

At a Glance

Corporate pension funds have been making numerous changes to their investment programs in response to the economic crisis.

However, relatively few companies have taken steps to better plan and implement risk strategies or lower costs.

Two-thirds of companies have made or are planning to make policy changes in 2009 and 2010 to their defined benefit plan asset allocations, while more than half have already made changes or are planning to make changes to the investment lineups of their defined contribution plans.

The New Reality of Pension Investment Strategies

August 2009

About the Survey

To understand how U.S.-based companies are adjusting their pension investment strategies for a post-economic crisis environment, Watson Wyatt conducted a short survey of 85 senior-level financial executives. The analysis focuses on how investors are seeking to manage their risks, optimize returns and improve their governance strategies.

Executive Summary

In light of the economic crisis, corporate pension funds are taking steps to reduce their exposure to risk – including decreasing defined benefit equity allocations, adding and eliminating defined contribution investment options, and taking more stringent approaches to managing fiduciary risk. Few, however, are taking steps towards cost-cutting and better governance.

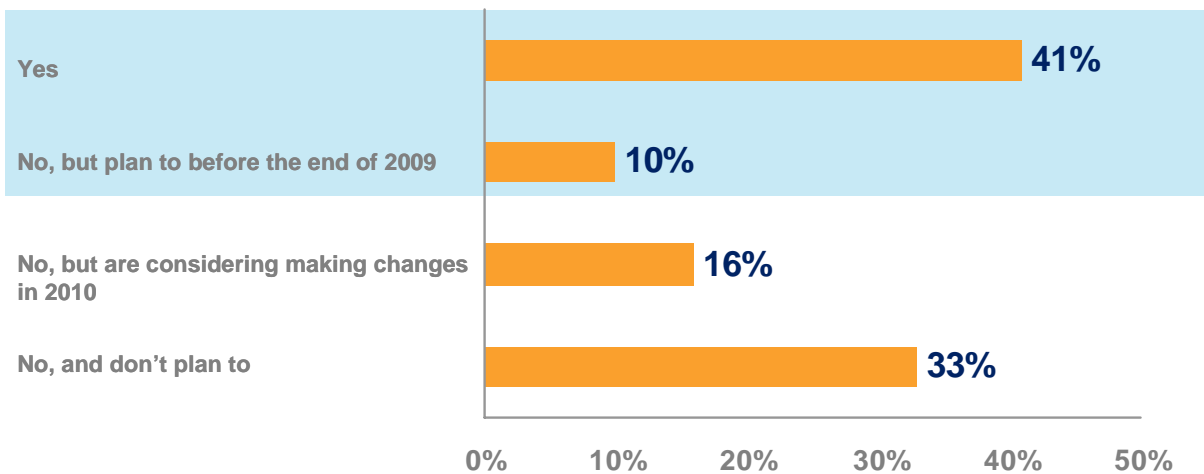
Key Findings

- Two-thirds of companies have made or plan to make changes in 2009 and 2010 to their U.S. defined benefit plan (DB) asset allocations. By 2010, these companies project they will have decreased their target equity allocations by 10 percentage points from their 2008 allocations.
- Almost three-quarters (73 percent) of companies with DB funds have hired or fired managers since June 2008; 52 percent have both hired and fired managers.
- Fifty-six percent of companies have made or plan to make fund additions or deletions to their U.S. defined contribution (DC) plans.
- By the end of 2009, less than half (41 percent) of companies with DB plans will have implemented cost-cutting strategies; 62 percent will have conducted stress tests on their ability to meet future funding requirements; and 12 percent will have established a risk advisory committee.
- By the end of 2009, a quarter (25 percent) of companies with DC plans will have formalized contract reviews for investment advisory services; 35 percent will have renegotiated investment and/or administrative fees; and 43 percent will have moved towards additional disclosure for participants.
- Almost two-thirds of companies have changed their approach to managing fiduciary risk to be more stringent.

