Reenrollment: One year later

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- One year after a reenrollment event, most participants remain invested in the default fund. However, opt-out rates have increased slightly over time. Those participants who opt out tend to be predominantly older, wealthier males who "try out" target-date funds but ultimately choose to construct their own retirement portfolios.

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Background

Early in 2016, we examined the impact of a reenrollment event within a large DC plan, analyzing participant behavior immediately after the event and then six months later. In this paper, we extend our analysis to study the behavior of the same participant cohort one year after the event.[1]

Reenrollment is one way to quickly improve plan diversification. It is a plan design strategy whereby participants' account balances are transferred automatically to the plan's qualified default investment alternative (QDIA). Participants are given advance notice of their right to opt out of the transfer. Sponsors also receive fiduciary protection under the Department of Labor's QDIA regulations.[2]

Reenrollment can be highly effective in changing participant behaviors for several reasons. Inertia often dominates financial decision-making. Similar to the effect of inertia in automatic enrollment and saving decisions, many participants will choose not to take any action in response to the reenrollment event and their portfolio holdings. A second reason is that many participants may lack strong convictions about their original portfolio choices. They may be unsure about the appropriate level of risk to take or how to adequately diversify their portfolios.

Reenrollment case study

The original reenrollment event occurred in two phases, beginning in December 2014 during the transfer of a large DC plan's recordkeeping services to Vanguard. Because of the presence of a stable value investment fund, which required advance notification to the insurer, the full reenrollment was not completed until June 2015. This study evaluates the continuous cohort of participants who were present in the plan on the three key dates: December 2014, June 2015, and June 2016, one year after the completion of the reenrollment process.

After one year, the plan menu remained consistent in terms of the styles and number of funds offered. However, the bond funds and one stable value offering were changed. As we will show, these fund changes did have an impact on a small percentage of participants.

1 Pagliaro and Utkus, 2016. In this original work, we also focused on the impact of fee reduction. Since there was no material change in the cost of plan menu options, we excluded plan fees from this updated analysis.

2 For a detailed discussion of the fiduciary and plan design aspects of a reenrollment, see *Improving plan diversification through reenrollment in a QDIA*. Vanguard, forthcoming.

Opt-out rates

Over time, the percentage of participants who chose to opt out of the default fund, either in part or in full, increased (**Figure 1**). Immediately after phase 1, at the end of December 2014, 10% of participants partially or fully opted out of the default fund and elected their own portfolios. After phase 2, this percentage increased slightly. One year later, 20% of participants were no longer solely invested in the default fund. Most of the increase is observed among participants who moved part of their portfolio out of the target-date default. The percentage of participants who fully opt out remains low over the entire one-year period.[3]

Figure 1. Opt-out rates

All continuous plan participants (present in every period)

	After reenrollment: phase 1 12/31/2014	After reenrollment: phase 2 6/30/2015	One year later 6/30/2016
100% default fund or default and stable value funds	90%	84%	80%
Partial opt-out	2%	10%	12%
Full opt-out	8%	6%	8%
Subtotal	**10%**	**16%**	**20%**
Total	100%	100%	100%

Source: Vanguard, 2016.

Changes in portfolio allocation

After one year, target-date funds were held by 92% of participants and captured 81% of plan assets. (**Figure 2**). One of the primary objectives of reenrollment into a target-date series is to address both extreme portfolio allocation and age-inappropriate allocations.

Figure 2. Target-date fund holdings

All plan participants

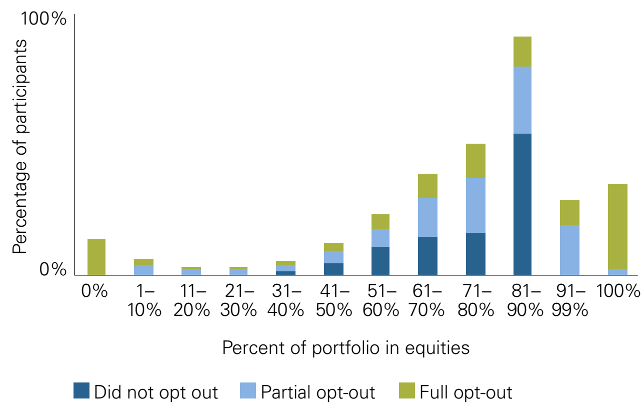
	June 30, 2015	June 30, 2016
Percentage of participants	94%	92%
Percentage of assets	74%	81%

Source: Vanguard, 2016.

