Institute and Faculty of Actuaries

Retirement Readiness

Survey Report from Australia, the United Kingdom & the United States

Key findings

Whilst all three countries reveal limited readiness for retirement the UK shows the lowest levels of preparedness compared to the US or Australia.

- Across all three countries the least prepared for retirement are:
  - females
  - young and middle ages
  - low and middle incomes
- Across all three countries retirement is no longer seen as a cliff-edge:
  - Approximately a fifth of respondents said that they never planned to retire and intended to work for their whole life
  - In the UK, over half of those who planned to retire, said that they would retire gradually
  - The dominant preparation for a potential drop in the value of retirement assets is a return to work
- Respondents on average are better prepared with respect to saving and acquiring information
- Respondents are least prepared with respect to:
  - knowing how much they will need when they retire
  - knowing how long their money will last
  - preparing for longevity risk and social care needs

Recommendations

1. **Financial education** - the results clearly indicate a need for more education related to financial literacy and retirement planning. While the results suggest a broad need, they also demonstrate the necessity for targeted (and potentially differently designed) educational approaches based on age, gender and income.
2. **Default options** - the results clearly indicate widespread lack of preparation for both saving for retirement and in anticipation of turning those savings into a retirement income. Yet there is widespread acknowledgement of the role of occupational pensions. Therefore, there could be a role for defaults within these saving vehicles, both during the saving and retirement phase, to help compensate for the limited attention that most people give to planning for the future.
3. **State pension adequacy and sustainability** – the State Pension is an essential part of the retirement package for a majority of citizens, yet in all three countries less than half of respondents aged 18 to 24 cite this as a source of retirement income. This may reflect concerns about the sustainability of the State Pension and unless preparedness is improved there may be greater pressure placed on the State.

Ageing population

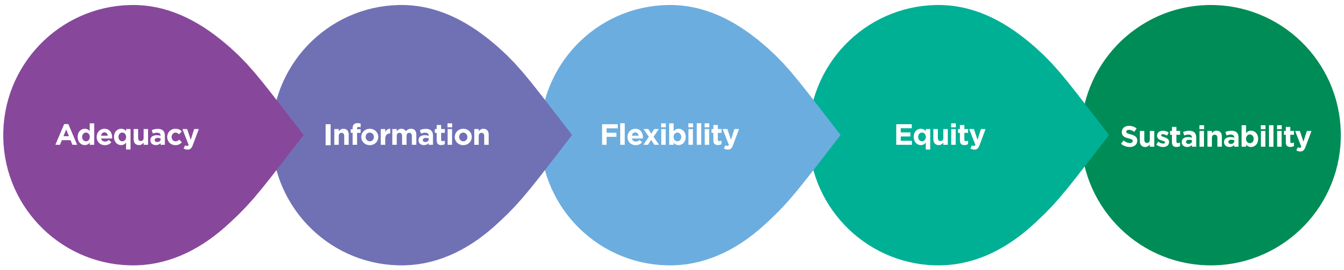
Contents

Introduction

In countries where employer-sponsored retirement plans are an essential part of the national retirement system, and where they have shifted from defined benefit (DB) to defined contribution (DC) arrangements, there has been a significant transfer of retirement risk from the employer to the employee.

Longevity risk is one of the risks that has been assumed, perhaps unknowingly, by employees. Three actuarial associations (the Actuaries Institute of Australia, the Institute and Faculty of Actuaries in the United Kingdom, and the American Academy of Actuaries) determined that longevity risk was a major issue in each of their countries and prepared a White Paper, **The Challenge of Longevity Risk**, to alert the public and policymakers to our concerns.[i]

This report summarises the results of a survey that we have subsequently commissioned to investigate adequacy, the first of the five principles we identified in our report as necessary to addressing longevity risk.



We surveyed working age individuals in each of the three countries to assess their preparation for retirement. To address this question we have organised the survey results into three themes:

1. Expectations for retirement
2. Preparations to retire
3. Retirement risks.

The fundamental question is whether differences across the three countries in history, culture, practices and policies with respect to retirement have produced material differences in the perceptions of and planning for various risks associated with retirement.

