some cases this can lead to people needing to sell their homes to fund their residential care. The value of a person's home is taken into account when calculating

[16] Chart reproduced from HM Government (2009a) page 98

eligibility for residential care funding, however the value of the home is not considered when calculating eligibility for care provided in the home.

The Government is consulting on the best way to fund care and support
In order to attempt to address the perceived unfairness of the current system, and to attempt to make funding care and support more sustainable for the future, the Government has proposed a new system of care funding[17] operated by a new National Care Service. It has not yet been determined how the new system of care funding will operate. The Government is currently consulting on three proposed models:

- **Partnership Model:** In this model, all people would be entitled to have some portion of their basic care and support costs, for example a quarter or a third, paid for by the state, irrespective of their means. Some individuals would also be entitled to means-tested, additional support, depending on their level of income and their level of need.
- **Insurance Model:** This model combines the Partnership Model with an option to purchase insurance to cover the portion of care and support that the state does not pay for. The Government has estimated that people might need to pay around £20 - £25 thousand to be protected under a scheme of this sort.
- **Comprehensive Model:** In this model, everyone over retirement age would be required to pay into an insurance scheme, whether they needed care or not. Pensioner's care and support would be paid for by the scheme. The Government estimates that individuals might need to pay £17 - £20 thousand under a scheme of this sort.

The three Government proposals for funding care do not propose to cover the costs of accommodation in residential care homes (around £14,000 per year)[18] as the Government reasons that individuals are expected to bear costs for their own accommodation whether they need care or not. However, the Government recognises that it will need to support those who cannot afford the costs of their own accommodation.[19]

In future, care is likely to be less costly for those who need it, however pensioners who do not need care may have to pay more than they currently do (for instance, through an insurance system).

[17] HM Government (2009a)
[18] Forder and Fernandez (2009) p. 20, Table 13. Forder and Fernandez derived figure by subtracting costs of care from overall residential home charges.
[19] HM Government (2009a)

The Conservatives have made a proposal for funding residential care
The Conservative Party has also made a proposal for the future funding of residential care.

- **The Conservative's Insurance Model:**[20] In this model, people can voluntarily pay into a state-backed insurance scheme at age 65 which will pay all of the costs of residential care, including accommodation costs, up to the 'highest' average cost of care.[21]

Personal care at home may be free for those with the 'highest needs'
The Government has recently introduced a bill[22] which would make personal care at home free for those with the 'highest needs,' estimated to be around 280,000 people (of which around 170,000 would be older people).[23] Under this policy, people whose needs do not qualify, or who are in residential care, may still have to pay towards their own personal care.

Conclusion

- It is not possible to calculate a single level of income that would be sufficient for all pensioners to meet their needs or expectations for all of their retirement, however there are some useful calculations of how much income pensioners could require to meet their basic needs, and how much income they might require to achieve a standard of living they would find acceptable (by calculating a 'replacement rate' of working-life income.)
- The level of income required by any pensioner may be dependent on their desired standard of living in retirement, the structure and location of their household and their health needs.
- Spending can vary during retirement due to a combination of needs, expectations and spending preferences.
- Changes in health tend to create the greatest need for increased spending and changes in health are more likely to occur the older a pensioner is.
- The Government is currently considering how best to fund care and support for pensioners in the future. Government policy decisions on how care for older people will be funded, and where the balance between state and individual funding should lie, will have implications for the amount of money that pensioners will need to spend on their own care in the future.

[20] www.conservatives.com/News/News_stories/2009/10/Ending_the_scandal_of_forced_home_sales_to_pay_for_care.aspx
[21] People over 65 when the policy is introduced would have the opportunity to pay into the scheme, www.timesonline.co.uk/tol/news/politics/article6862458.ece
[22] http://services.parliament.uk/bills/2009-10/personalcareathome.html
[23] DoH (2010)

Chapter two: how could pensions, housing and other financial assets be used to support retirement in the future?

A new pensions landscape will emerge due to the Government's state and private pension reforms, and to changes already occurring in the private pensions market. This chapter uses hypothetical case studies to explore how individuals may use income and assets to support retirement in the future.

Uses and limitations of hypothetical case study analysis

Hypothetical case studies are useful for looking at how certain individuals may fare under certain assumptions, however these case studies should not be considered predictions of how any particular income group will fare in the future. Each hypothetical individual has a specific history of working and saving behaviour and the behaviour and experiences of any individual in future may be very different from those of the case study individuals.

The assumptions in these case studies are based on expectations regarding the implementation of state and private pension reforms,[24] and regarding other potential changes in the private pensions landscape. The state and private pensions landscape may experience changes in future that are not accounted for in the assumptions in this paper.

The individuals in this analysis reach SPA at age 66 in 2030. The income the individuals receive from state and private pensions will be from both a pre and post reform pensions system. Pensioners who accumulate all of their assets and income in an entirely post reform pensions system may have different experiences during the accumulation of their income and assets.

These case studies use the Government's proposals on care funding to examine how the need for care may affect pensioners' income and assets in the future. This paper does not discuss the advantages and disadvantages of each proposal for care funding,[25] and does not intend to imply that any of the proposals would be more appropriate than any other.[26]

The following case studies examine how three hypothetical individuals who reach SPA in 2030 may use income and assets to support retirement. The case studies include illustrations of the costs individuals may face if they have care needs in retirement. In reality some individuals may be

[24] Such as the assumption that BSP is indexed to prices from 2012
[25] For a discussion of the advantages and disadvantages of the proposals see HM Government (2009b)
[26] For analysis of the costs and a distributional analysis of a partnership model along the lines proposed by the Government, see Hancock *et al* (2009)

eligible to have a portion of their care and support paid for by the state, especially personal care that is provided in the home.[27]

Any future system of care and support funding may involve reducing eligibility for, or cutting disability benefits, such as Attendance Allowance, and using the funding stream to support the new system of care and support. The impact that any future system of care and support funding will have on the income and assets of individual pensioners will depend on how the Government decides to fund care in the future.

Some pensioners may not wish to use equity release to fund care in the home

Some of the hypothetical individuals use equity release in order to meet the costs of their care. Many pensioners may not wish to use equity release to fund care in the home as housing wealth is disregarded when assessing eligibility for state funded care in the home, whereas income from equity release is not disregarded. Housing wealth is considered, however, when assessing eligibility for state funding for residential care. Some pensioners may use equity release to fund care in the home as well as in residential homes if they wish to exercise complete choice over their own care rather than receiving local authority provision.

These scenarios illustrate how different combinations of income and assets could be used to meet care costs. In reality people may choose to use their income and assets in a way which fits best with their individual circumstances.

In the future, low earners are likely to receive more income from state pensions

In the future, many low earners (for example, earning £11,200 p.a. or less in 2009)[28] will receive more from state pensions as a result of the state pension reforms. Some low earners may accumulate a small private pension pot from being auto-enrolled. Some low earners may need personalised information or advice to help them to decide whether to stay in or opt-out of pension saving.[29]

[27] Housing wealth is not taken into account when assessing eligibility for state funded personal care in the home

[28] Yearly gross income for someone working 37 hours a week for minimum wage (£5.80) in 2009/10

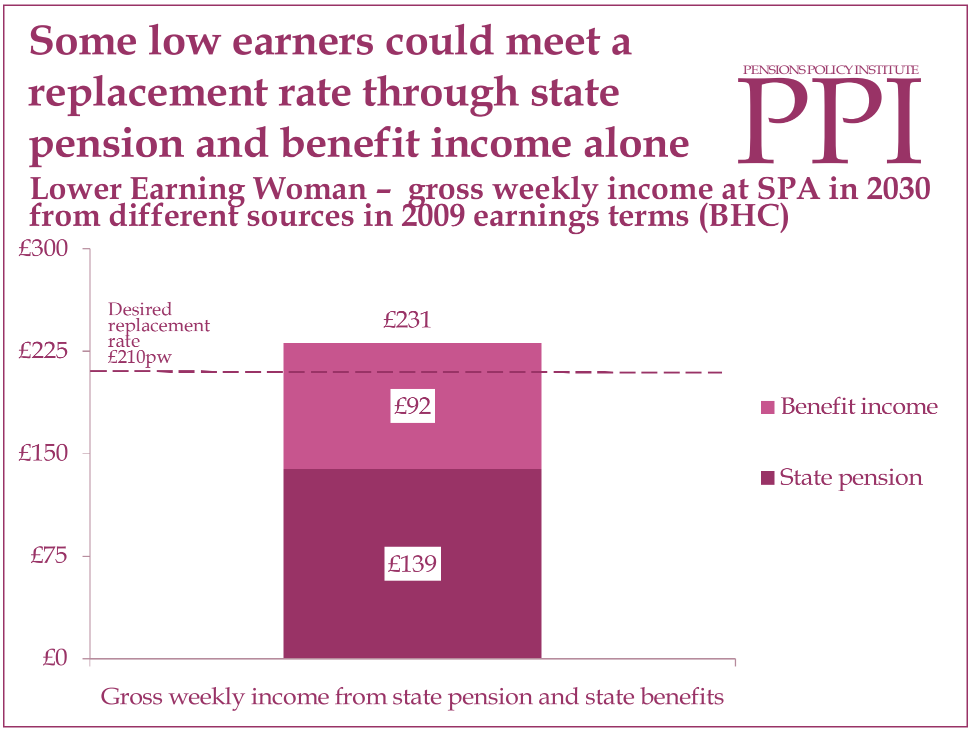
[29] For discussion of the potential impacts of the new pensions landscape on low earners see PPI (2009c)

Box 2: a low-earning woman with caring breaks, aged 66 in 2030

- She starts working full-time from the age of 18 in 1982.
- Between the ages of 22 and 32 she takes time out of work to care for her children during which time she qualifies for 10 years of Home Responsibilities Protection (HRP).
- She returns to work full-time for 13 years till she is 45, then she takes two years out of work to care for her mother (and qualifies for two more years of HRP) she returns to work at 47 and works for another 19 years.
- During her 36 years of full-time work she earns at low age-specific earnings for women.
- She is a tenant with no housing wealth and receives Housing Benefit in retirement.

This low-earning woman's weekly income in working life, at the point of retirement, is £300[30] per week. She would need a gross weekly income of £210 per week to meet her 70% replacement rate.[31]

Chart 3[32]



If it is assumed that she retires with no private pension or other savings, she could receive a gross weekly income from state pensions and state benefits[33] of around £230 in 2009 earnings terms (Chart 3). Under this scenario she would exceed her desired replacement rate of £210 per week

[30] 30th percentile, age specific earnings, Labour Force Survey (2008)
[31] Pensions Commission (2004) and PPI calculations
[32] PPI Individual Model
[33] Savings Credit, Housing Benefit, Council Tax Benefit

in the beginning of her retirement. Her income from benefits and additional state pensions may not increase in line with earnings (though the Government intends to increase BSP with earnings from 2012) and at some point in retirement her income may dip below her replacement rate in earnings terms.

Low earners are likely to have their basic care and support paid for after passing their income over to the state

If this low-earning pensioner requires care either in her home (rented accommodation) or in a residential care home, she is likely to have all of her care and support paid for, after passing all of her income over to the state, either through a nationally funded care system or a national insurance scheme. Under the current system, she would be allowed to keep a portion of her income equal to the value of the Personal Expenses Allowance.[34] She may not be considered to have high enough income to be required to contribute to an insurance scheme. The state is also likely to pay something towards her accommodation costs if she is unable to afford them herself.

