Aon UK DC Pension Tracker – Q4 2023

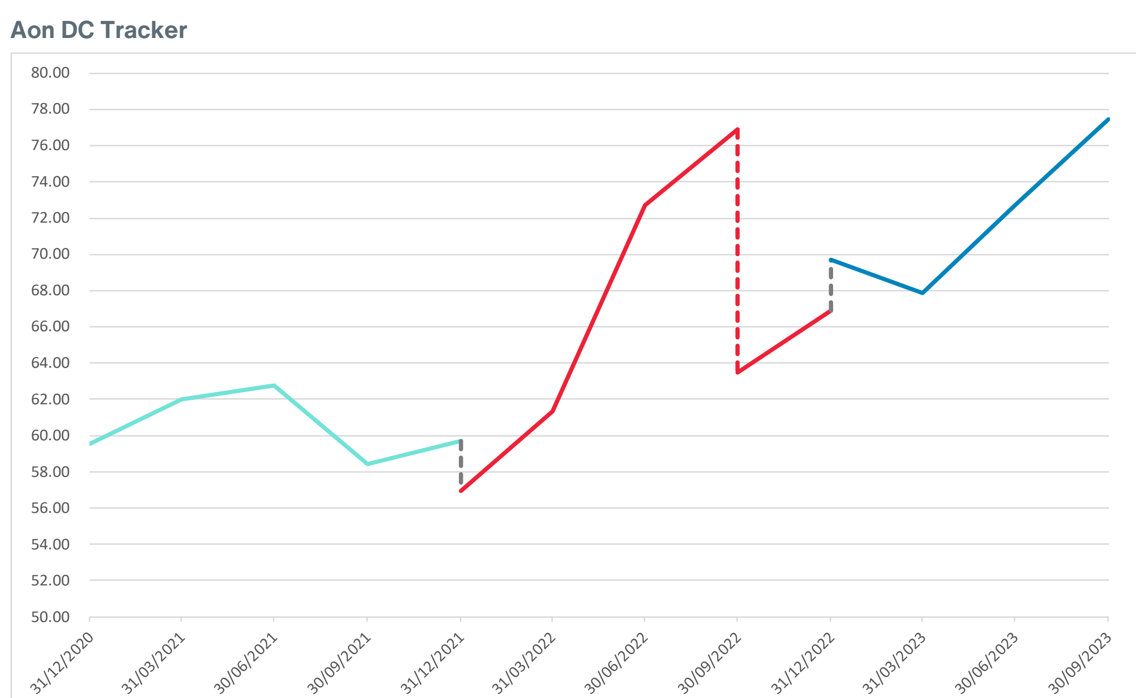
December 2023

- The Aon UK DC Pension Tracker rose over the quarter, with middle-aged savers benefiting the most
- Much of this increase was driven by increases in expected future returns, particularly when members come to access their savings

Over Q3 as a whole, the Aon UK DC Tracker rose, suggesting that the expected future living standard in retirement provided by defined contribution (DC) savings was higher than at the end of the previous quarter. As usual, this overall increase masks a more complex picture for the individual sample savers.

Matthew Arends, partner and head of UK retirement policy at Aon said:
"This period's Aon UK DC Pension Tracker shows that all savers are expected to be better off in retirement, due to higher expected returns, particularly when they start to access their savings. As with any DC pension saving these higher expected future returns are not guaranteed and may or may not occur in practice.

"Interestingly – and for the first time since the Aon UK DC Pension Tracker was introduced in 2021 - our two middle-aged savers are now expected to all but achieve the comfortable retirement living standard."



Source: Aon UK DC Pension Tracker (1 July to 30 September 2023)

