STATE STREET GLOBAL ADVISORS

Global Retirement Reality Report 2018

Chapter One

Balancing Flexibility and Security in Retirement

We are experiencing a global retirement transformation.

People are living longer; a seemingly benign development that has strained retirement systems around the world. Increasing longevity has already made the legacy income-for-life guarantees offered by defined benefit (DB) plans unsustainable. While defined contribution (DC) has been in place for decades in several countries, it also has its limitations, particularly with respect to the burden that it can place on individuals and the reduced level of risk sharing.

In the first of three chapters synthesizing results from the Global Retirement Reality Report (GR3), we explore the retirement challenge from several different angles:

- Areas of consistency across the globe, including the anticipated level of income in retirement as well as expectations with respect to saving, spending, and sacrifices
- The challenges related to changing working patterns and an extended working life
- How retirement solutions need to evolve to address individuals' dual need for flexibility and security

Across these dimensions, we plot countries on the DC spectrum, considering both the level of dependence on DC and the features of the DC system in each country. We find that employees in the more established DC systems have a greater sense of ownership, engagement, and certainty when it comes to their savings plan. However, many of these first-generation DC systems carry shortcomings. The countries now transitioning into DC are introducing more sophisticated systems that address many of these deficiencies. The countries with more established DC systems are also taking steps to re-introduce some of the positive features of DB, particularly guaranteed income in retirement.

Spectrum of DC System Maturity

Maturity is defined here as a country's overall level of dependence on DC savings. This dependence is a result of the prevalence of DC schemes within a given market.

Less ◄—— DC Dependency ——► More

	GER*	ITA	NL	SWE	IRE*	UK	US	AUS
Investments in Illiquid Assets		✓	✔	✓				✔
Lifetime Income Guarantee		✔	✔	✔				
Mandated Contribution Minimum		✔	✔	✔		✓		✔
Automatic Enrolment		✓	✔	✔		✔	✓	✔

✔ Feature of regional plans

✓ May be available/ability to opt out

Source: State Street Research

While younger survey respondents expressed anxiety around what lies ahead, they are also the most open to changing their behaviour to improve retirement readiness. As working patterns evolve to become more flexible, with retirement increasingly becoming a multi-year process rather than a discrete, single event, so must retirement solutions. Flexibility and security will be the guiding principles, offering both flexible access to savings in retirement and guaranteed income when it's needed most.

Policymakers and investment providers will need to rise to the challenge of this new, multi-dimensional world.

*DC schemes can only be introduced in Germany if they are negotiated as part of a collective bargaining process and they must by managed jointly by the social partners (trade unions and employers' organizations). The details of the scheme will be defined by the social partners. This will include whether to auto-enrol members, mandate contribution rates, etc. Policy makers in Ireland have published a Roadmap for Pensions Reform which includes details on a new automatic enrolment savings system. (Source: A Roadmap for Pensions Reform, Government of Ireland, February 2018).

Survey Methodology

As part of our global goal to deliver better retirement outcomes, our GR3 captures a picture of people's hopes, fears, expectations, and experiences surrounding retirement.

State Street conducted an online survey,[1] in conjunction with YouGov, across eight countries representing a range of retirement systems. We asked 9,451 people at every stage of the retirement spectrum, from those new to the workforce to those later in retirement itself, to better understand the milestones and inflection points across the whole savings journey. All respondents participate(d) at some level in a DC or private savings plan.

