How Much Could Personalization Disrupt Retirement Plan Design? (A Lot)

by Neil Lloyd | Mercer

A lot has been made about the recent success with retirement plans, which includes:

- Higher participation due to autoenrollment features
- Increasing contribution rates due to autoescalation features
- Improved investment allocations and improved returns due to better default investment choices, in particular through the use of target-date funds (TDFs).

Of these three developments, the use of TDFs has notably been the most visible. Since 2006, TDFs have become one of the biggest recipients of defined contribution (DC) plan assets. Plan sponsors readily recognize their value as a qualified default investment alternative (QDIA) with built-in automation and derisking features. From a plan design perspective, TDFs offer a one-size, simple glide path option that generally appeals to most participants (at least initially).

As participant wants and needs become more complex, TDFs may not provide the ideal solution. Indeed, questions are being raised about whether TDFs could be disrupted by emerging solutions that apply simple data from recordkeepers (let alone big data sources) and potentially incorporate other inputs to create more personalized retirement investment advice. (Note that there may be some issues with trust to overcome.)

How real is the disruptive threat from personalization? This article examines the question from a number of angles: the limitations of TDFs, the growing consumer demand for personalized products and services that “know them,” and foundational notions of trust and intrusiveness.

The Unmitigated Success of Target-Date Funds in DC Plans

When measuring the use of TDFs in retirement plans, the Mercer Target Date Funds Highlights and Trends survey re-

AT A GLANCE

- Autoenrollment, autoescalation and better default investment choices, particularly target-date funds (TDFs), have made defined contribution retirement plans more successful in recent years.
- As participant wants and needs become more complex, the popularity of TDFs may be challenged by emerging data-driven products that create more personalized retirement investment advice.
- Such products could consider information such as participant gender, account balance, salary and deferral rate in suggesting investment strategies.
- One important consideration, however, is that participants must be able to trust their plan provider and financial institutions, and organizations should be mindful of protecting the privacy of participant data.
ports that off-the-shelf TDF assets totaled $1.7 trillion as of December 31, 2018. The Defined Contribution Institutional Investment Association (DCIIA), of which Mercer is a member, released its inaugural study of custom TDFs (cTDFs) in March 2019. DCIIA researched 65 plans with approximately $345 billion in cTDF assets and estimated that its cTDF dataset covers about 80% of the custom universe assets. This data suggests that total TDF assets at the end of 2018 amounted to approximately $2.1 trillion. Given that total U.S. DC assets totaled $7.8 trillion, the dominance of TDFs in the U.S. DC market is clear, with a nearly 27% share of the total.

That said, automatic solutions such as autoenrollment, autoescalation and TDFs could be facing an emerging Achilles’ heel. They do not address the emerging demand for more personalized solutions.

For some time, the retirement industry has promoted a variety of retirement income solutions within DC plans. Commentators (not just providers) have recommended that plan sponsors integrate retirement income options into plan default investment options such as their TDF series, but this suggestion has been met with limited uptake. It has become clear that a reductive, one-size-fits-all retirement design does not address the heterogeneity that exists in their workforces as individuals approach retirement. Participants closer to retirement have longer tenures and more varied situations with respect to retirement readiness. It is apparent that retirees desire more personalized solutions, and there are signals that this also may be true for preretirees. Morningstar recently assessed which participants remained invested in default funds:

Across the three default types, managed accounts were the “stickiest” option (i.e., had the highest level of continued acceptance), followed by TDFs and balanced funds. While we do not know exactly why this occurred, the order of stickiness (managed accounts/TDFs/balanced funds) was consistent with the personalization associated with each default, with managed accounts offering the highest level of personalization (and the highest ongoing acceptance), and balanced funds the least.

Perhaps an unmet need for personalization is an important issue that even the most revered of DC investments—the TDF—must begin to confront.

**Products and Services That “Know Us”**

This concept of personalization is something we see as having the potential to disrupt the current way and the purpose for which retirement plans were designed. To explore this further, let’s leave the world of retirement and consider the impact of personalization on the world we live in day-to-day. It is worth considering how integral personalization is to the way products are marketed these days. In the past, we may have accepted limited choices. When I was young, for example, I lived in the United Kingdom, where we only had three TV channels for a long time. I don’t think my son or daughter would accept that now. Today, our experiences and our expectations are very different.

Consider:

- Netflix is a classic example. Instead of a choice of three channels, I can choose from a wide range of options and, most importantly, the software provides recommendations that are unique to me, based on feedback from my previous choices.
- My Yahoo daily feed looks very different from others’ feeds, and the banner ads uncannily shadow the issues the platform knows I may have searched for before.
- My Google search engine very clearly generates different results for me than it produces for others (such as my son or daughter).

