Phoenix
Insights

Tomorrow's problem? Analysing the future impact of DC pension undersaving

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Introduction

The UK's pension system is at a critical juncture, with significant concerns about the adequacy of retirement incomes for future generations. Working-age people today face a real challenge in being responsible for ensuring their financial security in retirement. Several societal changes including demographic shifts, increased life expectancy and evolving employment and retirement behaviours following the COVID-19 pandemic and the cost of living crisis, have placed increased pressure on this system.

As the working-age population faces more responsibility for securing their financial future, evidence suggests that many are not saving enough to meet their retirement needs. According to the DWP, 38% of working age people (equivalent to 12.5 million) are under-saving for retirement when measured against Target Replacement Rate (TRR) Before Housing Costs (BHC).[1] Previous analysis by Frontier Economics for Phoenix Insights in 2022, found that 15% of defined contribution (DC) savers (equivalent to 4.6 million people) expect an income in retirement of less than the PLSA minimum retirement living standard, while 40% of DC savers (equivalent to 12.4 million people) expect at least the PLSA's minimum income, but they are not on track to achieve it.[2]

This paper, undertaken with Frontier Economics, extends our previous analysis to understand when and how this under-saving problem may emerge over time. Using the Phoenix Insights Longer Lives Index data (a survey of around 16,500 people across the UK aged 25 and over who are not yet retired), we analyse the trajectory of new retirees' financial situations, providing a timeline for how the problem of under-saving may crystallise for new DC pensioners.[3]

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[1] Analysis of future pension incomes, DWP (2023) - www.gov.uk/government/statistics/analysis-of-future-pension-incomes/analysis-of-future-pension-incomes

[2] Great Expectations: Are people's retirement income expectations adequate and achievable? (2022) - https://www.thephoenixgroup.com/media/hzcfg1wo/phoenix-insights-great-expectations-report.pdf

[3] Given the data used captures only people who have not retired yet, our analysis is exclusive of current pensioners.

According to our modelling, over half (54%) of all DC savers retiring between 2025 and 2060 are expected to be either "undersavers" or "financially struggling". The total population of new DC pensioners is expected to peak between 2050 and 2054, reaching approximately 15.3 million.

Of this population:

8.7 million DC pensioners
will fall into the "undersavers" or "financially struggling" categories.

This includes:

6.4 million "undersavers"
who are not saving enough for a comfortable retirement.

2.3 million "financially struggling"
who are in an even more precarious financial situation.

Prior to this peak, by 2035, 5.8 million DC pensioners are projected to be in these two categories, with that number rising to 8.6 million by 2045.

The years 2040 to 2044 represent a critical period, as they will contribute the highest absolute number of "financially struggling" or "undersavers" new retirees. 2.67 million of individuals retiring in that period will fall into those two concerning categories. We found these individuals to be predominantly born in the 1970s, female, working full-time, earning below £80k (about half of them earn below £20k) and expecting to retire between the ages of 66 and 70.

Methodology

Our modelling exercise used Phoenix Insights Longer Lives Index data to estimate the percentages of people across the UK aged 25 and over who are not yet retired falling in the following five categories:[4]

- The "financially struggling": individuals expecting a retirement income below the PLSA minimum retirement living standard.
- The "undersavers": individuals expecting at least the PLSA's minimum income but not on track to achieve it according to our modelling.
- The "downgraders": individuals expecting at least the PLSA's minimum income and on track to achieve it, but for whom this income would be insufficient to maintain their pre-retirement standard of living.
- The "unsure": individuals who were not able to provide an expected retirement income (many of whom may be disadvantaged by not engaging with pension decisions that will have significant consequences for their retirement).
- The "happily on track": individuals expecting a retirement income above the minimum, on track to achieve it, and expecting it to maintain their living standards in retirement.

The model only considers outcomes from DC savers, and not from savers contributing to a defined benefits (DB) pension.[5]

To enable us to study the evolving composition of retirement cohorts in terms of pension preparedness we leveraged the birth cohort and stated retirement age data from the survey and we categorised survey respondents based on the year they are projected to reach their stated retirement age. We then estimated the flows of new retirees (both in absolute and percentage terms) and the cumulative population of the five groups of retirees in each future time period.