In the future low to moderate earners may be affected by changes in private pension provision

In future, many low to moderate earners (for example earning £11,200 - £37,000 p.a.,[35] which would include median earners) are likely to see an increase in their income from state pensions as a result of the state pension reforms. Many low to moderate earners are also likely to benefit from private pension reforms such as auto-enrolment and compulsory employer contributions and some low to moderate earners may accumulate private DC pension savings for the first time.

Box 3: a median-earning man, aged 66 in 2030

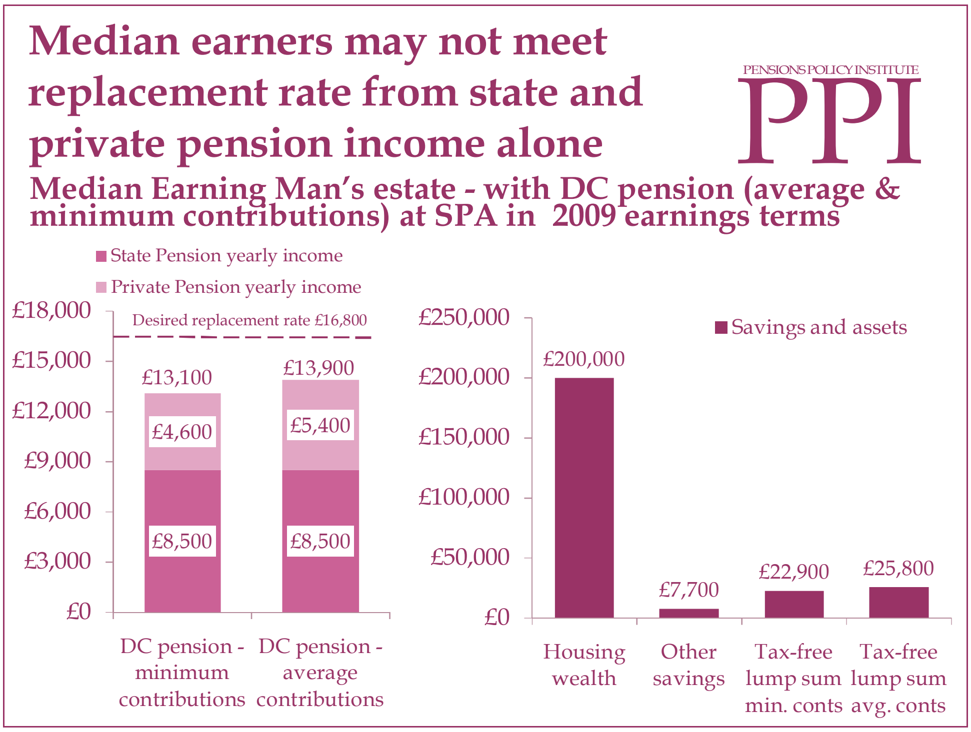
- He starts working full-time from age 21 in 1985.
- He works until he is 66 in 2030.
- During his 45 years of full-time work he earns at median age-specific earnings for a man.
- Between the ages of 30 and 66, he and his employer contribute to a DC occupational pension scheme.
- He reaches SPA with around £8,000 in savings.[36]
- He is an owner-occupier with a house worth £200,000.[37]

[34] Currently £21.90 per week (09/10 rate)
[35] Above full-time minimum wage earnings of £11,200, but below the upper limit of the personal accounts target group in 2009 earnings terms DWP (2006a), less than 20% of employees earned above £37,000 in 2008, ONS (2008b)
[36] Based on 50th percentile of savings for pensioners (rounded) calculated by PPI (data from Family Resources Survey 06/07 in DWP (2008)) inflated by earnings
[37] House price Index Sept. 09 - average house price £199,303, www.communities.gov.uk

Some median earners may not reach their replacement rates from state and private pensions alone

This median-earning man's weekly income in working life, at the point of retirement, is around £460[38] per week (£24,000 p.a.). He would need a gross weekly income of around £320 (£16,800 p.a.) to meet a 70% replacement rate.[39]

Chart 4[40]



If it is assumed that this pensioner saves in a DC pension throughout his working life, and that he and his employer contribute the average percentage of salary[41] to his pension, then he could receive a total gross income from his state and private pensions of around £270 per week (£13,900 p.a.) in 2009 earnings terms (Chart 4). Under this scenario he would not meet his replacement rate of around £320 (£16,800 p.a.) per week from income alone, but could use his savings, tax-free lump sum or housing equity to help meet his replacement rate.

[38] 50th percentile, age-specific earnings, Labour Force Survey (2008)
[39] Pensions Commission (2004) and PPI calculations
[40] PPI Individual Model, numbers rounded to nearest hundred
[41] 3% employee, 7% employer - ONS (2009a)

Box 4: Income received from private pensions could depend on employer's responses to the Government's private pension reforms

The amount that some pensioners receive from private pensions could depend on their employer's responses to the Government's private pension reforms and to changes in the pensions market.[42] As a response to the pension reforms, some employers may increase the level of their contributions to their employees' pension scheme, some employers may decide to maintain their existing pension, and some employers may level down their provision by switching from a DB to a DC pension or by lowering their contributions to their employees' pension scheme. Government research indicates that around 20% of employers who currently offer contributions of 3% or more may decide to offer lower contributions to new employees as a result of the reforms.[43]

If it is assumed that this pensioner saves in a DC scheme throughout his working life and that he and his employer only contribute the minimum required contributions for employees in work-based pension schemes,[44] then he could receive a total gross income from his state and private pensions of around £250 per week (£13,100 p.a.) in 2009 earnings terms (Chart 4). If he and his employer contributed to his pension at current average levels, then his income could be around 6% higher (£13,900).

It is likely that many pensioners will receive DC pension income from several different employers and that each employer will offer different levels of pension contributions. It is unlikely that many median to high earners will only work for employers who offer the minimum required contributions for their whole working life.

If this median-earning man and his employer made total combined contributions of 15% of his salary to his pension during his working life then would have a reasonable chance of meeting his replacement rate of £16,800 (70% of his final working-life income) from state and private pension income at retirement, age 66 in 2030.[45] In order to meet his desired replacement rate, he and his employer would have needed to contribute around 5% above average contribution levels.[46]

Future pensioners may have longer retirements to support

Longevity is increasing. By 2030 a 66 year old man could expect to live another 23 years, until he is 89, compared to 66 year old man today who might live for another 20 years.[47] As people live longer, they will have longer retirements to support. Many people may reach SPA and find that the income from their state and private pensions will not provide them

[42] See PPI (2009c) for a discussion of the Government's pension reforms and employers possible reactions
[43] DWP (2010)
[44] 3% of band earnings (employer), 4% of band earnings (employee) + 1% of band earnings through tax relief
[45] PPI calculations based on all-salary contributions
[46] 3% employee, 7% employer - ONS (2009a)
[47] Rounded up from 22.5, 88.5 and 20.4 ONS 2008-based national principal population projections, UK cohort data www.statistics.gov.uk

with a standard of living that they find acceptable. One way that people might attempt to increase their income after SPA is by working longer.

Box 5: Working after SPA could increase retirement income

Working longer can increase income in retirement by allowing pensioners to use their earnings to fund living costs after SPA or by allowing pensioners to save their earnings to use during later retirement. Working longer can also increase retirement income if people defer taking their state or private pensions while working. If people defer taking their state pension they will receive extra income from it when they do take it (in the form of a lump sum or an extra supplement to their pension).[48] If people continue contributing to their private pensions after SPA they can increase the amount of their pension pot by the amount of extra contributions and investment returns (in the case of DC pensions) or by any additional years of entitlement (in DB pensions).

The working-longer scenarios do not represent average behaviour

There is currently little available data on the average time people spend in work after SPA. These case studies look at some hypothetical scenarios of working after SPA to test their effects on retirement income. These scenarios are not intended to be representative.

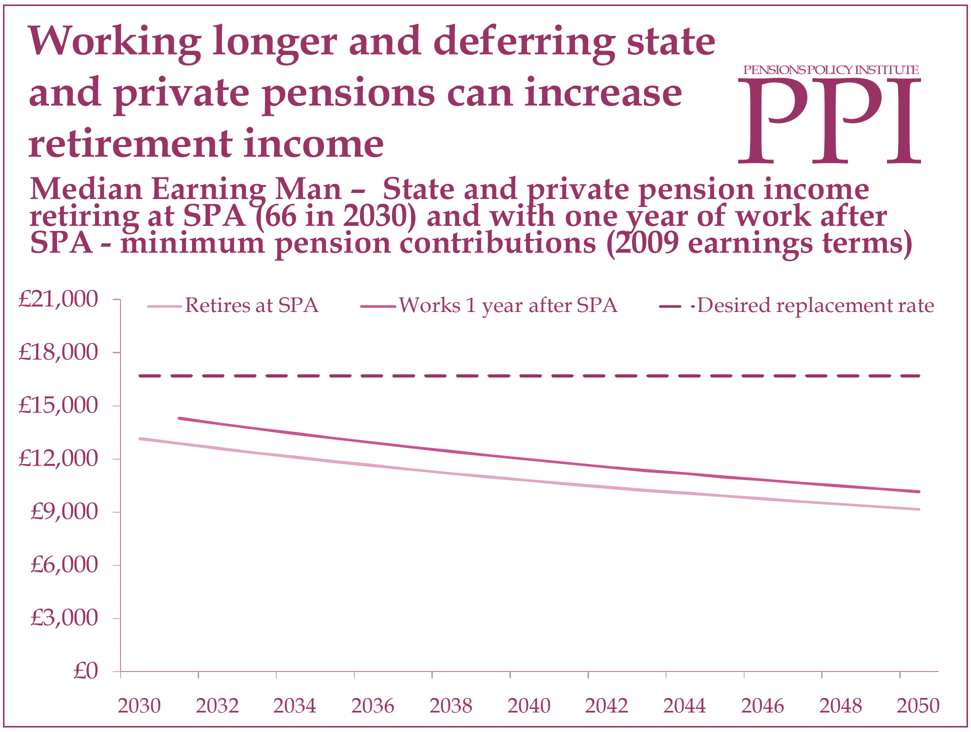
In order to test the potential effects of working after SPA for this median-earning man, it is assumed that:

- The median-earning man works for one year, full-time after SPA and then retires.
- Between the ages of 30 and 66, he and his employer contribute the minimum required to a DC occupational pension scheme of 5% and 3% of salary respectively.[49]
- During his year of work after SPA he defers both his state and private pension and continues to contribute to his private pension.
- When he retires he takes the extra entitlement accrued as an addition to his state pension rate.
- When he retires he takes a 25% tax-free lump sum from his pension savings and uses the rest of his pension pot to buy a single-life, level annuity.

