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The Golden Age of Retirement – does rising pensioner wealth mask future problems?

AEGON

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Foreword

Something huge has happened to Britain's pensioners but, until recently, no-one seems to have noticed. It's been a slow and steady trend, and barely perceptible year on year, but no less remarkable for that. I'm talking about improvements in pensioner wealth. In 1979[1], 43% of those on the lowest incomes in society were pensioners. Today that figure has fallen to just 13%. Not only have pensioners catapulted out of the lowest band of incomes, they have begun to close the gap on the working population. After housing costs, where increases have hit younger generations hardest, the weekly incomes of the working population are just 7% higher than those of pensioners today[2].

So profound has this rise been that we are now beginning to see intergenerational tensions arise over issues such as the distribution of property wealth between old and young. We've even seen Ros Altmann, former Pensions Minister and staunch campaigner for the elderly, calling for future increases in state pensions to be made less generous on affordability grounds. With the prospect of tough post Brexit decisions, how will government balance generational interests? Will we see universal benefits for the elderly such as free TV licences, winter fuel allowances and bus passes become subject to means testing and withdrawn from wealthier pensioners? Might the welcome news of increases in pensioner wealth prompt even more radical moves such as means testing of state pensions?

On the surface, current pensioner income figures suggest that there's never been a better time financially to be in retirement. But what's behind this fundamental change in the fortunes of pensioners and how sustainable is the growth in their living standards? And what about those approaching retirement? Record low annuity rates made even worse by the recent interest rate cut mean that those turning their pension fund into an income through an annuity today are – aside from any re-sale on the secondary annuity market – locking into worse terms than any of their predecessors for life!

Scope of the report

In this report Aegon digs deeper into the trends, building a picture of the retirement income challenges of those in different stages of retirement by combining government statistics on pensioner household wealth and our own research. In particular this report looks at:

- the main costs of those in different stages of retirement;
- a breakdown of their sources of income;
- the biggest concerns they have regarding their retirement income; and
- where different age groups might benefit from professional advice.

We consider whether the positive trend in pensioner wealth is likely to continue, or might a downward change in fortunes be looming for those retiring in future? This is a fundamental question and one that needs answered so that long-term pension policy, which will affect generations of retirees to come is based on a forward-looking analysis.

Given retirement can now last several decades, and the income needs and considerations of a 65 year old are likely to be very different from someone who is 85, we've chosen to separate out the findings into three different stages of retirement which we look at in turn. We've included those aged 50 and above who say they are fully or partly retired, reflecting the growing incidence of 'partial' retirement.

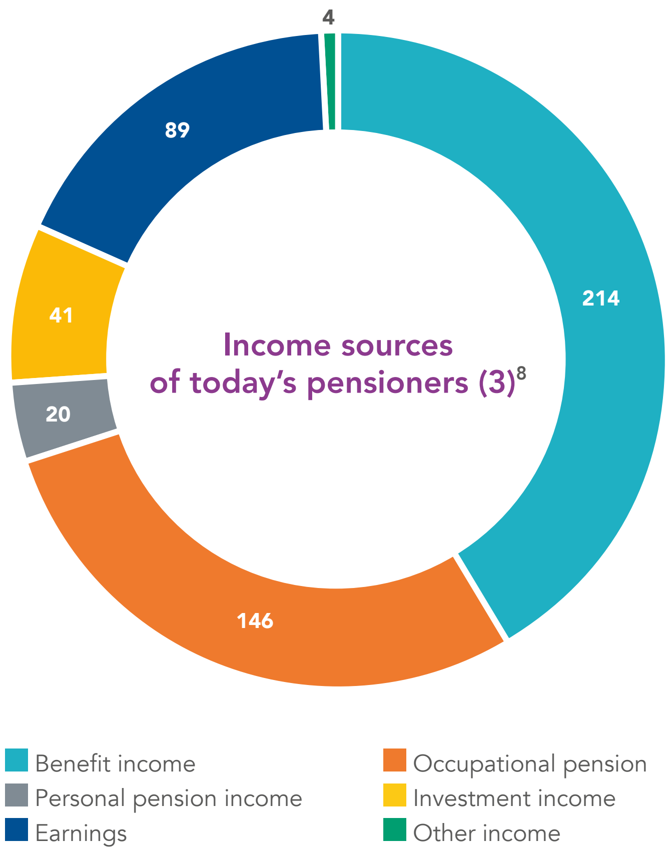
Quick take – why is pensioner wealth on the up?

