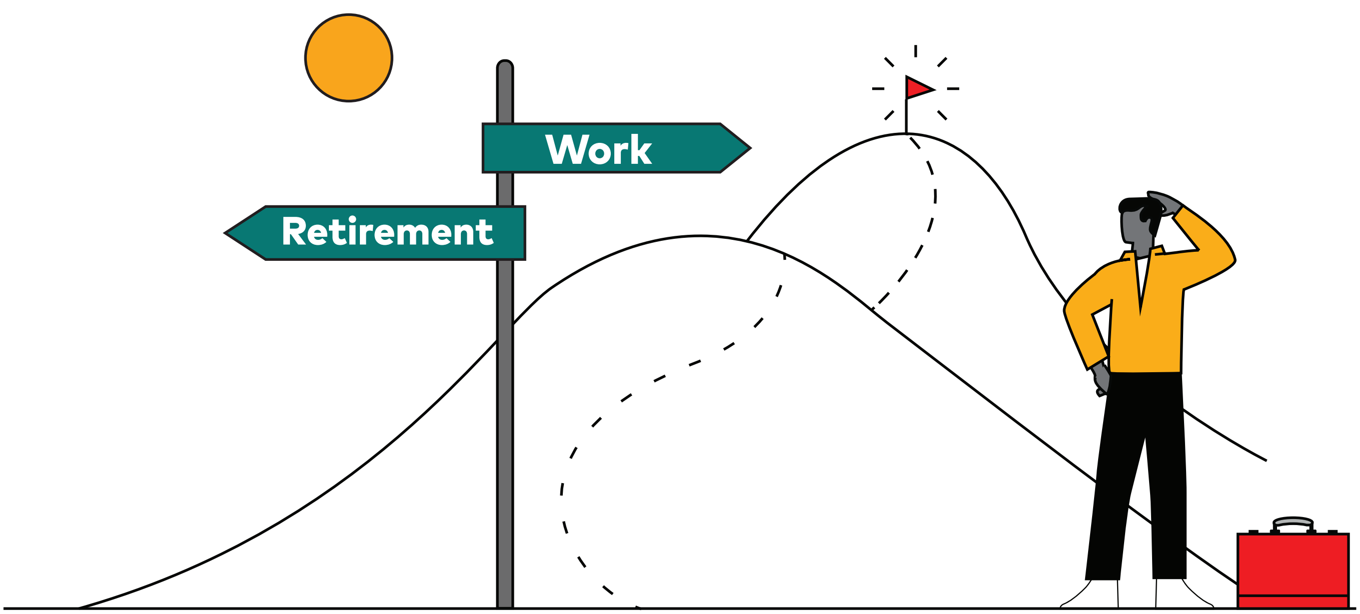
Vanguard commentary

June 2024

How plan design can help promote saving equity in retirement plans

A secure retirement. American employees share this common goal, but an examination of their retirement preparedness reveals disparate trends and behaviors in its pursuit. Many of these disparities can be better understood by asking:

- Does an employee have access to an employer-sponsored retirement plan?
- If an employee has access to an employer-sponsored plan, do they save for retirement?
- If they save, how much do they save?
- How do they invest their retirement assets?
- Do they tap into their retirement assets to meet present-day obligations?



Vanguard research has shown how demographic factors such as income, age, gender, and employment tenure influence employees' retirement saving. Studies from such research firms as Pew and Morningstar have also revealed large gaps in overall retirement saving outcomes, specifically when comparing race and ethnicity groups, including Black, Hispanic, Asian, and White employees. How do American employees of different racial and ethnic backgrounds save, invest, and access retirement assets within a defined contribution (DC) plan?

Vanguard's mission has always been to give all investors the best chance for investment success

While Vanguard's mission has always been to give all investors the best chance for investment success, not all investors have even access to the path to success—including the path to 401(k) retirement savings. And often, investors are making decisions and navigating through complex situations that could pose challenges to taking a consistently funded and appropriately allocated approach. Vanguard conducted research into the role that plan design plays in fostering more equitable saving to gain a deeper understanding of any saving disparities that could affect retirement preparation across racial and ethnic segments.* (Note that our research was limited only to an employer's defined contribution retirement plan.)

Plan design features deeply influence participant retirement saving behaviors. Over the past decade, DC plans have increasingly turned to automatic solutions to help their employees save more for retirement. As a result, plan participation rates are on the rise, employee saving rates have increased, and participant portfolio construction has improved with more age-appropriate, well-diversified allocations. Automatic enrollment designs help improve retirement savings for all employees, but how significantly do they improve outcomes across race and ethnicity groups?

Our study of current plan participants finds that the use of automatic plan design features helps reduce disparities—in some instances, significantly. Based on a sample of nearly 115,000 eligible employees from 14 DC plans that provided race and ethnicity data for participant populations, our research compared participants in automatic enrollment plans with those in voluntary enrollment plans across a wide spectrum of industries to better understand the impact plan designs have on creating more equitable retirement saving.

One important caveat is that our study was conducted in the context of employer-sponsored retirement programs. It's intended to examine differences in that context and not to address differences beyond workplace retirement plans, whether in personal savings or in household wealth accumulation. Our study addresses an employee's current workplace savings plan, which is only part of the household wealth picture—albeit a growing and significant part of the balance sheet for many Americans. Increasing the availability of workplace retirement plans would benefit the roughly one-half of employees who do not have access to a plan. A disproportionate number of those employees identify as Black and Hispanic.

The study sample

Our sample consists of 14 larger DC plans across 9 sponsors that provided race and ethnicity data for its active employee population. It encompassed nearly 115,000 participants. The companies operate in a diverse set of industries, including retail, engineering, financial services, manufacturing, transportation, and media. Data for the sample is as of year-end 2022.

White participants (64%) make up the largest group, followed by Black participants (12%), Hispanic participants (10%), and Asian participants (9%) (Figure 1). Other race and ethnicity segments, including participants of two or more races or ethnicities, compose the remaining 6%. The median age is 42; the median job tenure, four years. Median participant income is $74,696.

Six plans have an automatic enrollment plan design with initial default rates between 2% and 5%. In addition, five plans use an automatic escalation feature for automatically enrolled participants that automatically increases the employee deferral rate by 1 percentage point each year. The remaining eight plans have a voluntary enrollment design, and most provide participants with the ability to enroll in an automatic increase feature.

52%

of the employees in our sample were in an automatic enrollment plan.

In total, 52% of the employees in our sample were in an automatic enrollment plan. The average age, tenure, and compensation of employees in automatic and voluntary enrollment designs was similar.

