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IAPF ANNUAL INVESTMENT CONFERENCE 2014

ABC of LDI

26 March 2014

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Insight Investment





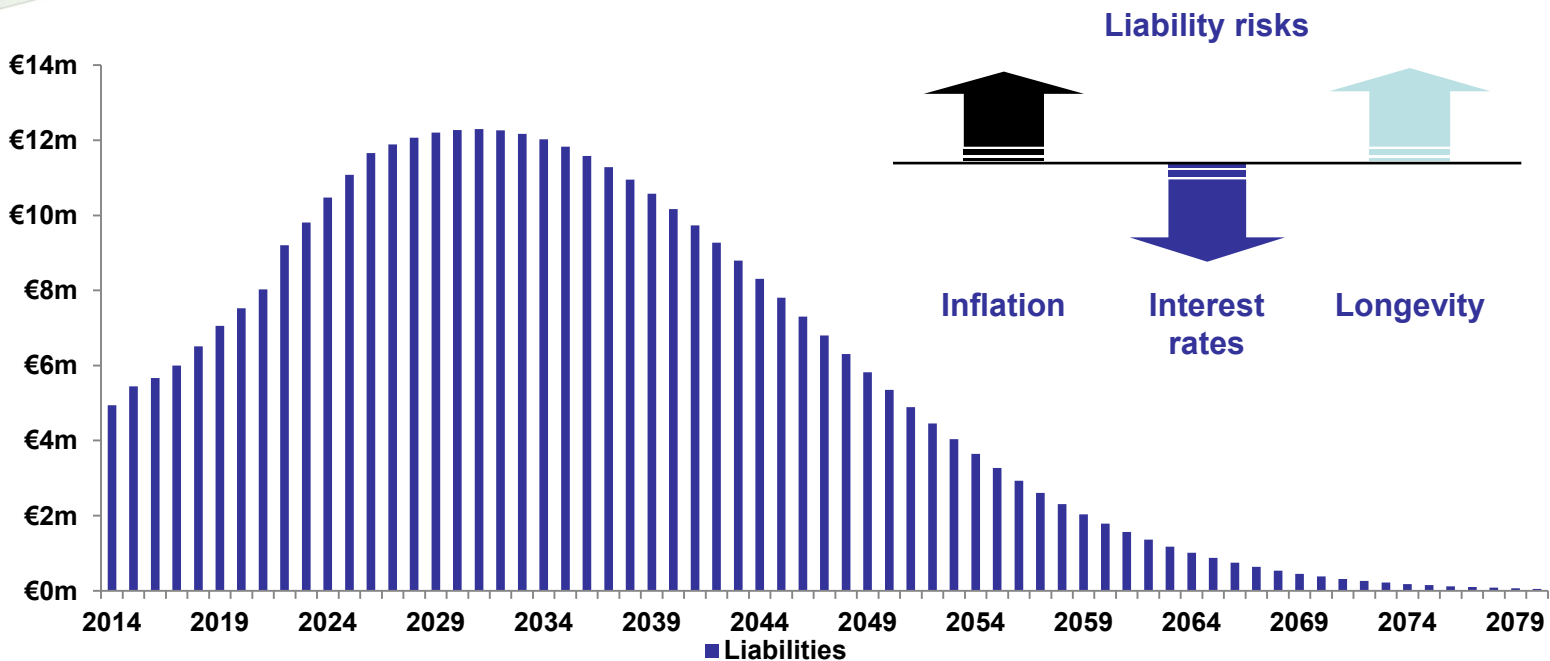
Liability driven investing (“LDI”)

- Managing your portfolio towards the explicit objective of increasing your ability to pay liabilities as they fall due
 - Buy cashflows, or
 - Hedge cashflows
- Helps stabilise the funding position and provides flexibility to pursue risk controlled returns





