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Retirement Readiness – How do we Compare?

By Ken Hohman

It has been two years since I wrote about my involvement on behalf of the American Academy of Actuaries with a project, in collaboration with the Actuaries Institute in Australia (AUS) and the Institute and Faculty of Actuaries in the United Kingdom (UK).

This project focused on the mutual concern of our three associations around the lack of appreciation of, and options for, lifetime income in retirement in our respective countries in light of transformation from a defined benefit (DB) oriented system to a defined contribution (DC) system. Our paper *Making Retirement Income Last a Lifetime* attracted media coverage around the globe, causing us to consider how we might take our collaboration to the next level.

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While I must admit to not always understanding everything my Australian and UK colleagues say, we are essentially three countries bound together by a common language and intertwined histories. The question we raised was whether there are significant national differences in the perception of retirement and how people plan for it.

We hit upon the idea of a survey of employment-aged individuals in our three countries to seek out differences in retirement readiness. Perceptions of—and preparation for—retirement were unsurprisingly similar, but we did discover some interesting deviations.

Before analyzing the results of this cross-border survey, it is necessary to consider several factors. One factor is the retirement framework in place in each country—we should, of course, expect people to feel more secure in their retirement preparation if they work under a national retirement policy that provides meaningful, secure retirement. A second factor is national demographics—there are substantial differences among countries in the age and work habits of their population. An equally important factor (perhaps even more important) is national cultural attitudes. We[1] performed some research around these factors in order to put the survey results in proper context.

Retirement framework

Australia, the UK, and the US have similar but significantly different retirement systems. Each has a national social security system that is weighted in favor of lower income individuals, but the degree of weighting varies greatly among the systems. Each also has employer-based retirement plans, but these range from mandatory plans with significant mandatory contributions (AUS), to mandatory auto-enrollment with the ability for an individual to opt out (UK), to voluntary plans with voluntary auto-enrollment (US). Each country also offers voluntary tax-favored options for personal savings.

The table below, Summary of Retirement Systems by Country, provides a high-level summary of the three systems.

Summary of Retirement Systems by Country

	AUS	UK	US
Social Security	Means-tested social safety net funded by general tax revenue	Flat-rate basic pension with additional means-tested “guarantee credit” funded by employee payroll deduction and general tax revenue	Salary-based progressive formula funded equally by employee and employer payroll tax
Employer Plans	Mandatory DC plan with compulsory 9½ percent of pay employer contributions, expected to increase to 12 percent by 2025	Mandatory DC plan with auto-enrollment (employee may opt out) with minimum contribution of 2 percent of pay (at least 1 percent by employer), with scheduled increase to 8 percent (3 percent employer and 5 percent employee) in 2019	Entirely voluntary on part of employer, most common plan is DC plan with employee contributions and employer match
Personal Savings	Voluntary tax-favored options for personal savings	Voluntary tax-favored options for personal savings	Voluntary tax-favored options for personal savings

With this background, it is instructive to see how much preretirement income is replaced through social security and mandatory employer plans (note that Australia has a robust mandatory employer plan system; the UK has a minimal mandatory system, and the US has no mandatory requirement).

Since social security systems are geared more heavily to lower-paid workers, we must also consider how this replacement rate varies based on preretirement income levels. We therefore looked at retirement income replacement ratios for those earning (immediately prior to retirement) 50 percent of the national average income in each country, as well as 100 percent and 150 percent. The table, Replacement Ratios by Country and Income, indicates a disparate pattern between the three countries (note: all tables and graphs shown in this article are taken directly from the survey report).

Replacement Ratios by Country and Income

For those earning this percent of national average income	AUS	UK	US
50%	89%	52%	54%
100%	58%	28%	45%
150%	46%	20%	39%

We found that Australia provides the greatest replacement, which is not surprising since this includes the majority of their employer-provided benefits. The UK is at the lowest level at all three income levels, while the US is very close to the UK at the lower income level but moves closer to Australia as income increases.

National demographics

Additional research uncovered demographic differences between the three countries that are relevant when considering retirement readiness. The table, Age Dependency and Over Age-65 Workers by Country, shows two statistics we think are important:

Age Dependency and Over Age-65 Workers by Country

	AUS	UK	US
Age Dependency	25%	31%	25%
Over-65 Employed	25%	21%	30%

The *age dependency ratio* is the number of people over age 65, divided by the number of working age individuals.

