



Are you prepared for retirement?

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Financial preparedness for retirement Differences within and between cohorts

Cormac O'Dea and Andrew Hood

Are households 'prepared' for retirement?

- Interesting and important question
- The answer to this question likely differs substantially between cohorts for several reasons...
 - State pension rules differ
 - Private pension coverage differs
 - House price returns have differed
 - Labour market opportunities have differed
- ...and will differ by the chosen definition of preparedness
- This presentation:
 - Challenges in assessing whether people were/are prepared
 - Three pieces of recent IFS work that shed some light on this topic
 - Some of the remaining questions and important issues

Preparedness for retirement

- Is a pensioner household with income of £15,000 well-prepared for retirement?
- Two broad challenges in answering that question:
 1. How do we define prepared?
 2. Can we obtain data sufficient to assess preparedness according to any particular definition?
- If the couple is under-prepared, then why?
 - Did they have a lack of information about their future entitlements?
 - Did they experience some shock to their resources (redundancy, divorce, bereavement etc.) or to their needs (health etc.)?
 - Did they simply choose to undersave?
- Policy response will depend on which of these is most relevant

Continual improvements in data

- Long running cross-sectional data:
 - Living Costs and Food Survey since 1961
 - Family Resources Survey since 1994
 - General Household Survey since 1971
- Panel data (follows the same people over time):
 - British Household Panel Survey since 1991
 - English Longitudinal Study of Ageing since 2002
 - Wealth and Assets Survey since 2006
- Panel data linked with administrative data:
 - ELSA linked to National Insurance records

Over the past few years we've been using these data to investigate differences within and between cohorts in terms of their retirement resources and other circumstances...

Three recent pieces of IFS work

- “Retirement sorted? The adequacy and optimality of wealth among the near retired”
 - Looks in detail at couples in the 1940s cohort
 - What retirement resources did this cohort hold on the eve of retirement, and how did that relate to lifetime earnings?
- “The Changing Face of Retirement”
 - Projects how circumstances at older ages may differ in 2022 to 2002 (i.e. broadly comparing those born prior to 1960 to those born prior to 1940)
- “The economic circumstances of cohorts born between the 1940s and the 1970s”
 - Compares the economic circumstances of the younger cohorts to their predecessors, providing a sense of their likely position in later life

“Retirement sorted?”

Explored how financially well-prepared couples born in the 1940s were on the eve of retirement

1. Observed wealth holdings and pensions rights in 2002/03
 - When households aged 52-63
 - From ELSA data
 2. Observe/estimate earnings each year of past working life
 - From linked National Insurance records
- Given their lifetime earnings, do households have “enough” retirement resources
 - “Enough” resources are such that they can expect to have the same standard of living in retirement as during working life

How much wealth did the 1940s cohort hold?

Average wealth levels in 2002/03 among couple households born in the 1940s:

	Median	Mean	Proportion of mean
Total net wealth	£444,600	£574,048	100.0%
<i>of which:</i>			
Financial	£21,108	£52,514	9.1%
Primary housing	£120,000	£147,431	25.7%
Other housing	£0	£23,589	4.1%
Physical	£0	£40,962	7.1%
Private pensions	£123,358	£187,281	32.6%
State pensions	£120,184	£122,271	21.3%

Notes: Cash values reported in 2002/03 prices

Source: Table 2, Crawford & O'Dea (2014): Cash and Pensions: Have the elderly in England saved optimally for retirement?

How much wealth do they need to maintain living standards?

- Many reasons why households need lower gross income in retirement than during working life:
 - No longer need to save for a retirement income
 - Expenses from children (may!) be lower
 - Average tax rates are lower
 - Lower spending needs (e.g. expenses from work likely to disappear)
- But some reasons why spending needs may be higher:
 - Long-term care costs
- Difficult to say exactly what replacement of gross working life income would be ‘adequate’ for each household
- Most analyses of the “adequacy” of households’ resources in the UK has used ad hoc thresholds
 - Always less than 100%

Replacement of average lifetime earnings

- For couple households born in the 1940s we define:

$$\text{Replacement rate} = \frac{\text{Estimated real income at age 65}}{\text{Average equivalised real earnings age 20 - 50}}$$

Percentage of couple with:	Total pension income	... plus annuitised non-housing wealth	... and plus annuitised housing wealth
<=67% replacement	19.6%	10.0%	2.3%
<=80% replacement	35.0%	19.9%	5.3%
<=100% replacement	58.6%	41.0%	16.0%

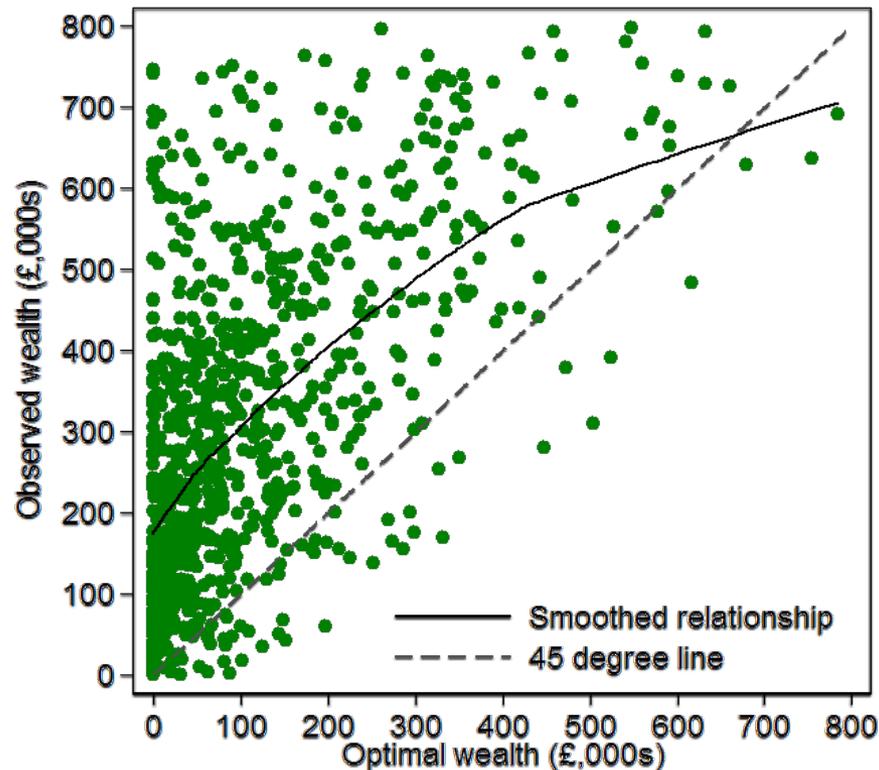
Source: Table 6.2, Crawford & O'Dea (2014): Retirement sorted? The adequacy and optimality of wealth among the near-retired?

