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/Report
CANADIAN EDITION

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Executive summary

When people think of financial preparedness for retirement, they often refer to the dollar amount they have saved in their retirement accounts. However, the concept of financial preparedness for retirement can also include non-financial factors, such as people's attitudes towards saving for retirement (i.e., degree of importance, relevance) and their behaviours in learning more about different types of retirement accounts and more about how to save and how to determine how much to save (i.e., talking to financial professionals, attending seminars). To gain further insight into the connection between the attitudinal and behavioural aspects of this preparation process, The BMO Wealth Institute conducted a Study[1] in collaboration with an international academic Research team[2] that demonstrated a substantial relationship between people's level of involvement (i.e., attitude) in their personal retirement savings decisions and their financial preparation for retirement (i.e., behaviours). This suggests that if messages about retirement planning are to be meaningful, they should contain elements that people are likely to perceive as personally relevant and important. In other words, people need be able to relate to these messages at a personal level. The Study also illustrated that time remaining to retirement, and not age, is a key indicator of an individual's financial preparedness for retirement.

The Study indicates that young adults under the age of 35 are the least prepared, based on an analysis that considered attitudes and behaviours as key measurements for financial preparedness for retirement. These findings can be helpful to the younger generations as common wisdom states that the earlier people start 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 attitudes and behaviours so that their level of involvement may increase sufficiently to drive positive information-seeking behaviour and lead them to take action.

Enhanced estate planning requires having detailed conversations to share the background and reasoning behind the estate decisions.

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Introduction

As people approach retirement, the question of whether they are financially prepared becomes top of mind. Questions regarding financial sufficiency may be raised by several trends, such as employers moving away from offering traditional defined-benefit pension plans and certain government pension benefits being decreased and delayed. These trends serve to shift 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.

Financial preparedness may best be viewed as a set of behaviours.

This article seeks to help answer the question of "what constitutes financial preparedness for retirement?" Financial preparedness for retirement may best be viewed as a set of behaviours that lead to improved financial planning for retirement. People may overlook emotional and behavioural 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 – which is actually the final step in a complex process. For example, booking a flight and a hotel is usually the final step in the process of planning a vacation. This final step is typically preceded by a thorough planning process, which may begin with feeling excited about the prospect of a vacation or trip, visualizing the destination, activities and pleasure to be derived from the trip, and setting an approximate travel date. These represent emotional or attitudinal thought processes. That may be followed by an attempt to learn more about the trip and the destination, by gathering information on the Internet and at bookstores, or by consulting a travel agent, and then actively saving for the trip. All of these are key behaviours that bring one closer to actually taking action (the final step of booking a flight and hotel).

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

To help adequately prepare for retirement, a similar behavioural preparation process ought to occur. First, a person may need to be excited about the prospects of retiring to become motivated to seek information and advice, and finally to take action to save for retirement. The final step usually involves choosing to save in a personal retirement savings account, an employer retirement savings program, or both. The stronger the attitudes and behaviours are before taking the actual step of saving in retirement accounts, the greater the likelihood that the chosen financial action will help ensure a comfortable future retirement. This means that

attitudes and behaviours can be strong predictors of financial preparedness for retirement, and the earlier these can be shaped, the better prepared Canadians can be for retirement. As a result, the focus on retirement planning could usefully be broadened from the traditional focus on dollars and cents in accounts to an approach that includes individuals' attitudes and behaviours.

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

To gain further insight into the connection between attitudinal and behavioural aspects of this preparation process, The BMO Wealth Institute conducted a Study[3] of Canadians 18 and older in collaboration with an international academic Research team[4] who analyzed people's level of involvement[5] (i.e., attitudes towards saving for retirement) in financial preparation for retirement decisions and its effect on behaviour. The Research team considered 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 needs to be saved and for how long and setting a retirement date) using a Financial Preparedness for Retirement Scale (FPRS)[6] and determining an FPRS score[7]. This analysis measured financial preparedness based on people's combined responses to a series of questions about their retirement planning attitudes and behaviours. No single response to a question about 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.

