TISA
The Investing and Saving Alliance

Getting Retirement Right

Plan, prepare, enjoy

The above-named organisations have contributed to this consultation response and/or were consulted in developing the proposals and recommendations in this report. None of the proposals should be assumed to be the individual policies of any of these organisations. They do, however, represent significant thought and debate and whilst not all organisations have had the same level of involvement, they all welcome the opportunities these proposals provide for a constructive dialogue with government, regulators and other financial services stakeholders.

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Recommendation 1

Increase Auto Enrolment (AE) contribution to 12% so that majority of households achieve the desired retirement income of £29,000 per annum, including the State Pension.

Recommendation 2

Implement the proposals to lower the minimum age for participation in AE to 18 within 2 years by 2022.

Recommendation 3

Implement the proposals to remove the lower earnings limit within 2 years by 2022.

Recommendation 4

As part of the next review, develop solutions for increasing consumer engagement with their pension savings, plus develop solutions for providing appropriate levels of financial guidance and advice to ensure that households are making informed decisions regarding levels of savings that are consistent with their retirement income expectations.

Recommendation 5

Ensure that any review and changes to the State Pension take in to account the overall retirement income targets that are deemed appropriate and the impacts this has on AE's ability to deliver on the income level that will be required from a private pension.

1. Executive summary

This paper is intended to help inform and influence the debate on AE contribution levels and will be of interest to policy makers, employers, consumer groups, trade associations and pension providers.

We have illustrated the typical lifetime challenges that households face in seeking financial resilience in retirement plus the potential outcomes of pension saving via AE. We explored key factors that underpin having sufficient provision for retirement and used a series of scenarios and models to evidence why an increase in AE contribution levels to 12% is required to deliver adequate levels of retirement income for life. This is based upon a median earnings household needing £29,000 net per annum in retirement and, assuming that both partners are entitled to a full State Pension, this means the State will provide £17,500 and their private pension needs to deliver the balance of £11,500.

We recognise that policy changes can take years to implement and we have therefore based our work on the cohort entering the workforce in 2025, as this is potentially the first group that will benefit from proposed changes, providing the system that will underpin pension savings during their working lives. We are also assuming the Government's 2017 proposals relating to the removal of the lower earnings limit and the reduction in minimum age to 18 are in place by that time.

We have considered this cohort from the perspective of retirement income needs for 2-adult households as this group currently represent 85% of total UK households and over 70% of retired households are couples. This also lets our modelling take into consideration the different career and savings journeys that the partners within a household may experience, combining their income needs as well as their collective ability to make sufficient provision for retirement.

Circa 19 million employees are already saving for their retirement through workplace schemes and are at varying stages on their journeys. Whilst this is positive progress, we are deeply concerned that two thirds of people are falling short of providing an adequate income in retirement. In terms of the savings landscape in general, current trends are also bleak. The June 2019 ONS Household Savings Ratio shows rates remaining at around 5%, near historic low levels. This compares to 11% for the EU. A recent report by Nationwide estimates nearly 1 in 4 UK adults (over 12 million individuals) do not have any form of non-pension savings product. Even for those who do have a savings account or other product, nearly one quarter do not save anything.

Recent ONS statistics show that debt, excluding mortgages is still on the rise. Credit card debt and personal loans rose by 11% in the two years to March 2018. Average household debt rose 9% in the same period to £9,400. December 2019 figures show a reduction in credit card debt but more evidence is required before we can conclude that this is part of a longer-term trend.

We have seen seismic shifts in several areas which may impact on the ability to save, especially for younger generations who are in the process of accruing wealth for their retirement.

Housing and pensions are the two most valuable assets for the typical household, and any changes to the accessibility and value of these assets has a significant knock-on impact to wealth creation. Not only have increasing house prices made it harder for younger generations to own property, they have the double whammy of entering work following a significant change in Occupational Pension provision.

House prices have risen 173% in England in the last two decades, whilst average pay for 25-34-year olds has risen by just 19% over the same period. Home ownership for this group has dropped to less than 30% of families owning a home, compared to 60% 35 years ago. This is forecast to result in more households entering retirement as lifetime renters, needing an additional c£9,000 of income per year to cover rental costs. This means having to save almost twice as much into their private pension to cover this cost where they choose not to avail of, or do not qualify for council housing. Furthermore, they will not have equity in a property available to them to cover other unpredictable costs in retirement, such as care home costs.

For those who do buy a home, the choice of staying in an AE scheme, or opting out whilst saving for a deposit, can be very complex as the long-term mortgage costs can vary greatly as can the investment performance on their pension savings. We have modelled several scenarios using different pension contribution rates and opting in versus opting out to build a deposit more quickly, which also impacts the size of the final pension pot. Taking the benefits of early mortgage repayment and offsetting this against larger pension pots, we concluded that based on our assumptions, private pension wealth was extinguished at a later age when remaining opted in, for all contribution levels. However, prospective house buyers should assess their specific situation to see what is best for them.

Regarding pensions, the private sector has seen a huge decline in employers offering Defined Benefit (DB) schemes, replaced by Defined Contribution (DC). In addition to the large reduction in employer contribution levels (19.2% DB vs 2.4% DC in 2018), the shift to DC moved all responsibilities relating to retirement outcomes away from the employer and onto the employee. Individuals now need to be aware of their responsibilities and plan accordingly. This sits at odds with the current levels of adult financial literacy whereby we have a population that typically do not understand how to manage their money, do not understand pensions and investments and have not realised that responsibility now resides with them. This is reflected in the extensive degree of under-saving referenced above.

As part of the planning process, households need to understand how long they need to provide for themselves in retirement. Until recently, life expectancy rates have been on the rise, with a person reaching State Pension Age (SPA) in 2025 needing to fund their retirement for 25% longer than someone reaching SPA in 1990. By extension, they also need a pension pot that is 25% larger. The group entering the workplace in 2025 have an average life expectancy of 90 years and also need to fund retirement for over 20 years.

Added to this challenge, years in good health have not increased at the same pace as life expectancy, so a longer period of retirement is likely to be spent in poor health, which has a knock-on impact of higher care costs.

Retiring early due to ill health can make households particularly vulnerable, especially where they have a number of years until reaching SPA and they are reliant upon their private pension savings. With the State Pension representing 60% of planned income in retirement, not having access to the State Pension from the outset of retirement means their private pension will be whittled away very quickly and will subsequently provide a reduced income from SPA due to the depleted size of the residual pension pot.

In 2017, there were 400,000 people over the age of 65 years old in a care home with 70% of care home residents suffering from dementia. In total 800,000, or 1 in 15, over 65s are suffering with this condition with numbers expecting to top 1 million in 2025 and 2 million by 2051. Combined with other ailments requiring care home or equivalent services in the home, this will place significant pressure on retirees and the State. Our models indicate that typical median earning household will need to save 12% of salary to ensure that they have sufficient income over their 20+ year retirement lifetime as well as the ability to meet moderate care costs.

This does not include the ability to meet care home costs. Whilst we know that care home (or equivalent) costs total over £80,000 per individual, we are not, at this stage, recommending a level of additional contributions as part of the standard AE contribution level. We believe that further work is required regarding how to deal with this problem given that the potential need for individual care in the distant future is very hard to predict, albeit we need to ensure individuals receive the appropriate care and support when it is needed.

Our modelling also identified an inconsistency between expectations of a lump sum at retirement and current under-saving, with many households simply not having enough surplus in their pension pot to enable a lump sum to be taken and still meet income requirements. Initial work indicates that an additional 2% to 3% level of contribution is required to boost savings sufficiently to provide for the maximum 25% lump sum.

We have also considered a range of other factors that many households will face as part of their working age experiences. Households fortunate enough to have a salary that increases above the average will likely seek a higher level of retirement income and this group will need to save well in excess of 12% over their career to compensate for early contributions being at a much lower level than later life when earnings are greater. If trends continue, 12% of households will have at least one adult who will be self-employed for some period of their working life, with this group historically being very poor at saving for retirement. Households may also

experience periods of unemployment or give up work early to care for parents or their household partner. Whilst some of these factors are hard to predict, it does re-enforce the point that households need to regularly review their financial affairs and determine if they remain on course to meet their retirement income targets.

Whilst AE has been a success, over 10 million employees are still not in a workplace scheme, many of them due to low salaries that are under the earnings trigger. The majority of these are women, which means the eligibility criteria for AE is widening the gender pensions gap on top of the existing inequalities in sizes of women's pension pots compared to men.

Given that most households consist of at least one female, this exacerbates the savings challenge. In addition, there are several other groups who are not eligible for AE such as the self-employed and full-time informal carers.

Compound interest is a key factor that underpins the growth and outcomes of all pension pots. The early pension contributions have the greatest opportunity to grow and by the time households are nearing retirement those early investments are the drivers behind wealth, whilst ongoing contributions have a far smaller impact on the size of the pension pot at retirement. Trying to make up for savings shortfalls in the later years requires much larger contributions and would challenge most households to find the additional money required. Delaying the start of contributing to a pension also has a dramatic impact, with every ten years' delay halving the pension pot at retirement. This also means that timescales to implement changes to AE would have a significant impact.

Households also need to consider the State Pension which is a critical component given it typically represents 60% of the average household's retirement income.

However, the State Pension has undergone considerable change over a long period which makes financial planning around this more complicated. Given the reliance that households have upon the State Pension we advocate that any future changes consider both the State Pension and AE together, to ensure that households can adapt their private savings to compensate for changes to the State system to preserve their target income in retirement.

We therefore think that it is critical to put more consumer support infrastructure around the AE proposition to assist people in understanding and making key decisions that will have long-term impacts on their financial wellbeing. Without some form of guidance being in place at all steps along the retirement journey, the typical employee will be unable to plan effectively and the household is likely to realise too late in their working life that they will fall well short of their retirement expectations.

It is crucial that consumers have access to guidance from 18 years old onwards to ensure they have the knowledge to make the best use of the savings opportunities that are available to them. The general population receives very little education either in schools or in the workplace to prepare them for these responsibilities. According to the FCA's 2018 Baseline Report, only 8% of the adult population receives advice. This results in the vast majority of the public becoming reliant upon financial guidance, being a service that does not personalise the information being provided to the consumer, nor does it provide a recommendation on the best course of action suited to that person.

The Money and Pensions Service (MaPs) provides guidance services to those over 50 in the form of Pension Wise, but there is much less support for people who are at an earlier stage in their retirement savings journey. We propose that industry plays a more significant part in both in their role as the product/service provider but also as they are typically the first point of call for people seeking assistance. However, the current guidance regulations deter firms from providing the degree of personalisation that would help individuals make better decisions with the benefit of insights that are relevant to them and their goals.

Not only do we advocate that the FCA clarify the boundaries between guidance and advice to make these much clearer, we also call for greater levels of personalisation within guidance to leverage the information that will be available through pension dashboards and other data sources.

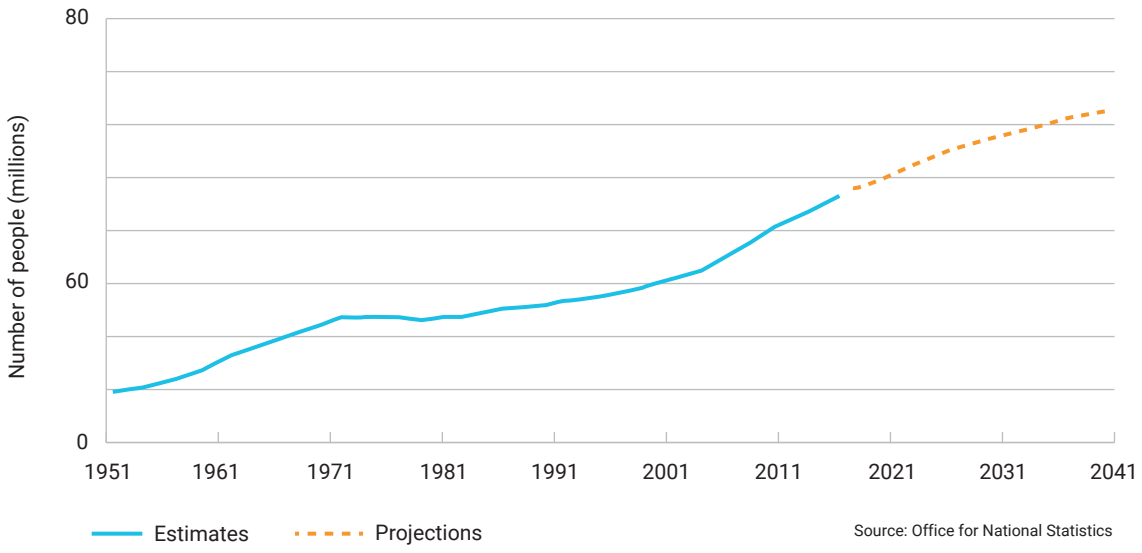
It is critical that the Government and financial services rapidly put in place solutions that address all the key challenges identified in this report and which are required to deliver the long-term outcomes for all age groups.

2. The new reality of preparing for retirement

We are living longer…

The UK population continues to grow, whilst trends in longevity mean that a greater proportion of people will be older and living in retirement for longer. The UK population was estimated at 66 million in mid-2017 by the ONS with 18.2% (12 million) over 65[1] and is expected to grow to over 72 million by 2041 with 24% (17.3 million) over 65.

UK population estimates and projections, 1951 to 2041



This is likely to put increasing pressure on the provision of State Pensions, hospitals and care services, requiring some combination of additional spend and tighter management of services to align with available budgets.

Life expectancy for newborns has increased from 73.06 years for those born in 1980[2] to 91 for those born today[3], with 20.8% of boys and 31.7% of girls of this latest cohort projected to be centenarians.[1] However, whilst we have seen a long-term trend in increasing longevity, projected lifespans are now beginning to plateau.

