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Retirement income and assets: how can pensions and financial assets support retirement?

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Summary of Conclusions

Pensions, both state and private, currently provide the majority of retirement income for most pensioners – around 60% of retirement income on average - although low earners are likely to receive a higher proportion of their income from the state. Pensioners on very high incomes are likely to receive a significant proportion of income from other savings and investments, however the majority of pensioners receive very little income from other savings and investments.

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. In the future, state and private pension income is still likely to provide the majority of retirement income for most pensioners and the importance of private pensions for many pensioners is likely to grow.

Even though pension income is likely to be the most important source of retirement income in future, it is still unlikely to be high enough for many individuals to meet their needs or preferences throughout retirement. Some pensioners may need to use income from other savings and assets (including housing) or from earnings to meet these needs and preferences.

The Government's state pension reforms are likely to mean that in the future:
- The level of income that all pensioners receive from state pensions is likely to increase as a result of the re-indexation of the Basic State Pension with earnings.
- Some inequalities in entitlement to state pensions, such as those between men and women, and between employees and carers are likely to be reduced.

The Government's private pension reforms and changes already occurring in the private pensions market could mean that in the future:
- The risks associated with pension funds are increasingly passed from employer to employee.
- Currently around 40% of the working age population (around 14 million people) are saving in a private pension, meaning occupational, private or personal pensions, including individual and group personal pensions.
- Assuming that opt-out rates after auto-enrolment are in line with Government expectations, 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) to around 21 million people, or roughly 60% of the UK working-age population once the Government's reforms are fully implemented.
- Active membership in Defined Benefit schemes could reduce by around 40% in the private sector by 2050, from current levels of around 2.5 million active members to around 1.5 million by 2050.

- Active membership in Defined Contribution schemes could reach around 15 million by 2020 and around 17 million by 2050, compared to an estimated 5 million today.
- 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.

As a result of greater numbers of people saving in DC pensions in the future:

- Greater numbers of people will need to convert their pension pots into an income and may need to use the annuities market in the future.
- The financial profiles of people who purchase annuities and the average size of pension pots used to purchase annuities could change. Pension pots may decrease in the early years after the reforms are first introduced and then increase as greater private pension entitlements are built up over time.
- There may be pressure to look at ways of making flexible retirement products and the Open Market Option more accessible for people with small to median pension pots.

The changed landscape has implications for the information and advice that individuals will need:

- People may have more complex combinations of income and assets to manage in future; some low to moderate and higher earners could have state pension entitlement, residual DB pension entitlement, DC pension savings, other financial savings and assets, housing assets, and earnings.
- Generic financial information and guidance services will need to be able to support people, mostly low earners, who 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.

The state and private pension reforms and the changes to the private pensions market are likely to affect private sector employees with different income levels in different ways.

Very low earners (for example, earning £11,200 p.a. or less in 2009):

- Will receive more from state pensions as a result of the state pension reforms.
- Could accumulate a small pension pot from being auto-enrolled, which they may be able to trivially commute or may convert into a relatively small amount of income through an annuity.
- May need personalised information or advice to help them to decide whether to stay in or opt-out of pension saving.

Low to moderate earners (for example, earning £11,200 - £37,000 p.a.):

- Will receive more from state pensions as a result of the state pension reforms.
- May benefit from auto-enrolment and compulsory employer contributions by saving in a private pension for the first time or receiving contributions from their employer for the first time, *or* could see no change to their pension, *or* could see a reduction in their current employers pension contributions if, as a result of the reforms, their employer reduces the generosity of contributions to their existing pension scheme.
- May accumulate several small pots of DC and DB pension savings if they change employment several times, although they are more likely to be offered a private DC pension by their employer than a DB pension in the future.
- May have some savings from other financial products when they retire.

Higher earners (for example, earning above £37,000 p.a.):

- Will receive more from state pensions as a result of the state pension reforms.
- Could receive the same, less or more income from private pensions depending on how their employer responds to the introduction of auto-enrolment.
- Are likely to have substantial savings and assets, including housing, when they retire.
- Are more likely than other groups to be able to spend more for independent financial advice.

Public sector employees will also benefit from the changes to the state pension. In the public sector, most pension schemes already use auto-enrolment so the Government's private pension reforms are less likely to lead to a significant change in public sector pension provision. However, public sector employees face political uncertainty about the type of pension that will be offered to them in the future and some individuals will work in both the public and private sectors. The PPI will be undertaking a separate piece of research on the future of public sector pensions so this issue is not covered in this report.