At Vanguard, we are constantly looking for new and innovative ways to help all investors make the best decisions. To that end, we are pleased to present the inaugural edition of *Insights to Action*, a companion to *How America Saves*, Vanguard’s annual analysis of the retirement saving behavior of participants in defined contribution retirement plans.

*Insights to Action* surfaces six key themes from *How America Saves* data and recommends actions plan sponsors can take to optimize their plan design. We believe a strong plan design will serve participants well in good times and bad—including the extreme uncertainty of the COVID-19 pandemic environment.
KEY THEMES

The power of automatic enrollment
This strategy—already used by the majority of plans—should be nearly universal.

Accelerating target saving rates
Help participants reach a target saving rate of 12% to 15% with automatic plan design.

The target-date fund effect
TDFs are at work in the vast majority of retirement plans, helping to improve participant outcomes.

Controlling withdrawals and loans
Set reasonable plan rules to limit money leaving the plan before retirement.

Your plan as a destination for retirees
Consider plan design elements to entice retirees to stay in their employer-sponsored plans.

High-quality, cost-effective advice
Account for the unique circumstances of individual participants using a suite of advice offerings.
THE POWER OF AUTOMATIC ENROLLMENT

For the first time since Vanguard began publishing *How America Saves*, half of retirement plans are using automatic enrollment.

Percentage of plans with automatic enrollment

<table>
<thead>
<tr>
<th>Year</th>
<th>All plans</th>
<th>Plans with 1,000+ participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>27%</td>
<td>47%</td>
</tr>
<tr>
<td>2014</td>
<td>36%</td>
<td>60%</td>
</tr>
<tr>
<td>2019</td>
<td>50%</td>
<td>71%</td>
</tr>
</tbody>
</table>

Source: Vanguard 2020.

Fifty percent of Vanguard plans permitting employee-elective deferrals have adopted automatic enrollment. And larger plans are even more likely to implement the strategy, with 71% of plans with at least 1,000 participants using the feature. As a result, nearly two-thirds of participants are now in plans with automatic enrollment.

WHY SO POPULAR?

Plans that use automatic enrollment have a 92% participant rate compared with 61% for plans with voluntary enrollment. And plans with automatic enrollment have higher participation rates across all demographic variables, most notably among participants younger than 35 and those with less than two years of tenure. This is important because defaulting employees into the plan early gives them a better chance for a successful retirement.

REENROLLMENT

Plans may also reenroll nonparticipants—either on a one-time basis or routinely every few years. In times of economic uncertainty, participants sometimes elect to stop participating. Reenrollment provides an easy solution for capturing nonparticipants who forget to reengage with their retirement plan once their financial situation improves.
Voluntary Automatic

Participation rates by enrollment type

92% / 61%

Voluntary
Automatic

THE BOTTOM LINE

Automatic enrollment continues to grow in popularity due to a successful track record of:

1. Using the inertia inherent in participant retirement saving decisions to improve outcomes.
2. Getting employees into the plan early, increasing the odds that they will achieve retirement readiness.
3. Taking the complex choice of how much to save and where to invest out of the picture, setting employees up automatically for success.

PLAN ACTIONS

- **Implement automatic enrollment** to benefit your employees by harnessing the power of inertia to reframe the saving decision and encourage plan participation.

- **Reenroll eligible nonparticipants** to provide current employees with the same benefits afforded to new hires.

- **Enact continuous enrollment by** reenrolling nonparticipants every three years to encourage employees whose financial situation may now permit retirement savings.

Source: Vanguard 2020.
ACCELERATING TARGET SAVING RATES

Americans still aren’t saving enough for retirement, but plan sponsors are increasingly using plan design to help boost participant saving rates.

Vanguard believes participants should be saving 12% to 15% of their pay each year for retirement, starting as early as possible. But saving rates have remained stubbornly below that range, creating a persistent 2-percentage-point gap for more than ten years. Change is on the horizon, however, driven by automatic enrollment plan design improvements.

A POWERFUL IMPACT

Automatic enrollment can be a game changer when it comes to saving.

The average employee total saving rate, which combines employee and employer contribution rates, was 10.3% in 2019 for plans with automatic enrollment. That’s 56% higher than the 6.6% total saving rate for participants hired under voluntary enrollment plans. Even more surprising, employees younger than 35 earning less than $50,000 in plans with automatic enrollment had an average total saving rate that was twice as high as employees in plans where enrollment was voluntary.

