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The ins and outs of retirement saving

11 June 2018

RICS, London

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Saving for retirement and automatic enrolment: what have we learned?

Jonathan Cribb

Saving for retirement in a world with automatic enrolment

Pensions Commission recommended three key policy changes in response to under-saving for retirement

- Earnings indexation of flat rate state pension ✓ "triple lock"
- Higher state pension age ✓
- Automatic enrolment ✓

How well prepared will the current working age population be for retirement?

What have we learned over the last 2 years that helps us to answer this question?

What have we learned?

1) Younger generations have lower wealth than older generations did at similar ages.

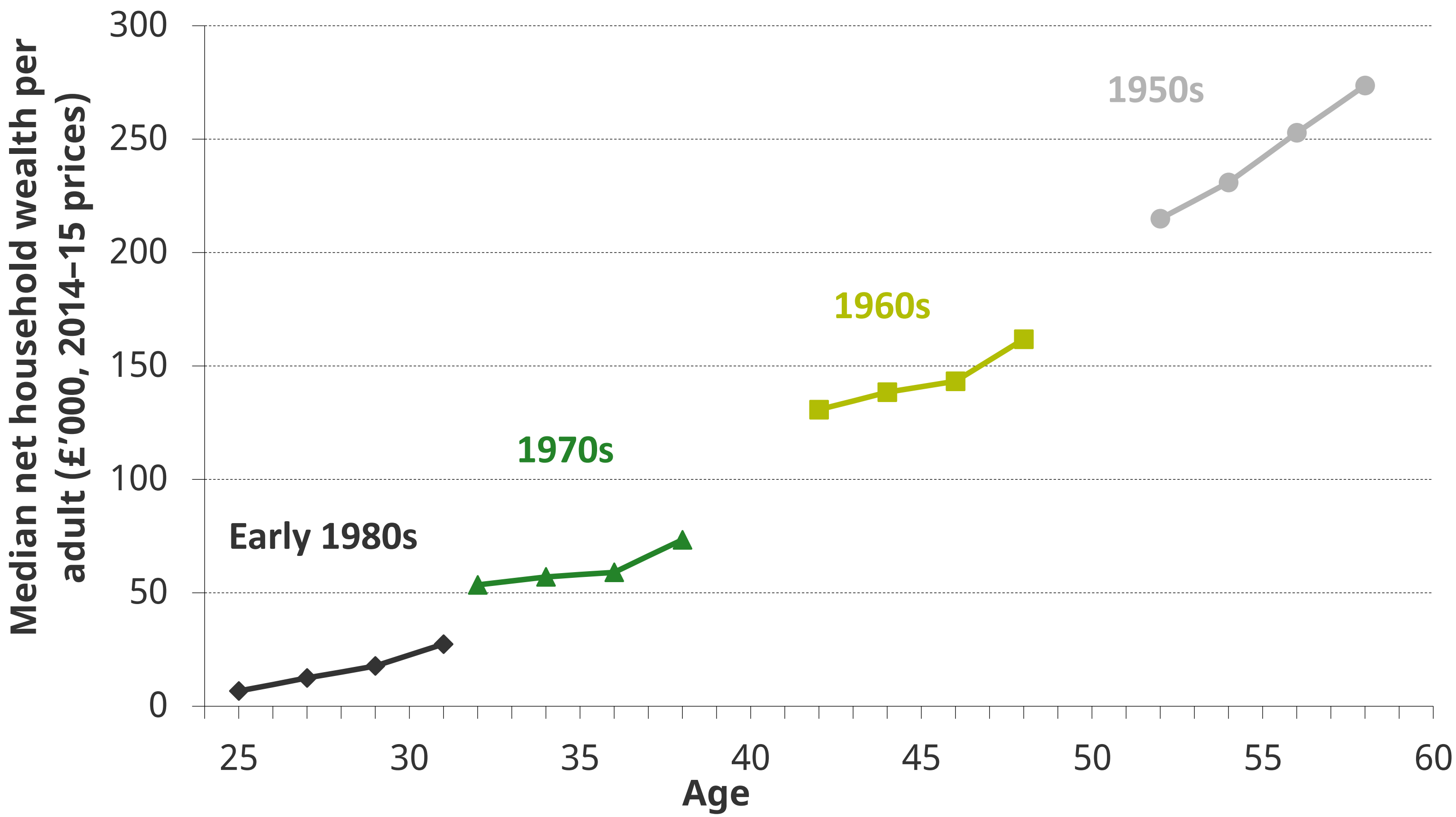
2) Automatic enrolment massively boosts pension participation. Mostly at very low contribution rates, but some with larger contributions.

3) Automatic enrolment boosts coverage by different amounts for different groups. And also boosts participation among "ineligibles".

4) Many people are not good at estimating their life expectancy.

1) Younger generations have lower wealth than older generations had at similar ages

Median net household wealth by age for different generations



Source: IFS calculations using Wealth and Assets Survey. (Figure 5 of Cribb, Hood and Joyce 2016)

2) Automatic enrolment massively boosts pension participation.

Mostly at very low contribution rates, but some with larger contributions.

Automatic enrolment: how it works

Employers have to:

- enrol all eligible employees into a workplace pension
- with at least minimum levels of total and employer contributions

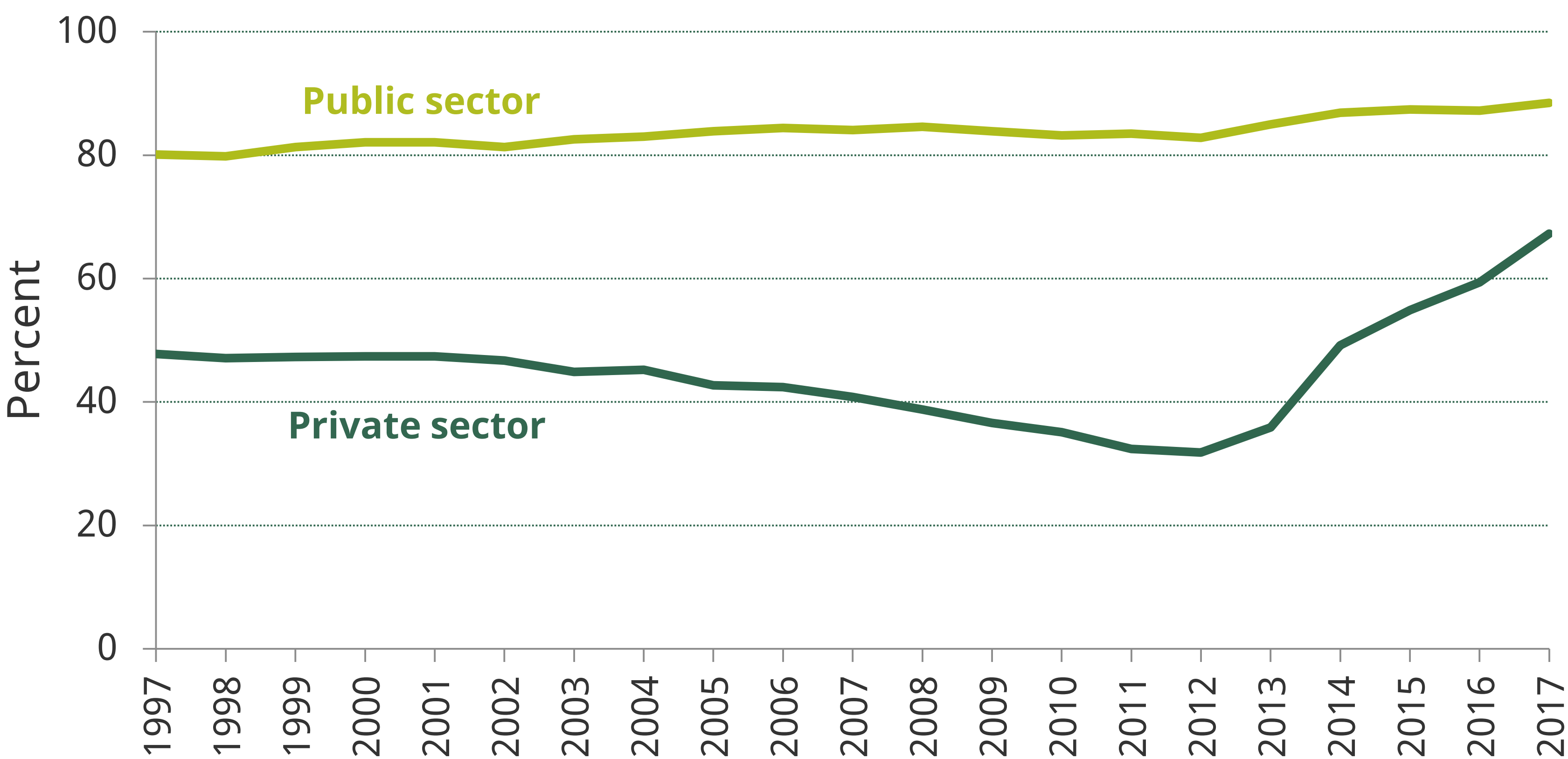
Employees can then choose to leave the pension if they wish

Automatic enrolment has been rolled out from the largest employers to the smallest employers

Minimum pension contributions have started to rise

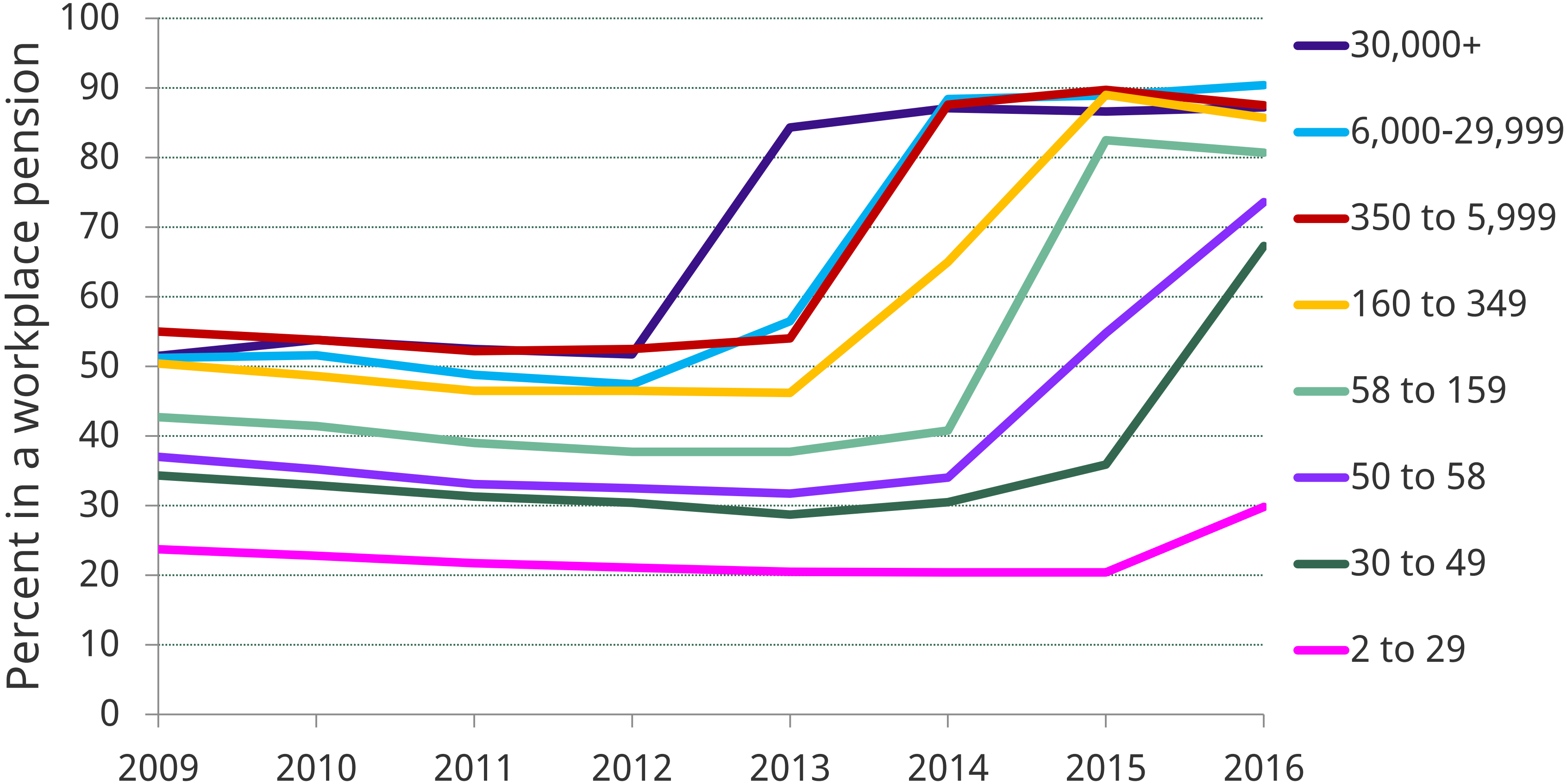
- 2% of qualifying earnings (1% from employer) up to March 2018
- 5% of qualifying earnings (2% from employer) in 2018-19
- 8% of qualifying earnings (3% from employer) from 2019-20

Overall workplace pension participation



Source: Crawford, Cribb and Emmerson (2018) using data from the Annual Survey of Hours and Earnings.