[48] In some cases, where pensioners die soon after SPA, deferring state pension and taking an extra supplement or lump sum could incur less benefit than taking state pension at SPA and saving (or investing) any unneeded surplus

[49] 3% of earnings (employer), 4% of earnings (employee) + 1% of earnings through tax relief

Chart 5[50]



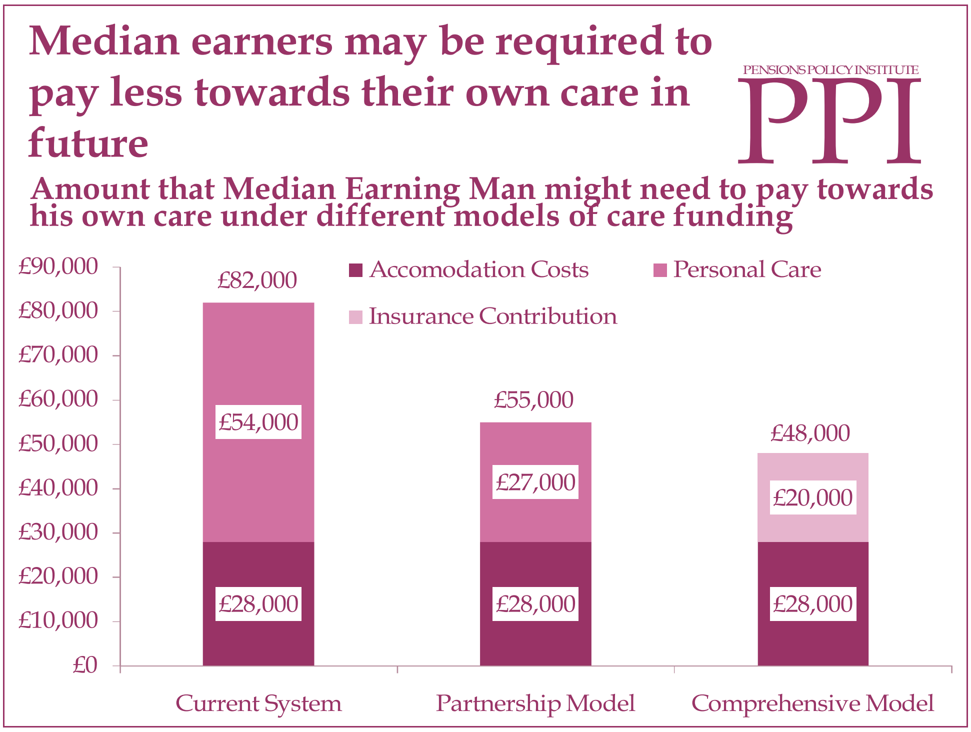
Working for one year, full-time, after SPA and deferring his state and private pensions could increase the yearly income of this pensioner by 10% at the start of his retirement (age 67 in 2031) from around £12,800[51] to around £14,300 (Chart 5). Under this scenario his weekly income from state and private pensions could be around £275 a week (£14,300 p.a.) in 2009 earnings terms at the start of his retirement. Deferring his state and private pensions for one year brings him closer to his desired replacement rate of around £320 per week (£16,800 p.a.).

Median earners may have to pay less towards their own care costs in the future

Not all pensioners will require care during their retirement. However, if it is assumed that this pensioner acquires a moderate disability at the age of 75[52] (in 2039) and a severe disability at the age of 80[53] (in 2044) at which point he enters a residential care home for two years, then he may have to pay around £54,000 for personal care for 7 years[54] and around £28,000 for residential care accommodation[55] for 2 years, a total cost of around £82,000 (in 2009 care costs).

[50] PPI Individual Model
[51] At age 66 he would have received £13,100 in 2009 earnings terms from his pension (Chart 4), at age 67 his pension income has reduced in 2009 earnings terms to £12,800
[52] By age 70 around 50% of people have a moderate or severe disability, figure 4.3 Kellard *et. al.* (2006)
[53] By age 80 around 70% of people have a moderate or severe disability, figure 4.3 Kellard *et. al.* (2006)
[54] £112pw - 5 years personal care at home & £230pw - personal care in care home, Forder & Fernández (2009)
[55] £270 per week for accommodation in a residential care home, Forder J, Fernández J.L. (2009) Table 13

Chart 6[56]



Under the current system he may be required to use his savings and assets to pay for all of his own personal care and accommodation costs (Chart 6):

- After using any remaining funds he has from his savings and his tax-free lump sum (around £30,000 at SPA) he could use the equity in his home to fund any remaining care and accommodation costs not covered by the state.
- He could release a lump sum of around £80,000 at age 75[57] using a lifetime mortgage from his home which is worth £200,000. If he used his equity to pay for the remainder of his care and accommodation costs he would have total remaining housing wealth of £120,000 or more. He may choose to pay for almost all of his care costs using equity from his home in order to keep his liquid assets available or if he has spent some or all of his savings and tax-free lump sum by the time he reaches the age of 75.

Under a Partnership Model he could be responsible, as a moderate income pensioner, for paying for half of his personal care:

- He may be responsible for paying £27,000 (half of £54,000) towards his personal care and £28,000 for two years accommodation in a care home, a total of £55,000.
- He could use the equity in his home to fund his care costs and still have housing wealth of £145,000.

[56] PPI calculations using data from HM Government (2009a) and Forder and Fernandez (2009)
[57] Limits on amount available vary by product provider, at age 75 he could release a lump sum of around 40% - 45%, www.aviva.co.uk, www.crownequityrelease.com, www.mortgages.co.uk

- Under the Partnership Model he could pay £27,000 less towards his own care than under the current model, a saving of 33% on total care costs (including accommodation).

Under a Comprehensive Model he would need to pay an insurance contribution of between £17,000 and £20,000 in order to cover any future care costs.[58] The individuals in this analysis are assumed to pay their insurance contribution at SPA.[59]

- This pensioner could use his tax-free lump sum (£23,000) and his savings (£7,700) to pay his insurance contribution. However, paying an insurance contribution from these sources could limit the amount of readily available liquid assets this pensioner would have to spend during retirement. He may choose instead to use some of the equity in his home in order to keep his savings and tax-free lump sum available for planned or unanticipated expenses in retirement.
- He could release a lump sum of around £60,000 (30% of his home's value)[60] at age 66 using a lifetime mortgage. If he uses his equity to pay his insurance contribution he would still have around £40,000 left of releasable equity or a total home value of around £180,000.
- After paying his insurance contribution, he would be entitled to have all of his care costs (£54,000) paid for by the insurance provider. However, he would still be responsible for paying his accommodation costs of £28,000 (which he could pay for with equity or remaining savings).
- Under the Comprehensive Model he could pay £34,000 less towards his own care than under the current model, a saving of 41% on total care costs (including accommodation). However he may be worse off under the comprehensive model if he is required to pay an insurance premium but never actually needs care.

This pensioner may choose to save for an insurance payment during his working life. Table 1 shows how much he might need to contribute to a Cash ISA during his working life to save up enough for an insurance contribution at age 66.

[58] His contribution may be lower/higher if the Government decides to adjust contribution amounts to means
[59] The Government has not yet decided when people will be required to pay their contributions if an Insurance or Comprehensive Model is introduced.
[60] www.aviva.co.uk, www.crownequityrelease.com, www.mortgages.co.uk

Table 1:[61] Amount an individual reaching SPA in 2030 would need to save each month in a Cash ISA to pay an insurance premium at SPA

Amount saved by retirement	Age 25	Age 35	Age 45	Age 55
£17,000	£13	£22	£42	£105
£20,000	£15	£26	£49	£123
£25,000[62]	£19	£32	£61	£154

However, if this median earning man saves up for an insurance contribution during working life he may compensate by reducing some of his other financial savings.

In the future higher earners could have more complex baskets of assets and income

In the future many higher earners (for example earning above £37,000 p.a.),[63] are likely to see an increase in their income from state pensions as a result of the re-indexation of BSP with earnings. Higher earners may have one or more DC (and/or DB) pensions in future and are likely to receive retirement income from other financial assets. Income from other savings and assets may become more important for higher earners in the future. The amount of income some high earners receive from private pensions may depend on their employer's responses to the Government's private pension reforms and to changes in the pensions market.

Box 6: A high-earning woman, aged 66 at SPA (2030)

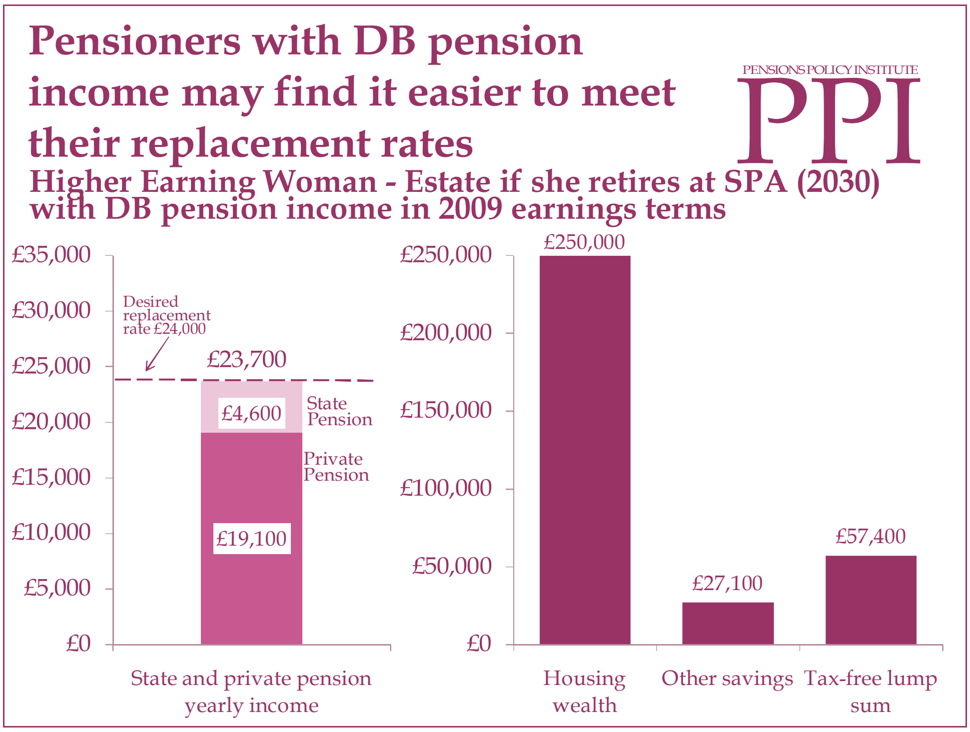
- She starts working full-time from age 25 in 1989.
- She works until she is 66 in 2030.
- During her 41 years of work she earns at high-earnings for a woman.
- Between the ages of 25 and 66 she contributes to a DB occupational pension scheme.[64]
- She reaches SPA with around £27,000 in savings.[65]
- She is an owner-occupier with a house worth £250,000.[66]

[61] Interest received on savings is assumed to be in line with the yields on UK Government gilts of appropriate duration
[62] Contributions could be higher than £20,000 under the proposed Insurance Model or if the Comprehensive Model contribution amounts are adjusted to means
[63] Above the personal accounts target group in 2009 earnings terms DWP (2006a)
[64] With a 1/80th accrual rate with an additional 3/80th lump sum
[65] Based on 90th percentile of savings for pensioners (rounded) calculated by PPI (data from Family Resources Survey 06/07 in DWP (2008)) inflated by earnings
[66] House price Index Sept. 09 - average house price £199,303, www.communities.gov.uk

Pensioners with DB pension income may find it easier to meet their replacement rates at the beginning of retirement

This high-earning woman's weekly income in working life, at the point of retirement, is around £770[67] per week (£40,000 p.a.). She would need a gross weekly income of £460 (£24,000 p.a.) to meet her 60% replacement rate.[68]

Chart 7[69]



