

# Building a Living Pension

Closing the pension savings gap for low-  
to-middle income families

David Finch & Cara Pacitti

January 2021



## Acknowledgements

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## Foreword

Pensions saving in the UK has been transformed by auto-enrolment. Since 2012, 10.4 million more people are saving into a workplace pension. However, the success in driving up the number of people saving for retirement hasn't increased employees' confidence that their pension will deliver the income they need in retirement.

That's why Aviva commissioned the report "Building a Living Pension" from the Resolution Foundation, which considers the feasibility of creating a Living Pension benchmark to improve pension outcomes.

The impact of Covid-19 in 2020 has further eroded confidence in pension outcomes. Research carried out for Aviva's recent [Embracing the Age of Ambiguity](#) report revealed that three quarters (78 per cent) of employees feel as if they will have to work longer before they retire. And less than a third (28 per cent) know how much they need to save to fund the lifestyle they want in retirement. So, in this context, there is a clear need for a Living Pension standard to encourage and reward employers going beyond auto-enrolment minimums, and reassure employees – particularly those on lower incomes – that their workplace pension is designed to deliver a decent standard of living in retirement.

The Report shows that creating a Living Pension benchmark is feasible. But there is more to do to translate this into an accreditation standard that will work well in practice for employers and employees.

That's why Aviva has been working together with the Living Wage Foundation to understand what the next steps should be in the creation of a Living Pension standard. The Living Wage Foundation will now use this research to develop and pilot a Living Pension accreditation standard that is equivalent to the highly successful Living Wage campaign in the UK – with the possibility of implementing a new standard that employers can accredit to in the coming years. We are excited to continue supporting the Living Wage Foundation to help achieve this.

The introduction of a Living Pension will also help low-to-middle income employees focus on how they can reach a decent standard of living in retirement. Low-cost, accessible services like tailored guidance and simplified, focused advice could support individuals in achieving this outcome.

If a new Living Pension accreditation standard is created, it will be an exciting step forward for pension saving. It will be clear and simple – calculated by organisations independent from the pensions industry that have extensive experience in encouraging

and recognising the actions of responsible employers. Not only will a Living Pension standard improve confidence in workplace pensions, but it could also significantly improve pension outcomes – particularly for people on low-to-middle incomes.

**Lindsey Rix**

**CEO UK Savings and Retirement at Aviva**

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## Executive Summary

The Living Wage has been successful in providing a focus on the living standards of low-paid workers and increasing pay for many lower-paid employees. However, there has been much less of a focus on the future living standards of the same group. A 'Living Pension' could help us understand the savings required today to provide an adequate income in retirement. Although the current focus of policy makers is on how to ameliorate the impact of pandemic restrictions, it is important to think about the longer-term prospect for living standards once the economy has recovered and beyond.

This report sets out a framework through which a 'Living Pension' could be calculated, identifying the contributions required by workers and their employers today to save for an adequate income in retirement. It is a first step in understanding the feasibility of a 'Living Pension' standard. This will then be further refined, and a governance and accreditation process explored, by the Living Wage Foundation.

There have been significant changes to the pension policy landscape over the last fifteen years. Since 2016, an almost-universal, flat-rate, currently triple-locked state pension is now paid to people reaching State Pension age, and the system of auto-enrolment has led to a large increase in private-pension coverage since its introduction in 2012.

However, despite these improvements, many of today's workers have little pension savings. Our analysis shows that typical total

pension wealth for workers in the bottom half of the income distribution without substantial Defined Benefit pension savings in 2016-18 was only £319 for those aged 25-34, £1,562 for those aged 35 to 44 and £2,391 for those aged 45 to 54. More positively, though, there have been gradual increases in saving since 2012-14, appearing to reflect the introduction of auto-enrolment.

A Living Pension would provide the private pension income in retirement that can facilitate a socially-acceptable adequate standard of living, taking into account the workings of the tax and benefit system. It would reflect how future living standards for pensioners might change relative to working families, as well as how living costs might vary between cohorts of pensioners. We show that it is feasible to calculate the contributions required by a low-to-middle income worker to secure an adequate income in retirement. The parameters chosen for the Living Pension calculation – and explored in this report – aim to balance the long-run stability of the calculation with realism and the need to reflect current behaviour.

The first step in our calculation is to estimate the income that future cohorts of pensioners would need in retirement to attain an acceptable adequate standard of living. Key assumptions and inputs to calculate this income include:

- The cost of a core basket of goods and services that pensioners need as a minimum (based on the Minimum Income Standard, mirroring the basis for the Living Wage);
- Forecasts of changes in the housing tenure composition between future cohorts of pensioners;
- That living costs for pensioners keep pace with earnings growth over the long term;
- Forecasts of the household composition of future cohorts of pensioners;
- Cohort life expectancy projections; and,
- The structure of the future tax and benefit system.



The estimated income requirement throughout retirement that can be calculated from this information, combined with the assumed use of a drawdown product to access those savings, allows the calculation of a target 'Living Pension' pot.

The second step is to calculate the annual contributions needed through working life to accumulate this target pot. Key assumptions and inputs used in this calculation include:

- A focus on the savings requirements of employees without significant existing Defined Benefit wealth and living in households with income below the median
- The current level of pension savings of the target population, informed by detailed analysis of the Wealth and Assets Survey (which shows lower-paid employees have little or no existing saving other than through auto-enrolment);
- That people make contributions from their earnings in line with auto-enrolment parameters;
- A working life beginning at age 22 and continuing on an earnings trajectory that varies with qualifications and sex until the individual reaches the State Pension age; and,
- That people receive a full State Pension in retirement and their income takes into account the payment of tax and receipt of benefits.

The calculation then increases the contribution rate in each year of working life from current auto-enrolment minimums until the savings pot reaches one sufficient to deliver a Living Pension, as calculated in the first step. Those required contributions would form the basis of a Living Pension benchmark.

Our calculations show that, on average, today's workers would need to save £3,000 a year to meet the Living Pension target. For a full-time Living Wage earner, that is £1,500 a year more than current minimum auto-enrolment requirements and equivalent to an additional 8 per cent contribution rate. This also assumes that contributions are made on total gross earnings, in line with the Government's aspiration to remove the lower earnings threshold in auto-enrolment.



But this additional savings requirement varies by cohort, largely reflecting the number of years left to save until retirement and the number of years the cohort will have spent saving under the auto-enrolment regime. Low-to-middle income employees aged 25 today would need to save an additional £600 a year if working full time on the Living Wage, equivalent to a 3 per cent of gross earnings, and a 35-year-old would need to save an additional £1,300, equivalent to 7 per cent of gross earnings.

Our analysis demonstrates the feasibility of constructing an employer-facing Living Pension benchmark that is stable over time and rooted in both the past and expected future experiences of those on low-to-middle incomes. There are further considerations to be made, such as over the precise way in which the benchmark is expressed; the emphasis on employer versus employee contributions; who it should cover and whether it should vary between groups; its governance; and the practicalities of a Living Pension accreditation process. The Living Wage Foundation will now take these considerations forward and pilot different approaches, aiming to make the Living Pension a reality in order to encourage and recognise those employers who are committed to the retirement living standards of their workers.

## Section 1

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### Why a living pension?

#### An adequate income for pensioners

The Living Wage campaign has been highly successful in providing a clear benchmark for wages to ensure employees are paid enough to meet a decent standard of living. Part of the success of that campaign is the credibility of the calculation of the Living Wage: it is updated annually, regularly reviewed to ensure it utilises the best available evidence, and calculated independently.<sup>1</sup>

There tends to be a greater focus on the living standards of lower-income workers today than there is on the living standards of the same group when they reach retirement.<sup>2</sup> Developing a parallel standard for an adequate income in retirement could help drive employee and especially employer behaviours towards boosting pension savings. To that end, this report sets out how a methodology for calculating a Living Pension could be formulated – a pension sufficient to deliver a socially-acceptable adequate standard of living in retirement for an average or typical low-to-middle income employee. This is a first step in the development of a ‘Living Pension’ accreditation standard that could help ensure that today’s workers can build a pension that will provide an adequate income in retirement.

In contrast to working-age families, the incomes of pensioners have improved significantly in recent years. The typical income of 70-year-olds has increased by 25 per cent between 2005-06 and 2018-19, whereas that of 30 year-olds has not changed at all.<sup>3</sup> This strong income growth has been driven by new cohorts of pensioners retiring with greater state and private pension entitlements, and reinforced by government policy that has protected pensioner benefits but not working-age ones, including first the commitment to uprate the Pension Credit in line with earnings, and now the ‘triple lock’ applied to the uprating of the basic and new State Pension.

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<sup>1</sup> <https://www.livingwage.org.uk/what-real-living-wage>.

<sup>2</sup> The Living Wage has now started to take into account the private pension savings that employees make under the auto-enrolment scheme in its calculation. See: N Cominetti, *Calculating the Real Living Wage for London and the Rest of the UK*, Resolution Foundation, November 2020.

<sup>3</sup> A Corlett et al., *The Living Standards Audit 2020*, Resolution Foundation, July 2020.

But, while the income position may look relatively positive for today's pensioners, the adequacy of savings for future pensioners is considerably less certain. Despite the significant reforms that have been put into place following the Pensions Commission in 2005<sup>4</sup> – a close to universal, flat-rate, earnings-linked state pension alongside auto-enrolment – concerns remain that a significant share of today's working-age population are not saving enough for their retirement.<sup>5</sup>

## The introduction of auto-enrolment has expanded private pension coverage

The introduction of auto-enrolment has led to significant increases in the number of private pension savers, with almost 10.4 million employees auto-enrolled by November 2020.<sup>6</sup> The scheme, gradually introduced since 2013, 'nudges' people into pension saving by assuming as a default that employees are part of their employer pension scheme (i.e. 'opting out' requires an explicit decision).

Employees aged 22 and over and earning more than £10,000 in a job are automatically enrolled into their employer's scheme. Minimum savings requirements are set by the government, and currently consist of a total 8 per cent contribution with 3 per cent from the employer, 4 per cent from the employee and an equivalent of 1 per cent from the government via tax relief. That contribution requirement relates to earnings between £6,240 and £50,000 a year. Employees with lower earnings can opt to enrol in their workplace pension or pay beyond the minimum requirements if they wish. Employers can also contribute more than the minimum.

Figure 1 shows that the growth in the number of auto-enrolled employees has continued, even as the minimum contribution level has been increased from 2 per cent before April 2018 to 8 per cent since April 2019.<sup>7</sup> The number of savers also appears to be relatively unaffected by the economic shock caused by measures to tackle the Covid-19 pandemic. In part, this is likely to reflect that the Coronavirus Job Retention Scheme has required that pension contributions continue to be made.

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<sup>4</sup> The Pensions Commission, *A New Pension Settlement for the Twenty-First Century*, November 2005.

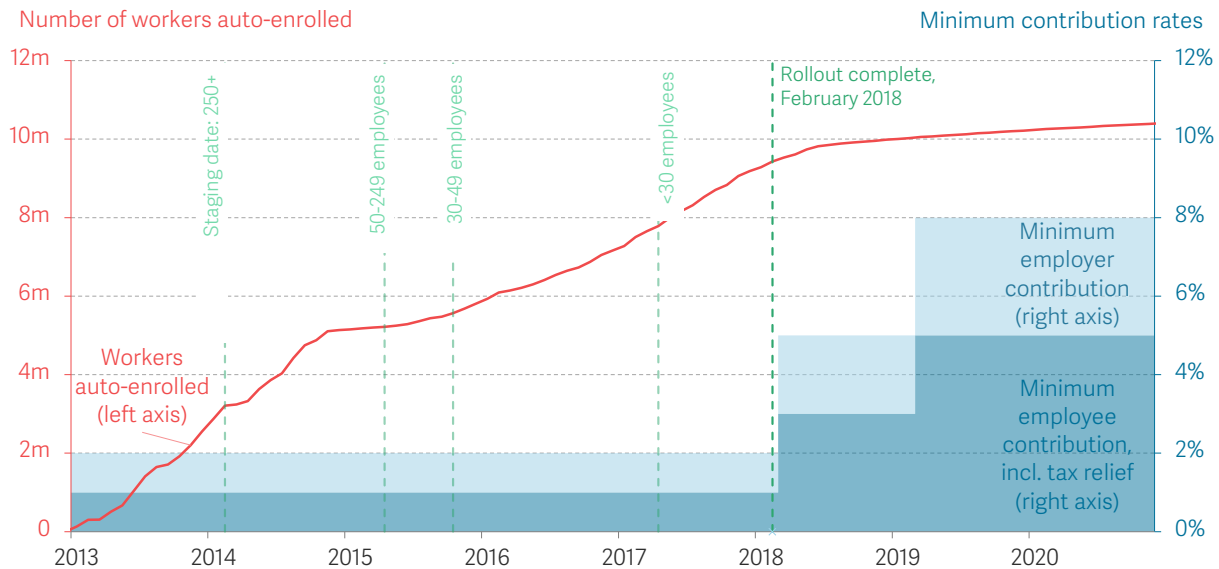
<sup>5</sup> Department for Work & Pensions, *Automatic Enrolment Review 2017: Maintaining the Momentum*, December 2017.

<sup>6</sup> The Pensions Regulator, *Automatic enrolment declaration of compliance report*, November 2020.

<sup>7</sup> D Willetts & L Gardiner, *More ambition, less risk – building on the success of auto-enrolment*, Resolution Foundation, April 2019.

**FIGURE 1: The number of auto-enrolled employees has continued to rise, despite increases in the contribution rate**

Number of workers automatically enrolled in a pension scheme, minimum contribution levels, and employer staging dates: UK, 2013-20



NOTES: Businesses in each size group were staged gradually according to their PAYE reference number, and the staging dates shown here are the final dates for each business size. New employers were staged between April 2017 and February 2018, at which point the rollout was complete. A version of this figure first appeared in: L Gardiner & D Willetts, *More ambition, less risk: Building on the success of auto-enrolment*, Resolution Foundation, April 2019.  
SOURCE: The Pensions Regulator, Automatic enrolment declaration of compliance report.

Auto-enrolment has led to significant rises in private pension coverage, and has happened across age, sex and pay levels. Previous Resolution Foundation analysis has shown that the rise in coverage at younger ages has led to almost two-thirds of female millennials in their 30s working as employees in private sector employee are contributing to a workplace pension, compared to around half of baby boomers when at the same age.<sup>8</sup>

This growth in coverage has been driven by workers in the private sector joining Defined Contribution (DC) schemes (where contributions from employers and employees are invested to build a pension savings pot). Defined Benefit (DB) schemes (where pension is based on final or career-average salary and years of service) are now mainly available only in the public sector. This distinction is important because a Defined Benefit scheme provides a guaranteed income through retirement. What a Defined Contribution scheme will provide depends on the contributions made during working life, financial returns on investments during accrual, and decisions on the final product chosen to access those savings during retirement. As such, they place a greater risk of an inadequate income in retirement on individuals.

<sup>8</sup> D Finch & L Gardiner, *As good as it gets? The adequacy of retirement income for current and future generations of pensioners*, Resolution Foundation, November 2017.

## Moving from auto-enrolment to an adequate income in retirement

The Pensions Commission always intended that employees would need to make voluntary contributions beyond that of the government's private saving scheme to provide an adequate income in retirement. In this report we explore the additional private saving beyond the State Pension and auto-enrolment scheme required for lower income earners to achieve an adequate standard of living in retirement.

