Pensions Policy Institute

PPI

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THE DC FUTURE BOOK 2023:

IN ASSOCIATION WITH COLUMBIA THREADNEEDLE INVESTMENTS

The nineth annual report sponsored by

COLUMBIA THREADNEEDLE INVESTMENTS

ISSUE #9

About The Pensions Policy Institute (PPI)

We have been at the forefront of shaping evidence-based policy for over 20 years.

The Pensions Policy Institute (PPI), established in 2001, is a not-for-profit educational research organisation. **We are devoted to improving retirement outcomes**. We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. Each research report combines experience with **INDEPENDENCE** to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our **INDEPENDENCE** sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

Our Vision:
Better informed policies and decisions that improve later life outcomes
We believe that better information and understanding will help lead to a better policy framework and a better provision of retirement income for all.

Our Mission:
To promote informed, evidence-based policies and decisions for financial provision in later life through independent research and analysis
We aim to be the authoritative voice on policy on pensions and financial and economic provision in later life.

Est. 2001

By supporting the PPI, you are aligning yourself with our vision to **drive better informed policies and decisions that improve later life outcomes,** and strengthening your commitment to better outcomes for all.

As we look forward now to the next 20 years, we will continue to be the trusted source of information, analysis, and impartial feedback to those with an interest in later life issues. The scale and scope of policy change creates even more need for objective and evidence-based analysis. There is still much to do, and we look forward to meeting the challenge head on.

For further information on supporting the PPI
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The DC Future Book in association with Columbia Threadneedle Investments


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PENSIONS POLICY INSTITUTE

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The DC Future Book 2023

The DC Future Book 2023: Foreword

I am delighted to present the latest DC Future Book, the ninth in a series of highly informative annual Defined Contribution (DC) publications by the Pensions Policy institute (PPI) which Columbia Threadneedle is proud to sponsor.

This year's edition continues to highlight the impact of higher inflation on pension savers. For those in the accumulation phase, the increasing cost of living may reduce their ability to save, which could lead to decreased contribution levels. At the same time, saving pot values will be eroded if investment returns do not keep pace with inflation.

It is positive to see the number of people saving for a pension increase, with 10.9 million employees automatically enrolled - an increase of 200,000 over the past 12 months.[1] However, there are an equal number of employees that are ineligible for automatic enrolment, leading to a potential gap in pension provision for a large portion of the population if not addressed.

We know that greater pension participation at younger ages has a positive impact on retirement outcomes, particularly as contributions made in the early stages of working life have longer to grow. It is pleasing to see automatic enrolment has significantly boosted pension participation among young people, with 85% of those aged between 22 and 29 currently participating, a strong rise from 24% in 2012, and the largest increase among any age group.[2] But as the report points out, despite higher participation rates, minimum contribution levels are not enough to deliver adequate retirement outcomes for future generations.

In Chapter 4 we explore how decumulation decisions will differ for future DC savers. Most future retirees will be wholly dependent on DC savings to provide an income in retirement, supplemented by their state pension. Current contribution rates, however, have stagnated, and if they do not rise, future retirees face difficult decisions between adequacy and sustainability. Furthermore, longer life expectancy means savings will have to be spread across a longer retirement period, and lower levels of home ownership will likely lead to higher housing costs in retirement, adding further challenges to good retirement outcomes for current workers. These drivers may delay retirement as working lives are extended.

We strongly encourage the pensions industry to adapt products and services to support individuals more effectively within the changing pensions landscape. Introducing more hybrid products that provide elements of both security and flexibility within one single wrapper would better support young savers.

Alongside a better offering in the future, it is imperative that the industry supports the social need for more education on pensions and retirement planning, highlighting the importance of increasing contribution rates. In particular, the provision of financial education in schools to ensure children and young people learn the tools and behaviours required to effectively manage their personal finances throughout their life.

We must all work together to consider how we can help current and future retirees look forward to a comfortable retirement by delivering the relevant education, products and frameworks to provide more people the prospect of a good outcome.

I hope you enjoy reading this year's edition of The DC Future Book.

Michaela Collet Jackson
Head of Distribution, EMEA,
at Columbia Threadneedle Investments

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[1] TPR (2023) Automatic enrolment declaration of compliance report
[2] DWP (2022) Workplace pension participation and savings trends of eligible employees: 2009 to 2021

Introduction

This report is the ninth edition of the Pensions Policy Institute's (PPI) **The DC Future Book: in association with Columbia Threadneedle Investments**, setting out available data on the Defined Contribution (DC) landscape alongside commentary, analysis and projections of future trends.

Demographic and policy changes mean that, compared to previous generations of pensioners, current and future retirees will:

- Live longer on average
- Receive their State Pension later
- Be more likely to reach retirement dependent on Defined Contribution (DC) savings, with little or no Defined Benefit (DB) entitlement
- Have greater flexibility when accessing and using their DC savings over the course of later life.

These changes increase the risk borne by pension savers and the complexity of decisions they must make at, and during, retirement. Given the potential risks involved for those retiring with DC savings, and the rapid expansion of the workplace DC market, it is important that a comprehensive compendium of DC research, statistics and longitudinal data is available to allow observation and analysis of developing trends.

Chapter One - What is the DC landscape?
Outlines the State and private pension system in the UK, and the main DC landscape changes over the past few years.

Chapter Two - What does the DC landscape currently look like?
Provides a picture of the current DC landscape, including data on automatic enrolment, saving levels, investment strategy, access to savings, and advice and guidance.

Chapter Three - How might the DC landscape evolve in the future?
Explores how the DC landscape might evolve in the future both for individuals and on an aggregate level, using PPI modelling.

Chapter Four - How will decumulation decisions differ for future DC savers?
Explores the factors that will mean that future generations of DC savers will face increased levels of risk in retirement and the additional support they are likely to need in order to achieve adequate and sustainable retirement outcomes.

Chapter Five - Reflections on policy
Contains reflections on the policy themes highlighted by the report from leading thinkers and commentators in the pensions world and beyond.

Chapter One:

What is the DC landscape?

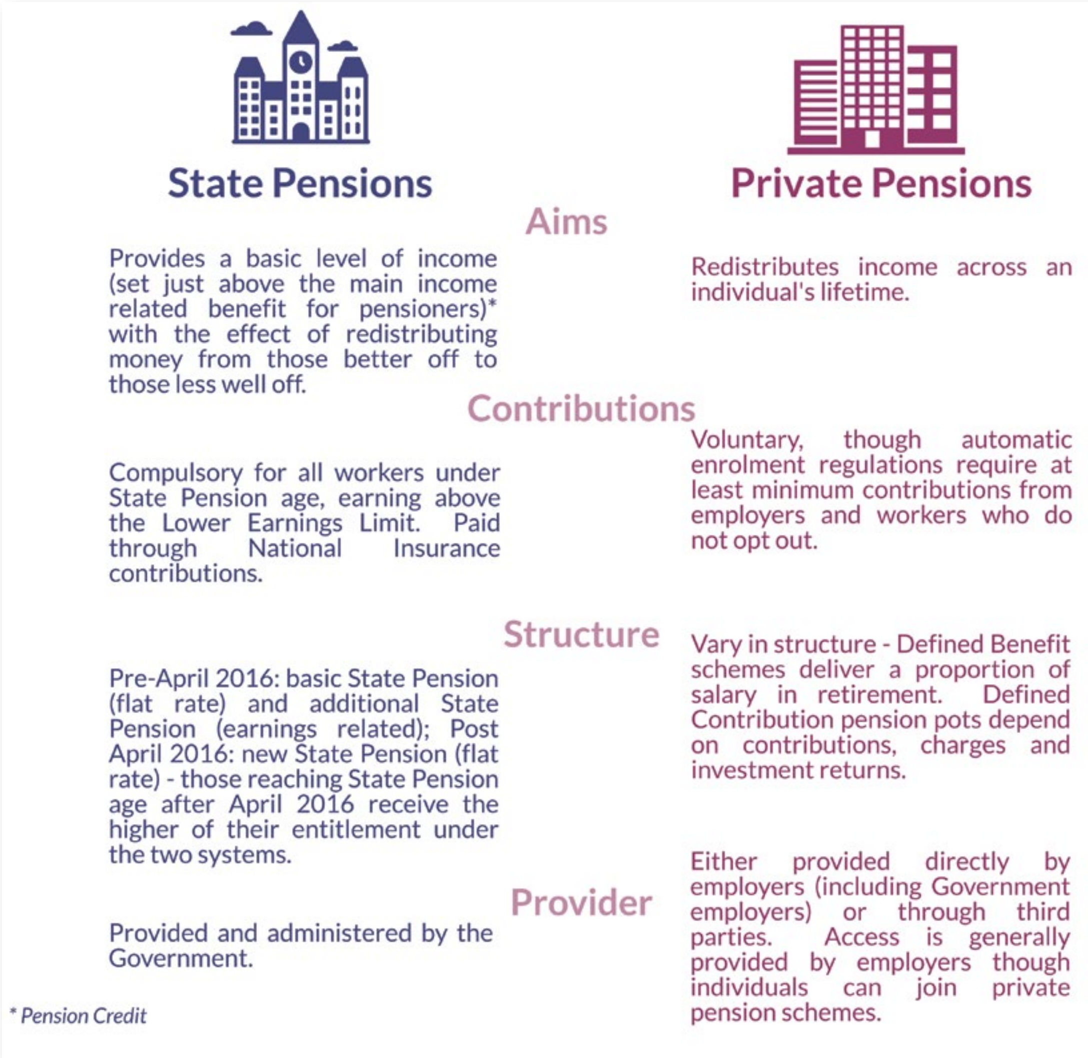
Chapter One: What is the DC landscape?

This chapter outlines the State and private pension system in the UK and the main Defined Contribution (DC) landscape changes over the past few years.

There are two main tiers in the UK pension system (Box 1.1):

- A compulsory, State tier; and,
- A voluntary, private tier[3]

Box 1.1: The State and private pension system



Pensions in the private tier can be either workplace (provided through an employer, either directly or through a pension provider, such as an insurance company or master trust) or personal (set up by the individual, who has a direct contract with the provider). While workplace pension saving is more prevalent than personal accounts, the market for non-workplace pensions is relatively large, especially in terms of assets under management (AUM). Non-workplace pensions are used by people in self-employment who don't have access to a workplace pension, as well as people who want to supplement their workplace pension savings. This means that some people have both workplace and personal pensions at the same time.

[3] For further detail regarding the UK pension system, see PPI's Pension Primer (2023)

There are different types of private pension schemes

There are two main types of pension scheme in the UK: Defined Benefit (DB) and Defined Contribution (DC). Workplace pensions can be either DB or DC, while personal pensions are DC only.

DB schemes:

- Promise a specific level of benefit when an individual retires, based on a member's salary and years as an active member. Employers make the promise and are responsible for making additional contributions if there are deficits in scheme funding.
- Operate on a pooled fund basis. All contributions are paid into a common fund, which is invested to provide all retirement benefits. In unfunded public sector schemes, contributions are used to pay the benefits of current scheme pensioners, the balance between contributions and payments is covered by the Government.

DC schemes:

- Operate on a money purchase basis with a specified rate of contributions being paid into the scheme, but with no guarantee as to the amount that will be paid out. When an individual reaches retirement, the accrued benefit is withdrawn and may be used to buy a retirement product.
- At retirement, the pension will depend on the accumulated fund, the amount deducted from the fund as a tax-free lump sum (which is usually up to 25% of the total fund) and the method of accessing savings. The size of the pot depends on contributions, length of saving, employer contributions, investment performance, charges, and the choice of retirement product or means of access. If investment returns or retirement income product rates are poor, then the resultant pension will be lower.

In addition to DB and DC schemes, a third type of pension scheme, Collective Defined Contribution (CDC), has now been introduced. The introduction of CDC is discussed in more detail on Page 8.

There are benefits associated with saving in private pensions over other types of saving

Private pension savings (along with other savings and assets) are used to top up State Pension income and improve people's standard of living in retirement.

Private pensions provide benefits over other forms of saving:

- Eligible employees enrolled in workplace pensions receive employer contributions.
- Pension contributions and investment returns are given tax relief (subject to certain limits).
- The long-term nature of pension saving allows for compound investment returns to accrue over time, which can substantially increase fund sizes.

However, there are also risks associated with private pensions

The most significant pension-related risk is the risk of not saving enough to achieve an adequate standard of living in retirement. Other significant risks are (Box 1.2):

Box 1.2

Investment, inflation and longevity risk are of most importance to DC savers. Within DB schemes, these risks are largely borne by the sponsoring employer, whereas, in DC schemes, the individual must bear these risks themselves. As a result, the widespread transition from DB to DC provision has led to the transfer of substantial levels of risk from the employer to the individual.

Inflation risk is a particularly important consideration within the current economic landscape. Unexpected and significant increases in inflation are likely to have far reaching effects for people during both their working-life/saving phase and during retirement. High levels of inflation, particularly if sustained over prolonged periods, have the potential to significantly impact DC outcomes.

For people in the pension saving phase, high inflation may impact savers in two main ways:

- Increased pressure on their income from rising bills may reduce their ability to save, which could lead to increased opt-out rates and/or decreased contribution levels (for those saving above the minimum rate); and
- The value of pension savings will be eroded if investment returns do not keep pace with inflation.

For people in retirement, the effects of inflation on retirement outcomes will be more immediate. Pensioners are affected differently by cost-of-living increases because they spend on goods and services in different proportions to the rest of the population, and their income does not always increase at the same rate as the cost of living. While the State Pension Triple Lock provides a high level of inflation protection for pensioners, incomes drawn from DC savings are more vulnerable to inflation risk.

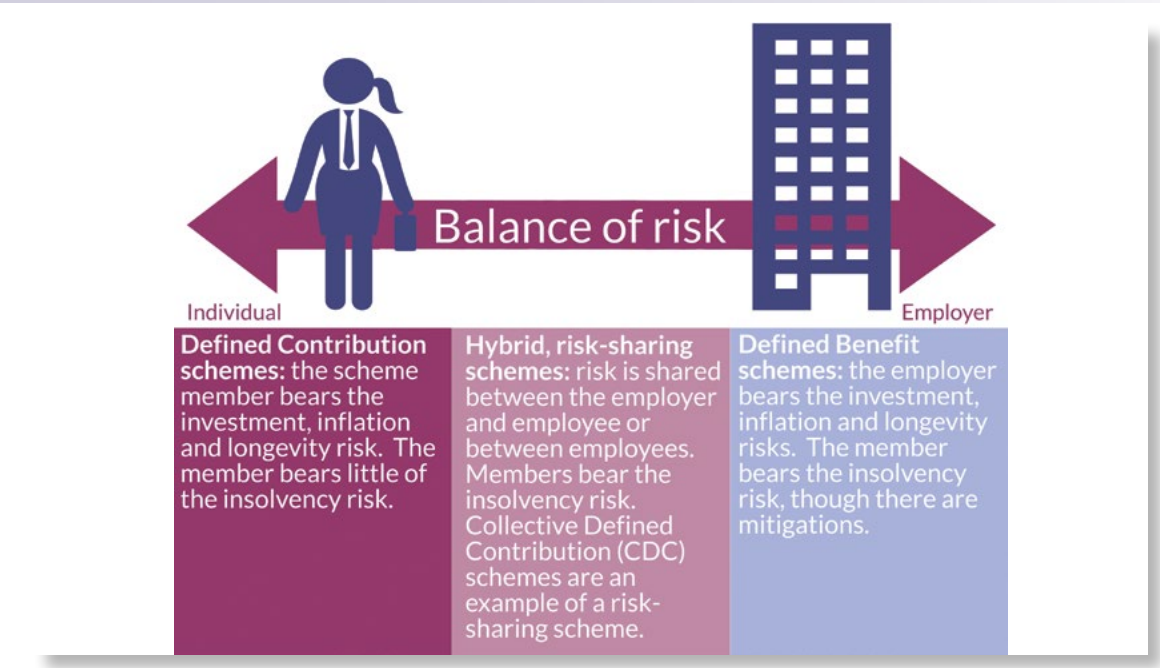
There are other risks associated with saving in and accessing private pensions, including (but not limited to):

- Making sub-optimal decisions about how to access retirement savings[4]
- Poor understanding of the income level required for an adequate standard of living, and the amount that needs to be saved to achieve that income level
- Excessive product charges (somewhat mitigated by the charge cap in workplace pensions)
- Poor annuity rates
- Poorly designed investment strategies
- Market turbulence
- Lost pensions (losing track of one or more pension pots)
- Becoming a victim of fraudulent schemes or other pension scams
- The risk of needs in retirement changing unexpectedly, for example, as a result of developing health and social care needs
- The interaction between pension savings and means-tested benefits.

The type of private pension scheme into which people save has implications for the level of risk they face

Members of DC pension schemes face more individual risk than members in DB pension schemes (Box 1.3).

Box 1.3



[4] This risk has become much greater following the introduction of pension flexibilities. Drawdown investment pathways will help to somewhat mitigate this risk for drawdown customers, but those accessing DC pensions may need further protection in the form of advice, guidance and structured choice architecture. Pension Wise was created in order to mitigate this increased risk by offering a free source of guidance for DC savers.

The impact of these risks will be mitigated for people who have only a small amount of DC savings and have other, larger, sources of income in retirement from, for example, DB pension entitlement. However, for those with very low incomes, even small amounts of DC savings may have significant proportional effects on later life living standards, while those with significant levels of DC savings will also face significant risks.

The introduction of a third type of pension scheme, CDC, presents a new option for risk sharing

The Pension Schemes Act 2021 legislated a framework for the establishment of CDC schemes in the UK. CDC schemes have two defining features:

- Collective: Risks and costs are shared collectively between the scheme's members rather than individually.
- Defined Contribution: Contribution rates (employer and employee) are defined in advance, with no ongoing liability to pay more in the future to cover benefits.

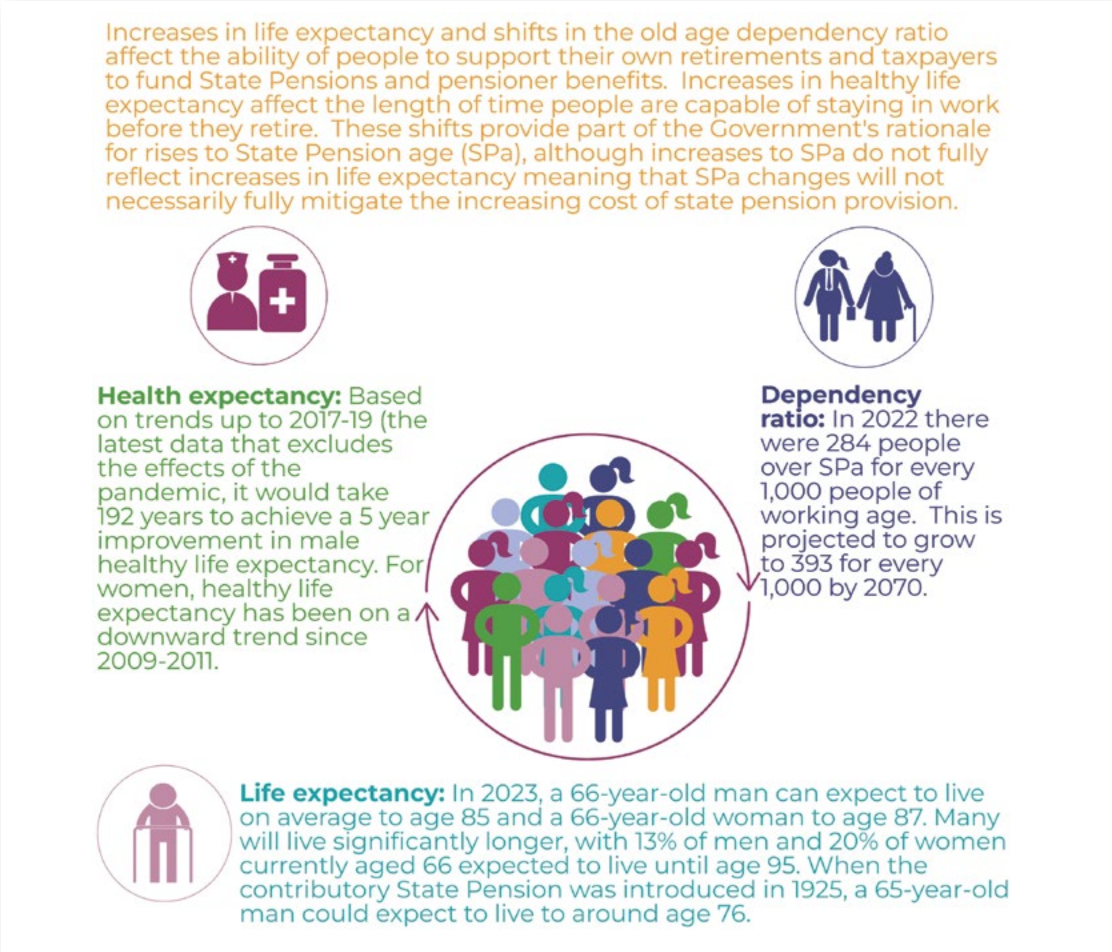
Unlike ordinary DC schemes, CDC schemes are designed to provide members with an income for life, similar to that provided by DB. However, CDC income levels are not guaranteed and can be subject to increases and decreases during both working life and retirement, depending on the scheme's funding position. CDC could offer a middle ground between DC and DB, providing members with greater certainty about retirement outcomes than is possible in DC, while providing greater cost and liability certainty for employers than a DB scheme. However, there are also risks associated with CDC schemes, including the potential for intergenerational unfairness (either real or perceived), member communication challenges and questions around the scale required to make CDC schemes feasible and effective.

The authorisation and regulatory regime for single employer CDC schemes came into force on 1 August 2022, with the first scheme, the Royal Mail Collective Pension Plan, authorised in April 2023. So far, this is the only CDC scheme to receive authorisation from The Pensions Regulator (TPR). As it becomes clearer how CDC schemes will function within the UK landscape, other schemes may join the market. Under current legislation, only single or connected employers are permitted to establish CDC schemes. However, in the first half of 2023 the DWP consulted on 'Extending Opportunities for Collective Defined Contribution Pension Schemes', with the Government response published in July 2023. The consultation sought views on a framework to accommodate CDC schemes providing benefits to unconnected multi-employer schemes and Master Trusts, as well as the potential for CDC decumulation products. Secondary legislation is expected later this year.[5]

The pensions landscape has changed over the last few decades as a result of demographic, market, policy and regulatory shifts (Box 1.4-1.7)

[5] DWP (2023a)

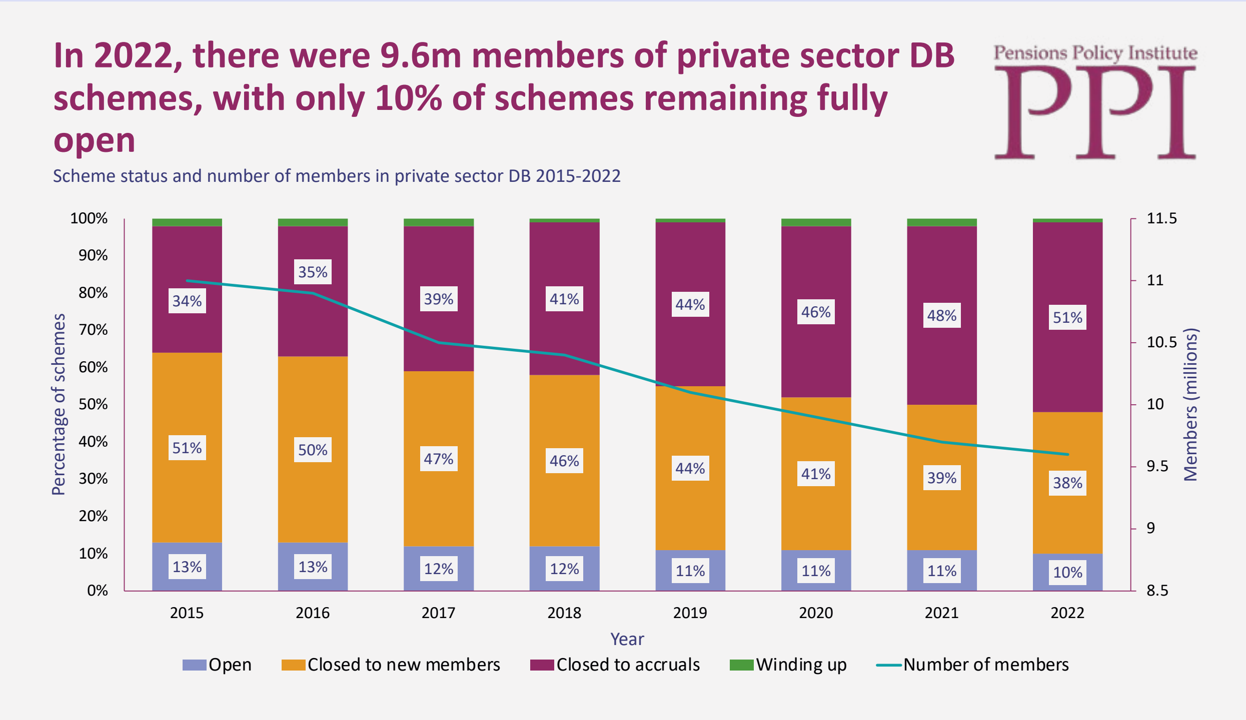
Box 1.4 Demographic shifts



Box 1.5: Market changes

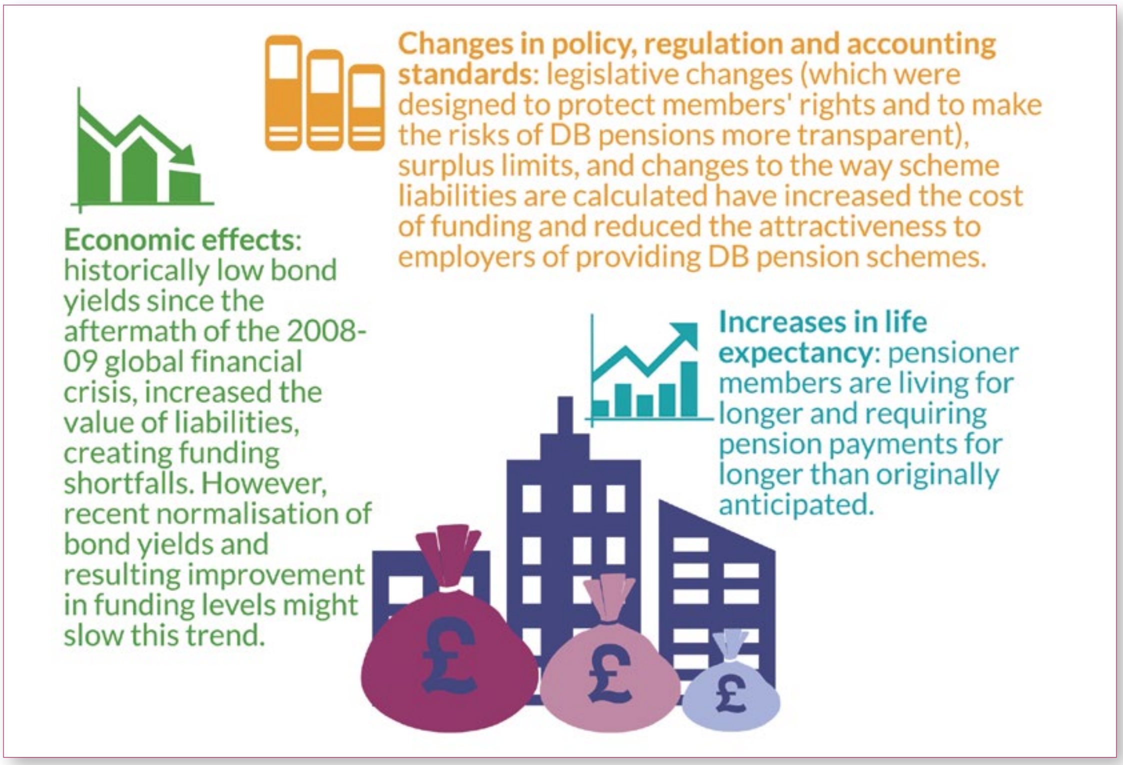
DB pension schemes historically dominated private sector pension provision and continue to be the main source of provision within the public sector. Membership of private sector DB schemes peaked in 1967, with around eight million active members. Since then, private sector DB membership has been in decline, especially in recent years. As of 2022, there were around 930,000 active members, having fallen below one million for the first time in 2021, with only 10% of schemes remaining fully open (Chart 1.1)