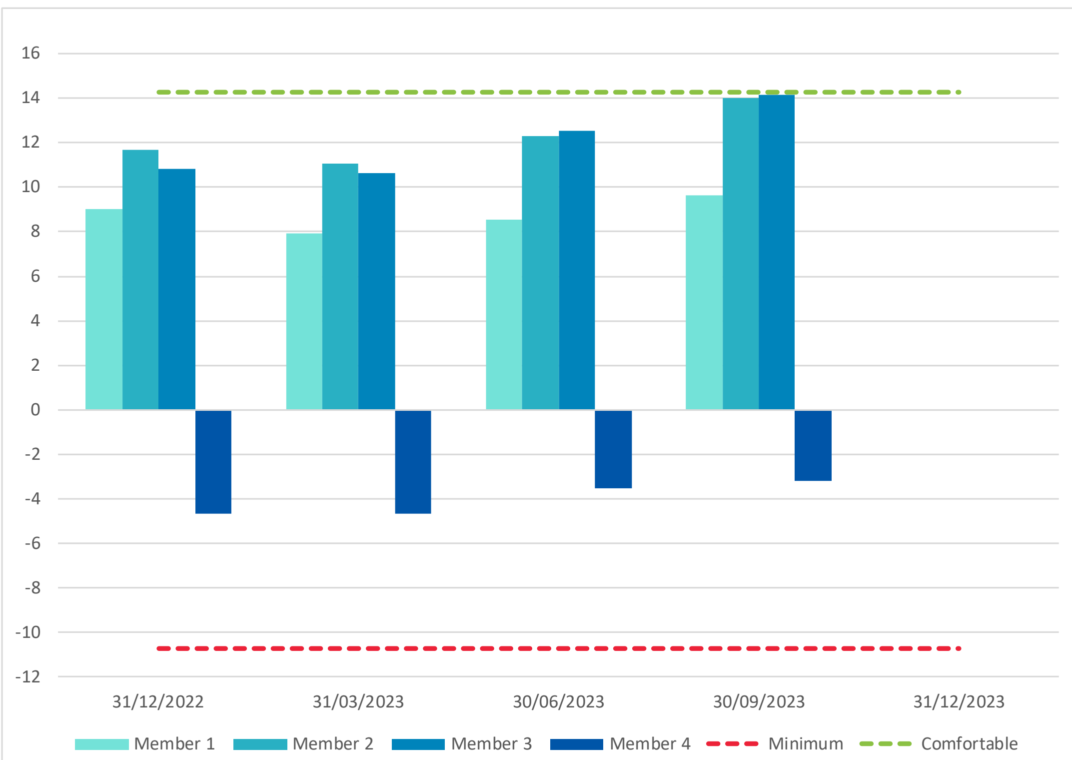
As a reminder, in January 2023, the Pensions and Lifetime Savings Association (PLSA) released the latest inflation update to its Retirement Living Standards. The Q1 2023 release of the Aon UK DC Tracker showed that scores fell significantly after being restated to reflect these updates, as shown on 30 September 2022.

Over the quarter (July to September 2023), the Aon UK DC Pension Tracker rose from 72.7 to 77.5

All members are expected to receive more from their private pension saving compared to the start of the period due to an increase in expected future returns - particularly when they reach retirement and begin to access their savings. However, this was offset slightly by weak benchmark investment returns over the quarter, particularly in growth assets.

The results suggest that our savers are, on average, expected to have a higher standard of living in retirement than was expected at the end of the previous quarter.

Savers' Positions



Source: Aon UK DC Pension Tracker (1 July to 30 September 2023)

Proposed auto-enrolment changes receive Royal Assent

The Private Member's Bill, brought by Jonathan Gullis MP and Baroness Altmann, which expands the scope of auto-enrolment has now received Royal Assent, paving the way for its introduction as the Pensions (Extension of Automatic Enrolment) Act 2023. The Act grants two extensions to auto-enrolment:

- Reducing the age at which employees are automatically enrolled from 22 to 18, and
- Abolishing the Lower Earnings limit for contributions meaning contributions would be paid from the first pound earned.

...and what this could mean...

For an 18-year-old entering the workforce now, the proposed changes could lead to an increase in their retirement income of around £6,250 a year, or an increase of around 27 percent, compared to the current system. As a much larger proportion of their income would become pensionable, the changes would be particularly beneficial to lower earning employees, including those working multiple part-time jobs. For a typical 18-year-old paying contributions for the first time, the cost could be around £55 per month from their take-home pay.

When added to the State Pension, the changes could mean that an average earner paying automatic enrolment minimum contribution rates is expected to achieve between "moderate" and "comfortable" standard of living in retirement as suggested by the PLSA/Loughborough University Retirement Living Standards. Without the proposed changes, the saver would be expected to receive less than the "moderate" standard of living in retirement.