An alternative approach

- Use an economic model of lifetime consumption and saving and the data on earnings histories to:
 - Generates an “optimal” (or target) level of private wealth for each household
 - “Optimal” level of wealth is that which allows expected living standards to be the same before and after retirement
 - Depends on their earnings, state pension entitlement and number of children
- This can be compared with how much wealth households are observed to hold
 - Households with less than optimal wealth will have to reduce their expenditure in retirement relative to during working life
 - Households with greater than optimal wealth can increase their expenditure in retirement and/or leave bequests

Comparing observed and “optimal” wealth

- Couple households born in the 1940s:
 - 92% have above “optimal” wealth



Source: Figure 4, Crawford & O’Dea (2014): Cash and Pensions: Have the elderly in England saved optimally for retirement?

Why have they ‘oversaved’?

- Housing
 - Experienced large (and probably unanticipated) price increases
 - But 75% still hold more than ‘optimal’ wealth even when all housing wealth is excluded
- Bequest motives
 - Perhaps (although housing accounts for most bequeathable wealth and does not, alone, drive our results)
- Long-term care costs
 - Need more research in this area to better understand the risks and private costs of long term care needs
- “Forced” saving
 - E.g. Through employer pensions, state pension
 - But if you’re being forced to oversave (and you understand this), you can offset the saving elsewhere

Summary

- Majority of couple households in the 1940s cohort have more wealth than two different methods suggest is necessary to maintain their pre-retirement spending
 - Still true if housing wealth is excluded from observed wealth
 - Very hard to find evidence of an undersaving problem among this cohort
 - Most households in this cohort could increase consumption in retirement or leave large bequests
- Does not suggest no one has low income in retirement and/or that no one is reliant on means-tested benefits
- Other cohorts may look very different
 - Different economic/policy/social environment

“The Changing Face of Retirement”

- Increasing longevity and large numbers born after WW2 means that the population aged 65+ is growing quickly
 - projected 22% increase between 2012 and 2022, from 17% to 20% of overall population
- How will tomorrow’s pensioners look different from today’s?
- We follow the 1940s and 1950s cohorts into retirement
 - compare them to their predecessors
 - model (among other things) mortality, health, work and incomes

Data and methodology

- English Longitudinal Study of Ageing (ELSA): 2002-03 to 2010-11
 - representative sample of 52+ population (born 1958 or earlier)
 - around 10,000 respondents per wave, in 7,000 households
 - surveys the same people in multiple years
 - biennial survey, so we model two-year transitions
- How do we produce our projections?
 - look at relationships between outcomes and characteristics over time
 - assume relationships continue to hold over time
 - eg. working status and health