Figure 1. Study sample

Number of plans	**14**
Plans with voluntary enrollment	9
Plans with automatic enrollment	5
Number of eligible employees	114,881
Number of employees in voluntary enrollment plans	54,972
Number of employees in automatic enrollment plans	59,909

Eligible employee sample	**Asian**	**Black**	**Hispanic**	**White**	**Other**	**Total**
# of eligibles	10,297	13,980	11,090	73,168	6,346	114,881
% of sample	9	12	10	64	6	100
# of eligibles in automatic enrollment plans	6,078	7,239	5,216	38,339	3,037	59,909
Average age	41	41	39	44	40	43
Median age	40	41	38	44	38	42
Average tenure	6	5	5	8	4	7
Median tenure	3	2	2	4	2	4
Average compensation ($)	98,677	65,542	73,221	101,143	93,239	93,434
Median compensation ($)	84,048	44,637	51,896	82,478	77,240	74,696

Source: Vanguard, 2024

Participation rates

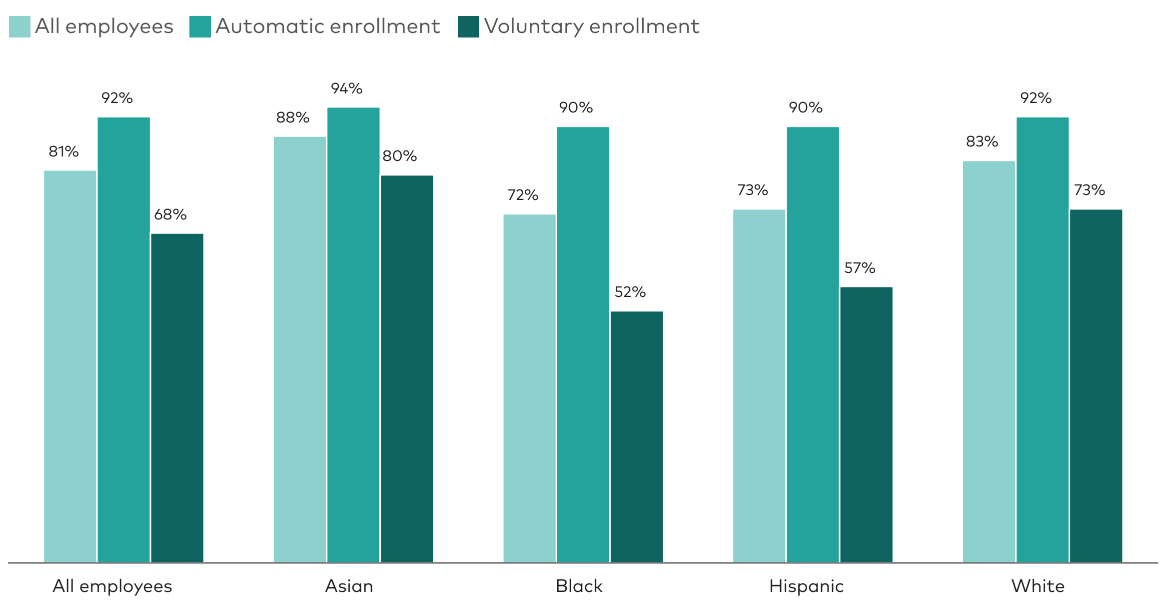
A plan's participation rate—the percentage of eligible employees who make voluntary contributions—remains the broadest metric for gauging 401(k) plan performance. Among the employees in our sample, 81% participated in their retirement plan. The participation rate for employees in automatic enrollment plans was 92%; 68% for those in plans with voluntary enrollment (Figure 2).

The participation rates for all races and ethnicities were 90% or higher in plans with automatic enrollment.

Overall plan participation rates of Black and Hispanic employees were lower than those of White and Asian employees. Across automatic enrollment and voluntary enrollment plans, Black and Hispanic employees' average participation rates were 72% and 73%, respectively, while Asian and White employees participated at 88% and 83%. However, in plans with automatic enrollment, the participation rates for all races and ethnicities were 90% or higher, with the largest increases for Black and Hispanic employees.

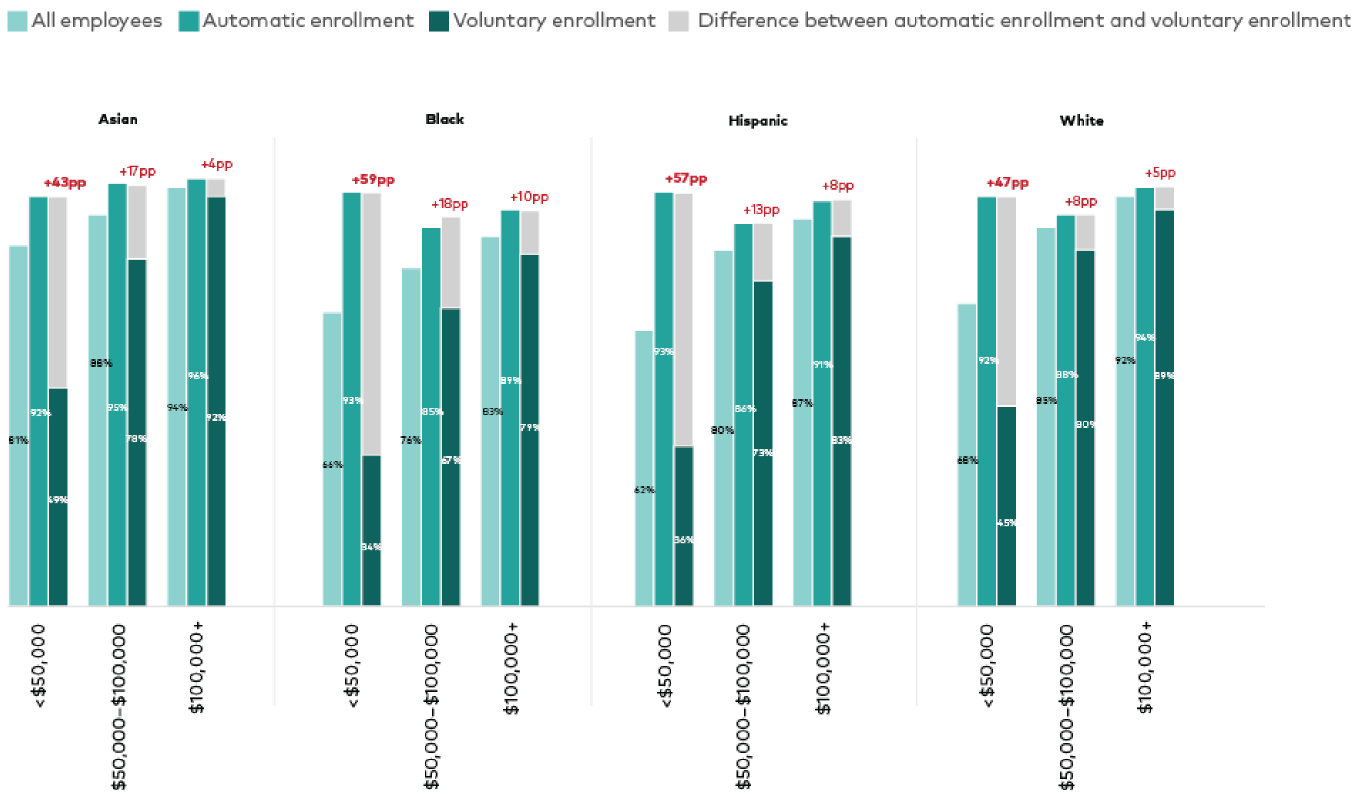
Automatic enrollment designs typically result in significant participation rate improvements for younger, lower-tenured, and lower-income employees. When examining the sample by income (Figure 3), automatic enrollment had the largest influence on the participation rates of lower-paid employees, especially Black and Hispanic employees. The participation rates of lower-income Black and Hispanic employees were 2.5 times higher in companies that automatically enrolled employees into their plan.