Managing Risk in Defined Benefit Plans

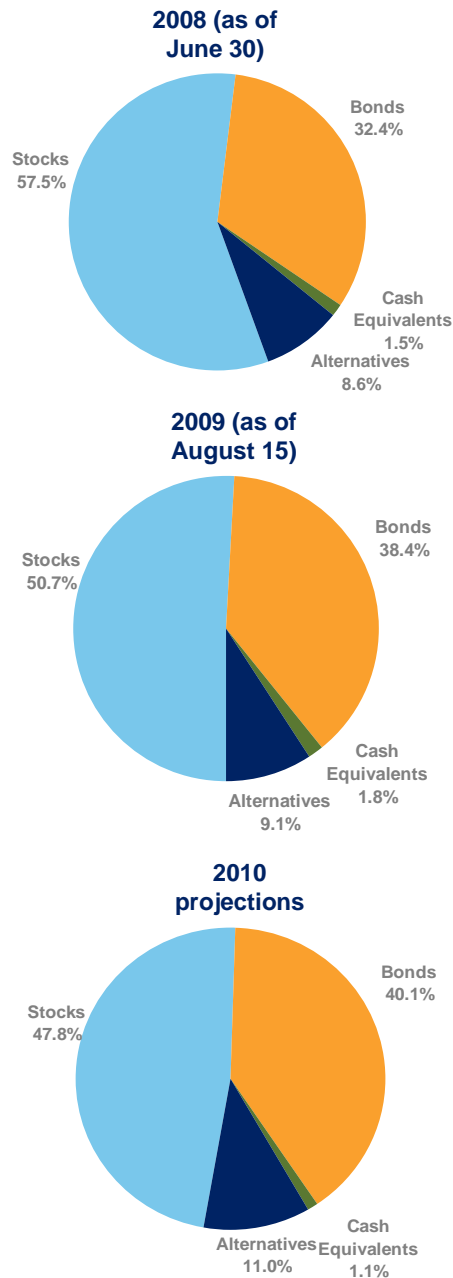
By the end of 2009, more than one-half of companies will have made changes to their U.S. defined benefit plan asset allocations.

Figure 1 | Have you made any policy changes to your company's U.S. defined benefit (DB) plan asset allocation since June 30, 2008?



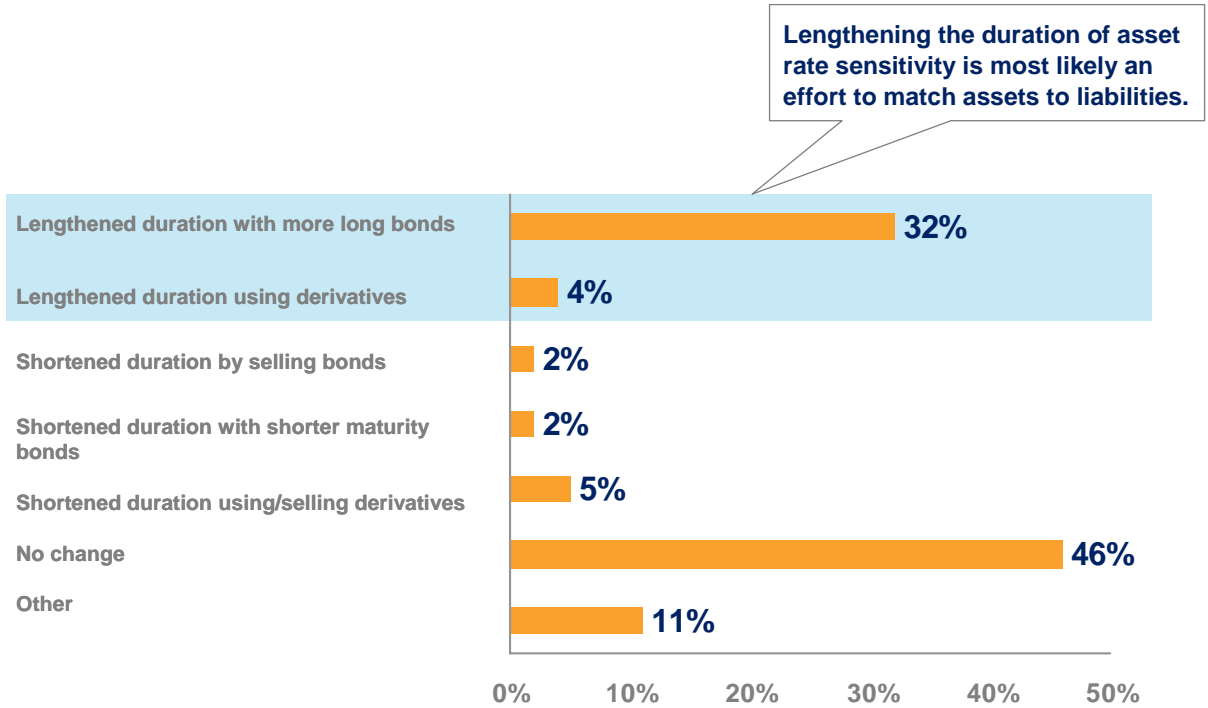
The companies that have made or are planning to make changes will have decreased their target equity allocations in 2010 by nearly 10 percentage points from their 2008 allocations – a sizable shift from long-established levels.

