

# The use of financial wealth in retirement

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# Executive summary

In this briefing note, we examine how individuals' financial wealth evolves as they age through retirement. We do so using data from the English Longitudinal Study of Ageing – a large-scale survey of the private household population of England aged 50 and over, that has interviewed the same individuals every two years since 2002–03. We can therefore examine changes in wealth for the same individuals over time (for up to 12 years) and examine how changes in wealth vary according to individuals' characteristics.

## Key findings

**Financial wealth is, on average, drawn down only slowly.**

Over the 12-year period 2002–03 to 2014–15, among those born in 1930–34 (who aged from 69 to 81 on average), median real net financial wealth declined by 14%. Among those born in 1925–29 (who aged from 74 to 86 on average), it declined by 13%. And for those born in 1920–24 (who aged from 79 to 91 on average), it declined by just 1%. In each case, these declines in financial wealth are slower than the fall in remaining life expectancy. In other words, each cohort's average financial wealth *per expected year of remaining life* increased with age.

**Current patterns of behaviour suggest that, on average, net financial wealth may decline by less than 31% between ages 70 and 90.**

If the rate of drawdown at a given age does not differ between generations, observed behaviour over the 2002–03 to 2014–15 period suggests that, on average, real net financial wealth is drawn down by 17% between ages 70 and 80 and by 31% between ages 70 and 90. This suggests that the majority of financial wealth held by retired generations is likely to be bequeathed, rather than used to fund consumption in retirement.

**The rate of drawdown of financial wealth is greater among those with higher levels of wealth.**

Recent behaviour suggests a reduction in wealth of 39% on average between ages 70 and 90 among the wealthiest half of individuals, and a decline of 13% on average among the least wealthy half.

**We cannot say whether this slow decline in financial wealth represents 'optimal' behaviour.**

We cannot say whether individuals are making the correct trade-off between their consumption in retirement, saving to cover the risk of unexpected expenses, and the bequests they leave on death (all of which are presumably valued to some extent), or whether there are some constraints (such as imperfect information, limited numerical ability or poor financial acuity) that is causing individuals to make poor decisions.

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**There are systematic differences in the rate at which financial wealth is drawn down according to individuals' characteristics and circumstances.**

Financial wealth, income, owner-occupation, holding other property wealth, numeracy, health and expectations of future long-term care expenses are all associated with the rate at which financial wealth declines in retirement. This suggests that precautionary saving, bequest motives and financial acuity may all play a role in individuals' choices.

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**Greater financial resources are associated with lower rates of financial wealth drawdown.**

Estimates suggest that (all else equal) each additional £10,000 of financial wealth is associated with a 1 percentage point greater decline in wealth over six years. Individuals with higher incomes on average spent their financial wealth less rapidly – an additional £1,000 per year is associated with a 0.2 percentage point smaller decrease in wealth over six years. We also find that those with property wealth other than a primary residence use their financial wealth less rapidly than those without (for a given level of financial wealth).

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**Expectations of paying for social care in future are associated with a slower rate of wealth drawdown.**

Those reporting zero chance of having to pay for long-term care in future saw a 14 percentage point greater decline in their wealth, on average, than those reporting a 1–49% chance. Those reporting a 50% or greater chance saw, on average, a 4 percentage point smaller fall in their financial wealth than those reporting a 1–49% chance. We cannot prove this is a causal relationship, but these results lend more support to the idea that, on average, individuals are holding on to their wealth in order to pay for social care, than to the idea that individuals are spending down their wealth in order to be eligible for state support.

These findings have implications for the debate around the adequacy of younger generations' accumulation of resources, both directly (through the inheritances they are likely to receive) and indirectly (through how concerned we are about younger generations not accumulating as much wealth as previous generations).

Going forwards, it will be important to continue to assess how individuals' use of wealth in retirement evolves, both as the freedom to access accumulated pension wealth becomes more established and as younger generations reach retirement with different portfolio compositions and likely smaller overall levels of resources.

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# 1. Introduction

In recent decades, pensions policymakers have focused almost entirely on the accumulation phase of saving for retirement, questioning whether individuals are saving enough for retirement and how recent reforms have affected that picture.<sup>1</sup> Recently, the debate has also expanded to include the question of ‘how much is “enough”’.<sup>2</sup> However, to date, much less attention has been paid to the way in which people use their accumulated resources in retirement. This is an important omission.

There are at least four reasons why understanding more about how individuals use their wealth in retirement would be extremely valuable. First, many commentators judge the adequacy of current working generations’ saving behaviour by comparing it (explicitly or implicitly) with the levels of pensions and wealth accumulated by now-retired generations. However, one might think about the appropriateness of that benchmark differently if current pensioners held on to all of their wealth until death, compared with if current pensioners spent their accumulated wealth over their remaining lifetimes. The argument that working-age individuals need to accumulate similar levels of wealth and pensions to current pensioners if they want to maintain their living standards in retirement is much stronger in the latter case. If current pensioners do not spend all their wealth, then the relative strength of bequest motives (and other reasons for saving at older ages) between generations is also important in the ‘how much is enough’ debate.

Second, greater understanding of how current retired generations are using their wealth is needed to estimate the likely bequests that will be given in future – in other words, to predict the likely inheritances that younger generations can expect to receive. Recent research has shown that the majority of individuals in younger generations expect to receive an inheritance, and that those born in the 1960s and 1970s are likely to be reliant on inherited wealth if they are to be any better off in retirement than their predecessors.<sup>3</sup> However, the accuracy of expectations formed on the basis of parents’ current wealth levels depends very much on how parents spend down their wealth over their remaining lifetimes relative to what their children expect. And again, the size and distribution of future inheritances will have important implications for how adequately younger generations are deemed to be preparing financially for later life.

Third, thinking about the retired generations themselves, there is interest in how well prepared individuals are to face the expense risks that they face in later life. Some risks are the same as in working life (e.g. home repairs), but health expense risks – namely, long-term care costs – are pertinent in later life, and particularly at very old ages. The government only funds long-term care for those with high needs, low income and low wealth, and therefore the majority of individuals with care needs would need to pay for any assistance services themselves. Understanding more about how individuals in different circumstances spend down their wealth could be informative about the extent to which individuals’ behaviour is affected by such expense risks. This is of particular interest to policymakers at the moment, given the upcoming Green Paper on potential reforms to the structure of government funding for social care.

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<sup>1</sup> See recently, for example, Department for Work and Pensions (2017), Finch and Gardiner (2017) and Pensions Policy Institute (2018).

<sup>2</sup> See, for example, Pensions and Lifetime Savings Association (2017).

<sup>3</sup> Hood and Joyce, 2013 and 2016.