Figure 2. Participation rates



Source: Vanguard, 2024.

Figure 3. Participation rates by income



pp refers to percentage points

Source: Vanguard, 2024.

Deferral rates

In DC plans, employee contributions are typically the main source of funding, while employer contributions play a secondary role. Thus, the level of participant deferrals is a critical determinant of whether the plan will generate an adequate level of retirement savings.

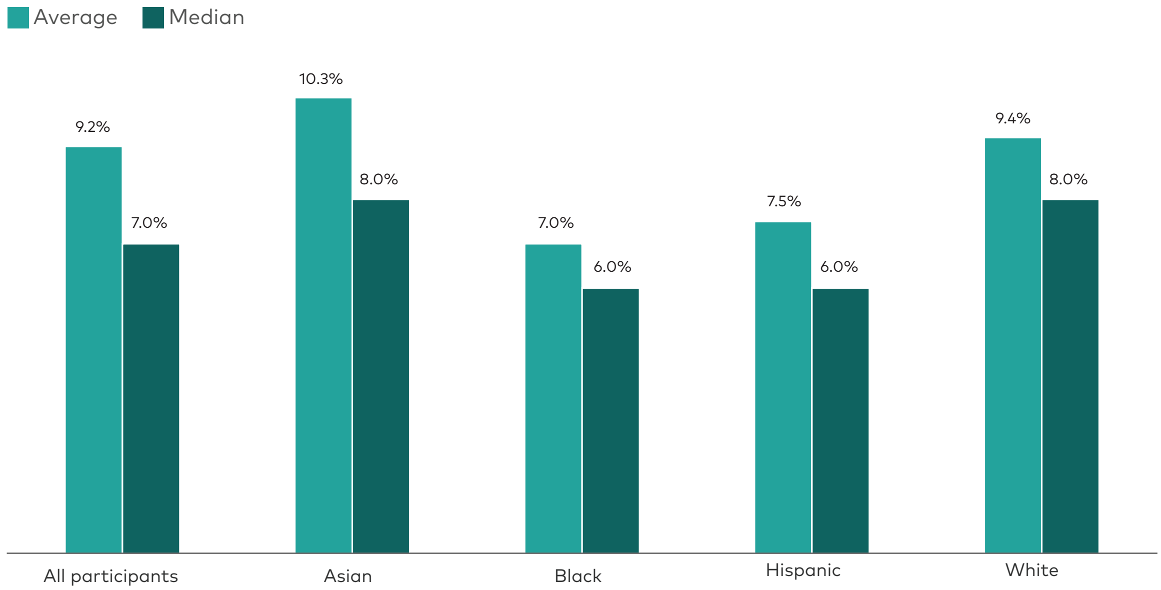
Participants saved an average of

9.2%

of their pay

In this research, we analyzed the elected deferral percentage of each participant, including both traditional pre-tax and Roth contributions. Participants saved an average of 9.2% of their pay, and the median deferral rate was 7.0% (Figure 4).

Figure 4. Participant elective deferral rates

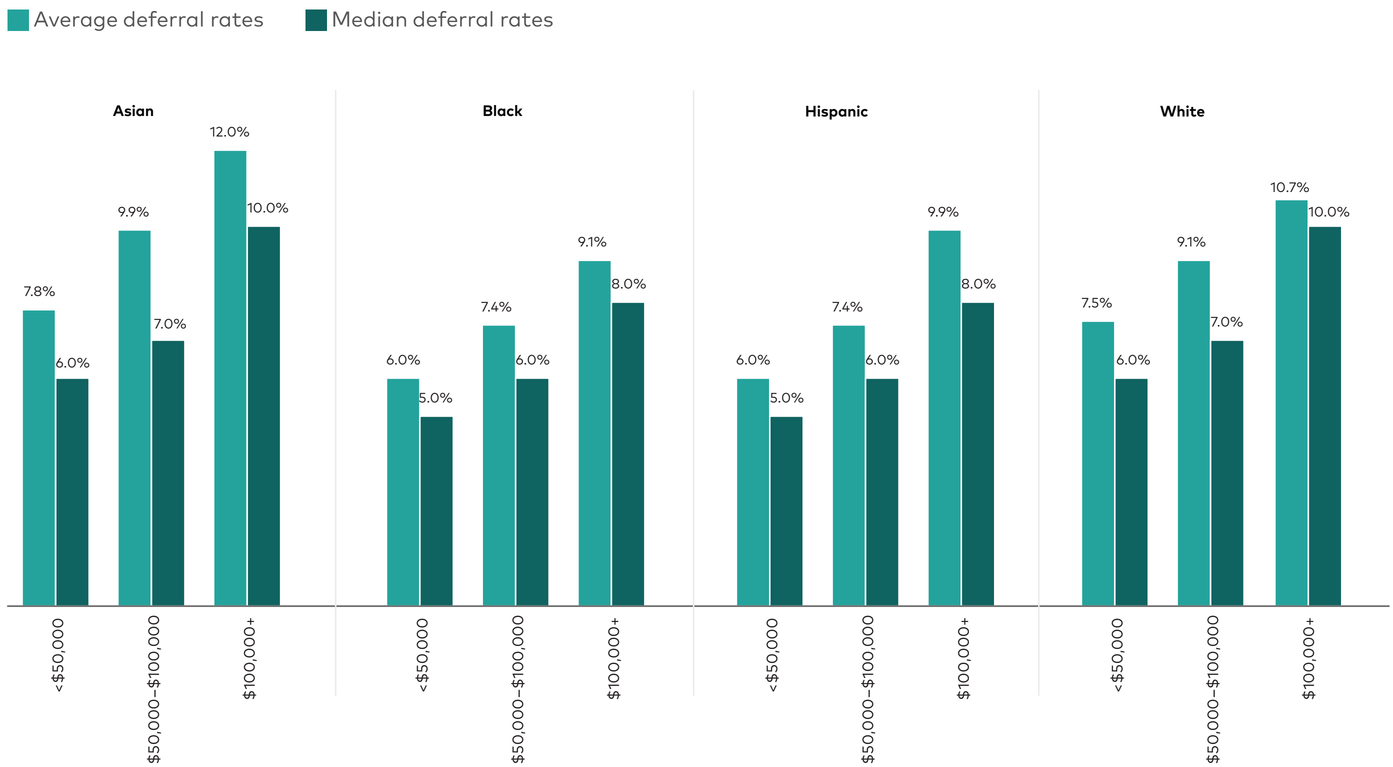


Source: Vanguard, 2024.