Sample Groups

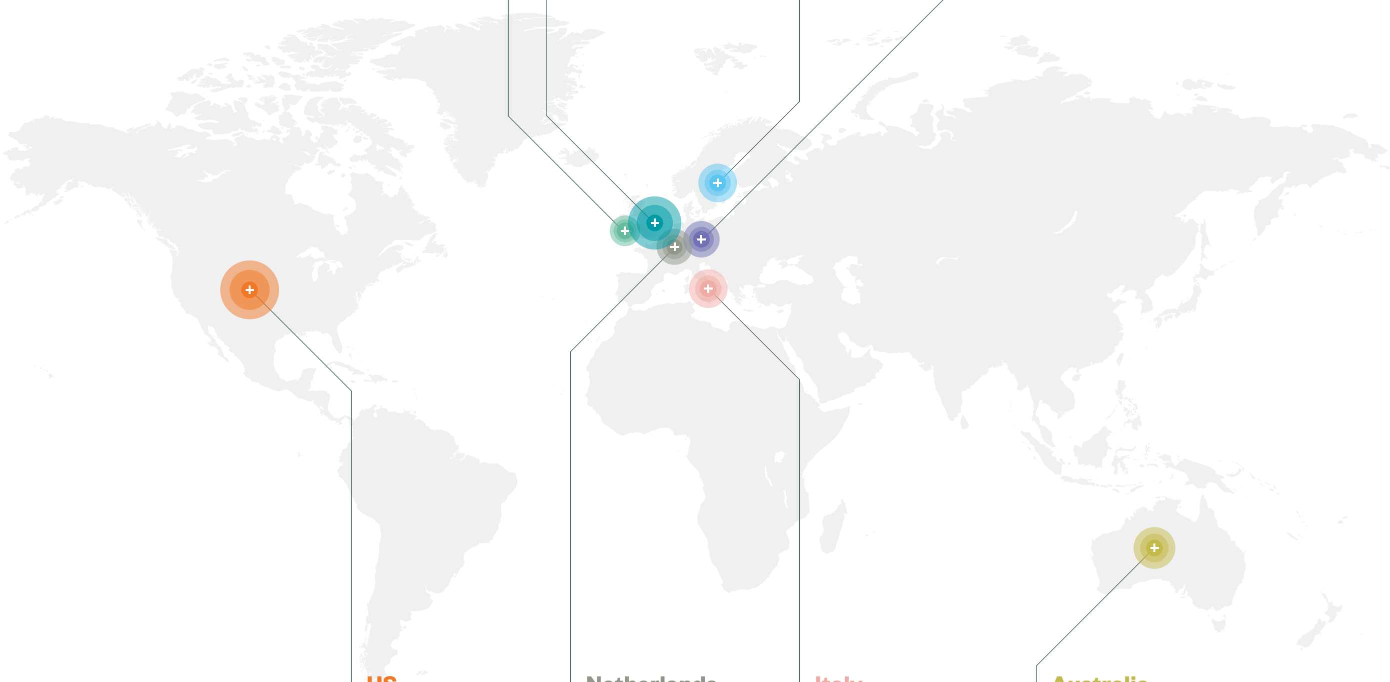
(WP) Working Population — Working and not planning to retire in the next 5 years
(AR) Approaching Retirement — Working and planning to retire in the next 5 years
(RR) Recently Retired — Retired within the last 5 years
(LR) Later in Retirement — Retired more than 5 years ago

Ireland	
WP	400
AR	148
RR	54
LR	-[2]
Total	**602**

UK	
WP	415
AR	384
RR	403
LR	401
Total	**1603**

Sweden	
WP	542
AR	149
RR	233
LR	251
Total	**1175**

Germany	
WP	423
AR	398
RR	152
LR	54
Total	**1027**



US	
WP	419
AR	407
RR	415
LR	416
Total	**1657**

Netherlands	
WP	410
AR	250
RR	164
LR	203
Total	**1027**

Italy	
WP	420
AR	300
RR	263
LR	154
Total	**1137**

Australia	
WP	400
AR	400
RR	228
LR	195
Total	**1223**

Finding 1
Expectation Meets Reality

Across the spectrum of time and place, people's expectation of their financial needs in retirement appear to be fairly realistic — from what they will make, to how they will spend it, to where they may have to make sacrifices.

Expectations for income replacement rates are in line with reality

Income The income replacement rates young people expect to receive in retirement are very similar to what current retirees are getting, suggesting a realistic assessment of the path ahead.

WP *% of current income that pre-retirees expect to receive in retirement*
RR *% of retirement income compared to working income*

(WP) Working Population – Working and not planning to retire in the next 5 years
(RR) Recently Retired – Retired within the last 5 years

Spending Across the globe — and generations — the spending habits and expectations of pre-retirees and retirees are largely consistent, with the priority being spending on regular essentials, holidays, and paying for health and care.

Top 5 spending items

1. Pay for regular essentials
2. Go on holidays
3. Health and care (for self and partner/ family member)
4. Financial help for children/ grandchildren
5. Save for a rainy day

Bottom 5 spending items

1. Take up a new hobby/further education
2. Buy something one always wanted
3. Move to a different home
4. Move to a more desirable climate/ other country
5. Buy a vacation home

We acknowledge the limitations of drawing connections between current workers' expectations and current retirees' experience, as the future is bound to change, both for individuals and systems, and have applied these considerations to our analysis.