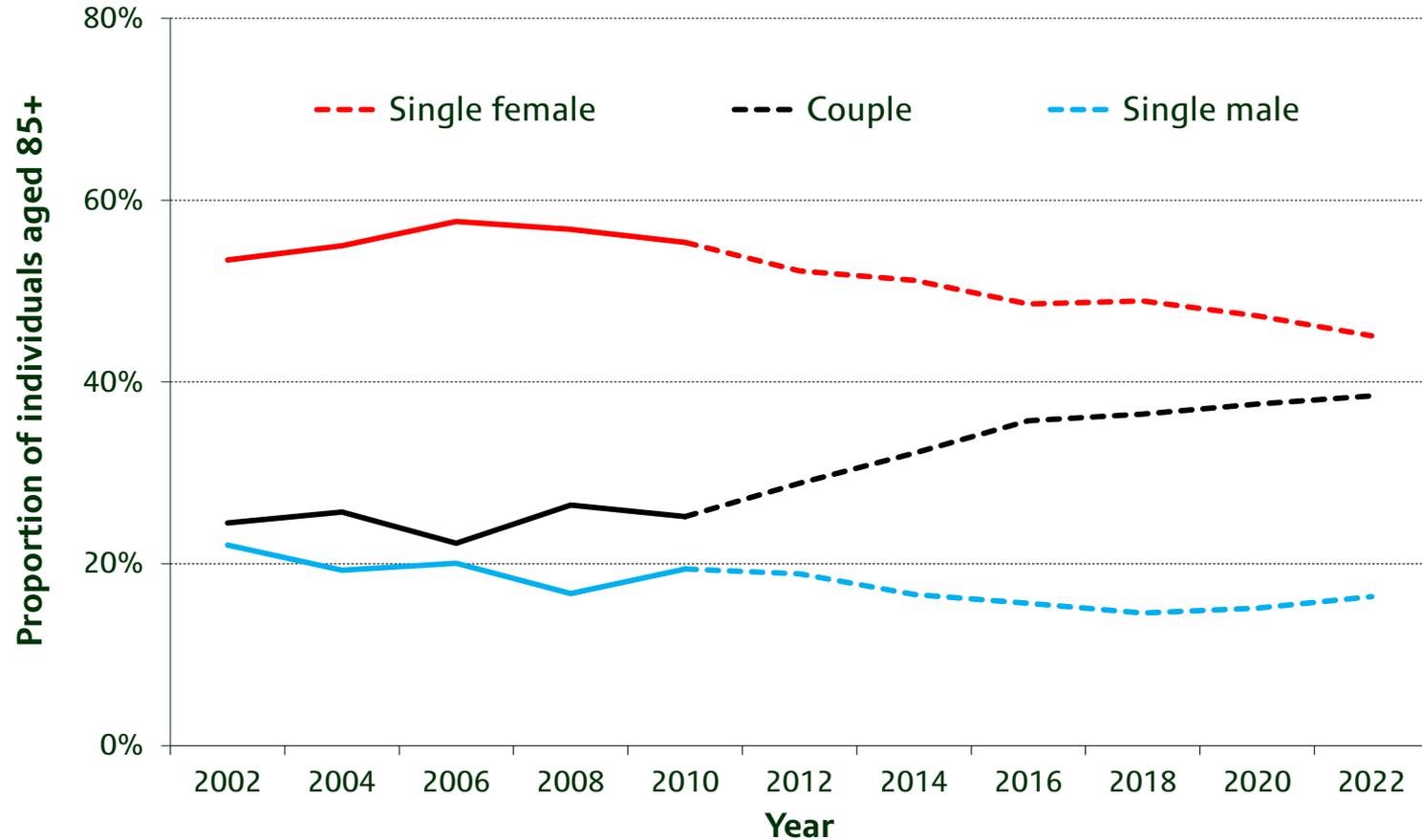
Headlines

- Life at older ages is changing particularly fast for women
- In the future:
 - they are more likely to have a surviving husband
 - they are likely to be healthier
 - they are more likely to be in work, if they are healthy

Older women more likely to live in couples...

- Both men and women are living longer
- The chance of dying in a given period is lower for people in couples than for single people
- So an increasing proportion of pensioners will live in couples in the future

Older women more likely to live in couples...

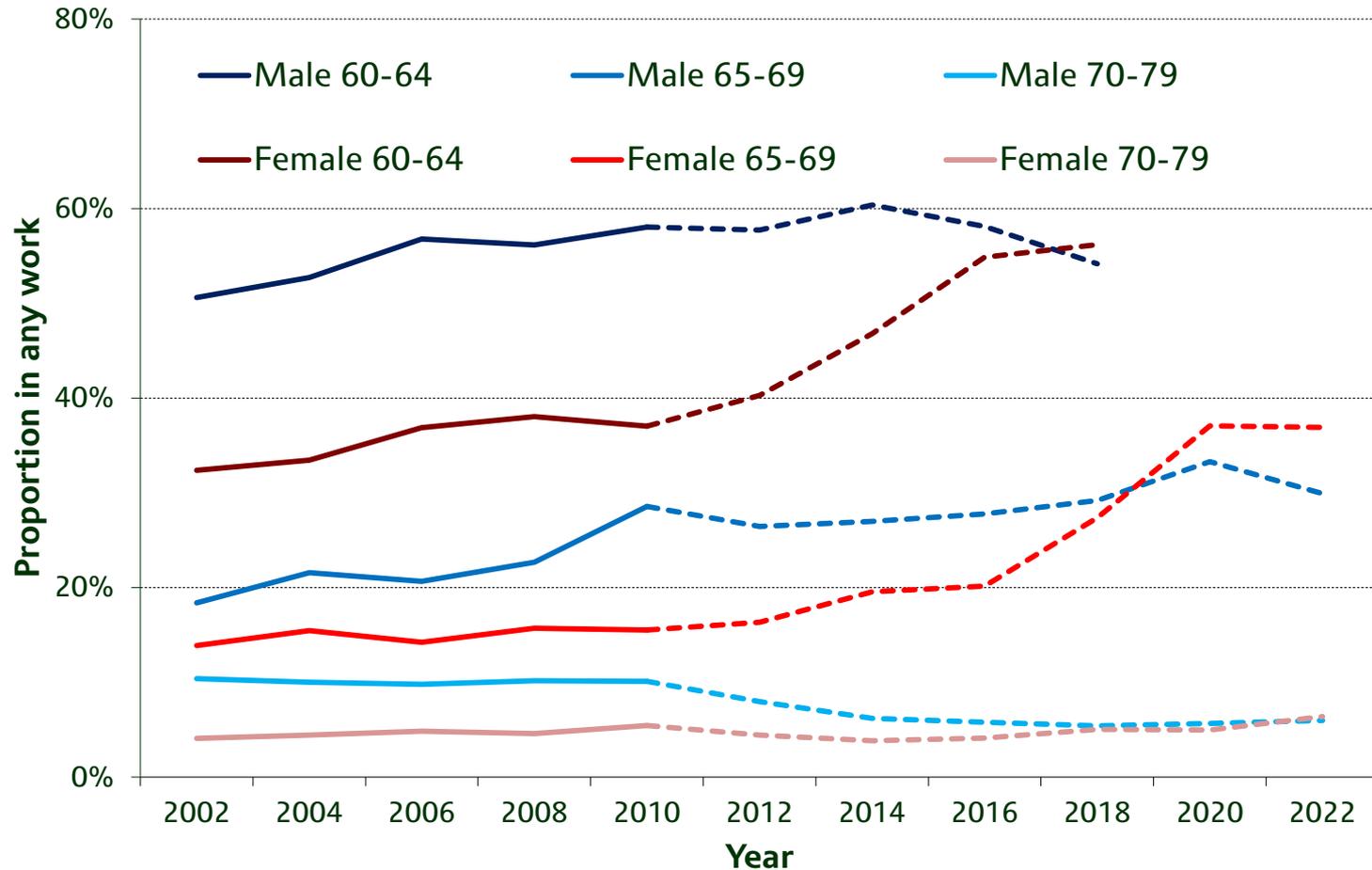


Source: Figure 3.5, Emmerson, Heald and Hood (2014)

Older women more likely to live in couples...