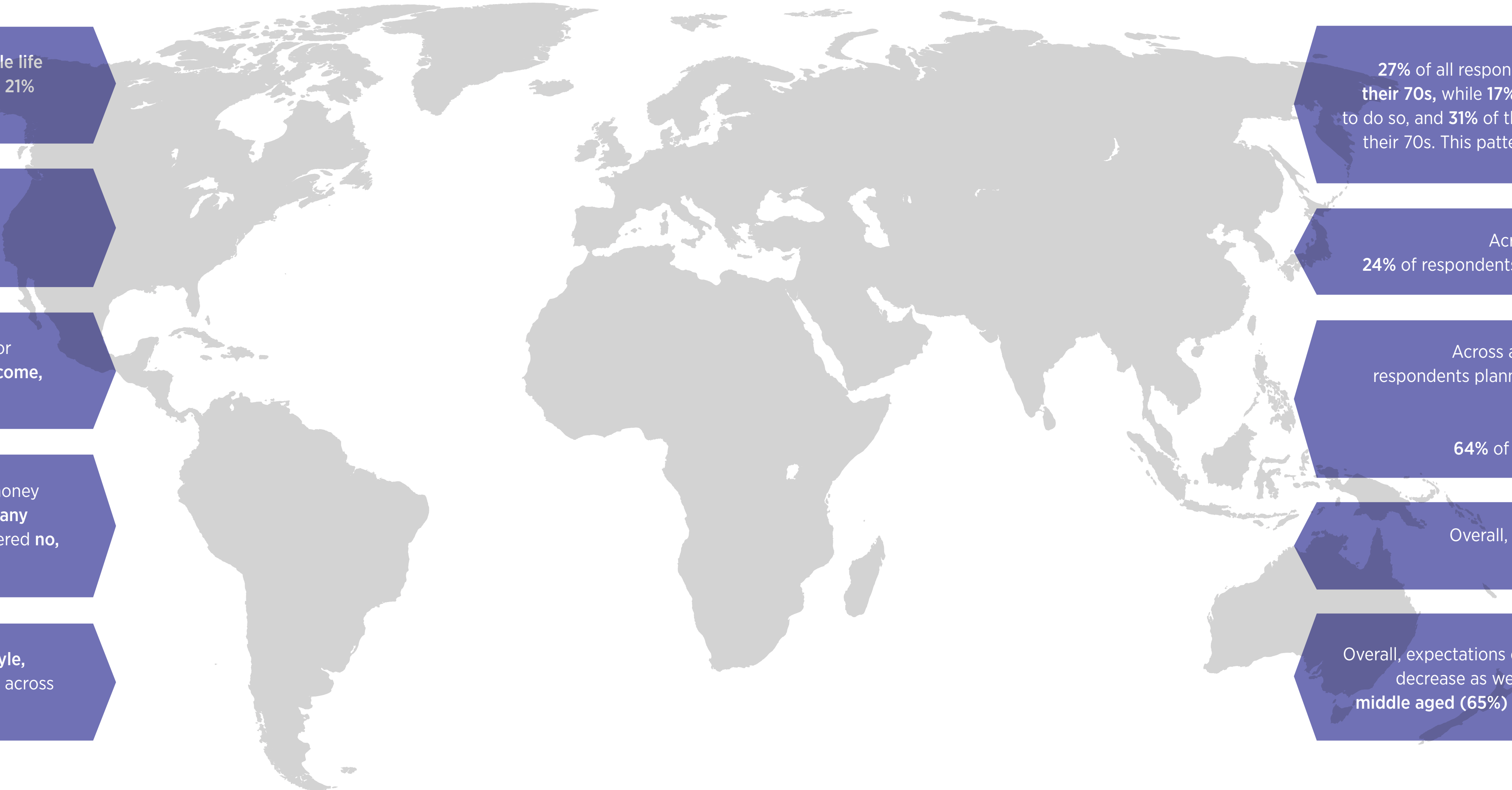
The results indicate broadly similar patterns in regards to expectations and preparations for retirement. However, of crucial importance for policymakers in the UK is that across all three themes the UK respondents indicated that they are the least 'retirement ready' when compared to Australian and American respondents. Across all of the three countries those at the highest risk of not being 'retirement ready' are:

- females;
- the middle-aged; and
- those on middle-incomes.

We therefore recommend that financial education initiatives be targeted towards these groups of individuals. The introduction of appropriate defaults will also likely help these groups as long as they promote adequacy of both savings and retirement income throughout the lifetime. If the trends our survey identified are not reversed, it could suggest an increased need for State provision; therefore adequate and sustainable State support will likely remain important for many individuals.

Within the three countries, we find that improvements in financial education, defaults and the perceived adequacy and sustainability of the State Pension are necessary.

Expectations for retirement



18% of **UK** respondents **intend to work their whole life and never retire,** compared to **28%** in the US and **21%** in Australia.

36% of **UK** respondents expect a **flourishing or comfortable lifestyle** in retirement, compared to **47%** in the US and **46%** in Australia.

Plans to retire increase with income, from **57%** for **lower income** respondents, to **76%** for **middle income,** and **85%** for **higher income** respondents.

We asked respondents if they **knew how much** money they planned to retire with. In the UK, **twice as many** people who answered **yes,** than those who answered **no,** plan to **retire in their 50s.**

In the UK, **13%** of **females** anticipate a **poor lifestyle,** compared to **7% of males.** This pattern is evident across all three countries.

27% of all respondents aged **18-34** expect to **retire in their 70s,** while **17%** of respondents aged **35-54** expect to do so, and **31%** of those **over age 55,** expect to retire in their 70s. This pattern is repeated in all three countries.

Across the three countries, on average, **24%** of respondents plan to **retire in their 70s and 80s.**

Across all three countries the percentage of respondents planning to retire declines with age, with **75%** of the **youngest** cohort, **70%** of the **middle age** cohort and **64%** of the **oldest** cohort planning to retire.

Overall, **58%** of respondents expect to live a **poor or modest** life in retirement.

Overall, expectations of receiving a form of **State pension** decrease as we move from the **oldest (81%)**, to the **middle aged (65%)** and to the **youngest cohorts (53%)**.