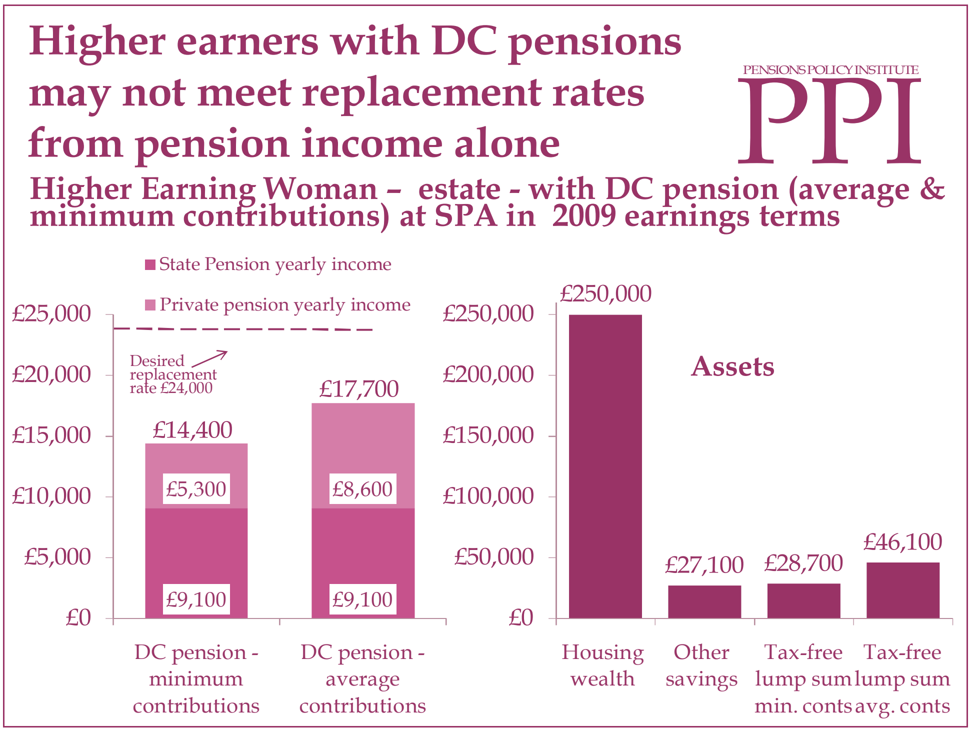
If it is assumed that she does not take any income from her other savings or from her housing wealth, then she could receive a total gross income from her state and private pensions of around £455 per week (£23,700 p.a.) in 2009 earnings terms (Chart 7). Under this scenario she would just about meet her desired replacement rate of £460 per week (£24,000pa).

Higher earners with DC pension income may not reach their replacement rates from state and private pension income alone

Within the private sector many employers are closing their DB schemes to new (and sometimes existing) members and, as an alternative, offering membership in a DC scheme to their employees.[70] It is likely that some median to high-earning pensioners will receive income in retirement from both DC and DB pensions in the future, as people may work for several different employers, with different pension arrangements, during their working life.

[67] 90th percentile, Labour Force Survey (2008)
[68] Pensions Commission (2004) and PPI calculations
[69] PPI Individual Model, numbers rounded to nearest hundred
[70] PPI (2009c)

Chart 8[71]



If it is assumed that this pensioner saves in a DC pension throughout her working life, and that she and her employer contribute the average percentage of salary[72] to her pension, then she could receive a total gross income from state and private pensions of around £340 per week (£17,700 p.a.) in 2009 earnings terms (Chart 8) a decrease of 25% from the amount she receives from a DB pension. Under this scenario she would not meet her replacement rate of £460 per week from state and private pension income alone, but could use her savings, tax-free lump sum or housing equity to help meet her replacement rate.

If it is assumed that this pensioner saves in a DC scheme throughout her working life and that she and her employer only contribute the minimum required contributions for employees in work-based pension schemes[73] then she could receive a total gross income from state and private pensions of around £280 per week (£14,500 p.a.) in 2009 earnings terms (Chart 8), a decrease of 18% from the amount she receives from a state and private DC pension with average contribution levels.

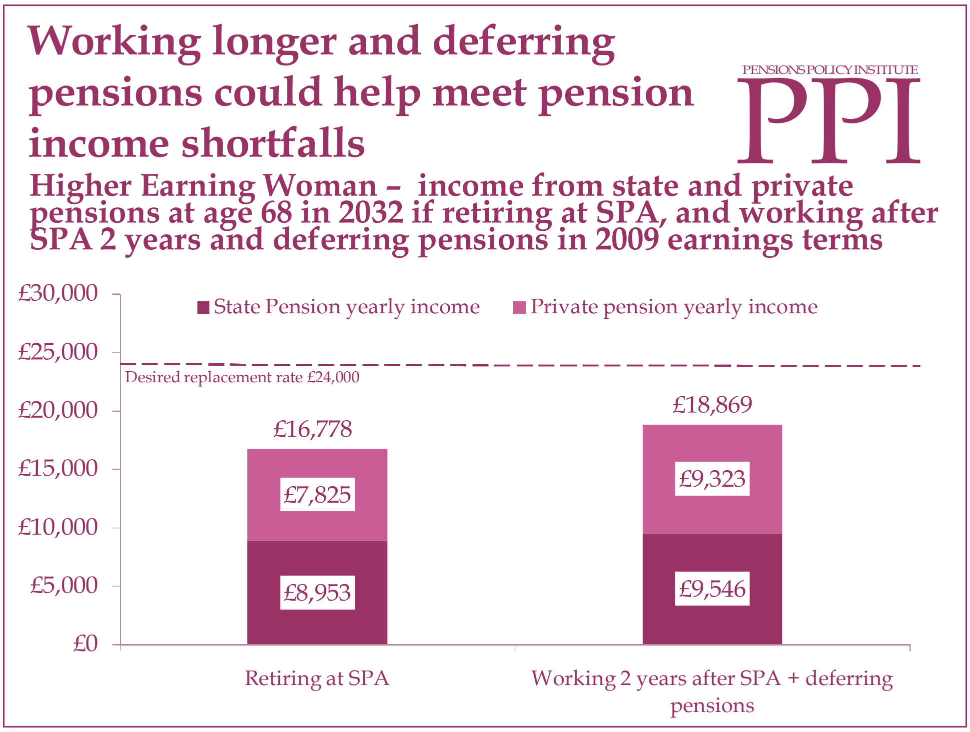
[71] PPI Individual Model, numbers rounded to nearest hundred
[72] 3% employee, 7% employer - ONS (2009a)
[73] 3% of band earnings (employer), 4% of band earnings (employee) + 1% of band earnings through tax relief

Working longer and deferring pensions could help pensioners to meet shortfalls in pension income

In order to test the potential effects of working after SPA for this high-earning woman, it is assumed that:

- She works for two years after SPA at age 66 (one year, full-time and then one year, part-time) and then retires.
- During her one year of full-time work she defers her state pension.
- She takes her state pension at age 67, taking the additional deferred income as a top-up to her rate rather than as a lump sum.
- She defers her private pension for two years after SPA (while working full-time and part-time).
- While in full-time work she contributes to her private pension, but does not contribute when she is in part-time work.
- At age 68 she uses her private pension pot to buy a single-life, level annuity.

Chart 9[74]



Working for one year, full-time and one year, part-time after SPA and deferring state and private pensions could increase the yearly income of this pensioner from state and private pensions at the start of her retirement (age 68 in 2032) by 11%, from around £16,800[75] to around £18,900 in 2009 earnings terms (Chart 9), though even with working longer this pensioner would not meet her desired replacement rate of £24,000.

[74] PPI Individual Model, numbers rounded to nearest hundred

[75] At age 66 she would have received £17,700 in 2009 earnings terms from her pension (Chart 8), at age 68 her pension income has reduced in 2009 earnings terms to £16,800

Higher earners may have to pay less towards their own care costs in the future

Not all pensioners will require care during their retirement. However, if it is assumed that this pensioner acquires disabilities in older age (see median-earning man above for assumptions) then she may have to pay around £82,000 (in 2009 care costs) to cover her personal care and accommodation costs.

Under the current system she may be required to use her savings and assets to pay for her own care. The following analysis assumes that this pensioner has retired at SPA in 2030 with income from a DB pension (Chart 7):

- This pensioner would in theory be able to fund all of her care and accommodation costs (of around £82,000) from her savings and tax-free lump sum (Savings + tax-free lump sum = £84,500) and still have around £2,500 remaining in liquid assets.
- She may choose to pay for her care and accommodation using equity from her home in order to keep her liquid assets available or if she has spent some or all of her savings and tax-free lump sum. She could release a lump sum of around £100,000 at age 75[76] using a lifetime mortgage to release equity from her housing wealth. If she uses her housing equity to pay for her care and accommodation she would still have total remaining housing wealth of £170,000 or more.

Under a Partnership Model she could be responsible, as a high income pensioner, for paying for either two-thirds or three-quarters of her personal care costs:

- She may be responsible for paying either £36,000 or £40,500 (2/3 or 3/4 of £54,000) towards her personal care and £28,000 for two years accommodation in a care home, a total of £64,000 or £68,500.
- Under the Partnership Model she could be responsible for paying between £13,500 to £18,000 less towards her own care than she would have to under current policy, a saving of 16% to 22% on total care costs (including accommodation).

Under a Comprehensive Model she would need to pay an insurance contribution of between £17,000 and £20,000 in order to cover any future care costs.[77]

- This pensioner could use her tax-free lump sum (£57,400) or savings (£27,100) to pay her insurance contribution.
- She could release a lump sum of around £75,000 (30% of her home's value)[78] at age 66 using a lifetime mortgage. If she uses her equity to

[76] At age 75 she could release a lump sum of around 40% - 45%, www.aviva.co.uk, www.crownequityrelease.com, www.mortgages.co.uk

[77] Though her contribution may be lower or higher if the Government decides to adjust contribution amounts to means

[78] www.aviva.co.uk, www.crownequityrelease.com, www.mortgages.co.uk

pay her insurance contribution she would still have around £55,000 left of releasable equity or a total home value of around £230,000.
- She could also choose to save during working life for her insurance contributions (Table 1) however this may result in some decrease in her other savings.
- After paying her insurance contribution, she would be entitled to have all of her care costs paid for by the insurance provider. However, she would still be responsible for paying her accommodation costs of £28,000.
- Under the Comprehensive Model she could pay £34,000 less towards her own care than under the current model, a saving of 41% on total care costs (including accommodation).

Box 7: Inheritance could help some people meet the costs of care

Around half of people are likely to receive an inheritance at some point in their lives, though people are more likely to receive an inheritance the older they are, if they are in a high social class, or if they are owner-occupiers. It is likely that many moderate to high income pensioners would receive some inheritance during their life in the form of assets, savings or housing. Pensioners who receive an inheritance during or close to their retirement may be able to use it to pay towards any insurance contribution they might need to make, or to fund the costs of care. However the majority of inheritances received are relatively small, less than 10% of people receive inheritances of more than £25,000.[79] People who are likely to receive large enough inheritances to have a substantial impact will generally already have higher than average income and assets.[80]

The costs of care may be affected by additional policies

Future pensioners may be affected by other care and support funding policies in the future. Under the personal care at home bill,[81] pensioners with the 'highest needs' may qualify to have all of their personal care costs paid for by the state, while they remain at home. Under the Conservative's Insurance Model,[82] pensioners may be able to purchase insurance which will cover both their personal care and accommodation costs in a residential care home. The case studies in this report did not include examination of these future policies because there was not enough available information at the time of publishing to consider the potential effects on the cost of care for individuals.

