Intergenerational Differences

Discussion Paper
DP19/2

May 2019

How to respond

We are asking for comments on this Discussion Paper (DP) by **1 August 2019**.

You can send them to us using the form on our website at: www.fca.org.uk/dp19-02-response-form

Or in writing to:
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The FCA has a Public Sector Equality Duty, under s.149 of the Equality Act, to eliminate discrimination, advance equality of opportunity and foster good relations between people with protected characteristics and those without. Age is a protected characteristic so in identifying the financial needs of financial service users we are supporting our public sector equality obligations. In publishing this Discussion Paper we have given due regard to the protected characteristics of age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation.

Foreword

What we need and expect from financial services changes over time.

For example, what I may require of the pension market when I come to retire will be different from what my parents did, and from what my children will do.

While changing financial needs across generations may be nothing new, there is now a wide public and policy debate over the deepening financial differences between generations – and the choices they have to make as a result.

Baby Boomers, Generation X and Millennials lead very different lives, have different expectations and different resources. They will have different financial needs as a result. Financial services markets will need to adapt and innovate to meet them.

This is not just a challenge for the financial sector. There is also a central role for public policy makers. Regulators, therefore, need to adapt.

Our strategic objective is to ensure that financial markets work well. To deliver on this and serve the public interest, we base our decisions on an understanding of what will best meet consumers' needs and prevent consumer harm. We do this in a variety of ways, such as our regular Financial Lives survey of 10,000 people, through consultations and by using the experience and knowledge of our independent consumer panel.

To pursue our objectives effectively, one of the most important things we can do as a regulator is to understand current and future consumer needs. We should test and challenge assumptions about what consumers need in the context of different intergenerational factors, to ensure our regulation adapts to the changing requirements of the different groups within and between generations.

There are others who have looked into aspects of these issues in greater depth, but the FCA is trying to start the debate about what it means for consumers, financial services, and firms.

We want this paper to achieve three main things. First, we want to test publicly our understanding of the issues that different generations face, to ensure our assumptions and approach stay relevant for tomorrow's consumers. Second, we want to bring stakeholders together to pinpoint the issues which need a response. Finally, we want to identify any specific action that we can take to help the market to meet these changing consumer needs.

Addressing these challenges requires a collective effort across society using a combination of solutions from social policy, to industry action, through to regulation. To start this collective response, we want feedback from consumer groups, industry, academics, think tanks and others with an interest. We will host a number of events, culminating in a major conference on 2 July 2019.

The data in this paper show how entrenched the financial differences between generations have become. By providing the evidence and opening the issues to discussion, we hope that we can help to build a consensus of how best to adapt our regulatory approach to meet the needs of all generations, both today and tomorrow.

Christopher Woolard
Executive Director for Strategy & Competition, the FCA

1 Summary

1.1 The FCA's strategic objective is to ensure relevant markets work well. We are here to serve users of financial services – individuals, businesses, and the real economy. We also have an operational objective to secure an appropriate degree of consumer protection, and an operational objective to promote competition in the interests of consumers. To do so, we must understand consumers' financial needs.

1.2 We serve the public interest best when we anticipate potential harm in the market, and act to prevent that harm from occurring. So we must understand how consumers' financial needs are changing, and the challenges consumers will face in future. This Discussion Paper presents data and both demographics and socio-economic trends to help identify the financial needs of three generations of financial services users – Baby Boomers, Generation X and Millennials. We want to encourage regulators, Government, academics, firms, and all stakeholders to participate in the debate, so that we can better protect these different groups of consumers and promote competition in their interest.

1.3 In this paper we:

- use Office for National Statistics (ONS) data to identify how people's patterns of wealth accumulation and decumulation have changed in the last decade
- provide broader observations about the financial lives of Millennials, Generation X, and Baby Boomers
- discuss the socio-economic drivers that have contributed to these changing patterns
- consider the implications for consumers and for financial services markets
- ask for your feedback on relevant regulatory areas that we may want to consider

Our findings

1.4 Patterns of wealth accumulation and decumulation have changed in the last decade. The three generations under consideration face, and will face, different challenges, not only due to their current stages in life, but also because of the cumulative effects of strikingly different economic circumstances.

1.5 To illustrate these significant differences between generations and changing consumer needs over the course of a lifetime we have used the ONS Wealth and Assets Survey data to provide a snapshot of the way UK consumers have accumulated and used wealth over the last decade. Comparing the period 2006 to 08 to 2014 to 16 we found:

- People of working age had less total wealth compared to people of the same age 10 years earlier. This contrasted with individuals around retirement age who had significantly more wealth in real terms.
- The median person starts accumulating property wealth 4 years later (from 30 in 2006-08 to 34 in 2014-16).
- People of working age saw a slight reduction in financial wealth compared with people of the same age 10 years earlier. In particular, Generation X (see below) are more financially stretched than before.

- The average individual had accumulated wealth up to a later point in their life (for 5 more years).
- Wealth levels did not change for people at the bottom of the wealth distribution.

Broader observations on the financial lives of different generations

1.6 We refer to the different generations by the years in which they were born, using date of birth ranges taken from: Work and Pensions Select Committee, The intergenerational contract under strain (2016):

- Baby Boomers born between 1946 and 1965
- Generation X born between 1966 and 1980
- Millennials born between 1981 and 2000

1.7 We have focused on the three main generations by population size for this analysis. For those born before 1946, we see many of the challenges they face, in the context of this paper, as similar to those represented in our analysis of Baby Boomers (eg equity release and uncertainty around later life care costs). Our work on the Ageing Population explored the needs of this age group in more detail.

1.8 Based on our Financial Lives survey and other relevant sources, we can make the following broad observations. These observations are general – within each generation there is significant variance in wealth, circumstances, and financial needs.

Baby Boomers

1.9 While Baby Boomers have benefitted from asset appreciation and defined benefit pensions, many will need to develop strategies to make the most of their accumulated pension wealth and maintain their living standards in later life. They may need different products to help them benefit from Pension Freedoms or enable them to draw down housing wealth. They have more freedom and more choice, but also more responsibility for their finances in old age. For those nearing retirement, however, only half have given a great deal of thought to how they will manage in retirement. Funding later life care costs represents a significant area of future uncertainty for older age groups. Current experience suggests that only a small number of individuals face significant end-of-life costs for long. This number, however, is expected to grow over time.

Generation X

1.10 Generation X are often financially stretched. While they tend to have higher than average incomes, many are unable to set aside enough money for their pension or to save for emergencies – leaving them open to financial shocks. They have lower than average cash savings and the highest amount of unsecured debt (excluding student loans). But they too have often benefitted from rises in house prices and low borrowing costs. Those who will inherit wealth from their parents will do nearer to the time they themselves retire.

Millennials

1.11 Millennials face a series of difficulties in building wealth. This is due to the combined impact of rising house prices, insecure employment, and higher debt (including student debt) – which limits their ability to save for retirement during core earning years. Compared to Baby Boomers, they start building property wealth later in life. A number of them will receive some inheritance, but later than previous generations including Generation X. This will have a positive impact on their retirement prospects.

1.12 In Chapter 8, we illustrate the implications of these trends for each age group through the life cycle model. People's financial circumstances vary within the population, with income and wealth being critical factors in determining consumers' financial needs. We focus on the current and future financial needs of typical individuals using profiles from each age group. Many individuals will use a wide range of financial products – credit products, savings products, pension products, protection products, mortgages and drawdown products. As shown in our profiles, the 25% of the population with low wealth across all generations tend to focus their financial product engagement more on credit and shorter-term savings.

Key socio-economic factors driving intergenerational differences

1.13 Overall, our analysis has identified 5 broad factors that define the different impact on different generations' financial circumstances and needs.

An ageing population

1.14 Due to high numbers of births after World War II (the Baby Boom) an increasing number of people are now approaching retirement age (65). In 1991, there were 9.1 million people in the UK aged 65 or older. 25 years later, in 2016, this had risen to 11.8 million people. As life expectancy is rising, the Baby Boomers will need to consider how they can continue to maintain living standards as they retire.

1.15 Retirees have started using the greater flexibility provided by the Pension Freedoms, which were introduced in 2014. Annuity sales declined by over 80% between 2014 to 2017, with growing numbers of people choosing to withdraw their pension pots as cash or opt for drawdown. As a result, far fewer retirees are using their pension savings to buy a guaranteed income in retirement. This means they also face the risk of running out of pension savings and are more exposed to changes in market valuations. The needs of this generation have seen the rise in equity withdrawal and products such as lifetime mortgages, but the need for more personalised 'later life lending' products or other relevant products is likely to grow.

Low interest rates

1.16 Interest rates fell significantly during the 2008/09 financial crisis and have remained at a record low for the last decade. Rates of return have been significantly lower in the last 20 years compared to the previous 20. Between 1975 to 1995, annual real investment returns in the UK were around 10.5% on equities and 6.0% on gilts. In 1995 to 2015 this had fallen to 3.7% for equities and 4.3% for gilts.

1.17 As a result, those who only became able to accumulate wealth more recently are seeing low rates of return and may even be discouraged from saving or investing. Conversely, those who already accumulated significant wealth between 1975 and 1995 have benefitted from both long-term property price appreciation and rising values of financial assets, including pensions.

1.18 The continuing low interest rate environment has made it cheaper for consumers to borrow money. This may have encouraged some to take on greater levels of debt in the last decade. In the decade before 2008/09, the average debt-to-income (DTI) ratio in the UK was 115%. In the last decade, the average DTI had increased to 135%.

1.19 The prolonged low cost of borrowing means that consumers are getting used to relatively cheap credit.

Rising house prices

1.20 In the last 30 years, house prices have increased much more than earnings. The gap between average income and house prices for first-time buyers more than doubled across all regions and tripled in some areas.

1.21 This made it harder for aspiring first-time buyers – mainly the young – to become homeowners. Compared to just a decade ago, today increasing numbers of people (+50%) live in private rented accommodations. This is having an impact on the ability of many of them to accumulate wealth through housing equity, despite various Government schemes such as Help to Buy loans and ISAs.

1.22 Young people are increasingly turning to the 'Bank of Mum and Dad' to get their own home. In 2017, 62% of under 35 home owners were helped financially by family and friends to buy their home. Some firms have responded by offering innovative products designed to enable wealth transfer between generations, such as guarantor mortgages. But these products are still a very small part of the mortgages market. At the other end of the age spectrum, a growing number of later life mortgage options are now available to older buyers, with lenders offering terms that the borrower will be paying into retirement and significantly beyond.

The changing nature of employment

1.23 The labour market has seen major growth in more flexible but often less secure forms of employment. Between 2010 to 2017, the number of self-employed people increased by 20% and almost half of these were in part-time roles. Zero-hour contracts have also increased – by the end of 2017 nearly 3% of the working population was on a zero-hour contract.

1.24 This means a growing proportion of workers may not meet auto-enrolment qualification criteria and are less likely to be part of employee benefit schemes with insurance and other protection products. 93% per cent of the UK's 4.8 million self-employed workers have no critical illness cover to protect their income if they have long-term sickness absence.

1.25 While self-employed and part-time workers can buy a range of alternative pension and insurance products, their relatively insecure or unpredictable income may make them less likely to do so. Many, especially younger workers, will prioritise other more immediate financial needs such as trying to save a deposit for a home. Labour market changes are also likely to affect many people's ability to save and demonstrate creditworthiness.

1.26 Technology is enabling firms to offer more flexible products, such as 'income smoothing' products to help consumers with fluctuating income to budget, but the number and take-up of these products is still negligible.

Student funding

1.27 The change in the way that students are funded means growing numbers of young people start work with increasingly higher levels of student debt. In 2008, students entered the labour market with an average outstanding student loan balance of £10,870. By 2017, this had tripled to £34,800.

1.28 While those in higher education will typically earn a higher salary in employment, student debt will almost inevitably limit their disposable income.

Implications for consumers and financial service sectors

Mortgages

1.29 Due to changing housing and labour market circumstances, young people may require greater flexibility in their mortgage and credit products.

1.30 Older generations may benefit from more innovative products meeting their need to maintain living standards in later life.

Pensions

1.31 Due to changing housing and labour market circumstances many workers, especially the young, are not saving enough money for retirement. They would benefit from services helping them to engage more with long-term pension savings.

1.32 As life expectancy increases those who are about to retire face the prospect of needing to fund a longer period in retirement. Industry innovation in this area has been limited so far.

Consumer credit

1.33 Use of consumer credit has increased in the last decade, probably also due to the low cost of borrowing.

1.34 Recent developments in the labour market may mean that growing numbers of people – especially younger generations – may need to access credit to smooth their spending in the very short term.

1.35 Due to increased life expectancy those retiring may need more flexible access to credit in later life, perhaps just to meet short term needs.

Insurance and protection

1.36 Many protection products are typically actively 'sold' rather than bought. Changes in the housing and labour market may mean that consumers are increasingly overlooking their protections needs. Industry may be able to nudge customers to consider their need for protection products.

Structure of this paper

1.37 In **Chapter 2** we provide our analysis of the ONS Wealth and Assets Survey data. The analysis shows that the way in which consumers build and use their wealth has changed between 2006 to 08 and 2014 to 16.

1.38 In **Chapter 3** we discuss the key socio-economic drivers that have contributed to this shift in wealth distribution, and may contribute to wider intergenerational issues.

1.39 In **Chapters 4-7** we discuss what these trends mean for mortgages, pensions, consumer credit, and insurance and protection.

1.40 In **Chapter 8** we summarise what these trends mean for 3 major generational cohorts – Baby Boomers, Generation X, and Millennials. We explore their changing financial needs and whether these are being met.

1.41 In **Chapter 9** we pose a series of questions and seek input that will help us identify ways in which the changing needs and circumstances of consumers could be better met by financial services providers.

Next steps

1.42 For us to protect consumers and promote competition, we need to understand how socio-economic changes impact both markets and individuals. We must ask ourselves the question – is there anything preventing the market adapting and innovating to meet changing user needs? Can we work with others to help improve public policy outcomes? Does this require us to make any specific changes to our regulatory approach?

1.43 We set out some of the drivers of intergenerational change, provide analysis of changing wealth patterns, and discuss the implications for specific financial services markets.

1.44 We are interested in feedback on the implications of these changes for financial services consumers, firms and markets. In particular, we are interested in views on how the FCA can best discharge our consumer protection and competition objectives within this dynamic context.

