

Pensions Watch | Issue 23: What's been happening and what's on the horizon in the world of pensions



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This year's annual revision to the Pensions and Lifetime Savings Association's (PLSA) retirement living standards has seen double-digit increases to each of its illustrative expenditures in retirement, with the cost of financing the minimum standard of living in retirement rising by almost 20%. Against the backdrop of wholly inadequate Defined Contribution (DC) pot sizes and the enormous decision-making burden placed, at and in retirement, on the shoulders of a largely unsupported and rapidly ageing population, ill-equipped to decide for themselves, suggests that without urgent reform many DC savers will continue to sleepwalk into retirement penury.

The PLSA's Retirement Living Standards¹

Introduced in 2019, the Pensions and Lifetime Savings Association's (PLSA) Retirement Living Standards (RLS) helpfully illustrate what life in retirement might look like for both a single retiree and a couple, either living in or outside of London, at three different levels of spending: minimum, moderate and comfortable.

To make the three high level expenditures relatable, each of the standards, which are derived from working with focus groups,² drill down into what could typically be spent annually on household bills, home maintenance, food and drink, transport, holidays and leisure, clothing, personal items, presents and charitable donations. However, rent, mortgage, health and social care costs, which are specific to each individual, are excluded. The RLS are further humanised via eight personas, each at various stages of their working lives. These personas aim to encourage DC savers to better engage with their retirement savings by illustrating what standard of living different people could reasonably expect in retirement depending on their income, current pension savings and contribution rates.³ Indeed, given that more than three quarters (77%) of DC savers do not know how much money they need in retirement to support their desired lifestyle, and with only 20% confident that they are saving enough, the RLS provide a much needed anchor for this somewhat rudderless decision-making process. Accessible to more than 14 million savers via the PLSA's dedicated RLS website, as well as the scheme members, clients and savers of 50 UK-based organisations, almost three-quarters (74%) of DC savers believe that the RLS make it easier to plan for retirement.⁴

¹ See: <https://www.retirementlivingstandards.org.uk/>

² The RLS are based on independent research from the Centre for Research in Social Policy (CRSP) at Loughborough University, working with 26 focus groups, comprising 249 members of the public, some working, some retired, across 14 locations, representing a variety of social, economic and cultural groupings. See: https://www.retirementlivingstandards.org.uk/developing_rls_research_report.pdf

³ See: <https://www.retirementlivingstandards.org.uk/details>

⁴ See: <https://www.retirementlivingstandards.org.uk/details>

So what level of expenditure do the three Retirement Living Standards meet?⁵

Retirement Living Standards: post-tax income requirements in 2023

	 SINGLE	 COUPLE
MINIMUM Covers all your needs, with some left over for fun	£12,800 <i>LONDON TBC*</i>	£19,900 <i>LONDON TBC*</i>
MODERATE More financial security and flexibility	£23,300 <i>LONDON £28,300</i>	£34,000 <i>LONDON £41,400</i>
COMFORTABLE More financial freedom and some luxuries	£37,300 <i>LONDON £40,900</i>	£54,500 <i>LONDON £56,500</i>

*The London minimum figures will be updated by end of Feb 2023
Source: PLSA Retirement Living Standards 2023. 12 January 2023

Aligning with the Joseph Rowntree Foundation's Minimum Income Standard (MIS), the minimum RLS covers all basic needs with provision for a little discretionary spending. To achieve a minimum standard of retirement living outside of London requires a post-tax retirement income of £12,800 if single and £19,900 for a couple.⁶ This income comprises, for each individual, a full new state pension (£10,600 for 2023/24)⁷ supplemented for a single retiree by the income from a level annuity purchased with a DC pot of £36,500.⁸ The latter should result from paying the minimum mandated contribution rate into an auto enrolled workplace pension during a full working life. A retired couple can achieve the minimum RLS simply by each receiving the full new state pension.

The moderate standard of retirement (£23,300 post-tax if single; £34,000 post-tax for a couple, each living outside of London)⁹ builds on the minimum standard by providing a little more financial security and flexibility. For example, raising the minimum standard of a £54 per week spend on food (£96 for a couple) to £74 and £127 per week respectively. Moderate requires the income received from a full new state pension and that from a level annuity from a DC fund of £248,000 for a single person, and two £121,000 pots for a couple.

