PENSIONS POLICY INSTITUTE

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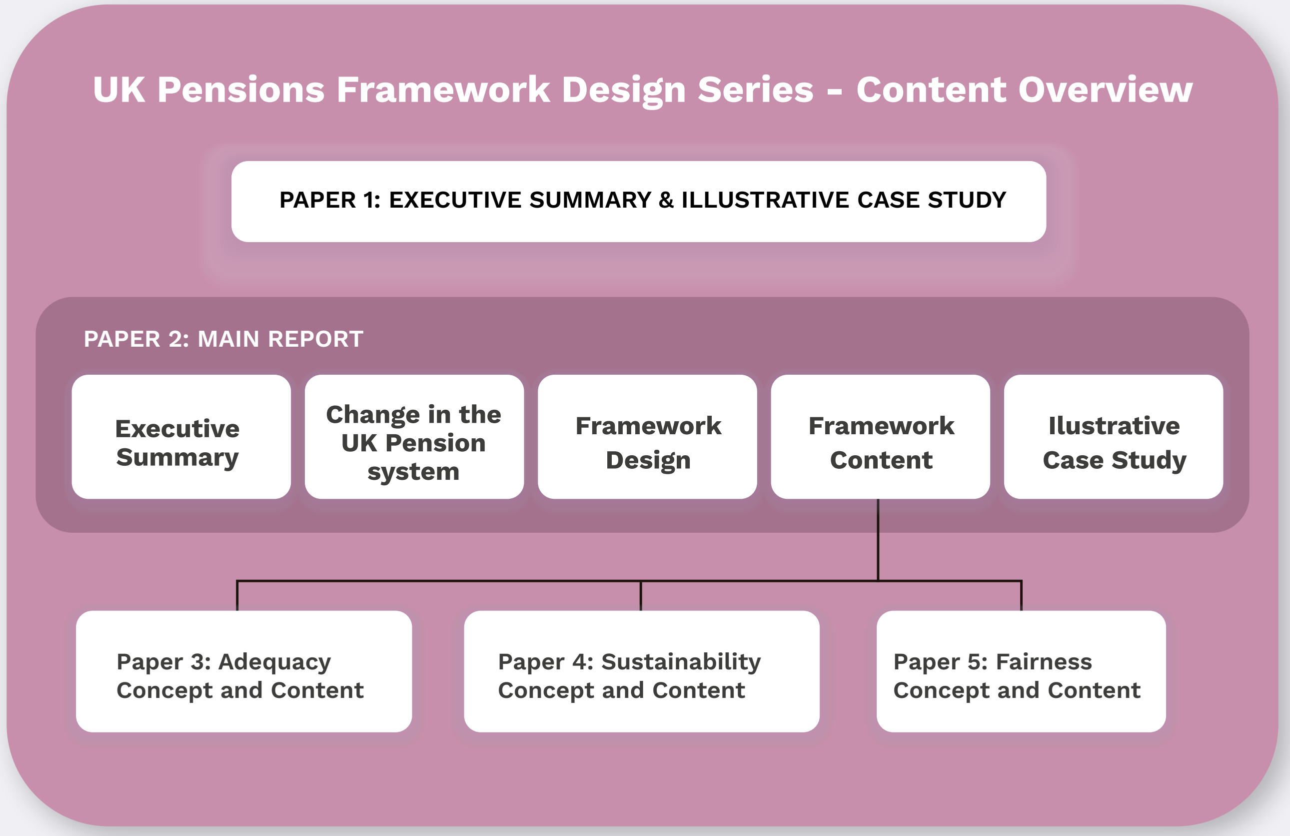
UK Pensions Framework Design Series

An examination of adequacy, sustainability and fairness in the UK Pension System

Paper 3: Adequacy – Concept and Content

UK Pensions Framework Design Series: Paper 3 - Adequacy Concept and Content



The **UK Pensions Framework Design Series** comprises five papers which together document the process of developing the UK Pensions Framework, undertaken over the course of 2021.

The UK Pensions Framework is a long-term analytical instrument which seeks to build a clear picture of how strengths and weaknesses in the UK pension system are evolving over time. From its first release, due in Q4 2022 and annually thereafter, it aims to provide a consistent and systematic approach to examining and simulating changes in adequacy, sustainability and fairness in the UK State and private pension system, which overall determine the financial security that people have in later life.

This paper presents a more detailed discussion on what adequacy means in the context of the UK pension system. It expands upon the introduction provided in the Main Report. The Main Report offers a detailed insight into the context, structure and content of the Framework, what the Framework is, why it is needed and how it has been designed. An abridged version is provided in the Executive Summary and Illustrative Case Study. Further examination of the concepts underpinning analysis of Adequacy, Sustainability and Fairness, along with their proposed content indicators, is provided in three supporting papers.

The Pensions Policy Institute is an independent not-for-profit educational research organisation, devoted to improving retirement outcomes by being part of the policy debate and driving industry conversations through facts and evidence. The UK Pensions Framework project has been kindly sponsored by Aviva. Sponsorship has been given to help fund the research, and does not necessarily imply agreement with, or support for, the analysis or findings from the project.

The UK Pensions Framework Design Series has been authored by Anna Brain, Research Associate at the PPI. The PPI would like to thank experts from across government, regulators, academia and industry around the world who have so generously given their time to provide insight and guidance into the development of this work. Their contribution is gratefully acknowledged in the Main Report. The next step in the Framework project is to undertake detailed analysis of the UK pension to understand how it is changing year on year, the results of which will be made available annually from the end of 2022 onwards.

