



Decision Citizens

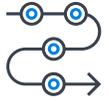
Exploring the Retirement Challenges Facing Future Generations

Beatrice Male & Marie-Lise Tassoni

18 January 2018



Agenda



Introduction



Are future generations adequately prepared for retirement?



Your future, your responsibility



Enrolment is not the same as engagement



Make your money work harder



You can't predict the future but you can protect it



Challenging times



It's not all about income

Introduction

- Royal London asked Milliman to bring to life the challenges future generations of retirees are likely to face both financially and socially
- 16 case study households
 - *How will they fare in retirement?*
 - *Case studies to look at how things could be different*

Over half of our households would be reliant on the state pension to cover their **basic costs**

Over 3/4 of our households would have to **reduce spending** when they reach retirement

1. <https://www.zurich.co.uk/en/about-us/customer-news/industry-news/2015/britons-likely-to-outlive-savings-as-two-thirds-underestimate-longevity>

Meet the households

Limited Choices

Squeezed

Manageable

Comfortable

30

William

Gavin and Kirsty

Tomasz

Charlotte

40

Jenny

Gareth and Hayley

Jason and Paula

Christopher and
Joanna

50

Phil, Angela (Callum
& Natasha)

Gordon and Yvonne

Anthony

Rajesh, Manjit (Nikhil
& Nisha)

60

Victor, June (Glyn &
Samantha)

