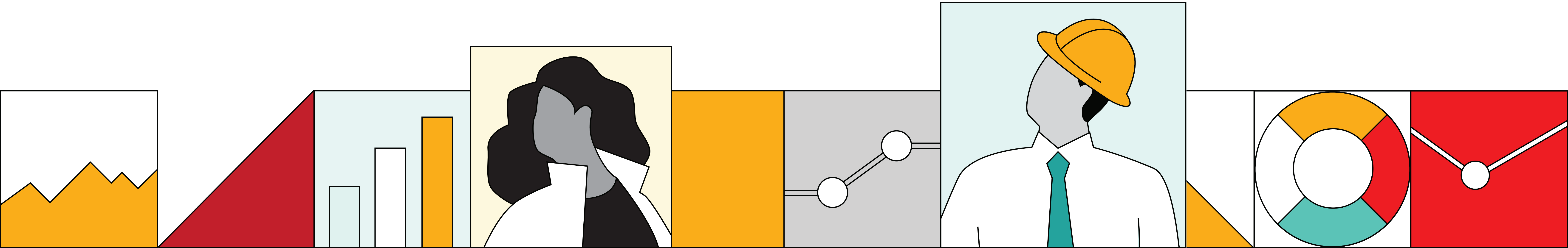
Vanguard

How America Saves 2022

Insights to Action



Insights 2022

We believe plan sponsors can use smart plan design to keep participants on the road to financial well-being.

During times of uncertainty, widening the focus of retirement plans to encompass every phase of a plan participant's financial journey simply makes sense.

Why?

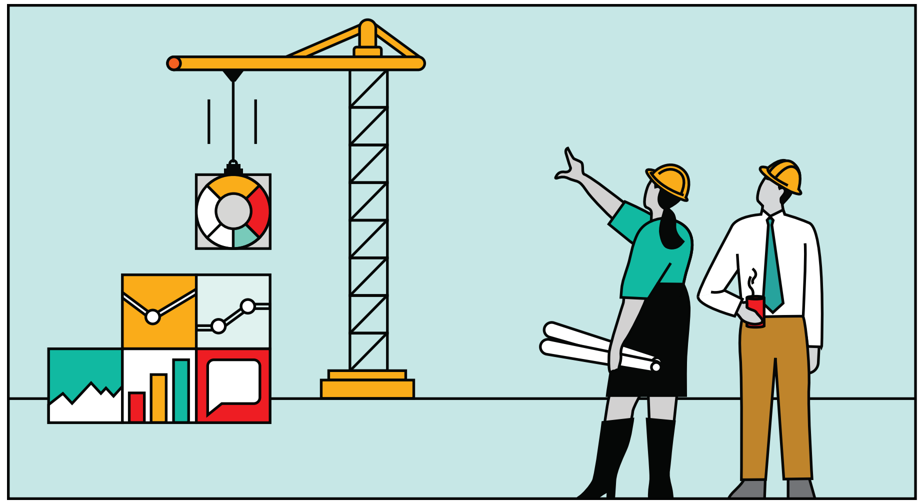
We know near-term financial challenges can jeopardize long-term retirement success. And participants continue to face what must seem at times like an unprecedented number of near-term challenges.

While the economy continued to recover from the COVID-19 pandemic in 2021, the challenges mounted: Inflation increased to its highest point in decades, supply-chain disruptions tempered economic growth, and a tightened labor market continued to test employers while their employees left in record numbers—either changing jobs or leaving the workforce entirely.

The good news: While these challenges remain, we believe plan sponsors can use smart plan design to keep participants on the road to financial well-being.

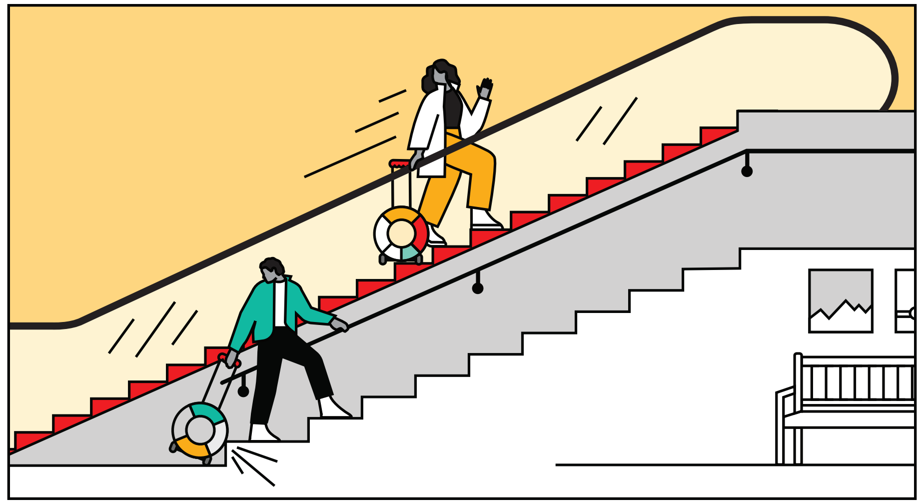
This year's *Insights to Action* focuses on three key themes we've identified from *How America Saves 2022* data—recommendations based on the belief that strong plan design serves participants well in all stages of their financial journey.