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The UK Pensions Framework

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ADEQUACY

1. The fact of being enough or satisfactory for a particular purpose

A clear system that enables people to plan reliably for a retirement which provides protection against poverty and the ability to maintain their living standards from working into later life.

Clear

A system which helps people to understand what a good retirement looks like and how to achieve it.

Reliable

Confidence that the savings people put aside today will generate sufficient income to meet costs throughout retirement.

Poverty

A system which offers equal protection against the risks of poverty and deprivation as people approach and live through retirement.

Resilience

Ability for people to withstand short-term financial shocks.

Living Standards

Support for a standard of living in later life that is comparable to that which is maintained with earnings in working life.

ADEQUACY

A clear system that enables people to plan reliably for a retirement that affords them protection against poverty and the ability to maintain living standards from working into later life

1 **Labour Markets**

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- Income and Earnings

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- State Support

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- Transition & Decumulation
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Introduction

This paper describes in detail the role of adequacy as the overarching goal of the UK Pension System, how it can be understood, and how it forms a central pillar of the Framework's analysis.

It also outlines the drivers of adequacy, along with how it will be defined and measured: poverty alleviation, income maintenance and financial resilience. The scale of potential adequacy risk is described using recent data showing the proportion of people estimated to be at risk of not achieving adequacy in retirement.

The paper addresses the following questions:

- What is adequacy and why does it matter?
- What are the adequacy indicators?
- How can adequacy be measured?

Finally, an overview of the rationale, content and current themes for each sub-group of indicators relating to adequacy in the UK pensions system is provided: Labour markets, State support, saving and investing, non-pension wealth, living costs and retirement outcomes.

What is adequacy and why does it matter?

Adequacy is critical to pensions policy, because people expect to be able to live with dignity and security in retirement, protected from poverty, and with a standard of living comparable to that which they have experienced during working life.[1]

People need a pension system which is clear, enabling them to plan for their future with a realistic definition of what a good retirement looks like and how to achieve it; and reliable, meaning that the costs they face in the future will not change significantly in relation to the income they generate from savings they put away today. These criteria do not just matter for individuals, however. They matter for every stakeholder in the pension system, including employers, pensions and financial services providers, and the State - who are working together towards the common goal of enabling secure and positive outcomes in later life.

The Framework definition of adequacy comprises three considerations against which the UK pension system will be examined: poverty protection, income maintenance and financial resilience.

Adequacy is dependent upon a complex array of short and long-term actions and interactions, which build up to determine retirement outcomes over the course of a member's lifetime. It is a journey during which the cumulative effect of choices and circumstances during working life can produce vastly different outcomes in the wealth that individuals accumulate by the time they reach retirement. Many of these circumstances can also be impacted by changes in the economic and political cycle, and in pension options over time. As people approach retirement, the next series of decisions they make around how to access and spend their savings will also impact on the adequacy of outcomes they are likely to achieve.

Although the design of the pension system emphasises individual responsibility for overall levels of retirement saving, particularly in the context of Defined Contribution (DC) schemes, structural, systemic and policy design issues will also make a difference. Impacts vary between groups, but some of the reasons that people face inadequate income in retirement include:

- Lack of access to workplace pensions
- The type of pension scheme and level of employer contributions available to them
- Not working, working reduced hours or having significant periods out of work
- Not saving, saving enough or making the most of savings incentives whilst in work
- Poor investment returns and value for money
- Poor options or choices on how to access and spend money at retirement
- Additional demands on retirement savings such as renting and unexpected household expenditure, care costs, lack of non-pension savings and household debt.

This broad array of factors shows that simply increasing member contributions is not the only solution to adequacy risks. Other factors, such as investment returns, working patterns and non-pension wealth, also have a role to play in improving outcomes and reducing disparity between groups. Together, they form the basis for the twenty two indicators, organised into six sub-objective groups, that will support analysis of adequacy in the UK pension system.

What are the adequacy indicators?

Framework indicators are structured around financial resources in retirement, and retirement costs.

By identifying elements that collectively make up the level of income or capital that people have available to them in retirement on one hand, and the elements that add up to how much they will need on the other, the Framework aims to identify factors on both sides of the retirement equation that can help to explain how and why adequacy is changing over time, and how it might change in the future.

Trends which suggest that the overall costs facing people in retirement are growing faster than income they are likely to achieve are likely to have a detrimental impact on adequacy, and the proportion of people able to realise it. These trends could be brought about by factors such as rising inflation or increases in housing costs in retirement on one side, or conversely to declining value of the State Pension or prolonged periods of low earnings or investment returns on the other. In contrast, conditions whereby the value of future incomes grow faster than expected costs are likely to have a positive impact on adequacy. These conditions could be attributed to factors such as increased employer contributions or earnings growth on one side, and policy reform such as a clear social care settlement on the other.

Four sub-objectives cover indicators that together produce the amount of income people have available to them in retirement.

- **Labour market dynamics** will examine workforce trends that have a direct impact on how much people are able to save for retirement, either through the type of work they do, the amount of work they do, or how much they earn.
- **State support** covers the entitlements people accrue and the income they receive from the from the State Pension in later life, as well as the extent to which people are dependent upon means-tested benefits to achieve a minimum level of income
- **Private pension saving and investing** covers rates of saving in Defined Benefit (DB), DC and personal pensions, as well as rates of investment returns and tax relief.
- **Non-pension savings and assets** includes factors that can impact how much people need, or how much they have available in retirement including home ownership and housing wealth, other forms of household saving and trends in inheritance.

