Fintech & Behavioral Finance:
A Sea-Change in Retirement Savings

Insights from behavioral finance, applied through emerging financial technologies, have transformed workplace savings, changed the nature of capital markets and turned retirement finance into a multi-trillion-dollar engine of capital formation. Transformative savings opportunities are permanently altering the perception of retirement options, ushering in a new era of retirement finance innovation. And the pace of change is accelerating.

A generation ago, when economists began applying the lessons behavioral psychology to financial markets, there was no road map. American workplace plan sponsors and financial firms began experimenting with "nudges" designed to stimulate greater engagement and superior retirement outcomes, without a firm sense of what to expect.

But as employers began applying to their savings plans signature innovations like automatic enrollment, automatic allocation (to target date funds, managed accounts and balanced funds) and automatic escalation that raised savings levels every year, the results were remarkable. Across the board, "automaticity" stimulated markedly improved behaviors. Academia and policymakers took notice, more plan sponsors became involved, plan record-keepers and asset managers began developing tools and indicators. By the mid-2000s, behavioral nudges and FinTech had emerged as standard components of leading workplace plans.

Today, with workplace savings plans nudging most participants toward automatic solutions and interactive tools that successfully stimulate higher levels of savings in optimized investment allocations, the defined contribution savings sector has become one of the most dynamic and consequential fields for financial technology innovation. And the significance of this achievement extends far beyond personal wealth management. Because with workplace savings plans and IRAs totaling more than $16 trillion in assets under management, defined contribution savings has become the single largest driver of capital formation in the American economy.

The partnership of behavioral finance and FinTech is galloping along at a healthy clip. Forward-thinking plan-sponsors, record-keepers and retirement plan advisors are delivering workplace investors insights into

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their future that were never before available. Using machine learning to model investors' personalized financial data and artificial intelligence to turn these insights into recommendations, they are delivering highly personalized, custom-made strategies that engage workers at a deep emotional level

Workplace savings plans, because they accumulate substantial asset levels, and because a financially sound retirement is such a critical life goal, have become central to workers' financial lives. They do so by blending many diverse elements of participants' financial lives – in and out-of-plan assets, homes and businesses, health care and education savings, insurance and Social Security income projections, as well as financial liabilities including student loan debt, educational spending for dependents, mortgages, unsecured debt , auto loans and anticipated health care spending in retirement. This integrated, "holistic" strategy is driving lifelong financial strategies with retirement savings at their center.

The Evolution of Financial Decision-Making

The generation of workers benefitting from the rise of "automaticity" has achieved superb financial results that underscore how behavioral finance and FinTech have proven their value in the market. According to a 2018 study from the Empower Institute, Success for Savers through Design Default: Three Ways to Encourage Better Savings Habits, employees with auto enrollment are on track to replace 95% of their income in retirement as compared to 84% for employees in plans without it. Employees in plans with auto escalation fare even better; they are on track to replace 107% of their income in retirement as compared with 80% for those in plans without this feature.

And recent data suggests that American workers have become comfortable with – and have come to expect – automatic behavioral nudges, are ready for their workplace savings plans to deliver next-generation, holistic approaches. A 2019 paper from the Empower Institute, Critical Tech Trends are Transforming the Retirement System, reveals that more than 70% of surveyed employees express a desire for financial suggestions – from one source – that take into account their total financial picture across all accounts. And the data points toward a time when it will be standard practice for workplace savings plans to embrace highly personalized FinTech solutions that take a holistic view of their finances.

New technologies like cloud computing, big data aggregation, machine learning, predictive analytics, unique risk modeling, portfolio customization and artificial intelligence are guiding workers through step-by-step processes that make success easy and failure difficult. And the benefits of these technologies aren't limited to simple asset accumulation.   A new generation of digital managed accounts are aiming for a more elevated target: lifetime income in retirement that replaces all – or more – of a participant's working income. Converting life savings into income has been called the Holy Grail of retirement

New technologies aim at a more elevated target: lifetime income that replaces working income

finance. And automatic plan solutions, holistic planning and digital managed accounts are important first steps.

To complete this process, plan sponsors and record keepers are using FinTech to integrate the lessons of behavioral finance and predictive analytics to build real-time estimation of investors' potential future asset accumulation as well as their potential future retirement income. These estimates take into account out-of-plan income sources like Social Security as well as actuarial projections of healthcare expenditures in retirement. Sophisticated tools like interactive "sliders" give investors a glimpse into their future, as well as the ability to increase savings rates to improve probable outcomes.

> Sophisticated tools give investors a glimpse into their future and the ability to improve probable outcomes

Next-Generation Workplace Savings Plans

As with many technological innovations, FinTech and applied behavioral finance can no longer be considered emerging options. Rather, they have become a new standard in financial planning, together with backup from traditional support services like call centers, investor education, account management and financial advisory. A next-generation workplace savings paradigm, with behavioral nudges to improve savings habits, smart algorithms to allocate assets, an expanding range of holistic services to encompass a wider array of assets and liabilities, and tools that facilitate the conversion of accumulated assets into lifetime income, is driving a sea change in personal financial management.

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