Understanding your liability risks



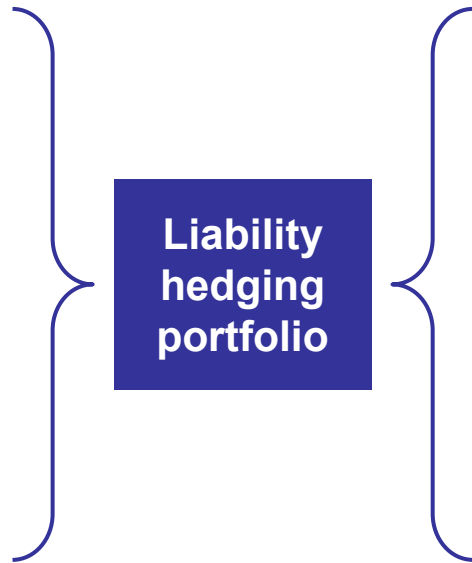
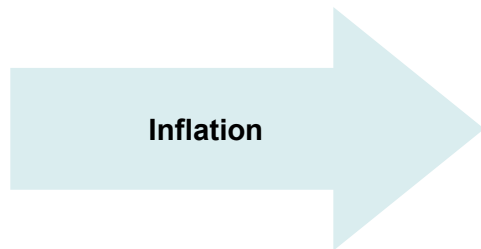
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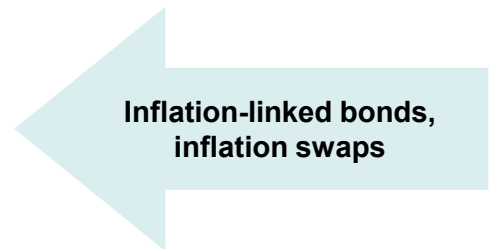
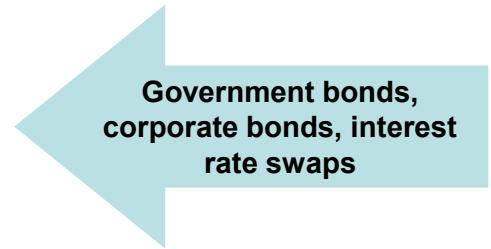


Managing your liability risks

Hedgeable sources of risk



Hedging instruments

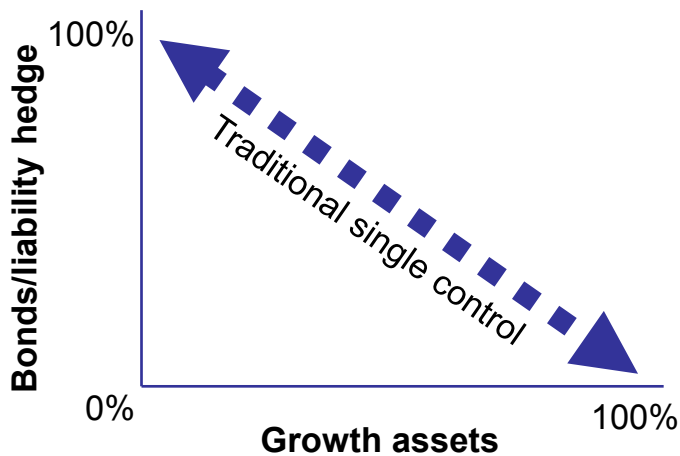


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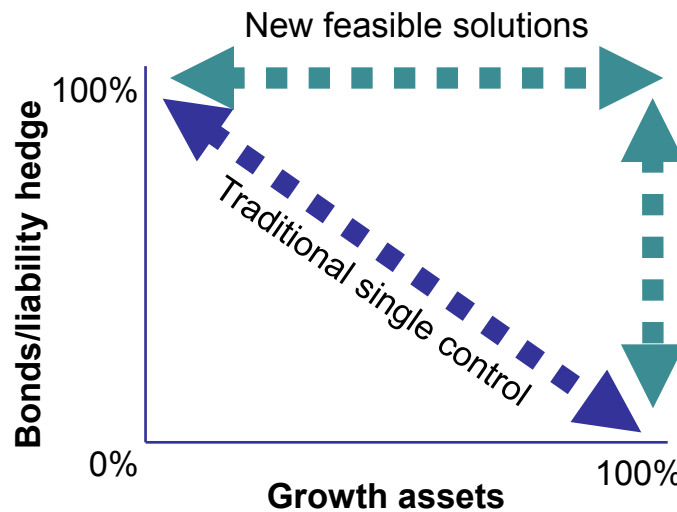