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 Study based on responses to individual survey questions.

Key findings:

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 on involvement in financial preparation for Canadians. Somewhat surprisingly, the more researched factors, such as age and gender, were not significantly related to FPRS when compared

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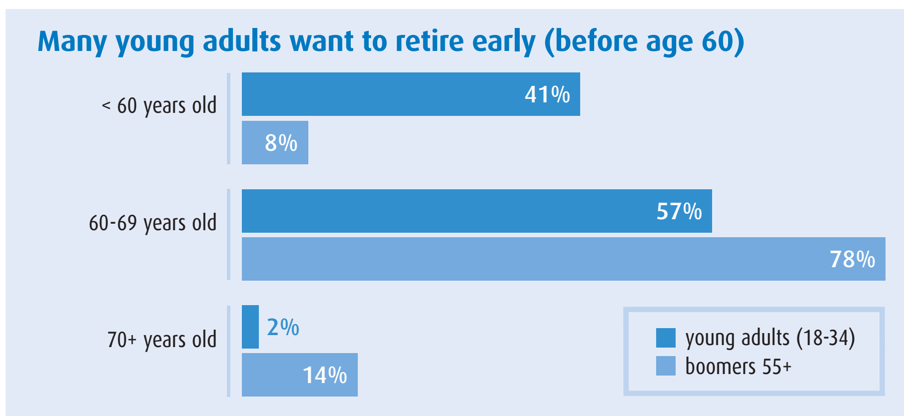
with other variables. For example, gender differences are present, but when the income variable is considered, there is no difference in the FPRS scores of men and women who are in same income tax bracket. Instead, the Research revealed that the FPRS score is best explained by years to retirement and education, which appear to be the two key drivers of retirement preparedness.

Not surprisingly, the closer people are 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 his or her desired retirement age than an older person (i.e., a 40-year-old who desires to retire at the age of 50, and therefore has ten years left before retirement, compared with a 50-year-old who aims to retire at the age of 65, and therefore has 15 years left). Nevertheless, as expected, the Research based on attitudes and behaviours concluded that the youngest generation of adults is the least prepared for retirement, because in all probability, their retirement date is the furthest away. Interestingly, the Study findings suggest that young adults under the age of 35 may be overly optimistic, since as many as 41 per cent expect to retire early (i.e., before age 60).

In addition to the time remaining until the target retirement date, the Research revealed that a person's level of education was another indicator of financial preparedness for retirement. It was found that higher levels of education can greatly influence people's motivation and

Young adults are the least prepared for retirement, yet as many as 41 per cent expect to retire before age 60!



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involvement in taking a more active role in planning their retirement by, for example, attending seminars or consulting financial planners, which are behaviours that increase basic financial education and empower people to make sound financial decisions and take action accordingly. This is why improving the financial literacy of all Canadians is so important, and it may also explain why government and financial institutions have taken an active role in advocating the promotion of financial literacy through diverse national campaigns and initiatives.

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

The fact that younger adults are the least prepared, however, should not be overlooked. Logically speaking, the earlier individuals start to save for retirement, the greater the potential for ensuring future financial security, thanks to the benefits of tax-sheltered compound growth over a longer period of time. Increasing younger people's financial preparedness for retirement can help them take positive action to surmount challenging and complex financial realities now and in the future.

However, motivating young adults to change their attitudes and behaviours is no easy task. Because young adults do not feel the same sense of urgency as older people who are closer to retirement, motivating them to take a more active role in preparing for retirement will require a special approach. Rather than taking the traditional dollars-and-cents approach, which often begins and ends with the action of saving money in a retirement account, perhaps it is time to shift towards modifying people's attitudes and behaviours about retirement. After all, the Research finds that these are the two most critical aspects that predict a person's financial preparedness for retirement. This challenging task depends, first, on understanding young adults' current attitudes and behaviours regarding retirement planning.

