

CONTENTS

About This Study	1
Global Trends in Pension Plan Choice and Funding	2
US Plan Sponsors and Their Service Provider Relationships in a Time of Change	4
Defined Benefit Custodial Relationships	7
Custody and Record Keeping for Defined Contribution Plans	9
Managing Risk and Revenues in Securities Lending	12
Asset Management Relationships for Defined Benefit and Defined Contribution Plans	14
Balancing Cost Pressures with Employee Protection	17
Private Plans	19
Public Plans	21
Meeting the Big Challenges: How Service Providers Can Help Create a Financially Secure Future for US Retirees	23

Redefining Retirement: What Changes to Defined Benefit and Defined Contribution Plans Mean for Plan Sponsors and Their Service Providers

Sponsors of defined benefit and defined contribution plans are working to solve a most pressing question: how to provide employees with retirement benefits that offer sufficient funding without causing further strain to employer balance sheets or government budgets. This report identifies how managers of retirement plans view this challenge and how their service providers, including their custodians and asset managers, can help confront it. Managers are particularly interested in their service providers extending beyond their traditional strengths in performance and risk measurement to focus on the empirical costs of changes in retirement benefit plans. Ultimately, as plan managers urgently seek to balance the needs of corporate balance sheets and the retirement security of their employees, opportunities exist for custodians and asset managers to offer much needed assistance.

Executive Summary

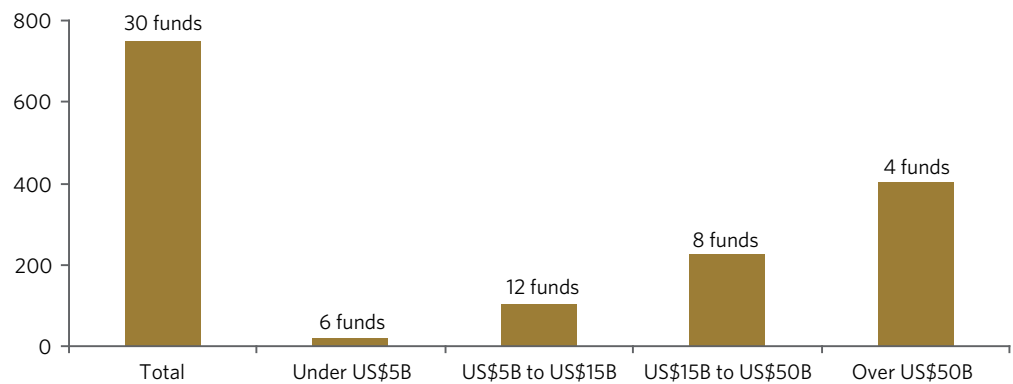
- Providers of retirement plans face unprecedented cost pressures in maintaining their programs; in an attempt to manage their finances, many are reducing the benefits they offer or are looking to balance funding between employers and employees. These changes are not necessarily to the benefit of the employees they serve.
- Retirement benefits packages continue to be seen as an important part of employee hiring and retention. 50% of private company executives surveyed said that their plans made them more competitive as an employer, whereas 73% of public plan executives felt that their plans were an asset.
- The attractiveness of defined contribution plans for employers lies in the reduction of funding volatility; in the long run, funding costs for defined contribution may be higher or lower than current costs, but the ability to control volatility is seen as an unparalleled advantage.
- Hybrid defined benefit/defined contribution plans offer the professional management of defined benefit with the portability of defined contribution; some type of hybrid plan may be the best solution for employers and employees if employer costs can be managed effectively.
- Executives are looking to their services providers for help with some of their most pressing challenges, including assessing performance for private equity and other illiquid assets, and defining new strategies for assuring a stable retirement for their employees.

About This Study

This study, conducted in conjunction with Finadium, is based on a series of interviews with executives of large US pension plans conducted in June of 2010. We spoke with 30 plans for the study, including 16 corporations and 14 public entities. Our questions covered many aspects of decision making in defined benefit and defined contribution plans including recent and projected changes to retirement plans. Our intention was to gather a base level of factual data and to learn about the opinions of individual executives who manage programs.

Our survey covered US\$749.9 billion in assets across 30 retirement systems. Defined benefit assets dominated the retirement systems we spoke with; 81% of assets were in DB plans with the remainder in DC and a handful of health care retirement accounts. The asset sizes for the plans we spoke with ranged from under US\$5 billion to over US\$50 billion, with over two-thirds of the plans falling in the US\$5 billion to US\$50 billion range (see Exhibit 1).

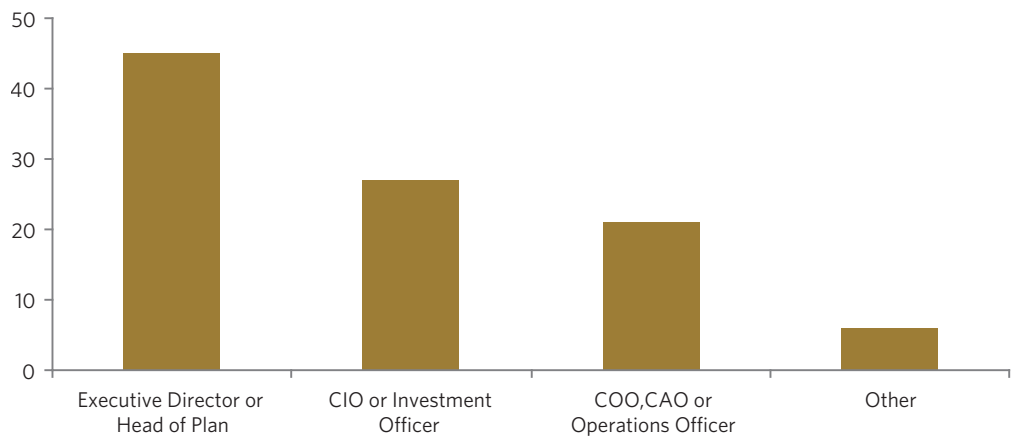
Exhibit 1: Assets Under Management of Surveyed Retirement Systems (US\$ Billions)



Source: Finadium

We spoke with 33 executives for the study, all managers with direct responsibility for the oversight of their retirement plans. Executive Directors and heads of plans were the largest category of interviewee, followed by CIOs and other investment officers, as well as operations officers (see Exhibit 2). The plans included in our survey came from across the US.

Exhibit 2: Titles of Surveyed Retirement System Employees (Percent)

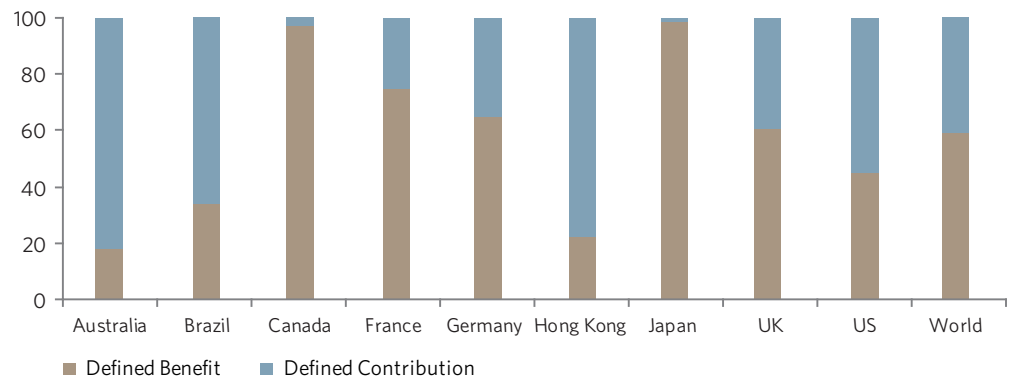


Source: Finadium

Global Trends in Pension Plan Choice and Funding

Retirement plans have taken a wide range of structures in developed countries. The mixes span from public to private and include compulsory, incentivized and voluntary plans. They can be personal or workplace-based arrangements with benefits paid as monthly annuity or lump sum payments. The types of plans seem infinite and are driven by each country's particular economic, social, cultural, political and historical circumstances. From a high level perspective, even the decision of whether to focus on defined benefit (DB) plans, where an employer is responsible for paying out a fixed amount at retirement regardless of employee contribution, or defined contribution (DC), where employees receive the floating value of their own retirement savings account, varies substantially by country (see Exhibit 3).