Overall

A third of all respondents do not plan to retire at all and only a quarter of all respondents indicate plans to retire fully. Combining these results with the observation that less than half of all respondents expect at least a comfortable retirement, **we appear to be experiencing diminished expectations compared to the previous two decades.**[ii] These results are strikingly similar across all three countries, despite their different histories, cultures and policies with respect to retirement. Yet **common to all is the transition from DB to DC pensions, along with the recent market declines beginning in 2008.**

Age

Fewer middle-aged respondents plan to retire in their 70s compared to younger and older cohorts. This suggests that **there is pessimism among the young about retiring in their 60s and realism among the oldest cohort.** Yet the middle cohort has greater levels of optimism.

There are also large variations between different age groups in the expectation of some form of State Pension as a source of retirement income. **Whether this is based on different levels of knowledge or on concerns by younger cohorts that a State Pension may not be available for them when they reach retirement is difficult to know.**

Gender

Males are significantly more likely to expect a comfortable or better lifestyle in retirement compared to females. The differences are not only substantial, but consistent across all three countries. This difference is also seen across all age groups, suggesting **gender differences in retirement expectations are not diminishing as might be expected for younger age groups.**

Income

Unsurprisingly, the proportion of respondents expecting a comfortable lifestyle in retirement doubles when we compare lower income to higher income respondents. However, expectations of comfort remain lower than might be expected amongst the middle income groups - 56% of middle-income respondents do not expect comfortable or better lifestyles in retirement. **Importantly for policymakers, this group of respondents may have the means to improve their retirement income if they take effective action early enough, or if the pensions framework facilitates effective actions e.g. via defaults.**

UK-specific

UK respondents are more likely than US or Australian respondents to anticipate retiring fully at some point in their lives, yet they are more resigned to having either a modest or poor lifestyle in retirement. UK respondents are also most likely to select the State Pension as an expected source of income and they are least likely to have personal savings set aside for retirement. **This suggests many UK respondents are expecting to rely on the State, even if they do not believe State provision will afford them a comfortable life in retirement.**

Expectations of income from an occupational pension scheme are the same across all three countries, suggesting that **recent reforms to occupational pensions in the UK could play a pivotal role in changing expectations in retirement,** especially as UK respondents are least likely to be putting aside any personal savings outside of their occupational pension. It is therefore **crucial that occupational pension schemes enable individuals to save adequately for retirement.**

Preparations to retire

Overall

Across the three countries, people are preparing for retirement by gathering information and saving at least a little. These are relatively easy steps, especially for people who are saving by contributing to an occupational pension scheme, where the employer takes an active role. However, fewer people are undertaking the harder tasks of figuring out how much they will need when they retire, or planning for an unexpected early retirement. Again, this **demonstrates the important role of occupational pension schemes in helping individuals to save adequately for retirement.** We have broken preparations to retire into four categories: **being informed; saving; setting goals;** and **managing risk.**

Across all three countries there are again **similar patterns across age, gender and level of income**, and again the **UK fairs worse** than either the US or Australia.

Age

Across all three countries, effective preparation increases by less than 10% from the younger (18-34 = 32%) to middle (35-54 = 40%) age groups, and improves by nearly 20% from the middle to older (55+ = 58%) age groups. Low levels of preparation are perhaps somewhat understandable amongst the youngest cohort, even if not desirable, but preparations amongst those in the middle and older cohorts remains worryingly low, especially in the UK where 65% of those aged 35-54 are not preparing, and even in the 55+ age group 47% remain unprepared. **Those in the middle-age group are well-placed to take effective action. Failure to prepare by this group might be the clearest indication of a need for more effective action across all three countries to engage people in their retirement planning.**

Being informed

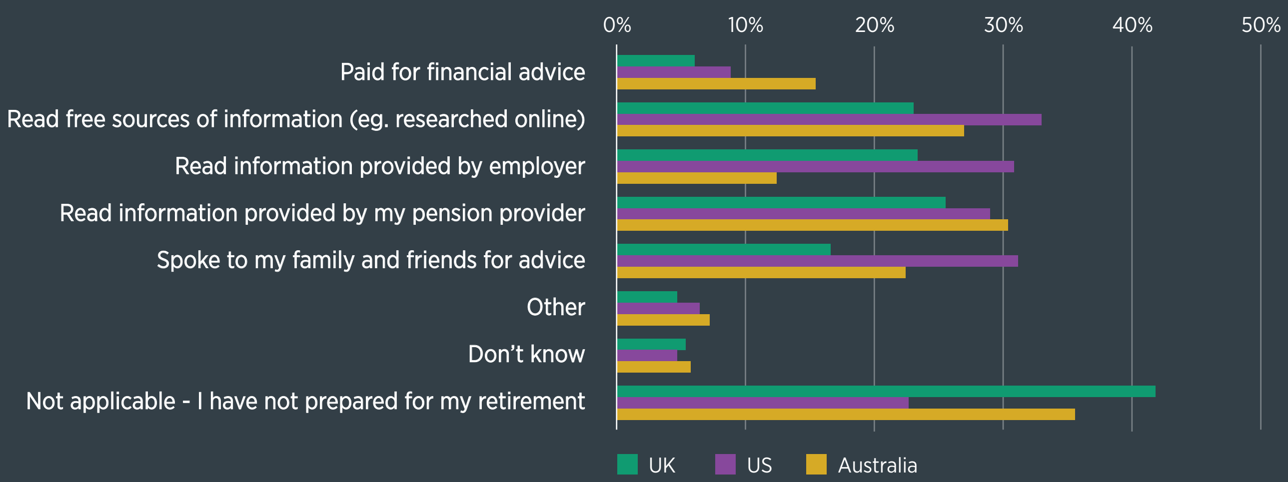
Only 52% of respondents in the UK claim to have done something to gather information, followed by 55% in Australia and 71% of respondents in the US.