Workplace pension membership of eligible employees, by employer size



Source: Cribb and Emmerson (forthcoming) using data from the Annual Survey of Hours and Earnings.

Effect of automatic enrolment on total pension contributions

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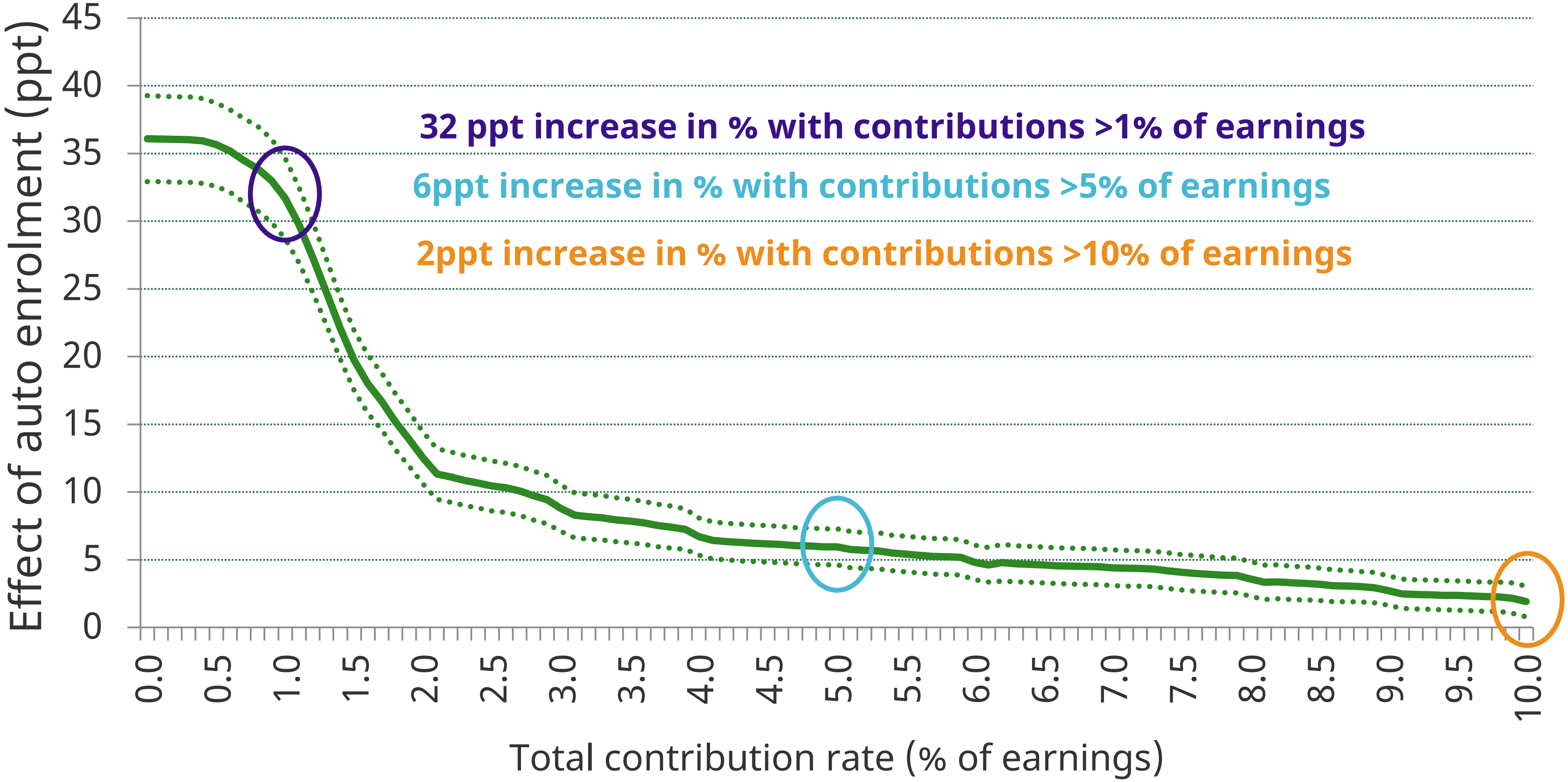

Source: Figure 3 of Cribb and Emmerson (2016) using data from the Annual Survey of Hours and Earnings.

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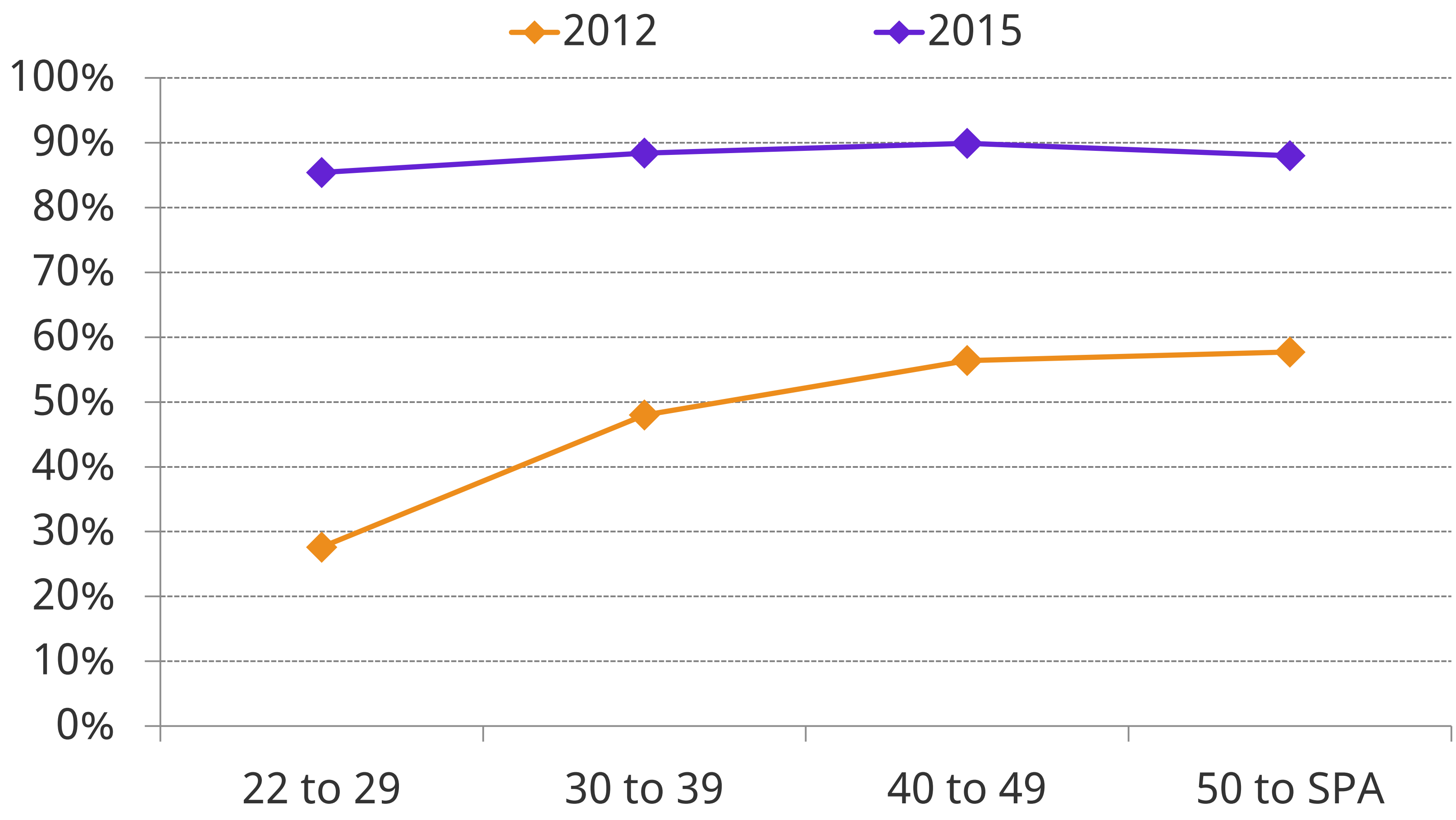
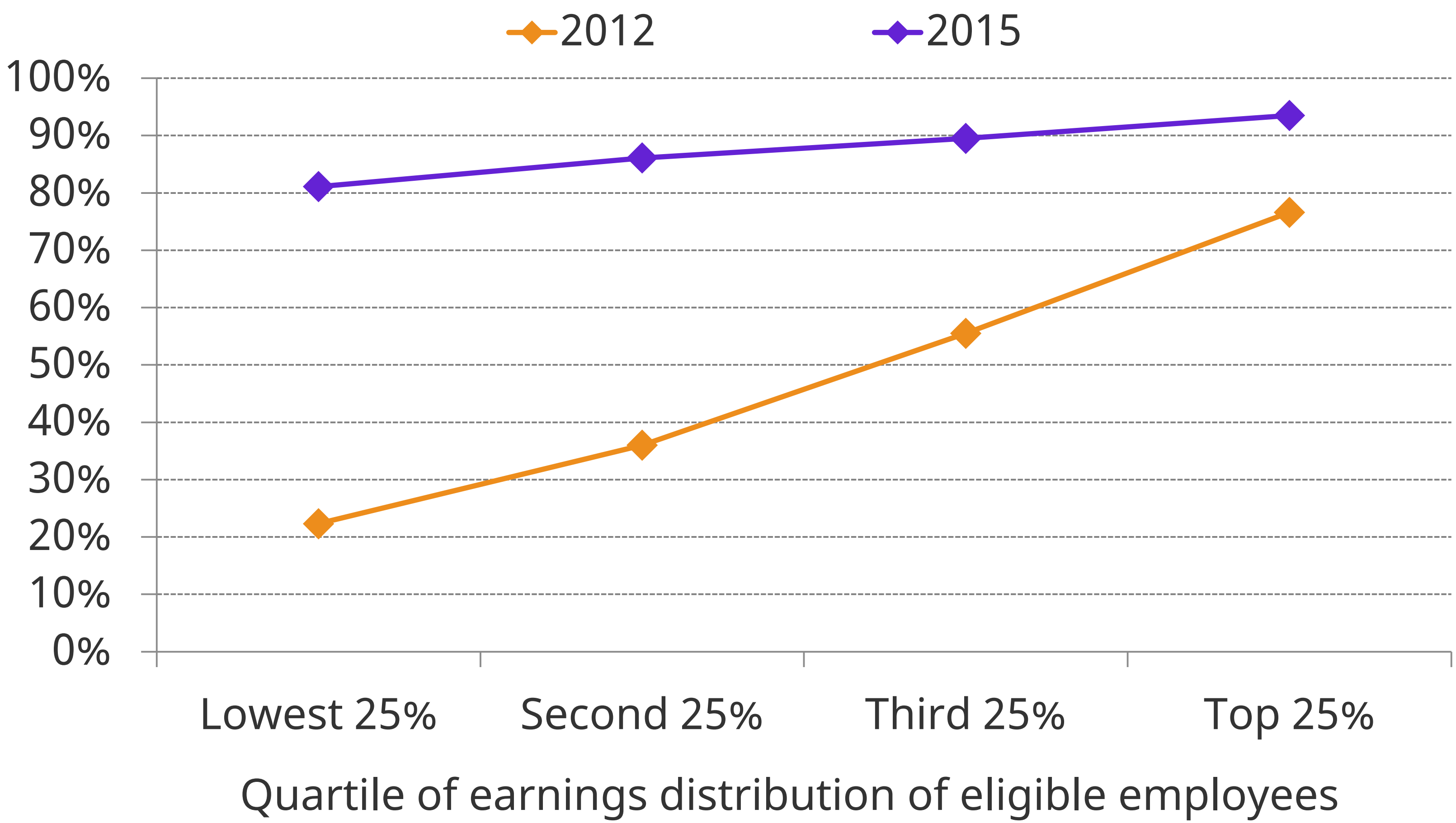
3) Automatic enrolment leads to many more with contributions above the minimums and higher pension participation of “ineligibles”