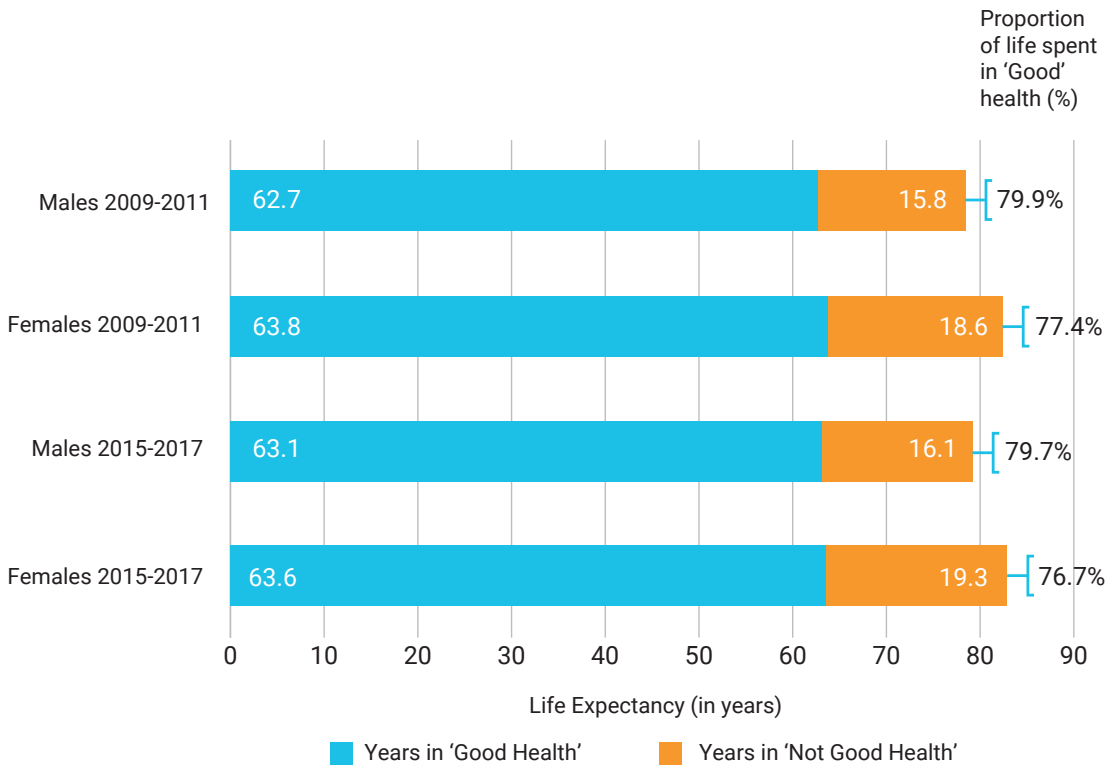
Someone who reached SPA at 65 years old in 1990 had an average time in retirement of 16 years[4] compared to someone who reaches SPA in 2025 (66 years old) who is projected to have an average 20 years in retirement.[5] In financial terms, this means that the individual retiring in 2025 will have to save more to create a pension pot that is 25% bigger to enjoy the same annual income over the longer retirement period even though their working career is only 1 year longer.

Looking further out, considering the trends in longevity and the SPA progressively increasing to 70, the time in retirement will remain broadly similar at around 20 years. Careers will get longer as will the length of time available to save the additional money required to fund an equivalent pension to someone who retired in 1990, however an additional five years over a fifty-year career to fund the extra 25% required remains a significant challenge.

1 ONS Overview of the UK population: November 2018
2 ONS National life tables, UK: 2015 to 2017
3 ONS Life Expectancy calculator
4 ONS: National life tables, UK: 2014 to 2016
5 ONS: Past and projected data from the period and cohort life tables, 2016-based, UK: 1981 to 2066

...but not healthier

The combined male/female average healthy life expectancy (HLE) at birth (very good or good health) is 63.3 years in 2015-17 based on self-reported health and is not increasing by the same rate as overall life expectancy. HLE has increased since 2009-2011 by 0.4 years for men and reduced by 0.2 years for women.[6]



This has two key implications. Firstly, retirement provision should factor in the costs for a longer proportion of retirement spent in poor health. Secondly, that this may cause individuals to finish their working lives prematurely, cutting short the opportunity to continue accruing pension savings.

The government is promoting 'fuller working lives' which includes working for longer. If this initiative is to be a wide-scale success, we need to consider how to extend the working lives of those impacted with poor health in their 60s and earlier.

Personal wellbeing, both in the workplace and outside are areas which need to be explored further to understand the positive impacts this can have throughout a working life, as this may help prolong a healthy life expectancy. Where poor health does not prohibit individuals from undertaking an alternative form of work, we need to consider the reskilling and retraining opportunities that are available.

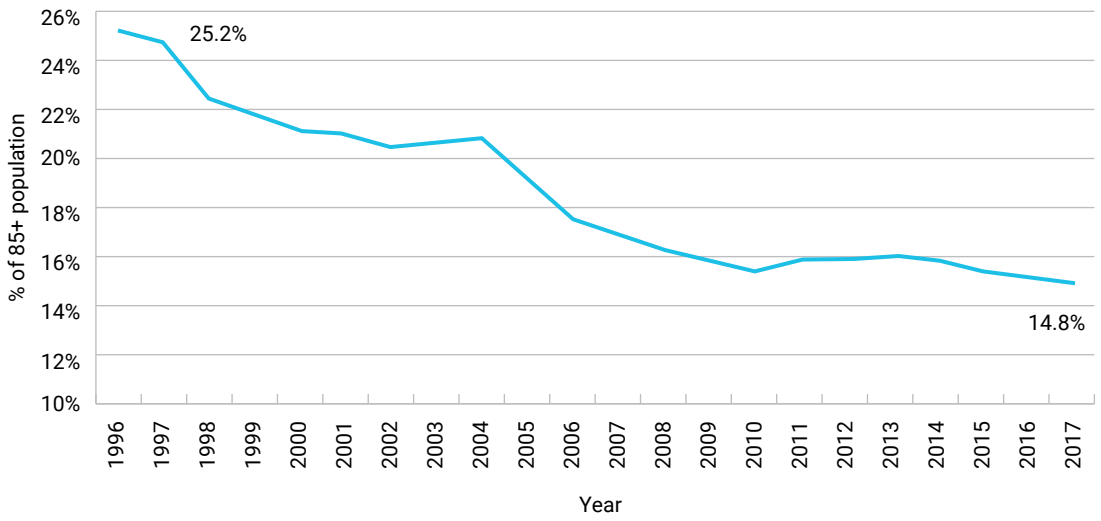
Care costs are rising

Around 425,000 of those aged 65+ were in residential and nursing care homes in 2017. This equates to around only 3.5% of that age cohort. However, over half of these (232,000 individuals) were aged 85+, representing 15% of that older cohort. This represents a decline since 1996 when 250,000 of those over 85 were in residential care, despite the total number of this cohort increasing from 1m to 1.5m over the same period. Likely drivers include the tightening of local authority budgets, which are referenced in other available research materials and more care within the home.

6 ONS Health state life expectancies, UK: 2015 to 2017

70% of care home residents (297,500 people) in 2017 suffered from dementia or severe memory loss. There are over 800,000 people in UK suffering from dementia (1 in 15 people over 65+) so less than half of these are in care homes. The number of sufferers is projected to rise to over 1 million in 2025 and double to 2 million by 2051[7], which is expected to increase the need for both care home residency and home care.

Proportion of the 85+ population in residential care



On average, people spend 30 months in a care home with costs ranging typically from £80,000 to £100,000, however many could end up paying a lot more than this.[8] The most common age of death in care is currently 86 for a male and 89 for a female.[9]

Average costs vary from £841 p.w. for nursing care homes and £600 p.w. for residential care homes. In March 2016, almost 50% of fees were partially or fully paid by local authorities.

State support for residency costs is determined by a means test. At the time of writing, if capital and income is over £23,250 (in England) then it is likely you need to pay care costs out of personal means. Between £14,250 and £23,250, residency will be part funded by the local authority and below £14,250, residency will be fully funded by the local authority. This assessment includes savings, investments, benefits, pensions and property (unless your partner is still living in the family home).

For Scotland, the higher and lower costs are £27,250 and £17,000, for Northern Ireland it is £23,250 and £14,250 and for Wales, the threshold is £50,000.

In Scotland, everyone over 65 is entitled to free personal care if they are assessed as requiring it. There may be some additional costs to cover the likes of laundry, housework, shopping etc. In Wales any homecare costs are capped at £80 per week and in Northern Ireland, help towards home care costs will be dependent on an assessment.

An Attendance Allowance is available throughout the UK for eligible individuals which provides a weekly sum to help cover costs where some form of home help is required.

It is also worth highlighting that many pensioners prefer to be cared for in their own home. The Department of Health confirmed in August 2017 that the number of home care agencies has risen since 2010 by 2,900.

7 Alzheimers Society
8 LaingBuisson, Care of older people: UK market report, May 2017
9 Grant Thornton report 2018 – Care homes for the elderly: Where are we now?

Currently, there is no live Government initiative on reforming adult social care. A green paper was promised in 2017 by the Conservative Party but has yet to be issued. It is now hoped that reform based on cross-party consensus can be achieved.

When planning for potential outcomes, people will have to consider how and who will pay for care costs and the likely impacts of options. This may involve other family members providing care, which in turn may help preserve wealth for younger generations to benefit from an inheritance. It may therefore make financial sense for a family member to give up paid work to undertake this responsibility.

- 1 in 7 of the UK working age population are caring for friend/family
- 2.6 million have quit their jobs to provide care
- More than 600 people quit work every day to take up care responsibilities[12]

Although caring for a family member may help manage costs, those who quit work may be losing out on future retirement saving, either through AE or other vehicles. This in turn places a greater strain on the household finances of those providing the care both pre and post retirement.

The need to address women's pension savings

The key issues that society will need to address are not limited to an ageing population, another important challenge is the disparity in the value of women's pension pots, which at 65 are typically just 20% (£35,800) of an equivalent man's pension (£179,000).[10] This is generally caused through women being paid less than men, plus taking time off to raise a family and assuming caring responsibilities.

The gender pensions gap has narrowed since 2009 when 26% of women were not saving for retirement and 47% were saving adequately versus 18% not saving in 2018 and 54% adequately saving.[11] However, much more needs to be done to address this disparity and some of the underlying reasons for the gap will not go away i.e. bringing up a family and caring responsibilities. Whilst more men could assume these responsibilities, it is still predominately women who carry these out. Women aged 45-54 are more than twice as likely to have given up work due to caring responsibilities and more than four times more likely to have reduced working hours due to a caring role.[12] Between April to June 2018, more than 9 in 10 fathers in England worked 30+ hours per week compared with 5 out of 10 mothers.[13]

Out of 19.2 million families in UK, there are 12.8 million married and civil couple families, 3.5 million are male/female cohabiting couples and 2.9 million lone parent families.[14] Up to 84% of these UK families could be facing the challenge of achieving an appropriate retirement income due to the gender pension gap. This is likely to apply to other households that include women and same sex couples, but more detailed data is less available to substantiate the potential extent of the issue.

Given the universal impact of this issue on UK society and the fact that women face the same challenges to save for retirement as men, a major rethink is required to consider how future generations will save differently to address this imbalance. This is especially pertinent to all female households.

The State Pension alone will not be sufficient

The State pension has increased coverage, however the amount paid has reduced over time.

In 1994/95, the median amount received for pension couples was £160 per week and 94% of pensioners were in receipt. This converts to £292 in 2018 terms.

In 2017/18 97% of pensioners were receiving a state pension with the median for couples being £239. The amount in real terms has dropped by circa 20% which means there is a greater reliance on other forms of retirement income to bridge the gap with older retirees.[15]

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10 CII report: Deficit by a thousand cuts October 2018
11 Scottish Widows Women and Retirement Report 2018
12 Carers UK
13 ONS: Families and the labour market, England: 2018
14 ONS: Families and households in the UK: 2019
15 National Statistics: Pensioners' incomes series

In 2018/19, to receive a full-state pension you require 35 years of contributions/credits. The DWP predicts between 85% and 90% of individuals reaching state pension age will receive the 'full gross' new State Pension.[16] This is more generous than the amount that couples have previously received as this totals £337, however this is only a prediction and there are still 10-15% of the population expected to receive less than this amount.

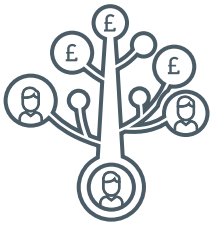
The considerable number of changes to the state pension over the past twenty years both in terms of years of contribution and amount received casts doubt over the degree to which people can rely upon their State Pension being guaranteed in the future. This in turn may prompt people to consider how much they need to save to make up the shortfall between the State Pension and their desired level of income in retirement.

The shift from Defined Benefit to Defined Contribution is having a marked impact

Over the last 30 years, the occupational pension scheme landscape has been transformed, with DC taking over as the mainstream approach to occupational pension saving, including the advent of AE and the general decline of DB within the private sector. The public sector continues to enjoy the generous benefits that DB pensions provide with 6.3 million active members of public sector DB pension schemes, 15% of the working age population (ONS). However, in the private sector, DB has been in decline for decades in terms of number of open schemes and active members. Figures from the latest Purple book issued by PPF illustrate this decline below:

Number of PPF eligible schemes

2006 7,800 ↓ 2018 5,450



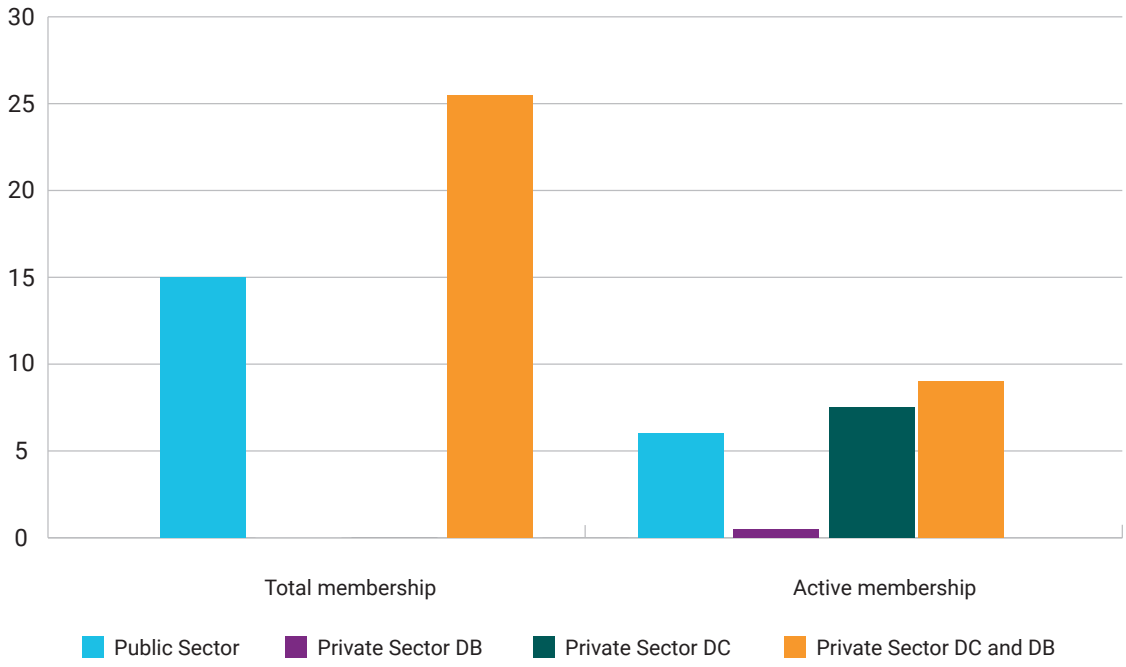
Percentage of schemes open to new members