[79] Rowlingson & McKay (2005) table, 3.6
[80] Rowlingson & McKay (2005)
[81] http://services.parliament.uk/bills/2009-10/personalcareathome.html
[82] www.conservatives.com/News/News_stories/2009/10/Ending_the_scandal_of_forced_home_sales_to_pay_for_care.aspx

Conclusions

- In future, some pensioners with lower incomes may find it easier to meet replacement rates because the state pension reforms will increase her state pension income.
- Pensioners on moderate to high incomes may find it difficult to meet replacement rates from state and private pension income alone in future and may need to supplement pension income with income from other savings and assets.
- The shift from DB to DC pensions may mean that more moderate to high income pensioners will find it hard to meet replacement rates from pension income alone in future.
- The hypothetical pensioners who deferred state and private pensions while working after SPA increased their income in retirement from state and private pensions by around 10%.
- The hypothetical median-earning man may have had a more reasonable chance of meeting his replacement rate if he and his employer had contributed 15% of his total salary to his DC pension during his working life. In order to meet his desired replacement rate, he and his employer would have needed to contribute around 5% above average contribution levels.
- Under current and future models of care and support funding, pensioners on low incomes are not generally expected to cover their own care and support, though they may be required to pass all of their income over to the state, retaining only enough for the Personal Expenses Allowance.
- Under the current model of care and support funding, moderate to high income pensioners may be responsible for paying for all of their own personal care and accommodation costs.
- Under the Government's 'Partnership Model' for care funding, the hypothetical moderate to high income pensioners were responsible for paying 16% to 33% less towards their own care costs in total (including accommodation costs) than under the current model.
- Under the Government's 'Comprehensive Model' for care funding, the hypothetical moderate to high income pensioners were responsible for paying 41% less towards their own care costs in total (including accommodation costs) than under the current model. However they would be worse off if they paid the insurance premium but did not need care.

The rest of this paper draws on the first three reports in this series and summarises their findings regarding:

- the roles which state and private pensions, other savings and assets, and housing play in supporting retirement,
- how the use of income and assets to support retirement may change in the future.

Chapter three: what is the role of state pensions in supporting retirement and how might this change in the future?

This chapter draws on the results of the third report in the series,[83] and examines the role which state pensions play in providing income to pensioners. This chapter explores the potential effects of the Government's state pension reforms on the role that state pensions could play in supporting retirement for pensioners in the future.

State pensions are the most important source of retirement income for pensioners

Currently, around 11.5 million[84] pensioners (95%[85] of total pensioners) receive income from state pensions, making it, on average, the most important source of retirement income. However, the relative importance state pension income plays for any pensioner household is dependent on what proportion of their total income is from state pensions. State pension income is relatively more important for lower income households, who are likely to receive a much larger proportion of their income from state pensions than higher income households.[86]

State pension reforms are likely to increase the levels of income pensioners receive from state pensions

The Pensions Act 2007 contains reforms to the state pension system which will have the effect of lowering the income threshold for S2P entitlement, reducing the number of qualifying years needed for a full BSP and making it easier for carers and people with disabilities to earn National Insurance credits. The state pension reforms are likely to result in an increase in the level of income which most pensioners receive from state pensions (Chart 10).

[83] PPI (2009c)
[84] ONS 2006 based population projections, principal projections
[85] DWP (2009a) p. 35 figures for 2007/08
[86] DWP data, see PPI (2009c) for more discussion

Chart 10[87]

Everyone who is entitled to some BSP will receive more income from state pensions than they would have without reform (Chart 10). Some groups, such as women, carers, and very low earners are likely to benefit substantially more from the reforms than people who already tended to accrue enough qualifying years to receive the full rate of BSP, .e.g., men with full national insurance records. For example, the low-earning woman with caring breaks in Chart 10 receives 30% more from state pensions than she would have without reform, whereas the high earner and median earner receive 17% and 21% more respectively.

Conclusions

- From 2010 and beyond pensioners are likely to receive more income from state pensions than they currently do. This will increase the importance of income from state pensions for many pensioners, though more significantly for certain groups, such as women, carers, the disabled and very low earners.
- Employed men and women with full National Insurance records and people on median to high incomes (higher earners and some low to moderate earners) may not see the proportion of income they receive from state pensions increase as dramatically as some low earners and carers.

[87] PPI analysis using the Individual Model, assuming high and median earners have a working life of 42 and 47 years respectively, and carer works for 26 years and earns at the 10th percentile. With-reform figures assume: BSP uprated by earnings from 2012, S2P flat rate from 2030, and necessary qualifying years for a full BSP is 30 for men and women.

In addition to income from state pensions, many people use income from private pensions and other financial assets to help support retirement. The next chapter examines the roles which private pensions and other financial assets play in providing income to pensioners and explores how the roles that private pensions and other financial assets play could change in the future.

Chapter four: what is the role of private pensions and other financial assets in supporting retirement and how might this change in the future?

This chapter draws on the results of the third report in the series,[88] and examines the roles that private pensions and other financial assets play in providing income to pensioners. This chapter explores the potential impact of the Government's private pension reforms, and the potential impact of changes already occurring in the private pensions market on the roles that private pensions and other financial assets could play in the future.

Private pensions are an important source of income for pensioners on moderate to high incomes

67%[89] of pensioners receive income from private pensions, though pensioners on high incomes receive on average a much larger proportion (around 35% of their income) from private pensions than pensioners on low incomes who receive on average between 9% and 14% of their income from private pensions.[90]

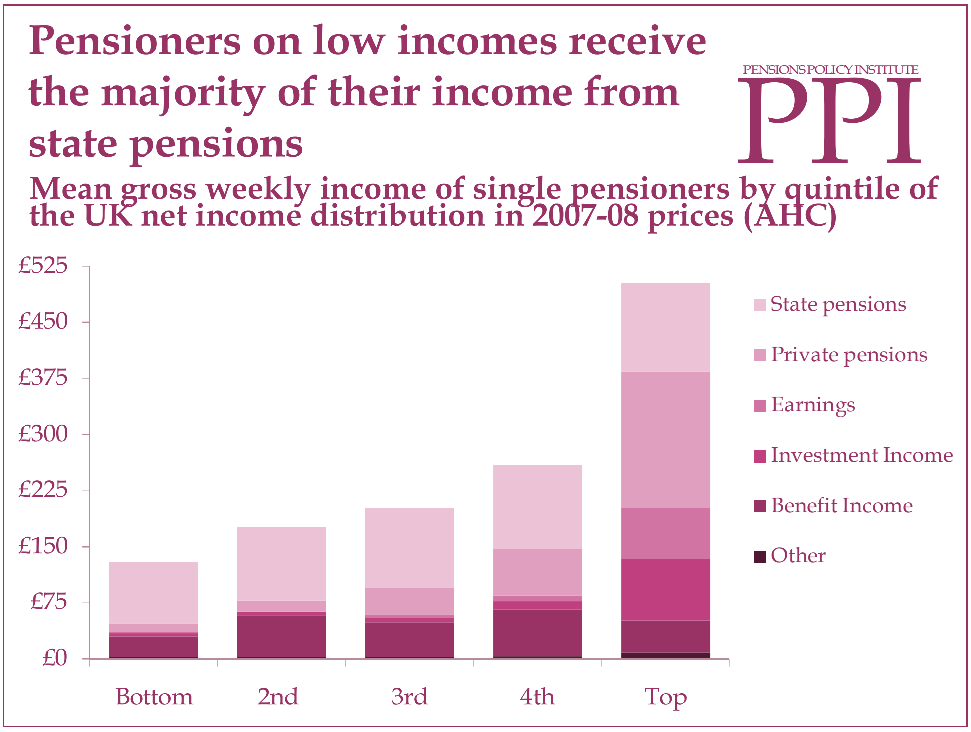
There are many options for the receipt of private pension income. People in receipt of private pension income, who saved in a DC pension, could receive their income from a retirement income product such as a lifetime annuity or an income drawdown arrangement.[91] People who saved in a DB pension in working life, or in some occupational DC pensions, could receive their private pension income directly from their pension scheme.

Other financial savings and assets are an important source of income for pensioners on high incomes

The majority of pensioners, around 70%,[92] receive some income from savings and investments, however saving and investments are a much more important source of income for wealthier pensioners. Pensioners in the top (wealthiest) quintile of the UK net income distribution receive on average 16% to 19% of their income from savings and investments while pensioners in the bottom four quintiles receive, on average, only 3% to 6% of their income from savings and investments.[93] Pensioners in the top quintile of the net income distribution are much more likely to have a varied basket of assets and income than pensioners in lower income quintiles (Chart 11).

[88] PPI (2009c)
[89] DWP (2009a) table 3.9, 2007/08 data
[90] Pensioners in the lowest and highest income quintiles, mean average 2005-08 DWP (2009a) table 4.4 - AHC
[91] An Unsecured Pension arrangement or, for those over 75 an Alternatively Secured Pension, see PPI (2009c) for further discussion
[92] DWP (2009a) table 3.6
[93] Mean average 2005-08, DWP (2009a) table 4.4 – AHC

Chart 11[94]



The private pension reforms could increase the proportion of pensioners receiving income from private pensions

The Pensions Act 2008 contains three major reforms to the private pensions system, all to be phased in or implemented from 2012. The reforms which affect employers will be phased in to reduce administrative burdens. The reforms in the Act:

- Require employers to automatically enrol eligible employees into a work-based pension scheme (employees have the option to opt out).
- Require employers to make contributions of at least 3% of band earnings[95] to eligible employee's workplace pension schemes.
- Introduce a new, low cost, national pension savings scheme, called NEST (National Employment Savings Trust).

Assuming that opt-out rates after auto-enrolment are in line with Government expectations of around 25%,[96] the proportion of people with private pension savings after 2012 could rise from around 40% of the working age population today (around 14 million people)[97] to around 21 million people, or roughly 60% of the UK working-age population, once the Government's reforms are fully implemented. This could result in the proportion of pensioners receiving income from private pensions rising as successive cohorts reach State Pension Age (SPA). Some pensioners are also likely to receive higher levels of income from private pensions than

[94] Data supplied by DWP
[95] Band earnings are earnings between £5,035 and £33,540 (in 2006/07 earnings terms)
[96] DWP (2009c)
[97] PPI analysis of Family Resources Survey 2005/06 and 2006/07

they would have without reform as a result of compulsory employer contributions.

Future levels of private pension saving will depend partly on employer responses to reforms

The reforms will increase the costs of pension provision for most employers because auto-enrolment is likely to result in higher levels of participation in pension schemes and because of the requirement for employers to contribute at least 3% of band earnings[98] for employees who remain opted in.[99] Employers may be able to pass on cost increases in a number of ways, for example, by charging higher prices, awarding lower wage increases, passing the costs on to shareholders through lower profits, or reducing their levels of contributions into employees' pension schemes. Although surveys of likely employer responses have been conducted, they cannot predict with certainty how employers will respond to the reforms.[100]

Future contribution levels will also depend on the decisions individuals will make regarding opting-in and opting-out of pension saving and what level of contributions to make. Therefore it is difficult to estimate exactly how private pension contributions and the proportions of income pensioners receive from private pensions may change in the future.

In the absence of reform, contributions into private pensions are projected to fall from around £40 billion to around £30 billion by 2050 (in 2006/7 earnings terms).[101] This is due to the assumption that employers will continue to close DB pension schemes and replace them with less generous DC schemes.

