# The choices and factors that can affect private pension income in retirement

Chris Curry, Research Director

Pensions Policy Institute

www.pensionspolicyinstitute.org.uk

09 February 2012

Research sponsored by the NAPF

# The choices and factors that can affect private pension income in retirement

PENSIONS POLICY INSTITUTE
PPI

- Different choices and factors can have an impact on retirement income

- When taken together, a number of choices and factors can have a very significant impact on retirement income

# Choices and factors that affect retirement income

PENSIONS POLICY INSTITUTE
PPI

Choices considered

- Opting in or out of pension scheme
- Employee contribution level
- Age at which the employee retires
- Choosing an annuity
- How much of fund is annuitised

Other factors

- Employer contributions
- Scheme charging levels

# The median earning man

PENSIONS POLICY INSTITUTE
PPI

Characteristics

- Median earning man
- Aged 25 in 2012
- Member of pension scheme from age 30 to 68 (SPA)
- He and his employer contribute to the pension scheme at minimum required levels under auto-enrolment

State Pension assumption

- State pension is a single tier pension as outlined in the DWP green paper

# The choices and factors that can affect private pension income in retirement

PENSIONS POLICY INSTITUTE
PPI

- Different choices and factors can have an impact on retirement income
- When taken together, a number of choices and factors can have a very significant impact on retirement income

# Choices and factors that affect retirement income

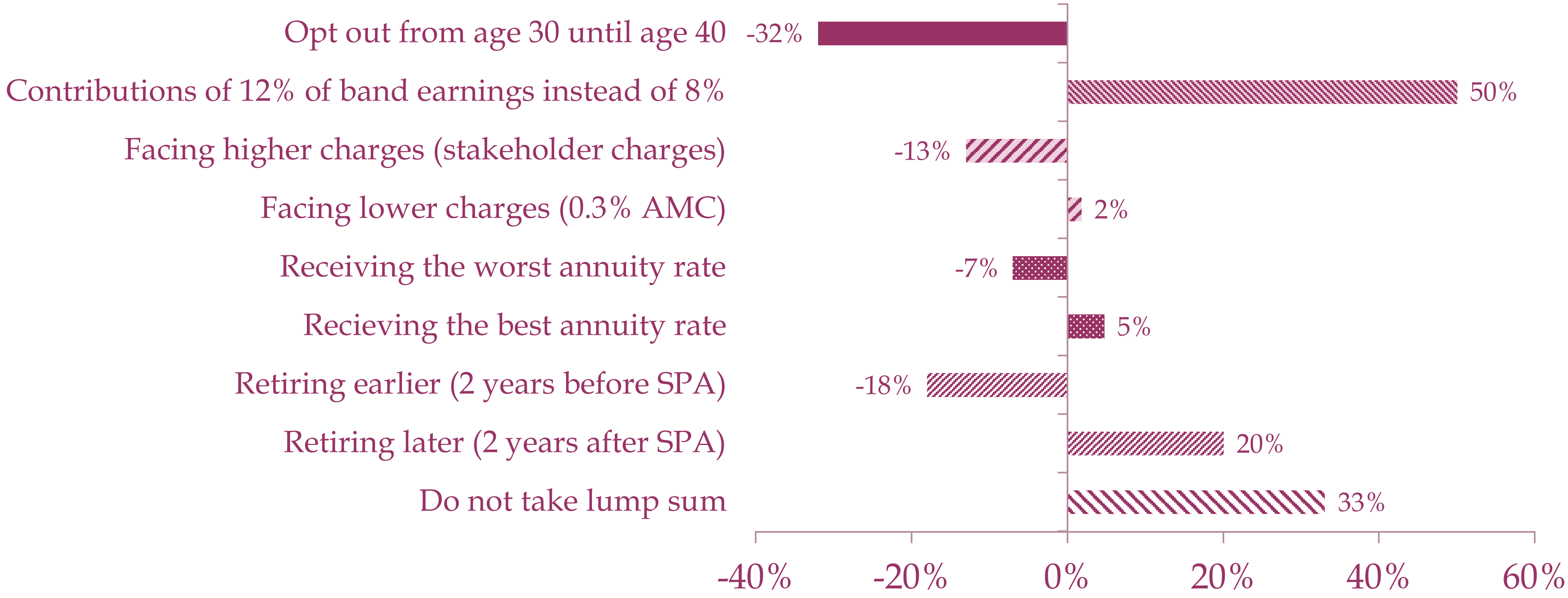
PENSIONS POLICY INSTITUTE
PPI

| Choice/Factor | Low retirement income scenario | Baseline scenario | High retirement income scenario |
|---|---|---|---|
| Age at which start pension saving | **40** | 30 | 30 |
| Employee contributions (percentage of band earnings) | 8% | 8% | **12%** |
| Charges | **Stakeholder** | NEST combined charge | **0.3% AMC** |
| Annuity rate (MAS comparison tables) | **Worst** | Median | **Best** |
| Retirement age | **66** | 68 (SPA) | **70** |
| Lump sum taken? | 25% of fund | 25% of fund | **No** |