Figure 2 | Please indicate your target asset allocation for stocks, bonds, cash equivalents and alternatives for 2008 and 2009 and projections for 2010.



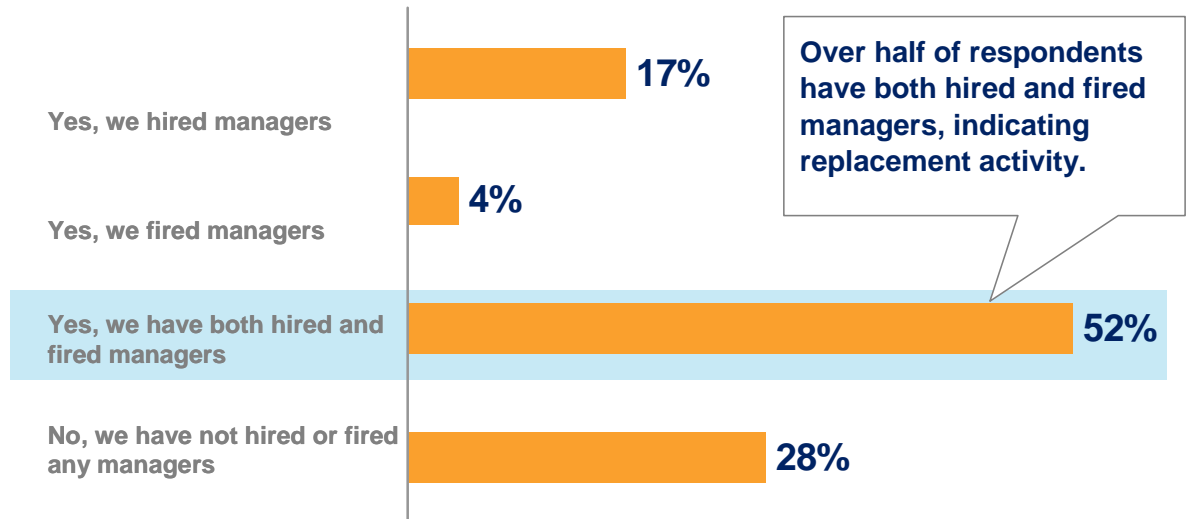
Since June 2008, more than one-third of companies have lengthened the duration of their defined benefit plan's asset interest rate sensitivity.

Figure 3 | What changes have you made to your plan's asset interest rate sensitivity since June 30, 2008? Select all that apply.



A vast majority of companies have hired or fired managers since June 30, 2008.

Figure 4 | Have you changed managers since June 30, 2008?



Of those that have hired or fired managers, a significant amount of movement was found around domestic equity and fixed income managers.