Before we delve into the research, it's worth setting the scene in more detail and expanding on the situation we find ourselves in today. In Aegon's view, there are three main reasons behind the growth of average pensioner household income.

1. According to ONS figures, in 2014/15, pensioner households received an average of £146[3] a week from workplace pensions. This is up £50 since the start of the millennium and is largely the result of today's pensioners benefiting from being members of the proliferation of generous defined benefit pension schemes set up from the 1960s[4] onwards. These offered a proportion of your final salary as an income for life, with many also offering increases to partly or fully protect against inflation – all very valuable! But this form of pension is generally only continuing to be built up by public sector employees today. In the private sector, there are concerns over whether some schemes will be able to meet promises based on previous service, or like the much publicised BHS scheme, will have to rely on a bail out from the Pension Protection Fund. There's a risk that some retiring in future will find their pensions, or the increases they expected, have been scaled back. These concerns, coupled with some schemes currently offering historically high-transfer values, may mean some individuals relinquish their defined benefit guarantees in return for a transfer to a defined contribution arrangement.
2. Income from state pensions and other in-retirement state benefits (referred to by ONS as benefit income) is still the biggest proportion of most pensioners' income and has grown by £47[5] a week since the year 2000. Particularly important to pensioners is the 'triple lock' aspect of the state pension which, since introduced in 2011, has ensured it keeps pace with the highest of inflation, earnings growth or 2.5% each year. But there is no commitment to continue the triple lock beyond 2020 and even some of those who campaign for pensioner rights are saying it should be trimmed back on affordability grounds.
3. While retirement is traditionally associated with leaving the workforce, as government figures show, earnings account for an increasing percentage of retirees' income. As people are living, and staying healthy, for longer, the scope to continue working in a part-time capacity increases. Our analysis of ONS data show households between state pension age and age 75 have average earnings of £148 per week[6] from ongoing work.

The average weekly incomes of pensioner households[7]

	2000/01 (£)	2014/15 (£)	Change (£)	Change (%)
Gross income	372	515	143	38
of which				
Benefit income	167	214	47	28
Occupational pension	96	146	50	52
Personal pension income	9	20	11	122
Investment income	41	41	0	0
Earnings	54	89	35	65
Other income	4	4	0	0



The role of advice in retirement

Traditionally, the main pension challenge people have faced is how to accumulate enough savings to cover the cost of their retirement. And this is still the case, but the pension freedoms have added an extra dimension, with individuals now having to consider not just the best way to save but also the best way to access their savings and manage their income over the course of their retirement. This further increases the need for advice not just up to, but well into, retirement.

Advice needs to reflect the different wishes, challenges and concerns people have as they move through the stages of retirement. Across all our age ranges, the three greatest concerns are concentrated around reductions in state pensions in future, the impact of inflation and providing for long-term care. However, the order of priority is different in the different age bands.

We hope you find the report a useful resource to help bring to life the position of retirees today and to think ahead to offer insight into the possible challenges and opportunities for retirees and their advice needs in the years to come.