Chart 1.1[6]



DB schemes closures can be attributed to several factors, including:

Box 1.5



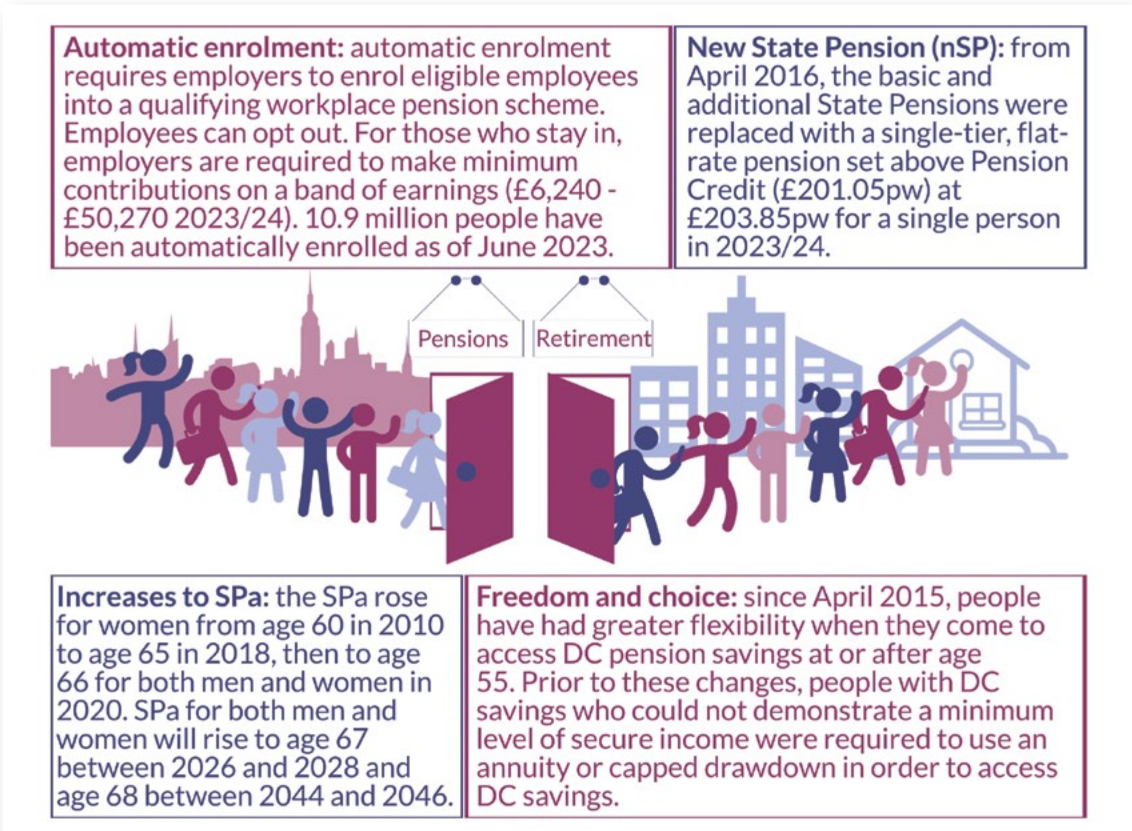
[6] PPF (2022)

Labour market shifts that have led to fewer people spending most of their working life with a single employer may have also diluted the rationale for offering private sector DB schemes. As provision of DB schemes became more challenging for private sector employers, the less risky DC model became more attractive. Many employers also choose to contribute less into DC arrangements. As a result of this, and the introduction of automatic enrolment in 2012, the number of active savers in DC schemes has increased rapidly and overtaken the number of active DB savers. In 2023, there are 14 million active members in DC schemes, compared to around 930,000 active members in private sector DB schemes in the latest available data (2022).

High levels of DB provision continue within the public sector, with 6.8 million active members in 2021/22. Many public sector DB schemes are funded on a pay-as-you-go basis (with contributions of current active members paying for income payments to current retirees, and the Government making up any shortfall), rather than being backed by assets like private sector DB schemes. There are some exceptions to this among public sector schemes – the Local Government Pension Scheme (LGPS), for example, is asset-backed.

While DC provision has overtaken DB in terms of numbers of savers, DB entitlement will continue to be an important component of retirement income for many in years to come, even in the private sector. In 2022, there were 4.6 million deferred, and 4.1 million pensioner, members of private sector DB schemes, who will continue to claim DB benefits for many decades regardless of the status of the scheme of which they are a member.[7]

Box 1.6: Policy changes



[7] PPF (2022)

Box 1.7: Regulatory changes

In 2023, the Government has launched consultations on a number of policy proposals aimed at improving outcomes for DC savers:

- Value for Money: Having already introduced a detailed value for money assessment for schemes below £100 million in 2021, in January 2023 the Government launched a consultation on its value for money framework that aims to provide a transparent and consistent way for schemes to assess their performance relative to others in the market. The framework covers three components: investment performance; costs and charges; and quality of services. The framework aims to shift the focus from costs to value, through requiring consideration of factors critical to longer term saver outcomes. It is expected that the introduction of the framework will also further accelerate the pace of consolidation among smaller schemes that may be underperforming.
- Deferred pots: Following a call for evidence in January 2023, in July 2023 the Government announced a consultation on 'Ending the proliferation of deferred small pots'. The consultation sets out a framework for an automated consolidation solution, with a central clearing house created to act as a central point informing schemes where to transfer a member's eligible deferred pot. Multiple schemes will be authorised by regulators to act as consolidators and members will have the option to self-select a scheme into which their pots will be consolidated, or a default consolidator will be used where a member does not make an active choice. It is proposed that a pot will become eligible for automatic consolidation 12 months after the last contribution was made into the pot, with the pot size limit initially being set at £1,000, with a statutory requirement for the Secretary of State to review this limit at regular intervals.
- Decumulation: In July 2023, the Government announced a consultation on 'Helping savers understand their pension choices', following on from a call for evidence in 2022. The consultation sets out policy proposals for a decumulation framework that will provide support for members at the point of access, both in terms of engagement and product offerings. The consultation also includes question on how to enable the government established master trust Nest to offer a full range of decumulation products to its members.
- Asset Allocation: In July 2023, the Government announced the Mansion House Compact, signed by many of the UK's largest DC schemes, representing around two-thirds of the UK's DC workplace pensions market. The Compact commits the signed DC schemes to the objective of allocating at least 5% of their default funds to unlisted equities by 2030.[8]

[8] https://www.gov.uk/government/speeches/chancellor-jeremy-hunts-mansion-house-speech

In addition to these developing regulatory changes, there have been other recent regulatory changes that are now embedded within the DC landscape:

- Environmental, Social and Governance (ESG) considerations: Since October 2019, trustees have been required to set out within a Statement of Investment Principles (SIP): how they take account of financially material considerations, including but not limited to ESG considerations; their policies in relation to the stewardship of investments, including engagement with investee firms and the exercise of the voting rights associated with those investments; and the extent to which, if at all, non-financial matters are taken into account in the selection, retention and realisation of investments. From October 2020, these regulations increased further, with trustees of DC schemes with 100 or more members required to produce an implementation statement explaining how they have followed and acted upon the stated investment principles set out in their SIP. This includes reporting on the way in which the scheme monitors its asset managers who undertake investment and engagement activities on its behalf and whether these managers have acted in accordance with the trustees' stated policies. In December 2019, the Financial Conduct Authority (FCA) introduced similar reporting requirements for contract-based schemes, including a new duty for Independent Governance Committees (IGCs) to consider and report on their firm's policies on ESG issues, member concerns and stewardship. Further regulation has been introduced in line with recommendations from the Task Force on Climate-related Financial Disclosures (TCFD). Since October 2021, DC schemes with more than £5bn AUM, and all master trusts, must produce an annual report specifically on their consideration of climate change risks. From October 2022, this was extended to apply to DC schemes with AUM between £1bn and £5bn.
- Drawdown investment pathways: In 2018, the FCA found that around a third of those who have used non-advised drawdown were invested in cash, or cash-like assets, rather than strategies with the potential for higher returns that better suit the member's aims. The FCA estimated that around half of these savers were likely to experience poorer retirement outcomes as a result of their investment choice.[9] As a result, drawdown providers are now required to offer "investment pathways" to members. These pathways require non-advised members to make a decision about how they intend to access their savings in the near future and then be given an appropriate underlying investment portfolio on that basis. Drawdown investment pathways came into force in February 2021. The FCA has also made it illegal to default consumers into cash drawdown; savers must now actively opt in if they want to invest in cash, or cash-like assets.

[9] FCA (2019)

Demographic, market and policy changes affect needs and resources in retirement

The above shifts affect the needs and resources of, and the risks faced by, people at and during retirement. Compared to previous generations, future retirees will:

- Live longer and take their State Pension later,
- Be more likely to reach retirement with DC savings,
- Be more likely to reach retirement with no or low levels of DB entitlement,
- Have near total flexibility in accessing their savings,
- Face more risk and complexity at and during retirement, and
- Be more likely to have a need for long-term care in later life, and will face challenging decisions about how to fund this.

Conclusions

Changes in private pension provision have shifted the balance of risk increasingly towards members

As the UK private pensions landscape has shifted rapidly from DB to DC, largely as a result of DB scheme closures and the introduction of automatic enrolment, there has also been a transfer of risk from employer to employee. With more savers bearing a greater level of individual risk and complexity in DC schemes, there is a risk that they will experience poorer later life outcomes if they do not receive adequate support.

The Government has set out a range of policy solutions to improve outcomes for DC savers

Current areas of developing regulatory change include a value for money framework that aims to provide a transparent and consistent way for schemes to assess their performance, an automated consolidation solution to the small, deferred pots challenge and a decumulation framework that will provide support for members at the point of access, both in terms of engagement and product offerings.

Chapter Two:

What does the DC landscape look like?

Chapter Two: What does the DC landscape look like?

This chapter provides a picture of the current Defined Contribution (DC) landscape, including data on automatic enrolment, saving levels, investment strategy, access to savings, and advice and guidance.

Automatic enrolment

Automatic enrolment requires all employers to enrol eligible employees into a qualifying pension scheme. To be eligible for automatic enrolment, an employee must be:

- aged between 22 and State Pension age (SPa), and
- earning £10,000pa or above in at least one job.

Once automatically enrolled, employers are required to contribute on behalf of workers while they remain active members. The minimum required level of aggregate contributions is 8% of band earnings (£6,240 to £50,270 in 2023/24), though employers and employees may choose to contribute more:

- Employers must contribute at least 3% of band earnings on behalf of employees, though some employers may choose to cover the whole 8%, and with some employers offering pension contributions above this level.
- Employees whose employer makes only minimum contributions are required to contribute a minimum of 5% of band earnings (though tax relief is applied to contributions, reducing the impact on take-home pay) unless they opt out. Employees with employers who choose to contribute at 8% or higher are not legally required to make any additional contributions, although some employers will require that employees contribute themselves in order to receive the higher rate of employer contribution.

New and newly eligible employees are automatically enrolled and have a one-month window to opt out and have their personal contributions refunded. People who cease contributing after the opt-out period has expired are not eligible to claim back their contributions, which will remain invested until at least age 55 when they can legally access their accumulated pot. Those who opt out or cease contributing are automatically re-enrolled every three years.

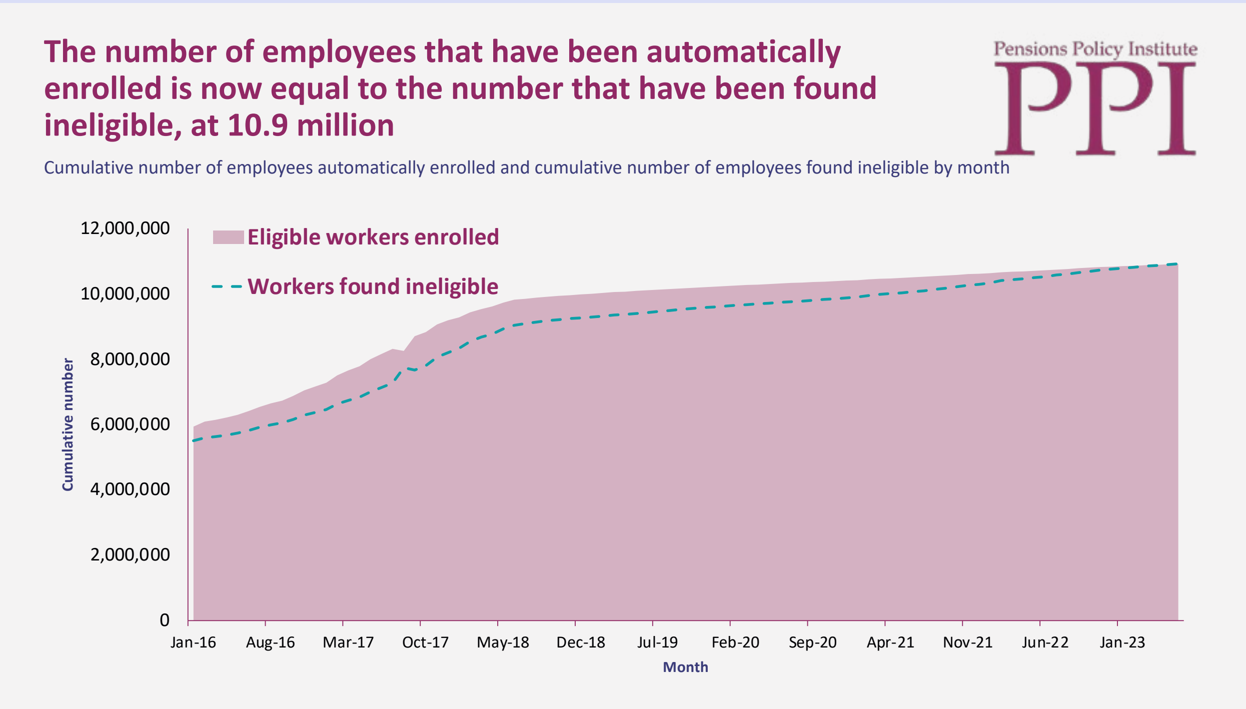
Automatic enrolment was introduced on a staged basis, starting with the largest employers, in October 2012. By the end of 2018, all existing employers were required to automatically enrol their employees and all new employers after that date have the obligation to automatically enrol their employees with immediate effect.

Employees and automatic enrolment

10.9 million people were automatically enrolled by June 2023

By June 2023, 10.9 million employees were automatically enrolled. However, the number of employees found ineligible for automatic enrolment (because of age or earnings) has also continued to grow, and for the first time is now equal to the number of employees who have been found eligible, at 10.9 million (Chart 2.1). The number of employees found ineligible has been growing at a more rapid rate than those found eligible, which may be the result of an increased number of employees in lower income jobs, or more employees working in multiple jobs. Because these automatic enrolment statistics are cumulative and employees' eligibility is assessed each time they join a new employer, the number found ineligible is increased by people who move jobs more frequently, who are more likely to be ineligible due to age or earnings, such as younger workers and those on low incomes who are more likely to be in less secure employment on average.

Chart 2.1[10]



In addition to employees who have been brought into pension saving through automatic enrolment, and employees who have been found ineligible for automatic enrolment, as at June 2023 12.1 million employees were already active members of a qualifying scheme on the staging date or duties start date.[11] Overall, including those who were already active members of a qualifying scheme and those who were newly brought into pension saving through automatic enrolment, around 87% of employees are eligible for automatic enrolment.[12]

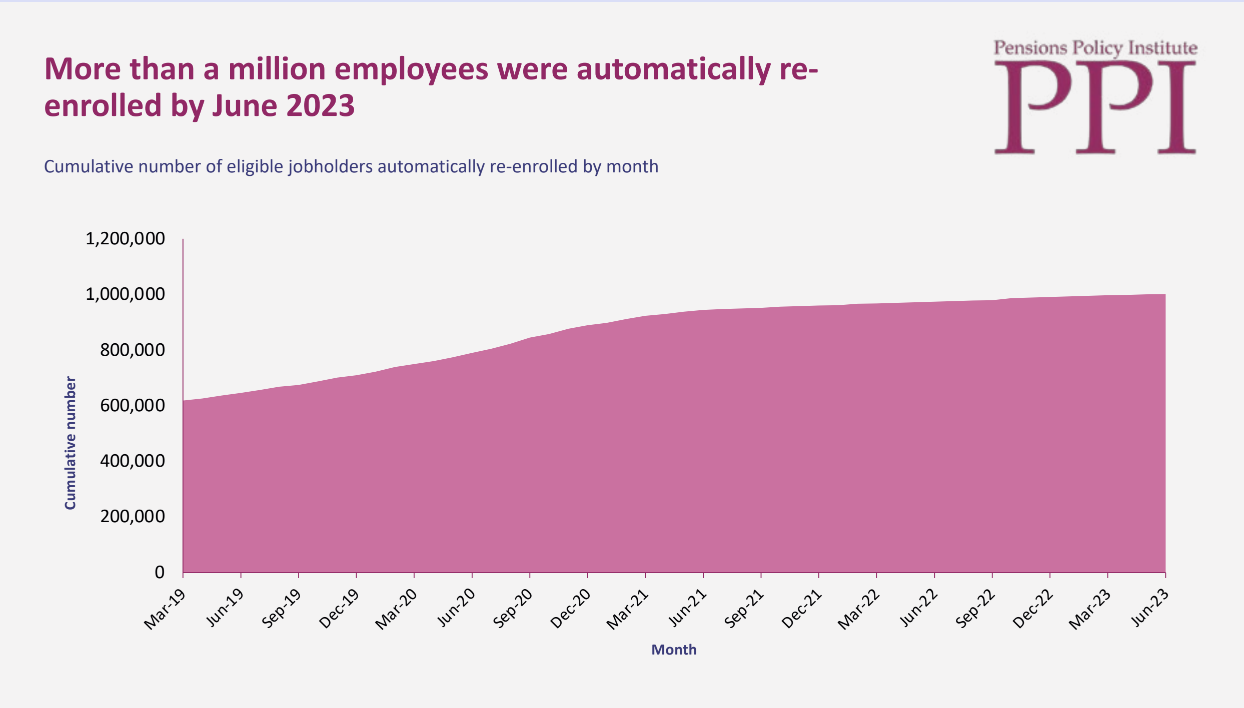
[10] TPR (2023)
[11] TPR (2023)
[12] 2022 PPI analysis of Labour Force Survey (LFS)

More than a million employees have been automatically re-enrolled

Employers are required to automatically re-enrol all eligible employees every three years. For employees who were already working for the employer at the time of automatic enrolment staging, this means they are re-enrolled three years after the date that they opted out for the first time, and every three years after that if they continue to opt out. For employees who joined the employer after automatic enrolment began, re-enrolment may take place sooner than three years after they first opted out, as re-enrolment is actioned across the full workforce at a set date every three years, rather than on an individual employee basis.

As of June 2023, slightly more than 1 million employees had been automatically re-enrolled, growing from 974,000 in June 2022 (Chart 2.2).

Chart 2.2[13]



Further reforms may be needed if more people are to be brought into pension saving

The 2017 Automatic Enrolment Review recommended that the minimum age for automatic enrolment eligibility should be reduced from 22 to 18.[14] This could increase eligibility by around 3%, and encourage saving for later life as the norm for young adults from the start of their working lives. At the time of the Review, the Government committed to implement this recommendation, alongside the recommendation to remove the lower limit on band earnings so that contributions are calculated from the first pound of earnings, by the mid-2020s.

In March 2023, the Department for Work and Pensions (DWP) supported MP Jonathan Gullis' Private Member's Bill, which aims to expand automatic enrolment by enacting the proposals from the 2017 Review. The Bill seeks to abolish the Lower Earning Level (LEL) for contributions and lower the age limit to 18. However, the provisions of the Bill are not expected to result in immediate change. Instead, it grants the Secretary of State the power to consult and report on the outcomes of the proposed changes before implementing them. The Bill also sets out the roadmap

[13] TPR (2023)
[14] DWP (2017)

for the reforms, including time for employers and workers to adapt to the transition, and is currently progressing through Parliament.

While implementation of this reform would increase eligibility among young workers, others will remain excluded from automatic enrolment. Those who are self-employed or have several jobs which each pay below the £10,000pa threshold are not eligible, even if combined income across multiple jobs totals more than £10,000pa.

The self-employed group, which includes around 4.4 million people,[15] is excluded from accessing the benefits of automatic enrolment because they do not have an employer who can automatically enrol them and contribute on their behalf. Meanwhile, many people with multiple jobs are excluded from automatic enrolment as a result of low earnings, although they may make an active choice to opt into pension saving. Of the 10.9 million workers ineligible to be automatically enrolled, 171,000 are multiple job holders, 147,000 women and 24,000 men. Changing eligibility criteria to take account of combined income across multiple jobs could bring an additional 108,000 women and 20,000 men into automatic enrolment.[16]

Despite concerns that opt-out rates would increase, they have remained broadly stable

Automatically enrolled employees have the opportunity to opt out and have their contributions returned to them within one month of being automatically enrolled. Prior to the introduction of automatic enrolment, the DWP's impact assessment predicted that around one in three people would opt out.[17] In practice, opt-out rates have been consistently lower than this, at around one in 10. As automatic enrolment was gradually rolled out, there were concerns that opt-out rates might increase, either once smaller employers started reaching their staging dates or as minimum contribution levels increased, first from 2% to 5% in 2018 and then from 5% to 8% in 2019.[18] However, opt-out rates remained broadly stable throughout staging and contribution rate increases.

Recent events, including the pandemic and the ongoing cost-of-living crisis, have raised fresh concerns about opt-out rates. Opt-out rates have remained broadly stable at around one in 10 over the decade since automatic enrolment was introduced, though there have been higher rates of opt-outs during times of particular economic uncertainty, such as the peak of the pandemic in 2022 when opt-out rates temporarily increased to nearly 11%, before stabilising again around 8%. However, opt-outs increased again to above 10% in 2022, and there are concerns that this trend could continue or even grow as the impact of the current cost-of-living crisis continues.

Fewer than 1% of savers stopped contributing as a result of an active decision not to continue saving after the opt-out period

While employees have a one-month period in which they can opt out of their workplace pension entirely, some people cease contributing to their scheme after the opt-out period has expired and their contributions remain invested in the scheme. People stop saving for a number of reasons:

- They leave their current job (they will be automatically enrolled via their next job if eligible),
- Their earnings fall below the limit for eligibility, or
- They do not wish to continue contributing to their pension scheme.

