



# Target-date fund adoption in 2014

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- In 2014, 45% of Vanguard participants were invested in a professionally managed account option, including 39% who were invested in a single target-date fund (TDF). Use of TDFs in defined contribution (DC) plans continued to grow rapidly. At year-end 2014, 88% of plans offered a TDF, 64% of all participants had a position in the funds, and the funds accounted for 41% of total plan contributions.

## Introduction

TDFs continue to grow in importance in DC plan investment menus.<sup>1</sup> The funds replace the complex task of portfolio construction with a simplified choice—the choice of an expected date of retirement—and provide automatic age-based rebalancing over time. They are likely to appeal to less sophisticated or less engaged investors looking for a streamlined portfolio choice, as well as to sponsors seeking a default investment for automatic enrollment. TDFs are an eligible qualified default investment alternative (QDIA) under the Pension Protection Act of 2006 (PPA).<sup>2</sup>

In 2014, 45% of Vanguard participants were invested in a “professionally managed allocation”—in other words, their entire account balances were invested in a single TDF, a single target-risk or traditional balanced fund, or a managed account advisory service (**Figure 1, page 2**). Driving this development is the growing use of TDFs. Thirty-nine percent of participants were invested in a single TDF in 2014—a percentage that has more than doubled over the past five years. Among new plan entrants (those entering the plan for the first time), 8 in 10 participants were invested in a single TDF (**Figure 2, page 2**).

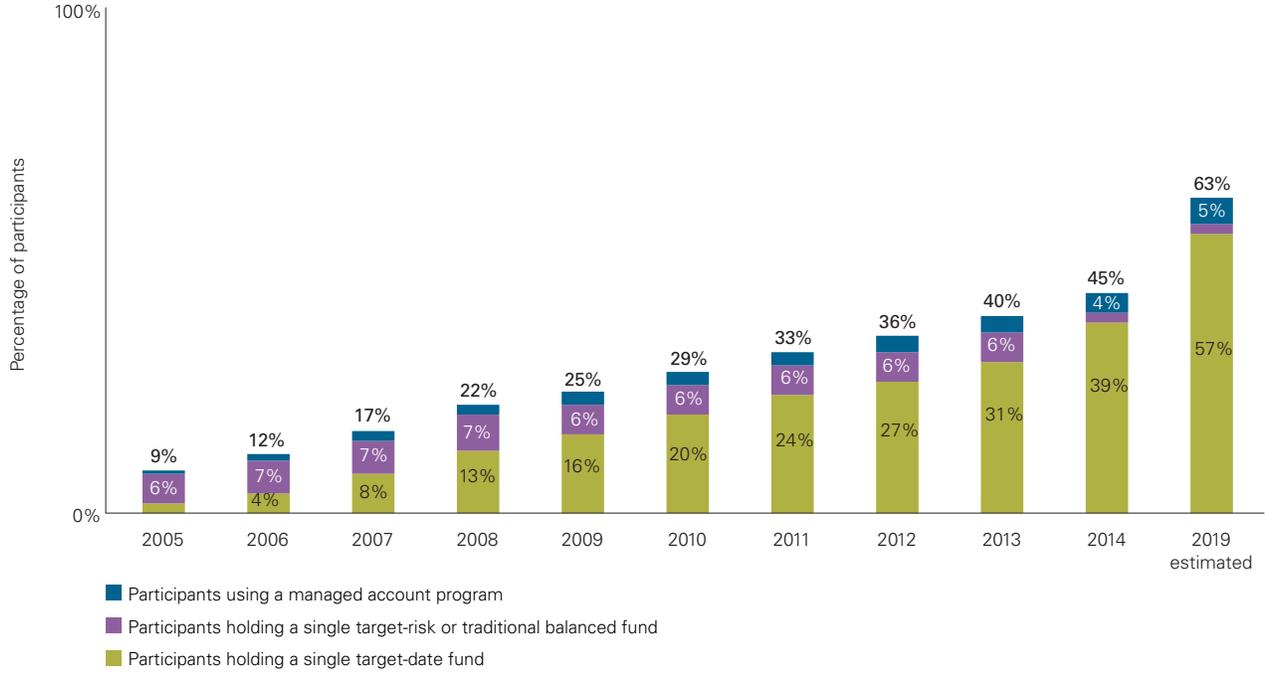
Because of the growing use of target-date options, we anticipate that nearly two-thirds of participants will be invested in a professionally managed option by 2019.

