LIVING PENSION

METHODOLOGY

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The Living Pension standard builds on the work of the real Living Wage by providing stability and security for workers now and in the future. It is a voluntary savings target for employers who want to help their employees build up a pension pot that will provide enough income to meet basic every day needs in retirement.

This document summarises the key objectives of this standard, the assumptions and testing that went into creating it, and how it will be monitored and reviewed in future years.

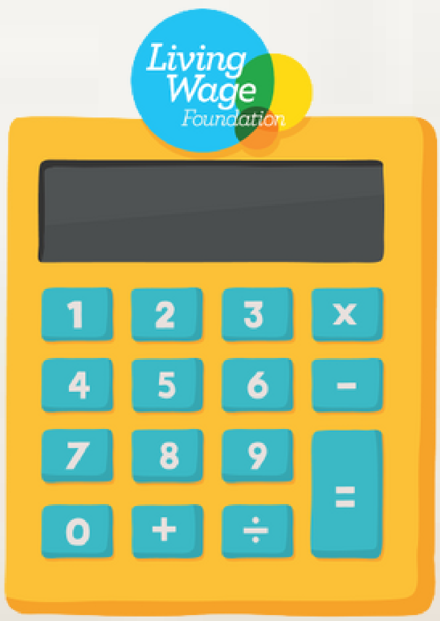
Objectives

In setting out to create this standard, there were three key objectives in approach:

- To agree a target that will set as many workers as possible on track for a retirement income that will meet basic everyday needs.
- Enable as many employers as possible to be able to meet a Living Pension for all workers, with those on lower incomes prioritised.
- For a target to be easy to understand and communicate to a mainstream audience, to engage employers and the wider public in the concept of a Living Pension.

Background and Context

As with the real Living Wage, the Living Pension standard was independently calculated, with researchers assessing what sized pension pot would be needed to provide an acceptable standard of living in retirement, and then working out how much pension saving would be sufficient to achieve that, assuming someone saved throughout a typical working life. Working patterns vary considerably between individuals, and retirement needs will also vary, depending on marital status and whether people own their own homes.



Like with the Living Wage, the Living Pension calculation is made for a range of ages, relationship statuses and housing tenures (including private and social renting), and the final calculation represents an average. The original report estimated that a typical pension pot would need to be around £70,000 in 2020-21 prices, and that this, plus the state pension, should provide enough for someone to reach the “minimum income standards” in retirement. For a couple who are renting in the social housing sector, this would be around £20,500 a year in 2020-21 prices.

This work was completed by the Resolution Foundation. Full details can be found in their report '[Building a Living Pension]' (published January 2021) and forms the basis of the Living Pension target. Below are the key assumptions used to calculate the savings pot needed:

- It is to provide a pension in addition to a full state pension (currently requiring 35 years of qualifying National Insurance contributions)
- Benefits taken at state pension age (currently 66 and rising to 68 by 2044)
- Life expectancy based on ONS cohorts (87 years at the time)
- Pension would be taken by drawdown (where part of the money is taken out each year and the remaining pension pot continues to be invested), at least in early years of retirement

Working back from this average savings pot, the amount that would need to be saved in order to meet this was reached using a range of assumptions in terms of investments, returns and working patterns:

- It allowed for changing work patterns over the lifecycle
- Assumed a nominal financial return of 4.9% on private pension pots in accrual
- Assumed an annual management fee of 0.5% on the total pot throughout
- That people have little to no existing savings already

Given the final assumption that people are starting from a basis of little to no savings, the overall savings target was different across the different age cohorts. The older people are, the less time they have to save to the same level as younger people.

These results were reduced to three age cohorts (25, 35 and 45) and an average of the three was taken. These are expressed both as a percentage of a full time (37.5 hour week) Living Wage salary, and as an equivalent annual cash amount (applicable as at January 2021).