Asian participants had the highest saving rates, deferring an average of 10.3%. White participants averaged 9.4%, and Black and Hispanic participants averaged 7.0% and 7.5%, respectively.

When examining the sample by income (Figure 5), higher-income participants had higher average and median deferral rates within all race and ethnic segments. While Asian and White participant deferral rates were a percentage point or two above those of Black and Hispanic participants, generally, participant deferral rates were strong across all races and ethnicities, considering that most plans also include employer contributions to retirement accounts.

Figure 5. Participant elective deferral rates by income



Source: Vanguard, 2024.

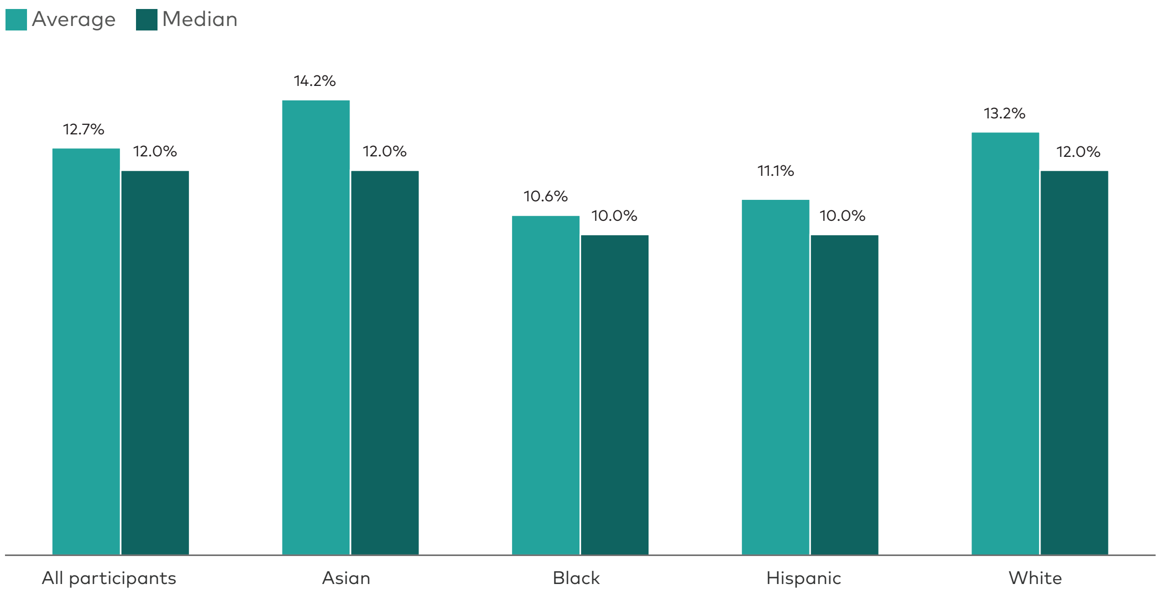
Total saving rates

Vanguard estimates that a typical participant should target a total contribution rate of 12% to 15%, including both employee and employer contributions. When including both employee and employer contributions, the average total participant contribution rate was 12.7%; the median total saving rate was 12.0% (Figure 6).

Within our sample, Asian participants had the highest saving rates, with an average of 14.2%. White participants averaged 13.2%, and Hispanic and Black participants averaged 11.1% and 10.6%, respectively. The median total saving rate in each racial demographic was 4 percentage points higher than median deferral rates, in line with the typical maximum value of employer matching contributions, 4%.

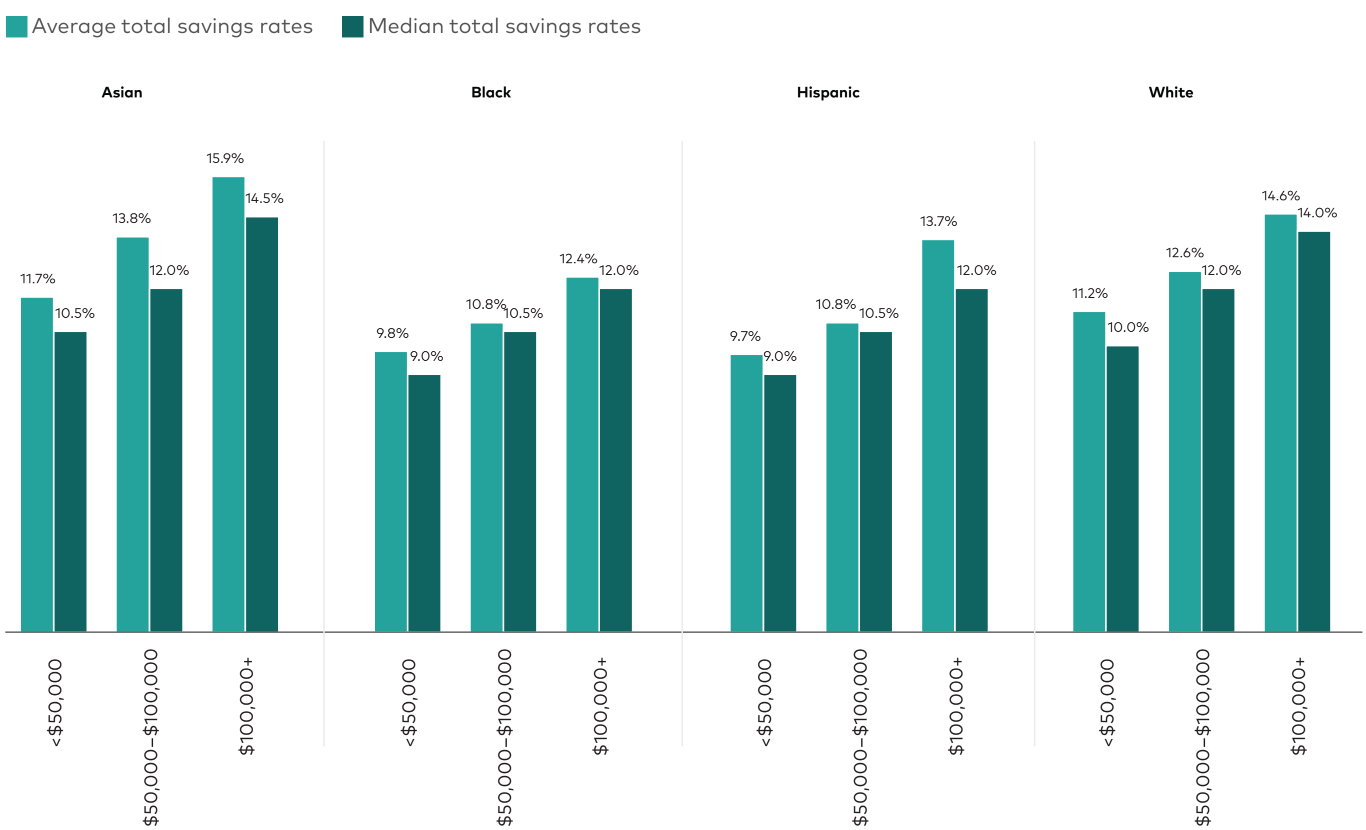
When examining total saving rates by income (Figure 7), higher-income participants had higher average and median saving rates within all race and ethnicity segments. Within the context of participants targeting a total saving rate of 12% to 15%, the median total saving rates indicate that about one-half of participants are saving at relatively strong levels, and about one-half of participants may need to save more, especially in the lower-income segments in this study.