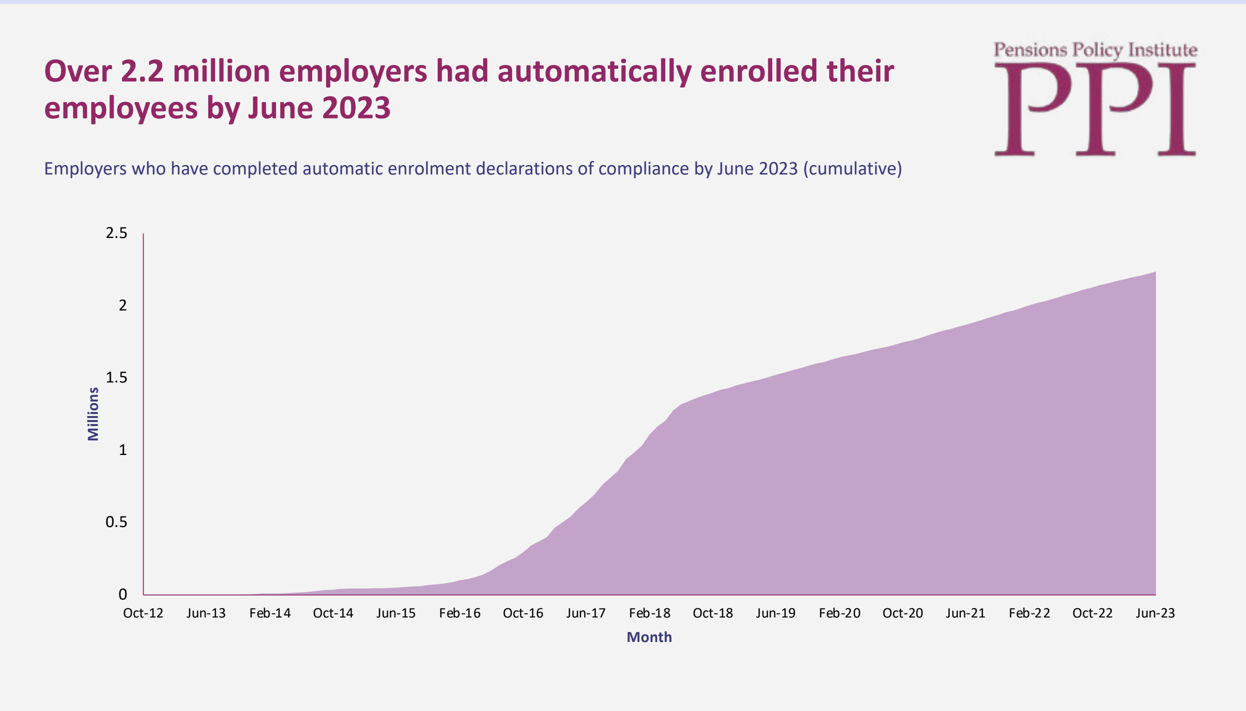
[15] Francis-Devine, Buchanan & Powell (2023)
[16] PPI (2022) The Underpensioned Index
[17] DWP (2008)
[18] DWP (2020)

Opt-out rates alone do not present the full picture of the proportion of employees that are actively saving into a pension, so it is useful to also look at the proportion who continue saving consistently. From April 2014 to March 2021, an average of 2.7% of employees stopped making contributions to their workplace pension each month. Within this group, 64% (1.7% of total savers) stopped contributing because the employment ended, 11% (0.3% of total savers) became ineligible for automatic enrolment (either because of older age or, more likely, a reduction in earnings), and 25% (0.7% of total savers) stopped contributing as a result of an active decision not to continue saving.[19] Many within the group that stopped contributing as a result of the employment ending will have moved to a new job and been automatically enrolled by their new employer. Data that captures the impact of the current cost-of-living crisis on rates of stopping saving is not yet available. Given the significant financial pressure on many savers, there are concerns that more may have stopped saving into their pension in order to meet more immediate spending needs.

Employers and automatic enrolment

Automatic enrolment is now fully implemented, with all employers reaching their staging date by 2018. All employers are now required to automatically enrol new employees and re-enrol existing employees who have opted out. The number of employers automatically enrolling grew exponentially as smaller employers began staging in 2014. By the end of automatic enrolment staging, 1.1 million employers had been through the process. By June 2023, this had risen to over 2.2 million employers, as a result of new employers joining the market (Chart 2.3).[20]

Chart 2.3[21]



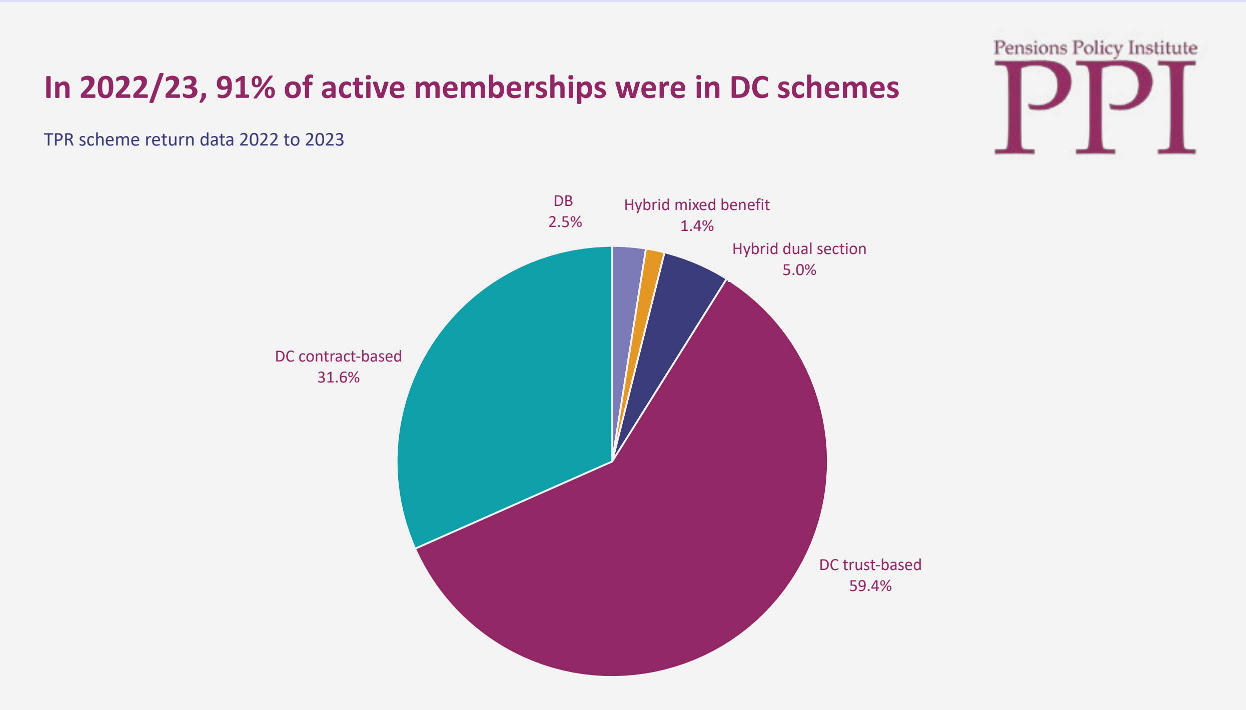
[19] DWP (2021)
[20] TPR (2023)
[21] TPR (2023)

Scheme type

Around 9 in 10 active memberships are now within DC schemes

Employers have a choice about the type of pension scheme they use for automatically enrolling their employees. The provision of Defined Benefit (DB) schemes has dwindled in the private sector (as described in Chapter One), and private sector employers are much more likely to automatically enrol their employees into DC schemes. The use of DC schemes, and especially master trusts, has risen dramatically with automatic enrolment, with around nine in 10 active memberships now in DC schemes (Chart 2.4).

Chart 2.4

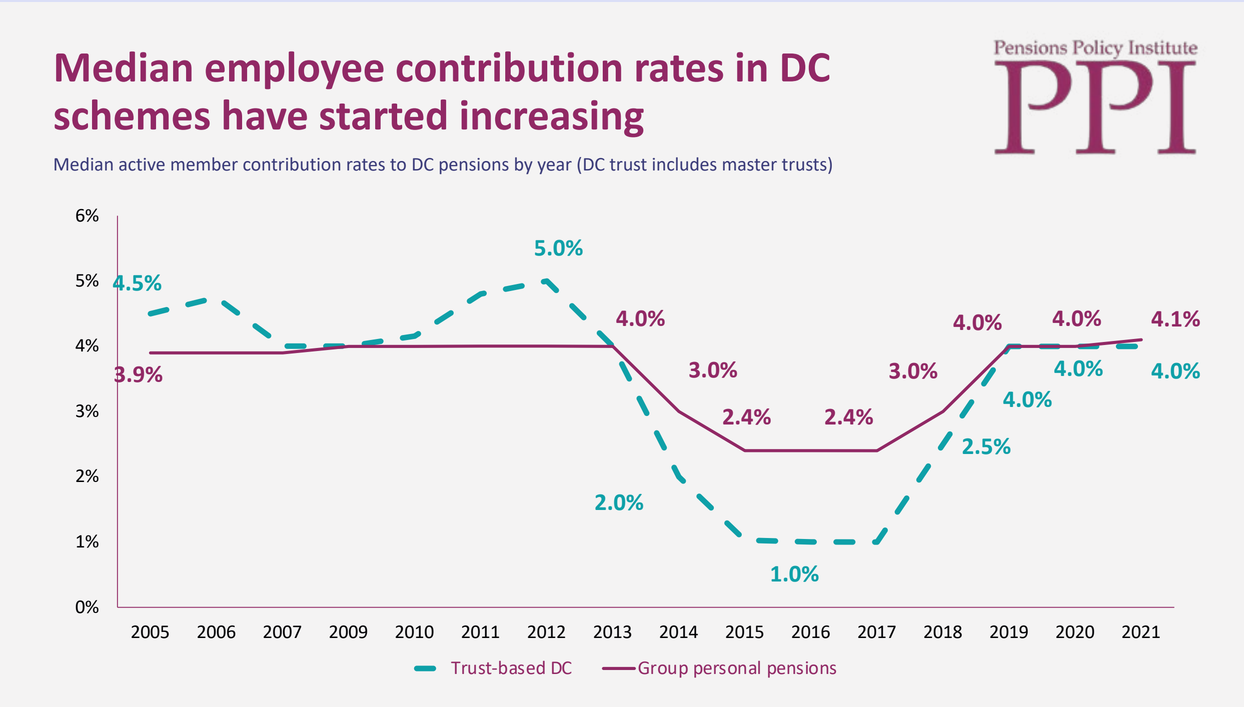


Contributions

Average employee and employer contributions have stagnated around the minimum mandated rate

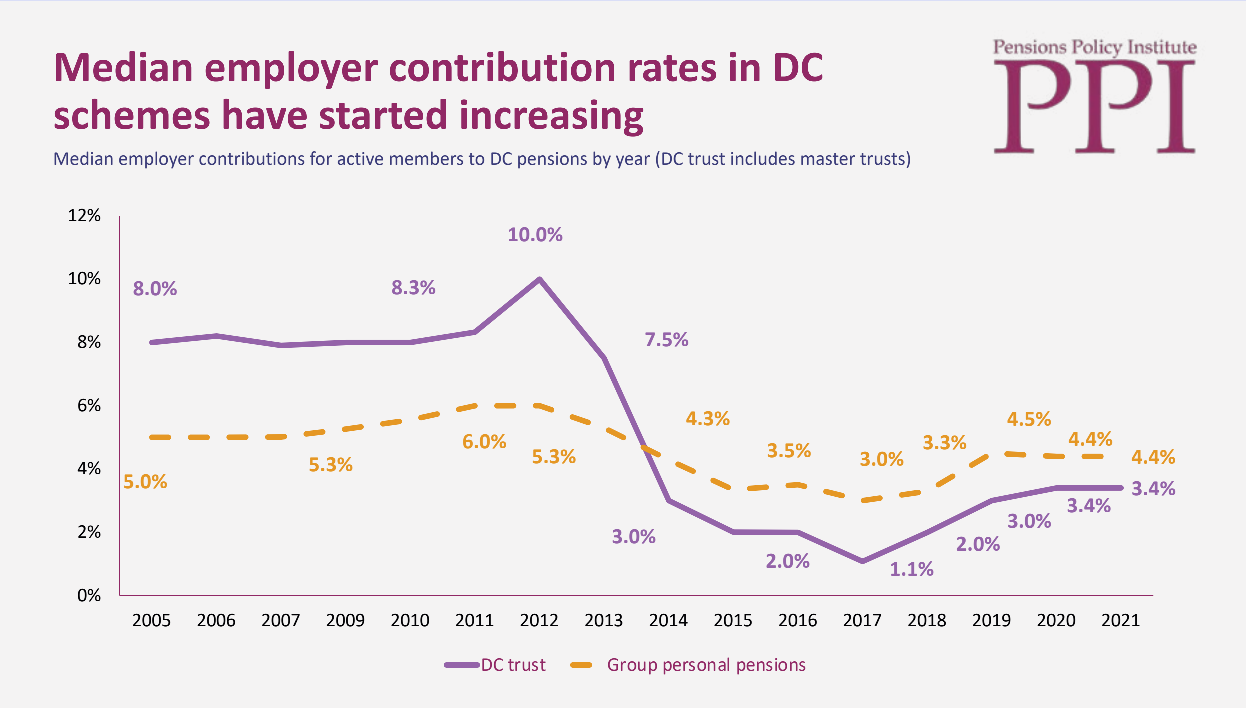
While those who were already members of workplace pensions prior to the introduction of automatic enrolment for the most part continued contributing at the same rates, large numbers of new savers contributing at minimum rates reduced the average contribution level. As automatic enrolment was introduced, median employee contribution rates initially fell as a result of more employees joining pension schemes for the first time and paying minimum contributions alongside their employers. Average employee contribution rates increased in correlation with increases to minimum required automatic enrolment contribution rates in 2018 and 2019. However, since these changes were made, and with no further increases currently planned for minimum contribution rates, average employee contribution rates have stagnated at 4% in trust-based DC schemes and have seen only a very small uplift of 0.1% to 4.1% in Group Personal Pensions (GPP) (Chart 2.5).

Chart 2.5



Median employer contribution rates have increased as a result of increases in the minimum required rate of contribution in 2018 and 2019. However, like employee contribution rates, average employer contributions have stagnated in the last couple of years (Chart 2.6). Data for 2022 and 2023 is not yet available, but it is expected that contributions rates will have remained stable at around the minimum rate.

Chart 2.6



Minimum contribution rates are unlikely to deliver adequate and sustainable retirement outcomes

Under an assumption of full entitlement to the new State Pension (nSP) and a lifetime of minimum required automatic enrolment contributions, anyone earning over £12,700 will require additional savings beyond the default 8% of band earnings to reach their target replacement rate, which will allow them to replicate working-life living standards in retirement. While there is a broad consensus that higher contribution rates are required to achieve adequate and sustainable retirement outcomes, there are differing views on the level of contribution needed, ranging upwards from around 12%. PPI modelling carried out in 2021 suggests that for those on median earnings, total contribution rates may need to be as high as 20%, a further 12% above the minimum required under automatic enrolment in order to meet their target replacement rate.[22] Chapter Four further explores the outcomes that are likely to be achieved by individuals that contribute consistently at the minimum rate throughout working life.

Now that all scheduled minimum contribution rate increases have been implemented, there have been recommendations across the industry for further increases to be considered. While past increases to minimum contributions have not resulted in substantial increases in opt-outs, any further increases need to be balanced against the potential risk of encouraging higher opt-out rates.

[22] PPI (2021) What is an adequate retirement income?

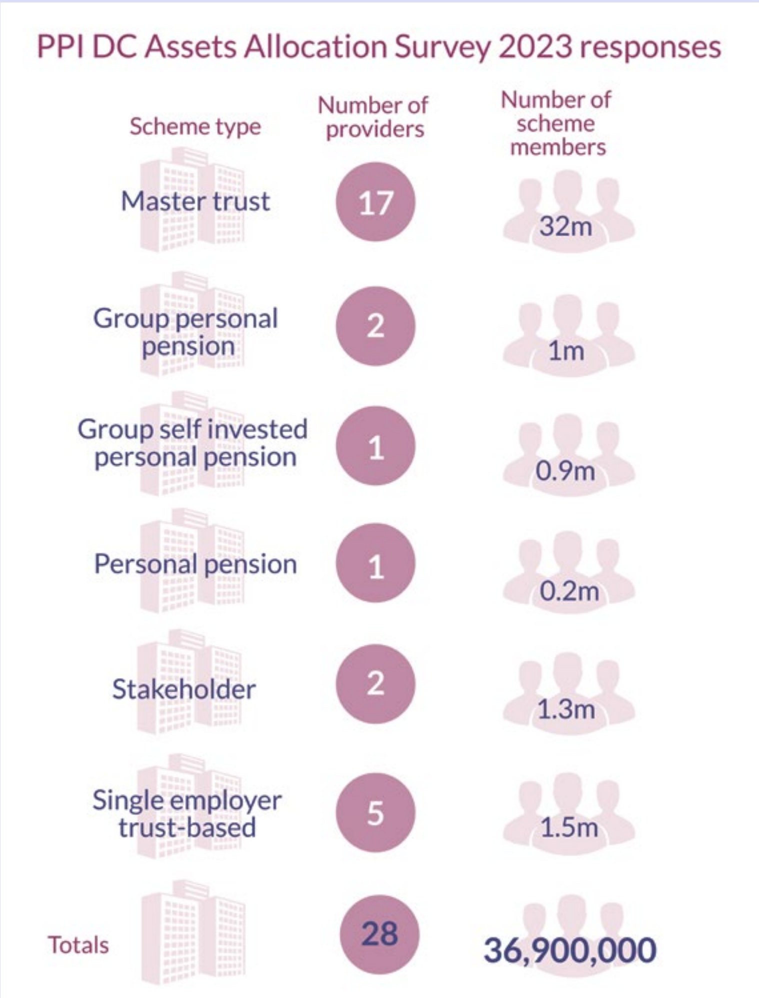
The Automatic Enrolment Review in 2017 recommended removing the lower earnings band for contributions, so both employees and employers would pay contributions based on the first pound of earnings up to the higher earnings band. The DWP's ambition is to implement this policy in the mid-2020s. If enacted, this change will increase saving levels for all those whose employer contributes based on band earnings (some employers choose to contribute based on total rather than band earnings). This would have the greatest proportional impact on lower earners. This change is also included in the Private Members' Bill on extending automatic enrolment that is currently making its way through Parliament.

DC investment

In addition to contribution rates, the returns achieved through scheme investment also impacts DC members' pot sizes at retirement, and, as a result, the adequacy of their retirement outcomes. The next section explores how assets are allocated within DC pension schemes' investment strategies.

The following data is based on responses to the **PPI DC Asset Allocation Survey 2023**. The participating schemes collectively manage nearly 37 million pots (Box 2.1) with aggregate assets under management (AUM) of around £145.6 billion.

Box 2.1[23]



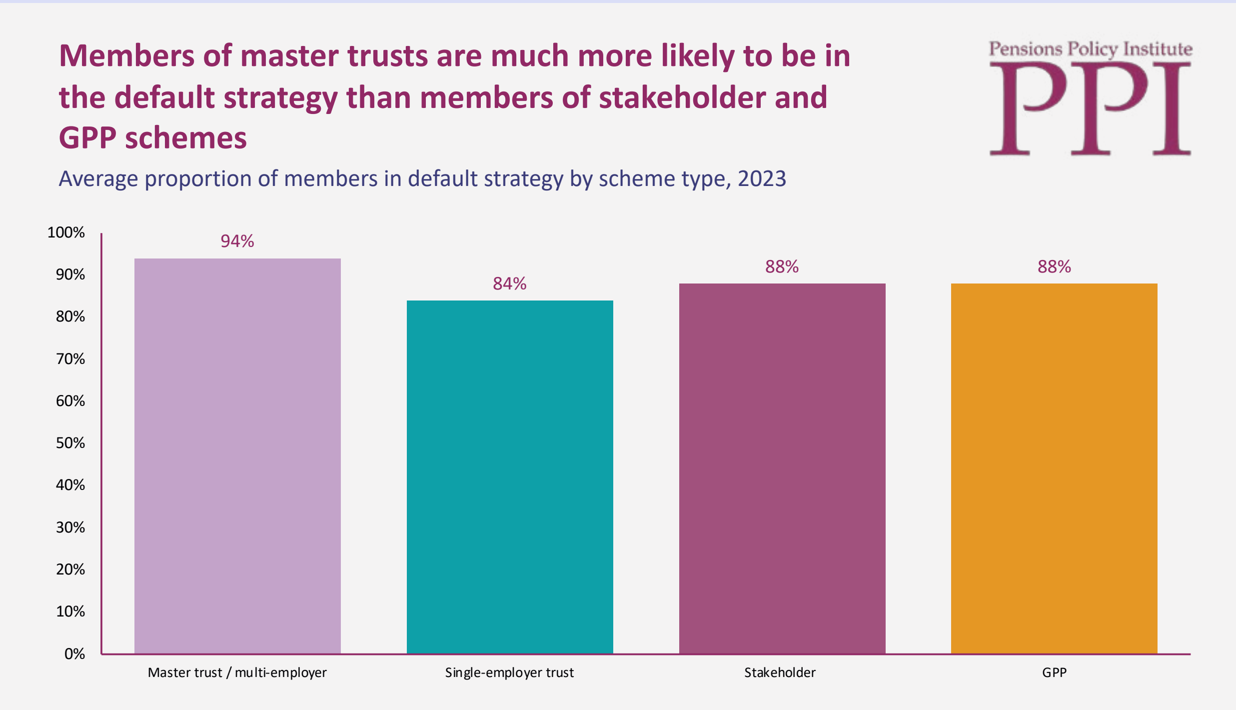
[23] This infographic shows the number of schemes that responded to the PPI DC Asset Allocation Survey 2023 and the number of members these schemes reported. It is not representative of the full DC market.

The PPI DC Asset Allocation Survey is an annual online survey that collects data on size, charges and asset allocation across the DC universe. Since its inception in 2015, alongside the first edition of The DC Future Book, the survey has grown from four providers covering around four million pots, to 28 schemes covering around 36.9 million pots. This year's survey was carried out from May to July 2023. Responses to the DC Asset Allocation Survey have become increasingly concentrated in large master trust schemes, reflecting shifts in the DC landscape. All data from the survey is self-reported by participating schemes, and is therefore dependent on the accuracy of the data provided, as well as the sample of schemes that respond each year. While many of the same schemes respond to the survey annually, changes in respondents year-to-year can impact the trends identified in the data.

Members of master trusts are more likely to be invested in the default strategy compared to members of single-employer schemes

The vast majority (94%) of master trust members are invested in their scheme's default strategy. Members of single-employer trust-based schemes, stakeholder and GPP schemes tend to have a smaller proportion of members in the default strategy (Chart 2.7).

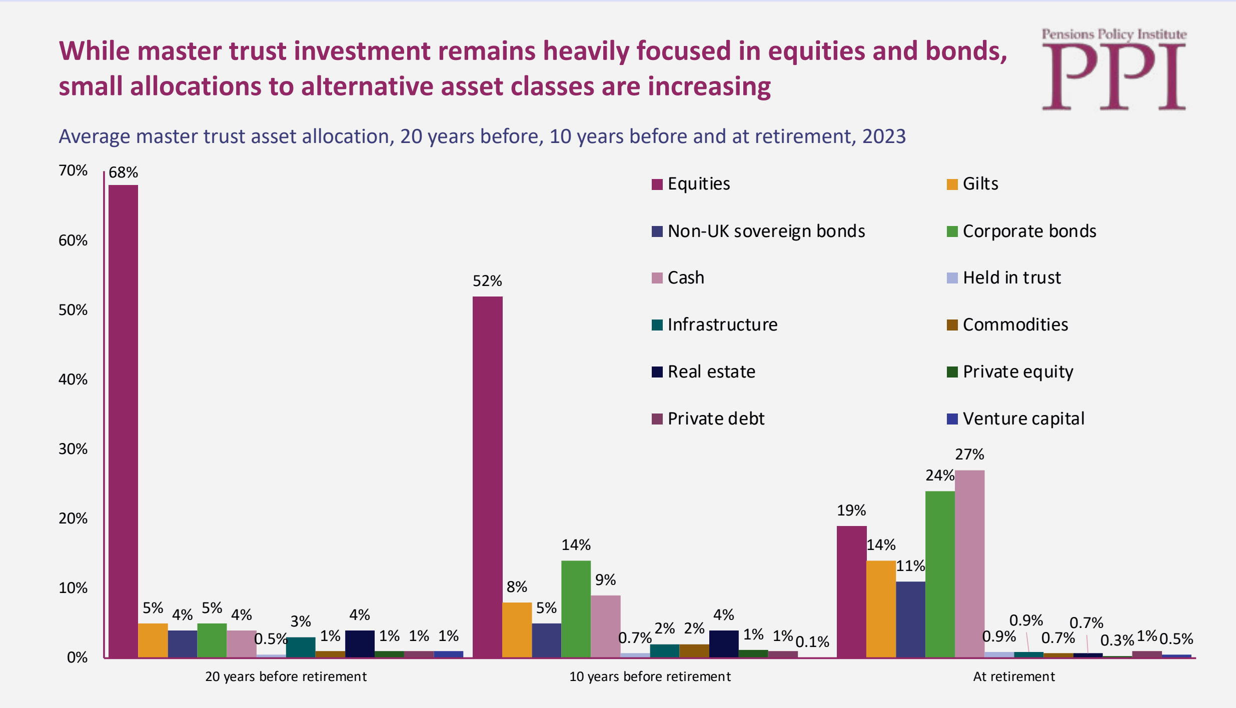
Chart 2.7



Although DC investment remains heavily focused in equities and bonds, small allocations to alternative asset classes are increasing, while allocation to UK equities declined significantly between 2022 and 2023 data

On average, master trusts allocate more than two thirds (68%) of assets to equities 20 years before a member's retirement date (Chart 2.8). Among master trust respondents that were able to provide a more detailed breakdown of the types of equities within which they are invested, 55% of overall AUM were allocated to global developed market equities, 6% to UK equities and 7% to developing markets. This represents a significant decline in allocation to UK equities compared to last year's data, in which 19% of allocation was to UK equities.