Workplace pension membership of eligible employees by age



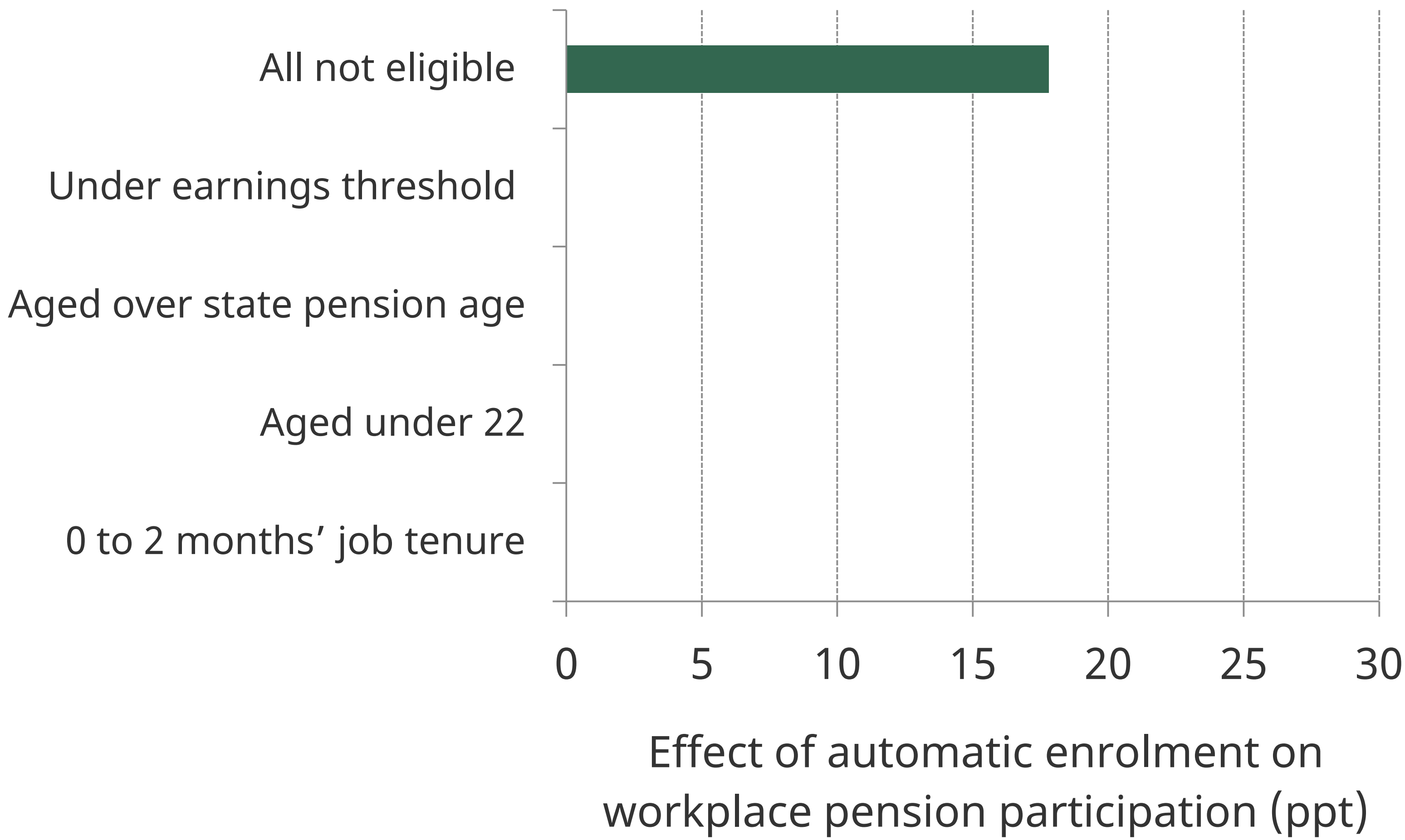
Source: IFS calculations using Annual Survey of Hours and Earnings. (Table 3 of Cribb and Emmerson 2016)

Workplace pension participation of eligible employees, by earnings level



Source: IFS calculations using Annual Survey of Hours and Earnings. (Table 3 of Cribb and Emmerson 2016)

Effect of automatic enrolment on “ineligibles”



Source: Table 5 of Cribb and Emmerson (2016) using data from the Annual Survey of Hours and Earnings.

Effect of automatic enrolment on “ineligibles”

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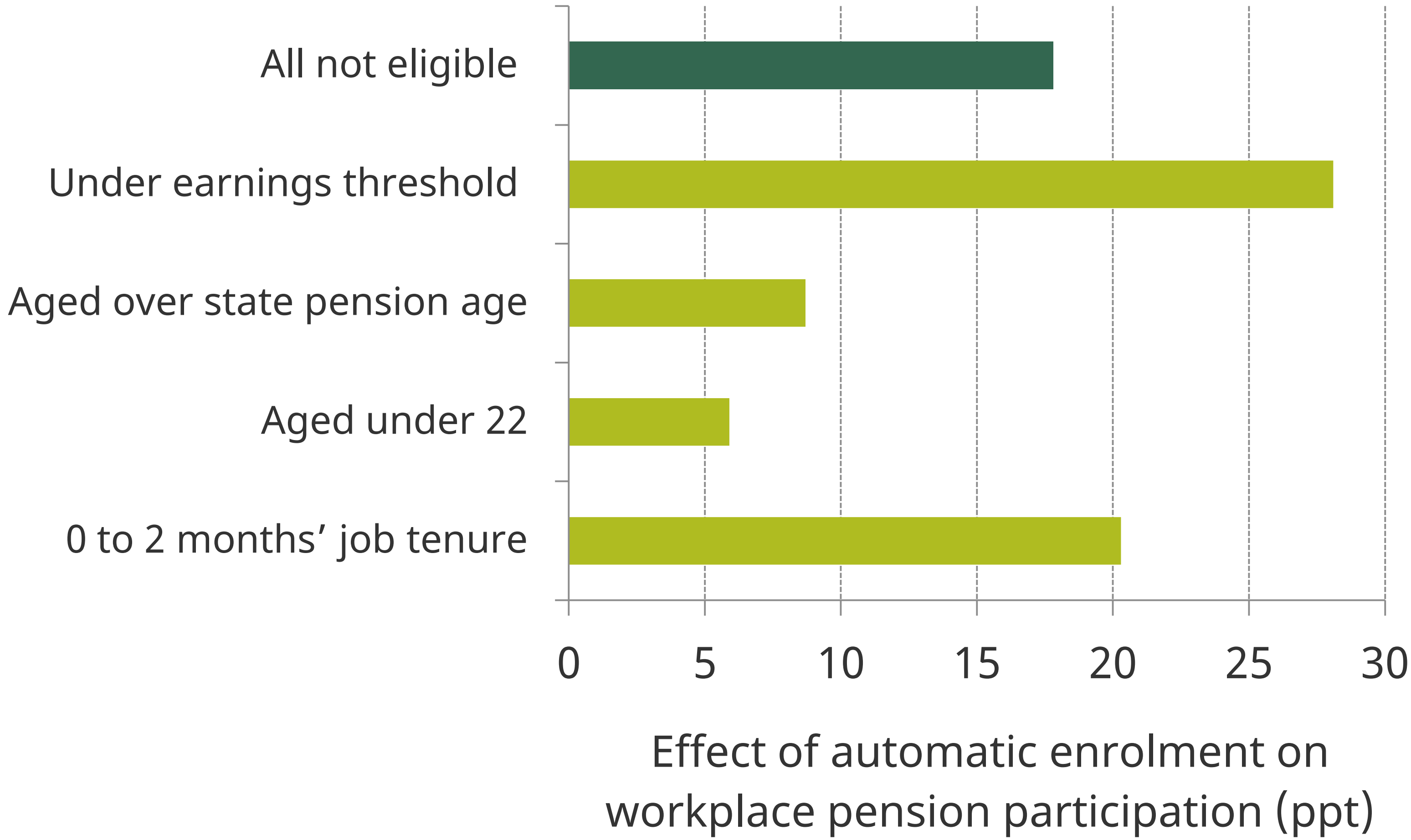


Source: Table 5 of Cribb and Emmerson (2016) using data from the Annual Survey of Hours and Earnings.

What will happen as contributions rise?

Increases in minimum contribution rates have started and they will rise again next year

From “mid 2020s” all earnings up to upper threshold to count towards minimum contributions

- Also widen age band from 22 to SPA to 18 to SPA
- Has potential to benefit people earning low amounts in multiple jobs

Higher minimum contributions to workplace pensions

Will more people choose to leave their pension scheme?

Reasons for government to be optimistic:

- Many already have contributions in excess of long run minimums
- Some (many?) will remain in scheme simply due to inertia
- Individual would have to give up a larger employer contribution
- Large firm in the USA with 3% employee and 3% employer cont. showed similar opt out rates to UK (Madrian and Shea 2001)

Higher minimum contributions to workplace pensions

Reasons for government to be cautious:

- Where the higher employer contributions are “coming from”? (lower wages, lower profits, higher prices or higher productivity)
- Are households reducing savings elsewhere?
- Are the “right” employees opting out?
- Will the higher minimum contributions be “high enough”?