# Choices and factors can impact private pension income

PENSIONS POLICY INSTITUTE
PPI

## Impact on private pension income for the median earning man on reaching SPA in 2055, percentage difference from the baseline



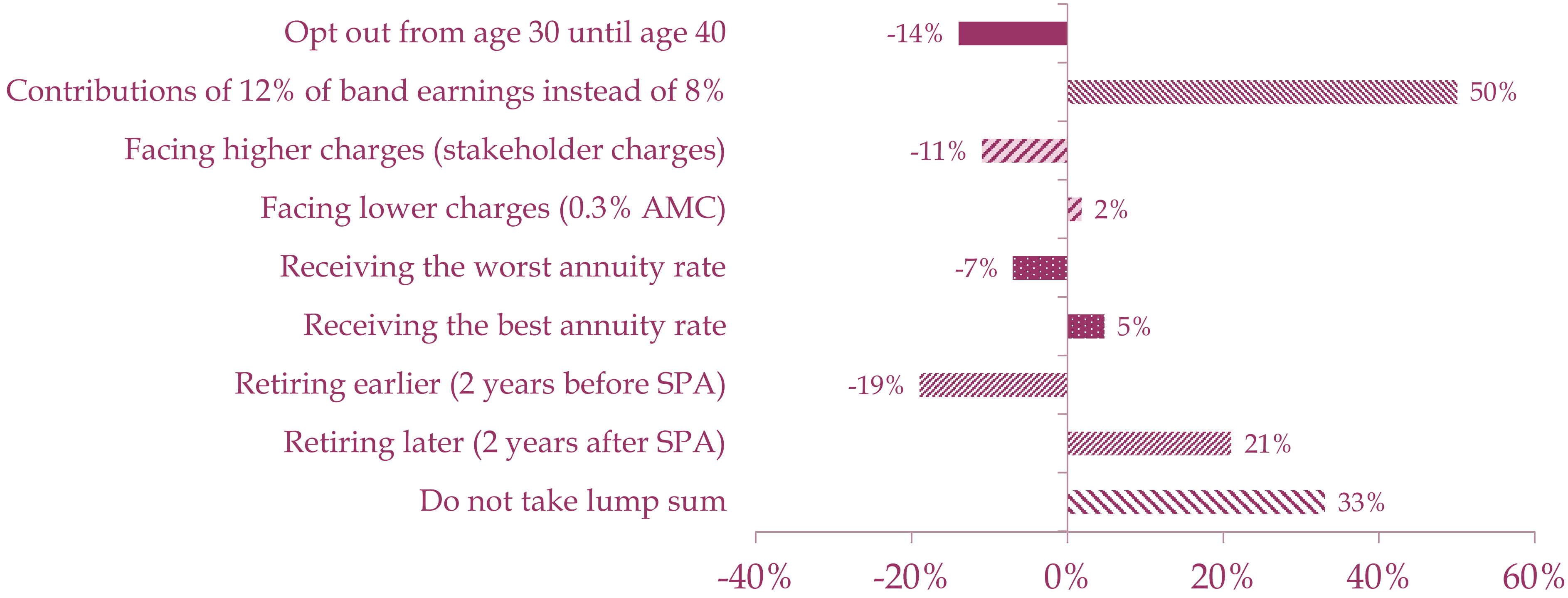
# The median earning woman

- Median earning woman aged 25 in 2012
- Between the ages of 30 and 35 she takes time out of work to care for her children
- When she returns to work she works part-time for two years (50% of full-time earnings).
- She returns to work full time until she is 55, then she takes two years out of work to care for her mother
- She returns to work at 57, working part-time for the first two years before returning to work full time until SPA.
- During her employment after age 30, she and her employer contribute to a DC private pension when she is auto-enrolled – if earnings are below the auto-enrolment threshold she is assumed not to make contributions.

