Vanguard

Vanguard research note

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# Professionally managed allocation adoption in 2021

## Executive summary


### The use of professionally managed allocations in defined contribution (DC) plans has grown significantly over the last 10 years.

In 2021, 64% of Vanguard DC plan participants (compared with 33% in 2011) were invested in a professionally managed allocation, including 56% who were invested in a single target-date fund (TDF), 7% in a managed account service, and 1% in a single balanced fund.

This increase has been accompanied by improved participant behaviors and outcomes, including:

- Better age-based equity allocations among all participants in professionally managed allocations.
- Higher engagement and saving rates for advised participants.
- A tendency among pure TDF participants to "stay the course" when saving, the result of plan design (automatic increase) and inertia.

What follows is an examination of these and other trends as they relate to professionally managed allocations—among the many developments chronicled in *How America Saves*, our annual analysis of retirement saving behavior that enters a third decade of industry coverage with its 21st edition this summer.

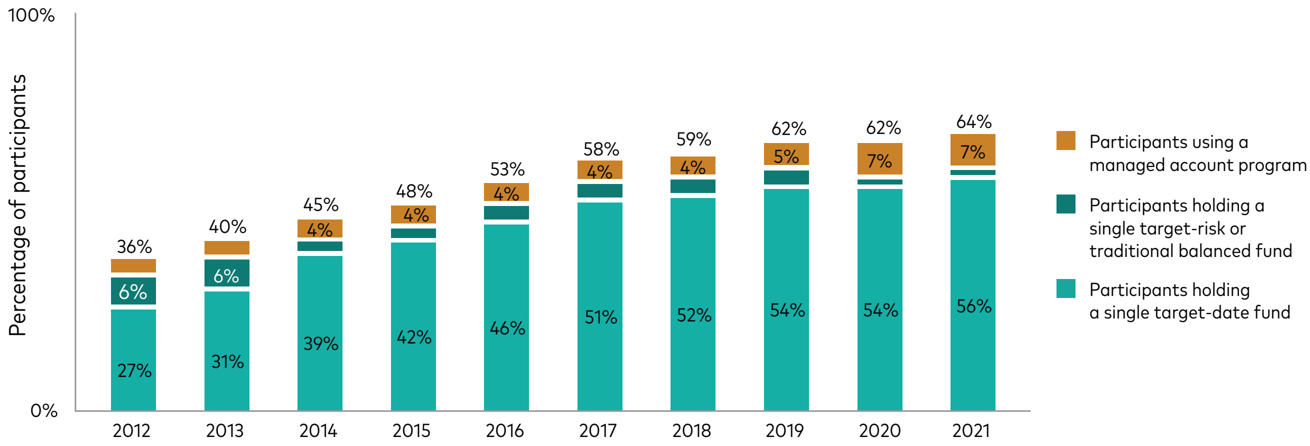

## Introduction

The increasing use of professionally managed allocations signals a shift in responsibility for investment decision-making away from the participant and toward employer-selected investment and advice programs.

In 2021, 64% of Vanguard participants were invested in a professionally managed allocation **(Figure 1)**.

**Figure 1. Participants with professionally managed allocations**

*Vanguard defined contribution plans*




Source: Vanguard, 2022.

Driving this development is the growing use of target-date funds and managed accounts. Fifty-six percent of participants were invested in a single target-date fund in 2021, more than twice as many as in 2012. In addition, the percentage of participants in a managed account has more than doubled during this period.