Exhibit 3: Retirement Assets in Defined Contribution and Defined Benefit Plans by Country, 2009



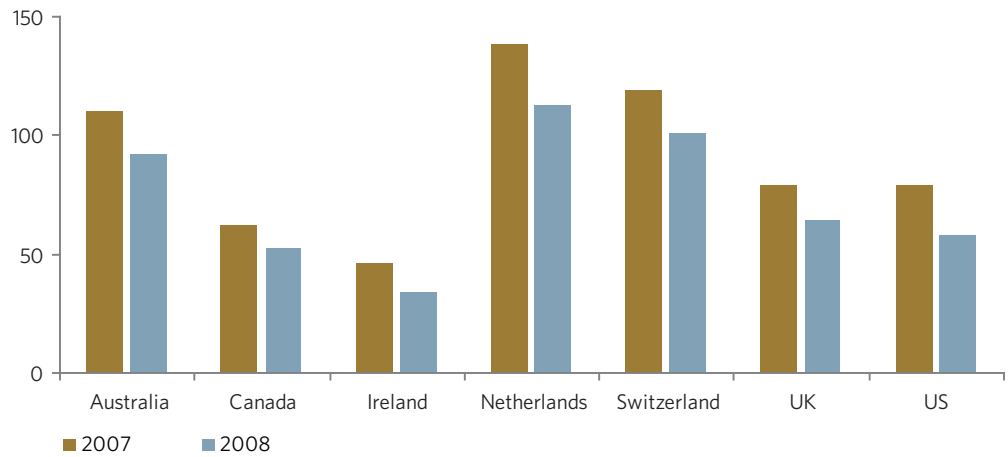
Source: Towers Watson Global Pension Asset Study 2010

With the recent downturn in financial markets, one commonality across retirement systems is the struggle to maintain adequately funded plans. Some private firms have been unable to maintain their funding levels from annual contributions and some public plans have had budget years when legislators failed to earmark any contributions at all. In the US, while private employers are legally mandated to fund their programs, public sponsors have some flexibility when it comes to approving budgets and contributions.

The most recent data from 2008, at the onset of the credit crisis, show US pension fund assets as a share of GDP dropping from 79% the year before to 58% (see Exhibit 4). This fall is shown in the vast majority of other countries as well.

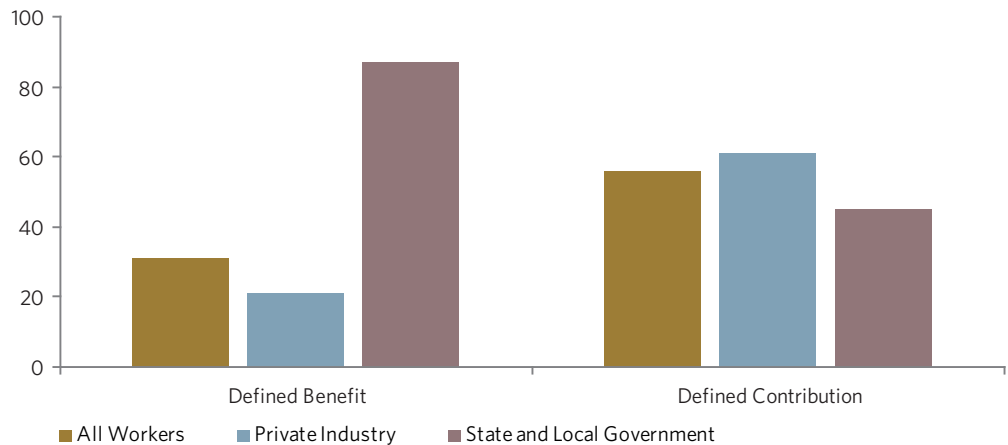
For US employees, access to a tax-deferred savings plan outside of Social Security has traditionally been considered imperative to a stable retirement. Although the majority of private companies offer some form of retirement savings program(s), they are not mandated to offer that benefit. This is reflected in official statistics: in 2009, only 31% of US civilian workers had access to a defined benefit retirement plan with most of these in the public sector; 56% had access to a defined contribution program (see Exhibit 5). As 13% of employed workers had no retirement plan at all beyond Social Security, and many workers face potentially underfunded private retirement accounts, ensuring retirement stability has already emerged as a major challenge of the 21st century.

Exhibit 4: Pension Fund Assets as a Share of GDP (Percent)



Source: OECD

Exhibit 5: Access to Retirement Plans, US Civilian Workers 2009



Source: Bureau of Labor Statistics, "National Compensation Survey: Employee Benefits in the United States, March 2009"

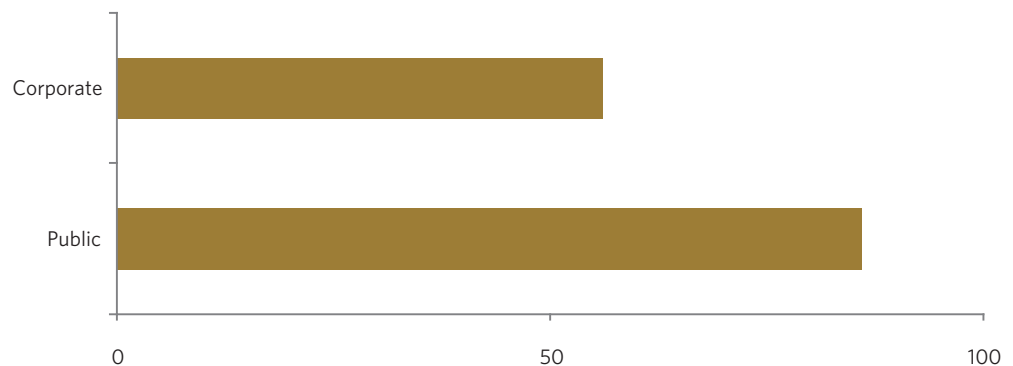
US Plan Sponsors and Their Service Provider Relationships in a Time of Change

Employers have been reevaluating the types of retirement security offered to employees over the last decade. The largest change has been a shift towards defined contribution plans and away from defined benefit. For private employers, this trend was possible starting in 1974 as the Employment Retirement Income Security Act (ERISA) has always authorized the use of defined contribution plans. However, the trend accelerated as a result of subsequent legislation requiring full funding of defined benefit plan liabilities; as this became more difficult for plans to achieve, launching defined contribution plans was a logical solution. The move towards defined contribution is now strongest among corporate plans except where unions have been successful in negotiating retirement benefits as part of collective bargaining agreements.

For plans not covered by corporate regulation, primarily public plans, defined benefit retirement plans continue to be the preferred solution. This is driven by multiple factors, including a strong organized public sector employee base and retirement benefits that make up for salaries that are in most cases lower than the private sector. Some change is coming to public sector plans as funding has not kept up with pension liabilities, but this is slow and almost always conflicts with the broader desires of employers to maintain a qualified workforce.

Emblematic of change in retirement thinking, all of the 30 plans surveyed for this study had offered a defined benefit plan in the past 10 years; of those, 67% continue to maintain an open plan for new employees. Of the corporate plans, 56% were still open with no intent on changing while 86% of the public plans remained open (see Exhibit 6). Union employee plans were noted separately as these groups have retirement benefits that cannot be easily changed.