The US and Australia are comparable, but the UK has a higher age dependency ratio.

- The percentage of people over age 65 who are still working ranges from 21 percent in the UK to 30 percent in the US, with Australia in the middle.

Generally speaking, the UK has an older population and the US has a greater percentage of older individuals working.

Culture clash

We uncovered research by the Dutch social psychologist Geert Hofstede, which indicates that Americans and Australians are much more likely to avoid uncertainty than are their counterparts in the UK. Our friends in the UK also tend to have a longer term view of things than do the Americans and Australians. Clearly these are important cultural differences when it comes to retirement planning. If asked, "how much do you need to save for retirement," Dr. Hofstede's analysis suggests an American or Australian is more likely to ignore the uncertainties implicit in the question, while a Brit or Scot will be more open about the long-term risks involved. The scores below, taken from Dr. Hofstede's study, are on a scale of 0 to 100.

Features Affecting Retirement Readiness

	AUS	UK	US
Uncertainty Avoidance	51	35	46
Long-Term Orientation	21	51	26

Source: https://www.hofstede-insights.com/product/compare-countries/.

This suggests an "old world" versus "new world" dichotomy, and this culture clash should be kept in mind as you review our survey results.

Our findings

We have three significant takeaways from our analysis.

Despite having three different cultures and different approaches to retirement policy, we found surprisingly similar results across the three countries.

All three countries have done a fair job of getting people to understand the need to save for retirement and plan for the accumulation phase of retirement; although, people are less successful in following through on a savings plan.

Developing and following a good plan for the decumulation phase of retirement has proven evasive in all three countries.

I've heard it said that life is the worst teacher—it gives the test first and the answers second. There may be many parts of life where getting the answers late can still accommodate a successful outcome, but I'm convinced retirement is not one of them.

Results

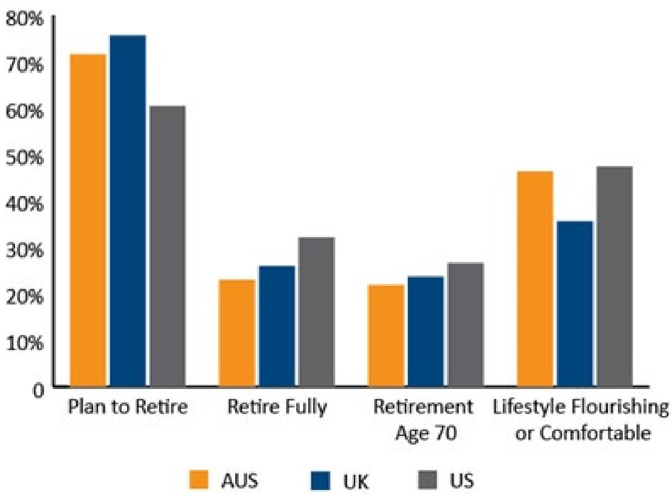
Our survey sampled nearly 3,000 working age individuals (ages 18–64) divided among the three countries. The questions fit nicely into the following categories:

- The retirement transformation
- Preparing for retirement
- The ability to address retirement risks

Retirement Transformation:

People's perception as to what exactly retirement is has clearly changed in the recent past. With the financial crisis of 2008 still relatively fresh in everyone's mind, this is not an unexpected result; however, we were surprised with how widely this transformation has occurred. In general terms, people are retiring later and with lower expectations.

Retirement Expectations by Location



Thirty percent of respondents have no thought of ever retiring, and of the 70 percent who do plan to retire, nearly three-fourths plan to retire gradually rather than diving off the retirement cliff (i.e., going from full employment to full retirement).

Perhaps the most meaningful (and most frightening) finding is that in each country only 42 percent of the respondents expect a comfortable retirement. The UK (36 percent) lags well behind Australia (46 percent) and the US (47 percent) in anticipated retirement lifestyle. This raises the question of whether those living in the UK are less prepared for retirement or simply more honest in their long-term outlook. The more important question, however, is how the 58 percent who expect a less than comfortable retirement plan to survive. While the survey addresses parts of this issue, there is much more research to be done in this regard.