So why does a 2-percentage-point savings gap persist?

Comparing employee saving rates

<table>
<thead>
<tr>
<th></th>
<th>Voluntary Enrollment</th>
<th>Automatic Enrollment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saving Rate</td>
<td>6.6%</td>
<td>10.3%</td>
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</table>

Saving rates are 56% higher in plans with automatic enrollment.

Source: Vanguard 2020.
BRIDGING THE GAP

When automatic enrollment was introduced in 2006, many plans adopted a 3% default rate for employee deferrals. More recently, more plans are automatically enrolling participants at higher contribution rates. In 2019, more than half of plans chose a default of 4% or higher, compared with 2010 when only 28% did. In fact, 24% of plans chose a default of 6% or higher—more than double the proportion of plans choosing 6% or higher in 2010. Vanguard data shows that higher defaults won’t diminish plan participation, as the opt-out rate stays at 7% whether participants are enrolled at 3% or 6% of their pay.¹

Another positive trend: Two-thirds of Vanguard-recordkept plans using automatic enrollment have implemented automatic deferral rate increases.

A CONTINUAL PROCESS

Plans can also use the power of inertia to help current participants save more. In times of economic uncertainty, participants may opt to lower their deferral rates. A two-part undersaver sweep can bring low savers up to the match level and add automatic annual savings increases, helping participants regain their traction on the road to a successful retirement.

What a difference the default makes

Consider the impact on an employee who changes jobs every four years and is defaulted into the plan at 3% versus 6%.

Comparing automatic enrollment defaults

Source: Vanguard 2020.

Note: Comparison based on an initial deferral rate of 3% with automatic annual increases of 1% up to a 10% cap, compared with an initial deferral rate of 6% with 2% automatic annual increases up to a 15% cap. In both scenarios, starting salary is $40,000 with a 1% real annual growth, and the employer match is 50% on the first 6% of employee deferrals. Returns are based on 4% real return. This hypothetical illustration does not represent the return on any particular investment, and the rate is not guaranteed. The final account balance does not reflect any taxes or penalties that may be due upon distribution. Withdrawals from a tax-deferred plan before age 59½ are subject to a 10% federal penalty tax unless an exception applies.

PLAN ACTIONS

- Default participants into the plan starting at least at the plan’s match level to take full advantage of the employer’s contribution.
- Implement a 2% annual autoincrease to get participants to the target saving rate of 12% to 15% sooner.
- Conduct undersaver sweeps to capture non-participants or to lift undersaving participants into higher saving rates.
THE TARGET-DATE FUND EFFECT

Nearly all Vanguard retirement plans offer target-date funds (TDFs)—a remarkable fact. TDFs contribute to more age-appropriate asset mixes and a reduction in extreme allocations.

Regarding extreme portfolio allocations, the percentage of participants with no allocation to equities has fallen by three-quarters since 2006.

USE OF TDFs IN DC PLANS

Nine in 10 plan sponsors offer TDFs as of year-end 2019. As a result, nearly all Vanguard participants (98%) are in plans offering TDFs. Seventy-eight percent of all participants use TDFs. And 54% of participants owning TDFs have their entire account invested in a single TDF.

Percentage of all plans offering TDFs

Note: 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 the target-date fund is not guaranteed at any time, including on or after the target date.

Target-date fund providers are responsible only for selecting the underlying investments and periodically rebalancing the holdings of the funds. The asset allocations selected for target-date funds are based on the providers’ investment experience and are geared to the average investor. Investors should regularly check the asset mix of the target-date option they choose to ensure it is appropriate for their current situation.

Source: Vanguard 2020.
THE ROLE OF PLAN DESIGN

An important factor driving the rising use of TDFs is plan design, specifically the use of TDFs as an automatic or default investment strategy. The qualified default investment alternative (QDIA) regulations promulgated under the Pension Protection Act of 2006 (PPA) continue to influence adoption of TDFs.

Eighty-six percent of plans in 2019 had specifically designated a QDIA. Typically, these were plans with automatic enrollment or employer contributions other than a match. Among plans choosing a QDIA, 97% of designated QDIAs were TDFs, and 3% were balanced funds.

