



SURVEY HIGHLIGHTS:

*Defined Contribution Consulting
Support and Trends*

DC SURVEY

2009

For Institutional Investors Only

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Defined Contribution Consulting Support and Trends

Survey Participation: 32 investment consulting firms participated:

Arnerich Massena & Associates, Inc.
 Bidart & Ross, Inc.
 Blue Prairie Group
 Callan Associates
 Clearbrook Investment Consulting
 Concord Advisory Group Ltd.
 Curcio Webb, LLC
 DeMarche Associates, Inc.
 DiMeo Schneider & Associates, LLC
 Ellwood Consultants
 Ennis Knupp & Associates
 EnVestnet Asset Management
 Evaluation Associates
 (A Milliman Company)
 Hewitt Financial Services
 Ibbotson Associates
 Independent Fiduciary Services, Inc.
 JPMorgan Investment Analytics & Consulting Group
 The Marco Consulting Group
 Mercer Investment Consulting, Inc.
 Mesriow Financial
 Morningstar Associates, LLC
 NEPC, LLC (New England Pension Consultants)
 Plan Sponsor Advisors
 RBC Wealth Management
 Rocaton Investment Advisors, LLC
 Rogerscasey
 Russell Investment Group
 R.V. Kuhns & Associates, Inc.
 Towers Perrin
 Watson Wyatt Investment Consulting
 Wilshire Associates Inc.
 Wurts & Associates, Inc.

The PIMCO DC Practice conducts its annual Defined Contribution Consulting Support and Trends Survey to help our clients understand the ideas, outlook and consulting services available in the DC marketplace. Given an ever-increasing dependence on DC plans as the primary source of retirement income, this survey aims to identify how the leading DC consultants help sponsors design and deliver successful plans. For our 2009 survey, we focused on how consultants help with asset allocation strategy support, investment structures and participant defaults. The survey captures data, trends and opinions from 32 consulting firms across the U.S. Together, these consultants serve more than 1,600 plan sponsors with aggregate DC assets in excess of \$1.6 trillion.

Among its key results, the survey found that consulting firms are:

- Modestly increasing their DC consulting resources as DC business continues to grow;
- Supporting clients in creating custom asset allocation strategies, including designing glide paths;
- Promoting diversification and inflation hedge by adding securities such as Treasury Inflation-Protected Securities (TIPS), real estate investment trusts (REITs) and commodities to plans;
- Evaluating retirement income guarantee investment option products for plans; and
- Helping clients manage through turbulent markets, as they have over the past year, by strengthening principal preservation and reducing overall investment risk.

Highlights:

- Consulting firms report an increase in their DC client base, which grew to a median of 35 clients in 2009 from 32 in 2008.
- The majority of firms (59%) have a dedicated DC consulting team. The median team size increased by one person since last year, and includes five consultants, four analysts and one support person. Notably, those firms without a dedicated DC team stated no intent to create one.
- The vast majority of firms (94%) believe target date strategies will continue to be the most prevalent form of investment default in DC plans. Two thirds of firms (66%) actively promote custom target date strategies to their clients. Over three quarters of the firms (76%) offer target date asset allocation (glide path) creation to clients. Nearly all of the firms (91%) will act as a fiduciary for the custom investment services they provide, while about half (45%) will act as an investment manager for custom strategies.
- Among consultants supporting clients with custom strategies, the median number of clients served is four (note: the median number of clients for all types of custom asset allocation is 43). Plan size for custom strategies ranges from \$1.3 million to many billions, with a median plan size of \$200 million.

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- Consulting firms note the greatest growth over the last year in the following DC consulting services: manager selection and monitoring, total plan cost/fee studies, target date asset allocation (glide path creation), investment structure analysis and investment policy documentation.
- All firms believe providing inflation protection in DC plans is somewhat important to critical. Consultants note the top three inflation hedge securities as Treasury Inflation-Protected Securities (TIPS), commodities and real estate investment trusts (REITs).
- Consultants report that given market turbulence and the economic downturn, plan sponsors are taking or likely to take the following actions: adding or considering adding a treasury money market, modifying their stable value investments, reducing or eliminating the company match or contribution, adding or considering adding inflation protection, plus they are reconsidering or revising their glide path or asset allocation (e.g., to become more conservative or diversified).
- Over three quarters of the consultants (78%) say their clients are somewhat likely to highly likely to add a guaranteed investment option to their DC plan in the next two years. Lifetime income (e.g., guaranteed minimum withdrawal benefit) followed by a fixed annuity are considered the most attractive products by the majority of consultants. However, concerns with insurance company default risk, cost, or transparency were noted by the majority of the consultants as primary concerns that may stop plan sponsors from offering guaranteed investment option products.

