BMO Retirement Institute Report

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Broadening the approach to preparing for retirement

Executive summary

When we think of preparedness for retirement, we often refer to the dollar amount an individual has saved in their retirement accounts. However, the definition of preparedness for retirement can also be explained by non-financial factors, such as an individual's attitude towards saving for retirement (i.e., degree of importance, relevance) and their behaviors (i.e., talking to financial professionals, attending seminars) towards learning more about how to save, how to determine how much they might need to save, and types of retirement accounts. To gain further insight into the connection between attitudinal and behavioral aspects of this preparation process, The BMO Retirement Institute conducted a Study in collaboration with an international academic Research team which demonstrated a substantial relationship between the level of involvement (i.e., attitude) of an individual in their personal retirement savings decision and their financial preparation for retirement (i.e., behaviors). This means that for messages about retirement planning to be important, messages should contain elements that individuals are likely to perceive as personally relevant and important. In other words, people need to be able to relate to these messages at a personal level. It also illustrated that time remaining to retirement, and not age, is a key indicator of an individual's financial preparedness for retirement.

Not surprisingly, the Study indicates that young adults under the age of 35 are the least prepared based on an analysis that considered attitudes and behaviors as key measurements for financial preparedness for retirement. These findings can be helpful to the younger generations as common wisdom states that the earlier one starts to save for retirement, the greater the potential that they will achieve future financial security. Strengthening efforts at improving their financial education can go a long way to modifying their attitudes and behaviors such that their level of involvement may increase sufficiently to drive positive information-seeking behavior and lead them to take action.

The BMO Retirement Institute was established to conduct research and provide thought-provoking insight and financial strategies for those individuals planning for, or currently in, their retirement years.

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Introduction

As individuals approach retirement, the question of whether they are financially prepared becomes top of mind. These doubts may be fuelled by several factors, such as employers moving away from offering the traditional defined benefit plan (pension plan) and the potential for Social Security benefits being decreased and delayed, all of which are increasingly shifting the responsibility to individuals to save for their own retirement. In addition, some may still be struggling to rebuild retirement funds depleted by the financial crisis.

Attitudes and behaviors can be strong predictors of financial preparedness for retirement.

So perhaps a better question is, more specifically, what constitutes "financial preparedness for retirement"? Financial preparedness for retirement may best be viewed as a set of behaviors leading to improved financial planning for retirement. Individuals very often overlook emotional and behavioral factors that play an integral part in the retirement planning process. Instead, they are often consumed by the numbers and the amount of money they have to save in various accounts - the final step to a complex process. For example, when one books a flight and a hotel, this is usually the final step in the process of planning a vacation. To arrive at this final step, one often begins with the process of feeling excited about the prospect of a vacation/trip, visualizing the destination, the activities and pleasure to be derived from the trip and setting an approximate travel date. These represent emotional or attitudinal thought processes. Afterwards, one might seek to educate themselves in this area by gathering information on the Internet, bookstores, or consulting a travel agent, and then actively saving for the trip- all of which are key behaviors that get one closer to actually taking action (the final step of booking a flight and hotel).

To ensure one is adequately preparing for retirement, a similar behavioral preparation process ought to occur. First, an individual must be excited about the prospects of retiring to be motivated enough to seek information and advice, and to finally take action to save for retirement. The final step generally involves choosing to save in personal retirement savings account, an employer retirement savings program, or both. The stronger the attitudes and behaviors are before taking the final step of saving in retirement accounts, the greater the likelihood that the chosen financial action would be "adequate" in ensuring a comfortable future retirement. This means that attitudes and behaviors can be strong predictors of financial preparedness for retirement, and the earlier these can be shaped, the better prepared

Americans can be for retirement. As a result, the focus on retirement planning should be broadened from the traditional focus on dollars and cents in accounts to one that includes individuals' attitudes and behaviors.