Avoiding the traditional trade-off

Equities or 'Bonds'



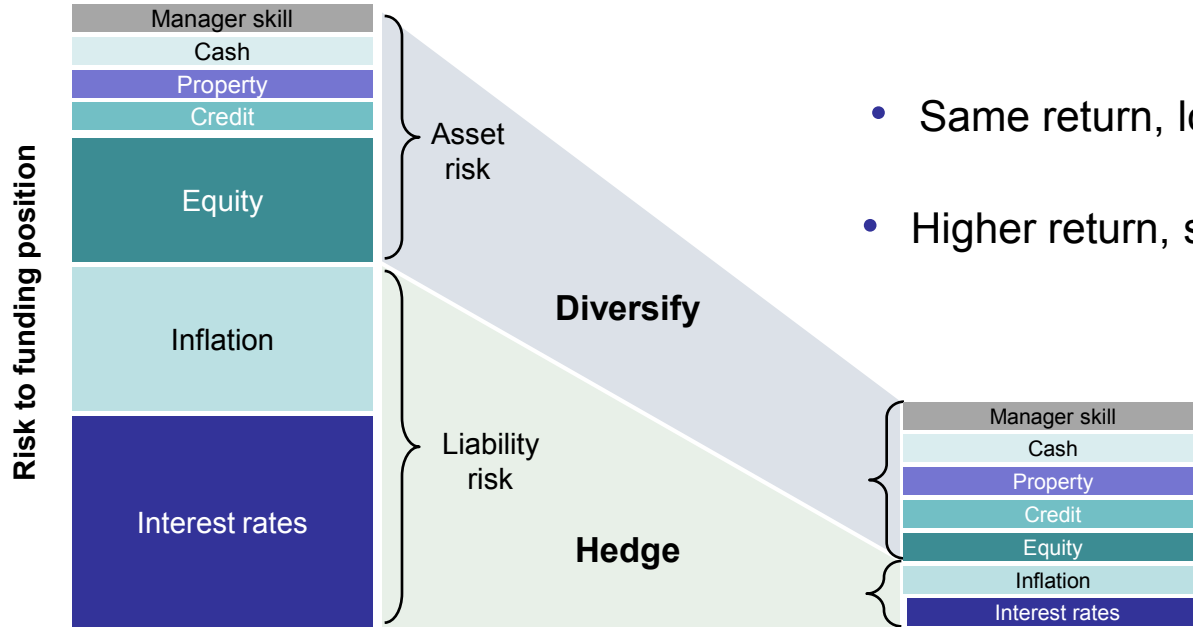
Equities *and* 'Bonds'