Figure 6. Participant total saving rates



Source: Vanguard, 2024.

Figure 7. Total savings rates by income



Source: Vanguard, 2024.

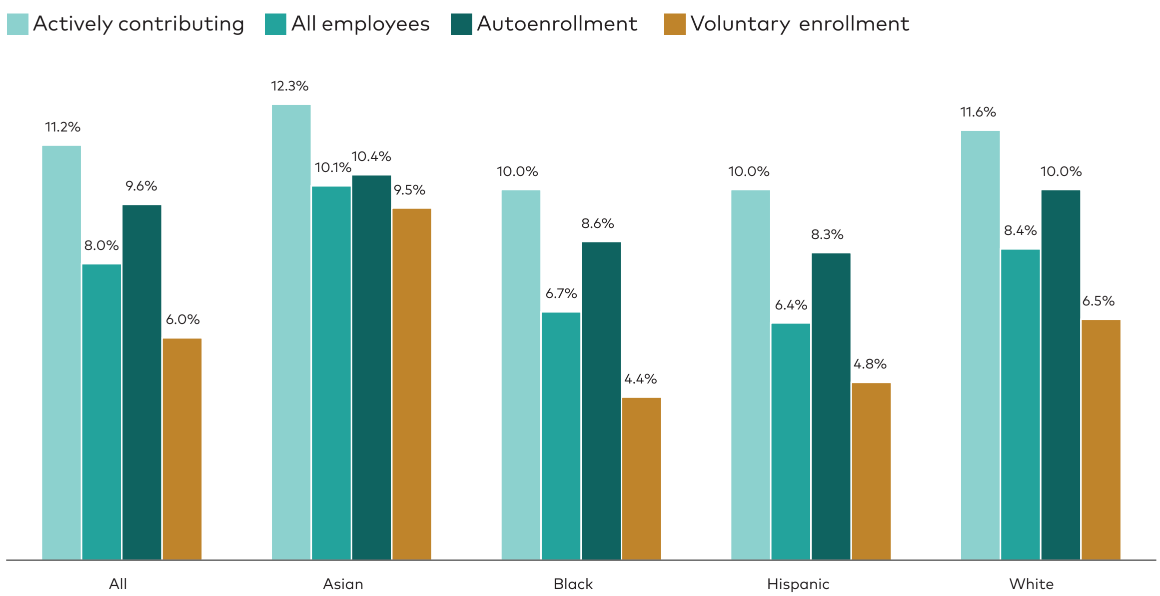
Total saving rates are

60%

higher in plans with automatic enrollment

Isolating the employees in the lower-income segment (income below the $75,000 median in this study), the average total saving rate was 11.2%, including both employee and employer contributions (Figure 8). When eligible nonparticipants were included, with their 0% saving rate, the average eligible employee total saving rate decreased to 8%. However, lower-earning eligible employees hired under an automatic enrollment design had a total saving rate of 9.6%, a rate that was 60% higher than those hired under voluntary enrollment. And when examining the differences between the two plan designs across race and ethnicity, lower-earning Black and Hispanic employees who work for a company that offers automatic enrollment save almost twice as much for retirement as do those in a voluntary enrollment plan.

Figure 8. Total saving rates (income <75,000)



Source: Vanguard, 2024.

Asset allocation

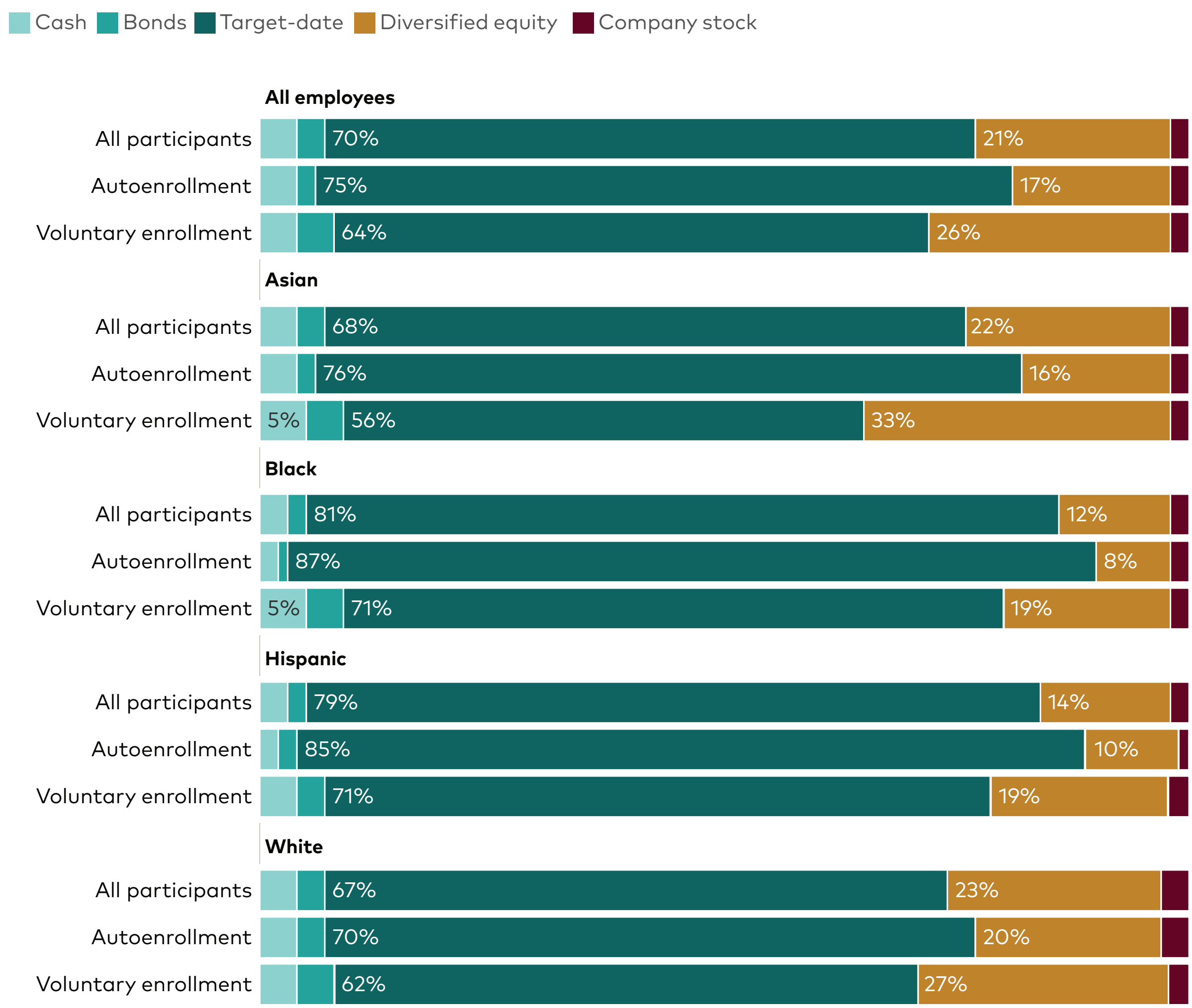
The growth of target-date funds (TDFs) is dramatically reshaping participant investment decisions. Target-date funds base portfolio allocations on an expected retirement date, with allocations growing more conservative as the participant approaches the fund's target year. For many participants, target-date funds are a great option to help meet retirement goals.