To gain further insight into the connection between attitudinal and behavioral aspects of this preparation process, The BMO Retirement Institute conducted a Study[1] of Americans 18 and older in collaboration with an international academic Research team[2] who analyzed the level of involvement[3] (i.e., attitudes towards saving for retirement) of individuals in the financial preparation for retirement decisions and its effect on behaviors. The team examined whether there is a significant positive relationship between involvement (i.e., degree of perceived personal relevance, excitement, necessity and importance) and financial preparation for retirement (i.e., collecting information, attending seminars, thinking about how much money they will need to save and for how long, and setting a retirement date) using a Financial Preparedness for Retirement Scale (FPRS)[4] and determining an FPRS score[5]. This analysis measured financial preparedness based on an individual's combined responses to a series of questions about their retirement planning attitudes and behaviors. No single response to a question on a particular thought or action was considered reliable enough on its own to determine preparedness. The results revealed a substantial positive relationship between involvement and financial preparation for retirement.

Results revealed a substantial positive relationship between an individual's involvement level and financial preparation for retirement.

This paper is a summary of the findings of the Research using the FPRS score as a measurement of financial preparedness for retirement and of the findings of the based on responses to individual survey questions.

Key findings:

Gender, income, time remaining to retirement and education matter most

The Research tested whether moderating variables such as, age, education, income, number of dependents, planned retirement age, and years to retirement had an influence of involvement on the financial preparation of Americans. It was found that gender was an important factor in some areas, but not others. By way of an example, when looking at the individual components of the Involvement Scale, men considered the relevance of retirement savings to be significant while women placed significance on how interesting it was and how much it meant to them.

Income had some affect as well. For those earning less than $40,000 per year, income was a significant factor on whether they would be involved in the decision making process for men, but not for women. It was not a significant factor for those earning more than $40,000 per annum, but less than $100,000 for either gender. Above the $100,000 income level, however, it became a very significant issue. At this level of income, it was also very significant for men in terms of what preparation they undertook. While it was also significant for women at this income level, it was not as significant as for men. In other words, high income women tend to prepare more for retirement than high income men.

Financial preparedness for retirement is best explained by gender, income, years to retirement and education.

As would have been expected, the Research also found a strong positive correlation between the degree of preparation for retirement and time left to retirement. Not surprisingly, the Research found that the closer one is to their target retirement date, the more likely they are to be prepared for retirement. However, the Research indicates that the key indicator is the time remaining to retirement, not the actual age of the individual. For example, in certain cases, it may be possible for a younger person to actually have less time before their desired retirement age than an older person (i.e., 40 year old who desires to retire at the age of 50 and therefore 10 years left before they retire compared to a 50 year who aims to retire at the age of 65 and therefore has 15 years left).

Young adults are the least prepared for retirement, yet as many as 35 percent expect to retire before age 60!

In terms of how much time a person has before they intend to retire, both men and women illustrate a very significant relationship between involvement and financial preparation for retirement if they had less than 10 years before their planned retirement. Men who were between 10 & 16 years away from retirement demonstrated a significant relationship between being involved in the retirement savings decisions and preparing financially for retirement, but women did not. What's more, women with more than 17 years to go before they retired demonstrated a negative relationship between involvement and preparing financially for retirement. In other words, the further away from retiring, the less emphasis women placed on it. One can speculate that this may be because the focus is more likely to be on other areas such as raising a family. Men on the other hand did not show this trait.

