



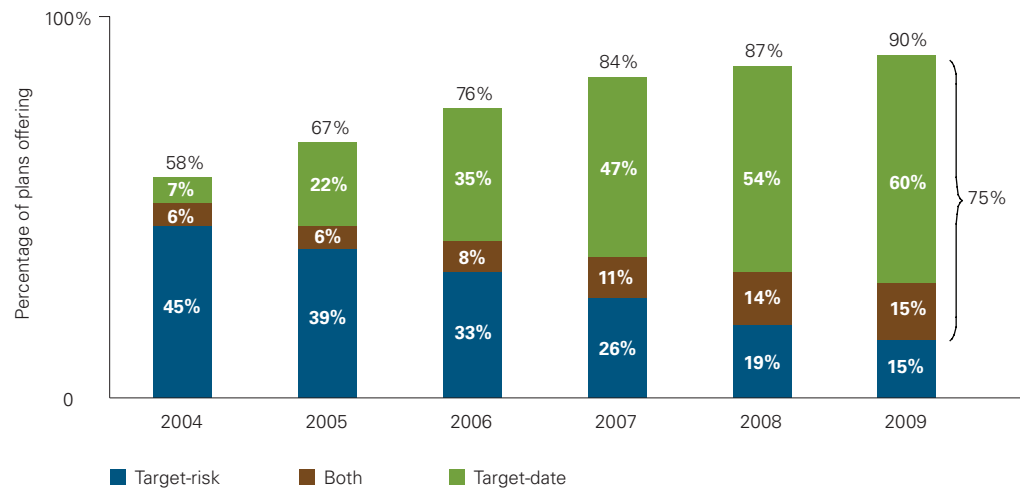
Target-date fund adoption in 2009

Authors¹
Cynthia A. Pagliaro
Jean A. Young

Use of target-date funds in defined contribution (DC) plans continues to grow rapidly, particularly as a qualified default investment alternative (QDIA). At the end of 2009, three-quarters of plans at Vanguard offered a target-date fund (Figure 1) and more than 4 in 10 participants used them when they were offered. Sixteen percent of all Vanguard participants are invested in a single target-date fund.

Figure 1. Trend in plan adoption of life-cycle funds

Vanguard defined contribution plans



Source: Vanguard, 2010.

Investments in target-date funds and Target Retirement 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 or Target Retirement Funds is not guaranteed at any time, including on or after the target date.

1 The authors would like to thank John A. Lamancusa for his support of the data analysis. Our analysis is based on data from plans for which Vanguard provided recordkeeping services. We analyzed 3.2 million unique participants holding 3.4 million accounts in 2,200 DC plans.

Introduction

Use of target-date funds—which allow investors to choose a portfolio based solely on an expected date of retirement—continues to grow as a DC plan investment option. The funds’ simplified approach to investment decision-making is thought to be particularly valuable for less sophisticated investors who struggle with the task of portfolio construction. The increased use of target-date options is related to two developments: the growth of automatic enrollment and the funds’ status as one of three eligible QDIAs under the Pension Protection Act of 2006 (PPA).²

Figure 2. Default fund designations in 2009

Vanguard defined contribution plans

	QDIA plans	Non-QDIA plans	All plans
Percentage of plans	58%	42%	
Target-date fund	80%	22%	56%
Balanced fund	20	18	19
	100	40	75
Money market or stable value fund		58%	24%
Other fund		2	1

Source: Vanguard, 2010.

Seventy-five percent of all Vanguard plans had selected a target-date or balanced fund option as a default investment in 2009 (**Figure 2**). Fifty-eight percent of plans had specifically designated a QDIA default, which offers additional fiduciary protection. Many of these are plans using automatic enrollment or making employer contributions other than a match (such as a non-elective, profit-sharing contribution). Among these plans, 80% of designated QDIAs were target-date options and 20% were balanced funds. Less than 1% of plans had selected a managed account advisory service.

By the end of 2009, 21% of Vanguard plans had adopted automatic enrollment (**Figure 3**). Among plans with more than 1,000 participants, more than 4 in 10 had adopted the feature. Adoption of automatic enrollment by Vanguard plan sponsors has quadrupled since the end of 2005. Nine in 10 plans with automatic enrollment are using target-date funds as their designated default fund.³

Target-date fund adoption

Target-date fund adoption by sponsors has accelerated from 13% of plans in 2004 to 75% of plans in 2009 (**Figure 1, page 1**). Target-date funds are rapidly replacing risk-based life-cycle funds in plan investment menus.