4) Many people are not good at estimating their life expectancy

Life expectancy and saving for retirement

Life expectancy can be an important consideration when planning for retirement

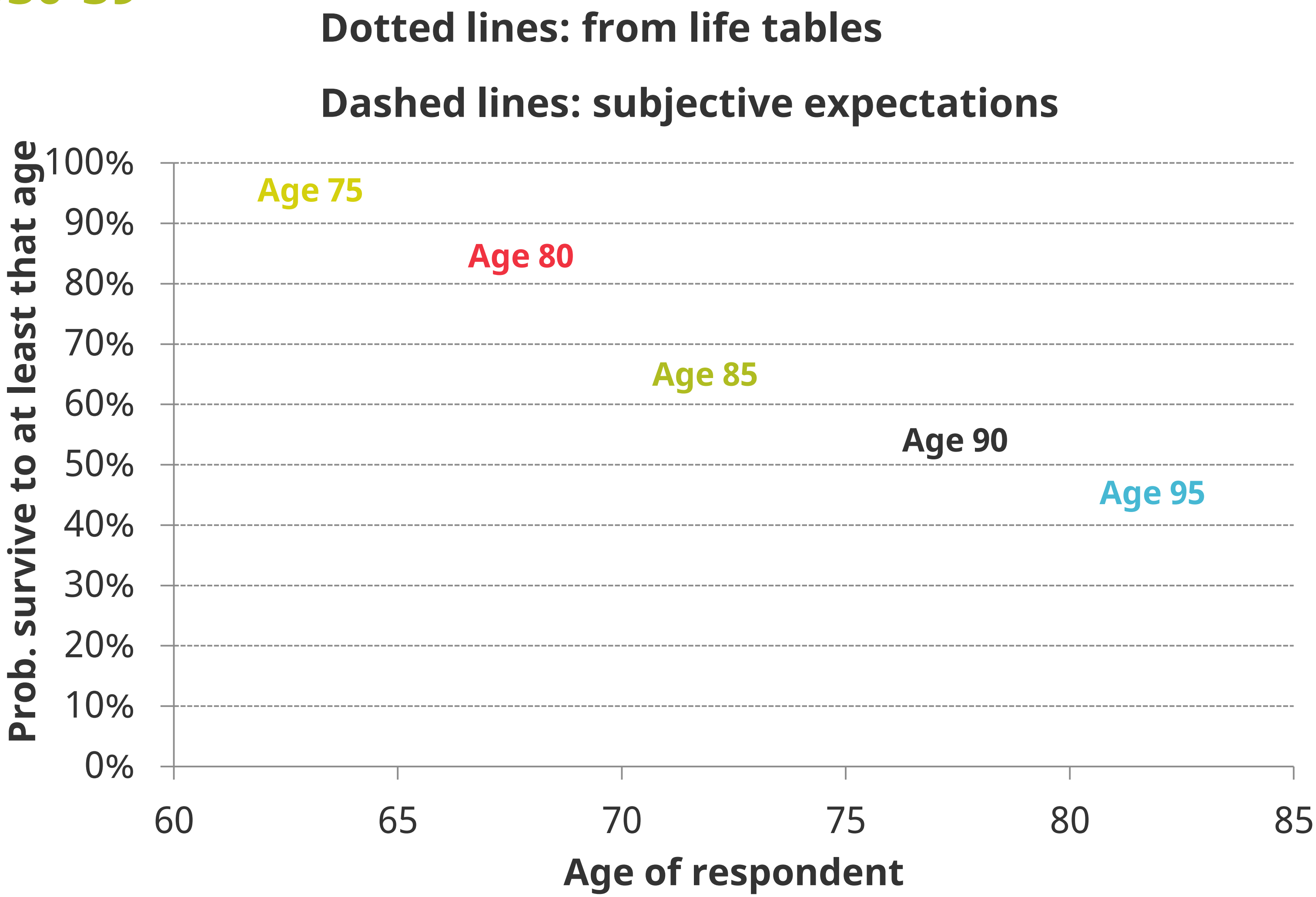
- How much to save for retirement?
- When will they retire?

But estimating your own life expectancy is very difficult

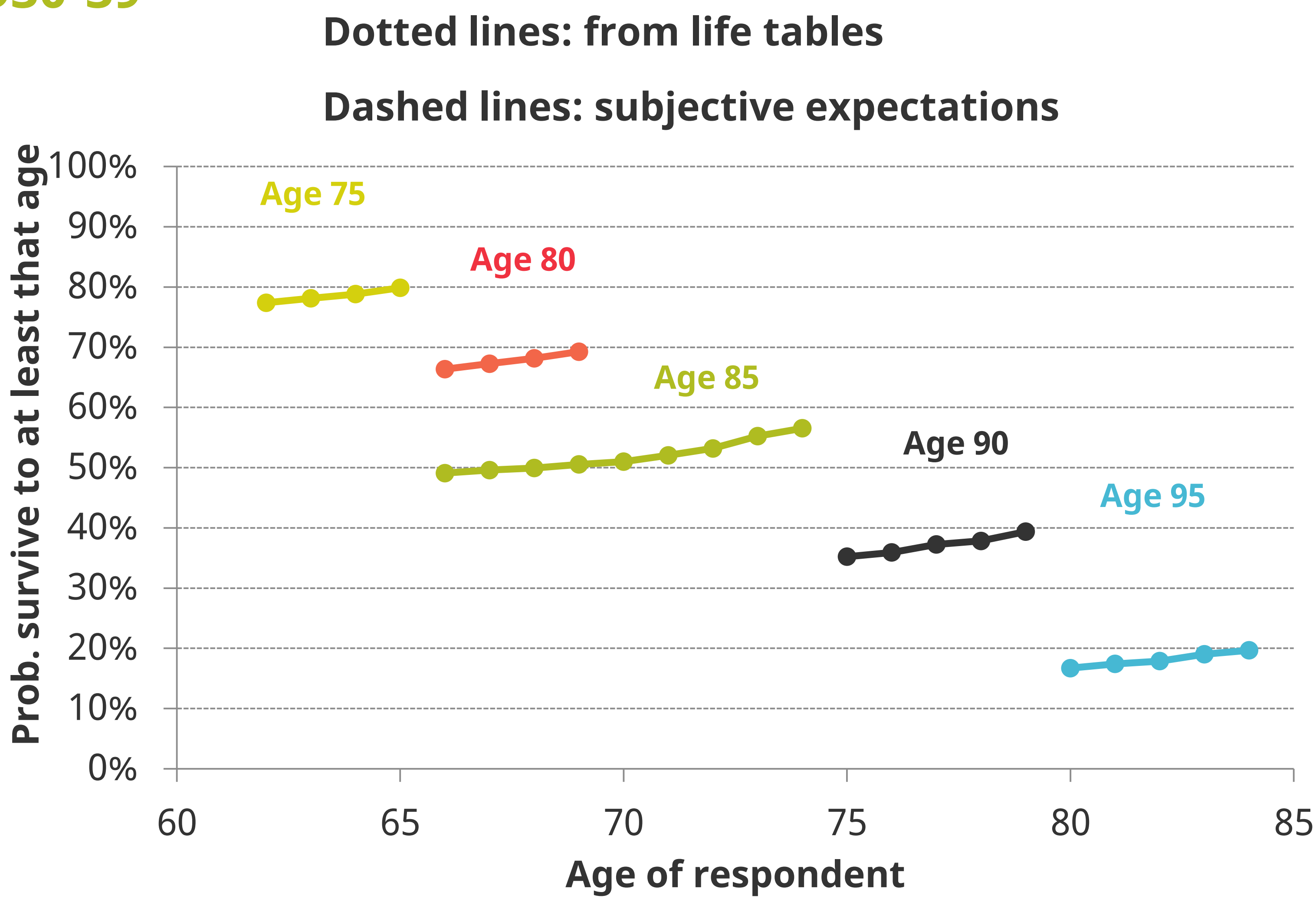
- Unrealistic expectations about chances of survival will make it difficult to plan well for retirement

IFS research has compared "subjective" expectations of surviving to given ages and "objective" measures from life tables

Survival expectations and rates for men, born 1930-39



Survival expectations and rates for men, born 1930-39



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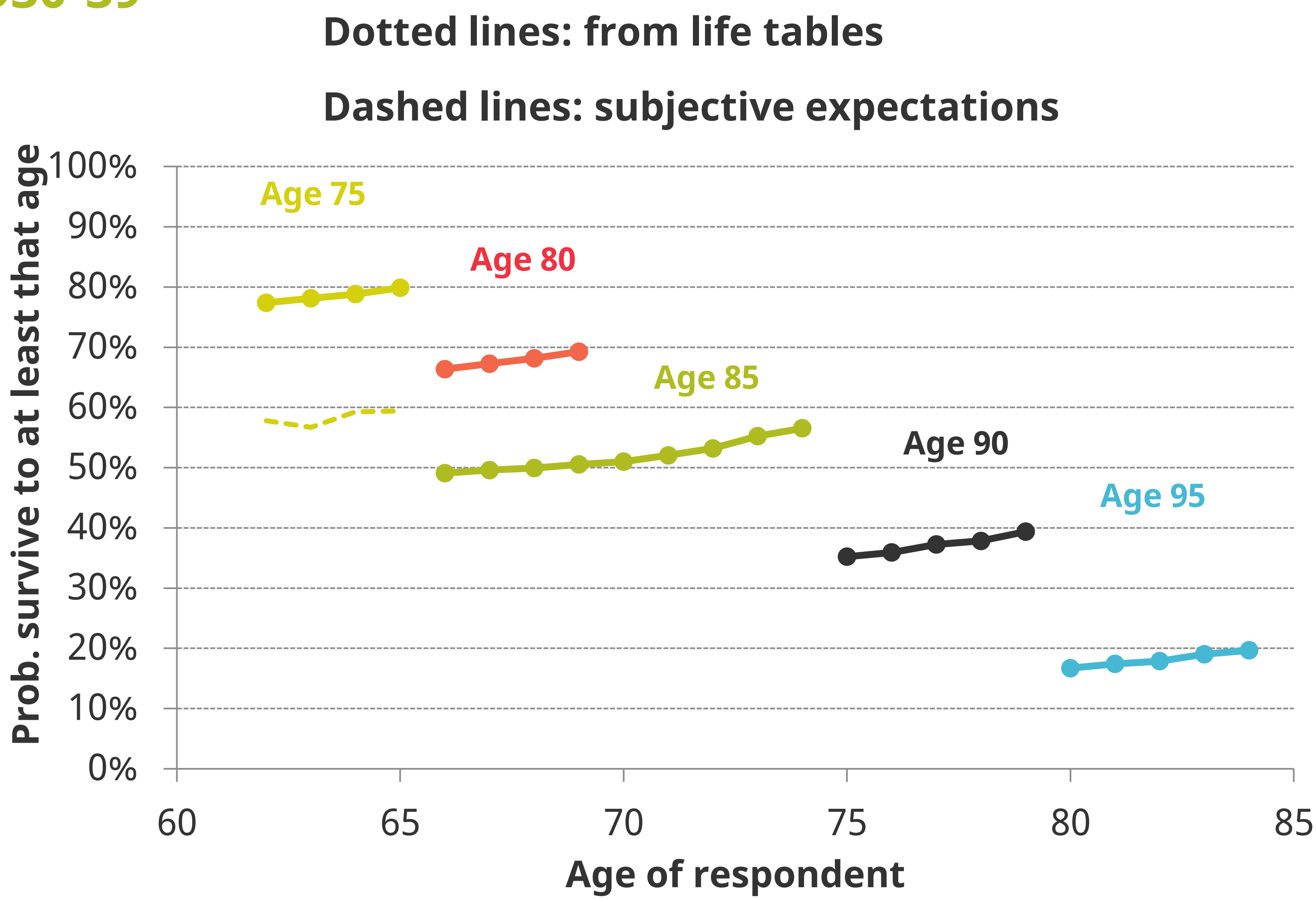

