Pensioner income projections

DWP ad hoc research report no. 23

A report of research carried out by the Department for Work and Pensions.

Contents

1 Introduction

The aim of this publication is to examine future trends in some components of pensioner incomes. Pensioner incomes will include amounts gained from State Pension (including basic and additional State Pensions for those reaching State Pension age up to 2015, and the new State Pension for those doing so from 2016), Defined Benefit (DB) schemes, and Defined Contribution (DC) schemes[1]. This will be looked at from an aggregate level, as well as examining potential gender differences and from an income quintile perspective.

1.1 Summary

- Overall, pensioners incomes are forecast to maintain their value against the wider economy over time, seeing a slight increase over the coming decades;

- State Pension amounts are forecast to marginally increase over time, owing to the impact of the triple-lock uprating (where State Pension amounts increase based on the highest of price inflation, increase in earnings or 2.5 per cent);

- DC scheme provision and amounts in receipt are forecast to increase, due in large part to the impact of automatic enrolment;

- DB scheme provision and amounts in receipt are forecast to reduce, as employers continue to scale back on DB schemes;

- Overall, broadly speaking, the increases in income from triple-locking the State Pension and the increase in DC scheme provision through automatic enrolment appear to be compensating for the projected decline in income from DB schemes;

- In terms of gender, women see a slight increase in incomes whereas for men incomes remain broadly flat. This means that the gender gap between the pension incomes for men and women is projected to narrow over time;

- In terms of the income distribution, all quintiles see a slight increase in incomes over the period of this analysis.

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[1] Note that DC amounts include occupational DC, Personal Pensions and Group Personal Pensions. Additionally the impact of the Budget 2014 flexibility is not included; it is assumed that the person will receive a 25 per cent DC lump sum, and an annuity is bought with the rest.

2   Methodology

The outputs in this publication are from the Department's Pensim2 dynamic micro-simulation model. Pensim2 is a model which simulates the evolution of both state and private pension accumulation between now and 2100. This modelling process uses a wide array of assumptions, for example around labour market participation, pension savings choices, and the rules that define State Pension incomes.

The results from the analysis in this publication have a common set of characteristics:

- The figures relate to the year in which the individuals reach State Pension age[2] (not the total 'stock' of all pensioners each year) and cover the years 2014 to 2060;

- All figures are in 2014 constant earnings terms, shown as weekly amounts in pounds;

- The results include pension amounts from the state, DB and DC schemes; other sources of non-pension income (such as any earnings or means tested benefits) are not included;

- The figures examine pensioner incomes based on full reform of the State Pension (i.e. the new State Pension is modelled to come into effect in 2016);

- The charts look at an overall aggregate level as well as by gender and income quintile;

- Within the text, amounts have been rounded to the nearest whole pound, and percentages have been rounded to the nearest five per cent;

- All figures and charts present results using five-year averages to illustrate key trends over time and remove any excessive short-term variation.

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[2] Note that the year an individual reaches State Pension age may be different from the age the individual can begin to claim their private pension, as private pension schemes have a normal pension age which may not match the State Pension age. Additionally, as each chart contains all people reaching State Pension age within that year, it may include people with zero amounts.

3 Results

3.1 Aggregate Projections

Chart 1 contains the projected mean amounts of pension income to be received by pensioners reaching State Pension age. People reaching State Pension age in 2014 have, on average, around £262 per week in pension income. Of this, around £135 comes from State Pensions (including basic and additional State Pensions), £103 from DB pension schemes, and £24 from DC pension schemes.

The mean pension income appears to remain at a similar level over time. However, the figures for 2014 to 2018 are slightly higher as they contain more men than women, while female State Pension age is increasing to catch up with that of men, and men have higher incomes than women. From around 2020, overall pension incomes are on a slowly increasing trend. The total amount of pension in 2060 is £275, a slight increase on the 2014 level (5 per cent increase).

State Pension mean amounts are seen to slightly rise over time due to the triple-lock; by 2060, the State Pension mean amount increases to approximately £161 per week (around 20 per cent increase). The introduction of automatic enrolment leads to a considerable increase in DC scheme mean amounts over time; by 2060, DC scheme mean amounts increase to around £78 per week (220 per cent increase). Conversely, DB scheme mean amounts are seen to reduce over time; by 2060, DB scheme mean amounts decrease to around £36 per week (65 per cent decrease). This is due to the continued scaling back of DB schemes in favour of DC schemes.