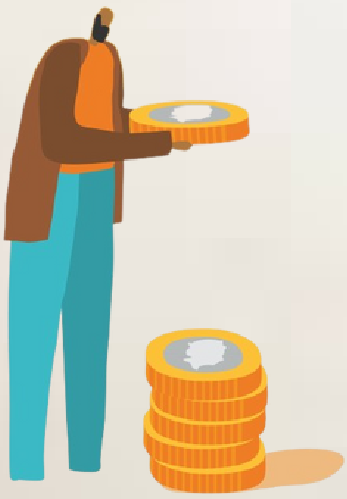
Table One: Resolution Foundation Living Pension Targets

Current Age of Cohort	Contribution % Rate	Contribution Cash Rate
25	11.2%	£2,100
35	15.1%	£2,800
45	21.2%	£3,900
Average	16.1%	£3,000

Notes: Cash contribution estimates have been rounded to the nearest £100 and are assumed to apply across all earnings. Source: Resolution Foundation analysis using the RF Private Pension accrual model.

Employer Testing

Initial consultation with almost 100 employers focused on the average 'all age' level of 16.1% (or £3,000 per year). There was strong support for the concept of a Living Pension, with most respondents saying they might or would be interested in a Living Pension standard for their employees. Further to this, 29% said they could potentially look to implement a Living Pension standard as outlined in the initial research above over a phased period of three years.



That said, even employers committed to the concept expressed several concerns:

16.1% was an unaffordable increase on the existing 8% minimum

Using a **% target** would disproportionately benefit the higher paid relative to the employer cost, and that a cash underpin would be essential

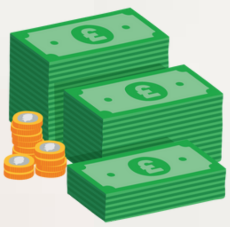
Allowing option to **opt down** or have a lower contribution was desirable, particularly for employees in earlier years who may have other savings priorities

The above findings were further reinforced by the pilot, particularly in respect of employer contributions which would have to rise in some cases from 3% to 11%. It was also important to keep the employee maximum at 5% to align with auto-enrolment minimums. The Living Wage calculation has also been calculated net of a 5% employee pension contribution since 2020, in line with auto-enrolment policy.

It was therefore concluded that the lowest age target of 11.2% should be adopted, but with a slight increase to 12% for simplicity, consistency with other calls from pensions policy experts, and to allow a buffer of 0.8% against the 'all career' benchmark. Research by the Resolution Foundation in July 2022 also showed that a huge number (80%) of people saving into Defined Contribution pensions are not saving even at that lower level, so this will make an impact if more widely adopted.

Earning Basis

The Living Pension savings target is calculated using a full time Living Wage salary and the 12% is applied to all earnings, without the deduction of the lower earnings limit. When it comes to practical application, employers will be able to use a pensionable pay of either basic pay, total earnings, OR total earnings up to the upper earnings limit (£50,270), which we are calling 'Qualifying Earnings Plus'. All of these definitions will usually result in an increase on auto-enrolment minimums which use 'Qualifying Earnings' (earnings between £6,240 and £50,270, in effect reducing pensionable pay by £6,240 in 2022/23).



As well as enabling the standard to be met using a percentage, we also created a cash equivalent as outlined below, to enable employers to meet a minimum level for low to middle earners whilst reducing impact on their overall cost base. This cash target still has the potential to make a real impact as in reality, to reach the same cash level using auto-enrolment minimums, earnings would have to be £38,000 or more (see table two).

