UK LDI CRISIS

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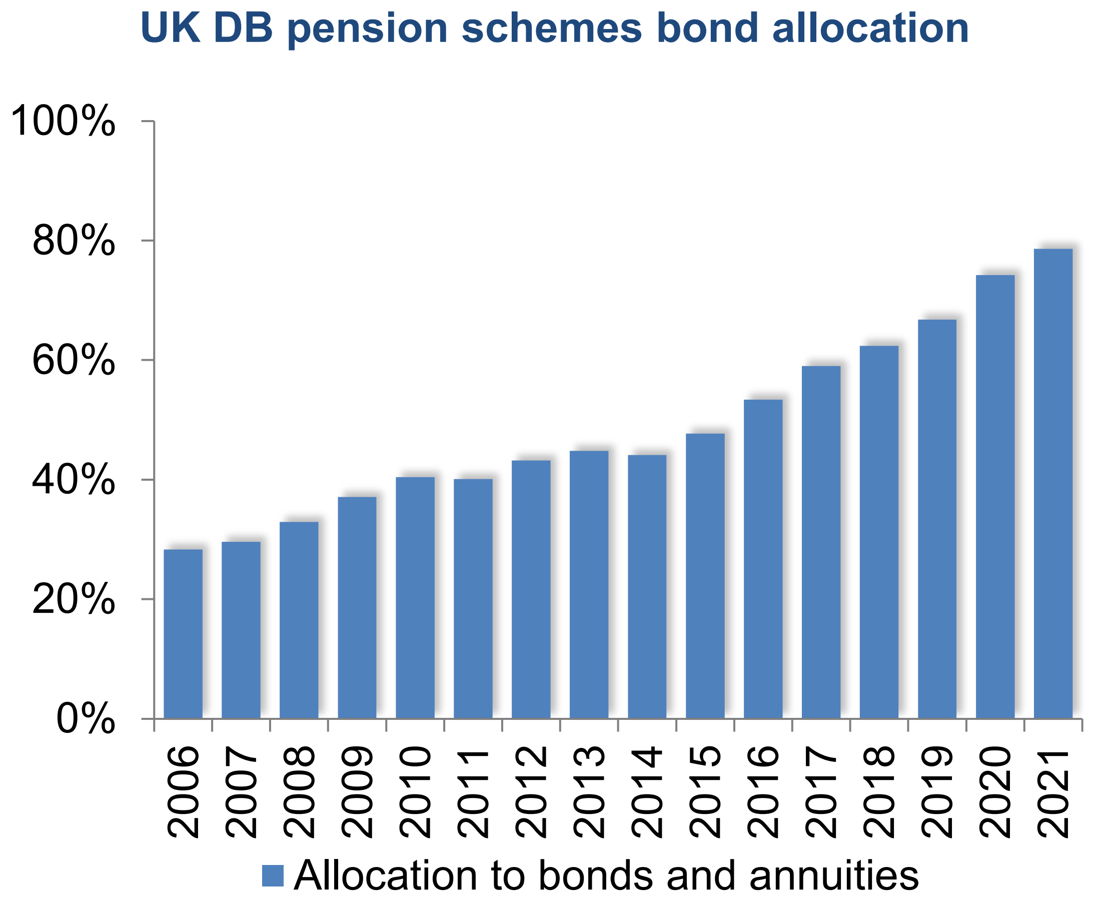