2006 43% ↓ 2018 12%

Percentage of schemes closed to new benefit accrual

2006 12% ↑ 2018 41%

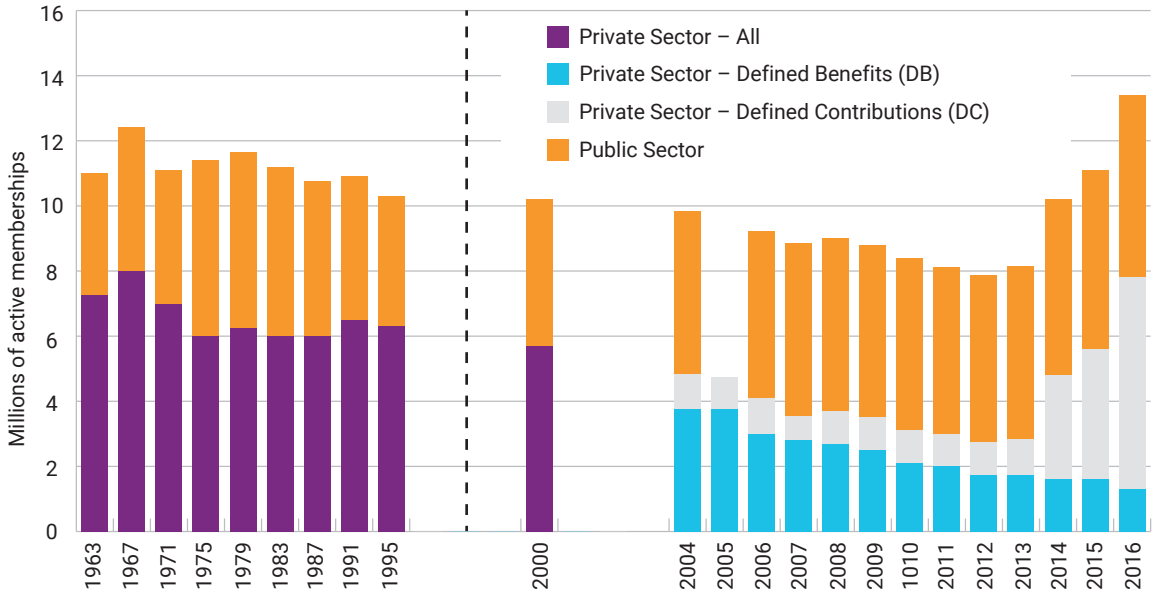
Occupational Scheme membership by type as at June 2017 (millions)



16 DWP: Impact of New State Pension (nSP) on an Individual's Pension Entitlement – Longer Term Effects of nSP Jan 2016

DB private sector membership peaked in 1967 with active membership topping 8 million out of a total working age population of 33.5 million. Nearly 1 in every 4 people held active private sector DB membership and 1 in 8 of the working age population were active members of a public sector scheme.12 Combined, approximately 12 million or 1 in 3 were an active member of an occupational pension scheme.

Number of active members of occupational pension schemes by scheme type and sector

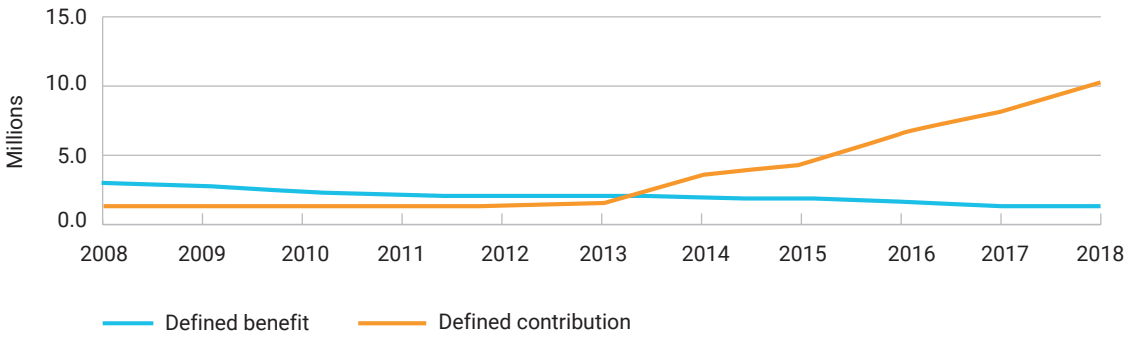


Source: ONS Occupational Pension Schemes Survey 2016
Note: quadrennial survey up to 1995; annual from 2004. Public sector not covered by 2005 survey.
Changes to methodology for 2006 onwards mean that comparisons with earlier years should be treated with caution.

By 2018, active DB private sector membership stood at 1.1 million[17] out of a total working age population of 41.5 million.[18] Only 1 in almost every 38 people held active DB membership.

It is also worth noting that DB schemes will usually provide spousal pension provision in the event of member death, providing an element of security for the surviving partner. 29% of households have DB wealth with the median being £108,200.[19] With the decline in private sector DB, this will be skewed towards older cohorts in the private sector with younger cohorts unlikely to accrue any DB pension benefits.

Active membership of private sector occupational pension scheme by benefit structure, UK 2008 to 2018



Source: Office for National Statistics – Occupational Pension Schemes Survey

17 ONS Occupational Pension Schemes Survey 2018
18 ONS Overview of the UK population: November 2018
19 ONS Wealth and Assets Survey wave 5: 2014-16

With DB, the responsibility of providing a guaranteed level of income for life falls on the employer, with low levels of employee engagement required. With DC, the employee is responsible for ensuring that sufficient contributions are made to reach their target savings pot, that investments are monitored and refreshed as required and that the preferred income option delivers the desired standard of living. All the risks are borne by the employee and requires active engagement.

In 2018, the average total contribution to a DB scheme per member was 25.2% of pensionable salary (employee 6%/employer 19.2%). With DC, the average total contribution per member was 5.1% of pensionable salary (employee 2.7%/employer 2.4%), a dramatic reduction in the amount invested, particularly from an employer perspective.[20] This increased under AE in 2019 for workplace schemes to 8% of banded earnings (employee 5% and employer 3%) but this is still significantly below the levels of DB schemes.

Using identical annual investment growth rates and the typical median salary of £28,000 p.a. we have modelled the average 2018 DB contribution of 25.2% versus the auto enrolment level of 8%, to demonstrate the difference in pension pot size at retirement. We have also modelled the resulting pension income, using the DB income guarantee based on 1/60 accrual rate compared to DC savings being used to purchase a joint-life annuity available in the market today.

In our model, the DB scheme delivers a notional pot size of £487K and a starting annual income of £18,666, equivalent to an annuity rate of 3.8% of the pot for an inflation linked pension with 50% spouses' pension. By comparison, the DC scheme would provide a pot of £155K based on an 8% total level of contribution and a starting annual income of £3,850, equivalent to a 2.5% conversion rate of the pot, for an inflation linked pension with 50% spouses pension. At the time of writing, this is based on current annuity rates available on the open market.

It is worth noting that the annuity rate is variable and will be based on the available terms at retirement. These are currently very low compared to the late 1980s where it was possible to achieve rates of circa 5% for an index linked annuity with 50% spouses' pension. Whilst this still only delivers £7,741 per annum compared to the DB income of £18,666, had both schemes enjoyed the same level of contributions, the DC scheme with a higher annuity rate of 5% would have provided £24,385 per annum and been the most attractive option. However, it is highly unlikely that DC schemes will benefit from such high contribution levels or enjoy such generous annuity rates meaning DB will remain the most attractive savings option.

DB PENSION
1/60 accrual
Salary £28,000 p.a.
19.25% employer contribution
6% employee contribution
5% net investment growth p.a.

40 years
Total employer contributions **£215,000**
Total employee contributions **£67,200**

RETIREMENT OUTCOME
Notional fund value £487,700
Guaranteed pension p.a. £18,666
Pension as % of fund value 3.8%
Spouses pension
Index linked

DC PENSION
Salary £28,000 p.a.
3% employee contribution
5% employee contribution
5% net investment growth p.a.

40 years
Total employer contributions **£33,600**
Total employee contributions **£56,000**

RETIREMENT OUTCOME
Fund value £154,800
Guaranteed pension p.a. £3,850
Pension as % of fund value 2.5%
Spouses pension
Index linked

The high contribution levels for DB schemes are determined by the income guarantee that the scheme provides. Strict and prescribed funding levels are put in place to demonstrate the scheme can meet its liabilities and where a scheme becomes underfunded, a catch-up payment is required to ensure funding levels are maintained. This means that contribution levels are directly aligned to the income guarantee and the scheme underlying investment performance.

Whilst investments will be determined by the scheme, the guarantee does not reduce when markets drop – the employer has no control over its obligations i.e. it cannot reduce benefits during periods of falling markets.

20 ONS Occupational pension scheme survey 2018

With DC, there is no guarantee and minimum contribution levels for AE schemes are determined by legislation. Retirement income is dependent on the choice of product selected, investment performance and/or the annuity rate in force at that time. All these decisions need to be determined by the individual.

There is a critical need for education, financial guidance and advice

An important factor regarding the shift to DC and AE relates to the moving of responsibility for retirement outcomes from the employer to the individual. This includes responsibility for setting an appropriate personal contribution level and reviewing this regularly in line with income and market changes. Individuals should also check if the default fund and lifestyle strategy is appropriate and if not, selecting an alternative strategy/fund ensuring that these remain appropriate throughout the accumulation phase and decumulation where Drawdown is selected. Individuals also need to consider commencing lifestyle strategies at the correct time, considering the merits of consolidation where they have multiple pension schemes and selecting the correct retirement options, potentially over a number of years with phased retirement plus any death benefits/IHT planning. They also need to consider, choose and implement the most appropriate retirement income strategy to deliver their desired lifestyle, taking into account factors such as long-term interest rates and longevity.

This is a huge undertaking for individuals, yet most people do not understand that they have these responsibilities.

To put current levels of understanding of pensions into perspective, 51% of employees auto enrolled believe the current contribution rate is the recommended savings level and 80% do not know if they are saving enough.[21]

The general public need to be far more aware of all aspects relating to the management of their pensions, including the significant impact and benefits of saving early and compounded growth. A delay of ten years in starting retirement savings could result in an individual receiving only half as much income due to the compounding effects of the final years.

The general population receives very little education either in schools or in the workplace to prepare them for these responsibilities. According to the FCA's 2018 Baseline Report, only 8% of the adult population receives advice each year. This results in the vast majority of the public becoming reliant upon financial guidance, being a service that does not personalise the information being provided to the consumer, nor does it provide a recommendation on the best course of action suited to that person.

The Money and Pensions Service (MaPs) provides guidance services within these constraints to those over 50 years old in the form of Pension Wise, but there is much less support for people who are at an earlier stage in their retirement savings journey.

Financial services firms could also play a significant role in helping people, but the current guidance regulations are sufficiently ambiguous that firms generally refrain from offering services that might inadvertently put them in breach of the advice rules.

Given the complexity that people are facing and their lack of financial understanding, constraints on providing a degree of personalisation that would help individuals make their own decisions with the benefit of insights that are relevant to them and their goals will almost certainly result in detrimental outcomes for millions of consumers.

The FCA stated at their annual public meeting in July 2019 that the advice boundary is 'almost impossible' to define, yet despite concerted effort on the part of TISA and its members, this critical issue remains unresolved.

Not only does TISA advocate that the FCA clarify the boundaries between guidance and advice to make these much clearer, we also call for greater levels of personalisation within guidance services offered to leverage the information that can be presented through pension dashboards and other data sources to enhance consumers' ability in making their own informed decisions.

21 PLSA: Hitting the Target

The Auto Enrolment success story

It is important to recognise the success of AE, having brought an additional circa 8 million private sector employees into occupational pension saving by the end of 2018.[22] This equates to 1 in every 4 people of the working age population being an active private sector member, albeit mainly DC rather than DB and significantly lower than 1 in 3 participation peak in 1967.

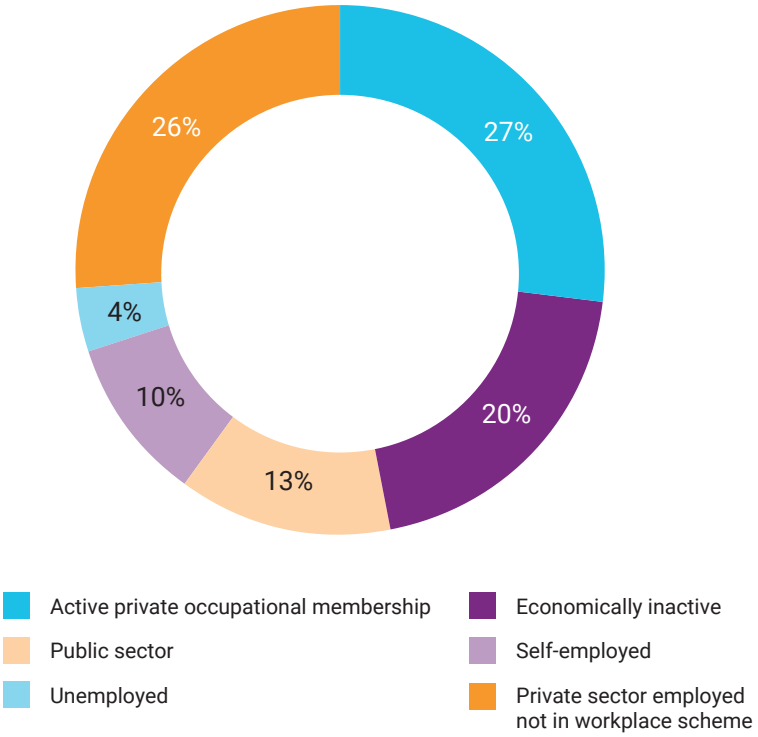
	Active members DB (millions)	Active members occupational DC (millions)	Total active members (millions)
2011	1.9	0.9	2.8
2018	1.1	9.9	11

Despite this success, the widespread adoption of pension savings has a long way to go. Of the UK working age population (aged 16-64), over 10 million employees are not in a workplace pension scheme, including 5 million gig economy workers in the UK[1], most of which are earning less than the £10,000 entry level for AE within a single employment. We therefore believe the earnings trigger of £10,000 should be included in the next AE review. There is no single agreed definition for the gig economy group so estimates do vary.

It is worth noting that workers with a contract of employment (written or otherwise) will be covered by AE if they meet eligibility requirements. This includes agency workers, temporary workers and zero hour contract workers.

Combined with the self-employed, unemployed and economically inactive, there are a broad cross section of society who will be reliant on other forms of retirement saving or on other household members that are saving through AE or other vehicles. The chart below shows the breakdown of the working age population[23].

Breakdown of UK working population 16-64



22 ONS Occupational pension scheme survey 2018
23 ONS: Labour Force time series/self-employment trends/Public sector employment 2019

The table below shows that since the introduction of AE, the number of contributors to Personal Pensions has risen from 4.75 million employees in 2011/12 to 11 million in 2018. The PEN3 data from the HMRC is the latest available at time of writing. Whilst this does not provide a breakdown between individual and group personal pension (GPP), the huge rise in the number of employees contributing since the start of AE implies that the reason for this increase is employees contributing to a workplace GPP. However, AE does not incentivise the self-employed to contribute to a personal pension with the number of individuals actively contributing to a pension having fallen by 230,000 since 2010/11.

PEN3

Personal Pensions.

Estimated number of individuals making or receiving contributions and average contribution by status (2007-08 to 2016-17).