Table Two: Living Pension & Auto-Enrolment Comparison

Salary	£21,255	£38,000
Qualifying Earnings	£15,015	£31,760
Auto-Enrolment (QE)	8%	8%
	£1,201.20	£2,540.80
Living Pension (QE Plus)	12%	12%
	£2,550.60	£4,560.00

In summary, the Living Pension target was then set out for the first year (2023/4) as both a cash and percentage:

Employers must ensure access to an annual contribution of **£2,550*** (of which at least **£1,488** comes from the employer)

This equates to **12%** of a full time Living Wage salary** (of which at least **7%** comes from the employer)

* the cash target will be uprated in line with the real Living Wage every year

** based on a Living Wage salary for 37.5 hour week

Where employers currently operate the auto-enrolment minimums, they will be able to keep the earnings basis as qualifying earnings for up to three years, but will have to immediately increase contributions by 4% (from 3% to 7%), or by the cash equivalent.

Flexibility within Structures

In addition to the testing of the target itself, we consulted and piloted the approach to implementation. We found that around one third of employers offered the auto-enrolment minimums, one third offered matching structures (usually capped at 10% from the employer), and the remaining third offered more favourable matching (starting at plus 2%, and going up to plus 10%, with many using a 2 for 1 approach up to a maximum level).

In most instances, there was an option for employees to get 12% (or more) total contribution by paying 5% or less themselves. For those that did not, they needed to adjust their structures to allow for this, or for the cash alternative. However, in all but one case, the default level on which employees were auto-enrolled was **lower** than 12%.

Whilst many employers offer very generous structures and the Living Pension level was **available**, we wanted to ensure as many employees as possible were accessing this level. By setting the future default for auto-enrolment at Living Pension level, inertia would mean more employees would stay there, whilst allowing the option to 'opt down' for those who want to pay less.

	Employee	Employer	Total
Example Default Levels	0%	10%	10%
	2%	8%	10%
	4%	4%	8%
	5%	5%	10%
	3%	5%	8%
Example Levels at LP (available by opting up)	2%	12%	14%
	3%	9%	12%
	5%	10%	15%
	6%	6%	12%
	5%	7%	12%

However, we stopped short of requiring that existing members accessing a lower contribution than 12% be moved upwards for two reasons:

- Employers would be required to gain consent and/or consult, adding an extra burden on the standard that would be prohibative
- In most instances, there would also be a requirement to increase employee contributions, which we did not feel was appropriate during a period of high inflation and cost of living increases

Instead, we have made it a requirement for new employees to be defaulted at a Living Pension level, and for existing employees to receive communications annually reminding them of the option to move up to a higher contribution level. Employers will also need to set targets for the proportion of employees in their workforce taking full advantage of these levels.

Ongoing Monitoring & Review

After the Living Pension standard is launched in March 2023, we will work with the Resolution Foundation to review the standard at appropriate intervals to ensure it remains fit for purpose.

We have agreed with the Resolution Foundation that this will be done every two years, alternating between a 'light touch' review and a full review.

The first review will be light touch and will be completed by Resolution Foundation in the second half of 2023, ahead of the Living Pension launch anniversary. This review will reflect changes in key assumptions from external sources that are plugged into the calculations, as follows:

- key economic indicators (including inflation, earnings growth)
- key financial factors (such as rates of return on pension fund investments and characteristic of draw-down products)
- the level of income pensioners will need in retirement (from Centre for Research in Social Policy at Loughborough University)
- current and likely future policy on auto-enrolment, pension credit and state Pension

Given the fact that the Living Pension cash level has been aligned to a percentage of the Living Wage, and with a 0.8% buffer as previously outlined, it is not anticipated that there will be a significant change to the level in the short to medium term.

This summary was designed to provide an outline of the key factors and decisions that went into the design of the Living Pension target. This work was supported by the Living Pension Steering Group with experts across the pensions industry as well as unions and employers in the Living Wage network and will continue to be reviewed as part of wider ongoing governance of the standard and the impact it is making to low- and middle-income earners.

Living Wage Foundation
Citizens UK Head Office,
Jacquard Point 1 and 3,
Tapestry Way,
London, E1 2FJ
020 7043 9882
www.livingwage.org.uk/living-pension
@LivingWageUK
Citizens UK Charity no. 1107264

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