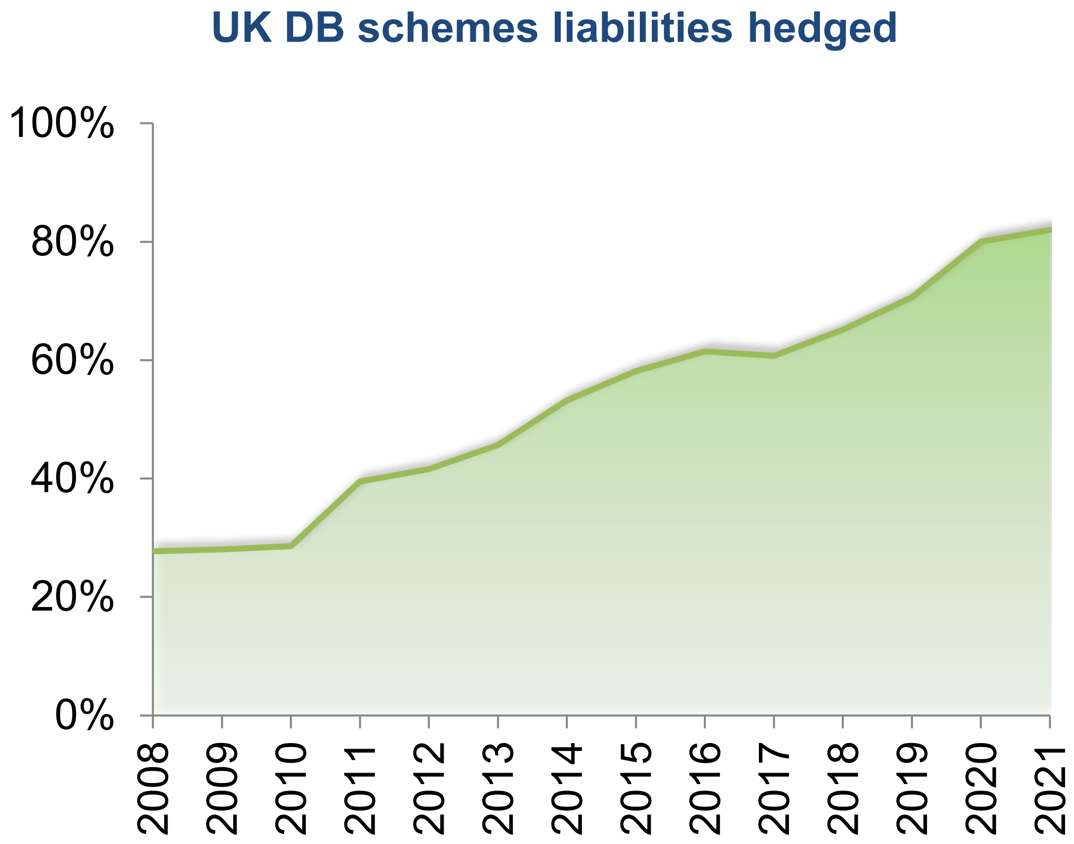
Pension fund de-risking: asset allocation and hedge ratios