Figure 3. Automatic enrollment in 2009

Vanguard defined contribution plans

	Number of participants			
	All	<1,000	1,000–4,999	>5,000
Percentage of plans offering automatic enrollment	21%	14%	43%	43%
Percentage of automatic enrollment plans using target-date funds as default	90	91	89	87
Percentage of participants in plans offering automatic enrollment	43	23	43	46

Source: Vanguard, 2010.

² QDIAs include target-date funds, other balanced funds, and managed account advisory services. See our November 2007 Regulatory Brief for an overview of the final QDIA regulations.

³ Because larger plans are more likely to use automatic enrollment, 4 of 10 Vanguard participants are in plans with the feature. However, automatic enrollment is typically applied only to newly eligible participants, not existing nonparticipants

While relatively new among Vanguard plans, target-date strategies in 2009 accounted for 1 out of every 8 dollars of plan assets among plans offering the strategy (Figure 4).⁴ Four in 10 participants who were offered target-date funds had an investment in them.

Participants invest in target-date funds in one of two ways. “Pure” investors are those who hold only a single target-date fund. They accounted for 46% of all target-date investors in 2009 and are more likely to be younger, lower-wage participants. The remaining

target-date investors are “mixed” investors. They hold a target-date fund in combination with other investments (or, less commonly, multiple target-date funds and/or other options).

More research is needed to understand the dynamic of mixed target-date investing. Some mixed target-date investors may be naively diversifying their portfolios. Others may be consciously choosing to combine a target-date portfolio with other higher- or lower-risk investment options. Almost half (45%)

Figure 4. Use of target-date funds

Vanguard defined contribution plans

	2004	2005	2006	2007	2008	2009
Percentage of plans offering	13%	28%	43%	58%	68%	75%
Total percentage of plan assets invested*	3	5	6	7	9	12
Percentage of plan assets*						
<5%	74%	58%	49%	39%	27%	23%
5%–9%	15	17	22	24	28	25
10%–14%	5	9	9	13	16	17
15%–19%	1	4	5	6	9	10
>20%	5	12	15	18	20	25
Percentage of participants using*						
Percentage of participants using*	11%	18%	22%	27%	37%	42%
Percentage of participant account balances**	31	36	36	38	37	38
Percentage of participant assets in target-date funds**						
1%–24%	51%	38%	32%	28%	26%	26%
25%–49%	21	17	15	13	12	12
50%–74%	7	7	8	8	7	8
75%–99%	4	5	7	7	6	7
100%	17	33	38	44	49	47
Percentage of participants owning**						
One target-date fund only	17%	32%	37%	43%	46%	46%
One target-date fund plus other funds	65	58	54	48	46	46
Two or more target-date funds only	1	1	1	1	2	2
Two or more target-date funds plus other funds	17	9	8	8	6	6

* In plans offering target-date options

** Of participants owning target-date options

Source: Vanguard, 2010.

⁴ Vanguard began offering Vanguard Target Retirement Funds in 2003. At the end of 2003 less than 1% of plan sponsors had added the funds.

become mixed investors through some type of plan sponsor action. Mixed investors also tend to hold twice as many investment options as non-target-date investors with multiple funds. While these tendencies among mixed target-date investors do raise concerns about improper diversification, it is equally the case that such diversification problems exist with non-target-date investors.

Single-fund holders

With the growing use of automatic enrollment and target-date funds, the percentage of participants invested in a single fund has grown in recent years (Figure 5). More than one-third of Vanguard

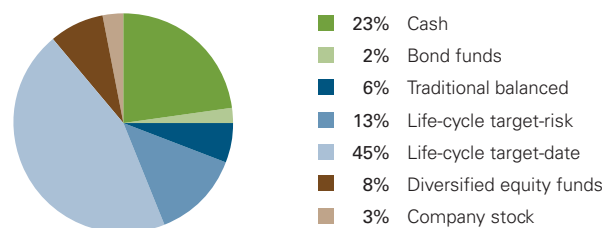
participants were invested in a single fund as of 2009. Among all Vanguard participants, around 1 in 6 (or 16%) were invested in a single target-date fund.

Since 2004, the percentage of single-fund investors holding cash investments has declined from 43% to 23%, while the percentage of single-fund investors holding target-date or other balanced strategies has grown to 64%. This shift reflects several factors: the introduction of target-date funds to simplify participant decision-making; the rising use of automatic enrollment; and the designation of QDIAs under the PPA.