Key themes



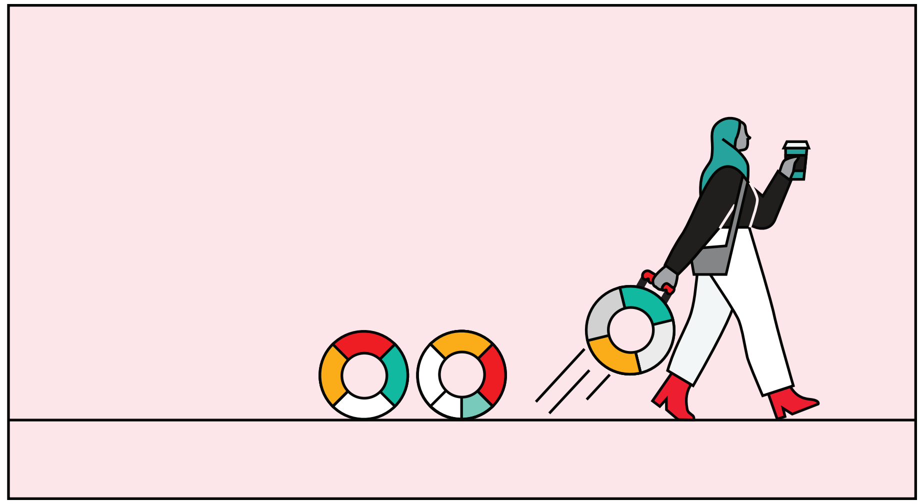
01

Support financial
well-being with professionally
managed allocations



02

Take smart
plan design to the
next level



03

Plan for
an increasingly
mobile workforce

01

Support financial well-being with professionally managed allocations

PLAN ACTIONS

1. Offer an advice option.
2. Make TDFs your default by using a QDIA and choosing TDFs as the option.
3. Reenroll participants into TDFs by sweeping them into an appropriate TDF, helping to ensure portfolios are age appropriate and properly diversified.

Broaden the scope of retirement plans to support participants' financial well-being with self-directed solutions and advice that focus on every step of their journey to and through retirement.

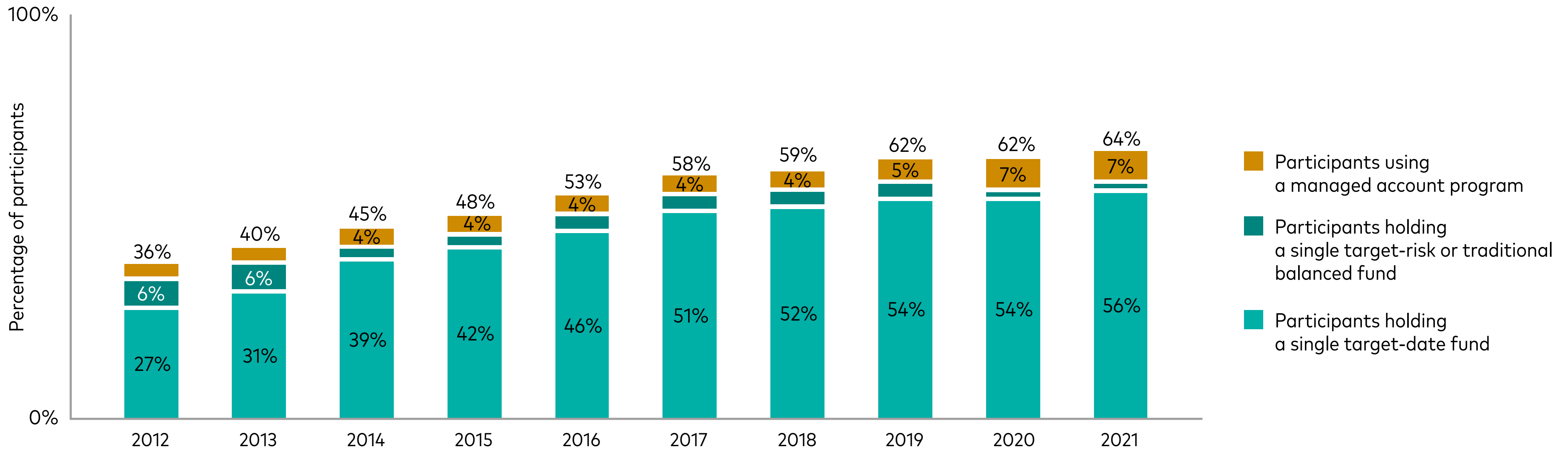
An increasing number of participants are invested in a professionally managed allocation. In fact, the percentage of participants in either a target-date fund or an advised managed account program reached all-time highs in 2021.

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

In 2021, the equity allocation among Vanguard DC participants was downward sloping by age. This is tied directly to the growing use of professionally managed allocations, which typically provide declining equity exposure with age.

Participants with professionally managed allocations

Vanguard defined contribution plans



Source: Vanguard 2022.

For example, in 2005, participants' age-based equity allocation was hump-shaped, with younger participants adopting more conservative allocations, middle-aged participants holding the highest equity exposure, and older participants having equity exposure on par with younger participants (see chart on next page).