# Choices and factors can impact private pension income

PENSIONS POLICY INSTITUTE
PPI

## Impact on private pension income for the median earning woman on reaching SPA in 2055, percentage difference from the baseline



# Overcoming the impact of opting out, higher charges, and lower annuity rates

PENSIONS POLICY INSTITUTE
PPI

- To overcome the impact of opting-out for 10 years the median earning man might need to contribute an extra 4% of band earnings into his pension for the rest of his working life.
- To compensate for facing stakeholder rather than long-term NEST charges the median earning man might need to save an extra 1.5% of his band earnings into his pension every year, or could retire 3 years after state pension age.
- To compensate for getting the lowest annuity rate rather than the best the median earning man might need to save an extra 1% of his band earnings into his pension every year or could retire 2 years after state pension age.

# Choices and factors can affect replacement rates

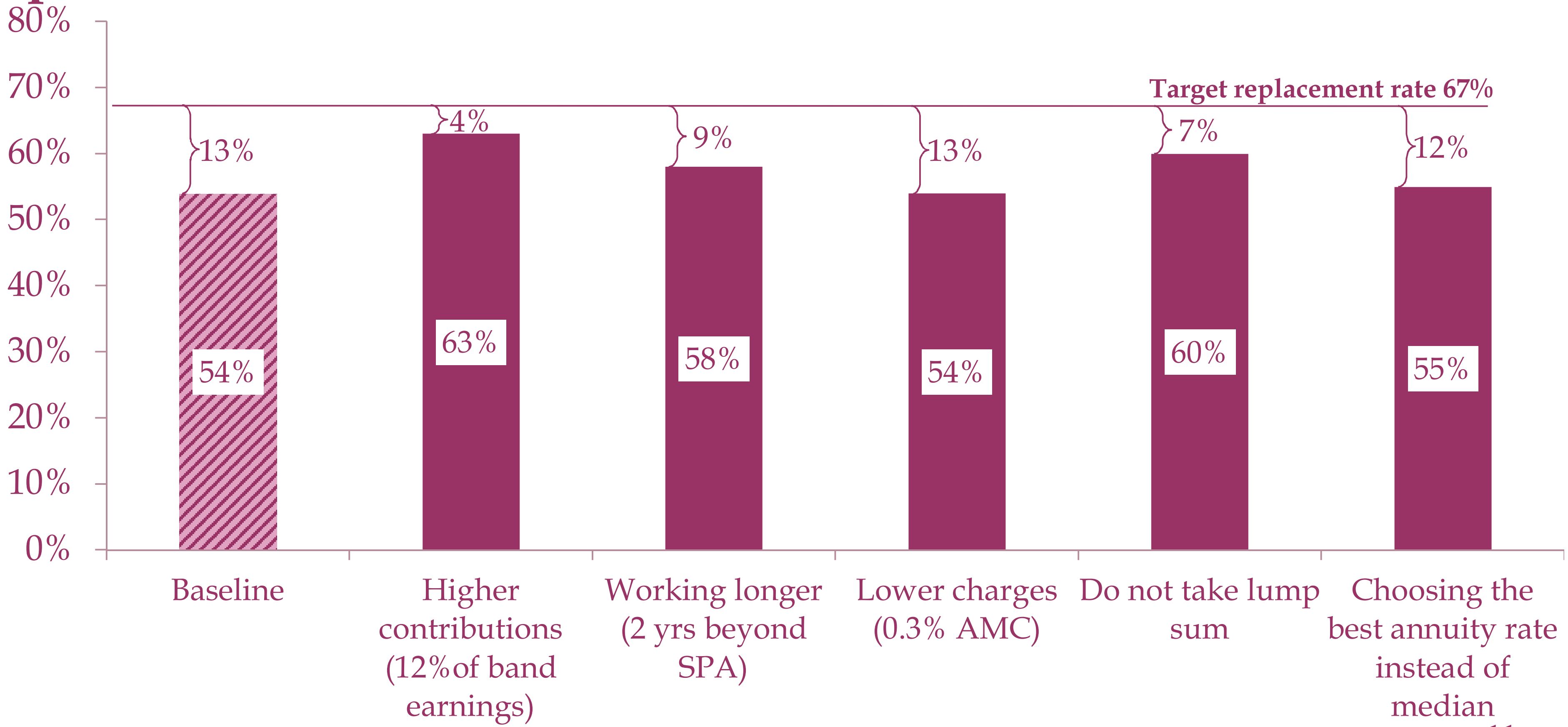
PENSIONS POLICY INSTITUTE
PPI

- The Pensions Commission set out benchmark replacement rates
- For the individual modelled, the benchmark replacement rate would be 67%
- The single tier pension may provide around 36%
- The baseline private pension may provide around 18%
- There is a shortfall of 13% in the baseline scenario