Where retirees spend Interestingly, people in retirement rank spending on healthcare higher than the working population currently expects (the US leads in terms of both expected and actual healthcare spending in retirement). Also exceeding pre-retirees' expectation is retirees' financial support of their families. This heightened focus extends to helping adult children and grandchildren as well as building an inheritance.

In fact, building an inheritance for heirs is a factor that grew in importance for retirees, displacing self-oriented investments that pre-retirees expected to make in activities like exploring a new hobby or continuing adult education. This shift likely reflects people's values changing with age, but may also be an indicator of the increasing financial needs of younger generations.

Where they don't spend Beyond not pursuing spending on new or deepened personal interests, those in retirement are also less adventurous than their imagined future selves. Compared to expectations, fewer move houses, buy a vacation home, or relocate to a more desirable location. Spending on regular essentials, health, and holidays unsurprisingly tops the list both for the working population and for retirees.

As the world ages, healthcare costs take on rising importance

While the US surpasses all countries in healthcare spending in retirement, healthcare spending in retirement is increasingly becoming a priority cost around the globe — one that exceeds expectations. This trend persists even in countries with comprehensive national health systems. Sweden presents an interesting example: respondents' expectation of how high healthcare spending will rank as a priority is the lowest of the survey; however, in reality, retirees' rank healthcare as a higher spending priority.

% of respondents ranking healthcare as a spending priority

	US	**Globally ex US**	**Sweden**
Approaching Retirement	47%	22%	7%
Later in Retirement	56%	32%*	18%

*Excludes Ireland, given insufficient data

Finding 2
Bridging the Gap Between Savings and Spending Needs

Participants approaching retirement have three main levers with which to improve their retirement readiness: they can save more, work longer, or try to find more efficient investment strategies. If they still find themselves with inadequate resources when they retire, they also have a fourth path — to change their expectations and reduce spending.

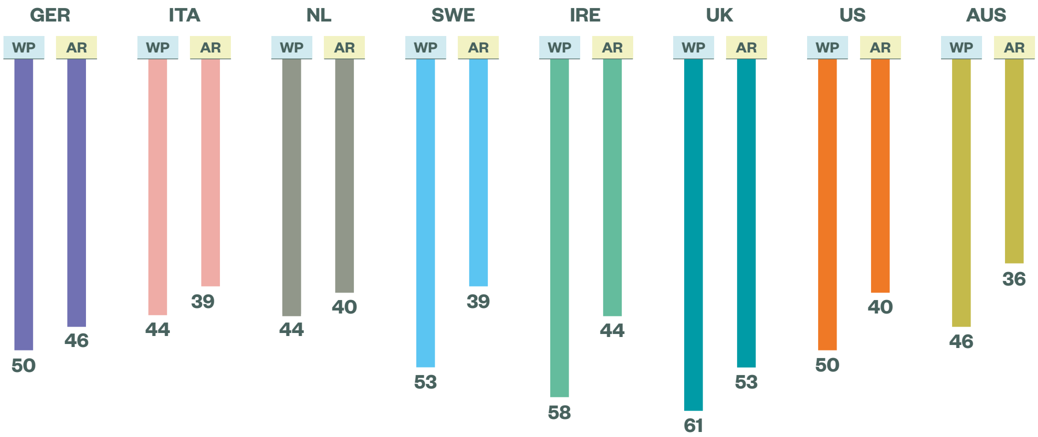
While younger generations seem to have fairly realistic expectations in terms of spending habits, achieving even the expected income level in retirement at current savings rates may present some challenges. In most of the countries we surveyed, a majority of people say they are saving less than 10% of their income. This finding stands out both for being consistent across varied markets and for being inadequate as standalone savings.

The consistency of the less than 10% savings rate is notable given that required minimum contribution rates vary widely by country. At one extreme, in the US, DC contributions are entirely voluntary for both employers and employees. Australia mandates a 9.5% employer contribution to DC and in the Netherlands, the required contribution is rate is on average 20-25% of salary, with the employee contributing 4-6%, on average, and the employer responsible for the rest.

For those who are saving less than 10% on a pure DC basis, net state pension or social security income sources, the potential for outliving retirement savings is high. In the current market environment, a participant who saves 10% of her salary from age 25-65 could expect to receive a replacement rate of about 30% of their salary at retirement.[3] This should give individuals and providers across the globe pause to consider course corrections.