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

Although the Study found that young adults aged 18 to 34 were less involved and engaged in retirement planning than older boomers, as confirmed by their relatively lower scores, the good news is that a large majority of young adults do, in fact, find retirement planning to be relevant (75 per cent) and important (82 per cent). In fact, the Study found that a little over half (52 per cent) are saving in an RRSP, and 36 per cent are saving in a TFSA. This is a good start.

Behaviours and actions fall short

One of the reasons that young adults produced the lowest scores is that they do not consistently score high on all the individual attitude questions. For example, our Study revealed that only one out of ten (10 per cent) young adults thought "a lot" about how much they will need to save for retirement. While it is difficult for anyone to accurately predict exactly how much they need to save for retirement, this is a critical starting point that requires visualization before an appropriate savings plan can be established.

Only 5 per cent of young adults "thought a lot" about how long they might be retired for vs. 23 per cent of boomers over the age of 55.

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 over time (i.e., income level and household debt changes that affect 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 behaviour of thinking about how much they will require. This suggests that to modify their behaviour (determining how much they need to save), a primary focus could first be on increasing young adults' level of involvement, rather than focusing their attention on visualizing how they would like to spend their retirement and the savings that it may require.

Also, while almost one quarter (23 per cent) of boomers over the age of 55 "thought a lot" about how long they might be retired for, only a negligible five per cent of young adults demonstrate this same behaviour. As discussed earlier, the retirement planning process involves certain attitudes that cause people to think "a lot" about their retirement and lead them to go through the step of visualizing it. In the absence of visualizing one's retirement, it is impossible to accurately forecast the amount of money that might be required, and for how long. Not knowing these details may be an indication that a person does not have a strong attitude towards retirement.

Perhaps 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) translates into corresponding behaviours falls short, compared with older adults. For example, the Study found that older adults are more involved than young adults, and their higher level of involvement translates into greater engagement

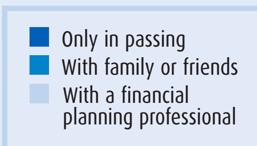
in behaviours such as gathering information on retirement planning, attending seminars and consulting others on retirement planning and, finally, taking action (i.e., saving in retirement accounts).

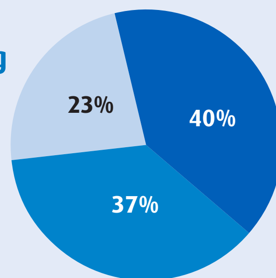
Indeed, the Study found that when young adults seek information on retirement planning, they tend to speak about it with family and friends, and generally in passing only. In contrast, boomers, tend to consult financial professionals (41 per cent of boomers 55 and older, compared with 17 per cent of 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 families and friends are not likely to have the tools and knowledge financial professionals use to perform complex financial forecasting calculations. Not surprisingly, our Study found that only 38 per cent of younger adults under age 35 took action following speaking with others about retirement planning, as compared with 64 per cent of individuals ages 35 and older.

Only 38 per cent of young adults took action after speaking with others about retirement planning vs. 64 per cent of individuals 35 and older.

Retirement planning seminars seem to have the greatest impact on motivating young adults to take action.

Of the majority (76%) 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.





