

FOR IMMEDIATE RELEASE

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WALTHAM, MA, September 24, 2007 – A powerful combination of structural, regulatory, and accounting changes is impacting the private sector plan sponsors to which institutional investment managers market, and as a result, those who trawl the \$2.3 trillion pool of private sector defined benefit (DB) assets¹ are facing profound changes to their marketplace. **The challenge for institutional asset managers is to discern what represents a new frontier, and what represents familiar ground.**

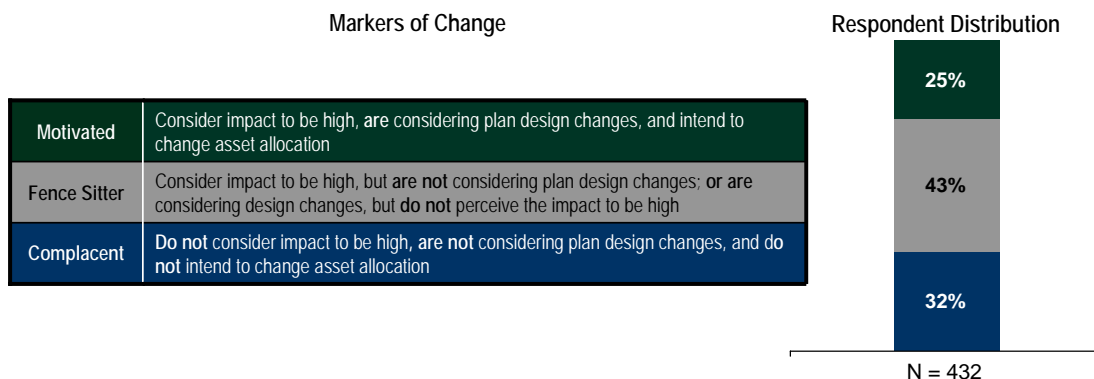
Chatham's research suggest that many of the dire predictions that were made upon the passing of PPA and the adoption of FAS 158 concerning the fate of private sector defined benefit plans have yet to come to pass. However, the world for investment managers is different. The difference is defined by how both institutional investment managers and investment consultants are reacting to the new pressures and challenges faced by one of their core constituencies – the private sector plan sponsor. As a result, there will be winners and losers.

"The results from the research were surprising. Despite the turmoil in the marketplace, plan sponsors appear to be taking a very pragmatic approach to, what many perceive to be, landmark regulatory and accounting rule changes. Additionally, attitudes and intended actions are largely defined by individual facts and circumstances rather than homogeneous consensus. In contrast, investment managers and consultants seem more certain of the fate of the corporate DB sponsor than of their own future prospects," noted Joshua Dietch, Managing Director at Chatham Partners.

Key findings from the research include:

Defining Opportunity

- Opportunity is often defined not only by ability to act, but by willingness to act. Chatham's research identified three primary markers of change. They include: intention to make plan design changes; intention to change asset allocation; and the perception that the regulatory reforms and accounting rule changes associated with PPA and FAS 158 will have a meaningful impact on their plan.



¹ Federal Reserve Board, [Flow of Funds Accounts of the United States](#), June 7, 2007, p. 103.

Defining Opportunity (continued)

- Chatham's research suggests that two-thirds of the DB market is in transition – one-quarter of respondents indicate that they are intending to make significant changes to their DB programs (either through considering changes to their plan design or adjusting their asset allocation), and another 43% illustrate a degree of uncertainty, indicating that they are still considering the impact that PPA and FAS 158 will have on their plans. To asset managers, there are profound implications: while there is clearly a core constituency committed to their DB plans (sponsors classified as "Complacent"), the lesser levels of commitment professed by others suggest that the DB plan has become less strategic in its importance as a benefit ("Fence Sitter" and "Motivated" sponsors) and of greater importance as a risk that requires mitigation.
- Intended actions must align with a plan's ability to take action; a plan's funding status is commonly aligned with its investment objectives. Mid-market sponsors (\$100 MM - 1 BN) are more concerned with the implications of both PPA and FAS 158, and their funded status may also put them in a position to address their concerns. These plans, generally better funded than smaller plans (<\$100 MM), appear more inclined to act than larger, generally well-funded plans (>\$1 BN). Not surprisingly, mid-market sponsors are somewhat split into those that are focused on funding-related objectives and those that are more focused on producing more consistent, less volatile returns.