We asked respondents 'Which, if any, of the following have you done to prepare for your retirement?'

Figure 1 shows that respondents in **Australia are most likely to have paid for financial advice,** whereas **US respondents are most likely to have read information** provided to them by their employer and free sources of information, as well as spoken to their friends and family. The **UK respondents are more likely to not have done anything** to prepare for their retirement.

Reading information from their pension/superannuation provider is the only option that over a quarter of respondents selected in all three countries. This demonstrates the important role of the pensions industry in helping improve retirement readiness.

Figure 1: International comparison of responses to 'Which, if any, of the following have you done to prepare for your retirement? Please select all that apply.' by country



Gender

Preparing to retire is more common for males than females across all three countries, although the gender gap is less pronounced in the UK than in either the US or Australia. Again, the gender gap is prevalent for all age groups. There are also differences in how each gender is setting goals, with males more likely to have thought about what they might need to pay for in retirement or guessed an amount. Females on the other hand are more likely to have taken advice from friends and family.

Income

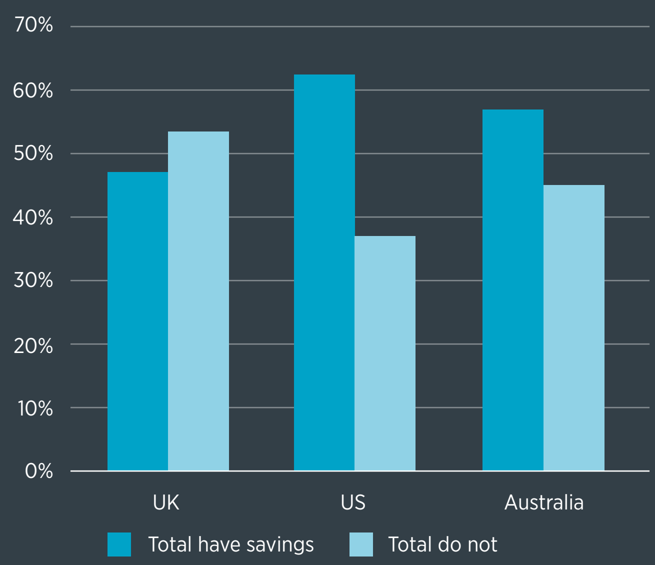
For the three countries combined, the percentage of respondents preparing increases with income from roughly 30% (lower income) to 45% (middle income) to 60% (higher income). **Lack of preparation by those at the bottom of the income distribution may reflect limits in their ability to divert resources from current consumption to retirement, or anticipated reliance on social insurance systems,** as State pensions fulfil relatively large shares of the income needs for the lowest income groups.[iii] **Preparation for retirement among the highest income respondents may reflect higher education levels and therefore an increased awareness of the need to prepare.**[iv] Higher income individuals are also more likely to have other non-retirement resources that can supplement the reported retirement savings.

Of greatest concern, is the relatively low preparation among those in the middle-income group, where no country has a majority of respondents preparing for retirement. Low levels of preparation in the middle-income group raises the possibility that many people who have sufficient income to save to supplement the State pension in their retirement are not doing so. Hence, as with the middle-aged category, the fact that the middle-income category is failing to prepare speaks to the need for new approaches in all three countries to encourage people to adequately plan for retirement. **Some of the more recent changes in each of the three countries, such as the growth in automatic enrolment features, may ultimately improve these outcomes.** Although in the UK the middle-income group will likely need to save above current minimum contribution levels to achieve adequacy.

Saving

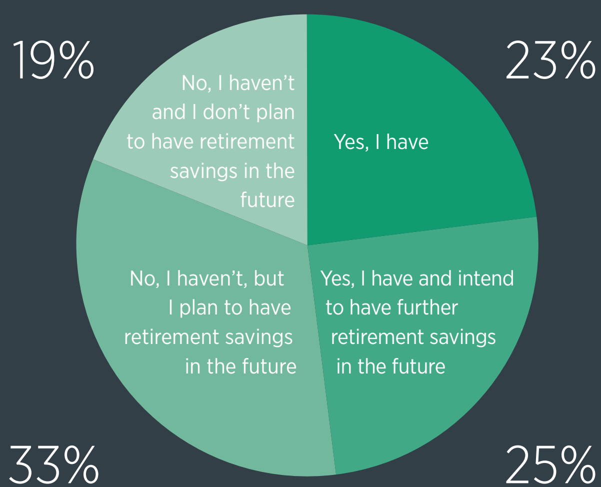
Only 47% of respondents in the UK claim to have begun saving for retirement, compared to 55% in Australia and 64% in the US.

Figure 2: International comparison of responses to 'Do you currently have retirement savings set aside for when you retire?' by country



In the UK, less than half of the respondents (47%) said they had set aside savings for when they retire, but just over half of this group planned to make additional savings for their retirement. Only 19% of respondents said they had no savings for retirement and no intention of saving in the future. A third of respondents (33%) had no savings but did intend to save in the future.

