Press Release

Up to one-in-five facing large income falls on retirement; Financial crisis knocks 10% off wealth holdings among older individuals

These are among the findings from two new reports by IFS researchers launched today, that use household survey data to investigate how well prepared for retirement individuals approaching the state pension age are, and how the wealth of older individuals has been affected by the financial crisis.

The research was funded by the IFS Retirement Saving Consortium, the Joseph Rowntree Foundation and the Economic and Social Research Council.

Estimated retirement income from state and private pensions only:

Concerns about the level of households’ preparedness for retirement, and in particular the fear that many individuals will have inadequate resources on retirement, have motivated recent and proposed reforms to the state and private pension systems. If you only look at the income that households get from their state and private pensions then there does seem to be cause for concern. On this narrow definition of retirement income, on two commonly used measures of adequacy we estimate that:

- The majority of people currently aged between 50 and the State Pension Age will have a replacement rate of less than 80%. That is they will see their income fall by at least 20% on retirement;
- More than 40 per cent will have a replacement rate less than two thirds. They will see their income fall by at least a third.

Broadening the definition of retirement income to include other sources:

Focussing only on pension income ignores the fact that many households could fund their retirement from sources other than pensions. These sources include savings, expected inheritances, pension credit and the return that owner-occupiers get from living in their homes. Under a broader definition of income that includes these, we find that:

- A large majority of those aged between 50 and the State Pension Age, 80%, should actually achieve a replacement rate of 80% or better. So only a fifth see their income fall by more than 20%;
- As many as 90% could achieve a two thirds replacement rate.

These figures are summarised in the table below.
Table: Percentage aged between 50 and the State Pension Age estimated to have inadequate retirement resources

<table>
<thead>
<tr>
<th>Proportion of individuals with estimated income at the SPA of less than:</th>
<th>Pension income only</th>
<th>Broader definition of income</th>
</tr>
</thead>
<tbody>
<tr>
<td>67% current income</td>
<td>41%</td>
<td>10%</td>
</tr>
<tr>
<td>80% current income</td>
<td>53%</td>
<td>21%</td>
</tr>
<tr>
<td>Pension Credit Guarantee level</td>
<td>12%</td>
<td>n/a</td>
</tr>
</tbody>
</table>

In some ways the news is even better for those with the lowest pre-retirement incomes. They will see a much higher proportion of their pre-retirement income replaced than the average. This largely reflects the fact that benefits are more generous for those over state pension age than for those under it.

But the absolute levels of income for this group will not be high. We predict that one-in-eight individuals approaching retirement would retire on an income from state and private pensions of less than the Pension Credit Guarantee level (currently £142.70 per week for single people and £217.90 for couples) and would therefore be reliant on state means tested benefits to ensure they had an income at this level.

Cormac O’Dea, a senior research economist and one of the authors of the report said: “In assessing how prepared households are for retirement, it is extremely important to take into account the fact that many households can fund their retirement from sources other than their pensions. Retirement resources are not the same thing as pension income. Taking into account only income from state and private pensions, two-fifths of those approaching the state pension age will see their income fall by more than a third on retirement. However, using a comprehensive measure of income, the proportion facing such large income falls on retirement is just one-tenth.”

**How older households have been affected by the financial crisis:**

A second study, also launched by the IFS today, simulates how older individuals in England might have been affected by the large asset price changes associated with the financial crisis and estimates the size of some of their responses to the resulting wealth shocks.

It finds that on average individuals aged 50 and over experienced a fall in their household’s gross wealth (which includes accumulated state and private pension rights, housing wealth and wealth held in liquid and illiquid financial assets) of 10% as a result of the financial crisis: a drop of almost £60,000.

The estimated losses are proportionately greater for those in wealthier households as they tended to have more of their wealth exposed to the assets that fell in price over the crisis. The mean loss among the least wealthy fifth was 4.6% of total gross wealth or £9,400, increasing to 12.9% – or £162,000 – among the richest fifth. Of these losses among the richest fifth just under half comes from falls in property values, and just over half comes from a fall in funds exposed to the stock market.

The impact on this age group may be of particular concern because they are unlikely to be able to make up the losses later in life.
Commenting on the results, Rowena Crawford, a senior research economist at the IFS and one of the authors of this report, said: “The decline in house prices and the stock market associated with the financial crisis depleted the wealth of the wealthy by proportionately more than that of those with less wealth. On average the richest fifth of individuals saw their household wealth fall by 13% or £162,000 – this at a stage in their life when they are most unlikely to be able to make up these losses later on. The losses occurred despite accumulated rights to defined benefit pensions being insulated from these shocks. Future generations of private sector employees will be much less able to benefit from this protection and are likely to be more exposed to asset price shocks.”

ENDS

Notes to Editors:

1. Both papers are being launched at an IFS briefing, 9.30am – 11.30am on Tuesday 23 October: http://www.ifs.org.uk/events/846.

2. The first set of analysis described above was undertaken by Rowena Crawford and Cormac O’Dea and is published as an IFS report titled “The adequacy of wealth among those approaching retirement”. This is available on the IFS website www.ifs.org.uk. This research was co-funded by the IFS Retirement Saving Consortium which comprises Age UK, Association of British Insurers, Department for Work and Pensions, Financial Services Authority, HM Treasury, Investment Management Association, Money Advice Service, National Association of Pension Funds, Partnership Pensions and the Pensions Corporation. Co-funding was also received from the Joseph Rowntree Foundation and from the ESRC-funded Centre for Microeconomic Analysis of Public Policy (CFP, reference RES-544-28-5001).

3. The second set of analysis described above was undertaken by James Banks, Rowena Crawford, Tom Crossley and Carl Emmerson, and is published as an IFS working paper entitled “The effect of the financial crisis on older households in England”. This is available on the IFS website www.ifs.org.uk. This research was funded by the ESRC (Grant RES 000-224-323) and cofounded by the IFS Retirement Saving Consortium.