Mind The Gap

Quantifying The Pensions Gap In The UK

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AVIVA

About Aviva UK

Aviva serves 53 million customers in 28 countries across Europe, North America and Asia Pacific. We are one of the world's largest insurance groups and have 46,000 employees.

We manage more than two million pension policies in the UK. Last year the value of maturing Aviva pension policies was around £500 million - roughly £10 million every week. We also provide company pensions to over 5,000 employers across the UK.

As one of the UK's market-leading pensions providers, Aviva was named as Pension Provider of the Year in 2009 by both Sesame, a leading UK network for independent financial advisers, and Simply Biz, a provider of financial compliance services.

Introduction

The issue of retirement funding in the UK has never been more relevant than now. People are living longer, staying healthier and have high expectations for their 'golden years'. However, we know that as a nation, we're not putting away enough to pay for the lifestyles we desire - which begs the question of who should pay for the shortfall?

Aviva research shows that most people currently think they will need at least half of their monthly income to get by in retirement*. In spite of Government proposals to raise the state pension age, many are still keen to give up work at 65. Furthermore, most expect their lifestyles to be 'comfortable'. Yet the reality is – for most – this is not achievable as things stand.

People are beginning to recognise that they may need to put aside more money, work longer or reconsider their retirement aspirations. But this is an uncomfortable truth and much needs to be done to help people in this position.

Our research into the European pensions gap has found that the UK has the biggest shortfall per person in Europe. This is largely due to high final salaries and a relatively low level of state pension compared to many other countries. In order to close the gap, people retiring between 2011 and 2051 in the UK would need to invest an average of more than £10,000 per person, per year. But is this realistic?

This report has been designed to open up this debate and tackle the issues affecting everyone. It is up to all of us, the private pensions industry, the Government, employers and individuals alike to look for solutions now, to provide security for the future.

Toby Strauss
CEO, Aviva, UK Life

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* Aviva Consumer Attitudes To Saving Research, May 2010.

The pensions gap in the UK

It is widely known that the UK - and indeed the whole of Europe - is facing a retirement funding shortfall.

This Aviva report was produced to quantify the pensions gap, to open up the debate and to find solutions. The pensions gap refers to the difference between the income needed to live comfortably in retirement, and the actual income individuals can currently expect (see page 7).

The study, carried out by Aviva in conjunction with Deloitte, shows that the annual European pensions gap for individuals retiring over the next 40 years is €1.9 trillion (£1.6 trillion).

The UK's pensions gap stands at £318 billion (€379 billion). This equates to an average of £10,300 (€12,300) per UK adult annually - the largest per person total across all European countries studied.

Retirement income gap for individuals retiring 2011 - 51

Country	Annual pensions gap per person	Annual pensions gap by country (billions)
United Kingdom	£10,300 (€12,300)	£317.5 (€379.0)
Germany	£9,700 (€11,600)	£392.7 (€468.8)
Republic of Ireland	£7,600 (€9,100)	£16.9 (€20.2)
France	£6,600 (€7,900)	£204.0 (€243.5)
Spain	£5,900 (€7,000)	£142.9 (€170.5)
Russia	£4,900 (€5,800)	£336.8 (€401.7)
Czech Republic	£3,900 (€4,600)	£21.2 (€25.3)
Romania	£3,100 (€3,700)	£33.7 (€40.2)
Poland	£2,900 €3,400)	£57.7 (€68.8)
Italy	£2,600 (€3,100)	£81.8 (€97.6)
Lithuania	£2,500 (€3,000)	£4.2 (€5.0)
Turkey	£2,000 (€2,400)	£76.3 (€91.0)
Hungary	£1,600 (€1,900)	£8.0 (€9.5)

Figures in GB pounds are based on an exchange rate of EUR = 0.838557 GBP / 1 GBP = 1.19252 EUR as provided by www.xe.com on 16 September 2010. Figures have been rounded to the nearest £100 / €100 for individual pension gaps and to one decimal place for national figures.

Case study: Kate Eddy

"At 32, retirement is still quite a way off for me, but thinking about the future is still important. I don't have a specific retirement date in mind, but I do know I want to be retired with enough money to enjoy myself.

I work as a fundraiser for YWCA England & Wales, a charity for girls and women. I have a work pension, as well as a private Aviva pension which runs alongside it. Generally I try to be a saver rather than a spender, so it's important for me to plan ahead.

I'm interested in socially responsible investing, so I have an SRI pension – to me it's important to be part of the solution, rather than the problem. Hopefully this way I can feel I've done my bit when I finally do retire!"

This startling figure - £10,300 (€12,300) - is an average based on the 31 million UK adults who are due to retire between 2011 and 2051. However, for older people who have less time to make good their personal shortfall, and those on lower incomes for whom it might be difficult to put money aside, the picture is more worrying.

The pensions gap poses the greatest challenge to individuals near retirement as they have a shorter period of time in which to address the shortfall. The table below provides an overview of the pensions gap by individuals' ages in 2010.

