Press Release

Most couples retiring over the last decade appear financially well prepared

The vast majority of couples born in the 1940s have levels of wealth that are more than sufficient to maintain their standards of living into and through retirement. This is the main finding of *Retirement Sorted? The adequacy and optimality of wealth among the near-retired*, new research published today by the IFS and funded by the Joseph Rowntree Foundation and the Economic and Social Research Council.

The research takes two approaches to assessing financial preparedness for retirement. The first approach is to compare the wealth holdings and estimated retirement income of couples with their average earnings between ages 20 and 50. 'Replacement rate' approaches of this type have been used widely before in the UK, including by the Department for Work and Pensions, to assess the adequacy of retirement wealth. Our second approach uses an economic model of behaviour over the life cycle to estimate, for each household, how much wealth they would have needed to accumulate in order to expect to maintain a stable standard of living throughout their lives.

Using the first, straightforward approach, we estimate that:

- 80% of couples born in the 1940s have annual gross pension income at age 65 (from state and private pensions) that replaces at least two-thirds of their average annual working-life earnings (adjusted for price inflation). Over 40% have gross pension income in excess of their average real working-life earnings.
- If you also take account of the income that could be generated from other financial wealth holdings (i.e. ignoring housing), 90% of couples would have replacement rates greater than two-thirds, while nearly 60% would have greater income in retirement than average real earnings during working life.
- Taking account of housing wealth as well raises the proportion able to replace more than two-thirds of their working-age earnings in retirement to 98%. We estimate that 84% could replace more than 100% of their average real gross earnings during working life on this basis.

Comparing the level of gross retirement income with working-life earnings is a simple way of assessing the adequacy of households’ retirement resources. However, the results are very sensitive to the threshold used to define adequacy (and to the way in which previous incomes are adjusted for price increases).

The threshold used is typically less than 100% replacement to reflect at least three important reasons why one might need a lower pre-tax income in retirement than during working life in order to secure a similar standard of living. First, tax rates are lower as those over pension age pay no National Insurance contributions. Second, costs associated with dependent children are likely to be lower in retirement. And third, there is no longer the need to save to provide a retirement income. However, exactly how much less than
100% replacement is counted as adequate has been arbitrarily chosen in UK analyses to date.

Therefore we have used a novel alternative approach to assess the adequacy of retirement resources which employs an economic model to quantitatively take account of these factors. The model also takes into account that households would have access to means-tested pension credit in retirement if they have low incomes. We find that:

- 92% of couples born in the 1940s have accumulated more wealth than the model suggests they need to maintain their standards of living into and through retirement. The surpluses are substantial on average – the median surplus being over £220,000, which would be enough to produce around £7,000 a year of income if used to buy an index-linked annuity.
- The surpluses are larger for those with higher average lifetime earnings than for those with lower lifetime earnings, and for those who live in London than for those who live elsewhere in England.
- Even excluding housing wealth, 75% of couples have more wealth than the model suggests they need to maintain their standards of living. The median surplus is over £120,000.

These results confirm the overall finding of the first approach that the majority of this cohort has saved ‘enough’ for their retirement. But the model also throws light on the value of the ‘simple’ replacement rate method. It suggests that the replacement rates of gross income that households need in retirement in order to expect to maintain a constant standard of living vary considerably between households. One-quarter are estimated to need a replacement rate of less than 40%, while one-quarter are estimated to need a replacement rate of more than 70%.

This suggests that considerable caution should be exercised when using simple replacement rate thresholds to assess the adequacy of households’ retirement resources and the impact of government policies on the preparedness of households for retirement.

Cormac O’Dea, a Senior Research Economist at the IFS and one of the authors of the report, said: “The large majority of couples reaching state pension age in recent years have more wealth than necessary to maintain their standards of living into retirement. This is a cohort that has, as it has turned out, ended up saving more than they needed for retirement. The picture for future generations, however, may look quite different.”

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Notes to Editors:

1. For embargoed copies of the report or other queries, contact: Bonnie Brimstone at IFS: 020 7291 4818 / 07730 667013, bonnie_b@ifs.org.uk
2. This work was funded by the Joseph Rowntree Foundation (project ref: 1112044A) and the Economic and Social Research Council (ESRC–NCRM Node ‘Programme Evaluation for Policy Analysis’ (PEPA) – ref: ES/I02574X/1; Centre for Microeconomic Analysis of Public Policy – ref: RES-544-28-5001).