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Finally, the introduction of ‘pension freedoms’ from April 2015 has given individuals greater flexibility over how they use their accumulated defined contribution pension savings in retirement. There is considerable debate over the way individuals will behave in response, with some concerned that people will spend all their savings quickly and run out of resources towards the end of retirement, while others are concerned that people will be too cautious and have unnecessarily low living standards because they do not spend their wealth quickly enough. It will be several years before data are available that reveal how individuals are responding, and even longer before such data are available for generations among whom defined contribution pension saving is the main source of retirement income. In the meantime, examining how individuals use their financial wealth in retirement (i.e. their existing liquid wealth) will shed some light on how well people manage their resources through retirement.

This briefing note therefore examines the important question of how do retired individuals use their accumulated resources in retirement. We focus on financial wealth holdings – another IFS briefing note summarises analysis examining the use of primary housing wealth at older ages.<sup>4</sup> We answer this question using data drawn from the English Longitudinal Study of Ageing (ELSA).<sup>5</sup> This is a survey of the private household population of England aged 50 and over, that has interviewed the same individuals every two years since 2002–03. We can therefore examine changes in wealth for a particular group of individuals over time (for up to a 12-year period), and examine the extent to which changes in wealth vary across individuals with different characteristics and in different circumstances.

This briefing note proceeds as follows. In Section 2, we briefly describe financial wealth holdings for those on the eve of retirement, in order to provide context on the level, composition, distribution and relative importance of this component of household wealth. In Section 3, we present the results of our main analysis on how financial wealth evolves as retired individuals age. In Section 4, we examine how the changes in wealth vary across individuals with different characteristics and circumstances. In Section 5, we conclude and draw out the policy implications of this analysis.

The main findings of this briefing note are brought together with the main findings of work examining the use of other components of wealth (primary housing wealth and other property wealth) at older ages in a summary piece.<sup>6</sup>

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<sup>4</sup> Crawford, 2018a.

<sup>5</sup> Marmot et al., 2017.

<sup>6</sup> Crawford, 2018b.

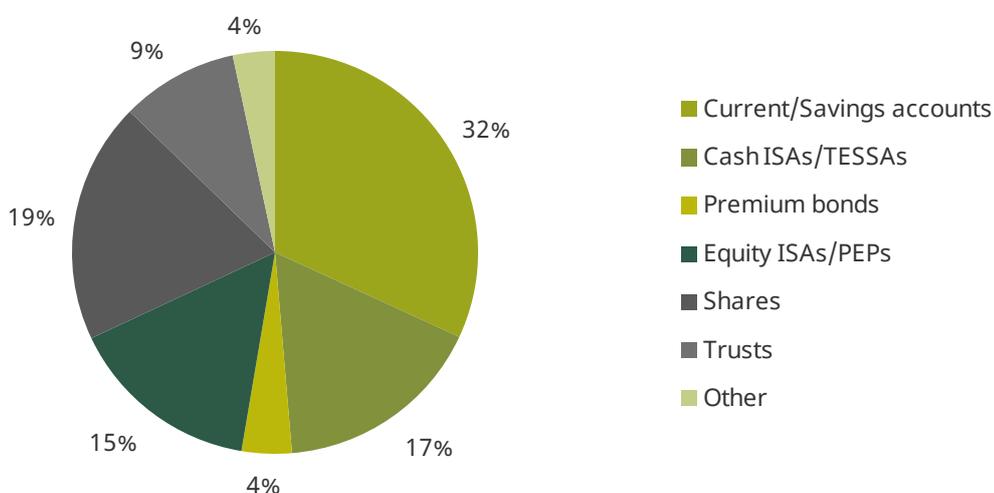
## 2. Financial wealth holdings

In this briefing note, we focus on the use of 'net financial wealth' through retirement. Net financial wealth is defined as total savings (e.g. current and savings accounts, cash ISAs) and investments (e.g. shares, bonds, investment ISAs) less financial debt (e.g. credit cards, loans). Our analysis is conducted at the individual level – in that we follow individuals over time, and examine the association between wealth and individuals' own characteristics – but we measure wealth at the household level. This is because many couples operate as one financial unit, and wealth is not identified as being held by any one particular individual. We do not 'equalise' wealth (e.g. by dividing by 2 and describing wealth per person), so that changes in wealth over time only reflect changes in the stock of wealth, and not changes in household composition. Throughout, we deflate wealth by consumer price inflation, with all reported figures in 2015 prices. We are therefore in effect examining the change in purchasing power of wealth holdings over time.

Before we describe the evolution of financial wealth in retirement, we start by giving some context on the level, composition, distribution and relative importance of this component of wealth. Among those aged 55–64 (i.e. approaching retirement) in 2014–15, median household net financial wealth was around £21,000 and the mean was around £84,000. Mean gross financial wealth was around £87,000 and mean financial debt around £2,000. The composition of gross financial wealth among this group is shown in Figure 1. For the group as a whole, around half is held in non-risky cash savings (current and savings accounts and cash ISAs) and around half in more risky financial assets. One-fifth is held in shares and 15% is held in equity ISAs.

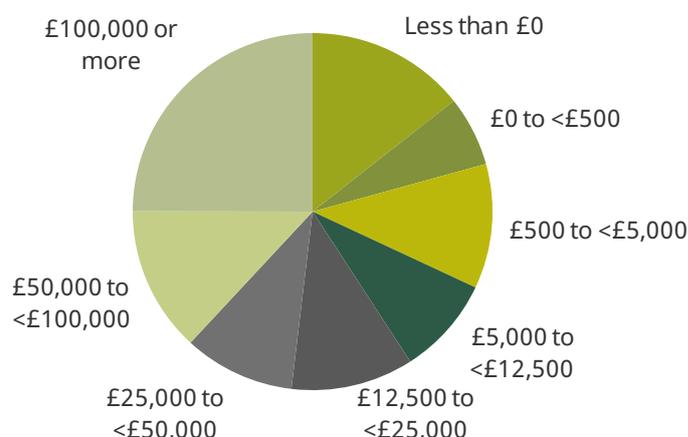
It is important to note, however, that financial wealth is held very unequally. The distribution of net financial wealth among those aged 55–64 is shown in Figure 2. 14% of individuals are in households with negative net financial wealth, and a further 6% have less than £500. Only 48% of individuals are in households that have £25,000 or more. But at the other end of the spectrum, some individuals have considerable wealth holdings – nearly a quarter are in households with £100,000 or more.

**Figure 1. Composition of gross household financial wealth, 55- to 64-year-olds in 2014–15**



Note: Sample = 2,334. Weighted using cross-sectional weights.

**Figure 2. Distribution of real net household financial wealth, 55- to 64-year-olds in 2014-15**



Note: Sample = 2,334. Weighted using cross-sectional weights. Figures are in 2015 prices.