Nevertheless, as expected, the Research analysis based on attitudes and behaviors concluded that the youngest generation of adults is the least prepared for retirement, because in all probability, their

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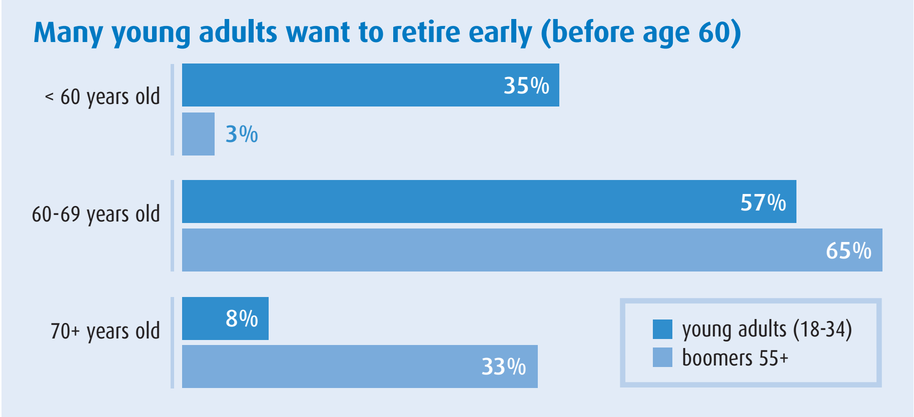
retirement date is the furthest away. Surprisingly, the survey findings suggest that young adults under the age of 34 may be overly optimistic, since as many as 35 percent expect to retire early (i.e., before age 60).



Aside from the time remaining until the target retirement date factor, the Research revealed that an individual's level of education was also another indicator of financial preparedness for retirement. In other words, higher levels of education can greatly influence an individual's motivation and involvement in taking a more active role in planning their retirement, for example, by attending seminars or consulting financial planners, all of which are behaviors that increase the basic financial education that empowers individuals to make sound financial decisions and take action. While this was true for men of all education levels, this was not the case for women. While education was a very significant factor in the amount of financial preparation for those who have a post graduate education, women undertaking undergraduate studies, unlike their male counterparts, lose this relationship. It appears that it is not as important or relevant to them at this stage in their lives.

This is why improving the financial literacy of all Americans is so important and may explain why the government and financial institutions have taken an active role in advocating for promoting financial literacy through diverse national campaigns and initiatives.

The fact that younger adults are the least prepared, however, should not be overlooked. This is particularly the case for young women, as they show they are the least likely to be involved and the least likely to be preparing financially for their future, yet they tend to live longer! Common wisdom states that the earlier one starts to save for retirement, the greater the potential for ensuring future financial security thanks to the exponential benefits of tax-sheltered compound growth over a longer period of time. Increasing the financial preparedness for retirement in the younger generations will help them take positive action to surmount the challenging and complex financial realities, now and in the future.

Motivating young adults to take a more active role in preparing for retirement will require a special approach.

However, the challenge of motivating young adults to change their attitudes and behaviors is no easy task. Considering that young adults do not face the same sense of urgency as older generations who are closer to retirement, motivating them to take a more active role in preparing for retirement will require a special approach. Rather than focusing on the traditional dollars-and-cents approach which often begins and ends with the act of saving money in retirement accounts, perhaps it is time to shift towards modifying their attitudes and behaviors about retirement. After all, the Research finds that these are the two most critical aspects that predict one's financial preparedness for retirement. Before taking on this challenging task, it is important to understand the current state of young adult's attitudes and behaviors towards retirement planning.

The majority of young adults feel that retirement planning is important: This is a good start

Only 21 percent of young adults spent "a lot" of time thinking about how much they might need to save for retirement vs. 38 percent of boomers over the age of 55.

Although young adults aged 18 to 34 were found to be less involved and engaged in retirement planning than older boomers as confirmed by their relatively lower score, the good news is that the Study found that a large majority of young adults do, in fact, find retirement planning to be important (88 percent) and more than half think it's interesting (60 percent). In fact, 45 percent of young adults under age 35 said they are currently saving in an IRA or ROTH IRA. This is a good start, but it could be better.

Behaviors and actions fall short

One of the reasons why young adults produced the lowest score despite this promising finding is they do not consistently score high on all individual behaviors questions. For example, our Study revealed that while approximately four out of ten (38 percent) boomers ages 55 and over said that they have spent "a lot" of time thinking about how much they might need to save for retirement, only two out of ten (21 percent) young adults have thought about it. While it is difficult for anyone to accurately predict exactly how much they need to save for retirement, this is a critical starting point which requires visualizing this future retirement event before they can establish an appropriate savings plan.