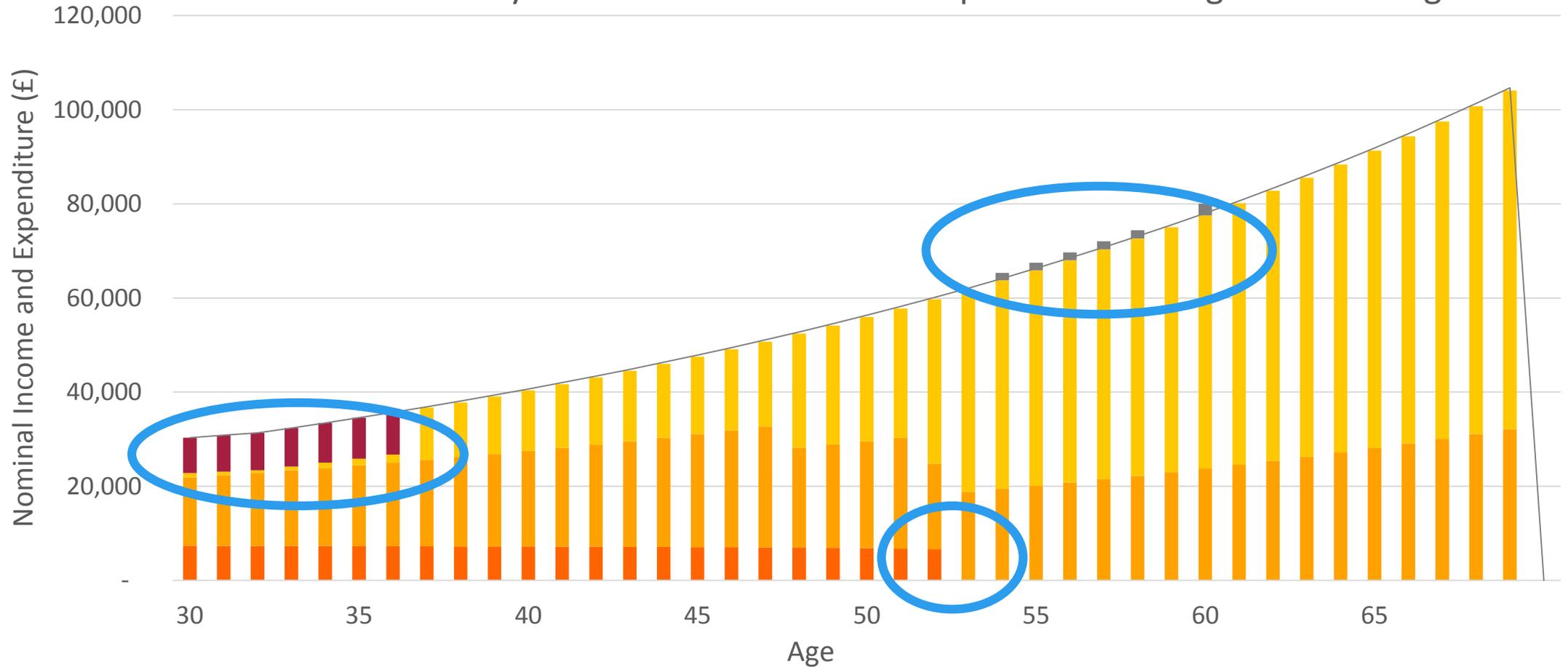
Elaine

Vincent and Lynne

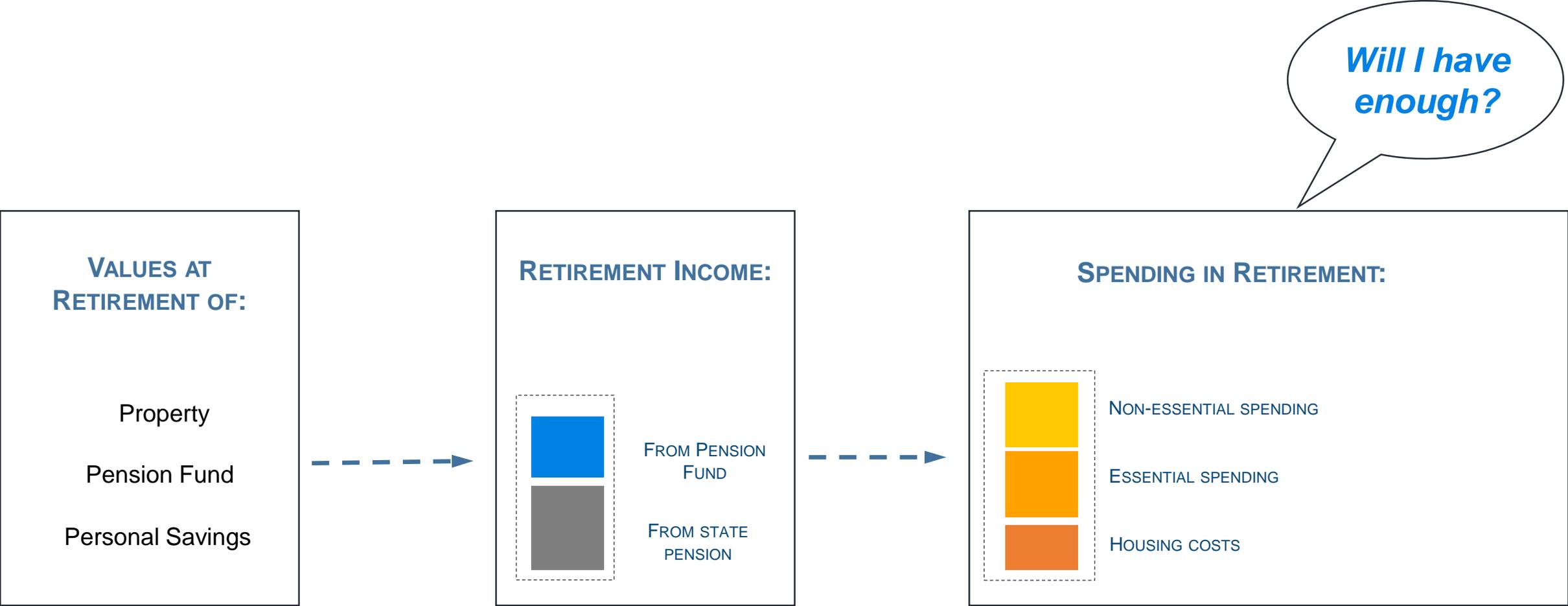
Martin and Janet

Gavin and Kirsty's journey to retirement

Gavin and Kirsty's household income and expenditure during their working lives

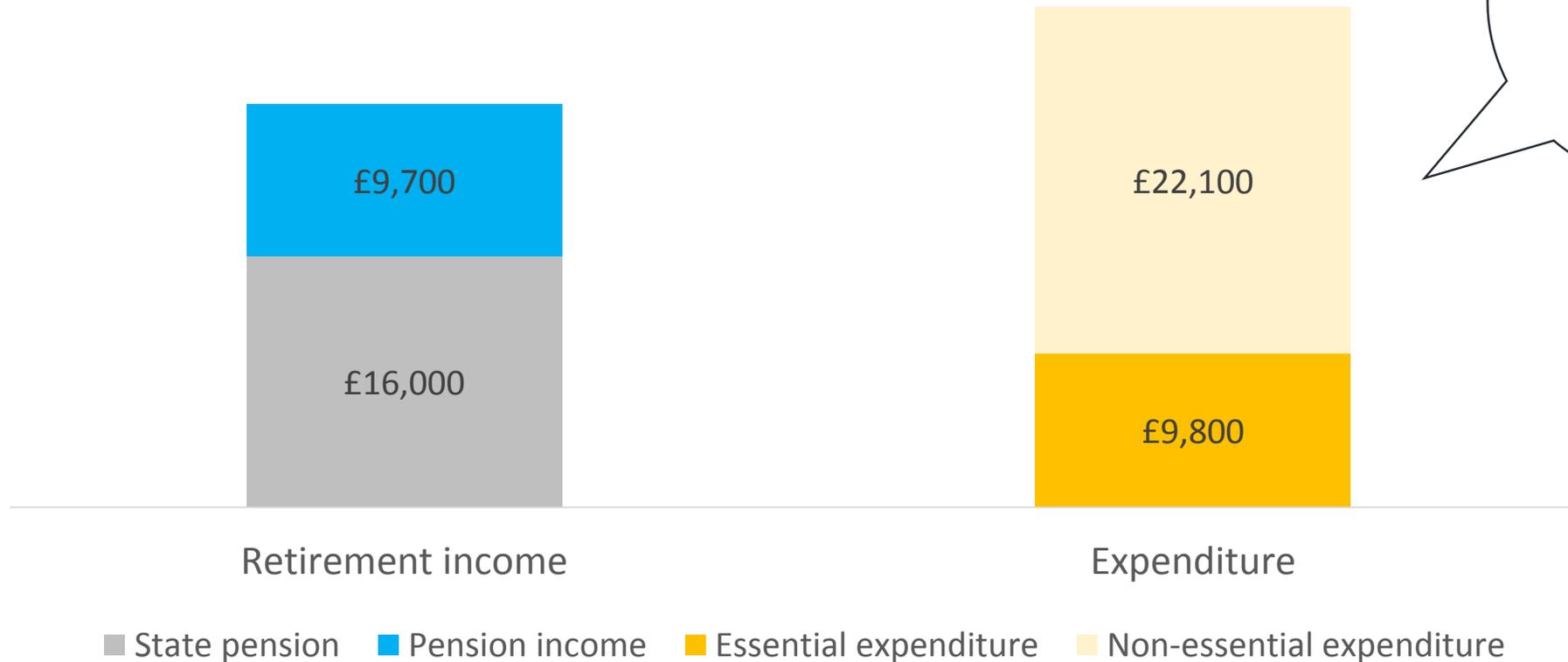


The analytical approach



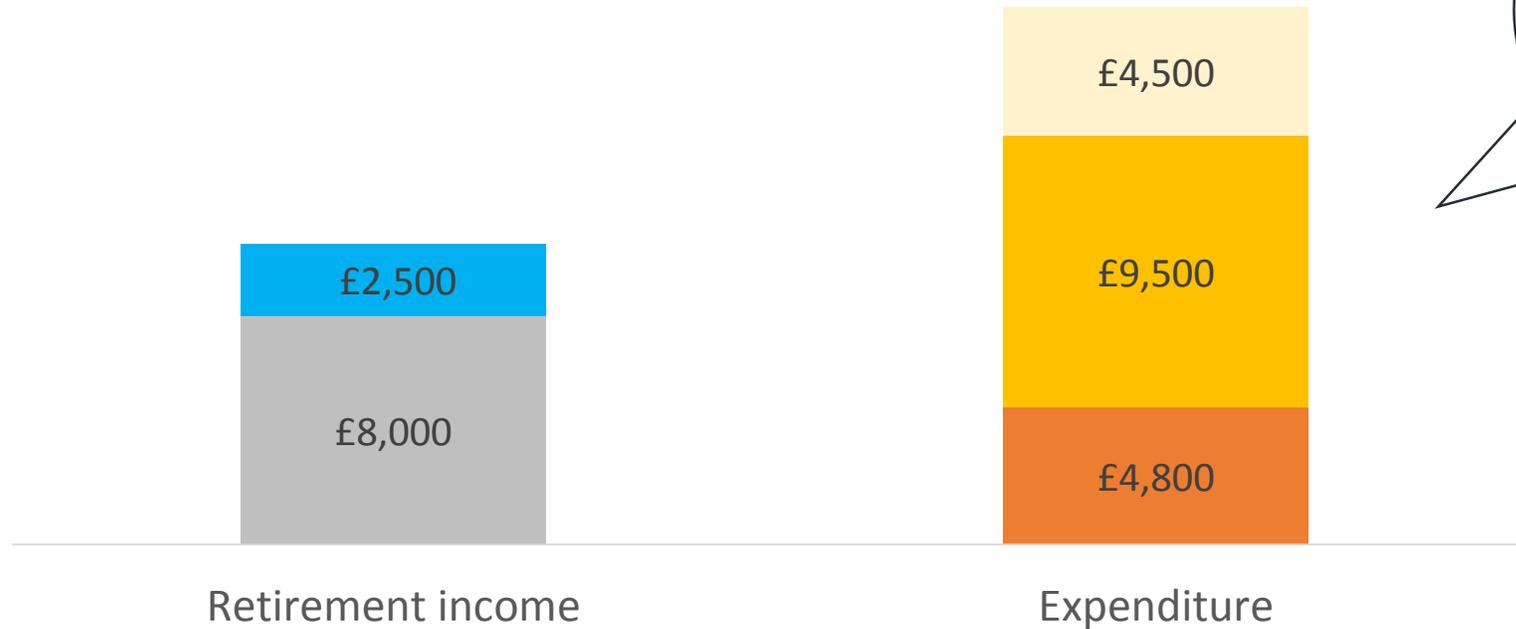
The analytical approach

Gavin and Kirsty's annual net retirement income and expenditure (in today's money)



The analytical approach

Jenny's net retirement income and expenditure
(in today's money)



I won't have enough to cover my basic costs!

■ State pension ■ Pension income ■ Housing Costs ■ Essential expenditure ■ Non-essential expenditure

Key assumptions

- We have assumed that financial performance reflects current market views
- Households' current composition, salaries, pension fund and personal savings levels are based on **FSS Experian data**
- We model future spending and savings habits based on the current spending and saving habits reported in **ONS data**
- The conversion of at-retirement pension savings into an income is consistent with projected interest rates based on today
- Tax and state benefits are assumed to increase in line with inflation

