TOWERS WATSON

Asset Allocations in *Fortune* 1000 Pension Plans as of Year-End 2011

By Erika Stoner and Brendan McFarland

Asset allocations in defined benefit (DB) plans strongly affect overall asset performance, funded status and funding volatility as well as the sponsor's cash cost and accounting expense over time. For interested parties, such as participants, creditors, investors and regulators, the plan's asset allocations suggest its risk exposure and long-term cost. The Financial Accounting Standards Board began requiring more detailed disclosures for fiscal years ending after December 15, 2009, and we have been analyzing these disclosures ever since.

This third Towers Watson analysis of the asset allocations of *Fortune* 1000 pension plan sponsors looks at allocations by asset class and valuation level. To enable users to assess the way fair value is measured, companies must disclose a valuation level for each major asset category:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities (typical for Treasury securities and the common stock of large U.S. companies)
- Level 2: Unadjusted quoted prices for similar assets in active or inactive markets, or other observable inputs (common for corporate debt)
- Level 3: Unobservable inputs supported by little or no market activity, such as an expert appraisal of a real estate holding[1]

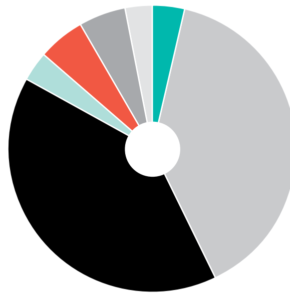
The analysis is performed on both an aggregate and average-sponsor basis as well as by plan size, funded status and the relative size of pension assets to corporate assets. For the first time, we compare asset holdings from 2009 to 2011 for a consistent sample of sponsors. Finally, we examine the prevalence and amount of pension assets invested in company securities.

Year-end 2011 asset allocations

Towers Watson's analysis of 2011 asset allocations takes a detailed look at 559 *Fortune* 1000 U.S. pension plan sponsors' disclosures. *Figure 1* summarizes aggregate asset allocations (weighted by plan assets). In 2011, these companies held more

[1] For Level 3 assets, a reconciliation of the beginning and ending balances is also required, reflecting the actual return on plan assets, purchases, sales and settlements.

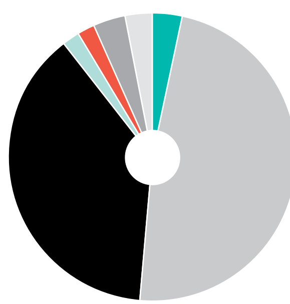
Figure 1. Aggregate distribution of pension assets by class and level at year-end 2011 ($ thousands)



Asset class	Level 1	Level 2	Level 3	Total
Cash*	1.8%	1.9%	0.0%***	3.7%
Equity	24.3%	14.5%	0.4%	39.2%
Debt	5.4%	34.0%	0.8%	40.2%
Real estate	0.3%	0.3%	2.8%	3.4%
Private equity	0.0%***	0.1%	5.3%	5.4%
Hedge funds**	0.1%	1.8%	3.2%	5.1%
Other	0.2%	1.5%	1.3%	3.0%
Total %	32.1%	54.1%	13.8%	100.0%
Total assets	$528,006,848	$883,873,026	$225,566,311	$1,637,446,185

* Cash includes cash equivalents and money market instruments.
** Hedge fund assets include derivatives, insurance contracts and interest rate swaps.
*** Value is less than 0.1%.
Source: Towers Watson

Figure 2. Average distribution of pension assets by class and level at year-end 2011 ($ thousands)



Asset class	Level 1	Level 2	Level 3	Total
Cash*	2.3%	1.3%	0.0%***	3.6%
Equity	26.2%	21.0%	0.7%	47.9%
Debt	9.8%	27.8%	0.5%	38.1%
Real estate	0.3%	0.4%	1.1%	1.8%
Private equity	0.0%***	0.2%	2.0%	2.2%
Hedge funds**	0.1%	1.2%	2.2%	3.5%
Other	0.5%	1.2%	1.2%	2.9%
Total %	39.2%	53.1%	7.7%	100.0%
Total assets	$944,556	$1,581,168	$403,518	$2,929,242

* Cash assets include cash, cash equivalents and money market instruments.
** Hedge fund assets include hedge funds, derivatives, insurance contracts and interest rate swaps.
*** Value is less than 0.1%.
Source: Towers Watson

than $1.6 trillion in pension assets, which are divided into seven categories: cash, public equity, debt, real estate, private equity, hedge funds (alternative investments) and other.