Chart 2.8[24]

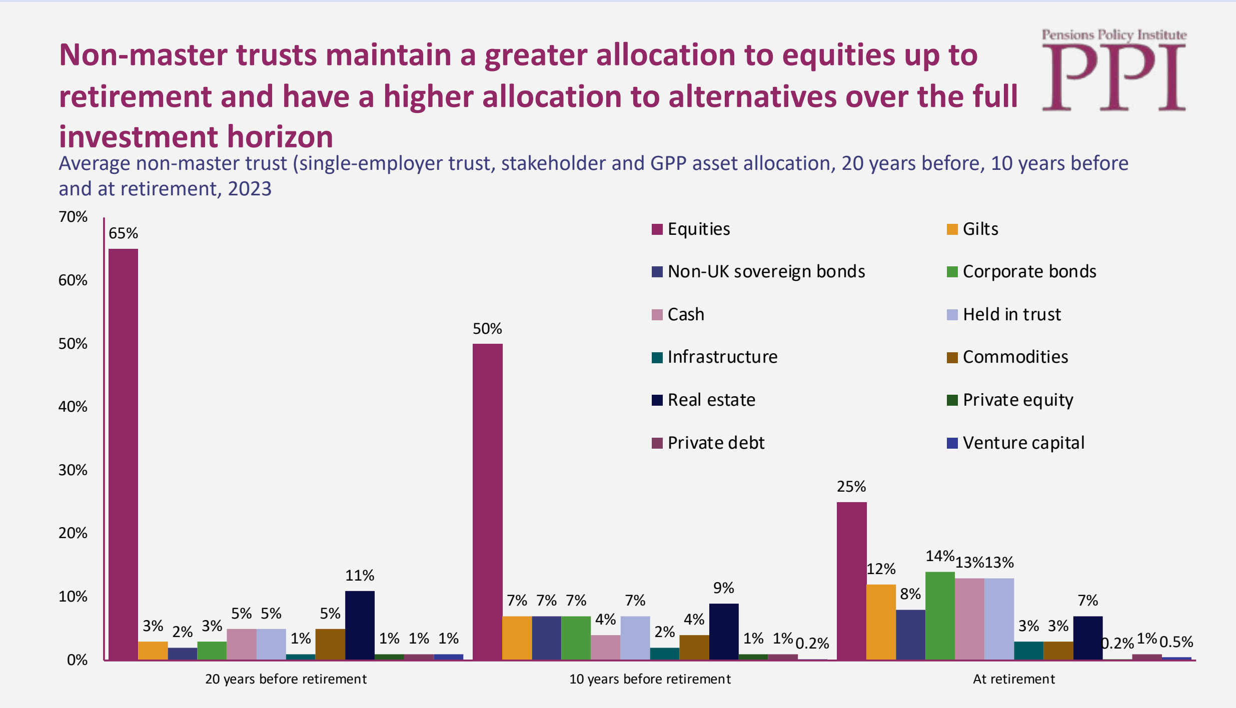


All master trust respondents to the survey utilise either a lifestyle or target date approach, and move in favour bonds and cash, with 76% of AUM allocated at retirement, compared to just 18% 20 years before retirement. This reflects the need to protect the value of pension savings as members approach retirement. Small allocations to alternative asset classes are present in master trust allocations, mostly focused in infrastructure and real estate, with higher allocations 10 and 20 years from retirement.

[24] Totals do not equal 100% due to rounding

While all non-master trust DC schemes covered by the survey also utilise either a lifestyle or target date approach, they maintain a higher allocation to equities at retirement compared to master trusts (25% vs 19%) (Chart 2.9). These types of scheme also have a greater allocation to alternative asset classes over the full investment horizon, although it does decline as members approach retirement. The highest alternative allocation is to real estate, with 11%, 20 years from retirement, but there are also higher allocations to commodities compared to master trusts, with 5%, 20 years from retirement. Another difference between master trust and non-master trust allocations is the significantly higher proportion of assets that are invested indirectly through an investment trust, with non-master trusts allocating 5%, 7% and 13% at 20 years before retirement, 10 years before retirement and at retirement respectively, compared to less than 1% throughout for master trusts.

Chart 2.9[25]

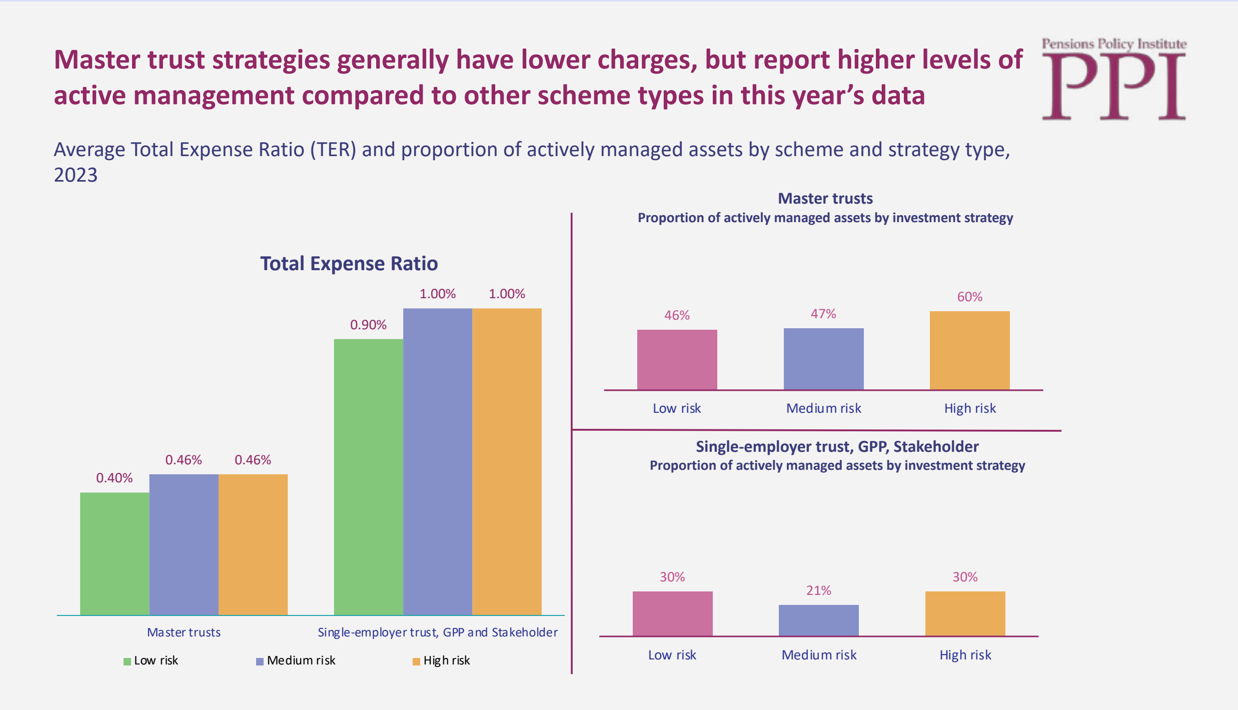


[25] Totals do not equal 100% due to rounding

Investment charges are lower in master trusts compared to other workplace DC schemes

Total Expense Ratios (TER) tend to be lower in master trust schemes than other DC workplace pensions, due to master trust schemes being specifically designed with economies of scale in mind and competing primarily on cost, as well as some other DC schemes containing older legacy scheme charges on non-default strategies. Master trusts are also more likely to use lower-cost funds and asset classes relative to single-employer trust-based schemes, as can be seen from the higher average allocation to alternative asset classes among non-master trust schemes. In previous years' data master trusts also had a lower level of active management across their funds, but this year's respondents report a higher level compared to other types of DC schemes, despite charges remaining lower (Chart 2.10).

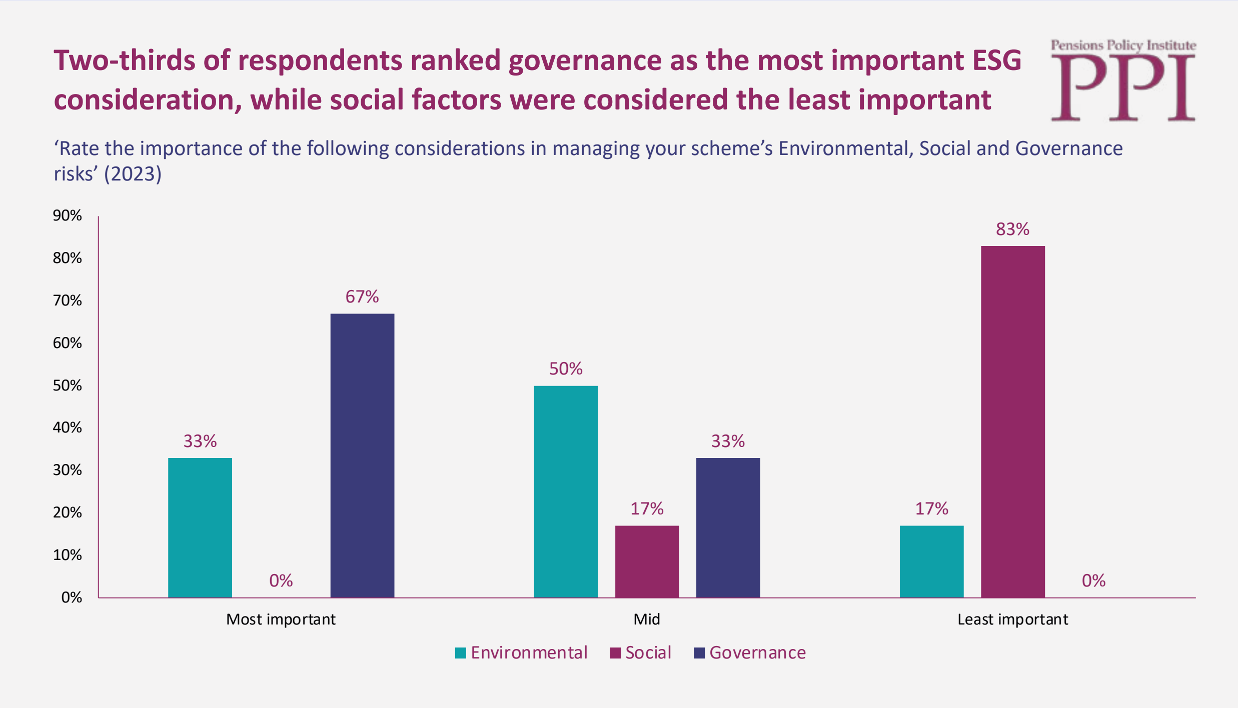
Chart 2.10



Environmental, Social and Governance (ESG) factors are recognised as important considerations in investment strategy, with the majority of schemes prioritising governance most highly

All respondents recognised the importance of ESG factors in managing their scheme's investment risks, with 92% saying that environmental and governance factors were very important (8% said they were somewhat important) and 75% saying that social factors were very important (25% said they were somewhat important). When asked to rank the three areas of ESG in order of importance, governance was considered the most important by two-thirds of respondents (Chart 2.11).

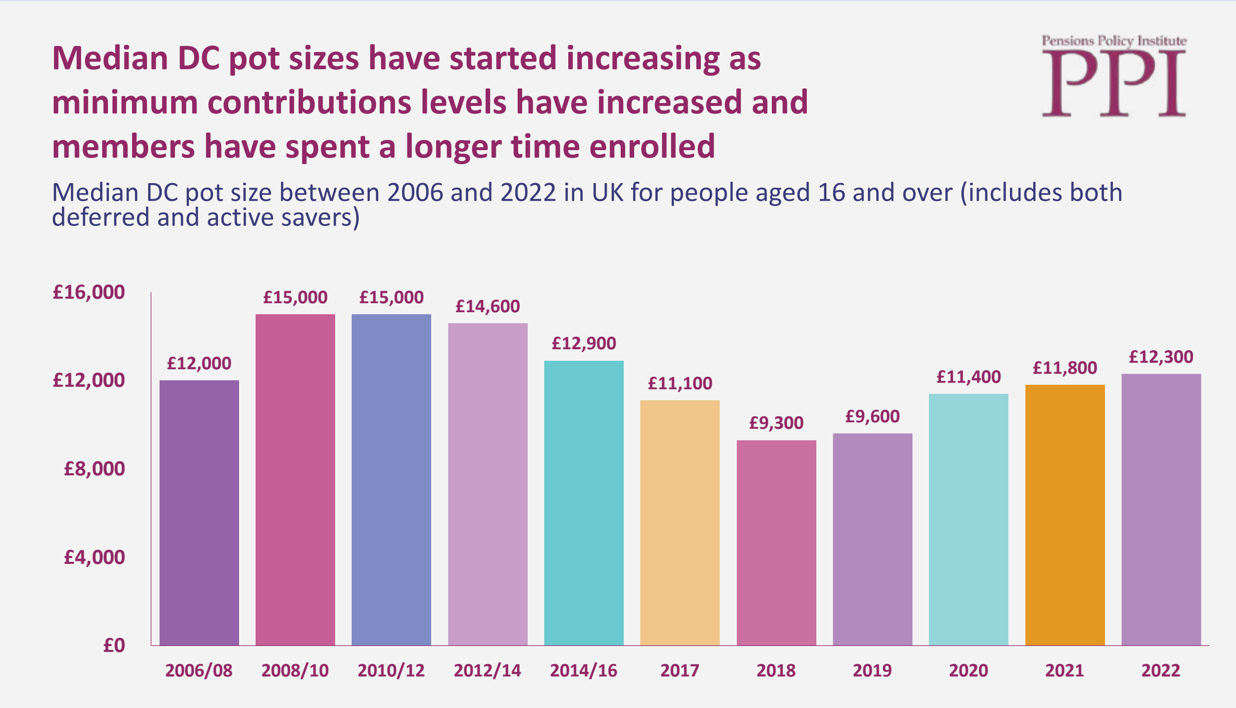
Chart 2.11



DC saving levels

The introduction of automatic enrolment initially caused the median DC pot size to decrease as millions began contributing to a pension for the first time and accrued initially small pots. Between 2010 and 2018, the median DC pot size decreased from £15,000 to £9,300. However, as a result of the increase in minimum contributions, and pots having some time to increase in value, median pot sizes began to grow from 2018 onwards, reaching £12,300 in 2022 (Chart 2.12). While growth in median pot sizes suggests a positive trend, the low contribution rates of many savers mean that they will accrue pension savings at a level that is unlikely to enable them to achieve adequate and sustainable retirement outcomes.

Chart 2.12



Although median DC pot sizes initially declined following the introduction of automatic enrolment, this resulted from an increase in the number of people saving for a pension who had not been saving previously, which skewed the baseline population for analysis. Aggregate assets across all DC savers collectively have increased dramatically since the introduction of automatic enrolment. For example, between 2015 and 2023, aggregate assets in DC grew from £324 billion to £600 billion. The strong investment returns from certain asset classes, such as equities, from 2009 to 2021, excepting the disruption to financial markets in the early stages of the pandemic in 2020, would also have been a contributory factor to the growth of DC assets.

Accessing DC savings in retirement

People can now access DC pension savings flexibly from age 55

Prior to 2015, most individuals accessing DC pensions were required to annuitise their savings (after taking an optional 25% tax-free lump sum). There were exceptions for those with savings below the trivial commutation amount (£18,000), who could take the total pot as a lump sum, and those who could provide themselves with a guaranteed lifetime income of £20,000pa from other sources (for example, DB entitlement or an annuity), who could access the remainder of their savings flexibly via drawdown. Those with pots of more than £18,000 but without a guaranteed minimum income of £20,000 per year were required to use their DC savings to secure a retirement income, either through purchasing an annuity or through the use of a capped drawdown product (which limited income withdrawals to 150% of an equivalent annuity).

In the 2014 Budget, the Government announced that, from April 2015, individuals would be able to flexibly access their DC pension savings with no requirement to secure a guaranteed income, with the objective of giving savers more freedom and choice over how they access their DC savings and provide a retirement income for themselves.

The options open to people with DC savings are limited only by the products available and the amount of savings people have. They are also governed by taxation. Those with DB pension savings cannot use flexible access unless they transfer their DB entitlement into a DC scheme first. Some DB schemes in the public sector do not allow transfers.

From age 55 (increasing to age 57 from 2028), people with DC savings may do one or a combination of the following:[26]

- Withdraw the total fund (25% tax-free up to the limit of £268,275, the remainder taxed as income).
- Leave their pension fund invested and withdraw unlimited amounts, taxed at an individual's highest marginal rate of income tax, with 25% of each withdrawal tax free. This is known as an uncrystallised funds pension lump sum (UFPLS) because the member does not "crystallise" their pension by buying a retirement product.
- Purchase an annuity. A lifetime annuity is a retirement income product that pays an income from the date of purchase until the date of death. There are many different types of annuity on offer, including level vs. escalating (adds protection against inflation), and single-life vs. joint-life (adds protection for a surviving spouse).
- Purchase an income drawdown product. An income drawdown means that the pension fund remains invested and potentially benefits from investment growth, but an individual can withdraw an income from it flexibly until the fund is depleted.

The data on access to savings in this report uses information provided by Association of British Insurers (ABI) members and therefore does not cover the full market. However, the data provides a picture of the overall trends in accessing DC savings.

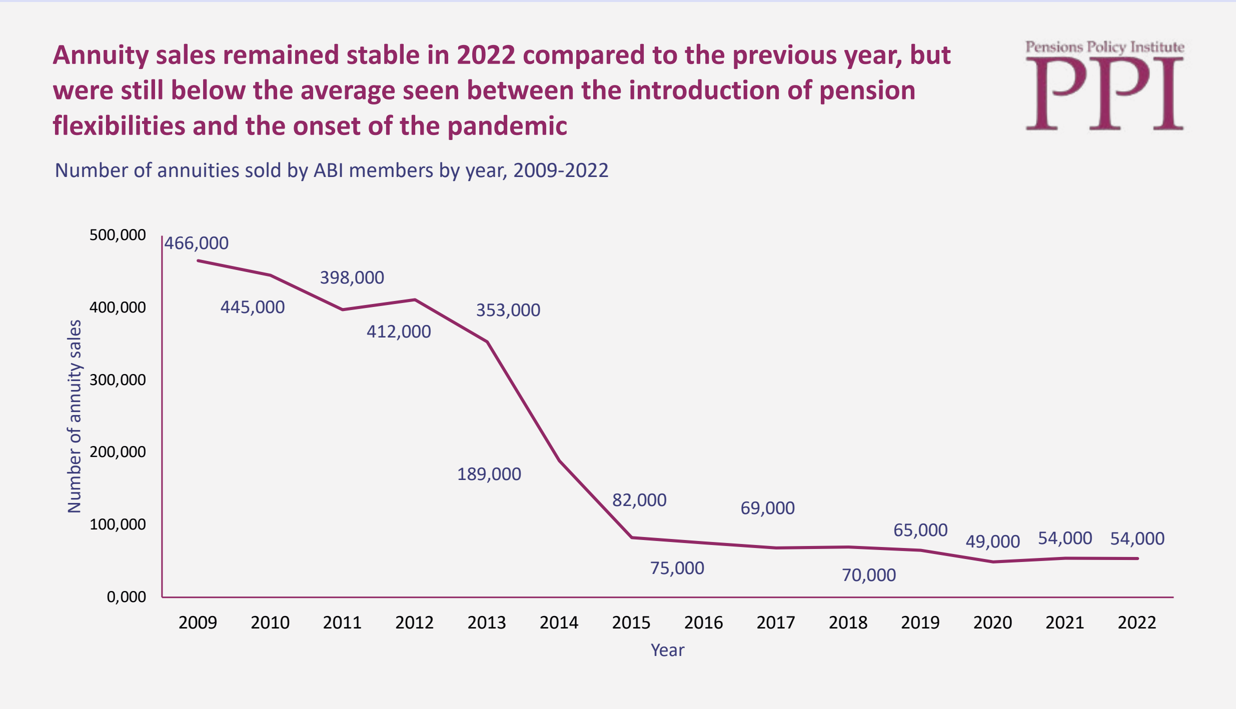
Annuities

Prior to the introduction of the new pension flexibilities in 2015, the majority of people used their DC savings to purchase an annuity as this was the main option available to many savers due to the regulations around how savings could be accessed at the time. In 2012, over 90% of DC assets accessed were used to purchase annuities, and overall sales of annuities peaked in 2009 at around 466,000.[27] Since then, they have been declining.

[26] This list is not exhaustive as the retirement income market is still evolving in light of the new policy.
[27] ABI (2015)

When pension flexibilities were introduced, annuity sales declined more rapidly, and averaged around 70,000 per year throughout 2016 to 2019. 2020 saw a further sharp decline in annuity sales, with just 49,000 sold over the course of the year, as a result of the pandemic increasing annuity prices, making annuities less attractive, and/or people delaying retirement because of the pandemic's negative effect on their savings. In 2021, annuity sales increased by 10% but remained much lower than pre-pandemic levels at 54,000. In 2022, annuity sales remained stable compared to the previous year, with 53,800 annuities purchased (Chart 2.13).

Chart 2.13

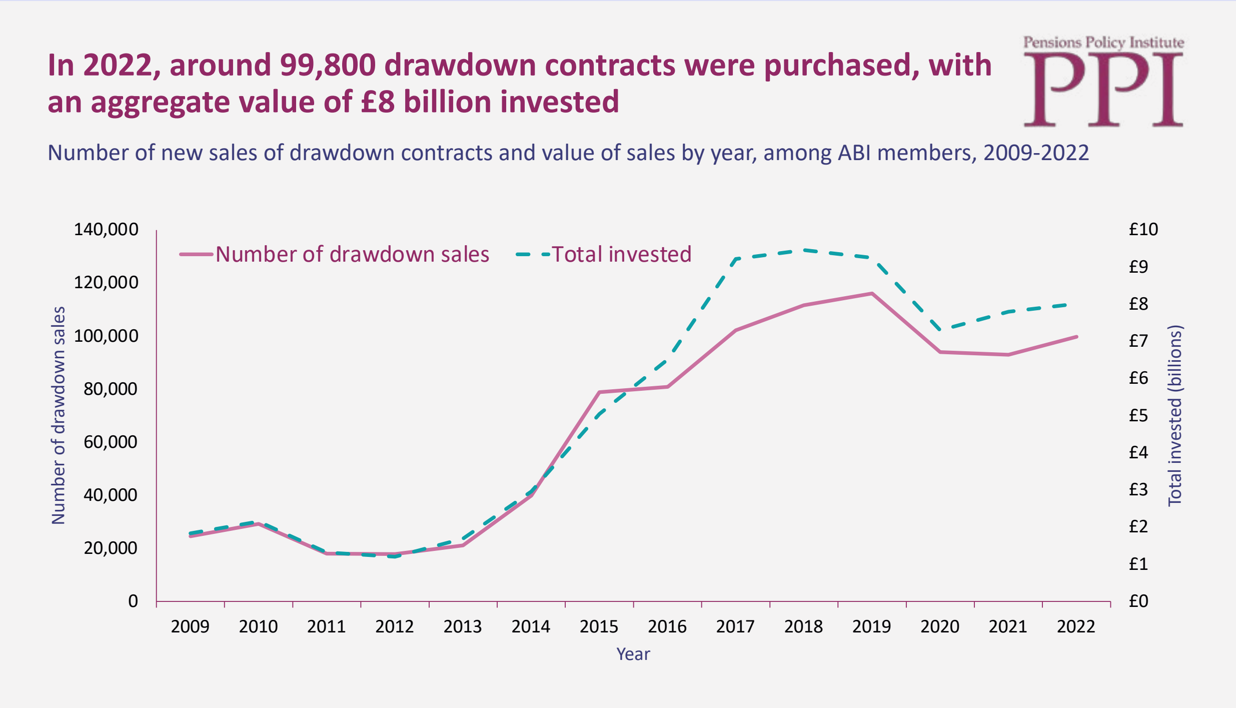


While full year data for 2022 remained stable at 2021 levels, annuity sales increased in Q1 2023 to more than 16,000 (compared to around 13,000 in Q4 2022). This was attributed to falling annuity prices, resulting from rising bond yields, as the Bank of England continued to raise the bank rate. Although this suggests that sales may increase back to pre-pandemic levels in the near future, this is hard to predict given the uncertain economic outlook.

Income drawdown

The use of income drawdown was fairly consistent between 2010 and 2014, with around 20,000 new contracts being purchased each year. In 2014, after the announcement of the pension flexibilities, the number of drawdown sales doubled to almost 40,000 new contracts. Since then, it has been steadily increasing, growing to around 116,000 new contracts being sold in 2019. In 2020, drawdown sales declined to 94,000. As with the decline in annuity sales, this was linked to the pandemic and associated volatility in investment markets. Annual drawdown sales remained relatively stable into 2021, declining slightly to 93,000, but in 2022 increased by around 7% to 99,800 (Chart 2.14).