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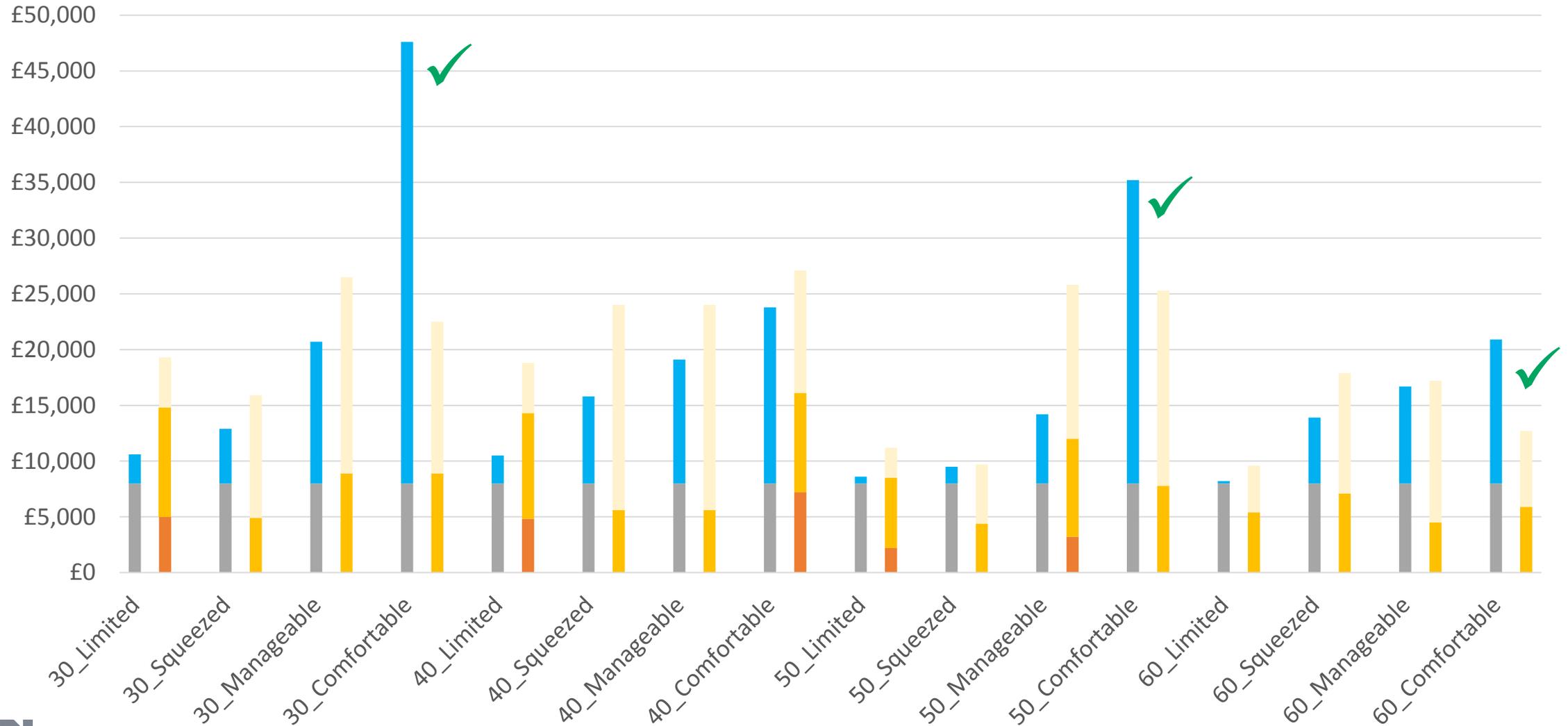
Challenging times



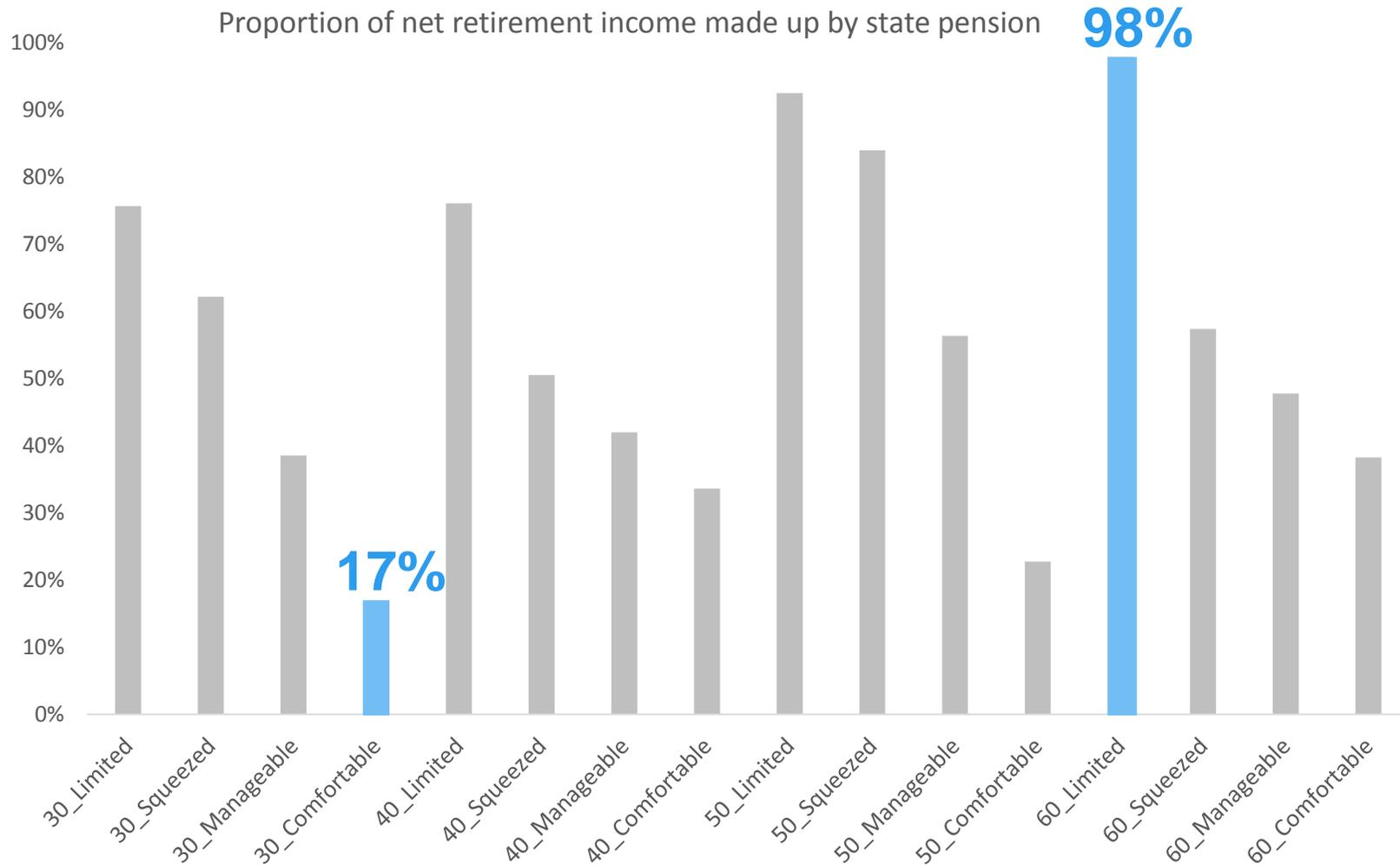
It's not all about income

Are future generations adequately prepared for retirement?

Comparing Retirement Income to Expenditure (in Today's Money, **per retiree** in the household)



Are future generations adequately prepared for retirement?



Half of the example households wouldn't be able to cover their basic costs without the state pension

On average across our households, the state pension represents **53%** of households' net retirement income

If left until retirement, there are three main options available to change financial situation

Working longer

Cutting down on
spending in retirement

Downsizing / equity
release

Working longer

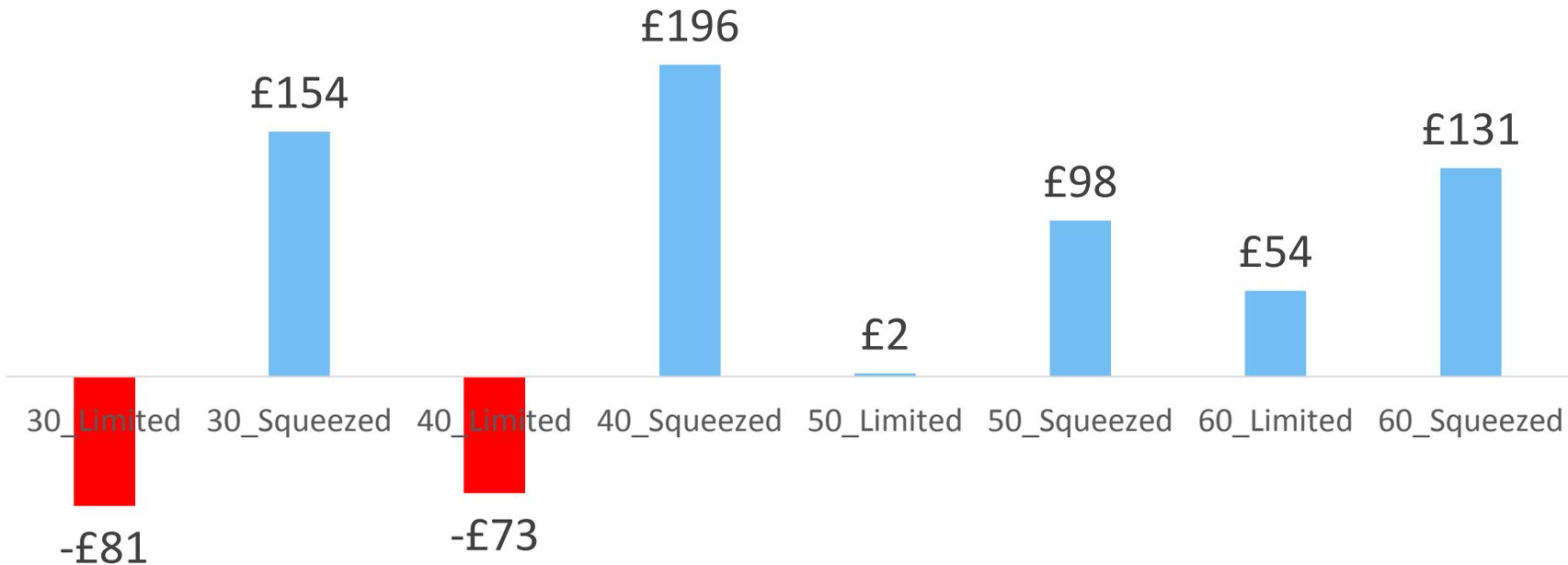
To cover their basic costs in retirement, our poorest households aged 30 and 40 will both need to **work for an extra 7 years full time**

Other households need to work anywhere up to **11 years full time** in order to maintain their pre-retirement level of expenditure

But working longer **won't be possible** for everyone.