The next two sub-objectives consider the costs that people are likely to face in retirement, and the overall outcomes that are produced by the extent to which the income they generate is expected to cover these costs.

- **Retirement livings** costs cover elements that together reflect the expenses people are likely to face in retirement. It includes household expenditure along with inflation outlooks, income tax, the proportion of people facing rental costs in retirement, household debt and possible costs of social care.
- **Retirement outcomes** indicators consider overall adequacy outcomes in retirement by looking at the total income people have available to them from different sources, including State and private pensions, decisions people make around decumulation, the extent to which changing levels of retirement income are likely to keep up with changing costs in retirement, poverty rates during and approaching retirement, and living standards.

The adequacy objective will focus upon overall outcomes for social groups most likely to face financial risk in retirement, or "underpensioned" groups. It will also consider the risks facing different groups of people as they approach retirement.

[1] Hutton (2006), Mercer (2020), European Commission (2018)

As well as changes to the pensions and labour market landscapes, shifts in the size and shape of the UK social security system are impacting adequacy in later life. Over time, the generosity of the welfare system has reduced, yet pensioners have been largely shielded from these cuts. The share of public spending on pensioners has increased proportionately, and the gap between means-tested benefits for people above and below State Pension age (SPa) in 2019-20 was at its widest for thirty years.[2]

For those over the SPa, these shifts have a largely positive effect on adequacy, as evidenced by the prolonged fall in pensioner poverty from around 2000 to 2015[3].

However, the widening welfare gap means that pension adequacy is becoming an increasing problem for individuals who leave the labour market before reaching SPa, particularly those who may be dependent upon State support, or who may leave due to ill-health or caring responsibilities due to labour market constraints for older workers.

In some cases, the design of the system is such that individuals may be forced to draw upon savings earlier than intended, whilst others may need to rely upon lower levels of the working age benefit system until they reach their qualifying age for retirement benefits. As the SPa increases, this could become a growing problem for adequacy over time and will be a key area of focus for the framework to consider.

How can adequacy be measured?

Despite the burgeoning field of pensions literature, there is extensive debate and little consensus over how best to define and measure targets that reflect realistic expectations of adequacy.

Defining adequacy

Although the single overarching goal of the UK pension system is to provide financial security in later life, its objectives are derived from policy targets that reflect two different ways of defining adequacy: poverty protection and income maintenance, or consumption smoothing. The two objectives are not independent however, since saving for later life and insuring against the risk of outliving savings can also help to avoid poverty and mitigate against the need for means-tested benefits.[4]

The UK, like many systems, employs different policy instruments to address each target. A minimum level of retirement income is generally provided through the State Pension, with additional insurance against poverty provided through the welfare state for those for who need it. Until 2016, the State provided for income maintenance through an earnings-related contributory benefit known as the Additional State Pension, or the State Earnings-Related Pension Scheme (SERPS). It was replaced with the flat rate new State Pension (nSP) in 2015, in order to reduce the long-term costs of pensions to Government. Since 2016, income maintenance or consumption smoothing has been provided through private pension saving, supported by a series of policy instruments such as automatic enrolment. It is particularly substantive for workers with earnings above a minimum level of income for whom the State Pension is unlikely to replace earnings adequately enough for living standards to be maintained.[5]

The Framework will assess retirement adequacy against both dimensions.

- **Poverty protection:** A threshold which is considered sufficient to protect people against deprivation such as the poverty line, or above, which retirement income is considered sufficient and socially acceptable for basic needs to be met - such as the minimum income standard.[6] In 2017/18, around 18% of pensioners lived in households below the poverty line, after housing costs, highlighting a reversal in the trend of falling pensioner poverty that took place between 1998 and 2015.[7]
- **Income maintenance**: A level at which post-retirement income is considered sufficient for an individual to replicate their pre-retirement standard of living in later life. This figure is typically lower than pre-retirement earnings to reflect the general fall in living expenses that occurs after retirement, due to lower costs of living associated with transport, mortgage payment and other factors.

The Framework will also consider the extent to which people have savings or capital resources available to withstand short-term financial shocks.

Measuring adequacy

For most people, the expectations they have of retirement will be determined by their experiences in life so far, and the changes they anticipate might happen in later life.[8] These expectations can be translated into adequacy measures in two ways.[9]

- **Proportional income targets** are used to determine how effectively an individual's earnings are replaced by their retirement income in later life. They are commonly known as "replacement rates" and are expressed as the ratio of pension income to earnings just before retirement. Replacement rates are already part of the existing framework of the current UK pension system. They are also used both nationally and internationally to compare retirement outcomes between different pension systems and between different population groups within them.[10]

Replacement rates alone are not sufficient to measure adequacy at retirement, as they do not incorporate a floor below which an individual's retirement income is considered insufficient to meet their basic needs.[11] For this reason, replacement rates are best used to analyse income maintenance rather than minimum income standards. Levels are typically measured using a relative income target, set as a proportion of median earnings.