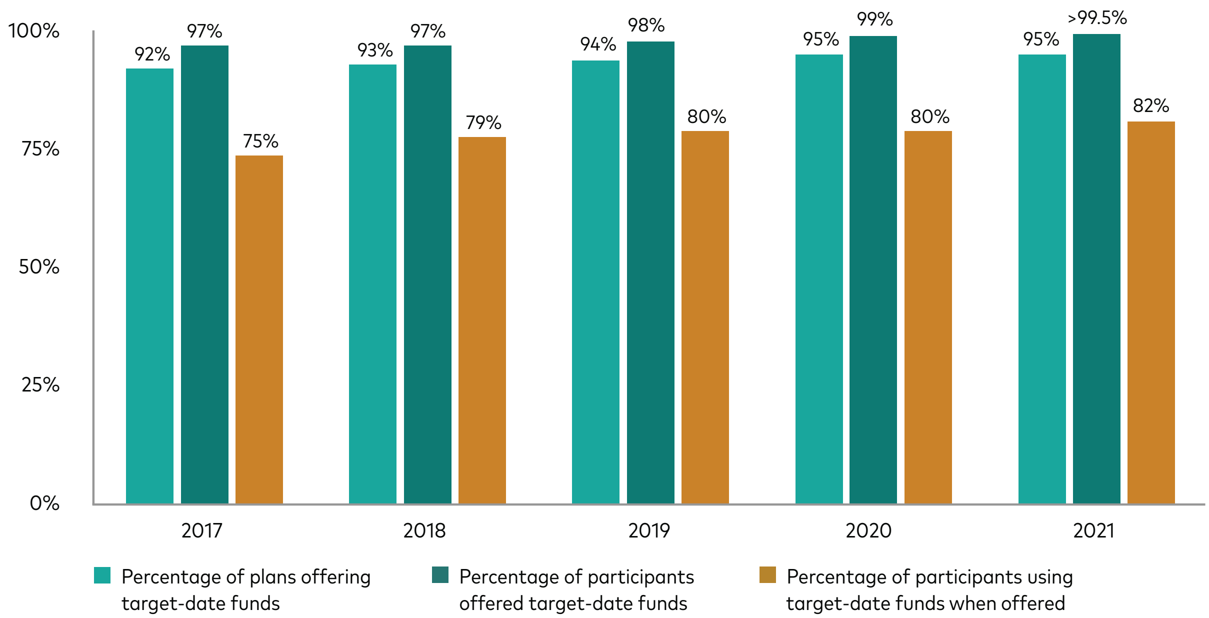
This shift has contributed to improved participant behaviors and outcomes—progress that will likely continue to drive the use of professionally managed allocations.

## Target-date funds

Target-date funds base portfolio allocations on an expected retirement date; allocations grow more conservative as the participant approaches the fund's target year. The percentage of plans offering target-date funds grew to 95% in 2021 **(Figure 2)**. At year-end 2021, nearly all Vanguard participants (more than 99.5%) were in plans offering TDFs, and of participants who were offered target-date funds, 82% invested at least a portion of their assets in them.

**Figure 2. Target-date fund offerings and use trend**

*Vanguard defined contribution plans*




Source: Vanguard, 2022.

We characterize participants who invest in TDFs in one of two ways. "Pure investors" are those who invest 100% of their assets in a single TDF. They accounted for 69% of all target-date investors in 2021. Of this total, about 6 in 10 joined their plan under automatic enrollment, where they typically were enrolled in a single fund by default. About 4 in 10 joined through voluntary enrollment, where they typically actively chose a single TDF.

The remaining target-date participants are "mixed investors." They hold a TDF in combination with other investments or hold multiple TDFs.

In 2021, 31% of all target-date investors were in this category. They appear very much like non-target-date investors in terms of their demographic and portfolio characteristics.

Participants who are single target-date fund investors not only benefit from continuous rebalancing but are also far less likely to trade when compared with all other investors. In 2021, only 3% of all pure TDF investors made an exchange, a rate nearly five times lower than all other investors (excluding managed account participants).