<sup>1</sup> Our analysis is based on data from plans for which Vanguard provided direct recordkeeping services. We analyzed 3.4 million unique participants holding 3.6 million accounts in 1,900 DC plans.

<sup>2</sup> QDIAs include target-date funds, other balanced funds, and managed account advisory services.

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

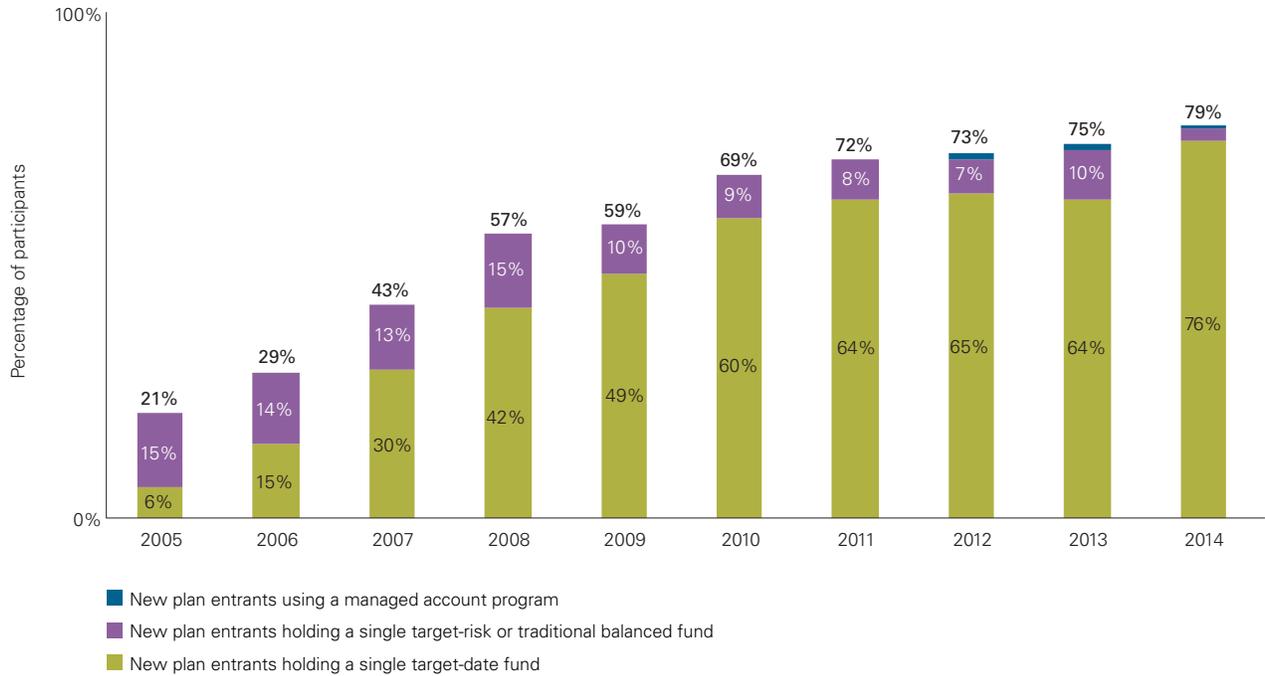
*Vanguard defined contribution plans*



Source: Vanguard, 2015.

**Figure 2. New plan entrants with professionally managed allocations**

*Vanguard defined contribution plans*



Source: Vanguard, 2015.