Our approach is sensitive to the assumptions made about future income growth and investment performance.[6] While this could influence the accuracy of our modelling at the individual level, our results are intended to paint a picture of the challenges faced by the population of the UK savers as a whole.

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[4] For further details on the modelling methodology see Great Expectations: Are people's retirement income expectations adequate and achievable? (2022) - https://www.thephoenixgroup.com/media/hzcfg1wo/phoenix-insights-great-expectations-report.pdf

[5] This is because the survey does not contain enough information to appropriately model future retirement income from current DB pension. We also exclude from our modelled sample a small number of people who were in work but did not report their salary.

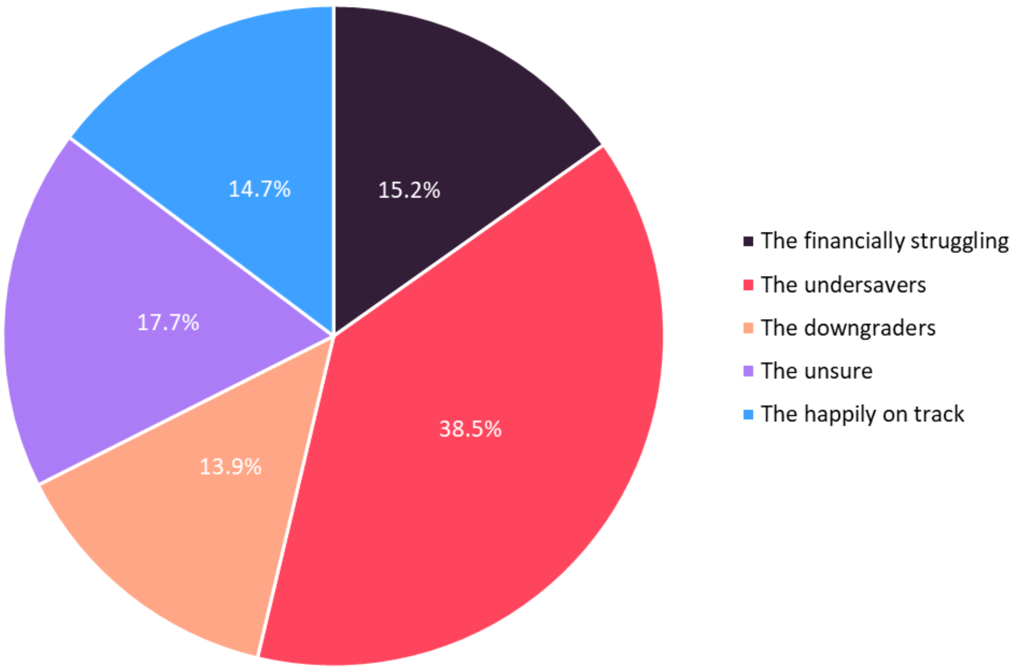
[6] For a discussion of assumptions see Great Expectations: Are people's retirement income expectations adequate and achievable? (2022) - https://www.thephoenixgroup.com/media/hzcfg1wo/phoenix-insights-great-expectations-report.pdf

Results

The projected composition of DC savers planning to retire between 2025 and 2060 shows that "undersavers" are expected to make up 38.5% of the total new retirees. Meanwhile, 15.2% of new retirees will fall into the "financially struggling" category. Together, these groups represent a majority of new retirees who will face significant financial difficulties, either failing to meet basic income needs or falling short of their anticipated retirement income goals.

While these categories pose the greatest concern, it is also noteworthy that 17.7% of DC savers fall into the "unsure" category, meaning they were unable to estimate an expected retirement income. Interestingly, the inability to estimate the expected retirement income is not correlated with the age of respondents, which means the issue is not limited to young individuals who have more time to clarify their retirement plans. Many of the "unsure" individuals may be disadvantaged by the lack of engagement with pension decisions that could significantly impact their financial security in retirement, and this is particularly concerning for older respondents who are closer to retirement.

