PENSIONS POLICY INSTITUTE

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Report for Age UK Financial Services Commission

Executive summary

This report was initially presented at a roundtable event that took place on 6 February, before the 2014 Budget announcement regarding the removal of restrictions on accessing Defined Contribution savings. For this reason the report does not take account of these proposed changes.

Summary

This briefing paper has been prepared for Age UK's second summit meeting of the Financial Services Commission and is on the topic of the 'recently retired' and their financial resilience. The note explains what we mean by the 'recently retired'; explores their financial resilience to economic, health and lifestyle shocks during early retirement; and highlights some key considerations for the industry when exploring how to improve financial resilience. This was prepared in advance of the Budget 2014 proposals and therefore does not take into account the impact of the removal of any limits on the amounts that individuals can draw down from their pensions.

Three shocks during the early years of retirement are considered in terms of their impact on retirement incomes and spending needs: a period of unexpectedly high inflation; the onset of a moderate severity disability or health issue; and the early death of a partner. Headline findings are that:

- For those individuals and couples reliant on the state pension, the triple-lock guards them well against the risks of inflation throughout retirement.
- Those more reliant on private pension income, and in particular DC pension income, could see a significant fall in their actual income against their income requirement (for our DC retiree here (Table 2), a fall from receiving 95% of required income in 2012 to 76% of required income in 2022).
- A return to the earnings-link for the state pension from 2016 would exacerbate this (a fall to 72% by 2022).
- The onset of a moderate severity disability or health issue is associated with a significant increase in spending needs, and hence required income, when the condition begins.
- Even those with a DB private pension find their income is no longer sufficient to meet their income requirements ***and*** cover the additional spending needs of their disability (for our DB retiree here (Table 4), a fall from receiving 114% of required income in 2012 to 92% of required income in 2022).
- The early death of a partner is also associated with falling actual income against income requirements. Whilst couples are generally more financially resilient, in the example considered here (Tables 5 and 6), actual income against income requirements would fall from 156% to 138% between 2012 and 2022 were the partner with the lower DC annuity income (single life) to die first 5 years into retirement, and from 156% to 116% were the partner with the higher DB income (including a 50% spouse benefit) to die first 5 years into retirement.

The risks to financial resilience from early death of a partner are likely to be greater in future years as more households are reliant on DC pensions for their incomes and where these may not provide any protection for spouses depending on whether a single or joint life annuity is selected. Once decisions

about the age of retirement and the choice of retirement income product have been made there is limited scope for individuals and couples to increase their financial resilience. Potential issues for the industry to address include:

- Ensuring that before making final decisions individuals are aware of the potential improvement to their retirement incomes and financial resilience from working an extra year or two beyond SPA (previous PPI research has shown that working and saving for an extra two years can increase retirement income by 20%).
    - Should illustrations be included in pre-retirement packs as standard information to break the default of an assumed retirement age and a conventional annuity?

- Ensuring that safety checks are in place (to clarify that individuals are aware of the inflation risks of taking a level annuity, and the financial risks to their partner of taking a single-life annuity) before allowing individuals to lock into a retirement income product.
    - Should clear warnings be sent to those who already have a single-life annuity to ensure they and their partner understand the implications?

- Ensuring that individuals are aware of the full range of their retirement income options and that they do not necessarily have to lock into an irreversible decision at the start of retirement (raising awareness of fixed-term annuities and income drawdown as alternatives, where appropriate).
    - Can clearer guidance and tools be developed to indicate when these products ***might*** be suitable without individuals needing to take full financial advice to understand the implications?

- Generating financial planning tools that allow individuals to consider the likelihood and risks of unexpected events that could knock their financial plans of course, including the risks of health and disability issues and the risk of losing a partner.
    - Do existing financial planning tools allow 'what-if' scenarios to be considered that model the impact of these lifestyle shocks over the course of retirement?

This note has not addressed the use of wider assets, including housing wealth and other financial assets, to supplement retirement income but for some individuals these may provide a credible 'Plan B' option. The strong correlation between private pension savings and other assets, however, means this is unlikely to help the groups with the lowest financial resilience.