**Figure 3. Plan use of target-date funds**

*Vanguard defined contribution plans*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of all plans offering target-date funds	28%	43%	58%	68%	75%	79%	82%	84%	86%	88%
Percentage of all recordkeeping assets in target-date funds	1	3	5	7	9	12	14	17	19	23
Percentage of all contributions directed to target-date funds	2	4	8	13	16	22	27	31	34	41
Percentage of all participants invested in target-date funds	5	10	18	28	34	42	47	51	55	64

*Among plans offering target-date funds*

Percentage of plan assets invested in target-date funds	5%	6%	7%	9%	12%	15%	17%	19%	20%	24%
Percentage of plan contributions invested in target-date funds	6	9	12	17	21	26	31	36	38	42

Source: Vanguard, 2015.

**Target-date fund adoption**

TDF adoption by Vanguard plan sponsors has accelerated from 28% of plans in 2005 to 88% of plans in 2014 (Figure 3). While introduced only within the last decade among Vanguard plans, TDFs have now reached 23% of total Vanguard DC plan assets and 41% of total DC plan contributions in 2014. Among plans offering the strategy, target-date options accounted for one-quarter of plan assets and 42% of plan contributions in 2014.

**Plan design and target-date funds**

Automatic enrollment—and the choice of the TDF series as a default investment—is a major factor influencing the rise of TDFs. By year-end 2014, 36% of Vanguard plans had adopted automatic enrollment, with half automatically enrolling both existing nonparticipants and newly eligible participants. Adoption of automatic enrollment by Vanguard plan sponsors has grown sevenfold since 2005. Among plans with more than 1,000 participants, 6 in 10 had adopted the feature by 2014 and 6 in 10 of all Vanguard participants were in plans with automatic enrollment.

Whether or not they used automatic enrollment, 82% of all Vanguard plans had selected a target-date or balanced fund as a default investment by year-end (Figure 4). Seventy-one percent of plans had specifically designated a QDIA, which offers additional fiduciary protection. Typically, these are plans using automatic enrollment or making employer contributions other than a match (such as a nonelective

**Figure 4. Default fund designations, 2014**

*Vanguard defined contribution plans*

	QDIA plans	Non-QDIA plans	All plans
<i>Among all plans</i>			
Target-date fund	67%	8%	75%
Balanced fund	4	3	7
	<b>71%</b>	<b>11%</b>	<b>82%</b>
<hr/>			
Money market or stable value		14	14
Total plans designating default	<b>71%</b>	<b>25%</b>	<b>96%</b>

*Among plans designating a QDIA*

Target-date fund	94%
Balanced fund	6
Total plans designating QDIA	<b>100%</b>

Source: Vanguard, 2015.

profit-sharing contribution). Among plans designating a QDIA, 94% of the QDIAs were target-date options and 6% were balanced funds. Less than 1% of plans had selected a managed account advisory service. Ninety-five percent of plans with automatic enrollment are using TDFs as their default fund.

## Participant use of target-date funds

By year-end 2014, nearly all Vanguard participants (97%) were in plans offering TDFs (Figure 5). Two-thirds of participants whose plans offered TDFs had an investment in them. Among participants investing in TDFs, half of account balances on average were invested in these funds. Participants holding TDFs directed three-quarters of their 2014 total contributions to TDFs.

Participants invest in TDFs in one of two ways. “Pure investors” are those who hold only a single TDF. They accounted for 60% of all target-date investors in 2014. Of this total, 6 in 10 were in plans with automatic enrollment, where they typically were enrolled in a single fund by default; and 4 in 10 were in plans with voluntary enrollment, where they typically actively chose a single TDF. Our research shows that pure target-date investors are more likely to be younger, lower-wage, shorter-tenured participants with lower 401(k) account balances than other investors. Sixty-three percent of single TDF investors were younger than 45, while 45% of mixed investors were.