The Automatic Enrolment Review 2017 found that a key challenge in to reduce the number of so-called 'undersavers' was a lack of engagement with pension saving or not taking greater personal responsibility to plan and save more for retirement.<sup>9</sup> There has been considerable effort by Government and other organisations to try and tackle this. The Pensions and Lifetime Savings Association, for example, have, with the Centre for Research in Social Policy, developed the Retirement Living Standards<sup>10</sup> to help people to better understand the type of lifestyle they want in retirement and the savings needed to achieve it. The Government is at the time of finalising this report introducing legislation which will provide a framework to support the provision of pension dashboards (a digital interface that will allow people to view their different pension pots in one place).<sup>11</sup>

This report differs in that it seeks to understand the current pensions saving position of low-to-middle income (LMIs) families in particular, and to calculate the additional savings workers in those families need to build a 'Living Pension' that could operate principally as an employer-facing standard to drive up saving. It could also help individuals, in conjunction with the information provided by pension dashboards, to understand the additional savings they may need for retirement.

This report provides a framework for the calculation of a Living Pension, and the contributions required to build one by retirement. The methodological framework has been developed to follow the spirit of the existing Living Wage calculation, in that it is based on societal expectations of an adequate income in retirement, and it accounts for the current and likely future living costs of pensioners, the current savings position of different types of lower income families, and reflects the latest expectations of future tax and benefit policy. The methodology is designed to be updated on a regular basis, while aiming to avoid undue volatility. It also aims to ensure the overall approach is intuitive and that the summary metric is simple to explain.

The calculations of the pension contributions required to provide such a pension rely on a number of assumptions and data sources. These represent our best judgement

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<sup>9</sup> Department for Work & Pensions, [Automatic Enrolment Review 2017: Maintaining the Momentum](#), December 2017.

<sup>10</sup> M Padley & C Shepherd, [Developing retirement living standards](#), Centre for Research in Social Policy, Loughborough University, October 2019.

<sup>11</sup> D Thurley & D Hirst, [Pensions dashboards](#), House of Commons library, December 2020

at this point in time, informed by consultation with external experts, but should not be taken as final. This report does also not attempt to account fully for the impact of the Covid-19 pandemic on earnings and pension savings, but this is clearly one area where further consideration would be needed once the short-term impact and the longer-term implications are better understood.

The final output of the calculations is a set of required contributions that are ultimately intended to form part of a 'Living Pension accreditation standard'. This report is the first step in a longer-term process of wider consultative activity that will now be undertaken by the Living Wage Foundation to consider the further refinement, governance and processes of a Living Pension accreditation standard and associated employer-facing campaign.

The remainder of this report:

- explores the current extent of pension saving among low to middle income families of working age (Section 2);
- sets out the methodological framework for the Living Pension calculation (Section 3);
- assesses the income that future cohorts of pensioners will require to achieve an adequate standard of living in retirement (Section 4);
- sets out the parameters to calculate the level of pension saving required to achieve an adequate income in retirement (Section 5); and
- presents first estimates of the level of contribution required to build a Living Pension (Section 6).

## Section 2

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# Current pension savings of low-to-middle income families

This section explores the distribution of pension savings of working age families in the UK, with a particular focus on low-to-middle income families – in this instance families where a person is an employee and net household income is below the median. The analysis shows that a substantial share of families had little or no private pension saving in 2016-18, the latest period for which we have data. The majority of existing private pension saving is accounted for by Defined Benefit provision, which largely reflects occupational pension provision in the public sector. Lower-income employees working in the private sector have little private pension saving. But auto-enrolment appears to be gradually having the intended impact on the coverage and extent of private pension saving, and pension wealth has gradually increased for families who have little Defined Benefit provision since 2012-14.

The last two decades have been ones of significant change in the pensions landscape, with important implications for the savings patterns of today's employees. The state pension has undergone reform to broaden coverage, raise generosity, flatten entitlements and increase the starting age of entitlement; private provision has also undergone radical change.

Auto-enrolment has been successful in generating increased coverage of private pension saving. However, it is not clear whether the continuation of current savings patterns, particularly for low-to-middle income families, will ultimately lead to the provision of a minimum adequate income in retirement. Below, we analyse the existing savings for low-to-middle income families, before Section 3 turns to what a minimum adequate income in retirement would be.



## Pension savings of low-to-middle income families

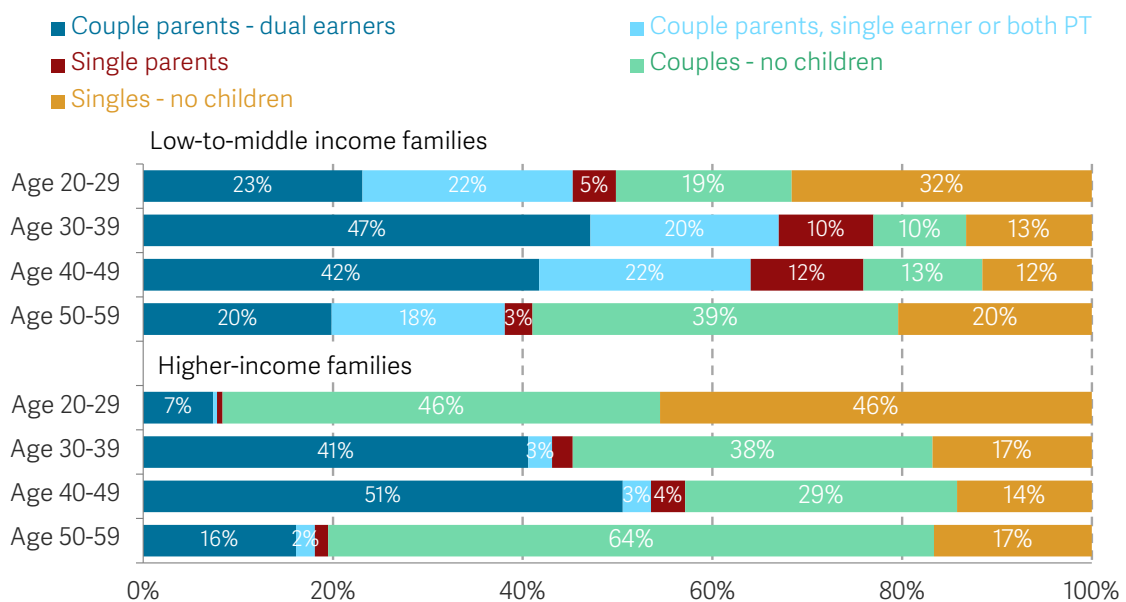
A first step in developing our understanding of any potential savings gap for members of today’s working-age low-to-middle income families is to understand how much people have already saved towards their retirement. Our focus here is the savings of low-to-middle income families (LMIs), working-age families where a family member is an employee and their net household income is below the median.<sup>12</sup> This group of 8.3 million families are likely to have lower earnings and, by extension, we would expect them to be more likely to have low pension saving. Exploring the characteristics of these families also helps to inform potential case studies that could be utilised in the Living Pension calculation, similar to the way the Living Wage calculation includes a range of representative family types (the characteristics of LMI families are discussed in Box 1).

### BOX 1: Characteristics of low- to-middle income families

Figure 2 sets out how LMIs compare to working-age families with higher income at various ages.

**FIGURE 2: Low-to-middle income families are more likely to be single or have children than higher-income families**

Share of working-age families by family type, low-to-middle income families vs higher-income families: UK, 2018/19



SOURCE: Resolution Foundation analysis using DWP, Family Resources Survey, 2018/19.

<sup>12</sup> Using equivalised income, see [The Living Standards Audit 2020](#), Resolution Foundation, July 2020.

It shows that a greater share of LMIs have children, are more likely to be single parents, and, if below the age of 50, are less likely to be singles without children. In the 50-to-59 age group, low-to-middle income families are more likely to be single adult families

Given the importance of earnings to private pension saving, it is important to understand how the earnings of LMIs compare to people in higher-income families, and so Figure 2 also

highlights whether couples have one or two earners in the family. LMI couple families with children are more likely to have only one earner or to have no one working full-time, suggesting that one family member will have some years in which they make no, or lower, contributions to a private pension. The higher likelihood of families with children also suggests a greater share of adults will be working part-time, and so also have lower earnings.

## Patterns of pension saving

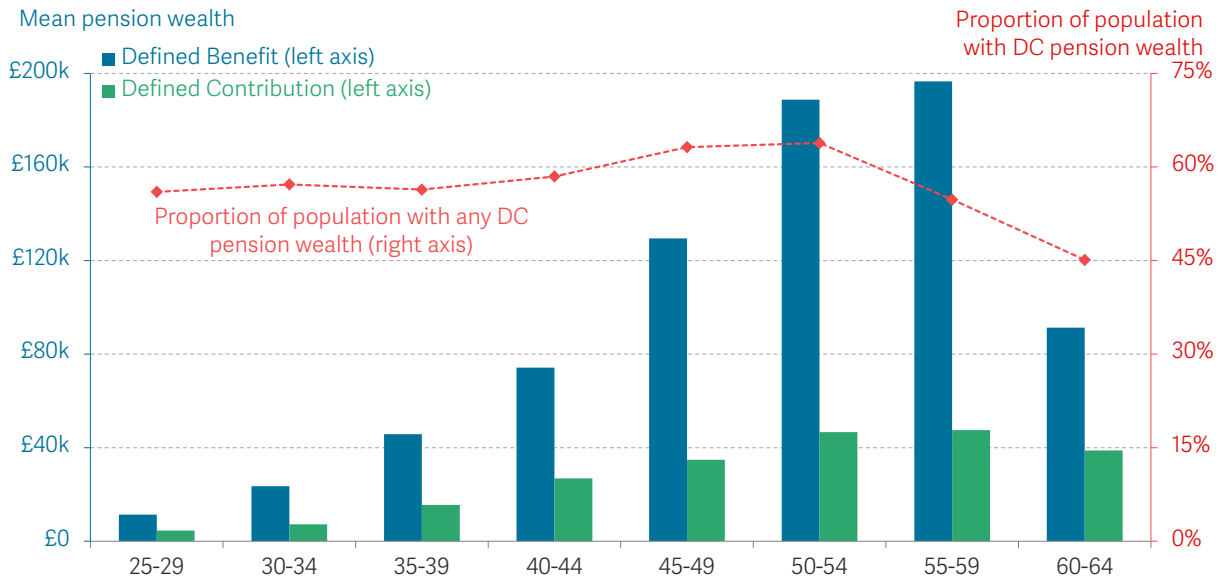
Analysis of the Wealth and Assets survey allows a comparison of both income and accrued pension wealth to provide a greater understanding of how pension savings vary by different characteristics. The latest wave covers the 2016-18 (April 2016 to March 2018) period which allows some investigation into the impact of auto-enrolment on pension savings. But this data does not yet account for the effect of the Covid-19 pandemic on savings patterns.<sup>13</sup>

Figure 3 shows how pension wealth is distributed by age and scheme type. As we might expect, average pension savings are greater for older age groups: they have had more years to save, more people tend to save as they get closer to retirement, and they tend to save more of their earnings. The chart also shows that average DB pension savings are far greater in value than average DC entitlements. In part this reflects greater historical coverage of DB schemes, but it also shows their greater generosity. The value of DB schemes reflects the market value of accrued rights, compared to the value of assets within a DC pension fund.

<sup>13</sup> But see K Handscomb & L Judge, [Caught in a \(Covid\) trap: incomes, savings and spending through the coronavirus crisis](#), Resolution Foundation, November 2020; A Davenport, R Joyce, I Rasul & T Waters, [Spending and saving during the COVID-19 crisis: evidence from bank account data](#), Institute for Fiscal Studies, October 2020.

### FIGURE 3: Defined Benefit pension savings make up the majority of existing pension wealth

Mean individual pension wealth, by scheme & Defined Contribution share of total, by age (2018-19 prices): GB, 2016-18



NOTES: Mean relates to all those with pension wealth and estimates exclude pensions from former spouses, retained rights for drawdown and pensions in payment.  
SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2016-18

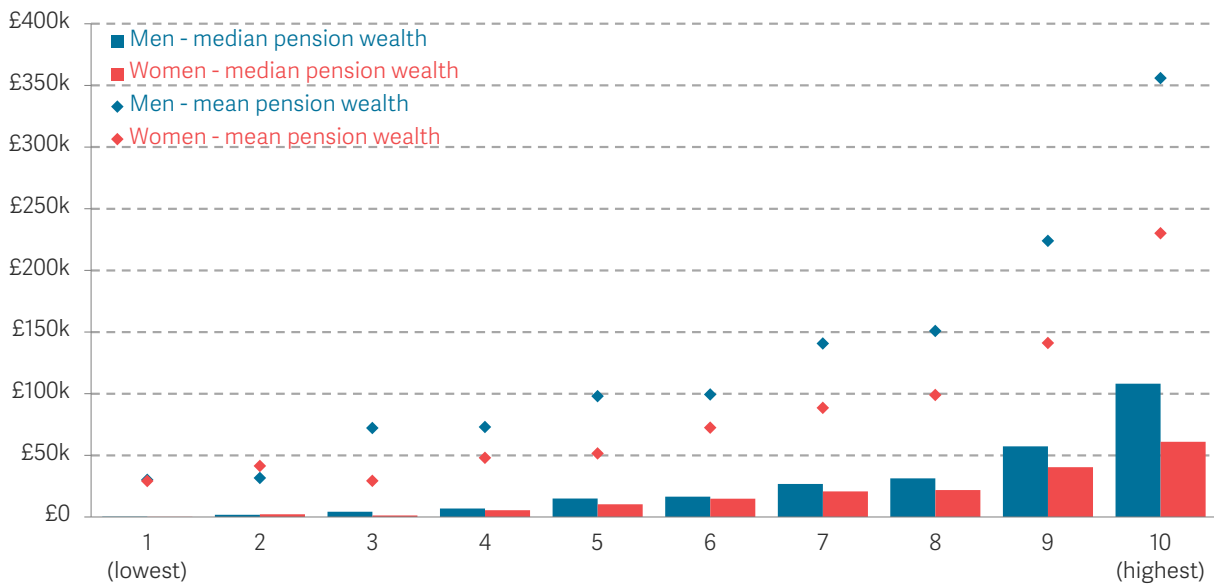
Pension wealth also varies by income. Figure 4 shows how pension savings are greater for employees in the top half of the income distribution, and especially in the top deciles, compared to employees in the bottom half.<sup>14</sup> Women have lower pension wealth than men, and the gap widens the higher up the income distribution employees are. It also shows that there is a significant difference between mean and median pension wealth, with the median substantially lower. This means that there is substantial skew in wealth even within deciles, with some having much higher amounts of wealth, but many have little, if any, existing pension savings.

To restrict our analysis to those more likely to depend on a DC pension for the bulk of their retirement income, Figure 5 repeats the analysis but excludes those with DB pension wealth of more than £10,000. Doing so reinforces that employees in the bottom half of the income distribution have very small amounts of existing pension wealth. Our analysis also suggests that pension saving is distributed relatively evenly within different parts of the income distribution – there is not a sudden step change in the level of pension wealth.

<sup>14</sup> We include all employees whether they have any wealth or not because the Living Pension is concerned with the pension savings of all employees, not just those with existing wealth.