Detailed survey results are grouped into three sections:

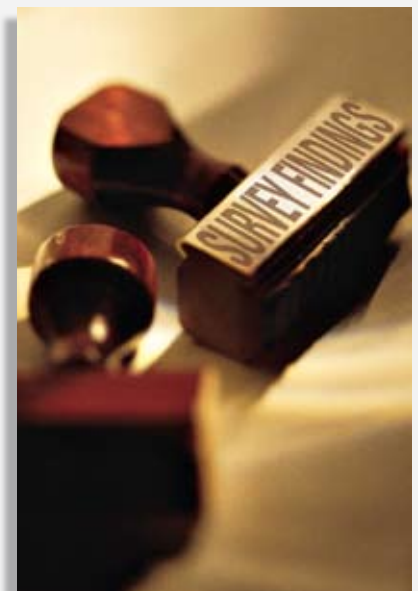
1. Data on the consulting firms' DC business;
2. Asset allocation support strategies;
3. Trends in defaults and investment structure.

DC Business

- The majority of consulting firms have fewer than 100 DC clients. On average, the firms support 57 clients, yet the median is 35. This compares to 49 and 32 respectively in 2008.
- The firms serve clients with DC plan assets totaling \$56 billion on average and \$20 billion at the median. This compares with \$47 billion and \$15 billion respectively in 2008.
- There was a slight decrease (69% to 59%) in the number of firms that report having a dedicated DC consulting team in 2009 versus 2008. However, the increase from 38% in 2007 is significant. Notably, those firms without a dedicated DC team (41%) stated no intent to create one.
- Firms that have a dedicated DC team are staffed, at the median, with five consultants, four analysts and one support person. This is an increase of one person from 2008.
- All but one of the firms surveyed (97%) provide manager selection and monitoring services. In addition, most provide investment policy documentation (94%), total plan cost/fee studies (84%), guaranteed option/annuity product evaluations (84%) and investment structure analysis (84%). Over three-quarters provide DC record-keeping searches (81%), balanced/target risk asset allocation creation (81%) and glide path creation (75%). Nearly three-quarters of firms (72%) provide both target risk and target date glide path management.
- When ranking the areas of greatest growth over the past year, over three-quarters of firms (76%) said manager selection and monitoring was the most common. This is followed by two-thirds of firms (66%) reporting total plan costs/fee studies and just over half (52%) reported target date asset allocation (glide path) creation and investment structure analysis.
- Finally, over two-thirds of firms (69%) have authored articles recently. The most common topics addressed include: target date and glide path management, annuity/income for life options, cost analysis and fee benchmarking, and Washington updates/legal issues.