Nearly half of all workers are saving less than 10% of their income

% of workers who are saving less than 10% of current earnings into their retirement plan



(WP) Working Population – Working and not planning to retire in the next 5 years
(AR) Approaching Retirement – Working and planning to retire in the next 5 years

Slightly more than half are confident that savings will cover some to all retirement expenses

Given this low expected replacement rate, it is encouraging to see that savings rates rise as people age — as does workers' confidence in their ability to fund their next phase. While the rate of change varies across the world, confidence consistently increases as people approach retirement. That said, there is still unease around savings sufficiency, with 40% of those approaching retirement expressing concern.

% of workers who believe their savings will be close to covering expenses in retirement

(WP) Working Population – Working and not planning to retire in the next 5 years
(AR) Approaching Retirement – Working and planning to retire in the next 5 years

When we asked current retirees what advice they would give to younger generations, the message was clear and consistent — start saving earlier and engage with your pension planning sooner. In all cases, retirees thought that saving and planning earlier were more important than saving more. Practically, saving earlier and strategically yields more savings with less effect on spending day-to-day — enabling better long-term financial results while reducing the immediate impact.

Voice of Retirees

Prepare Early Beyond saving, this means having a plan flexible enough to accommodate the unexpected. Prioritise financial needs and engage in dialogue with loved ones as well as outside resources to ensure a shared and informed vision.

"Should have looked more closely in the options that were available to me," **Male, 64, Germany**

"Make a comprehensive long-range plan as early as you can." **Male, 81, US**

"Discuss what you and your partner hope to have in retirement together." **Female, 67, Australia**

"Go into retirement debt-free." **Male, 64, UK**

"Hire a private counselor early." **Male, 67, Sweden**

"Don't rely just on the state system. Get additional private insurance," **Female, 71, Italy**

"Consider that you may have to retire earlier due to illness," **Female, 51, Ireland**

"I should have set an earlier end date for my occupational and private savings arrangements [an approach that may have yielded a higher benefit in the earlier years of retirement]." **Male, 68, Netherlands**

In addition to increasing savings during the working years, retirees should be preparing to reduce consumption. People expect to receive a cut in income once they retire and appear to have a fairly realistic idea of how they will modify their patterns. This does not necessarily mean having to make sacrifices; interestingly, about 30% of current retirees in all countries report not having had to make any sacrifices. This number falls to 10-20% for those who are still employed, again reflecting the fact that older generations have benefited from a somewhat more favorable financial backdrop.

Both pre- and post-retirees are fairly closely aligned on the items that they will cut back on — including reducing savings and spending less on clothing for example.

However, areas where inconsistencies are found point to what could be a transition in priorities. Pre-retirees think they will be forced to sacrifice on unnecessary luxuries, like larger homes, technology, and supplementary insurance policies. However, those items end up becoming central to a retirement organized around comfort and peace of mind, whereas eating out and holidays become the places retirees are cutting down. In keeping with our previous observations, retirees focus more on the home front than adventure.

Pre-retirees and retirees are aligned in some areas of reduced spending...

Spend less on clothing

Save less

...but differ in others

Pre-retirees	**Retirees**
Live in a smaller home	Go out less
Spend less on technology	Go on fewer holidays
Give up on non-essential insurance	Spend less on home improvements
These expectations suggest assumptions of 'living with less'	The reality suggests that retirees are simply living differently — reprioritising comfort over adventure/new experiences

Finding 3
Modified Behaviours to Better Fund Retirement

Younger people seem to understand the need for new behaviours in order to enjoy a comfortable retirement and many expect to extend their working life. As working patterns become more flexible, so should retirement.

One of the main reasons that current retirement systems are in crisis is that people are living longer, yet the retirement age has not always risen correspondingly. Younger generations appear to recognize that a longer life also implies an extended working life, and a large share of these individuals expect to retire later or do part-time work to cover the income shortfall. These transitions will not be frictionless and for some individuals, extending working lives will be more painful than for others — for some groups it may even be infeasible. This means that workplaces, public policy and tax systems will also have to evolve to fill the needs of a new, more flexible model of work and leisure in a way that treats different groups equitably.