- **Fixed income targets** are designed to specify an income level, net of tax, that represents the expected cost of living under a range of different living standard scenarios in retirement, based on what a range of common goods and services would cost. The framework will use the Pension & Lifetime Savings Association's (PLSA) Retirement Living Standards (RLS) targets (Figure 1). RLS targets can help to define the level at which people would need to save into their pension as a proportion of their existing income in order to achieve a minimum, moderate or comfortable standard of living in later life. Most people will be entitled to the State Pension which, along with automatic enrolment savings, will get most people to the minimum income standard. People who do not own their homes will face living costs above these targets. The RLS are derived from the Minimum Income Standards (MIS). MIS are a fixed income target developed by the Joseph Rowntree Foundation to reflect what the public thinks is an acceptable minimum income needed for a basic standard of living, based on a basket of goods and services. The PLSA minimum is set at the MIS level.[12]

At present, savers are automatically enrolled into workplace pensions at a default rate of 8% contributions. However, this is level is widely seen as being too low for most people to feel that a sense of adequacy has been achieved in later life. More realistic target contribution rates needed to reach moderate or comfortable levels of retirement are estimated to be in the region of 12%-15%.

[2] Gardiner, L. (Resolution Foundation) (2019)
[3] JRF (2021)
[4] Barr, N. & Diamond, P. (2008)
[5] Tinbergen, J. (1954), Holzmann, R., Hinz, R. P., & Dorfman, M. (World Bank) (2008)
[6] European Commission (2021); Davis, A. et al (2021)
[7] DWP (2019)
[8] Hurman et al (PPI) (2021)
[9] Hurman et al (PPI) (2021)
[10] OECD (2019)
[11] Chybalski, F. & Marcinkiewicz, E. (2015)
[12] PLSA (2021a)

Figure 1: PLSA Retirement Living Standard Targets

PLSA Retirement Living Standard	Single	Couple
Minimum (MIS) Covers all your needs with some leftovers for fun	**£10,900** London: £13,200	**£16,700** London: £21,100
Moderate More financial security and flexibility	**£20,800** London: £24,500	**£30,600** London: £36,200
Comfortable More financial freedom and some luxuries	**£33,600** London: £36,700	**£49,700** London: £51,500

> **"The Pensions Commission used an earnings replacement approach as their basis for assessing adequacy. In their first report, they concluded that having considered evidence from international comparisons, time trends in replacement rates, analysis of spending patterns in retirement and actual replacement rates at the time, there could be no clear definition of pension adequacy."**
>
> *Hurman et al (2021) p. 14*

There is a pressing need for industry, employers and Government to generate agreement on what targets should be used to set the boundaries of pension adequacy given the various economic, political and societal pressures involved.[13]

The absence of a consensus about adequacy measures, and by association the absence of clear contribution targets which can be used to help people plan their retirement, present a significant challenge in consistently and reliably projecting adequacy in the pension system.

Making personal adequacy assessments are particularly difficult in the DC system. Unlike the DB system, DC schemes require individuals to understand complex calculations and projections which underlie the level of contributions needed to accrue capital from which a defined and sustainable level of income in retirement can be generated.

Rather than adopting one adequacy measure, however, the framework will measure adequacy against various recognised levels of poverty protection and income maintenance. These include a combination of both fixed income targets (MIS and PLSA RLS), proportional income targets (Pensions Commission replacement rates) and relative income targets (the poverty line). However, it also aims to support discussions towards the development and adoption of consensus targets in the future

Measuring poverty

The MIS for an individual pensioner is £10,900 per annum, and £16,700 for a couple. The value of the nSP in 2021-22 will be slightly below this level, at £9,339.20 for an individual with full entitlements.[14] The most common measure of relative poverty in the UK, however, is set at 60 % of median income.