Exhibit 6: Defined Benefit Plans Open to New Employees (Percent)



Source: Finadium

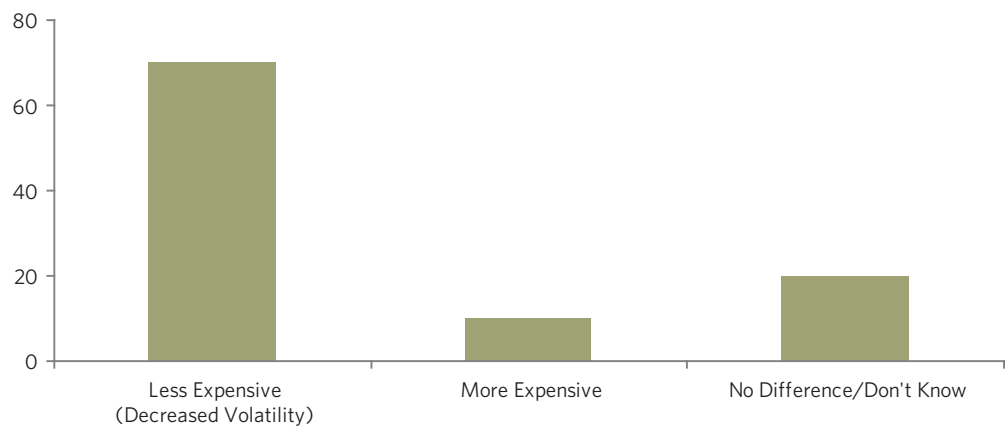
Ongoing defined benefit plans are not immune to change either; 50% of employers keeping a DB program had made some alteration to their plan in the last two years. Several noted changes to extend the retirement age or amend the structure of the program to improve portability. Other plans had recently engaged in an asset/liability study that, while not affecting the underlying participants, did result in a change of thinking about how to manage the plan going forward.

Employers that closed their DB programs to new entrants cited funding mandates as the primary reason. However, many were as concerned not just about immediate funding costs but also about the year over year volatility that can result in a need to unexpectedly increase funding due to market movements. For firms that had closed their DB programs to new entrants, only 70% thought that this would be less costly for the firm in the long run; funding volatility on a year by year basis would decrease but not the total funding cost. The remainder believed it would be either more expensive or remained uncertain about the future financial impact (see Exhibit 7).

“It is hard to say whether closing our plan will be more or less costly in the long run. What matters most is managing volatility in funding costs.”

Director, Corporate Plan

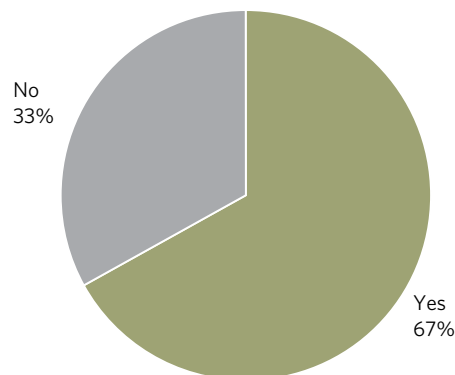
Exhibit 7: Plans That Closed Their DB Programs: Will New Retirement Programs Be More, Less or Equally Expensive in the Long Run



Source: Finadium

Across the private and public plans that we spoke with, 67% maintained a defined contribution plan (see Exhibit 8). Some of these plans were the primary retirement benefit for employees while others were additions to ongoing defined benefit plans. In total, the plan executives we spoke with managed \$137.3 billion in defined contribution assets, compared to \$610 billion in defined benefit programs.

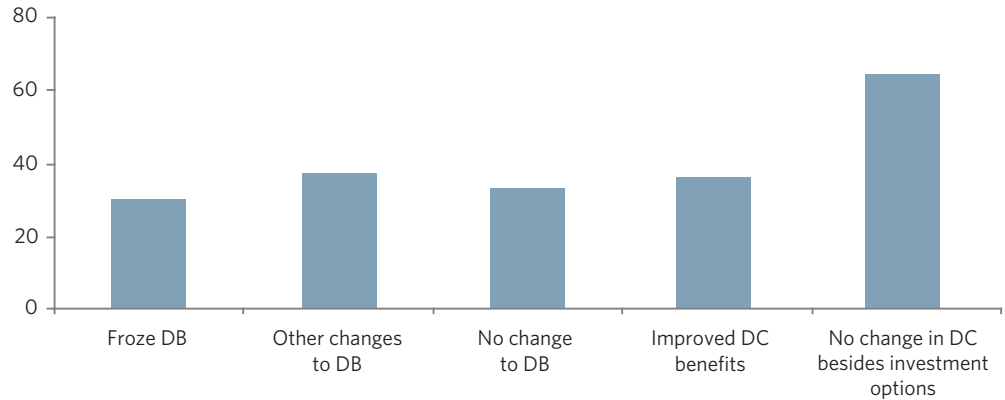
Exhibit 8: Plan Sponsors Managing a Defined Contribution Plan (Percent)



Source: Finadium

As would be expected, closures of DB programs have been matched by changes in DC plans on almost a one for one basis (see Exhibit 9). Where 33% DB plans have been frozen to new entrants, 36% of DC plan sponsors have expanded their programs primarily by increasing the match they offer on employee contributions. A few plans added what they called “bells and whistles,” including educational resources and more investment options. This could be attributable to the impact of the Pension Protection Act passed in 2006, which placed additional requirements on sponsors of DC plans to provide better employee education. It could also be a social result of the failure of Enron that exposed the danger of concentrated holdings, particularly in the stock of the employer.

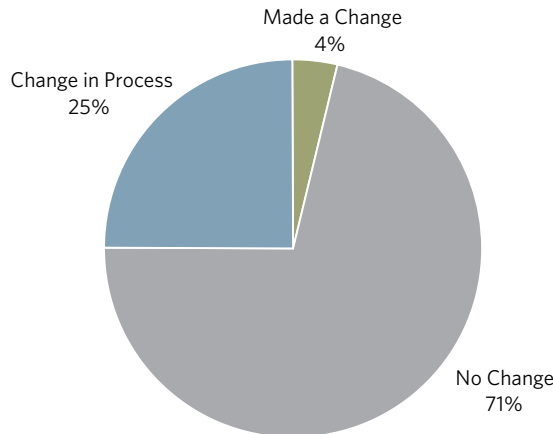
Exhibit 9: Changes to Defined Contribution Plan Over the Last Two Years (Percent)



Source: Finadium

Surveyed executives expected to offer more services to their employees in the future with the same level of resources they now have available. When asked if any changes had been made to recent service provider relationships, 71% responded no and an additional 25% noted that they were adding a variety of additional services (see Exhibit 10). Only 4% had ended any vendor relationships recently outside of routine changes in asset managers.

Exhibit 10: Pension Plans that Made a Change to Non-Custodial, Non-Asset Manager Service Provider Relationships in the Last Two Years (Percent)



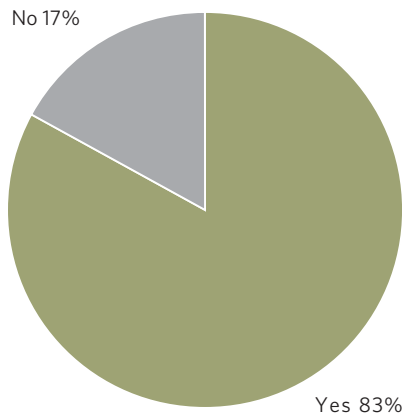
Source: Finadium

Defined Benefit Custodial Relationships

Surveyed executives had two general opinions about their defined benefit custodians. The first group was engaged with their custodians, seeing these service providers as critical business partners in program management and development. Whether using services on a bundled or unbundled basis, this group recognized that custody banks house a diverse range of professionals with specialized skills. The ability to access these professionals, as well as the technology that accompanies them, is an important asset for managing risk, understanding changes to accounting rules and creating new types of retirement programs. A second smaller group saw these custodians as simply holders of assets, a necessary but unexciting part of the asset management process.

The selection of the custodian for a defined benefit program tends to be a long-term choice; 83% of executives said that they had been with their DB custodian for more than two years, and many had been with the same custodian for over 10 years (see Exhibit 11).

Exhibit 11: Plan Sponsors Using the Same Custodian for More Than Two Years (Percent)



Source: Finadium

“Technology can be replaced but the skills of the people at our custodian are very important. This is what makes the relationship so sticky.”

