



Institute  
and Faculty  
of Actuaries

# Managing liquidity for defined benefit pension schemes

Martijn de Vree  
Insight Investment



# Agenda

1

What does 'liquidity' mean?

2

Liquidity management for defined benefit (DB) pension schemes

3

Is it an opportunity?



# Agenda

1

What does 'liquidity' mean?

2

Liquidity management for defined benefit (DB) pension schemes

3

Is it an opportunity?



# What is liquidity?

*“The ability to purchase or sell an asset without causing a drastic change in the asset’s price”*



# What does a liquid market look like?

## Counterparty

- More counterparties
- Frequent pricing
- Easy price discovery/execution

## Pricing

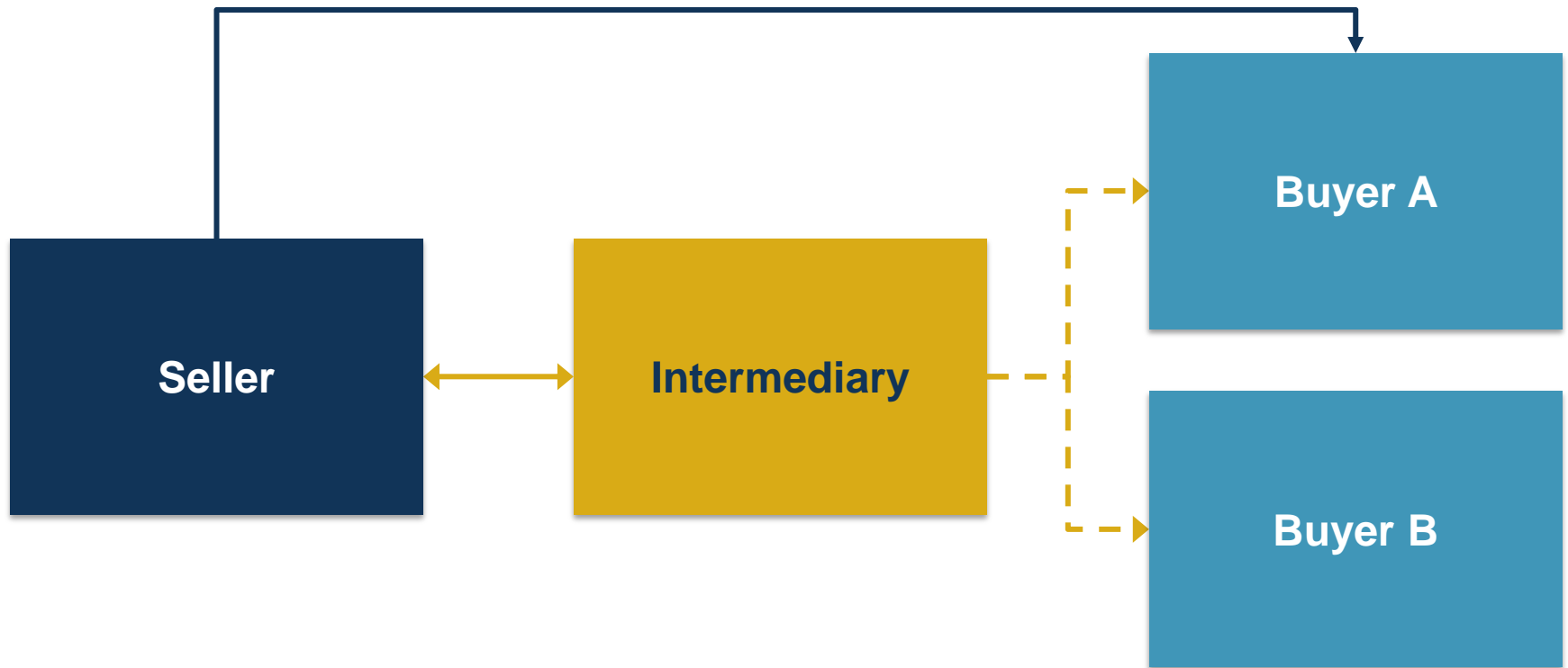
- Not sensitive to size
- Small difference between the price to buy and sell (the 'bid-offer' spread)