Within our sample, nearly two-thirds of retirement plan contributions were invested in target-date funds. Automatic enrollment into a target-date fund default is one important factor in the increased number of target-date fund investors.

Black and Hispanic participants had the highest average allocation in target-date funds (Figure 9). Black participants had an average weighting in target-date funds of 81%, with 12% allocated to other diversified equities, and about 2% allocated each to cash, bonds, and company stock. In comparison, White participants had 67% allocated to target-date funds, with 23% allocated to equities and the remaining 10% allocated to cash, bonds, and company stock.

Participants in automatic enrollment plans were more likely to have higher target-date fund allocations. Black and Hispanic participants had 87% and 85% allocated to target-date funds, respectively, while Asian and White participants had 76% and 70%, respectively. When examining allocation behaviors in voluntary enrollment plans, target-date fund allocations were lower across all races and ethnicities, with Asian participants having the lowest allocations at 56%.

Figure 9. Participant-weighted asset allocation



Source: Vanguard, 2024.

Values under 4% are not visually labeled

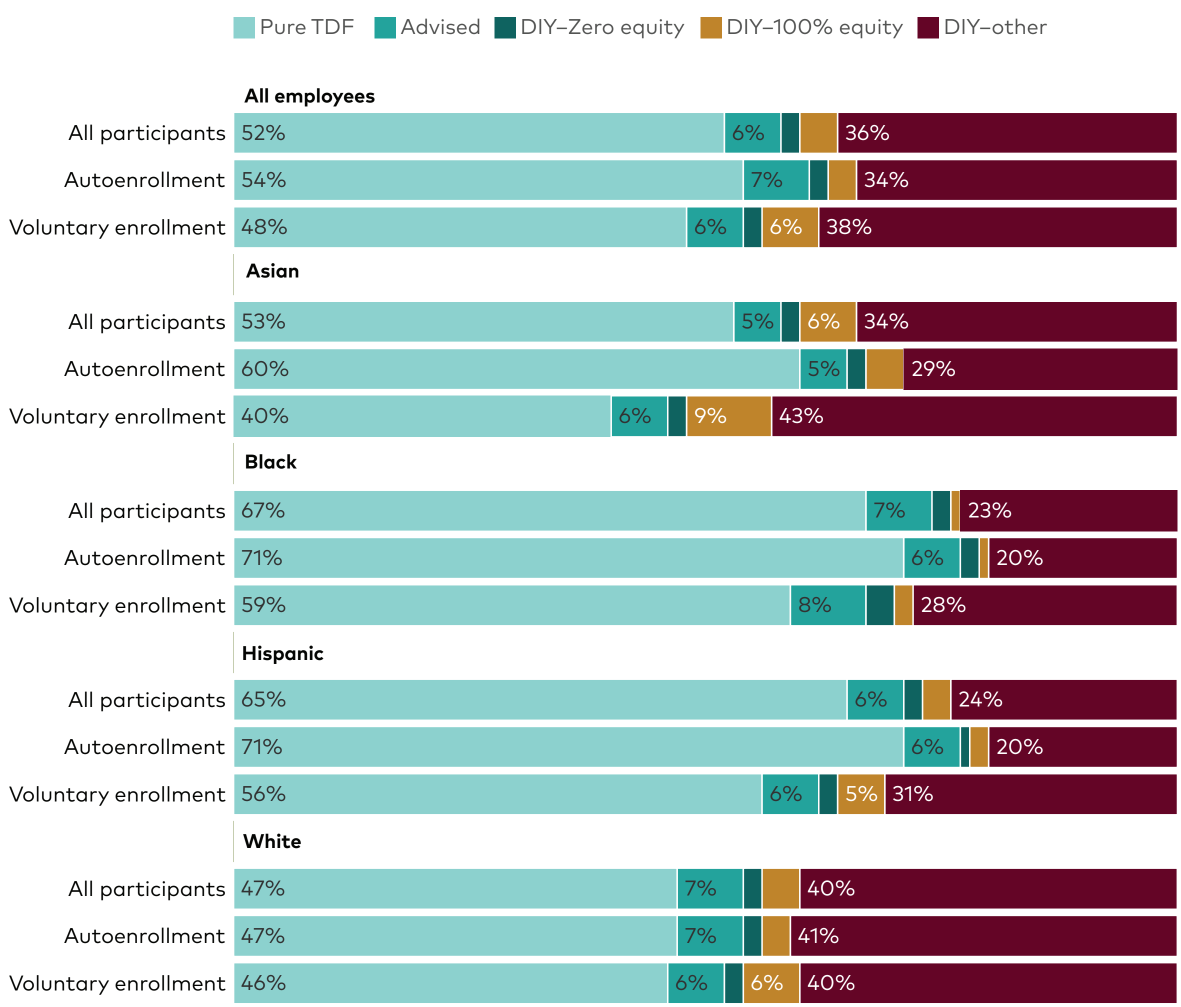
Professionally managed allocations

Participants with professionally managed allocations have their entire balance invested in a single target-date fund or traditional balanced fund, or in a managed account advice service. Within our sample, 58% of participants had a professionally managed allocation, 52% were pure target-date investors, and 6% were using managed account advice (Figure 10). These professionally managed investment options signal a shift in responsibility for investment decision-making away from the participant and toward employer-selected investment and advice programs.

When examining the use of professionally managed allocations by race and ethnicity, Black and Hispanic participants were more likely to be pure TDF investors, compared with Asian and White participants. Notably, all races and ethnicities, across both automatic and voluntary enrollment designs, had relatively similar use of managed account advice services.

The rising use of professionally managed allocations is also influencing extreme portfolio allocations. Only 4% of participants had 100% of their account balance allocated to equities, while 2% had no allocation to equities. As Black and Hispanic investors were more likely to have a professionally managed allocation, they were also less likely to hold an extreme equity allocation.

Figure 10. Professionally managed allocations



Source: Vanguard, 2024.

Values under 4% are not visually labeled.