Average equity exposure by age

Source: Vanguard 2020.
HELPING PARTICIPANTS STAY ON COURSE

TDFs help keep participants on target during volatile market conditions. Only 2% of pure target-date fund investors made an exchange during 2019, and early data shows that during 2020, pure TDF investors were more than five times less likely to trade compared with all other participants.

PLAN ACTIONS

* Make TDFs available to participants.
* Make TDFs your default by using a QDIA and choosing TDFs as the option. This will allow participants to start saving or retirement early with an appropriate exposure to equities.
* Reenroll participants into TDFs by sweeping participants into an appropriate TDF, helping ensure participant portfolios are age-appropriate and properly diversified.
CONTROLLING WITHDRAWALS AND LOANS

While data shows that the rate of retirement plan hardship withdrawals has remained relatively steady over the last decade, there is concern it may rise—a result of IRS restrictions on such withdrawals being eased last year.

WITHDRAWAL TRENDS

Nonhardship withdrawals have leveled off in recent years, and hardships are up in 2019 due to new regulations. That said, hardship withdrawals are still only being taken by about 3% of participants.

LOAN ORIGINATION TRENDS

The rate at which participants take loans from their DC plans has seasonal trends and has been slightly declining over the past ten years.

Vanguard DC active participants in plans offering in-service withdrawals and loans

Note: Number of withdrawals and loans issued per 1,000 participants.
Source: Vanguard 2020.
WHY A CAUSE FOR CONCERN?

Four in 10 participants who took a withdrawal in 2019 had also taken one in 2018, and about 1 in 10 in this group had taken a plan withdrawal in each of the past five years. Certain participants could, over time, jeopardize their retirement savings program if they continue to rely on this feature throughout their working careers.

THE BOTTOM LINE

The problem of leakage from the retirement system—the spending of plan savings before retirement—is a concern for the future retirement security of plan participants. In the short run, participants incur taxes and possible penalties on any amounts they spend. In the long run, because of the lost opportunity for compound earnings, they significantly increase the amount they need to save during the remainder of their working years to reach their goal.

That said, we understand there are valid reasons for participants to access their retirement savings in an emergency. We are living in one such moment in 2020, with COVID-19 spawning uncertainty and volatility. However, sponsors can design their plans in such a way—using minimum withdrawal limits, restricting the frequencies of withdrawals and loans, and capping the number of loans available—to meet participant needs.

PLAN ACTIONS

* Set a minimum hardship withdrawal limit of $1,000.
* Restrict withdrawal frequency to twice per year.
* Set a “cooling off” period of 30 days to 6 months between loan payoffs and new loans.
YOUR PLAN AS A DESTINATION FOR RETIREEES

Plan sponsors are increasingly looking for designs that enable their participants to remain in the plan through retirement.

Distribution of assets

<table>
<thead>
<tr>
<th></th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Remain in plan</td>
<td>63%</td>
</tr>
<tr>
<td>Rollover</td>
<td>13%</td>
</tr>
<tr>
<td>Installments</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: Vanguard 2020.

Retirees are likely to make up an increasingly bigger slice of the participant population as more baby boomers retire.

During 2019, about one-third of all participants could have taken their account as a distribution because they had separated from service in the current year or prior years. The majority of these participants (80%) continued to preserve their plan assets for retirement by either remaining in their employer’s plan or rolling over their savings to an IRA or new employer plan.

In terms of assets, 96% of all plan assets available for distribution were preserved, and only 4% were taken in cash.

BENEFITS OF A RETIREE-FRIENDLY PLAN

We believe participants can be best served by staying in an employer’s plan through retirement.

Participants benefit from:
- Fiduciary oversight.
- Institutional pricing that’s not available in retail IRAs.
- Availability of cost-effective advice.

Furthermore, plans set up to accommodate retirees and offer robust tools, guidance, and enhanced features help to engage pre-retirees in planning and ensuring their retirement plan is on track, which can be especially important in times of uncertainty and volatility.
PLAN DESIGN ELEMENTS TO CONSIDER

We believe there are four plan design elements that will serve retirees well: removing age restrictions, allowing installments, permitting partial withdrawals (with no dollar or frequency limits), and offering advice and guidance.

HOW DO VANGUARD’S FULL-SERVICE CLIENTS STACK UP?