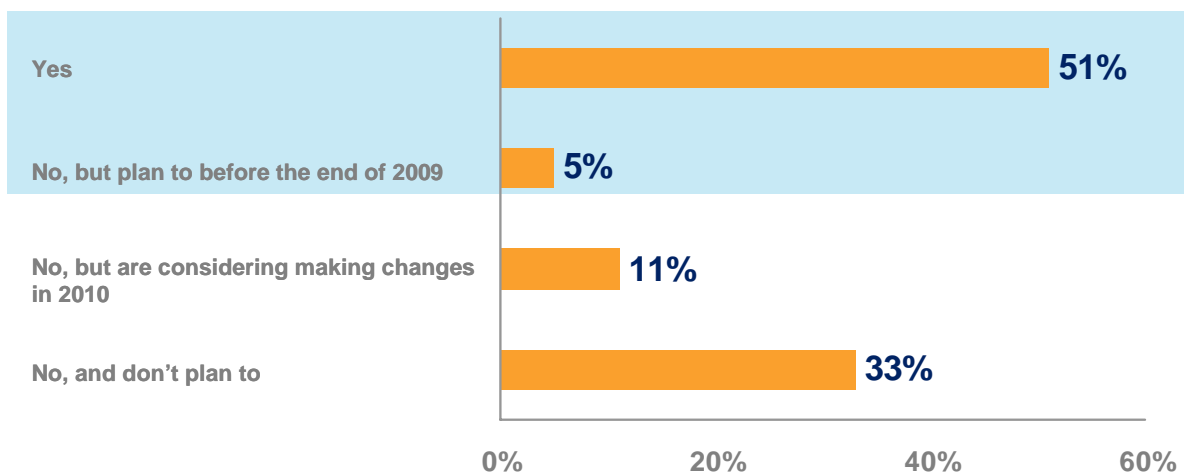
Types of Managers	Domestic Equities	International Equities	Fixed Income	Duration Overlay	Alternatives
Percent that hired managers	59%	32%	68%	0%	22%
Percent that fired managers	67%	33%	47%	0%	10%

Note: Numbers do not sum to 100 percent because respondents selected all answers that apply.

Optimizing Returns in Defined Contribution Plans

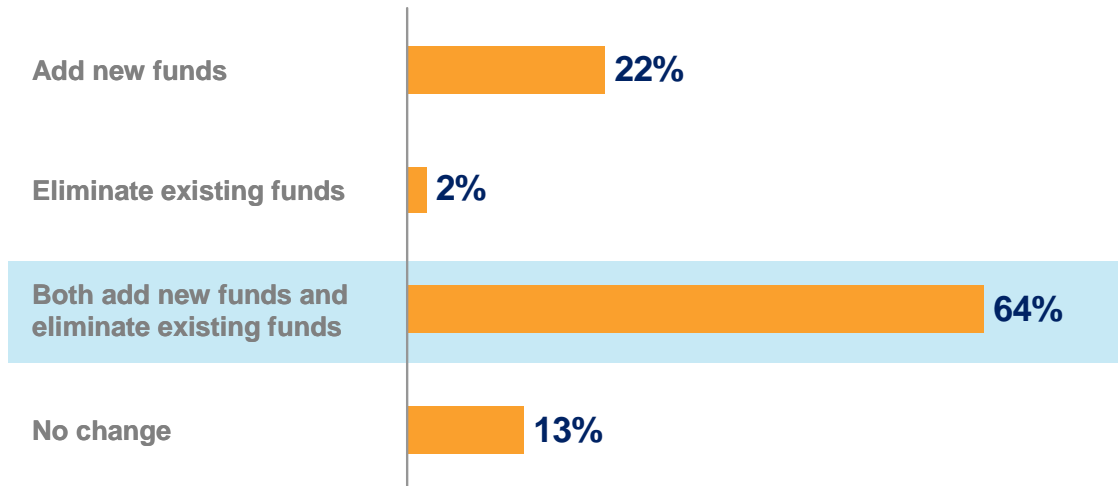
By the end of 2009, more than half of companies will have made changes to the funds in their U.S. defined contribution plan.

Figure 5 | Have you made any fund additions/deletions/changes to your company's U.S. defined contribution plan (e.g. 401(k) or 403(b)) since June 30, 2008?



Of those that have made changes to their funds, 64 percent have both added new funds and eliminated existing funds, with most of the turnover involving equity managers.

Figure 6 | What changes have you made or are you planning to make to the investment options your company offers?

