What if I live to 100?

A retirement reality check

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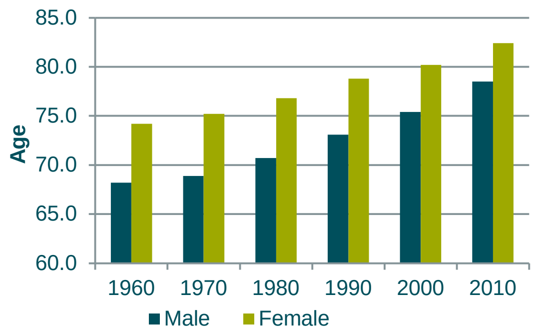
UK life expectancy has been rising dramatically. Around one-third of babies born in 2012 are expected to survive to celebrate their 100th birthday[1]. As a result, most of us can now expect to spend a significant proportion of our lives in retirement. Of course this is great news – decades of freedom and time to enjoy our families, friends and past-times. But it also means careful financial planning is more important than ever to avoid the risk of outliving our savings and running out of money in retirement.

The UK is getting older

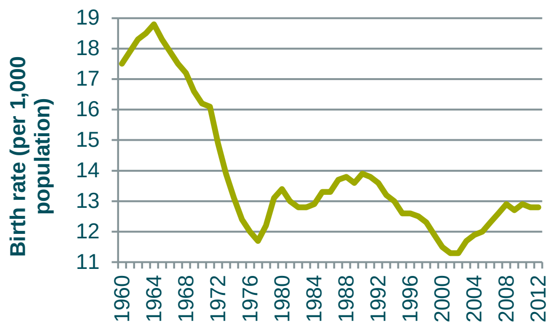
In the UK, and across much of the developed world, longer life expectancies coupled with lower birth rates are driving a trend towards aging populations. The charts below illustrate the profound demographic shift in UK society since 1960. This period has seen the age-mix of the population change and the 'dependency ratio' (the ratio of people over 64 to those aged 15-64) rise sharply.

An aging population means there are more retirees, living for longer, funded by a declining portion of working-age citizens. This has put a potentially unbearable strain on the sustainability of traditional pension provision and increased the need for individuals to provide financial support for their long retirements through other types of savings and investments.

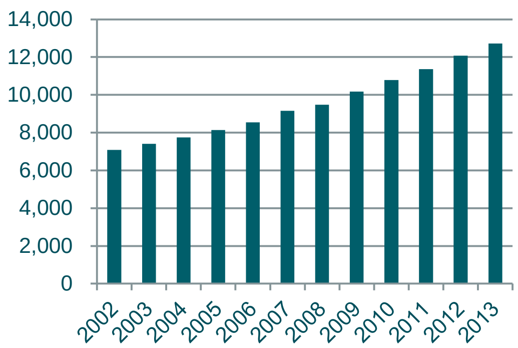
Growth in UK life expectancy at birth



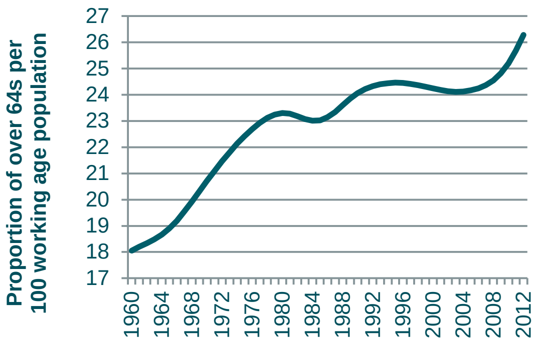
Falling UK birth rate



Rapid increase in number of UK centenarians



Increasing UK dependency ratio



Source: World Bank, Office for National Statistics and M&G, 31 May 2015

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Can I rely on the state pension?

The current maximum basic state pension is £115.95 per week[2].It seems increasingly unlikely that the state pension alone will be enough for most people to cover even their essential needs, let alone support the lifestyle they might have hoped for in retirement.