## Managed account services

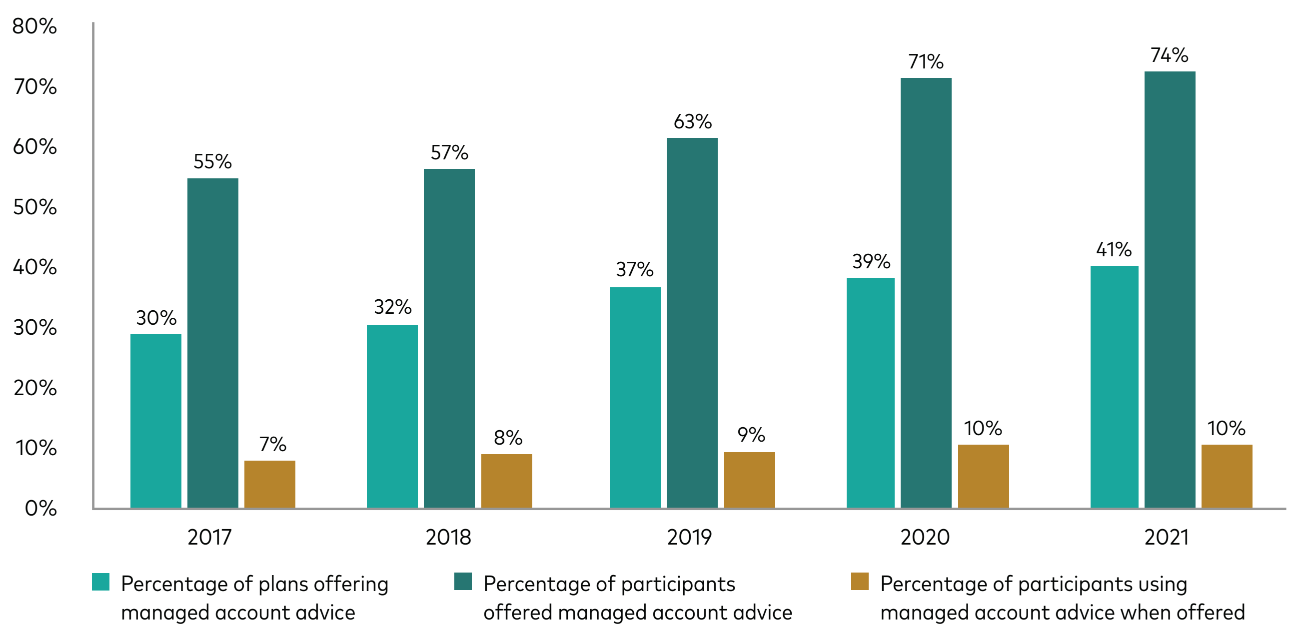
To address participants' needs for assistance with investing and planning decisions, more plan sponsors are offering managed account advice services.

Forty-one percent of all Vanguard DC plans offered managed account advice in 2021, and nearly 8 in 10 larger plans offered the service. As larger plans are more likely to offer advice, 3 in 4 participants had access to the service.

Supporting participants in creating holistic financial well-being has become a priority for plan sponsors and has led to increased availability of managed account advice. Over the past five years, the percentage of plans offering a managed account program has grown by more than 30%, and in turn, the percentage of participants offered the service has grown by a similar amount **(Figure 3)**. One in 10 participants who have access are enrolled in their plan's managed account program, up from 7% in 2017.

**Figure 3. Advice-offered trend**

*Vanguard defined contribution plans*




Source: Vanguard, 2022.

## Professionally managed allocations by demographics

There were distinct differences between participants with professionally managed allocations and those without, as well as distinctions among participants with each of the three types of managed allocations **(Figure 4)**. Participants who constructed their own portfolios tended to be older and longer tenured with higher average and median balances. Single target-date fund investors were shorter tenured with lower account balances and were more likely to be in an automatic enrollment plan and to have been defaulted into the fund. In contrast, managed account investors were older, longer tenured, and had higher balances.

The percentage of participants with a professionally managed allocation varied somewhat by participant demographics. Younger and less tenured participants were more likely to be single target-date fund investors. Higher-paid participants, with higher balances, tended to use managed account programs more often. However, use of the strategy was not concentrated in certain demographic segments, highlighting the value managed accounts can provide to various cohorts of participants.

Participants in automatic enrollment plans were more likely to have a professionally managed allocation than were those in voluntary arrangements because 98% of automatic enrollment plans defaulted participants into target-date funds.