Numbers: thousands; Amounts: £

	2007-2008		2008-2009		2009-2010		2010-2011	
Status	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual
Employees	6,530	2,520	5,510	2,980	5,310	3,010	4,980	3,260
Self-Employed	990	3,570	800	3,270	660	3,030	620	3,330
Unemployed	60	2,240	30	3,070	20	2,480	30	2,770
In receipt of a Pension	20	4,230	10	4,410	10	3,790	10	3,840
Child	10	2,480	10	2,330	10	2,310	10	2,380
Full-time Education	10	2,120	10	2,060	10	1,980	10	2,160
Carer	10	2,110	10	1,920	10	1,980	10	2,350
Total	7,630	2,660	7,630	3,010	6,040	3,010	5,680	3,260

	2011-2012		2012-2013		2013-2014		2014-2015	
Status	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual
Employees	4,750	3,640	6,320	2,810	6,720	2,780	6,920	2,980
Self-Employed	500	4,250	640	3,160	510	3,630	440	4,460
Unemployed	20	3,390	30	2,750	30	3,140	30	3,700
In receipt of a Pension	10	4,470	10	4,160	10	4,710	20	4,360
Child	10	2,460	20	1,790	20	2,110	20	2,310
Full-time Education	10	2,350	10	1,910	10	2,200	10	2,470
Carer	10	2,410	20	2,090	20	2,340	20	2,830
Total	5,310	3,690	7,050	2,840	7,310	2,830	7,440	3,070

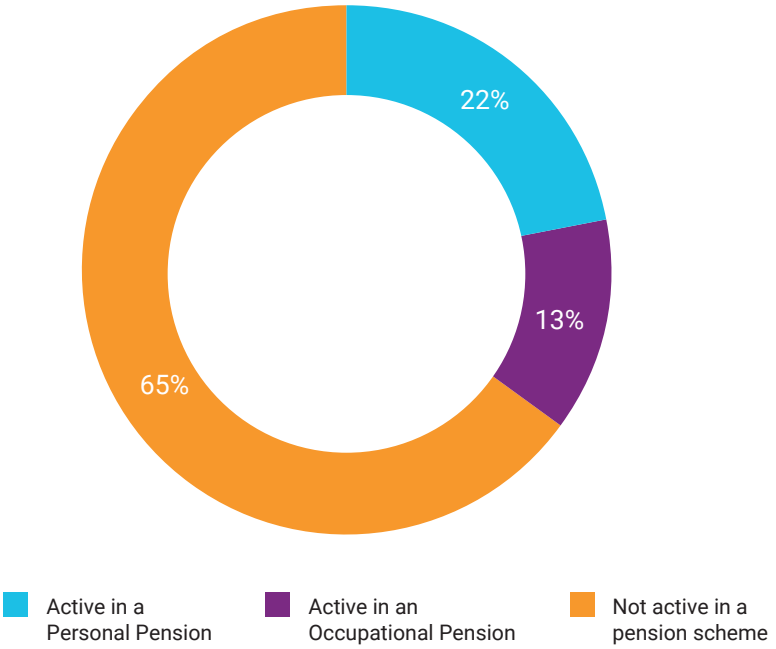
	2015-2016		2016-2017	
Status	Number of Individuals	Average Annual Contribution per Individual	Number of Individuals	Average Annual Contribution per Individual
Employees	7,650	3,230	8,000	3,110
Self-Employed	390	5,750	390	4,930
Unemployed	30	4,120	30	4,070
In receipt of a Pension	20	5,050	20	4,700
Child	10	2,560	10	2,290
Full-time Education	10	2,770	10	2,830
Carer	20	3,020	20	3,110
Total	8,130	3,360	8,480	3,200

Published: September 2018.

Pre-AE, there was no requirement for employers to provide a workplace pension scheme which included an employer contribution. Stakeholder pensions were introduced in 2001 which were intended to encourage long-term saving, however there was no auto enrolment into the scheme and no mandated employer contribution. Consequently, take-up was low, the initiative was not a success and many employer 'shell schemes' exist which have no members.

The absence of successful workplace pension saving initiatives for the private sector (outside of DB) resulted in a decline in pension savings until AE was introduced in 2012. Although the success linked to AE is encouraging, it illustrates the number of individuals who were not making savings into pension plans before being enrolled. By extension, this implies a high level of under-saving for retirement across a broad spectrum of society. The TISA paper "Can Housing Wealth Save The Day?" published in December 2016 undertook research to understand the impact of this under-saving on those approaching retirement, aged 50 to 65. The paper concluded that around 7million of the 10.6 million consumers in that cohort had failed to make sufficient provision for an adequate income in retirement.

Private Sector Employment UK 2011



The ONS Census shows us there were 63.2 million people in UK in 2011. This can be broken down to show there were 41 million aged between 16 and 64. 70.5% (29 million) were employed with 21% (6 million) of these in the public sector and 79% (23 million) employed in the private sector.

PEN 3 shows us that 4.75 million were contributing to a personal pension. There were 2.9 million active members of private sector occupational schemes[24] which leaves approximately 15 million not contributing to either.

A snapshot view in 2011 using the statistics above shows that 65% of the private sector aged 16-64 were not contributing to a pension scheme and will have entered AE later in their working life, which will in turn impact the retirement income that they can expect to receive. The situation for the wider society therefore closely reflects the data for the 50 to 65-year olds and scale of under-saving.

As above, banded earnings are expected to apply until the mid-2020s which means that the contributions made will not be the full tiered stages of 3%, 5% and 8%. The combination of a lack of saving over many years, AE only recently getting to 8% and banded still being in place, means that the majority of people will not come anywhere close to achieving an appropriate level of income at retirement, even when combined with a full state pension and any pre-AE pension wealth accrued.

Unless the majority of people make very high contributions to counterbalance this, which is not feasible for most of the population, there is likely to be a significant rise in the number who fall into the classification of 'pensioner poverty' over the next 15 years. This could result in an increase in the additional state support needed and we call for Government to begin assessing the impacts and potential mitigating policies and budgetary response now.

24 ONS: Occupational Pensions Schemes Survey, UK: 2011

3. What does Auto Enrolment's 8% of salary achieve for households?

Our Target Audience

Under proposed legislation changes, the lower earnings limit on AE contributions will be removed in the mid-2020s, with the 8% contribution then being based on whole of salary. A reduction in the minimum age of entry from 22 to 18 is also proposed. The first group that will contribute at these levels over their working career are school and university leavers post those changes. We have therefore targeted this group as our baseline and based our modelling on their projected lifetime experiences.

The aim of this strategic policy work is to ensure that AE delivers financial resilience, through adequate retirement incomes, for future generations and reduces reliance on the state for retirement shortfalls. We have modelled a range of scenarios that our target group are expected to experience and used different contribution rates to test their effectiveness in meeting adequate retirement income outcomes. Our models use an optimistic full working career of 50 years and take into consideration a number of factors which we have explored in more detail in the following pages.

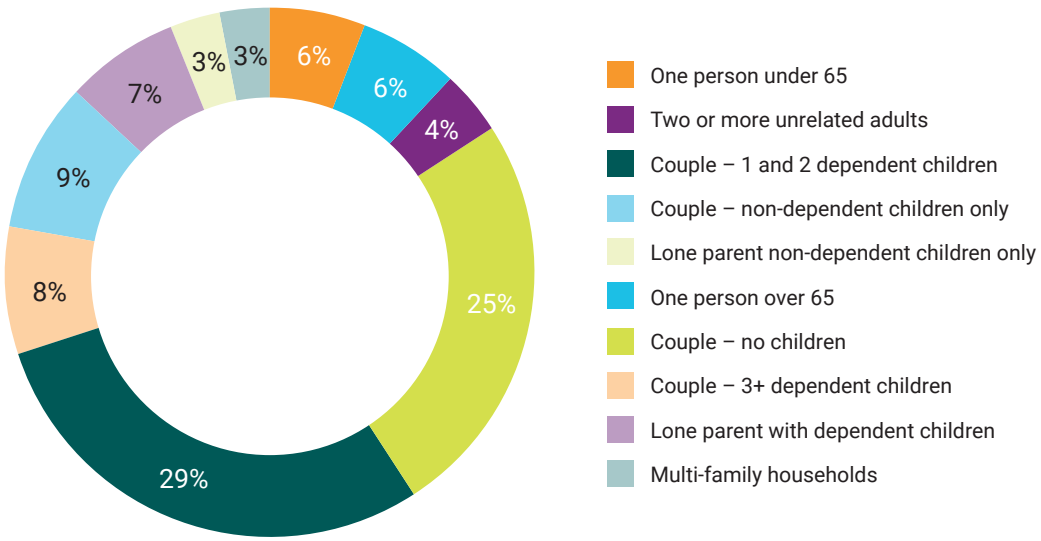
Factors include:

- longer retirement due to increased longevity
- poor health
- old age costs
- impacts of buying a house
- rise in caring responsibilities
- gender pensions gap

Profile of UK households

To better understand the extent to which AE rates are likely to meet the needs of people that are reliant upon this system, we have undertaken analysis that views the impacts on households rather than just individuals, given over 70% of households are couples. The savings journey the couple take and their combined outcomes will determine how well AE will work for them as a household.

UK population broken down by household/family type for 2018[25]



25 ONS People in households by type of household and family

There are 19.1 million families in the UK with nearly 11 million of them comprising children (8 million dependents).

The average age for a first-time mum is 28.8[26] and ONS statistics show the average family has 1.9 children and the average age gap between the two in UK is 3 years and 8 months[27].

So how much does a household need in retirement?

The PLSA issued their 'Retirement Living Standards' research paper in October 2019. The Pensions and Lifetime Savings Association (PLSA) issued their 'Retirement Living Standards' research paper in October 2019. Through commissioned research, they were able to develop three Retirement Living Standards: 'Minimum', 'Moderate', and 'Comfortable'. The Standards show savers what life in retirement looks like at these three different levels, and what a range of common goods and services would cost at each level. The PLSA concluded that for a couple to achieve a 'moderate' retirement, an annual income of £29,100 is required.

These standards are being widely adopted across the industry and to maintain consistency, we have used £29,000 as the net income target that a household will need to achieve.

It is worth noting that the target income level reflects general common costs for most people. Consideration needs to be given to the likelihood of incurring additional expenses, the levels of which are more highly personalised – these are:

- Mortgages – it is becoming more frequent for mortgages to be taken out for longer terms and at a later age. Two in five first-time buyers in 2017 will be still be paying a mortgage post 65 with 34% of first-time buyers opting for mortgages of 30+ years[28]
- Rent – it is also becoming more common to rent property as increased housing costs make it challenging for some groups to get on the housing ladder. Covering rent costs will remain a key expense for many households in retirement
- Debt – there are no forms of major debt such as unsecured loans or credit cards included in the spending patterns. The median unsecured debt for a household aged 65-74 in June 2008 was £900. This rose to £2,000 in June 2016.[29]
- Long Term Care – as the population ages and people are living longer, care costs will increase in retirement. Good health in older age has plateaued despite an increase in general life expectancy which means longer periods of ill health and associated costs, which could be significant

Crucially, how much do you need to save to provide an annual income of £29,000 if a moderate retirement income as depicted above is the aspiration?

There is no single answer to this question. A household can experience any number of life events in that 50-year period between 18 and 68, all of which may impact on the level of saving required to provide an income of £29,000 p.a. Furthermore, there may be other unexpected costs during retirement, meaning you need more income per year to maintain the lifestyle you aspire to.

Equally some elements of the population may want lower or higher levels of income, and there needs to be mechanisms to be able to accommodate their needs as well.

Baseline model and key assumptions

We have looked at a typical family journey to provide a Baseline and then undertaken further modelling to illustrate the impact of various factors which affect the level of saving required to deliver the target income, taking additional expenses into account. Our baseline also sets out non-graduates from graduates, given that one third of 18-year olds go onto university.

26 ONS Birth Characteristics England & Wales 2017
27 Netmums 2017
28 Financial Conduct Authority Sector Views February 2018
29 ONS: Households with debt, by age band, Great Britain, July 2006 to June 2016

The distribution of median and mean income and tax by age range and gender from Government National Statistics (below), illustrates income patterns for the various age bandings. This reflects the median earnings of all employed people in UK who paid tax for 2016/17 and provides a realistic earnings model that shows how median earnings rise with age and peaks at 40-44 before gradually decreasing.

Distribution of median and mean income and tax by age range and gender, 2016-17

	Taxpayers only					Numbers: thousands; Amounts: £
By age range	Total					
	No. of taxpayers	Median income before tax	Median tax	Mean income before tax	mean tax	Projected at 2025
Under 20 (18-19)	139	14,200	577	16,500	1,190	16,879
20-24	1,740	17,200	1,180	19,500	1,690	20,445
25-29	3,010	22,200	2,110	26,000	3,150	26,389
30-34	3,040	25,400	2,630	31,700	4,750	30,947
35-39	2,870	27,800	2,960	37,200	6,490	33,045
40-44	2,800	28,800	3,110	41,300	8,010	34,234
45-49	3,180	28,200	3,000	42,400	8,490	33,521
50-54	3,180	27,500	2,880	41,200	8,050	32,689
55-59	2,690	26,600	2,740	39,200	7,280	31,619
60-64	2,060	24,100	2,310	34,200	5,690	28,647
65-69	2,060	21,300	1,860	28,800	4,120	25,319
70-74	1,720	19,200	1,470	26,400	3,550	
75 and over	2,710	18,100	1,210	23,900	2,790	
All ranges	31,200	23,600	2,250	33,500	5,580	

Our baseline model projects these earnings forward to align with when our target age group start work and their ensuing salary over their career. We have used wage growth of 2.5% p.a.

In 2017 the average working age graduate earned £10,000 more than the average non-graduate graduate (£34,000 vs £24,000).[30] To reflect this difference in real terms, our model reduces the salaries for non-graduates by £5,000 for each of the above ages and increases graduate salaries by £5,000. This assumes the £10,000 difference will remain in the future and is based on the Department of Education statistics which shows this has been the consistent income difference since 2008.

Having projected what median salaries may look like in the future, all outcomes within the models have then been discounted back to reflect savings funds and incomes in today's monetary value.
Our models focus solely on private sector DC pension schemes, combined with the state pension. Other personal wealth, debt and state benefits (other than pension) are not included.

The projected outcomes from the models rely upon assumptions such as investment/wage growth and inflation being borne out in reality. A change in these could have a significant impact on outcomes over a 50-year working career.

We have modelled no tax-free cash being taken to highlight the potential shortfalls that may exist even before any lump sums are withdrawn.

30 Department of Education: Graduate Labour Market Statistics 2018

The Government has previously announced their intention to reduce the minimum age of auto enrolment eligibility to 18 and to have the lower band earnings limit removed so contributions are calculated from the first pound earned. These are due to be implemented in the mid-2020s although there is nothing in legislation currently. The cohort we are focusing on and modelling outcomes for, are those who enter the workforce having left school or university in 2025 with an assumption that the proposed changes are implemented by then. If they are not implemented, this will reduce overall fund values in the future meaning a higher level of contribution will be required to meet the desired outcomes.