Figure 3: UK responses to 'Do you currently have retirement savings set aside for when you retire?



Setting goals

Of those not preparing for retirement 70% - 80% did not know how much they would need to save for their retirement and almost half (45%) answered that they do not know how to work out how much they will need.

We asked respondents to think about all the sources of income they thought they would have when they retire, including the State Pension, any workplace pensions, private pensions and other personal savings. Unsurprisingly and perhaps promisingly, **older respondents tended to have a clearer idea of their expected retirement income,** but still less than two fifths of those over 55 (38%) answered 'yes'. This number dropped to 4% for those in the 18-24 age bracket.

We then asked those who said that they have an idea of how much money they plan to retire with how they had determined their goal. **Over half of respondents had determined their goal based on their understanding of what they might need to pay for in their retirement.** The popularity of this response resonates with an earlier IFoA report on assessing adequacy, where we recommended that an outcome-based approach could help to improve adequacy.[v] 39% had used their current salary as a determinant and 35% had taken professional financial advice. A further 25% had spoken with family and friends and 21% had guessed.

Younger age groups are more likely to have used their current salary and advice from friends and family, whereas those aged over 55 are least likely to have guessed and most likely to have used professional financial advice.

In the UK, **an average of just 6% of respondents had paid for financial advice.** Perhaps unsurprisingly, those with higher earnings are more likely to have taken advice. Of those on very low salaries (below £15,000), less than 1% had taken advice. This average increased to 6% and is relatively consistent for those earning up to £70,000. **There is a marked increase in the number of people taking advice when salaries increased to over £80,000,** with an average of one quarter of respondents having taken financial advice (this percentage is as high as 38% for those earning over £150,000).

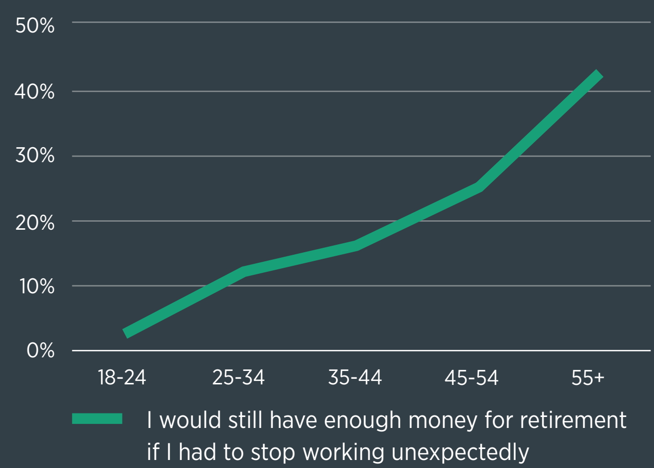
Figure 4: UK responses of 'financial advice' to 'Which, if any, of the following have you done to prepare for your retirement?' by gross household income per annum

Managing risk

We asked respondents to imagine a situation where they had to take an unexpected break from working and whether they had considered or made plans for this situation, as well as whether they thought they would still have enough money to fund their retirement.

In the UK, **only one fifth of respondents (21%) said they would still have enough money for retirement if they had to stop working prematurely.** Encouragingly, older respondents are generally much more confident that they could continue funding their retirement (43% for over 55s) compared to those in the youngest cohort (3%). This pattern is seen across all three countries.

Figure 5: UK responses to 'Thinking about before your retirement... Please imagine you had to stop working at any point because of job loss, ill health, to take care of a relative etc... Do you think you would still have enough money for retirement?' by age



Retirement risks

We asked questions to assess readiness for retirement for these five risks:

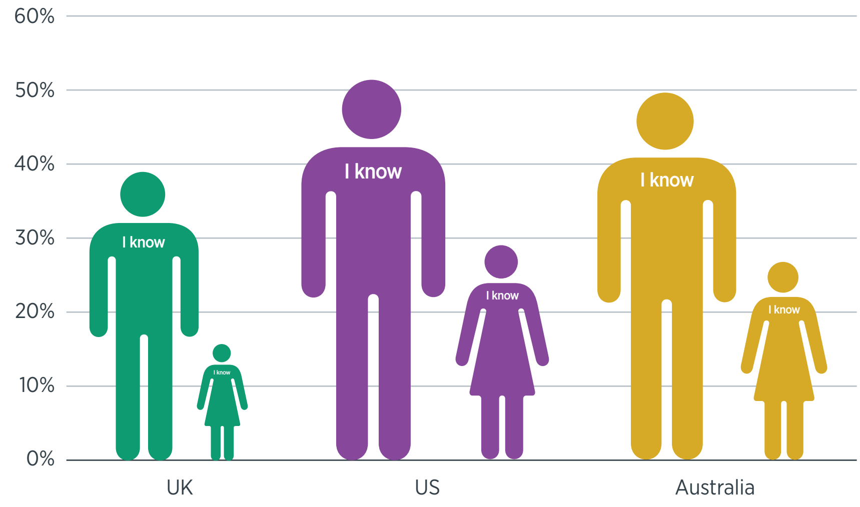
1. Knowing how long one's money will last
2. Having a plan for decumulation (spending down one's retirement assets)
3. Planning for longevity risk
4. Planning for a drop in retirement asset values
5. Planning for chronic ill health

Almost half of respondents indicated that they are not preparing for retirement risks. In all three countries, more than three quarters of all respondents are prepared for a drop in the value of their retirement assets, although **for the vast majority their preparation consists of them returning to work.** This may or may not be a realistic option depending on their age and health at the time of the drop in value. **Only about one third of the respondents know how long their assets will last in retirement, and about half have planned for the possibility of a longer than expected life.** Higher percentages of respondents in both Australia and the United States show evidence of preparedness for retirement's risks than in the United Kingdom.