Another activity considered was attending seminars. Although our Study found that in general only a few individuals attend retirement planning seminars, these events seem to have the greatest impact on motivating young adults to take action. Indeed, although only 19 per cent of those under 35 (vs. 43 per cent of those 55+) attended a retirement planning seminar, as many as 63 per cent of young adults under 35 years of age took action (while 67 per cent of those 45+ took action). Perhaps the impressive seminar success rate is because the education is provided by a financial professional instead of family or friends. If so, financial

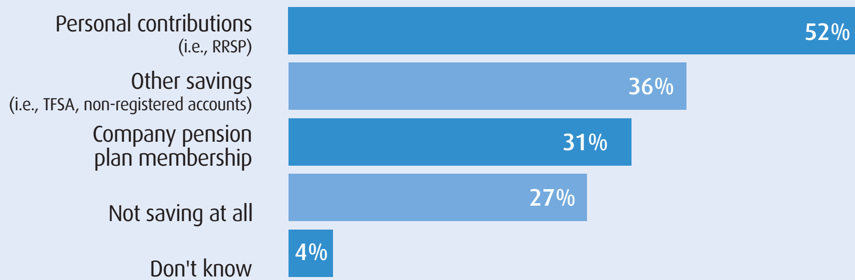
professionals clearly have the ability to positively change attitudes and behaviours in young adults.

In summary, individual behaviours that demonstrate a high degree of involvement (i.e., attitudes) in the process of learning about retirement planning are important drivers of financial preparedness for retirement. However, it is important to remember that only a combined set of attitudes and behaviours about a series of thoughts and actions can help predict a person's financial preparedness; no single attitude or behaviour reflecting a particular thought or action on its own is a determinant of financial preparedness. When it comes attitudes and behaviours related to preparation for retirement, young adults are clearly behind older boomers by a wide margin.

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

Today's unique challenges

There are various underlying causes for young adults' poor attitudes and behaviours in connection with retirement. Aside from retirement appearing as though an eternity away, this group faces certain realities that may hinder their progress on this emotional, non-financial front. Compared to previous generations, 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 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 third (27 per cent) of individuals ages 18 to 34 have not saved at all for retirement, whether through personal savings vehicles such as registered retirement savings plans (RRSPs) or through workplace pension plans. Although the Study found that two-thirds are saving for retirement, this activity may not be adequate, considering this cohort's low score on attitude and behaviours. 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 is left to chance.



Almost a third of young adults have not saved at all for reitrement.

A fragile global market, significant portfolio declines and the persistent volatility that started in 2008 may be the cause of heavy scepticism and hesitation about investing their "newly earned money." Home ownership is largely on hold, as the Canadian housing rally has made home ownership more expensive for today's younger generation than it was for their parents.[8] Prices have risen nearly twice as fast as income in the past decade,[9] which helps to explain why half of boomers believe their children will struggle to afford a home.[10] The combined effect of mounting student debt, underemployment, low wages and unaffordable housing may help to explain why so many young adults have no choice but to live with their parents, and why many are postponing life's milestones, such as marriage and having children.[11] In fact, 51 per cent of young adults 20 to 29 years old are living with their parents.[12] 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 behaviours 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 behaviours

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 behaviours regarding retirement. Educating young adults through practical, hands-on money management, such as budgeting or differentiating between necessary and discretionary spending, may help to instill good financial management habits that may begin shaping positive attitudes and behaviours about money. Once these attitudes and behaviours 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, retirement planning is a journey rather than a destination.

One way of demonstrating good financial management habits is to contribute to a child's RESP.

Role-modelling healthy spending and savings discipline

The power of role-modelling cannot be underestimated. One way of demonstrating good financial management habits is to have parents make regular contributions to a child's registered education savings plan (RESP), which can also help avoid or reduce future student debt. Parents can involve their children early in the process, perhaps in their early teens, by showing them RESP statements and teaching 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).

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

Unfortunately, not enough Canadians are saving for their children's education using an RESP. Getting an RESP can often be the first step in saving for a child's education. It is also the only way that low-income families can receive the Canada Learning Bond, which provides up to $2,000 without any parental contributions. However, almost 900,000 children across Canada who would be eligible are not receiving it, and many families are not aware that the Bond exists.[13]

Avoid bailouts

Another way for parents to help educate their adult 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 in modifying their children's attitudes and behaviours in connection with retirement planning.