Chart 1: Weekly mean amounts of pension, by pension type and year reach State Pension age, as a 5 year moving average
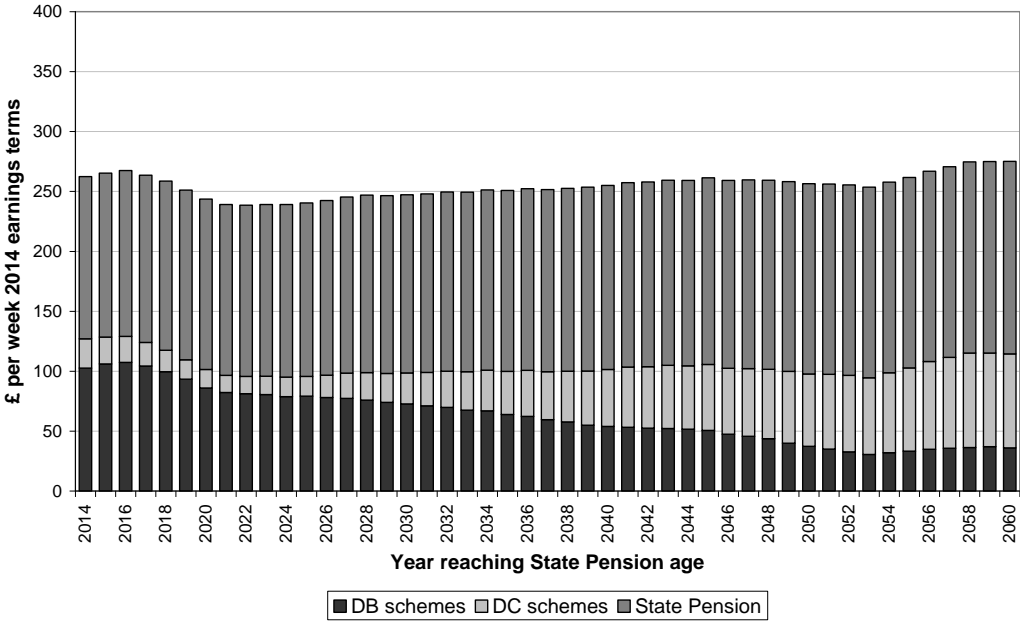

Chart 2 contains the projected median amounts of pension to be received by pensioners reaching State Pension age as a five year moving average. Examining the median is useful as, unlike the mean, the median is less affected by skewed data and outliers, which gives us a better idea of what a typical person is projected to receive. As can be seen, receiving a DC scheme amount begins to become a typical outcome for a person reaching State Pension age from the mid 2020's. Post 2050, it becomes typical for a person reaching State Pension age to not receive a DB scheme amount (and as a result the median amount of DB will be zero). This is due to the scaling back of DB schemes in favour of DC schemes and the rollout of automatic enrolment leading to increases in the number of people receiving income from DC schemes.

