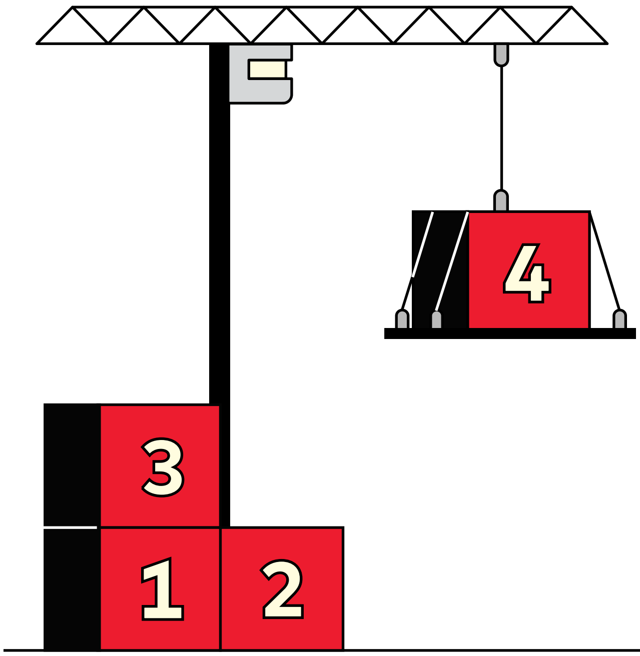
Strengthening defined contribution plan lineups



Given the crucial role that defined contribution (DC) plans play for a large portion of our country's population saving for their retirement goals, it is important that plan sponsors design a plan that will help provide their participants with the best chance for investment success. Vanguard believes that four best practices will help plan sponsors guide their participants to sound portfolio decisions.

Step 1

Identify plan objectives

DC plan sponsors seek to offer a valuable benefit to participants and have a fiduciary duty to put participants' interests first in selecting and monitoring investments. To that end, it is important for plan sponsors to have a strong understanding of their participants' demographics, experiences, and needs and tailor the plan lineup accordingly. Participants, who ultimately benefit from the plan, want to maximize its value for their individual circumstances.

At the highest level, sponsors and participants have similar goals:

- Readiness for retirement.
- Reasonable, competitive investment choices.
- Low-hassle decision-making.
- Competitive fees.

Default investment options, including professionally managed allocations, have streamlined choices and greatly improved participant portfolio diversification. A sound investment menu can provide the structure for participants who seek options beyond a plan's default option. Further, the adoption of tailored participant advice and financial wellness programs is another way for plan sponsors to help educate investors and improve financial outcomes.

Step 2

Review investing fundamentals

The elements of long-term investment success apply as much to DC plans as to any investment planning. While regulatory and fiduciary guidelines are important considerations when developing a plan lineup, some of the central elements of a sound investment strategy include:

- **Asset allocation.** It's widely accepted that the vast majority of an investor's long-term return patterns—assuming the use of broadly diversified investments—are derived from asset allocation rather than security selection or market-timing.[1] Thus, a DC plan that enables participants to select a mix of investments by asset class can improve the participants' odds of meeting their investment objectives, subject to their individual circumstances.
- **Diversification.** Exposure to different asset classes and segments of both the equity and fixed income markets, whose returns may vary widely at any given time, is an effective strategy for managing investment risk. Making it possible for participants to invest in diversified holdings can help them reduce the risks associated with a particular company, sector, or segment.
- **Cost.** Minimizing cost is critical to improving investment outcomes for participants. Every dollar paid for management fees or trading commissions is a dollar less of potential return. In addition, periodic plan sponsor and participant fee disclosure is required.

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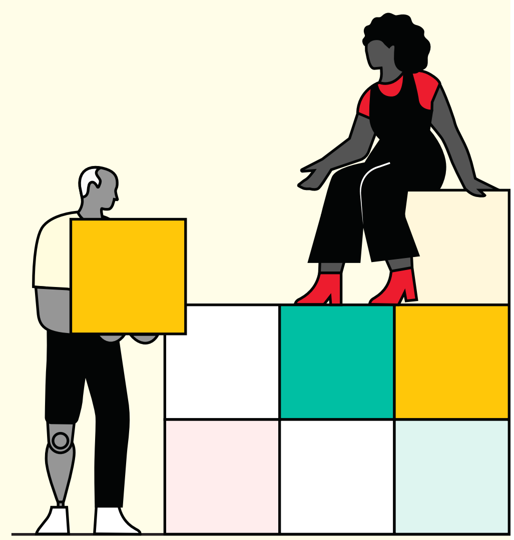