Figure 1 - Projected composition of DC savers planning to retire between 2025 and 2060 by saver category



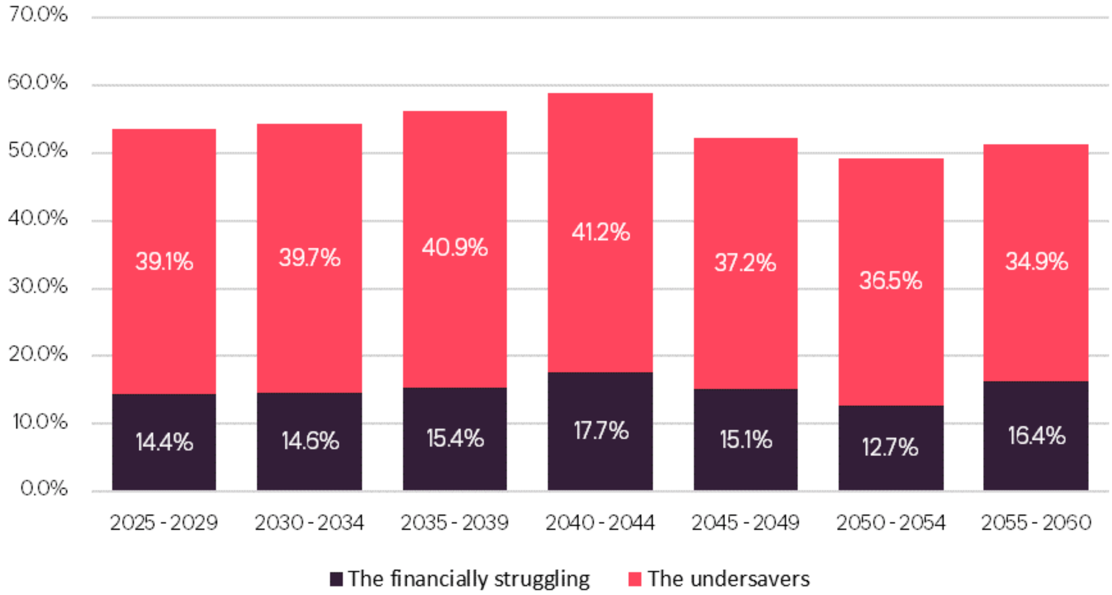
Source: Frontier Economics analysis of Phoenix Longer Lives Index data

The composition of future cohorts of newly retired[7] DC savers appears reasonably consistent over time. This indicates that a 'cliff-edge' scenario – a significant deterioration in savings adequacy for some cohorts of new retirees – is unlikely. While the proportion of newly retired individuals classified as "financially struggling" and "undersavers" increases over time, these groups are expected to peak between 2040 and 2044, accounting for 17.7% and 41.2% of DC savers, respectively. This is in line with the findings of the DWP's 2023 report on future pension incomes, which

[7] This means that each cohort includes only DC pensioners who retired within that specific time window, excluding those who retired earlier

similarly projects that the proportion of newly retired people unable to meet their TRR or the PLSA's Retirement Living Standards will grow gradually over time and peak during the same period.[8]

Figure 2 - Time series of estimated percentage of newly retired DC pensioners classified as "undersavers" or "financially struggling"



Source: Frontier Economics analysis of Phoenix Longer Lives Index data

The years 2040 to 2044 represent a critical period, as this is when the largest absolute number of newly retired DC savers falling into the "financially struggling" and "undersavers" categories are projected to enter retirement: 0.8 million "financially struggling" and 1.87 million "undersavers" are expected to retire during this period.

It should be noted that our model assumes individuals save a constant proportion of income over their lifetime, equal to what they state as current behaviour. If young people positively change their savings behaviour as they approach retirement age, this could reduce the projected number of "financially struggling" and "undersavers", meaning that our estimates are upward biased. While this is possible, available evidence suggests that the increase in average contributions into DC pensions as a share of earnings through working life is small. Data on life-cycle patterns in pension savings from before automatic enrolment was introduced in October 2012 shows it to be around 2 percentage points of gross pay between the early 20s and mid-50s across all private sector employees. Furthermore, while the contributions tended to slowly increase with age for men, they seemed to plateau for women after the mid-30s[9].