If an 18-year-old increases their contributions above the minimum to a rate of 12 percent, the automatic-enrolment changes proposed could mean the average earner is expected to achieve the "comfortable" standard of living in retirement.

Matthew Arends said:

"Clearly the effect of the changes to an individual's retirement income is significant. However, it is important to note that these examples are based around the assumption of a complete (50 year) working life of contributions. In reality, many savers are likely to take career breaks or not work full time for the entire period. They may also choose to adjust their contribution levels based on their financial circumstances at any given point in time. While contributing 8 percent per year from 18 is a great place to start, it is important for savers to keep their pension savings under review and maximise their contributions where possible and affordable.

"Aon supports the changes in the Act and believes that it will lead to improved retirement outcomes – and particularly for the lowest paid employees. Many employers already provide contributions above the minimum level required by auto-enrolment. For them, the proposed changes may make little or no impact on the employees eligible, or on the contributions paid into their employees' pension pots."

Movement over the second quarter of the year

The increase in the Aon UK DC Pension Tracker over the third quarter of 2023 was primarily driven by an increase in expected asset returns for the different sample savers. In particular, savers' pots were expected to provide a higher level of income in retirement, all else being equal, than at the start of the quarter.

All our savers are now closer to achieving the 'comfortable' level of retirement living standard than they were at the start of the quarter:

- The youngest saver saw an increase in their expected income, of around £1,000 p.a. or 3.4 percent. This was driven by a combined effect of an increase in post-retirement return assumptions and pre-retirement assumptions over the quarter.

- The 40-year-old saver saw the largest increase in their expected retirement income, at around £1,650 p.a. (or 4.7 percent), again this was primarily driven by an increase in the post-retirement return assumptions, although actual investment performance over the quarter detracted slightly from this increase.

- Savers closer to retirement also saw a significant increase in their expected retirement income, which saw the 50-year-old saver experiencing the second largest £ amount increase in expected income over the quarter of around £1,600 p.a. (4.5 percent) when compared with the start of the quarter. This was again driven by increases in pre-and-post retirement return assumptions, although relatively weak returns over the quarter were felt most by this saver, due to their larger existing fund value.

- The oldest saver also saw the smallest increase in their expected income - around £350 p.a. (1.8 per cent), as they are the closest to retirement and so benefit the least from higher future expected returns and were impacted by the relatively weak benchmark returns over the quarter.

- Overall, the oldest saver is expected to be the worst off in retirement, with a retirement income around 70 percent of the way between the updated minimum and moderate standards of living. This excludes any defined benefit pension benefits they may have but which are not included in this projection.

- The youngest saver is currently expected to achieve an income well in excess of the moderate standard of living in retirement. The latest update shows that the 40-year-old and 50-year-old savers are now expected to all but reach the comfortable standard of living in retirement when the state pension is taken into account.

/ends

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The Aon UK DC Pension Tracker

The Aon UK DC Pension Tracker measures the expected retirement outcomes of four sample defined contribution (DC) pension savers against the PLSA/Loughborough University Retirement Living Standards ('the living standards'). It is intended to provide a quarterly measure of changes to the DC savings market, reflecting market movements and changes to future expectations for individual pension savers.

How It's Constructed

The Aon UK DC Pension Tracker is constructed by projecting the expected retirement income of four sample DC savers (below) to each individual's State Pension Age and then comparing these figures to the 'moderate' retirement standard suggested by the living standards.

Where appropriate, it is assumed that individuals use income drawdown to convert their DC funds into an income in retirement. Figures are in 'today's money'. In other words, the effect of anticipated future inflation (up to each saver's State Pension Age) has been removed to give you a better idea of the money's current buying power. State pension benefits are added, and tax is deducted to give a projected post tax retirement income.

This post-tax income is compared to the retirement standards for a single person living outside London by scaling the projected income against the minimum, moderate and comfortable living standards.

The result is that someone achieving exactly the target comfortable retirement standard would have a tracker score of **25**, someone achieving exactly the moderate retirement standard would have a tracker score of **11** and someone achieving exactly the minimum retirement standard would have a score of **0.**

The scores for the four sample DC savers are combined to give the overall tracker value each quarter. If all four individuals meet a comfortable standard, the overall tracker value would be **100**.