The first stage of retirement – ages 50-64

39% retired

£79.50 a week on transport

£463.50 weekly costs

43% of income compared to when in work

57% have worries about running out of money in retirement

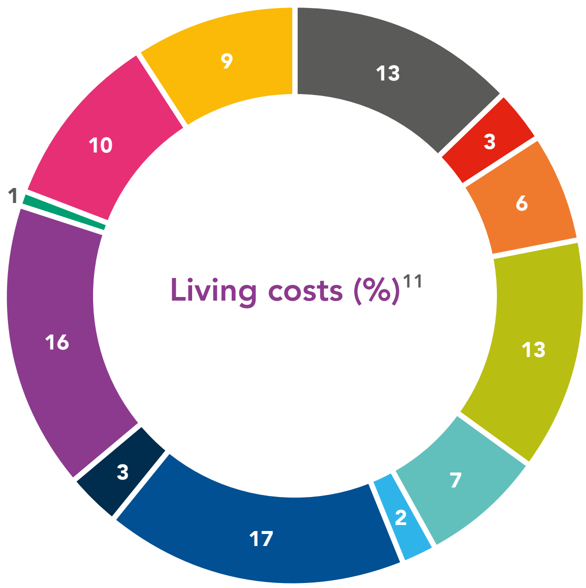
Changes to state pension seen as the biggest retirement income risk

Allowing for (increasing) state pension ages, typical retirement ages in most workplace schemes, and average life expectancy at age 65 today being 85[9], we class those who retire between 50-64 as having taken early retirement. There are two ways in which this group need to be treated differently in our report. First, despite the pension freedoms offering people the opportunity to access their savings from age 55, just under 40%[10] of 50-64 years olds are fully or partly retired, meaning that a majority are still in work. Secondly, the government does not provide detailed statistics on the income sources of people below state pension age. However, there is still a lot we can say about people in this age bracket.

Average weekly household incomes were the highest, surveyed by Aegon at £513 after tax. When this is further broken down between those still in work and those who are fully retired we see figures of £530 and £472 respectively. These are averages and shouldn't be taken as representative of the decrease in income for a particular household. Perhaps those anticipating higher incomes after retiring are more likely to do so at younger ages.

Among those still working, individuals are saving an average of 9% of their income towards retirement.

Analysis of this group's living costs shows they are highly active. Transport, recreation and restaurant spending account for 43% of weekly expenditure.



	Weekly spend (£)
Food & drinks	62.50
Alcoholic drinks & tobacco	15.90
Clothing	25.70
Housing (net)[2], fuel & power	59.50
Household goods & services	34.30
Health	7.60
Transport	79.50
Communication	14.60
Recreation & culture	73.10
Education	6.20
Restaurants & hotels	45.10
Other	39.50
Weekly expenditure	**463.50**

[Note – figures cover both working and retired households]

Among those who have taken the plunge and fully retired, the average age of doing so was age 57 and they estimated their incomes fell to 43% of the levels they'd been while still in work. This may be a better indication of the likely fall in household income in retirement, rather than the average figures shown earlier.

A large percentage (57%) of those who have retired early are concerned about the possibility of running out of money in retirement. There could be a range of reasons for this. 41% of 50-64 year olds say they didn't have a choice about retiring, and it's likely this group have fewer defined benefit pensions, which may raise concerns over volatile stock markets or the chance of living long into retirement.

The single biggest retirement income risk cited by those aged 50-64 was the concern about the future of the State Pension indicating that many worry it may be less generous when it's their turn to begin receiving it.

Just 16% said they were not at all worried about running out of money.

Top three retirement income concerns for this age group

1. Changes to the state pension	36.40%
2. Inflation	32.40%
3. Paying for social care	27.40%

Where advice can add value

This age group might seek advice on:

1. Building a realistic picture of income needs in retirement, both initially and through stages of retirement.
2. Having understood aspirations, how much to save in the run up to their retirement to meet these.
3. Deciding on when it's financially viable to retire and preparing for the potential of having to retire earlier than planned.
4. Reviewing any defined benefit entitlements from previous schemes and any options including the pros and cons of transferring.
5. Understanding investment choice including personal attitude to risk and 'capacity for loss'.
6. How state pensions will affect retirement income.
7. How to secure the required amount of guaranteed income either through annuities or alternatives like drawdown with guarantees.
8. Identifying the most tax-efficient order of drawing income from a pension and other savings.
9. Checking appropriate levels of life cover, critical illness and income protection.
10. Thinking about plans for leaving inheritance.