- Both men and women are living longer
- The chance of dying in a given period is lower for people in couples than for single people
- So an increasing proportion of pensioners will live in couples in the future
 - 25% of people aged 85+ lived in couples in 2010–11
 - our model suggests that 38% of people aged 85+ will live in couples in 2022–23

... and more likely to be in paid work

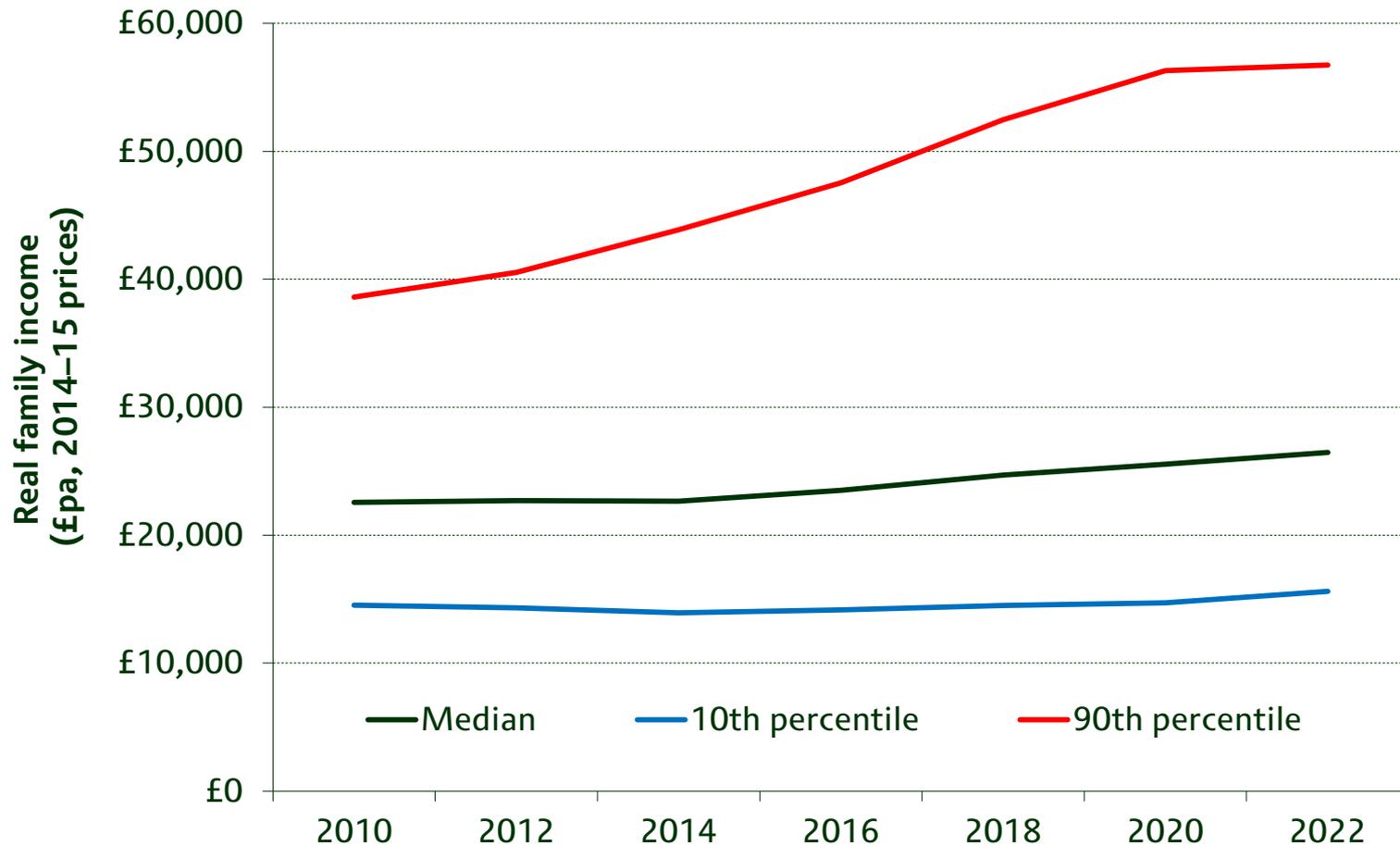


Source: Figure 3.10, Emmerson, Heald and Hood (2014)

... and more likely to be in paid work

- The proportion of women in paid work increases dramatically
 - 16% of women aged 65 to 69 were in paid work in 2010
 - we project that this will rise to 37% in 2020
- Women in their 60s are as likely to be in work as men in the early 2020s
- This is because of improving health, and in response to the rising state pension age
- This has big impacts on family incomes

Equivalised family income projections: 65+ population



Source: Figure 5.1, Emmerson, Heald and Hood (2014)

Equivalised family income projections: cohort comparisons

- Real median income around 10% higher for 1940s cohort at age 75-84 than for 1930s cohort at the same age
- Real median income over 30% higher for 1950s cohort at age 65-74 than for 1940s cohort at the same age
 - many more of the younger cohort still in work at that age
- Next decade will see continuation of long-term trend – each cohort has higher real incomes in retirement than predecessors