Chart 2: Weekly median amounts of pension, by pension type and year reach State Pension age, as a 5 year moving average
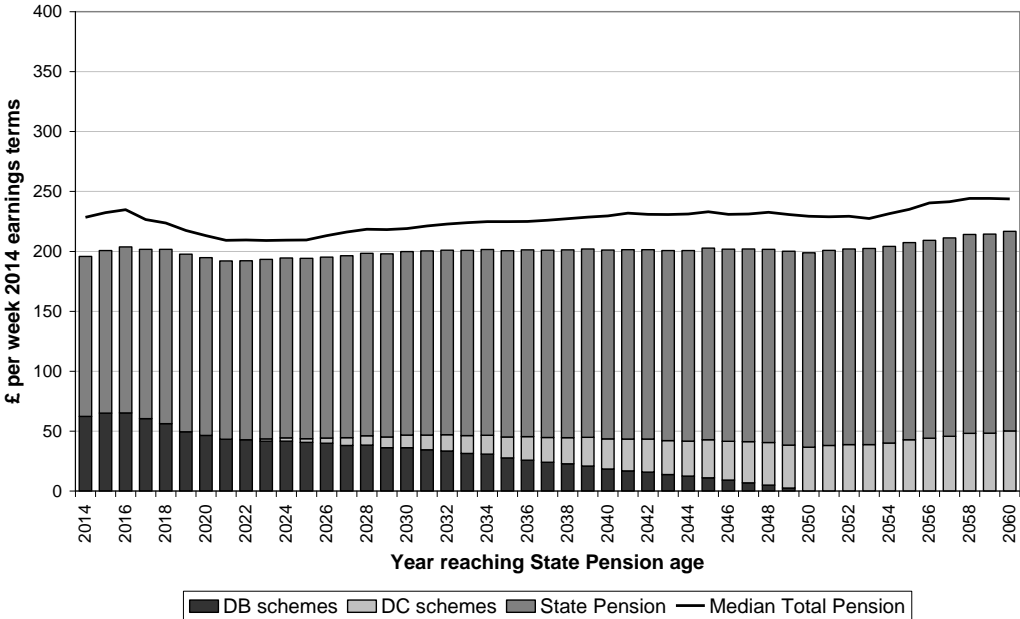

Chart 3 uses a five-year moving average to illustrate the proportion of individuals reaching State Pension age in each year that receive income from different types of private pension. There is a noticeable shift from DC to DB schemes over time; in 2014 income from DB only schemes is the most common (around 40%) and income from DC only schemes the least widespread (around 5%). However, by 2060 this pattern is reversed, with income from DC only schemes being the most popular (around 50%) and DB only schemes being the least common (around 5%). The increasing prevalence of DC pensions also means there are less people with no private pension coverage; initially around 1 in 5 people have no DB or DC scheme amounts; however, by the late 2030's this reduces to approximately 1 in 10. Automatic enrolment is largely responsible for the increasing popularity of DC pension schemes.

Chart 3: Private pension provision by year reaching State Pension age, as a 5 year moving average
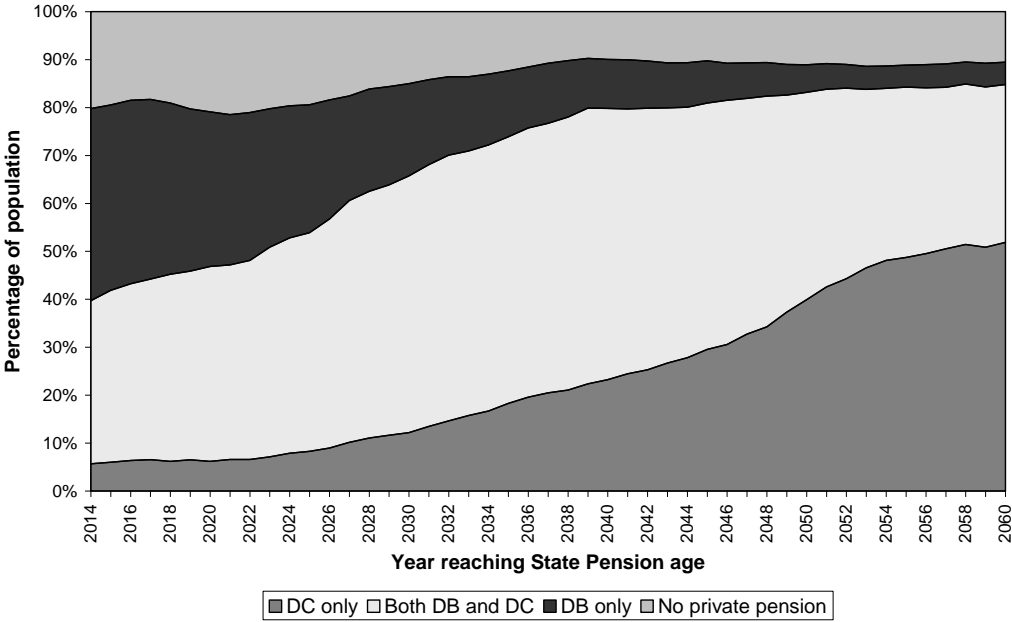
3.2 Gender Projections

Table 1 looks at the percentage change in mean total and component amounts of pension income from 2014 to 2060 by gender. A man reaching State Pension age in 2014 has, on average, £302 per week pension income, reducing to £300 in 2060. A woman reaching State Pension age in 2014 has, on average, £182 per week pension income, rising to £250 in 2060. For State Pension amounts both genders see similar small increases, and for DC amounts women see a considerably greater increase than men. Whilst both genders see a reduction in DB amounts, it is larger for men, with women receiving higher average DB amounts in 2060 than men.