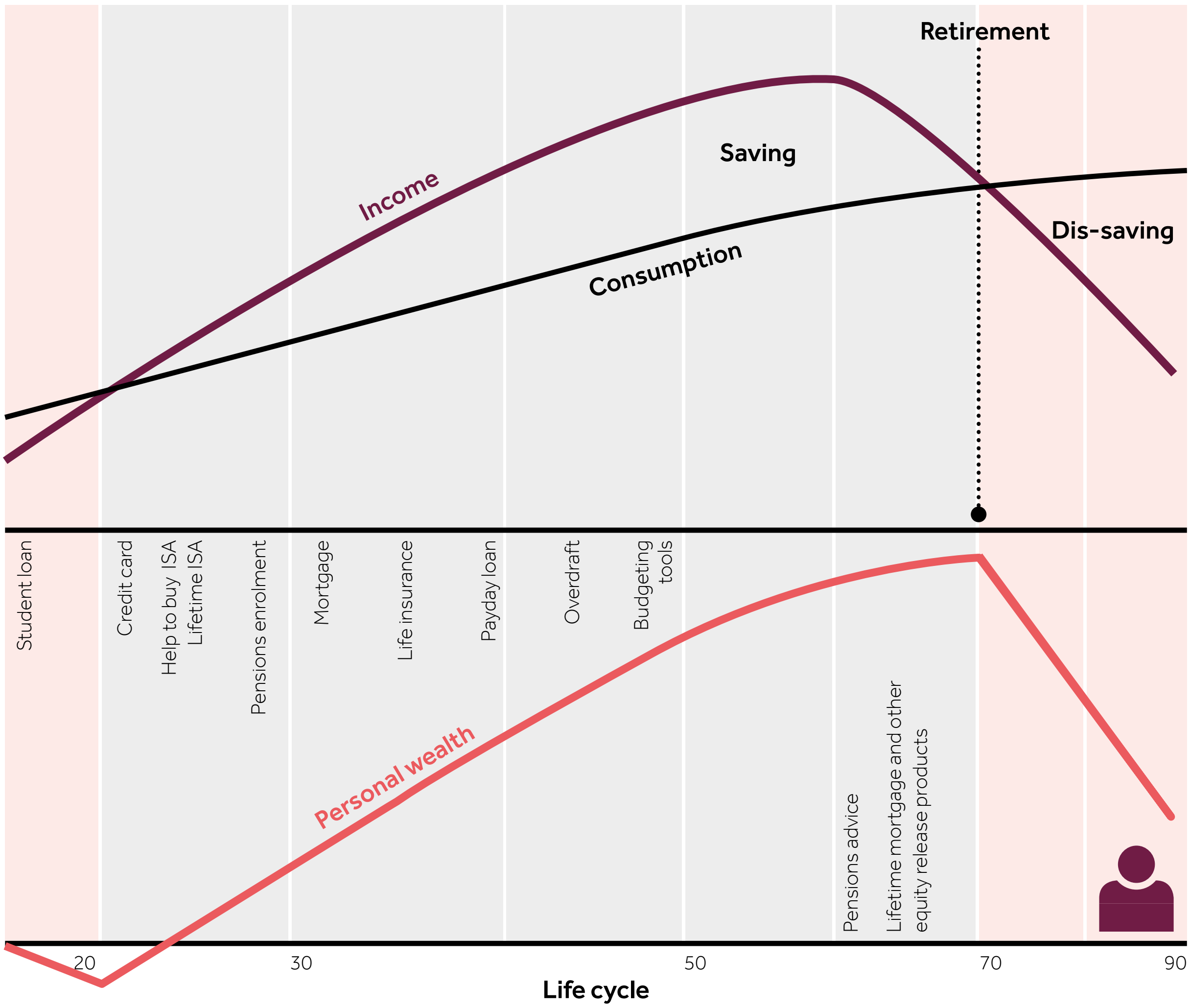
We ask 7 broad questions at the end of this paper. We would appreciate responses from firms, consumers and other stakeholders that can help us identify areas for consideration going forward.

See page 51 for the list of questions.

2 The life cycle model and evidence from the Wealth and Assets Survey

2.1 The life cycle model suggests that people make choices about how they spend and save at each point in their lives limited only by the resources available over their whole lives and thus independent of income at each point in their lives. Individuals typically incur debt in early adulthood in anticipation of growing income in the future. When entering their peak earning years, they repay debt and build financial, property, and pension wealth over time. Personal wealth typically peaks in people's final working years before retirement, from which point they start using it to maintain their living standards in later life. See Figure 1.

Figure 1: Income, consumption, and wealth in the life cycle model



We use Office for National Statistics (ONS) data to test how the way people build and use their wealth over their lives has changed in 10 years. From this, we identify that in the last decade consumers have accumulated and decumulated wealth following different patterns.

2.2 This is an illustrative example of the life cycle of the average individual, representing the situation of a consumer saving in working years to decumulate in retirement. Actual levels of wealth accumulation and decumulation, however, vary within the population. We know that many people are unable to save regularly, and many have insufficient earnings to save at all. For example, our Financial Lives survey shows that across the UK in general, 12% of the UK adults have no savings and investments.

2.3 The model, however, and this chart help to explain the typical financial needs and circumstances of people at different life stages, and how these are changing due to developments in the wider environment.

Changing patterns of wealth accumulation and decumulation

2.4 The way consumers build and then use their wealth has changed in a short period of time. Starting from the life cycle model, we have analysed these changes over the last decade, using the weighted median as a measure of the average level of wealth. We used ONS data to compare average (median) wealth levels – in today's money – for people aged between 20 and 80 surveyed at 2 points in time – 2006 to 08 and 2014 to 16.[1]

2.5 We have taken data from the ONS Wealth and Assets Survey for individuals aged between 20 and 80. This is a national survey based on a representative sample of households in Great Britain across all levels of wealth.

2.6 To explore how levels of wealth accumulation have changed over time, we compared the estimates reported for individuals sampled in Wave 5 (18,000 households) to individuals reported in Wave 1 (30,000 households). Survey respondents are interviewed every two years – with each two-year period being termed a wave. Wave 1 covers the period July 2006 to June 2008, while Wave 5 covers July 2014 to June 2016.

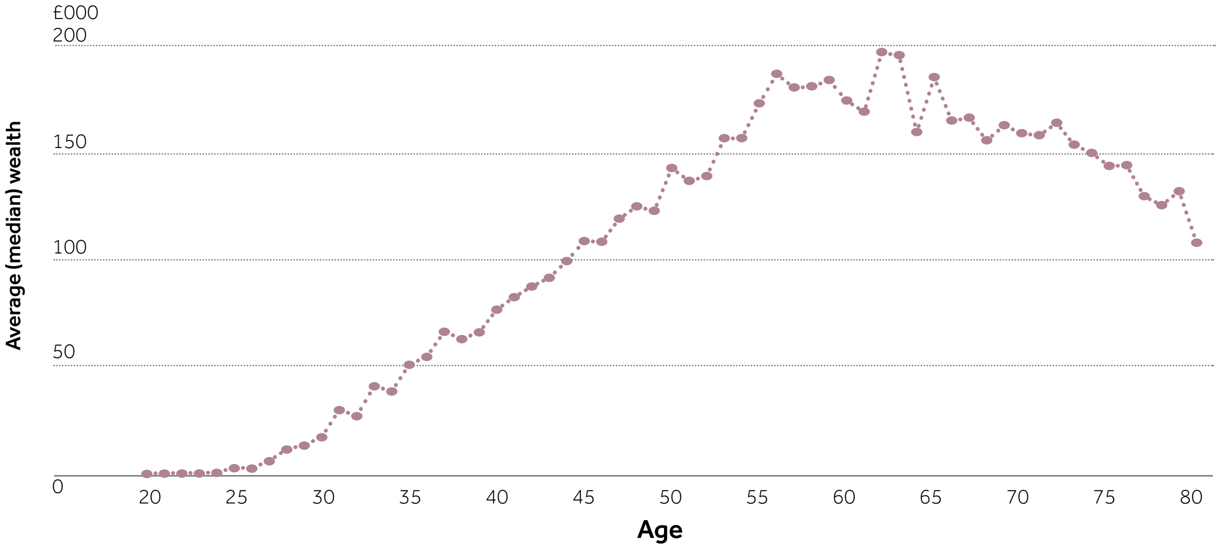
2.7 Average wealth is calculated as the weighted median (or 50th percentile) for groups of individuals with the same age.

2.8 We first considered the average levels of wealth for individuals surveyed in 2006 to 08. Figure 2 shows that those aged between 56 and 65 were the most well-off. This was the case for all wealth brackets. For example, wealth levels for those at the bottom 25% of the wealth distribution were higher across consumers aged between 56 to 65. The same was true for individuals at the top 25% of the distribution, though starkly different in the sense that this cohort had around 5 times the wealth of the lowest quartile and slightly more than twice the wealth of the median individual.

2.9 The data in Figure 2 do not track an individual's wealth holdings over time as they age. These illustrate wealth estimates from a cross-section of individuals sampled in 2006 to 08 and do not include any longitudinal dimension to track the specific individual cohorts. Figure 2 therefore illustrates the level of wealth of individuals of different ages at one point in time.

1 This work contains statistical data from the Office for National Statistics (ONS) which is Crown Copyright. The use of the ONS statistical data in this work does not imply the endorsement of the ONS in relation to our interpretation or analysis of the statistical data. This work uses research datasets which may not exactly reproduce National Statistics aggregates.

Figure 2: Average (median) total wealth, 2006 to 08



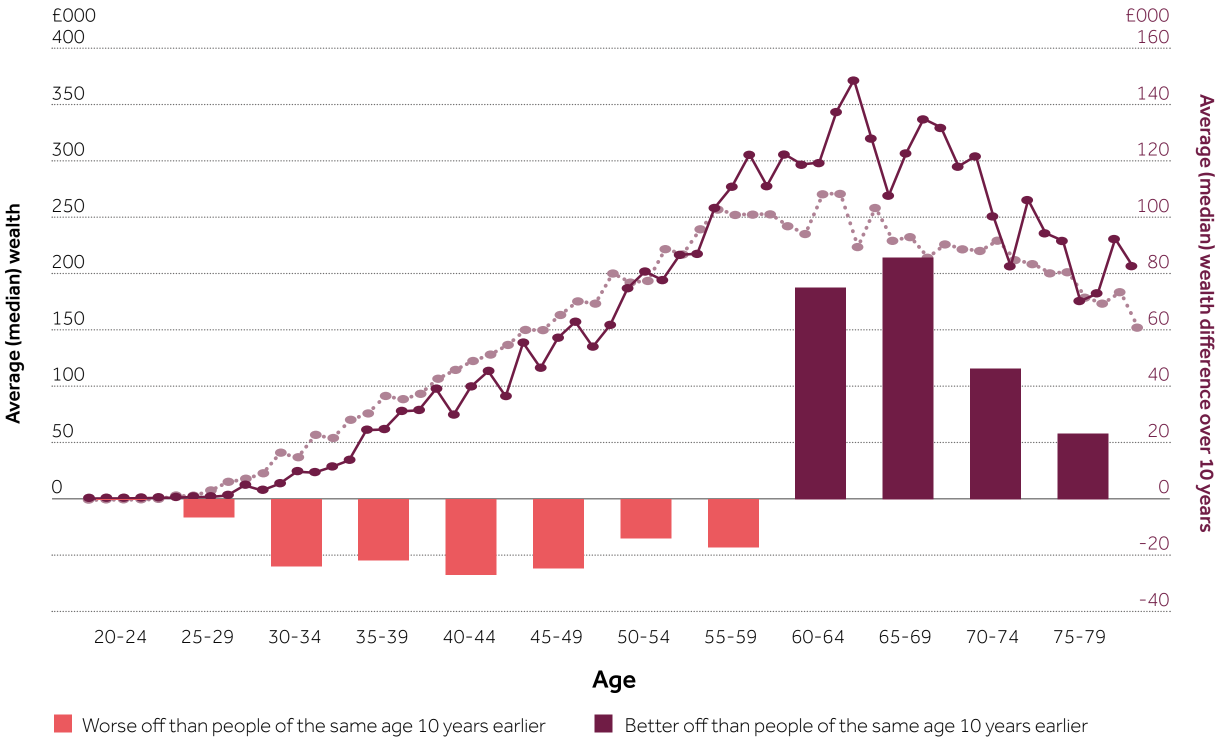
Source: FCA analysis of Wealth and Assets Survey data Nominal prices

2.10 We then compared average levels of wealth – in real terms – for people surveyed in 2006 to 08 (as above) with the results from the same survey made around 10 years later. We found a marked shift in that period, as people in later life in 2014 to 16 were better-off than those of the same age a decade earlier, while those in earlier stages of their life were worse off. To compare the wealth estimates recorded in the two waves of the survey, we need to express data in a common base. We use the UK Retail Price Index (RPI) to adjust the nominal values reported in the survey and express these in December 2018 prices. This adjusts for differences in the purchasing power of wealth and facilitates a more meaningful comparison.

2.11 As can be seen in Figure 3:

- Between 2014 to 16, the wealthiest people across average consumers were 60 to 69. This is 5 years older than the age at which the average consumer's wealth peaked in 2006 to 08, at 55 to 64. The average individual had accumulated wealth for 5 more years. This suggests that recently the average person accumulates wealth up to a later point in their life compared to people from a decade earlier.
- At given ages in the run up to retirement, people had accumulated less wealth. For example, for someone aged 40 to 50, total wealth was – in real terms – approximately £28,000 lower compared to those of the same age 10 years earlier (see the right-hand scale of Figure 3).
- People around retirement age (ie age 65) had accumulated significantly more wealth than those of the same age a decade earlier. For example, an individual aged 60 to 70 had approximately £78,000 more wealth in real terms (see the right-hand scale of Figure 3).

Figure 3: Change in median total wealth between 2006 to 08 and 2014 to 16



Source: FCA analysis of ONS Wealth and Assets Survey data. December 2018 prices. Note: the pink line represents the level of wealth of individuals surveyed in 2006-08, while the red line represents those surveyed in 2014-16.

2.12 The trends were broadly similar for people at different levels of the wealth distribution. For any level of the wealth distribution people in the run up to retirement had less wealth compared to people of the same age a decade before, while those around retirement age had more.

2.13 Wealth levels did not change for people at the very end of the wealth distribution. For example, those in the lowest wealth decile had negative or very little wealth (depending on age) in 2006 to 08 and this was still the case after a decade.

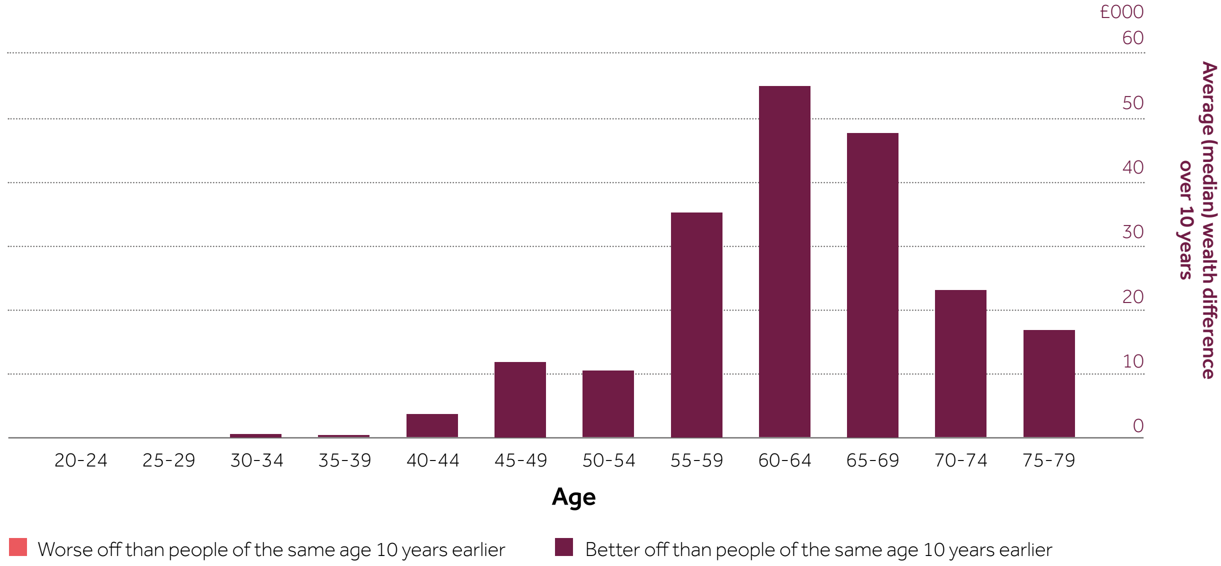
Changing patterns for individual wealth components: property, pension, and financial wealth

2.14 We also looked in more detail at the different parts of people's wealth. The focus here was on individuals with average (median) levels of wealth across the categories of housing, pension, and financial wealth. We compared average levels of wealth in today's terms for people surveyed in 2006 to 08 and in 2014 to 16. We also looked at consumers across the wealth distribution.

Pension wealth

2.15 In 2014 to 16 people around traditional retirement age (age 65) had significantly more pension wealth compared with those of the same age just 10 years earlier. We illustrated this in Figure 4. Falling interest rates tend to boost asset prices (eg financial assets including Defined Contribution pension pots) and have positive impact on the Net Present Value (NPV) of Defined Benefit pensions. (Bank of England, The distributional impact of monetary policy easing in the UK between 2008 and 2014).

Figure 4: Change in median pension wealth between 2006 to 08 and 2014 to 16



Source: FCA analysis of ONS Wealth and Assets Survey data. December 2018 prices.

2.16 The increase in pension wealth was particularly significant for those already at the higher end of the wealth distribution. For example, pension wealth levels for 60 to 70-year-olds at the top 25% of the wealth distribution was approximately £175k higher. But average (median) consumers of the same age experienced only a fraction of that increase over the same period. This is because wealth increases were broadly proportional to existing wealth levels, so varied substantially across the wealth distribution in cash terms.