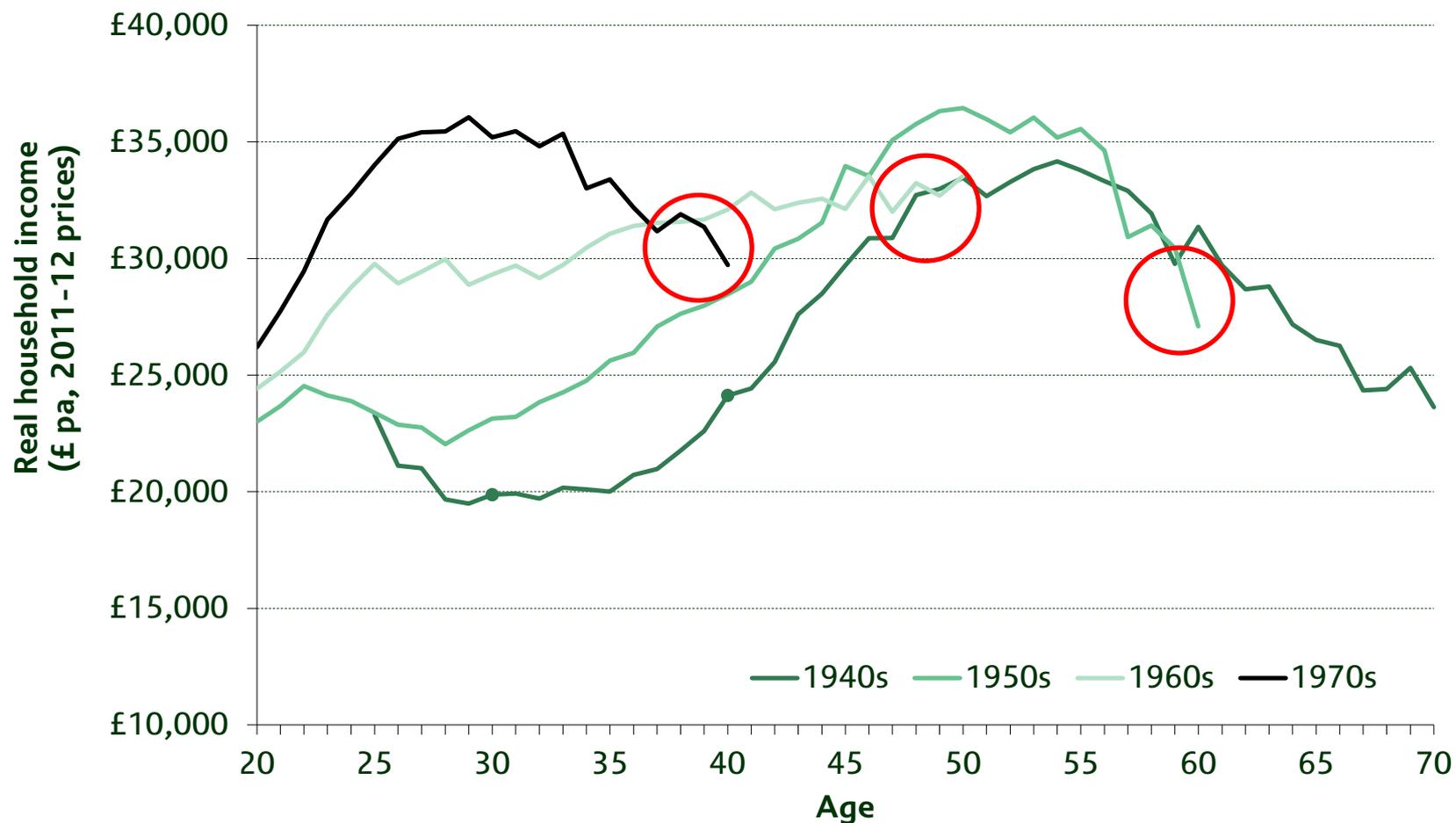
“The economic circumstances of cohorts born between the 1940s and the 1970s”

- What can we say about the economic prospects of those born in the 1960s and 1970s (now mid-30s to mid-50s)?
 - in absolute terms and relative to predecessors
- We compared the economic circumstances of different birth cohorts
 1. Incomes and saving
 2. Wealth and assets
 3. Inheritances (expected and received)

Methodology

- We want to compare different cohorts *at the same age*
 - use long run micro datasets to follow cohorts through their adult lives
- Since data are cross-sectional, cannot follow individuals over time...
- ...but every year has a representative sample of each cohort
 - “synthetic cohort” analysis

Equivalised median household income by age and birth cohort



Source: Figure 2.3a, Hood and Joyce (2013)