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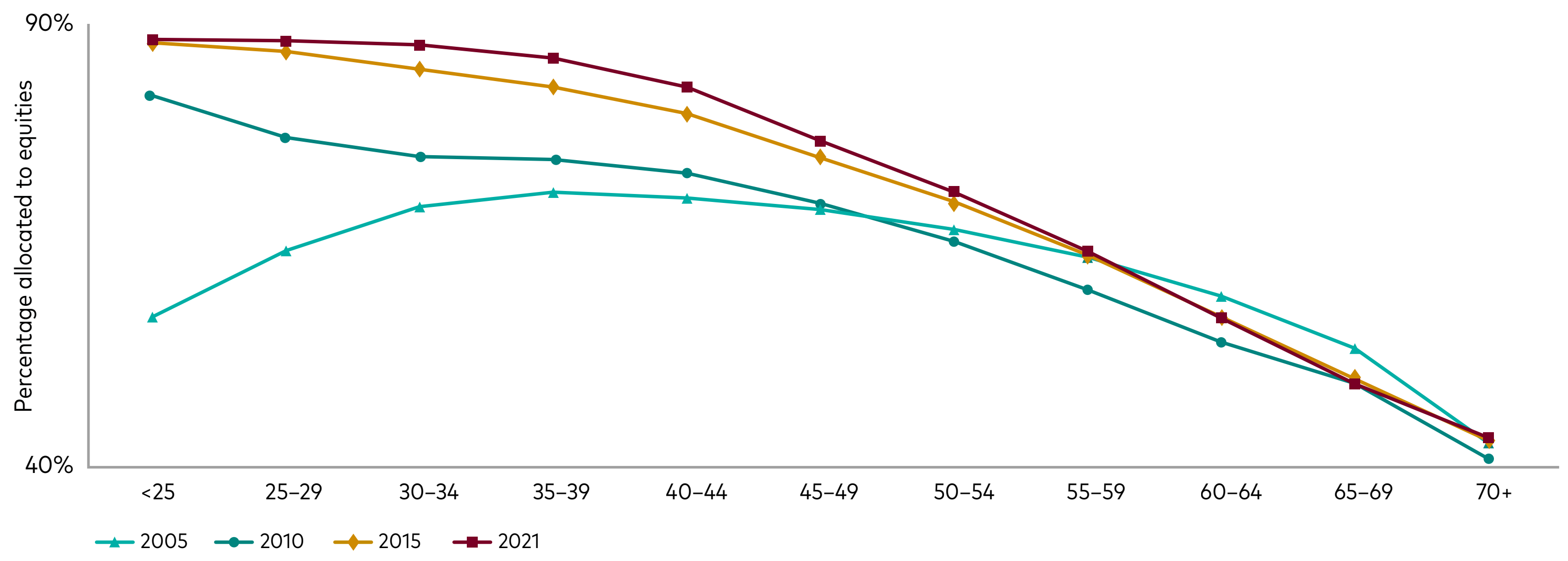
Trend in asset allocation by participant age

Vanguard defined contribution plans: Average equity allocation participant weighted



Source: Vanguard 2022.

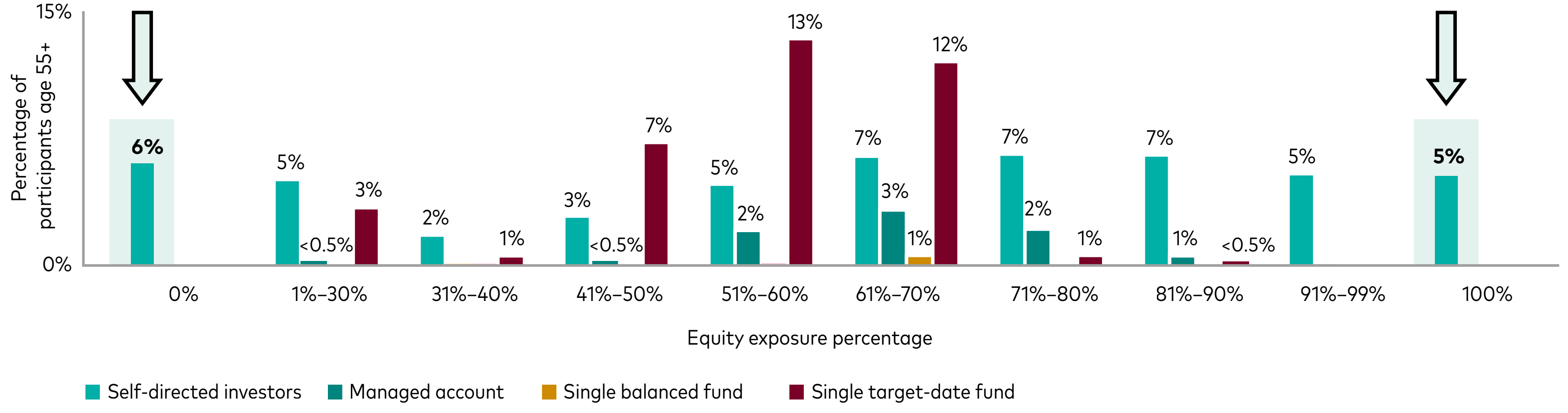
An opportunity for improvement

Interestingly, younger participants are more likely to have a professionally managed allocation, which results in a higher percentage of them having an age-appropriate equity allocation.

Fifty-one percent of older participants, who were nearing or in retirement, were self-directed investors who constructed their own portfolio in 2021. And participants who construct their own portfolios have equity exposure with both wider dispersions and generally greater extremes.

Distribution of equity exposure by older investors, 2021

Vanguard defined contribution plan participants age 55+



Source: Vanguard 2022.

02

Take smart plan design to the next level

PLAN ACTIONS

1. Implement automatic enrollment with automatic annual increases.
2. Default participants at 6%, or at least to the employer match.
3. Perform reenrollment, automatic escalation, and undersaver sweeps.