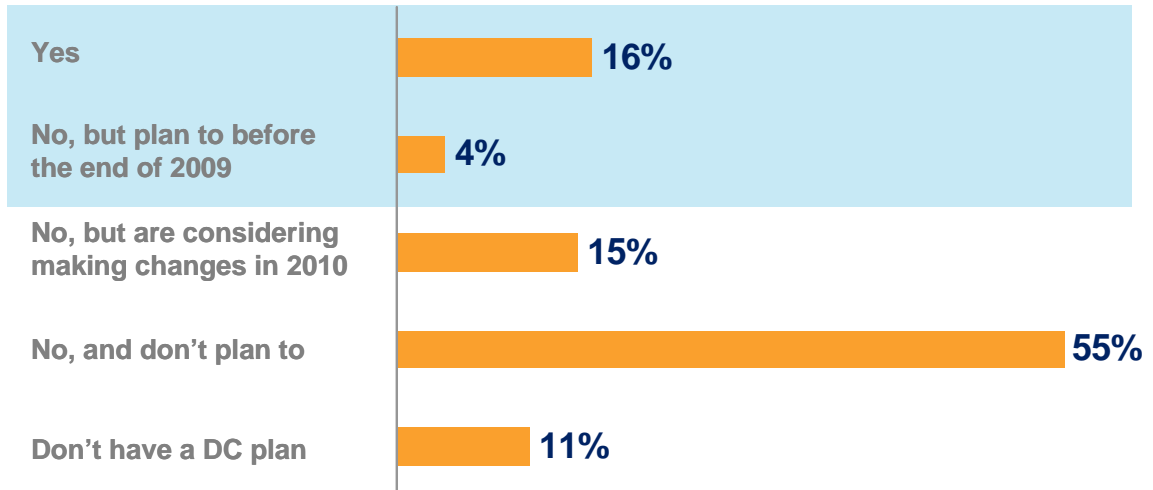


Types of funds	Domestic Equities	International Equities	Fixed Income	Money Market	Stable Value	Target Date	Balanced	Managed Account	Alternatives
Percent that added funds	45%	38%	38%	8%	10%	28%	10%	5%	13%
Percent that eliminated funds	62%	28%	34%	14%	7%	10%	14%	3%	0%

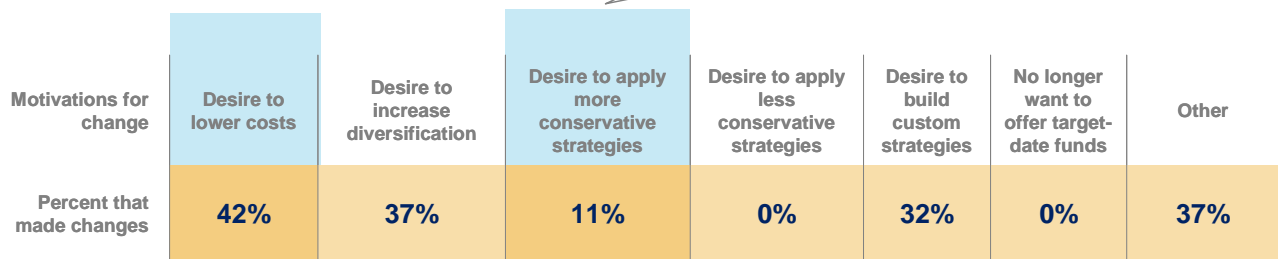
Note: Numbers do not sum to 100 percent because respondents selected all answers that apply.

Twenty percent of companies have made or are planning to make changes to their target-date funds despite their relative newness.

Figure 7 | Have you made any changes to the target-date funds offered by your plan?