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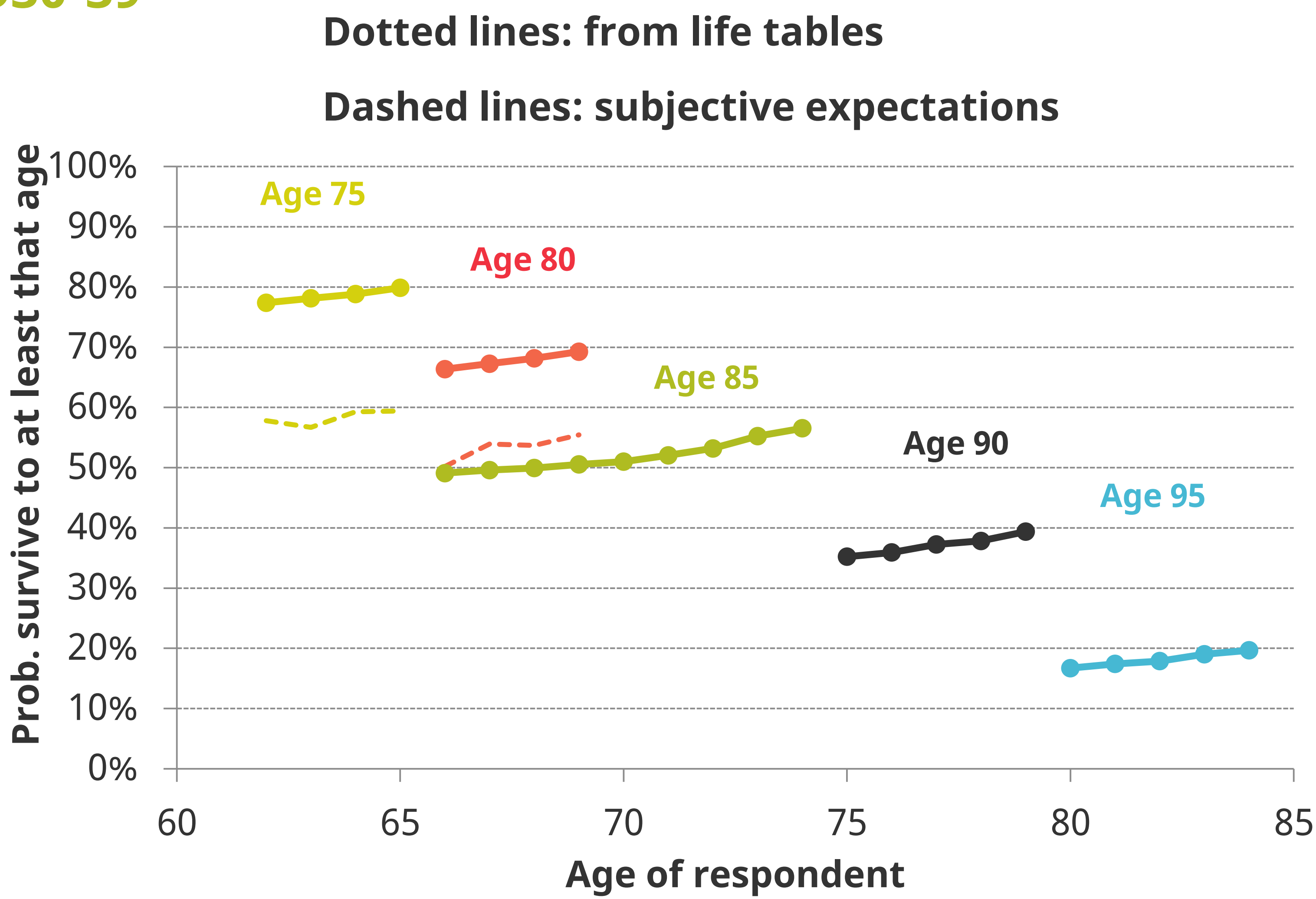

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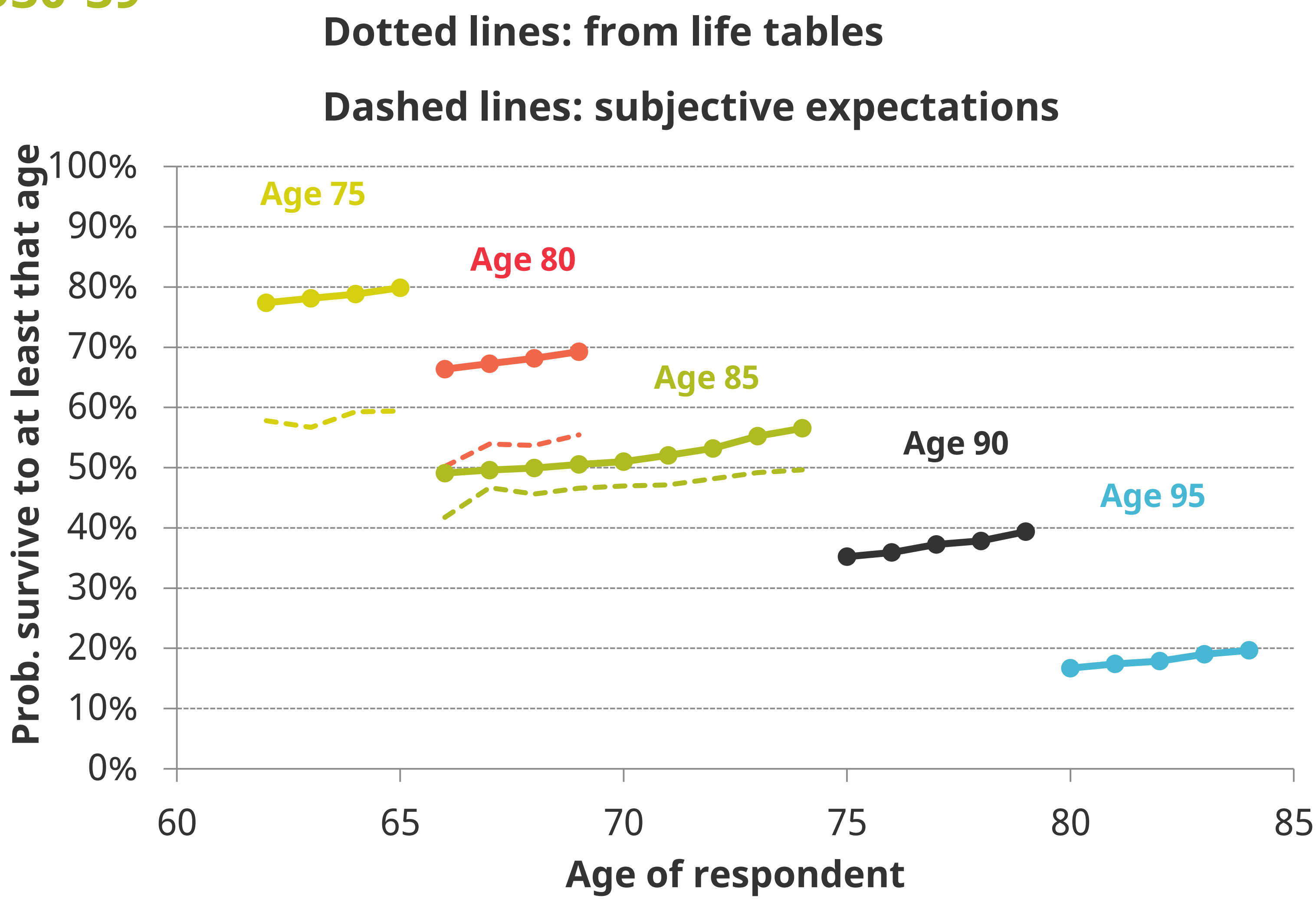

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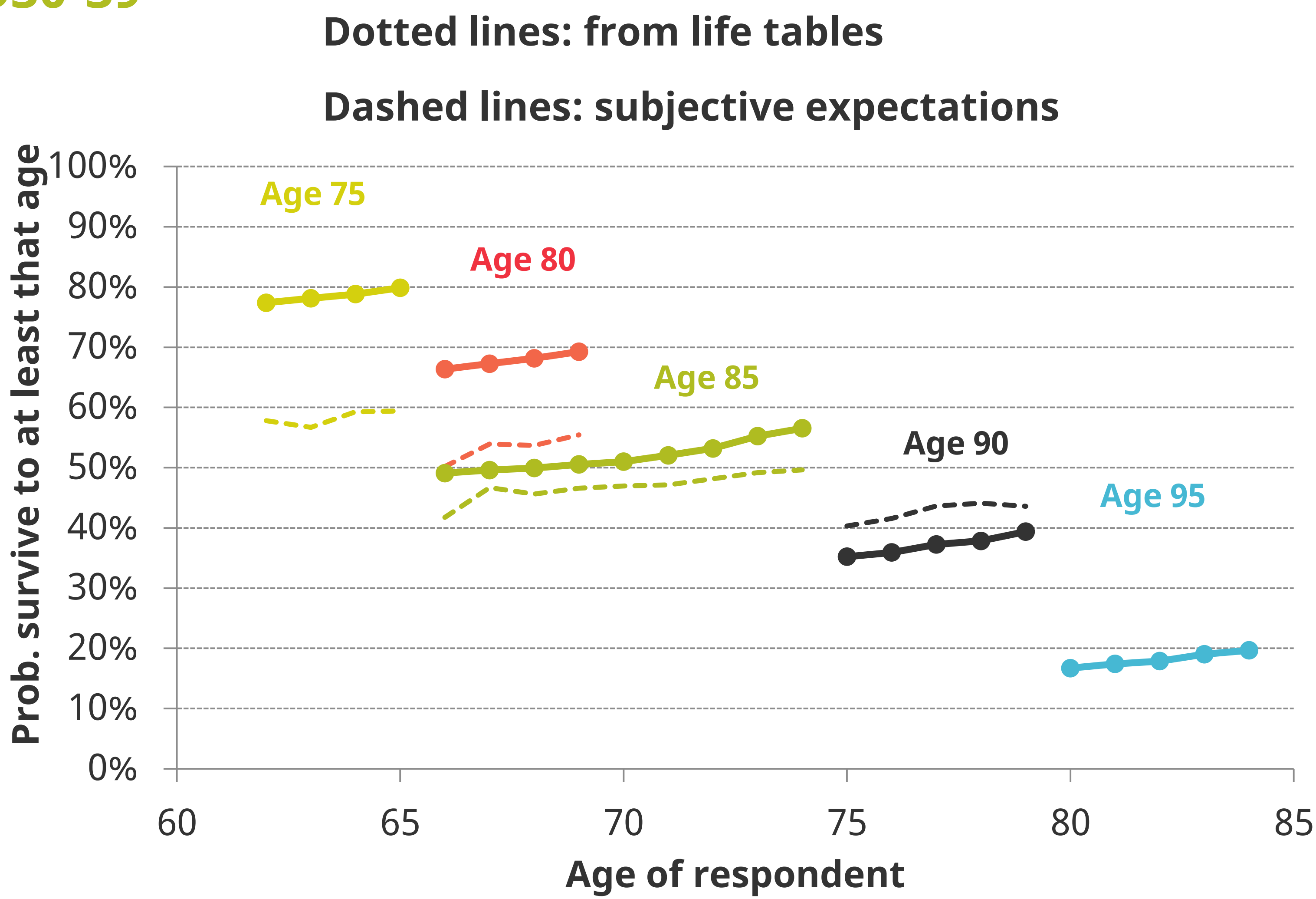