1. How long will my money last?

Overall just 29% of the respondents said that they knew how long their savings would last in retirement. This dropped to 15% in the UK. Perhaps somewhat positively the proportion of those who answered 'yes' to this question increased with age. **As with responses to a number of other questions, in all three countries, males are more confident about their preparedness than females.**

Figure 6: International comparison of responses to 'Do you know how long (i.e. how many years) your retirement savings will last in retirement?' by gender

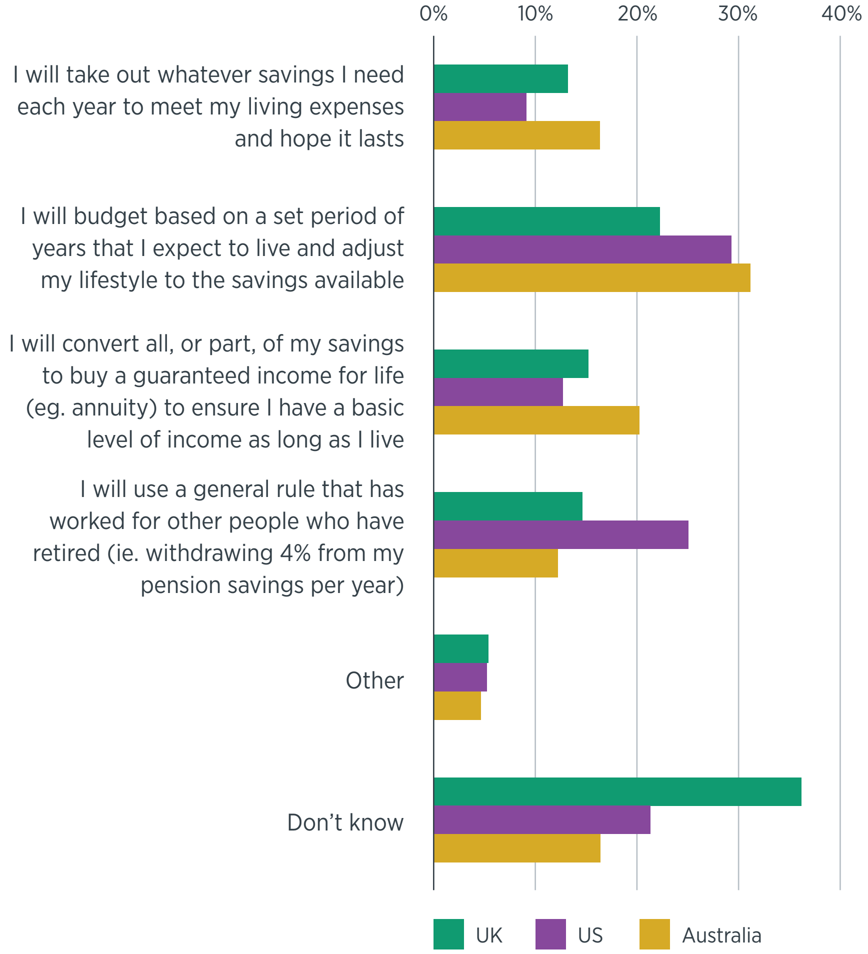


2. How will I withdraw and budget my savings?

When we asked the respondents how they would withdraw their savings and budget in retirement, just over **a third of the UK respondents selected that they did not know, compared to 21% in the US and 17% in Australia.** This demonstrates the particular importance of financial education in the UK context, especially when considered against the more proactive approach in other countries.

In the US and Australia approximately **30% said that they would budget based on the number of years they expected to live and adjust their lifestyle accordingly,** compared to 22% in the UK. **A fifth of Australia respondents would consider buying a guarantee,** compared to 13% in the UK and 11% in the US. **In the US just under a quarter of respondents would use a general rule of thumb,** compared with 13% in the UK and 12% in Australia.

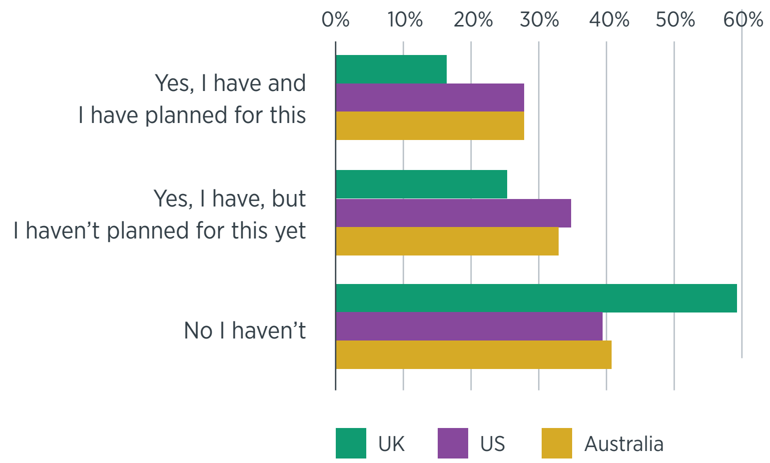
Figure 7: International comparison of responses to 'Which ONE of the following do you think BEST describes how you intend to budget and withdraw your retirement savings money to help fund your retirement?'