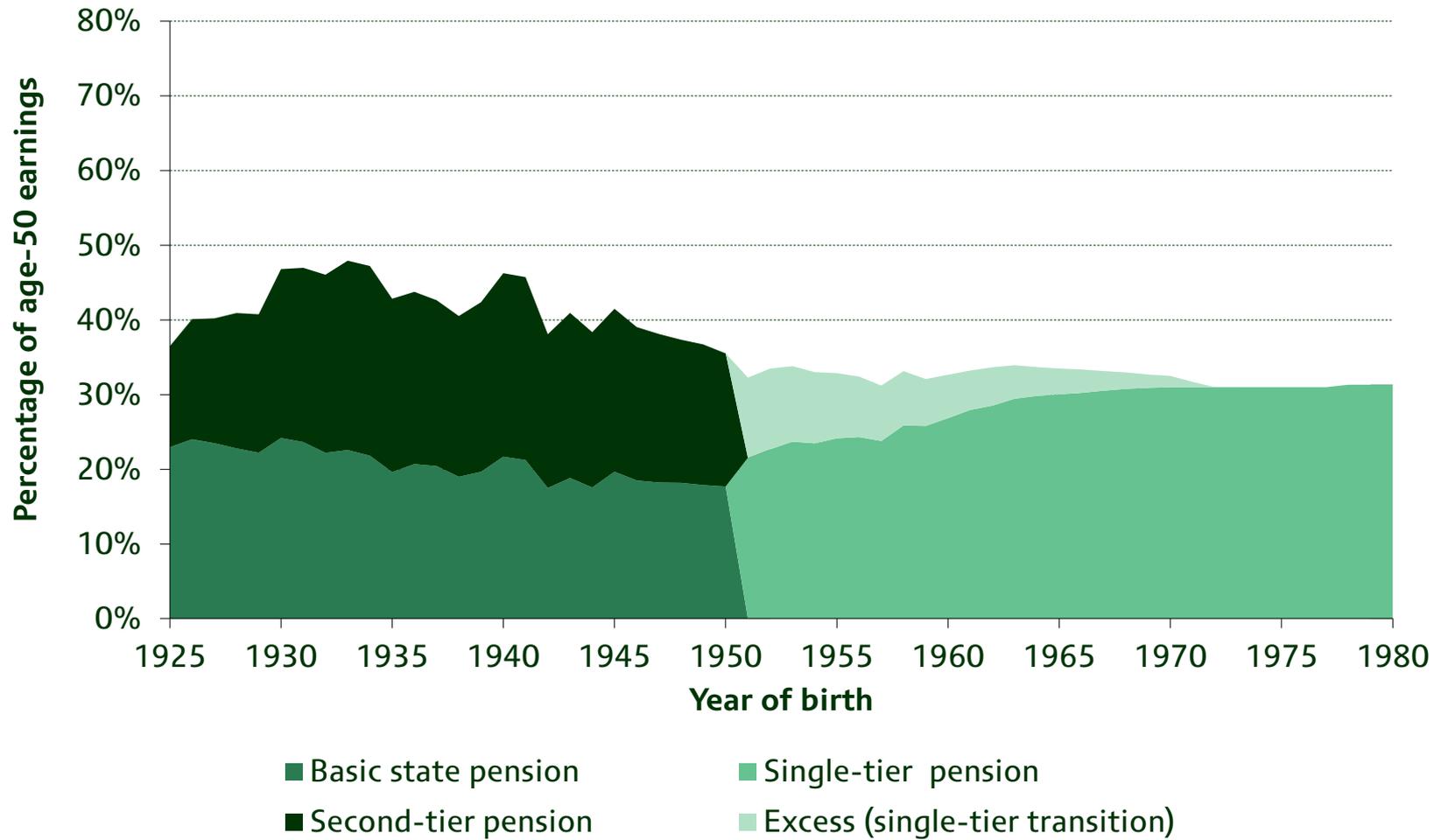
Incomes and saving

- Younger cohorts do not have higher incomes than those born 10 years earlier had at the same age
 - lack of income growth for working age population over last decade
- But those born in the '60s and '70s did have higher incomes in early adulthood
 - all of the additional income was spent

Wealth and assets

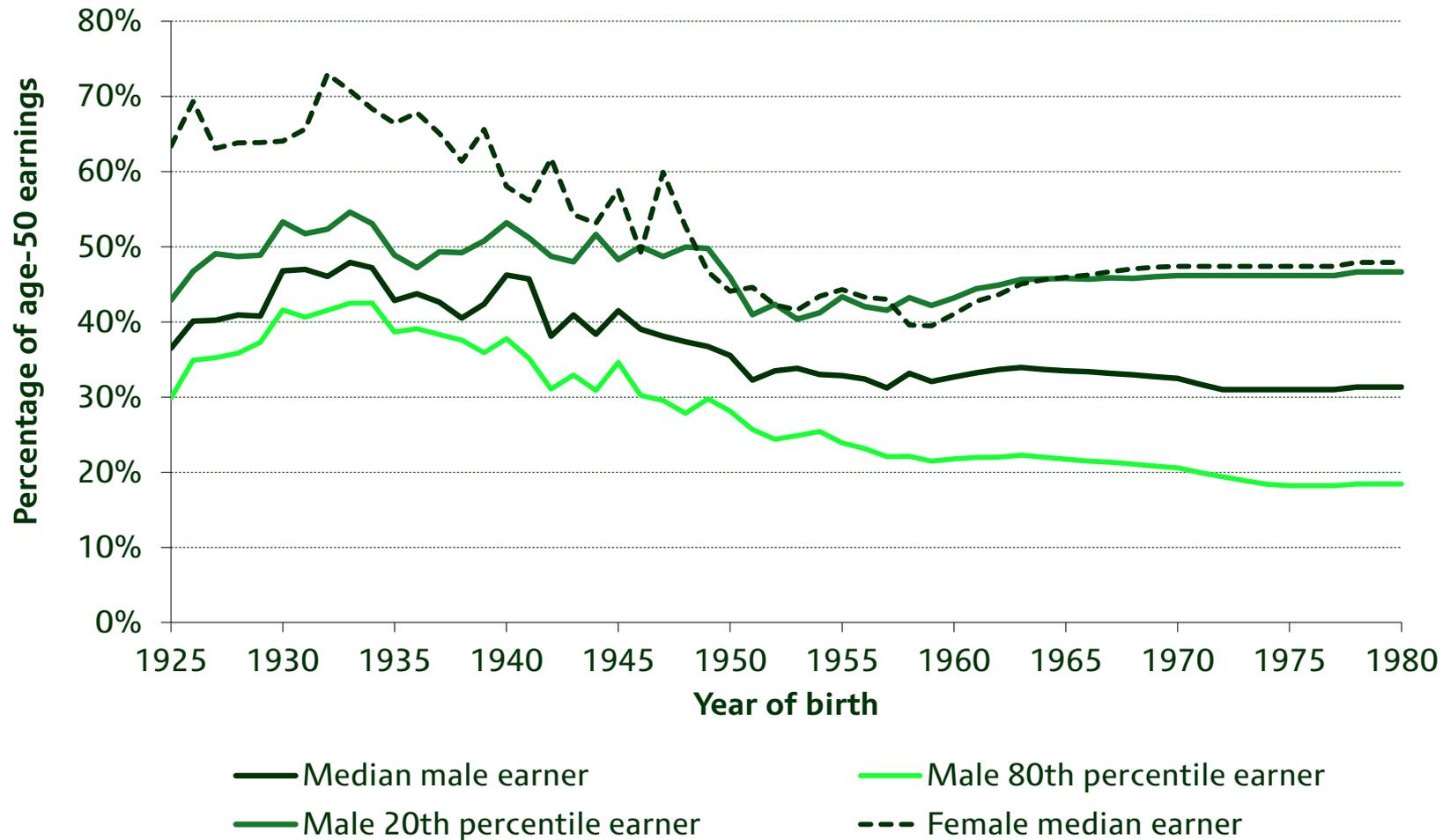
- 3 main components of wealth at retirement: state pensions, private pensions and property
- State pensions will tend to replace a smaller proportion of earnings for those born in the '60s and '70s than for those around retirement
 - process accelerated by single-tier pension: see “A single-tier pension: what does it really mean?” (<http://www.ifs.org.uk/publications/6796>)