**Figure 4. Demographic characteristics, 2021**

*Vanguard defined contribution plans*

| | Professionally managed allocations | | | | |
|---|---|---|---|---|---|
| | Single target-date fund participants | Single balanced fund participants | Managed account participants | All other participants | All participants |
| **Percentage of participants** | 56% | 1% | 7% | 36% | — |
| **Percentage male** | 54% | 61% | 58% | 60% | 57% |
| **Median age** | 39 | 47 | 49 | 50 | 44 |
| **Median tenure** | 4 | 11 | 11 | 14 | 7 |
| **Average account balance** | $55,521 | $118,272 | $200,196 | $264,586 | $141,542 |

Source: Vanguard, 2022.

## Participant engagement

In 2021, 68% of participants contacted Vanguard through a variety of channels—websites, mobile applications, telephone associates, and voice-response systems **(Figure 5)**. About one-third of participants contacted Vanguard intermittently. This group interacted with Vanguard between one and six times per year. Another one-third of participants contacted Vanguard frequently.

Participants in managed account programs were most likely to contact Vanguard and typically did so frequently, as 42% of managed account investors engaged with Vanguard more than once per month. Meanwhile, single target-date fund investors were less likely to access their accounts.

**Figure 5. Participant engagement, 2021**

*Vanguard defined contribution plans*

| | Professionally managed allocations | | | | |
|---|---|---|---|---|---|
| | **Single target-date fund participants** | **Single balanced fund participants** | **Managed account participants** | **All other participants** | **All participants** |
| **Percentage web registered** | 70% | 69% | 96% | 86% | 79% |
| **Percentage contacting Vanguard** | 57% | 52% | 89% | 76% | 68% |
| **Number of contacts per year** | | | | | |
| **No contact** | 43% | 48% | 11% | 24% | 32% |
| **1 contact** | 11% | 10% | 6% | 9% | 10% |
| **2–3 contacts** | 14% | 13% | 12% | 13% | 14% |
| **4–6 contacts** | 11% | 10% | 13% | 13% | 12% |
| **7–12 contacts** | 9% | 8% | 16% | 13% | 11% |
| **13–24 contacts** | 6% | 5% | 16% | 11% | 9% |
| **25+ contacts** | 6% | 6% | 26% | 17% | 12% |
| **Percentage contacting Vanguard via . . .** | | | | | |
| **Website** | 43% | 39% | 73% | 64% | 53% |
| **Mobile** | 27% | 21% | 52% | 34% | 31% |
| **Voice-response unit** | 6% | 6% | 11% | 8% | 7% |
| **Telephone associate** | 11% | 10% | 21% | 15% | 13% |

Source: Vanguard, 2022.

## Participant savings behavior

Elected deferral percentages are the saving rates participants defer from their salary. On average, participants elected to defer 9% of their pay in 2021 **(Figure 6)**. Participants in managed account programs saved at strong levels, similar to do-it-yourself investors. Single target-date fund investors saved at lower levels, in part because these participants are younger, with shorter tenures. Fifteen percent of all participants contributed to Roth accounts, and managed account investors were almost twice as likely as single target-date fund investors to contribute to these accounts.

When examining changes to deferral percentages throughout the year, 51% of participants made some change, whether they increased or decreased their savings. Managed account participants were most likely to initiate a change in deferral percentages and were also the most likely to increase their savings rate on their own. On the other hand, single target-date fund investors were the most likely to have their deferral percentage increased through an automatic escalation program.

**Figure 6. Participant savings behavior, 2021**

*Vanguard defined contribution plans*

| | Professionally managed allocations | | | | |
|---|---|---|---|---|---|
| | Single target-date fund participants | Single balanced fund participants | Managed account participants | All other participants | All participants |
| **Average elected deferral percentage** | 8% | 8% | 11% | 12% | 9% |
| **Median elected deferral percentage** | 6% | 6% | 10% | 10% | 7% |
| **Percentage contributing to Roth accounts** | 11% | 12% | 21% | 20% | 15% |
| **Deferral changes** | | | | | |
| **No change** | 46% | 58% | 42% | 54% | 49% |
| **Automatic escalation increase** | 31% | 24% | 23% | 18% | 25% |
| **Increase** | 16% | 12% | 23% | 18% | 17% |
| **Decrease** | 5% | 5% | 10% | 8% | 7% |
| **To zero** | 2% | 1% | 2% | 2% | 2% |

Source: Vanguard, 2022.