**Table 1. Share of wealth held in financial assets among 55- to 64-year-olds, by wealth**

	Share of total wealth held in:			Mean financial wealth	Mean total wealth
	Financial wealth	Primary housing	Other property		
Least wealthy	21%	75%	2%	5,166	25,125
Quartile 2	11%	87%	1%	18,721	176,206
Quartile 3	19%	74%	5%	66,758	348,091
Wealthiest	25%	50%	15%	246,817	992,073
All	22%	60%	11%	84,329	385,177

Note: As for Figure 2. Total wealth excludes pensions. Wealth is measured at the household level. Quartiles are constructed at the individual level, for individuals aged 55-64 in 2014-15.

On average among 55- to 64-year-olds, financial wealth accounts for around 22% of non-pension wealth holdings (which includes net financial wealth, net primary housing wealth, other property wealth and other physical assets). The absolute size and relative importance of financial wealth are greater for those with greater total wealth, as shown in Table 1. Even amongst those who hold the largest amounts of wealth, financial assets are on average still only a minority of their overall wealth portfolio. However, as the most liquid form of wealth, they are still very important.

This context on the level, composition, distribution and relative importance of financial wealth is all shown for those aged 55-64 in 2014-15, a younger generation than those for whom we consider their wealth trajectories in the rest of this briefing note. (We look at this younger group here so that the figures are not affected by wealth drawdown decisions made in retirement.) The wealth holdings of older generations when they were aged 55-64 will have been somewhat different (almost certainly lower, and with a likely different composition). However, the important features described above – that wealth is held very unequally, and that financial wealth is only a relatively small component of total household wealth – will have been true for older generations as well and should be borne in mind when drawing implications from the analysis that follows.

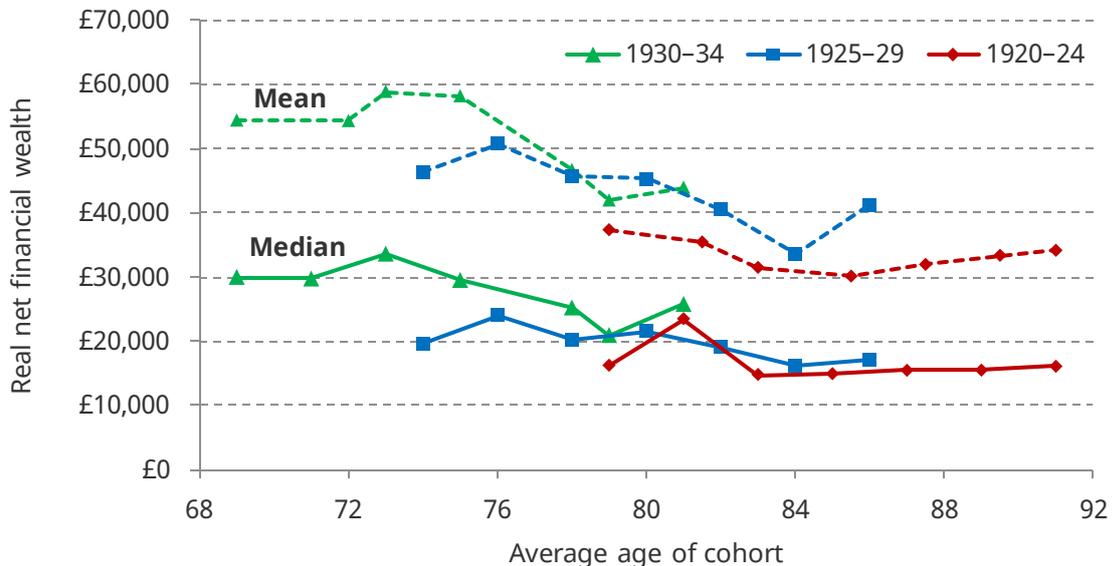
### 3. The trajectory of financial wealth in retirement

This briefing note examines the important question of how individuals use their financial wealth through retirement. To answer this question, we use data from the English Longitudinal Study of Ageing (ELSA). This is a survey of older individuals that has been running since 2002–03, interviewing the same individuals every two years (with additional respondents being added to the sample over time to compensate for people stopping responding (attrition) and to add in new, younger cohorts as the sample ages). There are now seven ‘waves’ of data available, covering the 12-year period 2002–03 to 2014–15. Every interview, individuals are asked detailed questions about their wealth holdings (as well as a vast number of other questions on demographic, economic, social and health circumstances). It is therefore possible for us to use these data to examine the ways in which the wealth holdings of a large group of individuals change as they age.

#### Descriptive age profiles

We start by showing how financial wealth holdings change as individuals age, for the sample of individuals who are observed every two years between 2002–03 and 2014–15 (a 12-year period). Figure 3 shows mean and median real net financial wealth by age, separately for three five-year birth cohorts. For example, the triangles illustrate average household wealth among individuals born 1930–34, in 2002–03 (when they were on average aged 69), in 2004–05 (when they were on average aged 71), and every two years up to 2014–15 (when they were on average aged 81).

**Figure 3. Mean and median net financial wealth by age, 12-year panel**



Note: Dashed lines connect mean wealth, solid lines connect median wealth. Each point represents data from a particular wave of ELSA, with average wealth plotted against the average age for each five-year birth cohort. For the calculation of mean wealth, only the middle 90% of the wealth distribution is included. Sample size is 537 for those born 1930–34, 320 for those born 1925–29 and 133 for those born 1920–24.

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Figure 3 shows that, on average, financial wealth is not drawn down very rapidly in retirement. Median real financial wealth among those born 1930–34 declined by just 14% over the 12 years in question. For those born 1925–29 (who aged on average from 74 to 86) it declined by 13% and for those born 1920–24 (who aged on average from 79 to 91) it declined by just 1%. These declines in financial wealth are much slower than the fall in remaining life expectancy. If we assume that all individuals have the average life expectancy of someone of their age in that year, then the average remaining life expectancy would decline by 56% for those in the 1930–34 cohort (from roughly 9 to 4 years), by 52% for those in the 1925–59 cohort (from roughly 12 to 6 years) and by 47% for those in the 1920–24 cohort (from roughly 16 to 9 years). In other words, each cohort’s average financial wealth *per expected year of remaining life* increased with age.