Source: PPF and Insight as at December 2021. Allocation is money-weighted.

Understanding the rationale for LDI

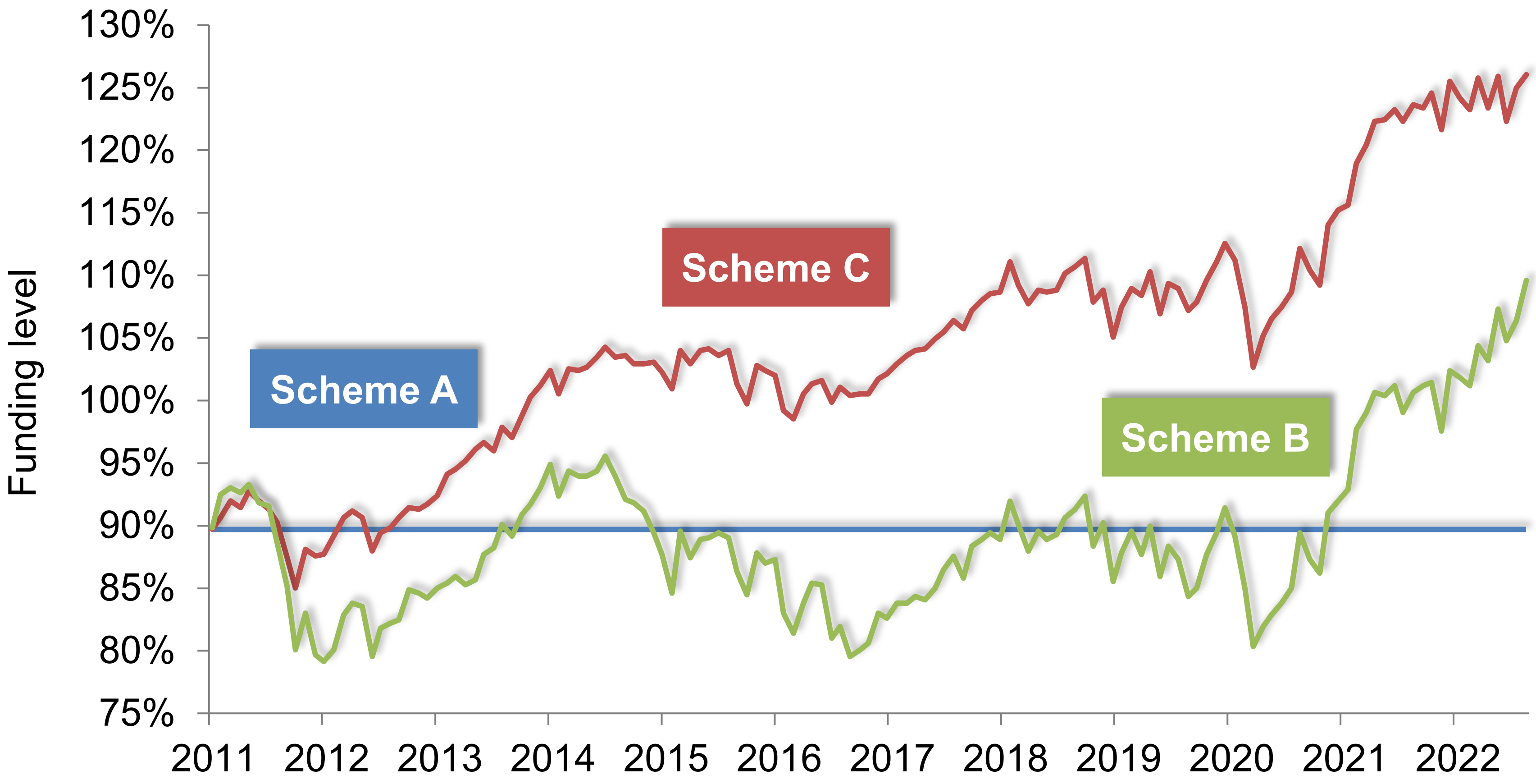
Risks clearly identified and hedgeable

- Recognition of existential threats to affordability of pension provision
- Ability to hedge with traditional assets (government bonds) and derivatives (swaps)
- Alignment with endgame – hedging market price for transferring liabilities to an insurer

Implemented using leverage

- Ability to retain exposure to growth assets… helped keep cost of pension provision affordable