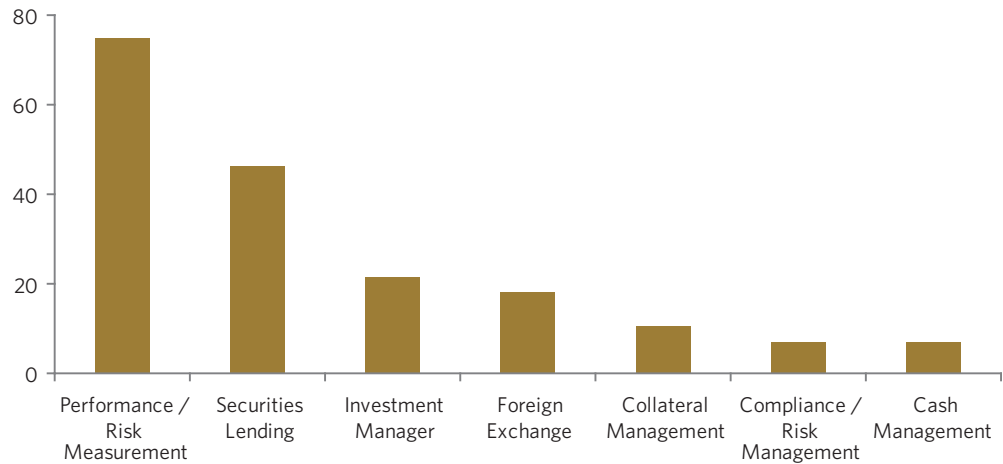
Director, Corporate Plan

“It is important to me to keep a well trained team at our custodian. If it felt like a commodity it would be easier to make a change.”

Senior Executive, Corporate Plan

Besides core custody, plan sponsors used their custodians for a variety of services, some of which were considered important and others not. The most important additional service was performance measurement; 75% of plan executives said that this is a service where their custodian was valuable particularly when it comes to tracking illiquid assets (see Exhibit 12). 21% of plan executives also noted that they use their custodian as an asset manager, and that this was a very important overlapping function.

Exhibit 12: Additional Services Provided by Defined Benefit Custodians Considered Valuable to Plan Sponsors (Percent)



Source: Finadium

Plan sponsors had a variety of opinions about the utility of bundling the defined benefit services that custodians offer; the best practice appears to be to request an unbundled bid for the provision of each service, recognizing that custodians and other bundled service providers will have an incentive to provide pricing that reflects a cross-selling of their capabilities. Plan sponsors can then select the best mix of services and pricing across RFP respondents.

“When we put custody out to bid we asked for an unbundled figure. Our custodian made it worth our while to keep services bundled.”

Operations Director, Public Fund

Concerns about bundling impacted fees for services large and small; public funds in particular note that the netting of custodial fees with other services on their Consolidated Annual Financial Report (CAFR) may reduce the reported cost of their custodial service but obscures other costs. This does not promote the cost transparency that they are seeking, although unbundling costs and explaining a sharp increase in custody fees to a Board may be a difficult task in the first year.

“We were getting quoted a very low fee for custody but didn’t feel that this was accurate. We worked hard to unbundle the fees. The downside the next year was that on our CAFR the custody line showed a 10 fold increase.”

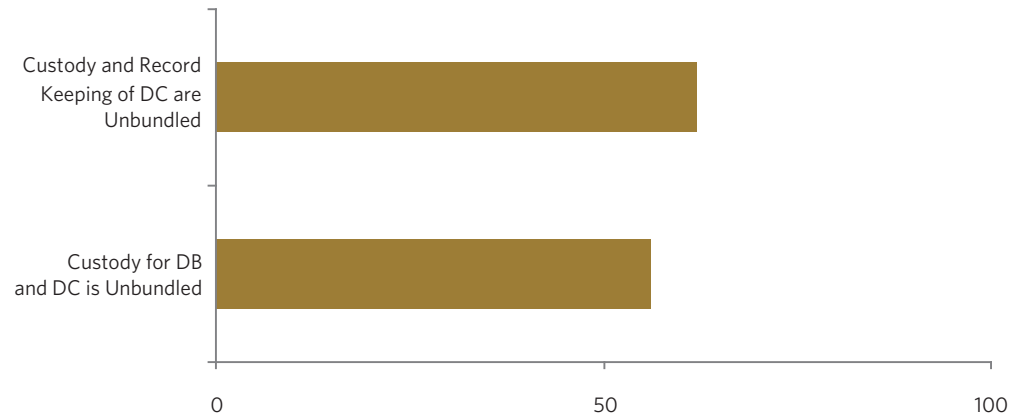
Executive Director, Public Fund

Custodians providing services to defined benefit plans are also seen as an important business partner when managing portable DB plans and defined contribution plans in a unit trust format. This aspect of the DB custodial relationship is both subtle and important, and reaches into an area of real concern for the executives we spoke with. Plan sponsors that are able to work with their custodians on hybrid DB/DC programs may face fewer challenges than their peers in meeting what at times may seem like conflicting corporate balance sheet goals with the needs of employees for increased retirement funding.

Custody and Record Keeping for Defined Contribution Plans

Similar to defined benefit plan management, a key decision sponsors make when selecting defined contribution service providers is whether to bundle or unbundle services. This may include bundling between defined benefit and defined contribution plans or between custody and record keeping for defined contribution plans alone. 56% of plan sponsors surveyed have chosen to unbundle custody services for their DB and DC plans (see Exhibit 13). Similarly, 62% of plan sponsors chose to use a separate service provider for each of the custody and record keeping functions of their defined contribution program.

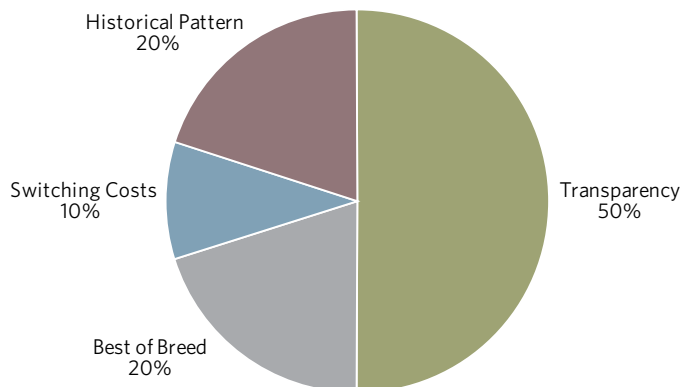
Exhibit 13: Plan Sponsors Bundling Services Between Defined Benefit and Defined Contribution Programs (Percent)



Source: Finadium

Plan sponsors that had unbundled custody and record keeping for their DC plans noted several supporting factors for their decision. Exactly half sought the transparency that unbundling provides; this group wanted to ensure that data was double checked and that processes were being managed accurately (see Exhibit 14). Another 20% were interested in best of breed providers, and in these cases that happened to mean two different firms for custody and record keeping. 10% cited the high costs that would result with changing any provider, even if bundling services would capture better pricing or operational efficiencies. The remaining unbundling has simply occurred over time; as noted by 20% of respondents, there was no particular reason or philosophy behind the choice.

Exhibit 14: Reasons for Unbundling Custodians and Record Keepers of Defined Contribution (Percent)



Source: Finadium

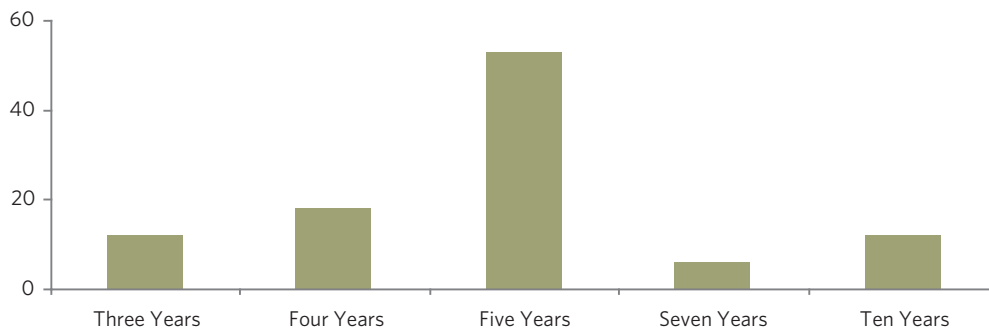
Unbundling custody and record keeping service providers is not for every plan however. Executives who are focused heavily on the costs of plan management downplayed the benefit. This is a reasonable choice as well, and one that is driven by practical motivations. For the most part, executives were pleased with their own choices to bundle or unbundle; 86% said they would recommend their current providers of DC services.