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Preparing for Retirement:

We found that three in five respondents are not preparing appropriately for retirement. We considered four criteria for this determination:

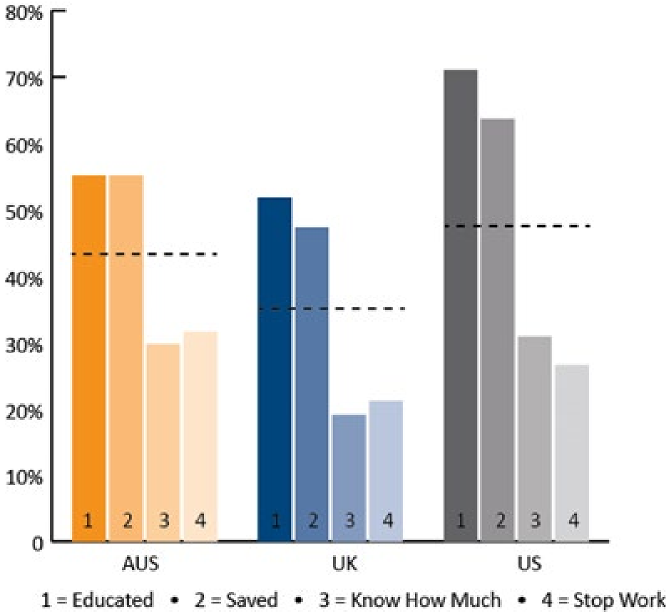
- Educated – are people seeking out ways to educate themselves regarding retirement savings and risks?
- Saved – have they already started saving for retirement?
- Know how much – do they know how much income they will require in retirement, and how much they will have accumulated at retirement?
- Stop work – have they planned for an unanticipated early cessation of work (e.g., due to layoff or health)?

Again, we found a significant variance by country, with the new world countries appearing to be better prepared than the old world country.

The average of these four criteria indicates that 48 percent of US respondents and 43 percent of Australians are reasonably prepared, compared to 35 percent in the UK, which lags behind in all four criteria. Is the UK really that far behind the other two countries, or is this another demonstration of cultural difference?

Looking at the graph, *Preparing to Retire*, it is obvious that all three countries have done a good job educating workers about retirement saving and getting them to actually start saving, but all three have failed to help people understand the amount of savings needed or to recognize the risk that events could intercede to shorten the savings horizon.

Preparing to Retire by Location



As we would expect, retirement preparation increases with age and income. We were somewhat surprised in the degree of difference by gender, with an average score of 47 percent for men and 34 percent for women. The difference is greatest in Australia—54 percent for males and 32 percent for females (this was the major headline regarding our survey in the Australian press). Our little group pondered whether this could be akin to the cultural differences by nation; that is, are women more honest in assessing their financial acumen and preparedness?

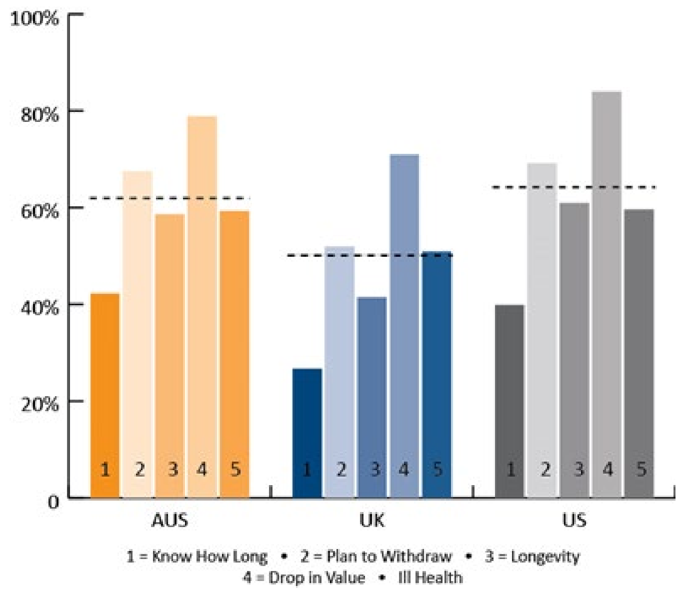
Addressing retirement risks

There are a number of risks when it comes to maintaining a financially secure retirement. We asked our survey respondents about the degree to which they have anticipated five specific post-retirement risks; specifically:

1. Know how long – do people know how long the money they anticipate having when they retire will last?
2. Plan to withdraw – do they have a plan for how they will spend down their retirement assets?
3. Longevity – have they planned for living longer than expected?
4. Drop in value – what will they do if they experience a significant loss in retirement assets?
5. Ill health – have they planned for the risk of chronic ill health?