It is important to note that the overall 'average' figure for all individuals retiring between 2011 and 2015 is much higher than for people aged 50 and below. This is because the data is skewed by the significant shortfall faced by those approaching age 65 in the next few years.

Average per person annual pensions gap in UK by age in 2010

	Age in 2010			
All individuals retiring 2011-51 up to age 65	**50 years**	**40 years**	**30 years**	**20 years**
£10,300 (€12,300)	£6,200 (€7,400)	£3,100 (€3,700)	£1,800 (€2,200)	£1,300 (€1,500)

Figures in GB pounds are based on an exchange rate of EUR = 0.838557 GBP / 1 GBP = 1.19252 EUR as provided by www.xe.com on 16 September 2010. Figures have been rounded to the nearest £100 / €100.

> The pensions gap poses the greatest challenge to individuals near retirement as they have a shorter period of time in which to address the shortfall.

Case study: Steve Marriage

"At the moment I'm 43, so I still have a few years of work ahead of me. But I would say that I'm keeping one eye on retirement.

I'm a printing manager by trade and I work night shifts at a company in east London. I used to think I would retire at 55 but now I think this is unlikely. I'm fairly certain I'll need to work into my 60s.

I have an Aviva personal pension, which I used to consolidate a series of private pensions, after taking financial advice. I have also joined my employer pension scheme.

I'm married with two children aged 11 and 15, so financial security is important to me. I want to be able to plan today so I don't need to worry about tomorrow."

Conclusions and calls to action

The UK's pensions gap is daunting. However the good news is that the UK has several initiatives underway to help reinvigorate retirement savings.

People in their late 50s and 60s have less time to boost their pension pots, but greater flexibility around retirement and annuity rules should help these retirees make the most of all their assets – not just pensions.

For people with longer to build a nest egg, plans to automatically enrol workers into pensions from 2012 are a great step towards creating investment habits.

It's crucial that putting money away is made more attractive to individuals. Government and pension providers must consider other reforms to help make this happen:

- It must be clear that it always pays to invest, and state provision must be clear, simple and consistent. A key step will be to reduce means testing in retirement – it is complex, fails to reach those who most need help, and discourages people from providing for themselves.
- To get people in the habit early in life, we should consider new models for young people to address their conflicting financial priorities (paying off student debt, saving a deposit on a home or even saving for a holiday). Incentivising workplace ISAs for young people may be a great bridge to longer term retirement savings.
- The inaccessibility of money in a pension is a major psychological barrier to putting money away, so Aviva welcomes indications that the Government intends to investigate allowing individuals access to some of their pension fund before retirement.
- People need to understand their own financial position to make clear plans for retirement saving. Making available simple, accessible information about what the state provides would help create an explicit platform on which individuals can build their own nest eggs.
- Consumers need to trust our industry to look after their interests and help them achieve a comfortable retirement. Changes to regulations in the UK, across Europe and around the world must focus on improving customer outcomes, such as simpler communications, better service standards, and greater access to advice and guidance.

As we move out of recession and rebalance our economy, the pensions industry and the Government must work in partnership to deliver a framework that responds to consumer behaviours and attitudes, and encourages greater levels of personal investment. If we don't, the UK's pensions gap may only get worse.

Calls to action

At a UK level

- The issuing of regular pension statements to all citizens: this would encourage consumers to consider the state pension as only part of a mixed strategy for providing for their future, and prompt them to take action as a result of seeing clearly what they stand to get in retirement.
- A review of national measures to encourage people to invest: this could consider the effectiveness of existing incentive schemes, their impact and visibility and whether they are appropriately targeted at changing the behaviour of the people who need the most encouragement to put money aside.

At a European level

- The creation of a European Quality Standard for Pensions: allowing providers to demonstrate the quality and security of their products, allowing comparability and increasing consumer confidence.
- The establishment of a European Pensions Target, variable by country, and calculated as a percentage of GDP and / or by the relative amounts from the state, employers, and individuals. A pensions target would encourage national governments to facilitate a greater investment culture in their country and move towards a greater percentage of funded schemes.

Summary of assumptions for European pensions gap research

In order to quantify the pensions gap across Europe, for the purposes of this report it has been necessary to make a number of assumptions.

Replacement rates:

The annual pensions gap is based on an analysis of the annual retirement income gap individuals face in retirement and the additional investment they require to close this shortfall.

This research assumes a 70% replacement rate for the 'average' individual as recommended by the Organisation of Economic Cooperation and Development (OECD).

"It is reasonable to consider the 70% rate as the adequate retirement income benchmark for the average individual that will allow the individual to enjoy a standard of living in retirement that is similar to the standard he or she enjoyed prior to retirement." Private Pensions Outlook, OECD, 2008.

Further assumptions:

- The model is on an "as-is" basis (i.e. assets don't accumulate interest and there is no inflation).
- The 60-64 year age group is 4.87% of population for each country.
- The number of people in the age band 60-64 remains fixed over the next 30 years (i.e. no account is taken of ageing populations).
- Retirement age of 65 in each country except France (which is 60).

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