“We conducted an analysis on unbundling services for custody and record keeping. We found no significant savings.”

Administrative Director, Corporate Plan

Executives took a dim view of the RFP process for selecting a defined contribution service provider; this opinion was driven by the amount of work required to run an RFP. RFPs were viewed as a necessary evil however, as executives recognized the need to obtain current pricing and to evaluate market options as they arise. On average, executives said that RFPs for defined contribution service providers should be conducted every five years (see Exhibit 15). Executives with multiple or very complex defined contribution plans were inclined to consider RFPs every 10 years while executives with one or two simple plans favored running the process more frequently.

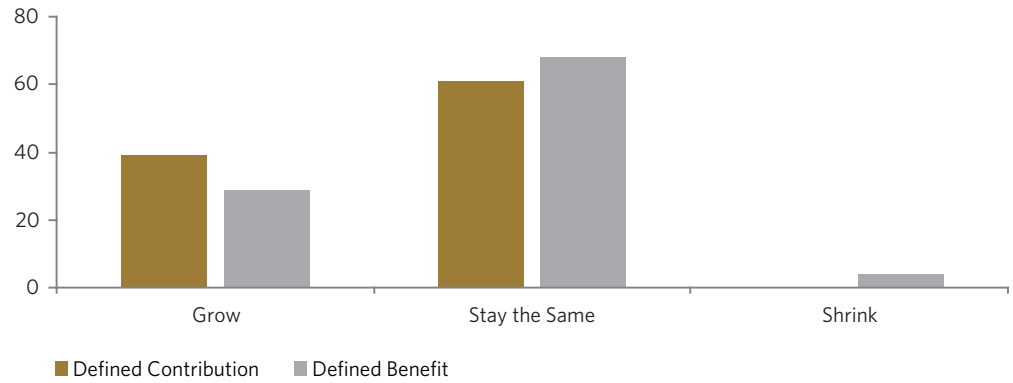
Exhibit 15: How Often Plan Sponsors Should Run RFPs for Defined Contribution Service Providers



Source: Finadium

Looking at their relationships with defined contribution custodians and record keepers, and with defined benefit custodians, 39% of executives thought their defined contribution relationships would grow in importance over the next two years (see Exhibit 16). Another 61% expected no change and no executive thought their defined contribution relationships would become less important. Likewise, 29% believed that their defined benefit custodial relationships would grow in importance. 68% expected them to remain the same, while only 4% thought this relationship would become less important over the next two years.

Exhibit 16: Plan Sponsors Expecting Their Relationships with Defined Contribution Service Providers and Defined Benefit Custodians to Grow, Shrink or Stay the Same (Percent)



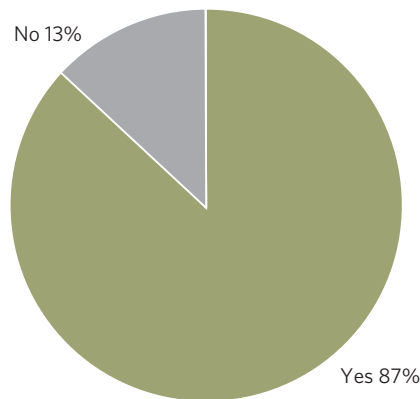
Source: Finadium

Managing Risk and Revenues in Securities Lending

While the vast majority of plans continue to lend securities, all have learned that the collateral pools associated with these programs carry more risk than they may have thought three years ago. Following actual losses or simply media reports of losses, and with interest rates at historic lows, plan sponsors are re-evaluating their existing securities lending programs. Some also continue to associate the healthy business of securities lending with decisions that led to collateral management losses; this has tainted the reputation of a well functioning part of the securities industry.

Executives surveyed for this report all recognize that securities lending programs carry both financial rewards and risks that need to be considered. 87% of executives said that their plans were currently engaged in a lending program, although half of this group said that they had recently reduced the amount of inventory they were lending (see Exhibit 17). A portion of these assets will return to the securities lending market as revenue opportunities become more attractive; others will stay away as executives look to redeploy their risk exposures elsewhere.

Exhibit 17: Plan Sponsors Engaged in a Securities Lending Program (Percent)



Source: Finadium

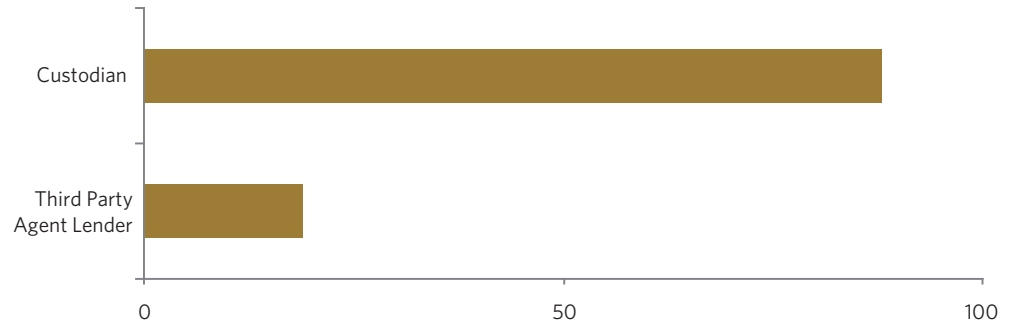
“Many systems are coming back to the drawing board on securities lending and realizing that there is no free lunch. We are not going to stay away because lending offers a nice income stream, but our collateral reinvestment guidelines are now less risky.”

Investment Officer, Public Fund

Intrinsic value lending, or making a return based solely on the value of the loan and not on the collateral reinvestment, has made a comeback. Executives spoke repeatedly about having reduced risk in securities lending and that collateral should be invested in T-bills or repo and considered part of the plan’s overall investment strategy. This is a change from the last five years when collateral was invested in more aggressive credit instruments leading to enhanced returns.

Custodians play a central role for the securities lending programs of plan sponsors; 88% of actively lending plans used their custodian as their primary or sole securities lending agent. This compares to 19% of plans using a third party agent lender (see Exhibit 18). In this respect, plan sponsors trend towards their custodians more than mutual funds, the other large pool of asset holders for securities lending programs; in a spring 2010 survey, Finadium found that 63% of large mutual fund managers used their custodian as their primary securities lending agent compared to 37% using a third party.

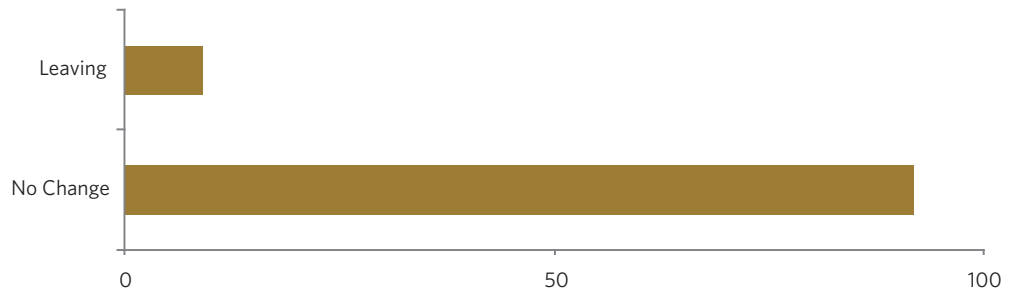
Exhibit 18: Securities Lending Agents of Surveyed Plan Sponsors (Percent)



Asset Management Relationships for Defined Benefit and Defined Contribution Plans

Changes in retirement plan structures signify changes for asset managers as well. To date the financial impact of plan changes on asset managers has been minimal due to few asset reductions. Between closures of defined benefit plans and fundamental changes in asset/liability structures, 9% of the DB plans surveyed have left or will leave their current managers over the next three years (see Exhibit 19); this figure does not include routine hirings and firings due to investment performance. As employers move to a DC structure however, the trickle may turn into a flood as the years pass by and DB assets are paid out. Most plan sponsors with closed programs note that they have not yet changed their defined benefit asset manager relationships but that they are aware of the inevitable end.