FIGURE 4: Median pension wealth is substantially lower than the mean

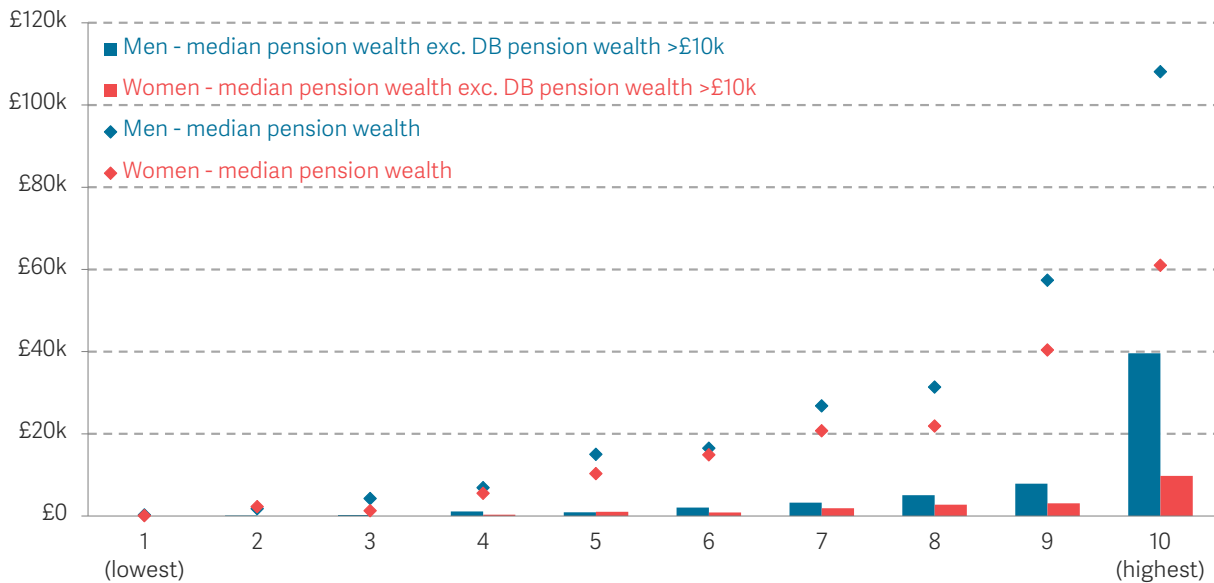
Real value of total pension wealth for employees, by net income decile and sex: GB, 2016-18



NOTES: Mean and median relate to all respondents, not just those with positive pension wealth. Pension wealth reflects all pension wealth including but not limited to occupational pensions.  
SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2016-18.

FIGURE 5: Employees in the bottom half of the distribution have little private pension saving unless they have Defined Benefit pension wealth

Real value of total pension wealth for employees, by net income decile and sex: GB, 2016-18

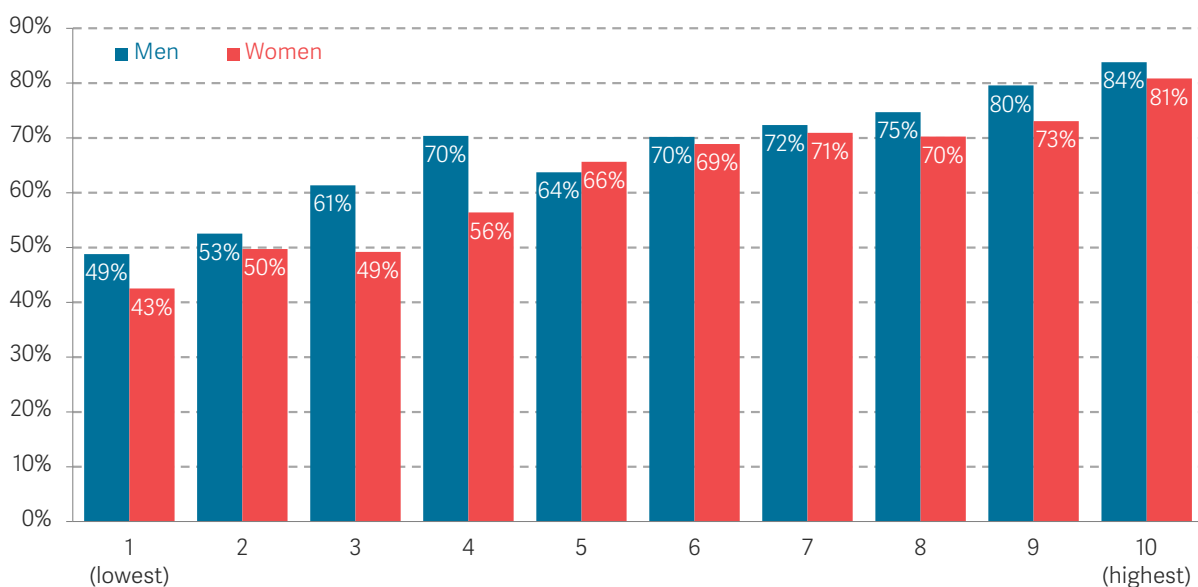


NOTES: Mean and median relate to all respondents, not just those with pension wealth. Pension wealth reflects all pension wealth including but not limited to occupational pensions.  
SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2016-18

Figure 6 further explains the low level of pension wealth among men and women in the bottom half of the income distribution who are likely to depend on a DC pension (i.e. they have no more than £10,000 of DB pension wealth). The data comes from a period during the majority of which auto-enrolment was being rolled out, the data spans the two years to March 2018 and roll out completed in February 2018 and shows that only around half of employees in the poorest third have any pension saving, compared to over three quarters of employees in the top third of the income distribution. Across the bottom half of the income distribution, 42 per cent of employees reported having no pension wealth. To some extent, the lower coverage of some of the lowest earners will reflect that, at present, only employees earning more than £10,000 a year are automatically enrolled and the shape of the roll out..

**FIGURE 6: Many employees dependent on a DC pension report no pension wealth at all, despite the introduction of auto-enrolment**

Proportion of employees with any pension wealth, by net income decile, excluding those with more than £10k Defined Benefit pension wealth: GB, 2016-18



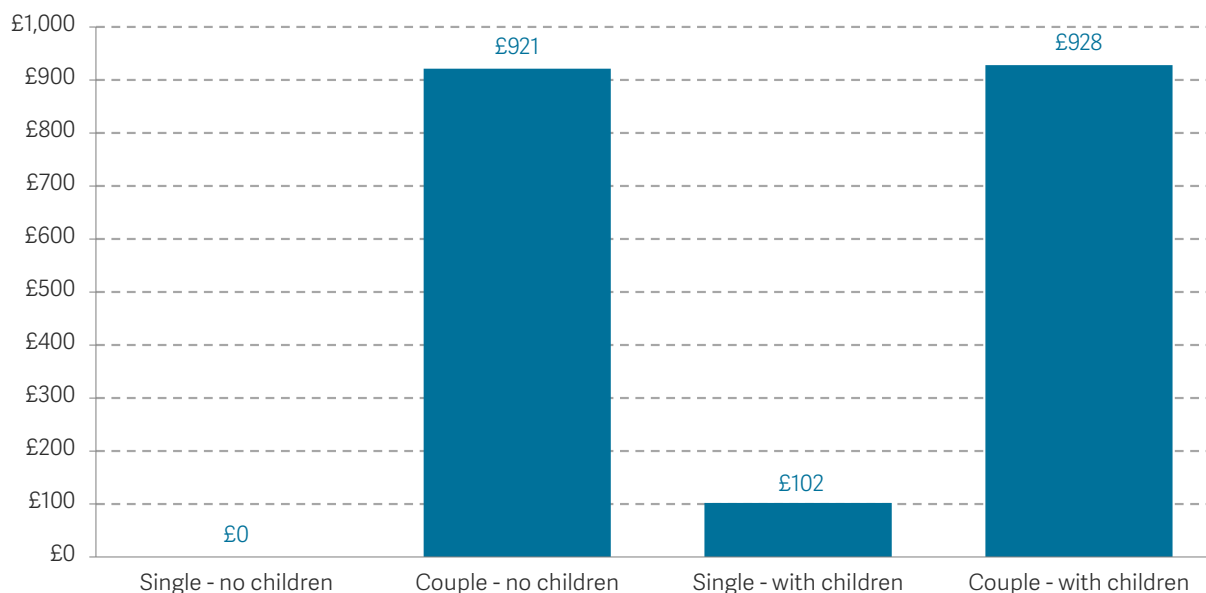
SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2016-18.

Focusing only on employees in the bottom half of the income distribution – LMIs<sup>15</sup> – Figure 7 shows typical pension wealth by family type. Single parents and single adults without children have the lowest levels of pension wealth, but typical pension savings are very small, at under £1,000, for all family types (by contrast, our analysis of the Wealth and Asset Survey (WAS) shows that median real pension wealth for all employees was £18,900 in 2016-18).

<sup>15</sup> In analysis using the Wealth and Assets Survey, low-to-middle income is defined using a before housing costs measure of net household income.

**FIGURE 7: Low-to-middle income families dependent on a DC pension have low typical pension wealth**

Median real value of total pension wealth for employees in bottom half of net income distribution, excluding those with more than £10k Defined Benefit pension wealth, by family type: GB, 2016-18



SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2016-18

NOTES: Estimates refer to all respondents, not just those with pension wealth. Pension wealth reflects all pension wealth including but not limited to occupational pensions.

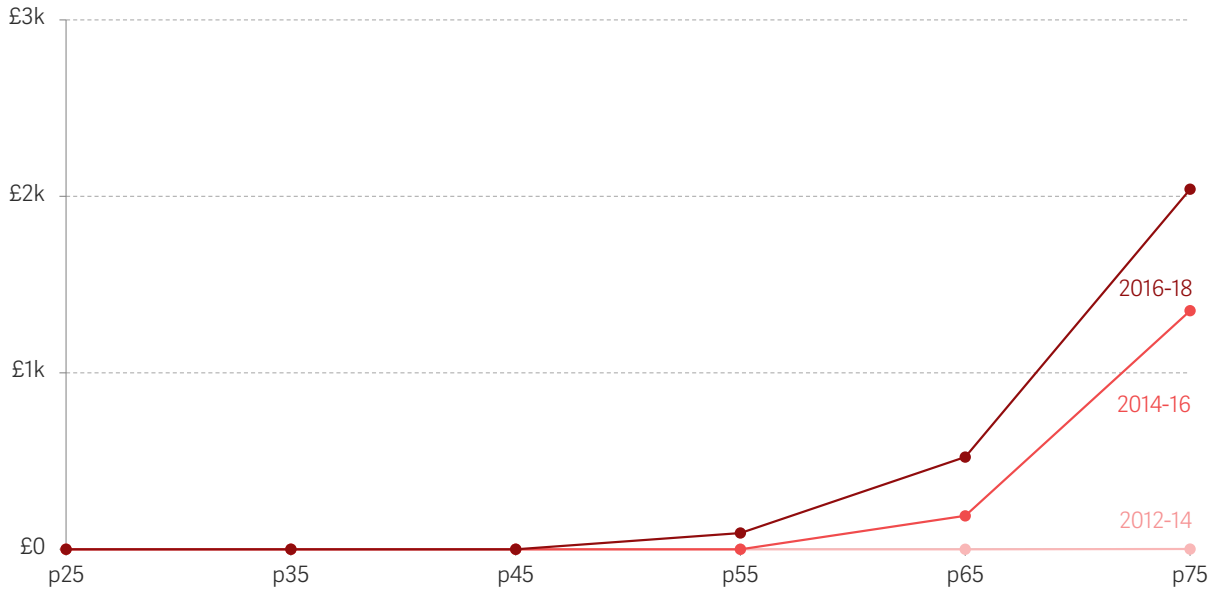
## The impact of auto-enrolment on pension savings

The very low pension entitlements of LMIs identified have important implications for the Living Pension method set out in the rest of this report. Our analysis so far suggests that LMIs have no, or very little, existing pension savings. However, it is important to understand the extent to which auto-enrolment has had an impact on savings patterns. Rapid change to savings due to auto-enrolment should mean that the pattern observed in the latest data analysed here (relating to 2016-18) could be significantly different in future waves of data – there will be more people with some savings and those savings would be growing.

Figure 8 shows how the distribution of private pension wealth among prime-age employees (age 25-54) who do not have significant DB wealth and who are in the bottom half of the income distribution has changed over the last three waves of the Wealth and Assets Survey. There has been a gradual rise in the share of this group reporting any pension savings, and in the total reported, since 2012-14. By 2016-18, 25 per cent of prime-age employees in low-to-middle income families had accrued more than £2,000 of pension wealth, compared to only £1,400 for the same group only two years previously.

**FIGURE 8: Pension wealth has been gradually building across the income distribution since auto-enrolment**

Distribution of private pension wealth among 25-54-year-old employees in the bottom half of the income distribution excluding those with more than £10k DB pension wealth, by year: GB, 2012-14 to 2016-18



SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2012-14 to 2016-18'

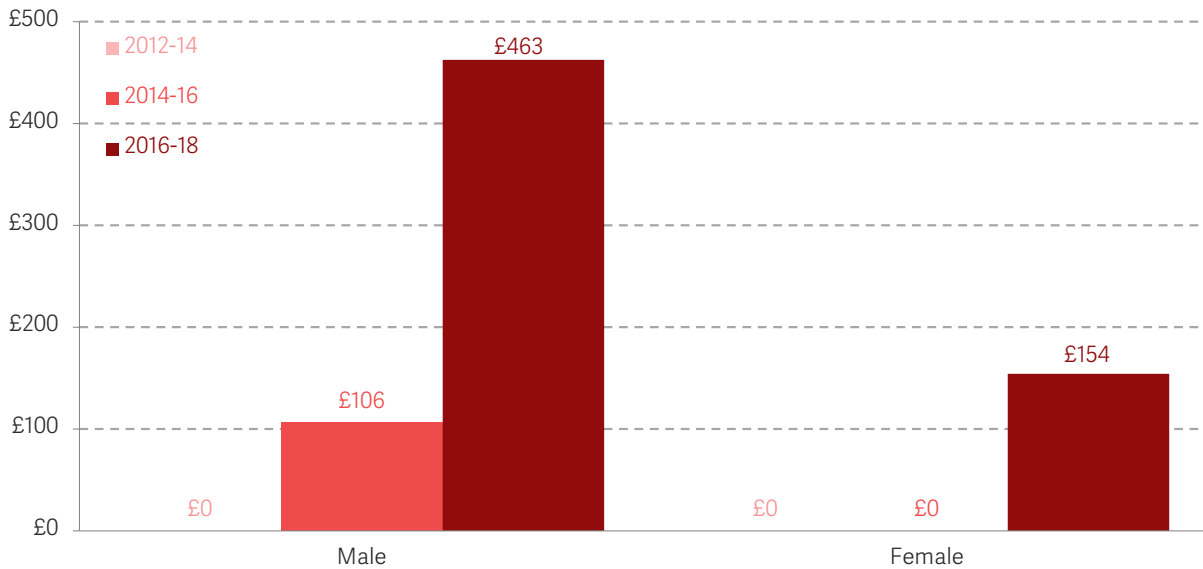
This pattern of rising pension wealth has occurred for both men and women in low-to-middle income families over this period. As Figure 9 shows, pension savings are greater for men than for women, but increased for women in the last two years. However, as already established above, the typical pension savings are still small.

Figure 10 shows that pension wealth has been rising for all age groups, although, as with all employees, pension wealth in low-to-middle income families without significant DB wealth is higher for older employees.