Typical non-graduate family journey – Baseline

For the purposes of our modelling, we have assumed that non-graduate households have a potential working career of 50 years (18-68) and are entering the workforce in the mid-2020s. This is based on the average British worker spending 84,365 hours in work over their lifetime which equates to a full-time working career of 53 years.[31] However, when responsibilities such as further education, raising a family and caring are included, the working career pattern is disrupted, so our model factors in time out of work for one of the household partners.

We have modelled outcomes based on the current minimum contribution of 8% and have assumed the proposed changes to remove the lower earnings limit and reduce the minimum age to 18 have been implemented. We have also modelled outcomes for contribution levels of 10% and 12% of gross salary. The fund values and age at which the fund is exhausted are displayed shown in the same format as the 8%/10%/12% e.g. £287,000 and 91 in the scenario below relate to the 8% contribution level.

We have used a tax-free personal allowance of £12,500 per person and assumed that this remains constant in the future, albeit adjusted for inflation. To make the model simple to use, we have assumed that any income achieved up to £25,000 p.a. is tax free and any income above that is taxed at 20%.

We assume that partner 1 builds a larger pension pot than partner 2 as this is the typical family experience. This means that a greater proportion of the combined tax-free allowance of £25,000 will be derived from partner 1's pension income. However, given the complexities of modelling this split for tax purposes, we have not factored this into the modelling. Where this does occur in practice, funds will run out a little earlier than in our scenarios.

Life expectancy is an average of 90 years for this cohort when equalising men and women.

Non-graduate homeowners with 2 children

Fund value at retirement – 8%/10%/12% – £287,000/£365,000/£438,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 91/ 97/103

31 AAT analysis 2018

Typical graduate life journey – Baseline

For the purposes of the modelling, we will assume graduates have a potential working career of 45 years (23-68), also entering the workforce in the mid-2020s. The Baseline graduate journey also factors in time off to raise a family and caring responsibilities for one of the partners and the same tax treatment. For simplicity and comparability, we have assumed the same target income level at retirement albeit in practice this group may aspire to a higher income target.

Student Debt

The Higher Education Initial Participation Rate (HEIPR) is an estimate of the likelihood of a young person participating in Higher Education by age 30, based on current participation rates. In 2016/17 this reached a record level of 49.8%. According to the Institute for Fiscal Studies, average student debt in 2017 exceeded £50,000.

We have not factored this debt into our modelling and assume that a graduate household, with their increased annual income can afford to repay their student loans and make pension contributions.

Graduate homeowners with 2 children

Fund value at retirement – 8%/10%/12% – £332,500/£415,500/£499,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 95/101/108

Key conclusions

The Baseline is an optimistic scenario with the partners experiencing a combined 72 years of full-time employment for the Non-Graduate scenario and 67 years for the Graduate scenario with an 8% level of contribution throughout plus 7 years part-time work. Full-state pensions are also accrued.

With no additional costs arising in retirement or interruptions in the accumulation stage, an 8% level of contribution achieves lifetime household financial resilience in retirement and may also enable an amount of tax-free cash to be withdrawn

Factors which impact retirement saving

Cost of Housing

House prices have risen 173% in England in the last two decades whilst average pay for the age group 25-34 has risen by just 19% over the same period. As a direct consequence, younger age groups are finding it increasingly difficult to get on the housing ladder, with 40% of adults not able to afford to buy the cheapest homes in their area, even with a 10% deposit.[32]

The chart below illustrates the decline in home ownership since 2000 for all age groups except 65+. It is most significant for 25-34 age cohort who have experienced a drop of over 20%.[33]

Younger cohorts possess less wealth and combined with higher house prices results in lower home ownership levels for this group. As these cohorts move into the older age bandings, this will reduce ownership rates for those older cohort bands over time.

32 Institute for Fiscal Studies
33 ONS Labour Force Surveys

The average UK first-time buyer deposit in 2018 was £32,841 on a property value of £212,473.3 The average weekly household spend for a couple under 30 is £553.90 per week, which excludes mortgage payments or rent.[34] If you factor in rent then this leaves circa £1,000 left per year excluding pension contributions for a median earning couple who have already reached £28,000 p.a. However, one half of the couple may often only work full time until late 20s/early 30s due to starting a family so saving for a deposit becomes even more challenging.

If they receive no help from the bank of mum and dad, they will need to prioritise existing outgoings and pension AE contributions are often identified as a lower priority to getting on the housing ladder. Unfortunately, opting out also means they lose the benefit of their employer contribution, tax relief and the compounding benefit over the next 50 years.

Table A9

Household expenditure by age of household reference person
UK, financial year ending 2018

		Less than 30	30 to 49	50 to 64	65 to 74	75 or over	All house-holds
Weighted number of households (thousands)		2,560	9,170	7,510	4,030	3,890	27,150
Total number of households in sample		410	1,820	1,560	950	670	5,410
Total number of persons in sample		990	5,590	3,490	1,670	1,040	12,780
Total number of adults in sample		720	3,430	3,120	1,640	1,030	9,940
Weighted average number of persons per household		2.4	3.1	2.3	1.8	1.5	2.4
Commodity or service		**Average weekly household expenditure (£)**					
1	Food and non-alcoholic drinks	48.20	66.70	66.50	57.50	46.40	60.60
2	Alcoholic drinks, tobacco and narcotics	11.00	12.00	15.00	14.50	7.00	12.40
3	Clothing and footwear	21.30	31.20	27.20	18.40	10.50	24.30
4	Housing(net)[1], Fuel and power	135.50	91.50	65.40	52.00	46.50	76.10
5	Household goods and services	35.00	42.90	45.90	44.30	25.40	40.70
6	Health	3.60	6.20	7.90	8.30	7.30	6.90
7	Transport	66.60	96.50	98.70	69.00	30.90	80.80
8	Communication	17.60	21.50	19.20	14.40	10.50	17.90
9	Recreation and culture	49.70	77.30	90.30	81.20	47.40	74.60
10	Education	14.10	10.20	12.50	[1.30]	–	8.70
11	Restaurants and hotels	48.30	59.50	55.70	43.20	22.30	49.60
12	Miscellaneous goods and services	42.40	50.80	42.70	37.10	35.30	43.50
1-12	All expenditure groups	493.40	566.30	547.20	441.40	291.10	496.20
13	Other expenditure items	60.50	95.70	81.70	64.70	43.10	76.40
Total expenditure		**553.90**	**662.10**	**629.00**	**506.10**	**334.20**	**572.60**
Average weekly expenditure per person (£) Total expenditure		**226.10**	**215.20**	**269.00**	**282.40**	**223.10**	**239.00**

Note: The commodity and service categories are not comparable to those in publications before 2001-02. Please see background notes for symbols and conventions used in this report.

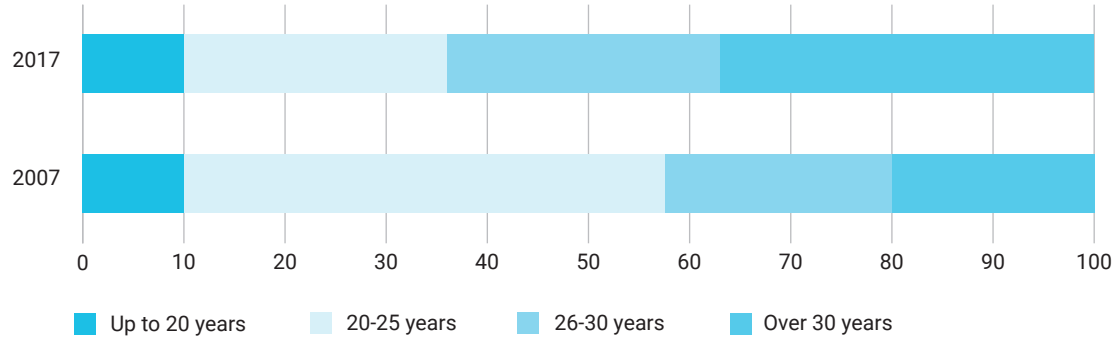
1 Excluding mortgage interest payments, council tax and Northern Ireland rates.

Source: Office for National Statistics

34 ONS Household expenditure by age of household reference person February 2019

For those who get onto the housing ladder, extra-long mortgage terms are becoming the norm for younger borrowers. 2,604 deals in the market in March 2019 allowed borrowing to be spread over four decades.[35] Two in five first-time buyers in 2017 will still be paying a mortgage post 65 with an increasing number of first-time buyers opting for mortgages of 30+ years. In 2017, this rose to 34% of first-time buyers taking out a mortgage term of 30+ years. [36]

First time buyers



Whilst taking out a longer mortgage term helps with the affordability of monthly payments, the amount of additional interest that is paid compared to a shorter-term can be significant. The average mortgage taken out by a new first-time buyer is £180,000.[37] If we take an interest rate of 4% as standard over the term of the mortgage then the repaying difference over a 25, 30 and 35-year term is shown below:

Mortgage	Term (year)	Monthly repayment	Total repayment	Interest paid	Interest difference from 25-year term
£180,000	25	£950	£284,912	£104,912	
£180,000	30	£859	£309,216	£129,216	+£24,304
£180,000	35	£797	£334,557	£154,557	+ £49,645

With the average age of the first-time buyer now at 31 and rising[38], there is a real prospect that people will carry repayment mortgage debt into their 70s, especially where they have progressively taken on new mortgages later in life to upgrade to larger properties.

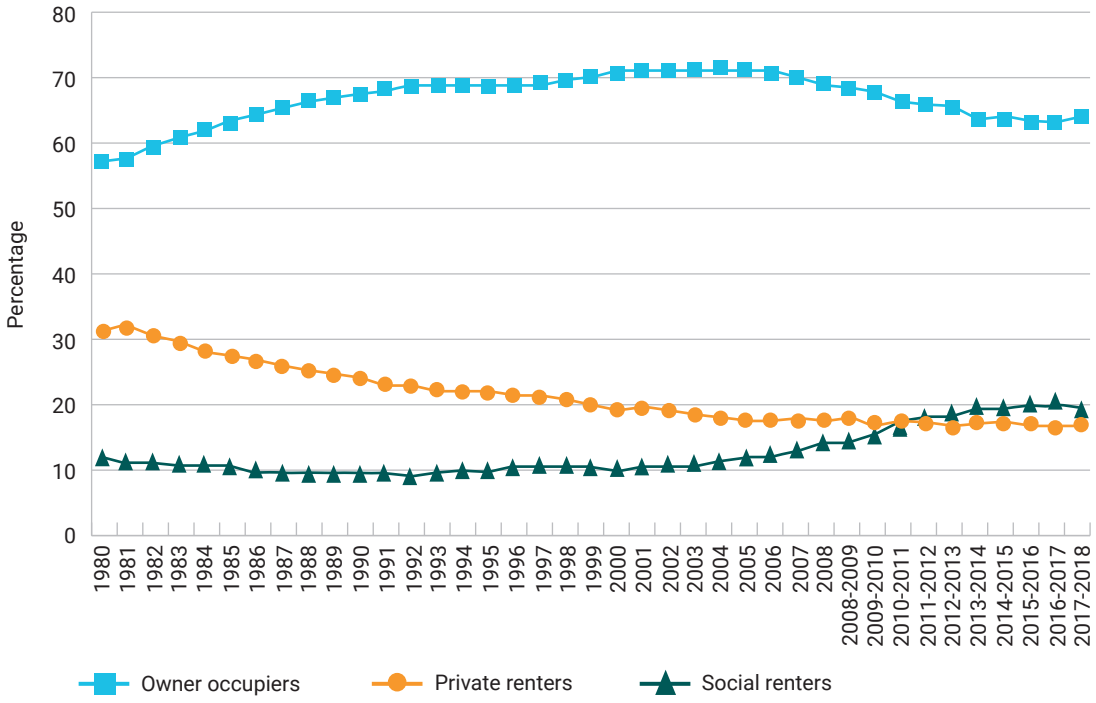
It should also be noted that current DWP replacement rates and annual retirement income survey data do not include mortgage costs as it assumes any mortgage is paid off by retirement, so when planning buying a house and retirement, this needs to be factored in.

Renting

38% of households are renting, which includes social housing. The table below shows the shift to private renting, which almost doubled since 2000, accounting for 4.5 million or 19% of households.

35 Moneyfacts
36 Financial Conduct Authority Sector Views February 2018
37 Halifax first-time buyer review 2018
38 Halifax first-time buyer review 2018

Trends in tenure (proportions), 1980 to 2017-18



Whilst overall levels of renting have been fairly stable for the past twenty years, this disguises the shift towards more of these being younger generations. In 2007/08, 28% of people aged 25-34 lived in private rental sector homes. By 2017/18 this had increased to 44% or 10.4 million households, whilst in the same period, owner occupation reduced from 55% to 38%. This means that this cohort are now more likely to be privately renting than owning their own home.[39]

Current DWP replacement rates and annual retirement income survey data do not include rental costs. This is a key issue given that the average UK rent is £747 per month[40] or £8,964 p.a. and would require a pension pot that is more than double that otherwise required to top up the State pension for an adequate retirement income. If renting is to become more common in retirement which trends in home ownership for younger cohorts suggests, this is a significant social issue that needs measured consideration and solutions now to avoid issues in future years.

Impact of housing option costs

We have modelled the options that will typically be faced by households within our target group regarding either getting on to the housing ladder or continuing to rent throughout life. The models set out the impacts of their decisions including how this affects their retirement savings and the expected length of time those savings can fund a lifestyle associated with £29,000 per annum. The models layer those factors on top of the non-graduate and graduate Baselines to provide outcomes to illustrate the impacts of those decisions. The models do not include scenarios where care home costs are experienced, however should this arise, then pension funds would be depleted rapidly unless eligible for full state support.

39 ONS English Housing Survey 2017/18
40 The Deposit Protection Service Rent Index Q1 2019

Non-graduate outcomes

Non-graduate homeowners with 2 children – saves for a deposit while continuing to contribute to an AE pension, mortgage is not paid off until 64

Fund value at retirement – 8%/10%/12% – £287,000/£365,000/£438,000

Total repayments on mortgage of £287,500 = £480,000 (£1,250 x 12 x 32)

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 91/97/103

Non-graduate homeowners with 2 children – opts out of AE until 32 to save for a house deposit (£50k). Mortgage paid off at 57

Fund value at retirement – 8%/10% /12% – £218,500*/£261,500*/£305,000*

Total repayments on mortgage of £250,000 = £375,000 (£1,250 x 12 x 25)

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 85/89/92

* As opting out means the mortgage is paid off 7 years earlier than by not opting out in our model, the repayments saved in this 7-year period are added to the pension contributions for years 57-63 and discounted back into today's terms. This has the benefit of increasing the pension pot by £45,500.