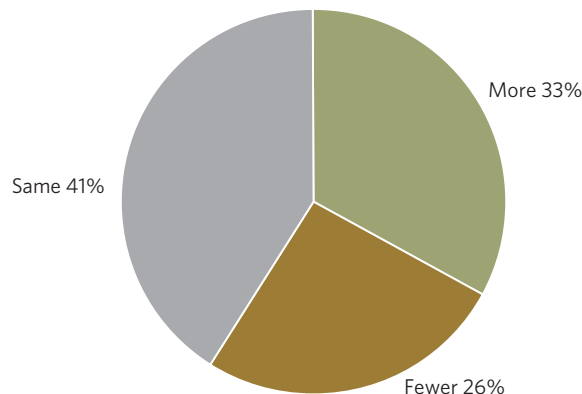
Exhibit 19: Defined Benefit Assets Leaving Their Current Asset Managers in the Next Three Years Due to Retirement System Changes (Percent)



Source: Finadium

For asset managers as a market segment, there is little to be concerned about in the short term: 74% of the executives surveyed said they are using the same number or more asset managers than two years ago (see Exhibit 20). The major increases are coming from investments in hedge funds strategies, as a number of plan sponsors prefer to make small investments across a large number of funds. Where plan sponsors are decreasing the number of managers with whom they work, the focus is on consolidating overlapping strategies or reducing exposure to plain vanilla equities.

Exhibit 20: Plan Sponsors Using More, Fewer or the Same Number of Defined Benefit Asset Managers as Two Years Ago (Percent)



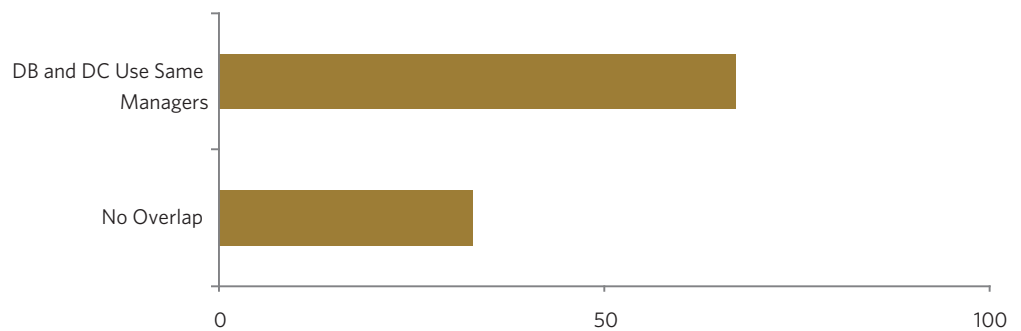
Source: Finadium

The expectation of a defined benefit plan's closure leads plan sponsors to several conclusions, including re-allocating assets to fixed income and other stable valued assets. For closed programs, the only variables now are retirement, death and survivor benefits; funding needs can be best met by developing an annuity investment strategy with a focus on fixed income.

“Since we closed our DB plan, we know our employees’ benefit today and can plan for that.”
Director, Corporate Plan

Assets that shift from a defined benefit to a defined contribution program will not disappear; they will simply move from concentrated asset pools to smaller individual accounts. Executives are concerned about this switch as it will lead to higher costs for program participants in the form of account maintenance and mutual fund fees. Of the plan sponsors surveyed, 67% use their current DB asset managers to also manage DC funds (see Exhibit 21). Several plans noted that they had made a deliberate decision to bundle their DB and DC asset management relationships, either to keep fees low or maintain current relationships because they were comfortable with the manager's investment options.

Exhibit 21: Plan Sponsors Using their DB Asset Managers to Also Manage DC Assets (Percent)



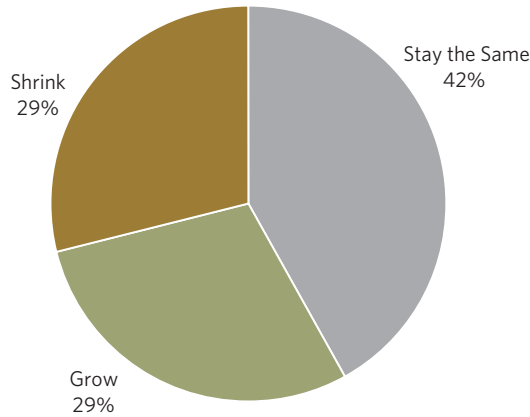
Source: Finadium

“We have good managers for our defined benefit program so why not use them for defined contribution management as well?”

Head of Investment Management, Corporate Plan

In the long run, 29% of respondents thought that the importance of their defined benefit asset management relationships would shrink. This would be driven by consolidating managers and implementing new asset allocation strategies resulting from revised asset/liability studies (see Exhibit 22). Of the remainder, 29% expected these relationships to grow while 42% expected no change.

Exhibit 22: Plan Sponsors Expecting Their Relationships with Asset Managers for Defined Benefit Programs to Grow, Shrink or Stay the Same



Source: Finadium

When discussing their asset manager relationships, executives were interested in looking for ideal investment structures to suit the needs of their plan participants. For defined contribution plans, this included a desire to move away from mutual funds as an investment structure; collective and commingled trusts or private mutual funds were seen as worthwhile alternatives due to lower costs and the ability of the employer to continue to provide professional management services. Using a pooled investment vehicle, executives believe the defined benefit custodian would assume additional responsibility for calculating and reporting a daily NAV for the defined contribution plan.

Balancing Cost Pressures with Employee Protection

As a core part of this study, executives were asked their personal thoughts about the value of their existing employee retirement offerings and whether they were making the right choices for their companies. Executives had strong, even passionate opinions about the value of defined benefit plans versus defined contribution. This was true whether the executive's employer was sponsoring a DC program or not.

For both private and public plans, the critical concern about defined contribution plans is that employees will not have enough money to retire when the time comes. There is also a strong sentiment that the vast majority of employees are not prepared to manage their own retirement money and programs to educate participants will not significantly improve results. At the same time, the challenge of keeping a defined benefit plan has proven too great for companies to bear, particularly when facing strong pressures from international competitors and domestic buyers looking to strip excess cost from their supply chains. Defined benefit plans provide the best social safety net, say executives, but they are simply too expensive to maintain.

“DB plans have a lot of social merit but they are just too costly.”

CIO, Corporate Plan

“The benefits we pay out are hefty. There has to be a change somewhere since the long-term is unsustainable.”

Operations Director, Public Fund

“The magic of compounding only works if you have a long-term savings horizon.”

Executive Director, Public Fund

While the dual concerns of cost and employee protection have led some plans to create unit trusts and other DC plans where the company retains asset management, the majority offer participants a selection of specified retirement options. This may help reduce the difficulties of asset management, but executives are almost uniformly certain that individual accounts will be less funded by employees than defined benefit plans and costs for employees will be higher.

Executives are particularly concerned that employees will not invest enough or start early enough in their DC plans. Like a defined benefit plan, DC plans need time to mature. Without sufficient assets, employees may retire without adequate funds or may choose not to retire at all. This second alternative will create difficulties for employers looking to bring on and train new employees but pressured to keep an aging workforce.

“With a retirement window of 25 to 30 years, there isn't as much time for a DC plan to grow as a DB plan will. This leaves less money for retirees.”

Executive Director, Public Fund

“If a DC plan is designed too cheaply in terms of the benefits that a company is providing, employees may not be able to retire that could mean they would stay with the company. That could have unintended consequences.”

COO, Corporate Plan

The alternative for employers having retirees with insufficient funds would be to put the cost onus on someone else; in most cases executives thought that this would be the government. This idea would result in a dramatically expanded Social Security program, which in turn would come back to companies and employees in the form of higher taxes. As one executive noted, “either we pay now or we pay later.” While neither scenario is desirable for the company nor is the uncertainty welcome for employees, the short-term benefits for companies that have cut their pension costs heavily outweigh long-term concerns for future retirees.

Company employees have had largely neutral responses to companies changing from defined benefit to defined contribution plans. This is driven by the fact that most current retirees are not affected by the program’s changes. Executives note that older retirees understand the implications of DB plan closures and that employers have lost some long-term employee loyalty. Most younger workers have no expectation of defined benefit retirement options and do not know what they have lost.