Figure 5. Single-fund holders, 2009

Vanguard defined contribution plans

Percentage of single-fund participants using



	2004	2005	2006	2007	2008	2009
Percentage of participants holding a single fund	25%	27%	28%	30%	34%	35%
Percentage of participants holding a single target-date fund	0	2	4	8	13	16
Percentage of participants holding a single balanced fund	6	8	10	15	20	22

Percentage of single-fund participants using

	2004	2005	2006	2007	2008	2009
Cash	43%	42%	41%	33%	27%	23%
Bond funds	3	3	2	2	2	2
Traditional balanced funds	9	8	9	8	6	6
Target-risk funds	15	15	15	16	14	13
Target-date funds	1	6	13	25	39	45
Diversified equity funds	19	16	15	12	9	8
Company stock	10	10	5	4	3	3

Source: Vanguard, 2010.

Equity allocation extremes

One of the benefits of target-date funds is that they eliminate extreme equity allocations. Non-target-date investors tend to hold greater extremes in equity exposure (Figure 6). A total of 37% hold extreme allocations (16% with no equities, 21% with only equities). Nearly half have equity exposure above 90% or below 10%. Target-date investors cannot hold extreme positions because target-date options include both equity and fixed income assets.

Among pure target-date investors, most (89%) have equity allocations ranging from 61% to 90% of their account balances, reflecting the ages of the respective participants and the equity allocations of the target-date funds they hold. Two-thirds of pure investors have between 81% and 90% in equities, an allocation targeted at participants under the age of 40. Mixed investors tend to have a wider dispersion

of results, but still avoid the extreme allocations because of their partial investment in a target-date strategy.

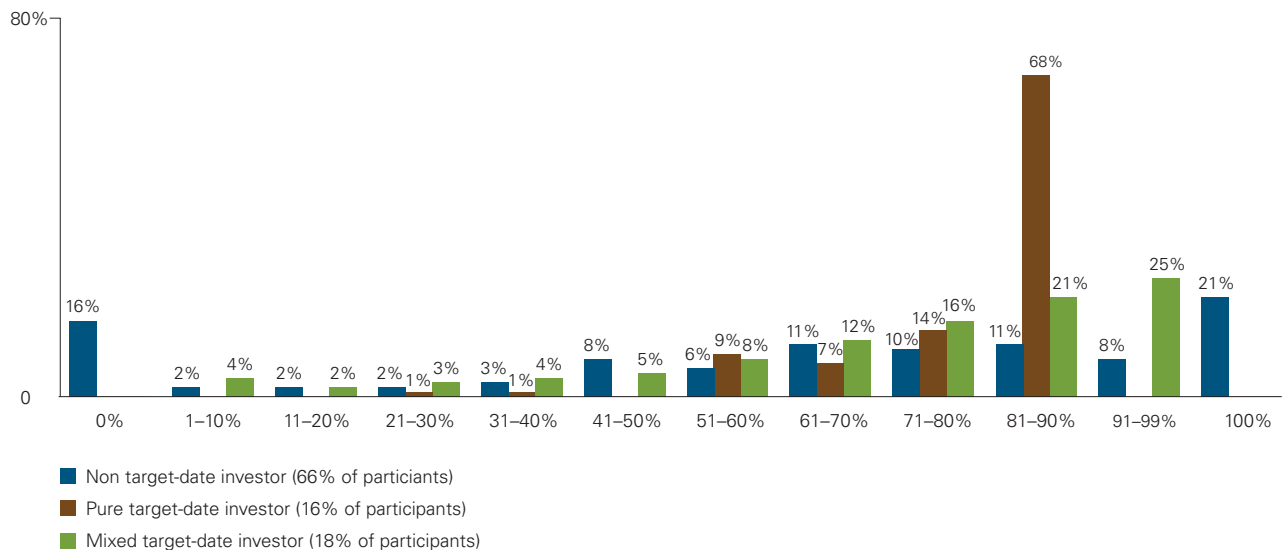
Implications

Target-date funds continue to reshape investment patterns in DC plans in fundamental ways. Three factors are driving their increased use by plan sponsors and participants: their simplified approach to investment decision-making; 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 participants age. They also help remedy the problem of extreme allocations found among many DC plan participants. For these reasons, they are likely to continue to be widely used in retirement plans in the coming years.

Figure 6. Distribution of equity exposure

Vanguard defined contribution participants



Sources: Vanguard, 2010.



P.O. Box 2900
Valley Forge, PA 19482-2900

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