Traditional retirement ages – 65-74

94% fully or partly retired

Recreation is the biggest expense **£66** per week

£373 weekly costs

48% of income compared to when in work

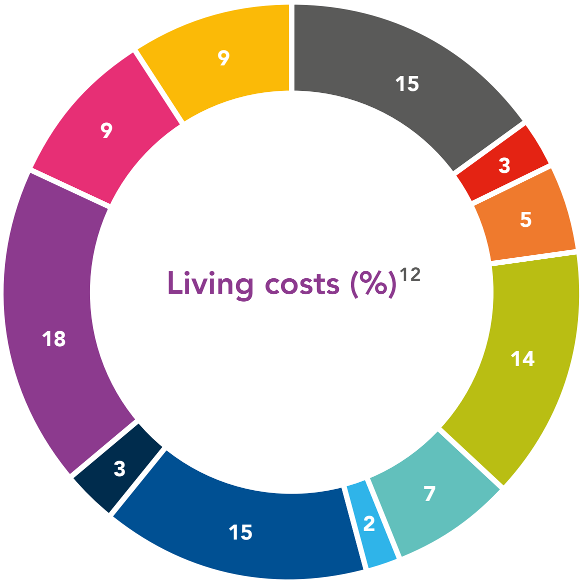
38% have worries about running out of money

Inflation seen as the biggest retirement income risk

There was a very notable shift in the survey results for those over 65, which is traditionally deemed the typical retirement age, with 94% of the group Aegon surveyed saying they were either partly or fully retired.

Weekly household incomes declined to an average of £483, or £450 for those who were fully retired. This group estimated their incomes to be 48% of the levels they received while still in work.

However, declining incomes were matched by reduced living costs which were 24% lower when compared against those of 50-64 year olds. It's notable that recreation (£66.50) is the biggest living cost, suggesting that people are making the most of their retirement, while transport continues to be a major expense at £55.50 a week.



	Weekly spend (£)
Food & drinks	55.60
Alcoholic drinks & tobacco	11.10
Clothing	17.30
Housing (net)[2], fuel & power	53.60
Household goods & services	27.90
Health	7.50
Transport	55.50
Communication	10.70
Recreation & culture	66.50
Education	1.60
Restaurants & hotels	32.80
Other	33.10
Weekly expenditure	**373.20**

Unlike the early retirees, the government provides detailed breakdowns of pensioner income sources between state pension age and 75. 62% of household income is made up of either benefit income (35%), which includes the state pension, or workplace pensions (27%). While only 6% of individuals in this age group are still in full-time work and a further 9% part time, earnings account for a substantial 24% of household incomes.

Weekly income of pensioner households aged under 75[13]

	2014/15 (£)	
Gross income	605	
Benefit income	210	35%
Occupational pension	165	27%
Personal pension income	24	4%
Investment income	53	9%
Earnings	148	24%
Other income	4	1%

(Note – combines households of singles and couples)

A smaller percentage of this group are concerned about the possibility of running out of money in retirement. While 57% of 50-64 year olds have some concerns, this figure falls to 38% among 65-74 year olds. Unlike the younger group who were most concerned about possible changes to the State Pension, this group are most worried about inflation, perhaps because they are more aware that their income is no longer increasing as their earnings once did. The prospect of possible care costs is also a significant worry among 31.5% of this group.

Top three retirement income concerns for this age group

1. Inflation	32.70%
2. Paying for social care	31.50%
3. Changes to state pension	26.80%

Where advice can add value

For those in this age group who have not yet retired, please refer to the section relating to the 50-64 age group.