Cutting down on spending in retirement

Spare Money to spend on non essentials each week in retirement
(in today's money, per household)



£256 per week
(average UK household
spend on non-essentials)

(ONS family spending, 2016)

Downsizing: the right 'move' for everyone?

- Around 3 million people of working age in the UK plan to sell their primary residence to fund their retirement¹
- Certain challenges may get in the way of realising this
- Income generated from downsizing may not be high enough

Downsizing: the right 'move' for everyone?

Fact File – Victor, June (Glyn & Samantha) (60 limited)

Age now: 60

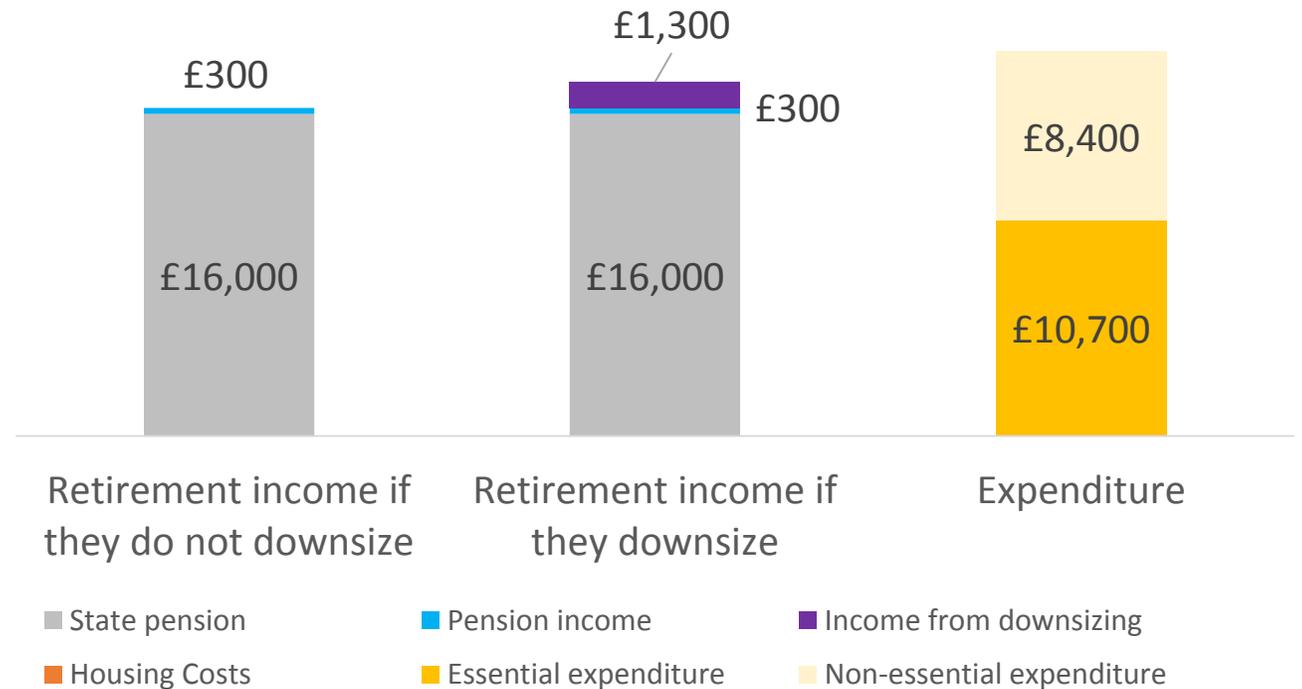
Household salary now: £20,000

Age at retirement: 66

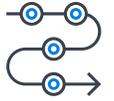
Home: They live with their adult children in their modest home, worth £100,000, which has a paid-off mortgage. For them, it is 'all about the home'

Wealth: They have very limited pension and other savings. Money is tight but they get by.

Victor and June's income and expenditure
(in today's money)



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Challenging times



It's not all about income

Lack of understanding the extent of personal provision needed

40% think they can rely on it

Retire at 64

DB → DC

2% interest rate on £100

Expect to live to 81 (men) / 79 (women)

State pension: unrealistic expectations

Not understanding the retirement system

Assume parents' generation rules will apply

Lack of financial literacy

Misunderstanding longevity

$\frac{3}{4}$ of our 30 year olds can't cover their basic costs with it

State retirement age is 68 for those under 39

Pensions freedoms

= ???

Life expectancy is 86 (men) / 89 (women)

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Auto-enrolment has boosted pensions saving

- 10 million workers newly saving / saving more¹
- Requires an active decision to opt-out
 - 1 in 10 opt-out rate²
- Self-employed workers / those with multiple part-time jobs could be left behind
- 4.6 million self-employed individuals haven't benefitted from auto-enrolment¹
 - Applies only to 'qualifying income'
- **It is a step in the right direction but not the whole answer**

1. Department of Work and Pensions (2016), Workplace pensions: Update of analysis on Automatic Enrolment
2. Institute of Actuaries (2015), 'Saving for retirement' policy briefing

Auto-enrolment: opting out

Fact File – Gavin and Kirsty (30 squeezed)
Stretch limited disposable income sometimes use credit cards/loans