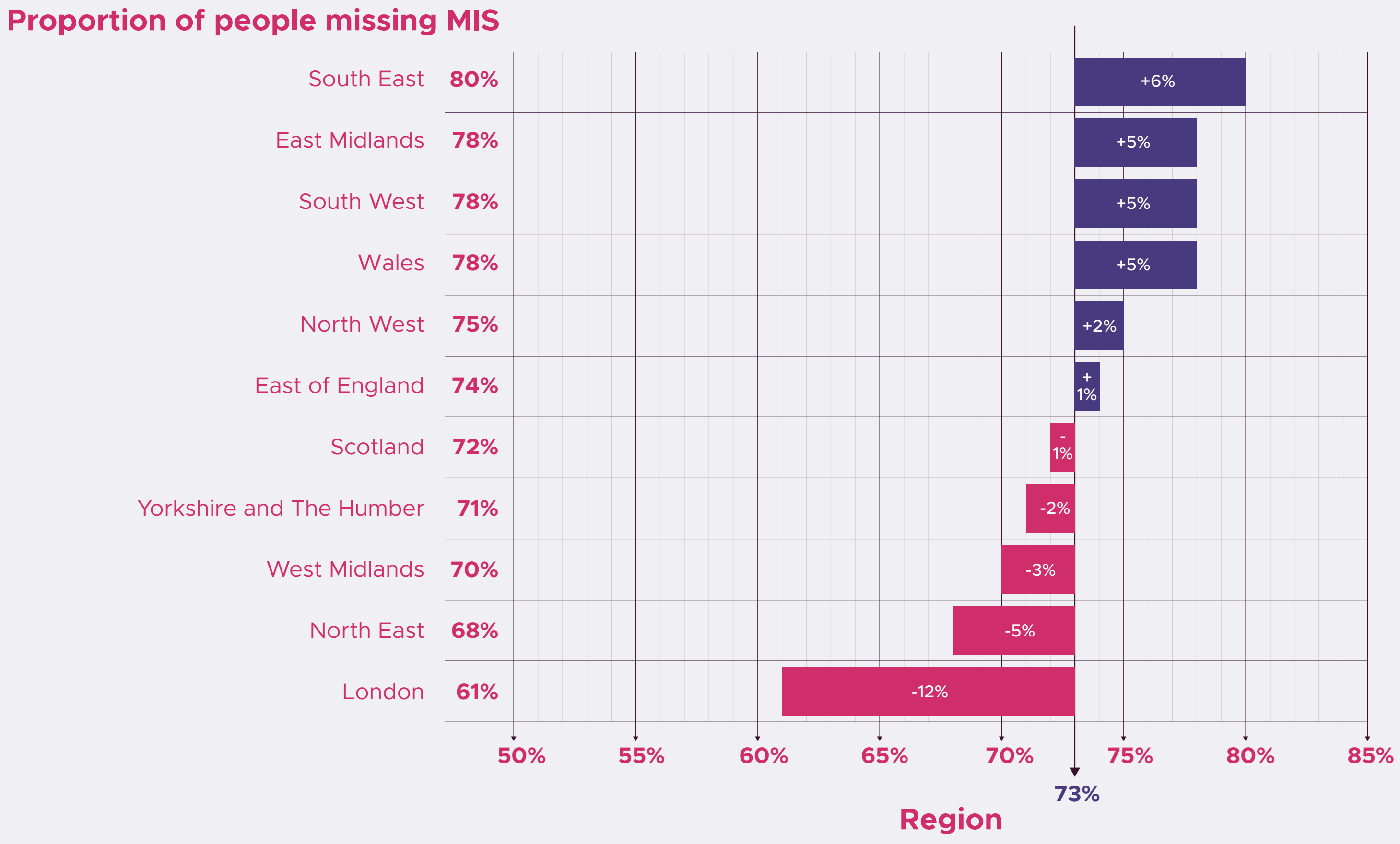
In 2018/19, the value of the MIS rose above the poverty line for the first time to 69% of median income for a single pensioner and 63% for a couple, having increased by 10 percentage points since 2008/9.[15] This suggests that the MIS is rising faster than earnings and could potentially erode future adequacy by outpacing the uprating of the nSP via the triple lock in years to come.

For individuals aged between 50 and 65 in 2016/18, the likelihood of achieving MIS compared to the population average differs significantly by region. Whilst those in the South East were most likely to achieve MIS, people in London were at greatest risk of having insufficient income, followed by those across the North East, West Midlands, Yorkshire and Humber, Scotland and East of England (Figure 1).

London households are less likely to meet the JRF Minimum Income Standard than those in other households

Proportion of population aged 50 to SPa in 2016/18 on track to reach JRF MIS (AHC) by region, GB relative to the GB average (73%)

Figure 1: PLSA Retirement Living Standard Targets



[13] Hurman et al (PPI) (2021)
[14] Davis, A. et al (2021)
[15] Davis, A. et al (2021)

The relationship between replacement rates and adequacy is a key part of the existing framework of the current UK pension system. DB pensions embed the concept of a guaranteed income replacement rate in their design, along with the ability to commute part of the benefit to a cash lump sum (which can currently be taken free of income tax up to 25%). Replacement rates are also used to set the upper limit for adequacy by the State, beyond which the favoured tax status of pensions is reduced.

The proportion of people likely to achieve the replacement rate relative to their income group, using both State and private pension income, decreases as people earn more. Almost all people in the lowest 40% of earners are likely to meet their target during retirement, mostly through the State pension and other benefits available to them. This compares to less than half of people in the top 40% of earners unless they draw upon additional capital (including the 25% tax free lump sum) and housing equity *Figure 3*[16]

Measuring income maintenance

The Framework will compare adequacy outcomes using both the RLS and replacement rates agreed by the Pensions Commission in 2004 (Figure 2). The embedded discount to pre-retirement earnings reflects the logic that mortgages are likely to be paid off by retirement and costs associated with employment such as transport will be less substantive.