**FIGURE 9: Private pension wealth has been gradually building for men and women in recent years**

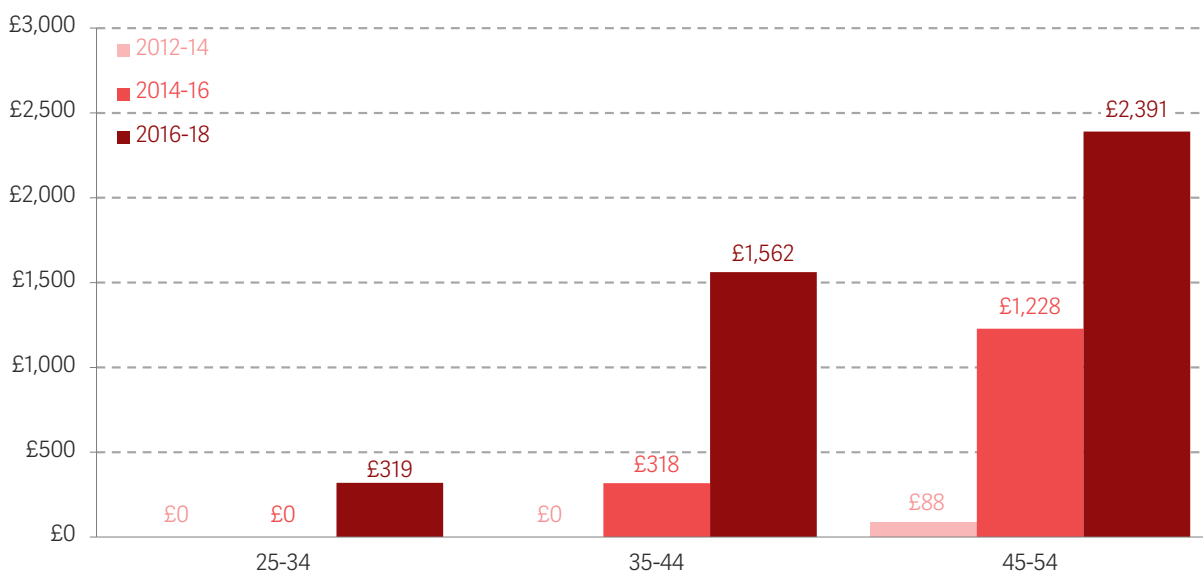
Median private pension wealth among 25-54-year-old employees in the bottom half of the income distribution excluding those with more than £10k DB pension wealth, by gender and year: GB, 2012-14 to 2016-18



SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2012-14 to 2016-18'

**FIGURE 10: The greatest increases in pension wealth among low-income families have been among the 45-54-year-old age group**

Median private pension wealth among 25-54-year-old employees, in the bottom half of the income distribution, excluding those with more than £10k DB pension wealth, by age band and year: GB, 2012-14 to 2016-18



SOURCE: Resolution Foundation analysis using ONS, Wealth and Assets Survey 2012-14 to 2016-18'

This Section has highlighted the lack of pension saving among LMIs. This can be attributed largely due to low occupational pension coverage historically in the private sector. The introduction of auto-enrolment appears to have led to an increase in pension savings but, given the gradual introduction of the scheme, these savings are still small (although the latest data dates back to the 2016-2018 period), and a significant minority still have no savings.

The analysis set out here also forms an input into Section 3, which sets out the key stages in our Living Pension methodology.

## Section 3

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### A framework to calculate a Living Pension

This Section sets out an overview of our methodology for calculating a Living Pension. The method aims to follow the spirit of the Living Wage methodology as closely as possible by accounting for social expectations of an adequate income in retirement and being representative of today's population.

The method requires a number of assumptions which in turn lead to trade-offs, such as striking a balance between the method being intuitive and simple, and it being an accurate representation of the many different circumstances faced by individuals. The analysis set out in Section 2 suggests that many individuals in low-to-middle income families start with no pre-existing pension saving beyond that accrued via auto-enrolment. Representative case studies of accruals during the working life also need to show the difference in pension saving patterns between men and women.

In this Section, we outline a potential method for calculating a Living Pension. In developing this, we have aimed to follow the approach used to calculate the Living Wage as far as possible. That means ensuring the Living Pension both reflects current conditions and provides a socially-acceptable adequate standard of living in retirement. However, rather than a wage rate, we aim to calculate the contributions required to build a savings pot that can deliver a Living Pension in retirement.

This Section discusses the broad framework of the Living Pension methodology with later Sections discussing data sources and their implications for the assumptions made in the calculation in greater detail.

#### From calculating a Living Wage to building a Living Pension

The Living Wage reflects the earnings required by a range of different family types to deliver a net household income that meets a minimum adequate standard of living. The method starts with 17 families of differing composition: singles, couples and families with up to four children of different ages. The basket of goods and services those families

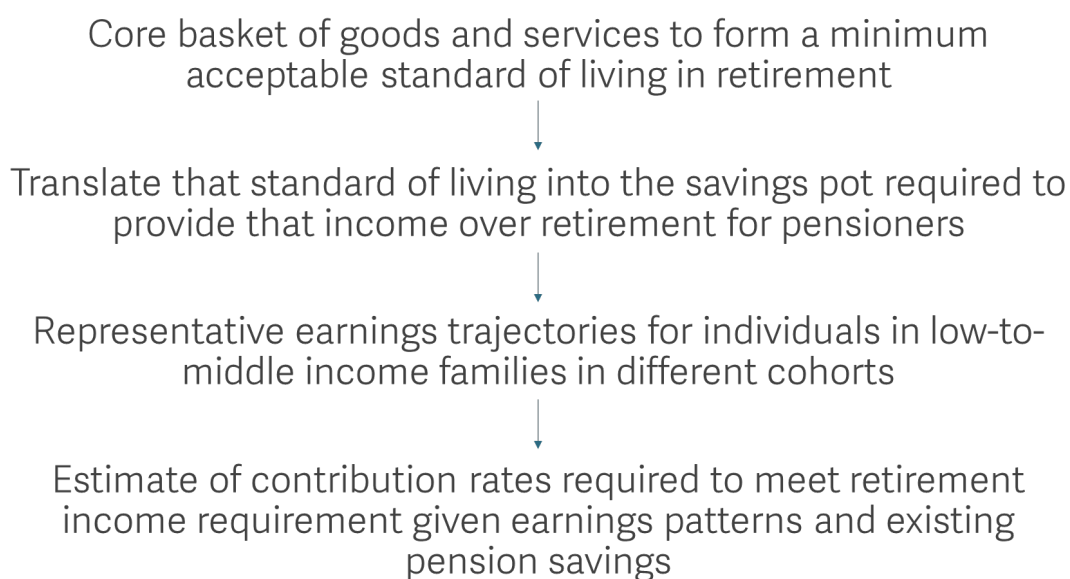
need to have an adequate standard of living is identified and priced. For each family, the wage the family would need to earn when all adults work full-time, taking account of the tax and benefit system, to have that income is calculated. Finally, a weighted average of those wages is taken, accounting for the actual composition of families in the population.<sup>16</sup> The calculation uses the latest available data in relation to the living standards and living costs of the UK's population. That includes in particular the Minimum Income Standard, but also data on living costs such as council tax and rents. Weightings of family type are derived from the latest survey data capturing the structure of the UK's population.

The framework outlined here to calculate a Living Pension takes a similar approach, but expands the method to estimate how private pensions are accrued during the working life. In summary, the method for calculating a Living Pension calculates the income required for an adequate standard of living in retirement for different cohorts; estimates existing private pension savings for employees in LMI families; and projects the contributions required for people to build enough pension savings for a Living Pension in retirement (see Figure 11).

The private pension income required to fill the gap between state support and the minimum adequate standard of living identified is then the 'Living Pension'. As discussed in Section 1, the contributions required during working life to build that Living Pension would then provide the basis for a Living Pension accreditation standard.

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**FIGURE 11: Overview of methodological framework to calculate a Living Pension**



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<sup>16</sup> C D'Arcy & D Finch, *Making the Living Wage: The Resolution Foundation review of the Living Wage*, Resolution Foundation, July 2016

Beyond the central question of how much income a pensioner needs in retirement, calculating a Living Pension requires us to take a view on when retirement starts and ends, how living costs may vary for different family types, and how the standard can reflect the needs of future pensioners. These questions are explored in more detail in Section 4. We also need to understand how much people are earning over their lifetime, the private pension scheme structures in which people save from those earnings, the stage of the working life people are at, the savings people have already built and ensuring the characteristics of savers are representative of the population we are concerned with. Finally, those pension savings then need to be accessed over retirement in an appropriate form. The detailed assumptions and approach to accruing a Living Pension and then accessing those savings in retirement is explored in Section 5. How the analysis set out in Section 2 relates to the methodology is discussed at the end of this section.

As the overview above suggests, a range of assumptions will be needed to calculate the Living Pension. In making those assumptions, trade-offs have to be confronted. This is why our method should be seen as a framework that enables the calculation of a Living Pension, and that consists of the best judgements that we are able to make at this time. It is entirely possible that others may draw different conclusions to those made here, and this is why we have attempted to set out clear rationales for the choices that we have made.

## The framework for calculating a Living Pension is necessarily more complicated than that for a Living Wage

Various aspects of the framework we set out for calculating a Living Pension are different from, or more complicated than, those used when calculating a Living Wage. We outline some of these here.

One feature of the Living Wage is that the wage rate calculated applies to an individual, but it is calculated based on the circumstances of the family as a whole. For example, in a family consisting of a couple with children, both parents are assumed to work full-time. For the Living Pension, the contributions required to build a Living Pension apply to the individual, but the income requirement in retirement would reflect that of the family. This necessarily differs to the Living Wage approach because family circumstances change over time: a person in a couple today may be single by retirement, and vice versa. The pot required for a Living Pension aims to reflect the savings an individual would, on average, need in retirement given the likelihood of living in retirement as a single or couple. This concept leads to two further assumptions which aim to maintain simplicity while ensuring that the calculations are relevant. The first is that the income requirement in retirement should be a weighted average of the different living arrangements of the

pensioner population. The second is that during the working life, while private savings are being accrued, the calculation should reflect representative earnings trajectories of individuals.

There is also a question about whether the method should be concerned with low earners, or people living in families with low income. Having low earnings is not the same as living in a family with a low income, as low earners can live with a higher-earning partner. However, most low-to-middle income families contain lower earners. Therefore, the calculation sets out to take account of the earnings trajectories of people living in low-to-middle income families.

Assuming that individuals have variable earnings patterns at different life stages appears something of a departure from the assumptions made in the Living Wage calculation. For the Living Wage, it is assumed that all family members work full-time. These choices are partly to maintain simplicity. In the Living Wage calculation, a single assumption about working patterns reduces the number of family types included in the calculation. For the Living Pension, the use of earnings trajectories provides a simple way of representing total earnings of different cohorts over the lifetime.<sup>17</sup>

### Balancing simplicity with representativeness

It is important that the Living Pension method can be easily updated so that the Living Pension can be reassessed regularly to reflect the latest data, policies and societal expectations. This in turn means that the method needs to be easy to update and to understand, which suggests that it should be kept as simple as possible, while also meeting its other objectives.

And the extra elements of the Living Pension method compared with the Living Wage mean that the approach could become very complicated very quickly. One strength of the approach taken to calculating the Living Wage is that it is intuitive, and relatively straightforward to replicate. Maintaining simplicity within the approach is important, but creates a direct tension with ensuring it is also representative.

For the Living Pension in particular, interactions between the different assumptions we could make during the accrual phase (i.e. working life) have the potential to create significant complexity. For example, how long people have left until retirement is a key factor in determining how much they need to save each year to build a given savings pot. Creating case studies to show each year of working life (currently 48 years taking age 18 to 65), as well as a wide range of family circumstances and different future earnings paths would quickly generate (at least) hundreds of scenarios.

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<sup>17</sup> An equivalent assumption in the Living Pension calculation is that pensioners are retired and reliant solely on State Pension and private pension provision for income, i.e. they have no earned income.

## Minimising volatility in the calculation

Ideally, a method for calculating a Living Pension should not lead to large changes in the outcome each year. But the added complexity inherent in the Living Pension calculation, and the reliance on long-term assumptions about the future, means that there is a greater risk of volatility in the calculations between successive updates. This is because small near-term changes can easily compound to something far more significant over the long term. For example, uprating the State Pension by the triple lock (higher of earnings growth, inflation or 2.5 per cent) is assumed to add an average 0.36 per cent a year to its value relative to earnings growth. Over fifty years, that would compound to leave the State Pension 20 per cent higher in nominal terms than if it is increased only by earnings growth. Similarly, small changes to the minimum pension contribution made through auto-enrolment could also have a large effect when compounded over the working life.

The Living Wage methodology has built in the capability to prevent short term volatility by, for example, gradually introducing any significant changes in inputs (such as the items included in the basket of goods and services) to the calculation to prevent short-term volatility. The Living Pension method will need to pay attention to changes to the minimum income standard for pensioners, changes in the relationship between earnings growth and the financial return on pension savings, and changes in earnings and employment patterns, as well as changes in the tax and benefit system. Trying to reduce the sensitivity of the calculation to these sorts of assumptions means that the method might reflect less well the latest information about living costs, government policy and societal expectations. This means that the Living Pension will require careful governance, reflecting an awareness of the inherent trade-offs between reflecting the very latest policy and data developments and the potential volatility of the estimates. The key mechanism which enables this for the Living Wage calculation is the Living Wage Commission, which has oversight of the method and assumptions. The governance arrangements for a potential employer-facing Living Pension accreditation standard will be considered by the Living Wage Foundation as it takes the idea of a Living Pension forward from this methodological feasibility study.

A special area of note is the assumed impact of the Covid-19 pandemic on the path of the economy and future living standards. Projections are always uncertain, but the pandemic makes forming views on the future more difficult than usual. For the Living Pension calculation, the long-run impact of the crisis on employment, pay and earnings patterns over the next 5 to 15 years is likely to have much more impact on the eventual calculations than the impact on unemployment and earnings during the crisis itself. Grounding the calculation in the latest available data and economic projections means that the Living Pension calculation will account for short-term changes in economic



outcomes, and changes in long term economic expectations.

The following Sections of this report explore the detailed assumptions to populate the methodological framework outlined above, with Section 4 exploring the adequate income for pensioners that will determine the size of the pension savings pot required to provide a Living Pension.

## Section 4

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### An adequate income in retirement

Section 3 gave an overview of the methodology for calculating a Living Pension. This Section explores the future income families would need to enable an adequate standard of living in retirement, how pension savings would be accessed over retirement and what this means for the pension pot needed to provide a Living Pension. In our calculation, the living costs of pensioners are assumed to start with the Minimum Income Standard and increase in line with earnings growth, to keep pace with the growth in living standards of workers. Housing costs are a significant source of variation in future living costs between cohorts.

The Living Pension method is designed to ensure that employees in low-to-middle income families are able to secure an adequate income in retirement. Unlike the Living Wage, which is based on the living standards needs of workers today, the Living Pension has the additional difficult step of seeking to identify what an adequate income will be for cohorts of future pensioners.

#### Determining an adequate income in retirement

The adequacy targets of the Pensions Commission were assessed with 'replacement rates': the share of an individual's pre-retirement income that their overall pension income would 'replace'. For a median earner, the target replacement rate was deemed to be around 67 per cent, with a higher target for lower earners and a lower one for higher earners.<sup>18</sup> Replacement rate benchmarks partially reflect absolute need, but their basis in pre-retirement earnings also speaks to maintaining the pre-retirement standard of living.