Age now: 30

Household salary now: £35,000

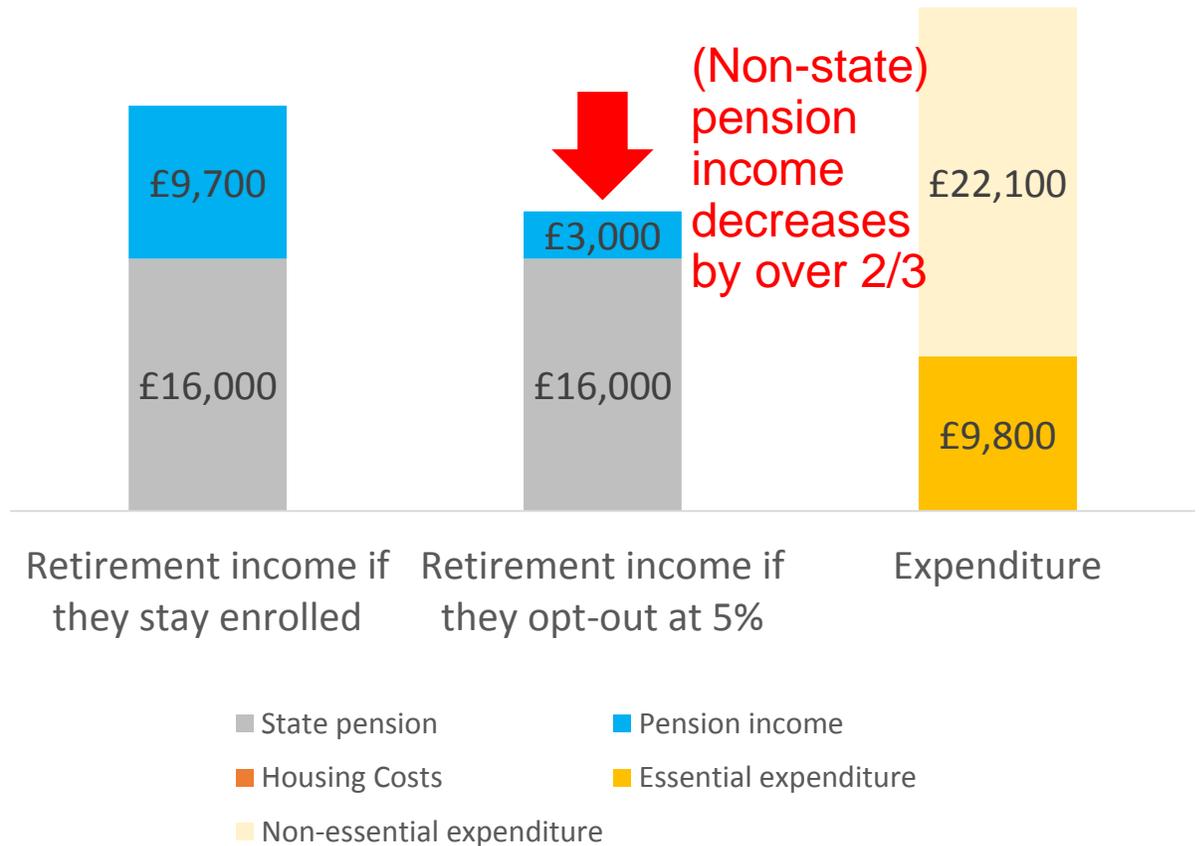
Age at retirement: 70

Home: Own a property worth £120,000

Personal life: Both Gavin and Kirsty work and their two young children are looked after by an au-pair and by family.

They opt out once employee contributions fully phase to 5%, and then opt back in 15 years before retirement

Gavin and Kirsty's net retirement income and expenditure (in today's money)



Making most of pension provision

- 64% of FTSE 350 companies offer some level of contribution matching in their pension schemes
- However not all employees maximise their employers' matching

Fact File – Jason and Paula (40 manageable)

Good progress paying off mortgage but little savings

Age now: 40

Household salary now: £54,000

Age at retirement: 69

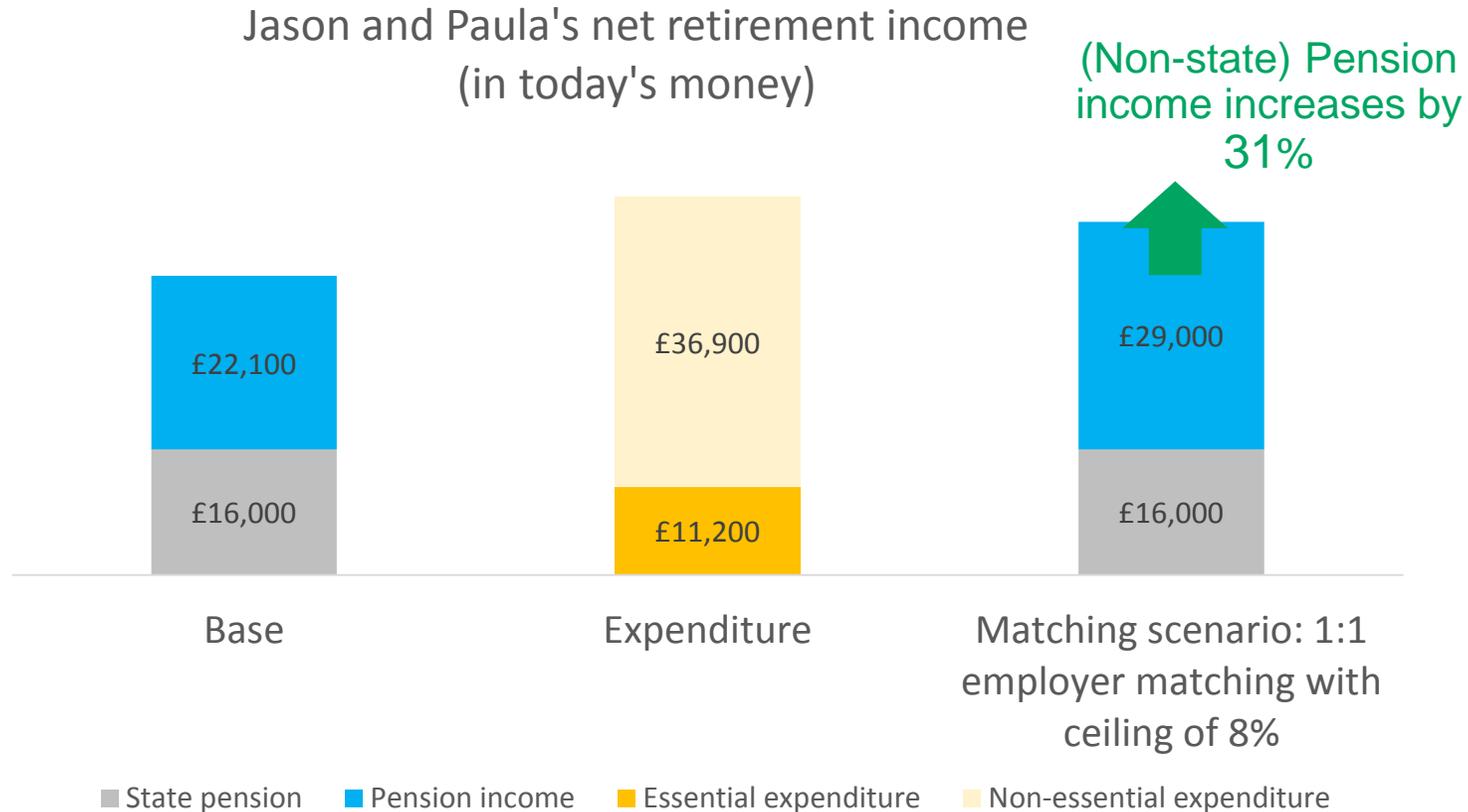
Finances: *Not very interested in personal finance and they have limited knowledge about savings and credit options*

Jason and Paula contribute the default amount to their pension scheme, 3%. Their employer contributes 5%.

However, their employer will additionally match further contributions up to 3%.

Making most of pension provision

- The £1,600 a year increase in pension contribution has resulted in having an extra £6,900 a year in retirement.



- It has also meant that Jason and Paula won't have to cut back on their spending when they reach retirement.

Reviewing pension contributions: 1% a year challenge

Fact File – Tomasz (30 manageable)

Age now: 30

Household salary now: £33,000 (doubles when he marries Agata)

Age at retirement: 70

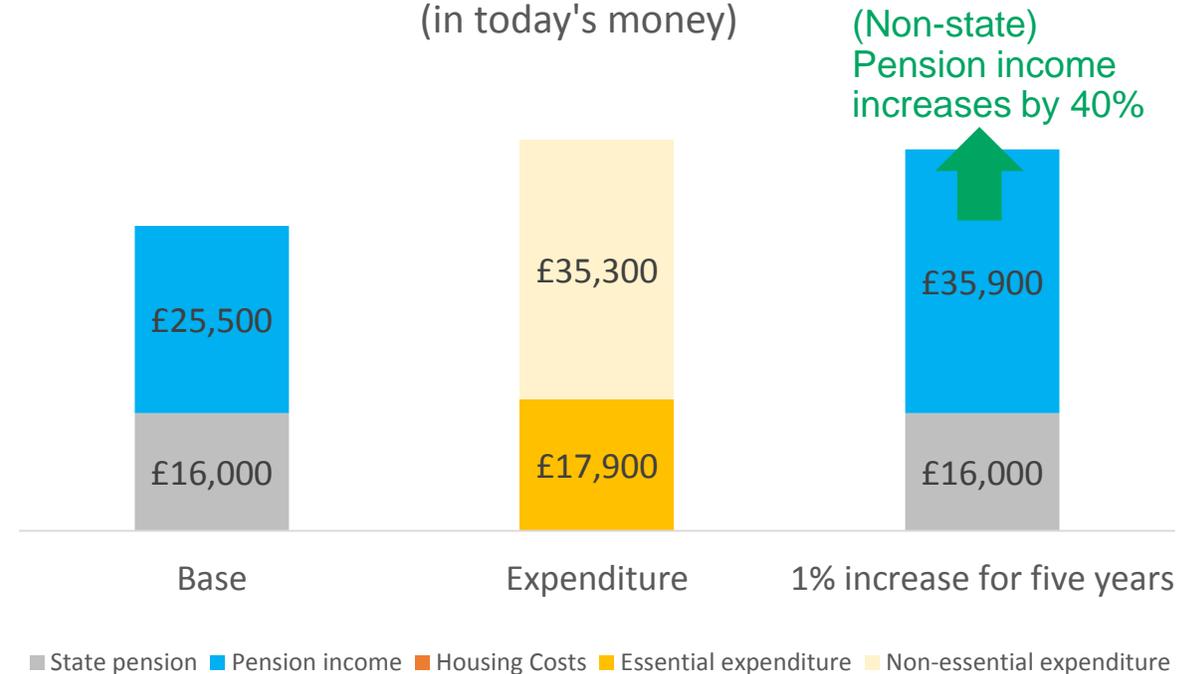
Home: Rents in London until he's 40. Buys a property in London with help from parents

Personal life: Marries Agata and has two children

Tomasz has been challenged by one of his friends to increase his pension contribution by 1% of salary each year.