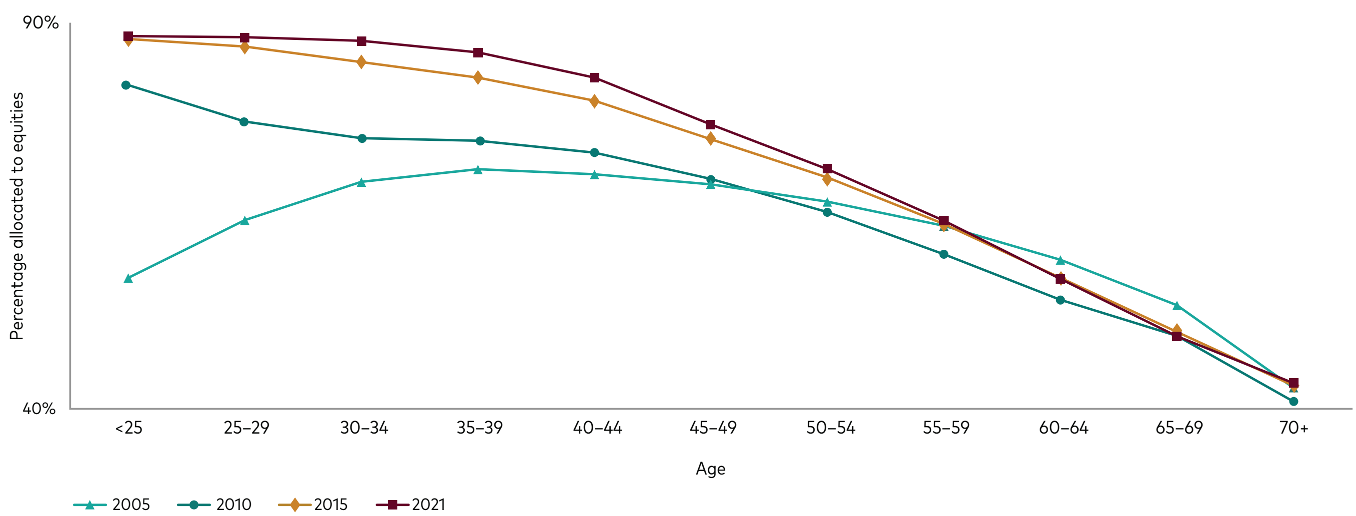
## Equity allocations by age

In 2005, participants' age-based equity allocation was hump-shaped, with younger participants adopting more conservative allocations, middle-age participants holding the highest equity exposure, and older participants having equity exposure on par with younger participants **(Figure 7)**. In 2021, the equity allocation among Vanguard DC participants was downward sloping by age.