2.17 Those in the bottom 25% of the distribution did not accumulate any workplace pension wealth, meaning that they will rely to a large extent on the state pension for their retirement years.

Property wealth

2.18 Property wealth is measured as the value of any property owned in the UK or abroad, less the outstanding value of any loans or mortgages secured on these properties.

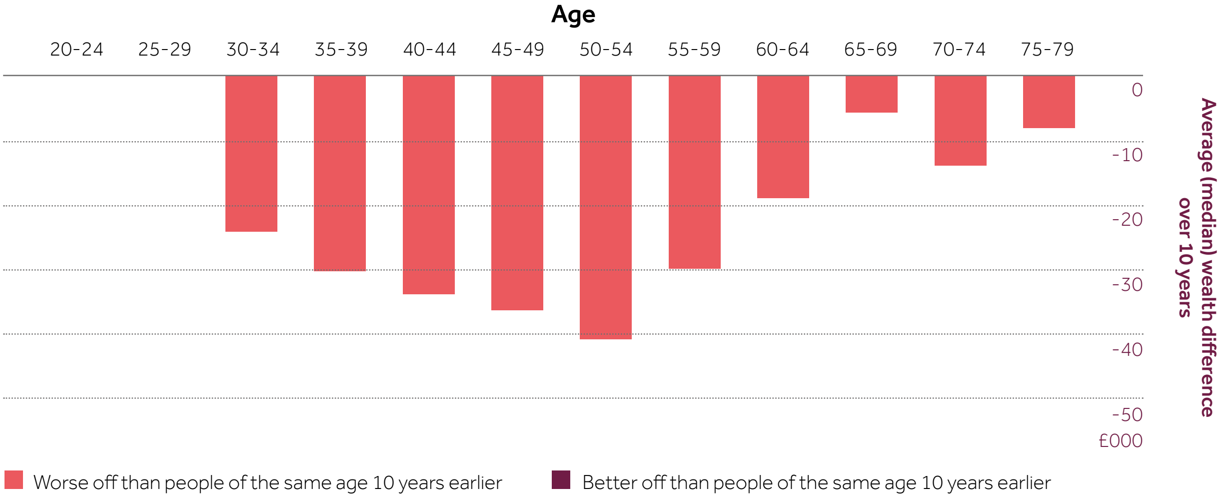
2.19 By comparing median property wealth levels at 2 points in time we note that over the space of a decade the age of first-time home buyers has gone up by 4 years (from 30 in 2006 to 08 to 34 in 2014 to 16).

2.20 In Figure 5 we see a decline in average levels of property wealth among people of all ages. The difference was starker (-32%) for those aged 35 to 65. This pattern was not as marked (-7%) for 65 to 80-year-olds, which is to be expected given that by this age those who were able to afford a home will have made their first purchase earlier in life. For those in the older age group, property wealth was not significantly lower compared with people of the same age 10 years earlier.

2.21 As discussed in paragraphs 3.18 onwards, property prices – in real terms – increased significantly in the last few decades. Higher house prices increase the wealth of existing home owners. In contrast, however, for aspiring home owners the cost of future housing and the amount they have to borrow through a mortgage increases.

2.22 As explained in paragraph 3.19, some regions of the country had more marked variations.

Figure 5: Change in median property wealth between 2006 to 08 and 2014 to 16



Source: FCA analysis of ONS Wealth and Assets Survey data. December 2018 prices.

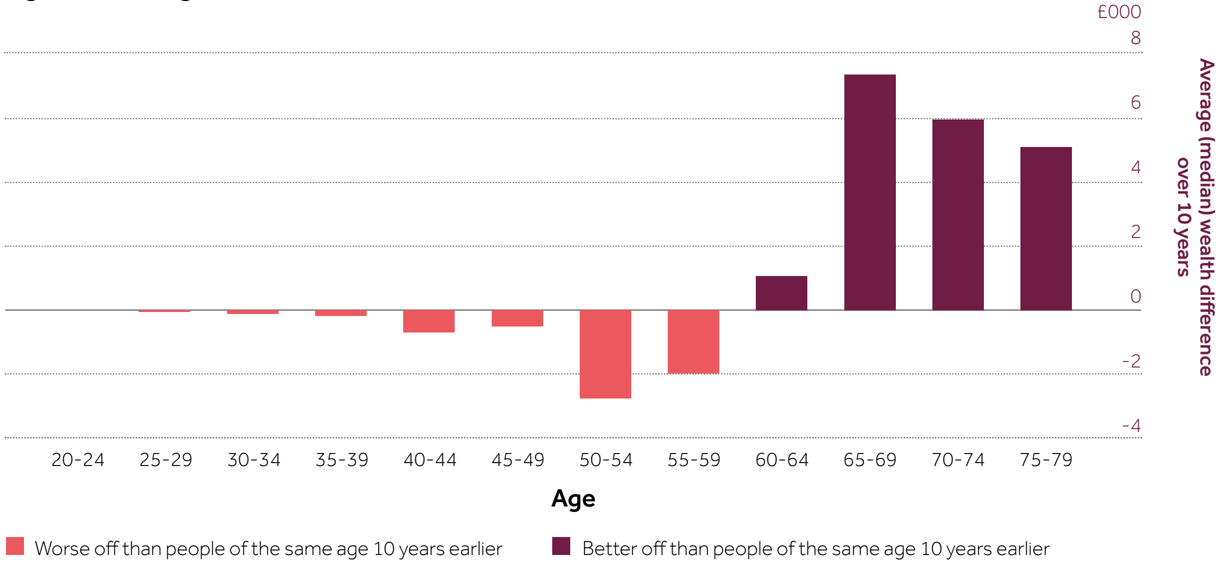
2.23 The trends were similar for people at different levels of the wealth distribution: for example, for those at the top 25% and bottom 25% of the distribution, property wealth decreased for the younger age groups and remained broadly stable for those around retirement age compared to those of the same age a decade earlier.

2.24 However, for people at the high end of the property wealth distribution (top 10%) property wealth increased rather than decreasing. This meant that in a decade there was a shift in property wealth towards the most well-off individuals.

Financial wealth

2.25 Our analysis clearly showed that older people (from around age 65) held more wealth. For example, someone aged 60 to 70 in 2014 to 16 had approximately £4,500 more (+38%) than someone of the same age in 2006 to 08 (see Figure 6). Comparatively, consumers aged 40 to 60 saw a slight reduction in financial wealth. This was broadly consistent across different levels of the wealth distribution.

Figure 6: Change in median net financial wealth between 2006 to 08 and 2014 to 16



Sourcew: FCA analysis of ONS Wealth and Assets Survey data. December 2018 prices

2.26 The Government's Pension Freedoms started in 2015. While it's too early to tell, it may be that part of the increase in net financial wealth among older people is linked to them accessing their pension wealth and investing it in other financial assets. Net financial wealth is measured as the value of any financial assets held (formal investments, current or saving account balances, investment vehicles such as Individual Savings Accounts (ISAs), endowments, stocks and shares, and other informal savings) less any financial liabilities (outstanding balances on credit cards, arrears on household bills, student debt, and any loans from formal or informal sources).

2.27 Prior to the introduction of Pension Freedoms most people with a DC pension could only convert their pension savings into an income (annuity).

2.28 The Pension Freedoms, indeed, enable DC pension customers, from the age of 55, to:

- take their pension savings as cash (in one lump sum or in smaller amounts over time)
- buy an annuity (or other income generating guaranteed products that may emerge)
- use drawdown without any limits applied
- use a combination of these

2.29 So far (Q4 2018) 1.04 million of savers have cashed in £23.6 billion from their pension pots since Pension Freedoms were introduced in April 2015. (HM Revenue & Customs, Flexible Payments from Pensions: January 2019).

Changing wealth patterns and drivers of change

2.30 In this chapter, we gave a snapshot of wealth levels for people of the same age at 2 different points in time, 2006 to 08 and 2014 to 16. We found that after 10 years the way people build and use their wealth has changed. In particular, after only a decade:

- the average person has accumulated wealth for longer (ie later in life)
- Generation X people have accumulated less wealth than previous generations at the same age
- Baby Boomers have accumulated significantly more wealth than previous generations at the same age

2.31 The drivers of these changes are complex and varied. They include demographic change, labour market developments, and other economic and policy drivers. We describe these further in the next chapter.

3 Drivers of intergenerational change

3.1 In this chapter we set out what we consider to be the demographic and economic factors affecting the financial needs of UK consumers. These factors contributed to the changes in wealth accumulation shown in Chapter 2, and are having an impact on people's financial lives.

3.2 We identify 5 broad factors as the main drivers of economic and social change: demographic change (due to health gains), persisting low interest rates, increasing house prices, labour market developments, and changing student funding arrangements.

3.3 The purpose of this Discussion Paper is to open a debate on actions we could take, as a regulator of financial services, to ensure that our approach adapts to the changing needs of different groups within and between generations (please see also Chapter 8). We would like to examine the implications of changing financial needs to explore possible ways in which we may adapt our approach to ensure financial markets meet changing consumer needs.

3.4 Below we provide an overview of the relevant factors that we consider are affecting people's financial circumstances and needs. We have not conducted new research. We welcome feedback on the content of this chapter to help develop further our understanding. With this paper, however, we do not intend to stimulate further debate on factors and drivers of change.

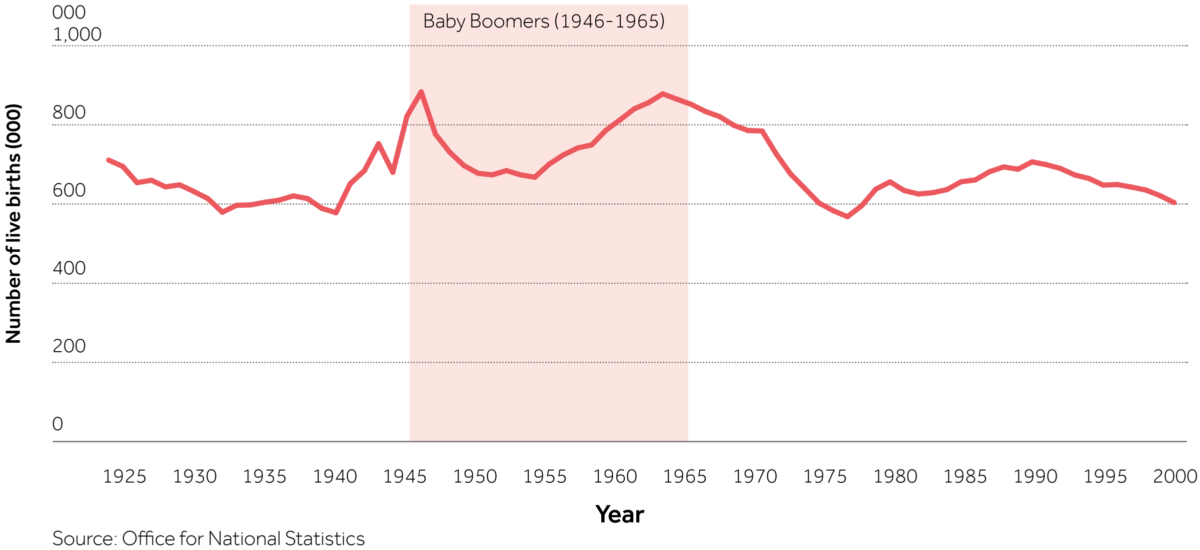
Demographics

3.5 Due to high numbers of births after World War II and increasing life expectancy, the UK has an ageing population. As a result, a growing share of the population is in or near traditional retirement age. They are likely to live longer than previous generations.

The UK has an ageing population. As a result, a growing share of the population is in or near traditional retirement age

3.6 The number of births peaked in 1947 and again in 1964 and was particularly sustained in the 1960s (the so-called Baby Boom).

Figure 7: The mid-twentieth century Baby Boom



Source: Office for National Statistics

3.7 The effects of this can be seen in the larger number of Baby Boomers currently in or approaching retirement age. There are also a larger number of people in their 70s due to a spike in births in 1947. For example, in 2016 there were 11.8 million people in the UK aged 65 and over, representing 18% of the total population. 25 years before, there were 9.1 million in this group, accounting for 15.8% of the population. (ONS, Overview of the UK population: July 2017).

3.8 Average life expectancy has increased steadily in the UK in recent decades. Life expectancy at birth in 2016 was over 79 years for males and 83 years for females. In 1980 life expectancy at birth was 71 and 77 for males and females respectively. (ONS, National life tables, UK: 2015 to 2016).

3.9 Increased investment in medical research over the past century has revolutionized the technology of preventative and curative medicine. This has maximized people's health and length of life. Our Financial Lives survey shows that only 5% of those aged 64-84 have financial commitments associated with long-term care (either for themselves or for someone else). This number, however, is projected to grow over time. (House of Lords, Ready for ageing?).

3.10 This is consistent with findings showing that in 2015 only 2.5% of those aged over 65 needed residential care. Evidence shows that for those needing residential care the average duration of staying in a care home is 15 months (PSSRU, Length of stay in care homes). With an average weekly cost of £846 for self-funders, this represents a cost of nearly £44,000 (Competition and Markets Authority, Care homes market study). Then, only small numbers will incur these costs, but these are significant in relation to median levels of UK consumer wealth. Funding later life care costs is likely to remain a key challenge subject to significant uncertainty for consumers about whether it will be needed and what it will cost.

3.11 In general, increased life expectancy means that individuals from all age groups, but especially those approaching retirement age, may need to save more or work later in life to maintain living standards. The average age of exit from the labour market has risen from 62.3 to 65.1 for men between 1997 and 2017, and from 60.8 to 63.6

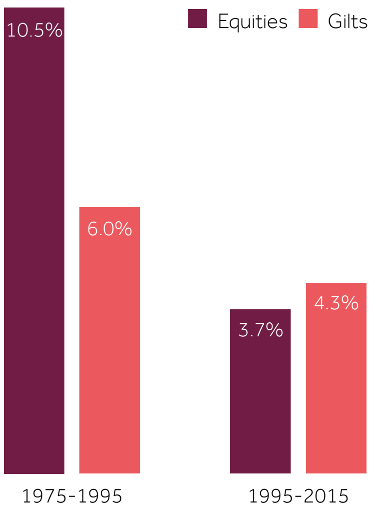
for women over the same period. (ONS, Labour market economic commentary September 2018). Even when they have generated sufficient wealth throughout their working life, rising life expectancy influences how quickly they should use it when retiring. There is a risk they may overspend and run out of pension savings leading to greater reliance on the state and support from families.

Low interest rates

3.12 Interest rates declined significantly in 2008/09 and have remained at a record low for the last decade. This long-term trend has contributed to falling rates of return on financial assets. (Bank of England, Why are interest rates low?). Persistent low interest rates have been affecting investors' ability to build wealth, but has also made the cost of borrowing cheaper over the same period.

3.13 Across the period 1975 to 1995 annual real investment returns in the UK were around 10.5% on equities and 6.0% on gilts. (Barclays, Equity Gilt Study 2016). For the period 1995 to 2015 average rates of return had fallen to 3.7% for equities and 4.3% for gilts. (Barclays, Equity Gilt Study 2016).