The remaining target-date investors are “mixed investors.” They hold a TDF in combination with other investments (or, rarely, multiple TDFs). In 2014, 40% of all target-date investors were mixed investors. Mixed target-date investors appear very much like non-target-date investors in terms of their demographic and portfolio characteristics.

Our research indicates that about half of mixed investors arise due to plan sponsor action, including employer contributions in company stock, nonelective contributions to the plan’s default fund, recordkeeping corrections applied to the plan’s default fund, or mapping of assets from an existing investment option to a target-date default because of a plan menu change.

The other half of mixed investors intentionally construct a portfolio of both target-date and non-target-date strategies, and many are pursuing what appear to be reasonable diversification strategies, although they do not fit within the “all in one” portfolio approach of target-date funds. Vanguard survey results show that most target-date investors understand the basic risk and return features of TDFs. Large percentages of participants report that they held other assets to make their portfolio allocation more conservative, more aggressive, or more customized. Forty percent cited “diversification” as a reason for holding additional investments with a TDF.

## Equity allocation extremes

Increased TDF adoption by sponsors and participants is reshaping participant portfolios.<sup>3</sup> One of the benefits of TDFs is that they eliminate extreme equity allocations. Non-target-date participants tend to hold greater extremes in equity exposure (Figure 6, page 6). About 2 in 10 of “do-it-yourself” investors hold extreme portfolios (no equities or only equities). Investors using professional management avoid extreme positions because professionally managed options include both equity and fixed income asset classes. “Do-it-yourself” investors exhibit minimal variation in equity exposure by age, while single-TDF investors’ equity exposures do vary with age.

Among pure target-date investors, the vast majority have equity allocations ranging from 51% to 90% of their portfolios. A large group of pure target-date investors has equity allocations in the 81%-to-90% range. This phenomenon reflects two facts: (1) automatic enrollment into TDFs typically applies to newly eligible plan participants who are disproportionately younger than 45; and (2) in voluntary enrollment plans, a single TDF is a popular strategy among new hires as well.

<sup>3</sup> For an in-depth analysis of portfolio outcomes see Lamancusa, John A., Utkus, Stephen P., and Jean A. Young, *Professionally managed allocations and the dispersion of participant portfolios*, August 2013, Vanguard research, [institutional.vanguard.com](http://institutional.vanguard.com).