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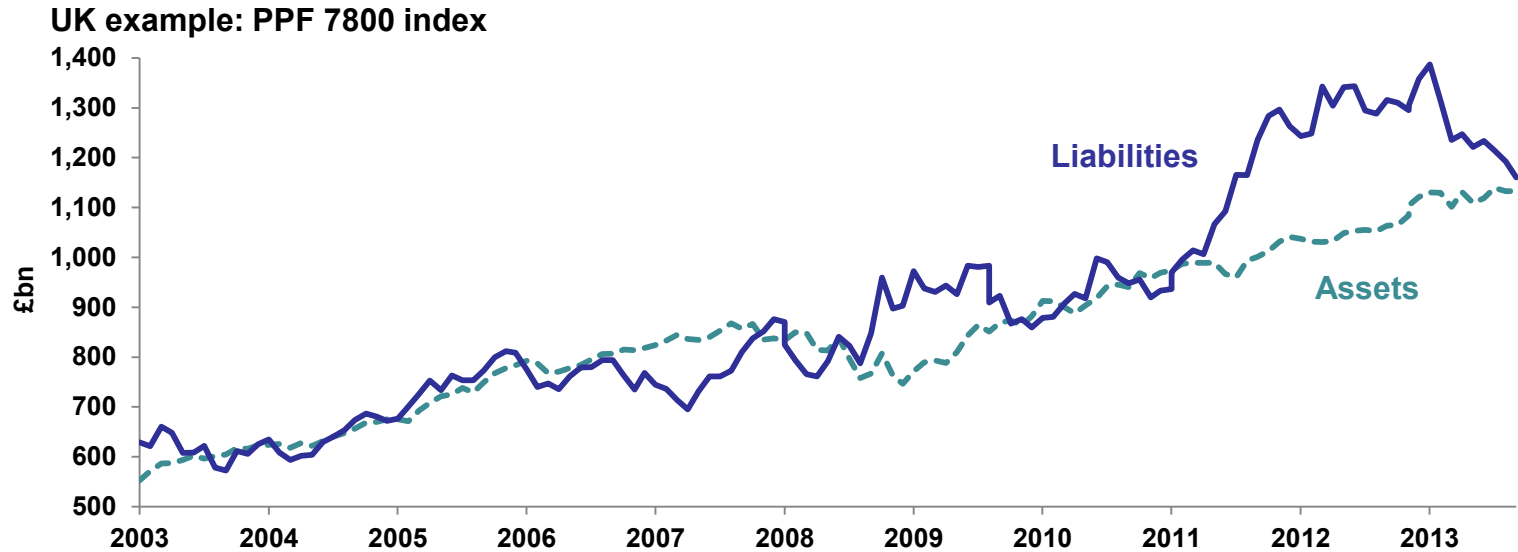
Minimise unintended, unrewarded risk



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Liability risks can have a significant impact on funding levels



Source: Pension Protection Fund



How large is the liability hedging market in the UK?