Loans

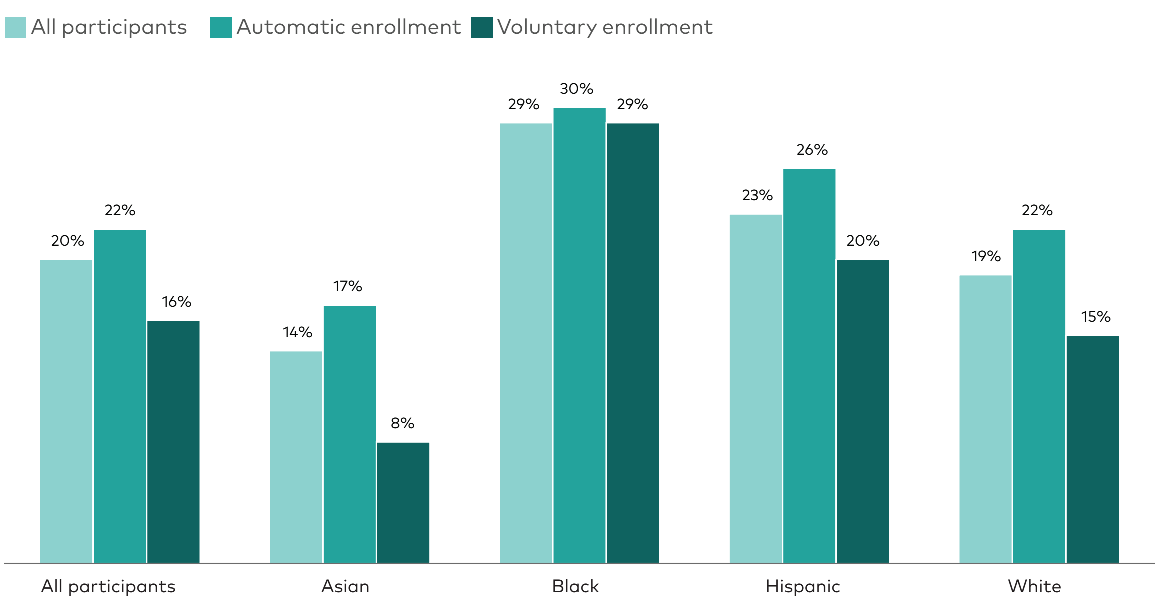
Plan loans allow DC plan participants to access their plan savings before retirement without incurring income taxes or tax penalties. If permitted by the plan, participants can borrow up to 50% of their balance (up to $50,000) from their DC plan account. Twenty percent of participants in our sample had a loan (Figure 11). Asian participants were the least likely to have a loan, while Black participants were the most likely, with nearly 3 in 10 having a loan. Participants in plans with automatic enrollment were modestly more likely to have a loan.

Income appears to have an influence on loan use (Figure 12). About 1 in 4 participants with a household income between $50,000 and $100,000 had a loan, while 13% of participants with an income of more than $100,000 had one. When examining loan use by race, ethnicity, and income, Black participants were more likely to have loans, across all income segments. At higher incomes, Black participants were twice as likely to have a loan.

Loans can also provide participants with a flexible source of liquidity

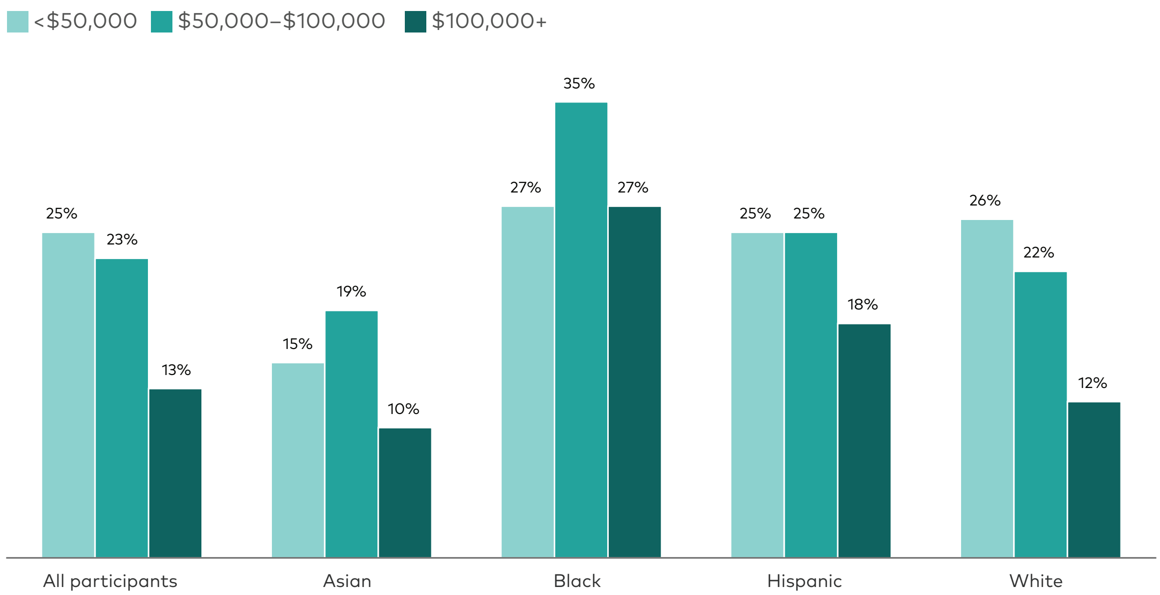
Loans come with risks. Cash that has been borrowed earns fixed income rather than equity market returns, and participants who leave their employer may need to repay any loan balance immediately. But loans can also provide participants with a flexible source of liquidity. In addition, most loans are repaid and are not as detrimental to long-term retirement savings as in-service withdrawals.

Figure 11. Loan usage (Percentage of participants with a loan)



Source: Vanguard, 2024.

Figure 12. Loan usage (By income)



Source: Vanguard, 2024.

Withdrawals

Hardship withdrawals allow participants to access a portion of their savings when they have a demonstrated financial hardship. The amount that can be withdrawn is limited to what is necessary to meet the immediate need, and the withdrawal is subject to income tax and a 10% early withdrawal penalty for those younger than 59½.