Figure 8: Changing real rates of return, 1975 to 1995 vs 1995 to 2015 (%)



Source: Barclay, Equity Gilt Study, 2016

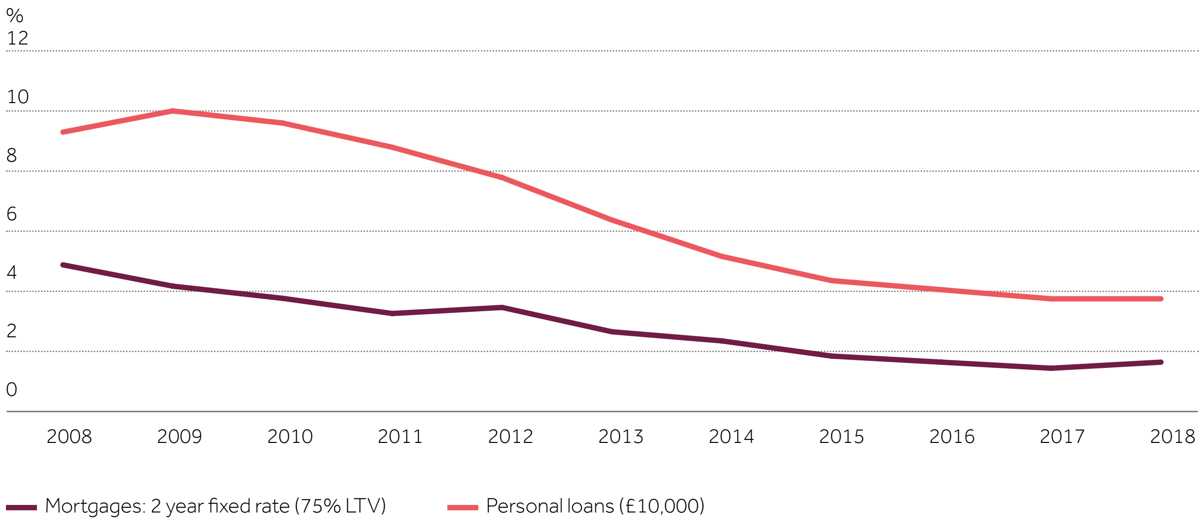
Persisting low interest rates have been affecting investors' ability to build wealth, but has also made the cost of borrowing cheaper

3.14 Those who already held significant wealth from 1975 to 1995 appear to have benefitted from the increase in the value of these assets – both long-term property price appreciation and rising values of financial assets including pensions. (Bank of England, Staff Working Paper No. 720, The distributional impact of monetary policy easing in the UK between 2008 and 2014). Those who started accumulating wealth only more recently are seeing low rates of return compared to previous generations. Low – and often negative – real rates of return may even discourage long-term saving.

3.15 Low interest rates have also meant cheaper borrowing, especially for mortgages and personal loans. This appears to have encouraged some consumers to take on greater levels of debt in the last decade. The decade before interest rates started declining (1998 to 2007) the average debt-to-income (DTI) ratio in the UK was around 115%. The debt-to-income (DTI) ratio is one way to measure people's indebtedness levels. This is calculated by dividing recurring monthly debt by gross income, and it is expressed as a percentage. It includes both secured debt (eg mortgages) and unsecured debt (eg credit card outstanding balances, personal loans, student loans, and loans from payday lenders). In the last decade the average DTI had increased to around 135%. (Bank of England, Housing tools data – Household debt to income).

3.16 The cost for UK households to service their debt over the period 1995 to 2018 was lowest in 2017. (Bank of England, Financial Stability Report – Issue No.42). For example, the average rate quoted for a 2-year fixed-rate mortgage at 75% loan-to-value was as low as 1.5% in 2017. This compared with an average of 5.5% between 1998 and 2007. (Resolution Foundation, An unhealthy interest?). Rates on personal loans have also fallen sharply. For example, the average quoted rate on a loan of £10,000 dropped from 10.8% in November 2009 to just 3.8% in November 2018. (Bank of England, Quoted household interest rates).

Figure 9: cost of credit (mortgages and personal loans) in the last decade (%)



Source: FCA analysis of BoE credit data

3.17 For completeness, we observe that in the last 20 years credit cards and overdraft interest rates first decreased and then increased to go back to initial levels.

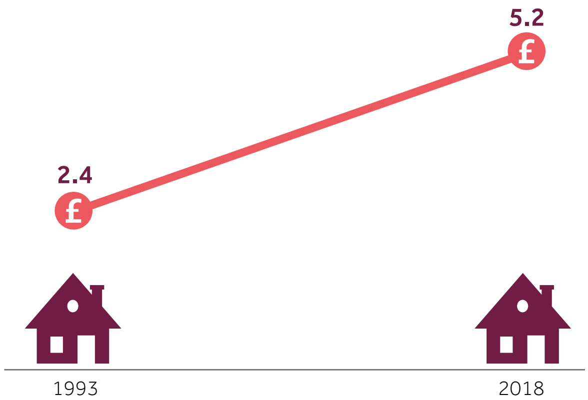
House prices and real earnings

3.18 In the boom post-war years, buying a house was a common way for people to start building wealth. Aspiring first-time buyers (typically young people) have found it hard to set aside a deposit and take a mortgage. As prices have increased, those who have a sufficiently large deposit will also end up paying larger proportions of their salaries in mortgage instalments. This will have implications on both their actual and perceived financial security.

3.19 The gap between average incomes and house prices has widened in the last few decades, even in the most affordable regions. (ONS, Housing affordability in England and Wales). In 1993 first-time buyers paid around 2.4 times their average salary to buy a property. In 2018 prospective first-time buyers could expect to pay around 5.2

times their average salary to do so. (Nationwide, House Price Index data – affordability estimates – first-time buyer house price to earnings ratios). This gap is more marked in certain regions. In London, on average first-time buyers today need to pay 9.4 times their salary, compared to 3.2 in northern regions. However, the gap has increased in all regions.

Figure 10: First-time buyer house price to earnings ratio over 25 years



Source: Nationwide's House Price Index data

3.20 Over the past decade the proportion of households living in properties with mortgages reduced by 24%. In contrast, the proportion of households living in private rented accommodation increased by around 50% over this time. (DWP, Family Resources Survey 2016/17, Tenure data tables, Households by Tenure).

3.21 Less home ownership and greater private renting is likely to stop many consumers accumulating wealth through housing equity. Renters spend a significantly higher share of their income on housing costs than homeowners. For example, for young renters this is 27% compared to 15%. (IFS, The Economic Circumstances of Different Generations: The Latest Picture). This is likely to put a squeeze on their living standards in the short term and restrict their ability to save in the long-term. We note that Millennials, and some from Generation X, are more likely to be affected by this.

24%
decrease in the proportion of households living in properties with a mortgage in the last decade

50%
increase in the proportion of households living in private rented accommodations over the same time

Labour market

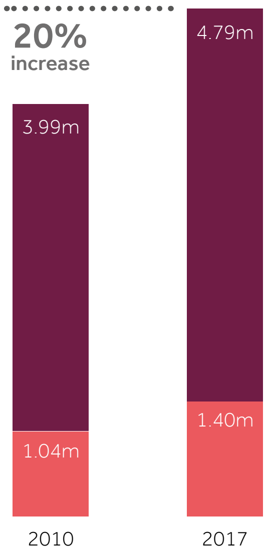
3.22 Labour represents the major source of income for people. It enables people to pay for their everyday spending and to save for a house deposit and for retirement. What happens in the labour market – particularly in terms of the hours they work and the pay they receive for it – has an important impact on living standards.

3.23 Traditional employment is based on full-time contracts where employees work regular hours and receive a stable income. Today's labour markets are undergoing fundamental change, presenting a wide variety of employment situations and the rise of new forms of work outside the traditional employment relationship. The number of self-employed, of those who are employed on a temporary basis, and of those who work on zero-hours contracts have increased across all age groups, but especially among young workers. This is having important consequences on people's lives and expectations, especially among younger generations.

3.24 The number of self-employed people increased by 801,000 (20%) over the period 2010 to 2017. There has been a particularly large increase in the number of self-employed people working part-time. The number increased by 429,000 (42%). (ONS, UK Labour Market Statistics: Aug 2017).

More flexible but often less secure forms of employment have increased while real earnings have decreased

Figure 11: Number of self-employed, 2010 to 2017 (millions)



Source: FCA analysis of ONS UK labour market statistical bulletins

3.25 1.56 million people were employed on a temporary basis in 2017, up 82,000 from 2010 (an increase of 6%). Estimates for October to December 2017 suggested that around 900,000 people were on zero-hours contracts – representing 2.8% of all people in employment. Young people are more likely to be working part-time, to be in temporary employment, or to be on a zero-hours contract than older workers. (ONS, Trends in self-employment in the UK, and People in employment on a zero-hours contract: Mar 2017). Levels of self-employment, however, have increased for all age groups, including those aged 65 and above. Self-employment among this group saw the number of self-employed increase from 159,000 to 469,000 between 2001 and 2016. Protections and benefits afforded to traditional full-time employees are often lost with these variations in contract.

3.26 In addition, inflation has outpaced average earnings growth for much of the past decade, meaning real incomes have been falling. (ONS, Inflation and price indices and Earnings and working hours). Declining real income levels have affected young workers more than those close to retirement. Real earnings for those in their 20s or 30s in 2017 were 5% and 7% lower than in 2008, but only 1% lower for those aged 60 and over. (IFS, 10 years on – have we recovered from the financial crisis?)

Student funding

3.27 Education helps social mobility by providing opportunities for people to move upwards in terms of income and social status, and remains one of the surest ways out of poverty and social inequality. Recent changes in the way in which further education (FE) is funded means that students now incur debt while studying and repay it over the course of their working lives. Increasing numbers of students currently in FE are taking on higher levels of student loan debt to fund their education. The latest Student Income and Expenditure Survey by the Department for Education reports that 84% of full-time English-domiciled students had taken out a Tuition Fee Loan, and among these the average was £8,165. This has an actual and perceived impact on their financial lives.

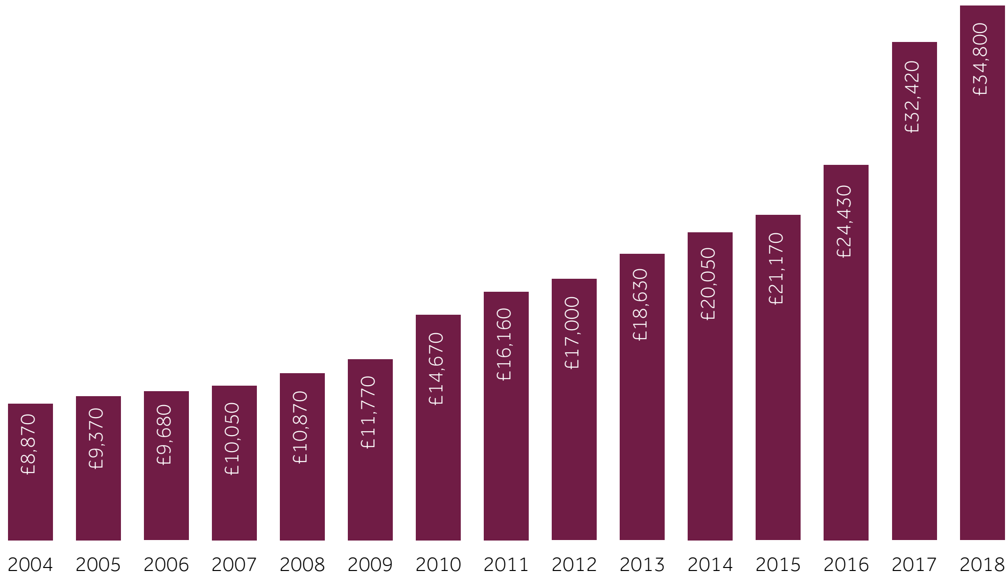
3.28 Total central funding for adult FE declined significantly in the last decade (House of Commons, Adult further education funding in England since 2010). As a result, student loans are increasingly used to fund education.

3.29 A growing proportion of the population is participating in higher education. In 2016/17 approximately 50% of the population aged 17 to 30 had been in higher education, compared to 42% in 2006/07. (Department for Education, Participation Rates in Higher Education: Academic Years 2006/2007 – 2016/2017 (Provisional)). 2017 saw the highest ever proportion (32.6%) of 18-year-olds get a place at university or college. (UCAS, Largest ever proportion of UK's 18 year-olds entered higher education in 2017). Growing numbers of young adults are therefore building up greater levels of student debt.

Growing numbers of young adults are building up greater levels of student debt

3.30 Figure 12 shows that in 2017, former students making their first repayment had an average outstanding student loan balance of £34,800. This was more than double the amount in 2012 (£17,000) and triple the amount in 2008 (£10,870). (Student Loans Company and Department for Education Statistics publication (SLC SP 01/2018)).

Figure 12: Average loan balance on entry into repayment cohort (£)



Source: Statistics publication (SLC SP 01/2018) from Student Loans Company and Department for Education

3.31 We note, however, that the Department for Education estimates that 70% of students will not repay their debt in full. The Institute of Fiscal Studies (IFS) estimates the figure to be 83%. (Institute for Fiscal Studies, New higher loan repayment threshold is a big (and expensive) giveaway to graduates). This is because student debts are written off if not fully repaid after 30 years. According to the OBR's latest forecast, 38% of total principal and interest charged to students will be repaid. (Office for Budget Responsibility, Accounting for student loans). To align more closely with the economic reality, starting from this year the ONS will count the cost of expected student loan write-offs to government spending when loans are issued, and will stop counting accrued interest that will never be paid.

3.32 The long-term impacts of the changes to student funding are not yet apparent and depend partly on the returns to students from their future earning potential. There is clear evidence showing that education is an intangible asset that helps people to earn more over their lives. (eg, Blundell et al., 2000). Repaying student debt, however, means recent graduates have reduced disposable income. This will influence their ability to save and build financial resilience for the longer term. It could further delay the age at which they can afford to buy a house, with knock-on consequences for other forms of longer term saving. (Yorkshire Building Society, New Yorkshire Building Society report explores first-time buyer challenges).

What this may mean for financial services

3.33 The next chapters describe how trends and developments are having a significant impact across financial services, and on users more generally. We focus on the sectors that are most directly affected – mortgages, pensions, consumer credit, and insurance and protection.

3.34 We welcome evidence from firms on product developments and sales, and from consumer groups and researchers on the challenges that consumers face. It is important to balance innovation with consumer needs. Regulation has a part to play in both maintaining a check on competitive forces while not placing limitations on innovation that could benefit consumers.

3.35 While we do not cover retail investments and wholesale sectors here, we would still welcome feedback on how these trends are affecting all financial services markets.

4 Implications for financial services – mortgages

4.1 Many products such as student loans, car finance, credit cards and other forms of credit enable people to smooth income and expenditure over their life. But mortgages are unique, both in terms of value and length of term. For example, the average loan for a first-time buyer in the UK is approximately £145,000 with an average term of 25-30 years. (UK Finance, Lending Trends).

4.2 Mortgages allow consumers to enjoy the benefits of home ownership often decades before they could afford to purchase a property outright. Mortgages also enable home owners to benefit from any house price increases from the moment of purchase, rather than when they own the property outright. More recently, mortgage-related products have been developed to support decumulation, by releasing assets, for example, to cover later life costs.

4.3 In this chapter, we consider the impact of changes, trends, and developments on the mortgage market. We set out how consumers, firms and policymakers have responded, and suggest some potential barriers to innovation.

4.4 We are seeking feedback on whether there are other implications for mortgages we should consider, and how far providers operating in this space are currently meeting changing consumer needs from different age groups. To the extent that this is not happening, we welcome feedback on possible reasons why this is the case, and on what we could do to encourage the industry to do so. Detailed questions can be found in Chapter 9.

Affordability

4.5 In the 1930s people in the UK started taking advantage of the growing availability of mortgages to buy properties. Since then, the proportion of home owners has more than doubled. (ONS, Home ownership down and renting up for first time in a century).

4.6 Home ownership rates, though, declined in the last decade, especially for those aged 18 to 34. Many young people would still like to buy a property, but are finding it increasingly difficult to do so. In the last 30 years house prices have increased more than wages (see paragraph 3.26). House prices in real terms have increased by 259% during this time, while wages increased by only 68%. (ONS, Housing affordability in England and Wales).

4.7 Labour market changes may also be having significant effects on borrowers' relationship with the sector. Those who work in jobs providing less reliable and stable sources of income (eg self-employment, zero-hour contract, or agency work) may find it harder to pass affordability assessments, which is also relevant to consumer credit. As these people's incomes may fluctuate from month to month, firms use a more rigorous proof-of-income process for them than for those who are employed.

4.8 Anecdotal evidence of Millennials suggests there is more fluidity between the workplace and further education. Young people may tend to join the labour market, then go back into education to enter the labour market again later – at times more than once. These consumers may require greater flexibility in their mortgage and credit products.