# Some factors can improve replacement rates for the median earning man

PENSIONS POLICY INSTITUTE
PPI

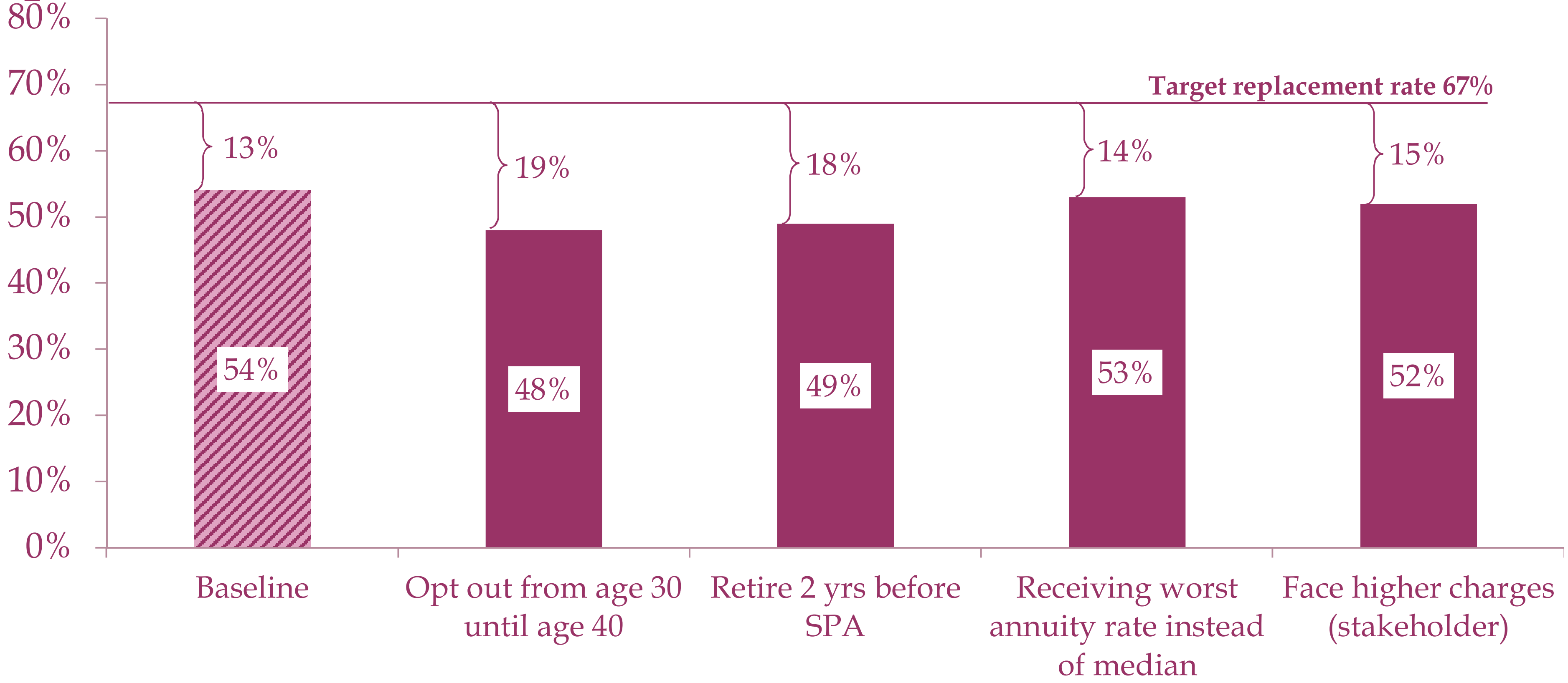
## Replacement rate of a median earning man reaching SPA in 2055 as a result of decisions and factors that may increase pension income



# Some factors can reduce replacement rates for the median earning man

PENSIONS POLICY INSTITUTE PPI

## Replacement rate of a median earning man reaching SPA in 2055 as a result of decisions and factors that may reduce pension income