A primary focus should be on increasing young adults' level of involvement first rather than on visualizing how they would like to spend their retirement and the savings that it will require.

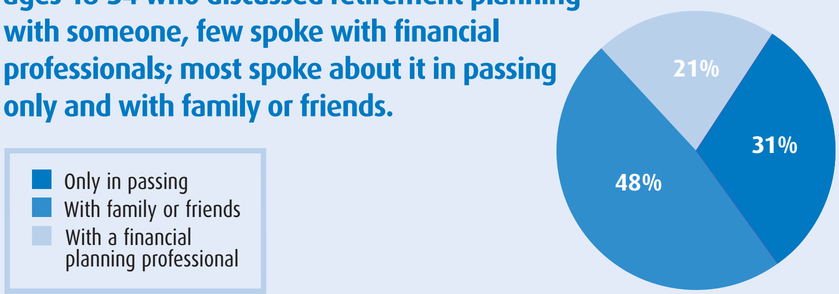
Only 38 percent of young adults took action after speaking with others about retirement planning as compared to 54 percent of individuals 55 years of age or older.

Understandably, everyone's goals are different (i.e., travelling and golf would mean higher expenses requiring more savings than a less active retirement) and can change overtime (i.e., income level and household debt changes that impact the financial situation) requiring the savings strategy to be reviewed regularly and adjusted along the way. Given the Study's finding that young adults have relatively low levels of involvement when it comes to retirement savings, it is not surprising that the majority do not engage in the behaviors of thinking about how much they will require. This suggests that, to modify their behaviors (determining how much they need to save), a primary focus should be on increasing young adults' level of involvement first rather than focusing their attention on visualizing how they would like to spend their retirement and the savings that it will require.

Another reason why young adults are scoring relatively low on financial preparedness for retirement is that the extent to which their overall involvement (i.e., attitudes) translate into corresponding behaviors falls short when compared to boomers. For example, as boomers are more involved than young adults (based on their responses to questions related to their attitude towards saving for retirement), their higher level of involvement translates into greater engagement than younger adults when it comes to behaviors such as gathering information on retirement planning, attending seminars and consulting others on retirement planning, and finally, taking action (i.e., saving in retirement accounts).

Indeed, when young adults engage in behaviors that seek out information on retirement planning, our Study found that they tend to speak about it with family and friends, generally in passing only, and collect information on their own (but, not to the same degree as boomers as the urgency is simply not as great), as compared to boomers who tend to consult financial professionals more often (26 percent of boomers 55 and older versus 17 percent young adults under age 35). This may explain why so few young adults have thought about how much money they might need in retirement. Their family or friend is not likely to be equipped with the tools or the knowledge available to a financial professional to perform complex financial forecasting calculations. Not surprisingly, our Study found that only 38 percent of younger adults under age 35 took action following speaking with others about retirement planning as compared to 54 percent of individuals 55 years of age or older.

Of the majority (81%) of young adults ages 18-34 who discussed retirement planning with someone, few spoke with financial professionals; most spoke about it in passing only and with family or friends.



Findings suggest that the preferred process of gathering information by young adults is to collect their own information and to speak to people.

Another activity considered was attendance at seminars. Our Study found that few individuals attend retirement planning seminars in general (30 percent), and these events appear to be the least effective at nudging young adults ages 18 to 34 into action (only 28 percent of those who attended a seminar took action). This is unfortunate as this cohort appears to lack professional guidance which a seminar can provide –albeit requiring a one-on-one follow-up to personalize the information to the individual. Overall, these findings suggest that the preferred process of gathering information by young adults is to collect their own information and to speak to people. This group seeks self-guided information, wants to be in control and prefers personalized one-on-one interaction over one-size fits all educational events. Nevertheless, a financial professional in the picture would be helpful.