The total allocation to debt was 40.2%, and the total allocation to equity was 39.2%. Private equity and hedge funds held 5.4% and 5.1%, respectively. A majority of the asset valuation (54.1%) is done at Level 2 — especially for debt — and much (32.1%) is also done at Level 1 — especially for equity. At 13.8%, however, Level 3 valuations are also significant, particularly for private equity, hedge funds and real estate.

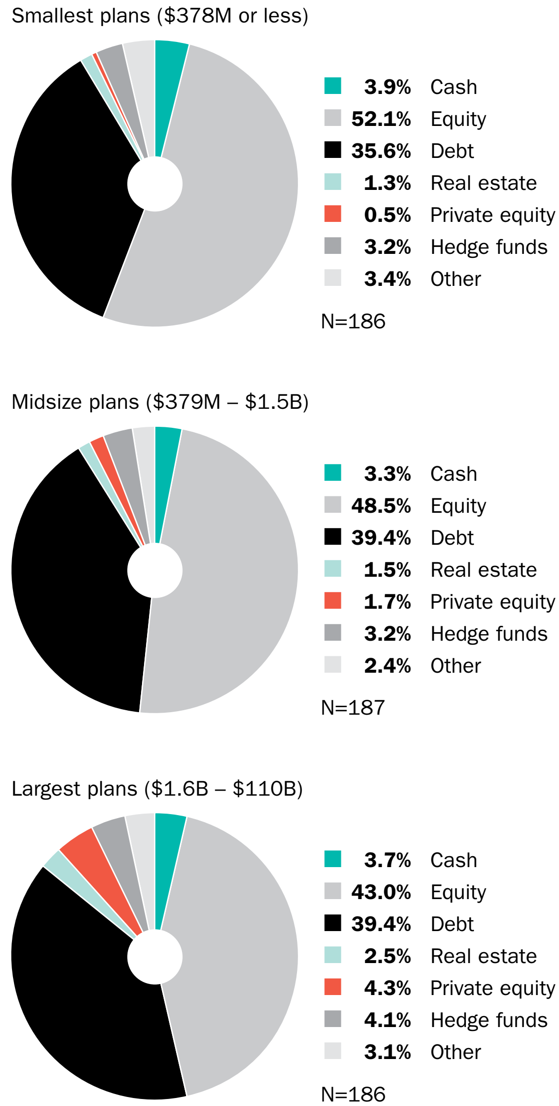
Figure 2 (previous page) depicts average asset allocations (not weighted by plan assets) for the same companies. The average *Fortune* 1000 pension plan sponsor in the analysis held almost $3 billion in pension assets at fiscal year-end 2011. There are some differences between the average and aggregate results shown in Figures 1 and 2. The average allocation to equity was 47.9%, while the aggregate allocation was 39.2%; average allocations to debt, real estate, hedge funds and private equity were smaller than aggregate allocations. On average, less asset valuation was done at Level 3 — only 7.7% — and more at Level 1 — 39.2%.

Asset allocations by plan asset size

Figure 3 shows asset allocations by asset size. The asset thresholds of three groups of equal size were used to define small, medium and large plans. Small plans are those that held $378 million or less in pension assets. Medium plans held between $379 million and $1.5 billion, and large plans held more than $1.5 billion (the largest plan held $110 billion in assets).

Equity allocations declined as plan size increased. This corroborates results showing lower percentages of equity holdings for overall results weighted by plan asset size. While larger plans allocated less to public equities, they held higher allocations in private equity than small and midsize plans.

Figure 3. Average asset allocations by plan asset size at year-end 2011

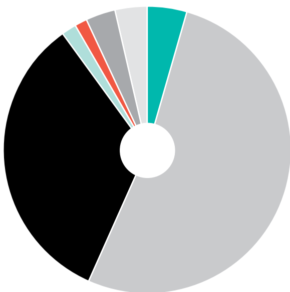


Source: Towers Watson

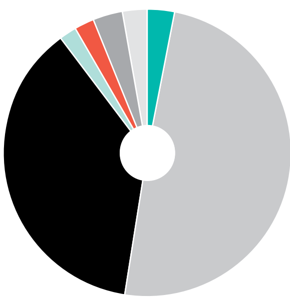
> "The average *Fortune* 1000 pension plan sponsor in the analysis held almost $3 billion in pension assets at fiscal year-end 2011."