Retiring later This is an extremely powerful strategy for improving retirement readiness, as it both increases the savings period and shortens the years in retirement that require financing. Younger people seem to realise — and even embrace — the fact that they will need to work longer than previous generations. Trends reflected in the annual Willis Towers Watson Global Workforce Study suggest that younger workers are increasingly focused on cultivating professional experiences defined by meaning and strong relationships[4] — dimensions that can arguably sustain employees throughout a longer, more engaged working life. When seen together, these positive signs point to a public adjustment to the new demographic reality of longer lifespans.

Younger workers expect to retire later

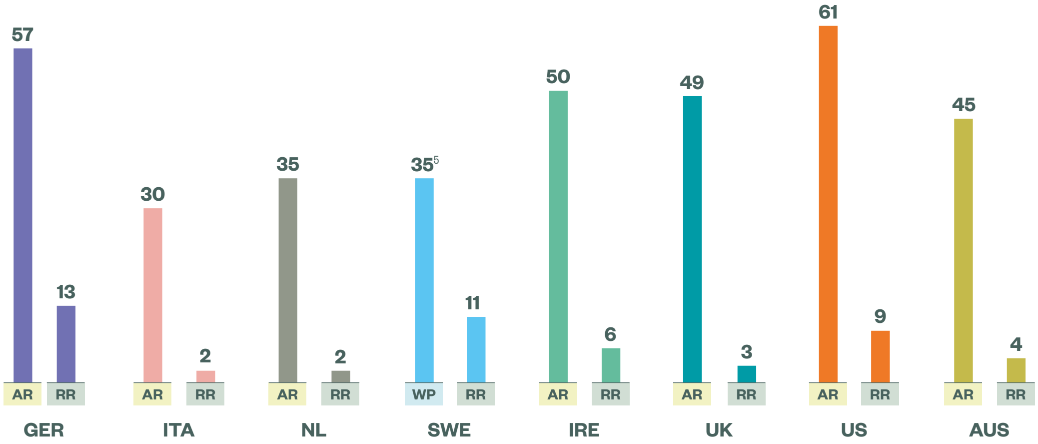
% of workers who intend to retire later to make up shortfall between retirement savings and expected spending

(WP) Working Population – Working and not planning to retire in the next 5 years
(AR) Approaching Retirement – Working and planning to retire in the next 5 years

Part-time work Many currently working see part-time work in retirement as a potential prospect, but few retirees currently engage in it. For those currently in retirement, part-time work may be unnecessary (due to sufficient funds, possibly gained by retiring later) or unrealistic (due to difficulty in finding aligned part-time employment). But for the younger generation, many people expect to work part-time in retirement. While this expectation may be due to heightened anxiety around what lies ahead, it is more likely a reflection of a reimagined retirement — one that is more aligned with longer lives.

People approaching retirement increasingly expect to work part-time

***AR** % of workers who intend to use part-time work to make up a retirement savings shortfall*
***RR** % of recent retirees who are using part-time work as a source of income to fund retirement*

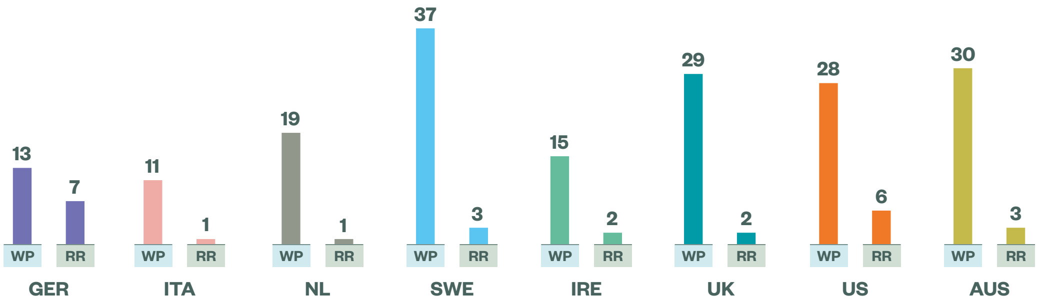


(AR) Approaching Retirement – Working and planning to retire in the next 5 years
(RR) Recently Retired – Retired within the last 5 years

Many workers expect to downsize homes, but few retirees do

Extracting equity from one's home, either through refinancing, downsizing, or property leasing is also a popular financial plan, shared by a number of respondents in several countries.