If we assume that financial wealth on average receives a return equal to the rate of inflation, then this is equivalent to saying that individuals’ total expenditure is only slightly greater than their income in retirement. The implication of individuals not spending down their wealth is that, unless there are large financial costs associated with death itself (which would not be captured in the above analysis), financial wealth is largely bequeathed on death, rather than being used to fund expenditure during later life. Analysis of ELSA ‘End of Life’ interviews, which collect information on (amongst other things) expenses in the last two years of life, suggests that, on average, there are not large financial costs experienced at the end of life: only 6% of individuals faced some out-of-pocket costs for medical expenses, and median out-of-pocket costs for funerals were around £2,000 (in nominal terms) between 2002 and 2012 (though increasing over time).<sup>7</sup>

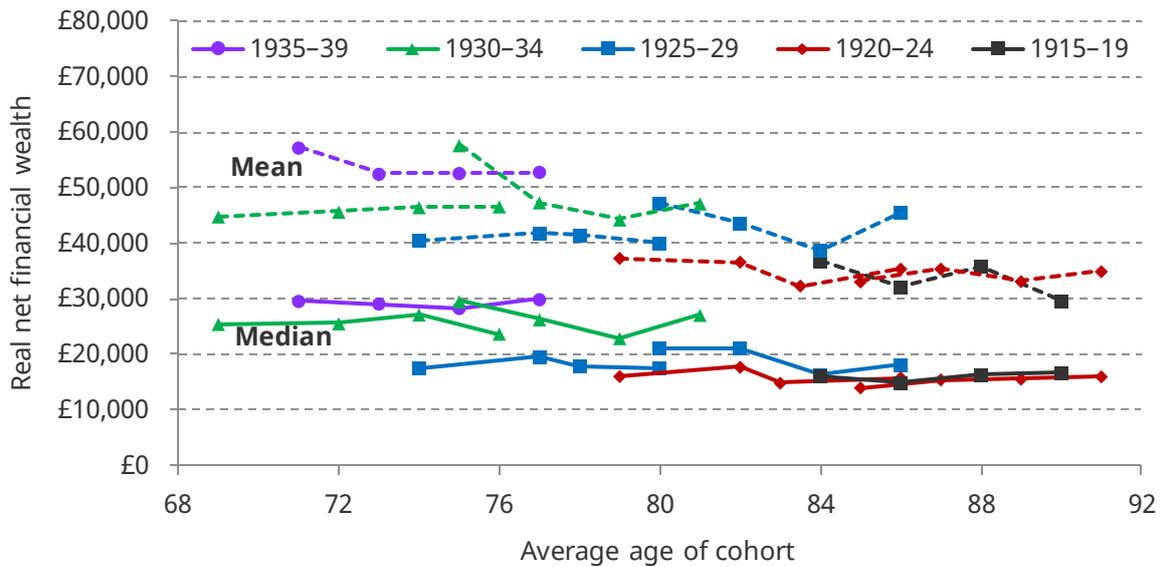
Focusing on those individuals present for all seven waves of ELSA gives us the longest possible age profile of wealth for a stable group of individuals. However, a consequence of this approach is that this is quite a selected sample. Those who survive and continue to respond to the survey every two years for more than a decade are unlikely to be representative of the original population. The extent of attrition is considerable: only 34% of the original ELSA sample members born 1930–34 were present in all seven waves of the data. The proportions are even smaller at older ages, when death is more likely: 24% of the original sample born 1925–29 responded in all seven waves, as did just 14% of those born 1920–24. This selection will be a disadvantage if we are interested in the change in wealth between ages 70 and 75 (say) for everyone alive at those ages. However, it may actually be helpful if we are interested in the change in wealth between ages 70 and 75 for those who will live to age 85.

In Figure 4, we are less restrictive in our sample selection, and examine wealth holdings among those present for four consecutive waves of ELSA, either in waves 1–4 (2002–03 to 2008–09) or waves 4–7 (2008–09 to 2014–15). Here we are able to present wealth profiles for two additional five-year birth cohorts: those born 1915–19 (of whom very few survive from wave 1 to wave 7 because of their age) and those born 1935–39 (who are aged under 70 when observed in wave 1). Figure 4 is more complicated than Figure 3, because it has extra cohorts and we observe most cohorts twice. However, it shows a very similar pattern: for any stable group of individuals (i.e. for any individual four-point line), average wealth only declines very gradually with age.

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<sup>7</sup> Crawford and Mei, 2018.

**Figure 4. Mean and median net financial wealth by age, 6-year panels**



Note: Each point represents data from a particular wave of ELSA. Each set of four connected dots illustrates average wealth for a stable sample of individuals (individuals are observed either in waves 1–4 or in waves 4–7). The vertical differences between lines for the same birth cohort indicate survivor effects – that those observed at older ages have, on average, slightly higher wealth. The vertical differences between lines for different birth cohorts observed at the same age indicate cohort differences in wealth – that those born later have higher wealth. For the calculation of mean wealth, only the middle 90% of the wealth distribution is included. Sample sizes range from 144 to 1,013.

### Estimating regression-based age profiles

The descriptive age profiles for wealth presented in Figures 3 and 4 have the benefit that they do not involve any assumptions – they simply illustrate average wealth among individuals grouped according to date of birth and year of observation. However, one disadvantage is that differences in the level of wealth between generations (seen as vertical differences between the average wealth of different five-year birth cohorts that are observed at the same age) make it harder to see what the average wealth of those born 1935–39 (say) might look like by age 90.

We therefore also estimate regression-based age profiles which, under a certain set of assumptions, can more simply illustrate how the wealth of a particular cohort or individual might be expected to evolve as they age. It tells us the ‘average’ age profile for wealth, abstracting from differences in wealth levels between cohorts. We use the following econometric specification:

$$\ln(\text{wealth}) = \alpha + \beta \text{age} + \delta' \text{cohort} + \gamma' \text{wave} + \varepsilon$$

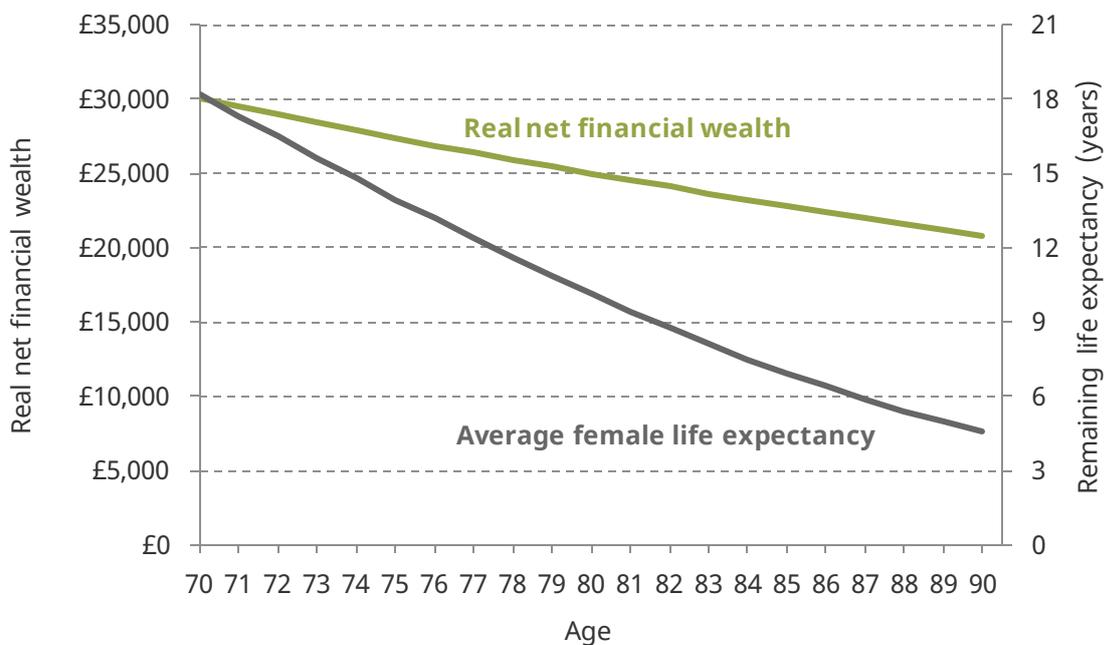
where  $\ln(\text{wealth})$  is the natural logarithm of financial wealth,  $\text{age}$  is the individual’s age,  $\text{cohort}$  is a set of dummies indicating both which five-year period the individual was born in and which four-year ELSA panel they were observed for, and  $\text{wave}$  is a set of dummies indicating the wave of ELSA in which wealth is measured (capturing time effects). The resulting coefficient  $\beta$  yields an estimate for the proportionate change in wealth as individuals age.

