Retirement:
From the mind of the TDF investor

Part 3: Insights from our target-date fund (TDF) survey
This is the third of three papers in our investor insight series *From the mind of the TDF investor*, which analyzes key findings from our survey.
From the mind of the TDF investor: Looking ahead to using the investment in retirement

Key highlights
- TDF investors expect employer-sponsored retirement plans to be their primary source of retirement income.
- The majority of investors plan to take systematic withdrawals or spend their savings as needed in retirement.
- The gradual use of savings in retirement aligns with “through” glide path structures.

Survey overview
Vanguard partnered with Greenwich Associates, an independent market research firm, to conduct an online survey of TDF investors. The goal of the survey, which was not limited to users of Vanguard’s Target Retirement Funds, was to broadly uncover investors’ expectations and overall understanding of TDF characteristics and risks.

Household income
- Under $20,000: 7%
- $20,000–$29,999: 11%
- $30,000–$39,999: 9%
- $40,000–$49,999: 16%
- $50,000–$59,999: 19%
- $60,000–$74,999: 23%
- $75,000–$99,999: 6%
- $100,000–$199,999: 4%
- $200,000 or more: 38%
- Decline to answer: 62%

Investable assets
- Under $50,000: 17%
- $50,000–$99,999: 16%
- $100,000–$499,999: 14%
- $500,000–$999,999: 9%
- $1 million and over: 5%
- Decline to answer: 39%

Base 2014: 1,640 (Total), 369 (IRA), 581 (Plan participant), 690 (Crossover)
Q42. Please identify your gender.
Q43. Which of the following income categories best describes your total 2013 household income before taxes?
Q44. In total, about how much money would you say you (and your spouse/partner) currently have in savings and investments, not including the value of your primary residence?
During their working years, investors focus on accumulating enough assets for retirement. Eventually their focus and concerns turn to managing spending during retirement so they don’t outlive their savings.

As the baby boom generation continues to move into retirement, there’s increasing discussion about the transition into the distribution phase. Employer-sponsored defined contribution (DC) plans and TDFs are a growing component of the debate on appropriate spending and investing in retirement.

According to 2014 Vanguard recordkeeping data, 88% of plan sponsors offered TDFs at year-end 2014 and 64% of participants had all or part of their DC account invested in TDFs.1 When polled in our survey, TDF investors identified a broad array of expected sources of future retirement income. However, when asked to identify which one would serve as the primary source of income, the composition and ranking of investor responses changed drastically.

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As depicted in the top of Figure 1, Social Security was the second most recognizable source of retirement income, far exceeding both IRAs and company pension benefits—yet, the order reversed when survey participants were asked to identify their “primary” source of retirement income. Within that context (Figure 1, bottom), employer-sponsored retirement savings plans emerged as the most significant source of retirement income with IRAs seemingly a distant second.

What investors plan to do with their savings

With the increased focus on TDFs, a related topic for investors has been the pros and cons of a “to” versus “through” glide path. A “to” glide path reaches its lowest level of equity exposure on the targeted retirement year and then keeps the level of exposure constant thereafter. A “through” structure, on the other hand, continues to decrease the equity exposure during the early retirement years. Some retirement spending plans may be better aligned with “to” glide path structures, while others may be better aligned with “through” glide path structures.

For investors planning to take a lump sum at retirement to either disinvest from the market entirely or purchase an annuity, a “to” glide path is likely the best approach. A “through” glide path may make more sense for those taking a more gradual approach to withdrawals, including those investors who roll their employer-sponsored savings balances into an IRA.

Vanguard research has shown that a “through” glide path is more closely aligned with how the vast majority of investors actually plan to use these funds in retirement. Specifically, the most common perceptions among respondents were that they will either take systematic withdrawals from their target-date assets or spend them on an as-needed basis in retirement (Figure 2).

![Figure 2. How investors plan to use their retirement savings](image)

Source: 2014 Vanguard TDF Survey. Responses included “I’m not sure.” [10%] Some numbers were rounded so percentages do not equal 100%.
What investors actually do with their savings

Our survey work on this topic aligns well with the primary research Vanguard has conducted for many years on the withdrawal patterns of participants in DC plans and investors holding IRAs. Our data on retirement distribution decisions among DC participants shows that a very small percentage of participants age 60 and older fully withdraw their assets from the market when they leave their employer. As shown in Figure 3, the majority of participants leaving their employer at this age rolled their accumulated balances over to an IRA. For example, about 72% of assets for investors who retired in 2007 left the plan in which they accumulated assets; however, these assets were not withdrawn entirely from the markets, but rather they were rolled over into IRAs. In aggregate, 90% of assets among investors who retired in 2007 were rolled over or remained in the plan through year-end 2011.

Figure 3. Where does the money go?

Note: December 31, 2014, value for assets remaining in the plan plus actual transaction value for assets distributed from the plan.
‘Through’ glide path aligns with investor spending

Vanguard believes a “through” approach is the most suitable approach for actual retirement spending plans of TDF investors and our survey work appears to validate that it may be the best fit for retirees’ own anticipated spending plans. Among many important considerations, a “through” glide path structure balances longevity risk and investment risk as participants transition from pre-retirement to their retirement date and hopefully many years beyond. Compared to a “to” retirement approach, Vanguard’s glide path is grounded in actual investor spending behavior, allowing participants to benefit from greater exposure to the equity risk premium. The “through” approach employed in Vanguard Target Retirement Funds transitions the final reductions in a participant’s equity exposure over a period of seven years, from age 65 to age 72, when investors are still early in retirement and are generally not accessing their tax-deferred retirement assets.

What does this all mean? Most investors aren’t accessing their IRAs or DC plan assets until they’re well into retirement. Accordingly, we believe it makes sense to have a glide path that continues to work on their behalf and not stop when investors reach age 65.

Survey summary

Most investors understand their TDFs, but . . .

In the world of investment management and defined contribution plan design, target-date funds are a relatively new product category. The first TDF was launched roughly 20 years ago and only about 20% of TDFs today have track records that extend over 10 years.* Following the Pension Protection Act of 2006, the establishment of a safe harbor for qualified default investment alternatives (QDIA), and the proliferation of defined contribution autoenrollment features, the TDF industry has experienced an incredible degree of growth in recent years.

With this growth has come some concern from plan sponsors and service providers that certain investors’ understanding of TDFs and their role in saving for retirement has not kept pace. Our survey work shows that the majority of TDF investors are in fact aware of the strategy’s basic investment risks and the broad framework of a glide path that reduces equity exposure over time. Further, we have found that TDF investor expectations regarding how they will fund their retirement income aligns well with other sources of data supporting Vanguard’s “through” retirement approach to glide path construction.

While it’s refreshing to see that the majority of TDF investors are appropriately incorporating the investment strategies into their retirement planning framework, there is a small—but not insignificant—portion of the investing public that doesn’t fully understand the role TDF strategies play and the investment risks they carry. Accordingly, this will continue to be an area where TDF practitioners and plan sponsors will need to work together to ensure that TDF acumen continues to improve.

* Source: Morningstar Direct as of November 30, 2015.
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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 the target-date fund is not guaranteed at any time, including on or after the target date.

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