Those in this age group at the point of retirement might seek advice on:

1. Reviewing all pensions from all periods of employment together – both private and state pensions – including any defined benefit pensions.
2. Determining minimum income to cover essentials.
3. Understanding how to secure minimum income including through the use of guarantees – annuities or drawdown with guarantees.
4. Understanding and picking from the range of new pension freedoms – annuities, flexi-access drawdown, products with guarantees or cash lump sums.
5. Building a picture of how income needs might change through the various stages of retirement.
6. Planning ahead for the most tax-efficient order of drawing income from pension and other savings.
7. Planning for leaving an inheritance.
8. Reviewing wills and considering power of attorney.

For those already taking a retirement income through drawdown:

9. Reviewing the level of income being taken to make sure it's likely to be sustainable throughout life.
10. Checking if more income might be taken because of investment performance or if in poor health.
11. Reviewing investment choices.
12. Considering the potential of having to fund long-term care including how to allocate savings for this possibility.

Later retirement – over 75s

98% are fully or partly retired

Fuel is the biggest living cost at £44 per week

£241 weekly living costs

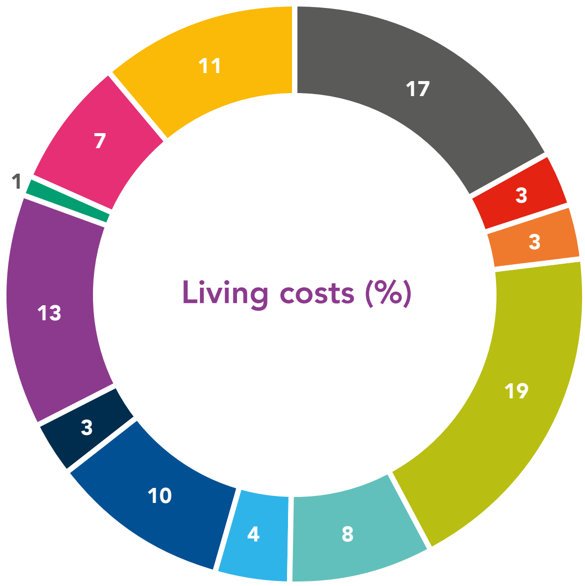
45% of income compared to when in work

37.4% have worries about running out of money

Potential care costs are the greatest concern for this group

98% of over 75s are fully or partly retired, and among those Aegon surveyed, their weekly incomes on average were £481. What's most marked, is the reduction in household costs, which drops to £241 per week, 35% lower than those of 65-74 year olds and a full 48% lower than those aged 50-64.

When compared against the earlier groups, two of the most notable reductions are in spending on transport (£24.10 per week) and recreation (£32.30) which have both more than halved when compared against 65-74 year olds. In contrast, spending on fuel and power increases as a proportion of costs, accounting for 19% of the oldest group, exposing them to increases in household heating bills.



	Weekly spend (£)
Food & drinks	41.50
Alcoholic drinks & tobacco	6.20
Clothing	8.30
Housing (net)[2], fuel & power	44.90
Household goods & services	19.90
Health	9.30
Transport	24.10
Communication	7.70
Recreation & culture	32.30
Education	2.70
Restaurants & hotels	17.20
Other	27.20
Total expenditure	**241.30**

The make-up of household income also varies considerably with benefit income accounting for more than half of over 75's income, with both the value and percentage of income coming from workplace pensions falling.

While those in the 75 and above category will often have done well from defined benefit schemes, they are also the group who've been retired for longest. Some will have had their pension increased with price inflation, but those who retired longer ago may not have benefited from such 'statutory protection'. And even if they've received price-inflation increases, pensions will not have kept pace with average earnings, meaning they gradually 'fall behind' those who retired more recently. In addition, it is this group who will have suffered from the years when state pensions were not increased in line with earnings, with the triple lock not implemented early enough to allow them to keep pace.

Unsurprisingly, earnings drop off to just £12 for this older group with the vast majority of people fully retired by this stage.