In 1960, with average life expectancy for men at just over 68 years, a retirement age of 65 seemed sensible – with only enough retirement income required for a couple of work-free years. Although there are plans to raise the retirement age in the UK, it is unlikely to be by enough to keep up with the pace at which life expectancy is growing. Clearly, this significant demographic shift has hugely altered the financial arithmetic of retirement.

Relying on state pensions alone to provide for the needs of an aging population is becoming unrealistic. The post-war explosion in the population means that as the 'baby boomers' come to the end of their working lives, there is a larger number of retired people seeking income for far longer than a generation ago.

What about my private pension?

In recognition that many individuals may struggle to fund retirement on the state pension alone, in 2012 the UK government introduced auto-enrolment. This new law requires every employer to automatically enrol workers into a workplace pension scheme, if they meet certain criteria. This has already resulted in a significant increase in the number of people in private pension schemes. However, these are newer-style Defined Contribution (DC)[3] schemes rather than older-style Defined Benefit (DB)[4] schemes.

The average rate (as a percentage of salary) at which an employer contributed to a DC scheme in 2012 was 6.6%, less than half the rate of employer contributions into DB schemes (15.2%)[5]. As such, there are concerns that while DC schemes now dominate the private pensions landscape, they may not be an adequate replacement for the DB schemes that were more common in the past.

Supplementing pensions with savings

It is likely that many people will need to have other savings and assets to supplement their pension income. However, it is important to remember the effect of inflation and interest rates on the purchasing power of your capital. In other words, if over a period of time the interest you are earning on cash in the bank is lower than the rate at which prices are rising, you will be able to buy less of the same goods and services in the future.

Savers are currently being hit hard by historically low interest rates. When inflation is taken into consideration, the real return that savers receive at very low interest rates is at best negligible and even negative. Although recent headlines have focused on the topic of the absence of inflation recently, we must remember that over long periods of time, such as the several decades most of us can expect to spend in retirement, inflation can have a very meaningful impact. Furthermore, different types of goods and services receive different levels of inflation, so a 'headline' inflation rate may not tell the whole story.

What next?

The best chance we can give ourselves of a comfortable financial future is to plan carefully and make sure we understand all of our options. When it comes to pensions, the government's Pension wise website (https://www.pensionwise.gov.uk/) could be a good place to start.

It is clear that these days individuals have to make returns on their savings work for them for many years past retirement. This could mean putting cash to work by investing in other financial assets, with the aim of generating a better level of income. For many people, this means choosing a fund or funds to invest in. These offer the opportunity to take a hands-off approach by pooling your money with that of other investors, so a professional fund manager can buy a portfolio of company shares, bonds[6] or other assets. Their aim is to deliver a return on your investment, either in the form of total return (the combination of income and growth of capital), or a separate income stream, in some cases combined with capital growth. However, all investments involve accepting a degree of financial risk. Therefore, if you are unsure, you should talk to a financial adviser.

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Any decisions regarding investments or pension savings are important and you should be aware of all your options. We are unable to give financial advice. If you are unsure about the suitability of your investment, you should speak to your financial adviser who will be able to provide regulated advice. Alternatively, you should consult Pension Wise (www.pensionwise.gov.uk) which is a free and impartial service designed to help you understand your retirement options.

The value of investments will fluctuate, which will cause fund prices to fall as well as rise and you may not get back the original amount you invested.

[1] Office for National Statistics: http://www.ons.gov.uk/ons/dcp171776_260525.pdf
[2] UK Government: https://www.gov.uk/state-pension/what-youll-get
[3] A pension pot based on how much is paid in
[4] A pension pot based on your salary and how long you've worked for your employer
[5] Pension Policy Institute: http://www.pensionspolicyinstitute.org.uk/pension-facts/pension-facts-tables/private-pensions-table-20
[6] A loan in the form of a security, usually issued by a government or company, which normally pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.