Figure 4. Average asset allocations by plan funded status at year-end 2011

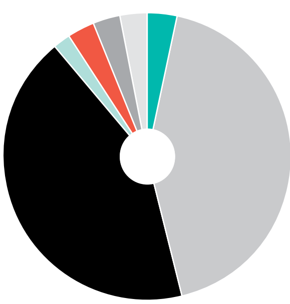
Funded status below 70%



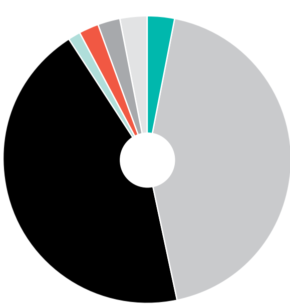
Funded status between 70% and 79%



Funded status between 80% and 89%

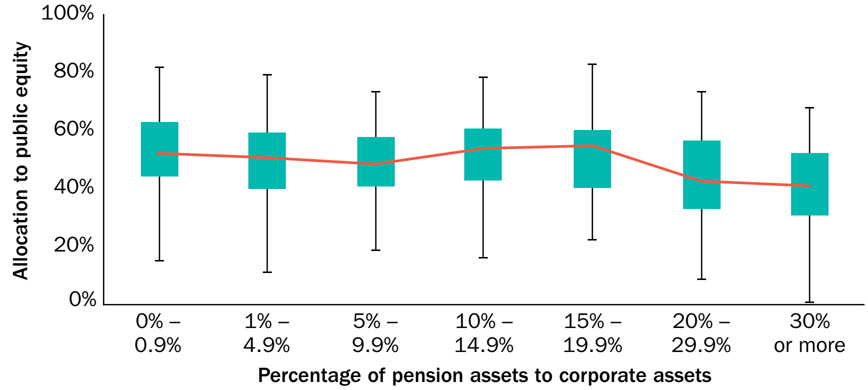


Funded status 90% or above



Source: Towers Watson

Figure 5. Equity distributions by ratio of pension assets to total assets, 2011



N	44	147	121	70	51	56	70
Median equity percentage	52.2%	50.7%	48.5%	53.9%	54.8%	42.6%	41.0%
Median alternatives* percentage	7.3%	4.6%	5.7%	7.0%	7.1%	8.0%	12.4%

*Alternative investments for this figure represent hedge funds, real estate, private equity and other investments.

Source: Towers Watson

Asset allocations by plan funded status

Figure 4 groups plans by funded status:[2] less than 70%, 70% to 79%, 80% to 89% and 90% or above. Plans that were less than 70% funded were relatively more aggressive investors, generally allocating more to public equities and less to debt. Plans whose funded status was between 80% and 89% had higher percentages in real estate and private equity. Plans whose funded status exceeded 90% invested somewhat more conservatively, allocating more than any other group to debt.

"Plans that were less than 70% funded were relatively more aggressive investors, generally allocating more to public equities and less to debt."

Only 4% of the plan sponsors in this analysis explicitly stated in their annual disclosure that the plan's funded status will shape their future target allocations. This glide path strategy is a way for plan sponsors to reduce the volatility of the plan's funded status by shifting assets from equities to debt as funding levels improve, thereby safeguarding the gains.

Equity and alternative investment allocations by ratio of pension assets to corporate assets

Figure 5 examines the distribution of equity by the ratio of pension plan assets to total corporate assets. Among sponsors whose plan assets were between 0% and 19.9% of total corporate assets, the equity distributions were roughly similar. Where pension assets were 20% or more of total corporate assets, however, allocations to equities declined.

[2] Funded status is the ratio of the fair value of assets over plan liabilities at year-end.