Tomasz currently contributes 3% per year to his workplace pension scheme but next year will contribute 4%, the following year 5% and so on until he reaches 8%.

Tomasz and Agata's net retirement income and expenditure (in today's money)



Don't leave reviewing contributions until it's too late

Fact File – Tomasz (30 manageable)

Age now: 30

Household salary now: £33,000 (doubles when he marries Agata)

Age at retirement: 70

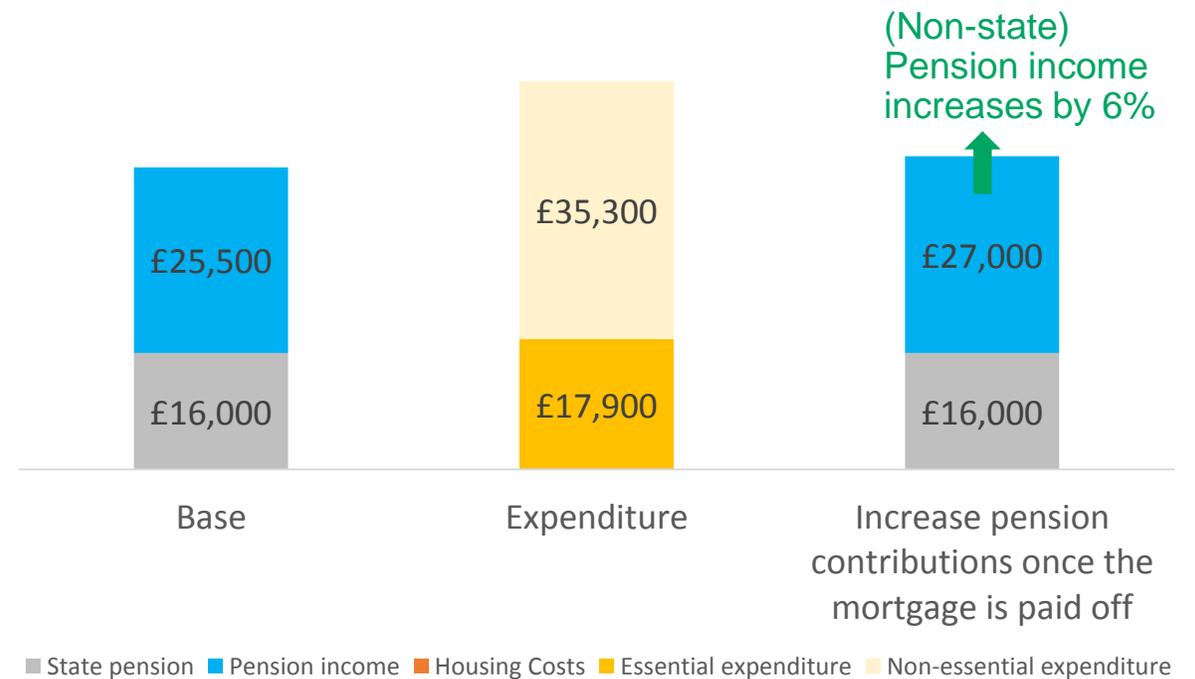
Home: Rents in London until he's 40. Buys a property in London with help from parents

Personal life: Marries Agata and has two children

At 65, Tomasz and Agata finally pay off their mortgage and decide to use this money to increase their pension contributions.

They increase their pension contribution from 3% to 12% for the last 5 years of their working lives.

Tomasz and Agata's net retirement income and expenditure (in today's money)



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Challenging times



It's not all about income

Effective savings vehicles

- When considering non-pensions savings, whether a vehicle is effective will depend on several factors
- An effective product delivers the best outcome for the customer allowing for their attitude to risk and capacity for loss
- However many households may not be choosing the most effective saving vehicles
- Some households may perceive non-cash savings as too risky. However, the value of their savings could be eroded if held in cash over the long term

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Insurance

- Many people worry about their financial future but do little to protect it
- As well as the obvious consequence of causing households to struggle with day-to-day bills, it will affect both retirement and personal savings as well

Income protection insurance

Fact File – Gordon and Yvonne (50 squeezed)

Age now: 50

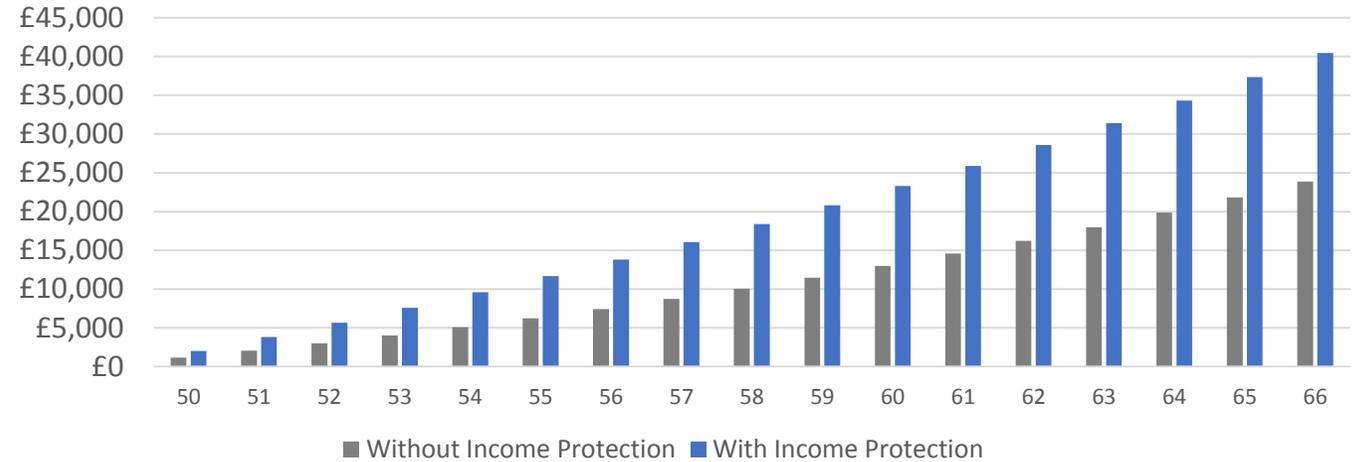
Household salary now: £14,000
(previously £31,000)

Age at retirement: 67

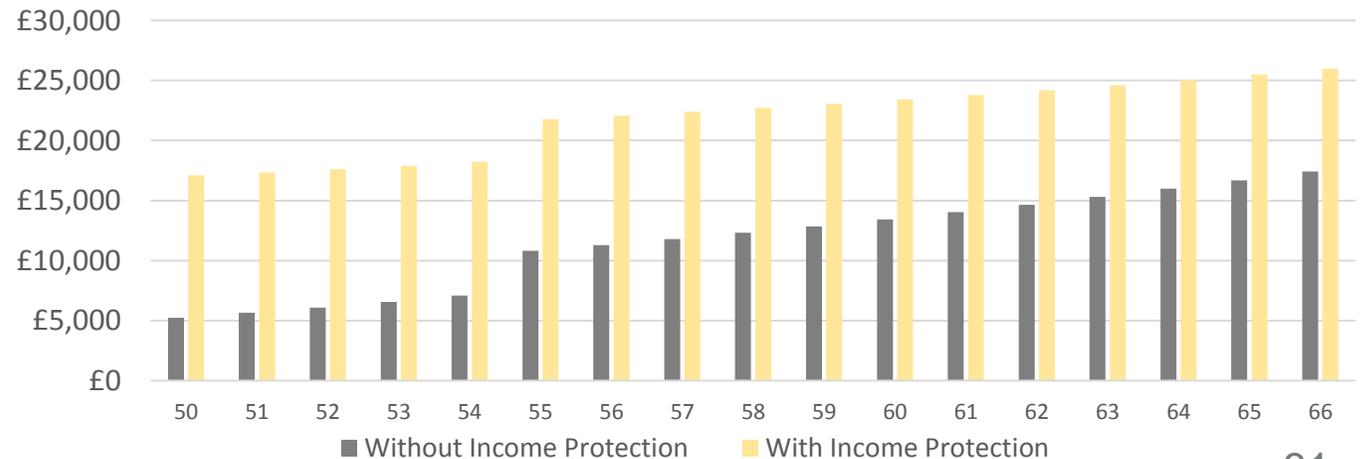
Home: Homeowners with a small mortgage outstanding

Employment: Yvonne works full time, Gordon had to stop working due to ill health

Savings (nominal)



Income to spend on non-essentials (nominal)



Trade-offs

- However, as well as considering the benefit of protection products, the costs must be considered too.
- We looked at the impact of contributing the cost of income protection cover (non-smoker, £15,000 benefit per year, level income, 26 week deferred period) into the workplace pension instead.