Combine automatic plan features with a higher default rate for a powerful savings boost

Automatic solutions (automatic enrollment and automatic escalation) are proven to increase plan participation and saving rates, but the benefits of the strategies depend largely on how they are implemented.

For example, Vanguard participants saved an all-time high 7.3% of their income, on average, in their employer's plan in 2021. This can partly be attributed to the fact that 58% of plans now default at rates of 4% higher—the continuation of an upward trend. We believe it's critical to maintain this momentum by increasing the initial default and marrying it to an automatic escalation feature.

66% Average participation rate in plans with voluntary enrollment

vs.

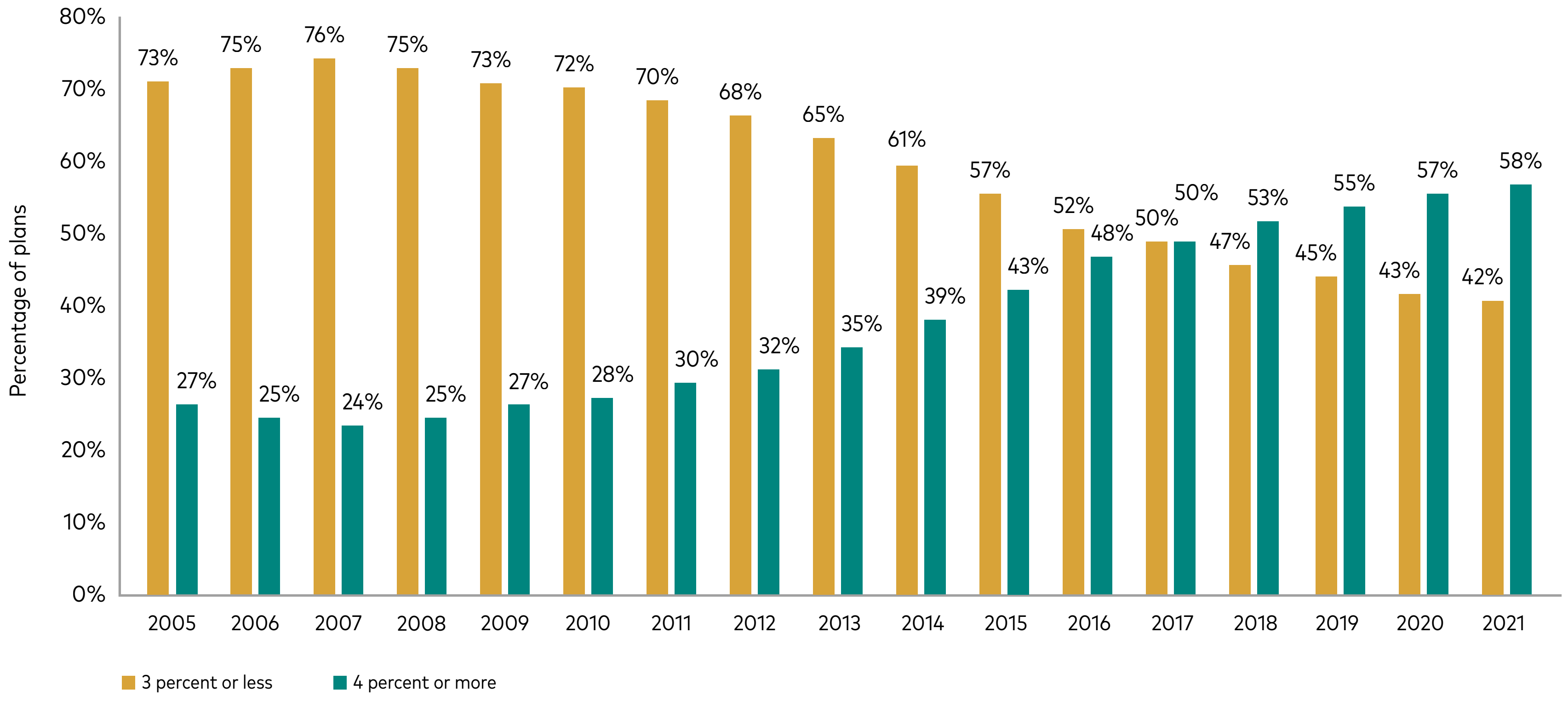
93% Average participation rate in plans with automatic enrollment

85% Average plan-weighted participation rate (an all-time high)

7.3% Average deferral rate (an all-time high)

Automatic enrollment default trends

Vanguard defined contribution plans with automatic enrollment



Source: Vanguard 2022.

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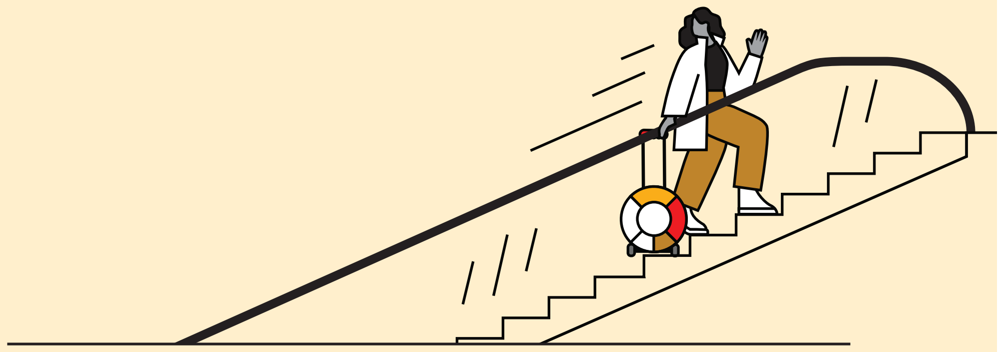


Why are automatic escalation features so important?