**Figure 5. Participant use of target-date funds**

*Vanguard defined contribution plan participants using target-date funds*

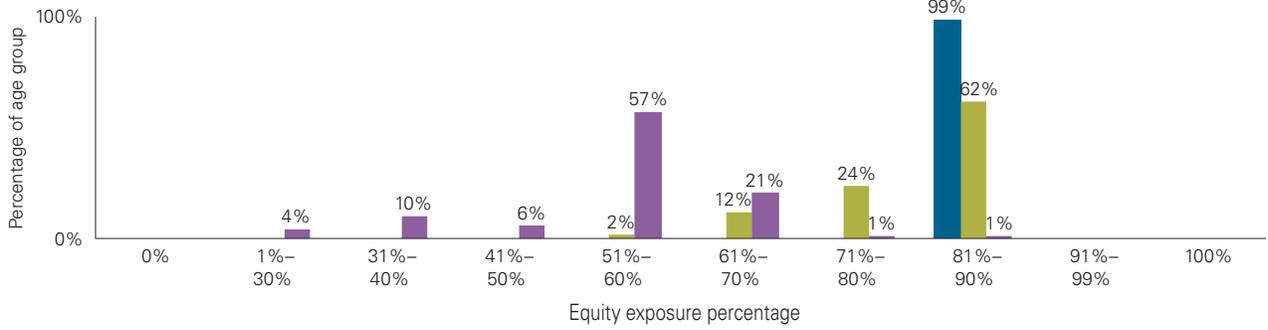
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Percentage of all participants offered target-date funds	29%	46%	67%	76%	81%	86%	87%	88%	90%	97%
Percentage of participants using target-date funds when offered	19	22	27	37	42	48	54	58	61	66
Percentage of participant account balances in target-date funds	36	36	38	37	38	41	43	46	48	50
Percentage of total participant and employer contributions in target-date funds	37	48	52	57	63	67	71	72	74	75
<b>Distribution of percentage of participant assets in target-date funds</b>										
1–24%	38%	32%	28%	26%	26%	24%	21%	19%	17%	15%
25–49%	17	15	13	12	12	11	10	10	10	9
50–74%	7	8	8	7	8	8	8	8	8	7
75–99%	5	7	7	6	7	8	8	7	7	7
100%	33	38	44	49	47	49	53	56	58	62
<b>Distribution of percentage of total participant and employer contributions in target-date funds</b>										
1–24%	41%	28%	24%	19%	16%	14%	11%	11%	9%	9%
25–49%	18	16	14	13	11	11	9	9	8	8
50–74%	8	7	7	7	7	6	7	7	7	6
75–99%	5	4	4	5	4	5	4	4	5	8
100%	28	45	51	56	62	64	69	69	71	69
<b>Percentage of participants owning</b>										
One target-date fund only	32%	37%	43%	46%	46%	48%	52%	54%	56%	60%
One target-date fund plus other funds	58	54	48	46	46	44	41	38	36	33
Two or more target-date funds only	1	1	1	2	2	2	1	2	2	2
Two or more target-date funds plus other funds	9	8	8	6	6	6	6	6	6	5
<b>Distribution of pure target-date fund holders by age</b>										
<25	8%	11%	11%	11%	9%	8%	8%	7%	7%	6%
25–34	28	30	30	31	31	31	32	32	32	31
35–44	28	26	26	25	26	26	26	26	26	26
45–54	23	21	21	21	21	22	21	21	21	21
55–64	11	10	10	10	11	11	11	12	12	13
65+	2	2	2	2	2	2	2	2	2	3
<b>Distribution of mixed target-date fund holders by age</b>										
<25	3%	3%	3%	3%	2%	2%	1%	2%	2%	2%
25–34	26	24	24	22	21	20	19	18	18	17
35–44	31	30	28	28	27	27	27	26	26	26
45–54	26	28	28	29	30	30	30	30	29	29
55–64	13	14	15	16	17	18	20	20	21	22
65+	1	1	2	2	3	3	3	4	4	4

Source: Vanguard, 2015.

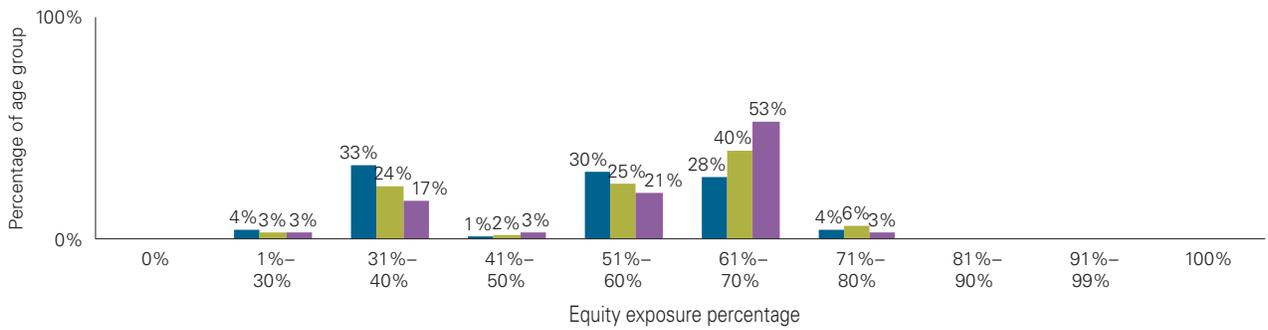
**Figure 6. Distribution of equity exposure by investor type, 2014**