The main assumptions implicit in this specification are: (i) that the *rate* at which wealth is drawn down is the same for different generations (equivalently, that average wealth is always the same percentage higher at every age for one generation as compared with another generation); (ii) that the effect of being observed in 2002–03 to 2008–09 as opposed to 2008–09 to 2014–15 is also a constant percentage difference in wealth for every age (though this difference is allowed to differ between generations); and (iii) that the rate at which wealth changes is the same at all ages. Given the descriptive age profiles presented in Figures 3 and 4, these do not seem unrealistic assumptions based on the evidence of different generations’ behaviour to date. The assumption that the rate at which wealth changes is constant across ages feels restrictive; however, it yields almost identical results (but with more precision in the estimates) to a specification that allows for a quadratic relationship between wealth and age.

The estimated relationship between age and wealth is that wealth declines by 1.8% for each year that an individual ages. This estimate has some uncertainty around it: the 95% confidence interval is between a decline in wealth of 3.7% and an increase in wealth of 0.1% for each year of age.

In order to cumulate these estimated proportionate changes in wealth across ages (e.g. to describe the percentage change in wealth between age 70 and age 80, rather than just the percentage change in wealth at age 70), we must make an important further assumption: that the rate at which wealth is drawn down by age is independent of longevity (i.e. individuals who live longer have the same percentage change in their wealth at any given age as individuals who are going to live less long). There are reasons to be concerned that this is not a valid assumption. If all individuals were planning to spend their wealth over their remaining life cycle, then we would expect those living longer to draw down their wealth less rapidly than those living less long. Furthermore, those expecting to live less

**Figure 5. Projected financial wealth drawdown from age 70**



Note: Wealth profile is calculated by reducing initial wealth of £30,000 by the estimated 1.8% per year. Average female life expectancy is taken from Office for National Statistics 2016-based principal cohort life expectancies for England.

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long are likely to be less healthy, which could be associated with higher costs and therefore a greater need to draw down wealth (all else equal).

It is difficult to test this assumption in practice, since we only have wealth data on the same households for a 12-year period. If we compare the change in wealth between 2002–03 and 2008–09 for those who respond to the survey in 2014–15 and those who do not (who may have died, or stopped responding for other reasons), we do find some small differences in the rate of wealth drawdown. Wealth levels were lower, and the proportionate decline over six years was greater, for those who stopped responding than for those who were still responding a further six years later. This suggests that cumulating the estimated change in financial wealth by age would to some extent *overestimate* the drawdown of wealth for someone who is going to survive past the age concerned.

With that important caveat in mind, Figure 5 illustrates how initial wealth of £30,000 would decline from age 70 if the individual reduced their wealth by 1.8% per year. This suggests that real financial wealth is drawn down by 9% between ages 70 and 75, by 17% between ages 70 and 80, by 24% between ages 70 and 85, and by 31% between ages 70 and 90. For an initial level of wealth of £30,000, that would imply a decline to £21,000 by age 90.

To put this decline in wealth in context, Figure 5 also illustrates how the average remaining life expectancy of a female aged 70 in 2015 is expected to decline as they age (using Office for National Statistics 2016-based principal cohort life expectancies for England). The rate of decline in average remaining life expectancy (75% between ages 70 and 90 for both men and women) is significantly greater than the estimated average rate of decline in net financial wealth.

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## 4. How does use of financial wealth vary with individual characteristics?

The analysis in the previous section indicated clearly that, on average, individuals do not draw down their financial wealth very rapidly during retirement. This is despite the significant shortening of expected remaining life as individuals age. This implies that consumption is being financed largely out of income (and possibly other sources of wealth) and that, unless there are significant costs associated with the end of life, most financial wealth is bequeathed on death rather than spent.

We turn now to examine whether, and how, the drawdown of financial wealth in retirement differs systematically according to individuals' characteristics or circumstances. To do this, we focus on the pooled sample of individuals observed over either 2002–03 to 2008–09 or 2008–09 to 2014–15, and examine how the change in their financial wealth over the six-year period correlates with their characteristics and circumstances.

### Differences by level of financial wealth holdings

We start by examining whether the rate of drawdown differs according to the level of financial wealth itself. One would expect to find differences here. Those with relatively little financial wealth may wish to hold on to virtually all their wealth as precautionary saving against shocks such as domestic repairs, while those with very large amounts of wealth could afford to spend a much larger proportion of wealth while still having enough funds to cover such emergencies.