Members and sponsors have benefitted from liability hedges



Scheme C

Liabilities 90% hedged, c.45% allocation to global equities

Scheme B

Liabilities 50% hedged, c.45% allocation to global equities

Scheme A

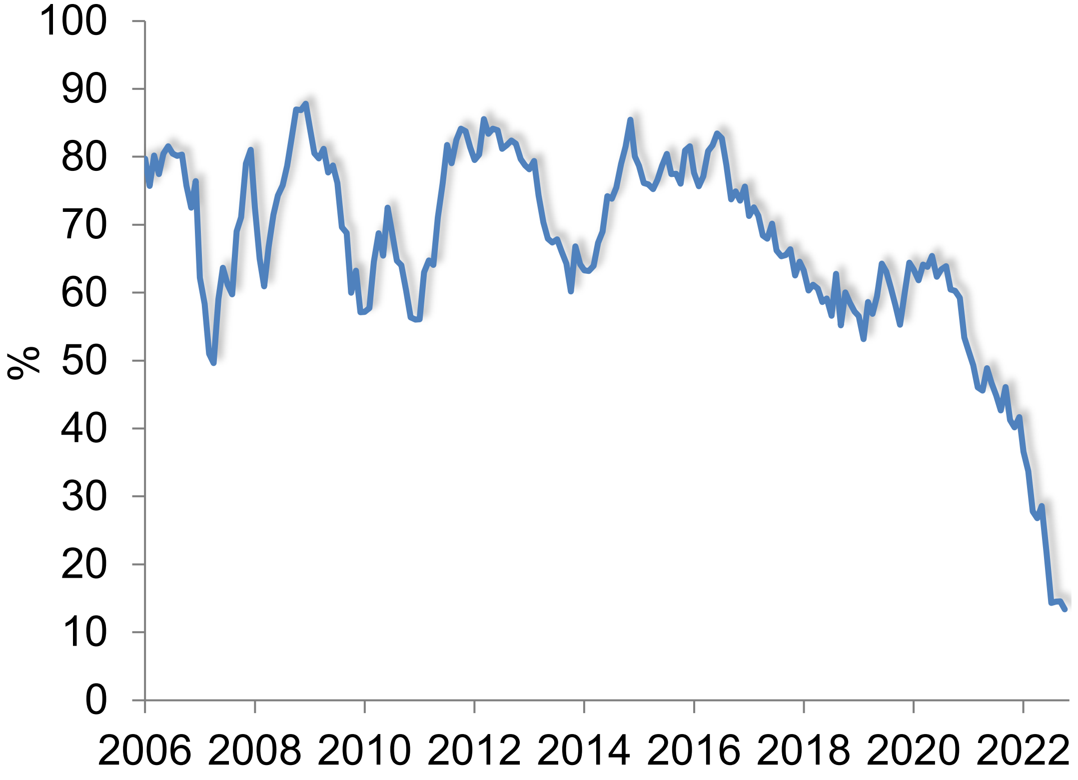
Liabilities 90% hedged using govt bonds, zero 'growth' assets

For illustrative purposes only. Data as at 31 August 2022. Allocations set at 1 January 2011; cashflows and rebalancing ignored for simplicity.