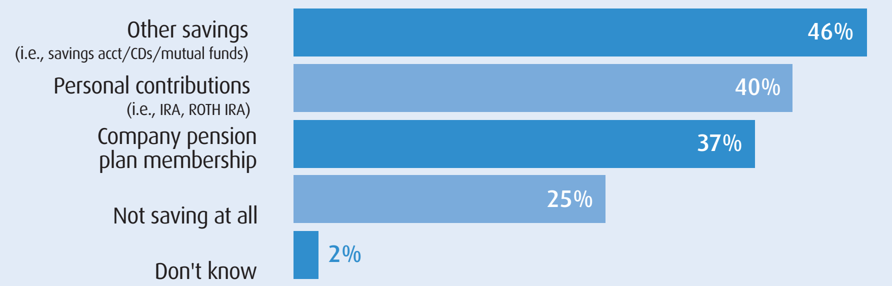
In summary, individual behaviors that demonstrate a high underlying degree of involvement (i.e., attitudes) in the process of learning about retirement planning are critical drivers of financial preparedness for retirement. However, it is important to remember that one must consider a combined set of attitudes and behaviors about many different thoughts and actions when predicting an individual's financial preparedness – no single attitude or behavior reflecting a particular thought or action is a determinant of financial preparedness on its own. When it comes to both retirement constituents- attitudes and behaviors - young adults are clearly behind older boomers by a wide margin while the picture for women against men is very mixed. A higher percentage of women gain low scores on both the Involvement Scale and the Financial Preparation for Retirement Scale, and a lower percentage of women (compared to men) gain high scores on either scale.

Today's unique challenges

There are potentially greater odds stacked against young adults' ability to establish themselves financially in today's post-economic recession era.

There are various underlying causes to young adults' poor attitudes and behaviors in connection with retirement. Aside from retirement appearing like an eternity away, their group faces certain realities that may hinder their progress on this emotional, non-financial front. Compared to the previous generation, there are potentially greater odds stacked against young adults' ability to establish themselves financially in today's post-economic recession era. Contributing factors may include significantly higher student debt, a longer job hunt, and lower real wages. This could potentially translate into years of lost lifetime income, which could place young adults at a significant risk of not saving enough for retirement. In fact, our Study revealed that almost a quarter (25 percent) of those ages 18 to 34 are not currently saving for retirement, whether through personal savings vehicles such as IRAs or a workplace pension plan. Although three quarters are saving for retirement, this activity may not be adequate, considering this cohort's low scores on attitudes and behaviors. Since the majority do not spend "a lot" of time thinking about retirement or determining how much they might need to save, financial preparedness for retirement appears to be largely left to chance.

Are you actively saving for retirement?



Almost a quarter of young adults are not currently saving for retirement.

A fragile global market, significant portfolio declines and the persistent volatility that started in 2008 today may be the cause of heavy scepticism and hesitation about investing their "newly earned money". The combined effect of mounting student debt, underemployment, and lower real wages, may help explain why so many young adults have no choice but to live with their parents and many are postponing life's milestones, such as marriage and having children. In fact, 29 percent of 25 to 34 year-olds lived with their parents during the Great Recession and 80 percent are satisfied with this arrangement.[6] However, sixty-one percent of adults in this age group say they have friends or family members who have moved back in with their parents over the past few years because of economic conditions.[7] Finally, it is difficult to picture retirement when one is young- perhaps one of the most challenging impediments to motivating young adults is to change their attitudes and behaviors so that they become more involved and engaged in their retirement planning and accepting difficult economic trade-offs.

How to influence young adults' attitudes and behaviors

Parents or other influential adults can play a significant role in modifying young adults' attitudes and behaviors regarding retirement.