Table 1: Change in weekly mean amounts of State Pension, Defined Benefit, Defined Contribution and total pension income from 2014 to 2060, by gender

Gender	Income type	2014 Amount (£)	2060 Amount (£)	Percentage change (%)
Male	State Pension	139	162	15
	Defined Benefit	130	33	-75
	Defined Contribution	34	106	210
	Total Pension	302	300	0
Female	State Pension	129	159	25
	Defined Benefit	49	39	-20
	Defined Contribution	5	51	1000
	Total Pension	182	250	35

Charts 4 and 5 contain the projected mean amounts of pension income to be received by men (chart 4) and women (chart 5) reaching State Pension age. Men see their overall pension incomes maintain over the years, whilst women see their amounts increase slightly. In terms of State Pension amounts, the mean weekly amount received by both men and women show the same marginal rising trend. The difference between men and women's average State Pension amount is never more than £10 per week between 2014-2060.

Incomes from DB pensions decrease considerably for men between 2014 and 2060, whereas the decrease for women is much less pronounced. This may be due to seeing greater falls in the proportion of men in DB schemes than women, with

pensioners with future DB income often being from female-dominated employment sectors (e.g. healthcare, education and the civil service).

There are also gender differences for incomes from DC pensions. Incomes increase for both genders, but are higher for men in 2014, and remain higher by 2060. This may be due in part to the increased time women take out of work to care for children (or elderly relatives), and as a consequence do not contribute to a private pension fund; State Pension amounts are unaffected by this due to National Insurance credits gained during any such years. Lower wages for female are also likely to be a factor.

