It's time to shed some light on retirement targets

Steven Leigh of Aon explains how schemes can help members stay on track to realising their retirement goals

Imagine standing in a dark room, with a bow and arrow. Somewhere in the room, there is a target, but you have no idea which direction it is in or how far away it is from you.

What would improve your chances: being handed more arrows in the dark – or turning the lights on so that you can see where the target is?

Having more arrows might improve your prospects of hitting the target by chance; knowing where to aim makes it far more likely that you will be able to hit the mark.

However, many defined contribution (DC) schemes still encourage members to simply shoot more arrows into the dark. By increasing their choices of contribution rates or investments, they could instead put the lights on to help them set and focus on realistic retirement targets.

Keeping members in the dark about how much they need to save has negative consequences both for employees and employers.

Simply telling people they should pay more into their pension without explaining how it will benefit them in retirement risks piling extra pressure onto employees who may already be struggling with day-to-day financial worries. At worst, it could discourage them from saving into a pension at all. And, they will still have the worry of not knowing when – or if – they can afford to stop work.

> 'Many schemes still encourage members to simply shoot more arrows into the dark'

Businesses also need to be able to predict when employees will retire. Without that insight, it is difficult to plan future workforce needs or to create realistic succession plans. Employers risk losing key skills that help to drive the business or being compelled to retain disengaged workers who cannot afford to retire.

Despite the risk to both savers and businesses, Aon's *2020 UK Defined Contribution Survey* showed that 65% of those running DC schemes do not know the expected outcome for a typical member of their scheme. However, our 2018 DC member research report, *Living the Dream?*, found that two-thirds of employees rely on their employer to set the right contribution rate for them.

Aon found that the average default contribution rates in DC schemes have increased, at around 10%.

This is made up of 4% coming from the employee and 6% from the employer. The findings also showed that contribution options are less varied than in the past, with closer clustering around a median figure. While this is likely to have been influenced by auto-enrolment minimum contributions, employers may also be benchmarking their schemes against others rather than considering the resultant retirement outcomes for employees.

What does a '10% contribution rate' really mean for a pension saver?

For high-earning employees aspiring to maintain the same (or a better) standard of living in retirement, contributions of 10% could be insufficient. But for low earners expecting a higher proportion of their retirement income to be met by the state pension, it might be more than enough. It all depends on the target level an individual is aiming for.

The Pensions and Lifetime Savings Association/Loughborough University Retirement Living Standards were launched in October 2019[1]. These set out the cost of maintaining a minimum, moderate or comfortable lifestyle in retirement, based on the cost of a basket of goods. For example, someone with a minimum standard of living in retirement might expect to be able to afford one holiday a year in the UK – whereas those in the 'comfortable' bracket could set their sights on more time abroad in the sun.

WHAT CAN SCHEMES DO?

Using the Retirement Living Standards as a rule of thumb can be an excellent starting point to help scheme members understand what they need to save over the course of their working life. Understanding how many employees are on track to achieve the different target levels can also help employers to plan the future shape of their workforce.

Combining targets with saving rules of thumb and self-help tools, such as planning apps and calculators, can ensure employees stay focused on their retirement goals throughout their working lives.

Equipped with a better understanding of what they need to achieve, members can make informed choices on pension contributions or other actions such as choosing to retire later.

By shifting members' focus away from thinking about contribution rates in isolation, and towards targeting a standard of living in retirement, pension saving quickly starts to feel more tangible. Trustees and employers will need to ensure that their scheme design, communication messages and at-retirement solutions are all focused on helping members understand what their goals are – and how they can hit them.

To request a copy of the full findings from Aon's 2020 DC Survey, visit bit.ly/AonDCSurvey2020

Steven Leigh
Senior consultant, Aon

1 www.retirementlivingstandards.org.uk