## Depth

- Can deal during good and bad times
- Counterparty able to 'warehouse' risk



# The role of intermediaries



# The negative impact of regulation

## The Volcker Rule

- Limits proprietary trading by banks
- Diminishes banks' ability to step in and intermediate in challenging market environments

## Capital requirements and leverage ratios

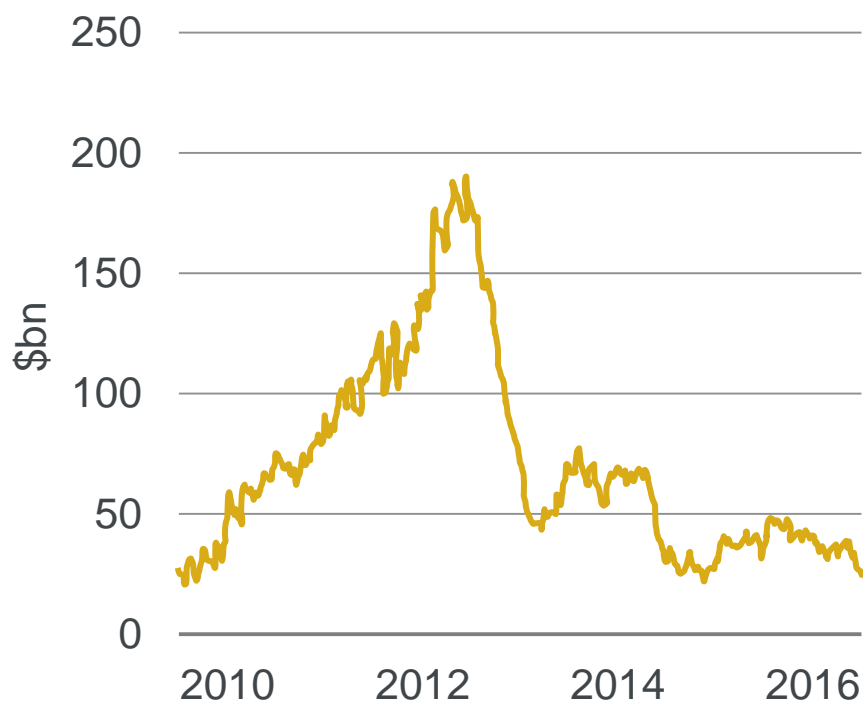
- Regulatory push for balance sheet strength to make banks safer and prevent future crisis