**Figure 7. Trend in asset allocation by participant age**

*Vanguard defined contribution plans*

Average equity allocation participant weighted



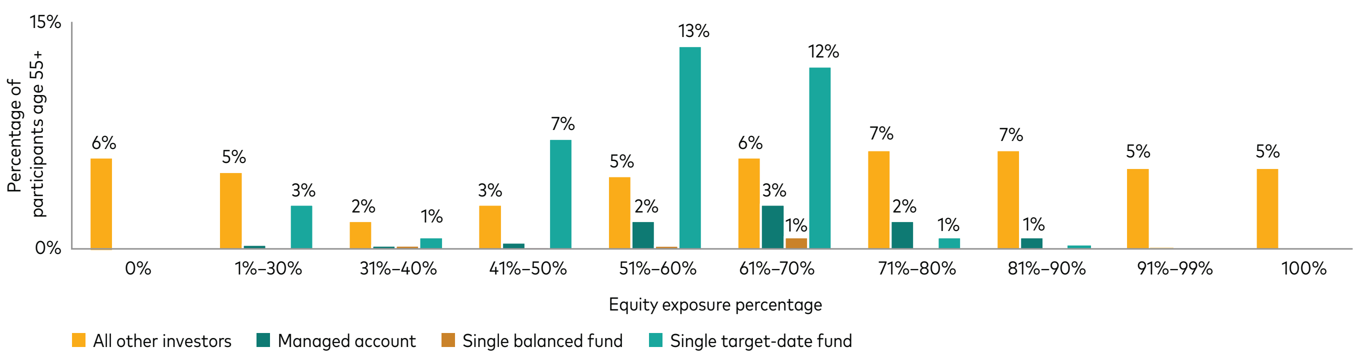

Source: Vanguard, 2022.

As previously noted, younger participants were more likely to have a professionally managed allocation, and therefore a higher percentage of them had an age-appropriate equity allocation in 2021. Older participants, who were perhaps preparing for or already in retirement, were most likely to construct their own portfolio **(Figure 8)**.

Fifty-one percent of participants age 55 or older created their own allocations, while nearly 4 in 10 used a single target-date fund and 9% used a managed account program. While older participants with professionally managed allocations typically had equity exposure between 40% and 80%, those who constructed their own portfolio had a wide dispersion of equity allocations, which were evenly distributed from 0% to 100%. These participants also had the highest average balances. This points to the possibility that many of these older, higher-balance participants could benefit from a professionally managed allocation.

**Figure 8. Distribution of equity exposure by older investors, 2021**

*Vanguard defined contribution plan participants age 55+*




Source: Vanguard, 2022.

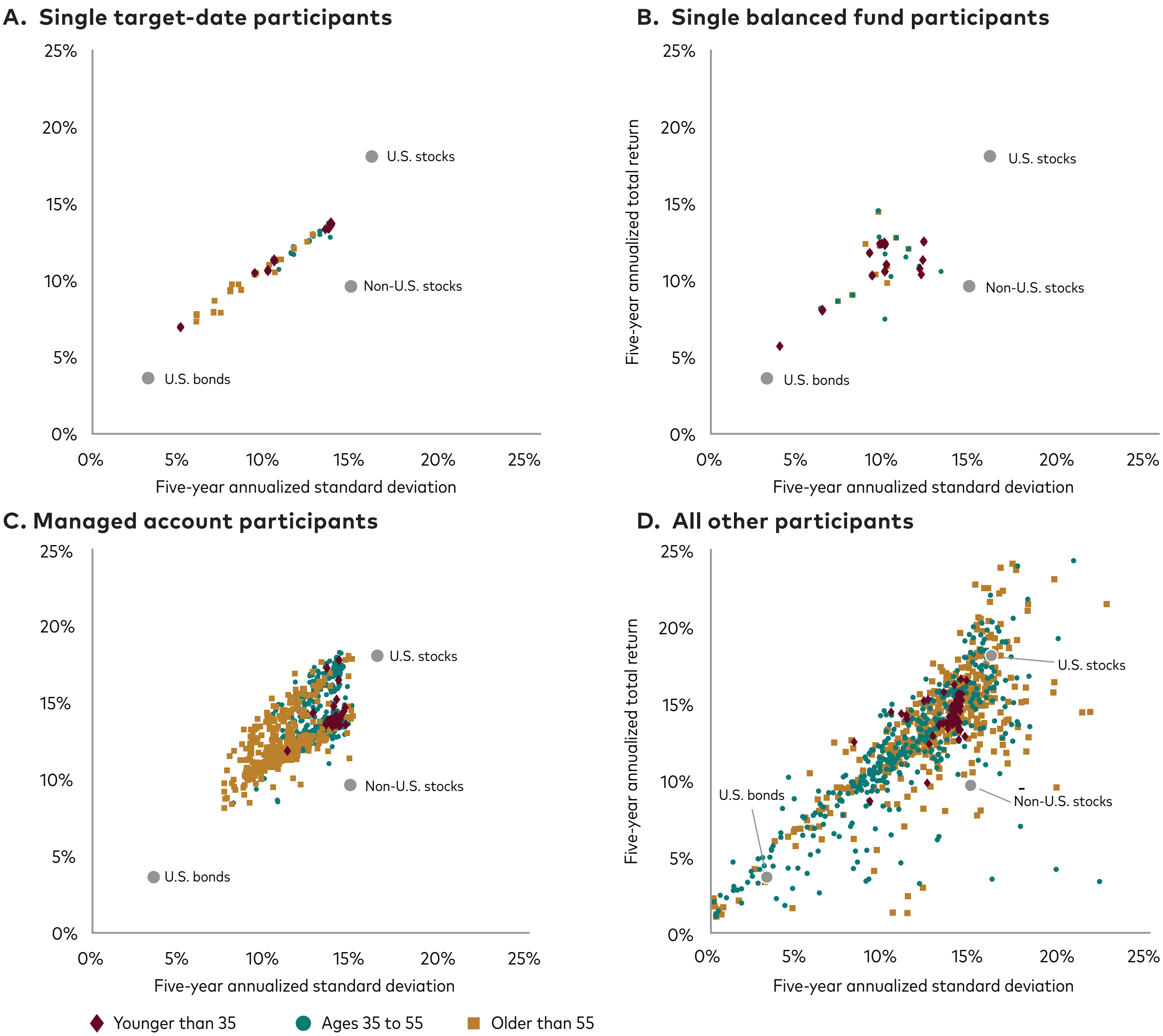
| | All other investors | Managed account | Single balanced fund | Single target-date fund |
|---|---|---|---|---|
| **Percentage of population** | 51% | 9% | 1% | 39% |
| Average balance | $384,332 | $297,334 | $193,116 | $94,531 |
| Median balance | $178,853 | $159,119 | $72,489 | $26,052 |