Asset Allocation Support Strategies

- The median size of plans using custom asset allocation strategies ranges from \$125 million to \$4 billion. This compares to \$90 million and \$2 billion respectively for 2008. The overall median of plan size is \$200 million in 2009.
- The majority of consulting firms (84%) offer DC custom-strategy consulting, virtually the same as 2008 (84%). For those who offer such services, most charge a retainer (52%) or project fee (52%) or asset-based fee (48%). Only one firm said it charges an hourly consulting rate.
- The majority of firms (66%) actively promote custom target date strategies and their own consulting capabilities, similar to 2008 (68%). For the past two years, no firm reported discouraging the use of a custom strategy approach.
- The vast majority of firms (82%) believe it makes sense for plan sponsors to create their own custom strategies for plans with \$500 million. Notably, nearly half (48%) believe custom strategies make sense for plans with \$200 million. Many believe they make sense at even smaller asset levels.
- Consultants believe that the top three reasons why a plan sponsor would choose not to implement custom strategies are difficulty of set-up (69%), insufficient asset size (66%) and lack of staff (59%). Last year, the top three reasons were insufficient asset size, fear of liability and difficulty of operational set-up.
- The vast majority of firms (91%) accept fiduciary responsibility for the custom investment services they provide. This compares to 86% in 2008 and 78% in 2007.
- Nearly two-thirds of firms (61%) use proprietary software for asset allocation modeling. Over half of firms (55%) also use an off-the-shelf/commercially available software program. This is very similar to 2008 results where 62% reported they used their own proprietary software.
- The vast majority of firms (97%) create their own capital market assumptions. Nearly half of these (47%) do so by using a forward-looking approach using current risk premia levels. Other consultants (27%) use historical with subjective adjustments, while the remaining (27%) rely on other approaches with some combination of client-specific risk exposure factors, global CAPM as well as market and macroeconomic factors.
- Nearly all firms (97%) apply Monte-Carlo simulation analysis for DC investment offerings, followed by efficient frontier analysis (77%). Few firms (17%) use the Black-Litterman approach, while others consider holdings-based analysis, LDI and advanced optimization techniques.
- All firms account for inflation in their asset-allocation modeling. When accounting for inflation, almost half (48%) of firms assume a static inflation rate, while a smaller percentage (41%) assume the inflation rate as a dynamic variable. Only four firms (15%) assume that asset-class returns asymmetrically adjust for changes in inflation. This compares to 36%, 36% and 28% respectively for 2008.
- Almost two-thirds of firms (63%) regard Treasury Bills as the risk-free asset* in DC asset-allocation modeling, while the remaining nine firms (28%) regard TIPS as the risk-free asset*. Notably, compared to 2008 five more firms now look to TIPS as the risk-free rate*.
- Nearly two-thirds (66%) believe that an Liability Driven Investing LDI approach is applicable when designing an asset allocation structure within a DC plan. This was exactly the same in 2008. About a fifth of firms (19%) were uncertain whether LDI applies, while a smaller percent (16%) believe LDI does not apply in 2009.
- Quarterly rebalancing of asset allocation strategies were suggested by the largest percent of consultants (40%). Others advise rebalancing only when portfolios reach an established deviation or other metric (37%). Only three firms (10%) believed



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strategies should be rebalanced either annually or on some other basis (e.g., target bands, monitoring of demographics, etc). No firm believed daily rebalancing should occur. Notably, in 2008, only upon an established deviation or other metric was suggested by only 14% of the consultants.

- Consultants were evenly split on whether tactical asset allocation is an important consideration for creating glide paths. Half of the firms felt that it's important, with a one saying it's critical (3%) and others saying it's somewhat important (47%). The other half (50%) said that tactical asset allocation is not important.
- Over two-thirds of the firms (71%) believe that re-enrollment will be very or somewhat common in the future, while some firms believe it will not be very common (16%) and others say they are unsure (13%). This compares to 66%, 34% and 0% respectively for 2008.
- When clients introduce target date strategies to their plan participants, the majority of consultants (61%) report that plans typically map by participant age. Almost a quarter (23%) said they typically leave the other strategies in place. Few (10%) map based on strategy correlation. These results are virtually the same in 2008 at 59%, 22% and 7% respectively.
- Nearly all firms (87%) do not offer their own proprietary investment products. Only four firms (13%) do offer proprietary investment products. Among the majority that do not offer proprietary products, no firm said they intend to introduce products in the future.
- A long list of record keeping firms have been used to establish custom target strategies. The most commonly identified record keeping firms were Fidelity, JPMorgan, Charles Schwab/401(k) Company, ING/CitiStreet, Wells Fargo/Wachovia and Hewitt.
- The most commonly used record-keeping approach by DC plan sponsors is the "Paper" or Model Portfolio (i.e., allocation on record keeping system) followed by the Trust Portfolio (i.e., funded trust account) method.
- The majority of consultants believe target date or target risk strategies that use a multi-manager lineup of passive and active approaches will be selected most often by plan sponsors.
- The most important factors that consultants believe plan sponsors should consider as they evaluate target date or target risk strategies are fees (78%), the glide path (63%), breadth of underlying investment options (59%) and performance (56%). Half of the consultants said that return volatility is a top factor, while 44% ranked the probability of meeting a retirement goal as most important. Just over a third of firms (34%) felt considering active vs. passive is an important consideration. Brand name or the proprietary products of the DC platform provider were the lowest ranked factors at 16% and 13% respectively.