These replacement rate standards have been the basis of much research to understand which people are saving enough for retirement. However, replacement rates are not suitable for the purposes of the Living Pension. This is because expressing retirement income as a fraction of working-age income does not tell us whether retirement income

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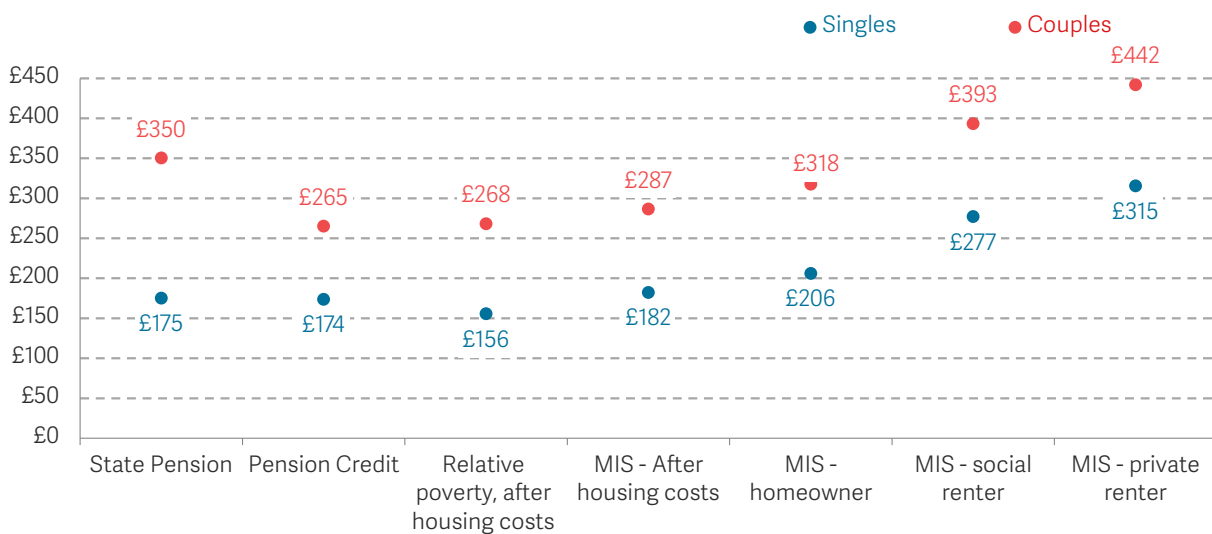
<sup>18</sup> The Pensions Commission, *A New Pension Settlement for the Twenty-First Century*, November 2005.

is adequate in relation to an absolute minimum acceptable standard. The starting working-age income may not have been adequate in the first place, or it may have been very high, such that a rather low proportion of it may be needed to achieve minimum adequacy levels.

Instead, as with the Living Wage calculation, our starting point is the Minimum Income Standard, research by the Centre for Research in Social Policy. The Minimum Income Standard (MIS) estimates the cost of achieving a socially-acceptable minimum adequate standard living for a range of different family types, as determined by the public in focus groups.<sup>19</sup> As with the Living Wage, a Living Pension should aim to achieve societal expectations of a minimum acceptable standard of living. The Minimum Income Standard is also updated regularly, over a four-yearly cycle, to ensure it reflects changes in expectations.

FIGURE 12: Indicators of minimum living standards in retirement: 2020/21

£, weekly amount



NOTES: The poverty threshold from 2018/19 is expressed in 2020/21 CPI price terms.

SOURCE: RF analysis using OBR, Economic and Fiscal Outlook, November 2020, DWP, Households Below Average Income, 2018/19; D Hirsch, et al, A Minimum Income Standard for the United Kingdom in 2020; CIH, UK Housing Review 2020; VOA, Private rental market statistics 2018/19; and DWP, Benefit and pension rates 2020 to 2021.

To understand how MIS compares to other indicators of basic income adequacy for pensioners, Figure 12 plots the MIS for pensioners against state support (in the form of the new State Pension and Pension Credit) and the relative poverty line, defined as 60 per cent of median household income, after housing costs, showing couples and singles separately. It shows that the new State Pension provides a substantial share of the income required to meet the MIS (without any mortgage payments or rent) for a single

<sup>19</sup> D Hirsch, M Padley, A Davis & C Shepherd, *A Minimum Income Standard for the United Kingdom in 2020*, July 2020

person, and actually exceeds the standard for couples. This is because the state pension income for a pensioner couple is twice that of a single pensioner, but MIS (excluding mortgage or rent) is only 57 per cent higher, reflecting economies of scale in living costs. This significant difference in living costs according to household composition should also be reflected in the Living Pension calculation.

## Housing tenure

Figure 12 also shows the important role that housing costs play in achieving the Minimum Income Standard, with different MIS for families in different tenure types. Taking account of the cost of renting and council tax widens the gap between the new State Pension and MIS. In some circumstances this gap may be covered entirely by Housing Benefit and Council Tax Support, but in other situations such support would be insufficient or reduced because they are means-tested and take into account existing savings and other sources of income. Beyond state support, unless people work, private savings would need to fill the gap. Housing tenure is, therefore, a further important factor to take into account in the Living Pension calculation. The majority of current pensioners are homeowners, but current trends for younger generations suggest this is likely to change in future decades.

## Geographical variation

The Living Wage has two rates: one for London and one for the rest of the UK. This partly reflects that the London Living Wage was developed first, but also that elements of the cost of living in London for working-age families – housing, childcare and transport – are significantly different from other parts of the UK.

MIS research has also identified that pensioners living in the capital experience greater costs than for the rest of the UK. For example, pensioner couples in Inner London experience living costs that are 27 per cent higher than in the rest of the UK as a whole, and 5 per cent higher for those in Outer London.<sup>20</sup> When rental costs are included, the difference in living costs relative to the rest of the UK increases to 32 per cent for a couple pensioner in inner London and to 15 per cent in Outer London.

Introducing regional variation for a Living Pension is more problematic than for a Living Wage because people do not necessarily retire in the same area that they worked, or even where they lived in their working-age years. Also, the variation in the core MIS basket of goods and services for pensioner couples between London and the rest of the UK is similar to that of variation between more rural and urban areas in the rest of the

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<sup>20</sup> M Padley, *A Minimum Income Standard for London 2019*, Centre for Research in Social Policy, Loughborough University, February 2020.

UK.<sup>21</sup> Therefore, we have not calculated a separate Living Pension for London (this also means that, unlike the Living Wage, estimates of living costs such as housing include London costs within the national average).<sup>22</sup>

## How might living standards change for future cohorts of pensioners?

Basing the Living Pension on MIS is a starting point, but the income required to achieve an adequate standard of living for pensioners is also likely to change in future. Coming to a view on what this will be requires making a number of judgements about how the cost of living for pensioners will change relative to the working age population, through retirement, and between cohorts.

### Keeping pace with working families over the long-term

Today's 20-year-olds will retire in over 40 years' time, and it is very difficult to predict how living standards, as well as societal expectations of those standards, will change over such a long period. What we do know is that, over the long-term, the living standards of the working population tends to be determined by growth in earnings. And, given that the state pension is linked to earnings, and reflects the policy position of successive governments over the last 15 years, also suggests that societal expectations of what constitutes an adequate income for pensioners are that it will need to keep pace with earnings. This is not to suggest that the cost of the basket of goods and services that currently constitute the Minimum Income Standard will increase in line with earnings growth, but that the make-up of that basket will change, and the total cost will rise in line with earnings over the long-term.

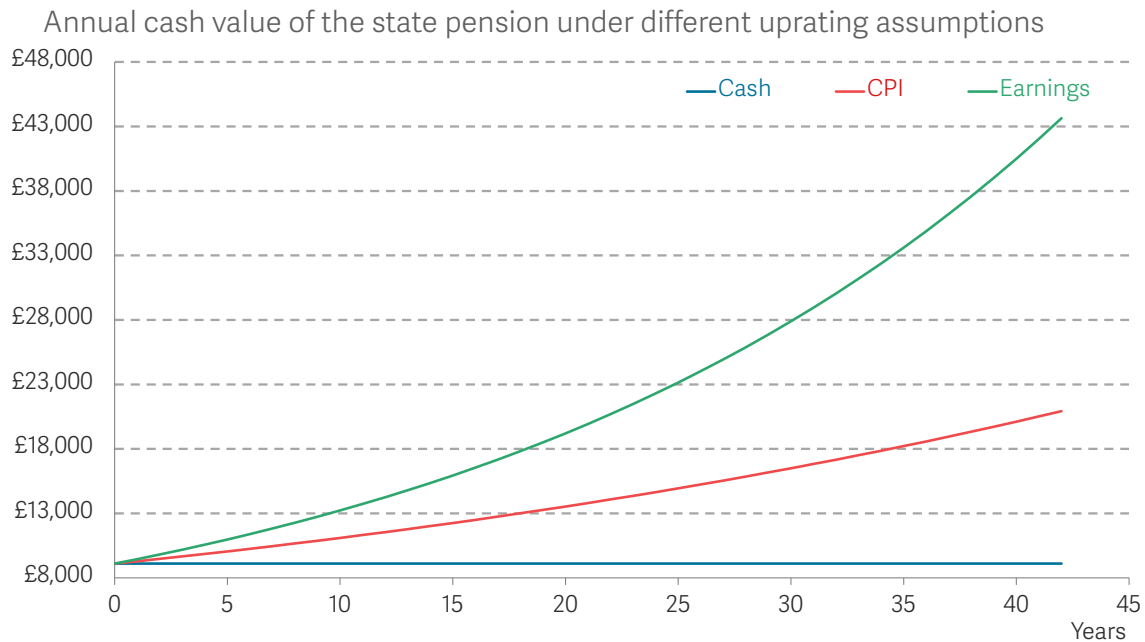
Figure 13 highlights the importance of the uprating assumptions. It expresses the April 2020 rate of the new State Pension as an annual amount that is held constant in cash, increased by a long-run CPI assumption (2%) and by a long-run earnings assumption (3.8%). Over a 42-year period – the expected years of working life left for a 25-year-old today – increasing the State Pension by prices would leave it at under half the value than if it is uprated by earnings. Uprating the cost of a minimum acceptable standard of living just by price inflation would be reasonable if thought that the goods and services required to meet that standard did not change, but we would surely expect the contents to change over a 42 year period as tastes, preferences and technology and the general affluence of society evolves over time.

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<sup>21</sup> D Hirsch, et al, *A minimum income standard for rural households*, November 2010

<sup>22</sup> We also note that people living the majority of their lives in an area with high housing costs are also likely to be paid higher wages which would automatically lead to a higher absolute pension contribution at a given contribution rate (for example, a worker on the Living Wage in London would end up with a larger pension pot than a worker in the rest of the UK if both made pension contributions at the same rate).

**FIGURE 13: How pensions are uprated makes a huge difference to the value in the long-term**



SOURCE: Resolution Foundation analysis using DWP, Benefit rates 2020-21; OBR, Fiscal and Sustainability Report, 2020

NOTES: Long run assumptions for CPI inflation is 2% and for earnings growth is 3.8%.

Preventing the living standards of pensioners from falling behind the working population is the key rationale for linking the state pension to earnings. Therefore, our method assumes the living costs that will need to be met in retirement by the Living Pension track earnings growth over the long-term, effectively assuming that the minimum pensioner living standard remains fixed relative to those of workers. However, it is possible that social expectations of minimum standards of living for workers and pensioners change relative to each other. While any such shift is likely to be gradual over time, it would be captured by changes in future assessments of the Minimum Income Standard, and subsequently in updates of the Living Pension calculation. Changes to the MIS would also reflect any differences in the cost of achieving a minimum acceptable standard of living between different cohorts of pensioners.

### Changes to family composition

The vast majority of pensioner households are either couples or singles without dependent children (analysis of the Family Resources Survey shows that less than 1 per cent of pensioner families had dependent children living in them in 2018/19). On simplicity grounds, pensioner families with dependent children are not included in the calculation.

More important is that we can expect changes in household formation over retirement due to divorce or break-up or widow(er)hood. The estimated income required over retirement should therefore reflect likely changes in household formation over time.

### Changing housing tenure

High home ownership rates among current pensioners – 78 per cent of families headed by a person aged 65 plus own their own homes – mean that their housing costs for pensioners are, on average, considerably lower than those of working-age families. However, home ownership rates are lower in younger cohorts: whereas 64 per cent of those born in the early 1950s owned their own home by age 35, only 46 per cent of those born in the early 1980s did so by the same age.<sup>23</sup> The resultant greater share of younger people who privately rent has increased housing costs as a share of income for younger cohorts. If there is no catch-up in home-ownership rates in later life, then a greater share of future cohorts of pensioners can be expected to privately rent and so have higher housing costs than today's pensioners (home-owning families with a head aged 65 or more spend only 5 per cent of their net income on housing costs, compared to almost a third (32 per cent) of income on housing costs among renters of the same age<sup>24</sup>).

Resolution Foundation analysis for the Intergenerational Commission projected home-ownership rates for different cohorts under an optimistic scenario – where home-ownership rates for younger generations caught up to those of baby boomers by age 45 – and a pessimistic scenario – in which current trends continued.<sup>25</sup> These scenarios are set out in Figure 14.

Figure 14 projects to age 45 because there is little room for further increases in home ownership from this age due to limitations in mortgage terms, although some further improvement could be anticipated due to inheritance from parents or other relatives. Taking the mid-point of the two scenarios in Figure 13 and accounting for potential inheritance-driven increases in home ownership would suggest that 74 per cent of those aged 45 today will own homes by State Pension age, 66 per cent of those aged 35 today and 65 per cent of those aged 25.<sup>26</sup>

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<sup>23</sup> L Gardiner et al., [An intergenerational audit for the UK 2020](#), Resolution Foundation, October 2020.

<sup>24</sup> L Gardiner et al., [An intergenerational audit for the UK 2020](#), Resolution Foundation, October 2020.

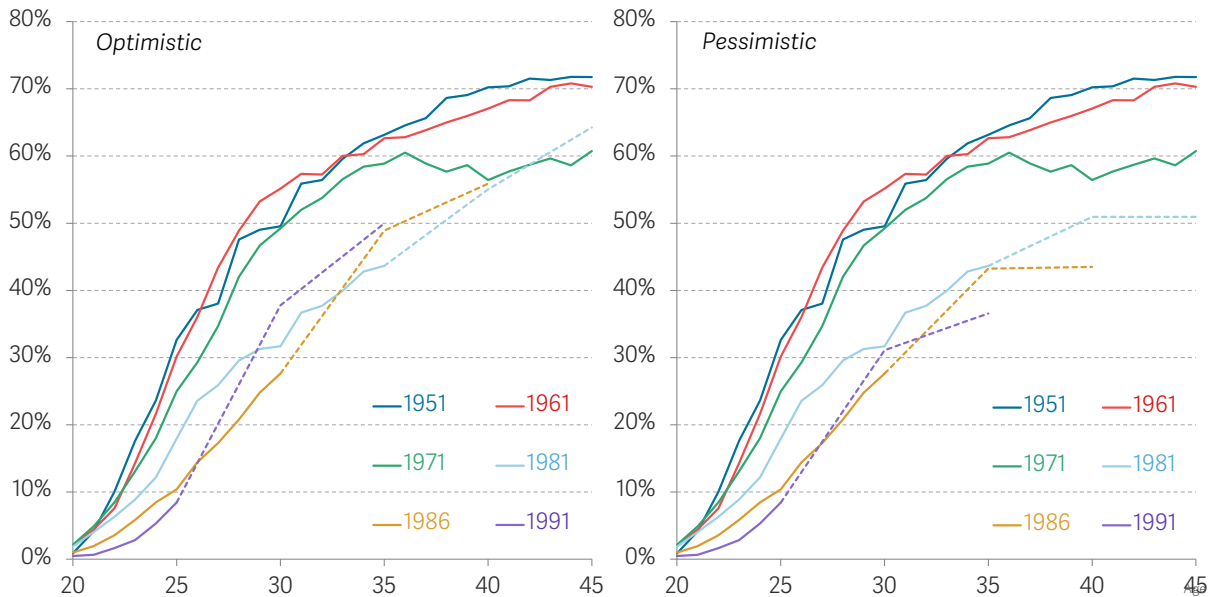
<sup>25</sup> Resolution Foundation, [A New Generational Contract: The final report of the Intergenerational Commission](#), May 2018.