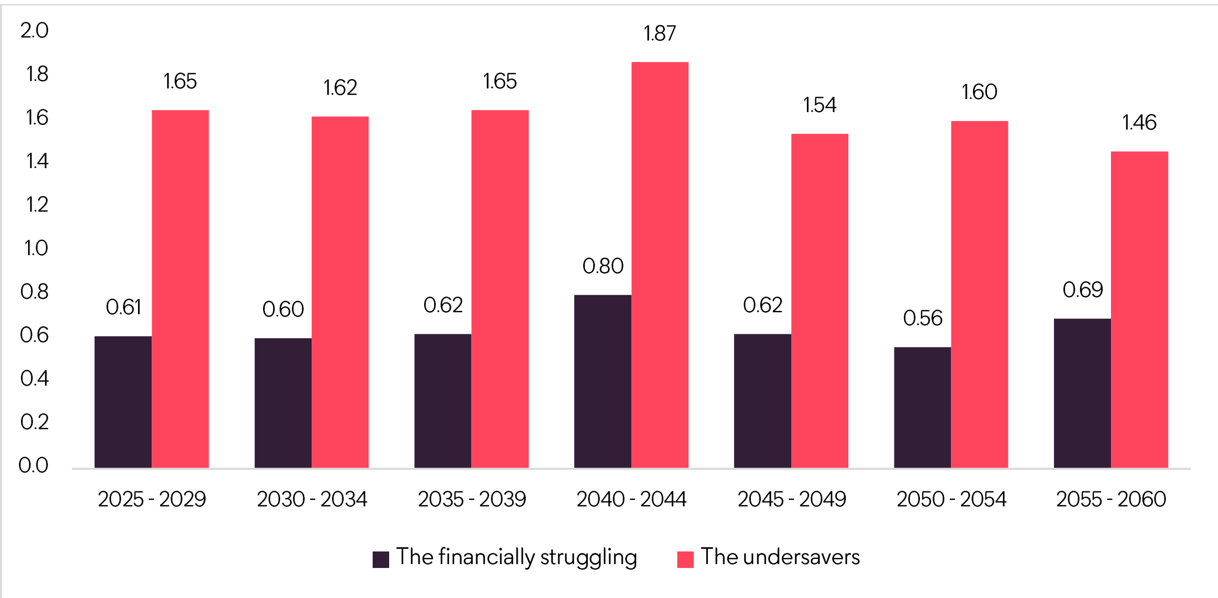
[8] Analysis of future pension incomes, DWP (2023) - www.gov.uk/government/statistics/analysis-of-future-pension-incomes/analysis-of-future-pension-incomes

[9] Life-cycle patterns in pension savings. Institute for Fiscal Studies, May 2021. https://ifs.org.uk/sites/default/files/output_url_files/BN327-Life-cycle-patterns-in-pension-saving.pdf

The key demographic and financial traits of those retiring during this "peak" period can be summarised as follows:

- 74% of those affected are individuals born in the 1970s, 14% were born in the 1980s and 9% were born in the 1960s (the proportion of individuals born in the 1990s and 1950s is negligible).
- The majority are women – either in a couple (32%) or single (27%) (25% are single men and 15% are men in couple).
- Employment data shows that 60% are working full-time, 28% part-time, and 9% are self-employed (2% plans to work in the future, while 1% are out of work indefinitely).
- With regard to stated retirement age, almost half of this group expects to retire between the ages of 66 and 70, while one-in-four plan to retire between 61 and 65. (A smaller portion, 14%, expect to retire between 51 and 60, 9% plan to retire after 70, and 2% expect to retire at 50 or under.)
- In terms of salary distribution, 52% of individuals earn less than £20k and 48% earn between £20k and £80k (less than 0.5% earn over £80k).
- 43% are current or future renters, 39% are paying off a mortgage, and 13% have paid off their mortgage (renters planning to buy a home make up just over 5% of the group).