## Dispersion of outcomes

During the five-year period ended in 2021, outcomes for single target-date and advice investors were distributed among major market indexes **(Figure 9)**. They were slightly upward sloping, indicating a positive equity risk premium. These results are consistent with the fact that many of the professionally managed allocation portfolios in our sample are a specific combination of U.S. equities, international equities, U.S. bonds, and international bonds. In the target-date scatter plot **(Panel A)**, younger participants (represented by turquoise dots and in long-dated portfolios) are to the right of the chart; older participants (represented by yellow dots and in near-dated portfolios) are to the left.

The results for single-balanced-fund investors reflect the fact that most balanced funds have similar ranges of equity allocations, typically around 35% to 65% of assets **(Panel B)**. Managed account investors' results were more dispersed, revealing the customized nature of managed account advice **(Panel C)**. The greatest dispersion of risk/return outcomes was among participants making their own investment choices **(Panel D)**.

**Figure 9. Risk and return characteristics, 2017–2021**




Source: Vanguard, 2022.

Note: Includes 1,000 random samples of participant accounts drawn from respective samples. Excludes ½% top and ½% bottom outliers for both risk and return, for a net sample of 980 observations.

When determining which index to use, we selected the index we deemed a fair representation of the characteristics of the referenced market. For U.S.stock market returns, we use the MSCI US Broad Market Index. For non-U.S. stock market returns, we use the MSCI All Country Wold Index ex USA Net Return Index. And for U.S. bond market returns, we use the Spliced Bloomberg Barclays U.S. Aggregate Float Adjusted Index (reflects the Barclays U.S. Aggregate Bond Index through December 31, 2009; and the Bloomberg Barclays U.S. Aggregate Float Adjusted Index thereafter).

**Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.**

## Conclusion

Professionally managed allocations continue to reshape investment behavior in DC plans. Increased use of the strategy by plan sponsors and participants is improving portfolio construction and leading to more disciplined participant investment behavior.

The target-date and advice approaches are leading to a more disciplined approach to portfolio risk-taking, with risk levels falling as investors age. Managed allocations are also helping remedy the problem of extreme allocations found among many DC plan participants. For these reasons, their adoption will likely continue to rise in the coming years.

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*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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