DC Defaults and Investment Structures:

- Amid the current financial crisis, plan sponsors are most likely to add or consider adding a Treasury money market fund (61%), modify stable value options (61%), and reduce or eliminate company contributions or matching (52%).
- Nearly half of consultants (48%) said that plan sponsors are adding or considering inflation protection such as TIPS or adding a guaranteed investment option product to the plan (e.g., lifetime income or annuity). Just over a third (35%) are reconsidering glide path or asset allocation mixes (e.g., to a more conservative or diversified approach), while just under a third (32%) are revising or likely to revise their glide path or asset allocation mix. A few reported considering adding a hybrid DB/DC plan (e.g., contribution to money purchase), or other actions such as reconsidering re-enrollment.
- Firms largely agree (94%) that the most common DC-plan default for the next several years will be target date strategies. This compares to 79% in 2008. Target risk ranked second. The majority believe stable value and guaranteed annuity products will likely be the least common default. Managed accounts were viewed in the middle as neither likely to be the most or least common.

- Over half (53%) of firms believe Collective Investment Trust (CIT)'s are critical or very important for serving their DC clients. An additional 34% believe they are mildly important. Only one firm (3%) does not see the benefit of CITs, while a few believe it depends on plan size or other variables.
- Over half (53%) of investment consultants believe ETFs have no place in DC plans, while 13% believe they do have a place. Over a third of firms (34%) believe ETFs may have a place in DC plans.
- A majority of firms (72%) believe that there will be an increase or significant increase in the use of passive strategies in DC plans in the future. The remainder of firms (28%) believe the allocation to passive management will remain generally the same.
- Firms believe, given the standard core lineup in DC plans, TIPS (88%) followed by emerging-markets equity (69%) and then REITs (66%) would bring the most value as added asset classes within DC plans. In 2008, firms rated TIPS, high yield and global fixed income (hedged) as the top three needed asset classes. Other assets that followed the top three in the 2009 survey include: commodities (59%), high yield debt (56%), guarantee investment option or annuity products (53%) and absolute return strategies (44%).
- Over one-third (34%) have not seen the use of illiquid investments in DC plans and do not expect this to become an area of demand. A quarter of firms (25%) anticipate increased use of illiquid investments in DC plans. Over a quarter of firms (28%) believe use of illiquid investments will remain flat, while the balance (13%) expect a decrease in the use of illiquid securities.
- The vast majority of firms (84%) believe it is critical or very important to provide inflation protection in a DC plan. This is up significantly from 2008 when only two-thirds of firms (66%) believed inflation protection was critical to very important. Only (16%) believe inflation protection is somewhat important, while no firms said it is not important. In 2008, three firms said inflation protection was not important in DC plans.
- All consultants (100%) rated TIPS as providing the most inflation hedge, followed by commodities (68%) and REITs (61%). These were the same inflation hedge securities that were identified as most effective in 2008.
- The vast majority of firms (78%) believe over the next two years it is somewhat to highly likely that clients will add guaranteed income as an investment option to their DC plans. Only seven firms (22%) believe it is unlikely that sponsors will add guarantee investment option products in the next two years.
- Consultants said that the products most likely to attract client interest were guaranteed minimum withdrawal benefits (84%), followed by fixed annuity products (65%). A payment-stream product ranked as the third most attractive (35%). Results were similar in 2008, when the top two choices were guaranteed-minimum benefits and payment stream products.
- Consultants' primary concerns with offering guaranteed income products include insurance company default risk (84%), cost (72%), transparency (66%) and fiduciary oversight (59%). Other concerns include: insufficient government support (e.g., safe harbor, regulatory clarity), lack of participant demand, monitoring/benchmarking concerns and selection criteria.

Related Survey

In the separate PIMCO 2009 DC Recordkeeping Survey of thirty recordkeeping firms, the vast majority (93%) stated that they support custom asset allocation strategies (i.e., open architecture or mix-of-core). Of the twenty eight firms that said they support custom strategies, the Model Portfolio (i.e., allocation on record keeping system) is the most common operational approach used by their clients (71%), followed by unitization of the underlying funds by an external trust company (36%) or unitization of the underlying funds by an internal trust company (29%).

About PIMCO DC Practice:

The PIMCO DC Practice is based in Newport Beach, and is dedicated to promoting effective DC plan design and innovative retirement solutions. Our team is pleased to support our clients and broader community by sharing ideas and developments in DC plans in the hopes of fostering a more secure financial future for employees of corporations, not-for-profits, governments, and other organizations.

If you have a topic you'd like to discuss, please contact your PIMCO representative or email us at pimcodcpractice@pimco.com. We're interested in your ideas and feedback!



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Steve Ferber
CIT Strategist and
Account Manager



Christina Stauffer, CFA
Platform Provider Services



Bret Estep
Stable Value Services



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