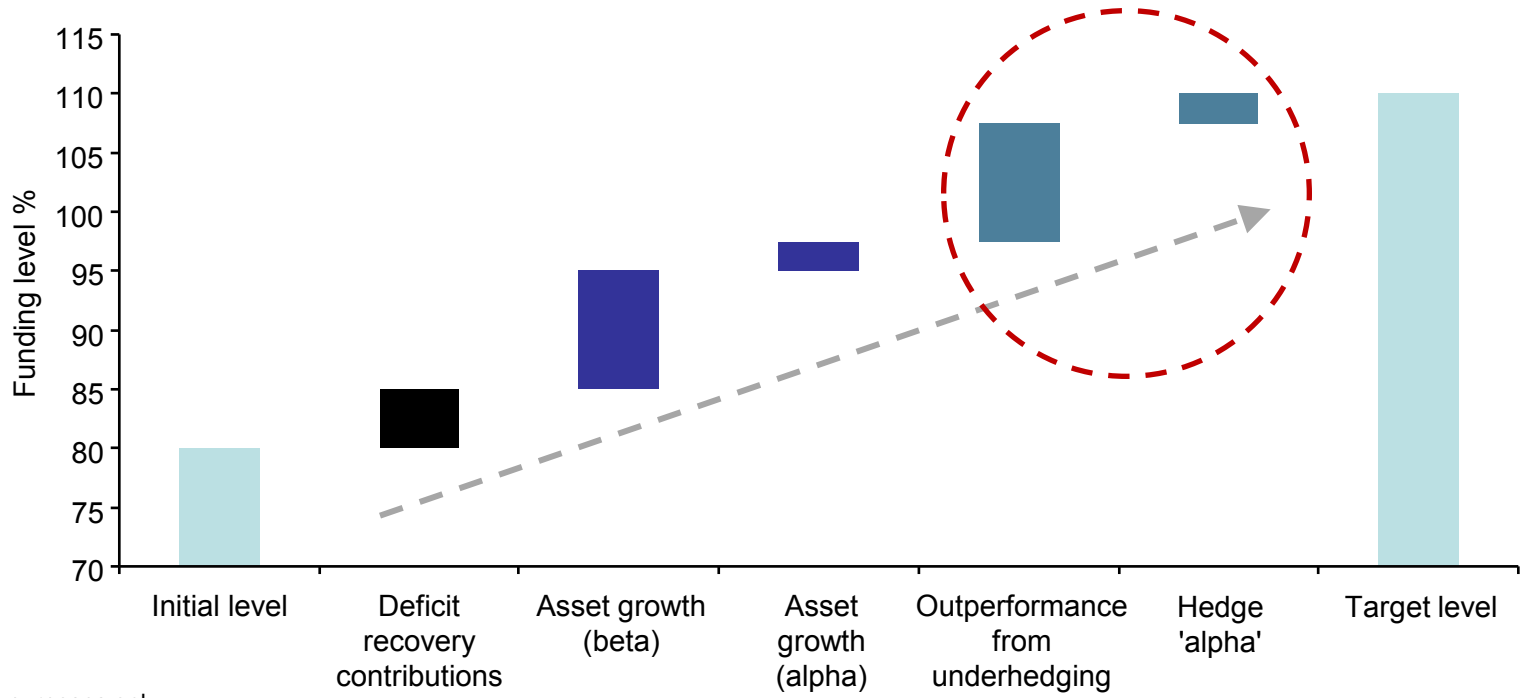
- LDI is a key component of investment strategies
- UK LDI market AUM grew 11% in 2012 to £446bn
- 686 LDI mandates as at end 2012
- Many pension schemes implement a partial liability hedge
 - 35% of LDI mandates use triggers
- Inflation hedging has been a key area of growth



Source: 2013 KPMG LDI Survey.



Liability hedging decision making within your “flight plan”



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Is now the right time to implement a liability hedge?