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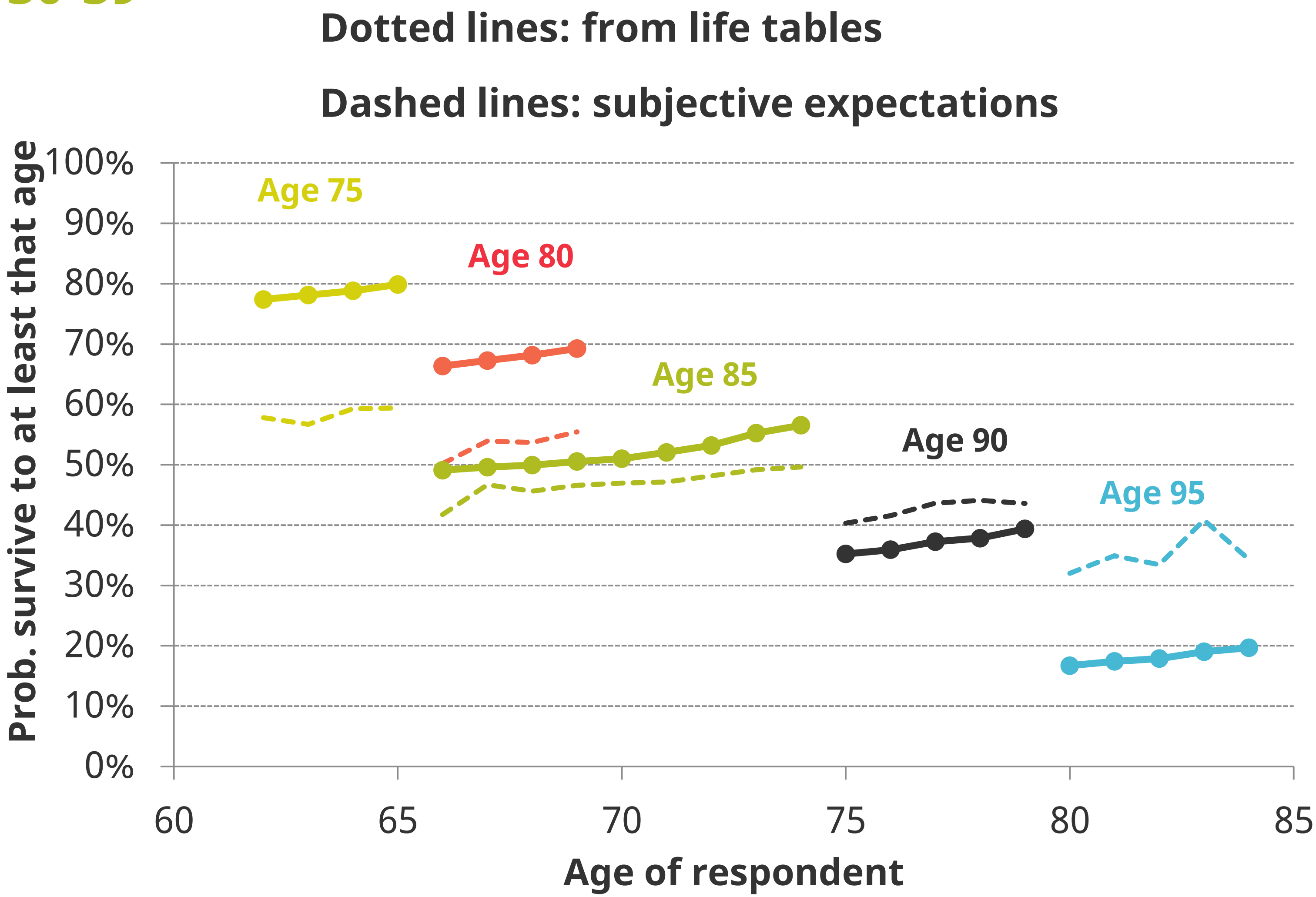

Implications of biased expectations

Subjective expectations of survival show systematic biases

- Significant survival ‘pessimism’ about surviving until 70s and early 80s
- Over optimistic about survival to very oldest ages

Concerns about savings for retirement and spending at older ages

- Pessimism may mean ‘too low’ saving & ‘too fast’ spending in 60s/70s
- Optimism at oldest ages may mean over-reluctance to spend

Survival pessimism could explain unpopularity of annuities

- Around two thirds of individuals could view an ‘actuarially fairly’ priced annuity as offering an unfairly low rate

Four things we have learned so far

1) Younger generations have lower wealth than older generations did at similar ages.

2) Automatic enrolment massively boosts pension participation. Mostly at very low contribution rates, but some with larger contributions.

3) Automatic enrolment boosts coverage by different amounts for different groups. And also boosts participation among "ineligibles".

4) Many people are not good at estimating their life expectancy.

Four questions for the future

1) **Will lower rates of homeownership persist, and what are their implications for retirement resources?**

2) **How could automatic enrolment work for those working for their own business (i.e. self employed)? And would it be a good thing for them?**

3) **How high should government set minimum contributions? Will they have to trade off higher contributions with lower participation?**

4) **To what extent do individuals have the information they need to make good plans for their retirement?**

The use of wealth in retirement: evidence and implications

Rowena Crawford

What did we know?

Older households, on average, hold a lot of wealth

- Among those aged 55-64 (i.e. on the eve of retirement):
  - Median household non-pension wealth £250,000
  - 60% primary housing, 22% financial assets, 11% other property
  - Very unequal: least wealthy 10% have nothing on average, most wealthy 10% have on average in excess of £1m

What did we know?

Older households, on average, hold a lot of wealth

Individuals expect to use many sources to provide retirement income

Expected sources of money in retirement

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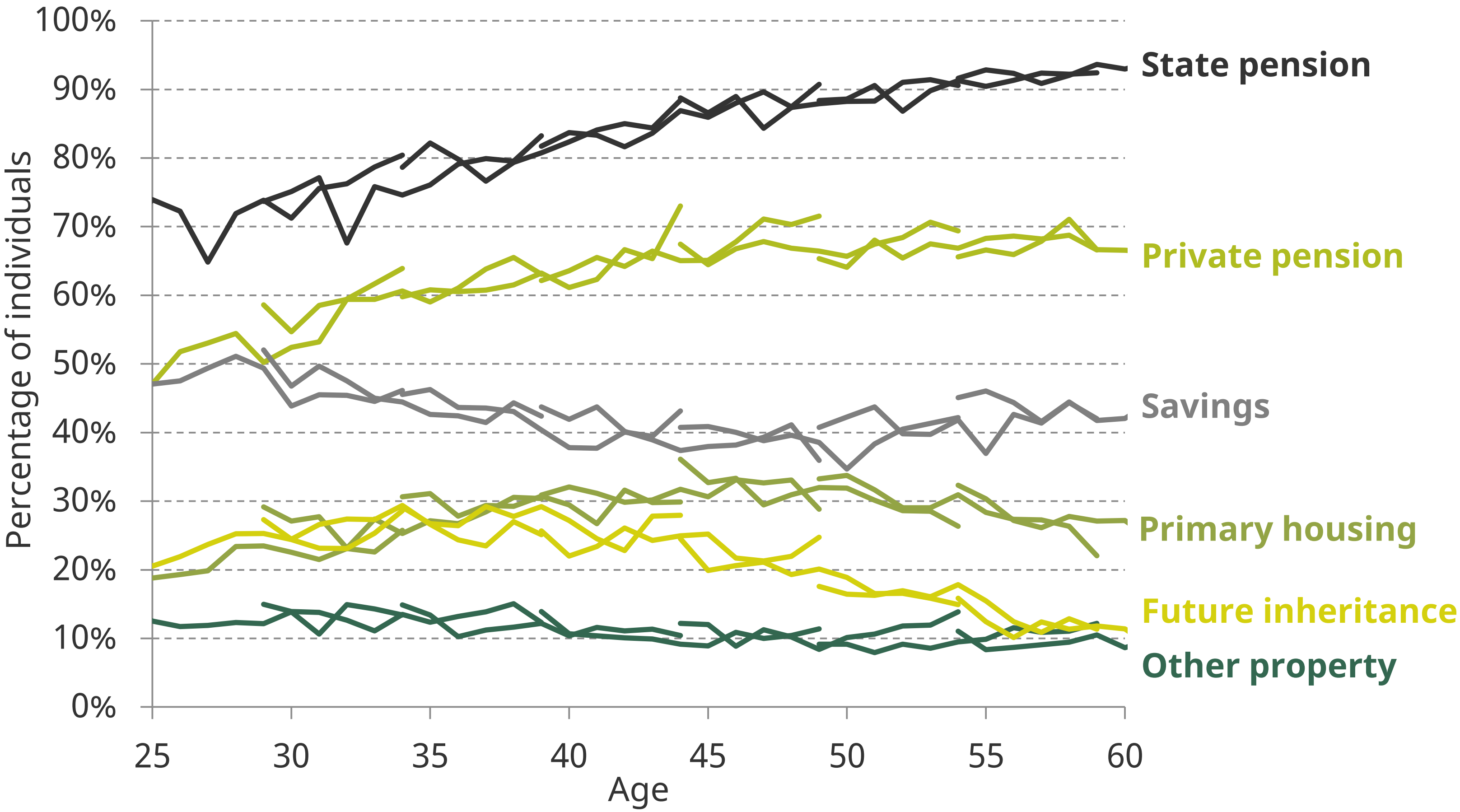


Notes: Lines are drawn for 5-yr date-of-birth cohorts. Calculated using Wealth and Assets Survey waves 1-5
Source: 'The use of wealth in retirement', IFS Briefing Note 237, Figure 2

What did we know?

Older households, on average, hold a lot of wealth

Individuals expect to use many sources to provide retirement income

Q: How do individuals currently draw on their wealth in retirement?

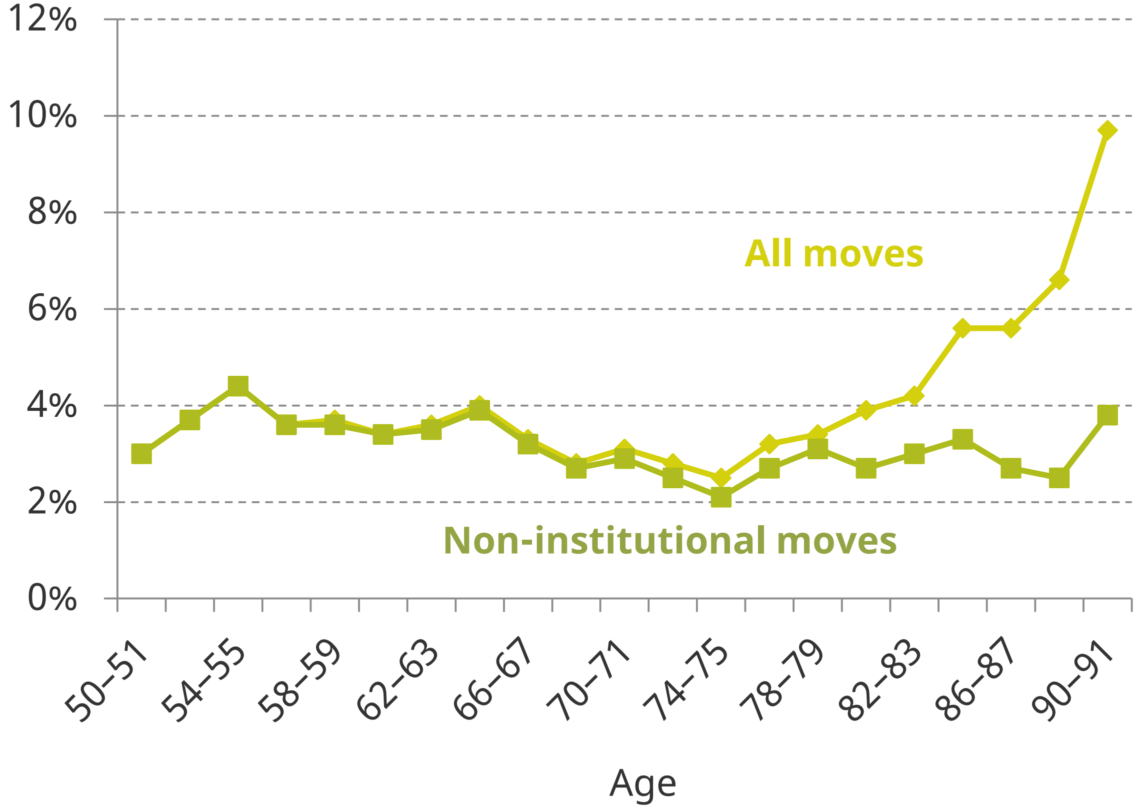
We studied this question using data from the English Longitudinal Study of Ageing (ELSA)

- Repeated observations of the same individuals over time
- Data covers the period 2002/03 to 2014/15
- Some follow-up interviews with proxies after individuals' death

Use of primary housing wealth

How common is moving among home owners?

Proportion who move over the next two years:



Cumulating over retirement suggests…

of owners at age 50:
⅓ would move by age 70
over ½ would move by age 90

weighted by life expectancy
40% would move before death

Source: 'The use of housing wealth in retirement', IFS Briefing Note 235, Figures 3 and 4.

Are people releasing housing wealth?

Moves out of owner occupation?