A modest increase in participant deferral rates of 1, 2, or 3 percentage points would enable an additional 20% of participants to attain a 75% replacement ratio in retirement, according to soon-to-be-published Vanguard research.

The case is clear: Higher defaults lead to stronger savings.

But do higher deferral rates influence the likelihood that an employee will quit an automatic enrollment plan?

We might expect that plans with initial deferral rates of 2% or 3% would see fewer employees quitting the plan, given that these lower deferral rates have little impact on take-home pay. Conversely, we might think that deferral rates of 5% or 6% would lead to a higher opt-out rate because of their larger impact.

However, our research suggests that employee quit rates do not appear to vary in response to a plan sponsor's choice of the initial deferral rate.[1]

A modest increase in participant deferral rates of 1, 2, or 3 percentage points would enable an additional **20%** of participants to attain a **75%** replacement ratio in retirement.

[1] For an in-depth analysis of automatic enrollment, see Jeffrey W. Clark and Jean A. Young, *Automatic Enrollment: The Power of the Default*. Vanguard research. February 2021. institutional.vanguard.com

03

Plan for an increasingly mobile workforce

PLAN ACTIONS

1. Consider new design strategies to attract workers.
2. Design your plan to ensure the cycle of strong saving and investing behavior continues uninterrupted through job changes.
3. Question your service provider about portability services.

Ensure plan portability, protecting employee retirement assets for the future and preserving the work you've put into the plan.

As we emerge from the COVID-19 pandemic, the U.S. workforce is experiencing significant changes. Millions of employees are changing jobs or leaving the workforce entirely. This is creating both opportunities and challenges for employers.

Many employers are reviewing their retirement benefits and evaluating options to attract and retain employees.

In 2021, 14% of participants left their employer and were eligible for a distribution.

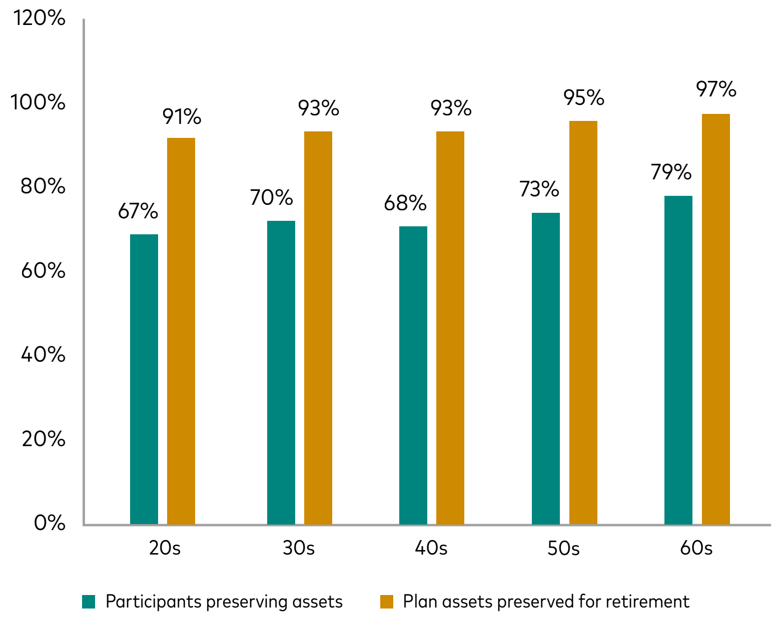
But higher attrition can lead to disruptions in retirement saving. When employees change employers, there is a risk that retirement assets will be cashed out, potentially spoiling the work you've put into the plan.

Younger participants are more likely to have smaller balances, which are more likely to be cashed out than preserved for retirement. And although these balances tend to be smaller, these cash-outs can negatively impact retirement readiness down the road because of the potential power of compounding growth.

Such numbers strongly suggest that plan sponsors consider design elements that promote smart and seamless retirement plan transitions for an increasingly mobile workforce.

Assets preserved for retirement by age

Vanguard defined contribution plans



Source: Vanguard 2022.

The benefits of a portability solution

Instituting an automatic portability feature in the plan can help to make it easier for employees to preserve their retirement assets between employers.

For example, Vanguard has engaged a leading provider of consolidation services for defined contribution plans to provide plan sponsors with a new portability solution to simplify small-balance 401(k) rollovers, help more employees preserve their retirement savings, and improve their chances of investment success. The service is expected to launch in early 2023.

Offering a portability solution is part of Vanguard's holistic focus on financial wellness solutions. These solutions are rooted in the idea that to achieve retirement readiness, plans should consider very specific challenges that often get in the way of successfully saving for retirement such as managing debt or paying for an emergency.

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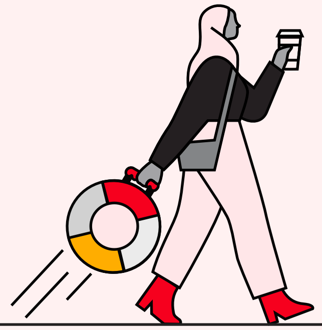


Automatic enrollment provides another solution

Defaulting at low rates, even with an automatic escalation feature, can lead to a cycle of employees continually undersaving if they change jobs every two to three years.

