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"Many pensioners may not be able to achieve a desired standard of living in retirement from pension income alone" says Pensions Policy Institute report

In future, many pensioners are likely to have a greater variety of income and assets, including housing wealth, available to support retirement, however many pensioners may not be able to achieve a desired standard of living in retirement from pension income alone, according to new research published today by the Pensions Policy Institute (PPI).

Retirement income and assets: outlook for the future is the fourth report in the PPI series looking at the future of retirement income and assets in the UK. The report considers the income and assets that a future generation, reaching state pension age in 2030, may have to support retirement.

Commenting on the report, Chris Curry, PPI Research Director, said "State pension reforms mean that state pensions should provide a much firmer foundation for retirement income in future. By 2030, and assuming that Basic State Pension is re-indexed to earnings, it is more likely than today that lifetime low earners will be able to replicate working-life living standards in retirement."

"However many median earners who contribute to DC pensions at average levels of 10% of salary are unlikely to have sufficient state and private pension income to achieve a desired standard of living in retirement. In order to provide their desired retirement income solely through the state and private pensions, median earners reaching State Pension Age in 2030 may need to have around 15% of their salary contributed to their private pension."

"Many people will need to contribute more to their pension during working life, work longer, or run down savings, investments or housing wealth to achieve a standard of living in retirement they might consider acceptable."

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Key project findings were:

- As a result of state and private pension reforms, pensioners are likely to receive more income from state pensions in the future and more pensioners are likely to receive income from private pensions in the future
- Changes occurring in the private pensions market could lead to a tripling of the number of people saving in DC private pensions from an estimated 5 million today to around 15 million by 2030, though within the private sector the number of DB pension savers could drop from 2.5 million today to around 1.5 million by 2030.
- Future generations of pensioners may also have more available housing wealth. If current trends continue, around 80% of pensioners could be owner-occupiers within the next few decades.

- A PPI case study of a hypothetical median-earning man found that he would have had a good chance of replicating working life living standards in retirement if he and his employer had contributed 15% of his salary to his DC pension. This rate is around 5% above current average contribution levels for DC pensions.

Notes for editors

1. The Pensions Policy Institute is an educational charity, which provides non-political, independent comment and analysis on policy on pensions and retirement income provision in the UK. Its aim is to improve the information and understanding about pensions policy and retirement income provision through research and analysis, discussion and publication.

2. This report is the fourth in a series of reports looking at the evolution of financial needs during the course of retirement and the roles of different sources of income in meeting those needs. The retirement income and assets project has the overall aim of providing independent evidence to inform debate about the role of different types of assets in funding retirement. The first report in the series, *Retirement income and assets: do pensioners have sufficient income to meet their needs?* considers the needs and aspirations of pensioners. The second report *Retirement income and assets: how can housing wealth support retirement?* considers the role that housing assets can play in supporting retirement. The third report *Retirement income and assets: how can pensions and financial assets support retirement?* considers the role that state and private pensions and financial assets can play in supporting retirement. All three reports can be downloaded from the PPI website at www.pensionspolicyinstitute.org.uk.

3. This report considers how the trends and issues identified in the first three reports could combine to produce a picture of possible needs, income and assets for a future generation of pensioners reaching state pension age in 2030. In addition this report explores the potential impacts on retirement income and assets of working longer and recent reform proposals for the funding of long-term care for pensioners. The report has been sponsored by Age Concern & Help the Aged (Age UK), the Association of British Insurers, the Investment Management Association, The Department for Work and Pensions, JP Morgan Asset Management and Prudential.

4. Median earnings vary by age. Median earnings for men are currently £16,000 (at age 22), £29,000 (at age 45), and £24,000 (at age 65).

A summary of conclusions from the report follows on the next page. The full report can be downloaded from www.pensionspolicyinstitute.org.uk

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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.

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

ABI Association of British Insurers

J.P.Morgan Asset Management

Retirement has more potential with PRUDENTIAL

DWP Department for Work and Pensions

Investment Management Association ima

AGE Concern

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