...likely path is towards more regulation not less

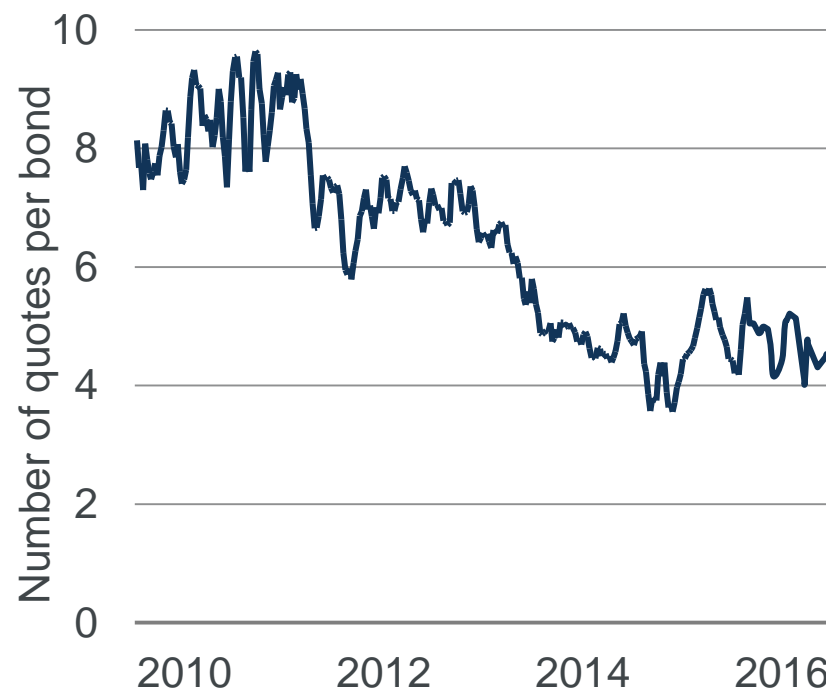


# Intermediaries less willing to provide liquidity

## US dealer inventories



## Average number of quotes per corporate bond trade



Source: Markit iBoxx, Morgan Stanley Research. Data as at January 2016.