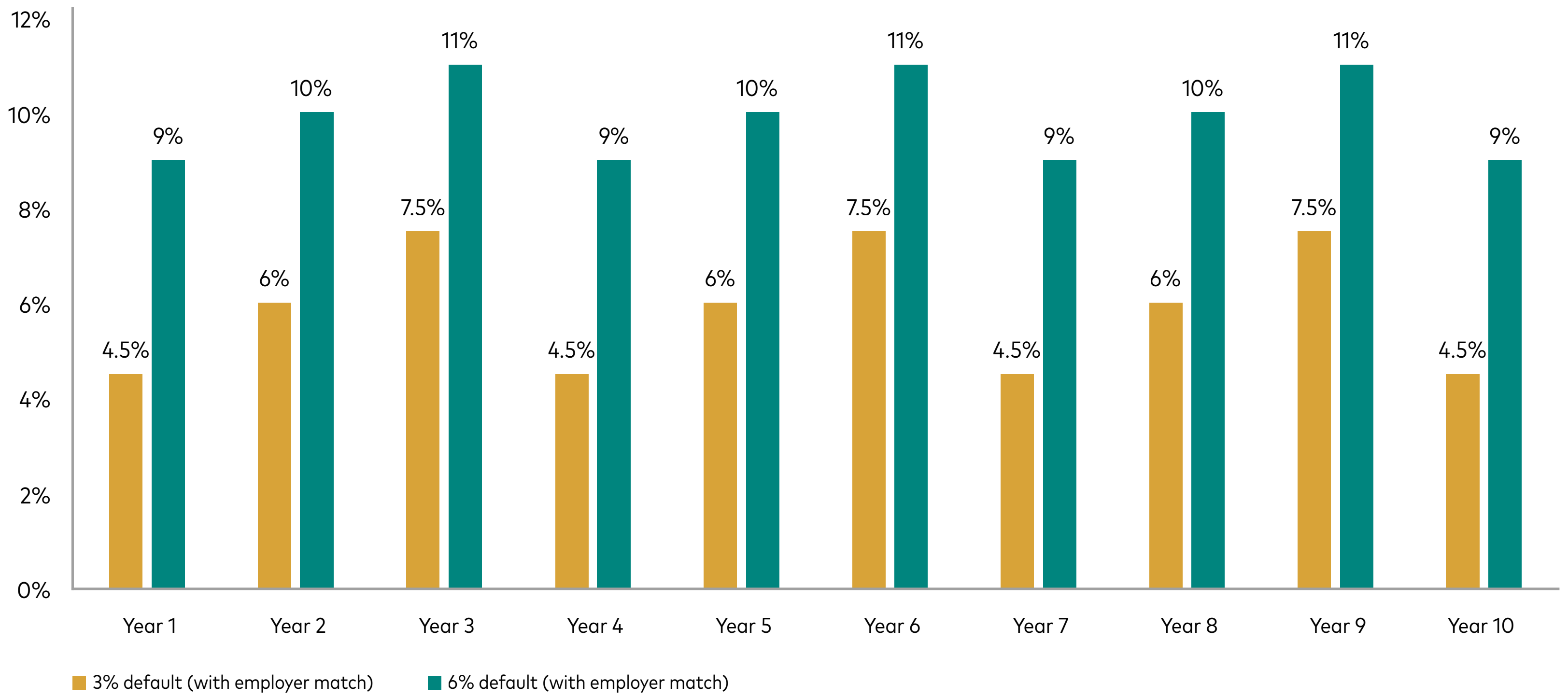
Setting defaults at a strong level (at least to the match) helps to ensure that new employees are saving at strong levels from day one. Consider that after 10 years, employees defaulted at 6% have an accumulated balance that is nearly 70% higher than those at a 3% default.

70%

After 10 years, employees defaulted at 6% have an accumulated balance that is nearly **70%** higher than those at a 3% default.

Comparing impacts of defaults: 3% vs. 6%

Assumes an employer match of 50% on 6% employer matching contribution



Notes: Employees change jobs every three years. Automatically enrolled at either 3% or 6%. Automatically increased in both scenarios. Employer match of 50% on 6% in each scenario. Starting salary of $50,000. Wage increases of 2% annual and 4% real return.

Source: Vanguard 2022.

Conclusion

We believe plan sponsors must continue to focus on smart plan design.

Additionally, they should consider broadening the scope of retirement plans to support participants' financial well-being by focusing on every step of their journey to and through retirement. Finally, with an increasingly mobile workforce, sponsors may want to consider ways to keep participant assets in the plan.

The three 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 2021 DC 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 2022*, please reach out to a Vanguard representative.

How America Saves 2022

Insights
2022

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Writer: Alison Hoffman

What does it take to build a retirement income solution?

With so many participants at or nearing retirement, investments intended to provide participants with retirement income are having a moment.

Service providers are rushing to market with new products, much of them focused on annuities.[1]

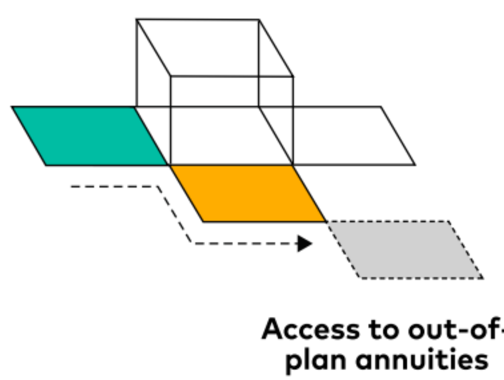
The problem is that—in some cases—that's where the focus stops.

