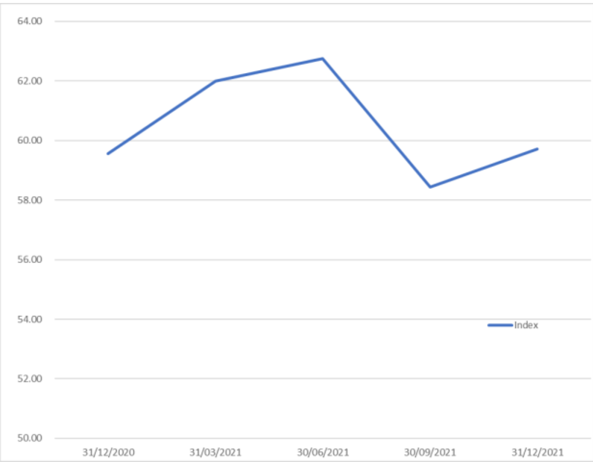
Aon UK DC Pension Tracker

Update – Q1 2022

Aon's UK DC Pension Tracker rose over the last quarter (September to December) of 2021. This suggests that the expected living standard in retirement provided by DC savings was higher than at the end of the previous quarter. However, this masks a more complex picture for the different age categories.

Aon DC tracker



The DC Tracker rose from 58.4 to 59.7 over the quarter and was broadly level with the position at the start of 2021. This suggests that our sample savers are, on average, expected to have a slightly higher standard of living in retirement than they were expected to have at the end of the previous quarter - but similar to the expectations at the start of the year.

Good news for asset owners but volatile times ahead?

Strong investment returns, particularly on equity assets, meant that it was a good time to be an asset holder. These strong returns (in isolation) increased the expected retirement incomes for all our sample savers. However, the effect was much more pronounced for the savers with the larger DC pots already built up (the 40- and 50-year-old members).

While the younger savers also benefited from this, their existing fund value is relatively small and the majority of their benefits will be built up in the future so the returns had less of an impact on the overall potential retirement benefits for them.

However, generally, growth assets fell in the first quarter of 2022 and we look set for a period of high volatility due to ongoing geopolitical tensions and their knock-on effects on the economy.

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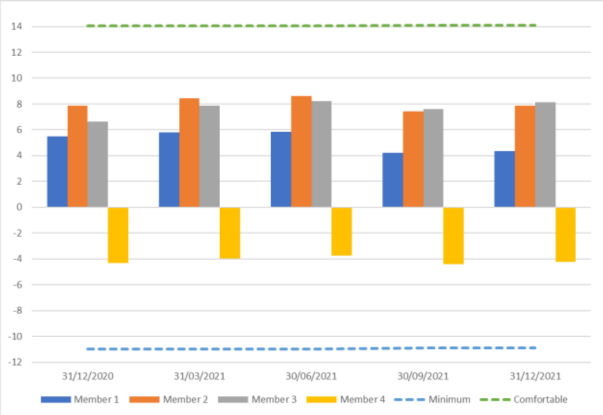
Mixed position for savers



The increase in the Aon UK DC Pension Tracker over the last quarter of 2021 was driven by increases across the board in expected pensions for the different sample savers:

- Savers with the largest existing fund values saw the biggest increase in expected benefits (40-year-old and 50-year-old) - increasing by around £400 p.a. and £500 p.a. respectively.
- The youngest saver had the smallest increase in expected income (around £125 p.a.) due to their smaller existing fund and the impact of a slight reduction in future expected returns.
- The expected income for the oldest saver increased by around £150 p.a. but was still the lowest income overall.
- Overall, the oldest saver is expected to be the worst off in retirement, with a retirement income between the minimum and moderate standards of living. This excludes any DB benefits they may have which are not included in this projection.
- The younger three savers are all currently expected to achieve between moderate and comfortable standard of living in retirement.

Recap of 2021

In another unusual year of lockdowns and upheaval, DC pensions generally performed well. High investment returns on growth assets led to increases in fund values almost universally. However, lower expectations of future returns reduced the expected outcomes for savers, particularly younger savers who are further from retirement. The spectre of higher inflation also raises questions of the affordability of extra contributions for many.

Despite the strong investment returns, the younger saver saw a reduction in their expected income over the year of around £450 p.a.

The 50-year-old saver was the biggest gainer due to the value of their existing funds – they were expected to be almost £2,000 p.a. better off in retirement.

The 40-year-old saver was expected to be around £550 p.a. better off compared to their position at the start of the year. The 60-year-old saver's income is expected to have increased by around £700 p.a. However, this increase would still not move the saver into the PLSA's "moderate" living standards.

From the start of 2022 all sample savers in the Aon DC Pension Tracker are re-set back to their initial ages and starting fund values.

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% 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% 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% 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% 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% 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 2021/22 tax bands and rates. 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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