The evolution of pension wealth and contribution dynamics

Rowena Crawford and Gemma Tetlow
Context

• Private pension saving has always played, and continues to play, an important role providing income to older people in retirement

• Private pension environment has evolved in recent decades
  – Introduction of personal pensions in late 1980s
  – Declining prevalence of employer provided DB schemes
  – Increased labour force participation of women
  ⇒ Interesting to examine differences in pension coverage and wealth between cohorts and over time

• Important to understand interactions between private pensions, labour market activity and income levels
  • Particularly given policy ambitions to increase pension coverage, work at older ages and the adequacy of incomes in retirement
  ⇒ Examine contribution, income and employment dynamics around ‘retirement’
Private pension “lifetime” coverage
Private pension “lifetime coverage”, by sex

- Increased among later cohorts of women but not men

Notes: Figure 2.1. Pooled ELSA 2002–03 to 2010–11. N = 18,164
Private pension “lifetime coverage”, by type

Among men

- Increase in personal pension coverage among men who have been covered by an employer pension (at some point)

<table>
<thead>
<tr>
<th>Year of Birth</th>
<th>Any Private Pension</th>
<th>Employer Pension</th>
<th>Personal Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929-32</td>
<td>80%</td>
<td>70%</td>
<td>10%</td>
</tr>
<tr>
<td>1933-36</td>
<td>85%</td>
<td>75%</td>
<td>20%</td>
</tr>
<tr>
<td>1937-40</td>
<td>90%</td>
<td>85%</td>
<td>30%</td>
</tr>
<tr>
<td>1941-44</td>
<td>95%</td>
<td>90%</td>
<td>40%</td>
</tr>
<tr>
<td>1945-48</td>
<td>100%</td>
<td>100%</td>
<td>50%</td>
</tr>
<tr>
<td>1949-52</td>
<td>100%</td>
<td>100%</td>
<td>60%</td>
</tr>
<tr>
<td>1953-56</td>
<td>100%</td>
<td>100%</td>
<td>70%</td>
</tr>
<tr>
<td>All</td>
<td>100%</td>
<td>100%</td>
<td>70%</td>
</tr>
</tbody>
</table>

Notes: Figure 2.2 panel A. Pooled ELSA 2002–03 to 2010–11. N = repeat observations of 5,649 men
Private pension “lifetime coverage”, by type
Among women

- Increases in employer and personal pension coverage

Notes: Figure 2.2 panel B.
Pooled ELSA 2002–03 to 2010–11. N = repeat observations of 6,492 women
Private pension wealth
Private pension wealth

- Looking only at pension coverage can be misleading as it could disguise significant differences in the *amount* of pension saving

- Investigate private pension wealth holdings:
  - How these have changed between cohorts
  - How these have changed as people have aged

- Focus on the subsample of ELSA who were:
  - Observed in all 5 waves: minimise the effects of differential mortality
  - Covered by a pension in wave 1: no compositional effects from people who *become* covered at older ages
Private pension wealth, by cohort
Among men

Mean real pension wealth (£, March 2012 prices)

Average age

Notes: Figure 2.3 panel A.
Private pension wealth, by cohort
Among women

Notes: Figure 2.3 panel B.
Dynamics around “retirement”
Dynamics around retirement

• When is “retirement”?  
  – When individuals start to draw their private pension income?  
  – When individuals leave work?  
  – When individuals start to self-report themselves as “retired”?  
Starting to draw a private pension income

- Starting to draw a private pension income is not synonymous with leaving the labour market
  - 69% of individuals in work prior to first starting to draw a private pension
  - 55% of these individuals remained in work after starting to draw
- Women are more likely than men to leave work at the point that they first start drawing income from a private pension, as are older individuals, those who report having a work-limiting disability and those who are drawing income from an employer pension

Notes: Table 2.1.
Starting to draw pension ≠ leaving labour market
Percentage of private pension income recipients working - men

- Increase in proportion working while receiving a private pension income is greater than general increase in proportion of individuals at these ages in work

Notes: Figure 2.8 panel A.
Dynamics around retirement

- When is “retirement”?  
  - When individuals start to draw their private pension income?  
  - When individuals leave work?  
  - When individuals start to self-report themselves as “retired”?  

