Summary

- Many DC savers are not on course to save enough to match the average retiree spend of £26,000 a year.
- Personal finances are becoming more stretched, particularly for younger people.
- Solutions such as Nest's savings sidecar and a heavier emphasis on employer contributions may alleviate the problem.

The numbers don't work

At present, the average earner saving into a DC pension faces a stark choice. They must either cut back on current spending, or lower their retirement income expectations

Searching for a consensus view on how DC schemes can deliver adequate retirement incomes can be a bewildering exercise. There is, however, one thing that everyone agrees on, and which, in reality, underpins every newfangled target default fund and flexible annuity product out there. The archetypal DC member needs to save more. A lot more, in fact.

Consumer magazine *Which?* quizzed thousands of its retired readers last year in an attempt to build a picture of how much income people require once they have been handed their last P45. It found that retirees spend £26,000 a year on average. More extravagant retirees expecting to enjoy long-haul trips and regular new cars need an annual pension income of about £39,000.

Analysis from Scottish Widows shows that if someone starts saving into a pension at 25 years of age, then they would need to put aside £293 each month to reach a £23,000 annual income. Given that the current maximum new state pension benefit works out at £8,767.20 a year (with the old state pension mazimum at £6,718.40 a year), a pensioner could expect their pot to pay out something around £30,000, if means-testing works in their favour. Should they put off paying contributions for a decade however, then their monthly savings would need to rise to £443. At 45, they are looking at payments of £724.

For median earners however, reaching these sorts of contributions look about as realistic as a Chinese ESG-focused ETF that outperforms the Shanghai Stock Exchange on a regular basis.

According to the Office for National Statistics (ONS), at the end of 2018, the median household disposable income in the UK was £28,400. Assuming an employer only puts in the minimum 3 per cent under the latest auto-enrolment contribution rules, then an average earner needs to put in 5 per cent (£1,420 a year) to make up the required 8 per cent (£2,272). But under Scottish Widows' calculations, a 25 year old needs to be saving £3,516 annually, while a 35 year old needs to be contributing £5,316 every year.

The picture gets worse when current household expenditure and pot sizes are factored in. Last year, PensionBee estimated that the average amount of money sitting in a pension is £21,441. At the same time, according to the ONS, average weekly household expenditure in the UK was £572.60 in 2018. This equates to just under £30,000, meaning that there is little, if any wriggle room for median earners to go above the 8 per cent contribution threshold without it impacting their finances — unless wage growth picks up significantly from its 3.4 per cent latest rate.

It is hard to see where cutbacks in personal finances can be made to accommodate increased pension savings as well, unless median earners are expected to live like monks until they reach the state retirement age.

Transport, at an average cost of £4,202 a year, takes up 14 per cent of income, while £3,151 (11 per cent of an average total budget) is spent on food and non-alcoholic drinks. Household needs and utilities make up another seven and 6 per cent of expenditure, respectively, and clothing, council tax, communications and insurance come to 14 per cent of a household's disposable income. Personal items such as toiletries account for 3 per cent of spend.

Thrifty savers may frown at other recreational costs such as £2,480 (8 per cent) spent on gym membership fees, television subscription services and the like, but many people would now look upon these as essential features of a 21st century developed world lifestyle.

In the main, the rest of people's average spending goes on hotels and restaurants, holidays, health, education, licences and fees, and alcohol and tobacco.

Nevertheless, says Scottish Widows' retirement expert, Robert Cochran, it is possible to siphon some money away from non-critical items into a pension.

"While it would be unrealistic to suggest that we live entirely without splashing out on small treats every now and then, making small lifestyle adjustments can help build a longer term saving habit and make a real difference to quality of life in retirement," he says.

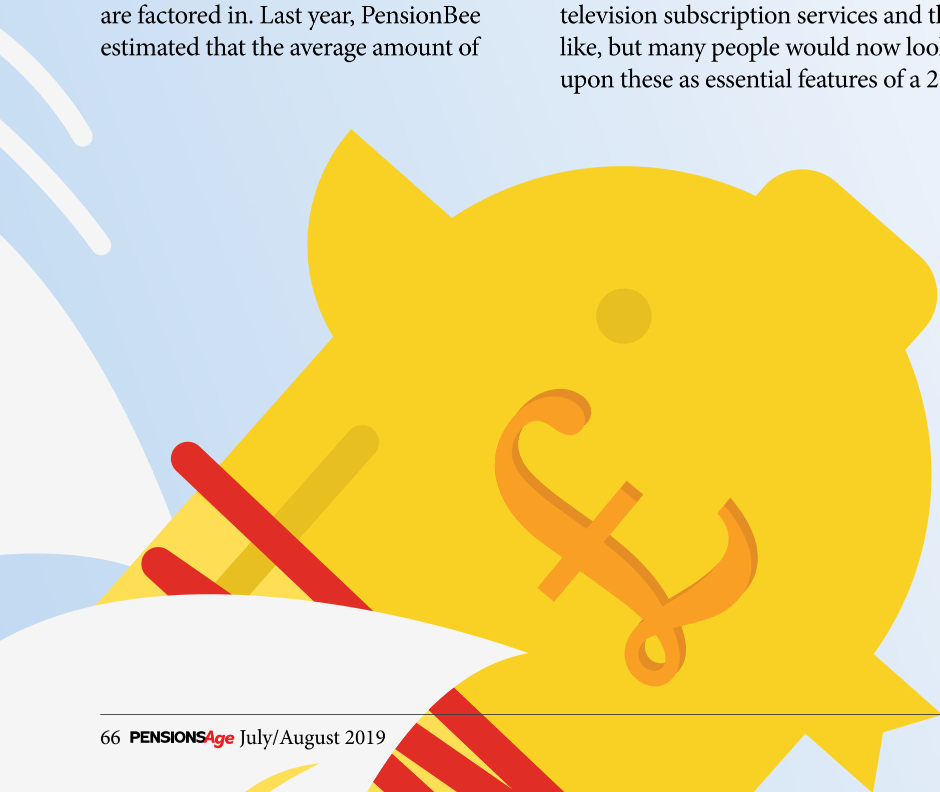
"Our research also shows that the average Brit spends £124 each month on little luxuries such as takeaways and taxis — a figure that most people significantly underestimate," he says. "Putting this incidental spending in to a pension instead could be worth as much as £9,853 in additional annual income in retirement."

