Institute and Faculty of Actuaries

Policy & Public Affairs

Savings goals for retirement series

Paper 2: Moving between goals

In 2019, the Institute and Faculty of Actuaries (IFoA) launched its ‘Savings goals for retirement’, a set of ‘rules of thumb’ intended to indicate how much people might need to save over a full working life in order to achieve a certain standard of living in retirement[1]. This was based on the Pensions and Lifetime Savings Association (PLSA)’s retirement living standards, which set out the expenditure needed to achieve a ‘Minimum’, ‘Moderate’, or ‘Comfortable’ lifestyle in retirement[2].

The Savings Goals

1. Coupled with the State Pension, **saving at the current 8% minimum Automatic Enrolment contribution level** should be broadly enough to provide a **‘Minimum’** level of retirement income.

2. For an individual to be likely to achieve a **‘Moderate’** level of retirement income, their total savings need to be **around one quarter (26%)** of average full-time earnings.

3. If an individual or couple is aiming to achieve a **‘Comfortable’** level of retirement income, they need to save **more than double** what they’d need to save if aiming for ‘moderate’.

In our follow-up paper, “Risks to staying on track”, we discussed the difficulties faced by savers in planning for their retirement in a Defined Contribution (DC) pension world. The high cost of pension provision results in a risk that the desired level of retirement income is unaffordable, while the investment and longevity risks savers are exposed to make the outcome very uncertain.

While the PLSA’s retirement living standards provide a very helpful framework for retirement planning purposes, inevitably they will not suit all circumstances. In particular, people will need to adopt Savings Goals that are affordable, and for many people this is likely to mean targeting a pension that, for example, sits somewhere between the ‘Minimum’ and ‘Moderate’ – this is where our next rule of thumb can assist.

Tailored Savings Goals

This rule of thumb is used to calculate a monthly savings goal that targets a more tailored living standard.

Our original ‘Moderate’ Savings Goal - £799 per month (£9,588 per year) – targets a DC pension of £13,400 per year which, when added to a full State pension, provides a ‘Moderate’ retirement income.

£9,588 is approximately £13,400 ÷ 1.4, leading us to the following rule of thumb:

Savings Goal = Target Pension ÷ 1.4

[1] Institute and Faculty of Actuaries, Savings goals for retirement, October 2019 https://www.actuaries.org.uk/news-and-insights/public-affairs-and-policy/ageing-population/adequacy /savings-goals-retirement

[2] Pensions and Lifetime Savings Association, Retirement Living Standards https://www.retirementlivingstandards.org.uk/

We have explored below how this might help someone who wishes to set the Savings Goal to target a pension between the 'Minimum' and 'Moderate' living standards. We have called these 'Minimum +', 'Modest', and 'Moderate –'.

Target living standard	DC pension component	Annual Savings Goal *(target pension ÷ 1.4)*	Monthly Savings Goal
Minimum	£1,445	1,032	86
Minimum +	**£4,000**	**2,857**	**238**
Modest	**£7,000**	**5,000**	**417**
Moderate –	**£10,000**	**7,143**	**595**
Moderate	£13,423	9,588	799

In practice of course, savers of different income levels will have different expectations of retirement income and ability to vary their Savings Goals. In the table below, we show for each retirement living standard an illustrative salary and the Savings Goal expressed as a percentage of that salary. Note that in each example, the target pension is equivalent to around 50% of salary once allowance is made for the State Pension.

Target living standard	Illustrative salary	Savings Goal as % of salary
Minimum	£20,500	4.2%
Minimum +	£26,000	11.0%
Modest	£32,000	15.6%
Moderate –	£38,000	18.8%
Moderate	£45,000	21.3%

In viewing the above contribution rates, it should be borne in mind that:

- The minimum contributions required by Automatic Enrolment (AE) are between 5.5% and 7.0% of earnings;
- Additional contributions might be partially funded by an employer, e.g. on a matching basis;
- There is tax relief on the individual's contributions.

Consider the example for the new 'Modest' living standard. If the employer were to match employee contributions on a 1:1 basis up to 6% of salary, the employee would need to pay about 9.6% of salary to reach the Savings Goal, which equates to £205 per month (after basic rate tax relief at 20%). **This highlights the value of employer matching contributions**, reducing the required level of employee contributions to a more affordable level.

The employee might wish to adopt a higher target living standard in the future, perhaps following a promotion. In order to achieve this the employee would need to increase their contributions in line with the relevant, higher, Savings Goal. However, as lower contributions will already have been paid in previous years, a shortfall would need to be made up over the period until retirement. **This highlights the need to begin saving and retirement planning as early as possible**, in order to have the maximum chance of reaching an adequate retirement living standard.

The calculations in this and previous papers are all based on a retirement age of 68.

Our next paper will show how rules of thumb can be used to further tailor the Savings Goals to reflect different assumed retirement ages.

Note: All calculations in this paper use assumptions consistent with those used in the Savings Goals for Retirement paper.

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