Chart 4: Weekly mean amounts of pension for men, by pension type and year reach State Pension age, as a 5 year moving average
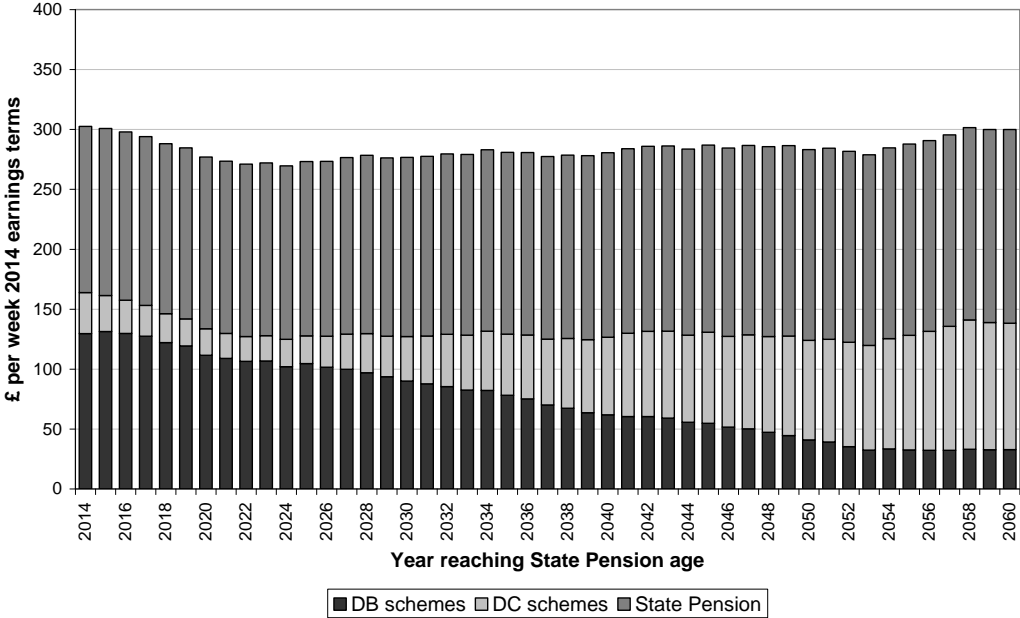
Chart 5: Weekly mean amounts of pension for women, by pension type and year reach State Pension age, as a 5 year moving average
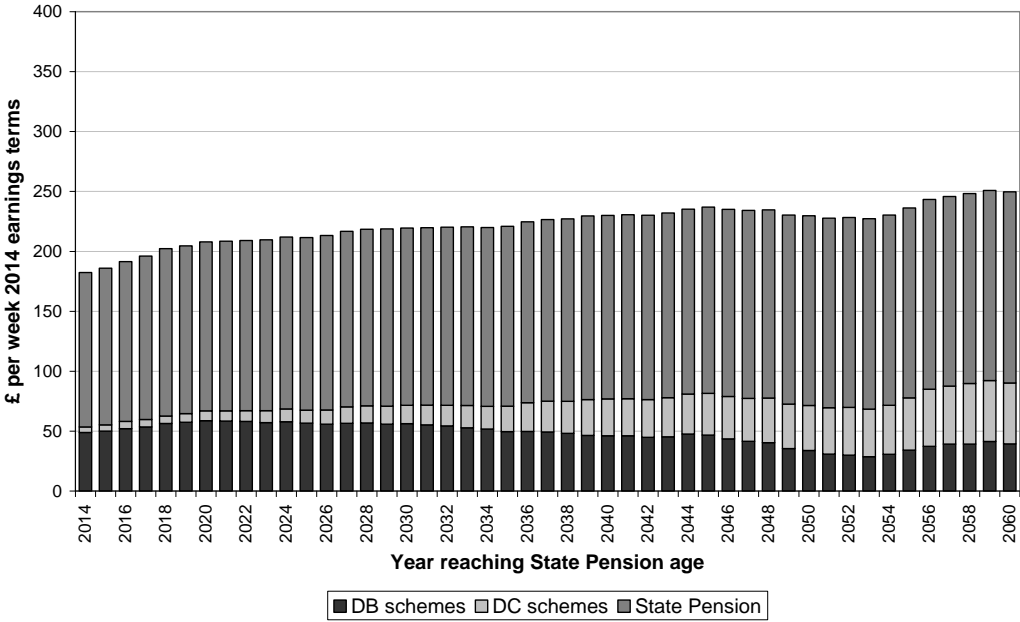

Charts 6 and 7 illustrate the proportion of men (chart 6) and women (chart 7) reaching State Pension age that receive income from different types of private pension, using a five-year moving average. When comparing those with no private pension coverage, women see the greatest improvement. In 2014 approximately 40% of women have no private pension coverage, yet in 2060 this reduces to around 15%.

Both genders see an increase in DC only pension coverage, with men more likely to have this type of coverage over all the years than women. Women see the greatest increase in the proportion with income from DC schemes, although for many women this is in addition to – rather than instead of – income from DB schemes.

The overall picture is a positive one; both genders see a reduction in those with no private pension provision, and automatic enrolment appears to be having a positive impact in the numbers of people with DC schemes. By 2060 it is more typical for men to have just DC scheme amounts, whilst for women it is more typical to have both DC and DB scheme amounts.