***WP** % of workers who intend to use downsizing or equity release to make up a retirement savings shortfall*
***RR** % of retirees who have used downsizing or equity release as a source of income to fund retirement*



(WP) Working Population – Working and not planning to retire in the next 5 years
(RR) Recently Retired – Retired within the last 5 years

For most people, their home is their most valuable asset, making it a potentially effective resource for retirement funding. The 2013 Willis Towers Watson report, Equity Release: Accessing Housing Wealth in Retirement, estimated a potential for over €200 billion to be freed from equity release products over the next 10 years. This trove of funding could be a meaningful source for addressing the European pensions gap, currently assessed at €2 trillion or 13% of the European GDP.[6] There is a similar situation in the US. According to the Bipartisan Policy Center, Americans own more than $12.5 trillion in home equity, a sum that rivals the $14 trillion that Americans hold in retirement savings.[7]

In reality, retirees are not tapping into their home equity at the rate that younger generations expect. For one thing, smaller is not necessarily cheaper. Moving to a smaller home near an urban center may not actually reduce costs given increased real estate and cost of living expenses. Furthermore, people are reluctant to use the financial products that would allow them to access their home equity while still living in the property. Reverse mortgages (equity release plans) would allow people to tap into their home equity, but in practice, understanding, comfort, and usage of these products is low.[8] Overall, respondents' expectations of being able to use home equity as a source of income in retirement are likely to be exaggerated.

Finding 4
Retirement Income

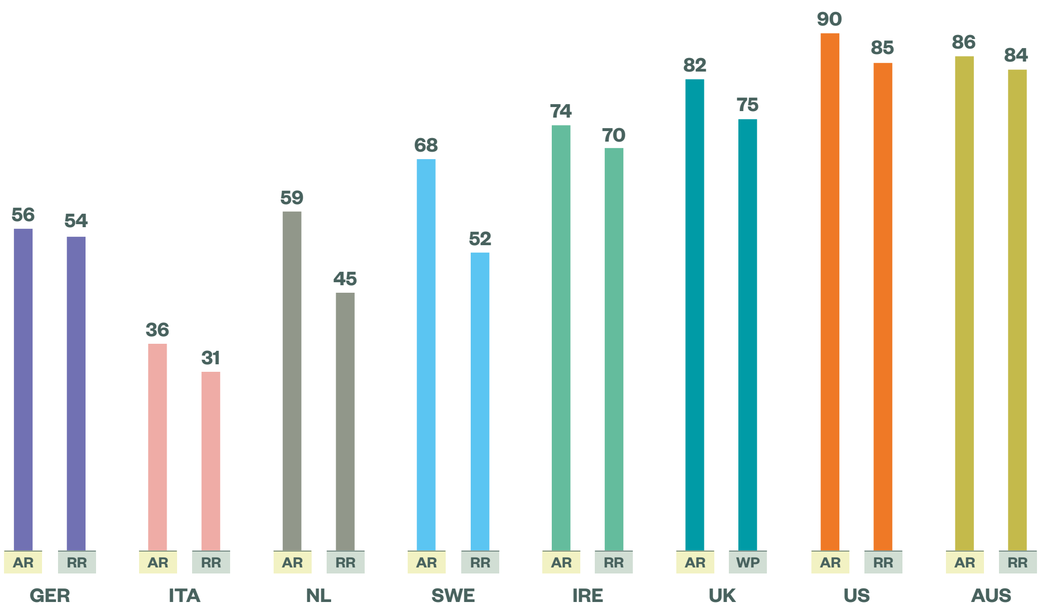
The shift to DC plans has transferred the risk for investment and savings decisions from financial professionals to individual employees. While DC addresses the key limitations relating to the financial sustainability of DB, in many countries it lacks a core advantage of DB — guaranteed income in retirement.

The increased level of saver autonomy and responsibility comes with its own challenges. In the absence of DB plan professionals making fund and asset allocation decisions, DC plans have streamlined investment decision making by introducing smart default investment vehicles, like target date funds. In countries where contribution rates are not mandated, plans can also offer automatic features, such as auto-enrolment or auto-escalation, to enable a set-it-and-forget-it approach to saving.

Savers in different countries are in different stages of embracing this individual responsibility. In the countries with more mature DC systems (UK, US, Ireland and Australia) about 75-85% of respondents see themselves as having the primary responsibility for income in retirement. In the countries that are still in a relatively early stage of transition from DB to DC (Germany, Sweden, Italy and the Netherlands), the share of respondents who consider that they themselves bear the primary responsibility for retirement income is clearly lower. This transition is also visible in the marked difference between the responses of retirees, who have lived in a mostly DB-centric world, and younger generations, who are beginning to accept more individual responsibility.