Renters at risk

For all the talk of not relying on property for your pension, it turns out that accommodation arrangements are likely to play a big factor in boosting retirement income.

Research conducted by Santander in 2018 has shown that homeowners could save £189 a month, or £2,268 a year, if they own a property. The average monthly rent in the UK in 2018 was £912 per household, compared to monthly mortgage repayments of £723, based on an average mortgage rate of 2.48 per cent.

There is also a distinct advantage for retirees who are on the housing ladder who need to top up their inadequate pensions pots. In its 2017 *Hitting the Target* report, the PLSA calls for a wider availability and use of lifetime mortgages, in order to provide retirees with some much-needed equity release. The report points out that in October 2016, people aged over 55 held approximately £1.5



trillion of UK housing wealth. This is projected to increase to £2.9 trillion by 2036.

"We tend to look at pensions alone," says the PLSA's policy lead for lifetime savings, George Currie. "But we need to consider people's lifetime savings in the round.

"So people who may not have enough pension income might have some property wealth that they could use to support them in retirement, maybe through an equity release product or by downsizing, so to get the fullest picture of their options, they need to consider all their assets and income sources in the round."

There's a major snag with home ownership, of course. These days, buyers are typically having to find over £50,000 for a deposit on their first home.

The rising debt problem

Building up a deposit for a house purchase is also becoming harder than ever for many, particularly as so many young people are now finding themselves in debt.

Step Change, a charity that helps people get control over their finances and debts, says that it is experiencing an increase in the proportion of younger clients who contact it for advice. The charity's latest statistics show that almost two-thirds of its clients are aged under 40. In 2014, this figure was just half of all the people it helped.

Last year, Step Change was contacted by 657,930 new clients searching for help with their problem debt and the average debt of its clients now stands at £13,544 — an increase of £264 compared to 2017. The proportion of clients renting their homes has also been rising across the past five years.

Finding solutions

One criticism that has been levelled at the auto-enrolment, despite its evident success, is the slow, staggered process towards higher contributions. For many, waiting for auto-escalation to boost contributions may well be a case of too little, too late.

One way to encourage higher contributions at a faster pace is to use auto-enrolment as a way to help people build an accessible emergency savings fund. This idea, in the form of the sidecar savings model, has been piloted by Nest Insight since last November, and could soon prove to be the key to unlocking further saving. It works by diverting a small proportion of pension contributions into an accessible savings pot.

Having commissioned the Pensions Policy Institute to look at the idea, Step Change found that putting a proportion of auto-enrolled payments into an accessible savings pot would cause only a very limited impact on people's pensions. It could also prove to be a match for the Lifetime ISA, which has continued to gather pace as a workplace benefit.

Step Change's senior public policy advocate, Grace Brownfield, explains that this would make pensions saving more attractive to people worried about making ends meet at present. "A rainy-day savings pot may prevent people from dropping out of paying pension contributions all together — something that is likely to be a more damaging to pension savings," she says.

Ultimately, says Currie, given the pressure on the average household income, the only realistic way to boost retirement savings is to get more employers to rediscover their paternalistic instincts.

"There are ways of achieving higher contributions without putting a higher burden on employees," he says. "Our policy is to move to contributions at the rate of 12 per cent of salary. And we would weight that more towards the employer and expect them to do more of the heavy lifting. There are ways of achieving higher contributions without

Written by Marek Handzel, a freelance journalist

By the numbers

- Retirees spend £26,000 a year on average
- To reach a £23,000 annual income at retirement:
  - A 25 year old would need to save £293 a month
  - Age 35 -£443 a month
  - Age 45 - £724 a month
- The current maximum new state pension benefit is £8,767.20 a year
- Average pension pot size: £21,441
- The median household disposable income is £28,400
- The average amount of debt is £13,544
- Average monthly rent is £912
- Average monthly mortgage repayment is £723
- Average weekly household expenditure: £572.60
- Transport is 14 per cent of the average person's income (£4,202 a year)
- 11 per cent is spent on food and non-alcoholic drinks (£3,151)
- Household needs equate to 7 per cent of expenditure
- Utilities cost 6 per cent of finances
- Clothing, council tax, communications and insurance total 14 per cent of income
- Toiletries account for 3 per cent of spend
- Recreation, such as gym membership fees and television subscription services, costs 8 per cent (£2,480)
- £124 spent each month on luxuries such as takeaways and taxis

**See feature for sources*