Chart 6: Private pension provision amongst men by year reaching State Pension age, as a 5 year moving average
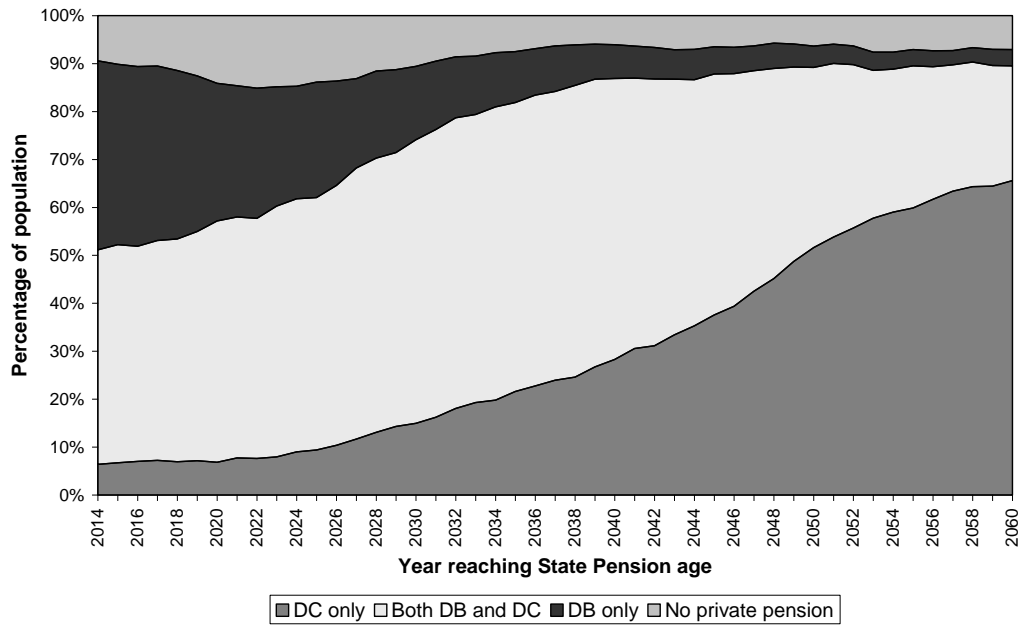
## Chart 7: Private pension provision amongst women by year reaching State Pension age, as a 5 year moving average
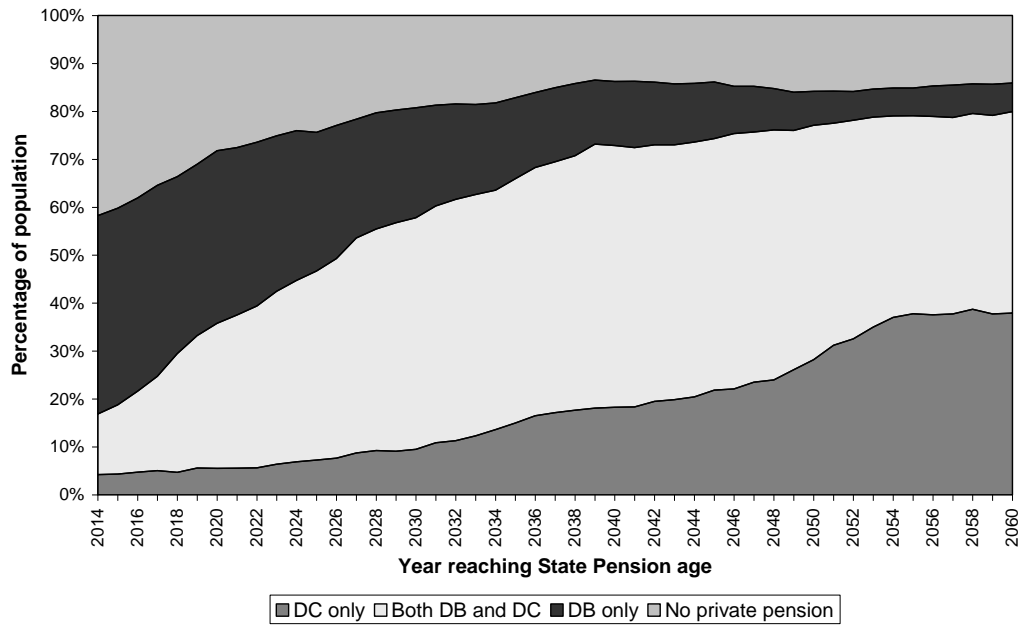
3.3 Income Quintile Projections

The following charts contain projected weekly mean amounts of income from State Pension (chart 8), DC pensions (chart 9), DB pensions (chart 10) and total pension income (chart 11) received at State Pension age, using a five-year moving average. The charts have been separated by income quintile; these quintiles are calculated based on total pension incomes (amounts of State Pension, DB and DC) in State Pension age year. As the quintiles are of total pension income, it is possible that people in different quintiles will not necessarily have any income from that particular source – more so for DB and DC pensions where coverage is not universal.

For State Pension income (chart 8), there is a marginal upwards trend in State Pension amounts for all quintiles, largely due to the triple-lock. People in the bottom quintile have lower State Pension amounts than the other quintiles. Whilst this appears potentially problematic, people in this group are more likely to have access to means tested benefits which are not captured here.