The numbers suggest there is room for improvement. Only 1 in 7 Vanguard plans offer all four of the design elements we believe make a plan truly retiree-friendly, which is not surprising, considering DC plans were not originally designed to serve a company’s retirees. However, times—and participant demographics—are changing, and sponsors should consider adjusting their plans to fit this new reality.

PLAN ACTIONS

* Eliminate age restrictions by ensuring your plan doesn’t force participants out at a certain age.

* Permit flexible withdrawals and even rollovers into the plan. Without this feature, any withdrawal would force a participant to leave the plan.

* Allow for installments by making sure payments can be based on a percentage or can be fixed-dollar.

* Offer advice and guidance to help participants navigate what could be the most complex financial stage of their lives.
HIGH-QUALITY, COST-EFFECTIVE ADVICE

The varied nature of retirees’ individual circumstances points to the need for individualized advice at a low cost.

THE POPULARITY OF ADVICE

Vanguard has long realized the value of advice. Plan sponsors using Vanguard as their recordkeeper have had access to a range of advice programs, including an online advice service, Personal Online Advisor; a managed account advisory service, Vanguard Managed Account Program; and Vanguard Financial Planning Services.

Importantly, Vanguard has recently evolved its advice offer, which we will begin reporting on with the 2021 edition of How America Saves. Our advice services are now offered within the Vanguard Personalized Advice and Guidance suite. It’s based on the idea that every investor who wants to consult an advisor should be able to do so.

That said, the data still tells an important story. While many plan sponsors offer advice services, the percentage of participants accessing them has been relatively low.

GOALS

- basic living expenses
- contingency reserves
- discretionary spending
- legacy

RISKS

- markets
- health
- longevity/mortality

RESOURCES

- guaranteed income
- liquid assets
Consider the experience of participants who have adopted managed account advice.²

- Portfolio risk was reduced through the reallocation of assets for 4 in 10 participants.
- Nearly half (46%) of participants chose to increase their saving rate by an average of 3 percentage points.
- For participants with concentrated single-stock positions of 20% or more of their account balance, the average allocation to company stock fell from 52% to 9% as a result of managed account advice.

SHIFTING GEARS AS RETIREMENT BECOMES REALITY

Among plans that offer managed account advice, 9% of participants are using the service. One possible reason more participants aren’t taking advantage of advice is that for those about to retire, saving for so long may make it harder for them to switch gears—to start actively thinking about drawing down their savings. However, as retirement becomes reality, we believe participants will increasingly seek advice, making it incumbent upon plan sponsors to provide advice options—services that have been shown to have a positive effect on participant portfolios.

² Findings from Vanguard research, The Value of Managed Account Advice, Cynthia A. Pagliaro and Stephen P. Utkus, September 2018.
ADVICE DURING TIMES OF UNCERTAINTY

During periods of market volatility, participants sometimes make drastic changes to their portfolio based on emotions. In these instances, advice can be instrumental in helping participants keep a long-term perspective and navigate volatile markets with a focus on future goals.

ADVICE FOR ALL WHO WANT IT

Given the results for participants who have adopted managed account advice, we believe that every investor who wants to consult an advisor should be able to do so. That’s why we recommend plan sponsors provide comprehensive, holistic support to participants in retirement by offering advice. But beware that successful advice provides an appropriate value relative to its cost. When investors overpay for advice, they put less money to work in their portfolios. If you’re a plan sponsor who encourages employees to save more, disproportionate costs, including hidden fees, can dilute some of your efforts.

PLAN ACTIONS

- Provide advice that features a transparent methodology, helping ensure accountability.
- Select advice that is accessible in a form that meets investors’ needs and preferences.
- Choose advice that can lead to measurable outcomes in meeting investors’ goals, as well as enhanced emotional attributes like a sense of financial security.
We hope you find this inaugural edition of *Insights to Action* informative and useful. Based on data from *How America Saves*, the six key themes and recommended plan actions were identified by Vanguard Strategic Retirement Consulting (SRC) group. SRC helps defined contribution (DC) plan sponsors optimize their plan design, develop fiduciary best practices, ensure regulatory compliance, as well as share insights on investor behavior and collaborate on strategic communications.

**Our complete analysis of Vanguard 2019 defined contribution plan data can be found at institutional.vanguard.com.**

If you would like to learn more about the key themes surfaced in *Insights to Action*, or any of the data from *How America Saves*, please reach out to a Vanguard representative.
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