3. How long will I live?

When we asked respondents whether they had thought about what they would do should they live longer than expected and subsequently made plans **the UK are the least prepared.** Respondents from the US and Australia are similarly prepared should they live longer than expected, with around 60 percent having at least thought about it.

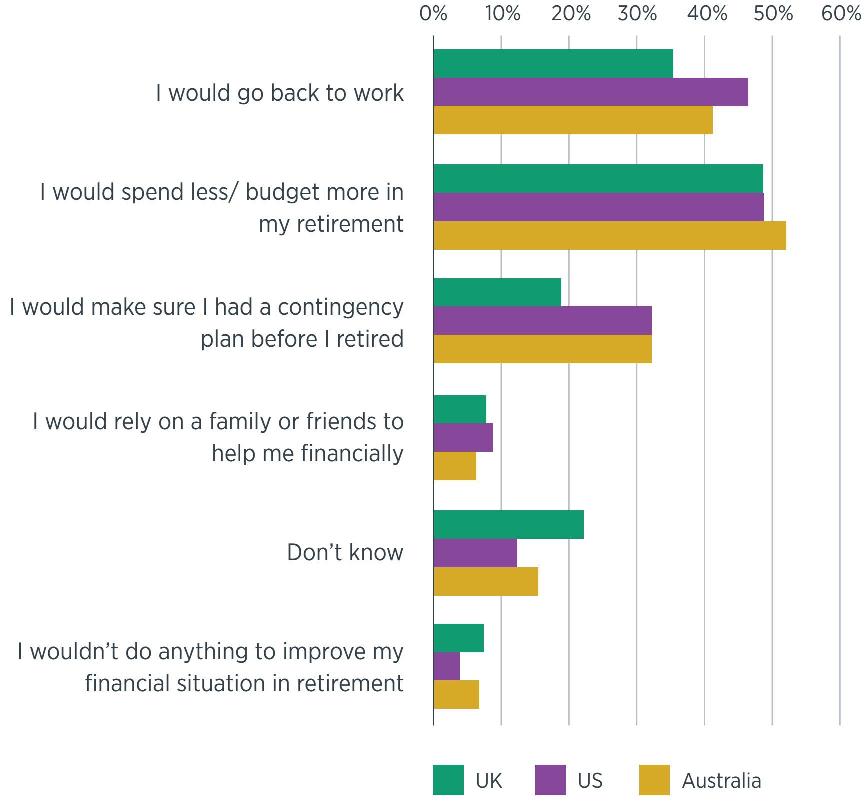
Figure 8: International comparison of responses to 'Please imagine that you lived significantly longer than you expected to... Have you thought about what you would do in this situation?'



4. What happens if my savings are less than I thought?

We asked respondents what they would do if there was a sudden drop in the value of their retirement savings, for example if there was another financial crisis. UK respondents were again least likely to know what they would do to improve their financial situation in retirement. **A third of the Australian and US respondents would make sure they had a contingency plan in place, compared to a fifth of UK respondents,** although around half from all three countries would spend less. US respondents are most likely to consider returning to work as an option.

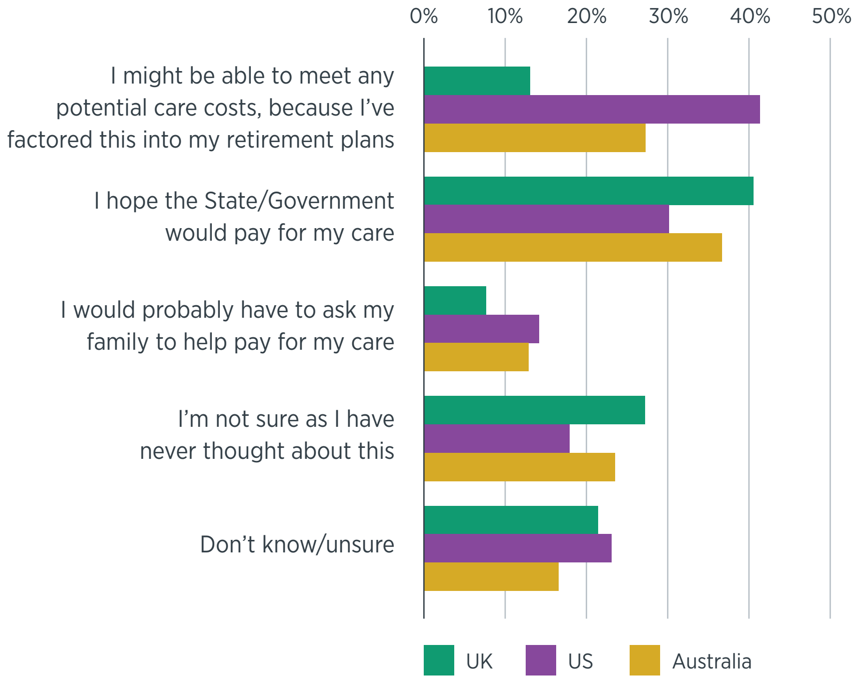
Figure 9: International comparison of responses to 'Please imagine that your total retirement savings suddenly dropped in value (e.g. there was a global financial crisis)... Which, if any, of the following do you think you would do to improve your financial situation?'