Chart 8: Weekly mean amounts of State Pension as a 5 year moving average, by quintile and year reach State Pension age
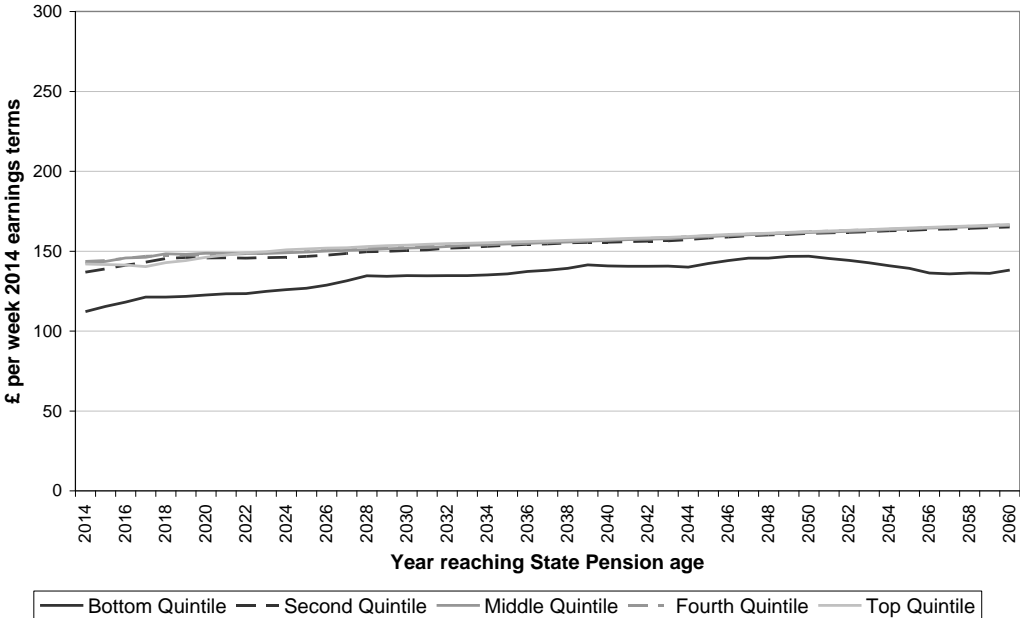

For DC pension income (chart 9), for the majority of the quintiles the positive effects of automatic enrolment are apparent; most quintiles see an increase in DC amounts over time. However, this is not the case for the bottom quintile, which remains consistently low - people who have lower incomes in working age (those more likely

to be below the automatic enrolment earnings trigger and therefore not contributing to a private pension) are likely to fall into the bottom quintile at pension age. However, it is important to reiterate that people in the bottom quintile are more likely to have access to means tested benefits.[3]

Chart 9: Weekly mean amounts of DC as a 5 year moving average, by quintile and year reach State Pension age
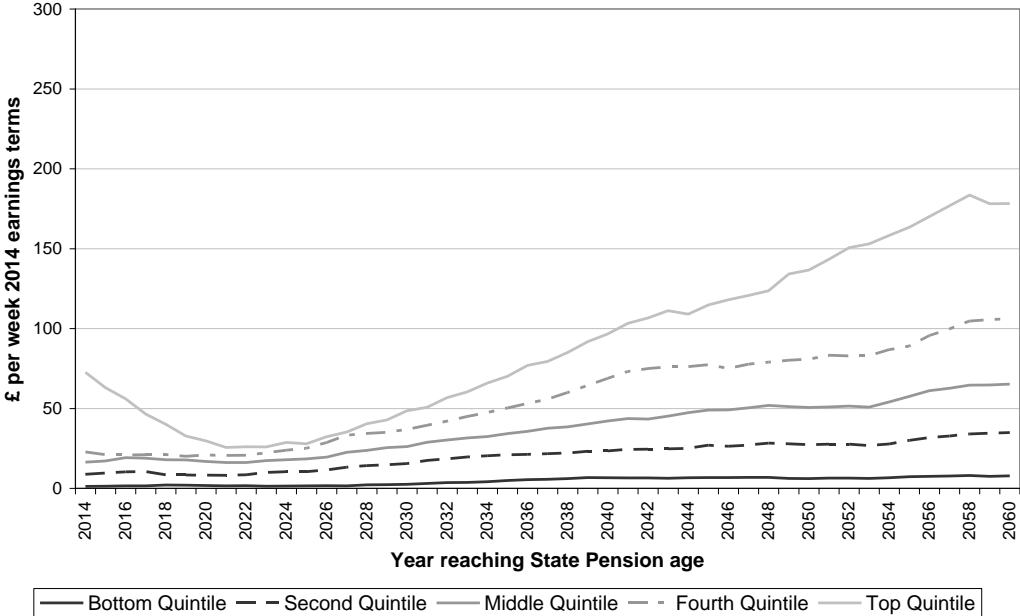