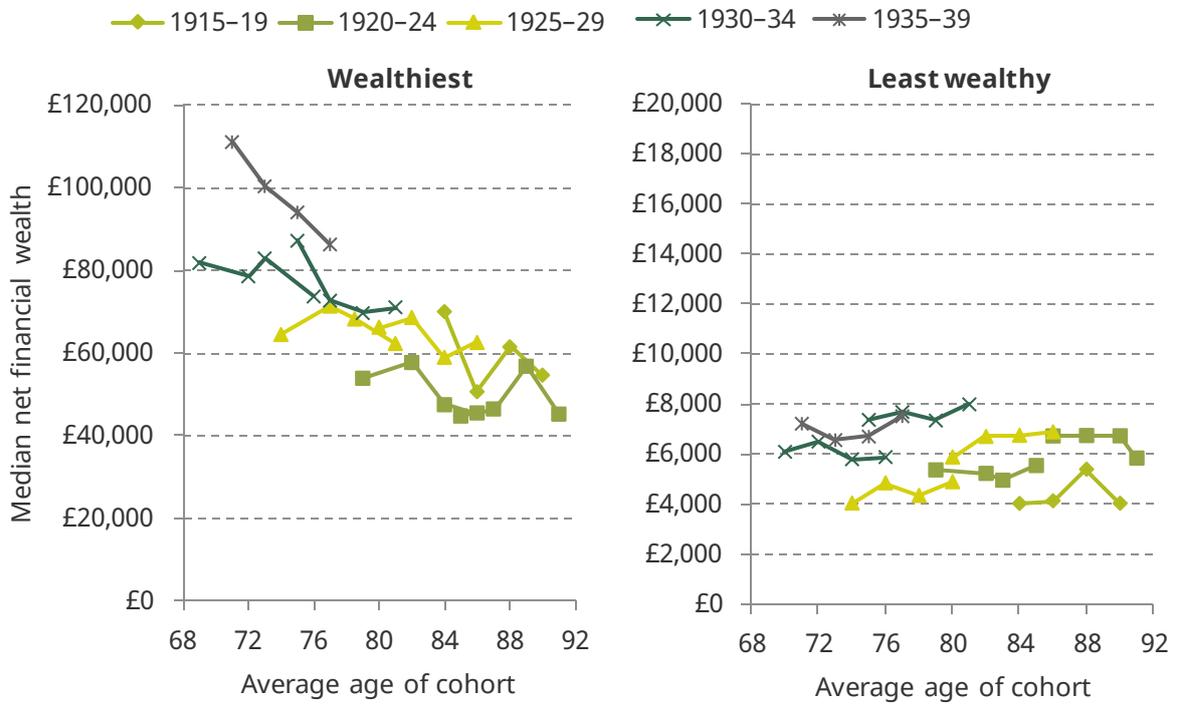
To examine this, we divide our sample into two, depending on whether an individual's average wealth over the six-year period was in the top or bottom half of the distribution compared with others in their five-year birth cohort. Figure 6 illustrates the descriptive age profiles of median wealth among those in the top and bottom halves of the sample. A decline in average wealth with age is indeed much more evident among those with higher levels of wealth.

We also estimate a regression-based age profile for financial wealth, using the approach described in Section 3, but run separately for those in the top and bottom halves of the wealth distribution. This allows the age profile and cohort differences in wealth to differ between those with the most wealth and those with the least wealth.

The estimated average decline in financial wealth is 0.7% per year for those in the bottom half of the wealth distribution (with a 95% confidence interval that ranges from a decline of 2.9% to an increase of 1.6% per year) and 2.4% per year for those in the top half of the wealth distribution (with a 95% confidence interval that ranges from a decline of 4.1% to a decline of 0.8% per year). This again illustrates that the proportionate decline in wealth is greater among the wealthiest. Cumulating these estimated declines in wealth from age 70, subject to the caution that this likely overstates the extent of financial wealth drawdown among those who live to the oldest ages (as discussed in Section 3), suggests a reduction in wealth of 39% between ages 70 and 90 on average among the wealthiest half of individuals and a decline of 13% among the least wealthy half. The implied age profiles

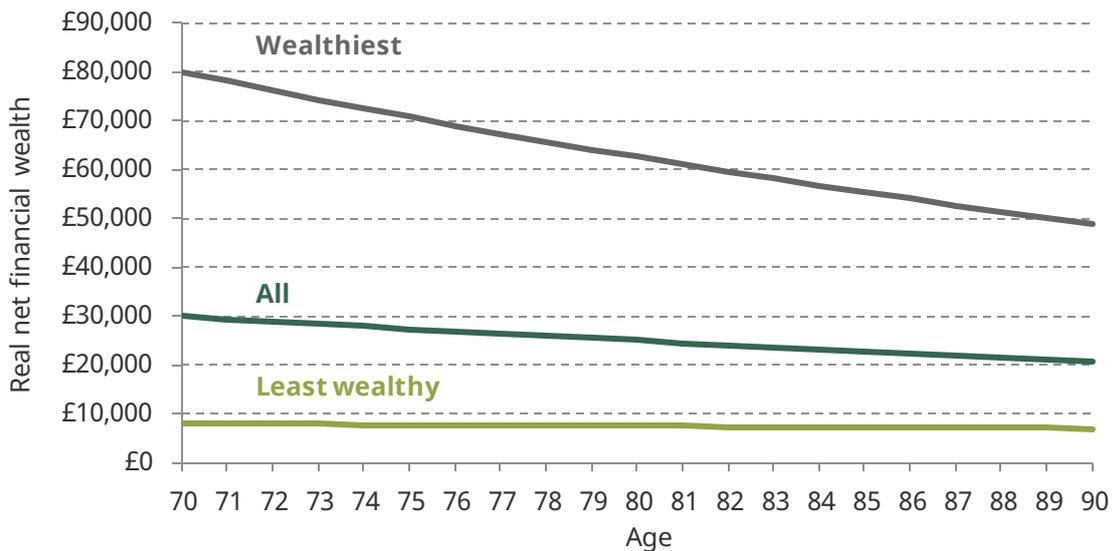
of wealth, applied to initial wealth of £8,000 among the least wealthy and £80,000 among the wealthiest, are shown in Figure 7.

**Figure 6. Median financial wealth by age**



Note: Each point represents data from a particular wave of ELSA. Each set of four connected dots illustrates average wealth for a stable sample of individuals (individuals are observed either in waves 1-4 or in waves 4-7).

**Figure 7. Projected financial wealth drawdown from age 70**



Note: Wealth profiles are calculated by reducing initial wealth of £80,000 by the estimated 2.4% per year for those in the top half of the wealth distribution, and by reducing initial wealth of £8,000 by the estimated 0.7% per year for those in the bottom half of the wealth distribution.

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While this analysis suggests that the rate of drawdown of financial wealth does differ significantly between those with higher and lower levels of wealth, and in a way that we might expect, we should be cautious attributing this difference solely or entirely to the difference in the level of wealth holdings. Higher wealth is correlated with a number of other characteristics that differ across individuals – for example, wealth is higher among couples, and it is also positively correlated with income. However, the results presented in the next subsection illustrate that a relationship between wealth and the rate of drawdown of a similar magnitude remains even once we control for other individual characteristics and circumstances.

## Differences by other individual characteristics

We turn now to examining whether other individual characteristics and circumstances are associated with the rate at which financial wealth is drawn down in retirement. We do so by calculating, for each individual, the percentage change in their wealth over the six years they are observed (either between 2002–03 and 2008–09 or between 2008–09 and 2014–15), and then running a multivariate regression to establish the association of that change in wealth with individual characteristics. This approach allows us to examine the association between wealth drawdown and a particular characteristic of interest, while holding all other characteristics constant. We use median regression so that our results are less affected by the extreme outliers that can arise when examining individual-level percentage changes in wealth. We also only include individuals in this analysis if they reported positive net financial wealth at both the start and the end of the period. The results of this analysis are set out in Table 2. The ‘marginal effects’ show the association of a characteristic with the percentage point change in wealth over six years – for example the  $-0.194$  in the first row indicates that an individual becoming widowed is associated with a 19.4 percentage point greater decrease in wealth (smaller increase in wealth).