- In the following take retirement to be when an individual leaves full-time work  
  - Focus on the subsample of ELSA individuals observed making a consistent transition from full-time work to retirement  

- Investigate some dynamics around the point of retirement  
  - Pension contribution behaviour  
  - Changes in total family net income
Pension contributions dynamics

- Pension contributions might be expected to increase in the years leading up to retirement
  - Individuals become better informed about their accumulated pension wealth and their likely pension income needs
  - Other expenditure needs might decline (children leave home, mortgage paid off etc.)
- Pensions are relatively tax advantaged
  - Contributions exempt from income tax and ¼ fund can be taken as tax-free lump sum
  - Particularly pertinent for those close to retirement
Pension contributions dynamics

- Self-report as ‘retired’
- With a current pension

Percentage of individuals

- Mean pension contribution (current DC)
- Median pension contribution (current DC)
- 75th percentile (current DC)

Annual individual pension contribution (£, March 2012 prices)

Years after point at which individual first leaves full-time work

Notes: Figure 2.10.
N = max: 1,1451 individuals (Y=-2, Y=0), min: 442 individuals (Y=-8)

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Income dynamics

- ‘Adequacy’ of individuals’ retirement resources is often a direct object of policy concern
- ‘Adequacy’ can be taken to mean different things
  - Sufficient to avoid poverty?
  - Sufficient to provide a similar standard of living to working life?
- Lifecycle models suggest individuals want to smooth consumption between working life and retirement
  - Does not necessarily have to be 100%
    - Work related consumption may not need to be maintained
  - Does not necessarily require smoothed expenditure
    - Cheaper but more time intensive methods of consumption may be utilised
  - Does not necessarily require smoothed income
    - Retired individuals pay lower taxes (broadly speaking)
    - Less need for saving
Replacement of income in retirement

Mean total net family income in each year, as a proportion of pre-retirement income:

Notes: Figure 2.11 panel B.
N = max: 1,1451 individuals (Y=-2, Y=0), min: 442 individuals (Y=-8)
Replacement of income in retirement

- Calculate average family income across years observed before leaving full-time work, and years observed after leaving full-time work.
- On average, the replacement rate after leaving full-time work is 72%.
- Little difference by sex, education, non-pension wealth quintile.
- Replacement rate is decreasing in pre-retirement income.

<table>
<thead>
<tr>
<th>Mean family net income</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average</strong></td>
<td><strong>Average post-ret</strong></td>
</tr>
<tr>
<td>All</td>
<td>738</td>
</tr>
</tbody>
</table>

**Income quartile (pre retirement)**

<table>
<thead>
<tr>
<th>Quartile</th>
<th>Average pre-ret</th>
<th>Average post-ret</th>
<th>Replacement rate</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest</td>
<td>303</td>
<td>319</td>
<td>105.1%</td>
<td>354</td>
</tr>
<tr>
<td>2</td>
<td>532</td>
<td>417</td>
<td>78.4%</td>
<td>351</td>
</tr>
<tr>
<td>3</td>
<td>739</td>
<td>552</td>
<td>74.8%</td>
<td>351</td>
</tr>
<tr>
<td>Highest</td>
<td>1,381</td>
<td>837</td>
<td>60.6%</td>
<td>352</td>
</tr>
</tbody>
</table>

Notes: Income figures shown as £ per week. Other notes see Table 2.5.
Sources of income in retirement

Mean family net income (£ per week, March 2012 prices)

Pre-retirement

Post-retirement

Notes: Figure 2.12.
N = 1,408 individuals

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Summary

- Private pension coverage in England is high and has increased across successive generations of women.
- Among those with pensions there is no evidence of increases or decreases in the amounts held by successive cohorts of men or women.
- Starting to draw a private pension is not synonymous with leaving the labour market.
  - Working while receiving private pension income has become more prevalent over time.
- Behaviour and income around the point of leaving full-time work:
  - Proportion of individuals contributing to a pension increases in the years leading up to leaving FT work but little evidence of increased contributions.
  - On average family net income falls by 28% when individual leaves FT work.
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