For DB pension income (chart 10), the mean amount of DB is consistently low (less than £10 per week) for the bottom quintile, and does not appear to change over time. The other quintiles appear to start with reasonably higher amounts of DB compared to the bottom quintile. However, these amounts noticeably reduce over time, particularly for those in the middle of the income distribution.

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[3] The quintile graphs for DC and DB pensions are based on a smaller number of cases in receipt of the income source than the SP graph, as not all people receive DC or DB pensions. As a consequence there is a little more variation in these graphs, particularly for the top quintile of DC in the early years (prior to 2020) of the graph and for the top quintile of DB in both the early (prior to 2020) and later (from 2055) years.

Chart 10: Weekly mean amounts of DB as a 5 year moving average, by quintile and year reach State Pension age
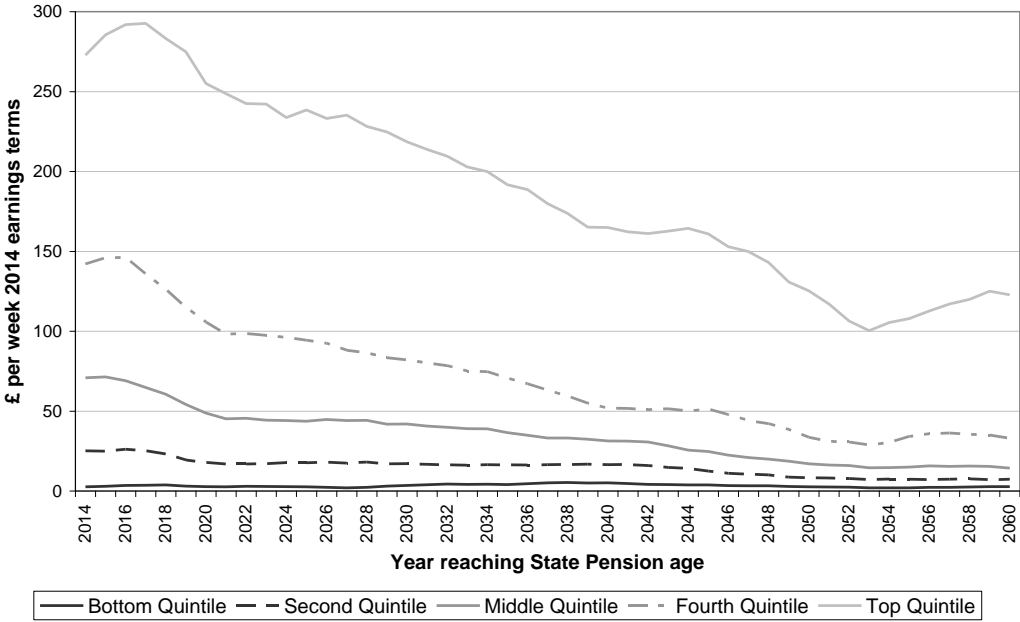
For total pension incomes (chart 11), the pattern of a slight upwards trend is apparent across all quintiles. This is through a combination of the various elements discussed earlier in this publication – the triple-lock uprating of State Pension, a decline in DB pensions and increasing coverage of DC pensions. The overall levels of pension income do not decrease in the short or medium term due to the changes in coverage of DB and DC pensions – both for the pensioner population as a whole and for the different income quintiles within the pensioner population.

Chart 11: Weekly mean total amounts of pension (State Pension, DB and DC) as a 5 year moving average, by quintile and year reach State Pension age