There is a wide range of possible outcomes for the flow of contributions into pensions in the private sector as a result of the reforms. How employers and individuals respond to the reforms will be very important in determining whether overall levels of private pension saving are higher or lower than they would have been in the absence of the reforms.

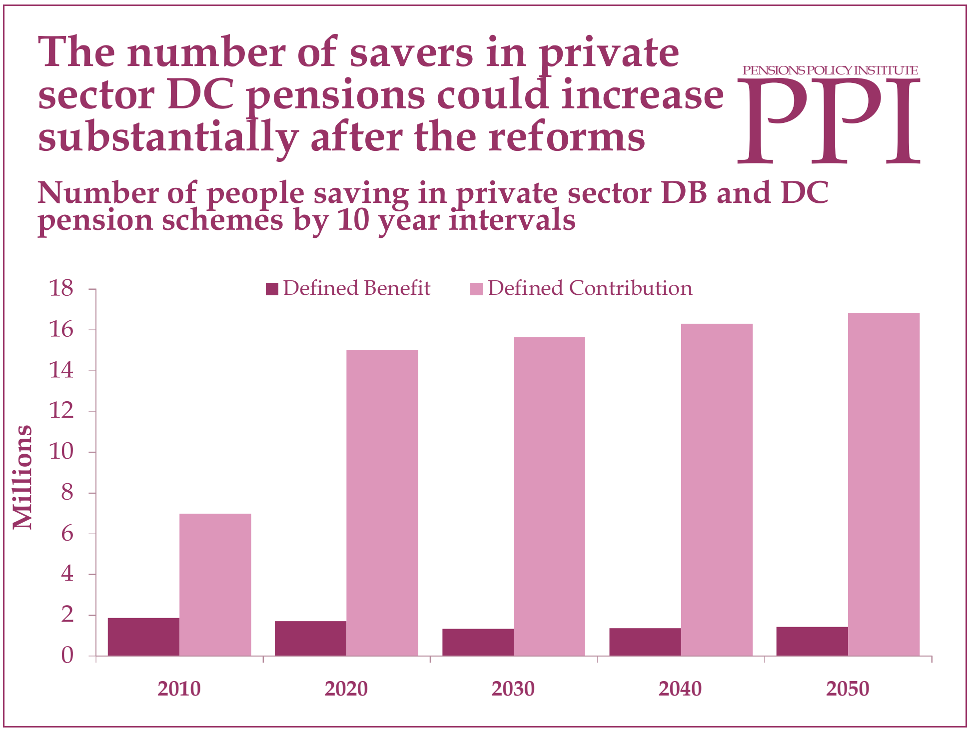
PPI analysis indicates that by 2050 total annual pension contributions could be £10 billion higher or £10 billion lower than in the absence of reform (in 2006/7 earnings terms)[102] depending on how employers and individuals respond to the reforms.

[98] £5,035 to £33,540 in 2006/07 earnings terms
[99] Currently, only around 15% of private sector employers offer pension scheme membership with a more generous employer contributions than the 3% minimum contribution, DWP (2006a)
[100] PPI (2007)
[101] PPI projections
[102] PPI Aggregate model, see PPI (2007) for more discussion

Income from private pensions will be affected by changes occurring in the private pensions market

Though work-based pension provision has traditionally been supplied in the form of Defined Benefit (DB) schemes, the last two decades have seen an acceleration in the trend for private sector DB schemes to close, either to new members or to new and existing members,[103] and for employers to offer membership in Defined Contribution (DC) schemes instead.[104] If current trends continue, then active membership in private sector DB schemes could reduce from 2.5 million today, to around 1.5 million active members by 2050 (Chart 12). The trend for DB schemes to be replaced by DC schemes is more prevalent in the private sector than in the public sector[105] where the predominant form of pension provision remains DB pension schemes.

Chart 12[106]



An expected increase in savers resulting from auto-enrolment coupled with the trend for employers to offer DC scheme membership rather than DB, indicates that many more people are likely to be saving in DC pensions in the future than are saving in them today. Active membership

103 Schemes which are closed to existing members may continue to hold and invest existing member's benefits while not allowing further accrual, or may settle benefits with members and close down altogether

104 This could take the form of a DC scheme with an insurance provider or the employer may choose to open a DC section within their previous DB scheme

105 Within the public sector 5.2 million people (a rise from 4.1 million in 1991) are active members of DB schemes, while in the private sector 2.7 million people (a drop from 3.2 million in 2006) are active members of DB schemes - PPI (2008), ONS (2008a) table 3.1 and 3.3, TPR, PPF (2008) table 3.5

106 PPI Aggregate Model, DC saver numbers includes all personal, private and occupational DC pensions including SIPPS. DC saver numbers may contain a small amount of public sector savers.

in Defined Contribution schemes could reach around 17 million by 2050, compared to an estimated 5 million today (Chart 12).

A shift from DB to DC could mean some people will receive lower income from private pensions

DC pensions could yield lower pension income than DB pensions primarily because contribution rates are often lower in DC pensions than in DB pensions.[107] In private sector DC pensions, employers contribute on average around 7% of salary and employees contribute around 3% of salary. While in private sector DB pensions, employers contribute around 16% of salary and employees contribute around 5%.[108] There is some evidence that employers lower their contribution rates when switching from DB to DC schemes.[109]

The shift from DB to DC could also affect private pension income levels because, by offering a DC scheme rather than a DB scheme, employers can pass on some of the risks associated with hosting a pension scheme to their employees. In DC schemes, it is the scheme members who bear the risks of low investment returns, fund losses due to market fluctuations, and poor annuity rates at the point of retirement. While in a DB scheme, the employer is liable for agreed payouts to scheme members regardless of the performance of the invested pension fund.

An increase in private DC pension saving means that more people will use the annuity and retirement products market

As a result of auto-enrolment and the shift from DB to DC, a greater proportion of pensioners will retire with private DC pension savings in future than is currently the case. There are an estimated 5 million people saving in DC pensions today.[110] By 2020 there could be around 15 million people saving in a DC pension, and by 2050 there could be around 17 million people saving in a DC pension. The amount held within DC pension funds could grow from around £600 billion today to between £700 billion and £900 billion (2009 earnings terms) by 2050, depending on how employers respond to the private pension reforms.[111] In the future:

- the retirement products market will face a greater number of new customers and,
- the annuity and retirement products market will need to hold and manage a larger proportion of people's wealth in retirement than it does today.

[107] See PPI (2009c) for further discussion on the risks associated with DB pensions
[108] ONS (2009a), 2007 figures, all figures rounded to nearest whole number
[109] Campbell *et al* (2006)
[110] ONS (2008a), PPI Aggregate model, DWP data
[111] PPI Aggregate model, see PPI (2009c) for a description of the scenarios used

Auto-enrolment could cause the financial profiles of pension savers to change
As a result of auto-enrolment the financial profiles of people who purchase annuities is likely to change in the future to include more people on low to moderate incomes (the target group for NEST).[112] An increase in low to moderate earners saving in private pensions may affect average pot sizes, as low to moderate earners may make smaller pension contributions than higher earners. As the numbers of people with private pension savings increases, and especially the number of people with small pots, it will be necessary to ensure that appropriate advice, information and products are made available so that people can maximise their income in retirement.

More people will need financial advice or information in future
Shifts within the private pensions and savings landscape mean that in the future people may be required to make more choices regarding their savings than they needed to in the past.

- Changes such as the shift from DB to DC will mean that many new and existing savers will need to make more complex choices regarding pension investments and retirement income than previous generations.
- People may have more complex combinations of income and assets to manage in future. Some people, especially higher earners, could have baskets which include state pension entitlement, residual DB pension entitlement, DC pension savings, other financial savings and assets, housing assets, and earnings.

Within the new pensions and savings landscape, more people are likely to need some kind of information or advice to support them in making these complex financial decisions.

Low to moderate earners may need to use the new Money Guidance services if they want assistance with financial decisions
The Government and the FSA are jointly launching a new, national financial information and guidance service, currently known as Money Guidance[113] which will be most relevant to the new savers in private pensions with low to moderate earnings who may be unable to afford to use the services of financial advisers.

On auto-enrolment, employers will be required to provide their employees with information packs detailing the different implications of opting-out or staying in. However, many new private pension savers may need to use the new Money Guidance services if they want further assistance with decisions regarding their pension investment options or

[112] DWP (2006a)
[113] www.fsa.gov.uk/financial_capability/our-work/money_guidance.shtml, Money Guidance may not be the brand name which is eventually used

which retirement products to use, for example, which type of annuity to purchase.

It will be quite important that Money Guidance and other free, generic information and guidance services are effectively promoted to those who may need them and are able to provide financial guidance and information for all stages of life, pre and post retirement. People's income needs can change several times during retirement[114] and therefore it will be important for guidance and information services to be effectively promoted and tailored to people in early and later retirement as well as people of working-age.

Conclusions

- There are an estimated 5 million people saving in DC pensions today. By 2020 there could be around 15 million people saving in a DC pension, and by 2050 there could be around 17 million people saving in a DC pension.
- The amount held within DC pension funds could grow from around £600 billion today to between £700 billion and £900 billion (2009 earnings terms) by 2050, depending on how employers and individuals respond to the private pension reforms.
- In future the retirement products market will face a greater number of new customers.
- In future the annuity and retirement products market will hold and manage a larger proportion of people's wealth in retirement than it does today.
- Shifts within the private pensions and savings landscape mean that in the future people may be required to make more choices regarding their savings than they needed to in the past. Within the new pensions and savings landscape, more people are likely to need some kind of information or advice to support them to make these complex financial decisions.

In addition to income from state pensions, private pensions and other financial assets some people use, or have the potential to use housing wealth to help support retirement. The next chapter examines the role that housing plays in supporting retirement and explores how the role that housing plays in supporting retirement could change in the future.

[114] PPI (2009a)

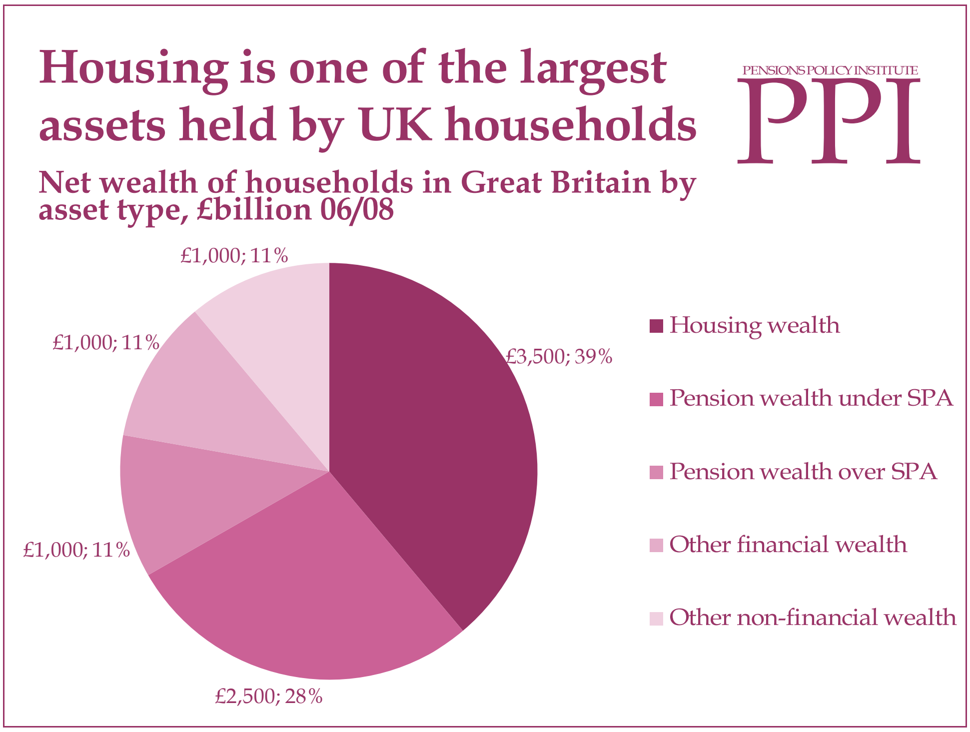
Chapter five: what is the role of housing in supporting retirement and how might this change in the future?