Male median earner who works continuously up to his state pension age



Source: Figure 3.5, Hood and Joyce (2013)

Replacement rates for other example individuals

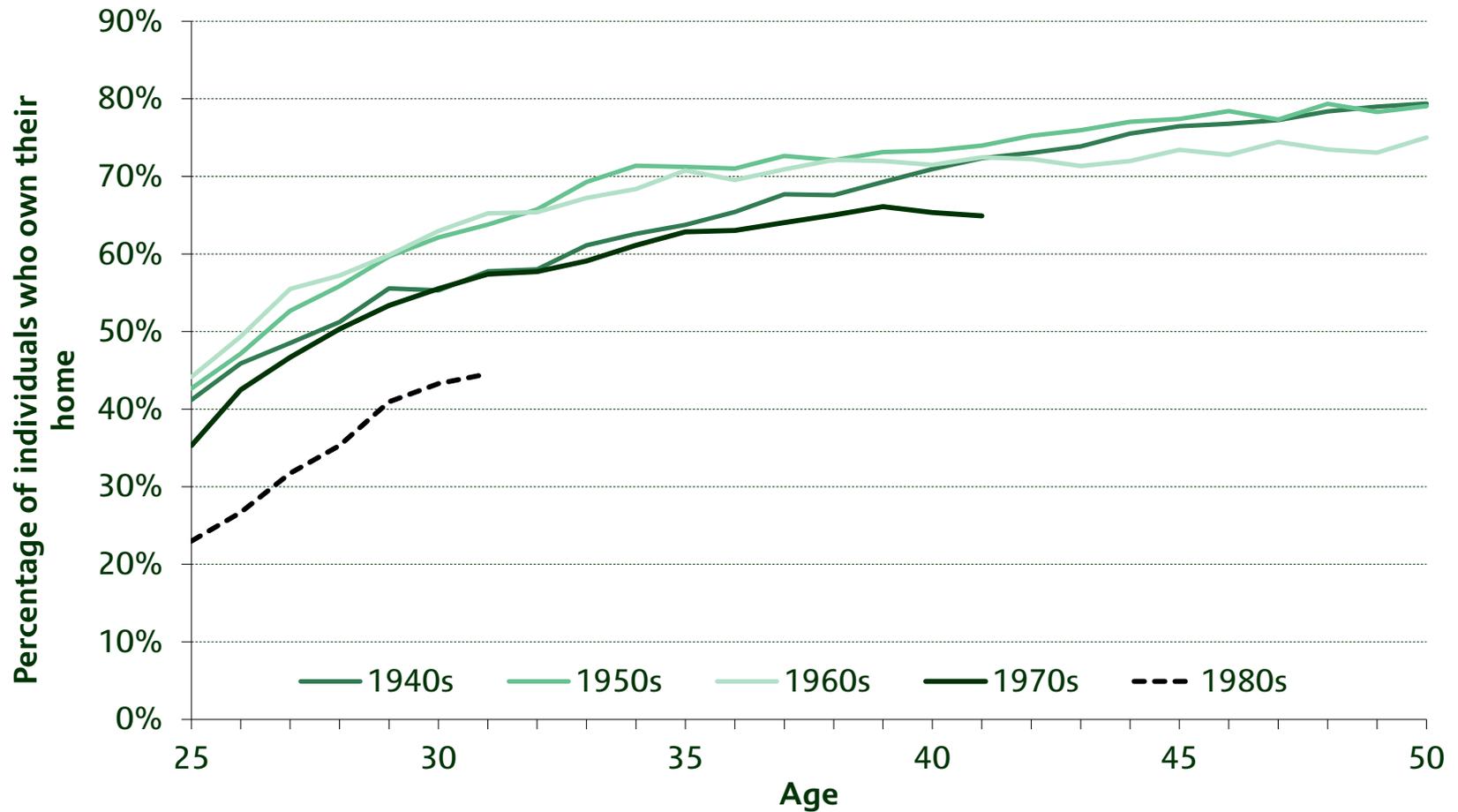


Source: Figure 3.5, Hood and Joyce (2013)

Wealth and assets

- 3 main components of wealth at retirement: state pensions, private pensions and property
- State pensions will tend to replace a smaller proportion of earnings for those born in the '60s and '70s than for those around retirement
 - but difference across cohorts is smaller for lower earners and carers
- Shift towards less generous DC schemes in private sector likely to affect younger cohorts more