We believe retirement income is uniquely complex, requiring a level of personalization that can't be achieved with a single product. It's why we've built a spectrum of solutions that includes annuities as a potential piece of an individual participant's retirement income solution, not the solution itself.

Our approach recognizes that annuities may be appropriate for some—not all—participants. Annuities are best suited for those who:

- Expect to live a long life.
- Have a low risk tolerance for outliving their assets.
- Can maintain an adequate pool of assets to meet unexpected expenses after purchasing the annuity.
- Have no legacy intent for the money used to purchase the annuity.

To ensure Vanguard supports the need for these participants, we provide access to implementation of out-of-plan annuities through Hueler Income Solutions® Annuity Platform. This enables individuals to obtain institutionally priced income annuity quotes from multiple insurance companies on a conflict-free, no "pay-to-play" basis.



Annuities belong to a spectrum of solutions that we've developed so every participant can meet their unique retirement income goals and engage with Vanguard in the way they prefer.

A spectrum of solutions vs. a one-size-fits-all strategy

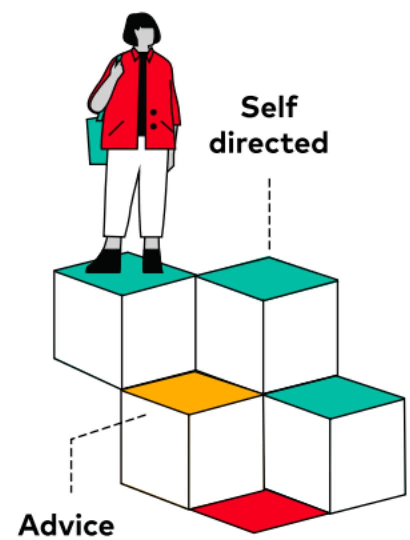
Every participant's prioritization of goals, risk tolerance around meeting goals, and resources available to meet each goal are different and can vary quite dramatically.

Combine this with the unique health, longevity, and tax situation of every participant, and it's easy to understand why a "one size fits all" retirement income solution may not work for all participants.

That's why we provide a range of retirement income options.

For participants who prefer a self-directed approach, we offer:

- **Spending service.** An annual personalized retirement spending recommendation based on characteristics such as participant's asset allocation and age.
- **Investment strategies**. These include Target Retirement Funds and Trusts that support different spending goals with embedded asset allocation.
- **Participant guidance.** A client experience that includes guidance regarding the equity landing point that aligns with retiree goals.



For participants who want more help, we offer comprehensive advice options for all stages of the financial journey, including leading to and living through retirement. Our inclusive approach, built so that every investor, from every background, at every stage of life can access, understand, and implement the advice and guidance they need.

In contrast, some financial service providers simply offer an in-plan annuity as a single retirement income option. And more recently, we've seen others position their target-date funds (TDFs) with an annuity component as a single retirement income solution.

TDFs are great as qualified default investment alternatives (QDIAs) due to their ability to get participants to retirement. But because no two participants are alike, we believe TDFs with an annuity component aren't the solution for everyone.

The decision to purchase an annuity is a highly personal one with many factors to consider, including:

- How long does the participant expect to live given current health and family history?
- How much of the participant's accumulated wealth should be annuitized?
- What is the best time for the participant to purchase an annuity?
- Which annuity is the best choice?
- Is the peace of mind that an annuity might bring worth the annuity's cost?

- Can the participant become comfortable exchanging liquid assets for an illiquid contract with an indefinite payoff?

Continued investment

We believe participants need more than just a single-product solution. Our approach to retirement income combines participant guidance, spending services, and investment strategies to help participants throughout retirement.

And we won't stop. We're continually investing in new technology and innovating our services. But we're not chasing the latest flashy trend. Our innovation begins and ends with what we think will be best for your participants and your plan.

If you'd like to learn more about our retirement income solutions, please reach out to your Vanguard representative.

[1]Annuity income guarantees are subject to the claims-paying ability of the issuing insurance company.
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[begin disclaimers]

Notes:
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Writer: Alison Hoffman

To better help plan participants, don't be like 'Rabbit'

The protagonist of John Updike's *Rabbit* novels, Harry "Rabbit" Angstrom, is always running, striving, and searching for meaning.

There is something familiar in his quest—a desire to better one's circumstances. Sometimes it's a desire that leads to positive change. And sometimes, as "Rabbit" often demonstrates, it results in change that's counterproductive.

It all depends on how change is executed, which is something plan sponsors firsthand.

Always looking for ways to improve participant outcomes, sponsors are ever cautious of tripping over fiduciary issues that can result from changes to the plan.

In 2022, we see three areas of fiduciary concern that sponsors should be especially aware of: The cost of advice, SECURE Act 2.0, and proposed regulation regarding the use of environmental, social, and governance (ESG) factors.

The cost of advice and total cost of ownership

One feature we see plan sponsors adding more than any other is advice.

Plan sponsors are very practiced at thinking about cost and fees as they relate to the funds in their lineup. But they may not be accustomed to applying that same fiduciary rigor to the cost of advice.