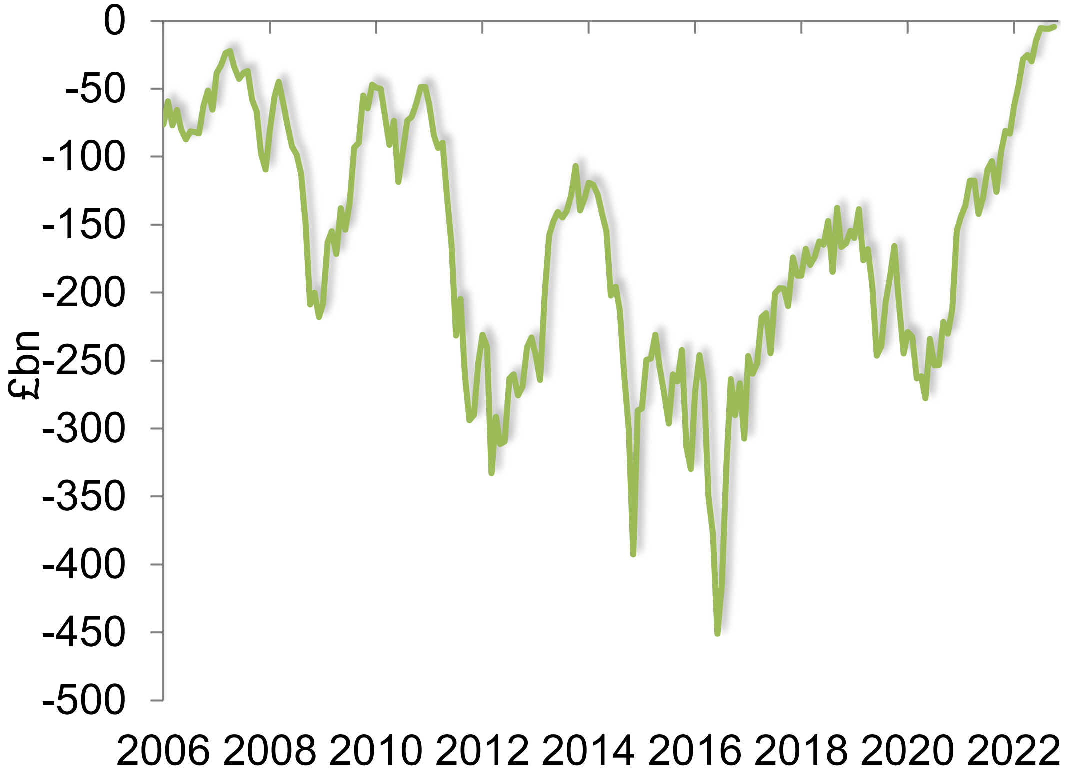
iapf representing pension savers

Pension schemes financial health is much improved

Proportion of UK schemes in deficit has fallen



Aggregate UK schemes deficit has reduced



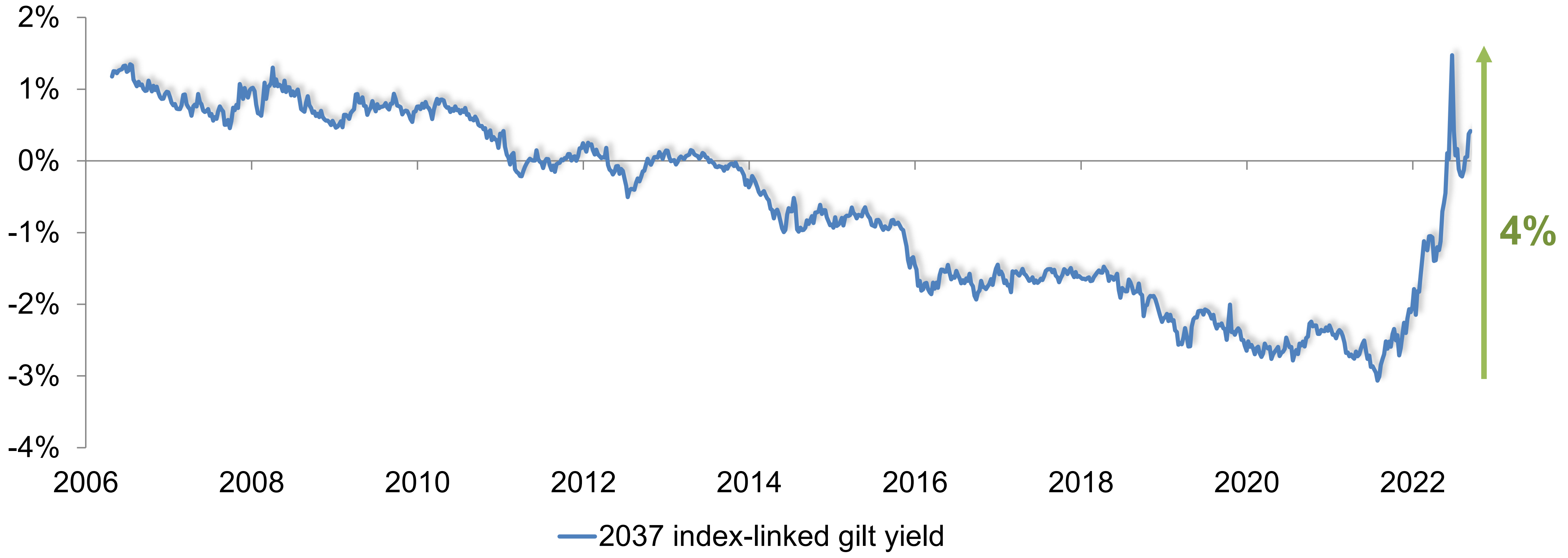
Source: PPF (on s179 liabilities) as at 31 December 2022.

iapf representing pension savers

Liquidity crisis, not a solvency crisis

But the years ahead may be more volatile than the past

15 years of real gilt yield declines reversed in 9 months



Source: Bloomberg. Data to 31 December 2022.