Chart 2.14[28]



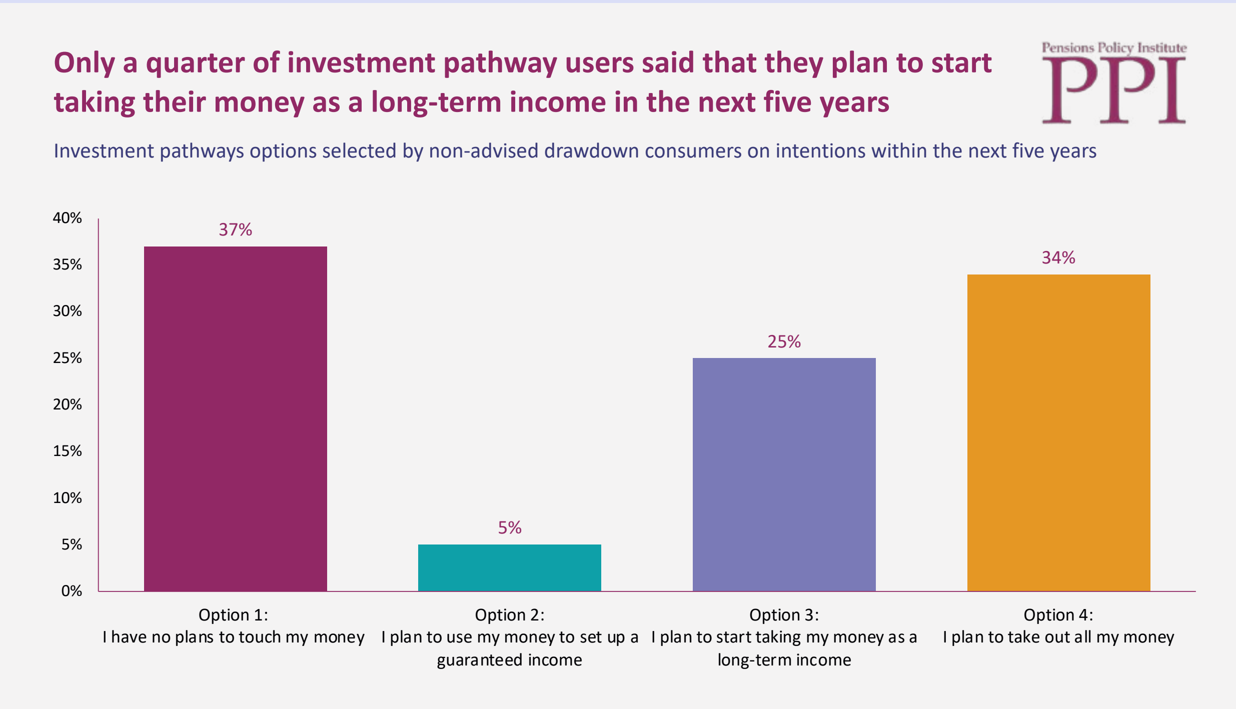
DC savers taking out annuity or drawdown contracts tend to do so using larger funds than those taking lump sum withdrawals. In 2022, the average fund used to enter drawdown was around £80,000 (significantly lower than the £114,000 average in 2021) and the average fund used to purchase an annuity was around £67,000. The average amount fully withdrawn from pots was around £15,500.

[28] ABI data

Drawdown investment pathways

As set out in Chapter One (Box 1.7), drawdown investment pathways were introduced in February 2021, and require non-advised drawdown customers to make a decision about how they intend to access their pension pot in the near future, according to which they will then be given an appropriate investment strategy to meet their aims. Take up of investment pathways among drawdown customers was at 50% in Q1 2023, with 4% instead choosing to self-select their investments, and the remaining 46% opting to stay in current investments. Among those who entered into the investment pathways, the majority selected that they plan to either leave their money invested without taking any income in the next five years or that they plan to withdraw all of their money within the next five years, while only a quarter said they intended to begin taking a flexible income from their pot within the next five years (Chart 2.15).

Chart 2.15[29]

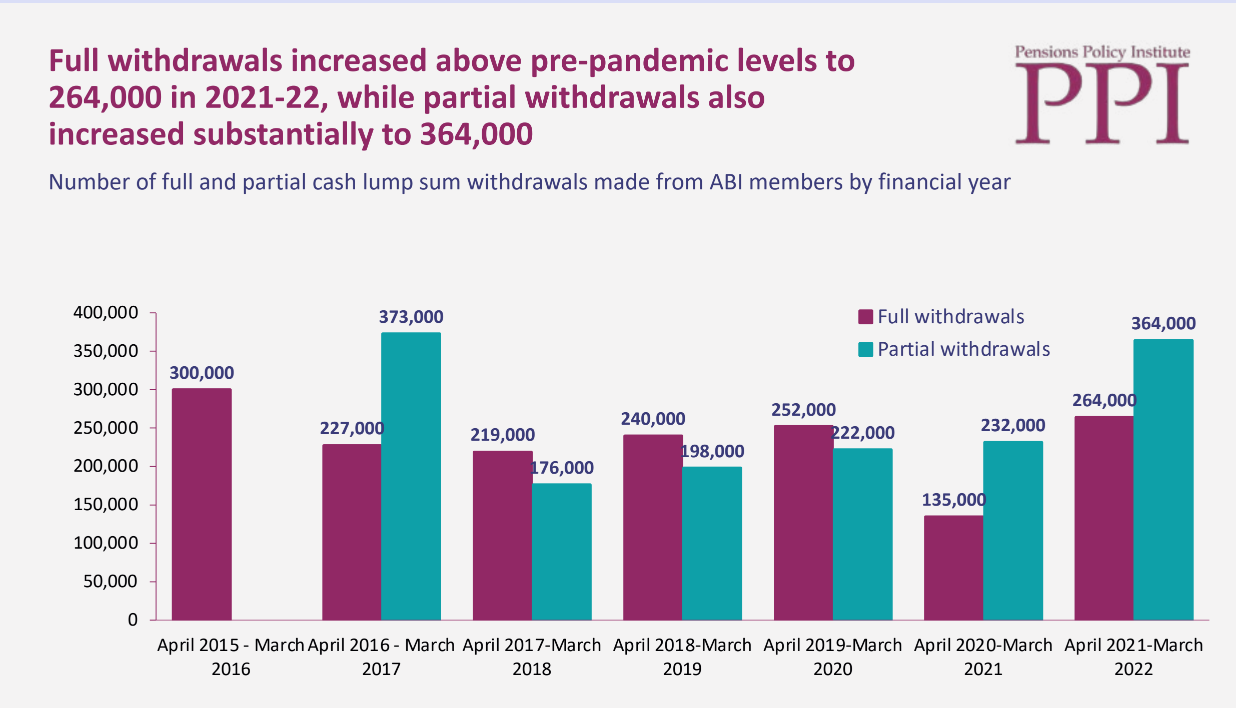


[29] ABI data

Lump sums

Since April 2015, those aged 55 and over can take partial or full cash lump sums from their DC savings, regardless of the size of their pot. Withdrawals are taxed at the individual's highest marginal rate of income tax, with 25% tax free.[30] The number of full (total pot) lump sum withdrawals was initially high at 300,000 in the financial year 2015/16, due to pent up demand, but decreased to around 252,000 in 2019/20. As with other means of accessing DC pots, full lump sum withdrawals declined in 2020/21, to 134,500, while partial withdrawals increased to 232,000. In 2021/22, full withdrawals increased to above pre-pandemic levels at 264,000, while partial withdrawals also increased substantially to 364,000. This resulted from a combination of factors, including savers holding off from accessing their pots during the uncertainty of the pandemic, as well as cost-of-living pressures and early exit from the labour market as a result of the pandemic causing people to access their pension pots in higher numbers at earlier ages. In the first half of the 2022/23 financial year (April-September), 140,000 pots were fully withdrawn through a lump sum. Full year data for 2022/23 is not yet available, but if withdrawal rates remain stable compared to the first half of the year, this would mean an increase to around 280,000 pots fully withdrawn, somewhat higher than the number of full withdrawals made in 2021/22.

Chart 2.15[31]



[30] Prior to April 2015, only those with DC pots under £15,000 (increased to £18,000 in 2015) could withdraw their entire pot as a lump sum without incurring a tax penalty.
[31] ABI data

There is still a reasonable amount of variation in the number of withdrawals taken each year, so it is unclear what the overall trend might be over the longer term. This has been further exacerbated by the unpredictability and volatility brought on by the pandemic and the ongoing cost-of-living crisis, which is likely to extend the time before we can make definitive statements about long-term trends in withdrawals.

DB transfers

While pension freedoms apply to DC rather than DB, members of DB schemes are allowed to transfer out of DB and into DC, with their entitlement converted into a Cash Equivalent Transfer Value (CETV). People may choose to transfer from DB to DC in order to be able to access their pension savings flexibly or to feel a greater sense of ownership over their pension savings. While transferring may benefit some people, there are two main risks associated with transfers from DB to DC:

- Individual risk: If people transfer out of a DB scheme when it is not in their best financial interest.
- Scheme risk: Where substantial transfers out of DB schemes could cause schemes to change or review their investment strategies. However, in some cases, transfers out could help scheme funding through the reduction of ongoing liabilities.

While DB transfers increased following the introduction of pension flexibilities, they have since begun to decline. The number of DB to DC transfers reduced from 30,600 in 2020/21 to 26,600 in 2021/22.[32] Because of the risks associated with accessing DC savings, high numbers of DB transfers raise concerns that some savers could experience poorer retirement outcomes as a result of transferring. The Financial Conduct Authority (FCA) has increased guidance for those advising on DB transfers in order to support better retirement outcomes. Anyone transferring a DB entitlement worth £30,000 or more is required to take regulated advice before doing so, and there is a diminishing number of advisers willing to help, given the liability to recourse.

Advice and guidance

Because of the complexity of decisions about how to access DC savings, people may need to access guidance and/or advice to support them in making choices to achieve positive retirement outcomes. The introduction of the new pension flexibilities in 2015 has impacted the market for advice and guidance in a variety of ways:

- Some people who previously would have bought an annuity will choose to access pension savings through other means, such as drawdown. Some of these people may use advisers at and during retirement to help manage more flexible access methods.
- DC pension scheme members are now eligible for £500 of tax-free employer-arranged advice, if their employer chooses to provide this, and may take £500 from their pension pots up to three times to pay for advice. However, very few employers actively offer this.
- Some organisations offer online "robo-advice", which is aimed at people who would benefit from advice but may not have access because they cannot afford or believe they cannot afford, regulated financial advice. Online advice uses algorithms to help answer money-based questions and should allow advice to be offered more quickly and cheaply.

[32] FCA Retirement income market data 2021/22

- The introduction of pension flexibilities was accompanied by a new, national guidance service known as "Pension Wise". Pension Wise offers free independent guidance (online, by telephone or face-to-face) to those aged 50 or above with DC savings (Box 2.3). Pension Wise has since merged with two other guidance providers, The Pensions Advisory Service and the Money Advice Service, to form a single guidance body, the Money and Pensions Service (MaPS), which provides guidance on pensions and other financial issues under the umbrella of MoneyHelper.

Box 2.3: Take up of Pension Wise guidance[33]

During the 2022/23 financial year:

- Face-to-face appointments began to return, after being suspended in 2020 in response to the pandemic. In 2022/23 there were around 6,000 face-to-face appointments. Compared to the 81,400 face-to-face appointments that took place in 2019/20 (the last year of data before the pandemic), this may seem low, but the number of appointments is growing substantially each quarter, with 27% growth between Q2 and Q3 2022, and a further 43% between Q3 and Q4 2022.
- There were around 115,400 telephone appointments, compared to 114,700 in 2021/22. Pre-pandemic, there were 50,300 telephone appointments in 2019/20. The rapid growth in telephone appointments was largely attributed to the removal of face-to-face appointments at the time. However, as face-to-face appointments have returned, though still well below pre-pandemic levels, telephone appointments have continued to increase.
- There is a significant gap between the number of appointments arranged and appointments attended, both for face-to-face and telephone. In 2022/23, around 78% of face-to-face appointments and 71% of telephone appointments arranged were attended.
- In addition to appointments, there were around 72,600 self-serve journeys completed via the Pension Wise website, compared to 59,100 in 2021/22.
- In Q4 2022 Pension Wise had a 95% customer satisfaction rate among those who had telephone appointments, and a 75% satisfaction rate among those who completed a self-serve journey. 95% of telephone customers and 82% of self-serve customers were likely to recommend the service.

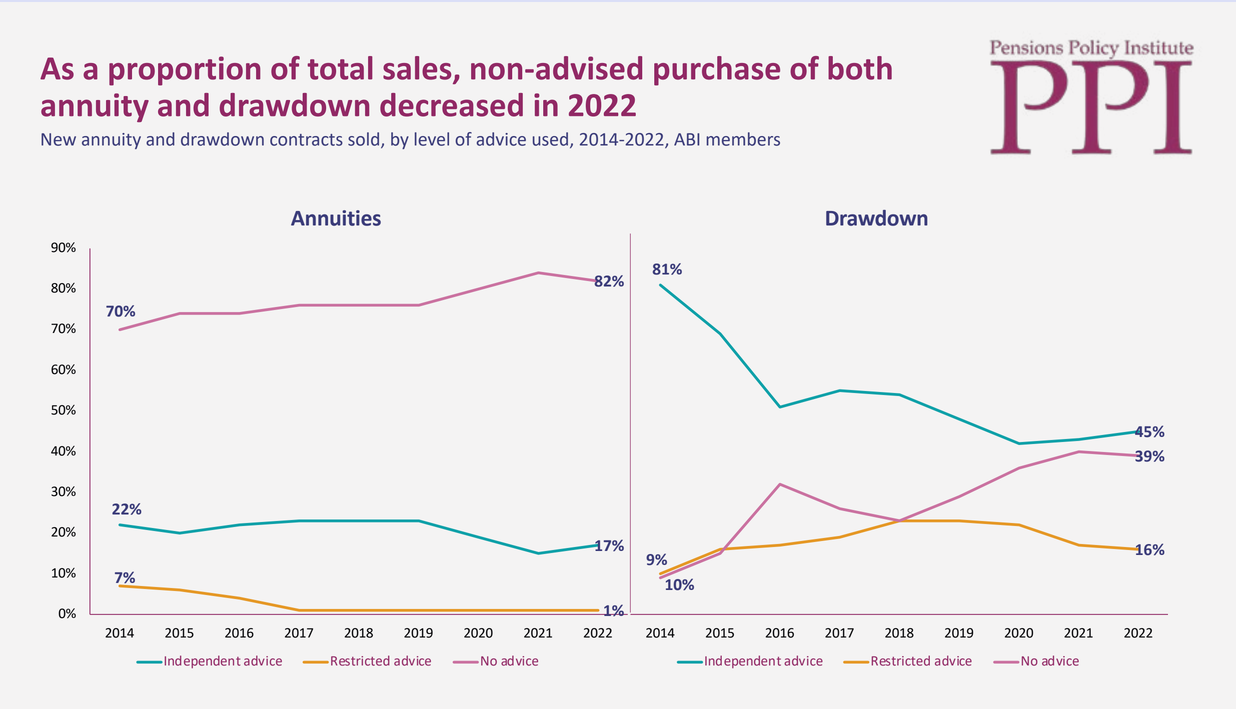
New regulations came into force from 1st June 2022 that require pension providers to give members accessing their pension pots a 'stronger nudge' towards Pension Wise's guidance services, including offering to book a Pension Wise appointment on the member's behalf.[34] As this is still a relatively new policy, it remains to be seen how substantial the impact will be on the uptake of Pension Wise appointments, especially as behaviour remains unstable as a result of the pandemic and ongoing cost-of-living crisis.

[33] https://maps.org.uk/moneyhelper-pension-take-up-dashboard/ These figures differ from those reported in previous editions of The DC Future Book as previously data was only publicly available on the number of appointments arranged, which is higher than the number actually attended. This year's edition uses attendance data which is available alongside arranged data on the MaPS website.
[34] DWP (2022a)

After several years in decline, in 2022 more people used advice when purchasing an annuity or drawdown product

Following the introduction of pension flexibilities in 2014, the use of regulated advice declined among those purchasing a drawdown product, but remained relatively stable at a low level for those purchasing an annuity. Since 2018, non-advised purchase has grown among both annuity and drawdown customers. However, 2022 saw a small increase in the proportion taking advice, from 60% to 61% for drawdown and from 16% to 18% for annuities (Chart 2.16).

Chart 2.16[35]



Purchasing retirement income products without the use of advice or guidance increases the risk that individuals will make sub-optimal decisions for meeting their income needs in retirement. An increase in the proportion of annuity and drawdown customers taking advice has the potential to improve retirement outcomes. However, as this is the first year of increase, following several years of decline, it remains to be seen how this trend will develop over the longer term.

[35] ABI data

Conclusions

Automatic enrolment has continued to bring more savers into pensions
By June 2023, 10.9 million employees were automatically enrolled, with more than a million now having been automatically re-enrolled. The number of employees found ineligible for automatic enrolment has also continued to grow, to 10.9 million by June 2023. Further reforms may be needed if the goal is to bring more people into pension saving.

Contribution rates remain around the minimum, but average DC pot sizes continue to grow
Both employee and employer contribution rates have remained stable in line with the minimum mandated amount. This rate of saving is unlikely to deliver adequate and sustainable later life outcomes, but increases to minimum rates must consider the potential for increased opt-outs as a result.
While average DC pot sizes declined in the early years of automatic enrolment, they started to increase between 2018 and 2019. In 2022, the average DC pot size reached £12,300.

Trends in access to DC savings have not yet returned to pre-pandemic levels
Annuity sales remained stable in 2022 compared to 2021, although data for Q1 2023 suggests prospective future growth as a result of more attractive annuity pricing. Drawdown sales increased by around 7% between 2021 and 2022, but remain below pre-pandemic levels.
Drawdown investment pathways have begun to embed within the pensions landscape, with 50% of drawdown customers entering the pathways. Only a quarter of those entering the pathways say they plan to start taking a flexible income from their pot within the next five years, with most saying they either have no plans to touch their money (37%) or plan to fully withdraw their pot (34%) in the next five years.

Chapter Three:

How might the DC landscape evolve in the future?

Chapter three: How might the DC landscape evolve in the future?

This chapter uses PPI modelling to explore how the Defined Contribution (DC) landscape might evolve in the future both for individuals and on an aggregate level.

The evolution of the DC market depends on many factors

Previous chapters have set out the current state of the DC market and outlined the factors which are likely to lead to changes in the future, including:

- Automatic enrolment
- The shift from Defined Benefit (DB) to DC pension provision in the private sector
- The introduction and use of pension flexibilities
- Changes to the way that advice and guidance are utilised and delivered

The way that the DC market evolves in the future will also depend on how individuals respond to policies such as automatic enrolment and pension flexibilities, as well as external factors such as employer behaviour and the performance of the overall economy.

Box 3.1: Explanation of the modelling

This chapter uses the PPI suite of models and data from the Office for National Statistics' (ONS) Wealth and Assets Survey (Round 7), to explore how DC assets may change and grow in the future under the assumption that current trends continue. The chapter also sets out the potential distribution of DC assets, under a range of possible future economic scenarios (based on historical data).

The future value of DC assets depends on many variables:

- Employee behaviour – participation and contribution levels
- Employer behaviour – contribution levels, scheme choice, remuneration decisions
- Industry behaviour – charges, investment strategies, default offerings, new scheme development (e.g., Collective Defined Contribution (CDC) schemes)
- Economic, demographic and financial market effects – market performance, interest rates, inflation, and the age and size of the working population.
- Policy changes – taxation, changes to minimum pension age, introduction of new scheme types, or a policy of auto-escalation and/or opting down of contributions under automatic enrolment.

The model outputs should be viewed as an illustration of a range of potential scenarios arising from current trends, and not a prediction of the future.

The following analysis explores how a continuation of current trends in DC saving could affect the membership numbers and the aggregate value of DC scheme assets in the future.

How might scheme membership develop in the future?

Under automatic enrolment, employers could choose to use their existing workplace pension provision as long as it qualified under the automatic enrolment regulations. Those without existing provision, or who wished to change their offering for new or existing members, had the choice to set up and run a DB, DC or Hybrid/risk-sharing scheme themselves, or to offer membership in a DC scheme run by a third party. Some employers offer a combination of these.

Box 3.2: Assumptions

The following analysis is based on the assumptions that:

- All eligible workers are automatically enrolled and 15% opt out or cease contributing, after the opt-out period has expired, before accruing meaningful amounts of assets.
- Of newly enrolled workers:
  - » 80% are enrolled into a master trust scheme
  - » 20% are enrolled into a non-master trust, automatic enrolment DC scheme[36]

The displacement of members, leaving one type of scheme and entering another (as a result of movements in and out of the labour market or between jobs) results in roughly the same proportions of the workforce in different types of schemes. New members of DC schemes, who may be leaving DB schemes or be newly automatically enrolled, are split in the proportions outlined above between automatic enrolment and workplace DC schemes which pre-dated automatic enrolment.

By 2043, there could be 10.6 million people actively saving in master trust schemes, and 14.9 million active DC savers overall

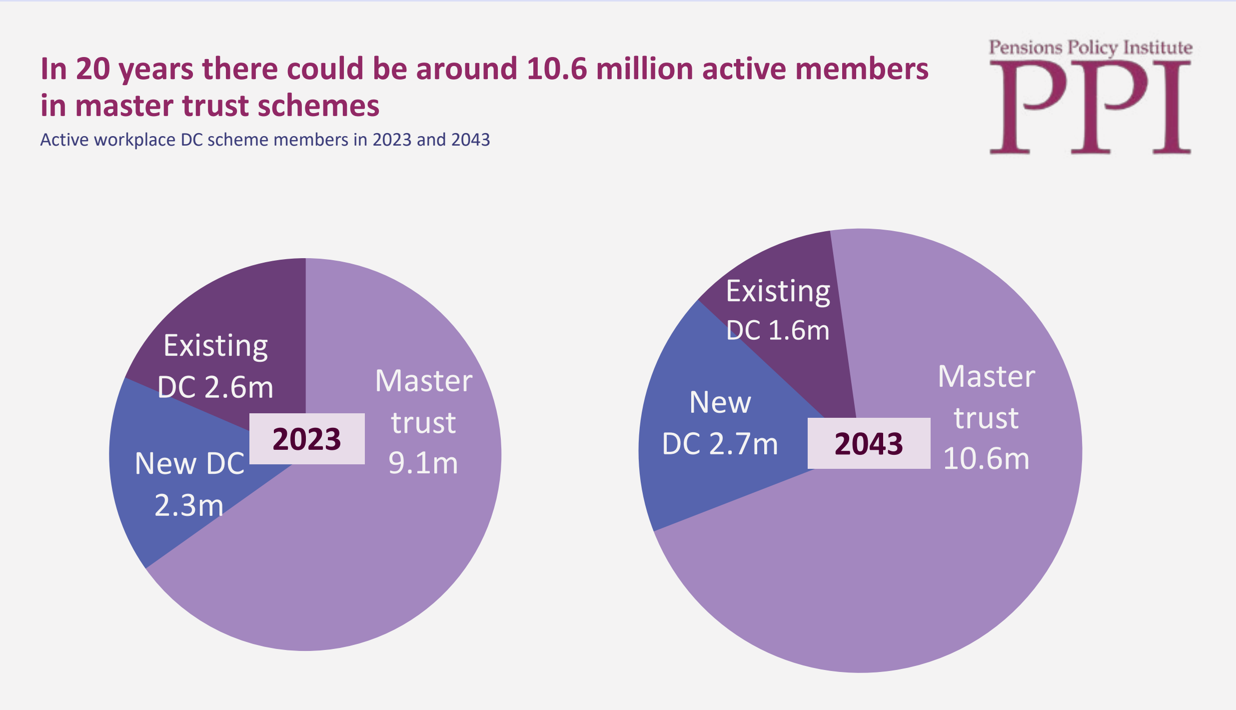
In 2023, there are around 14 million active members in DC workplace pension schemes. Around 9.1 million of these are in master trusts, around 2.6 million are in DC schemes which existed prior to automatic enrolment, and around 2.3 million are in new DC schemes created subsequent to automatic enrolment (but which are not master trusts).[37]

Assuming current trends in scheme allocation continue, by 2043 there could be around 14.9 million active members in DC workplace pension schemes, with around:

- 10.6 million in master trust schemes,
- 1.6 million in DC schemes which pre-dated automatic enrolment, and
- 2.7 million active members in other automatic enrolment DC schemes (Chart 3.1).[38]

[36] Based on information about scheme allocation from The Pensions Regulator – does not account for opt-ins or ineligible workers who are automatically enrolled.
[37] PPI Aggregate Model
[38] PPI Aggregate Model

Chart 3.1[39]



Box 3.3: Assumptions

The following analysis is based on the assumptions that:

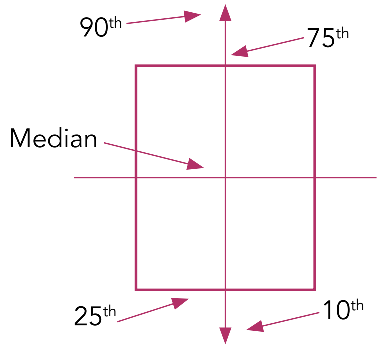
- Those currently saving into a workplace DC pension (trust- or contract-based) continue saving at their current level and continue contributing, with their employer, in the same proportions.
- Those who are not currently saving, but are eligible, are automatically enrolled and do not opt out.[40]
- Before charges, investments yield a nominal average annual investment return of 6%.[41]
- Earnings increase by 3.5% on average per year over the course of the projection.[42]
- Annual Management Charges (AMCs) range between 0.5% and 0.75% depending on scheme type. These are the member-borne charges, including administration and investment costs.