Weekly income of pensioner households aged over 75[14]

	2014/15 (£)	
Gross income	397	
Benefit income	219	55%
Occupational pension	121	30%
Personal pension income	15	4%
Investment income	26	7%
Earnings	12	3%
Other income	4	1%

There's little notable difference in the percentage of people who are worried about running out of money, versus those aged 65-74. Those with defined benefit schemes don't face the same risks. The biggest difference here is the fact that social care costs now top the list of retirement income concerns.

It's understandable that health becomes more of a consideration with age and 41% of over 75s have given lasting power of attorney to a loved one compared to just 18% of 65-74 year olds. This figure also ties in with the percentage of people who have thought about inheritance planning, with 36% of over 75s having thought about and/or planned their inheritance. This is still a relatively low percentage given the significance of inheritance planning, but it's far larger than the 20% of 50-64 year olds who have a plan in place.

Top three retirement income concerns for this age group

1. Paying for social care	30.90%
2. Inflation	28.60%
3. Changes to state pension	23.50%

Where advice can add value

Those in this age group might seek advice on:

1. How to manage finances to cover the possibility of having to fund long-term care, including how this is best arranged for couples.
2. For those in drawdown, ongoing investment advice and when an annuity might become more suitable.
3. How releasing equity from the home could boost income.
4. Considerations around inheritance planning, wills and power of attorney.

Conclusions

A U-shaped retirement?

Retirement income needs are often said to be U-shaped, with high initial spending in active early retirement, a levelling out in the middle phase, followed by a final hike in expenses in later life. The figures in this report provide some evidence in support of this model with people in the earlier phase of retirement making the most of their new found leisure time. Our research, coupled with the government figures, certainly highlighted spending on transport and recreation is highest amongst the younger age band as people begin accessing their retirement savings.

Spending levels do then slow down as people move into a less active phase, more akin to the historic picture of pensioners. This was evident in the expenditure figures of the over 75s which were 35% lower than those of the earlier age group.

This could be followed by an increase in spending as poor health and/or care costs becomes more of a consideration. There was no tangible evidence in our findings to highlight that people's costs spiral at this point, but this largely because this group is understandably difficult to survey. It was evidenced in part by the proportion of people citing care costs as the major retirement income concern in later life.

Whatever the exact shape of retirement income needs, we can conclude that today's pensioners are in a stronger position than any generation to come before them. The average pensioner household has a well-diversified income made up of relatively secure sources including workplace and state pensions.

Top three shifting concerns

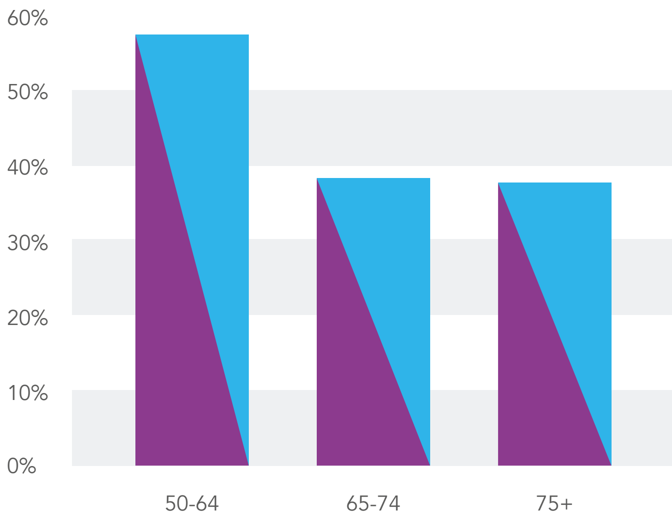
- Changes to state pension
- Inflation
- Potential care costs

How long can we keep the good times going?