The distribution of equity allocation continues to reflect the impact of target-date strategies. The majority of participants hold an age-appropriate equity allocation (**Figure 3**). This is true even among those participants who supplement the target-date fund with other investments options. A small group, 7% of participants, holds extreme positions. This group is predominantly participants who fully opted out of the target-date default fund and constructed their own portfolios.

Figure 3. Distribution of equity allocation

All plan participants



Source: Vanguard, 2016.

A good way to assess the impact of the reenrollment event is to compare age-related equity allocations with the equity glide path of the target-date series. Before the plan reenrollment, the distribution of participants' average equity allocations (gray area) varied widely and the median value deviated from the equity allocation of the target-date funds (**Figure 4—Panel A**).

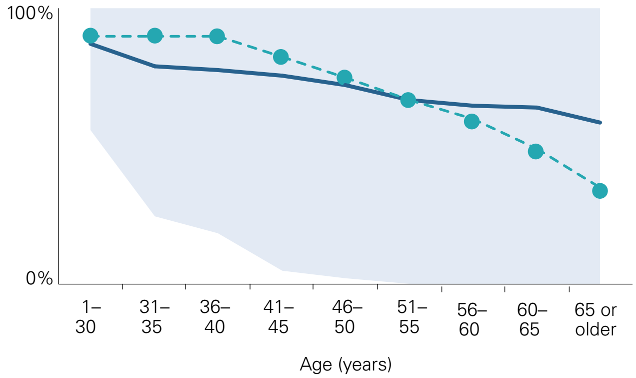
After the two-phase reenrollment event, the trajectory of the median equity allocation aligned more closely to the target-date series (**Figure 4—Panel B**). The distribution or variation around the glide path, representing individuals who chose to deviate from the single target-date default fund, grew wider as participant age increased. This widening of the distribution reflected later-than-normal retirement ages anticipated by some older investors—an expectation leading to somewhat riskier portfolios.

3 As in the original report, opt-out rates varied based upon a participant's status within the plan. A quarter of active participants (those currently contributing to the plan) either partially or fully opted out compared with just 6% of inactive participants. This difference most likely reflects a higher level of inattention among inactive participants.

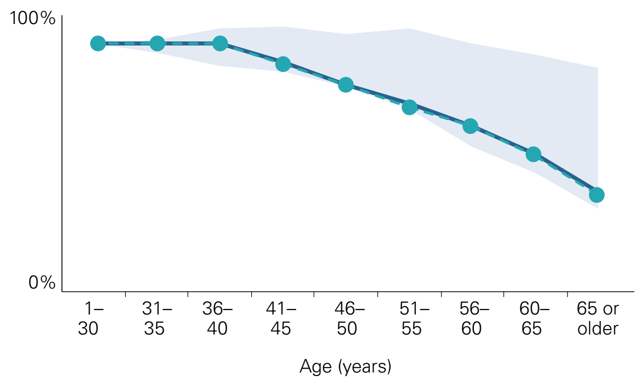
Figure 4. Reenrollment and age-related equity allocation

All plan participants

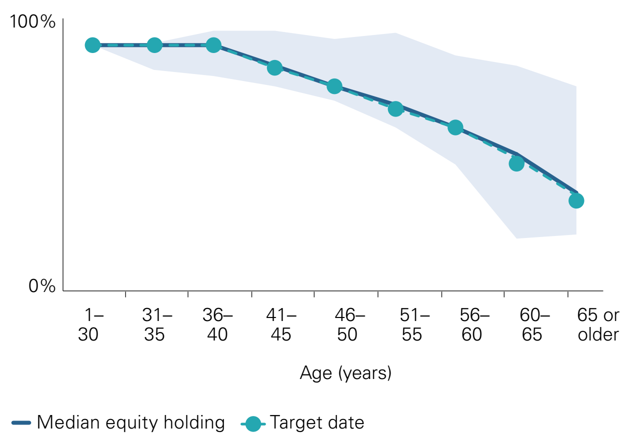
Panel A: Before reenrollment event—September 2015