Economic assumptions are based on Office for Budget Responsibility (OBR) projections appropriate to the projection period.[43]

[39] PPI Aggregate Model
[40] It is expected that a proportion of people will opt out of automatic enrolment; reasons for doing so are specific to each person and difficult to predict. While the aggregate modelling approach allows us to make a blanket assumption across the population, the modelling presented in this section is based on analysis of individuals making it difficult to accurately predict who would and who would not opt out. The modelling instead presents the potential savings under the current automatic enrolment system.
[41] A blend of OBR returns based on an asset mix to represent typical pension portfolios. The long-term economic assumptions are based on the OBR Fiscal Sustainability Report (July 2020)
[42] Based on OBR projections from he EFO (2023)
[43] See the appendix for further detail on assumptions

Box 3.4: Box plots

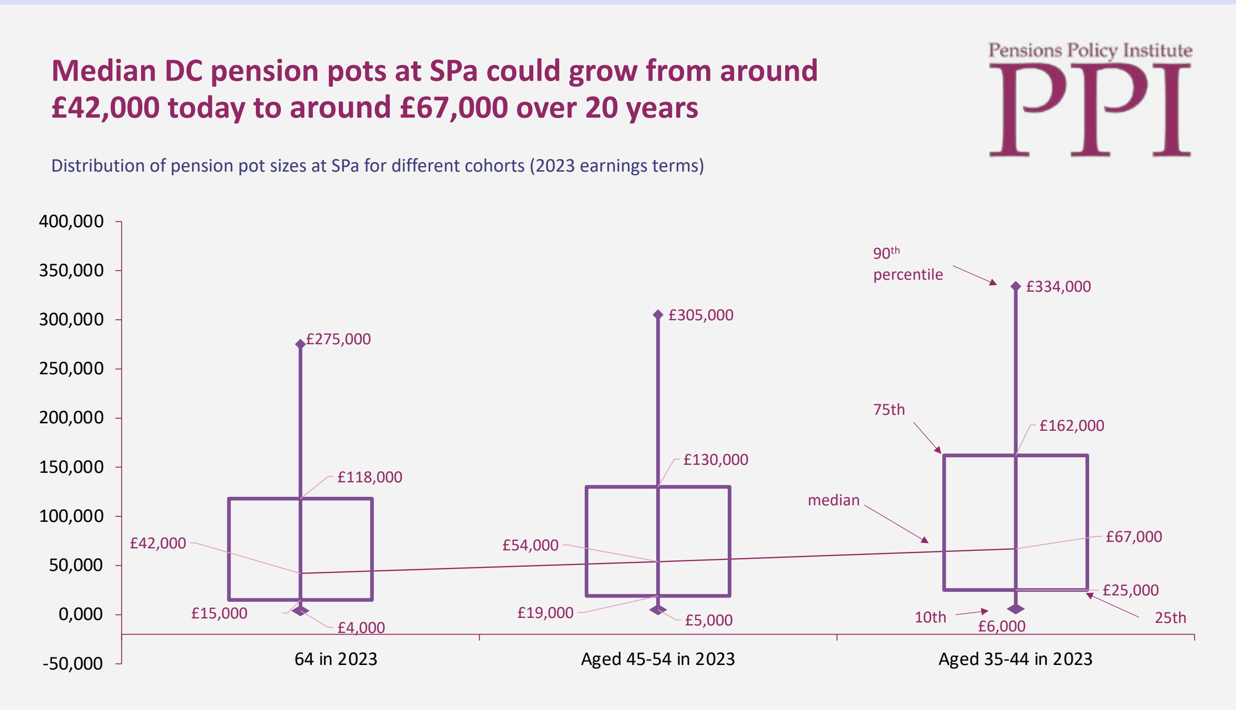
Box plots allow graphic representation of a distribution of outcomes. The rectangle represents the 25th to 75th percentiles of the distribution, while the ends of the vertical line represent the 10th and 90th percentiles. The horizontal line through the middle of the box represents the median.



Median DC pension pots at State Pension age (SPa) could grow from around £42,000 to around £67,000 over 20 years

Assuming that those currently contributing to a pension fund with their employer continue to do so, the median DC pension pot size at SPa could grow over the next 20 years from around £42,000 (for those aged 55 to 64 in 2023) to around £67,000 (for those aged 35 to 44 in 2023), all in 2023 earnings terms (Chart 3.2).

Chart 3.2[44]



[44] PPI Aggregate Model

The low average levels of DC pension savings that people will accrue over the next few decades means that many will be mainly dependent in retirement on income from the State Pension, State benefits and any DB pension, or non-pension savings, they have.

How might the aggregate value of private sector DC assets grow in the future?

The following section explores how the aggregate value of DC assets might grow based on certain assumptions about employee and employer behaviour, and under a range of potential future economic performance scenarios.

Box 3.5: Assumptions

The following analysis is based on the assumptions that:

- All eligible employees are automatically enrolled and existing savers remain saving.
- 15% of automatically enrolled savers opt out or cease contributing, before accruing any meaningful assets.
- Employee/employer contributions vary by scheme type:
  - Those in master trusts and other automatic enrolment DC schemes make contributions with their employers based on band earnings.
  - Existing savers continue contributing at the same rates, on total earnings (if applicable).
- Investment scenarios are a product of the PPI's Economic Scenario Generator (ESG), which uses data from Bloomberg. Long-term median rates are taken from the OBR's Fiscal Sustainability Report.
- Median nominal investment return is dependent on pension scheme and varies between 5.5% and 6%.[45]
- Annual Management Charges (AMCs) vary by scheme.

Economic assumptions are based on long-term OBR projections appropriate to the projection period.

By 2043, aggregate assets in DC schemes could grow to around £1.2 trillion

Assuming that current trends continue, the aggregate value of private sector workplace DC assets could grow from around £600 billion in 2023 to around £1.2 trillion in 2043. The aggregate value of assets is sensitive to economic performance. If the market performs very poorly, DC assets could stagnate, reaching around £849 billion by 2043. In a very positive market performance scenario, DC assets could grow to around £1.6 trillion by 2043 (Chart 3.3).

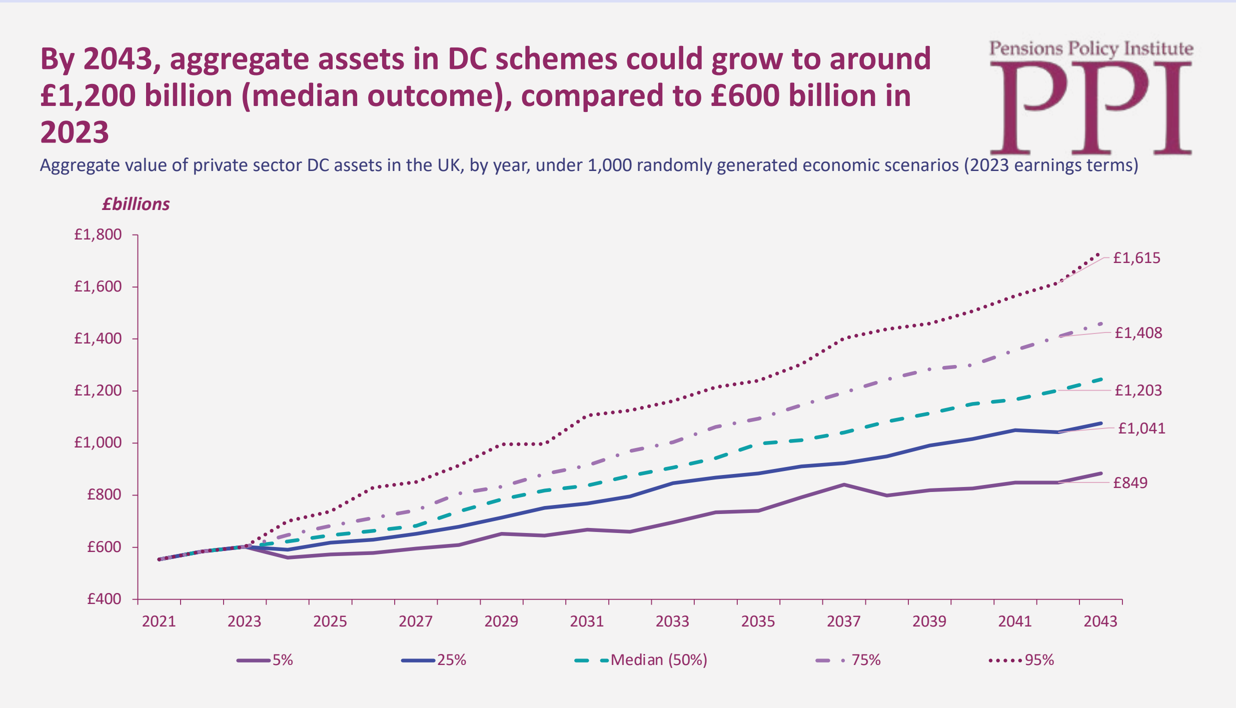
[45] A blend of Office for Budget Responsibility (OBR) returns based on an asset mix to represent typical pension portfolios. The long-term economic assumptions are based on the OBR Fiscal Sustainability Report (July 2020).

Box 3.6: Percentiles

The following charts illustrate how a range of economic scenarios could affect the value of DC assets. The values are shown in terms of the likelihood that they will occur:

- The 5% line represents the very poor performance end; in the modelling only 5% of outcomes were worse than presented by this line.
- The 95% line represents the very good performance end; in the modelling only 5% of outcomes were better than presented by this line.
- The 25% and 75% points represent a 25% probability of relatively poor or relatively good performance respectively.
- 50% (median) is the central projected outcome, based on past performance.

Chart 3.3[46]



Employee and employer behaviour, and Government policy will all affect the aggregate value of DC pension schemes in the future

The aggregate value of private sector workplace DC schemes will vary, not just as a result of economic fluctuations, but also as a result of employee and employer behaviour, and Government policy. There are a wide range of possible changes in market conditions, pensions policy and saving behaviour that could materialise in future, and each would have a different effect on the aggregate value of DC assets and the value of a member's pot at retirement.

[46] PPI Aggregate Model: refer to the Technical Appendix for more details on the methodology

Conclusions

- In 20 years, there could be 10.6 million active members in master trust schemes, and 14.9 million active DC savers overall.
- Median DC pension pots at SPa could grow from around £42,000 today to around £67,000 over the next 20 years.
- By 2043, aggregate assets in DC schemes could grow to around £1.2 trillion, from the 2023 value of £600 billion. Investment performance, employee and employer behaviour, the economic and demographic backdrop, and Government policy will all affect the aggregate value of DC pension schemes in the future.

Chapter Four:

How will decumulation decisions differ for future DC savers?

Chapter Four: How will decumulation decisions differ for future DC savers?

This chapter explores the changes and consequent risks future generations of Defined Contribution (DC) savers will face at and during retirement, and the additional support they are likely to need in order to achieve adequate and sustainable retirement outcomes.

Demographic, economic and policy changes mean that future generations of retirees will face very different retirement prospects than those retiring today.
Compared to current retirees, future retirees:

- will be more dependent on DC, with few likely to have any Defined Benefit (DB) entitlement;
- are at risk of having lower levels of income or savings to draw upon, although they are likely to accrue higher levels of DC savings than previous generations;
- are likely to need more money in order to achieve similar standards of living in retirement; and
- will need more substantial support to prepare for retirement, make challenging decisions and mitigate the increased risks that they are likely to face.

Innovation in products that provide both security and flexibility could better support young savers in their future retirement

With young savers likely to be wholly dependent on DC savings to supplement their income from the State Pension, security and sustainability will become even more important in decisions about how to access these savings. Most retirement products available today involve a trade-off between security and flexibility. Annuities provide security, with a guaranteed income for life, but lack flexibility to adjust income up or down to meet variations in needs. Drawdown provides flexibility to adjust income as needed, and enables continued investment growth, but lacks the security of a guaranteed income, with the risk that the pot could be exhausted if withdrawn too rapidly.

Hybrid approaches to accessing DC pension savings, which combine elements of both flexibility and security, could help future generations of DC savers in retirement, who are unlikely to gain access to security through DB entitlement. It is already possible for DC savers to implement an individualised hybrid strategy by using some portion of their savings to purchase an annuity for the security of a guaranteed income, while moving the remainder into a drawdown account for flexible income needs. Given low levels of engagement and understanding of pensions products, it is unclear how many future DC savers will be aware of the benefits of and feel capable to effectively enact this type of hybrid strategy. They could benefit from the introduction of more hybrid products that provide elements of both security and flexibility within a single wrapper. In terms of responses from policymakers, administration, tax and regulatory changes might be necessary for the introduction of hybrid short-/long-term products and accessible pension savings. These could help people to develop savings strategies that more closely reflect a multi-stage life.

Future retirees will be more dependent on DC compared to current retirees

The introduction of automatic enrolment has significantly increased pension participation among young people. Workplace pension participation among people aged between 22 and 29 increased from 24% in 2012 to 85% in 2021, the largest increase among any age group.[47] Increased pension participation at younger ages will have a positive impact on retirement outcomes, particularly as contributions made in the early stages of working life have longer to grow, through accruing investment returns, and are therefore worth more at retirement than contributions made later in working life. However, increased participation rates alone are not enough to deliver adequate retirement outcomes for future generations; contribution levels and investment returns will also significantly affect future incomes.

Due to the decline in DB provision in the private sector, most future retirees will be wholly dependent on DC savings to supplement income from the State Pension

There are currently around 14 million active members in DC workplace pension schemes, compared to 981,000 active members in private sector DB schemes. Only 10% of remaining private sector DB schemes remain open to new members.[48] As increasing numbers of DB schemes close to new members, young savers are less and less likely to accrue any DB entitlement, unless they work within the public sector. As a result, future generations of retirees will be more heavily dependent on DC savings to provide income in retirement alongside entitlement to the State Pension.

The transition from DB to DC has increased the risks borne by individual savers, where much of this risk used to be borne by the scheme and sponsoring employer. In a DB scheme, investment, longevity and almost all inflation risk is borne by the sponsoring employer, with insolvency risk largely mitigated by the Pension Protection Fund (PPF). In contrast, in DC, the individual member bears the investment, inflation and longevity risk themselves. This increased level of risk is further exacerbated by the increasingly complex decisions that DC savers must now make in a post-pension flexibilities landscape. While those with DB entitlement will receive a guaranteed income for life, paid directly from their scheme or a buyout provider in cases where their scheme has been bought out by an insurer, people with DC savings must make challenging choices at and during retirement about how best to convert their pot(s) into an income that is both adequate and sustainable. For young savers who are likely to retire without any guaranteed income from DB, the decisions they make about how to access and utilise their DC savings will be even more crucial.

Future retirees who save consistently throughout their working life will accrue higher levels of DC savings than most current retirees, but minimum contribution rates are unlikely to deliver adequate retirement outcomes

Someone currently aged 22, automatically enrolled at the minimum contribution rate of 8% and having median earnings over the course of their working life, could expect to accrue around £180,400 in DC savings by the time they reach State Pension age (SPa), which for them will be age 68. Assuming they take the full allowed 25% tax free lump sum, their pot size is reduced to £135,300 before they even begin withdrawing a regular income from the pot.

[47] DWP (2022b)
[48] PPF (2022)

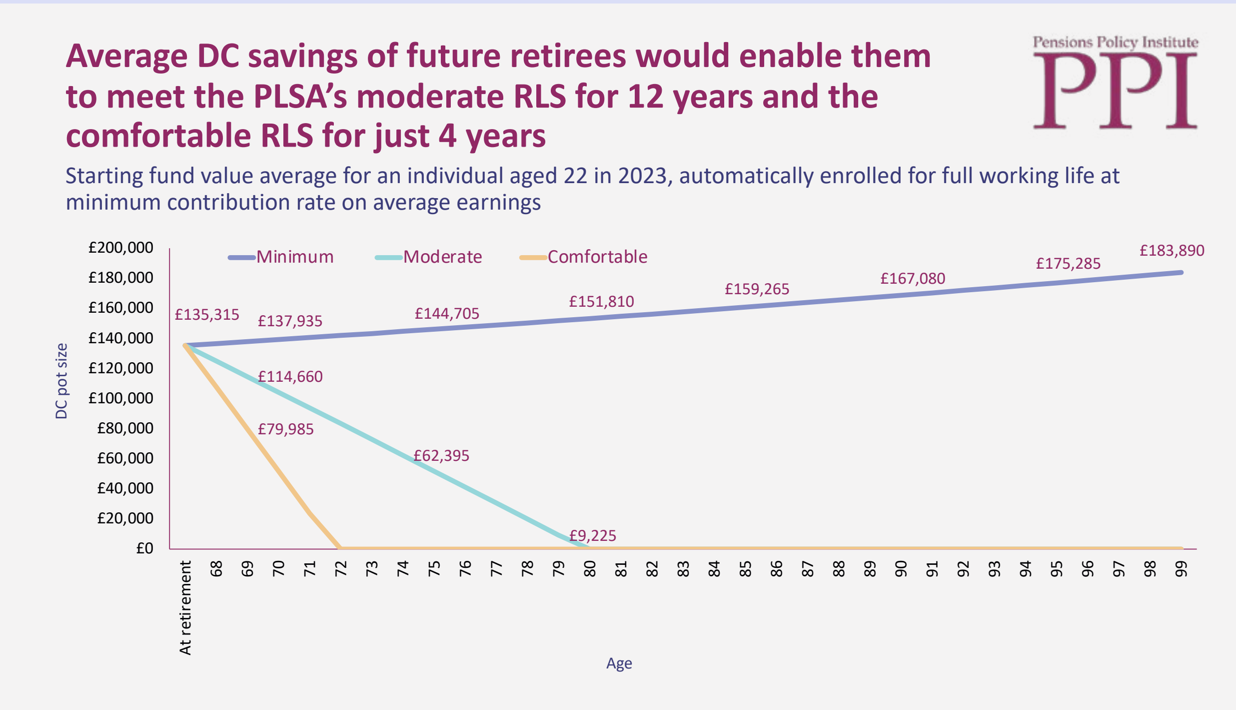
Entitlement to the full new State Pension (nSP) would enable a future retiree to meet the Pensions and Lifetime Savings Association's (PLSA) minimum Retirement Living Standard (RLS), assuming they are living outside of London, where the cost-of-living is significantly higher (Table 4.1). In order to meet the moderate RLS, which would meet basic needs and allow for some luxuries, a single retiree would need to take an additional £244 per week from their DC pension pot, and £513 per week to meet the comfortable RLS.

Table 4.1: PLSA RLS[49]

	Single	Couple
Minimum	£12,800	£19,900
Moderate	£23,300	£34,000
Comfortable	£37,300	£54,500

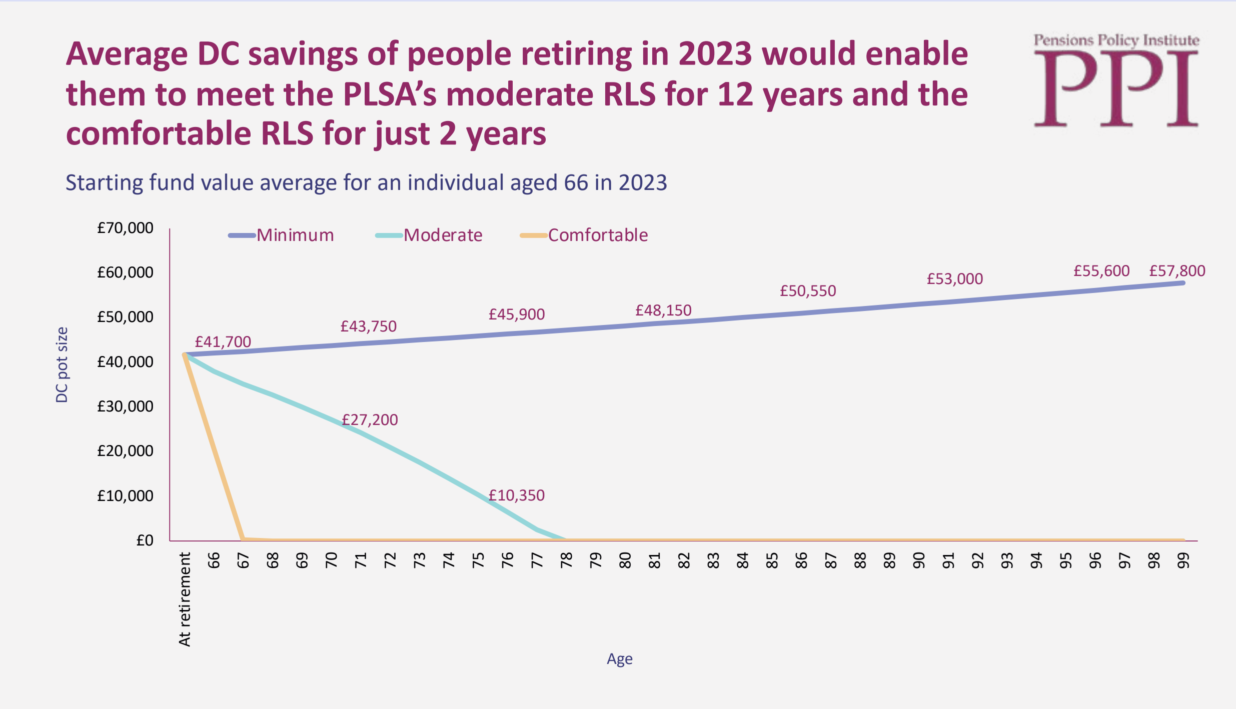
With current contribution rates stagnated around the minimum required rate, future retirees will struggle to achieve retirement incomes that are both adequate and sustainable. The additional income needed in order to meet the moderate RLS would see an average future retiree's DC pot depleted by age 80, while meeting the comfortable RLS would deplete savings by age 72 (Chart 4.1).

Chart 4.1[50]



[49] https://www.retirementlivingstandards.org.uk/ - For those living outside London
[50] PPI Individual Model

Chart 4.2[51]



While the period over which DC savings can sustain RLS living standards appears to be broadly similar for future retirees as those retiring today, with both able to achieve the moderate RLS for 12 years and the comfortable RLS for four and two years respectively (Charts 4.1 and 4.2), early exhaustion of DC pension savings will have a much more detrimental impact on living standards of future generations. Someone retiring in 2023 with entitlement to the full nSP and average amounts of DB, with no additional DC savings or a pot that has already been exhausted, would easily achieve the minimum RLS, with a weekly income around £80 below what is needed to sustain the moderate RLS. Someone currently aged 22, who is likely to retire with no DB entitlement, would still be able to achieve the minimum RLS after exhausting their DC pot, provided they have entitlement to the full nSP. However, the gap between their guaranteed income from the State Pension and the moderate RLS would be significantly higher at £244 per week, leading to significantly poorer standards of living for future retirees.[52] With most future retirees likely to retire with no DB entitlement, they will require significantly higher levels of DC savings in order to achieve retirement incomes that are both adequate and sustainable.

Some future retirees are at risk of experiencing significantly poorer retirement outcomes

This chapter considers projections of average outcomes for future retirees. Some future retirees are likely to experience significantly poorer outcomes than those projected. The hypothetical individual modelled from age 22 in 2023 has average levels of earnings and contributes consistently to a DC pension for the entirety of their working life. However, many will earn below average levels of income or have gaps in contributions over the course of their working lives. Certain characteristics are correlated with experiencing poorer later-life outcomes as a result of labour market inequalities and variable working lifecourses. Underpensioned

[51] PPI Individual Model
[52] PPI Individual Model

groups who are at greater risk of experiencing poorer later life outcomes include: women, people from some minority ethnic backgrounds, people with disabilities, carers and people with atypical working patterns, such as multiple jobholders and the self-employed. Overlap between these groups, for example women being more likely to have atypical working patterns due to divisions of domestic labour, further compound the increased level of risk faced by underpensioned groups.

Future retirees are likely to need more money in order to achieve similar retirement outcomes to current retirees

As well as changes in pension provision, demographic and economic changes will make it more challenging for younger savers to achieve adequate and sustainable retirement outcomes. Retirement incomes will need to stretch further in order to account for increased longevity, while decreases in homeownership are likely to increase housing costs in retirement. This means that future retirees will need more money to achieve similar retirement living standards to today's retirees.

Increases in longevity mean that future retirees pension savings will have to stretch further

Average life expectancy for current 22-year-olds is higher than life expectancy for current retirees. Life expectancy for someone currently at SPa (age 66) is 20 years, with male life expectancy at retirement being 19 years and female life expectancy 21 years. Life expectancy at age 66 for someone currently aged 22 is 24 years, 23 years for male and 25 years for female. This means that, on average and assuming that they both retire at their SPa (66 and 68 respectively), someone who is currently at the start of their retirement saving journey will have to make their pension savings last for an additional two years in retirement, compared to someone who is retiring today. This assumes that they are able to continue working up until their SPa. If someone currently aged 22 retired at the current SPa of 66, they would have to make their pension savings last for an additional four years, compared to someone retiring today, as well as having to draw more heavily on their private pension savings between ages 66 and 68 to mitigate their longer wait for State Pension payments to begin.

Decisions about how to make sure savings provide for the entirety of retirement require more complex consideration than just average life expectancies, as inherent to an average is the fact that many will live longer than this estimate, with some living significantly longer. 13% of men and 20% of women currently aged 66 are expected to survive until age 95.[53] Differences in life expectancies are impacted by a myriad of interconnected factors, including socio-economic characteristics, region and lifestyle behaviours. Considering the inherent uncertainty around longevity, future retirees with purely DC savings and no DB entitlement, may value security more highly in considerations of how to access their savings.

Increases in life expectancy are not necessarily directly correlated with increases in healthy life expectancy (the age to which someone can expect to live without disability or long-term illness impacting their quality of life). Based on trends up to 2017-19, the latest data which excludes the effects of the pandemic, it would take 192 years to achieve a 5-year improvement in male healthy life expectancy. For women, healthy life expectancy has been on a downward trend since 2009-11, which means that overall healthy life expectancy (for men and women combined) is falling.[54] As with life expectancy more broadly, healthy life expectancy can be impacted by socio-economic factors, regional differences and lifestyle behaviours. Healthy life expectancy

[53] IFS (2023)
[54] The Health Foundation (2022)

impacts both the ability to extend working lives and the needs that income will have to cover in retirement.

The physical effects of climate change are also likely to become a relevant factor impacting both life expectancy and healthy life expectancy. The effects of climate change could also impact the availability of suitable housing and the goods and services that are accessible to future retirees.