Affordability – market and public policy response

4.9 There have been various Government initiatives, market developments, and innovative models of mortgage lending aimed at helping first-time buyers on to the housing ladder. The Government Help to Buy equity loan scheme aims to help them to buy a new build home with a lower deposit. (HM Government, Help to Buy: How does it work?). The Help to Buy ISA also helps consumers to save to buy their first home by offering a Government bonus to boost these savings. (Gov.uk., Affordable home ownership schemes).

4.10 The Government has been addressing barriers to getting onto the housing ladder by presenting the industry with the 'Rent Recognition Challenge'. The industry was asked to come up with ways to enable lenders to consider past rental payment history when potential borrowers apply for a mortgage or other forms of borrowing. (Gov.uk., Rent Recognition Challenge: Using FinTech to help renters).

4.11 Some consumers have responded by turning to the 'Bank of Mum and Dad'. Research shows that 26% of property owners in 2017 had financial help from family and friends when they bought their current home. (Legal & General, The bank of mum and dad). This rises to 62% among those under 35, compared to just 6% of those over 55. Evidence suggests that happens informally – through loans between family members or gifts.

4.12 Firms have offered innovative products designed to enable wealth transfer between generations. For example, 'family assist' mortgages are designed for parents and grandparents to help family members who don't have the level of deposit that lenders typically require. There have also been a range of products designed for similar purposes such as guarantor mortgages and family offset mortgages. However, internal analysis of Product Sales Data shows that these products still represent a small portion of the market.

Mortgages and the life cycle model

4.13 Those able to buy a property tend to do so later in life, borrowing over longer time horizons than in the past. 39% of new loans in 2016 had a term of longer than 25 years compared to 17% in 2007. (FCA, Data Bulletin).

4.14 Over the past decade there has been a trend among people buying and moving to a larger house usually requiring a higher loan amount. They have tended to choose a longer-term mortgage that ends beyond the traditional 25-year term. In 2006, 83% of homeowners had a mortgage term of between 5 to 25 years, while the remaining 17% had terms of over 25 years. In 2016, 39% of mortgages had terms between 25 and 35 years, while the number of mortgages for terms of 5 to 25 years fell to 61%. (Lloyds Bank, Number of homemovers falls for the first time in 5 years).

4.15 Historically, a mortgage was a product that consumers took out in early life and repaid before retirement – leaving a number of years to accumulate pension wealth without making mortgage repayments. Today, consumers are more likely to take out their first mortgage a few years later in life and not fully repay it until after they retire.

4.16 Interest-only mortgages with more affordable monthly payments were popular before the 2008 financial crisis.[2] Since borrowers pay only the interest charges on the loan, and not any of the original capital borrowed, monthly payments are lower. However, at the end of the mortgage term they still owe the lender the original amount they borrowed. After the credit crunch, it emerged that hundreds of thousands of interest-only customers would struggle to pay off their home loan later on. For this reason, it is now very difficult to borrow on an interest-only basis.

Mortgages and the life cycle model – market and public policy response

4.17 To meet users' changing needs, mainstream lenders are increasing their maximum lending age criteria. They have recently increased or even removed their maximum lending age. The average maximum age of consumer that mortgage providers will lend to is now over 80 years. (Building Societies Association, Building societies' lending age limits).

4.18 While the standard mortgage repayment term was traditionally 25 years, many high street lenders have now set their maximum term length at 40 years. As a result, more than one-third of mortgages taken out in 2017 will not be repaid until after the borrower turns 65. (Financial Times, Extra-long mortgages push up the age of borrowers).

4.19 Not all lenders offer interest-only mortgages and those that do will have strict criteria, such as a high deposit. In addition, our rules (MCOB) require there to be a credible repayment strategy in place for paying off the capital at the end of the term.

Later life

4.20 People, especially older people, may want to use their housing wealth to support their own or their families' financial needs. They can use various strategies to withdraw equity. This includes selling their home and moving to rented accommodation, downsizing, or borrowing against their property (later life lending).

4.21 Equity release is a small but growing section of the market. Our Mortgage Market Study found that the main form of equity release, lifetime mortgages, made up 1.5% of all mortgages arranged in 2016. While this market remains small, this represents significant growth of 12% pa between 2012 to 2016. This tells us that consumers, especially those in later years, are increasingly looking to draw on housing wealth. One possibility would be turning to mortgages for purposes other than buying a property – they may turn to mortgage type products to maintain living standards and/or help their relatives.

2 Monthly payments are lower since the borrower pays only the interest charges on the loan, and not any of the original capital borrowed – at the end of the mortgage term they will still owe the lender the original amount borrowed.

Later life – market and public policy response

4.22 In the last few years, we have taken steps to tackle regulatory barriers to later life lending as part of promoting innovation that benefits consumers. This includes changes to our mortgage rules (MCOB) on lifetime mortgages and retirement interest-only mortgages. These changes have allowed firms to remove affordability assessment requirements for lifetime mortgages.[3]

4.23 We also amended the conduct requirements that apply to retirement interest-only mortgages (MCOB) so that they better reflect the actual level of risk. This brings them more into line with that of standard mortgages. These changes are likely to improve access by allowing mainstream lenders to lend to older consumers and creates another option alongside more traditional equity withdrawal, downsizing and equity release.

Possible barriers to innovation

4.24 While we are seeing some innovation in later life lending, there may be commercial barriers to innovation in this market, such as the funding models required for equity release.[4] Firms require flexible long-term funding to provide equity release mortgages that can adapt to the uncertainty of repayment amounts and timing. As a result, funding for these products is predominantly from insurers.

4.25 Peer-to-peer home finance could play a bigger role in the housing market in the future. We have seen some interest in peer-to-peer platforms from our 2016 Call for Input. We have also proposed changes designed to address the ways in which the loan-based crowdfunding model has been developing. We note, however, that the demand for this kind of service is still insignificant. This may also be due to lack of awareness or lack of trust from potential lenders.

4.26 Our rules (MCOB) and Financial Policy Committee recommendations do not restrict or discourage firms from lending to younger or older people. The key factor is not age, but whether the consumer can afford to repay the mortgage. We allow firms to use their judgement, and have the flexibility to define their own appetites for commercial risk.

3 These products are lifetime mortgages where consumers make regular payments but can switch to interest-roll up at any point. They are designed for consumers who have higher levels of housing equity and can make regular repayments which can lessen the impact of interest roll-up on the equity left in the home at the end of the lifetime mortgage.

4 Equity release providers lend out substantial amounts over very long terms. Repayments generally only take place when the person dies or moves into care, and are funded from the equity from selling the home. Therefore, the funding model requires lending of substantial amounts without return until, often, many years later. This requires long-term funding models. Most equity release lenders are also life insurance providers.

5 Implications for financial services – pensions

5.1 Pensions help people to maintain living standards in later life. They enable workers to set aside wealth in earning years to use in retirement. In this chapter, we consider the impact of changes, trends, and developments on pensions. We set out how consumers, firms and policymakers have responded, and discuss potential barriers to innovation.

5.2 Recent years have seen two major changes in the pensions sector: the introduction of auto-enrolment from 2012, and the implementation of Pension Freedoms from 2015. (Gov.uk., New timetable clarifies automatic enrolment starting dates) and (House of Commons, Pension flexibilities: the 'freedom and choice' reforms). Together with increased life expectancy and labour market developments, these developments influence the ways in which people generate and access pension wealth.

5.3 We are seeking feedback on whether there are any other implications for pensions we should consider, and how far providers operating in this space are currently meeting changing consumer needs from different age groups. To the extent that this is not happening, we welcome feedback on possible reasons why this is the case, and on what we could do to encourage the industry to do so. Detailed questions can be found in Chapter 9.

Accumulation

5.4 More flexible but less secure forms of employment (paragraphs 3.23 to 3.25) often fall outside the scope of auto-enrolment. The growth in less secure forms of employment (paragraph 3.24) also means that a growing proportion of workers may not meet auto-enrolment qualification criteria.

5.5 The rapid growth of self-employment has been relatively strong among young workers in the last 15 to 20 years. In 2017, a large share of young self-employed (45.1% among the 35 to 54 age group) did not have any private pension wealth (ONS, Trends in self-employment in the UK).

5.6 Even when they do meet auto-enrolment criteria, some young workers prefer to opt-out. They may prefer to use the money to build a deposit for a house purchase. Saving for a deposit is becoming increasingly demanding due to increased house prices.

Accumulation – market and public policy response

5.7 Workers in flexible employment can access a range of alternative pension products, if they actively seek them. This includes individual personal pensions, stakeholder personal pensions, and self-invested personal pensions (ie non-workplace pensions).

5.8 The Department for Work and Pension (DWP) recently announced it will be running trials to explore how to increase pension participation among the self-employed.

In response to the need for, and importance of, good quality financial education the Single Financial Guidance Body (SFGB) has launched a Guidance and Advice Programme. Bringing together three former bodies – Pension Wise, the Pensions Advisory Service, and the Money Advice Service – the SFGB coordinates the UK's Financial Capability Strategy and other strategic activities. It also provides a single place for people to access free and impartial support when considering questions about their money, their pension and their future financial plans.

5.9 Technological advances have allowed micro-saving and investment apps (ie digital tools designed to encourage individuals to save and invest even small amounts of money) to enter the market, with the potential to help to increase long-term savings rates in the future. These make saving and investing manageable both in terms of the time they take and the investment they require. These apps could also make pension investments more appealing.

Decumulation

5.10 Retirement is changing as life expectancy increases. The transition away from full-time paid employment to retirement appears to be happening later and, in some cases, is phased over a few years. (ONS, Economic and labour market status of individuals aged 50 and over time: September 2017). Many workers face the prospect of needing to fund a longer period in retirement or working in later life.

5.11 Funding later life care costs is increasingly becoming a key challenge and is subject to significant uncertainty for consumers as to whether or not it will be needed and what it will cost. Currently, only a small number of individuals incur long-term care costs. This number, however, is expected to grow over time. (House of Lords, Ready for ageing?). For those who will, these can be significant – up to one fourth of the total wealth of the average person.

5.12 The ways in which consumers are generating and accessing wealth following the Pension Freedoms has changed. Since the Freedoms were introduced in 2014, annuity sales have declined by 81%, meaning far fewer retirees are using their pension savings to buy a guaranteed income in retirement. In 2017, 55% of consumers chose to withdraw their pension pots as cash and 30% opted for drawdown. (FCA, Data Bulletin March 2018). This move away from guaranteed incomes means that retirees now have greater flexibility in how they use their retirement savings. At the same time, they face the risk of running out of pension savings and are more exposed to changes in market valuations.

Decumulation – market and public policy response

5.13 Customers who can access their pension savings have not seen significant innovation in pension products. Innovations discussed over the past few years focused only on deferred annuities, hybrid products, 'care annuities', and long-term care insurance. So far, evidence for the development of these products has been very limited.

5.14 In 2018, the FCA and The Pensions Regulator published a joint regulatory strategy for regulating the pensions and retirement income sector. The strategy identified that the overarching harm in this sector is that people may not have adequate income, or the income they expected, in retirement.

5.15 As Pension Freedoms have given consumers much greater flexibility, regulators have focused on 'pensions decumulation' over the last four years. Examples include requiring providers to deliver retirement risk warnings, collecting data on retirement income, making changes to pension rules and capping early exit pension charges.

5.16 Our current work includes that which came out of our Retirement Outcomes Review (ROR). This work aims to protect drawdown customers who do not seek advice. This includes developing 'investment pathways', rules for customers taking an active decision when investing wholly or predominantly in cash, and annual charges disclosures from firms. ROR remedies also require providers to issue 'wake up' packs to customers at age 50. This is aimed at tackling the perception of early pension access as a 'windfall'. These steps are targeted at consumers who cannot yet access their pension savings, and are examples of how we are seeking to shape and respond to an emerging market.

5.17 There has been an increase in people transferring their defined benefit schemes (DB) to defined contribution (DC) investments in recent years. This is related to the Pension Freedoms, the record high levels of transfer values being offered on DB pensions, and under-funded DB pension schemes looking to reduce their risks.

5.18 We carried out 2 consultations aimed at improving the quality of pension transfer advice and finalised new rules and guidance last year. This includes requirements for all advice to be a personal recommendation (which means the adviser has to tailor the advice to the person's individual needs) and a comparison of the value of benefits being given up with the cost of buying the same income through a DC investment.

5.19 DB pensions, and other safeguarded benefits providing guaranteed pension income, give valuable benefits so most consumers will be best advised to keep them.

Possible barriers to innovation

5.20 A lack of financial education and poor access to pensions information among young workers may mean they are still disengaged despite auto-enrolment. Some commentators point out that engagement levels soar when people can check their pension value through mobile access and employers offer their staff an ongoing financial education programme.

5.21 One possible reason for limited innovation in the sector may be the conditions required for a scheme to become an HMRC approved pension scheme. The tax relief that makes pension savings appealing to many consumers is only available through HMRC registered schemes.

6 Implications for financial services – consumer credit

6.1 The ability to borrow and save allows individuals to fund themselves by borrowing when their income is lower, repaying debt when it is higher. Consumers can turn to different types of credit with different access and repayment terms – these come with different borrowing costs.

6.2 The Bank of England estimates that UK consumer credit debt was £216bn in October 2018. (Bank of England, Statistic-Money and Credit). Mainstream credit products (ie credit cards, motor finance, unsecured personal loans, and overdrafts) account for the clear majority (over 85%) of this. The remainder is accounted for by less mainstream products, such as rent-to-own (RTO) and home-collected credit. But some of the less mainstream products have higher costs of borrowing and a disproportionately high number of sub-prime or other financially vulnerable consumers use some of these products (eg RTO).

6.3 In this chapter, we consider the impact of changes, trends, and developments on consumer credit. We set out how consumers, firms and policymakers have responded, and discuss about potential barriers to innovation. We would like input on our analysis of these trends and markets.

6.4 We are seeking feedback on whether there are any other implications for consumer credit we should consider, and how far providers operating in this space are currently meeting changing consumer needs from different age groups. To the extent that this is not happening, we welcome feedback on possible reasons why this is the case, and on what we could do to encourage the industry. Detailed questions can be found in Chapter 9.

6.5 Persistent low interest rates have helped levels of consumer credit grow rapidly in recent years. For example, annual growth was 9.6% in 2017 and 6.6% in 2018. (Bank of England, Household credit).

6.6 Motor finance and 0% credit cards make up the majority of consumer credit growth since 2012. These products are concentrated among people with the highest credit scores. While around 50% of consumer debt is held by consumers who also have a mortgage, growth is mainly driven by consumers with no mortgage. (FCA, Who's driving consumer credit growth?).

6.7 The prolonged low cost of borrowing means that consumers are getting used to relatively cheap credit. Over time, this could leave them unprepared to deal with a potential future increase in interest rates. Recent developments in the labour market may mean that growing numbers of people may need to access credit to smooth their spending in the very short term. Increased life expectancy in those retiring may mean they need access to credit in later life (ie later life lending), perhaps just to meet short-term needs.

Market and public policy response

6.8 We are seeing innovation in consumer credit, as some firms have modernised their products and distribution channels to meet changing customer behaviours. This modernisation is often driven by technological developments.

6.9 Technology is enabling firms to offer more flexible products, such as 'income smoothing' products to help consumers with fluctuating income to budget (paragraphs 3.30 to 3.32). These products may help to meet both current demand for more flexible short-term credit products and new demand caused by changes in the labour market.

6.10 Income smoothing products – usually online and mobile applications – help people smooth out the highs and lows in their income and offer an alternative to expensive forms of credit like payday lending. These analyse the customer's bank account and related transactions to work out their average monthly income. The application then takes money away when customers have higher than average income and use that surplus either to cover low-income months or repay any loans, essentially turning irregular income into something like a regular salary. Currently, the supply and take-up of such products is insignificant.

6.11 Technology developments also enable firms to provide increasingly accessible products via online and mobile applications. These may be more convenient for consumers and enable online transactions, but they also carry risks. In particular, the speed of transactions and ease of access could cause some consumers to make decisions quickly without fully considering the potential costs and alternatives.

6.12 There are also now some point of sale lending products that focus on online retail transactions. These products are designed to enable frictionless borrowing when consumers buy goods online. There are a number of firms which provide credit (at times with interest free periods) for online purchases.