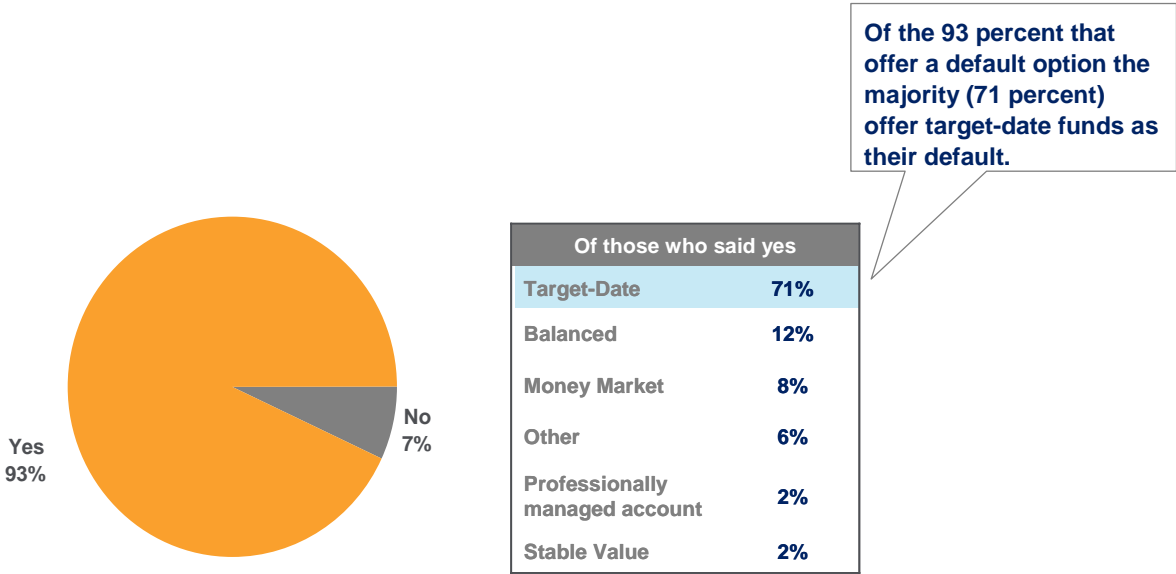
While many companies making or planning to make changes are motivated by cost savings, only a small percentage are motivated by the need for more conservative strategies.



Note: Numbers do not sum to 100 percent because respondents selected all answers that apply.

Ninety-three percent of companies offer a default investment option, and of those almost three-quarters offer target-date funds as their default.

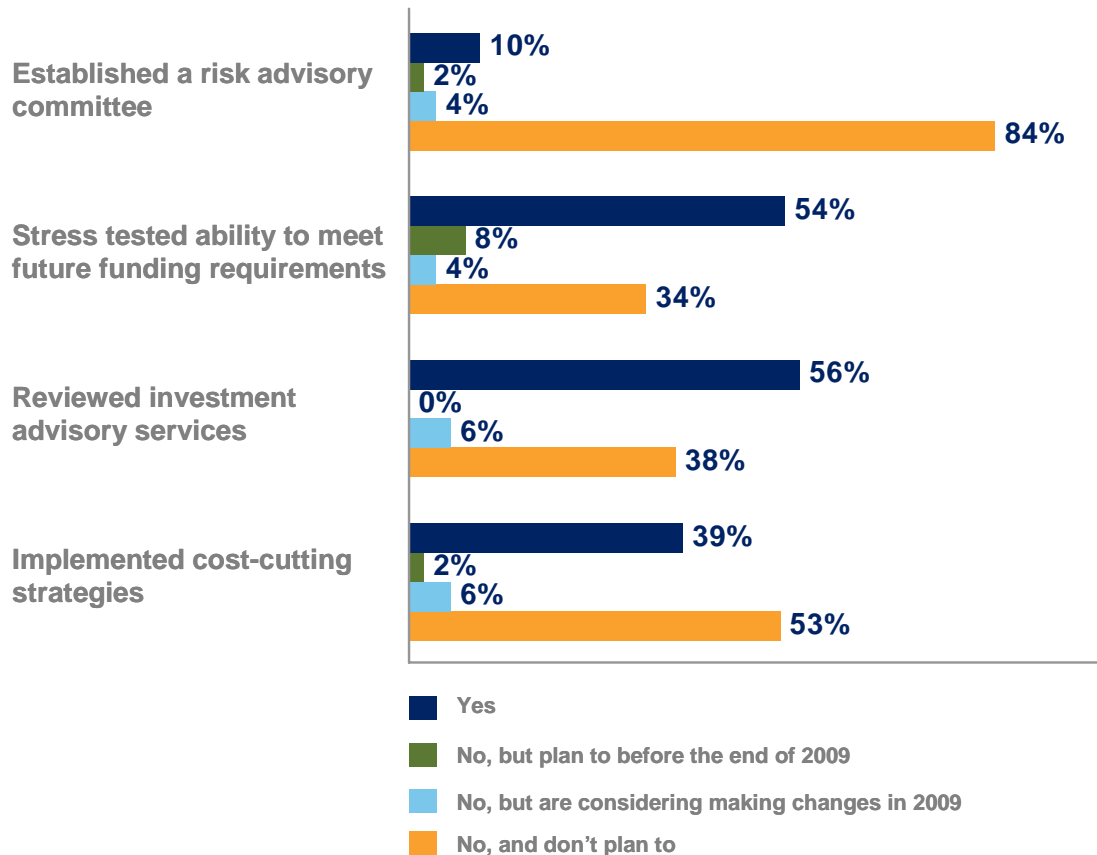
Figure 8 | Do you offer a default investment option?