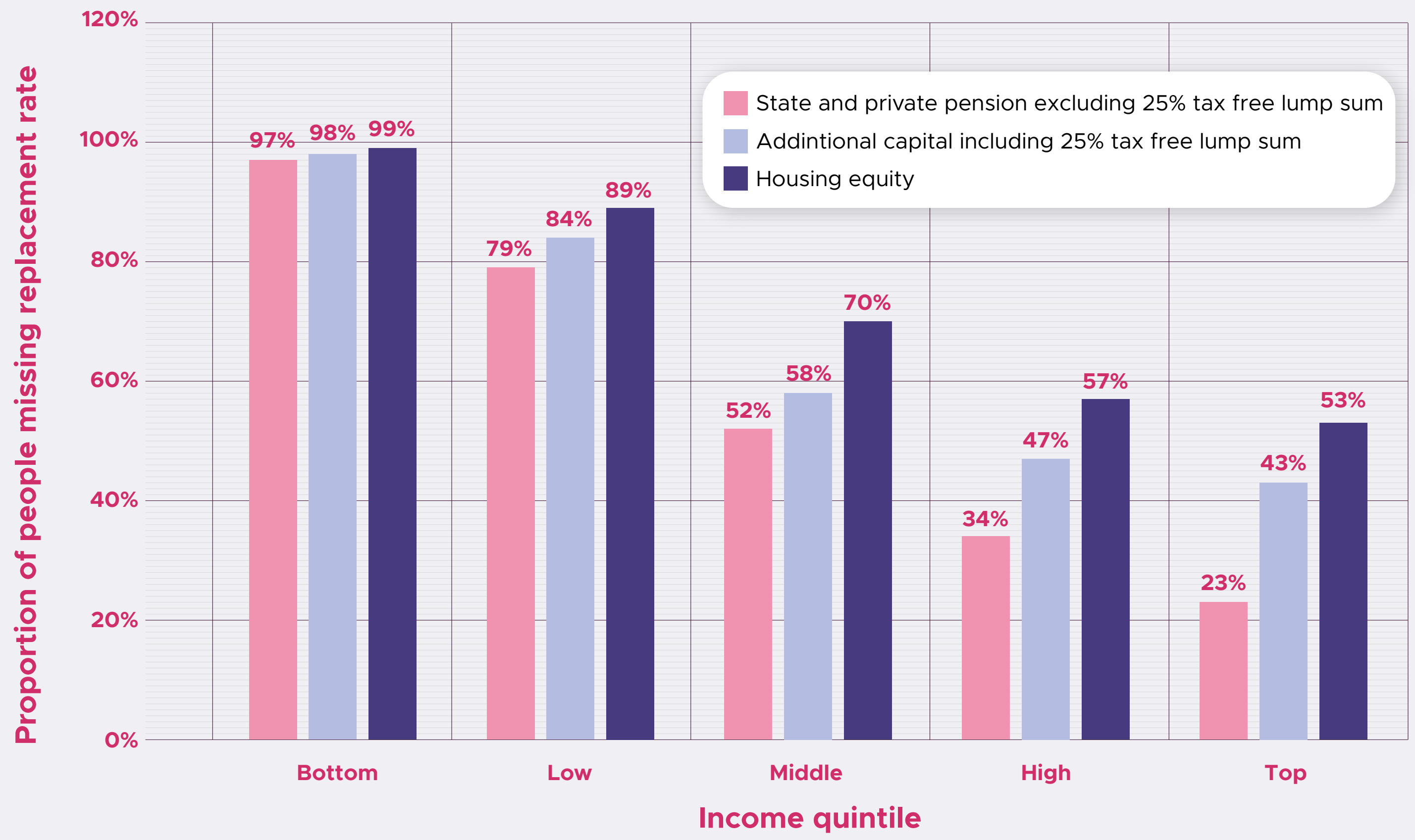
Figure 2: Pensions Commission target replacement rates by income band

Original 2004 income band	Income band in 2021 earnings terms	Target replacement rate
Up to £9,500	<£14,100	80%
£9,500-£17,500	£14,100 to £25,999	70%
£25,000-£40,000	£26,000 to £37,199	67%
£25,000-£40,000	£37,200 to £59,599	60%
Over £40,000	£59,600 or more	50%

Nearly all those in the lowest income quintile are likely to meet the Pensions Commission replacement rate during retirement using State and private pension income

Proportion of people in different income quintiles who are on track to achieve their Pensions Commission replacement rate during retirement, 2016/18, GB

Figure 3[16]



[16] PPI Modelling

The next section of this paper briefly reviews how the six sub-objective groups and the indicators within them will contribute to overall analysis of adequacy in the pension system.

A1: Labour market dynamics

This group of indicators examines how differences in adequacy among current pensioners may be derived from labour market behaviours and earnings, and how changes could lead to differences in adequacy outcomes in the future.

The two key components of this sub-objective are employment rates and earnings. Despite not being directly part of the pension system, they are critical part to analysis on account of the UK's traditional, employment-based and earnings-related pensions model. The model relies on uninterrupted careers and linear wage growth for adequate outcomes to be produced, meaning that where inequalities in the labour market exist, inequalities in retirement savings will follow. This leaves millions of people facing financial risk in later life.[17] The gender pensions gap, for example, is around twice as big as the gender pay gap, reflecting the cumulative impact of differences in working patterns between men and women.[18]

In similar trends, longer working lives, digitalisation and globalisation offer opportunities for growth and development, but they also increase the number of people in self-employed and non-standard work, or unstable working conditions. On average, these workers earn less than traditional employees on an hourly and yearly basis, with women, BAME people and other at-risk groups most vulnerable.[19] Increases observed in employment among older age groups for over ten years were reversed during the pandemic. They will also be a key focus of the framework as pension ages rise and DB retirement income declines.[20] At older age groups, women are more likely on average to be out of work before SPa than men and are also at higher risk of poverty.

Employment indicators can further aid analysis of the extent to which the pension system incentivises or disincentivises labour market behaviours; whilst affordability of pension saving is directly linked to earnings. Earnings also underpin the fabric of the UK pension system and welfare state through indexation and benchmarking mechanisms such as the triple lock, automatic enrolment eligibility and means-tested benefits. A heavier lower tail in the earnings distribution curve, as is seen in the UK, implies increased adequacy risk and need for poverty relief.[21]

A1.1 Employment Rates

Changing patterns in the proportion of people from different social groups in standard and non-standard types of employment; impact of incentives for early retirement derived from replacement rates and changes in net pension wealth achieved from working additional years

A1.2 Income and Earnings

Average earnings, real earnings over time, income distribution and inequality among population groups

A2: State Support

This group of indicators considers the role of the State Pension and means-tested benefits in providing a minimum level of income, and protection against poverty respectively.