A little more than half (56 percent) of our respondents indicate they have taken steps to address these five retirement risks. That, of course, means that almost half have done little or nothing in that regard. Upon further analysis, we suspect that the 56 percent may be overstated, because this average is driven by the fact that 77 percent believe they have appropriately planned for a drop in their retirement assets. For the vast majority of these individuals, their "plan" for this contingency is to go back to work. It would appear that few have considered the possibility that their health may not allow them to return to work or that employers may not be willing to hire an 85 year old who has been out of the labor force for 20 years.

Preparing for Retirement by Location



The average score by country shows the familiar pattern of stronger preparation for the US (63 percent) and Australia (61 percent) relative to the UK (48 percent). On average, two-thirds of those over age 55 in the US indicate they have taken steps to prepare for the five stated risks, but 88 percent of this group think they have adequately addressed the drop in value risk—most by returning to work. Regardless of the efficacy of their responses, we still have one-third of this group nearing retirement who admit that they have not adequately considered these risks.

Our recommendations

We arrived at several public policy recommendations as a result of our analysis.

1. It should surprise no one that we feel the public requires greater financial education. This is a general statement, but our focus is on financial education as it relates to retirement. Most people have no idea how much money they will have at retirement, or how much money they will need. My actuarial training does not prepare me to make a precise determination of these amounts; instead, it informs me that there is a range of possible outcomes with some level of probability assigned to amounts within the range. We cannot expect this degree of financial education, but a broad understanding of the risks involved will provide much needed perspective.
2. If people don't understand the risks and the financial implications, aside from educating them, we can nudge them in an appropriate direction. This is accomplished with default provisions such as auto-enrollment, auto-escalation, and default investment options that we find in US 401(k) plans, and we need to look for other places where a nudge would be useful.
3. The social security system is an important part of the retirement structure in all three countries. The survey indicates that younger workers have less faith in these government-provided benefits, suggesting concern over the viability of these systems. It is crucial that these programs be adequately maintained and be recognized as sustainable by those covered by the system.

My hope at the outset of this project was to discover different areas where each country excelled and from which the other two could learn. I cannot say we were successful in this regard. My initial impression upon reviewing the survey output was that the headline in Australia and the US would be, "Things are Bad . . . But at Least We Are Better Than the Brits!" Upon further reflection, however, I have migrated to the view that our friends in the UK are simply more realistic about their position related to retirement. Thomas Jefferson once noted that "If ignorance is bliss, why aren't more people happy?" The survey suggests a large degree of ignorance when it comes to retirement planning, and, while perhaps not blissful, Americans and Australians appear content. While sharing in the ignorance, those in the UK are not as satisfied.

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There has been a debate in the US as to whether we are simply facing a retirement challenge or a crisis. A challenge implies that retirees can find ways to cope with their financial shortfalls, and they have seemed to do so to this point by cutting back their lifestyle and relying on friends and family. A crisis arises when those solutions are no longer available or feasible, with responsibility falling back on the government and, ultimately, the taxpayer.

There are some definite differences between the retirement systems that are worthy of note and additional consideration—in particular, the employer-based retirement plans in each country. While the US has retained a completely voluntary system, the UK has recently adopted a mandatory system with auto-enrollment, by which an employee is automatically included but can opt-out of the plan. The Australians, who moved from a DB dominated retirement system to a DC system a full generation before the US and UK, made the jump 25 years ago to a compulsory plan that now has a very substantial contribution. While the contribution is technically an employer contribution, I am told by my Australian colleagues that it is understood by workers to be deferred compensation—that is, it would have been distributed as pay if not for the mandatory retirement program—thus, they see it as an employee contribution. Is it politically feasible to move to a mandatory employer-based program in the US? I have not seen much appetite for this as long as we are merely challenged, but perhaps this could change in a crisis.

The Joint publication, found on the American Academy of Actuaries website, is available here, *"Retirement Readiness: A Comparative Analysis of Australia, the United Kingdom & the United States".*

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