If, as the Study found, young adults tend to count more on family and friends for retirement planning advice than on financial professionals, then parents or other influential adults can play a significant role in modifying their attitudes and behaviors regarding retirement. Educating young adults through practical hands-on general money management experiences, such as budgeting or differentiating between necessary and discretionary spending, may help instil good financial management habits that can begin to shape attitudes and behaviors about money in a positive direction. Once these attitudes and behaviors are ingrained in the everyday "earning, spending and savings" decisions, it may be far easier for a young adult to successfully advance to the more distant and vague retirement planning process. Clearly, this is a journey rather than a destination.

Role-modelling healthy spending and savings discipline

The power of role-modelling cannot be underestimated. One way to demonstrate good financial management habits is for parents to make regular contributions to their child's college savings plan, such as a 529 plan, which can also help avoid or reduce a future student debt load burden. Parents can involve their children early in the process, perhaps when in their early teens, by showing them their 529 plan statements to teach them about the power of compound growth and how regular savings and a sound investment strategy can contribute to achieving a specific goal (i.e., their future education).

Just as it is important to set goals for retirement and to implement a regular savings plan to ease the burden of having to come up with a lump sum in the future, it is equally important to set goals for the future funding of children's education. Education savings plans, such as the 529 account, are one of the most tax-efficient ways to save for this purpose as contributions compound tax-free (if used towards qualifying college expenses like tuition, etc.).

Avoid bailouts

Another way for parents to help educate their children about money management is to engage them in general financial management while they are still living at home. Teaching those important budgeting skills today can go a long way when it comes to modifying their children's attitudes and behaviors towards retirement planning.

Parents can educate their children about money management while they are still living at home.

Unfortunately, many parents continue to bail out their children. In fact, according to a recent U.S. Study, parents spend ten percent of their annual income to support their adult children, regardless of their income level.[8] Meanwhile, a recent BMO Study revealed that as many as 90 percent of parents agree that they are concerned about the younger generation's ability to manage money.[9] Perhaps for the parents who feel guilty, they can simply invest the "rent" money from their adult child in a special account earmarked for their child and make it a gift at a later date. If still feeling guilty, remember the oxygen mask advice we are given when flying! Apply your own oxygen mask first!

Education through professional financial advice

Talking to a family member and friends can only go so far. It is important to introduce young adults to financial professionals.

As the Research demonstrates, financial literacy is a key factor in empowering individuals to make sounds financial decisions. Making more of an attempt to educate the younger generations about saving for their future financial security can play an important role in strengthening their current attitudes and behaviors regarding retirement planning. There are several ways to achieve this. Parents, or other influential adults, can provide them with written material on non-financial considerations of retirement planning, encourage them to attend seminars or webinars on retirement planning, talk to them about saving in a Roth IRA to have a future tax-free asset, and in a 401(k) account to avail themselves of the employer match, and provide assistance with asset allocation and investment decisions. Educating young adults about the "pay-yourself-first" strategy (i.e., directing a portion of their pay to be automatically deposited to a retirement account) is the simplest way to help them establish sound financial management habits early in life. However, talking to family and friends can only go so far. Therefore, it is important introduce young adults to financial professionals who can provide personalized one-on-one guidance that will further shape and solidify their attitudes and behaviors that will help them prepare successfully for retirement.

Speak their language and connect their way

Finally, it is important to realize that, to a young adult, "retirement" probably feels like an eternity away. Consequently, conversations should keep the word "retirement" to a minimum and be replaced perhaps by "building wealth" for "today" and for "tomorrow". The goal is to help make retirement planning more "real", "vivid" and "relevant". Demystifying myths about money being "locked-in" until retirement can also help to make the retirement savings process to a younger person a little more relevant. For example, young adults are often unaware that it may be possible to save for retirement while also having the flexibility to withdraw the funds to fund a much shorter-term goal, such as the purchase of a home or continuing education. By clarifying common misconceptions about how to save for retirement, this may help to make retirement seem more appealing (i.e., one of the "attitudes"), thus shaping the individual's attitude in the desired direction. These interactions will increasingly need to take place using the young generation's preferred channels of communication such as social networking websites and smart phones.