<sup>26</sup> More detail on this approach can be found in the full methodology document linked here: S Clarke, [The future fiscal cost of 'Generation Rent'](#), Resolution Foundation, April 2018.



**FIGURE 14: Home-ownership rates are lower for younger cohorts, who are unlikely to catch-up with the baby boomers by mid-life**

Actual and projected home ownership rates, by age, birth year and scenario: UK, 1961-2027



NOTES: Solid lines show out-turn; dashed lines show projections. For details of the modelling approach, see Annex 3 in: Home affront (Intergenerational Commission report 9).  
SOURCE: RF analysis based on ONS, Family Expenditure Survey; ONS, Labour Force Survey.

Those home ownership rates are for the cohort as a whole, but the Living Pension is focused on the living costs in retirement of today’s low-to-middle income families. Working families in the lower half of the income distribution have lower home ownership rates, and we take this into account in the tenure assumption used in the Living Pension calculation.<sup>27</sup> The final tenure composition is set out in Table 1. Our final calculations are that the share of each cohort who would privately rent in retirement is 18 per cent for today’s 45 year olds, 25 per cent for today’s 35 year olds and 21 per cent for today’s 25 year olds.

**TABLE 1: Projections of tenure in retirement for today’s low to middle income families**

Current age of cohort	Social renter	Private renter	Homeowner
25	23%	21%	55%
35	26%	25%	49%
45	26%	18%	57%

SOURCE: Resolution Foundation analysis using DWP, Family Resources Survey 2018/19 and RF, The future fiscal cost of ‘Generation Rent’, 2018

<sup>27</sup> This is done by reducing home ownership rates by the ratio of LMI homeowners compared to overall homeownership rates for each cohort, using data from the Family Resources Survey.

The implication for the cost of living in retirement is that, although the core basket of goods and services for pensioner cohorts is assumed to remain of the same value (relative to earnings), the cost of housing will be greater for all cohorts in the calculation relative to pensioners today, and even higher for the younger cohorts.

### Changing living costs through retirement

The mix of goods and services considered as the socially-acceptable minimum changes through life as needs change – from being a baby through to old age. It can also be expected that needs change throughout retirement, particularly given the likelihood of worsening health at older ages (a person reaching State Pension age in the UK today has a life expectancy of 21 years, and this duration is likely to grow in future).<sup>28</sup>

The usual MIS pensioner basket of goods and services is designed to reflect the requirements of people at age 72 without significant health problems. Further research has been undertaken to understand how needs may change throughout retirement. This found that the needs of older pensioners – those in their 80s – were not lower than for younger pensioners, and there was no evidence of lower expectations of living standards as people aged. Some additional needs are identified, but these add relatively little to the income requirement of older pensioners.<sup>29</sup> We therefore assume that the usual MIS for pensioners applies throughout retirement as people age.

From this, we in turn deduce that living costs will grow in line with earnings growth throughout retirement. This is important because many private pensions are paid at a flat rate in cash terms, so a pensioner with a private pension award delivered by a flat-rate annuity or a drawdown product that is sufficient to have an adequate income in their first year of retirement could quickly fall behind through the retirement years. Our assumption means that the private pension pot required to provide a Living Pension will need to be large enough to afford a minimum acceptable standard of living that itself keeps pace with growth in earnings through retirement.

## Estimating the size of pension pot that can provide a Living Pension

### Income requirement in retirement

The discussion and assumptions set out above can be used to provide a target weekly income for different pensioner family types, and these are shown in Figure 15.<sup>30</sup>

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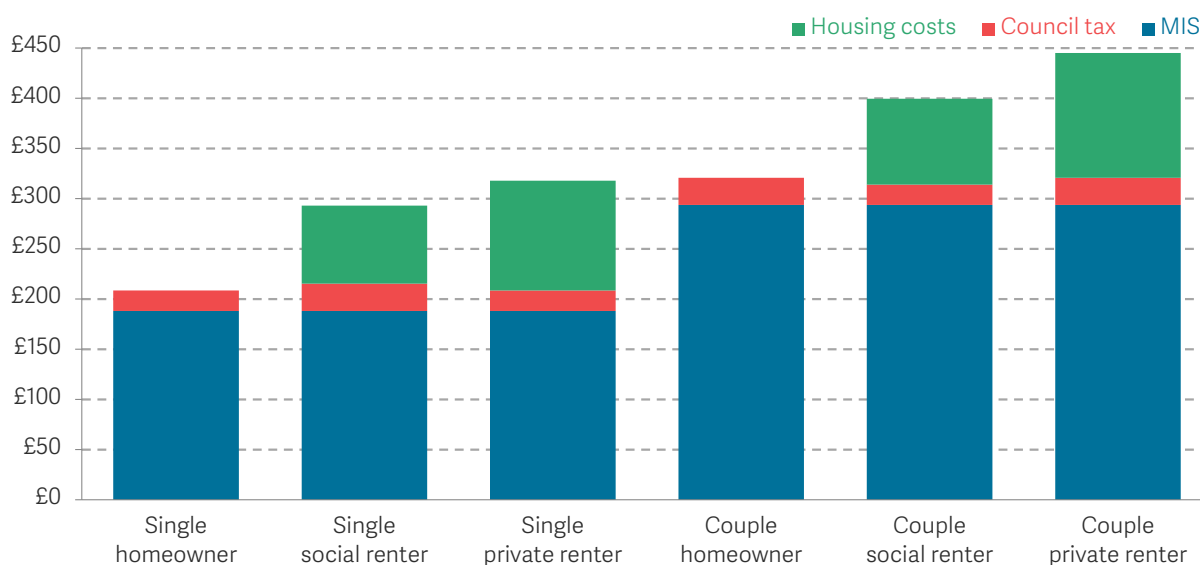
<sup>28</sup> On the basis of cohort life expectancy from Office for National Statistics, [Cohort life expectancy projections](#), 2018-based National Population Projections.

<sup>29</sup> Y Hartfree, D Hirsch & L Sutton, [Minimum income standards and older pensioners' needs](#), Joseph Rowntree Foundation, January 2013.

<sup>30</sup> The income requirement for each family type is the same for each cohort, but the average weekly income requirement of each cohort will differ because of variations in housing tenure.

FIGURE 15: Income requirements differ for different types of pensioner families

Weekly income requirement in retirement for pensioners by family type and tenure, £ per week



SOURCE: RF analysis using D Hirsch, et al, A Minimum Income Standard for the United Kingdom in 2020; CIH, UK Housing Review 2020; VOA, Private rental market statistics 2018/19; RF, Calculating a Living Wage, October 2020.

There are two further steps to move from the income requirement for each family type to the private pension required to meet that income. The first is to calculate the private pension income required to achieve that level of income once tax and benefits have been taken into account.<sup>31</sup> The second is to estimate the savings required at the start of retirement to provide the necessary private pension income to fill the gap between state support and the income requirement throughout retirement.

### The tax and benefit system for pensioners

As well as the new State Pension, pensioners can also be entitled to forms of means-tested support through Housing Benefit and Council Tax Support, and other benefits such as Winter Fuel Payments.

Not all benefits will apply in our calculations. For example, the Pension Credit minimum income guarantee is set lower than a full new State Pension, and we assume that individuals make enough contributions through their lifetime to build a full entitlement to the new State Pension. The knock-on implication is that they will not be entitled to a

<sup>31</sup> We assume pensioners do not access any existing housing wealth to provide income over retirement, and do not have other sources of financial saving. The Minimum Income Standard does make an assumption that purchases of one-off expensive items, such as white goods, are averaged out over a number of years, so the Living Pension is calculated to provide the income to cover such costs.

free TV licence either, but they will have entitlement to Winter Fuel Payments (free bus travel is already taken into account in the cost of living estimates that form the Minimum Income Standard).

We also take account of any tax that families will need to pay. For the purposes of this calculation the relevant elements are Council Tax and income tax. Following the findings of MIS research, we assume that Council Tax is paid for a Band D property. The income tax regime used in calculations reflects current policy, with private pension savings also benefitting from a 25 per cent tax-free lump sum.

For all elements of the tax and benefit system, parameters are aligned with current policy to the end of the medium term (the next five financial years) and then updated in line with earnings growth into the long term. This approach aligns with that taken by the Office for Budget Responsibility in their Fiscal Sustainability Report.

### Accessing private pension savings in retirement

Private savings tend to be accessed via a form of financial product, and, since the introduction of pensions freedoms removed default arrangements, we need to make an assumption over what is used to make the Living Pension calculation.

Annuity purchases (an annuity provides a guaranteed income through retirement, typically purchased from pension savings) were mostly mandatory for those with Defined Contribution pensions until 2015, but now people are able to access their pension savings however they want from age 55. In the six months to March 2020, only 10 per cent of people accessing their pensions savings for the first time did so through an annuity, down from 16 per cent in the six months to March 2016. This may also reflect that annuity rates have also fallen significantly over the last 15 years. Some of those withdrawing savings also only have small pots, but, even so, there has been a decline in those purchasing an annuity.<sup>32</sup>

The majority of people now either drawdown their entitlements in full (though this tends to be for smaller pots) or access them through a drawdown product. A drawdown product is effectively a savings vehicle from which income can be drawn down throughout retirement. One drawback with this product is that the market is yet to mature, with about 10 per cent of people accessing a drawdown product receiving no interest on savings, and some even paying fees despite the lack of return.<sup>33</sup> It is generally thought that the characteristics of the current market is unlikely to reflect what is on offer in future, so we take recommendations from the FCA Retirement Outcomes Review to frame the product used in this calculation.<sup>34</sup> The two main features of this are a low

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<sup>32</sup> Financial Conduct Authority, [Retirement income market data 2019/20](#), September 2020.

<sup>33</sup> Financial Conduct Authority, [Retirement income market data 2019/20](#), September 2020.

<sup>34</sup> Financial Conduct Authority, [Retirement Outcomes Review: Final report](#), June 2018.

fee, which the FCA suggest should be in line with the 0.75 per cent administration charge cap applied to pension savings in accrual, and a competitive rate of interest. We therefore assume that the annual administration charge is 0.75 per cent, and the return on savings is calculated based on assumptions used in the FCA review and the 'balanced' asset mix suggested as a central scenario by the Institute and Faculty of Actuaries.<sup>35</sup> Doing so equates to a nominal growth rate that is marginally (0.1 percentage points) lower than our earnings growth assumption.<sup>36</sup>

The final important feature of pension withdrawal is the ability to withdraw the first 25 per cent of savings tax-free. This can be in the form of a lump-sum, but this tax-free allowance can also be applied to smaller individual withdrawals, with the first 25 per cent of each withdrawal being tax free. For the Living Pension, we assume that the first 25 per cent of the income drawn down each year is tax-free and that all income withdrawn is used to provide the required minimum income. This is a simplifying assumption given that in practice only a small minority (5% in the Oct 2019 - March 2020 period) use this option, with most taking a cash lump sum.<sup>37</sup>

### A pension savings pot to provide an adequate income in retirement

We then need to move to a Living Pension pot, which is a weighted average for a cohort as a whole that is adequate to meet the minimum adequate standard of living set out above over all years of retirement. To calculate this, we take the population of the cohort at State Pension age, applying the survival curve for the relevant cohort in future years and an assumption about pensioner family formation and tenure to come up with an average figure. The survival curve is taken from ONS's principal cohort life expectancy principal projections.<sup>38</sup> These reflect the life expectancy of the population as whole, which best represents the target population of the Living Pension.

The amount in the 'Living Pension' pot calculated for the cohort at retirement is equal to the private savings needed, given the assumptions about a drawdown product outlined above, that will provide the Living Pension income target in each year of retirement given the prevailing tax and benefit system.

The size of this pension pot varies from around £68,000 for the cohorts aged 25 and 45, to £76,000 for the cohort aged 35. This variation largely reflects differences in the housing tenure mix for each cohort. The average is around £70,000 over all current low to middle income employees.

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<sup>35</sup> Institute and Faculty of Actuaries, [Can we help consumers avoid running out of money in retirement?](#), March 2018.

<sup>36</sup> Individuals with lower amounts of wealth may prefer to take lower risks with their investments because they do not have other resources to fall back on.

<sup>37</sup> Financial Conduct Authority, [Retirement income market data 2019/20](#), September 2020

<sup>38</sup>

## Implications for the Living Pension methodology

Predicting the future is never easy, and the calculations for the Living Pension requires making projections that span the next 80 years and more.

Our suggested approach follows two key principles: that growth in the living costs of pensioners should keep pace with those of working families; and that large structural differences in living costs between cohorts should be reflected in the calculation. It also aims to ensure the stability of the calculation if repeated in future years. These principles and the discussion above have the following implications for the Living Pension calculation:

- The income required by pensioners to achieve an adequate standard of living in retirement should be based on the Minimum Income Standard.
- The Minimum Income Standard should rise in line with earnings growth over the long term and be met in each year of retirement.
- Changes to household formation during retirement should be reflected in the calculation.
- The calculation should reflect cohort differences in substantial components of living costs, such as housing tenure.
- The current tax and benefit regime applies in retirement, with parameters maintained in line with current policy plans over the medium term of the next five years and then increased in line with earnings growth over the long run.
- The survival probability of each cohort is based on ONS cohort life expectancy estimates and weighted by the ONS, population projections using the principal scenarios.
- A drawdown product with fees and financial rate of return in line with FCA standards is used to access savings in retirement.

Section 5 sets out our approach to projecting future pension savings for today's employees.

## Section 5

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### Estimating future savings requirements

Section 4 explained how our methodology calculates the pension pot that would be needed so that future cohorts of pensioners have an adequate income in retirement. This Section sets out how we calculate how much we might expect employees to earn and save given current patterns of savings and future trajectories of earnings. Expressing average earnings as a share of the median by age and accounting for sex and education level provides an average earnings trajectory.

The final Section of this report sets out the resulting contribution requirement from the steps of our calculation set out in this report.

The previous two Sections analysed existing savings patterns for low-to-middle income workers, identified a 'target income' in retirement that provides an adequate standard of living and estimated the savings needed to achieve that standard of living throughout retirement. This Section sets out the method we propose to estimate the contributions needed to build that pot.

As with the Living Wage, a Living Pension should be representative of the needs of different family types during working life and during retirement. Providing a range of contribution requirements for different family types and people at different ages as the final metric, which may more accurately reflect individual requirements, is in conflict with the simple, single ask that has been so key to the success of the Living Wage campaign. Therefore, our method aims to provide a summarised metric to reduce complexity – a single contribution requirement for the three cohorts of people in their 20s, 30s and 40s. However, it can also show the variation in the requirement for each cohort, given the impact that the years people have left to save has on the contributions needed to build a Living Pension.

A further complexity arises from the role of the individual and the family. In retirement, some people will need to support themselves as a single adult, while others will be part of a couple, and their status is likely to change through retirement. That is why the total

Living Pension savings pot is an average weighted to account for household composition through retirement. However, because pension entitlements tend to be built individually, and earnings relate to an individual, the contributions required to build that savings pot reflect a weighted average for individuals.

The calculation can then also be used to provide an indication of the savings gap between the pension income built by a person given any pensions savings they may already have along with future saving under the minimum requirements of auto-enrolment, and the savings required to achieve a Living Pension. With tools like the pensions dashboard becoming available, this could provide further insight to individuals to consider the gap between their existing savings and the Living Pension pot.