Unfortunately, many parents continue to bail out their children. In fact, according to a recent U.S. Study, parents spend 10 per cent of their annual income to support their adult children, regardless of their income level.[14] Meanwhile, a BMO survey revealed that only a small majority of parents are confident in their children's ability to manage their inheritances.[15] Perhaps parents who feel guilty about withholding support could consider investing 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 parents still feel guilty, remember the advice we are given when flying: Apply your own oxygen mask first!

Education through professional financial advice

As the Research demonstrates, financial literacy is a key factor in empowering individuals to make sound financial decisions. Making more of an attempt to educate the younger generation about saving for their future financial security can play an important role in strengthening their current attitudes and behaviours regarding retirement planning. There are several ways to achieve this. Parents and other influential adults can provide them with written material on the non-financial considerations of retirement planning, encourage them to attend seminars or webinars on retirement planning, talk to them about saving in a TFSA or RRSP account and provide assistance with investment decisions. Educating young adults about the "pay yourself first" strategy (i.e., directing a portion of pay to be automatically deposited to a retirement account) may be 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 to consider introducing young adults to financial professionals who can provide personalized one-on-one guidance that will further shape and solidify the attitudes and behaviours that will help them prepare successfully for retirement.

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

Speak their language and connect their way

Finally, it is important to remember that to a young adult, retirement likely seems too far away to worry about. Consequently, conversations may want to keep the use of the word "retirement" to a minimum, and replace it with "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 may also help to make the retirement savings process a little more relevant to a younger person. For example, young adults are often unaware that it may be possible to save for retirement while also having the flexibility to withdraw the assets to fund a much shorter-term goal, such as the purchase of a home or continuing education (subject to certain terms and conditions). Clarifying common misconceptions about how to save for retirement may help to make retirement seem more appealing, thus improving an attitude. Increasingly, discussions of these matters may need to take place using the younger generation's preferred channels of communication, such as social networking websites and smartphones.

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

Conclusion

Considering Canada's aging population and concerns about changes to employer and government pensions, the future financial security of Canadians depends on today's young adults' financial knowledge and their involvement in saving for their own retirement. Judging by the low financial preparedness scores found by the Research, 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 they start to save for retirement, the more financial security they are likely to 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 they face today and in the future.

1,3 Leger Marketing (2011) conducted the survey 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.

2,4 D.G. Ross, L. Wills and M. Gilbert, Canadian financial preparation for retirement. Unpublished research paper, May 2012.

5 Level of involvement (to determine attitudes towards retirement savings of respondents) was examined using the Zaichkowsky, J. (1985b) Revised Personal Involvement Inventory 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) and high involvement (high scores in top quartile).

6 The research measured financial preparation for retirement using the Financial Preparedness for Retirement Scale (FPRS) presented in D. Ross and L. Wills, "Measuring Financial Preparedness for Retirement: A New Scale Using Australian Evidence," Financial Services Review, 18(4) (2009), 381–399. The FPRS considers various dimensions of financial preparation behaviour 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 considered how much money they will need.

7 The research determined the FPRS score for each individual by translating answers to each question into an FPRS score. The highest score was given to answers that were consistent with behaviours that demonstrated the highest level of preparation. Alternatively, the lowest score was given to answers that demonstrated the lowest level of preparation.

8 PWC, Emerging Trends in Real Estate 2012, Canada Edition, p. 13.

9 BMO Economics, June 2012.

10 Leger Marketing survey conducted on behalf of BMO Financial Group, March 2012.

11 Tim Shufelt, "From Doom to Gloom – Generation unlucky," Financial Post, Oct. 15, 2011.

12 "Generation Boomerang," CBC Network, November 10, 2011.

13 May Wong and Sheila Murray, "More than Money," Maytree Policy in Focus, December 2010, Issue 14.

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

15 2011 Harris/Decima online survey conducted on behalf of BMO Harris Private Banking among 459 Canadian adults who have $1 million or more in investable assets.

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