Figure 6a. Aggregate distributions of pension assets by class and level for consistent sample, year-end 2009 – 2011 ($ thousands)

2009

Asset class	Level 1	Level 2	Level 3	Total
Cash*	2.1%	2.6%	0.0%***	4.7%
Equity	28.9%	15.7%	0.8%	45.4%
Debt	4.2%	29.3%	2.0%	35.5%
Real estate	0.2%	0.4%	2.5%	3.1%
Private equity	0.0%***	0.0%***	4.7%	4.7%
Hedge funds**	0.0%***	0.6%	2.0%	2.6%
Other	0.3%	1.8%	1.9%	4.0%
Total %	35.7%	50.4%	13.9%	100.0%
Total assets	$433,294,068	$610,943,031	$167,744,082	$1,211,981,181

2010

Asset class	Level 1	Level 2	Level 3	Total
Cash*	1.7%	2.3%	0.0%***	4.0%
Equity	28.3%	15.8%	0.3%	44.4%
Debt	4.0%	29.6%	0.9%	34.5%
Real estate	0.3%	0.2%	2.8%	3.3%
Private equity	0.0%***	0.2%	5.6%	5.8%
Hedge funds**	0.1%	1.7%	3.3%	5.1%
Other	0.4%	1.4%	1.1%	2.9%
Total %	34.8%	51.2%	14.0%	100.0%
Total assets	$465,819,835	$681,907,432	$187,934,773	$1,335,662,040

2011

Asset class	Level 1	Level 2	Level 3	Total
Cash*	1.8%	1.8%	0.0%***	3.6%
Equity	23.9%	14.0%	0.4%	38.3%
Debt	4.8%	34.8%	0.8%	40.4%
Real estate	0.3%	0.2%	3.1%	3.6%
Private equity	0.0%	0.1%	5.6%	5.7%
Hedge funds**	0.1%	1.8%	3.5%	5.4%
Other	0.2%	1.5%	1.3%	3.0%
Total %	31.1%	54.2%	14.7%	100.0%
Total assets	$426,200,246	$741,784,681	$200,706,696	$1,368,691,623

N=362

* Cash includes cash equivalents and money market instruments.

** Hedge fund assets include derivatives, insurance contracts and interest rate swaps.

*** Value is less than 0.1%.

Source: Towers Watson

"Plans whose funded status exceeded 90% invested somewhat more conservatively, allocating more than any other group to debt."

Over recent years, sponsors have become more interested in reducing DB plan risk, so it is not surprising that many sponsors of very large DB plans (relative to their total corporate assets) are looking to diversify their portfolio and mitigate investment risk. At the other end of the spectrum, sponsors with smaller pensions relative to company assets may be more inclined to take more risk in their pension. Sponsors whose pension assets are more than 30% of their total corporate assets allocated less to equity and more to non-equity and non-debt alternatives as they acted to diversify their pension portfolios.

Comparison of 2009, 2010 and 2011 asset allocations

There was a consistent sample of 362 companies in our 2009, 2010 and 2011 studies, and *Figures 6a* and *6b* (next page) show their asset allocations on an aggregate and average basis over that period. From 2009 to 2010, overall asset allocations showed little change, but between 2010 and 2011, average allocations to equity dropped from 51.7% to 47.0%, and average allocations to debt rose from 34.9% to 38.6%. By year-end 2011, equity had fallen by 10 or more percentage points for 14% of these sponsors, while debt had risen by 10 or more percentage points for roughly 12% of them. Based on these companies' reported target strategies, this shift from equities to debt will continue during 2012.

Company securities in pension assets

In 2011, 13% of DB plan sponsors held company securities as a component of their pension assets. Of that group, 8% contributed company securities for plan year 2011, with the contributions averaging $541 million — roughly 4.8% of pension assets. Of DB plan sponsors holding company securities, such allocations averaged 4.4% of pension assets. When weighted by end-of-year assets, the average drops to 2.1%. The weighted average is lower than the simple average because larger plans had smaller allocations to company securities than smaller plans.

In most of these plans, employer securities made up less than 4% of assets in plan year 2011 (*Figure 7*, next page). Company securities were more than 10% of plan assets in only a handful of companies, and those cases likely reflect asset growth and decline, rather than higher allocations to employer securities.[3] In this analysis, the highest percentage of company securities as a share of plan assets was roughly 26%.

[3] Under the Employee Retirement Income Security Act (ERISA) in the U.S., DB plans may not invest more than 10% of their assets in company securities. This restriction is intended to promote asset diversification in pension plans.

Conclusion

For plan year 2011, sponsors invested more conservatively, shifting assets from public equities to debt to help reduce investment risk. As reducing investment risk has become more important to DB plan sponsors, some companies are taking a targeted glide path approach to control the magnitude and timing of the shift, at least based on their explicit disclosures. Evidence of this trend includes more conservative asset allocations by sponsors of relatively well-funded plans than by sponsors of poorly funded plans. Among companies with high ratios of pension assets to total corporate assets, we see a wider distribution, overall lower holdings in equities (with increases in other non-equity/debt instruments) and greater diversification.