History of 20 year Euro interest rate swap rates

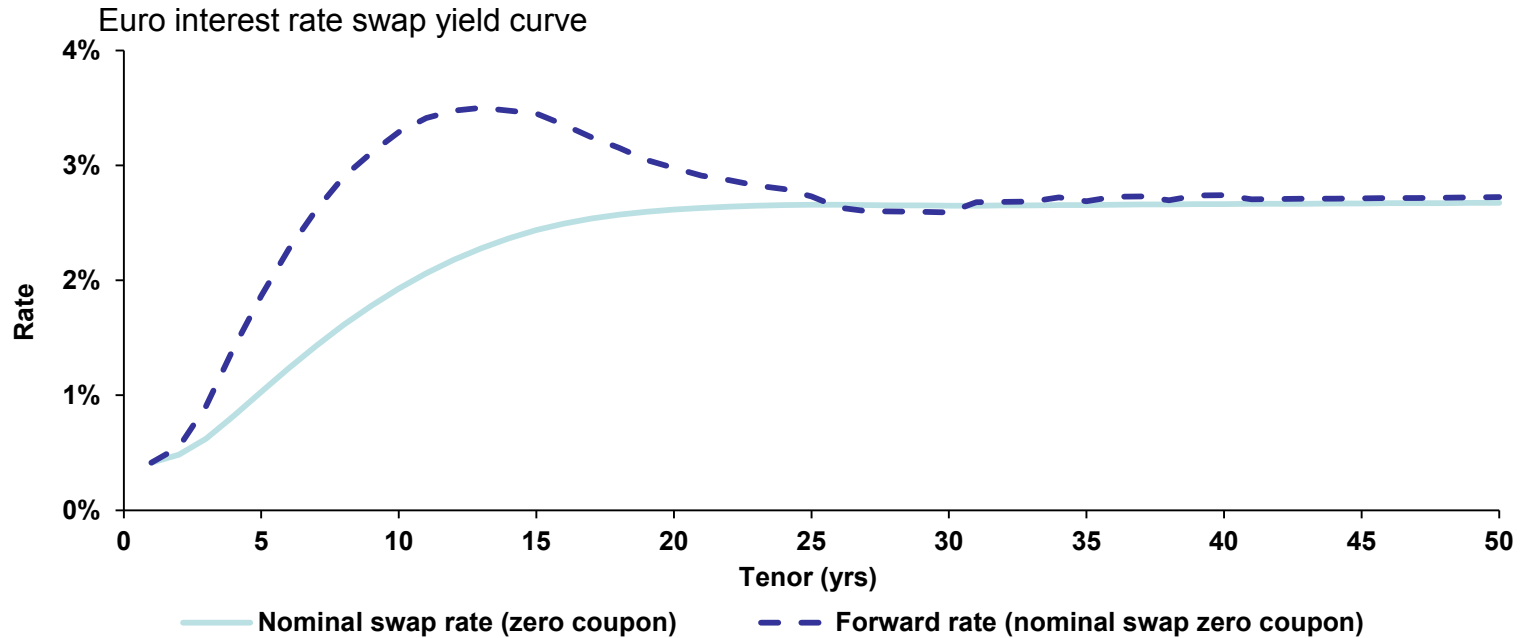


Source: Bloomberg. Data as at 11 March 2014.





Expectations of interest rate rises are reflected in the yield curve

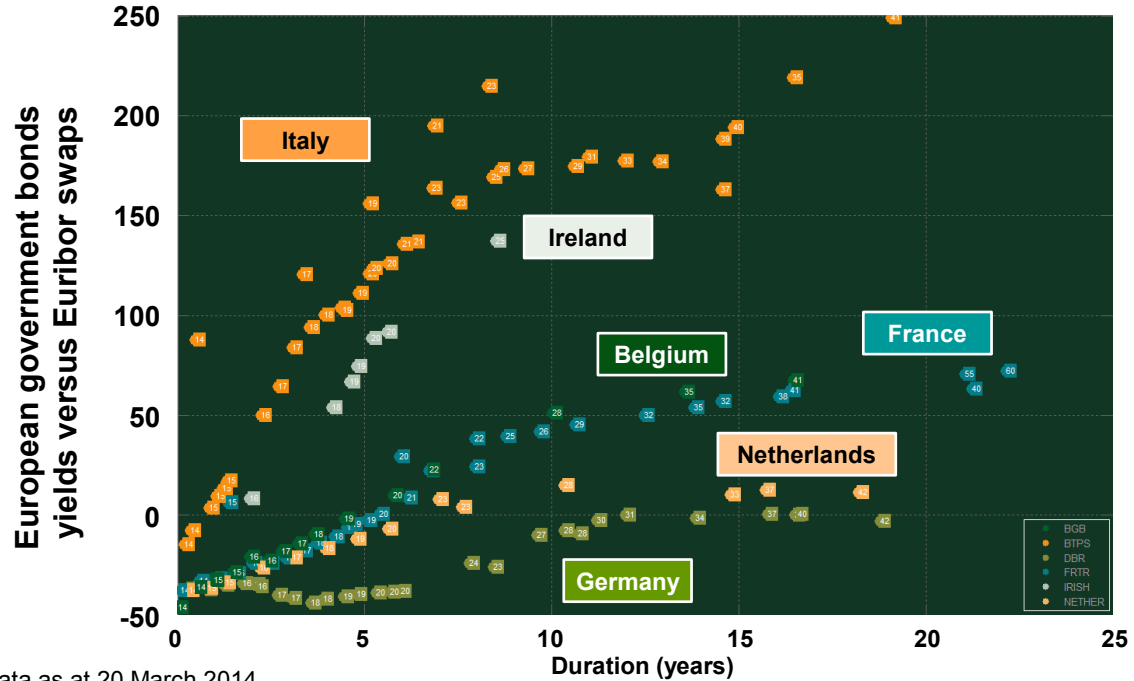


Source: Bloomberg. Data as at 11 March 2014.