Sample Savers

The Aon UK DC Pension Tracker models the expected retirement outcomes of four sample members who are intended to cover a broad range of DC savers. These are based on typical values and ONS salary data for the country as a whole rather than any particular workforce.

- **The 30-year-old** – is a younger member early in their savings journey. Aged 30, they are currently earning a salary of £28,000 p.a. and have an existing DC fund of £20,000. Contributions to their DC fund total 8 percent of their salary.

This member's expected retirement income is most likely to be impacted by changes to future investment returns and inflation expectations. Actual investment performance each quarter has little impact on this member due to their small existing fund value and long period until retirement.

- **The 40-year-old** – is a mid-career member. Aged 40, they earn £32,500 p.a. and have built up a £70,000 fund through workplace savings and are currently making contributions of 10 percent of salary into their DC fund.

The 40-year-old member is also likely to be heavily impacted by changes to future investment and inflation expectations, but they will also be impacted by actual investment experience each quarter due to their larger existing fund.

- **The 50-year-old** – is starting to plan for retirement. Aged 50, they pay higher contributions of 15 percent of their £34,000 salary in the hope of boosting their existing DC fund value of £125,000.

The 50-year-old member is heavily impacted by actual investment experience each quarter due to their larger fund value and shorter time until retirement. They will still be impacted by changes to future investment and inflation expectations over the period until they reach retirement.

- **The 60-year-old** – is approaching the point of retirement. Aged 60, they have increased their contributions to 20 percent of their £30,000 salary to try to boost their £80,000 existing DC fund.

As this member is close to retirement, changes to future investment and inflation expectations have little impact on their expected retirement income. Actual experience each quarter has a much bigger impact on their expected retirement benefits.

Member Investments

When projecting the DC pension saver's pots, members are assumed to be invested in a typical 'drawdown lifestyle' fund which reduces the level of investment risk taken as a saver approaches retirement. Members are assumed to be fully invested in growth assets until 15 years before retirement, at which point investments begin to be transferred into lower risk funds, including bonds.

Future investment returns are assumed to be in line with Aon's best estimate Capital Market Assumptions for each asset class – these are updated quarterly by Aon's Global Asset Allocation team.

Investment performance over the previous quarter is taken in line with benchmark index returns for the relevant asset class.

Other Assumptions

Savers are assumed to pay fixed contributions as a percentage of salary over the remainder of their working lifetime. Salaries (and therefore £ contributions) are assumed to increase at 0.5 percent p.a. above inflation.

At retirement, funds are used to provide a drawdown income through a combination of bond and real asset returns. We have assumed that members will look to recreate a steady annuity style income from their invested assets.

We have also assumed that all savers will be eligible to receive the full State Pension in retirement when they reach state pension age.

All figures are converted into 'today's money'. The effect of anticipated future inflation (based on Aon's best estimate of inflation up to each saver's State Pension Age) has been removed to give you a better idea of the money's current buying power.

Tax has been deducted based on the tax bands and rates applicable at each quarter end. This implicitly assumes that tax bands will increase in line with inflation in the future and tax rates will be unchanged.

Savers 'age' each quarter over the calendar year. At the end of the calendar year the Aon UK DC Pension Tracker is re-set and the sample savers are returned to their starting age, salary and fund values.

Disclaimer

The Aon UK DC Pension Tracker is intended to provide a high-level commentary on changes to the DC savings market. Nothing in this paper should be considered advice and it should not be used as the basis for making any retirement or investment decisions.

Any member outcomes quoted are illustrations of a potential future benefit. Actual benefits received by the sample members, or any other DC saver, will depend on the actual contributions, investment returns and market conditions over the period to retirement and beyond. They may be higher or lower than the figures quoted.

The calculations of projected member outcomes set out in the Aon UK DC Pension Tracker, are all the work and methodology of Aon Solutions UK Limited. The PLSA/Loughborough University Retirement Living Standards have been used as input parameters to these calculations and methods.

The PLSA/Loughborough University Retirement Living Standards

The PLSA/Loughborough University Retirement Living Standards are the property of and are provided by the Pensions and Lifetime Savings Association and Loughborough University.

Further details about the standards can be found on their website:

https://www.retirementlivingstandards.org.uk/

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