We believe the cost of advice (and, in the future, broader services like financial wellness programs) will be seen as a source of potential litigation risk, similar to how fund expense ratios and per-participant fees have been viewed historically. Moreover, this heightened fiduciary risk underscores the importance of total cost of ownership, a framework that factors in not only base recordkeeping fees but also other sources of revenue associated with the plan to allow for true cost comparisons of greater transparency.

SECURE Act 2.0

The Securing a Strong Retirement Act of 2021, sometimes called the Secure Act 2.0, is widely expected to be passed into law in some form this year.

We believe it would have numerous benefits for retirement savers, including greater choice in investments, improved retirement plan participant decision-making, and simplified retirement plan administration. We are particularly supportive of the provision expanding access to low-cost collective investment trusts (CITs) for retirement savers in 403(b) plans.

The Act would also pave the way to incorporate student loan repayments directly into an employers' retirement benefits solution.

We believe this provision could prove valuable, assuming participants fully meet their contribution matches before paying debt to make sure they are maximizing their saving rates. But plan sponsors will want to understand the optimal trade-offs such a provision would raise for their employees (how to incent long-term saving and short-term debt management).

In short, sponsors will need to apply fiduciary best practices when determining whether to offer student-loan paydown within their retirement plan, including the selection and ongoing monitoring of such a service.

ESG factors

Proposed Department of Labor regulation regarding the use of ESG factors would recognize the important role they can play within a retirement plan, while continuing to uphold fundamental fiduciary obligations.

The fundamental requirement remains that investments be made in the financial best interest of plan participants. But the proposed regulation specifically states that the evaluation of the risk/return characteristics (the financial factors) of an investment may often require consideration of the economic effects of climate change and other ESG factors. That is, it supports the inclusion of ESG as a financial factor (and suggests it's a risk not to).

Fiduciaries who plan to implement an ESG strategy must continue to follow a diligent and documented process, ensuring decisions are made in the best interest of participants. While we await the final regulation, we have developed a three-level framework to help sponsors navigate the fiduciary landscape related to their consideration of ESG options.

A continuing evolution in plan design

These fiduciary concerns—the cost of advice, SECURE Act 2.0, and ESG factors—are emblematic of plan sponsors' desire to better meet the needs of participants. If approached with care and the counsel of industry expertise, these emerging fiduciary topics can produce positive change.

It's perhaps an approach Harry "Rabbit" Angstrom should have taken. Of course, there's a reason happy endings in fiction are rare—many readers prefer drama and narrative tension. Luckily, with planning and forethought, plan sponsors can minimize this tension in the real world. That's where Vanguard Strategic Retirement Consulting (SRC) can help.

With deep experience spanning plan design, legal and regulatory concerns, fiduciary best practices, investor behavior, and communication strategy, SRC takes a comprehensive approach to retirement plan consulting. To learn more about how we can help ensure your plan models fiduciary best practices throughout the year, please contact your Vanguard representative.

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Notes:

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Vanguard TDF Comparison article LinkedIn posts

Organic LinkedIn Post Date: 1/18/23

Intro Text: Help your participants retire happy with a retirement income solution from Vanguard that understands not everyone travels the same road.

Image: Headline: Read about our unique approach to retirement income.

Organic LinkedIn Post Date: 2/1/23

Intro Text: When looking for a retirement income solution, annuities may be appropriate for some, but not all, participants. Learn how annuities fit in Vanguard's solution here.

Image: Headline: Learn how annuities fit in Vanguard's solution

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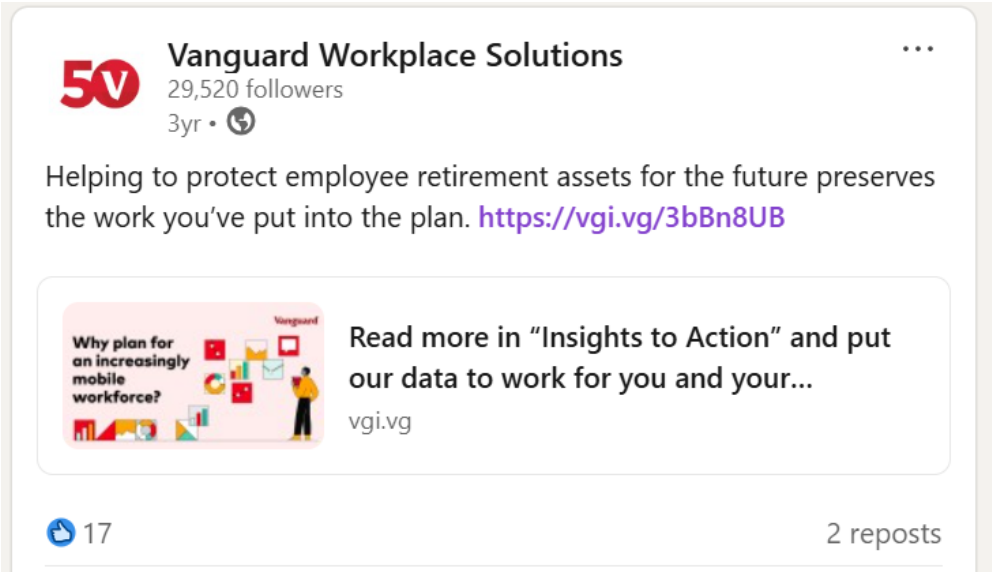

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