As the SPa increases, some future retirees may choose to work for longer, while others will be more dependent on private pension savings to bridge the gap between retirement and SPa

SPa will be higher for future retirees, increasing to age 67 between 2026 and 2028, and again to age 68 between 2044 and 2046. This means that a current 22-year-old will have an SPa of 68, reaching it in 2069. This assumes that no further SPa increases are legislated for in the meantime. While there are currently no plans to increase SPa beyond 68, suggestions that the planned increase to 68 should be accelerated presents the possibility that further increases could be implemented. The second State Pension Age Review, published in March 2023, recommended that SPa should increase from age 67 to 68 between 2041 and 2043. This is earlier than currently legislated for (2044-46), but later than proposed by the first State Pension Age Review. The Review also considered the possibility of increasing SPa to 69 between 2071 and 2073. The Government announced that no immediate changes would be made regarding the planned increase to 68, but a further review will be held within two years of the next parliament to reassess in light of more up to date data on the long-term impact of COVID-19.[55]

As SPa increases, some future retirees may choose to extend their working lives and retire at the same time that they become eligible for the State Pension. However, those with lower healthy life expectancies in particular will struggle to extend their working lives. Similarly, caring responsibilities, for both younger (grandchildren) and older (parents) generations will limit some people's capacity to extend their working lives. Older workers can also face discrimination in hiring processes and may need to invest time and money into training and re-skilling in order to extend their working lives within evolving industries.[56]

People who are unable to work until older ages and those who would prefer to retire earlier will need to draw more heavily upon their DC savings in the early years of retirement in order to bridge the gap in income until they reach their SPa. This will accelerate the exhaustion of savings, with potential for significantly negative consequences, particularly given the already insufficient levels of savings that future retirees are likely to accrue. As SPa increases, so too will the minimum age at which people can access their private pension savings. The minimum age of access will increase to 57 from 2028, and it is expected that further increases to SPa will result in corresponding increases to private pension access in order to keep the gap between the two stable, at around ten years.

Lower levels of home ownership and later starts on the housing ladder mean that future retirees are likely to have higher housing costs in retirement

Compared to previous generations, young savers are finding it harder to get onto the property ladder and are therefore more likely to be renters, with the higher housing costs and increased insecurity this entails, in later life. At the peak of home ownership in 2003, 71% of people owned their own home, either outright or with a mortgage. Recently, however, ownership rates have fallen, particularly among younger age groups. The continuing rise in property prices

[55] DWP (2023b) State Pension age Review 2023
[56] PPI (2018) Living the future life: the implications of a longer life; Gratton & Scott (2016)

and the continued shortage of new affordable housing has increased the number of (mainly younger) people who will be less likely to own their own home. Levels of homeownership among people aged 25-34 halved between 1989 (51%) and 2016 (25%), before increasing slightly to 28% in 2019.[57] One in three young people in the UK today might never own their own home and will continue to rent throughout retirement, with 67% of those who expect never to purchase a property citing deposit costs as a significant barrier, and 41% mortgage costs.[58]

Rental costs can prevent people from building up meaningful savings, making it harder for them to save for a deposit for a mortgage. This has implications for the future likelihood of people owning their own homes in retirement, which in turn could have a negative impact on their disposable income in later life.

While inheritances might help some people to purchase property later in life, bequests are not typically used to fund house purchases. Housing wealth is relatively illiquid and is likely to be shared between siblings as a bequest, meaning that housing, while it may form a significant part of an estate, is unlikely to provide a platform for house buying, and more likely to form part of general saving or investment.[59]

Even among those who do make it onto the housing ladder, doing so at older ages and the increased length of mortgage terms is likely to increase housing costs in retirement. In 2021-22, over half (56%) of first-time buyers with a mortgage had a repayment period of at least 30 years. The average age of a first-time buyer in the same period was 34 years old.[60] With more long-term mortgage products and people purchasing property for the first time at older ages, more people will find themselves with outstanding mortgage debt by the time they reach SPa.

Future retirees will need more substantial support to achieve adequate and sustainable retirement outcomes

Faced with significant risk of undersaving, and the complex decisions they will need to make at and during retirement, young savers will need more support to achieve adequate and sustainable retirement outcomes. Future retirees are likely to need support centred around three main categories:

- Individuals are likely to need support to consider working life, retirement and preparation for later life
- Industry may need to adapt its products and services to more effectively support individuals within the changing pensions landscape
- Policymakers need to ensure that pensions policy is fit for purpose for the changing world within which young people are saving and will eventually retire[61]

Increased education and innovative engagement on pensions and retirement planning will be needed to improve future retirement outcomes of young savers

Future generations of retirees will face increased levels of financial risk, which extend from at-retirement decision making into mid and late retirement, and many will not have the financial capability to make informed decisions without support. Low levels of engagement are one

[57] Resolution Foundation (2021)
[58] Resolution Foundation (2018); Resolution Foundation (2021)
[59] PPI (2020) To buy or not to buy: the changing landscape of housing in retirement; IFS (2018)
[60] Department for Levelling Up, Housing & Communities (2022)
[61] PPI (2021) Briefing Note 126: How can today's pension savers prepare for tomorrow's retirement?

of the core challenges facing the pensions industry and making it harder for individuals to achieve positive retirement outcomes. Given the particularly low levels of engagement and understanding of pensions among young savers, finding ways to improve their knowledge and encouraging them to proactively engage with decisions about retirement planning is especially challenging.

The support young savers will need is likely to be substantial, as most are currently unprepared and disengaged from retirement planning. The PPI Young People and Pensions Survey identified three main attitude profiles among respondents aged 18 to 35: Pessimistic and disinterested (40%); Worried and unsure (33%); and Engaged but want more guidance (27%). The first group had particularly negative views of pensions, even among those who recognised their importance, but felt that the challenge is insurmountable. Members of this group are likely to be the most challenging to engage. The latter two groups will also need support to build their knowledge and engagement, to varying degrees.

Levels of financial literacy and capability are relatively low, especially among younger people. Young savers can often feel overwhelmed by information overload, while feeling unsure where to find trustworthy sources of financial information and guidance.[62] Younger groups also respond more effectively to different types of communications than older individuals, so it is worth revisiting the ways in which guidance and access to services is provided, and ensuring that the format is in keeping with the way that younger people absorb information. It is also worth recognising that the success of automatic enrolment is based on inertia and that increased engagement has the potential to lead to detrimental outcomes, such as higher opt out rates, especially during the current cost-of-living crisis, as well as the potential to increase positive actions, such as higher contribution rates.

A focus on increasing contribution rates is vital to improving young savers' ability to achieve adequate and sustainable retirement outcomes

The projections in this chapter of the DC savings an average 22-year-old is likely to accrue by SPa illustrate that achieving adequate and sustainable retirement outcomes with minimum contribution rates is very unlikely. However, most young savers contribute at the minimum rate and do not actively engage with decisions about contribution rates or give much consideration to how this will impact their future living standards in retirement.

Almost one in eight (12%) respondents to the PPI's Young People and Pensions Survey 2021 did not know their current contribution rate.[63] Without knowing their current rate of contribution, young savers cannot assess whether this is appropriate, neither in terms of how effectively it will allow them to achieve adequacy in retirement nor how it interacts with current financial needs and shorter-term goals. While members of pension schemes receive annual statements from their providers, more could be done to raise awareness of the importance of contribution rates among younger savers, both in terms of knowing their current contribution rate and understanding how to evaluate the retirement income it is likely to translate to. A greater focus on retirement outcomes and how they relate to contribution rates may encourage younger savers to re-evaluate how much they are currently saving.

Most young savers substantially underestimate how much they need to be saving in order to achieve an adequate income in retirement. 47% of DC savers in Generation Z believe that

[62] MacFarland and Hayes (2020)
[63] PPI (2021) Briefing Note Number 128: The Future Life: How can younger people be supported to achieve adequate retirement outcomes?

saving at minimum automatic enrolment contribution rates will enable them to achieve the moderate RLS, while 7% think it will provide the comfortable RLS.[64] However, the projections in this chapter illustrate that this is unlikely to be the case for those on average earnings. Education around what constitutes an adequate contribution rate would help young savers to better understand and assess their current progress towards retirement adequacy.

Now that all scheduled minimum contribution rate increases have been implemented, there have been recommendations across the industry for further increases to be considered. While past increases have not resulted in substantial increases in opt-outs, any further increases need to be balanced against the potential risk of encouraging higher opt-out rates. The Association of British Insurers (ABI) has called for default contribution rates to be increased to 12%, with either an opt-up or opt-down mechanism, meaning that savers can choose to contribute at a lower rate (and potentially receive equivalently lower contributions from their employer) but must make an active decision to do so.[65] Other options include auto-escalation, with contribution rates automatically increasing, either when pay increases are received or as members age. Seven in ten DC savers in Generation Z (born after 1997) agree that the government should automatically increase employee contributions as they get older.[66]

Conclusions

With the decline of DB in the private sector, most future retirees will be wholly dependent on DC savings to provide an adequate and sustainable income in retirement alongside the State Pension. However, current contribution rates, which have stagnated around the minimum rate mandatory under automatic enrolment, are unlikely to accrue sufficient DC savings. If contribution rates do not increase, future retirees face challenging decisions between adequacy and sustainability.

The risk faced by future retirees is compounded by demographic, economic and policy changes that mean their money will have to stretch further in order to achieve similar standards of living to current retirees. Longer life expectancies mean that savings will have to be spread across a longer retirement period, unless working lives can be extended, and lower levels of home ownership are likely to lead to higher housing costs in retirement for future generations.

Future retirees will need more substantial support to achieve adequate and sustainable retirement outcomes. Increased education and innovative engagement on pensions and retirement planning will be needed to improve outcomes, particularly around the importance of increasing contribution rates and the likely poor outcomes of continuing to contribute at minimum rates. In retirement, future retirees could benefit from the introduction of more hybrid products that provide elements of both security and flexibility in order to effectively meet variable needs.

[64] B&CE/Ignition House (2022)
[65] ABI (2022)
[66] B&CE/Ignition House (2022)

Chapter Five:

Reflections on policy

Chapter Five: Reflections on policy

Generating retirement outcomes to be enjoyed and not endured

Chris Wagstaff, Head of Pensions and Investment Education, Columbia Threadneedle Investments, and Senior Visiting Fellow, Finance Faculty, Bayes Business School, City University, London

Overcoming the risks of freedom and choice

While improving financial outcomes to retirement remains the principal focus of pension policymakers and industry thought leaders, the myriad of risks that surround at- and in-retirement decision making, post-freedom and choice, and the ever-increasing numbers accessing their Defined Contribution (DC) pots, has seen DC decumulation steadily attracting the attention of both.[67] Indeed, individuals at- and in-retirement, with ever-increasing pot sizes, must navigate a multitude of largely unquantifiable risks which, if not managed well, can add up to an uncomfortable retirement at best or, worst case, lead to the retiree outliving their savings or living in penury in fear of the latter.

Given that at- and in-retirement decision making has been described by Nobel prize winning economist Bill Sharpe as, "the nastiest, hardest problem in finance", it seems unfathomable that despite the difficult choices that need to be made, this process continues to be largely unsupported by the provision of accessible frames of reference, guidance and low-cost advice. Moreover, this enormous decision-making burden, which weighs heavily on the shoulders of a largely ill equipped, disengaged and rapidly ageing population, comes at a stage in peoples' lives when financial literacy and cognitive ability often starts to decline. Coupled with the multiple behavioural impediments to achieving optimal outcomes, for some this is exacerbated by a reluctance to engage with technology that can facilitate the decision-making process.

Despite this, since 2015 nearly 4.5m DC pots have been accessed, with over 700,000 accessed in 2021/22 alone, culminating in £160bn+ of DC funds having been drawn upon since 2018 (FCA, October 2022).[68] While this partly reflects the continued long-term ill health of many older workers and the persistency of the cost-of-living crisis, these numbers exclude the demographic bulge of those tail-end baby boomers (now in their late-50s to early-60s) and early Gen Xers (now in their late-40s to mid/late-50s) – the so-called sandwich generation - who've yet to dip into their DC pots. Yet, despite the ever-greater reliance on DC pots in retirement, as the point of peak DB pensions fast approaches and the spectre of the state pension forming the mainstay of many retirement outcomes looms large,[69] there continues to be a reluctance to seek regulated advice, to the very real detriment of these outcomes.

The changing shape of retirement

For many, not least the sandwich generation, retirement is no longer a one-off event with a well-defined destination point, as it was for the make do and mend generation, those born or who grew up during WW2. Rather, it's increasingly a phasing. Moreover, as the first generation to be simultaneously caring for ageing parents while helping out financially dependent adult

[67] In June 2022, the Department for Work and Pensions (DWP) launched a call for evidence to explore what support members of pension schemes need to help them make informed decisions about how best to utilise their pension savings. See: Helping savers understand their pension choices. DWP. 14 June 2022. This led to the DWP, in July 2023, launching "a consultation on a policy framework for supporting individuals on how to use their private pension savings at the point of access." Prior to this, in June 2023, the DWP suggested that duties should be placed, "on trustees to consider the needs of their members at the point of accessing their pension… [by providing] some sort of product for members… at the end of their DC accumulation journey". See: PLSA IC 2023: DWP 'likely to require DC schemes to provide a decumulation product'. Laura Blows. Pensions Age. 7 June 2023.

[68] Source: Retirement Income market data 2021/22. FCA. 6 October 2022.

[69] See: The Ski Slope of Doom – Is this the most worrying chart in pensions? Sir Steve Webb. LCP. 24 April 2021. Moreover, the PLSA predicts that almost two-thirds of households saving into a DC pension will fail to achieve at least a moderate standard of living in retirement. See: A research report supplement to five steps to better pensions: time for a new consensus. PLSA. 2022 p.3.

children (hence sandwich) and be faced with the rapidly declining economics of social care - the sandwich generation will likely be the most long-lived in history and the first whose financial commitments and real spending will increase, not decrease, throughout retirement.

The role of guidance

Couple that with the need to formulate a view on the vagaries of longevity and health longevity, both of which have a strong postcode lottery element, allied to unplanned contingencies, and you have a whole generation of retirees fretting over and likely failing to align the longevity of their DC pension pot with the expected duration of their retirement, while typically underestimating the level of income required to meet desired expenditures and support a comfortable standard of living.

However, those approaching at- or in-retirement decision making need not be completely rudderless. Indeed, there are two invaluable, relatively well signposted sources of free-to-access guidance in Pension Wise and the Pensions and Lifetime Savings Association's (PLSA) Retirement Living Standards (RLS). Pension Wise, the free-to-access telephone and face-to-face based generic pensions guidance service for those aged 50+ has, by approaching an ultimately complex decision via logical and well framed questioning within a series of simple steps, helped many achieve better retirement outcomes. However, one-off generic guidance from Pension Wise, typically at the point of retirement, is unlikely to be sufficient, given that peoples' circumstances and spending patterns change throughout retirement. Meanwhile, the PLSA's RLS, via simple, accessible and relatable rules of thumb, helpfully illustrate what life in retirement might look like for both a single retiree and a couple, either living in or outside of London, at three different levels of spending: minimum, moderate and comfortable.[70] However, neither substitute for the advice gap for end investors.

So, what is the solution?

With yields normalising, for some, still likely the minority, annuitisation may now seem to be the answer to guaranteeing income security, at least in nominal terms, thereby avoiding the early depletion of pension pots and the risk of living too frugally in fear of the latter.[71] Whereas for others, likely the majority, the solution that most closely meets their needs, demands both income security and flexibility, i.e. income drawdown. The problem is, of course, that income drawdown, which must prospectively underpin a desired standard of living that might extend to 30+ years, must sidestep the worst effects of investment sequencing risk, especially early in the decumulation journey, unexpected inflation and, often vastly underestimated, longevity risk. Yet more complexity. Of course, annuities and drawdown are not mutually exclusive and can be complementary – a point noted in considering a potential solution.

However, and this is the crux of the issue, most people simply do not know what is feasible and realistic at and in retirement. As a result, to reinforce the point made earlier, many are at risk of sleepwalking into poor active and passive decisions and landing in a very bad place. Many already have and are. Consequently, and perhaps unsurprisingly, the contention of many prominent pension practitioners and commentators post-pension freedom and choice, is that most people will never truly engage with the complex decisions to be made at and in

[70] To make the three high level expenditures relatable, each of the standards, which are derived from working with focus groups, drill down into what could typically be spent annually on household bills, home maintenance, food and drink, transport, holidays and leisure, clothing, personal items, presents and charitable donations. However, rent, mortgage, health and social care costs, which are specific to each individual, are excluded. The RLS are further humanised via eight personas, each at various stages of their working lives. Accessible to more than 14 million savers via the PLSA's dedicated RLS website, as well as the scheme members, clients and savers of 50 UK-based organisations, 74% of DC savers believe that the RLS make it easier to plan for retirement. See: https://www.retirementlivingstandards.org.uk/details

[71] While effectively the default pre-2015, annuitisation - typically via level, rather than escalating or index-linked, annuities - has been the minority choice during, what has been, an exceptional period of historically low yields, accounting for between 9% to 16% of DC pots accessed. Source: Retirement Income market data 2021/22. FCA. 6 October 2022. Although sales of annuities in Q123 recorded their highest levels since 2014, they were only up 7% on Q122. Source: Association of British Insurers. 30 May 2023.

retirement, nor will they ever have the confidence and capability to select and successfully manage the retirement solution that most closely meets their needs.

Leading on from this, three additional points are increasingly being made. The first is that a collectivist solution, one that pools the largely unquantifiable risks, noted above, that come with flexibility in decumulation, trumps an individualist retail-type solution. Indeed, the latter can prove sub-optimal and costly, in both absolute and opportunity cost terms, given the lack of shopping around and advice being taken prior to purchase. Consequently, Decumulation-only Collective Defined Contribution (CDC), while not yet a reality, already has a core band of supporters. The second is that the success of automatic enrolment in the accumulation stage is testament to the power of harnessing the inertia of the disengaged by opting eligible employees into pension saving and so should be replicated in decumulation. The third is the legendary power of the default. In pensions, as in all aspects of life, the default option is that which is overwhelmingly selected.

A potential solution…

Therefore, for a largely unsupported and unadvised mass market, the solution surely lies in an auto-enrolled, well-governed, behaviourally robust, appropriately charge capped, institutionally-managed default, with appropriate flexibilities. These flexibilities could comprise an option to finesse the default's key defined parameters at set times, within certain tolerances, to meet individual preferences – contingent on the flexing of the other features, the individual's age and the size of the remaining pot. Optout provisions would be made available to those who are better able and willing to make their own decisions and create their own bespoke solution. Of course, both optouts and flexibilities should only be enacted with regulated advice. Crucially, to support a desired standard of living, the solution would need to be underpinned by an investment medium which obviates the threats to the preservation of capital, noted earlier, and its ability to sustainably generate a fixed real income withdrawal rate, supplemented by a minimum income guarantee unpin and longevity insurance, the latter courtesy of a deferred annuity.[72]

…which targets a desirable result

The result? A secure and sustainable real long-term income stream which would lay the foundations for a retirement to be enjoyed and not endured.

But what if…?

However, if a collective auto enrolled default isn't seen as the solution, then there's no getting away from the fact that people will need to be properly supported throughout the retirement planning and implementation process. They will need to have their options, choices and potential outcomes explained and illustrated to them in a simple, clear, understandable, relevant and practical manner, and be assisted by the more widespread provision and signposting of accessible tools, guidance and advice.

So, to end on a blunt note, ultimately whether a minimum, moderate or comfortable retirement becomes the norm, is largely contingent on timely and decisive action or continued inaction by both the pensions industry and policymakers. Indeed, the economic and societal risks that may result from continued inaction could be significant, if not catastrophic. The clock is ticking.

[72] See: Generating Retirement Outcomes to be Enjoyed and not Endured. Chris Wagstaff. Columbia Threadneedle Investments. February 2018. Of course, others may instead wish to simply make ad hoc withdrawals, often at short notice, to supplement other sources of income. This solution likewise demands a similar investment underpin.

Predictably Unpredictable: The Impact of Life Expectancy Uncertainty on DC Savers

Stuart McDonald, MBE, Head of Longevity and Demographic Insights, LCP

Nobody likes to think about their own life expectancy. But for Defined Contribution (DC) pension scheme savers, life expectancy is more than just a number – understanding how long you are likely to live is fundamental to retirement planning.

If a DC saver plans for a retirement based on a life expectancy of 80 but lives until they are 90 then that additional decade will require significant additional funding. They can insure against that uncertainty with an annuity but that comes at a cost, and higher life expectancy flows directly through to annuity pricing and lower incomes.

Life expectancy uncertainty arises from three main sources:

- Changes to population life expectancy
- Variation in life expectancy between groups
- Individual variation

Population Life Expectancy

In 1990, a typical person retiring at 65 had a life expectancy of 16 years. By 2019, this had increased to 20 years.[73] So within a generation, the length of a typical retirement had increased by 25%.

Perhaps this historical improvement goes some way to explaining why studies have repeatedly shown that people underestimate their life expectancy.[74] Anyone estimating their own life expectancy by reference to how long their parents or even grandparents lived is failing to allow for decades of progress.

The Covid-19 pandemic may make this situation worse. Even now in 2023 mortality rates remain higher than pre-pandemic levels, despite significant reductions in the numbers of people dying as a direct result of contracting Covid-19.[75] But, while the pandemic was undoubtedly a tragedy and will leave a legacy of ill-health and pressures on healthcare, the actual impact on population life expectancy is relatively modest compared to historic improvement. There is a danger that people focus on the recent bad news rather than the long-term progress.

The rise of personalized medicine, artificial intelligence in healthcare and breakthroughs in treating diseases of later life all have the potential to extend our lives further. But for pension savers hoping for a comfortable retirement, these gains are a double-edged sword.

Variation between groups

Life expectancy in the UK is extremely unequal and, despite commitments made by successive Governments, these inequalities have been getting worse. In 2019 there was an astonishing 27-year gap between the life expectancy of a man in part of Blackpool (68 years) and part of Kensington and Chelsea (95 years).[76] The gap between the longest- and shortest-lived areas for women is 21 years. DC pension savers, simply by virtue of being part of the workforce, can expect to live longer than the general population.

[73] National life tables: UK - Office for National Statistics (ons.gov.uk)
[74] Millions of Brits underestimating their life expectancy by a decade | The Actuary
[75] Mortality monitor | Institute and Faculty of Actuaries
[76] Life expectancy and risk of death in 6791 communities in England from 2002 to 2019: high-resolution spatiotemporal analysis of civil registration data - The Lancet Public Health

Individual variation

Even actuaries have our limitations! We can calculate population life expectancy based on age and sex, and we can refine that further using information on health, lifestyle or deprivation. But we still can't forecast the life span of individuals. Two people can have all the same underwriting characteristics, but one might be one of the unfortunate few who die young after being run over by the proverbial bus, while the other may rival Jean Calment's reported 122 year lifespan. Such significant individual variation is the part of the reason that Nobel Prize-winning economist William Sharpe called decumulation decisions the "nastiest, hardest problem in finance".

Everyone is an actuary now

With the decline of Defined Benefit (DB) pensions in the private sector, the risk has shifted squarely to the shoulders of individuals. This is part of what the Institute and Faculty of Actuaries[77] calls the "Great Risk Transfer", where risks previously borne by institutions – the state, employers and financial services companies – are increasingly passed to individuals who are ill-equipped to manage them.

Young pension scheme savers face a precarious landscape: with lower levels of home ownership, job instability, and State Pension Age increasing while healthy life expectancy stagnates. We have yet to see the first generation excluded from private sector DB schemes hit retirement age – it's unlikely to be a pretty picture when they do.

Auto-enrolment has been a great policy success but if we are to rely on inertia to keep people saving for pensions then we have a responsibility to ensure that those pensions have a chance of providing an adequate retirement – that is not currently the case.

Future retirees need more than just innovative products. They require robust education on pensions and retirement planning, especially around the amount needed to provide a comfortable retirement and the contribution rates required to produce such a fund.

With longer life expectancies, retirement provision will need to stretch further than before. DC scheme members need to be mindful of their planning and financial capability in later life or they may face the risk of financial strain in retirement.

Empowering individuals with the tools, education, and support needed to navigate these uncharted waters is essential. Collaborative efforts between the government, employers, and financial institutions will be necessary to help forge a path that ensures not just heathier longer lives, but financially secure and comfortable retirements.

[77] Great Risk Transfer (actuaries.org.uk)

Precarious Work, Precarious Lives and Pensions

From left to right:

Professor Debora Price, Department of Sociology, University of Manchester

Kris Fuzi, Centre on Household Assets and Savings Management (CHASM), University of Birmingham

Dr. Hayley James, Centre for Personal Financial Wellbeing, Aston University

The shifts from DB to DC and auto-enrolment have fundamentally altered pension futures for younger people, and the core problems that these developments raise of knowledge, risk, and engagement are much discussed. However these changes have taken place alongside other profound changes in the world of work towards non-standard employment: a marked rise of self-employment, dependent self-employment, short term and zero hour contracts, and gig-economy work. One in three jobs across OECD countries is now estimated to be in non-standard employment.[78] These jobs are broadly characterised as precarious forms of work, which have spread vertically up the occupational scale as well as horizontally across it. The consensus is that the consequences for our retirements are very serious.

These are domains of weak labour organisation but being tied to an employer may no longer be what all people want. Technology has enabled more flexible alternatives, with potential for greater autonomy and control over hours and terms of labour, and new possibilities for participation in paid work. There are dangers to flexibility, however. While both men and women might articulate flexibility as a necessary or desired choice, it is also fluctuating; earnings are volatile, erratic, and often very low paid; the work is inconsistent; there is no job security; and it carries an almost complete loss of social protection. Flexible work entrenches existing gender (and other) inequalities, where many men are better positioned to apply flexibility positively whereas women are driven to precarious work by failures in other spheres of support such as childcare and adult social care.[79]

These sectors grew substantially in the first two decades of the 21st century and now cover a significant proportion of the workforce. In the UK, approximately 4.2 million workers are self-employed (almost 15% of the workforce), with 85% of these being people who work solo.[80] Insecure work, defined as employed with varying or uncertain hours, is currently estimated at 6.1m workers.[81] The ONS estimates that 1.2million people are employed on zero hours contracts, and 1.6 million on temporary contracts. About 4.4 million are estimated to participate in the gig economy.[82]

Government, policy actors and employment lawyers have recognised the problem of course. The solution in the UK and elsewhere has been mobilisation around gig-economy industries, trying to make businesses accept those who work for them as employees or formally recognised workers with social protection and legal rights. But these approaches come from an assumption that we can continue to shoehorn ever-more creative, disruptive, and insecure models of paid

[78] https://www.oecd-ilibrary.org/social-issues-migration-health/pensions-at-a-glance-2019_b6d3dcfc-en
[79] Chung & Booker (2022)
[80] ONS (2022); Henley (2022)
[81] Richardson (2023)
[82] ONS (2023) EMP17: People in employment on zero hours contracts; ONS (2023) EMP07: Temporary employees; TUC (2021)

work into our seemingly ill-suited notion of a standard employment contract, rather than thinking that the world of work has permanently changed, and the present and future look very different to the past.