In addition to income from state pensions, private pensions and other savings and investments, some people are able to use housing wealth to help support retirement. This chapter draws on the results of the second report in the series,[115] and examines the role which housing plays in supporting retirement. This chapter explores how the use of housing to support retirement may change in the future.

Housing wealth is one of the largest single assets held by UK households

The largest asset classes held by UK households are housing wealth and pension wealth (Chart 13).

Chart 13[116]



[115] PPI (2009b)

[116] ONS (2009b), this data has been updated from the data in PPI (2009b) to include most recently available data from the Wealth and Assets Survey 2006/08

10% of all working people expect property to be their main source of retirement income,[117] however many people do not consider housing wealth as a way of saving for retirement. Pensions are currently the most popular way to save for retirement.[118] Some people with housing wealth see it as an additional, rather than the main, source of retirement income.

Housing wealth is unequally spread across the population

A large number of people have little or no housing wealth, while a relatively small number of people have high levels of housing wealth:

- 10% of people over age 50 own a third of all of the housing wealth held by people over age 50,[119]
- wealthier people, and people living in certain regions, are more likely to have housing assets than others,[120]
- housing wealth varies by age - net housing wealth is higher for individuals aged 55 to 69 than for those aged 70 or older.[121]
- 20% of people over age 50 have no housing wealth. [122]

There are several ways in which pensioners can use housing wealth to support retirement

- Owning your own home can reduce living costs.
- Homeowners can use housing equity to provide extra income or a lump sum when required.
- Property can be used as part of an investment portfolio, or provide rental income (for example, from a second home).

Owning housing can reduce living costs

Owning property reduces costs in retirement. Even though owner occupation brings some increased costs,[123] a large saving is made through not having to pay rent. Pensioners who live in their own home, with a fully paid off mortgage, could reduce living costs by up to 30% for a single person and by up to 40% for a couple, after allowing for the increase in costs that are associated with owning a home.[124, 125]

People can access some of the wealth in their homes by downsizing

People can access some of their housing wealth by selling their house and then purchasing another, smaller, house at a lower cost, or by selling their house and then moving to rented accommodation. Of working people who do own their own home, 29% plan to downsize their property in order to provide retirement income.[126]

[117] ABI (2008)
[118] Around 65% of people currently in work are saving for retirement in a private pension ABI (2008)
[119] PPI analysis of wave 3 of the English Longitudinal Study of Ageing (ELSA), 2006
[120] PPI (2009b)
[121] PPI analysis of wave 3 of the English Longitudinal Study of Ageing (ELSA), 2006
[122] PPI analysis of wave 3 of the English Longitudinal Study of Ageing (ELSA), 2006
[123] Such as buildings insurance and maintenance
[124] Parker (2006)
[125] This difference may not arise for low income pensioners, where some rent could be paid by Housing Benefit
[126] ABI (2008)

Equity can be released using financial products
Equity can be released using financial products known as equity release products. There are three main types of equity release product:

- **Lifetime mortgages** - a loan is secured against the property, which can be taken either as a lump sum or withdrawn over time using a drawdown facility. The loan is normally repaid on the death of the owner, or if the house is sold.
- **Home reversion schemes** - all or part of the property is sold to a reversion company who then own a proportion, or the total, of the property. The pensioner lives rent-free in the property until death.
- **Sale and rent back agreements (SARBs) -** the property is sold to a third party who then rents the property back to the customer at a lower level than their mortgage payments.

Currently relatively few UK households use commercial equity release products to release equity from their home. At the end of 2005 there were 100,000 lifetime mortgages outstanding, worth around £5bn.[127] This is around 1% of the net housing wealth held by UK pensioner households.[128]

Not all housing equity can be released using lifetime mortgages
People who use a lifetime mortgage to release equity from their homes will generally only be able to release a percentage amount of the total value of the home. The amount that can be released will depend on the value of the home, expected future changes in the value of the house, as well as the age and life expectancy of the home owner.

Retirement income may be improved by renting out rooms or investing in a second home
Rental income may be obtained by pensioners renting out rooms in their home or investing in other properties. In 2006 there were around 16,000 boarders and lodgers living in pensioner households.[129]

Retired people can also obtain income through investing in properties other than their primary residence. This could mean buying a holiday home, or one or more properties to rent out (also known as buy-to-let). During retirement, these properties can be sold in order to access housing wealth, or retained and rented out. 'Provision of retirement income' is often reported as a major motivation of part-time buy-to-let landlords,[130] and 15% of all people in work say they plan to use income from properties other than their home as retirement income.[131] In 2006 around 2% of retired adults (around 200,000 people) reported receiving rental income from a second property.[132]

[127] CML statistics, figures refer to the end of 2005
[128] PPI (2009b)
[129] PPI analysis of the Family Resources Survey 2006/07
[130] Bevan and Rhodes (2003)
[131] NOP (2003)
[132] PPI analysis of the Family Resources Survey 2006/07

Using housing wealth to support retirement may not be appropriate for all people who own housing

There are a number of social and structural barriers to the use of housing assets to support retirement including:

- High transactional costs[133] or, in the case of downsizing, costs associated with adapting a new house.[134]
- People's emotional attachment to their home or local area.
- The amount of housing wealth which can be released may be small.
- Some pensioners may wish to preserve their home to give as inheritance.[135]
- Releasing income from housing wealth can reduce entitlement to some means tested benefits.[136]

The potential for using housing wealth depends on the income level of pensioners and the value of their property

The potential that any pensioner household will have to use their housing wealth is dependent on their income level and the value of their property. In order to illustrate the potential that individual households have to use housing wealth this report categorises pensioners by whether their income and property values are low, medium or high[137] and considers whether pensioner households are unlikely to access housing wealth, or have the potential to release income, release a lump sum, or release income or a lump sum. **These groups are broad brush. Individuals in any group may act in different ways to those discussed here after taking account of all of their personal circumstances.**

- **Unlikely to access housing wealth**: People with low value properties (property worth less than £100,000[138]) may be unlikely to be able to access substantial housing wealth from their property in order to help support retirement. Nevertheless, home ownership may still play a role in supporting the retirement of people with low value properties, for example, by reducing living costs or providing rental income if rooms are rented out. Around a third (3.6 million) of all pensioner households who own their own home are unlikely to access their housing wealth.[139]
- **Potential to release income**: Low income pensioners[140] with a medium to high value property (property worth £100,000 or more) may wish to access equity in order to raise or complement their retirement income. Around 7% (700,000) of all pensioner households who own their own home have the potential to release income.[141]

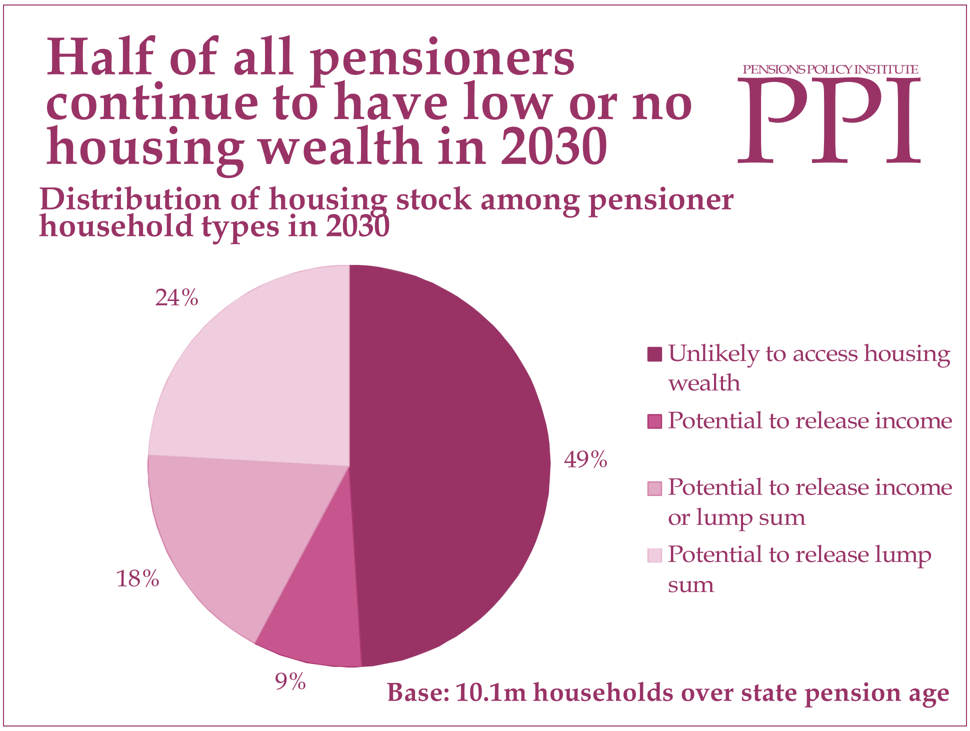
[133] Such as stamp duty, legal fees, and the interest rates charged by equity release providers
[134] Such as furnishing and decorating
[135] Gay (2004)
[136] Such as Pension Credit and Council Tax benefit.
[137] Income groups defined and analysed in PPI (2009b)
[138] Low property values include households with no housing wealth
[139] PPI Aggregate Model
[140] Income of less than the 30th percentile of pensioners' income
[141] PPI Aggregate Model

- **Potential to release lump sum**: High income pensioners[142] with a medium to high value property may have less need to use equity in order to complement their income. They may prefer to access equity in order to pay for lump sum expenditures, such as paying for care or assisting family members. Around 20% (1.8 million) of all pensioner households who own their own home have the potential to release a lump sum.[143]
- **Potential to release income or lump sum**: Pensioners with medium income levels[144] and property of medium to high value may wish to release money for income, for a lump sum or for both income and a lump sum. Around 15% (1.4 million) of all pensioner households who own their own home have the potential to release income or a lump sum.[145]

Around half of pensioners could have potential to access housing wealth in 2030

Chart 14 shows the projected number of people over SPA with housing wealth in 2030. In 2030 around half of pensioners could have low or no housing wealth and around half could have some potential to access housing wealth.