### Changes in household structure

Unsurprisingly, changes in household composition are associated with changes in financial wealth. Those who gained a partner over the period in question saw their (household) wealth nearly double, while individuals whose partner died over the period in question saw much greater declines in their wealth (nearly 20 percentage points greater) than those whose household structure did not change.

### Demographics

Age has little systematic association with the rate of wealth drawdown, once other characteristics are controlled for. This is perhaps surprising, given the greater proportionate decline in remaining life at older ages, but could be the result of bequest or precautionary saving motives. Having children has a small positive association with the growth in wealth (which could be indicative of a bequest motive), but this association is not statistically significant.

### Levels of wealth and income

The results of the multivariate regression suggest that for each additional £10,000 an individual has, the decline in their financial wealth over six years is 1 percentage point greater (equivalently, the growth in their wealth is 1 percentage point lower). This confirms that our previous finding, that the rate of wealth drawdown does depend on the

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level of wealth, holds true even when we control for other characteristics that systematically differ with the level of wealth.

Having other financial resources also seems to be associated with how quickly financial wealth is drawn down in retirement. Owner-occupiers on average reduced their financial wealth holdings by more than non-owner-occupiers, but those with other property wealth saw much smaller average falls in wealth (around 12 percentage points smaller) than those without other property wealth.

We also find that equivalised income (measured at the start of the period) is associated with the rate at which wealth declines. Those with higher levels of income had slightly lower rates of wealth drawdown – specifically, an additional £1,000 per year is associated with a 0.2 percentage point smaller decrease in wealth. In some respects, this is unexpected. If all individuals were aiming to spend their wealth over their lifetimes (or even were aiming to spend the same proportion of their wealth, leaving a proportion as a bequest), then the level of income should not matter – all that would matter would be the length of remaining life. However, this association with income could be explained by those with higher incomes (for a given level of wealth) choosing to save to leave a larger bequest.

### Education and numeracy

The association between changes in financial wealth and characteristics such as education and numeracy is potentially important, since (all else equal) these characteristics may be indicative of individuals who might struggle to make the ‘best’ choices about how to use their wealth in retirement due to financial capability constraints. Education does have a positive association with changes in wealth – those who left education after the compulsory school-leaving age on average saw a 5 percentage point smaller decline in their wealth over six years, though this difference is not statistically significant. The association of wealth drawdown with numeracy is less clear-cut.<sup>8</sup> The results in Table 2 suggest that those in the second-worst numeracy group drew down their wealth most rapidly (to a considerable extent), while those with the lowest and highest numeracy drew down their wealth less rapidly. This suggests that financial capability may have a role in explaining differences in financial wealth use in retirement, although it is not simply the case that higher numeracy always implies faster or slower wealth drawdown.

### Health and life expectancy

Self-reported health is also strongly associated with the change in financial wealth, but not in a clear-cut way. Relative to those reporting being in ‘excellent’ health or in ‘good’ health, those reporting being in ‘very good’ health or in ‘fair’ or ‘poor’ health saw much smaller decreases in their wealth. Mobility issues are consistently associated with lower rates of wealth drawdown, though these associations are in general not statistically significant.

Interestingly, individuals’ self-reported life expectancies do not seem to be strongly associated with the rate at which financial wealth is used.<sup>9</sup> This is surprising – since theory

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<sup>8</sup> ELSA asks respondents up to five questions involving successively more complex numerical calculations. We group individuals into four broad numeracy groups depending on their answers to these questions, following Banks and Oldfield (2007) and Banks, O’Dea and Oldfield (2010).

<sup>9</sup> ELSA asks individuals the chance that they will live to a certain age ‘X’ in future, where the age ‘X’ asked about depends on their current age. We estimate a regression of  $chance = a + \beta_1 age + \beta_2 age^2 + \gamma sex + \delta' X$  (where X is

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would suggest those who expect to live less long would, all else equal, spend their wealth more quickly. However, the relative lack of drawdown of financial wealth over all (shown most simply in Figure 5) perhaps suggests individuals are not behaving in this way, and therefore that the rate of drawdown might not be as sensitive as one might expect to individuals' own life expectancies.

### **Expectations of long-term care needs**

Another factor that we might expect to be associated with the use of financial wealth is individuals' expectations over the likelihood of their needing long-term care in future. There is much debate among policymakers and others as to whether the risk of needing social care in future is forcing individuals to hold on to large sums of wealth, so that they can pay for care if they need it, or whether it is encouraging individuals to spend their wealth so that they become eligible for state-funded social care services (which are means-tested and only available to those with low incomes and low assets).

In the 2014–15 ELSA survey, individuals were asked what they thought the chance was that they would ever move to a nursing home in future, and what they thought the chance was that they would ever need care in their home (not provided by family or friends) in future. We can therefore examine the association between these expectations and wealth drawdown between 2008–09 and 2014–15 (for those observed over that period). The results of this analysis are shown in the final two columns of Table 2. The smaller sample size means that many of the associations between other characteristics and wealth drawdown are no longer statistically significant. For the most part, the associations are qualitatively unchanged, though the association of becoming widowed, of an adult joining the household, of being an owner-occupier and of self-reported health with the change in wealth are all reduced.

There does seem to be an association between expectations of moving to a nursing home in future and wealth drawdown. Those reporting zero chance of moving to a nursing home in future saw percentage declines in their wealth over the previous six years that were, on average, 14 percentage points greater than for those reporting a 1–49% chance. Those reporting a 50% or greater chance saw, on average, a 4 percentage point smaller fall in wealth than those reporting a 1–49% chance (though this difference is not statistically significant).

We cannot say that this is a causal relationship – there may be some other factor causing these individuals to both draw down wealth less rapidly and report higher chances of moving to a nursing home in future. However, these results lend more support to the idea that, on average, individuals are holding on to their wealth in order to pay for social care if they expect they might need it, than to the idea that individuals are spending down their wealth in order to be eligible for state support.

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a set of dummies indicating the age asked about), and allocate individuals into three groups depending on how optimistic their reported survival chance was relative to the prediction of our regression model. The 'top third' are therefore those who are most optimistic about living a long time, conditional on their age and sex, and the 'bottom third' those who are least optimistic.