Vanguard defined contribution plan participants

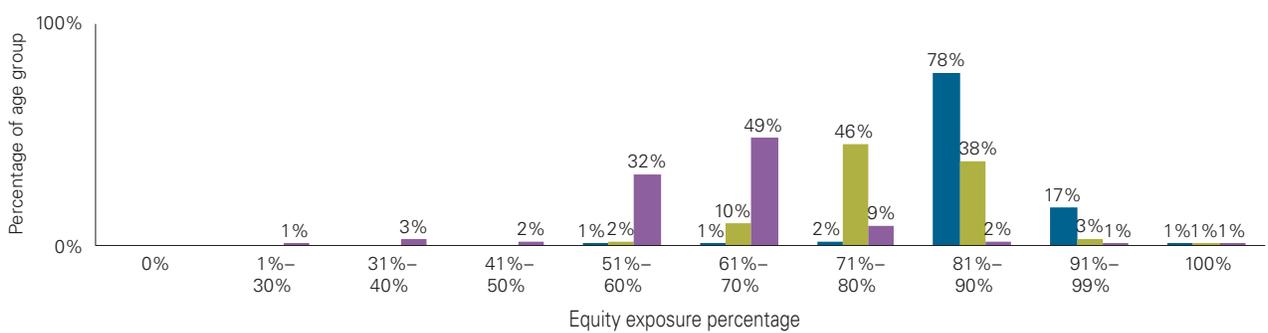
A. Single target-date participants (39% of all participants)



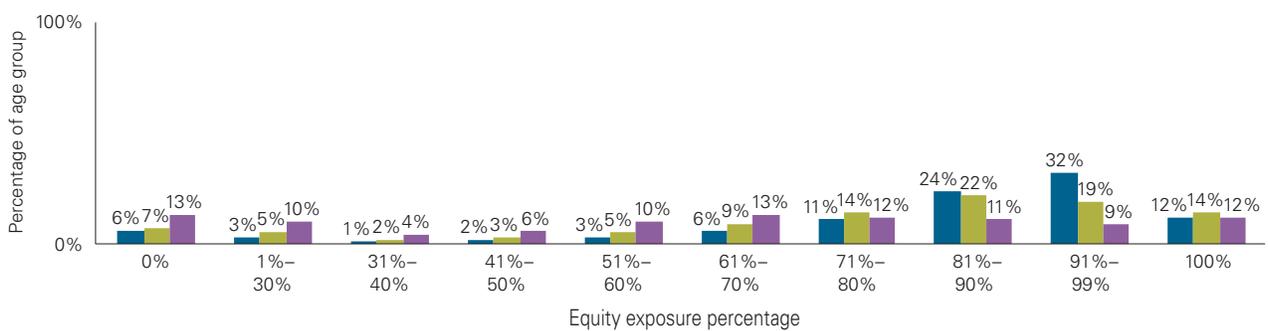
B. Single balanced fund participants (2% of all participants)



C. Managed account participants (4% of all participants)



D. All other participants (55% of all participants)



■ Younger than 35 years of age   ■ Ages 35 to 55   ■ Older than 55 years of age

Source: Vanguard, 2015.