Chart 14[146]

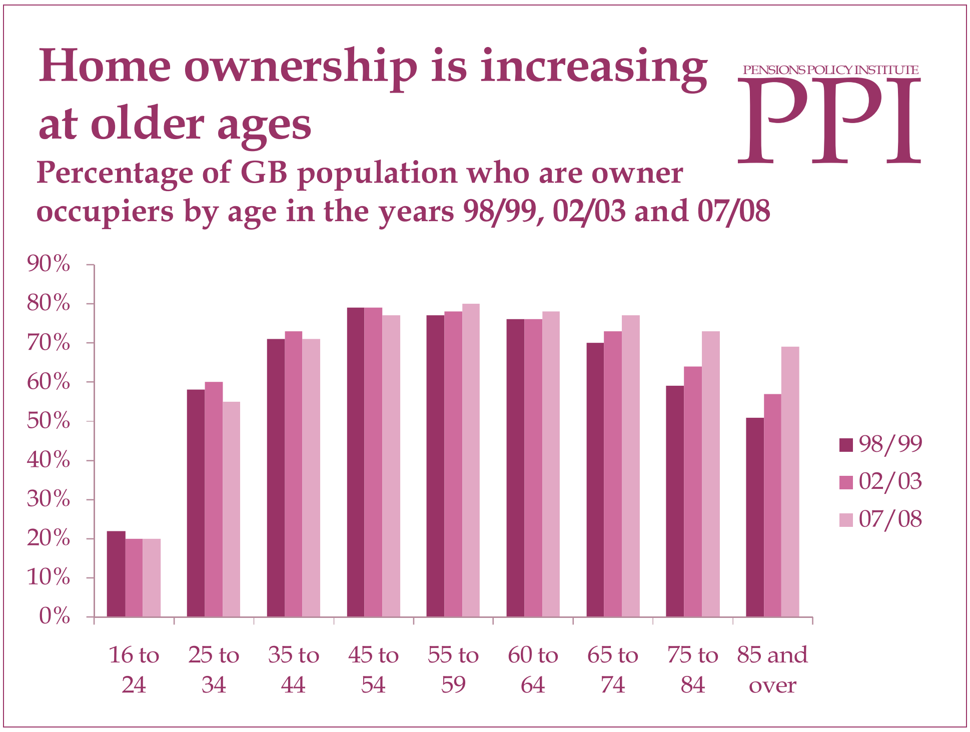


[142] Higher than the 70th percentile of pensioner income
[143] PPI Aggregate Model
[144] Between the 30th and 70th percentile of pensioners' income
[145] PPI Aggregate Model
[146] PPI Aggregate Model

The number of households where the head is over SPA, with medium or high value houses, who could release their housing wealth in order to support their retirement could increase by a third, from 3.9 million households in 2009 to 5.2 million households in 2030.[147]

More people may reach retirement with housing wealth in the future
The use of housing wealth to support retirement may grow in the future, as the proportion of older households with housing wealth increases (Chart 15).

Chart 15[148]



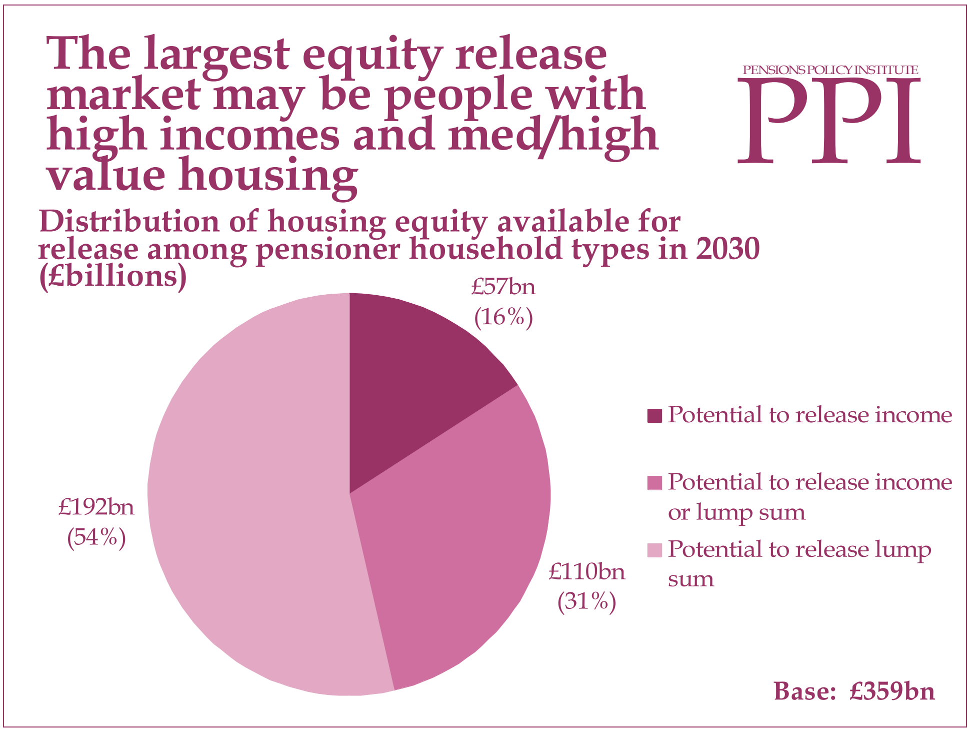
Home ownership is currently highest amongst 55-59 year olds. As this generation gets older there may be higher levels of home ownership amongst people in their 60s, 70s and 80s. If people continue to enter retirement with current levels of housing wealth, then there could be home ownership levels of 80% amongst people over SPA within the next few decades. However, there is currently a slight reduction in levels of home ownership at ages below 55.[149] Future levels of homeownership are uncertain and will depend on changes in the housing market.

An increase in older homeowners could lead to greater numbers of people receiving property as inheritance in future. An increase in the inheritance of property in later life could mean that in future more people will be able to use inherited property to help support retirement.

[147] PPI Aggregate Model
[148] DWP(2000), DWP(2004) and DWP(2009b)
[149] This could reflect the growth in house prices making houses unaffordable for first time buyers

More housing wealth may be available in future to support retirement
The total housing value in 2009 for people over SPA who may have potential to release housing wealth (i.e. people with housing worth more than £100,000) is £803bn in 2009, increasing to £1,100bn in 2030, in 2009 earnings terms. However not all housing wealth is available to be released as equity. Chart 16 gives broad estimates of the maximum amount of equity that could be released in 2030. The estimates assume that people are allowed to release equity up to the limits currently allowed in lifetime mortgage products.

Chart 16[150]



Pensioners with the potential to access housing wealth could release up to £251bn of housing wealth in 2009, rising to £359bn in 2030 (2009 earnings terms). This is an increase of 43% between 2009 and 2030.

Pensioner households with medium/high value houses and high income are likely to see the largest growth in their potential to access housing wealth between 2009 and 2030. Pensioner households with a medium/high value house and a high income are more likely to access housing wealth in order to provide a lump sum. Housing wealth that could be released as a lump sum under a commercial equity release product in this group could increase by around 50%.[151]

150 PPI Aggregate Model
151 PPI Aggregate Model

Much of the growth in housing wealth is among pensioners who are over age 75. There could be a 70% increase in the value of housing that could be released in households where the head is aged over 75, from £124bn in 2009 to £211bn in 2030 (in 2009 earnings terms).

Conclusion

- Housing wealth is one of the largest single assets held by UK households - Around 40% of UK households' £9,000bn net wealth is held as housing wealth
- The main way that housing will support retirement for most homeowners is to reduce living costs in retirement.
- Some of the equity available within a home can be released to support retirement or retirement income can be obtained by renting out rooms or investing in a second property.
- Home ownership has increased amongst older people. If this trend continues, around 80% of people over State Pension Age could be owner-occupiers within the next few decades.
- There may be more scope for the use of inherited property to help support retirement in future.
- The value of housing wealth owned by people over State Pension Age could increase by around 40% from £907bn in 2009 to £1,274bn in 2030 (in 2009 earnings terms).
- The number of pensioner households with medium or high value houses who could release their housing wealth in order to support their retirement could increase by a third, from 3.9 million households in 2009 to 5.2 million households in 2030.
- There could be a 40% increase in the value of housing wealth that pensioners could release to support retirement from £251bn of housing wealth in 2009, rising to £359bn in 2030 (in 2009 earnings terms).
- However there are attitudinal and cost barriers to accessing housing wealth which may mean that not all available equity is used to support retirement.

Appendix A: care funding proposals

Government proposals for the funding of care and support:[152]

- **Partnership Model:** In this model, all people would be entitled to have some portion of their basic care and support costs, for example a quarter or a third, paid for by the state, irrespective of their means. Some individuals would also be entitled to means-tested, additional support, depending on their level of income and their level of need.
  - Low income individuals: (e.g., people on Pension Credit) would have all of their basic care and support paid for by the state, from a low level of need.
  - Moderate income/asset individuals: would have half of their personal care costs paid for by the state when needs are low. As needs increase, they will receive more funding from the state until at high severity, all care costs will be paid for by the state.
  - High income/asset individuals: would have either a third or a quarter of their personal care costs paid for by the state.

- **Insurance Model:** This model combines the partnership model with an option to purchase insurance to cover the portion of care and support that the state does not pay for.
  - People would have the option to purchase insurance which would cover any personal care costs not covered by the state. (It has not yet been determined whether the insurance scheme/s would be state-run, run by the private sector, or available from both the state and the private sector.)
  - The Government estimates that insurance would cost a one-off payment of between £20,000 and £25,000.[153]

- **Comprehensive Model:** In this model, everyone over retirement age would be required to pay into an insurance scheme, whether they needed care or not. Pensioner's care and support would be paid for by the scheme.
  - The Government estimates an individual contribution of £17,000 to £20,000.[154] The figure could be the same for everyone or could be adjusted to means. Couples may be entitled to pay a reduced contribution.

The Government is still considering whether insurance contributions in both the insurance and the comprehensive models, could be paid by people during their working life, at or during their retirement, or from their estate after their death.

[152] HM Government (2009a)

[153] Insurance premiums could be lower than current care insurance because more people would be taking care insurance out. However, if not many people took out care insurance then the charges may need to be higher than these estimates, HM Government (2009a).

[154] The premium would be lower than in the previous 'insurance model' as more people would be paying in to the scheme

The three Government proposals for funding care and support do not propose to cover the costs of accommodation in residential care homes (around £14,000 per year)[155] as the Government reasons that individuals are expected to bear costs for their own accommodation whether they are disabled or not. However, the Government has recognised that it will need to support those who cannot afford the costs of their own accommodation.[156]

The Conservatives have made a proposal for funding residential care
The Conservative Party[157] has also made a proposal for the future funding of residential care.

- **The Conservative's Insurance Model:**[158] In this model, people can voluntarily pay into a state-backed insurance scheme at age 65[159] which will pay all of the costs of residential care, including accommodation costs, up to the 'highest' average cost of care. This could be around £26,000.[160]
  - Ø The Conservatives estimate that the insurance contribution people make at age 65 could be around £8,000.
  - Ø People in residential care homes which charge above the average cost of care may need to pay top ups.
  - Ø The Conservative proposal applies only to residential care and does not address how personal care in people's own homes would be funded.

[155] Forder and Fernandez (2009) p. 20, Table 13. Forder and Fernandez derived figure by subtracting costs of care from overall residential home charges.
[156] HM Government (2009a)
[157] The opposition party at the time of this paper's publication
[158] www.conservatives.com/News/News_stories/2009/10/Ending_the_scandal_of_forced_home_sales_to_pay_for_care.aspx
[159] People over 65 when the policy is introduced will have the opportunity to pay into the scheme
[160] www.timesonline.co.uk/tol/news/politics/article6862458.ece

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Contact: Niki Cleal, Director
Telephone: 020 7848 3744
Email: info@pensionspolicyinstitute.org.uk

Pensions Policy Institute
King's College
26 Drury Lane
London WC2B 5RL

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