Initiatives that have focused on trying to persuade people in these economies to save more using "guidance", better messaging, and technology based nudges, have not looked promising.[83] The idea of auto-enrolment for the self-employed and those on zero hours or short-term contracts has been floating around for the best part of the last decade, but has proven very challenging, and even if implemented may not make sufficient difference given the scale of the issue and the barriers that precarious workers face.

Importantly, precarious work is linked to other aspects of precarious lives. There is increasing evidence that young people seek to create stability in their adult lives before thinking about long-term saving.[84] And insecure work often exacerbates other precarities, for example, forcing reliance on private rental markets which are themselves increasingly unaffordable. For those with limited access to intergenerational support, the journey to homeownership involves a complex juggling act, with austerity and tight mortgage lending raising further barriers. This leads to workers prioritising saving for homeownership, to try to achieve some semblance of security in their adult lives, above saving for later life. Furthermore, experiences of precarity have a cumulative effect on gendered inequalities in work, income and wealth. For as long as later life provision is predominantly tied to traditional expectations of work, countering precarity will also be a feminist issue.

Whether there are natural limits to the growth in precarious work remains to be seen.[85] In the meantime, for pensions, our focus on occupational pensions and workers' pension rights is on a system that likely represents fewer and fewer people. We know very little yet about how these new forms of work are stitched together across the lifecourse, but the statistics suggest that work is fundamentally changing.

The problems these issues raise are so fundamental that we must ask whether the current pension system remains fit for purpose. Through incremental libertarian reforms, we have already decimated the societal risk sharing that makes a pension system sensible, fair and just. To this we now add the problems of new, much higher risk, more precarious working lives. Perhaps it is time to circle back to focus on the State Pension. The new single tier pension will service these younger workers, and it is a long-term imperative that it is politically supported and that its value keeps pace with minimum societal norms for poverty prevention. But since the abolition of the state second pension and the AE reforms, and with increasingly libertarian government in the UK since 2010, there is no longer a discussion about whether the state needs to play a greater part in providing income adequacy in old age for its population. Yet it is only the state that can redistribute – from rich to poor, and across and within generations, and perhaps in the end, it is only the welfare state that can protect. If we do not want to see poverty return at scale to our older population, all options may need to come back on the table.

[83] https://www.nestinsight.org.uk/research-projects/self-employed-pension-saving/#1669666420453-d39766d6-d1a0
[84] Suh & James (2023)
[85] Stanford (2023)

'Killer apps': helping young savers to overcome pensions challenges

Stephen Lowe, Group Communications Director at the retirement specialist, Just Group plc

They say that with age comes wisdom… although it's not always guaranteed.

Pensions are one area where the adage holds up reasonably well. With retirement many decades away young people don't see the need to be pension savvy. Surely that can wait until the twilight of a working life, can't it?

Unfortunately, wiser heads know that the earlier you start, the better the likely outcome. Pensions are not something you can put off to the last minute.

Undoubtedly today's young working people face some serious headwinds – higher costs of renting or buying a home, starting a family, servicing student loans, longer life expectancy, etc.
But they also have a couple of big advantages – what could be termed 'killer apps' in terms of social and technological developments. These could prove transformational in offsetting and perhaps overcoming some of the difficulties.

The first and most obvious 'killer app' is automatic enrolment (AE) into pensions. This should be a game-changer. Workplace pensions may have been more generous in the past, but they were also much less widespread with a large cohort of workers often missing out, dramatically worsening their long-term retirement prospects.

Pension participation among private sector workers in the 22-29 age group more than tripled from 24% to 85% between 2012-21. Even among public sector workers where participation rates were already high, participation rose from about 82% to 91% in the 22-29 age group. The automatic enrolment policy has successfully broadened the base of pension-saving and, while it has well-known flaws, some of these are addressable. Lowering the age threshold to 18 from 22 and amending qualifying earnings limits – changes supported by the government – will bring in more younger workers and those who work part-time.

Contribution rates are a far thornier subject. We all know today's minimum is not enough, but is an increase affordable? In the absence of government action on contribution rates, we need to get the 'save more' message out there. Putting more in while working is one of the most reliable ways of getting more out in retirement.

Which brings us on to the second 'killer app' – the financial satnav.

Driver navigation tools have been with us for 20 years and few of us would dream of tackling an unfamiliar journey without electronic help. These are so much more than glorified maps. They route-find, tell us our speed and ETA, warn us of delays and highlight points of interest near to where we are or tell other people our location.

If our working lives are a journey and retirement our destination, then we could really benefit from a satnav to help identify objectives and track progress. That way there's no excuse for not knowing where we are headed.

Young workers often lack financial knowledge and confidence. Recent research by the Financial Conduct Authority found more than half (52%) of 18 to 24-year-olds rated themselves below 6 on a scale of 1-10 when asked about their financial knowledge, compared to 32% of 55 to 64-year-olds.

The same research shows younger people do, however, have a much higher level of trust in financial technology companies and that digital exclusion was almost non-existent among adults aged under 34.

From a young person's perspective, the advantages of technology are:

- Readily accessible and familiar to all, harnessing the power of AI and gamification;
- Personalised to offer tailored guidance at low cost; and
- Potentially scalable to include investments, taxes and regulated advice when required.

Visions of the future can date quickly. But we know this type of technology is not science fiction because it is already fact, up and running in the pre and at-retirement space. Digital services are now not only delivering information, guidance and regulated advice to thousands of retirees but can execute recommendations and continue managing finances through retirement.

Their most powerful advantage is that they give people a vision of their own future and how it can be shaped by their own actions, whether that is saving a bit more, or retiring a little earlier or later.

Although currently focused on those closer to retirement, it's a matter of time before attention switches to developing these same user-friendly but powerful services for those starting out in their careers.

For several years we have been waiting for the launch of the Pensions Dashboard with the public launch recently pushed back again to beyond October 2026. The government sees this as transformational in giving people 24-7 access to their pension information.
When it eventually does appear, there is no doubt it will be a bold step forward, helping people see how their pension benefits are building and as a result, hopefully encouraging engagement.

But while it's useful to know where we are, the big question is how do we best get to where we want to be? And for that, you need more than just a dashboard, you need a satnav.

The Future of Retirement Income: A New Generation of Trailblazers

Russ Wright, Senior Vice President – DC & Financial Wellbeing, Redington

Today's retirees are the trailblazers of the defined contribution age. They're among the first to use the 2015 pension freedoms. And many are living life on the edge without the backup of a defined benefit pension.

Being a trailblazer isn't easy. Today's retirees have discovered that finding, engaging and interacting with their pensions comes with a lot of unnecessary friction and angst.

Future retirees will be following a more established pathway when they come to retire. Find your pension? Easy, just use a pension dashboard. Engage with your pension? Of course, Consumer Duty regulations and consolidation in the pensions market will improve communications. Interact with your pension? No problem, everything can be done through an AI RoboAdviser.

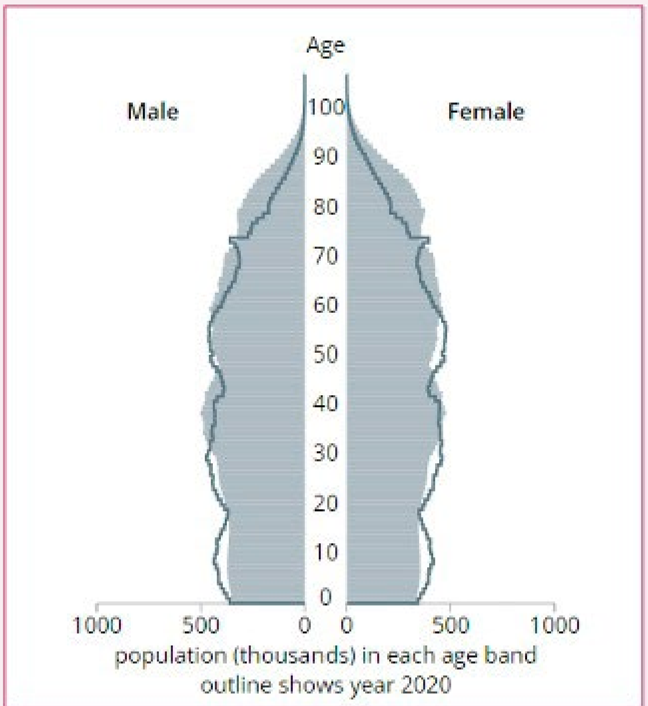
But there are some mega trends that could threaten the whole idea of retirement for future generations. To really understand the retirement prospects for today's young savers, we need to think about what the world might look like for them.

Demographic changes

We know the UK population will look very different in the future. A long-term trend of lower birth rates and improved longevity means the balance between those of working age and retirement age in the population will shift.

Compared to 2020, population projections from the ONS show that despite overall expected population growth of just 6% by 2050, the number of 85-year-olds is expected to more than double to 534,000.[86] The population pyramid below shows how the overall picture will change – with a trend of population growth in older ages, and decline in younger age groups (Chart 5.1).

Chart 5.1: UK population (thousands) projection in each age band for 2050. Outline shows 2020



[86] ONS (National population projections: 2020-based interim), 2020 and 2050 projection for UK, published January 2022, link: https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/bulletins/nationalpopulationprojections/2020basedinterim

Pressure to adapt will mount on policy makers, pension providers and everyone as this trend develops. Annuities will become more expensive. And an aging, healthier population will mean minimum retirement ages increase and lifelong working becomes more common.
It seems unlikely that a triple-locked, universal state pension would be able to withstand this pressure. Could we see a state pension that's means tested and acts more like a deferred annuity, only kicking in to help those who live longer than average life expectancy? And will the currently-much-loved 25% pension commencement lump sum hold the same value in the future when long-term income needs feel much more important?
For today's young savers these demographic changes will mean their pension needs to work harder and more responsibility will be placed on them to manage their retirement income, rather than being able to rely on the state.

Climate impact

An even greater, indeed existential, threat to the future of retirement income is climate change. The catastrophes we've seen this year, like the wildfires in Hawaii and Greece, are a vivid reminder of how changes in our climate can have devastating consequences.
Whether or not the UK and other countries meet net zero targets, the world is likely to be a very different place when today's young savers retire.

Research tends to show that younger savers are more concerned about the impact of their investments than older savers (Table 5.1).[87]

Table 5.1[88]

Age	Likelihood to invest in ESG, green and impact funds
18-24	80%
25-34	74%
35-44	67%
45-54	68%
55-64	48%
65+	24%

As today's younger cohorts of savers reach retirement, and the impacts of climate change are realised, we're likely to see a shift in investment priorities.

Currently a retiree managing their own investments is usually most concerned with maximising risk-adjusted returns to match their income needs. The future could well see more focus on impact-adjusted returns as retirees become more conscious that a good outcome in retirement isn't just a financial measure. They will want to know their investments are keeping them safe from environmental disasters as well as paying their bills.
Choosing investments that can achieve appropriate risk- and impact- adjusted returns comes with significant challenges, not least agreeing on reliable measures of impact. But as the inevitable impacts of climate change become a more regular part of life, the direction of travel is set.

Net Zero retirement trailblazers

In comparison to major demographic changes and the existential threat of climate change, today's retirement challenges somewhat less significant. However, making it easier to locate, engage and interact with pensions will help future retirees when they come to walk a new path as Net Zero retirement trailblazers. With a retirement date of 20 June 2057, I'll need to be one of them!

[87] FT Adviser (Younger investors 3x more likely to invest in ESG funds), published November 2021, Link: https://www.ftadviser.com/investments/2021/11/03/younger-investors-3x-more-likely-to-invest-in-esg-funds/ & Barclays (Investor Motivations for Impact: A Behavioural Examination), published July 2018, link: https://www.barclays.co.uk/content/dam/documents/wealth-management/investments/impact-investing-product/investor-motivations-for-impact.pdf
[88] Saltus Wealth Index, 2021

A young saver's perspective

Shantel Okello, Intern, PPI

By the time they retire in the 2060s, current young savers will rely heavily on DC pensions, of which they are unlikely to build up sufficient amounts to replicate the retirement living standards of current retirees. This may be a result of unfavourable economic conditions as well as demographic changes, leading to retirement outcomes that vary considerably compared to those of their parents and grandparents. A number of factors are likely to impact the retirement outcomes of today's young savers, compared to previous generations:

- High property and rental costs are negatively affecting young savers. The amount they can save into their pensions may be significantly reduced due to these high housing prices.
- Housing prices are predicted to rise by 17% in the next decade, which may significantly reduce the number of future homeowners among younger generations. As a result, more people over the state pension age will still be renting into retirement.[89] Individuals over state pension age with high housing costs are likely to experience poorer standards of living in retirement, or may even need to consider a later retirement, if any at all.
- The State Pension age (SPa) for current young savers is uncertain. Current plans will see SPa increase to 68 by the time current young savers are 45.[90] There is also still the possibility of further increases before SPa is reached.
- As life expectancy rises, there are concerns among young savers that the state pension may no longer be in place as the government may no longer be able to afford to provide for the growing number of people over SPa. Around 34% of young people believe the state pension will cease to exist by the time they reach retirement.[91]
- While there could be continued support in the form of supplementary benefits, such as help with prescriptions and gas and electricity in the winter, and free public transport, if the State Pension was abolished, the majority of retirement for young savers would have to be self-funded. With currently low rates of saving, providing for retirement with private savings alone would likely lead to extremely poor retirement outcomes.

Changes in the labour market are also likely to have an impact on young savers' future retirement outcomes. Studies highlight that Gen Z have different attitudes to the workplace compared to previous generations. They are less likely to work in roles they do not find fulfilling, and prioritise work-life balance, and personal wellbeing over salary.[92] This prioritisation of satisfaction and happiness could result in more individuals over SPa retiring later out of passion for their work - or perhaps not at all. However, it is important to note that, unfortunately, many people may be physically unable to work for so long. There are differences in demographics among young savers, with white-collar workers being the main group that could feasibly consider later retirement. Blue-collar workers, on the other hand, are at greater risk of needing to retire early due to lower healthy life expectancies. These differences are important to consider when thinking about the future retirement of young savers, as not everyone will have the same experience.

89 https://www.idealhome.co.uk/news/good-move-housing-market-10-year-forecast-265707#:~:text=UK%20house%20prices%20are%20on%20course%20to%20rise,an%20increase%20from%20the%20current%20average%20of%20%C2%A3239%2C927.
90 DWP (2023b)
91 PPI (2021) Briefing Note 128: The Future Life: How can younger people be supported to achieve adequate retirement outcomes?
92 https://www.businessinsider.com/what-gen-z-wants-workplace-expecations-salary-benefits-perks-2022-5?r=US&IR=T#the-typical-gen-zer-cares-most-about-the-working-environment-salary-takes-a-backseat-for-them-6

Automatic enrolment is something that will benefit many young savers, as they will have been saving for their pension for a longer period compared to previous generations. However, some young savers are not eligible for automatic enrolment due to earnings not meeting the threshold. This particularly affects underpensioned groups such as women, who are likely to spend more time out of the labour market due to domestic responsibilities and childbirth.

Although many young savers are likely to spend a greater proportion of working life contributing to a pension as a result of automatic enrolment, this may not necessarily translate to better retirement outcomes. Previous generations are more likely to be members of DB schemes, entitling them to a guaranteed income throughout retirement. Current young savers are more likely to be members of DC schemes, leaving their later life savings heavily dependent on investment performance and individual choices about how to access their savings, increasing the levels of individual risk they will face.

Young savers could benefit from greater education around pensions and preparing for later life. Nearly a quarter of young savers report not having received any education or guidance relating to pensions.[93] Education may be especially important within specific demographics such as the working class, and those with less access to familial wealth and financial knowledge. Other ways to improve young savers' future outlook could include possible incentives for under 30s to save towards their pension or increasing mandatory contribution rates. Currently, a lot of young savers contribution rates are stagnated at the mandatory minimum. This could be attributed to them believing that the mandatory minimum is what is optimum since it was suggested by government, or because of inertia and the feeling that retirement is a long way off. Without increased contribution rates, current young savers are at risk of experiencing poor retirement outcomes. Overall, the retirement outlook for young savers may be perceived as bleak, but with the right support from government, the pensions industry and education, there is still time for circumstances to change for the better.

[93] PPI (2021) Briefing Note 128: The Future Life: How can younger people be supported to achieve adequate retirement outcomes?

Appendix Modelling Assumptions

Appendix: Modelling Assumptions

The modelling for this report considers the projection of an individual using the PPI's Suite of Pension Models, and a stochastic approach of economic assumptions. The economic scenarios are generated using the PPI's Economic Scenario Generator. The Models used are detailed below. Results are presented in 2023 earnings terms.

The pensions system

The pension system modelled is as currently legislated. The triple lock is assumed to be maintained. Individuals are assumed to be members of a Defined Contribution (DC) occupational pension scheme.

General assumptions

Investment returns are modelled stochastically with curves generated by the PPI's Economic Scenario Generator (ESG). 1,000 scenarios were produced providing values for equity returns, bond returns, cash returns, Consumer Prices Index (CPI) and earnings increases each year for each scenario.

Other economic assumptions

Other economic assumptions are taken from the OBR's Economic and Fiscal Outlook (for short-term assumptions) and Fiscal Sustainability Report (for long-term assumptions).

Asset allocation

Unless otherwise specified, asset distributions are assumed to be 56.7% invested in equities, 33.3% invested in bonds and 10% in cash, such that the median return is 5.8%. These assumptions are consistent with those used across the PPI Modelling Suite and are the result of consultation with the PPI's Modelling Review Board, which consists of a number of experts in the field of financial modelling.

Fund charges are assumed to be 0.75% for existing workplace DC schemes,[94] and 0.5% for other DC/master trust schemes set up for automatic enrolment.[95]

Earnings growth and other economic assumptions are taken in line with OBR assumptions,[96] derived from their 2019 long-term economic determinants. The earnings band for automatic enrolment contributions and minimum salary assumption are assumed to grow with average earnings.

The Economic Scenario Generator (ESG)

The PPI's ESG is used to produce randomly generated future economic scenarios based upon historical returns and an assumption of the median/long-term rates of return. It was developed by the financial mathematics department at King's College London. It is used to test how the distribution of outcomes is influenced by the uncertainty of future economic assumptions.

[94] Average charges for trust-based schemes are 0.71% and for contract-based schemes 0.95%, DWP (2012), and a 0.75% charge cap will be introduced for any DC default funds being used for automatic enrolment from April 2015 onwards.
[95] Equivalent Annual Management Charge for multi-employer/Master trust schemes such as Legal and General's Worksave, NEST and The People's Pension.
[96] OBR (2023)

Key results

The Model generates projected future inflation rates, and earnings growth

- Inflation rates
  - Future CPI increases and earnings inflation rates
- Investment returns
  - Returns are produced for the major asset classes of equity, cash and gilts

This produces nominal returns which can be combined to produce investment returns for a more complex portfolio.

Application of output

The output of the ESG is a number of economic scenarios which are employed by the PPI's other models to analyse the distribution of impacts on a stochastic economic basis.

Key data sources

The specification of the model is based upon historical information to determine a base volatility and future assumptions to determine a median future return:

Historical returns: Historical yields and returns, as well as inflation measures, are used to determine the key attributes for the projected rates.

Future returns: Future returns are generally taken from the OBR Economic and Fiscal Outlook (EFO) to ensure consistency with other assumptions used in the Model for which the economic scenarios are being generated. Volatility can also be scaled against historical levels.

Summary of modelling approach

The six identified risk factors modelled are:

G	Nominal GDP
P	CPI
W	Average weekly earnings
Y1	Long-term yields
Ys	Money market yields
S	Stock returns

Using these variables, a six-dimensional process, x_t is defined.

$$x_t = \begin{bmatrix} \ln G_t - \ln G_{t-12} \\ \ln(P_t - \ln P_{t-12} + 0.02) \\ \ln W_t - \ln W_{t-12} \\ \ln\left(e^{Y_t^l} - 1\right) \\ \ln\left(e^{Y_t^s} - 1\right) \\ \ln S_t \end{bmatrix}$$

Where t denotes time in months.

The development of the vector x_t is modelled by the first order stochastic difference equation:

$$\Delta x_t = A x_{t-1} + a + \varepsilon_t$$

Where A is a 6 by 6 matrix, a is a six-dimensional vector and ξ_t are independent multivariate Gaussian random variables with zero mean. The matrix A and the covariance matrix of the ξ_t were determined by calibrating against the historical data. The coefficients of a were then selected to match the long-term economic assumptions.

It follows that the values of x_t will have a multivariate normal distribution. Simulated investment returns will, however, be non-Gaussian partly because of the nonlinear transformations above. Moreover, the yields are nonlinearly related to bond investments.

The first and third components of x_t give the annual growth rates of GDP and wages, respectively. The fourth and fifth components are transformed yields. The transformation applied ensures that the yields are always positive in simulations. Similarly, the second component gives a transformed growth rate of CPI. In this case, the transformation applied ensures that inflation never drops below -2% in the simulations. This figure was selected to be twice the maximum rate of deflation ever found in the historical data.

PPI Aggregate Model

Overview of Aggregate Modelling of Private Pensions

The PPI Aggregate Model links changes in the UK population, the labour market and economic assumptions to project forward private (and State) pension savings. Population projections are taken from 2016-based figures published by the ONS.

Current distributions of individuals across pension scheme types are taken from the Lifetime Labour Market Database (LLMDB),[97] a panel dataset of 1% of UK National Insurance records. The workforce data includes numbers of individuals and average earnings split by age, gender and earnings band. The data are further split between public and private sector contracted-out schemes and those who are contracted-in to the State Second Pension (S2P).

Initial Conditions

In the base year of projection (2010), individuals with private sector pension arrangements are split between public and private Defined Benefit (DB) schemes and workplace Defined Contribution (DC) schemes. 17.5% of working individuals are assumed to be members of DC workplace pensions and 32.1% of individuals are assumed to be members of DB workplace schemes.[98] 73.2% of those in DB schemes are assumed to work within the public sector,[99] leaving 8.6% of the workforce in private sector workplace DB schemes.

The workforce not initially enrolled in public sector DB, private sector DB or private sector workplace DC, are considered as the eligible population for automatic enrolment. This includes individuals not in workplace pension schemes who contribute to personal pensions.

Stocks of existing assets for DB schemes and workplace DC schemes are split across cohorts by contribution levels. Initial stocks of workplace DB assets were assumed to be £890 billion in the base year.[100] It was assumed that the stocks of DC assets in 2010 were £275 billion.[101]

[97] Data from LLMDB 2010-11
[98] ONS (2013)
[99] Average proportion of males and females employed in public sector COSR schemes according to LLMDB 2010-11
[100] TPR (2012) The Purple Book Chapter 4 Table 4.1 Assets discounted to the base year.
[101] Workplace DC assets taken from ONS (2012) Table 3, adjusted for decumulated assets.

Movement of individuals between schemes due to decline in DB schemes

The proportion of individuals in each scheme is not stable over time: the proportion of the total workforce who are enrolled in a private sector DB scheme is assumed to decline by 80% between 2010 and 2030 and these individuals are moved into the existing DC workplace schemes.

Movement of individuals between schemes post automatic enrolment

From 2012, employees in the private sector without workplace DC provision are placed in a scheme to represent automatic enrolment, which is split further into master trust schemes and other DC schemes, assuming 80% are automatically enrolled into master trusts and the remaining into other DC schemes. Individuals are enrolled in proportion to the likely number of employees becoming eligible each year due to staging of their employers. Similarly, during the staging period, employees in existing DC schemes who become eligible for automatic enrolment either remain in the existing scheme or are moved to a new automatic enrolment workplace DC scheme (again split into master trusts and other DC schemes in the same proportions as mentioned above). It is assumed that 80% of existing members remain in their current scheme, and 20% are expected to move to the new automatic enrolment scheme. New members to DC schemes who have an employer with an existing scheme either join the new automatic enrolment scheme (80%) or join an existing DC scheme (20%).

Overall, after 2012 the private sector workforce is assumed to contribute to either private sector DB pension schemes, DC schemes which were existing prior to automatic enrolment, DC schemes which were set up for automatic enrolment, or DC schemes set up for those that are eligible for automatic enrolment that did not contribute before the implementation of automatic enrolment. It is assumed that 14%[102] of the workforce change jobs from year to year, which causes individuals to shift from existing DC schemes into new DC automatic enrolment schemes over time.

Contributions

Contributions are taken as a percentage of total earnings for employer-provided schemes (both existing schemes and those set up after automatic enrolment) and are taken across band earnings for individuals automatically enrolled who previously were not saving. The earnings band is taken to be £6,240 to £50,270 with an earnings trigger of £10,000 (all in 2023/24 terms).

When automatically enrolled, individuals and their employers are assumed to contribute at the minimum levels required under automatic enrolment legislation (phased in from a combined contribution of 2% of band earnings in 2012, rising to 8% of band earnings in 2019 in accordance with existing regulations) unless otherwise stated.

Limitations of analysis

Care should be taken when interpreting the modelling results used in this report. In particular, individuals are not considered to change their behaviour in response to investment performance. For example, if investments are performing poorly, an individual may choose to decrease their withdrawal rate and vice versa.

Monte Carlo simulation can be a powerful tool when trying to gain an understanding of the distribution of possible future outcomes. However, in common with other projection techniques, it is highly dependent on the assumptions made about the future. In this case, the choice of distribution and parameters of the underlying variables, the investment returns of equities, gilts and cash are important to the results.

[102] Average annual workforce churn. DWP (2010) p49

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