### Target-date fund selection

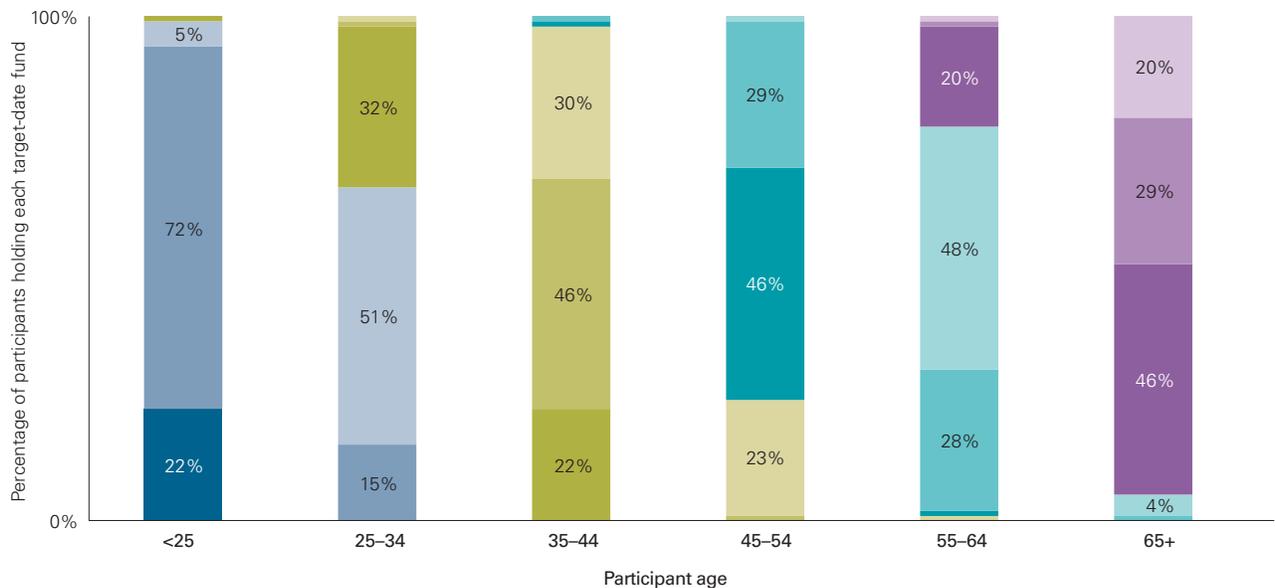
Single TDF investors appear to select, or are defaulted into, a TDF with an appropriate target date (Figure 7). Half of participants ages 25 to 34 are invested in a 2050 TDF, with most of the other participants using either a 2045 or 2055 TDF. Similarly, about half of participants ages 55 to 64 are invested in a 2020 TDF, with most of the other participants using either a 2025 or 2015 TDF.

### Account balances

Average and median account balances for single target-date and balanced fund investors are approximately one-quarter of the assets accumulated by all participants (Figure 8). As noted above, our research shows that these investors are more likely to be younger, lower-wage, shorter-tenured participants. Managed account investors have balances that are much higher, reflecting longer tenure and longer plan participation.

**Figure 7. Target-date fund utilization by age, 2014**

Vanguard defined contribution plan participants holding a single target-date fund (39% of all participants)



Distribution of single target-date fund holders

<25	25-34	35-44	45-54	55-64	65+
6%	31%	26%	21%	13%	3%

2060 2055 2050 2045 2040 2035 2030 2025 2020 2015 2010 Income

Source: Vanguard, 2015.

**Figure 8. Account balance by investor type, 2014**

Vanguard defined contribution plan participants

	Percentage of participants	Account balance	
		Average	Median
<i>Professionally managed allocations</i>			
Single target-date investors	39%	29,606	7,802
Single balanced fund investors	2%	57,136	17,402
Managed account investors	4%	136,370	74,155
All other "do it yourself"	55%	153,223	66,028
<b>All</b>	<b>100%</b>	<b>\$102,682</b>	<b>\$29,603</b>

Source: Vanguard, 2015.

## Implications

TDFs continue to reshape investment patterns in DC plans in fundamental ways. Three factors are driving their growing use by plan sponsors and participants: their simplified approach to investment decision-making and portfolio construction, the growing use of automatic enrollment, and their designation as a QDIA under the PPA.

By design, the funds lead to a disciplined approach to portfolio risk-taking, with risk levels falling as a participant ages. They also help remedy the problem of extreme allocations found among many DC plan participants. For these reasons, their adoption is likely to 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 a target-date fund is not guaranteed at any time, including on or after the target date.

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