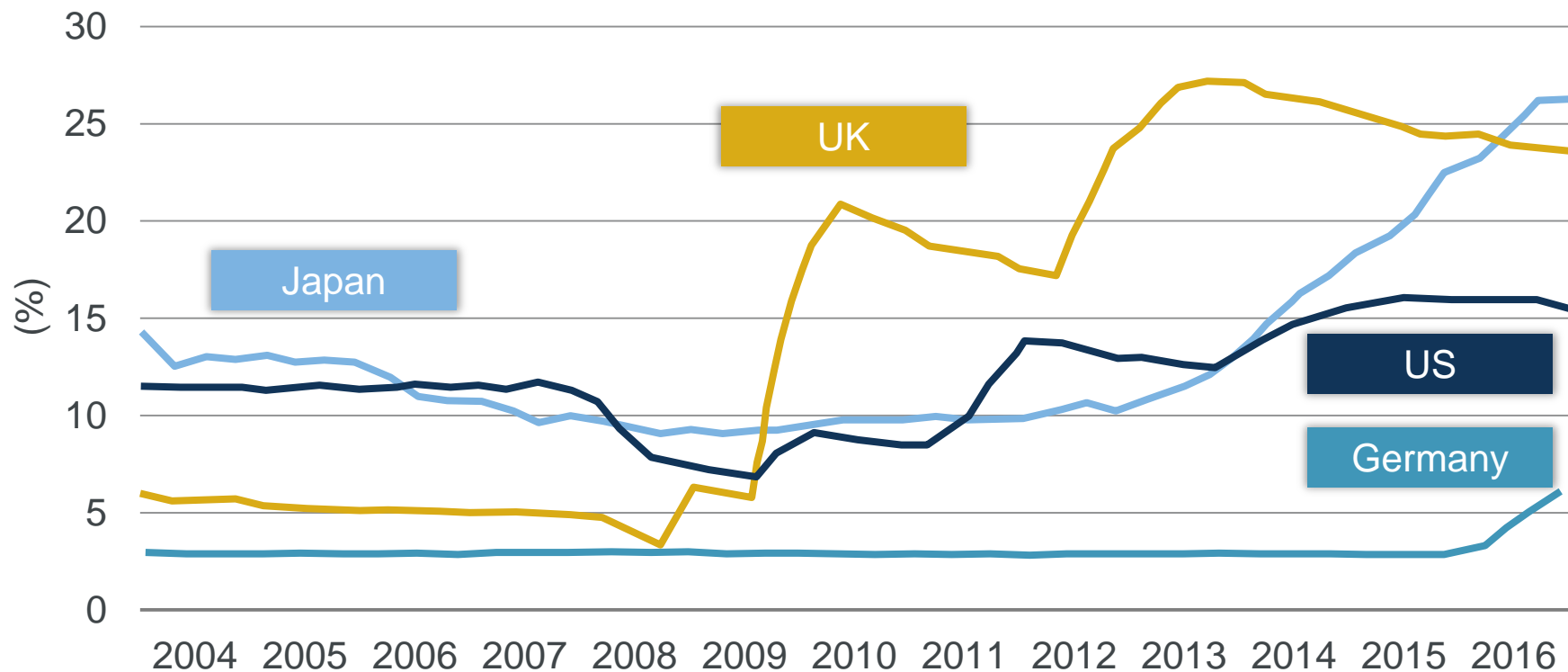


Institute  
and Faculty  
of Actuaries



# Government bond liquidity

## Sovereign debt held by central banks



Source: IMF, Deutsche Bank. Data as at June 2016. Chart shows percentage of total sovereign debt held by each country domestic central bank.



Institute  
and Faculty  
of Actuaries

# Agenda

1

What does 'liquidity' mean?

2

Liquidity management for defined benefit (DB) pension schemes

3

Is it an opportunity?



Institute  
and Faculty  
of Actuaries

# Factors influencing pension scheme liquidity

## Liabilities

- Status of scheme
- Contributions
- Timing of outflows
- Net cash flow position
- Member options and transfers

## Assets

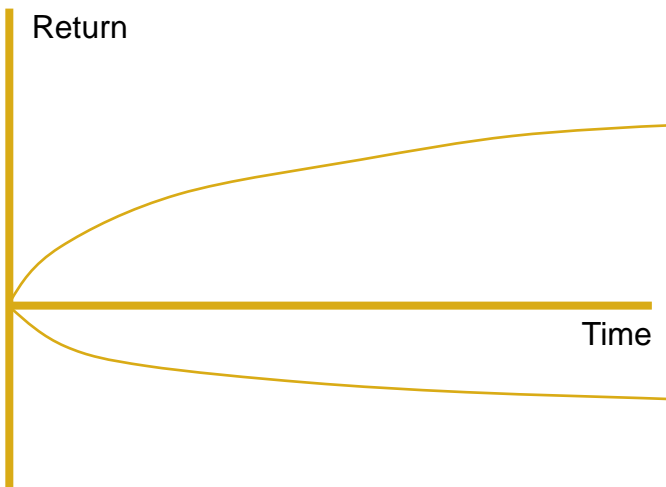
- Income from assets
- Trading frequency
- Dealing spreads
- Market impact
- Timing of selling



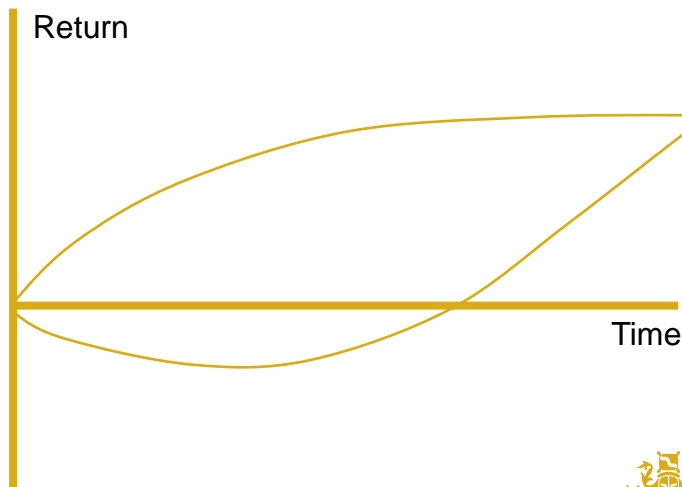
# Non-contractual versus contractual assets

- Short-term volatility does not capture certainty of returns
- Focus on investment outcome through contractual growth assets
- Assets with contractual returns have a role to play

## Non-contractual assets



## Contractual assets



For illustrative purposes only.