Improving Governance Strategies

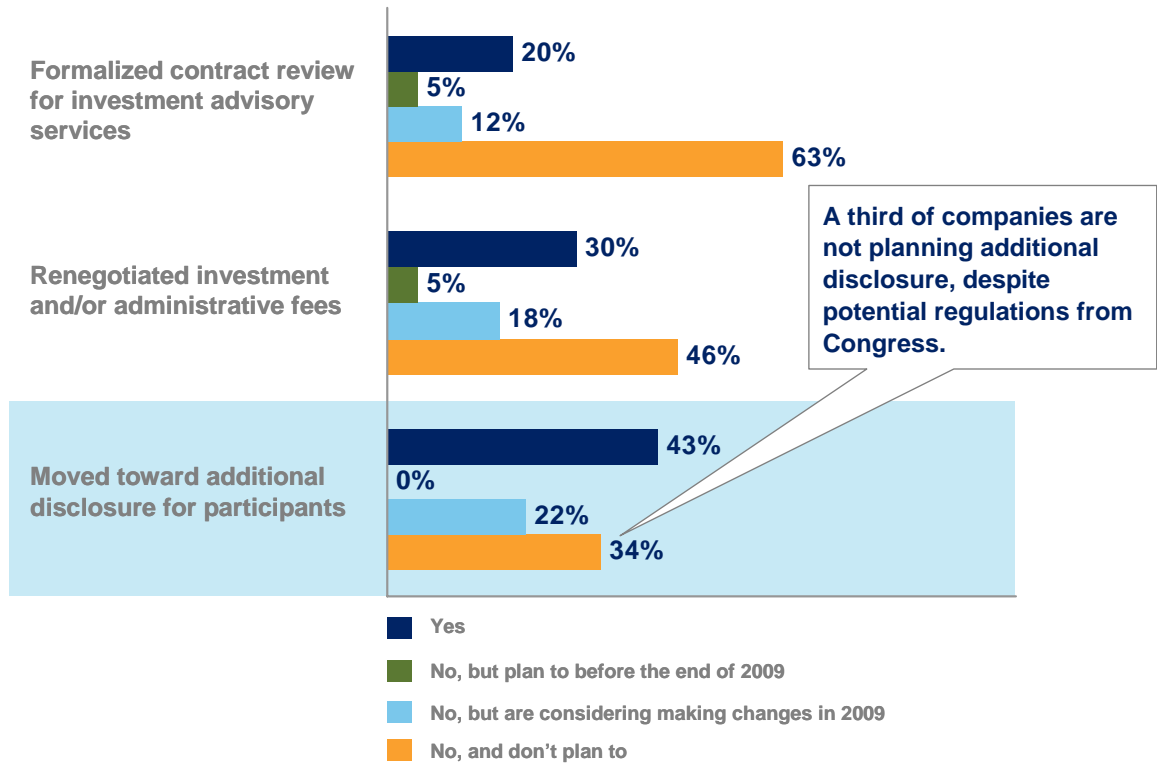
In terms of improving DB governance strategies, a number of companies are not establishing risk advisory committees or implementing cost-cutting strategies. Many companies are conducting stress tests and reviewing their investment advisory services.

Figure 9 | What changes have you made to your organization's U.S. defined benefit plan governance strategy since June 30, 2008?