Non-graduate lifetime renters with 2 children

Fund value at retirement – 8%/10% /12% – £287,000/£365,0000/£438,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £9,000 net to meet rent

Age at which private pension pot is exhausted – 80/83/86

Graduate outcomes

Graduate homeowners with 2 children – saves for a deposit while continuing to contribute to an AE pension, mortgage is not due to be paid off until 64

Fund value at retirement – 8%/10% /12% – £332,500/£415,500/£499,000

Total repayments on mortgage of £332,500 = £556,800 (£1,450 x 12 x 32)

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 95/101/108

Graduate homeowners with 2 children – opts out of AE until 32 to save for a house deposit (£60k) Mortgage paid off at 57

Fund value at retirement – 8%/10% /12% – £289,500*/£348,500*/£408,500*

Total repayments on mortgage of £290,000 = £435,000 (£1,450 x 12 x 25)

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 91/96/101

* As opting out means the mortgage is paid off 7 years earlier than by not opting out in our model, the repayments saved in this 7-year period are added to the pension contributions for years 57-63 and discounted back into today's terms. This has the benefit of increasing the pension pot by £52,500.

Graduate lifetime renters with 2 children

Fund value at retirement – 8%/10%/12% £332,500/£415,500/£499,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £9,000 net to meet rent

Age at which private pension pot is exhausted 82/85/89

Key conclusions

For those who choose to buy a house, the difference of the total amount saved at retirement is a combination of the amount of mortgage interest paid and the value of the pension pot. In addition to the length of the mortgage, the two key drivers that determine the attractiveness of opting in or out of AE are the applicable interest rate (for simplicity we have used a single rate of 3.5%) and the level of the pension contribution. On an 8% level of contribution, by not opting out the pension pot is £68,500 larger for non-graduates and £43,000 larger for graduates. However, the additional mortgage repayments for the couple who do not opt out are £105,000 for non-graduates and £122,000 for graduates.

On a 12% level of contribution the pension pot size by not opting out is £133,000 larger for non-graduates and £90,500 larger for graduates.

Non-graduate

- Extra mortgage costs if not opting out are £105,000. The pension fund at 8% contributions is worth £68,500 more – net benefit of opting out is £36,500, however those opting out will not have sufficient savings to provide target income levels to last their lifetime
- At 10% the net benefit of opting out reduces to £1,500, but those who opted out still do not have sufficient savings to provide target income levels to last their lifetime
- At 12% it is better to not opt out as the net benefit of remaining a member of the scheme is £28,000, plus there is sufficient income for life
- Outcomes will be dependent on mortgage term, interest rate, amount saved for deposit and length of the opt out period as well as retirement age
- Where the household does not opt out whilst saving the house deposit, there should be sufficient funds to cover household income needs to 90 years old for all of 8%, 10% and 12% contributions levels
- Where the household does opt out whilst saving the house deposit, only the 12% contribution level should provide sufficient funds to cover household income needs to 90 years old
- The above highlights that the additional pension accrued by not opting out only exceeds the additional mortgage repayments at a contribution level of 12% but that only at 12% do couples that opt out create sufficient savings for their retirement income, implying it is better not to opt out

Graduate

- Because of the larger salary, the converse is true for graduates
- At 8% 10% and 12% contributions, it is better to opt out as the difference in mortgage payments is £122,000 versus pot size growing by an additional £43,000, £67,000 and £90,500 respectively
- Outcomes will be dependent on mortgage term, interest rate, amount saved for deposit and length of the opt out period as well as retirement age
- There should be sufficient funds to cover household income needs to 90 years old, including the impacts of a house purchase for all of 8%, 10% and 12% contributions levels
- Should the Graduate household wish to have a higher level of income then the best option to suit their specific needs would require further consideration

Renters

- Non-graduate and graduate renters will run out of funds within their lifetimes even on a 12% contribution
- Renters do not have security of the equity tied up within a house to fall back on in times of need

Lifetime ISA considerations

We have not factored in the LISA as a vehicle for boosting savings for first time property purchases. For non-graduates the deposits for those who opted out versus those who did not were £50,000 and £12,500 respectively with a property purchase of £300,000. For graduates these were £60,000 and £17,500 respectively with a property purchase of £350,000. If the money was invested in a LISA then they would have received a 25% bonus on eligible subscriptions, which would increase the deposit and reduce the mortgage required. Alternatively this could mean they reach their savings target earlier.

Long-term care costs

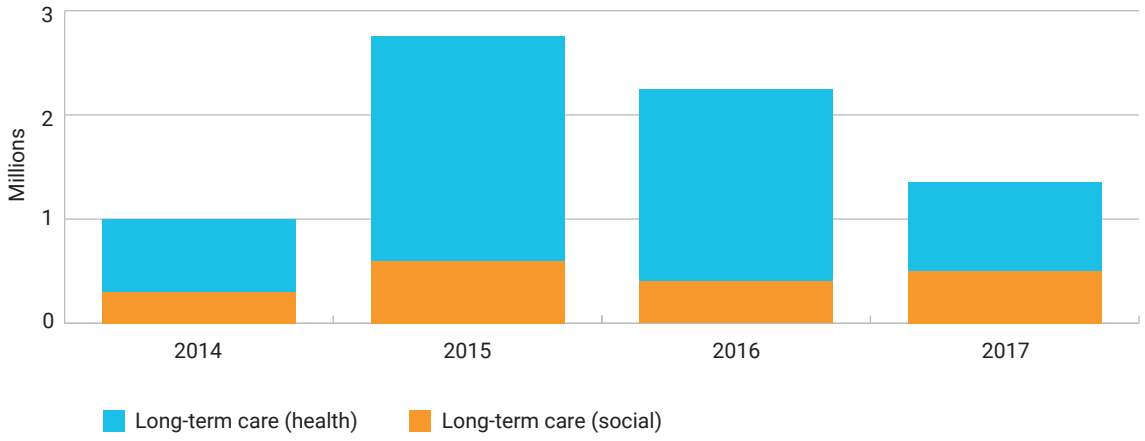
The implications of long-term care can impact retirement in different ways. Firstly, the accumulation journey can be affected where one or both adults in a household need to either reduce working hours or quit work entirely to take up caring responsibilities, as included in our typical family journey.

It could also be that a family member helping with care responsibilities preserves an inheritance which could otherwise be eroded through care being provided by a third party.

The other impacts are during retirement, when in-house or care home costs can significantly increase the cost of living and erode the retirement fund faster than originally budgeted, meaning facing either a reduced retirement fund or paying in more during accumulation to mitigate any potential costs which arise through long term care.

In 2017, total long-term care expenditure totalled £48.2 billion covering both health and social related elements. Growth in recent years has been driven mainly through the health services although both have grown in real terms since 2013 (see below). [41]

Both components of total long-term care have grown every year between 2013 and 2017
Contributions to growth in long-term expenditure by component in 2017 prices, UK, 2013 to 2017



Source: Office for National Statistics – LaingBuisson

Services within the long-term health care category include where a substantial proportion of the support involves basic Activities of Daily Living (ADLs), such as bathing, dressing and walking. Long-term social care, which is not included in the definition of total current healthcare expenditure, covers services that consist of support with Instrumental Activities of Daily Life (IADLs), such as shopping, cooking and managing finances. Long-term health care covers services provided in residential and nursing homes and long-term social care includes spending on supported housing and supported accommodation which help people to live independently and primarily relates to help with IADL.

The value of informal adult care (friends/family free of charge) was estimated at £60 billion, which is in addition to the £48 billion referenced above.

The chart below shows how the breakdown of health and social long-term care is financed. Out of pocket expenditure is 31% for health and 12% for social which represents a total of 43% or £20.7 billion being funded privately by individuals. The cost is broken down primarily by residential and nursing care, direct payments and home care.

In 2017, the average disability free life expectancy for a UK citizen was 62.3 with 18.7 years spent with disability.[42] There were 12 million individuals aged 65+ in 2017 and around 2 million received informal care based on ONS data.

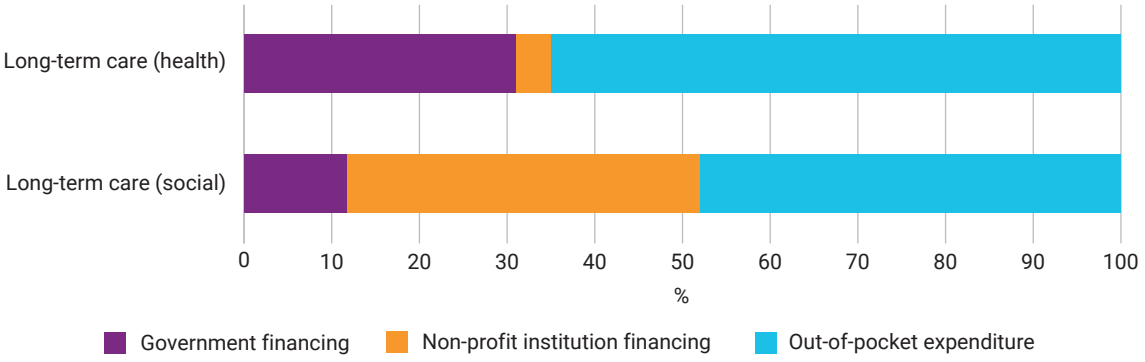
41 ONS Healthcare expenditure, UK Health Accounts: 2017
42 ONS Health state life expectancies, UK: 2015 to 2017

The bigger cost of long-term care is felt when residential and nursing home costs need to be paid. Around 400,000 of 65+ year olds (3.5%) were in these homes during 2017[43].

41% of care home residents fund themselves (164,000 people).[44] On average, older people stay in a residential care home for 30 months[45], at an average cost of approximately £32,000 per person for the first year, and increasing over subsequent years, coming to a total of around £82,000 over two and a half years[46], although many people could end up paying much more than this. This means out of pocket expenditure on care homes totals £13.4 billion.

Government financing represented the largest shares of both long-term care (health) and long-term care (social)

Components of long-term care expenditures by share of financing schemes, UK, 2017



Source: Office for National Statistics – LaingBuisson

Most care home residents are over 85 and Age UK shows there are 1.6 million individuals 85+ year olds in UK. Total out of pocket long term care expenditure net of care home costs is £7.3 billion. Making an assumption that long term health care costs are primarily related to the group aged 75+ year olds, of which there are 5.4 million in UK, this means that the average long term care cost per individual outside of a care home is around £1,350 per year. For the purposes of modelling, we will assume that an average couple may spend £3,000 p.a. on these costs from age 75.

ONS 50-year projections estimate there will be an additional 8.2 million people over 65 by 2068 so the likelihood of households facing long-term care costs is likely to rise unless there is a change to the way in which it is funded. This means that in the event of no state assistance, these related costs will need in large part to be met through retirement funds or other accrued wealth.

Impacts of housing costs and long-term care

We have modelled the average long term care costs that may be faced by households from the age of 75 within our target group to identify the key impacts on their retirement savings and the expected length of time those savings can fund a lifestyle associated with £29,000 per annum plus the additional care costs. The models layer long term costs as well as housing cost on top of the non-graduate and graduate Baselines to provide outcomes that show how quickly savings will be spent reflecting the additional expenditure.

43 Laing & Buisson 2018
44 Gov: Care homes market study: summary of final report
45 Laing & Buisson, Care of older people: UK market report, May 2017
46 Will the cap fit? What the government should consider before introducing a cap on social care costs' (2017)

Non-graduate outcomes

Non-graduate homeowners with 2 children. Baseline plus long-term care costs are experienced from 75

Fund value at retirement – 8%/10% /12% – £287,000/£365,000/£438,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 87/92/97

Non-graduate homeowners with 2 children – saves for a deposit while continuing to contribute to an AE pension, mortgage is not paid off until 64. Long-term care costs are experienced from 75

Fund value at retirement – 8%/10% /12% – £287,000/£365,000/£438,000

Full state pensions – £17,500 p.a.

Total repayments on mortgage of £287,500 = £480,000 (£1,250 x 12 x 32)

£11,500 net required to achieve £29,000 p.a. plus further £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 87/92/97

Non-graduate homeowners with 2 children – opts out of AE until 32 to save for a house deposit. Long-term care costs are experienced from 75

Fund value at retirement – 8%/10% /12% – £218,500/£261,500/£305,000

Full state pensions – £17,500 p.a.

Total repayments on mortgage of £250,000 = £375,000 (£1,250 x 12 x 25)

£11,500 net required to achieve £29,000 p.a. plus further £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 83/86/88

Non-graduate lifetime renters with 2 children. Long-term care costs are experienced from 75

Fund value at retirement – 8%/10%/12% – £287,000/£365,000/£438,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £9,000 net to meet rent and £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 79/82/85

Graduate outcomes

Graduate homeowners with 2 children. Baseline plus long-term care costs are experienced from 75

Fund value at retirement – 8%/10% /12% – £332,500/£415,500/£499,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 90/95/100

Graduate homeowners with 2 children – saves for a deposit while continuing to contribute to an AE pension, mortgage is not due to be paid off until 64. Long-term care costs are experienced from 75

Fund value at retirement – 8%/10% /12% – £332,500/£415,500/£499,000

Full state pensions – £17,500 p.a.

Total repayments on mortgage of £332,500 = £556,800 (£1,450 x 12 x 32)

£11,500 net required to achieve £29,000 p.a. plus further £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 90/95/100

Graduate homeowners with 2 children – opts out of AE until 32 to save for a house deposit. Long-term care costs are experienced from 75

Fund value at retirement – 8%/10%/12% – £289,500/£348,500/£408,500

Full state pensions – £17,500 p.a.

Total repayments on mortgage of £290,000 = £435,000 (£1,450 x 12 x 25)

£11,500 net required to achieve £29,000 p.a. plus further £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 87/91/95

Graduate lifetime renters with 2 children. Long-term care costs are experienced from 75

Fund value at retirement – 8%/10% /12% – £332,500/£415,500/£499,000

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £9,000 net to meet rent and £3,000 net from 75 to meet care costs

Age at which private pension pot is exhausted – 81/84/87

Key conclusions

The models have not included the potential costs of residency in a care home or equivalent assistance of home care. The average cost is around £80,000 if this level of care is required. In all instances, this will rapidly deplete the savings pot unless other assets can be used to cover these substantial costs. Where households have rented over their lifetimes there will be no property to fall back on and the state support will be the final recourse.

Non-graduate

- Where households have no housing costs in retirement or have remained opted into AE when saving for a house deposit, contribution levels of at least 10% are required to cover the modelled level of old age care
- Where households have opted out of AE to accrue a house deposit, their funding will run out 2 years before life expectancy even contributing at 12% which would suggest that opting out to save for a deposit is the least attractive solution when planning for long-term outcomes unless higher rates of contributions are subsequently made to provide sufficient savings in retirement

Graduate

- Where households have no mortgage in retirement, savings levels of 8% may be sufficient to cover the modelled level of old age care but 10% would be more prudent
- Where households have opted out of AE to accrue a house deposit, contributing at least 10% is required to cover old age care costs

Renters

- Even at 12%, savings for non-graduate renters will run out of funds 5 years before their life expectancy and for graduates the funds are depleted 3 years early.