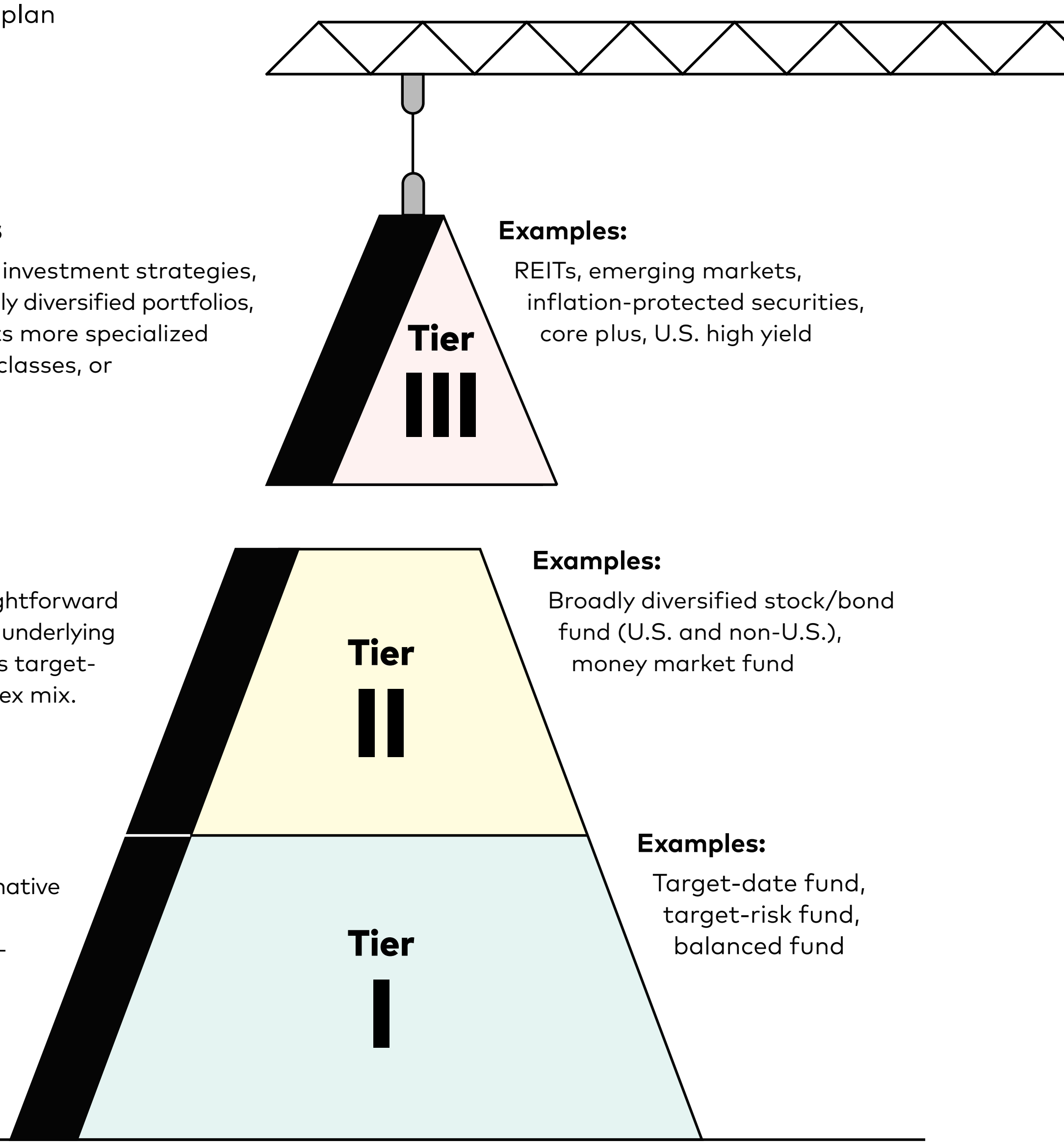
1 Scott J. Donaldson, CFA, CFP®; Harshdeep Ahluwalia; Giulio Renzi-Ricci; Victor Zhu, CFA, CAIA; Alexander Aleksandrovich, CFA. *Vanguard's Framework for Constructing Globally Diversified Portfolios*. Vanguard, 2021.

Step 3

Create a tiered investment structure

To help participants navigate the selection process, plan sponsors can organize the plan's investment options into logical groupings or tiers. A tiered lineup can reduce complexity for participants and reflect the plan sponsor's philosophy on retirement investing. Investment tiering can also accommodate participants with varying degrees of investment experience, acumen, and preferences for additional options or supplemental investments.

A basic framework for a tiered plan lineup includes:



Tier III: Supplemental choices

Additional equity and fixed income investment strategies, though not essential for creating fully diversified portfolios, offering highly engaged participants more specialized access to investment styles, asset classes, or risk preferences.