# The choices and factors that can affect private pension income in retirement

PENSIONS POLICY INSTITUTE
PPI

- Different choices and factors can have an impact on retirement income

- When taken together, a number of choices and factors can have a very significant impact on retirement income

# Choices and factors used in cumulative impact analysis

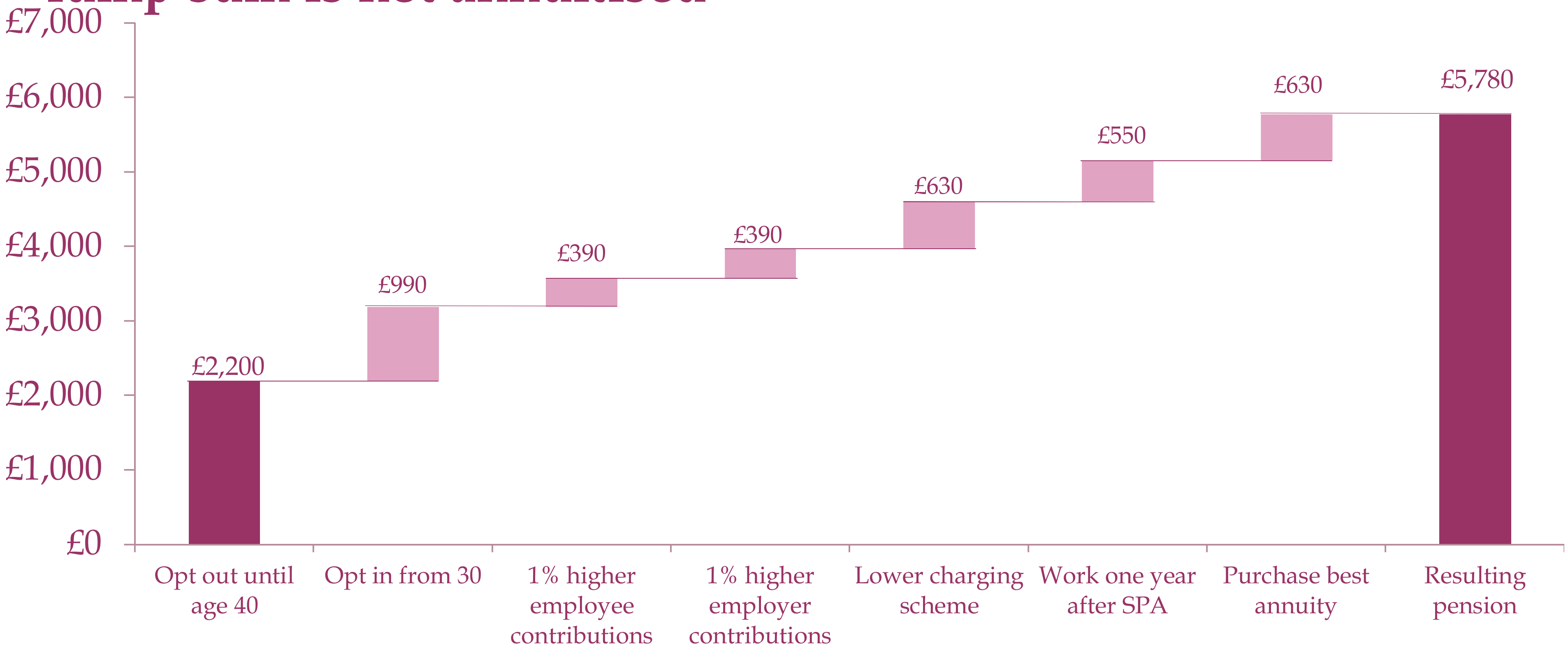
PENSIONS POLICY INSTITUTE
PPI

| Choice/Factor | Low retirement income scenario | High retirement income scenario |
|---|---|---|
| Age at which start pension saving | 40 | 30 |
| Employee contributions (percentage of band earnings) | 4% plus 1% Government tax relief | An additional 1%, 0.8% from the individual and 0.2% from Government |
| Employer contributions (percentage of band earnings) | 3% | 4% |
| Charges | Stakeholder | 0.3% AMC |
| Annuity rate (MAS comparison tables) | Worst | Best |
| Retirement age | 67 (one year before SPA) | 69 (one year after SPA) |

# Cumulative impact of factors and choices on income in retirement

PENSIONS POLICY INSTITUTE
PPI

## Annual private pension income for the median earning man on reaching SPA in 2055, £ per year in 2011 earnings terms if lump sum is not annuitised