6.13 As later life lending needs have grown, the guarantor lending market has also grown significantly, but still accounts for a very small proportion of the total consumer credit market.[5] This may also be because retired consumers are often unable to get credit due to lower income and credit scores, which may force them to seek other forms of (expensive) credit.

Possible barriers to innovation

6.14 Consumers, especially the most vulnerable, often find it difficult to compare and choose the credit products that best suit their needs, particularly the actual cost of borrowing for different options. We expect technology and regulatory changes such as PSD2 and Open Banking to lower these barriers and help consumers to shop around. Less digitally skilled consumers, however, may not benefit from this.

5 The FCA's High Cost Credit Review noted that the guarantor loan market is noticeably smaller than many of the other less mainstream markets. However, this market has grown rapidly over the last few years. The number of consumers who took a guarantor loan in 2016 was 80k (0.2% of the adult UK population). This is 3 times as many as in 2012 and represented a 50% increase relative to 2015. The number of people holding guarantor loans more than doubled between 2012 and 2016 to reach 135k from 60k respectively. The £440 million value of total outstanding guarantor loan debt at the end of 2016 represented a significant increase compared to £229m (2014) and £300m (2015).

6.15 In some cases, consumers with low credit scores can only get very expensive forms of credit. Credit scores may not recognise consumers' individual circumstances and may cause harm to consumers who would benefit from having cheap forms of credit to meet short-term needs.

6.16 We have been tackling issues in the high-cost credit markets since we took over regulation of consumer credit in 2014. Our interventions so far have resulted in a transformation of some high-cost sectors. We have taken significant action where firms fail to meet our standards, using the authorisations process, supervisory work and, where appropriate, enforcement. Firms have made substantial improvements, particularly in their creditworthiness assessments and dealing with consumers in financial difficulty.

6.17 We have made significant changes to the market. These include introducing a price cap and new rules on payday lending, changes to other high-cost credit products and to credit cards to help customers repay debt more quickly. For example, we require firms to intervene and help customers in persistent debt by transferring the balance on their credit card to a lower-interest personal loan. Where the customer is unable to repay more quickly, the firm must show forbearance (for example, by reducing, waiving or cancelling any interest or charges).

6.18 We have recently proposed a price cap in the RTO market. This came into force on 1 April 2019. We also introduced rules (coming into force later this year) aimed at helping consumers better understand their overdraft, and have proposed more radical changes to address harm related to use of unarranged overdrafts. These measures will protect some of the most financially vulnerable people in the UK by making sure that the way firms charge for overdrafts is fairer and more transparent.

6.19 Such overdraft proposals are expected to benefit those who make more use of unarranged overdrafts and incur more refused payment fees (ie unpaid item fees) – this includes younger adults.

6.20 We are also planning to launch the Credit Information Market Study (CIMS) to identify whether the market works well. CIMS will look particularly at the role of credit reference agencies (CRAs), and whether they enable responsible lending and access to credit.

7 Implications for financial services – insurance and protection

7.1 Insurance and protection products can help to mitigate the financial impacts of losses from a wide range of circumstances over a person's life, such as death, ill health, or disability. Economic literature shows that insurance and protection products provide benefits to individuals and to the wider society, as they help the overall economy to grow faster (Kugler et al., 2005, Liedtke et al., 2007).

7.2 Typically, many protection products are actively 'sold' rather than bought – for example as an add on to, or at the same time as, another product such as a mortgage. (Royal London, State of the protection nation).

7.3 In this chapter we consider the impact of changes, trends, and developments on specific insurance and protection products. We set out how consumers, firms and policymakers have responded, and discuss potential barriers to innovation. We would like input on our analysis of these trends and markets, and whether there are other products we should consider.

7.4 We are seeking feedback on whether there are any other implications for insurance and protection products that we should consider, and how far providers operating in this space are currently meeting changing consumer needs from different age groups. To the extent that consumer needs are not being met, we welcome feedback on possible reasons why this is the case, and on what we could do to facilitate the industry in offering new products to the market. Detailed questions can be found in Chapter 9.

7.5 Research shows that house purchase is a common trigger for considering protection. 60% of those with a mortgage have life cover in place, 29% have critical illness, and 19% have income protection. Changing tenure patterns could then reduce the number of points at which consumers consider their protections needs. Research by Royal London (paragraph 7.2) states that house purchase is a common trigger for considering protection.

7.6 Consumers without workplace schemes face higher costs and fewer opportunities to engage in decisions about protection products, and low take-up of these products could expose consumers to long-term hardship.

7.7 Research also shows that only 39% of private tenants and 48% of social tenants have home contents insurance. This compares to 89% of people with mortgages and 93% of those who own their homes outright – of which 73% and 80% respectively are combined with buildings insurance, which tenants typically do not need. (YouGov, Only 39% of private tents have contents insurance). Surveys suggest that renters often do not see the need for life insurance either, particularly if they do not have children or other dependents. (Gen Re, Appetite for life insurance – A survey of UK Millennials).

7.8 Research also shows that 93% of the UK's 4.8 million self-employed workers have no critical illness cover to protect them if they have long-term sickness absence (equivalent to 4.3 million workers). Changing working practices (paragraphs 3.23 to 3.25) mean that more workers are less likely to be part of employee benefit schemes with protection and other benefits. (Scottish Widows, 4.3 million self-employed people left exposed by financial protection gap).

7.9 The increased use of technology is leading consumers to buy and renew their insurance products online, with high street insurance brokers now less common and with price comparison websites increasingly being used. This could mean that insurance products become less visible and accessible for people without access to the internet, such as some older people.

Market and public policy response

7.10 Protection products have typically been sold through traditional channels like banks or brokers, alongside other products or advisory services. Consumers are moving to digital channels for interactions with financial services more widely. New and more customer-friendly interfaces could provide an opportunity to nudge customers to consider their need for protection products. For example, there could be a growing need and interest in budget income protection with the growth of more self-employed flexible working. Innovation in this market has, however, been limited so far.

7.11 Consumers can also buy life, house contents, critical illness and income protection insurance through popular price comparison websites. While younger people are less likely to buy these types of insurance, they are more likely to use these sites to buy the types of insurance they do take out, such as motor and travel, or other products. Potentially there is an opportunity for these sites to remind consumers of the existence of and need for such protection products.

7.12 Some lettings agencies and referencing services have begun to nudge tenants to take out contents insurance, with one of the major referencing services also providing insurance directly. It is unclear, however, how widespread this is in the market and what the consequences of this behaviour are.

7.13 The increased use of technology has enabled firms to assess risk at a more granular level leading to more segmentation of customers and more personalised pricing. This has the potential to reduce the pooling of risk, making insurance accessible to higher risk consumers. In our thematic review on general insurance pricing practices we highlighted that concerns around price differentiation (where consumers with similar risk characteristics pay different prices when buying similar, if not identical, products) have grown as firms have been able to obtain ever increasing amounts of data on their customers. The FCA is undertaking a market study on General insurance pricing practices to consider consumer outcomes from pricing practices, the fairness of pricing practices and the impact of pricing practices on competition.

Possible barriers to innovation

7.14 Due to pressure on earnings, consumers in jobs with unstable incomes may see insurance products such as ill-health insurance as superfluous or unaffordable. Similarly, many tenants may underestimate the impact on their finances of house burglaries.

7.15 Lack of awareness among the self-employed and those who participate in more unstable jobs may also explain why innovation in this space is still limited.

7.16 In markets such as home insurance, we found evidence that customers who stayed with their home provider for a long time pay significantly more than newer customers. This can act as a barrier to new and innovative entrants to the market, as they are less able to compete with established firms with more profitable back-books.

8 Intergenerational challenges

8.1 In previous chapters, we described various changes, trends and developments and the impact that these are having across the financial service sectors most directly affected.

8.2 In this chapter, we consider the financial needs of typical individuals from the three major age groups through the lens of the life cycle model. Some of these needs are related to the life stage they are at, while others are the result of the changes, trends and developments previously discussed.

8.3 To better understand evolving financial needs across generations we project and compare the typical financial life cycles for each of these. The approach allows us to explore some of the key differences in the financial life cycle of Baby Boomers, Generation X, and Millennials and how financial needs are evolving due to changes in the wider environment.

Life cycle, wealth, and financial needs of different age groups

8.4 We have estimated how much wealth we expect the typical (average) individual from each generation to accumulate over their lifetime using a series of assumptions. We have used two different methodologies to project wealth levels, details of our assumptions can be found in Annex 1.

Method 1

8.5 Using estimates for future earnings, property and pension wealth we find that overall wealth levels that younger generations (Millennials and Generation X) will accumulate throughout their life cycles will not be so different compared to those of Baby Boomers. Millennials and Generation X will have slightly lower wealth levels during working years compared to Baby Boomers, but will reach similar wealth levels in retirement.

8.6 On average, property wealth and pension wealth are the main drivers of personal wealth. For Millennials and Generation X this is largely driven by property wealth. Based on current average levels of disposable and gross incomes, and corresponding workplace pension contributions, Millennials are expected to accumulate significantly lower levels of pension wealth compared to Baby Boomers.[6] To a similar extent, this is the case also for Generation X. One potential implication of this is that those Millennials and Generation X who will not get on the housing ladder will be worse-off not only compared to those Baby Boomers who have accumulated property wealth, but also compared to those who have not. At retirement, not only they will have accumulated no property wealth, but they will also have lower pension income.

6 Due to lack of relevant data we are not able to estimate and project the level of non-workplace pension wealth that younger generations will accumulate over their life. Non-workplace pension wealth would reduce the gap, in terms of pension wealth at retirement, between younger generations and Baby Boomers.

8.7 Compared to Baby Boomers, Millennials (and to some extent also Generation X) start accumulating wealth levels a few years later in life. Unlike Baby Boomers, they will not have repaid their mortgage debt by the time they are in their 60s.

8.8 The average Millennial, however, is more likely than a Baby Boomer to be left some wealth in inheritance. For those who will receive some inheritance, this will happen later than previous generations.

8.9 Many Baby Boomers will also face some financial challenges. Our research paper on wealth accumulation and the preparedness for retirement in Britain explains how for wealthier (less deprived) individuals, the majority can expect a modest or comfortable retirement. While at least half of poorer (more deprived) individuals are not expected to achieve the minimum income standard and are likely to be dependent on State pension and benefits.[7]

8.10 At the same time, unlike previous generations, Millennials will need to deal with high student debt levels throughout their lives. They are also more likely to join the workforce a few years later than previous generations. They are more likely to have higher levels of education than previous generations and this may help them progress in their careers (and financially) more quickly. While their income during the first years of employment could be lower than those of their parents at comparable ages, their lifetime income is likely to be higher. Those who, despite having higher education levels, will not experience increasing earning levels, will repay only a part of their student debt as this will be cancelled after 30 years.

Method 2

8.11 To understand how feasible it is for a Millennial to accumulate the current levels of wealth enjoyed by the Baby Boomer generation, we have compared the average levels of wealth for each generation, and calculated the percentage year on year (YoY) increase in wealth required to bridge the gap.

8.12 We find that for the average Millennial to achieve similar levels of wealth accumulation as those who are reaching retirement today, they would need to achieve wealth growth of approximately 48% YoY between age 20 and 36, approximately 7% YoY between age 37 to age 51, and approximately 6% YoY between age 52 to age 64. More details of the methodology can be found in Annex 1.

8.13 This is highly sensitive to changes on returns to savings, property appreciation, and future accumulation rates. Depending on these, the average Millennial may not enjoy the levels of wealth of the average Baby Boomer today.

8.14 Overall, people from different generations are facing and will face different challenges over their lives. These are likely to translate into a diverse range of financial needs in the UK population that, as one of the industry's regulators, we want to ensure are met.

8.15 We intend to consider the different significant financial needs across the generations mentioned in this paper that the financial services industry should be looking to meet. As a regulator, we would like to consider how to facilitate development in this area. We are aware that these needs may be varied and diverse depending on individual

7 The Minimum Income Standard was proposed by the Joseph Rowntree Foundation as the acceptable minimum standard of living in the UK.

circumstances. For this reason, we would welcome feedback on financial needs of different individuals within each of the 3 age generations we considered.

Implications for typical profiles for each generation

8.16 In what follows, for each generation we set out a 'typical' profile – a high-level description of a consumer's background, current circumstances, and expectations for the future. Based on the life cycle model, this description helps us identify circumstances typical of these age groups. We then set out the emerging financial needs of these 'typical' consumers.

8.17 People's financial needs, however, vary depending on individual circumstances and not everyone within each age group fits the profiles we illustrate below. For this reason, at the end of this chapter we also present less typical needs, ie the financial needs of people from the most different backgrounds within each age group.

8.18 In this chapter, we are seeking feedback on (please see also the list of questions included in Chapter 9):

- whether we have identified the main consumer needs within these age groups
- how the market is responding to these consumer needs
- what barriers are preventing firms from meeting consumer needs
- whether we can take specific regulatory action, in line with our Mission and objectives, to help address market weaknesses

Baby Boomers (born 1946 to 1965)

8.19 Figure 13 sets out the financial life cycle of the 'typical' Baby Boomer couple. This couple both completed school education, but did not undertake any further or higher education, and got married in their 20s. One of them worked full-time as a skilled worker, while the other combined part-time work with a role as a homemaker. The full-time working member of the couple is undertaking phased retirement (ie is working part-time to transition into retirement).

Financial life

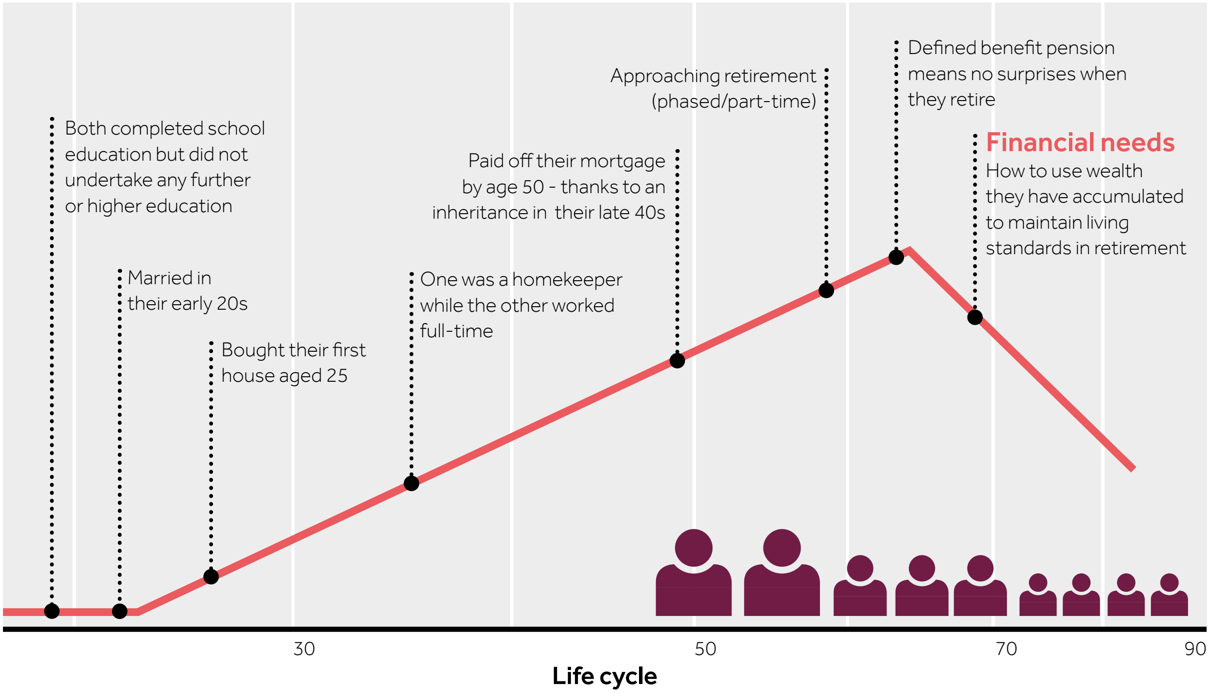
8.20 The couple took on their first mortgage and bought their first property around age 25. A few years later they renegotiated the mortgage to move into a larger property for their growing family, but they did not extend the mortgage term. By their early 50s, they had repaid their mortgage in full before the end of its original term. This was helped by the inheritance they received from their parents when they were in their late 40s.