The comfortable standard of retirement (£37,300 post-tax if single; £54,500 post-tax for a couple, each living outside of London)¹⁰ provides yet more financial freedom and affords more of life's luxuries, such as three weeks spent holidaying in Europe every year. However, this is still a far cry from living the millionaire lifestyle as, for example, it only accommodates replacing a two-year old car (two cars for a couple) every five years and installing a new kitchen and bathroom every 10-15 years. In addition to a full new state pension, a comfortable retirement for non-London dwellers requires the income generated by a level annuity from two £328,000 DC pots for a couple and a whopping £530,000 for a single retiree.

⁵ The RLS were updated on 12 January 2023. The cost of financing the minimum standard of retirement living rose 18% for a single retiree and 19% for a couple. That for a moderate standard of living in retirement rose 12% and 11% respectively, while for a comfortable standard of living the year-on-year increases were 11% and 10%.

⁶ The updated London minimum RLS is in the process of being calculated by the PLSA.

⁷ See: <https://www.gov.uk/new-state-pension>. Currently paid from age 66, a full new state pension requires 35 qualifying years of National Insurance Contributions.

⁸ See: <https://www.retirementlivingstandards.org.uk/How-to-estimate-likely-RLS-20230110.pdf>. The level annuity rate is assumed to be 6.2% of the DC pot, ie £6,200 of income per £100,000 of capital invested. Given current inflation expectations, an equivalent index-linked annuity rate would be at least 2% lower, ie 4.2% or lower.

⁹ For those living in London the retirement income levels are £28,300 and £41,400 respectively.

¹⁰ For those living in London the retirement income levels are £40,900 and £56,500 respectively.

Why does this matter?

As we approach the point of peak pension income, in the absence of a dramatic increase in contribution rates, stellar long-term investment performance, and a renewed focus on value for money, DC simply won't substitute for the abrupt decline of private sector Defined Benefit (DB) pension rights. Indeed, the state pension will increasingly form the mainstay of most retirement outcomes, consigning the majority of DC savers to the minimum standard of living in retirement.¹¹

Moreover, with around one in five of the UK population already aged 65+, the direction of travel is to one in four by the early 2040s,¹² as the so-called "sandwich generation"¹³ of tail-end baby boomers (now in their late-50s to early-60s) and the early Generation Xers (now in their late-40s to mid-50s) start to turn 65.¹⁴ Therefore, not only will we likely see a marked increase in the proportion of a growing population hitting state pension age over the next two decades, but it is also a generation that will be the most long-lived in history¹⁵ and whose financial commitments are likely to increase throughout retirement.

So where does that leave us? Well, while the RLS act as simple, accessible and relatable rules of thumb for retirement planning, enabling DC savers to better target their level of saving and ultimate DC pot sizes in order to achieve a desired standard of living in retirement, there is no getting away from the fact that people need to be properly supported throughout the retirement planning and implementation process. They need to have their options, choices and potential outcomes explained and illustrated to them in a simple, clear, understandable, relevant and practical manner, and be assisted by the more widespread provision and signposting of accessible tools, guidance and advice. While rules of thumb like the RLS are undoubtedly a step in the right direction, ultimately whether a minimum, moderate or comfortable retirement becomes the norm is largely contingent on timely and decisive action or continued inaction by both the pensions industry and policymakers. The clock is ticking.

¹¹ See: Pensions Watch, Issue 8 at <https://www.columbiathreadneedle.co.uk/en/inst/insights/pensions-watch-issue-8/>

¹² See: Overview of the UK population, 2020. ONS, 25 February 2022. The ONS estimates that in mid-2020, 22% of the UK's 67.1 million population was populated by those at or over state pension age (SPA). By mid-2041 this percentage is projected to rise to 26% of a population totalling 70.5 million, as the numbers reaching SPA outstrip the growth in net migration and the birth rate and longevity continues to improve.

¹³ In contrast to "the make do and mend and never let anything go to waste generation", who were either born or who grew up during WW2 and whose real spending in retirement typically declines over time, aspirational baby boomers and early Generation Xers (the sandwich generation) are the first generation in history to be simultaneously caring for ageing parents while helping out financially dependent adult children. They will also be faced with the rapidly declining economics of social care. See: Generating retirement outcomes to be enjoyed and not endured: Why we must harness the opportunities and overcome the risks at and in retirement in a world of freedom and choice. Chris Wagstaff, Columbia Threadneedle Investments, February 2018, pp.24-25.

¹⁴ Those born between 1963 and 1971 currently number more than 900,000 for each of these nine years, while those born from 1972-1976 currently number more than 800,000 for each of these five years. See: Mid-year population estimates, UK. ONS data as at June 2021.

¹⁵ See: Past and projected period and cohort life tables: 2020-based, UK. ONS, 12 January 2022. Also see: Estimates of the very old, including centenarians, UK. ONS, 23 September 2021.

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