Work History

Our Baseline family journey shows Partner 1 being in full-time employment with a gradually rising salary peaking at 40-44 in accordance with Government statistics based on median employed income and tax paid. Partner 2 also secures full-time or part-time employment in line with family commitments.

The examples below were developed to demonstrate that households may experience a wider variety of working life journeys and that adds to the richness of insights that our modelling work is providing.



HIGH EARNER

SELF EMPLOYED

Other typical life journey scenarios

Non-graduate lifetime renters with 2 children. Mixture of employed and self-employed work throughout working life

Fund value at retirement – 8%/10% /12% – £198,500/£248,000/£297,500

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a. plus further £9,000 net to meet rent

Age at which private pension pot is exhausted – 76/79/81

There is no current system in place to automatically enrol the self-employed into a pension arrangement. Lower average earnings compared to their employed counterparts combined with the lack of an employer contribution, means the level of pension saving is very low within this group.

It is not uncommon for individuals to move from employed to self-employed status over their working life. When this disrupts pension saving, particularly if this is for a sustained period, it can have large negative impacts on final retirement outcomes. Contribution levels in excess of 12% should be considered to help offset the periods of non-contribution. Regular financial planning is required for this group both to determine where they are in the savings cycle and likelihood of meeting their retirement targets, plus taking action as required to correct their saving trajectory.

Non-graduate homeowners with 2 children. Early retirement with higher than average long-term care costs starting at 60 years old of £10,000 p.a.

Fund value at retirement – 8%/10% /12% – £253,500/£323,000/£387,500

Full state pensions – £17,500 p.a.

£29,000 net p.a. required from age 60 plus £10,000 net to meet care costs.

From 68 when SPA is achieved £11,500 net required to achieve £29,000 p.a. plus further £10,000 net to meet care costs

Age at which private pension pot is exhausted – 65/67/70

Early retirement due to ill health before state pension age, could have a significant impact on retirement assets, especially where long term care costs are also taken into consideration. State benefits may be available dependent on individual circumstances but due to their complex nature, they have not been factored into our model. However, it is clear that this scenario will have a major impact on the future living standards for the household. This scenario is also particularly difficult to plan for as the signs of ill health may not be obvious until close to the point of having to retire and there is limited ability to make changes to savings that will have any significant long-term benefit.

Graduate homeowners with 2 children. Significantly higher earnings than median with increases throughout working careers. In today's terms, modelled salary starts at £20k at 23 and increases to circa £60k by 60

Fund value at retirement – 8%/10%/12% – £583,500/£729,500/£875,500

Full state pensions – £17,500 p.a.

£11,500 net required to achieve £29,000 p.a.

Age at which private pension pot is exhausted – 114/126/138

If a replacement rate of circa 50% of household pre-retirement income was required, the age at which the pension pot is exhausted reduces to 79/82/85

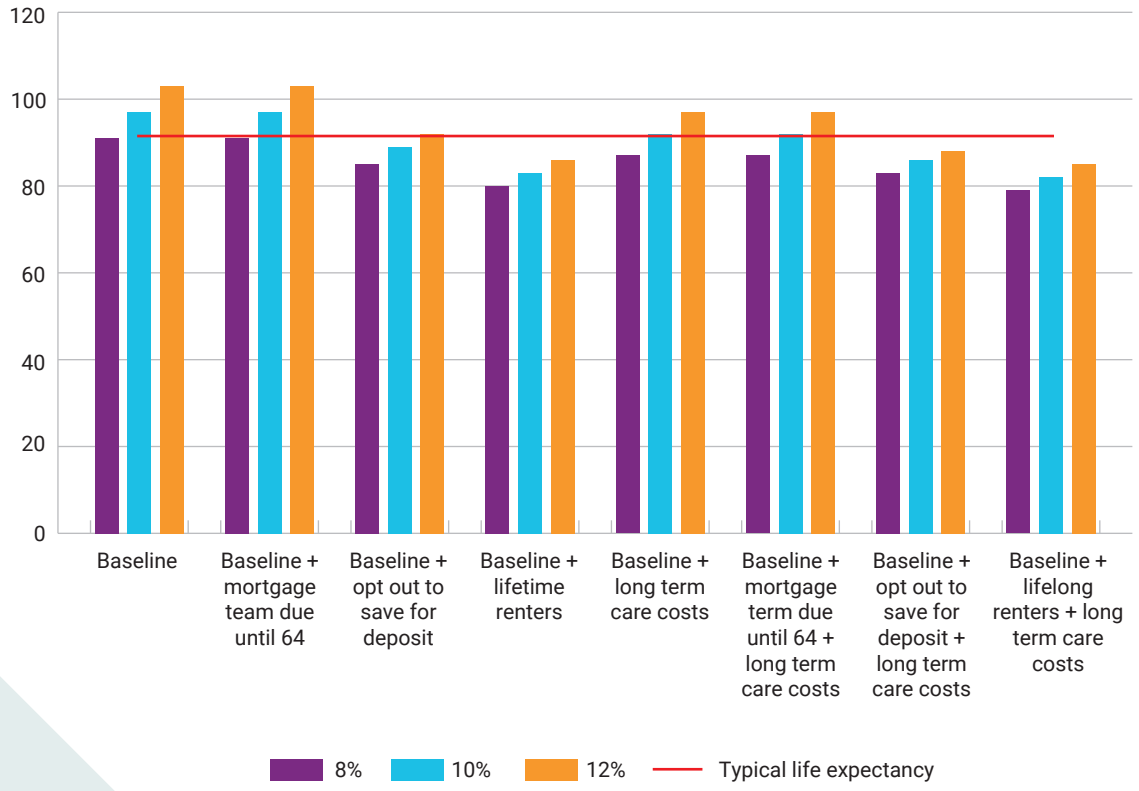
Whilst £29,000 (net) has been deemed as achieving a moderate retirement, this is a figure which is broadly appropriate for median earners. Higher earners would be expected to seek an income more akin to their pre-retirement levels to maintain a similar standard of living during retirement. Where salaries rise throughout a working career, for instance to a high of circa £60,000 p.a. as we have modelled in the above scenario, contribution levels need to increase significantly if an appropriate replacement rate is to be achieved for a household.

If a 50% replacement rate was required based on peak earnings for this scenario, the fund even at 12% would be exhausted by 85.

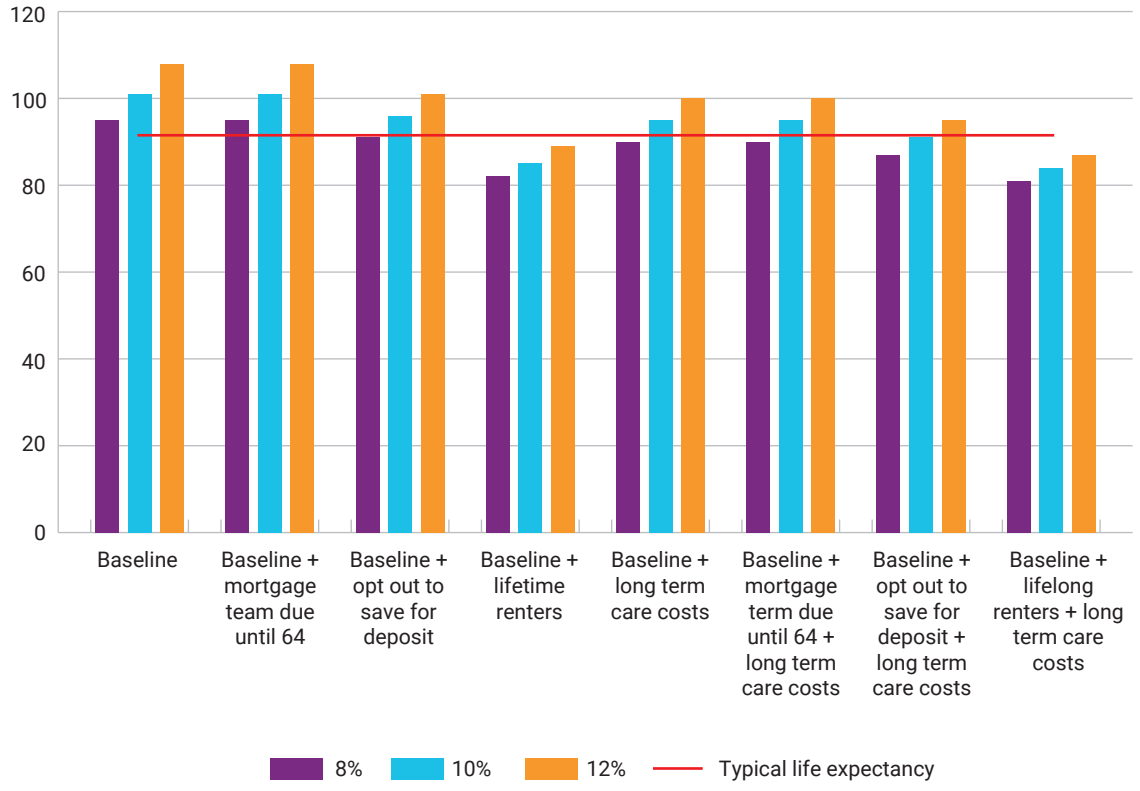
This implies that people who expect to be higher earners in the future need to either increase their early career contributions to compensate for future higher earnings or save an even higher percentage in later years. Regular financial planning will be key to meeting income expectations in retirement.

Charts reflecting age at which funds are exhausted for scenarios

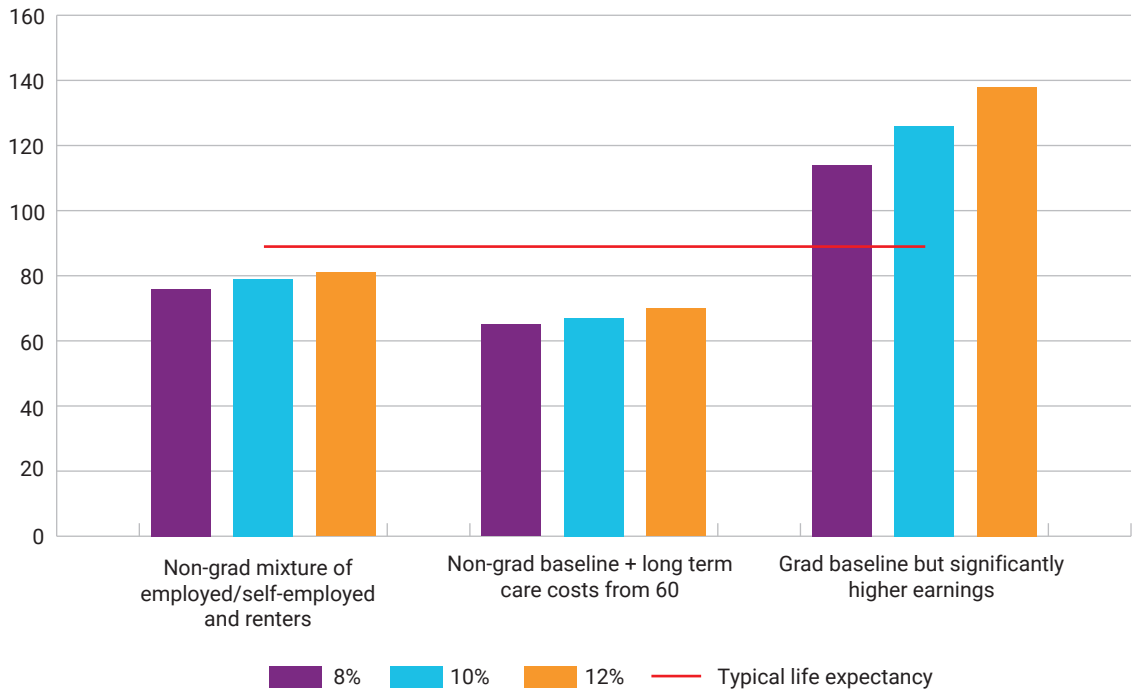
Non-graduate scenarios and age at which fund is exhausted



Graduate scenarios and age at which fund is exhausted



Ad-hoc scenarios and age at which fund is exhausted



4. Key findings

The scenarios we have modelled demonstrate a range of indicative outcomes that are underpinned by typical life journeys that we anticipate households will experience over their lifetime. Overlaying these, each household will experience their own unique set of circumstances and will need to make a number of choices to suit their specific needs over a long period of time. Whilst there is no "one size fits all", our research and evidence identifies some key themes that are likely to impact the majority of people and any system that is intended to deliver adequate incomes in retirement needs to accommodate these themes.

This implies that AE, by necessity, needs to be designed to support a very wide audience, have a contribution level that meets the needs of the mass market savers. In addition to the core scheme there needs to be mechanisms that point people in the direction of appropriate support to ensure that their own personal savings requirements are met, which could include additional voluntary savings schemes.

This also implies that there needs to be a degree of education that sits around AE to help consumers understand what the system is designed to deliver, its limitations and appropriate sign posting to additional support and advice.

The right replacement income targets

There is growing consensus amongst financial services firms and trade organisations regarding suitable replacement rates of income for key segments of society. At the request of our members, TISA have adopted the work undertaken by the PLSA and used their Retirement Livings Standards as a benchmark for our modelling work, focusing on the moderate income for a household with a couple in retirement.

There is also a growing consensus on the contribution levels required to deliver a pot of savings sufficient to provide the proposed income requirements. These typically range from 10% to 15% with an increasing number of firms and bodies landing on 12% as a pragmatic level of contributions, albeit this still relies on a limited number of negative factors impacting the savings history of the household over their working lives and in retirement.

Where there is currently less consensus is regarding how to raise contributions to the appropriate level as there are several levers from automatic increases through to incentivisations. There is also debate around which combination of employee, employer and government should be responsible for raising the contribution level. We will therefore work with industry on creating a consensus view on how to raise contributions as our next piece of policy work but are publishing our findings on the savings level now so as not to delay debate and agreement on the amount of income and contribution required for an adequate retirement income.

The importance of the State Pension

Our modelling demonstrates the key role that the State Pension plays in providing a significant part of the income required to meet the target of £29,000 net per annum. Assuming both partners in the household receive a full State Pension, this represents around 60% of their target income.

Our research also points to the amount of change to the State Pension over the past twenty years and the impact this has on households. This creates considerable uncertainty for the household as changes to the State pension might arise too late in their savings journey to be able to make up for this through private means. The general lack of financial awareness amongst the public means that most people are unaware of these changes and the impacts they have until engagement in their finances increases close to retirement.

It is therefore critical that the Government takes this into consideration when contemplating any further changes as well as the assumptions underpinning how the combination of a State Pension and AE will be the primary retirement income solution for the majority of people.

The right level of contribution

Our modelling has used a relatively optimistic set of assumptions regarding the working career that a household on median incomes will experience over a 50-year period. We have seen other modelling that uses significantly more cautious assumptions but these are in the minority when looking at the sorts of assumptions that the market is using more broadly. More cautious assumptions could be used and these will have the effect of increasing contribution levels for a given amount of target income or a lower income for a given level of contributions. In reality, the actual outcomes are challenging to predict and households should monitor their actual progress against targets on a regular basis.