Euro government bond conditions: yield spreads to Euribor

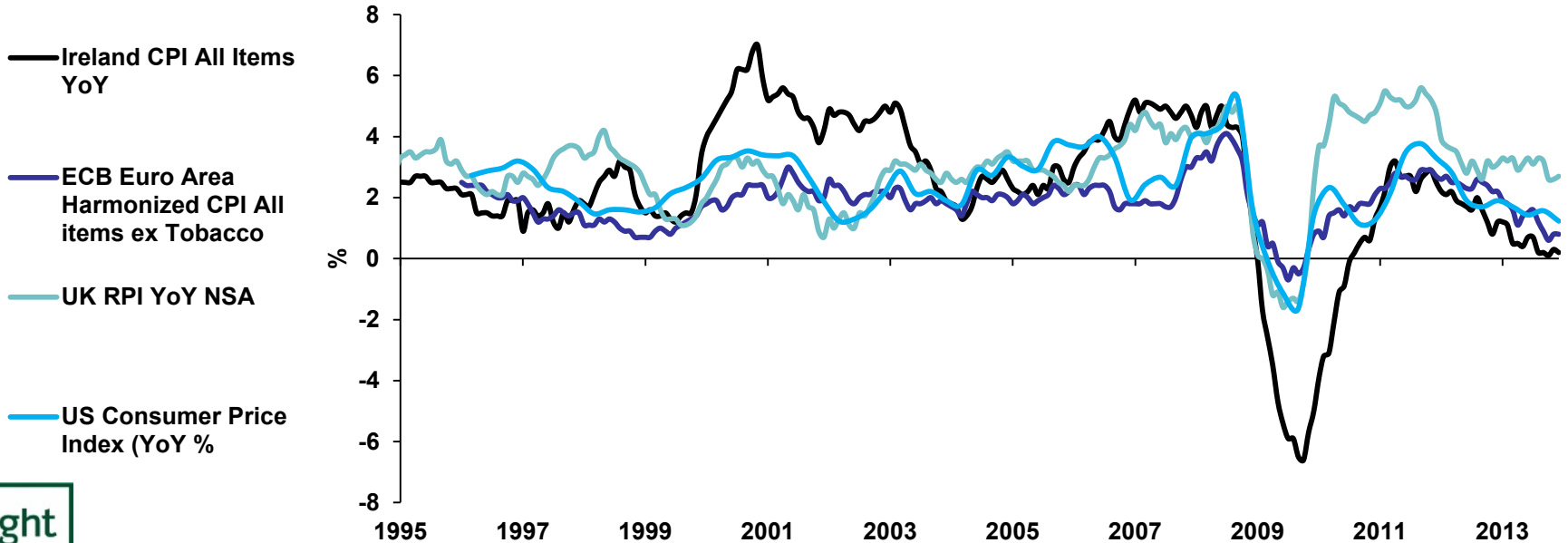


Source: Bloomberg. Data as at 20 March 2014.





How about inflation?



Source: Bloomberg. As date December 2013.



Risks/challenges

- Governance design of the right LDI solution for you
- Trustee education and consensus building on the direction of travel
- Counterparty risk management, documentation/legal set up and operational controls
- Managing the long-term journey





Conclusion

LDI is NOT about ...

- Eliminating all financial risks
- Removing/reducing investment outperformance potential of the asset portfolio
- Locking-in existing funding levels, raising long-term funding cost
- Investing purely in bonds

LDI is about ...

- Better and proactive risk management
- Deciding on timing of liability hedge implementation in a manner consistent with the overall “flight plan”, reducing risk when market levels and/or solvency level reaches pre-determined levels
- Removing ‘unrewarded’ risk; retaining exposure to remaining risks where appropriate
- Diversifying sources of return





Notes

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