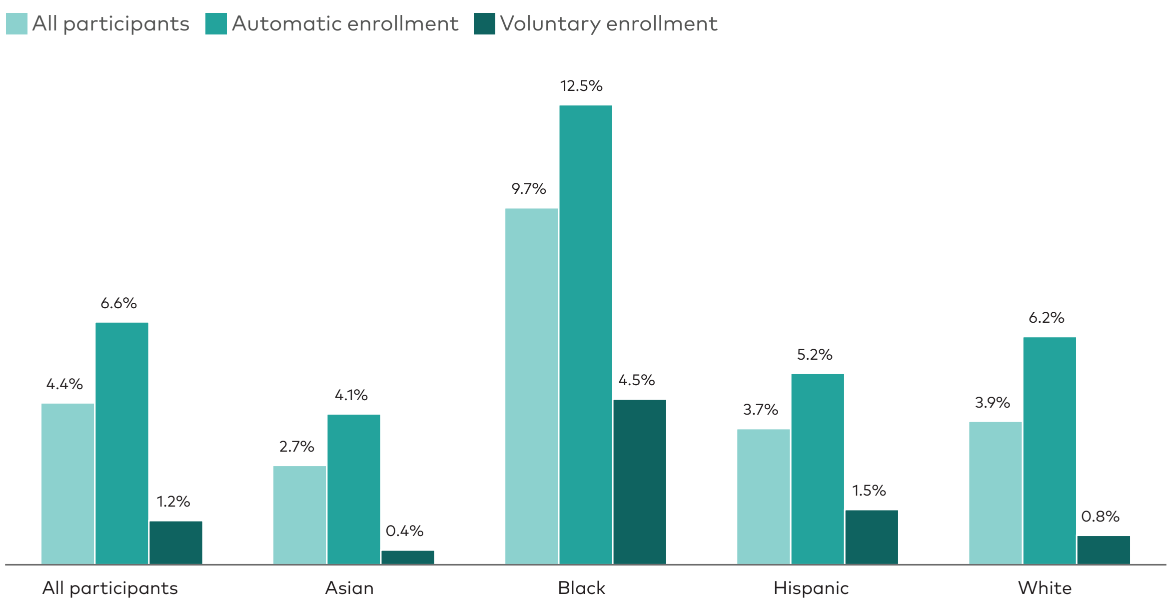
Hardship withdrawal activity has modestly increased over the past few years. The Bipartisan Budget Act of 2019 introduced changes to hardship withdrawal provisions. These changes were designed to ease restrictions for participants who needed to access their qualified retirement plan assets because of an immediate financial need. Given that it's now easier to request a hardship withdrawal and that automatic enrollment is helping more employees save for retirement, especially lower-income employees, a modest increase is not surprising.

Within our sample, 4.4% of participants took a hardship withdrawal (Figure 13). Asian, Hispanic, and White participants had relatively similar use rates of hardship withdrawals, between 2.7% and 3.9%. However, nearly 10% of Black participants took a hardship withdrawal.

Like loans, income has an influence on hardship withdrawal use (Figure 14). Within our sample, about 5% of participants with a household income between $50,000 and $99,000 took a withdraw, while less than 1% of participants with an income of more than $100,000 took one. This difference reflects liquidity constraints among those with low wealth and income—that is, higher-income households have less of a need to withdraw retirement assets before retirement. When examining hardship withdrawal use by race, ethnicity, and income, Black participants were more likely to have initiated a hardship withdrawal across all income segments. Even at higher-income segments, Black participants were three times as likely to have taken a hardship withdrawal.

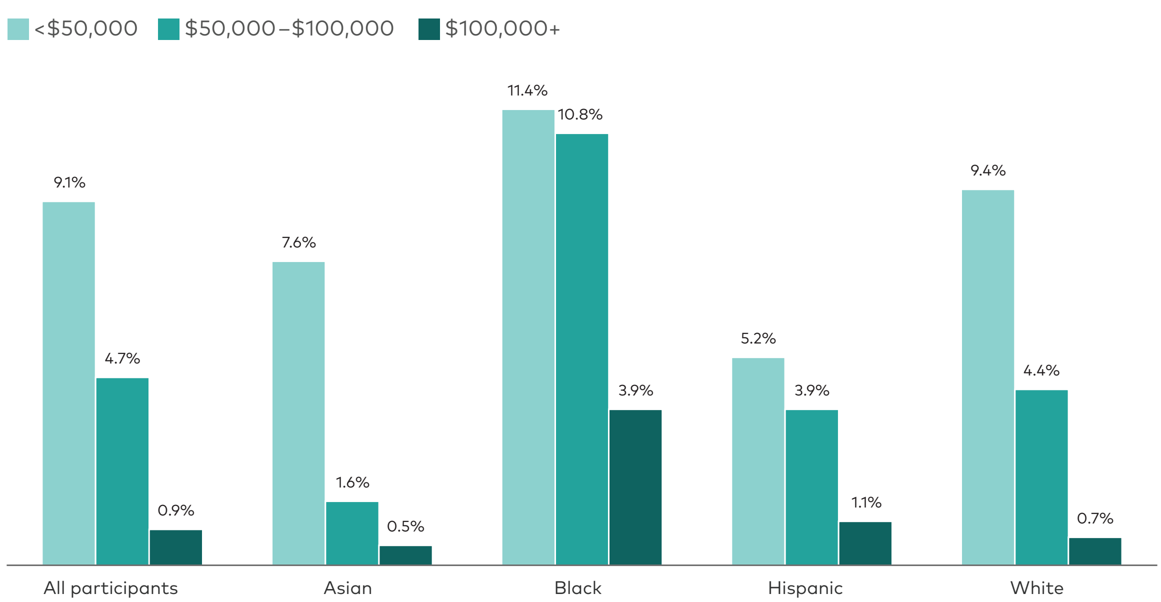
Participants in automatic enrollment plans were significantly more likely to have taken a hardship withdrawal. While the hardship withdrawal rate of automatically enrolled participants is higher, it's important to note that as plans have increasingly implemented automatic solutions to improve retirement outcomes, more employees now have an additional resource that may be accessed in an emergency. Accessing plan assets before retirement should be a last resort for participants. However, for participants who may have faced a financial shock, they are better off than employees without a retirement savings cushion.

Figure 13. Hardship withdrawals (Percentage of participants with hardship withdrawals)



Source: Vanguard, 2024.

Figure 14. Hardship withdrawals (Hardship withdrawals by income)



Source: Vanguard, 2024.

Implications

Our objective was to determine the extent to which plan design affected participant saving behavior among different racial and ethnic groups. And our findings show that an employer-sponsored retirement plan with strong plan design features can promote equitable saving and help participants achieve retirement success.

This is important because strong retirement readiness comes down to two important actions: saving enough and investing appropriately. Automatic enrollment, target-date funds, and advice have significantly altered the trajectory of how Americans save and invest for retirement and have provided a simple and effective process to help employees do so.

This study's implications are revealing in several ways and build off earlier Vanguard research. While we have long known that automatic enrollment drives better participation and especially improves outcomes for lower-compensated employees, these findings offer additional proof that automatic solutions drive significantly stronger retirement behaviors for Black and Hispanic employees, with large improvements in participation, employee savings, and target-date fund use.

However, it's important to acknowledge that within all cohorts, some participants are doing better than others. Each participant is unique, with individual goals, varied demographics, and distinct retirement saving behaviors. Indisputably, all employees would be better off with smart, readily accessible, and simple yet powerful automatic solutions in their employer-sponsored retirement plan.

* Our research was conducted within the definitions and guidelines of the Equal Employment Opportunity Commission.

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All investing is subject to risk including the possible loss of the money you invest.

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 work force. 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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