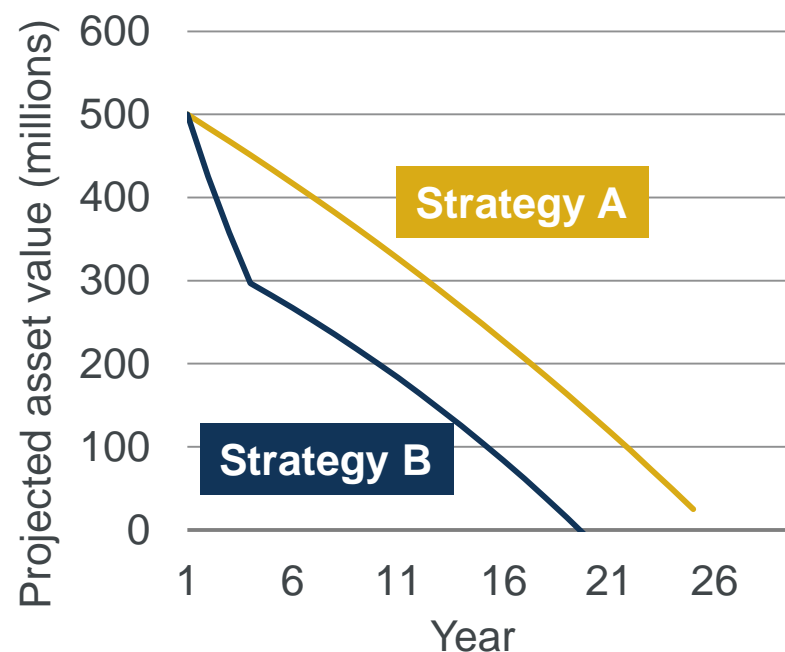
Institute  
and Faculty  
of Actuaries

# The impact of forced selling

Change in value (assuming £1 of initial investment)



£500m portfolio factoring in £25m 'forced selling' each year



For illustrative purposes only.

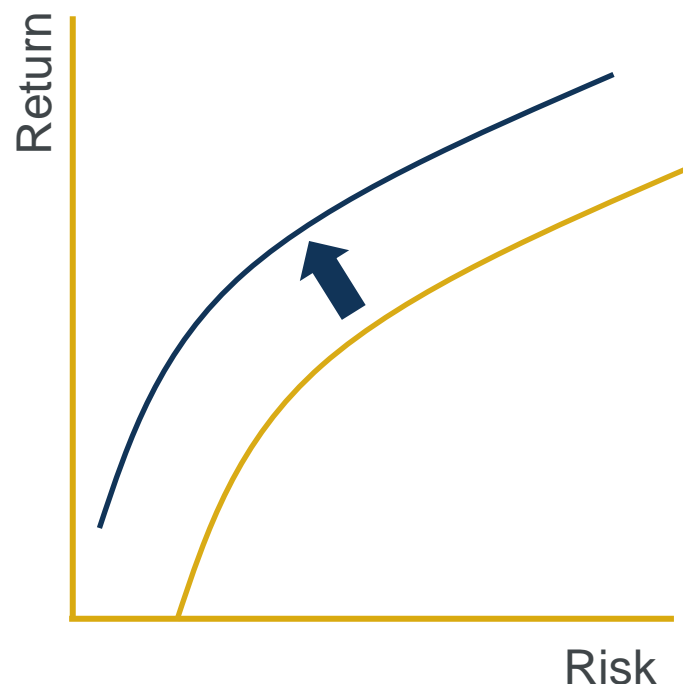


Institute  
and Faculty  
of Actuaries

# What is required?

- A shift from focussing on risk, returns and balance sheet ...
- ... to cash flow driven investment, with liquidity being a central consideration
- Develop a plan for cash flow management considering assets and liabilities sides
- Use scenarios to consider liquidity buffers
- Timing of returns is important