“I think we lost some long term employee loyalty when we closed our defined benefit plan.”

Director, Corporate Plan

Private Plans

Where a defined benefit plan was still the primary retirement choice, private plan executives had reserved opinions about defined contribution plans and, contrary to media reports, did not believe that a move away from a DB plan was inevitable. These executives thought that many of their peers were going to maintain defined benefit plans for new employees long into the future. In particular, corporate plans that had kept their DB programs felt that the news over disappearing DB benefits had been heavily overblown, and employers that froze DB plans had received substantially more press and notoriety than plans that had kept their programs intact.

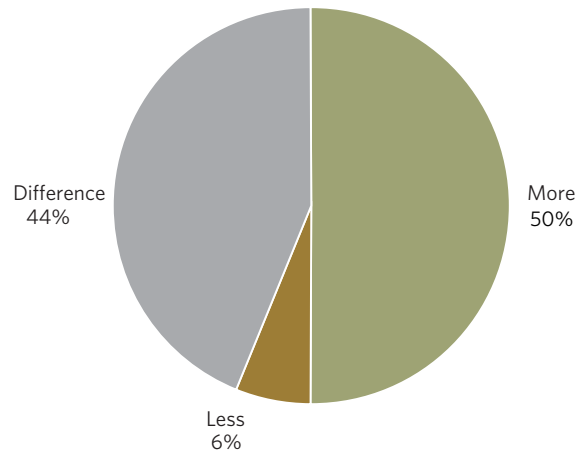
For private plans that had reduced or eliminated their DB plan, there was a general sense of resignation that although defined contribution plans were less beneficial for employees than a defined benefit offering, there was no financial alternative but to move towards the lesser option. These executives acknowledged that the strain on company balance sheets has been too large for firms to withstand, and that a combination of regulatory full funding requirements and the recent economic downturn have prompted plan changes whether they were preferred or not.

All survey respondents recognized that there is a finite number of dollars available for retirement benefits and that their companies must optimize spending where they find the greatest value. The cost derived by offering employees a defined benefit offering does not always appear to produce the desired rewards.

Many executives noted the importance of retirement benefits for competitiveness in hiring and keeping employees. Companies recognize that employees today may see a traditional defined benefit program with vesting rights as a detriment; the inability to leave a plan with full benefits before retirement age reduces a desire or imagined desire for employee mobility. Executives also noted that the increasing popularity of defined contribution plans is partially driven by employees who do not always appreciate the benefits they are receiving. A younger, more mobile workforce often wants to have the greatest control over their own investment assets, not always recognizing that a defined benefit plan can perhaps provide better results from those assets than individuals managing their own investments. This is a concern to executives we spoke with.

Whatever their choices, private sector executives feel positive that their selection of retirement plans makes them either more competitive as an employer or at least no worse than before. Retirement plans were viewed by 50% of corporate executives as an asset, while 44% thought that their retirement plans had no impact (See Exhibit 23). Numerous executives noted that although the plans offered employees may not be their personal preference, their companies were in line with larger trends and appeared no worse compared to their peers. Only 6% thought that their plans made them less competitive as an employer.

Exhibit 23: Do Retirement Options Make Corporations More or Less Competitive as an Employer, or No Difference (Percent)



Source: Finadium

Employers electing to offer only defined contribution plans recognize the important issues at play for their companies and retirees. They understand in order to generate enough wealth, employees must begin saving for retirement early and consistently throughout their careers. Corporate employers have placed a strong emphasis on education for DC participants to offset in part the loss of professional asset management.

A few employers have responded to the funding weaknesses of DC plans by seeking portable defined benefit programs where assets are managed by the company in a pooled format but employees have more ability to remove their own retirement assets at any time. Employers like the ability to continue managing assets professionally on their employees' behalf. From a financial perspective, portable DB plan types are more attractive to employers if an employee leaves the company before retirement age. However, portable DB plans fail to accomplish the major benefits of defined contribution plans: eliminating concerns about volatility and open liabilities. This concern has driven more employers towards DC plans and away from DB in general.

“All new employees are now in our portable DB program. This is cheaper for the company and good for employees wanting to escape golden handcuffs.”

Administrative Director, Corporate Plan

Public Plans

The concerns of public fund executives echo those of their private sector colleagues although with a greater degree of tension. Whereas the private sector needs mostly to look internally to solve their problems, public funds must contend with a wide range of actors and motivations, including feuding legislators and uncertain public budgets. These issues range from mild to severe, depending on the funding level of the program and the financial stability of the public employer.

Public plan executives were particularly concerned with hiring and retention of new employees if benefits were reduced. They noted that robust benefits have traditionally made up for lower pay packages than employees can earn in the private sector. Some executives also alluded to competition with bordering states or municipalities that may offer similar pay but improved retirement benefits. Among this group, an air of uncertainty surrounding the programs drove a concern that potential employees would get anxious and look elsewhere. For this reason executives hoped to quickly resolve any questions about what types of benefits they could offer to new hires.

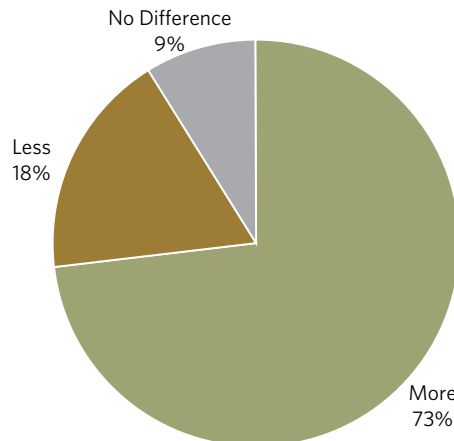
“It doesn’t help our employees to hear about unfunded ratios of plans. The sooner this gets resolved the better.”

Senior Executive, Public Fund

The public plan executives we talked with reported a range of funding levels for their programs. This was a major determinant with how concerned the executive was with the future of defined benefit versus defined contribution programs. Well funded plans were not heavily engaged with legislatures or municipalities looking to cut additional funding or benefits. Underfunded plans naturally were very concerned. Executives also mentioned changes to projected actuarial rates of return, and this was considered when commenting on the funding status of a plan.

In comparison to their private sector peers, 73% of public sector fund executives felt that their retirement plans made them more competitive as an employer as opposed to only 50% in the private sector (see Exhibit 24). The 18% of public sector executives that said their retirement plans made them less competitive blamed recent reductions in benefits. Like private plan executives, these professionals also noted that they saw little choice but to reduce benefits given current funding conditions.

Exhibit 24: Do Retirement Options Make Public Funds More or Less Competitive as an Employer, or No Difference (Percent)



Source: Finadium

The public plan executives we spoke with had stronger opinions than their private sector peers about the lasting importance of defined benefit programs. While recognizing the financial difficulties that DB plans are inflicting on municipalities and states, they firmly supported the notion of a defined benefit retirement option. As legislators and elected government officers question plan executives on the possibility of moving to a defined contribution plan offering, executives have responded by showing that DC plans would not produce significant cost benefits in the long run. Once this is made clear government officials tend to pull back on demands to change the current DB solution. This opinion is largely echoed by the private sector; the main benefit is the reduction of volatility.

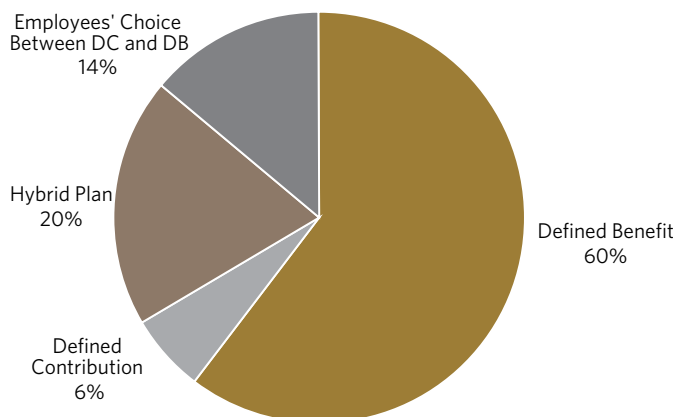
“In a period when legislators can’t fund their budget, it may not be the best solution to move to a DC plan if the decision is cost driven.”