8.21 They financially supported their children until they completed their university studies. This, at times, put a strain on their finances. The couple, however, also experienced significant house price appreciation and invested in a home extension. As a result, they have built up significant property wealth. Since their children have left home they have managed to set aside more savings. While these are not generating meaningful returns, their value is not being eroded by inflation.

8.22 The full-time working person has accumulated some pension wealth, mainly through a defined benefit (DB) pension scheme. The other has a variety of small pension pots from different employments. Both will receive the state pension, but later than they had originally planned. This will provide them with a stable income for the rest of their lives, which will be enough to cover their day-to-day spending. They will, however, have financial choices to make about using smaller pension pots, other savings, and their housing wealth.

Figure 13: Financial life cycle of a Baby Boomer couple

Baby Boomers (born 1946 to 1965)



Current financial needs

8.23 The typical Baby Boomer has accumulated some wealth, and will live longer than previous generations. They will also face choices both around retirement and, once in retirement, about how best to manage and use that wealth. The typical couple described here plan a phased retirement, and may work for short periods while together drawing down pension wealth. They have more choices in retirement than their parents, but also face more uncertainty.

8.24 The key question for this couple is how to use the wealth they have built up. They want to maintain living standards, enjoy some travel and offer some financial support to their children and grandchildren. They must, however, balance these wants against the possibility of needing to fund long-term care, and the uncertainties of life expectancy. As well as balancing their needs against the uncertainties they face, the typical Baby Boomer must make choices about how to practically access and use their wealth. Around traditional retirement age they will continue to get income from work, but could add to this by drawing down on accumulated wealth. They must also consider how to support children and grandchildren, and whether and how to access the equity tied up in their homes.

8.25 They have spent relatively little time in their working lives engaged in financial or tax planning, and are having to increase their engagement with financial services in retirement. In general, they have not given a great deal of thought to how they will manage in retirement. The individual pension pots they have built up do not meet the £30,000 criteria for compulsory financial advice ahead of drawdown. The couple have a good understanding of the DB pension. They believe they may need to release equity in their home, but are nervous about doing so. They would prefer to support their children and grandchildren through informal loans and gifts, rather than using 'family-assist' types of mortgages.

Future financial needs

8.26 They are still in good health, but they are increasingly concerned about the need to fund expensive long-term care. This is despite the fact that in reality only few people do so in the last part of their life.

Generation X (born 1966 to 1980)

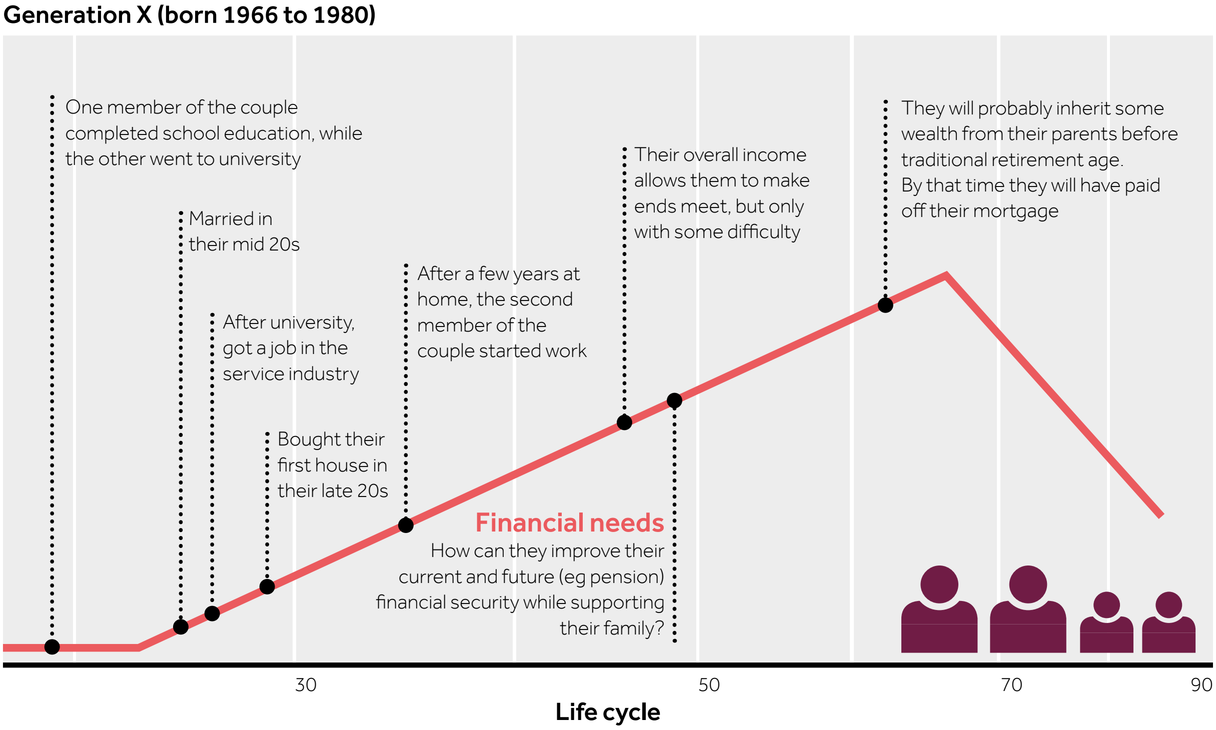
8.27 Figure 14 sets out the financial life cycle of the 'typical' Generation X family. The couple have 2 children and got married in their mid-20s. One member of this couple completed university and has a job in the services sector that allows them opportunities to grow professionally and increase their income over time. After the children started going to school, the second member of the couple started working. This job is vital to support living standards, but the income it provides is unlikely to grow substantially over time.

Financial life

8.28 The couple took on their first mortgage and bought their first property in their late 20s, around 5 years later in life than their parents. They have since re-mortgaged to buy a family home, extending the mortgage term to do so. They are unlikely to pay off their mortgage much before traditional retirement age. While they are likely to inherit wealth from their parents, this is unlikely to happen before they are in their late 50s.

8.29 Despite having an adequate income the couple's finances are stretched and they are unable to set aside enough money for their pension or to save for a rainy day. They have low cash savings and some unsecured debt. They have, however, experienced significant house price appreciation. Both individuals have defined contribution (DC) pension schemes, and have benefitted from auto-enrolment. But they require income now and are unable to set aside additional income to save for retirement. At times, they use relatively expensive short-term borrowing products, such as credit cards and current account overdrafts. They are also time-poor and increasingly need to spend time looking after their ageing parents and help them manage their finances.

Figure 14: Financial life cycle of a Generation X couple



Current financial needs

8.30 The couple is under financial pressure and has immediate financial needs. Their income normally allows them to make ends meet, but they are more likely to need to borrow in the short-term than they are to save. Their inability to save makes them vulnerable to sudden financial shocks. They buy fewer protection products – such as comprehensive life cover, critical illness, or income protection – than their Baby Boomer parents did. They see financial advice as both expensive and time consuming.

8.31 This couple faces a short-term challenge of managing for today, and a longer-term challenge of planning for tomorrow. They handle short-term financial pressures well, and have a good understanding of credit products and core financial concepts. They rely on consumer credit products to smooth short-term income and expenditure, and their credit status and income level allows them to get credit at reasonable cost, without damaging their longer-term borrowing prospects. However, they are unable to balance their short-term needs against longer-term prospects, and take decisions based almost exclusively on the former.

Future financial needs

8.32 They have accumulated less wealth than their Baby Boomer parents at the same age. They are aware that their pension pots are not large enough for them to maintain their lifestyles in retirement. However, they believe that a combination of working longer, wage increases, releasing their property wealth, and some inheritance from their parents will enable them to enjoy a comfortable retirement.

8.33 Around traditional retirement age (60 to 65), their financial lives will change significantly. Unlike their parents who were financially comfortable before retirement, the typical Generation X couple may face short-term financial pressure up until their

60s. They may then experience a significant change due to three factors – having a paid-off mortgage, being able to access their pension pots, and getting an inheritance.

Millennials (born 1981 to 2000)

8.34 Finally, we consider a Millennial in their late 20s. They are educated to Masters' level but have substantial student debt, which limits their disposable income and ability to save. This person is self-employed. Although they make a comparatively good living, their income is unpredictable, limiting their ability to save regularly.

Financial life

8.35 Like many Millennials, this person delayed starting work to get a higher education and a Masters degree. They expect this will get them higher earnings over their lifetime, which should be enough to allow them to own their own home.

8.36 This person is currently living in a shared flat, but would like to purchase a property. This does not seem possible in the short-term because they face a widening gap between house prices and earnings. In addition, they have significant student debt which they are paying off in monthly instalments. This is limiting their disposable income and ability to save. They need time to save for a first-time buyer deposit, but their finances are squeezed since a significant portion of their earnings is going on rent.

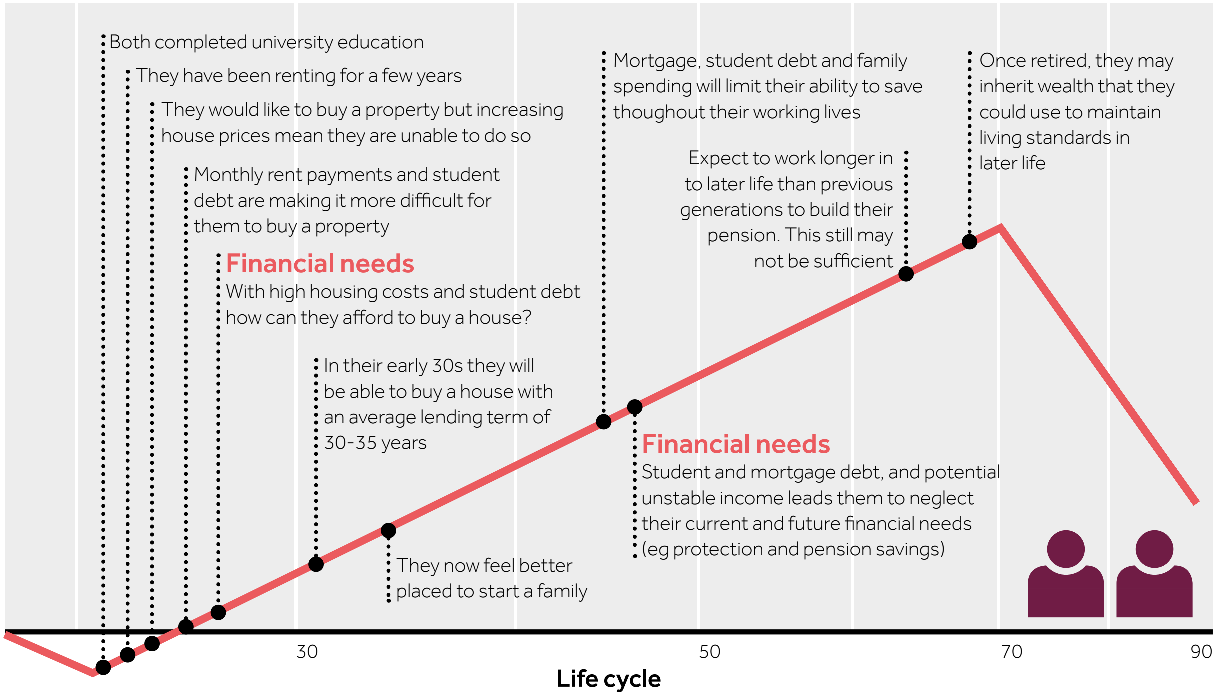
8.37 To get their foot on the housing ladder, they are considering Government schemes such as Help to Buy and Shared Ownership. Their parents may also be able to give some financial support to help towards a deposit. Having paid rent for a few years, they believe that their rental payments history should help them when applying for a mortgage.

8.38 This person will eventually afford to buy a house in their early 30s, with an average lending term of 30-35 years. They may feel in a better place to start a family then. While repaying their mortgage and raising children, they will still have considerable amounts of student debt. This will continue to limit their disposable income and their ability to save. They will have this debt for much of their working lives (ie up to their early 50s) as they will not manage to repay it in full before the loans are wiped.

8.39 Once they have managed to buy their first property, they may want to start accumulating some form of pension wealth. They already expect to retire later than previous generations to build their pension. This, however, may still be not sufficient to help them maintain standards of living in later life. At the same time, they will receive family inheritance just before retirement age – this will help them for when they retire.

Figure 15: Financial life cycle of a Millennial

Millennials (born 1981 to 2000)



Current financial needs

8.40 A key issue for this Millennial is how to afford to buy a house given the challenges of high housing costs and student debt. Income smoothing products could help them with their unstable income. Similarly, budgeting tools and bill smoothing products would also help them plan regular savings despite their unpredictable income. This would help them to save for a deposit and get on the housing ladder earlier.

8.41 Being self-employed, this person would benefit from income protection products should they become unable to work. But pressure on income, and on saving for a mortgage deposit, may make them feel such products are unnecessary.

Future financial needs

8.42 In the long-term – thanks to their high level of education – this person expects to earn higher than average wages. Existing mortgage products, however, do not factor this in. Once they have bought their first property, they are planning to contribute towards their pension (and to save more in general). As these are future plans, currently they are not engaging with the pension sector. Like individuals from Generation X, they would benefit from advice on financial planning around retirement.

8.43 Like many other Millennials, they will inherit larger amounts of property wealth compared to, for example, Baby Boomers. This will likely be later compared to previous generations (including Generation X) and just before retiring or once retired.

Variations in individual circumstances

8.44 In this chapter we have described the common challenges that typical Baby Boomers, Generation X, and Millennials will face. But we know that people's financial needs will vary depending on individual circumstances.

8.45 The following infographics provide examples of challenges and needs for people from the same age groups, with a different profile, as an illustrative example of the UK populations' varied needs. We welcome feedback on the financial needs of people from the most varied backgrounds within each age group.

Baby Boomer
Couple aged 65 and 64

- 2 adult children (non-dependent)
- Left school at 15 to work, now retired
- Low salaries = low pensions
- Housing association tenants
- Concerned about lack of financial stability – no home ownership to draw equity if needed
- No savings for cost of long-term care
- Lack of financial education and digitally excluded

Financial need

How can they ensure they maintain living standards in later life and feel less exposed to financial shocks?

Baby Boomer
Widow aged over 75

- 3 grandchildren - 2 already completed higher education
- Retired, with a healthy pension
- Owns family home, but does not have particularly high levels of savings
- Has a long-term chronic condition likely to require increasingly long-term care
- Due to chronic condition and advanced age, struggles to access suitable later life lending products

Financial need

How can they provide financial support to grandchildren without leaving their family home?

Generation X
Recently divorced couple aged 41 and 40

- One of them is currently living with their two children in the home they bought with a joint mortgage
- They agree they should not sell their family home to avoid unsettling to the children
- At the same time, the one who no longer lives in the family home would like to take their name off the mortgage as they want to be able to borrow some money if needed
- The one living with the children, however, cannot afford to take over the full mortgage

Financial need

How can they ensure their credit files are no longer linked without having to sell their family home?

Generation X
Couple aged 43 and 41

- They own a home with a mortgage – 10 years left of mortgage term
- Both working, one is self-employed and the other is on a low income
- Struggling with everyday expenses due to rising cost of living (eg childcare) and stagnating real earnings
- £18,000 of unsecured and expensive debt spread across credit cards and overdrafts
- Low credit scores

Financial need

How can they reduce cost of borrowing despite relatively low credit scores?

Millennial
One person aged 29

- Just completed top 10 MBA
- Expected high future earnings
- Currently a private tenant – wants to buy a home but as a single person is struggling with the high deposit and salary multiples based on their current salary
- Able to save but only achieving fairly low returns

Financial need

How can they buy a house considering expected future earnings are high?

Generation X
Couple both aged 44

- Two children in a two-bedroom house
- Want to upsize but have little equity in their current home – can't afford to put down a bigger deposit and borrow more
- They will probably inherit some wealth from their parents when they retire (ie in around 20 years)

Financial need

How can they upsize and meet their family's current need for a bigger house?