As was true for 2010, most DB plan sponsors did not hold company securities as pension assets.

Equity allocations have declined significantly over time. Stricter and more market-sensitive accounting and funding requirements — as well as investment losses during the financial crisis — have likely encouraged sponsors to better hedge their pension liabilities. However, the impact of recent changes in funding rules due to the Moving Ahead for Progress in the 21st Century Act (MAP-21) may shift asset allocations away from liability-hedging assets.[4]

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[4] See "The Implications of Funding Relief: What Does it Mean for Asset Allocation and Liability-Driven Investing?" Towers Watson, September 2012.

Figure 6b. Average distributions of pension assets by class and level for consistent sample, year-end 2009 – 2011 ($ thousands)

2009

Asset class	Level 1	Level 2	Level 3	Total
Cash*	2.5%	1.8%	0.1%	4.4%
Equity	29.8%	21.0%	0.8%	51.6%
Debt	8.8%	24.5%	1.2%	34.5%
Real estate	0.2%	0.3%	1.0%	1.5%
Private equity	0.0%***	0.0%***	1.3%	1.3%
Hedge funds**	0.0%***	0.8%	2.0%	2.8%
Other	0.7%	1.7%	1.5%	3.9%
Total %	42.0%	50.1%	7.9%	100.0%
Total assets	$1,196,945	$1,687,688	$463,381	$3,348,014

2010

Asset class	Level 1	Level 2	Level 3	Total
Cash*	1.9%	1.3%	0.0%***	3.2%
Equity	28.4%	22.7%	0.6%	51.7%
Debt	8.4%	26.0%	0.5%	34.9%
Real estate	0.2%	0.3%	1.0%	1.5%
Private equity	0.0%***	0.2%	2.1%	2.3%
Hedge funds**	0.1%	1.0%	2.3%	3.4%
Other	0.5%	1.4%	1.1%	3.0%
Total %	39.5%	52.9%	7.6%	100.0%
Total assets	$1,286,795	$1,883,722	$519,157	$3,689,674

2011

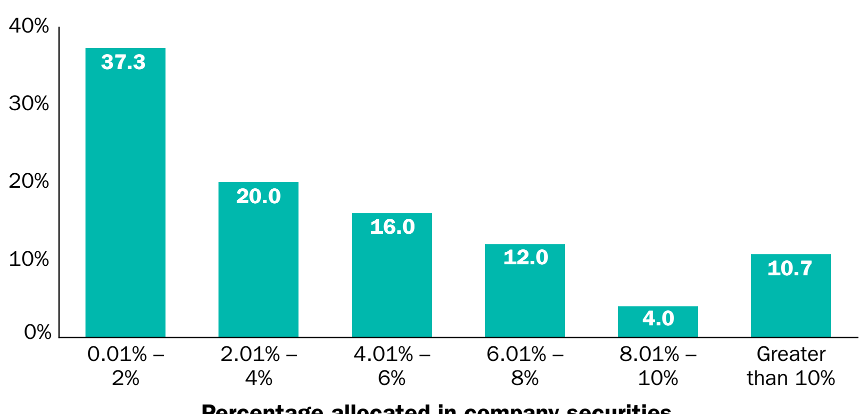
Asset class	Level 1	Level 2	Level 3	Total
Cash*	2.1%	1.2%	0.1%	3.4%
Equity	24.8%	21.6%	0.6%	47.0%
Debt	8.6%	29.5%	0.5%	38.6%
Real estate	0.3%	0.4%	1.1%	1.8%
Private equity	0.0%***	0.1%	2.2%	2.3%
Hedge funds**	0.1%	1.2%	2.3%	3.6%
Other	0.5%	1.4%	1.4%	3.3%
Total %	36.4%	55.4%	8.2%	100.0%
Total assets	$1,177,349	$2,049,129	$554,438	$3,780,916

N=362

* Cash includes cash equivalents and money market instruments.
** Hedge fund assets include derivatives, insurance contracts and interest rate swaps.
*** Value is less than 0.1%.
Source: Towers Watson

Figure 7. Allocations of company stock with positive holdings in 2011

Percentage of companies



N=75
Source: Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, financial and risk management. With 14,000 associates around the world, we offer solutions in the areas of employee benefit programs, talent and reward programs, and risk and capital management.

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