5. What happens if I need care?

When we asked the respondents what they would do if they faced care costs in their retirement US respondents were most likely to anticipate being able to meet those costs themselves. **UK respondents were most likely to hope the State would pay towards their care or to have never thought about this.** This again demonstrates the importance of an adequate and sustainable State framework, which includes encouraging people to save for these costs if the State is not able to meet them.

Figure 10: International comparison of responses to 'Please imagine that you suffered from chronic ill health that meant you had to pay for care (i.e. either at home, or for a long-term care facility, care home etc.)... Which, if any, of the following do you think describes what you would do?'



Conclusions and recommendations

Despite differences in culture and social retirement programs, the survey results indicate broadly similar patterns in regards to expectations and preparations across all three countries. However, **UK respondents are the least prepared** across all three themes (expectations for retirement, preparations to retire and retirement risks).

Overall, the respondents indicated that they are **best prepared with respect to saving and acquiring information.** However, respondents on average are **least prepared with respect to knowing how much they will need when they retire, how long their money will last, and preparing for longevity risk or chronic ill health.**

The relatively low percentages of middle-aged and middle-income respondents who are well prepared are particularly noteworthy **as low levels of preparation in the middle-income group raise the possibility that many people who have sufficient income to supplement their State Pension are not doing so.** Additionally, **low levels of preparation in the middle age group raises the possibility that for many people who do not begin preparations until they are 55, there will not be enough time if they ever plan to retire.** Failure to prepare by these groups speaks to the need for effective approaches in all three countries to encourage people to adequately plan for retirement.

Females were also particularly poor at planning for retirement, and this was true for all age groups, suggesting initiatives targeted at females could be worthwhile.

To improve retirement readiness we propose three policy initiatives:

1. Financial education

Financial education is needed to tackle low levels of preparedness. This could usefully be targeted towards those who are least likely to be taking positive action (females, low and middle income, as well as young and middle age). Across all questions, UK respondents were least likely to be taking any action, or even know what action to take. This suggests the UK is lagging behind Australia and the US in engaging individuals with saving for their retirement.

2. Default options

As already discussed, the results indicate low levels of engagement overall, but particularly in the UK. Defaults could go some way to help compensate for the limited attention that most people give to planning for the future, although if they are going to benefit those on middle incomes then they should be designed to achieve adequacy. Current auto-enrolment minimum contribution levels are unlikely to achieve this for these individuals and they are likely to be well placed to save more than this level if prompted to do so, therefore we recommend policymakers explore some form of auto-escalation within default options.

In addition to defaults for saving, default options are also needed for decumulation as demonstrated by the lack of preparation for retirement risks, from longevity risk to market risk and the risk of needing care. Respondents across all countries indicated the importance of reading information from their pension provider. Information from providers on how defaults could help individuals to mitigate these risks could play an important part in preventing bad outcomes (i.e. individuals running our of money in retirement).

3. State pension adequacy and sustainability

The UK had the highest response rate for expecting the State Pension to be a source of income in retirement as well as the State funding any care needs. If individuals in the UK are going to have adequate incomes in retirement they will need to save more than this. However, as there is such a highly anticipated reliance on the State, it is even more important that the system is sustainable and adequate, to prevent poverty for those without any additional saving. Younger age groups have a markedly lower expectation that they will receive a State Pension and, whilst our results cannot prove this, it could be due to a perception that the current system is not sustainable, and that younger age groups should not expect to receive the same support as previous and current older generations.[vi]

References

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Available online: **http://dx.doi.org/10.1787/pens_outlook-2016-en** , p. 15: "The pensions landscape has changed in recent decades."

[iii] Anita M. Schwarz, *Pension System Reforms, World Bank, SP Discussion Paper No. 0608*, September 2006, p. 5: "What are the objectives of a pension system? First, a pension system tries to reduce poverty among the elderly." See income replacement rates in Table 3 above.

[iv] Office for National Statistics (2015) *Financial capability in Great Britain: 2010 to 2012.*
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[v] IFoA (2016) *Assessing adequacy of retirement income: a bottom-up approach.*
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Institute and Faculty of Actuaries

Contact us

If you would like to know more about the IFoA's work on pensions and retirement readiness please contact us at:
policy@actuaries.org.uk

Beijing

14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004
Tel: +86 (10) 6535 0248

Edinburgh

Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA
Tel: +44 (0) 131 240 1300 · **Fax:** +44 (0) 131 240 1313

Hong Kong

1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong
Tel: +852 2147 9418

London (registered office)

7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP
Tel: +44 (0) 20 7632 2100 · **Fax:** +44 (0) 20 7632 2111

Oxford

1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD
Tel: +44 (0) 1865 268 200 · **Fax:** +44 (0) 1865 268 211

Singapore

163 Tras Street · #07-05 Lian Huat Building · Singapore 079024
Tel: +65 6906 0889

www.actuaries.org.uk

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