## Current pension wealth of low-to-middle income families

To begin forming the detailed assumptions that will underpin the pension accrual part of this method, we consider the analysis set out in Section 2 about current savings of LMI employees. The starting point to understand the savings that are needed over the remainder of the working life to achieve a Living Pension is the extent of pension savings that have already been accrued to date.

Section 2 showed that auto-enrolment has been successful at boosting private pension coverage, but many employees had little or no pension savings before the scheme began. So far, auto-enrolment appears to be leading to gradual growth in savings of lower-income workers, and that savings are growing broadly in line with the minimum requirement of the scheme. This also suggests that savings will continue to grow for these cohorts in future years. Therefore, our method assumes that the starting point for pension accruals is that cohorts have accrued pension wealth only since the introduction of auto-enrolment. This assumption aims to replicate the gradual building of pension wealth shown in Section 2.

The analysis in Section 2 also showed that the difference in accrued wealth to date appears greater between men and women. Savings do also vary by family type, but we can expect an individual's family status to change through their lifetime, and much of that variation due to those life stages will be captured by differences in the earnings trajectories of men and women. Therefore, case studies to project future earnings and pension accruals will be split by gender.

## The structure of private pension accruals

Determining the pattern of future savings requires a set of assumptions about the structure of pension accruals, such as the amount of earnings that contributions are

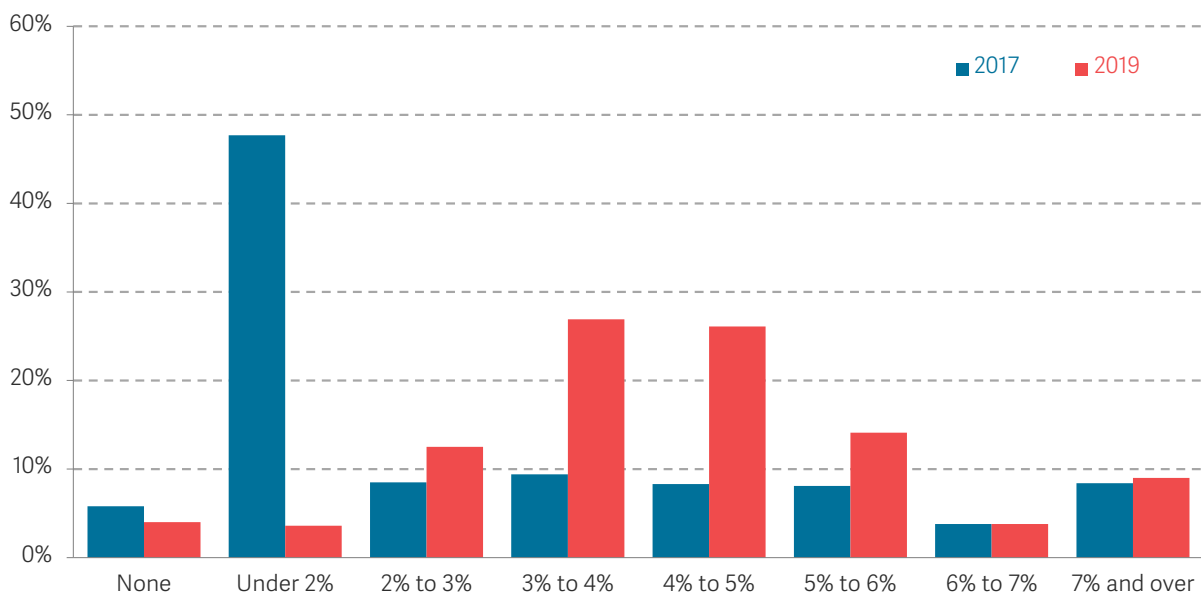


taken from, and fees charged by a pension provider. It also requires an assumption about how people’s earnings change over time.

Our starting point for an assumption about private pension accruals is the contribution rules under the auto-enrolment scheme. As discussed in Section 1, auto-enrolment has led to a large increase in the share of private sector employees contributing to a private pension. Figure 16 shows how the contribution rate of employees in a Defined Contribution scheme changed from 2017 when the employee contribution was expected to be 1 per cent, and 2019, when it had increased to 5 per cent (both figures including tax relief).<sup>39</sup> In 2017 there was a concentration of employees contributing under 2 per cent of their pensionable earnings. When the minimum contribution had increased, there was a concentration at 3 to 5 per cent of pensionable earnings. The distribution of contribution rates suggests that employee contribution rates have risen in line with auto-enrolment requirements (the rates in Figure 16 do not perfectly align with the auto-enrolment minimum because they apply to pensionable earnings which can differ from qualifying earnings (i.e. those between £6,420 and £50,000)).

**FIGURE 16: Increased private pension saving for private sector employees has concentrated at the minimum auto-enrolment contribution rate**

Employee contribution rate to occupational pensions as a share of pensionable earnings for private sector employees: UK, 2017 and 2019



NOTES: Contributions are taken over pensionable earnings rather than the qualifying earnings used for auto-enrolment, therefore contribution rates do not exactly align with auto-enrolment requirements.  
SOURCE: Resolution Foundation analysis using ONS, Employee workplace pensions in the UK:2019 provisional, 2017 final.

<sup>39</sup> This reflects the overall 8% contribution rate of which a minimum of 3% must come from the employer.

Given that contribution rates appear to be following the requirements for the auto-enrolment scheme, the Living Pension method assumes that employees save within the parameters of auto-enrolment: i.e., if their earnings are above the threshold of £10,000, then contributions are paid on earnings between £6,240 and £50,000 a year. The current overall contribution rate is the equivalent of 8 per cent, so a person earning £25,000 a year would have an overall contribution to their pension pot of £1,500 a year ( $(£25,000 - £6,240) \times 0.08$ ). The Living Pension calculation begins with this minimum contribution rate and increases it for all future years of accrual until the target savings pot is reached.

We also make a simplifying assumption that all employees are auto-enrolled, given that 86 per cent of eligible private sector employees were participating in a workplace pension in 2019, up from 42 per cent in 2012.<sup>40</sup> The largest gaps of coverage remain for either those working very short hours in smaller firms – so falling below the eligibility threshold and less likely to be enrolled along with other staff by their employer – and the self-employed, and the first of these is taken into account within our earnings profiles, discussed below. The further development of an employer-facing Living Pension accreditation standard will need to consider the group of employees covered by contribution requirements, and in particular whether it includes those who fall outside of auto-enrolment eligibility.

The minimum requirements of auto-enrolment are not fixed. Key elements of the scheme – the threshold and band of earnings contributions are made over – are reviewed regularly. To date, the threshold has been maintained at £10,000 in cash terms – so gradually falling relative to earnings – and the earnings bands have moved in line with the National Insurance thresholds. The former provides a balance between opting in those who would find that relying on state support only in retirement is insufficient to fund their anticipated living standards, and allowing those on low earnings to prioritise funds for their immediate needs. The uprating of the earnings bands simplifies the system for employers by not introducing additional thresholds into payroll processes.

In the latest annual review of auto-enrolment thresholds, the Government reiterated its intention to remove the lower limit of qualifying earnings in the mid-2020s. This follows recommendations made in the 2017 review of the overall auto-enrolment scheme to further boost private saving.<sup>41</sup> The impact of removing this threshold could be considerable for the Living Pension calculation, given that, for a person earning £25,000 a year, it would increase their contribution by almost half, and double it for anyone earning less than £12,500 a year. It remains unclear when this threshold will be removed,

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<sup>40</sup> Department for Work and Pensions, [Workplace pensions participation and saving trends: 2009 to 2019](#), June 2020.

<sup>41</sup> Department for Work and Pensions, [Automatic enrolment: review of the earnings trigger and qualifying earnings band for 2020/21](#), February 2020 and Department for Work & Pensions, [Automatic Enrolment Review 2017: Maintaining the Momentum](#), December 2017.

particularly given the current economic crisis and likely hesitancy to change policy that will either raise employer costs or lead to a short-term reduction in workers' incomes.

To ensure the Living Pension calculation has long-term stability, we assume that the lower earnings band is gradually removed outside the immediate five-year horizon, with the intention of maintaining a rolling five-year lead-in time until a firm date is announced. We assume that the qualifying threshold is maintained in cash terms for the first five years and then maintained in earnings terms into the future. We assume that the upper earnings band is updated with CPI inflation in the medium term, in line with government policy, and then with earnings longer-term.

### The financial return to private pension savings

Savings in a Defined Contribution scheme will typically be invested by a pension provider in a mix of financial assets such as stocks, property and bonds. The return on such investments tend to vary by how well a fund performs, as well as by the level of risk an individual chooses to take in their investment. This can mean that employees making similar-sized contributions throughout their working life have very different sized pension pots in retirement, but we assume in our calculations an average rate of return for pension savings in accrual.

In previous research, we have assumed a long-run nominal return of 5.6 per cent a year, based on assumptions used by the Pensions Policy Institute.<sup>42</sup> This reflects a portfolio of investment split between equities and bonds. These assumptions were in turn based on an assumption made by the OBR that long-run nominal earnings would grow at 4.3 per cent. However, the OBR have since revised down their long-run assumption to a nominal 3.8 per cent for earnings growth, or 1.8 per cent above CPI inflation. To maintain the same relative rate of return over earnings in our central scenario, we also reduce the real financial return on private pension savings by the same ratio of reduction in the earnings assumption. This leaves a nominal financial return of 4.9 per cent on private pension pots in accrual.

### Private pension scheme fees

Private pension providers charge an administration fee on the funds that they manage. Since April 2015, there has been a cap on charges applied to schemes containing auto-enrolled contributions of 0.75 per cent a year. A DWP survey of pension schemes published in 2017 showed that most schemes charge between 0.38 per cent and 0.54 per cent. In our previous research, we assumed an annual fee of 0.5 per cent on the total pot: this is broadly equivalent to the charging structure of NEST, the workplace pension

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<sup>42</sup> D Finch & L Gardiner, *As good as it gets? The adequacy of retirement income for current and future generations of pensioners*, Resolution Foundation, November 2017.

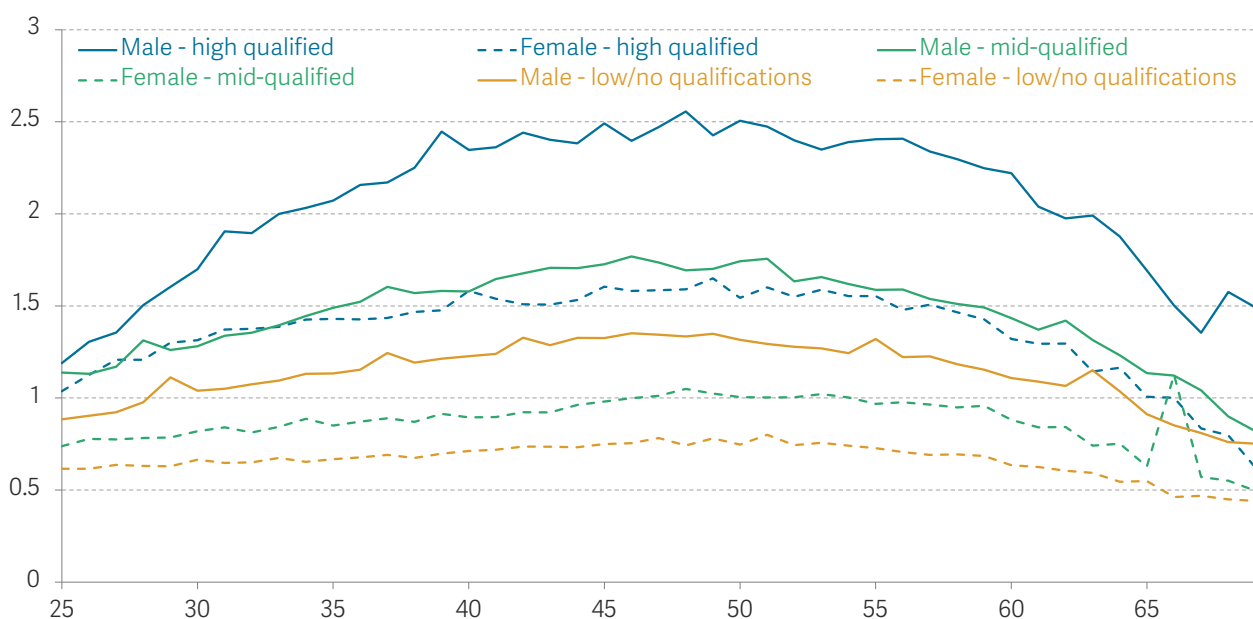
scheme set up by the government to support auto-enrolment, which has a 0.3 per cent annual fund management charge and 1.8 per cent charge on new contributions.<sup>43</sup> Therefore we assume an annual fee of 0.5 per cent on the total pot each year during accrual.

### Future earnings trajectories

The other key determinant of pension savings is how much a person earns over their lifetime. Many factors influence an individual’s earnings, including age – people tend to earn more as they age and gain experience; education – people with higher qualifications tend to have higher earnings; and non-work-related responsibilities – people with caring responsibilities may reduce their hours of work. The economic situation when starting out in work can also have long-run impacts on lifetime earnings and employment.

FIGURE 17: **Employee earnings differ by age, qualification and sex**

Weekly pay relative to median pay, by age, sex and highest qualification: UK, Q3 2010-Q1 2020



SOURCE: Resolution Foundation analysis using ONS, Labour Force Survey Q3 2010 to Q1 2020

Figure 17 shows the earnings of men and women with low (equivalent to GCSE or lower), intermediate (above GCSE level but below degree) and high (degree and above) qualification levels at different ages. It reports average gross weekly pay for all employees relative to the median wage, with a value of 1 meaning that someone earns the median wage, and presents an average over the decade running until the first quarter 2020. Our

<sup>43</sup> Department for Work & Pensions, *Automatic Enrolment Review 2017: Maintaining the Momentum*, December 2017.

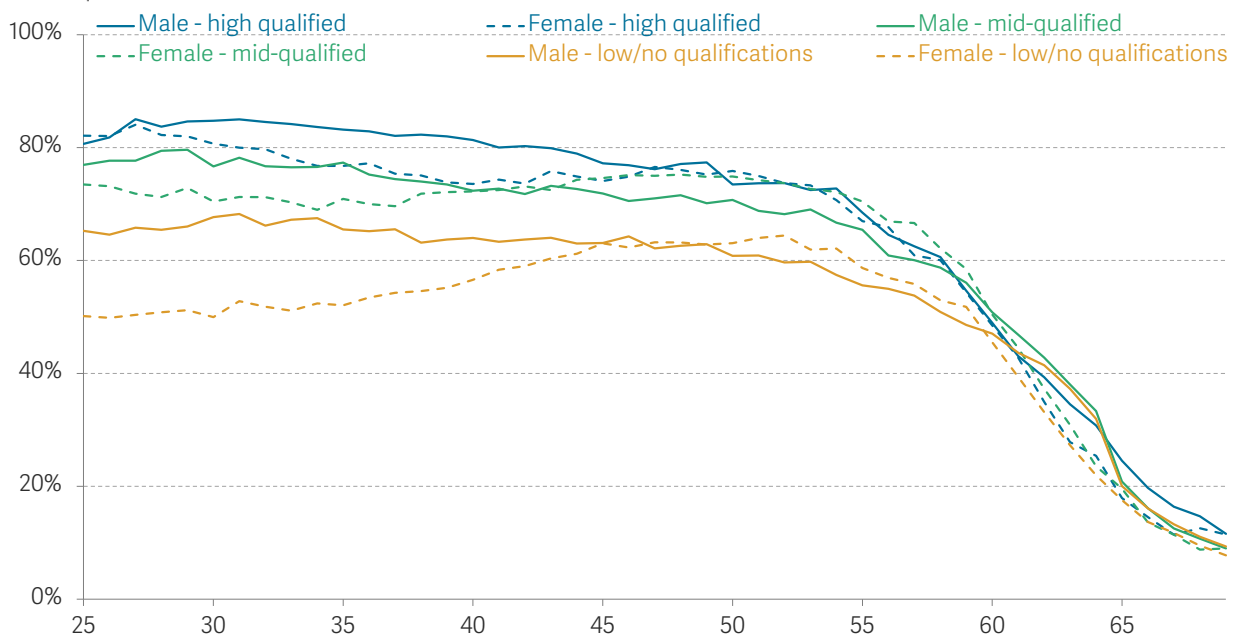
analysis does not include data from further quarters of 2020 to exclude the impact of the pandemic in those months from our assumptions.