The majority of workers see themselves as responsible for retirement income

% of respondents ranking themselves as most responsible for making sure they have adequate income in retirement



(AR) Approaching Retirement – Working and planning to retire in the next 5 years

(RR) Recently Retired – Retired within the last 5 years

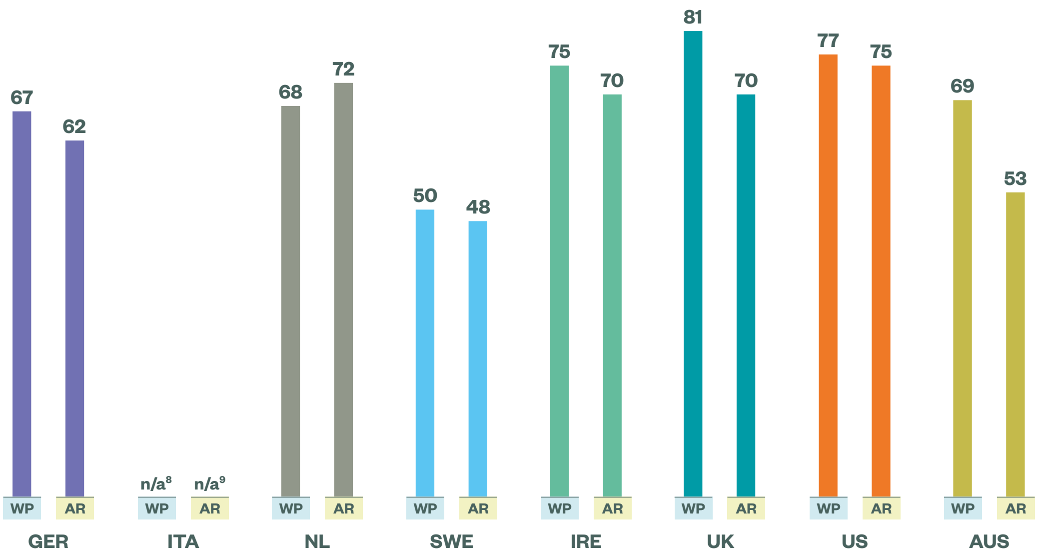
Public policy has driven much of the innovation in DC, from enabling automatic or mandated savings plan enrolment to endorsing default investments. However, in many countries, there is not yet a clear path to drawing down accumulated retirement assets. The absence of guidance here could have a significant impact on how people access their hard-earned savings — either spending savings too quickly and leading to shortfall or overly rationing their savings to the detriment of their lifestyle (and the broader economy).

Adding a guaranteed income component — through an annuity, for example — would provide individuals with a more balanced approach, protecting against outliving their assets while enabling greater drawdown flexibility. As DC becomes the predominant source of retirement savings, it is increasingly important to extend the automated solutions that are available during the working years to the retirement years. It is interesting to note that the more established DC countries, such as the US or Australia, are currently working to add guaranteed income to the drawdown phase. On the other hand, countries such as Sweden or the Netherlands, which are in the earlier stages of DC transition, are leapfrogging directly to retirement solutions that incorporate guaranteed income.

Savers would welcome guidance for the retirement phase. For example, when we asked respondents whether they would value a solution from their employer that provided predictable income in retirement, the majority of respondents in all countries said yes. (The lower response rates in Australia and Sweden are likely due to the structure of the local system, where retirement savings are provided through a superannuation fund (Australia) or the government (Sweden), rather than being sponsored by the employer.) Younger workers were the most interested in an employer-sponsored retirement income solution, likely because they currently save through an employer-sponsored plan and have come to connect retirement savings to the workplace and they may appreciate guidance on a matter that seems impossibly far away.

Most workers would value an employer-provided retirement income solution

% of workers who agree with the statement: "I would value a solution from my employer that provides a predictable income in retirement"



(WP) Working Population – Working and not planning to retire in the next 5 years

(AR) Approaching Retirement – Working and planning to retire in the next 5 years

We asked pre-retirees what their preference would be for how to draw down their assets in retirement and gave them three options, spanning the spectrum from security to flexibility:

34%

Security
A stable retirement income that lasts for all of my life, even if it means I lose flexibility and cannot change the amount I receive from month to month.