Examples:

REITs, emerging markets, inflation-protected securities, core plus, U.S. high yield

Tier II: Building blocks

Broadly diversified options for straightforward portfolio customization, such as the underlying individual mutual funds in the plan's target-date fund offering or an active/index mix.

Examples:

Broadly diversified stock/bond fund (U.S. and non-U.S.), money market fund

Tier I: A single-fund solution

A qualified default investment alternative (QDIA) that's appropriate for all investors in a plan, such as a target-date fund, target-risk fund, or balanced fund—indexed or actively managed.

Examples:

Target-date fund, target-risk fund, balanced fund

In addition to a tiered plan lineup, plan sponsors may want to consider offering education and advice programs to improve the likelihood of participants making sound investment decisions.

These programs can also help with decisions outside of investment selection, such as setting an appropriate saving rate, or the incorporation of participant assets in outside accounts. At the same time, a well-thought-out tiering framework allows for a more effective implementation of the advice program.

Step 4

Ensure active, ongoing oversight

Plan sponsors, as fiduciaries, have a responsibility not only to select appropriate investment strategies for the plan but also to monitor them formally on an ongoing basis and to add or remove investments when warranted. Responsibilities include:

- Ensuring that the plan lineup aligns with the sponsor's identified goals and objectives.
- Specifying criteria by which funds will be selected and evaluated.
- Maintaining a disciplined process for hiring, evaluating, and terminating investment managers for the plan.
- Confirming that the QDIA is appropriate and considering reenrollment if changing the QDIA or establishing one for the first time.
- Monitoring advice programs periodically, if applicable, to assess the provider's qualifications, quality of advice services, and fees.
- Documenting the preceding steps in an investment policy statement and revisiting the policy regularly with the plan's investment committee.
- Staying abreast of new products as well as changes in the investment and regulatory landscape.

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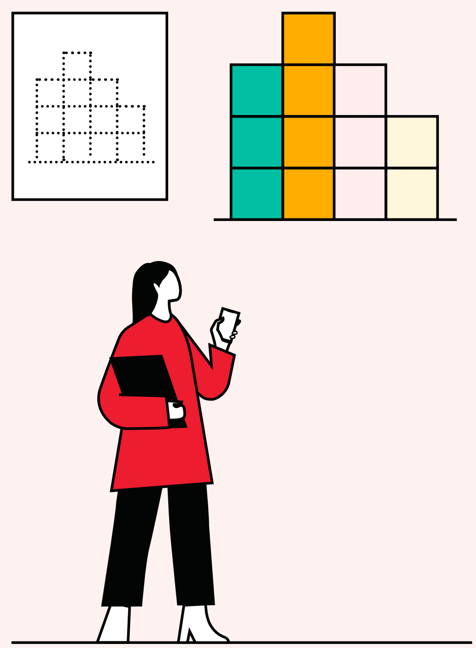

Final thoughts

The best practices outlined here will help plan sponsors develop and offer robust investment lineups that suit the plan sponsor's organization and provide participants with the right tools to make sound retirement decisions.

The checklist on the following page can help you implement the best practices.

To learn more, please contact your Vanguard representative.

Contact us

Checklist for DC plan investment lineup

A focus on fundamentals	
☐ **Asset allocation**	Allocation offers diversified exposure to primary asset classes.
☐ **Low cost**	Plan investment options are low cost.
☐ **Automatic enrollment**	Plan automatically enrolls new participants.
☐ **Automatic increase**	Plan uses automatic increase for new participants.
☐ **Reenrollment**	Plan has completed a reenrollment since the last QDIA (qualified default investment alternative) update.
☐ **Saving rate**	Plan meets the Vanguard-suggested saving rate.
Participant-friendly lineup	
☐ **Tiered lineup**	Presence of tiered lineup.
☐ **Tier I: Single-fund solutions**	Low-cost, transparent, risk-controlled options.
☐ **Tier II: Building blocks**	Straightforward and efficient exposure to portfolio construction.
☐ **Tier III: Supplemental choices**	Options meet the unique needs of the participant base; usage is reviewed on an ongoing basis.
☐ **Participant advice**	Low-cost alternative to a single-fund solution.
Active, ongoing oversight	
☐ **Goals and objectives**	Align investment lineup and plan objectives.
☐ **QDIA review**	Monitor industry trends and peer benchmarking.
☐ **Active fund review**	Maintain process for manager evaluation.
☐ **Documentation**	Document process (investment policy statement), regulatory updates.

Source: Vanguard.

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All investing is subject to risk, including the possible loss of the money you invest. Diversification does not ensure a profit or protect against a loss. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income.

Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in target-date funds is not guaranteed at any time, including on or after the target date.

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