Consider a 40 year-old who earns £30,000 a year.

She's considering a product that will provide 50% of her income

The premium for income protection cover is £340 p.a.

By the time she retires, these additional contributions would increase the income from her pension fund just over £790.

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It's not all about income

Home ownership in retirement

- Large increase in the house price to earnings ratio:
 - Harder to get on housing ladder
 - Mortgage in retirement?
 - Renting in retirement?
- Retirement income will have to more cover housing costs too for those who don't own their house outright.

Consumer debt

- Almost one in five people aged 35 and 44 say that they borrow simply to make ends meet¹
- The average UK household owes almost £7,300² in consumer credit debt including purchases obtained with credit cards, lines of credit and some loans.
- Credit card rates have also hit record highs³ at 22.8%. So the cost of debt is also increasing
- Servicing debt is a barrier to personal saving and to contributing to a pension scheme.

Credit card debt

Fact File – Gavin and Kirsty (30 squeezed)
Stretch limited disposable income sometimes use credit cards/loans

Age now: 30

Household salary now: £35,000

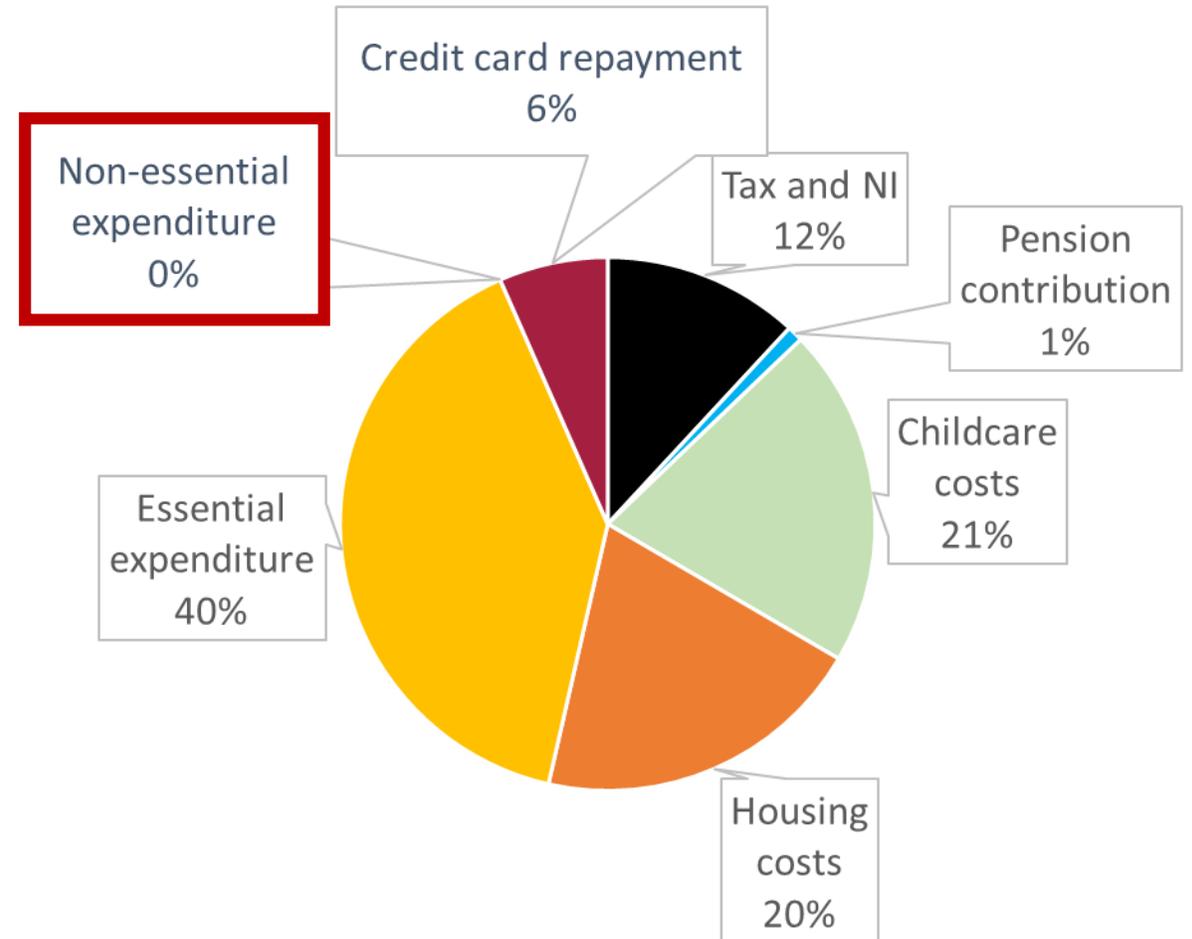
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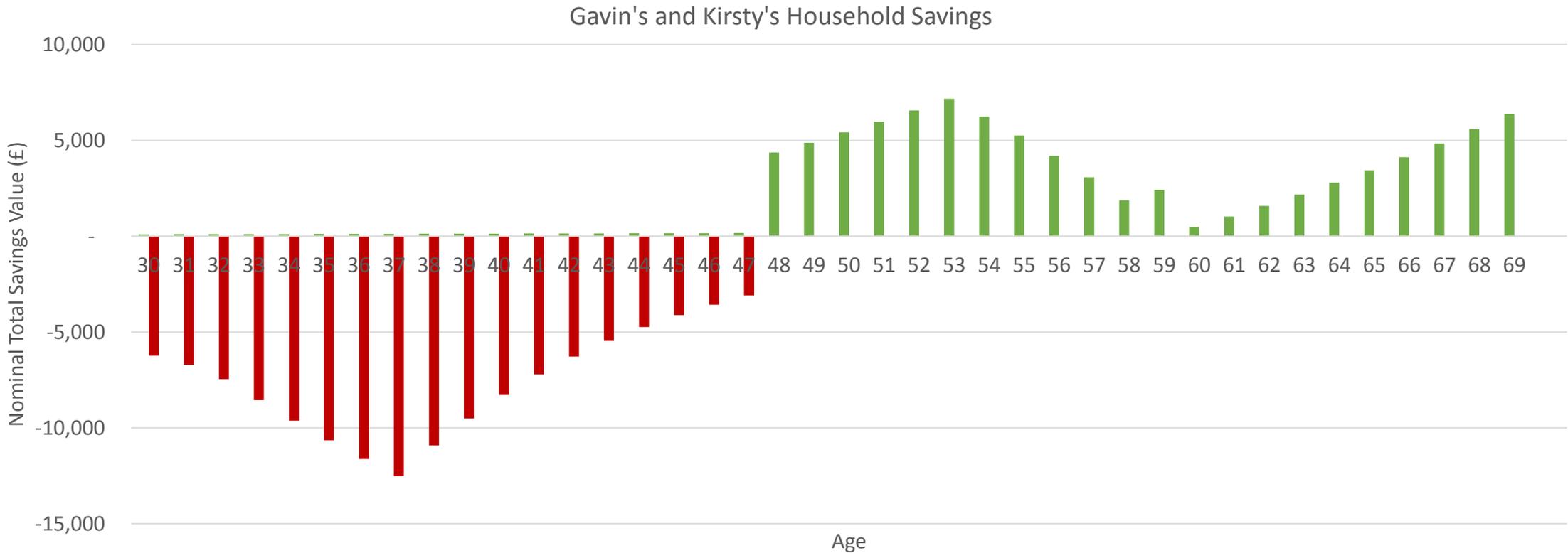
Personal life: Both Gavin and Kirsty work and their two young children are looked after by an au-pair and by family.