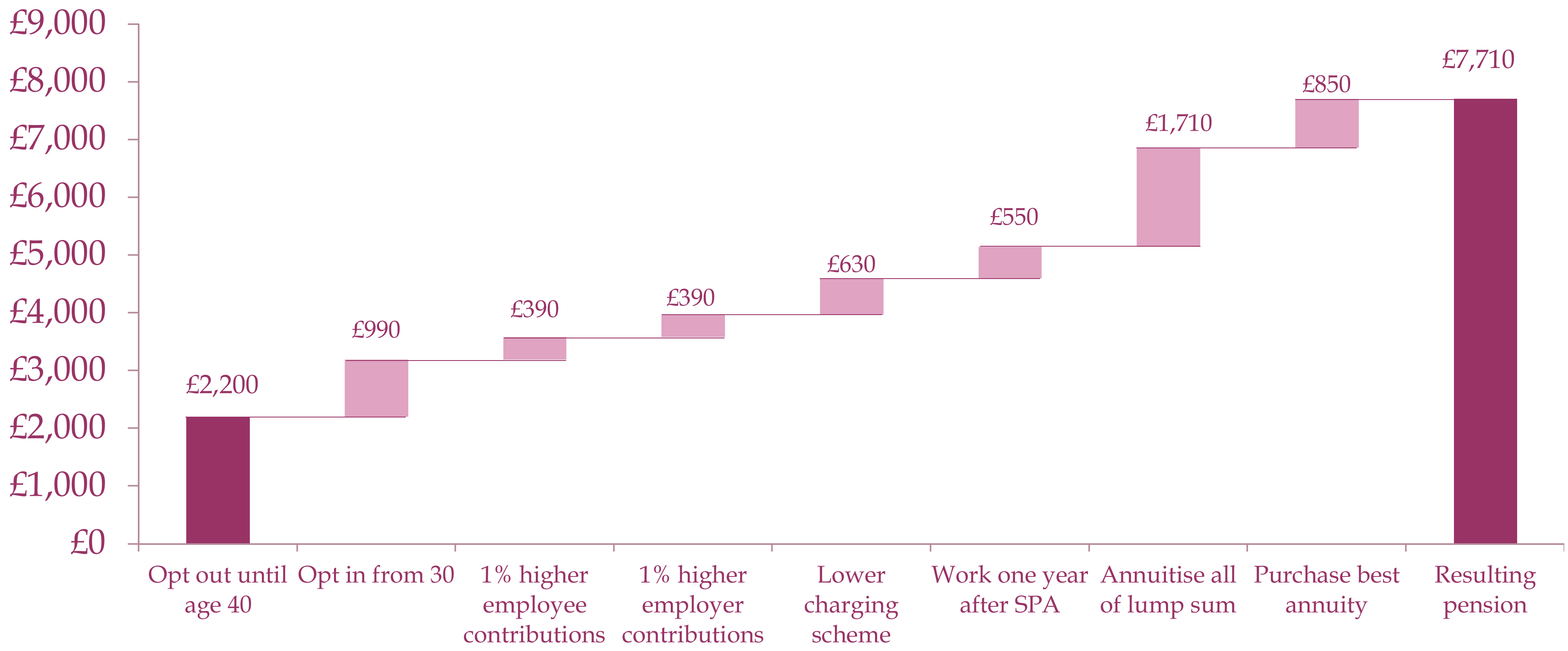


# Cumulative impact of factors and choices on income in retirement

PENSIONS POLICY INSTITUTE

PPI

## Annual private pension income for the median earning man on reaching SPA in 2055, £ per year in 2011 earnings terms



# Summary of findings

PENSIONS POLICY INSTITUTE
PPI

- Contributing 12% of band earnings rather than 8% can increase private pension income by 50%
- Working 2 years longer can increase private pension income by 20%
- Moving from stakeholder charges and the worst annuity rate to a 0.3% AMC and the best annuity can increase private pension income by 30%
- Cumulatively making different employee and employer choices can lead to a  private pension income that is two and a half times higher

# Policy implications

PENSIONS POLICY INSTITUTE
PPI

- How can employees and employers be encouraged to contribute more than minimum levels?
- Working longer can have a significant impact on private pension income, but how can this be turned into reality?
- Lower charges and better use of annuities can have as big an impact as other changes but with less self-sacrifice – how can these be encouraged?
- None of the changes by themselves delivered an adequate retirement income – how can combinations of changes be encouraged?