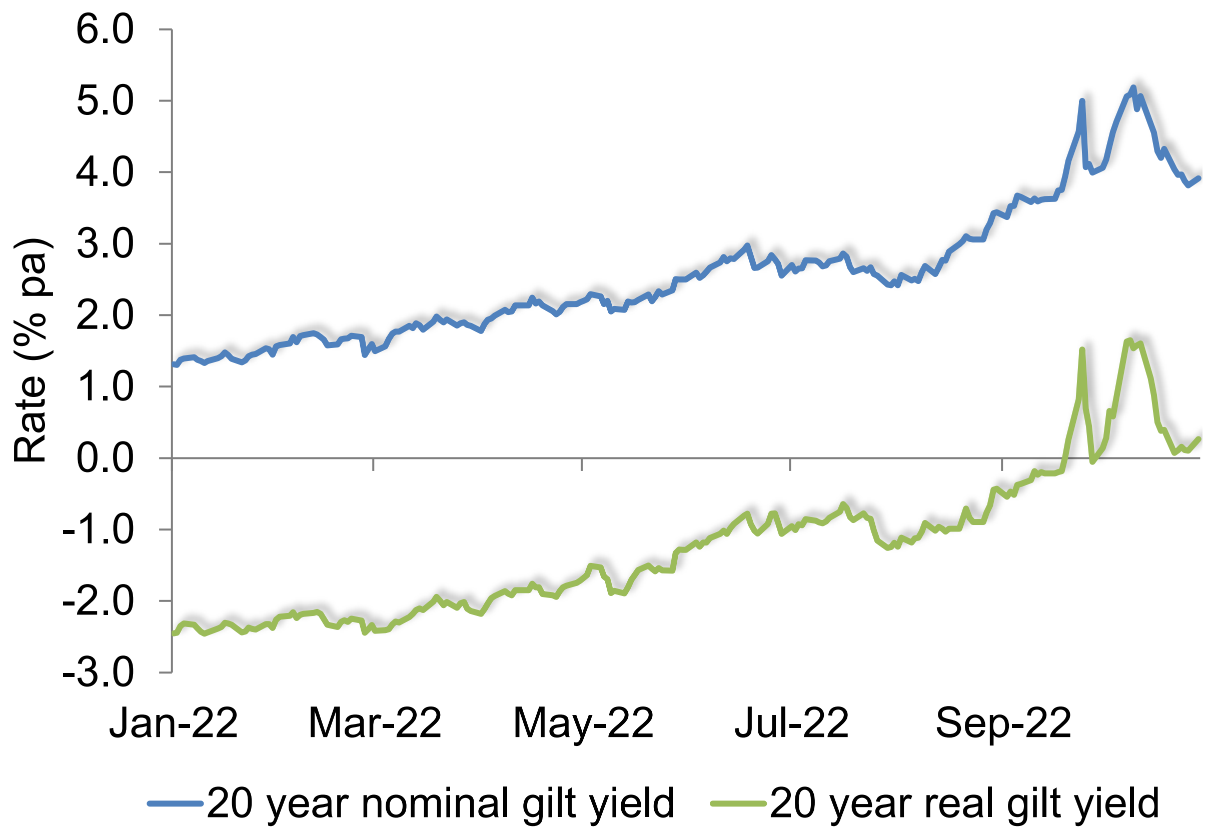
UK gilt crisis: material yield rises preceded the rapid spike

Changing market dynamics

- Liabilities largely hedged
- Concentrated index-linked gilt ownership

- QE ceased, QT starting
- High inflation and rising base rates

- Mini-budget, confidence and speculation



Source: Bank of England and Insight. Data to 31 October 2022.

Questions to answer in 2023…

Key considerations for investment and risk management of Irish pension schemes

Risk

1

Do you have a forward looking plan?

- Given improved funding levels in 2022 – what is the timeframe to reach full funding?
- What is the scheme's 'endgame' target?
- Can full funding be achieved using high quality fixed income assets?

Returns

2

What is the liquidity profile of your assets?

- Stress test to show how large moves in yields impact collateral and funding levels and check you have enough assets in daily dealing funds?
- Non daily dealing funds may not be suitable for fully funded schemes or for supporting LDI assets – what role do illiquid funds play?

Volatility

3

Does your governance model allow for quick decision making?

- Delegate authority to sub-committee?
- Timely access to relevant information?
- Who is tasked with implementing the actions? Are they accessible and proactive?
- Up-to-date signatory lists?
- Delegation of forward-looking risk management and implementation?

For illustrative purposes only.

THANK YOU

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Associated investment risks

Liability-driven investment

- A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

- Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

- Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

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