The goal is to help make retirement planning more real, vivid and relevant to a young adult.

Conclusion

Considering America's aging population and concerns about potential changes to Social Security, the future financial security of Americans depends on today's young adult's financial knowledge and involvement in saving for their retirement. Judging by their lowest financial preparedness scores, their future prosperity may be currently at risk. It is important to help this younger generation and soon, as it is clear that the earlier one starts to save for retirement, the more financial security one will have in the long run. Demonstrating more involvement in preparing financially for retirement may encourage young adults to take positive action despite the challenging and complex financial realities facing them - today and in the future.

Women are also particularly vulnerable, as they tend to live longer and with increasing divorce rates, they may not have a partner to rely on for financial support later in life, yet the evidence from this Study indicates that a smaller percentage of women compared to men are preparing for their retirement, even though they are likely to live longer in retirement than men. However, it was found that once women become involved in the decision making process, they actively prepare for their retirement and demonstrate a stronger relationship than their male counterparts. The challenge is to get them involved.

The purpose and nature of this piece is informational and educational. The analysis and views expressed in this report reflect personal views about the subject and not related to any specific recommendations. The information and statistics in this report have been obtained from sources we believe are reliable but we do not warrant their accuracy or completeness. We do not undertake to advise the reader as to changes of our views in the future. This is not a solicitation of an order to buy or sell any securities. Past performance is no guarantee of future results.

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[1] Leger Marketing (2011) survey conducted on behalf of The BMO Retirement Institute. The "Study" refers to The BMO Retirement Institute's analysis of individual responses to the questions posed in this survey.

[2] Research team: Ross, D. G., Wills L & Gilbert, M. (May 2012). American financial preparation for retirement. Unpublished research paper.

[3] Level of "involvement"(to determine "attitudes" towards retirement savings of respondents) was examined using the Zaichkowsky, J (1985b) Revised Personal Involvement Inventory measurement seven point rating measurement scale. Answers to questions such as "to me, preparing financially for retirement is…"boring vs. important", "irrelevant vs. relevant", "unexciting vs. exciting", "means nothing vs. means a lot", "unappealing vs. appealing", "worthless vs. valuable" were scored to contrast low involvement (low scores in bottom quartile) from high involvement (high scores in top quartile).

[4] The Research measured financial preparation for retirement using the Financial Preparedness for Retirement Scale (FPRS). presented in Ross, D. & Wills, L (2009). Measuring Financial Preparedness for Retirement: A New Scale Using Australian Evidence. Financial Services Review, 18(4), 381-399. The FPRS considers various dimensions of financial preparation behaviors and questions that are commonly employed in financial planning literature. The FPRS has a reliability coefficient score of .92 and is considered a reliable measure. The FPRS asks about activities undertaken by individuals to prepare for retirement including whether they thought about retirement, collected information, discussed the issues with someone, attended any seminars and/or meetings, considered when they will retire, thought about how long they may live in retirement and how much money they will need.

[5] The Research determined the FPRS score for each individual by translating answers to each question into an FPRS score- highest score was given to answers that were consistent with behaviors that demonstrated the highest level of preparation. Alternatively, the lowest score was given to answers that demonstrated the lowest level of preparation.

[6, 7] Kim Parker, "The Boomerang Generation," Pew Research Center, March 15, 2012.

[8] "Familial Financial Assistance to Young Adults, Patrick Wightman", University of Michigan, Robert Schoeni, University of Michigan, Keith Robinson, The University of Texas at Austin, May 3, 2012.

[9] Ipos poll (Sept. 2011) conducted on behalf of BMO Harris Bank among 2714 Americans with children between the ages of 5 to 17 living living at home and with household income between $15,000 and $75,000.

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