Although State Support only comprises one sub-objective group for the framework, it is particularly relevant to adequacy considering the significant proportion of people for whom State support is the primary source of income in later life. Around half of all retirees in 2020 were dependent upon State support for 40% of their retirement income or more, with 20% of the population dependent upon it for 80% of their income in later life.[22] The value of the State Pension compared to other macroeconomic indicators such as earnings and inflation is fundamental in determining the standard of living that many are able to achieve.

The value of the State Pension and means-tested benefits in relation to other measures of adequacy including the MIS and RLS targets will be considered over time, as will other economic benchmarks and uprating mechanisms including earnings and inflation. Of interest will be the extent to which self-stabilisation mechanisms such as indexation and the triple lock can help to minimise the need for decisions and interventions in the State Pension system, or the extent to which the rules themselves are subject to changing circumstances.[23]

Measures relating to eligibility to, and take up of, means-tested benefits in retirement will seek to understand the extent to which people are protected from poverty in later life. The take up of means-tested benefits is an issue of current concern, as a significant minority of older people may be entitled to income which affords them greater levels of adequacy, but do not claim the means-tested benefits.[24] The value of these payments will also be considered relative to other indicators, and in particular to working age benefits, between which a significant gap has opened in recent years. Finally, State support is particularly sensitive to demographic change, meaning that changes in the proportions of people contributing to, and eligible for the State Pension, will become increasingly evident as population ageing impacts the system over time.

A2.1 State Pension accruals

Changes in the proportions of people contributing to and eligible for State Pension and means-tested benefits

A2.2 State Pension income

Value of State Pension income in relation to adequacy targets and macroeconomic indicators

A2.3 Means-tested benefits

Eligibility to, and take up of, means-tested benefits in retirement; value of means-tested benefits to working age benefits and macroeconomic indicators

A3: Private Pension Saving

This group of indicators will consider how changes in participation rates, contribution rates and investment returns across public sector, DB and DC pensions, along with the support of tax relief, are contributing to overall adequacy outcomes in the pension system.

Private pension wealth is growing as higher rates of DC participation and contributions produce growing aggregate and median pot sizes, and people approaching or living through retirement today continue to receive DB benefits. This section of the Framework will track workplace pension participation rates, which impact more highly on adequacy outcomes than other forms of saving because they allow individuals to access the benefits of both tax relief and employer contributions. It includes public sector DB, private sector DB and DC pensions.

Indicators will also examine changes to individual and employer contribution levels across all pension types, which, in DC, have clustered around minimum since the introduction of automatic enrolment.[25] As well as the extent to which adequacy may be impacted by changes in future contribution rates, indicators will examine how policies designed to increase them could impact affordability and prompt changes in savings behaviour, such as opting out.

Tax relief and investment returns will be included to track how they can help grow the value of pension savings and preserve long-term adequacy. Of particular relevance will be the performance and governance of default funds, in which more than 90% people enrolled in master trust / multi-employer schemes are invested.[26] Many of these funds remained resilient to the extreme market volatility brought about by the pandemic thanks to long-term investment horizons and diversified portfolios.

[17] Gould, S. (2021)
[18] Arza, C. (UN) (2015)
[19] OECD (2019)
[20] Crawford & Karjalainen (IFS) (2020)
[21] Syed et al (ONS) (2016)
[22] DWP (2021)
[23] Borsh-Supan (2014)
[24] Price, D. (2008)

A3.1 and A3.2: DB and DC Coverage

The proportion of people saving actively into DB (including public sector) and DC pensions. Indicators are separated in order to avoid conflating results through averages. Opt-out rates, proportions of workers not eligible for workplace pension saving.

A3.3 and A3.4: DB and DC Contributions

Average individual and employer contribution rates by employment type, sector and income group, rates of take up of additional employer contributions where data is available. Gaps in total net remuneration for workers with and without pensions. Expected level of contributions required to meet adequacy targets by income group and employment type.

A3.5 Investments and Assets

Investment returns, portfolio diversification, total assets, proportion of savers invested in default funds. Charges will be covered under sustainability, value for money in fairness.

A3.6 Tax Relief

Value to savings, distribution by income band, interactions with employment,

A4: Non-pension savings and assets

Non-pension wealth is a major element of financial adequacy in retirement. Although it may be found in many different forms, this group of indicators will focus on three key sources of non-pension wealth: non-pension savings, home ownership and inheritance.

Having retirement savings outside the pension system can help people to top up other sources of income to an adequate level and achieve a better standard of living, or to become more resilient to financial shocks and short-term spikes in need. As well as levels of saving, the framework will briefly consider how people hold non-pension savings, such as bank accounts, Individual Savings Accounts (ISAs) or investments, in order to understand the extent to which their value could be at risk of erosion from inflation. This is particularly relevant to people who may choose not to spend or invest the tax-free lump sum they take from their pension at or ahead of retirement.