42%

Flexibility + Security
Flexible access to part of my retirement savings in the early years of retirement and use of the remaining portion for stable income in later years.

24%

Flexibility
Flexible access to my retirement savings even if that means the savings might run out before I die.

Note: these percentages are based on the people who expressed a preference.

Not surprisingly, the option that offered the best of both worlds — flexibility in early retirement plus predictability in late life — was the leader. This is also very consistent with how respondents anticipate that their working patterns in retirement will change. We also asked retired participants how satisfied they were with the options that they had chosen. While the majority in most countries was satisfied, the major regret among those who were not satisfied was that they had not chosen more secure income.

Interestingly, respondents from many of the countries in the earlier stages of DC transition — Germany, Italy, and Netherlands — strongly favored the security option. These same three countries expressed dissatisfaction with the options available for funding their retirement and frustration at not having more choice in selecting how to use their savings once in retirement. This may reflect the fact that DC is not yet widely established in these countries, and respondents would have preferred to have a traditional DB plan.

Finding 5
Lessons From Evolving DC Systems

As the early stage DC countries reform their systems, they are often able to leapfrog legacy shortcomings to innovate approaches that combine the best elements of DC and DB.

For example, the Netherlands plans to reform its retirement system by converting DB liabilities into DC by 2020. These new DC plans will still offer lifetime income in retirement, but this will be based on the level of accumulated savings rather than the employee's salary. Most workers will also be subject to mandated savings rates.

As a result the plans will no longer suffer from the underfunding problems associated with DB, but will still offer individuals lifetime income in retirement while also introducing some of the additional flexibility of DC. In this sense, the countries with established DC systems could learn from the reform approaches that the early stage countries are adopting.

The next generation of individuals and systems is reimagining what retirement looks like; in leaving behind strategies limited by 'or,' we are embracing those defined by 'and' — such as flexibility and security.

Conclusion

In this first chapter of our Global Retirement Reality Report, we focused on expectations around income and spending in retirement. Overall, people appear to have fairly realistic expectations regarding their income needs and spending priorities in retirement. While many are concerned that they may not be saving enough, we also see that younger generations intend to embrace new behaviours such as postponing retirement or working part time. Retirement will become more of a process than a singular event, and this will require workplaces, legislation, and retirement products to evolve. Countries globally have adopted different approaches to DC and can learn from each other.

In the two GR3 chapters that will follow, we will continue to take the individual's perspective in examining how it feels to work, save, and age across a range of countries with different levels of dependency on DC savings. We will explore the areas of communication and advice, including where savers seek information and how it impacts their overall financial confidence, as well as what truly constitutes satisfaction in retirement.

By putting people at the centre of our research, we are taking an active role in the retirement transformation — a role the goes beyond managing portfolios to include that of listener and learner. As a result of our global presence, we have in-depth knowledge of retirement systems around the world. We are witnessing the increased emphasis of individual responsibility as countries introduce reforms and we are preparing for the impacts. In the context of these systemic shifts, we look forward to sharing additional insights from the GR3 over the remainder of the year.

[1] Survey data fielded between 8 February and 3 April 2018.
[2] A significant sample of respondents in later retirement could not be formed for Ireland.
[3] Byrne and Reilly, "Investing for Retirement in a Low Returns Environment: Making the Right Decisions to Make the Money Last," Pension Research Council Working Paper, September 2017, PRC WP2017.
[4] Forbes, "Do Millennials Think Differently About Money and Career?" 17 September 2013, https://www.forbes.com/sites/karstenstrauss/2013/09/17/do-millennials-think-differently-about-money-and-career/#1c2c3f9a6b89
[5] Working Population (WP) shown for Sweden as a significant sample of Approaching Retirement (AR) respondents could not be formed.
[6] Aviva, "Mind the Gap: Quantifying the pension savings gap in Europe," September 2016.
[7] Bipartisan Policy Center, "Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings", June 2016, https://bipartisanpolicy.org/library/retirement-security/
[8] The Motley Fool, "Reverse Mortgage Pros and Cons," 8 April 2016, https://www.fool.com/retirement/general/2016/04/08/reverse-mortgage-pros-and-cons.aspx
[9] This question was not asked of Italian respondents.

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Start with rigour
Build from breadth
Invest as stewards
Invent the future

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*This figure is presented as of 31 March 2018 and includes approximately $56 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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