Credit card debt: £7,258 on their credit card

How Gavin and Kirsty spend their gross income



Credit card debt



18 years to pay off debt

Repayments add up to **over 7 times** the value of the initial loan

Student debt

- Student debt is a problem that young people today will have to carry throughout their lives that did not apply to older generations
- These levels of debt will affect future generations financial futures. This is a new challenge to overcome when considering financial planning

Student debt

Fact File – Tomasz (30 manageable)

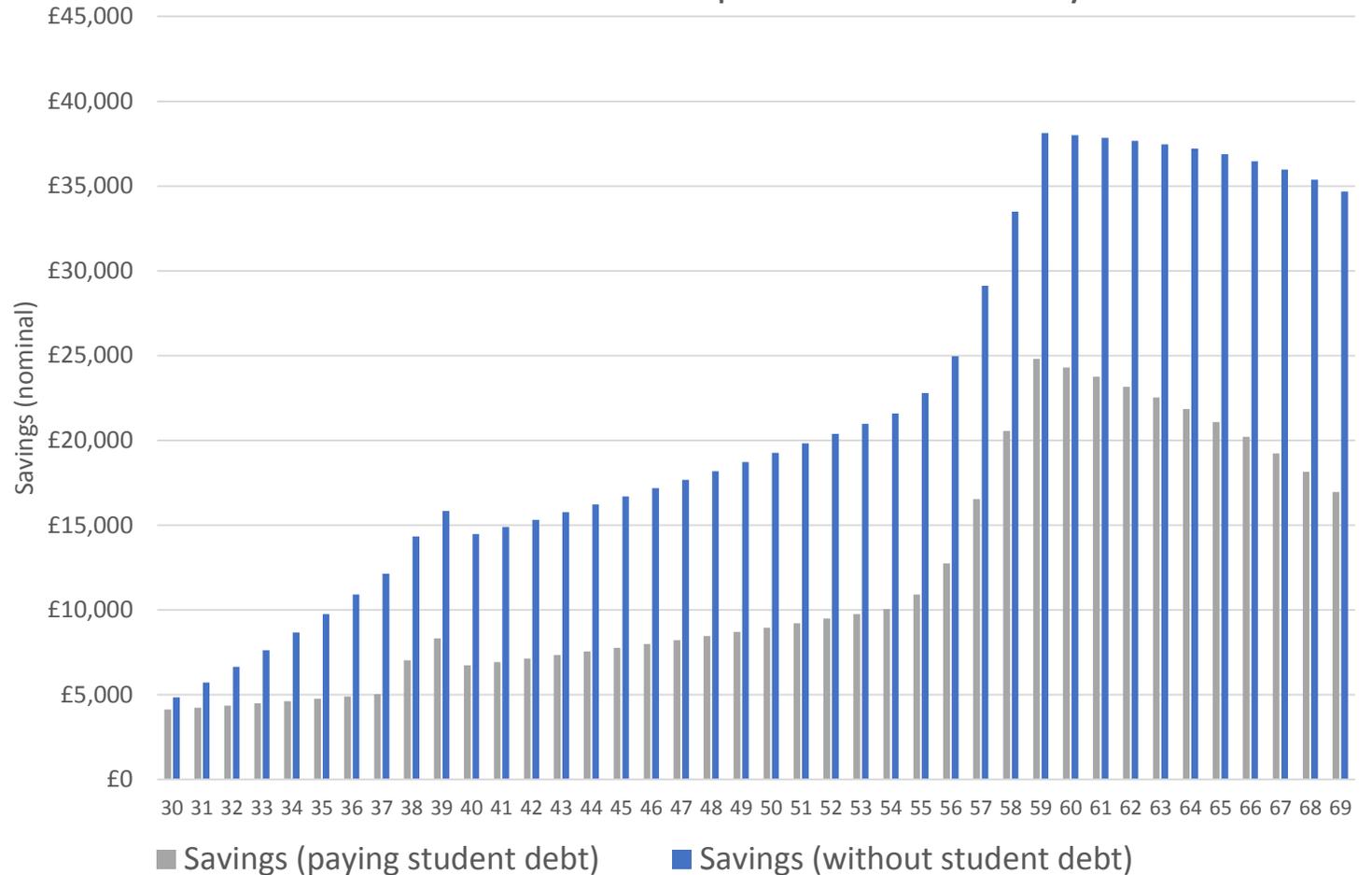
Age now: 30

Household salary now: £33,000

Age at retirement: 70

Student debt: £44,000 when he graduated at age 21, which has escalated to £78,000 by the time that he turns 30

How does student debt impact Tomasz's ability to save?



Family matters

- Life can be expensive and, whilst 9 out of 10 people understand that they should be saving or investing, 54% say that they don't save more now simply because they can't afford to¹
- There are times in households' lifetimes where other priorities come first ahead of saving for retirement, including:
 - Childcare costs
 - Saving for a property
 - Contributing to parents' care costs

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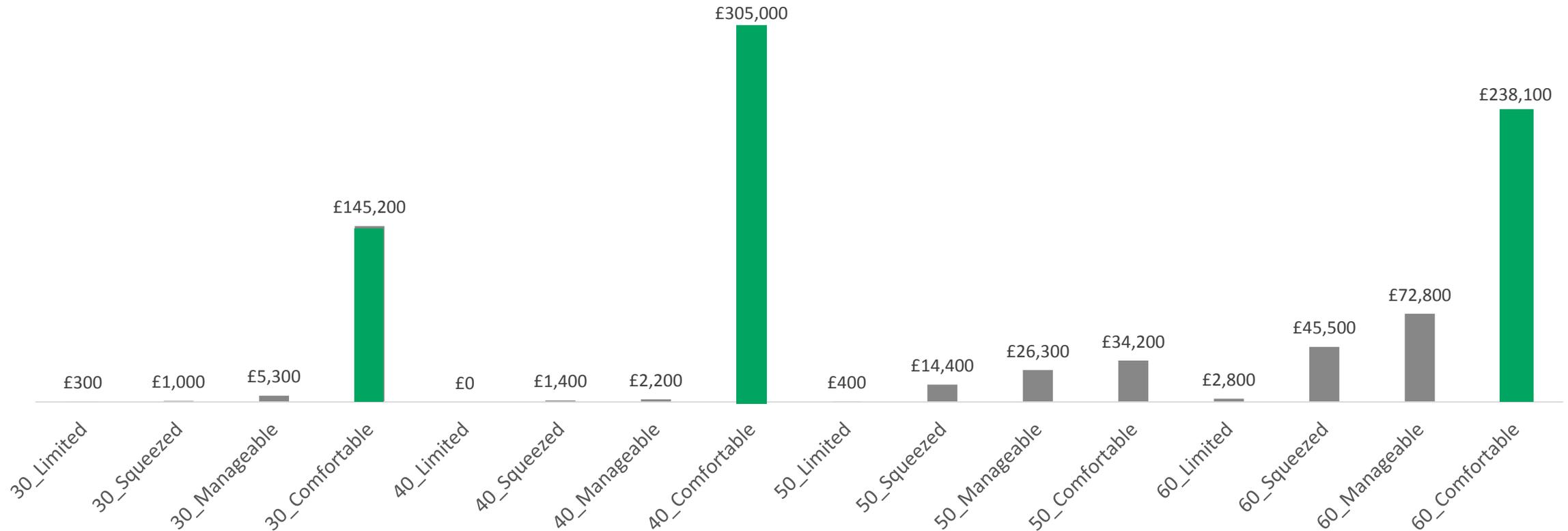


It's not all about income

Long-term care

- The government have pledged to cap of care costs of £72,000 as of 2020 but living costs excluded

Who has enough savings for long-term care?
(in today's money, per retiree)



Summing Up

- Current pensions savings is unlikely to be sufficient to fund retirement
- Unrealistic expectations compound the challenge
- More informed, more proactive decisions can make a big difference
- Significant barriers to executing those decisions



Any questions?

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