Millennial
Couple aged 32 and 33

- Both in stable jobs with reasonable prospects for gradual salary increases
- No children yet
- Recently bought their first home – now able to start building up their savings again
- Interested in saving/investing for the very long-term, but also want to keep the option to access this money, if needed
- Return rates on saving accounts are very low, pension contributions would provide significant tax relief benefits but would restrict the possibility to access savings if needed

Financial need

How can they ensure they are not going to regret their current saving/investment decisions later in life?

Millennial
Couple aged 26 and 25

- One child
- Did not go to university
- Both working (one self-employed, the other on a zero-hour contract)
- Private renters – always paid rent regularly (c£800 per month)
- Childcare costs have wiped out their savings and put pressure on their finances
- Overdrafts/credit cards balance of around £2,000, paying the minimum each month
- They feel unable to save and improve their finances

Financial need

How can they take on a mortgage and start building property wealth?

9 Prompts for discussion and next steps

9.1 In this chapter we pose a series of questions to which we are seeking input. We expect that responses to these questions will help us identify ways in which the changing needs and circumstances of consumers could be better met by financial services providers. This could include identifying potential barriers preventing firms innovating to meet changing needs.

9.2 We are seeking input from firms, consumers and other interested parties. There are seven broad questions whose responses will help us to identify areas which may warrant further investigation as we seek to ensure our approach remains fit for purpose in light of changing circumstances.

List of questions

Q1: **Are there other factors driving changes in the consumer needs of different generations (in addition to those we have listed in Chapter 3 of this paper) that we should consider? What are these?**

Q2: **Are there other ways in which the factors we have identified as driving changes influence how individuals from across different age groups build up and access wealth?**

Q3: **To what extent are financial services providers currently meeting the changing needs across different age groups? How could innovation in product design help meet changing consumer needs of different age groups?**

Q4: **Are there any barriers (including FCA regulatory barriers or barriers to competition) that are adversely affecting access to, and use of, financial products that would meet new and changing consumer needs? Are these affecting particular age groups? If so, in what way? How should we address these while ensuring consumers still receive an appropriate degree of protection.**

Q5: **Is there anything more that we could do to encourage and enable positive innovation in these sectors, or to enhance competition in the interests of consumers?**

Q6: Is there any market or firm behaviour that causes or may cause potential harm to consumers? For example, is industry failing to recognise varying needs of consumers from different age groups and as a consequence, of this:

a: offering products which may be unsuitable to certain age groups

b: excluding, discriminating against, or failing to advance equal opportunity between certain age groups for no legitimate and objectively justifiable commercial reason (or where the reason is potentially legitimate but the approach is not proportionate)

c: otherwise treating certain age groups unfairly?

Q7: Are there areas related to intergenerational issues which fall more appropriately to Government or another public body, but in which, in accordance with our objectives, we can play a role? If so, which ones and in what way?

Next steps

What do you need to do next?

9.3 Please provide responses to this Discussion Paper by 1 August 2019.

How?

9.4 Use the online response form on our website or write to us at the address on page 2.

What will we do?

9.5 We are organising a conference on the 2 July 2019 to further discuss and debate the issues in this paper. More details will be available in the second quarter of 2019.

9.6 Based on responses to this Discussion Paper and input from the conference we will consider work to ensure we continue to advance our objectives under changing circumstances. Where appropriate, we will consider policy changes (for example, in the context of the Handbook Review) or other regulatory interventions.

Annex 1
Wealth projections

1. In this Annex we first provide details of the methodology we use to project wealth levels of average individuals from each age group – Baby Boomers, Generation X, and Millennials (see Method 1, Chapter 8).

2. We then illustrate assumptions of the alternative approach we use to estimate the wealth growth rates that would be required by a Millennial to replicate existing wealth levels accumulated by a Baby Boomer (see Method 2, Chapter 8)

Method 1

3. To produce forward-looking estimates (projections) of wealth accumulation we make a number of assumptions on a multitude of dimensions and parameters. These relate to the financial life cycles of a person and in particular to:

- future earnings, ability and willingness to save
- property wealth accumulation (first-time buyer age, appreciation rates, and mortgage payment terms)
- private pension wealth accumulation (including both work-place and non-workplace pension contributions), future state pension levels, and retirement age

Methodology

4. Our starting point is the current level of wealth for the typical (ie median) individual from each age group. We consider their property wealth, pension wealth, and net financial wealth. These are sourced from the ONS Wealth and Assets Survey (see Chapter 2).

5. For simplicity, we project wealth levels only for the typical (average) individual from each age group – for each of the above dimensions we use average (mean and median) values. Being based on average values, such projections are not representative of the entire wealth distribution, but still provide relevant insights into the projected wealth patterns of many individuals.

6. For the average Baby Boomer (aged 63 in 2018) we project wealth accumulation and consumption patterns for circa 20 years, and proxy these for the previous 40 years.

7. For the average Generation X (aged 45 in 2018) we project wealth accumulation and consumption patterns for circa 40 years, and proxy these for the previous 25 years.

8. For the average Millennial (aged 28 in 2018) we project wealth accumulation and consumption patterns for circa 60 years, and proxy these for the previous 10 years.

Assumptions

9. Projections are based on the very simplistic assumption that future trends will be similar to long-term trends from the past (eg property appreciation or return on investments), and that consumers' consumption behaviour (past and future) is the same across the three generations – these however vary with age.

10. Variables like i) age at which people buy their first property, ii) age at which they retire, and iii) life expectancy, change by generation (eg Millennials buy a property later and live longer). To take into account ongoing economic and demographic change discussed in this paper, we use existing ONS estimates on average first-time buyer age, and life expectancy of people of different ages.[8]

11. In Table 1 we list the set of assumption we used for each generation.

Table 1: wealth projections – assumptions for each generation

		Baby Boomer (age 63)	Generation X (age 45)	Millennial (age 28)
Property wealth	First-time buyer age	23	26	32
	Average (median) property wealth today (Dec 2018 prices)	c. £118,000	c. £60,500	£0
	Property wealth appreciation	2.5% (YoY) in real terms	2.5% (YoY) in real terms	2.5% (YoY) in real terms
	Mortgage term	25 years	30 years	35 years
	Household average mortgage capital repayments (p.a.) (based on ONS estimates)	Not applicable	c. £4,430	c. £4,430
Pension wealth	Average (median) pension wealth today (Dec 2018 prices)	c. £117,000	c. £32,000	£0
	Work-place pension contributions	Employee £10,000 to under £20,000: 2% £20,000 to under £30,000: 3% Employer £10,000 to under £20,000: 3% £20,000 to under £30,000: 5% Return on pension investments is 4% (YoY) in real terms	Employee £10,000 to under £20,000: 2% £20,000 to under £30,000: 3% Employer £10,000 to under £20,000: 3% £20,000 to under £30,000: 5% Return on pension investments is 4% (YoY) in real terms	Employee £10,000 to under £20,000: 2% £20,000 to under £30,000: 3% Employer £10,000 to under £20,000: 3% £20,000 to under £30,000: 5% Return on pension investments is 4% (YoY) in real terms
	Expected retirement age	65	68	70
	Life expectancy (age)	85	86	87
	Disposable income in retirement today	Workplace pension wealth at retirement (level annuity) + State pension	Workplace pension wealth at retirement (level annuity) + State pension	Workplace pension wealth at retirement (level annuity) + State pension

8 In practice this means that younger generations start accumulating wealth a few years later (circa a decade later), live longer, and retire later in life compared to Baby Boomers.

		Baby Boomer (age 63)	Generation X (age 45)	Millennial (age 28)
Financial wealth	Net financial wealth today (Dec 2018 prices)	c. £18,000 of which: cash: 2/3 (0% YoY returns in real terms) other financial assets (eg gilts and equities):1/3 (4% YoY returns in real terms	c. £2,000 Current and future net wealth is allocate as follows: cash: 2/3 (0% YoY returns in real terms) other financial assets (eg gilts and equities):1/3 (4% YoY returns in real terms	~£0 Future net wealth is allocate as follows: cash: 2/3 (0% YoY returns in real terms) other financial assets (eg gilts and equities):1/3 (4% YoY returns in real terms)
	Starting working age	21	21	21
Savings and consumption	Household disposable income in working years and in retirement (based on ONS estimates)	Age 16-24: £26,607 Age 25-34: £34,160 Age 35-44: £34,131 Age 45-54: £36,531 Age 55-64: £34,399 Age 65+: £28,052	Age 16-24: £26,607 Age 25-34: £34,160 Age 35-44: £34,131 Age 45-54: £36,531 Age 55-64: £34,399 Age 65+: £28,052	Age 16-24: £26,607 Age 25-34: £34,160 Age 35-44: £34,131 Age 45-54: £36,531 Age 55-64: £34,399 Age 65+: £28,052
	Household average weekly expenditure (including interest mortgage payments or rent) (based on ONS estimates)	Age 21-30: £553.90 Age 30-49: £662.10 Age 50-64: £629.00 Age 65+: £506.20	Age 21-30: £553.90 Age 30-49: £662.10 Age 50-64: £629.00 Age 65+: £506.20	Age 21-30: £553.90 Age 30-49: £662.10 Age 50-64: £629.00 Age 65+: £506.20

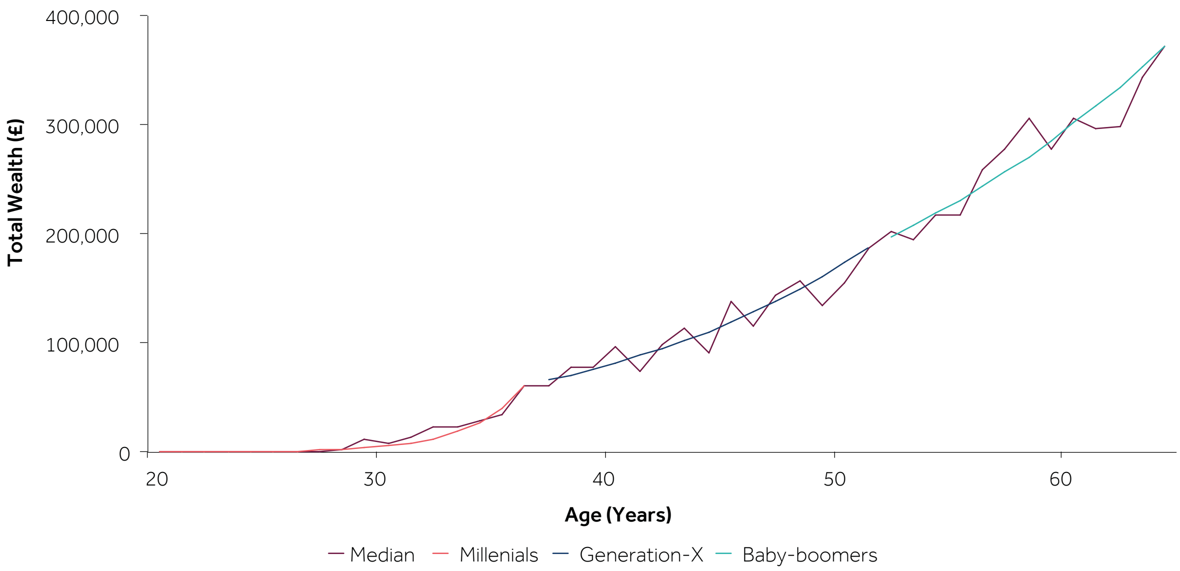
Method 2

12. We assume that future levels of accumulation will be the same as in the past. This approach is based on the following simplifying assumptions:

- Total wealth is based on a single composite measure of accumulation whose value tracks the stock of individual wealth in each period. It is the sum of all sources of wealth – pension, property and net financial wealth – and jointly includes any new flows or contributions and capital appreciation between successive years.
- Rates of accumulation are proxied as a multi-stage growth process. Savings are characterised by high initial growth rates – which reflect the low base in the stocks of wealth and exposure to risky assets – and lower growth rates in later years. To reflect this, we assume 3 phases of constant growth, aligned to the three generations of interest.
- For the median individual within each generation to accumulate the same level of total wealth as the median individual who is currently reaching retirement, the individual would need to achieve a constant annual growth rate of:
  - 48.3% between the ages of 20 and 36;
  - 7.8% between the ages of 37 and 51;
  - 5.4% between the ages of 51 and 64.

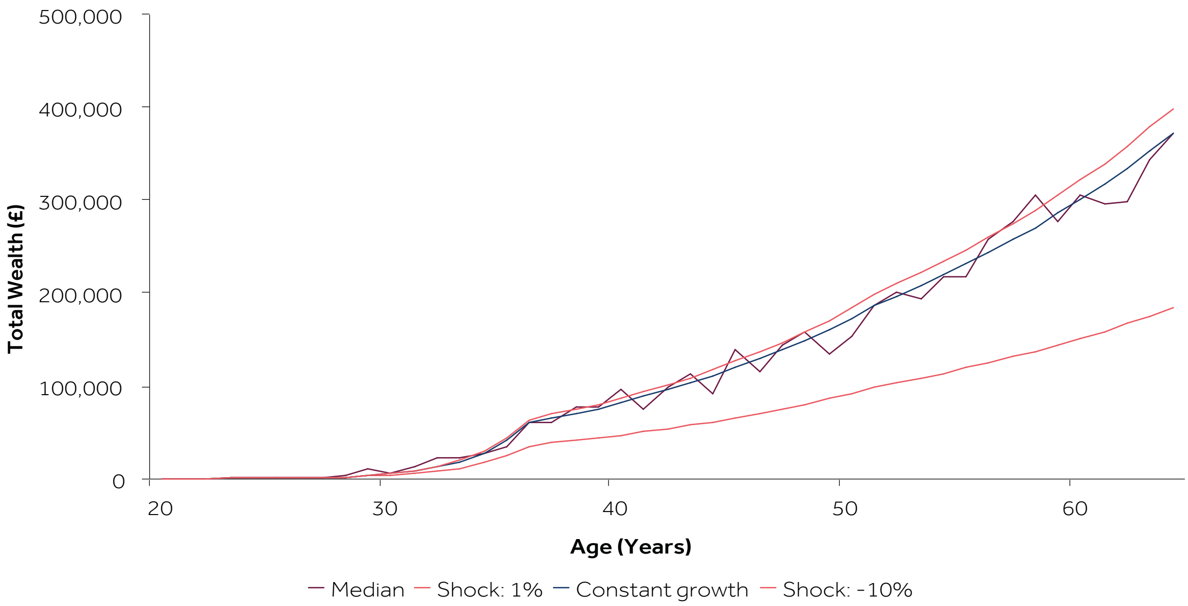
13. Figure 16 shows the median accumulated total wealth by age. Starting with the initial median wealth at age 20 (~£112 in Dec 2018 prices), we apply the constant growth rates across the three period which are required to track current levels of accumulation in successive years, and achieve pre-retirement wealth, by age 64, of approximately £370,000 (in Dec 2018 prices). (ONS, Wealth and Assets Survey).

Figure 16: Total wealth accumulation



14. Figure 17 shows what the impact could be of annual constant growth rates in the future being 1% higher or 10% lower than at present. This simple analysis illustrates the uncertainty around long-term projections.

Figure 17: Potential wealth projections for Millennials



Annex 2
Abbreviations used in this document

BoE	The Bank of England
CIMS	Credit information market study
CRA	Credit reference agency
DB	Defined Benefit pension scheme
DC	Defined Contribution pension scheme
DTI	Debt-to-income ratio
DWP	Department of Work and Pensions
FE	Further education
FCA	The Financial Conduct Authority
HMRC	HM Revenue and Customs
IFS	Institute of Financial Studies
ISA	Individual Savings Account
MBA	Masters of business administration
NPV	Net Present Value
ONS	Office for National Statistics
PSD2	The Second Payment Services Directive
ROR	Retirement Outcomes Review
RPI	Retail Price Index
RTO	Rent-to-own
SFGB	Single Financial Guidance Body
UCAS	Universities and Colleges Admissions Service

We have developed this Discussion Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Pub ref: 005806

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