- 77% of moves (83% of non-institutional moves) are to another owner occupied property
- Current trends suggest 14% of home owners at age 50 would move out of owner occupation before death

‘Downvaluing’?

- On average those who move within owner occupation do release some housing wealth - amounts (£ and %) increasing with age
- Financial situation strongly correlated with ‘downvaluing’
  - Those with the lowest financial wealth access more housing wealth when move, as do those with greatest housing wealth to income ratio

Taken together, perhaps around two-thirds of moves release some (but not necessarily much) housing wealth

Implications

For the time being most housing wealth looks set to be bequeathed

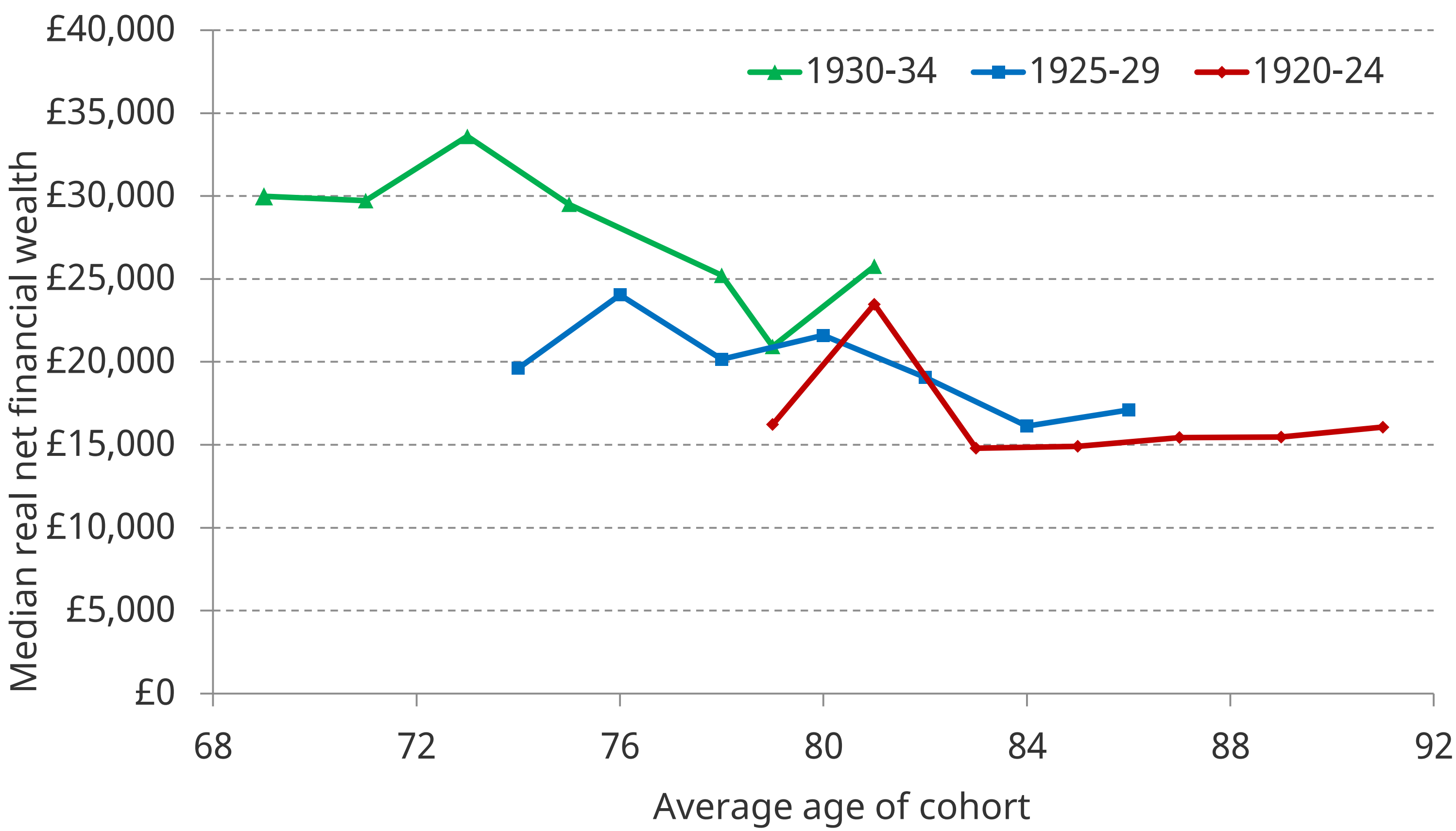
Findings suggest individuals are prepared to access housing wealth

Might expect accessing of housing wealth to increase in future

- Greater proportion of working-age expect to downsize than the proportion of current retirees reporting moving for financial reasons
- If future generations have less pension saving then they may be more likely to release wealth, or release more wealth, when they move

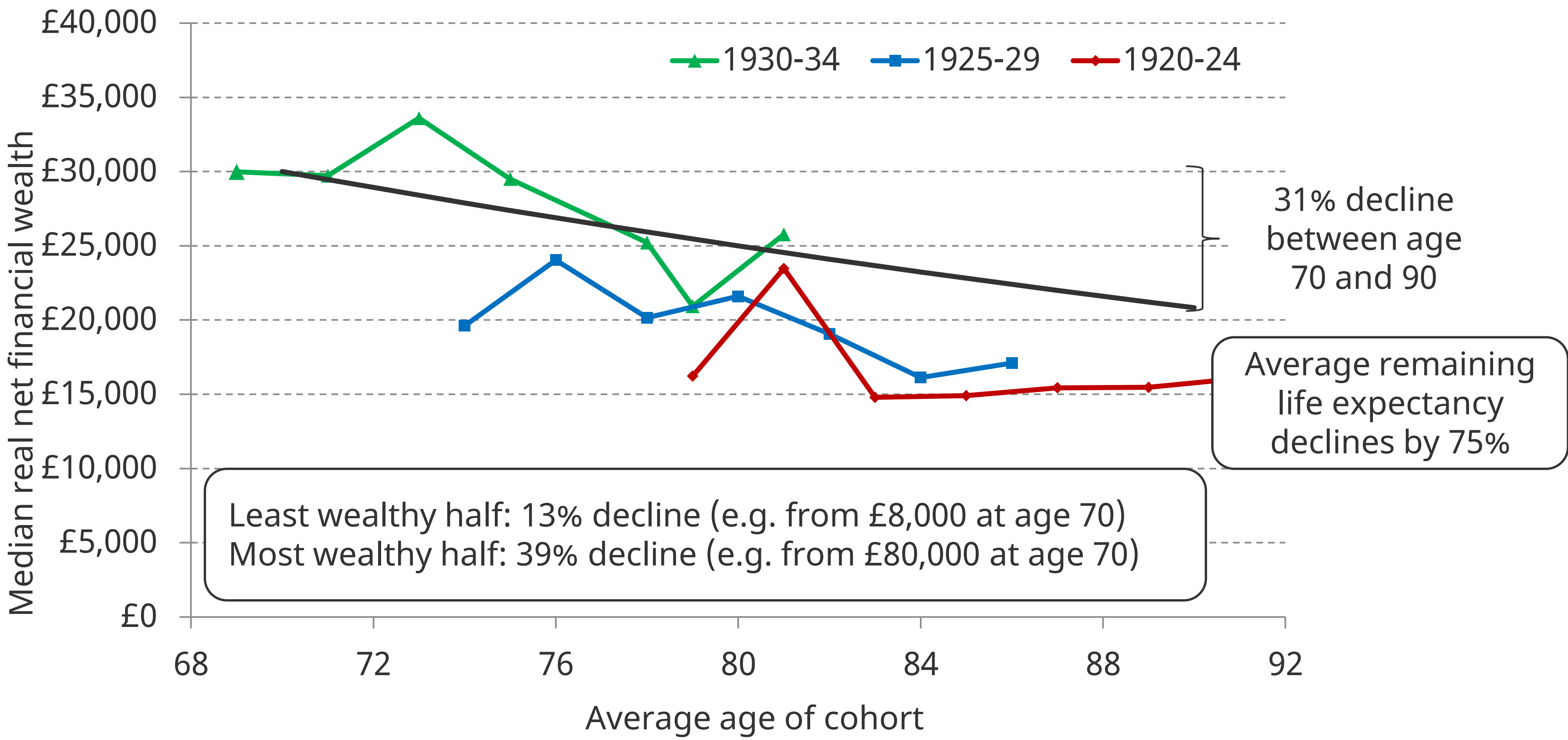
Use of financial wealth

Trajectory of financial wealth in retirement



Notes: Sample stays the same within each line. Each point represents data from a particular wave of ELSA, average wealth plotted against average age for each 5-yr birth cohort.
Source: 'The use of financial wealth in retirement', IFS Briefing Note 236, Figure 3

Trajectory of financial wealth in retirement



Notes: Sample stays the same within each line. Each point represents data from a particular wave of ELSA, average wealth plotted against average age for each 5-yr birth cohort.
Source: 'The use of financial wealth in retirement', IFS Briefing Note 236, Figure 3

Implications

Majority of financial wealth looks set to be bequeathed rather than spent in retirement

Lack of drawdown of financial wealth does not necessarily imply current retirees are making “bad” choices

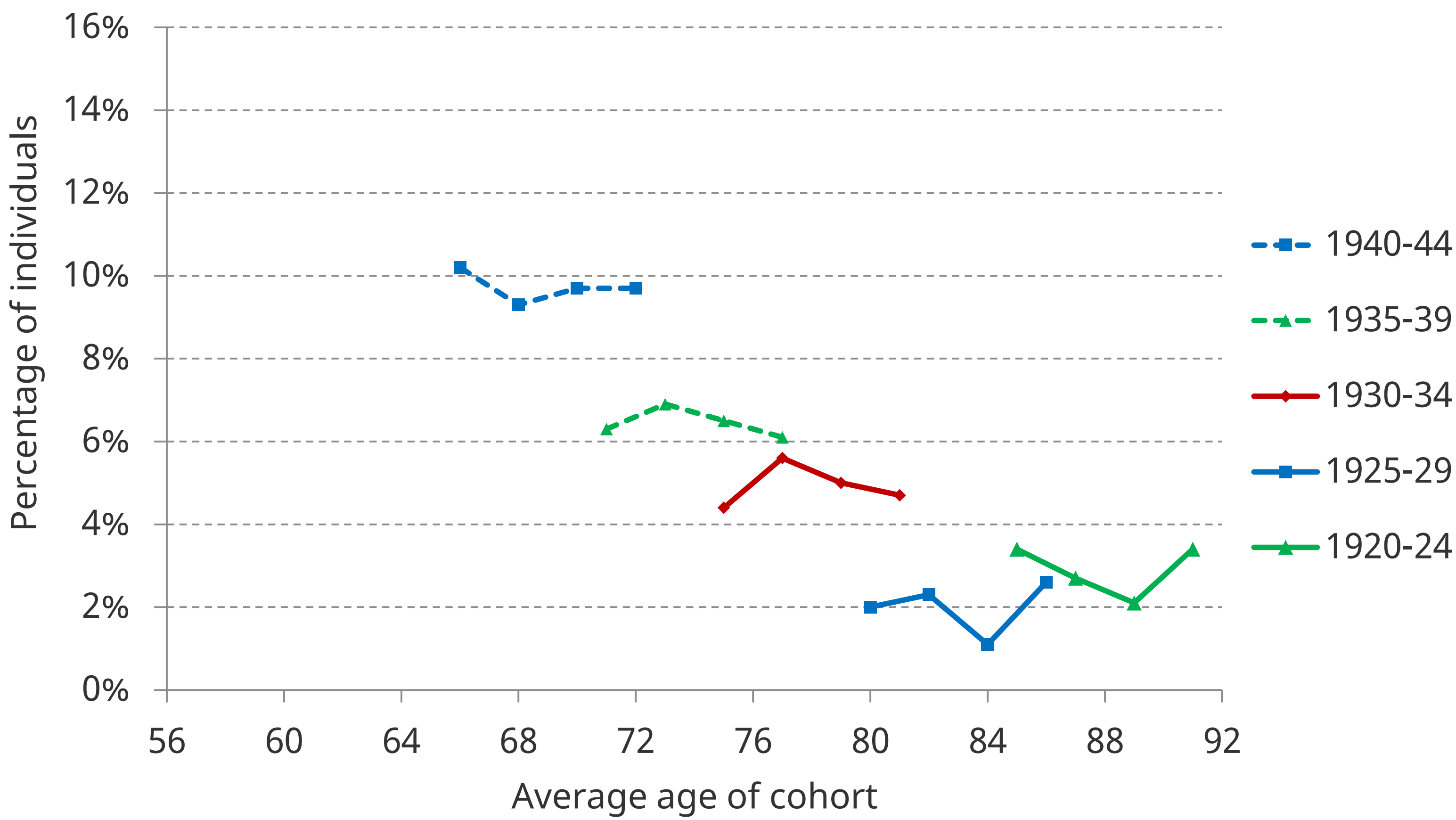
- Likely largely driven by precautionary saving and bequest motives
- But could indicate an adverse effect of low public provision of social care and lack of private insurance