Panel B: Completion of two-phase reenrollment event—June 2015



Panel C: One year after reenrollment event—June 2016



The shaded area is bounded by the 5th and 95th percentile of the equity distributions within each age group.

Source: Vanguard, 2016.

(**Figure 4—Panel C**) One year later, what was most noticeable is the change in equity allocations among those age 50 and older. Most individuals stayed at the default, but among those changing, deviations from the glide path were greater, particularly in the conservative direction. This may be the response to the change in the menu. As mentioned earlier, the bond and money market funds changed during the one-year period and these changes were communicated to participants. It could also reflect a gradual drift away from the default among older investors. These same effects may be at work for younger investors, though to a more limited degree.

Participants who opt out

Over the year, there were some small but significant changes in a participant's opt-out status. **Figure 5** compares a participant's opt-out status between June 2015 and June 2016. Three percent of full opt-out participants in June 2015 chose to add target-date funds to their portfolios in 2016, becoming partial opt-out participants. Four percent of participants who held only the default fund added other funds to their portfolios, again becoming partial-opt out participants. The most interesting shift occurred among nine percent of partial opt-out participants, who dropped target-date funds altogether.

Figure 5. Participant opt-out behavior

Active participants only

	June 2016		
June 2015	Did not opt out	Partial	Full
Did not opt out	95%	4%	1%
Partial opt-out	2%	90%	9%
Full opt-out	0%	3%	97%

Source: Vanguard, 2016.

These participants tend to be older, longer-tenured, wealthier men. On average, they were 51 years old with 12 years of tenure, had average balances around $133,000, and earned more than $100,000 per year.

Interestingly, these are the same parameters that characterize fully opt-out participants (Figure 6). It appears that this small group of investors stayed invested in a default target-date fund initially, the new and popular investment choice, but eventually dropped the fund from their portfolios.

Figure 6. Average participant characteristics

Active participants only

	Remained in default	Partial opt-out	Full opt-out
Age	46.0	47.0	50.0
Tenure	8.5	10.7	12.2
Balance	$68,900	$84,298	$138,004
Compensation	$91,673	$87,050	$117,374
Percent male	45%	53%	59%

Source: Vanguard, 2016.

Implications. Over time, investment defaults remain "sticky." This reinforces our findings that reenrollment is an effective strategy to improve portfolio diversification, which is particularly valuable for longer-tenured participants who made portfolio choices under prior investment menus on their own, or who did not benefit from automatic enrollment into a diversified default fund.

Appendix 1:

	Before reenrollment 9/30/2014		6 months after reenrollment 6/30/2015		1 year after reenrollment 6/30/2016	
A. All participants (n=17,028)						
Opt-out rates						
100% default fund				84%		80%
Default fund and stable value				0%		0%
Subtotal				84%		80%
Partial opt-out				10%		12%
Full opt-out				6%		8%
Total				100%		100%
Switched target-date fund				3%		N/A*
Portfolio allocation	Participants (%)	Percentage of plan assets	Participants (%)	Percentage of plan assets	Participants (%)	Percentage of plan assets
Target-date	25%	5%	94%	74%	92%	81%
U.S. equity	54%	41%	13%	16%	15%	7%
International equity	39%	9%	8%	3%	8%	2%
Bond	53%	10%	8%	2%	7%	3%
Stable value	42%	15%	2%	2%	4%	3%
Traditional balanced	57%	20%	5%	3%	5%	4%

*Data not included in our one-year analysis.

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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 (stocks) to more conservative ones (bonds and short-term reserves) based on its target date. An investment in a target-date fund is not guaranteed at any time, including on or after the target date.

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