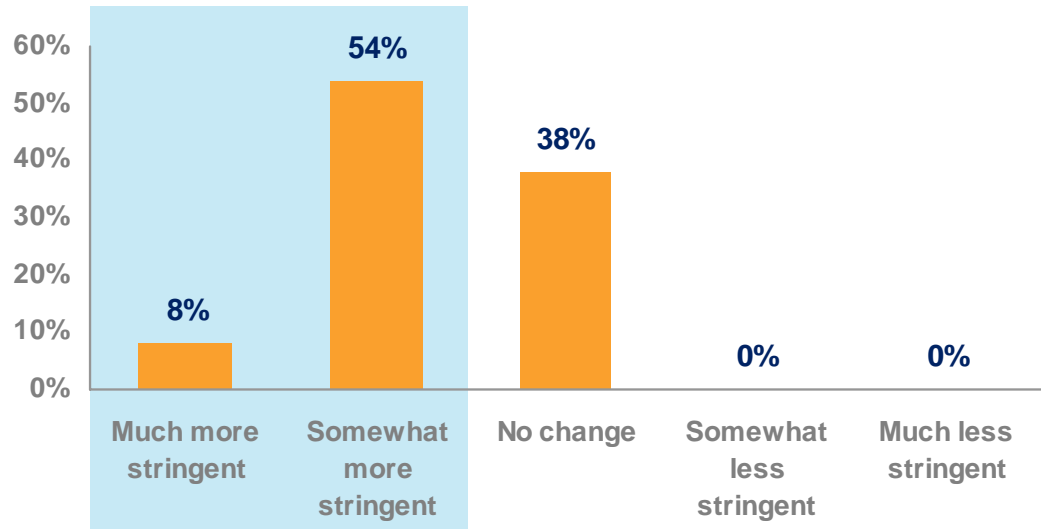
When it comes to DC governance strategies, companies have not formalized contracts for advisory services or renegotiated fees, but a fairly significant number of companies are moving towards additional disclosure for participants.

Figure 10 | What changes have you made to your organization's U.S. defined contribution plan governance strategy since June 30, 2008?



Sixty-two percent of companies are changing their approach to managing fiduciary risk to be more stringent.

Figure 11 | How has your approach to managing fiduciary risk changed since June 30, 2008?





Conclusion

Many investment managers were caught by surprise when the financial crisis hit. The current uptick in activity could be a sign that they are now beginning to make changes in their approach to risk.

Focusing on solutions and smart strategies is critical in the current market. Of course, the response must be consistent with the size and sophistication of the fund. For instance, although a risk advisory committee might be beyond the capacity of many funds, most can still look more closely at their risks and measure them more accurately or more frequently. In this way, managers can further explore their options and take more steps in the right direction.

Disclaimer: *The information contained in this article does not constitute legal, accounting, tax, consulting or other professional advice. Before making any decision or taking any action relating to the issues addressed in this article, please engage a qualified professional adviser.*

Watson Wyatt Investment Consulting

Watson Wyatt Investment Consulting, a division of Watson Wyatt, creates financial value for institutional investors by offering independent, best-in-class investment advisory services. We are specialist investment professionals who provide coordinated investment strategy advice based on our expertise in risk assessment, strategic asset allocation and investment manager selection.

Watson Wyatt Investment Consulting provides investment advisory services to some of the world's largest pension funds and institutional investors, and has more than 500 associates in Europe, the Americas and Asia.

In the United States, investment advisory and investment consulting services are provided by Watson Wyatt Investment Consulting, Inc., a subsidiary of Watson Wyatt & Company. Watson Wyatt Investment Consulting, Inc., is a registered investment adviser with the Securities and Exchange Commission.

Watson Wyatt Worldwide

Watson Wyatt is the trusted business partner to the world's leading organizations on people and financial issues.

Our client relationships, many spanning decades, define who we are. They are shaped by a deep understanding of our clients' needs, a collaborative working style and a firm-wide commitment to service excellence.

Our consultants bring fresh thinking to client issues, along with the experience and research to know what really works. They deliver practical, evidence-based solutions that are tailored to your organization's culture and goals.

With 7,700 associates in 33 countries, our global services include:

- Managing the cost and effectiveness of employee benefit programs
- Developing attraction, retention and reward strategies that help create competitive advantage
- Advising pension plan sponsors and other institutions on optimal investment strategies
- Providing strategic and financial advice to insurance and financial services companies
- Delivering related technology, outsourcing and data services

For more information call Watson Wyatt at 800.388.9868 or visit watsonwyatt.com.