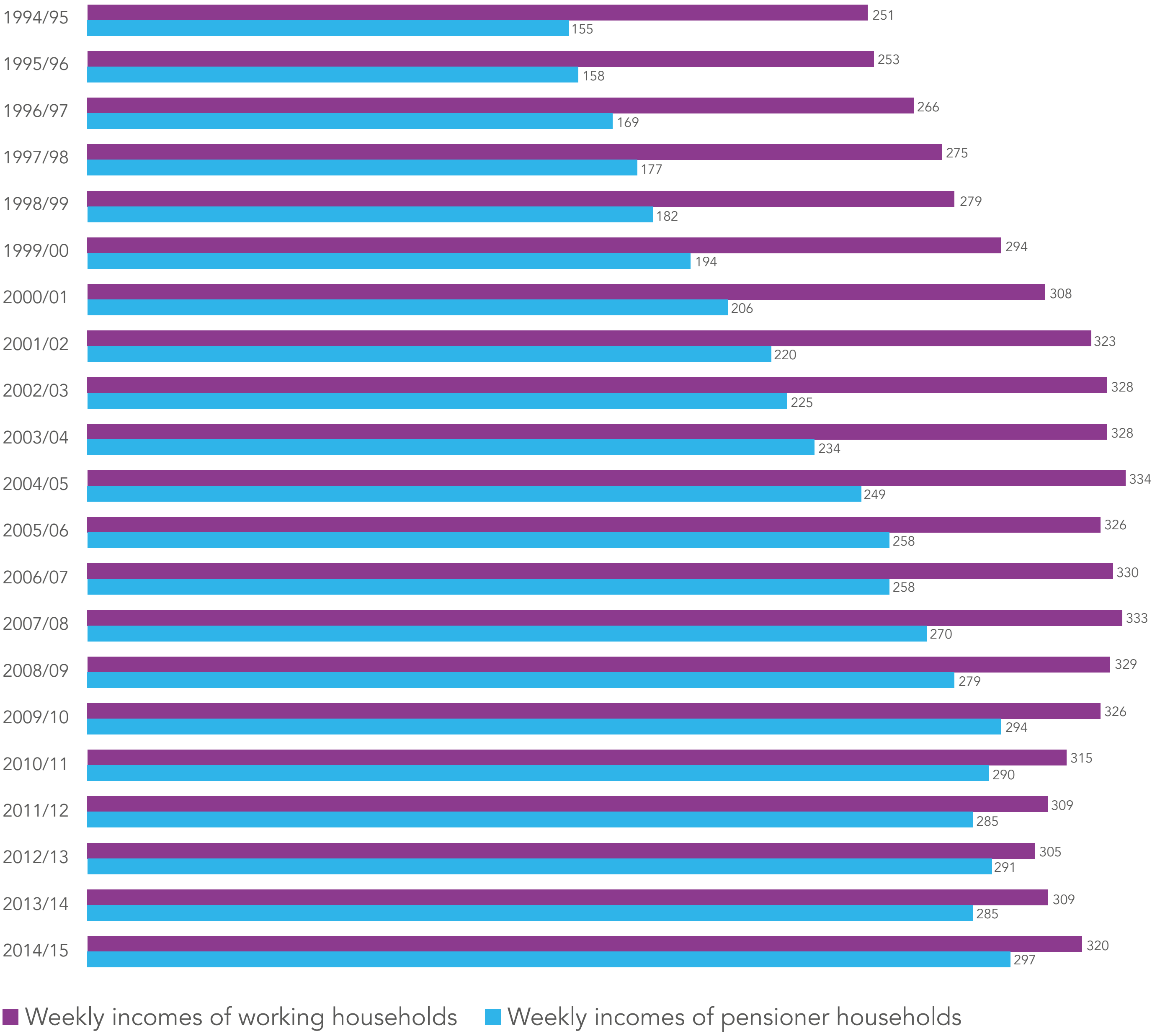
Sustainable income

Despite the positive increase in pensioner wealth, there is a concern, particularly among the younger groups, that they may run out of money. The Financial Conduct Authority has identified this as one of the greatest risks with pension freedoms and it is an area where advisers are ideally placed to help by identifying what looks like a sustainable income level, and then reviewing that periodically to allow for investment performance. The move to full flexi-access drawdown without any upper limit set by the government (the Government Actuary Department 'GAD' limits) makes the adviser's role even more important. Ironically, the increase in individuals opting for drawdown without the support of an adviser comes at the precise time when they have less protection as under flexi-access drawdown, the government no longer sets an upper limit on how much income can be taken. For this reason, it's not surprising that the Financial Conduct Authority is particularly concerned about sustainable income levels, especially amongst those not seeking advice.

Percentage who are worried about running out of money



Weekly incomes after housing costs



Is the Golden Age of retirement about to lose its glitter?

While this report has highlighted a great deal to be positive about regarding today's pensioners, we need to be realistic about how likely these trends are to continue. Unfortunately, it's increasingly clear that the Golden Age of generous defined benefit schemes within the private sector are well and truly over. While many individuals retiring in the coming years will still have a significant defined benefit entitlement from past periods, we believe the amounts that those retiring in future years will receive have already levelled off and we should expect them to begin to drop over time.

While many private sector employers replaced defined benefit pensions with a defined contribution scheme, such as a group personal pension, these tend to be far less generous, with total contributions, and hence proceeds, much lower than under-defined benefit. Automatic enrolment is widely regarded as having been a government success in getting millions starting to save or saving more towards retirement. But if people don't significantly increase their contributions, they will not find themselves as well off as today's pensioners.