Executive Director, Public Fund

Public plan executives also commented that defined benefit programs were key employee hiring and retention tools. They believed that the base salaries public employers offered were too far below the private sector to encourage strong applicants, making benefits including retirement packages a strong incentive for new hires to take the job. Still, the most senior executives we spoke with at public plans were concerned with the cost of defined benefit programs. This concern will not be going away anytime soon, particularly as retirement costs are so frequently discussed in the media and cited as a primary reason for additional state and municipal tax revenue requests.

Comments from survey participants echo public pension offerings across the US. Data collected by Finadium show that out of 87 plans, only 60% now offer a defined benefit plan to their new employees (see Exhibit 25). Most noticeable is the decision by 20% of these plans to move to a hybrid program combining elements of both defined benefit and defined contribution plans: in looking to meet the needs of a workforce that relies on employers for retirement benefits but is not necessarily able to manage individual retirement accounts on its own, plans that combine the portability of defined contribution with the professional management of defined benefit may become the best choice for both employers and employees.

Exhibit 25: Retirement Plans for New Employees of Public Retirement Plans (Percent)



Source: Finadium

Sample: 87 plans

Note: Hybrid Plans include both defined benefit and defined contribution components.

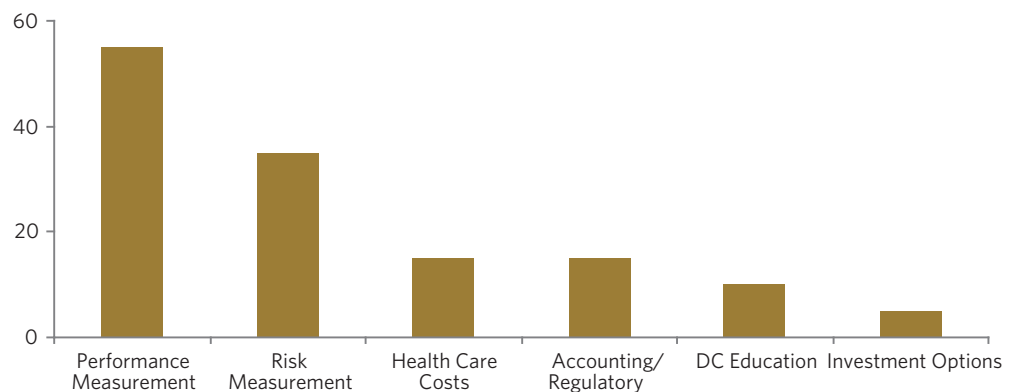
Meeting the Big Challenges: How Service Providers Can Help Create a Financially Secure Future for US Retirees

Executives surveyed for this study at both public and private pension plans seek assistance from their service providers with their single most pressing question: how do employers create an affordable, comfortable and reasonable retirement for their current and future employees? This complex question has no simple answer in today's environment as corporate, government and personal budgets indicate that the traditional retirement supports of the recent past are under severe strain. However, arriving at one or more functional solutions is a primary challenge for pension plans and their service providers.

Plan executives believe that service providers can help by conducting research that looks empirically at the costs and benefits of diverse retirement plans. Sponsors want assistance in weighing the benefits of defined benefit and defined contribution plan options against each other from more than just the financial aspect; they want to know the long-term impacts to their companies, states, municipalities and employees if tomorrow's retirees cannot truly afford to retire. These considerations include the traditional three stools of retirement security: defined benefit plans for employees, Social Security and personal savings. There is little question in the minds of plan executives that they will either pay now for their retirees' benefits or that they, or society, will pay later. The main questions are how much, and how interrelated, are those two alternatives and how far will the implications stretch.

After the big picture question about the structure of retirement programs, executives identified a range of specific needs for the future of their current programs (see Exhibit 26). These centered on the necessity of managing risk for defined benefit plans and providing greater education and investment options for defined contribution participants. Services that executives expected to need more of included:

Exhibit 26: Service Areas Where Plan Sponsors Expect to Need Greater Assistance in the Future



- Performance measurement (55%) and risk management (35%), particularly for illiquid investments in their defined benefit programs. Executives pointed out that more evaluation is needed to provide Boards and senior executives additional comfort with alternative strategies. Executives hoped that their defined benefit custodians would provide these services while recognizing that in some instances new services and relationships may become necessary in order to obtain the depth of information that will be required.
- Support for understanding and responding to new accounting regulations including FAS 157 (15%). Defined benefit custodians are the first resource that plan executives turn to for help on their accounting matters.
- Employee education regarding investments within defined contribution programs and additional education concerning employee behavior while in a program (10%). A number of plan sponsors have already moved forward in providing employee tools but believe that more will be essential in the future. Executives also hope to gain a greater assurance that their employees are investing wisely.
- Managing the de-accumulation of defined contribution programs (5%). One idea is to promote insurance or annuities vetted by employers that take the risk out of ongoing management with defined contribution plans. Plan sponsors cannot currently offer annuity type products alone; sponsors are however looking to partner with insurance companies to refer participants without taking on unwanted internal risk.

In addition to assessing retirement costs and options, plan executives are also seeking new ideas and initiatives when managing health care and retirement benefits as expressed by 15% of the plan executives. According to data from the Employee Benefits Research Institute (EBRI), the percentage of employees participating in health insurance programs at medium and large companies has dropped from 97% in 1980 to 63% in 2009 (see Exhibit 27). This indicates an unmet need for the 37% of employees who opt out of or are not offered health care coverage through an employer. Plan executives are fully aware that health care offerings to retirees are an unfunded pay-as-you-go kind of benefit, and that there are no regulatory funding requirements.

Exhibit 27: Percentage of Employees Participating in Health Insurance Benefit Programs, Medium and Large Private Establishments (Percent)



Source: EBRI Databook on Employee Benefits

The next 30 years will be a challenging time for employees as a greater burden of funding retirement benefits shifts from private companies and governments to individuals. Plan executives recognize that defined benefit programs can manage assets much more effectively than individuals within the defined contribution framework that exists today. And yet, the ideal defined benefit program may be too costly or volatile for employers to afford. Finding effective mechanisms for reconciling the cost of retirement and the ability of employers to provide a secure financial future for employees is a long range challenge for plan sponsors and their service providers alike.

About BNY Mellon

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation. BNY Mellon is a global financial services company focused on helping clients manage and service their financial assets, operating in 36 countries and serving more than 100 markets. BNY Mellon is a leading provider of financial services for institutions, corporations and high-net-worth individuals, providing superior asset management and wealth management, asset servicing, issuer services, clearing services and treasury services through a worldwide client-focused team. It has \$21.8 trillion in assets under custody and administration, \$1.0 trillion in assets under management, services \$11.6 trillion in outstanding debt and processes global payments averaging \$1.5 trillion per day. Learn more at www.bnymellon.com.

About Finadium LLC

Finadium is a research and consulting firm focused on financial markets. In its research practice, the firm assists brokers, custodians, hedge funds, private equity and technology firms with understanding the market for asset services and in maximizing the effectiveness of their resources. Finadium research is available on a subscription basis. Finadium also conducts consulting assignments in trading and asset services for plan sponsors, mutual funds and service providers in the financial markets industry. For more information, please visit our website at www.finadium.com or contact Josh Galper, Managing Principal, Finadium, LLC (978) 318-0920



BNY MELLON
ASSET SERVICING

© 2010 The Bank of New York Mellon Corporation.

All rights reserved.

The Bank of New York Mellon – Incorporated with limited liability in the State of New York, USA. Head Office: One Wall Street New York, NY 10286, USA. London Branch registered in England & Wales with FC No 005522 and BR No 000818 - Registered Office at One Canada Square, London E14 5AL, authorised and regulated in the UK by the Financial Services Authority.

This report, which may be considered advertising, is provided with the understanding that it is for informational purposes only and does not constitute the rendering of legal, tax, accounting or other professional advice by Finadium LLC, The Bank of New York Mellon or any of their affiliates. Finadium LLC and The Bank of New York Mellon do not guarantee the accuracy of any information contained herein and cannot be held liable for any errors in or reliance upon this information.