Does not necessarily mean future generations do not need to accumulate so much

- Could IF driven by bequest motives and future generations have smaller desire to leave money to children

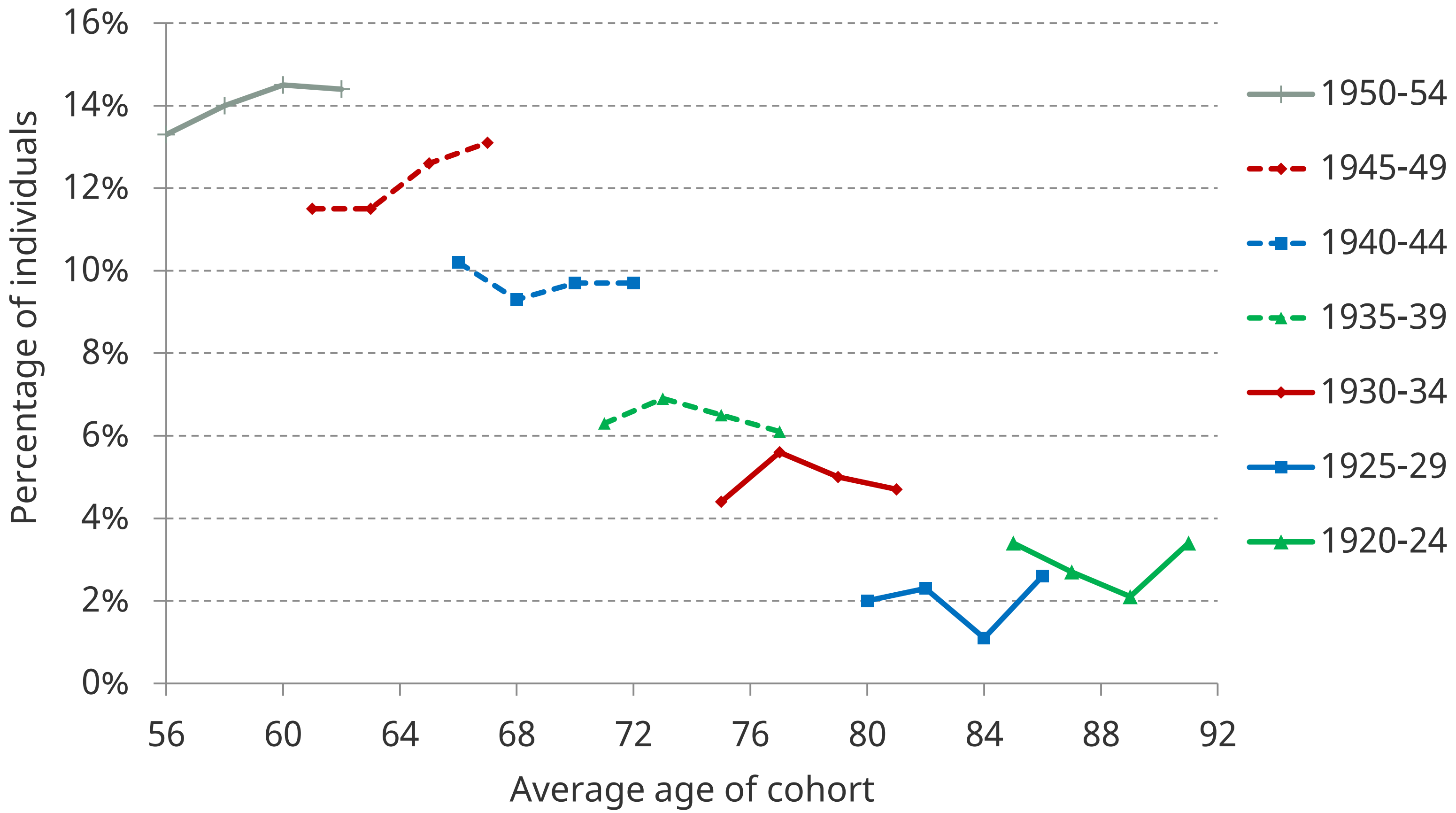
Use of other property wealth

Prevalence of second home ownership



Notes: Calculated using ELSA 2008-09 to 2014-15. Excludes properties worth less than £50,000.
Source: 'The use of wealth in retirement', IFS Briefing Note 237, Figure 5

Prevalence of second home ownership



Notes: Calculated using ELSA 2008-09 to 2014-15. Excludes properties worth less than £50,000.
Source: 'The use of wealth in retirement', IFS Briefing Note 237, Figure 5

Prevalence of second home ownership

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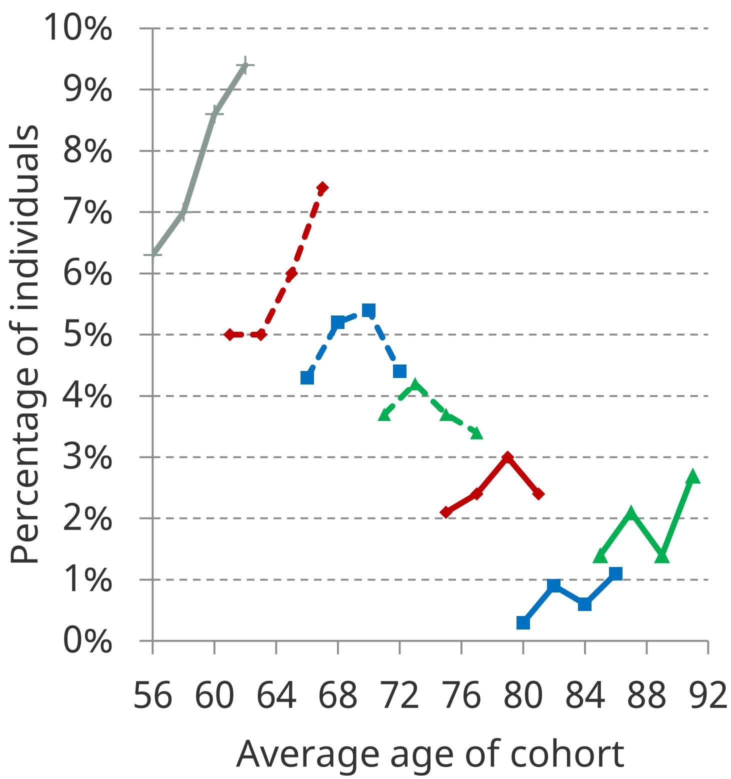
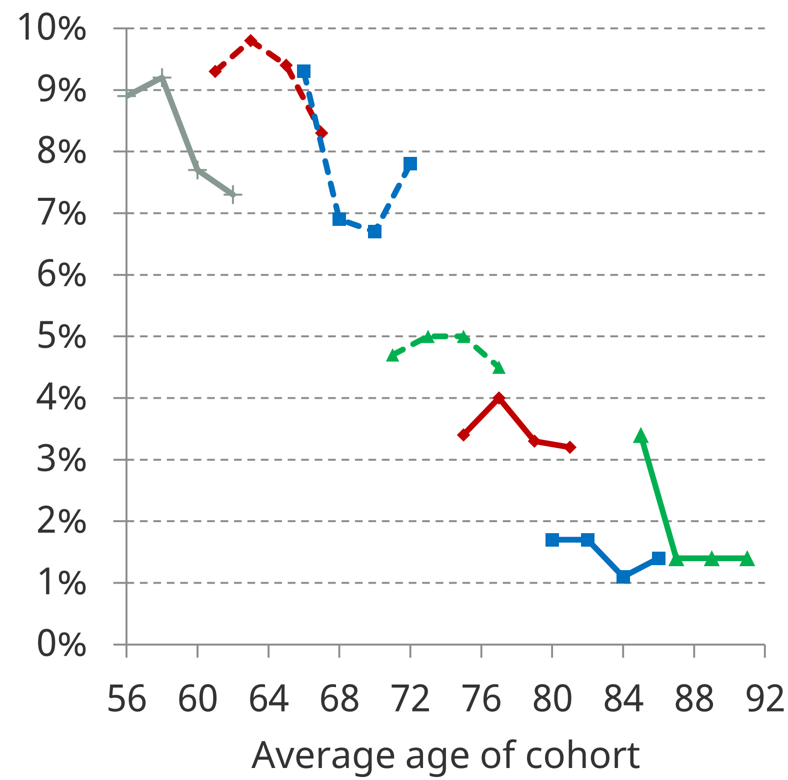
Receives income or rent from property:



Does not receive income or rent:



Source: 'The use of wealth in retirement', IFS Briefing Note 237, Figure 5

Implications

Second homes (even non-income yielding ones) held at ages 70+ are not generally being sold to finance retirement

Differences in prevalence between generations

- With higher level of ownership, selling to fund retirement could be more common

End-of-life expenses and bequests

End-of-life expenses and bequest behaviour

Do not appear to be large end-of-life expenses that would use up remaining wealth holdings of most individuals

- 7% of deceased individuals received assistance with daily activities from a privately paid employee in the run up to death
- 21% stayed in a nursing home in the last two years of life
  - 32% of whom for 6 months or more
- Median out-of-pocket cost for funeral expenses only £1,700 in 2002-03

Bequests are normally made to multiple recipients

Inheritances are likely to be received at relatively older ages

- Bequests typically only made when last partner in a couple dies
- Majority of cases do not see inheritances given directly to grandchildren

Summary

What we know now

Retired individuals did not draw on their wealth much over the period 2002-03 to 2014-15

- Two-fifths of home owners at 50 projected to move before death
- Moves rarely motivated by financial reasons, but do on average release some wealth
- Financial wealth (even among the wealthy) drawn down much slower than decline in (expected) remaining life
- Prevalence of second home ownership at ages 70+ pretty stable

Not, in general, big expenses associated with death

Bequests normally made to multiple individuals, and only when no surviving partner

Overall implications

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Most wealth held by current retirees looks set to be bequeathed

- Implications for the level and distribution of resources among current working age individuals
- Though inheritances likely to be (directly) received at relatively older ages

Can this shed light on likely responses to pension freedoms?

- Behaviour with respect to main pension resource could be different to current use of liquid financial wealth
- Results likely to provide more reassurance to those worried about spending too quickly than those worried about spending too slowly

Careful monitoring of how the use of wealth evolves in future important

- For the living standards of <u>both</u> retirees and younger generations

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WIFI: RICS Guest network (no password required)

Panel discussion

Given the current policy context, what are the key challenges for government, the pensions industry and individuals in trying to ensure decent retirement outcomes?

- John Godfrey

  Corporate Affairs Director at Legal and General, former head of Downing Street Policy Unit
- Professor John Hills

  London School of Economics, and former Pensions Commissioner
- Laura Webster

  Chief Economist and Lead Analyst for Private Pensions, Department for Work and Pensions

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