Workplace Savings

An Isio blog

Blog 20: September 2021

Will Millennials ever be able to afford to retire? The adequacy of DC contributions.

Being a Millennial working in the pensions industry, this is the question front and centre of my mind. With DC pension provision making up a significant proportion of the overall retirement income for Millennials due to the recent shift from DB, the question of how much to save has become more important than ever.

The answer depends on many different factors, including the level of income needed in retirement, the investment return achieved, and when I choose to retire.

The level of income needed in retirement

The Pensions Policy Institute estimate that workers need 60% to 66% of their pre-retirement earnings to replicate their current working-life standards in retirement[1]. In order to achieve this, they recommend employees make contributions of 16% of earnings over the course of their working lifetime – this is double the current auto-enrolment minimum contribution of 8% of earnings.

Investment return achieved on the contributions made

The size of members' DC pots will not only rely on the level of contributions made, but also the net investment returns achieved on those contributions. Following several years of strong returns, market expectations for growth are now looking lower going forward. A 1% reduction in expected return means I'd need to increase my contributions from 8% to 10% in order to achieve the same pot at retirement.

The age at which retirement income starts to be taken

I'll reach State Pension age at 68, and as much as I love my job, I would love to retire earlier. An extra 2% of contributions p.a. above the 8% auto-enrolment minimum has the same impact on my projected pot as saving for an extra 5 years! Putting aside any additional income needs over those 5 years if I was to retire early, it is clear that contributions have a significant impact on when I can retire.

So what is the magic number?

So you may be asking, is the answer 10%, 16%, or something else entirely? Only time will tell as Millennials move closer and closer to retirement. However, what all the different sources seem to agree on is that the auto-enrolment minimum of 8% of earnings is unlikely to be sufficient to provide an adequate outcome in retirement for the majority of DC savers.

Clearly the earlier members make higher contributions, the longer they have for investment returns to compound before retirement. This highlights the importance of engaging members early in the retirement saving process and helping them set retirement goals for the future.

Whilst we don't have a crystal ball to predict what the future holds, at Isio we help our clients communicate this message to members, provide market insight into trends in contribution rates and conduct analysis on various scenarios for member outcomes.

Rachel D'Agostino is a DC consultant at Isio.
rachel.dagostino@isio.com

1.270990(1) PPI Adequacy Report.indb (pensionspolicyinstitute.org.uk)