As well as overall levels of saving, the trend is also towards a lower proportion of retiree's income being guaranteed for life. The decline in defined benefit provision could be accelerated further if an increasing number of individuals transfer out of schemes that they are no longer building benefits within. There are currently relatively high transfer values on offer and concerns over the funding viability of some defined benefit schemes that makes this a growing concern.

For these reasons, unless there's a real shift in voluntary savings habits, we must face up to the fact that the positive trends of the past are unlikely to continue in future. We mustn't allow the generation retiring in 10 or 20 years to be lulled into a sense of security by observing the current 'Golden Age of retirees' boosting the economy with their grey pound in restaurants and on cruise ships. As well as encouraging greater savings, we also need to find innovative means of allowing future retirees to secure their minimum income needs through the use of guarantees including within drawdown.

Perhaps we are being unduly pessimistic. **We hope so.** But there is some evidence in our research that those in the relatively younger age groups are beginning to face up to reality with increased concerns about running out of money in retirement.

Against this backdrop, advisers, pension providers and the government all have a role to play in helping savers build an accurate picture of what they have in store in retirement – their likely income levels, their spending needs during the various stages of retirement and how to make sure they can meet their minimum income needs through guarantees. And we need to do this well before 'retirement' approaches so people have time to act if that future looks less 'Golden' than they might have imagined.

References

[1] ONS Pensioners' Income Series 2013/14, p5

[2] ONS Pensioners' Income Series 2014/15, p1

[3] ONS Pensioners' Income Series 2014/15, table 2.1

[4] ONS Pensioners' Income Series 2013/14, p30

[5] ONS Pensioners' Income Series 2014/15, table 2.1

[6] ONS Pensioners' Income Series 2014/15, table 2.7

[7] ONS Pensioners' Income Series 2014/15, table 2.1

[8] ONS Pensioners' Income Series 2014/15, table 2.1

[9] ONS Life Expectancy at Birth and at Age 65 by Local Areas in the United Kingdom: 2006-08 to 2010-12

[10] Cencuswide research among 2,000 adults aged 50 or over, May 2016. All figures Cencuswide unless otherwise specified from this point in the report

[11] ONS Family Spending report

[12] ONS Family spending report

[13] ONS Pensioners' Income Series 2014/15, table 2.7

[14] ONS Pensioners' Income Series 2014/15, table 2.7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