Our model indicates that an 8% level of contribution throughout this 50-year period might be sufficient to deliver £29,000 net per annum in a limited number of scenarios for median income households, however this leaves no buffer for the other costs that families will typically face during their lifetimes.
Households therefore need to consider the potential events, and their likelihood of occurring, that would cause a detrimental impact to retirement income and factor these into contribution levels. Periods of redundancy, self-employment, caring and raising a family will all have an impact on the accrual of pension savings during the accumulation phase. Housing costs and long-term care are increasingly common as an expense during retirement and will impact on retirement outcomes, particularly where additional state benefits are not available.

Given the unpredictability of these events occurring in the future, it is prudent to save more than 8%, especially as even a 12% contribution level is insufficient to deliver the target income for some of the scenarios modelled.

It is also important to take into consideration the impact of compound interest on pension savings over a long period whereby higher levels of saving earlier in the retirement journey generate the best compounded returns in the long-term. Saving at a modestly higher level than required in the early days can provide a significant boost to the long-term value of the pension pot. This might even allow a “savings holiday”, especially near retirement where the money invested in the early days is producing the bulk of the pot’s growth versus ongoing contributions which have limited chance to benefit from the effect of compound interest. Conversely, trying to make up shortfalls late in one’s career may require significant additional contributions which are unlikely to be affordable for most of households.

To further demonstrate the power of compound interest, deferring starting pension savings by ten years could reduce private pension income levels by half at retirement. This is based on the average growth and returns from dividends of the FTSE 100 index providing a doubling of the portfolio every 8 to 10 years.

Banded earnings and minimum age

Building upon the point above regarding the power of compound interest, the impact of deferring the proposals to remove the lower earnings limit and/or reducing the minimum age to 18 would have an impact on pension savers. In the instance of our target cohort, should these not be implemented until 2035, this has the effect of reducing the pension pot for the baseline non-graduate household contributing at 8% by £57,000. We would like to see these proposals included in legislation at the earliest opportunity to bring certainty to the implementation date.

Tax free lump sum

Tax-free cash is typically taken when accessing pension funds and represents one of the major incentives of saving into a pension product. We have seen from the Retirement Outcomes Review that many households view this entitlement as a windfall and may spend it on non-essential items.

It is also clear that in many of the scenarios modelled, even at higher levels of savings, in reality there is limited scope for taking the 25% tax free lump sum as the savings pot will need to be kept intact to provide the target income required, albeit re-investing this money in alternative tax efficient vehicles (such as ISAs) remains a sensible option. Creating the ability to take the full 25% tax free cash might require contribution levels to rise by a further 2% to 3% per annum (for the average individual) to still deliver core retirement income needs.

It is likely that only by planning for potential life events and including this within the level of pension contributions, that there will be scope for tax free cash being available to cover discretionary items such as a new car or holidays whilst still having sufficient cash left to sustain a moderate retirement lifestyle.

Buyin50-use

Saving for a house deposit and its impact on retirement savings will be a key decision faced by millions of people saving through AE. This is a very complex area, especially as some of the decisions taken will have long-term ramifications with a high probability of assumptions made not panning out.

Our models show that the decision to opt out or stay in a workplace pension to save for a house deposit is dependent on several factors, including the salary you are on, the cost of the house you are buying, the level of your pension contributions, mortgage interest rates and term of the loan. Non-workplace pensions have a different dynamic as there is no employer contribution.

The primary trade-off is between the benefits of paying off a mortgage more quickly or using the long-term pension growth to cover any outstanding mortgage costs in retirement. In the later instance the household may decide to take a mortgage over a longer term to spread the monthly costs or reducing contribution levels where more than the minimum is being paid with employer matched incentives. Whilst this means paying back more interest if the mortgage lasted full-term, the benefits of compound interest, employer contributions and tax relief for the period opted out could more than offset the saving made in interest payable, especially if the mortgage balance is paid off using tax-free cash before the term concludes.

There is no single answer and households need to consider their projected life journey on a case by case basis.

Renters

Households that are renting at the time they reach retirement are particularly vulnerable. If they are renting from the private sector, the average cost of this is c£9,000 per annum. When compared to the £11,500 income required in addition to the State pension, this means that these households need a saving pot that is almost double that of a household that owns their home. TISA research has also identified lower levels of savings amongst renters versus home owners across all income segments meaning this group have smaller non-property buffers to fall back on.

Relying upon State funded accommodation where private arrangements are not affordable may be uncomfortable for many of these households.

Renters may also find themselves vulnerable in the instance that one or both of the household needs to have home care or move into a care home. They have no housing wealth to draw upon and unless a sufficient retirement pot has been accrued they will be means tested on the benefits they could receive from the State. This could deplete their private pension very quickly.

Above median earners

Although £29,000 p.a. has been deemed as achieving a moderate retirement for median earners, higher earners are likely to seek an income more akin to their pre-retirement income levels. Where salaries rise throughout a working career, a higher level of contribution is required to counter balance the smaller salary earlier in the career as the investment growth over a long period is derived from contributions from a smaller salary. Either large contributions are required from the start of the career or these need to grow progressively as salary increases. To be most efficient, planning is required to determine an appropriate contribution approach that can be applied over the working lifetime of the individual. This can be hard to calculate, especially in the early years of a career.

Long-term care costs

Good health in older years is not rising at the same rate as longevity meaning more households may face longer periods with long-term care costs. Our models show that if one or both adults experience moderate long-term care costs in retirement (e.g. £3,000 per annum), contribution rates of between 10% and 12% are required over their working lifetime to provide the required income in retirement. Whilst it is almost impossible to predict who will face long-term care costs and how much these will be, building in some latitude for long-term health care is prudent.

Provision for higher levels of long-term care, such as residency in a care home could be met in a number of ways and will depend on the personal choice of the household. Options include:

- Making provision for a higher level of income throughout retirement, accepting that any care home costs incurred in late life will reduce this income and /or the pension pot's ability to last for the lifetimes of the household
- Making provision for care home costs within the capital of the pension pot, ring fencing this so that this portion of the pot continues to benefit from investment growth after retirement commences until the funds are required. This solution can also help provide an income for lifetimes that exceed the average 90 years expected of the target cohort
- Using the equity in a property to pay for long-term care home costs either by down-sizing, selling the property or using equity release
- Having savings that are below means testing levels with the State paying for long-term care home costs

Early retirement due to ill health

Where an adult experiences ill health before retirement and needs to give up work prematurely, this can have a significant impact on retirement outcomes. Not only does saving stop but the retirement fund may need to be used before State Pension commences. Starting to use the retirement fund early may also impact the final years of investment growth, being the most impactful due to the effects of compound interest.

Given that our model predicts the State Pension making up 60% of retirement income, relying upon the pension fund alone will rapidly deplete any private pension fund. Furthermore, the other partner in the household may also need to give up work to undertake caring responsibilities further affecting working income, savings and retirement income.

There may be some state benefits available however these will be dependent on exact circumstances. Due to this complexity, we have not factored these benefits into our models. We anticipate that using private funding alone ahead of SPA will see the private pension fund being exhausted within a decade even on a 12% contribution.

If it is likely that ill health will be experienced early on (e.g. due to genetic family ill health), consideration should be given to contributions in excess of 12%.

Increasing employee participation in AE

Despite the success of getting 10 million employees to participate in AE, there are a further 10 million who do not contribute to an AE pension. It is estimated that this includes 5 million Gig Economy workers. A review of the earnings trigger should be undertaken which could help increase participation as will reducing the minimum age to 18. However, further solutions will be required to tackle the bulk of these employees.

Self-employed

The self-employed now make up almost 5 million people and are a very diverse group ranging from semi-retired well paid professionals, through to manual labourers and carers.

There is currently no system in place to automatically enrol the self-employed into a pension arrangement. The combination of lower average earnings than their employed counterparts, the lack of an employer contribution and a low propensity to save means the level of pension saving is very poor within this group.

It is becoming more common for individuals to move from employed to self-employed and vice versa over their working lives. When this disrupts pension saving, particularly if this is for a sustained period, it can have significant impacts on final outcomes. Contribution levels in excess of 12% should be considered to help offset longer periods of non-contribution and/or lack of employer contribution.

Financial Guidance

The scenarios we have used clearly illustrate the degree of complexity that households face in seeking to provide financial resilience in retirement. Research points towards our society not currently have the basic levels of understanding regarding managing their financial affairs combined with very low levels of engagement in managing their money. This is a critical issue given the responsibilities households have for their own financial wellbeing.

Not only is it vital that the AE system has an appropriate contribution level to meet the income needs of the majority of households, much greater support is required in helping households to understand and act upon key financial decisions that they will face during their lifetimes.

Only 4 million out of the adult population of 51 million people receive advice each year[47], plus of the 10.5 million adults aged 50 – 65 years old, Pension Wise has had face to face meetings with around 150,000 people per annum. This would indicate that there are a very large number of households that are either not engaged or not seeking/receiving support in managing their pension savings.

TISA is advocating that financial guidance is made more widely available and accessible to households and that the current rules be changed to permit a greater degree of personalisation, enabling the guidance offered to be more relevant and assist households in making informed decision. The current boundaries between financial guidance and advice are ambiguous and this is deterring financial services firms from offering free guidance in case this is subsequently deemed as advice, being a regulated activity that brings considerable costs, responsibilities and liabilities for any firm offering advice. This significantly limits the support that households currently receive from pension providers when seeking help in making some basic financial decisions.

The proposed launch of Pensions Dashboards could provide a catalyst to address this issue given that the pension data being presented is personal to the individual and for the service to have any real value for the consumer, there will need to be guidance available to help households determine what actions are required for them to meet their retirement targets.

TISA advocate that the FCA undertake a formal review of the issues related to the provision of personalised guidance as this is a key obstacle in achieving the retirement outcomes that AE and other initiatives are seeking to deliver.

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5. Recommendations

Increasing the current AE contribution level

The TISA modelling work assessing common life journeys, with the objective of delivering a moderate standard of living in retirement that includes the State Pension, concludes that a pension contribution rate of 8% will not deliver the desired outcome for the majority of people.

Whilst every life journey will be different and there is no single answer in terms of a universal pensions savings rate that works for all households, any one rate that is selected to act as the national standard must meet the needs of households relying on that system to deliver their private pension income.

For most non-graduate households, an 8% contribution level only achieves the desired retirement income in a limited number of lifetime journeys. 10% contribution levels will help facilitate buying a house, but only at 12% contribution levels does the pension pot support the ability to also meet typical average long-term care costs, albeit not the costs associated with residency in a care home or equivalent care within at their own home. Even at 12% contribution levels, there are segments where even higher levels of saving would be required, including where families experience self-employment, long periods of unemployment, increasing salaries or are lifetime renters.

Whilst 12% does not deliver the desired income outcome for everyone, it is a significant step forwards and will be far more likely to satisfy the lifetime income needs of most median earning households bar having the ability to fund care home costs.

We would see this as a staging post to potentially higher contribution rates than 12% in the long term, further increasing the chances of good consumer outcomes in retirement. However, we are aware that additional contribution rates through the AE framework may not be appropriate for everyone and other sources of investment could be used to achieve a higher level of financial resilience in retirement.

Recommendation 1

Increase Auto Enrolment (AE) contribution to 12% so that majority of households achieve the desired retirement income of £29,000 per annum, including the State Pension.

We suggest that further research is undertaken to assess the number of households for whom a 12% contribution level is likely to meet their lifetime retirement income requirements, building on the modelling work already undertaken.

We also advocate further debate on how to get to 12% in terms of which combination of employee, employer and Government should provide the additional contribution, appropriate timescales for implementation, plus contextual factors such as education regarding the increase for employees and employers, legislative timescales required, implementation of removal of banded earnings, etc.

Implementation of existing proposed changes

The Government has already proposed changes to AE that will benefit the younger generation entering the workforce by reducing the entry level to 18. We advocate that this is done quickly and ideally within 2 years, by 2022. Given that this is the strategic intent, there seems little reason to defer implementation.

Recommendation 2

Implement the proposals to lower the minimum age for participation in AE to 18 within 2 years by 2022.

The Government has also proposed the removal of banded earnings. This could have a significant positive impact on those that are saving less than 8% per annum due to the effects of banded earnings, plus those employees who are falling outside of AE as their salaries are below the threshold, albeit many of who hold more than one job. Whilst it may be not be appropriate for all of these workers to participate in AE, the option to opt out remains.

The current proposals do not specify when this change will be implemented and we recommend that, if not already underway, the necessary planning is undertaken now so that a firm date is fixed and implementation can be advanced.

Given that any delays impact the financial resilience of households in retirement, we advocate implementation by 2022. This also means that further increases to AE can be progressively accommodated after that time, again providing for timescales that will be beneficial for households.

Recommendation 3

Implement the proposals to remove the lower earnings limit within 2 years by 2022.

Engagement and planning

Consumer research consistently points to a lack of engagement with pension savings and this is resulting in significant levels of under-saving and poor preparation for financial resilience in retirement. We estimate that two thirds of the adult working population have and continue to under-save for retirement, with the bulk of these working in the private sector.

This is a combination driven by a wide range of factors that both individually and collectively need to be addressed. Whilst this is a particularly complicated area, we believe that some of the key factors that need to be addressed include:

- A lack of education provided within schools both at primary and secondary level to ensure a basic level of understanding regarding personal financial management, including retirement
- Reliance upon an AE system that will not deliver the levels of required income to meet replacement targets that are broadly agreed across Government and financial services
- The supporting infrastructure around AE to provide prompts and assistance in validating that AE contribution levels will meet households needs, plus delivering appropriate levels of financial guidance (including access to that guidance) as well as sign posting to advice. Pensions Dashboard, the Money and Pensions Service and employers all have key roles within any overall solution set.

As part of this last point, we also strongly advocate a review of the financial guidance rules. We believe that the current ambiguities in the interpretation of the regulations, plus the restrictions on the degree of personalisation that are permitted, significantly reduces both the quality of the guidance that is available as well as access to services that the private sector could make available free of charge to the mass market. We believe this is critical to addressing the issues of under-saving.

Recommendation 4

As part of the next review, develop solutions for increasing consumer engagement with their pension savings, plus develop solutions for providing appropriate levels of financial guidance and advice to ensure that households are making informed decisions regarding levels of savings that are consistent with their retirement income expectations.

Impact of the State Pension

The State Pension has undergone considerable change in the past, with the latest manifestation of this, the Basic State Pension, having been introduced only recently. Debates around the age at which people should receive the State Pension continue, including whether early access should be permitted to those suffering from ill health.

Now that AE has been introduced, it is important that any review of the State Pension considers the target income levels that the combination of the two schemes are seeking to deliver. This includes changes to the SPA.

It is also important that any changes to the State Pension assess the impact this will have on non-AE pensions given that there are millions of savers that sit outside of AE as their prime means of saving for retirement.

Recommendation 5

Ensure that any review and changes to the State Pension take in to account the overall retirement income targets that are deemed appropriate and the impacts this has on AE's ability to deliver on the income level that will be required from a private pension.

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