Homeownership rates by age and birth cohort

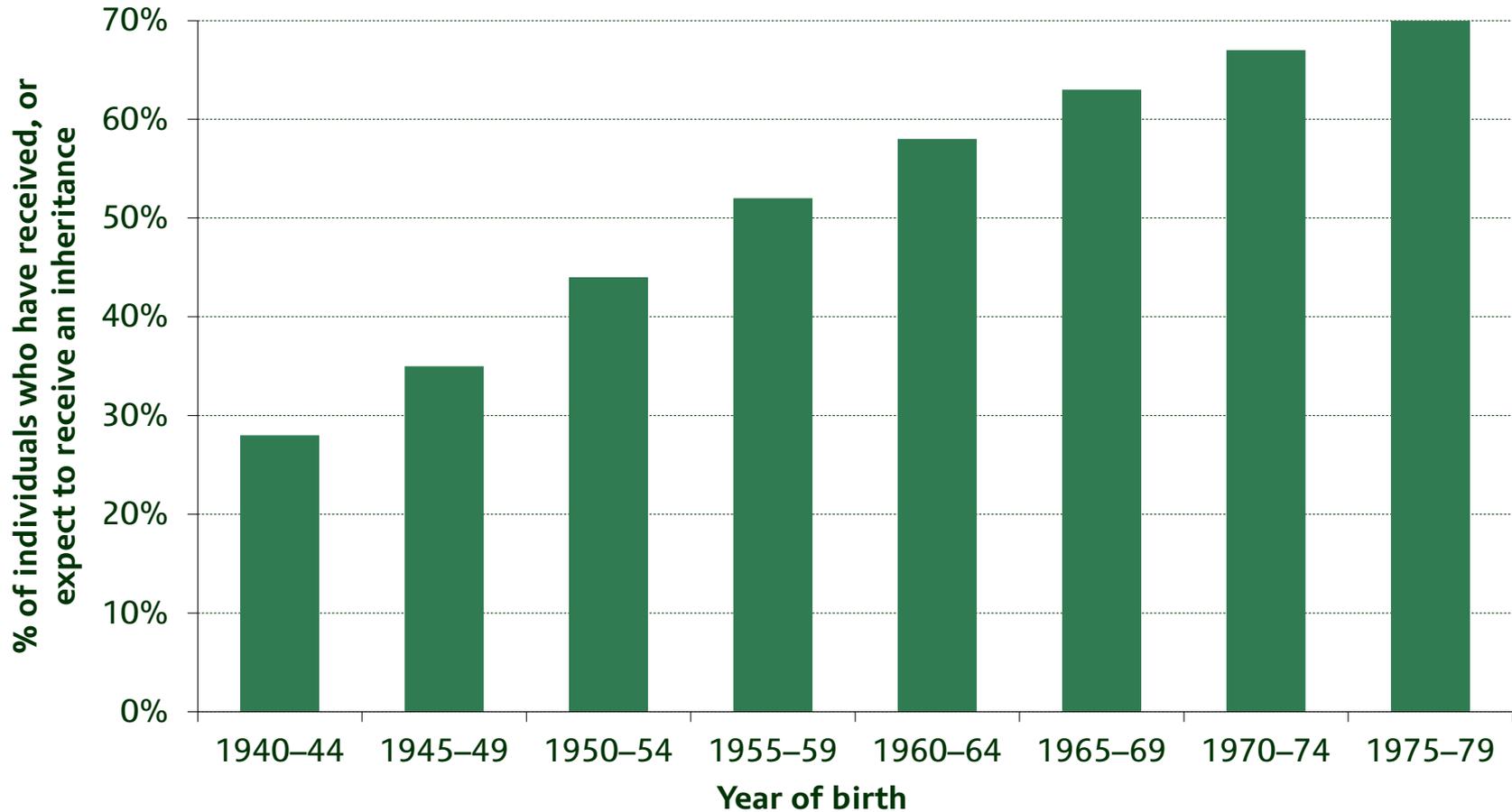


Source: Figure 3.12, Hood and Joyce (2013)

Wealth and assets

- 3 main components of wealth at retirement: state pensions, private pensions and property
- State pensions will tend to replace a smaller proportion of earnings for those born in the '60s and '70s than for those around retirement
 - but difference across cohorts is smaller for lower earners and carers
- Shift towards less generous DC schemes in private sector likely to affect younger cohorts more
- Those born in the 1970s taking longer to get on the housing ladder, and homeownership rate has stalled lower than predecessors

Inheritances more important for younger cohorts...



Source: Figure 4.2, Hood and Joyce (2013)

... but unevenly distributed across households

- Highly correlated with existing wealth...
 - among those born in the mid-1970s, 35% of wealthiest third expect an inheritance of over £100,000, compared to 12% of least wealthy
- ...and concentrated within the same households
 - 52% of those whose partner expects an inheritance of more than £100,000 also expect an inheritance of more than £100,000, compared to 9% of those whose partners expect no inheritance

Conclusions

- Those born in the '60s and '70s have similar incomes to those born 10 years earlier at the same age...
- ... but look to have lower pension and property wealth
 - raises questions about their preparedness for retirement
- Inherited wealth only major factor likely to make individuals born in '60 and '70s better off in retirement than predecessors
 - inequalities in inherited wealth could have important consequences for inequality *within* younger cohorts in later life

Questions still to answer...

- What will be the impact on preparedness for retirement of recent major policy reforms?
 - auto-enrolment
 - the end of compulsory annuitisation
- What other factors determine how much people save for retirement?
 - the costs of long-term care
 - gifts and inheritances to children
 - understanding the (increased) need to save privately

References

- “The adequacy of wealth among those approaching retirement”, October 2012, <http://www.ifs.org.uk/publications/6403>
- “The economic circumstances of cohorts born between the 1940s and the 1970s”, December 2013, <http://www.ifs.org.uk/publications/7007>
- “The changing face of retirement: future patterns of work, health, care and income among the older population”, June 2014, <http://www.ifs.org.uk/publications/7251>
- “From me to you? How the UK state pension redistributes”, August 2014, <http://www.ifs.org.uk/publications/7324>
- “Retirement sorted? The adequacy and optimality of wealth among the near retired”, September 2014, <http://www.ifs.org.uk/publications/7358>
- “Cash and pensions: Have the elderly in England saved optimally for retirement?”, September 2014, <http://www.ifs.org.uk/publications/7357>