**Table 2. Median regression of percentage change in wealth over six years**

	<b>Full sample</b>		<b>Those in waves 4-7</b>	
	Marginal effect	Standard error	Marginal effect	Standard error
Individual became widowed	-0.194**	0.077	-0.090	0.109
Adult left the household	-0.092	0.184	0.009	0.275
Adult joined the household	1.868***	0.360	0.078	1.162
Aged 70-74	0.082*	0.044	-0.047	0.058
Aged 75-79	-0.044	0.052	-0.008	0.070
Aged 80-84	0.076	0.068	-0.016	0.093
Aged 85-89	0.005	0.109	-0.022	0.151
Single man	0.044	0.065	0.103	0.085
Single woman	-0.090*	0.046	-0.093	0.063
Has children	0.012	0.057	0.036	0.079
Initial financial wealth (£000s)	-0.001***	0.000	-0.001***	0.000
Owner-occupier	-0.093*	0.055	0.030	0.077
Has other property	0.119**	0.059	0.106	0.083
Equivalised income (£000s per year)	0.002**	0.001	0.002	0.002
High education	0.048	0.039	0.030	0.053
Numeracy: 2	-0.182***	0.062	-0.222**	0.090
Numeracy: 3	-0.100	0.067	-0.180*	0.097
Numeracy: highest	-0.038	0.083	-0.119	0.114
Self-reported health: very good	0.132**	0.062	0.083	0.083
Self-reported health: good	-0.005	0.063	-0.011	0.086
Self-reported health: fair/poor	0.194***	0.074	0.107	0.100
1 ADL/iADL difficulty	0.094*	0.056	0.020	0.075
2+ ADL/iADL difficulties	-0.021	0.062	0.040	0.087
1 mobility issue	-0.042	0.053	-0.029	0.070
2+ mobility issues	-0.080	0.050	-0.081	0.066
Survival expectation: middle third	-0.004	0.045	-0.065	0.060
Survival expectation: top third	-0.016	0.046	-0.028	0.062
Waves 4-7	-0.008	0.037	N/A	N/A
Chance ever move to nursing home: 0%			-0.136*	0.075
Chance ever move to nursing home: 50%+			0.039	0.063
Chance ever need domiciliary care: 0%			-0.031	0.089
Chance ever need domiciliary care: 50%+			-0.040	0.060

Note: Sample size is 4,759 for the full sample and 2,351 for those in waves 4-7. \*\*\*, \*\* and \* indicate statistical significance at the 1%, 5% and 10% level respectively. 'High education' indicates education continued beyond the compulsory school-leaving age. The reference category for self-reported health is 'excellent'. ADL = activity of daily living; iADL = instrumental activity of daily living.

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## 5. Conclusions

The analysis in this briefing note has provided a long-overdue examination of the rate at which individuals use their financial wealth in retirement. While financial wealth represents only a (sizeable) minority of households' wealth, even for the wealthiest, it is the most liquid form of wealth, and therefore an important component of households' financial portfolios. We have shown that, on average, financial wealth is not drawn down very rapidly at all, despite the shortening length of remaining life as older individuals age. This suggests that the majority of financial wealth held by retired generations is set to be bequeathed, rather than used to fund consumption in retirement, unless there are significant expenses associated with the end of life.

We do find that the rate of financial wealth drawdown is greater for those with higher levels of wealth. For example, a likely overestimate based on the current behaviour of retired individuals is that those in the top half of the wealth distribution would spend around 39% of their wealth between ages 70 and 90, while those in the bottom half of the wealth distribution would spend around 13%. This suggests that precautionary saving, for risks such as home repairs, or saving for end-of-life costs could well be a motivation for individuals holding on to wealth. These costs are likely to be greater relative to stocks of wealth for lower-wealth individuals than for higher-wealth individuals.

These findings are obviously just averages – a picture across retired individuals as a whole – and many individual experiences will look quite different. However, we find that there are some individual characteristics and circumstances that are systematically related to the rate at which financial wealth is used. In particular, we find that (all else equal) those with higher levels of income use their wealth slightly less rapidly than those with lower income, those with property wealth other than a primary residence use their wealth less rapidly than those without, those with mobility needs use their wealth more rapidly than those without, and those with higher expectations of moving to a nursing home in future draw down their wealth less rapidly than those with lower expectations. These are just associations; we cannot prove that these characteristics have a causal effect on the rate at which financial wealth is used. But they are interesting, and potentially indicative of some of the motivations at play.

Unfortunately, it is not possible to say from this analysis whether this slow drawdown of financial wealth represents 'optimal' behaviour for retired individuals – in other words, whether individuals are making the correct trade-off between their consumption in retirement, precautionary saving and the bequests they leave on death (all of which are presumably valued to some extent), or whether there are some constraints (such as imperfect information, limited numerical ability or poor financial acuity) that are causing individuals to make poor decisions. It is the case that some of those with financial wealth resources do report having 'too little money to spend on their needs' – among those aged 65 and over in 2014–15 with some financial wealth, 4% reported having too little money to spend on their needs 'often' or 'most of the time', while a further 15% reported that it was the case 'sometimes'. But it could still be a rational response for these individuals not to draw down wealth, if there is a risk of expenses in future or if bequests are valued highly. Our results do suggest that numerical ability does seem to have some association with the rate of wealth drawdown, even after controlling for many other individual characteristics. However, it is not clear that better numerical ability always means faster or slower wealth drawdown.

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Even though we cannot say whether retired households are making the right choices, there are still important implications of this analysis.

First, our findings (combined with analysis on end-of-life costs<sup>10</sup>) suggest that the majority of financial wealth among current retired generations does look set to be bequeathed – unless the behaviour of current young retirees at older ages turns out to be different from the behaviour of current older retired individuals. The same is also true of primary housing wealth.<sup>11</sup> This will have important implications for the level (and distribution) of resources among current working-age individuals, in particular those with wealthy parents.

Second, if the slow drawdown of wealth among current retired individuals is due to bequest motives, then if younger generations do not have similarly strong bequest motives, they may not need to accumulate as large resources for their retirement. They would be able to maintain a similar standard of consumption with lower wealth (all else equal). However, if the main driver of slow wealth drawdown among currently retired generations is precautionary saving (as perhaps seems likely – particularly for those with lower levels of wealth), then younger generations may need to accumulate similar levels of resources, even if on average that wealth is never drawn on, in order to protect against the risk of adverse shocks at a time of life when other margins of response are limited.

Finally, a pertinent question is what light these results shed on how well future generations may manage their resources through retirement. This is particularly important given the introduction of ‘pension freedoms’ (the ability for individuals to flexibly access their accumulated defined contribution pension savings). Our findings do not necessarily imply that individuals will hold on to their pension savings throughout retirement in the way that they do their financial wealth – how individuals behave with respect to their accumulated pension wealth, when it is their main or only source of retirement income, may be very different from how they use their (much smaller) amounts of financial wealth when they have secured income from other sources. However, it is interesting to note that, at the moment, individuals do not – at least on average – spend all their resources early in retirement and do hold a large proportion of their wealth through to death.

Going forwards, it will be important to continue to assess how individuals’ use of wealth in retirement evolves, both as the freedom to access accumulated pension wealth becomes more established and as younger generations reach retirement with different portfolio compositions and likely smaller overall levels of resources. Individuals now have incredible freedom and choice about whether and how to save for retirement, and how to spend down their accumulated resources. It is vital that their situation is monitored carefully to ensure that individuals are coping appropriately with such responsibility – not just in the accumulation phase, but in the decumulation phase as well.

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<sup>10</sup> Crawford and Mei, 2018.

<sup>11</sup> See Crawford (2018a).

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