In fact, every click on a website, every tap on a smartphone, even every activity on a wearable device such as a Fitbit or Apple Watch leaves behind increasing levels of digital exhaust about their users—highlighting what they like, where they are traveling, what they do and, yes, even how physically active (or inactive) they are.

Younger generations will not remember a time when they were not having such personalized experiences. Given these expectations, how will, or how can, a simple one-size-fits-all investment strategy like a TDF suffice?

Marketers believe that today’s consumers want to be known, as Figure 1 shows.

In addition to these strong online user preferences, 74% of customers feel frustrated when a website is not personalized, and 77% of consumers have chosen, recommended or paid more for a brand that provides a personalized service or experience.
Furthermore, consumers say they are willing to share data to get personalized experiences. 7 (Figure 2)

Ultimately, we need to remember that retirement plan participants are really consumers who have choices. The fact that so many people choose to exit their employer-sponsored plans around retirement age indicates they may prefer to shop elsewhere.

But there are some caveats to this desire for personalization, as indicated by David Kirkpatrick, in writing about an Accenture consumer preferences report. Kirkpatrick has these interesting insights: "People want and expect a personalized brand experience, but at the same time there is a fine line between being responsive to consumer needs and being creepy." (I recall a provider mentioning that it was acceptable to point out to customers that they had been overcharged bank fees, but it is not OK to mention they had spent too much money on fast food.) Kirkpatrick continues: "Businesses should also pay close attention to who they partner with for digital marketing, as some platforms are more trusted by consumers than others." 8

Trust and Personalization Must Walk Hand in Hand

Trust is a profoundly critical issue that needs to be considered hand in hand with personalization. Done well, personalization can enhance trust. I recently served as a panelist at a conference about the future of the retirement industry. (I confess I was clearly a representative of the traditional retirement establishment.) In the next session, three leaders from financial technology firms spoke, and I could not help but notice how they focused on demonstrating to their customers that they knew their needs really well and how they were providing personalized suggestions. What was also made clear was how vital it is to gain the trust of their customers, who no longer feel satisfied being fed the same cookie-cutter solutions as everyone else.

I believe this is a hard trend. Even as venerated a source as Reader’s Digest takes note of it. Its 2018 “Trusted Brand” survey reported the following key findings.

- Trust outweighs product pricing.
- Trust ensures customer retention and brand loyalty.
- Customer loyalty can be lost quickly.
- Millennials are more likely to engage with brands they trust.
- Millennials have high expectations of brands. 9

This trust issue is very profound and creates yet another source of potential disruption for retirement plans. The 2019 Participant Trust and Engagement Study by the Na-
Disrupters

TIAA Institute concluded that:
- Brand trust affects asset allocations.
- Employer trust affects asset allocations.
- Brand trust affects perceptions of expected return and risk.

The Risks of Intrusiveness and Data Breaches

Although personalization can be disruptive in a positive way, it may not be a panacea for the retirement industry on its own. In fact, knowing the “wrong things” about people can feel very intrusive and lead to serious distrust. Srivathsan Karanai Margan of Tata Consultancy Services defines intrusive personalization as “personalization that occurs when a company overdoes certain things or oversteps into private spaces that customers consider to be sacrosanct. Customers feel uneasy and perceive that their privacy is being intruded.”

Cybersecurity concerns are an additional potential minefield, whereby employers are wary of sharing their employees’ personal data, and employees are justifiably scared by the prospect of security breaches. In any broadly publicized security breach of personally identifiable information (PII), customer trust can be lost for a very long time.

As we look to the future, the opportunity for disruption of the retirement plan industry through personalization clearly exists; in fact, it’s happening now. The simplicity of automatic default, one-size-fits-all solutions is attractive, and there is no doubt that the TDF market remains a very robust market. But one cannot escape the fact that TDFs ignore so many very basic facts and circumstances that a growing number of participants expect their plan provider and recordkeeper to know. Gender, account balance, salary and deferral rate are table-stakes factors that should influence any proposed investment strategy. The interesting part will be if more robust personalization solutions move us into issues that we may not presume the provider to know.

However this plays out, there should be a clearly defined relationship between trust and personalization. At its best, personalization will enhance trust in a way that a TDF cannot but, at its worst, personalization can go too far and destroy trust totally. (And woe to anyone who loses or compromises participant data.)

Author

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As all of the issues discussed in this article continue to coalesce, and as we hypothesize about the future, I am reminded of Amara’s Law: “We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run.”

I am pretty sure that personalized solutions will ultimately replace or materially change one-size-fits-all TDFs, autoenrollment and autoescalation. I am just not sure when. To paraphrase Darth Vader (describing Luke Skywalker), “The Force is strong with this one.”

endnotes

3. The Franklin Templeton Retirement Strategies and Expectations (RISE) Survey 2019. Online sample of 2,002 adults comprising 1,000 men and 1,002 women 18 years of age or older.
7. Ibid.

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