Earnings tend to increase relatively faster until around age 40, peak over the next 15 years and then slowly decline after age 55. Unsurprisingly, it shows that women and those with lower qualifications have on average lower pay throughout the lifetime. Lower pay for women partly tends to reflect time taken out of the labour market to look after children or a shift to part-time work, which tends to feature lower hourly pay, as well as fewer overall hours, to fit work around caring responsibilities.

As well as varying earnings over the lifetime, people also have periods in which they are not working as an employee. For young people this will typically be while in education; in mid-life, it may reflect a period of illness or looking after children; at older ages, it can reflect people retiring. For the purposes of private pension accrual, being self-employed or an employee is also important. Active contribution to a private pension is much lower among self-employed people, and, not being employees, they will not have access to an employer-provided pension. We assume that during a period of self-employment no contributions are made. Figure 18 therefore shows the share of men and women who are employees by qualification level and age.

**FIGURE 18: Employment rates vary by age, sex and qualification**

Proportion of the population in a paid employee job, by age, sex and highest qualification: UK, 2008-2018



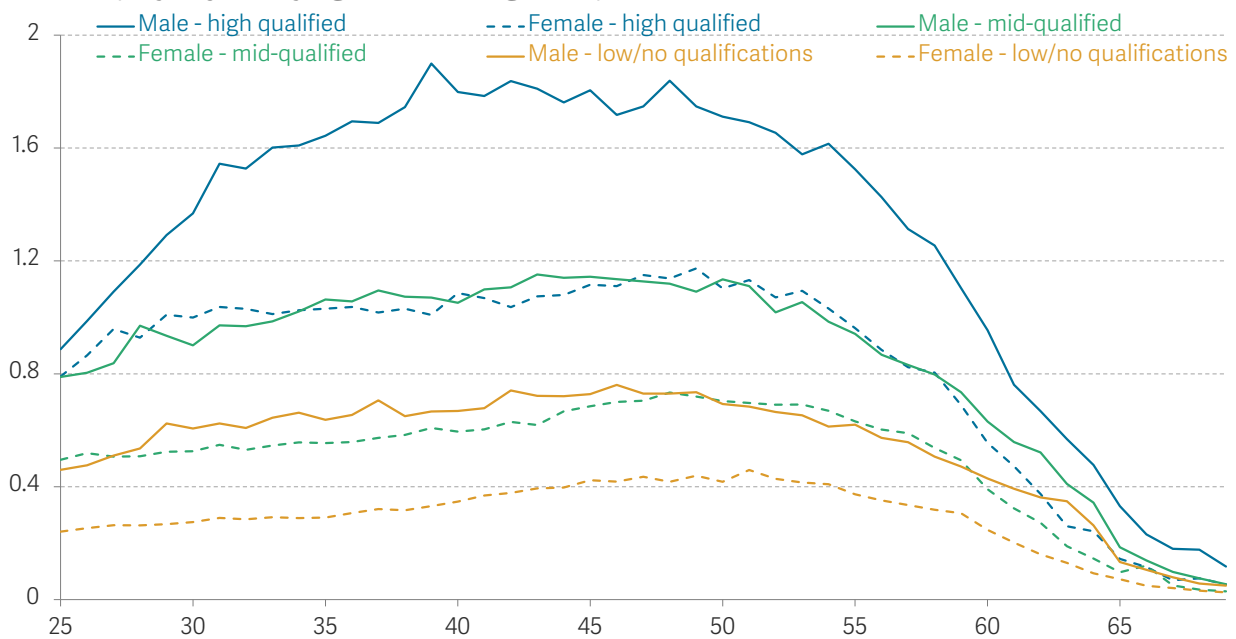
SOURCE: Resolution Foundation analysis using ONS, Labour Force Survey Q3 2010 to Q1 2020.

Accounting for such varying employment and earnings trajectories is a key part of the Living Pension calculation. Reflecting the range of potential experiences could be achieved by creating hypothetical case studies, and applying a range of earnings profiles to those case studies. Such an approach is likely to introduce complexity to the calculation and would require many permutations, particularly given that we would be varying case studies by family composition and earnings profiles for three different cohorts.

Instead, we take the approach of estimating six earnings trajectories that vary by education level and sex. We do this by combining our estimate of people’s earnings relative to the median (Figure 17) with the probability of them being in an employee job at all (Figure 18), and the result is shown in Figure 19. These trajectories will apply to each cohort from their starting age (25, 35 and 45 in the year of the calculation).

**FIGURE 19: We combine earnings paths and employment probabilities to create six earnings trajectories**

Modelled weekly pay relative to median pay trajectories, including those not in employee jobs, by age, sex and highest qualification: UK, Q3 2010-Q1 2020



SOURCE: Resolution Foundation analysis using ONS, Labour Force Survey Q3 2010 to Q1 2020

Converting the earnings factor in Figure 19 to an absolute level of earnings is achieved by multiplying by the median gross earnings for men and women taken from the latest release of ASHE, and uprating it with average earnings growth projections produced by the OBR in the November 2020 Economic and Fiscal Outlook and July 2020 Fiscal Sustainability Report.

Having projected annual earnings using the trajectories identified above, we then apply the pension accrual rules we set out above. We can then calculate an average pension pot for each cohort by taking a weighted average of LMIs based on qualification level and sex.<sup>44</sup>

One disadvantage of this approach is that our earnings profiles do not vary by cohort, even though we know that different cohorts have experienced different trajectories to date. Instead, they reflect the distribution of earnings for people today at each age. Providing greater detail to these forecasts would be a complex undertaking, and we opt for a simpler approach to balance the complexity of producing a forecast for earnings over the next 40 years with the ease of both interpretation and the ability to update the assumed earnings profiles in future years.<sup>45</sup> Our approach does allow for the fact that different cohorts have different levels of earnings and associated pension savings now, but for simplicity assumes that all will follow the same future path of earnings, one that is based on the earnings of those at older ages today.

## Implications for the Living Pension methodology

The three key factors taken into account when modelling future pension savings are the structure of private pension accrual, the financial return on savings through the working life, and the working pattern through someone's lifetime. The parameters chosen for the Living Pension calculation aim to balance the long-run stability of the calculation with realism and a desire to reflect current behaviour. This has the following implications for the Living Pension calculation:

- The range of earnings over which savings are made and when they are triggered are assumed to follow minimum auto-enrolment requirements, and all people contribute from their earnings in this framework;
- Employees from low to middle income families, who form the starting point of the Living Pension calculation, should be assumed to have pre-existing pension savings in line with the minimum requirements of auto-enrolment (which broadly reflects the evidence from the Wealth and Assets Survey – presented in Section 2 – on how much the target population has saved to date); and,

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<sup>44</sup> We assume that people retire in the year they reach State Pension age. State Pension age increases are in line with announced dates reaching 68 by 2038, and further rises projected to maintain the share of adult life spent in retirement at 31 per cent. The transition to retirement, that can mean lower employment rates and lower earnings, is captured by the earnings profile set out in Figure 18

<sup>45</sup> A more sophisticated approach can be taken to account for cohort differences in education and labour market experiences. While we may expect younger, higher qualified cohorts of women to experience higher earnings and employment than older cohorts have done relative to men, younger cohorts have experienced lower earnings than the cohorts that preceded them. For example, see M Cushing & D Rosenbaum, *Cohort effects in Age-Earnings Profiles for Women: Implications for Forensic Analysis*, Eastern Economic Journal, Summer 2010.

- Future earnings paths reflect current earnings and employment patterns accounting for age, sex and education level.

Having calculated the amount of earnings that people are likely to have over the lifetimes, the final Section reports the final calculations, resulting in the different contribution rates and amounts required to build a Living Pension.



## Section 6

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### Contributions to a Living Pension

This Section of the report sets out the results of our methodology, providing the different contribution rates and amounts required to build a Living Pension. This calculation takes account of the analysis set out in the previous Sections of the report which have set the assumptions used within our methodology.

Our calculations show that, on average, today's workers would need to save an additional £1,500 a year above the current minimum auto-enrolment requirements, equivalent to an additional 8 per cent contribution rate. For the cohort aged 25 today this requirement is £600, with an additional 3.2 per cent contribution rate, and for the cohort aged 35 today, it is an additional £1,300 or 7.1 per cent contribution rate.

Precisely how the contribution requirement for a Living Pension should be presented is to be determined through further work by the Living Wage Foundation to make an employer-facing Living Pension benchmark a reality. This section therefore presents the contribution rates in different ways to show possible approaches.

The Living Pension represents the average private saving needed for a range of representative family types to achieve an adequate standard of living in retirement. This saving is required on top of entitlement to a full State Pension and can be shown as an amount additional to that expected under the minimum auto-enrolment requirements.

As with the Living Wage, the Living Pension is intended to provide a simple summary figure that can be easily digested by the public. Calculating a Living Pension contribution requirement is complicated because doing so requires taking account of workers at different life stages and throughout the rest of their lives. To show the differences that the starting age makes to the contributions required, we present estimates for three cohorts – those in their 20s, 30s, and 40s – represented by people at the mid-point of those cohorts in the current year, at age 25, 35 and 45. We do not include a cohort of savers aged 50 because the combination of a short working life left to retirement with our assumption of no pension accruals prior to auto-enrolment results in a contribution rate

that is so high as to be unrealistic.

As with other assumptions set out in this report, if the framework set out in this report is taken forward, then the age groups used may be reassessed to reflect changes in working patterns, longevity or State Pension age, and future development work on a Living Pension accreditation standard will determine whether it makes sense for the benchmark to include any differentiation by age or not.

In the Annex, we present further results to show the sensitivity of the calculation to different economic assumptions. The sensitivity analysis is provided given uncertainty about the future and the importance of the relationship between earnings growth and the rate of return on savings. It should also be noted, though, that any improvement or deterioration in financial returns or earnings growth are likely to also have a knock-on impact on the expectations captured in MIS research, meaning that upward or downward pressure on contribution requirements may be offset by changes to expectations of what constitutes an adequate standard of living in retirement.

## Communicating the Living Pension contribution requirement

A summary estimate for all cohorts as well as for individual cohorts is presented in Table 2. This shows that, averaged across cohorts in their 20s, 30s and 40s., an LMI earner would need to save an additional 8.1 per cent, double the current 8.0 per cent contribution rate mandated under auto-enrolment, to build a Living Pension. That contribution rate relies on a band of earnings that is wider than the current minimum requirement because we assume that the Government's aspiration to remove the lower earnings threshold for saving is met after ten years.

The cohort breakdown shows how this additional requirement is lower for the youngest cohorts, and higher for older cohorts. Not only do older cohorts have fewer years to save to meet the Living Pension requirements, but also more of those years have lower earnings and a lower employment rate as the cohort approaches retirement (see Figure 18).

Table 2 also provides an estimate of what the contribution rate translates to on an annual cash basis for a person working full-time and earning the Living Wage. The additional 8.1% contribution rate translates to an additional £1,500 a year of saving for such an individual (assuming contributions are made on total gross earnings, rather than the current auto-enrolment threshold, in line with the assumptions set out in Section 5).

These estimates have been presented in different ways for information and to provide context. How these estimates are used as part of any accreditation process (not least the appropriateness of cash versus percentage-based benchmarks) will be considered by

the Living Wage Foundation as it develops and refines the Living Pension accreditation standard.

One feature to note is that representing the contribution required as a cash figure prevents the absolute contribution from a lower earner at a given contribution rate being lower than for a higher earner. It can also be easier for employees and employers to understand a pounds and pence figure. Alternatively, a single contribution rate is simple and would fit with current messaging about auto-enrolment. Finally, a hybrid approach could also be possible combining a contribution rate with a cash floor for the lowest earners, but this adds complexity.

**TABLE 2: Living Pension contribution rates and annual cash contributions for 2020**

Current age of cohort	Contribution rate		Cash contribution working full-time at the Living Wage	
	Total	Additional to auto-enrolment minimum	Total	Additional to auto-enrolment minimum
25	11.2%	3.2%	£2,100	£600
35	15.1%	7.1%	£2,800	£1,300
45	21.2%	13.2%	£3,900	£2,500
Average	16.1%	8.1%	£3,000	£1,500

SOURCE: Resolution Foundation analysis using the RF Private Pension accrual model.

NOTES: Cash contribution estimates have been rounded to the nearest £100 and are assumed to apply across all earnings

The analysis in this report has demonstrated the feasibility of constructing a methodology to deliver a Living Pension benchmark. It sparks a number of questions, including the precise way in which the benchmark is expressed; the emphasis on employer- versus employee- contributions; which employees should be covered; whether the benchmark should vary between groups; the scheme's governance; and the practicalities of a Living Pension accreditation process. With support from the Standard Life Foundation, the Living Wage Foundation will now take these considerations forward and pilot different approaches.

## Annex

### Sensitivity analysis

In this Annex we set out two further tables of results to show how sensitive the calculation is to differing assumptions about financial returns. Table 3 presents results where the nominal return to pension savings in accrual and through retirement are 1 percentage point lower than in our central scenario. Table 4 shows results where the nominal return is 1 percentage point higher. The tables help to indicate the range within which the results might fall if there are any changes to the longer-term assumptions included in our central scenario.

**TABLE 3: Low financial return scenario - Living Pension contributions for 2020 where financial return is 1 per cent lower than our central scenario**

Current age of cohort	Contribution rate		Cash contribution working full-time at the Living Wage	
	Total	Additional to auto-enrolment minimum	Total	Additional to auto-enrolment minimum
25	13.2%	5.2%	£2,400	£1,000
35	18.9%	10.9%	£3,500	£2,000
45	27.0%	19.0%	£5,000	£3,500
Average	20.1%	12.1%	£3,700	£2,200

SOURCE: Resolution Foundation analysis using the RF Private Pension accrual model

NOTES: Cash contribution estimates have been rounded to the nearest £100 and are assumed to apply across all earnings

**TABLE 4: High financial return scenario - Living Pension contributions for 2020 where financial return is 1 per cent higher than our central scenario**

Current age of cohort	Contribution rate		Cash contribution working full-time at the Living Wage	
	Total	Additional to auto-enrolment minimum	Total	Additional to auto-enrolment minimum
25	9.2%	1.2%	£1,700	£200
35	11.4%	3.4%	£2,100	£600
45	15.4%	7.4%	£2,900	£1,400
Average	12.1%	4.1%	£2,200	£800

SOURCE: Resolution Foundation analysis using the RF Private Pension accrual model

NOTES: Cash contribution estimates have been rounded to the nearest £100 and are assumed to apply across all earnings

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged.

We do this by undertaking research and analysis to understand the challenges facing people on a low to middle income, developing practical and effective policy proposals; and engaging with policy makers and stakeholders to influence decision-making and bring about change.

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