Competition is Emerging for the Role of Trusted Advisor

- Managers and consultants expect that search activity will increase given perceived high levels of interest in new products, tools, and approaches for managing DB plans. However, the realized level of search activity to date, for many, has been less robust than hoped for, as plan sponsors appear less committed to changing their current asset allocations. Furthermore, roughly half of respondents appear disinclined to affirm their intent to make changes at all.
- Consultants would appear to be well positioned to be the natural beneficiary of any increased activity resulting from both PPA and FAS 158. The near-term complexity brought on by both changes (asset / liability studies, asset allocation / reallocation, and sponsor education) will likely spur usage of consultants by plan sponsors. However, plan sponsors are not looking solely to consultants as trusted advisors - managers also cite increasing actuarial and consulting resources to provide a more holistic approach to client service. The implication is that there is a potential battle brewing for the hearts and minds of the plan sponsor for the role of trusted advisor.

PPA is a Boon to the DC Market, but DC is not a Panacea for Managers

- PPA is universally viewed as a favorable accelerant to the growth of the DC market. While the trend is favorable across the board, it is interesting that for respondents who also offer a DC plan, their actions and intentions are often colored by the status of their DB plan. Key provisions of PPA provide regulatory safe harbors and encouragement to plan sponsors to offer automatic enrollment and contribution step-up and the use of investment advice and lifecycle funds will spur additional contributions and improve overall asset allocation. Furthermore, those with DB plans that either have closed to new entrants, frozen, or are in the process of terminating are more likely to have already implemented many of these features, or else they intend to use them or are considering implementation.
- Cross-selling into the DC space by institutional asset managers has been lacking. Two-thirds of the managers surveyed indicate that the consultants they target are the same for both DB and DC, but despite this overlap, the overwhelming majority of managers do not leverage these opportunities. In spite of this, managers are optimistic about both their opportunities and the level of importance this initiative will take on. Favorable factors driving their optimism include the DB relationships they presently enjoy, an increased focus on institutional quality investing in the DC market, and price compression.

PPA is a Boon to the DC Market, but DC is not a Panacea for Managers (continued)

- Institutional managers believe that one of their best opportunities for making inroads into the DC marketplace is through the marketing of lifecycle funds. Managers point to DB-like characteristics such as active risk controls, overlay strategies, and glide path development as areas where their particular skill set brings value to lifecycle fund management. However, not everyone can be a lifecycle fund manager – although the assets managed in lifecycle funds are increasing rapidly, there are at least 50 managers currently in the marketplace. Furthermore, an analysis of top DC recordkeeping platforms reveals that 57% of assets are recordkept by retirement service providers whose investment management affiliates also manage lifecycle funds, indicating that the most fertile opportunities may be largely staked out.

Conclusions

The days for institutional asset managers that manufacture the typical active and index beta products that dominate the market today may be yielding the future to manufacturers that can generate alpha across a variety of both traditional and alternative asset classes in a risk-controlled manner. Managers interviewed pointed to the likelihood of a barbell effect, where both the scale of multi-discipline asset gathers and the nimbleness of adaptable managers with unique products are equally valued. The implication is that there will be a thinning of the middle among managers with high-beta correlations, however competent. Additionally, niche firms that lack the resources of larger firms or are outside the current of prevailing investment strategies will also suffer, as their particular expertise may fall in and out of fashion.

Differences between winners and losers will be nuanced, while the challenges faced by all institutional managers are not. In the new frontier, regulatory and accounting factors driving plan sponsor behavior have changed, but the underlying market dynamics should be viewed as familiar ground. The practical impact of PPA is that pensions must be fully funded and can no longer sit on the back burner. In time, plan sponsors will look to their managers for new and innovative solutions that defy mediocrity and produce desired outcomes. The winners in all of this will do just that.

The 118 page report's foundation is in-depth online surveys completed by 656 plan sponsors affiliated with corporate Defined Benefit and Defined Contribution plans ranging in size from 250 employees to more than 10,000 employees. Additionally, Chatham Partners conducted 36 telephone interviews with leading investment managers and retirement services providers and 39 investment consultants.

Chatham Partners, based in Waltham, Massachusetts, provides strategic advisory services and market research to the financial services industry.

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