Figure 3 - Time series of estimated number of newly retired DC pensioners classified as "undersavers" or "financially struggling" (millions)



Source: Frontier Economics analysis of Phoenix Longer Lives Index data

According to our modelling, the total population[10] of DC pensioners entering retirement after 2025 is expected to peak between 2050 and 2054, reaching approximately 15.3 million.

Of this population:

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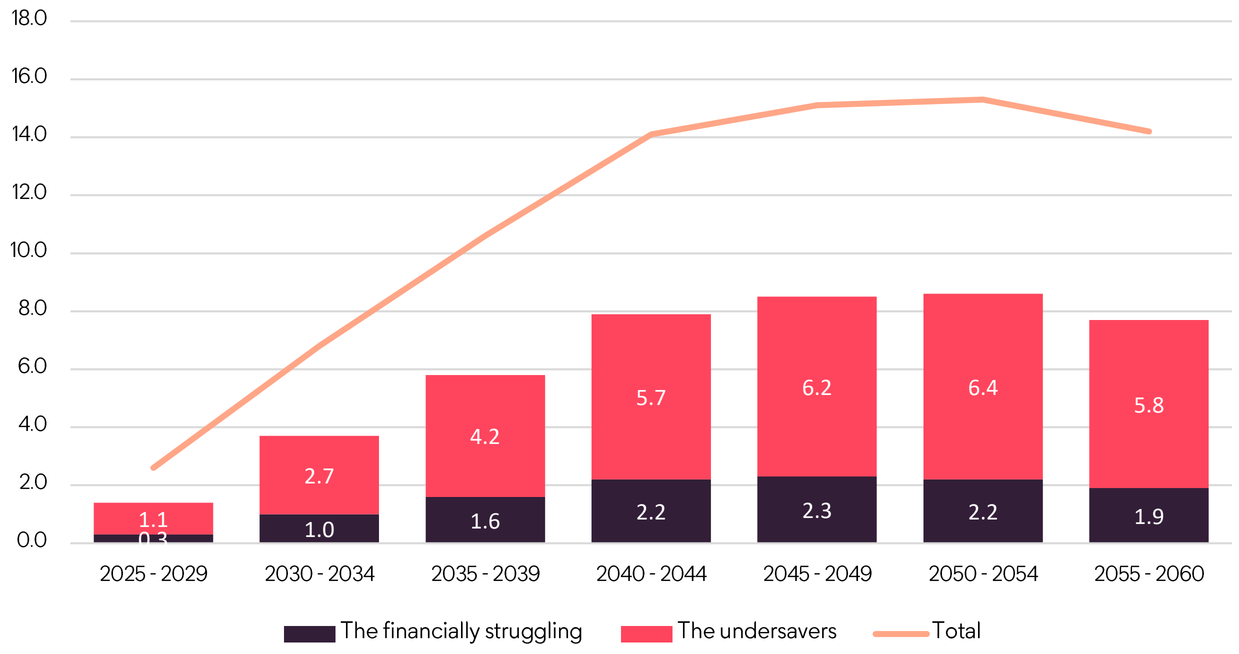
Prior to this peak, by 2035, 5.8 million DC pensioners retired after 2025 are projected to be in these two categories, with that number rising to 8.6 million by 2045.

Figure 4 - Time series of estimated number of overall DC pensioners retired after 2025, classified as "undersavers" and "financially struggling" and total (millions)



Source: Frontier Economics analysis of Phoenix Longer Lives Index data

[10] This includes all DC pensioners who are retired in a give time window, not only those who enter retirement during that time window.

This analysis offers a partial picture, as it excludes any DC savers who retired before 2025. However, given that automatic enrolment began in October 2012 and DB schemes were historically more prevalent prior to this, it is reasonable to assume that the majority of people who retired before 2025 are currently receiving a DB pension. As such, the results presented here should provide a reasonably accurate representation of the evolution of the population of pensioners on DC schemes over time.

These findings underscore the growing pressure on the UK pension system as a large share of the population faces the prospect of inadequate retirement income. While the overall composition of retiree cohorts remains relatively stable over time, the peak in under-saving and financial difficulty projected for the 2040-2055 period requires more immediate policy intervention to address the challenges posed by the UK's ageing population and inadequate savings rate.