Owning a home rather than renting in retirement will also impact adequacy, as it reduces housing costs and the income needed to maintain living standards in later life. It can also allow people to release income to top up their pension, or equity to manage a change in circumstances such as the onset of health problems, widowhood or divorce. Despite rising rates of home ownership among the older population, home ownership and housing wealth are falling among younger age groups, meaning that without a significant reversal in trends, future pensioners could face higher living costs in retirement and be less likely to be able to access housing equity in times of need than those in retirement today.[27]

Inheriting wealth, particularly housing wealth, from families could however help young people to top up retirement income or fund a lump-sum purchase. Trends suggest that inheritances are likely to be larger for younger generations when compared with lifetime incomes than for their predecessors, thereby indicating a growing impact on adequacy outcomes.[28] Whilst in some cases the expectation of receiving an inheritance may affect the amount people choose to save today, leaving an inheritance is also a factor in decisions people make around how to manage their pensions and spend their savings. Inherited wealth can also increase inequalities between those with richer and poorer parents.

A4.1 Non-pension savings

Levels of non-pension savings including ISAs, cash and liquid investments, including wealth distribution by age and income group. Savings as a proportion of overall wealth.

A4.2 Home ownership

Trends in home ownership and housing wealth, equity release and the proportion of people with rental or mortgage costs in later life.

A4.3 Inheritance

Average inherited wealth as a proportion of lifetime income, inheritable wealth, distribution and interactions with pension saving and decisions

A5: Retirement Living Costs

This group of indicators covers elements that together make up some of the main expenses people are likely to face in retirement. It includes household spending, housing costs in retirement, household debt and the cost of social care.

The way in which people spend their pension savings is evolving due to increases in longevity and the length of retirements, the amount of savings people reach retirement with, and changes in the variety and levels of consumption at different stages in later life. These indicators will examine how adequacy could be impacted by changes in what people need to pay for in later life, and how their costs are distributed over time.

Consumption patterns vary between households. For some, they take a traditional “U” shaped form of higher costs in early and late retirement with reduced spending in the middle as participation in leisure activities declines; for others, it may peak and trough over time, gradually decline or remain even. The impact of consumption patterns on adequacy is determined by the demands that people have on their savings and the spending decisions they make - patterns in which will be examined by the Framework. For example, future pensioners are more likely to be in debt in retirement than older generations and may also be more likely to provide gifts or ongoing financial support to family members.[29] Those who reach retirement with rent or mortgage costs to pay will also have significantly less disposable income than owner-occupying pensioners, although this will depend upon levels of housing benefit.

Social care has implications for adequacy among those paying for care, and the growing number of people whose working patterns are affected by the need to provide care for family members themselves, as caring at older ages becomes more common.[30] Despite recent developments in social care policy, there is still uncertainty over the future cost of care, and reforms aimed at reducing its cost are unlikely to be felt for a number of years. The cost of social care to the state is examined in indicator S1.3.

A5.1 Household Spending

Household expenditure, patterns in consumption as a proportion of household income, gifts

A5.2 Housing Costs in Retirement

Proportion of people renting or paying off mortgages in retirement, rent and mortgage costs as a proportion of retirement income, levels and impact of housing benefit on living costs

A5.3 Household Debt

Proportion of people reaching retirement with debt, levels and types of household debt

A5.4 Social Care Costs

Estimated average cost of social care to self-funders, proportion of people facing different levels of care costs (none to “catastrophic”), impact of means-tested threshold or cost caps

[25] ONS (2018b)
[26] Wilkinson et al (PPI) (2020)
[27] Ministry of Housing, Communities & Local Government (2020)
[28] Bourquin, P., Joyce, R. & Sturrock, D. (2021)
[29] Silcock et al, PPI (2018)
[30] Silcock et al, PPI (2018)

A6: Retirement Outcomes

This sub-objective covers some of the most important Framework indicators in order to demonstrate the overall impact of system components on the adequacy of outcomes that people have in later life. It includes accessing pensions, the retirement equation, poverty and living standards in retirement.

One of the biggest differences between current and future pensioners will be the way in which they access and use their pension savings. The impacts of pension freedoms, announced in 2015 to release people from the requirement to purchase an annuity, and their implications for adequacy will be a focus of the Framework. Pension freedoms are producing many benefits. As yet, however, little is known about how people will cope with managing drawdown accounts as they age, and in particular how they will manage overwhelming decisions needed to mitigate against longevity, market and inflation risk. These shifts will be reviewed in the Framework, along with how uncertainties over the role of annuities, interaction between pension freedoms and the benefit system, and ease of taking tax free cash might affect adequacy prospects for growing numbers of pensioners retiring with DC pensions or transferring in from the DB system.[31]

Overall adequacy will be measured both by levels of poverty, or minimum income standards, and by the PLSA RLS. Outcomes will be examined from a number of perspectives including gender, ethnicity, income, socioeconomic and age groups. In respect of age groups, particular emphasis will be placed on understanding what differences in the age at which people leave the labour market, coupled with differences in levels of means-tested benefits, could mean for levels of adequacy among people before and after SPa.

Finally, in order to develop a picture of the overall direction of adequacy in the UK pension system, the Framework will bring together data from across a series of indicators to show how the overall costs associated with retirement are changing in relation to overall income over time. This is known as the 'Retirement Equation'.

[31] Webb, S. (2021)

A6.1 Pensions Access

Annuity sales, DB transfers, rates of full DC withdrawals, decumulation journeys and drawdown products, interaction with benefits system

A6.2 The Retirement Equation

Average retirement costs (by group and need) v. average retirement income over time

A6.3 Poverty in Retirement

Poverty rates and MIS by age, gender, ethnicity, region, and marital status (single/couple)

A6.4 Living Standards in Retirement

Proportion of people meeting and expected to meet retirement income targets by decile and population groups

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