## Traditional risk vs returns

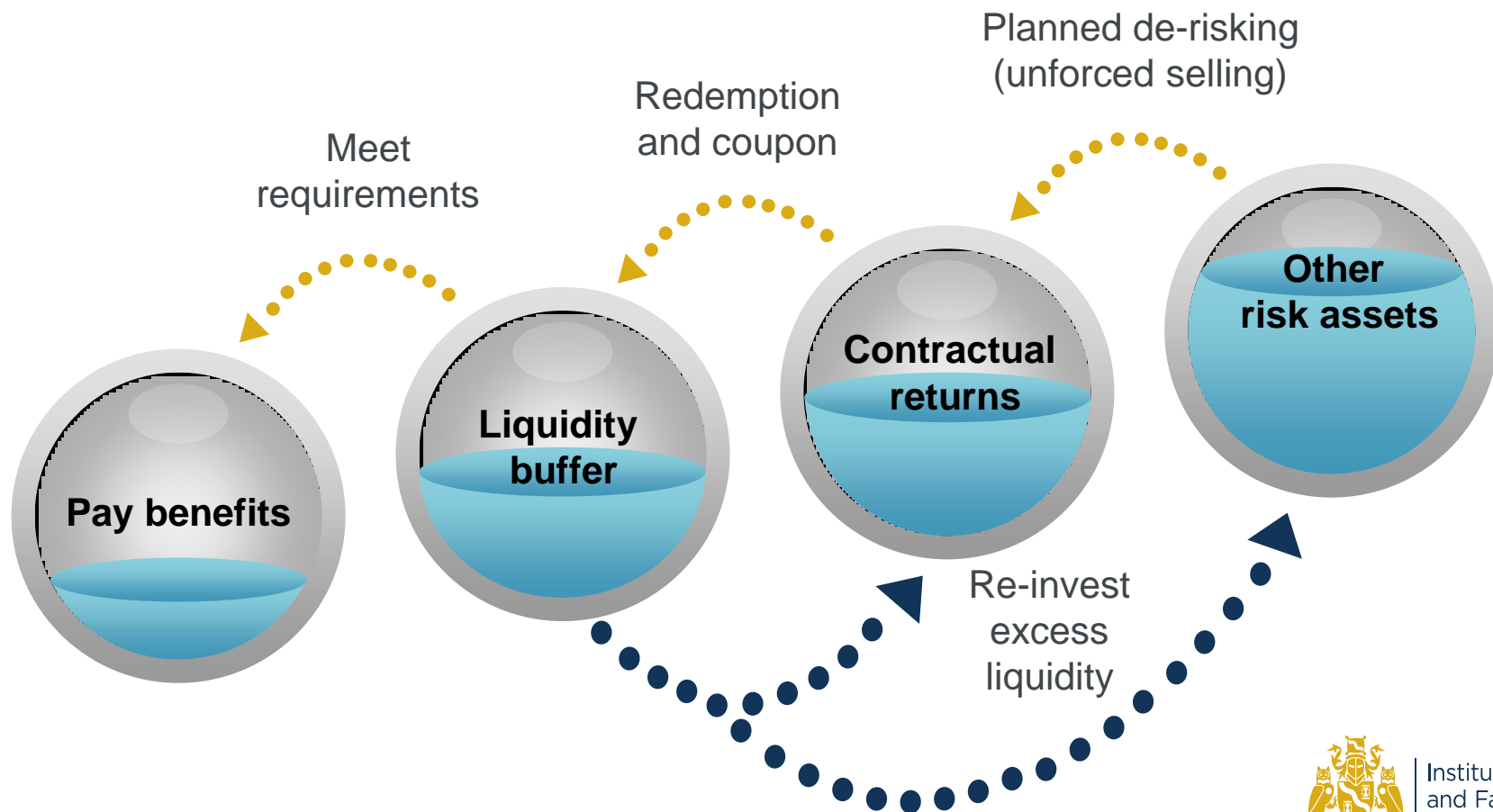


For illustrative purposes only.



Institute  
and Faculty  
of Actuaries

# Cash flow management in practice



# Ideal position



Income from assets +  
liquidity buffer



Cash flow required

- Avoid forced selling as timing of returns is important
- Sufficient but not excessive buffer under most circumstances
- Ability to re-invest in current opportunities

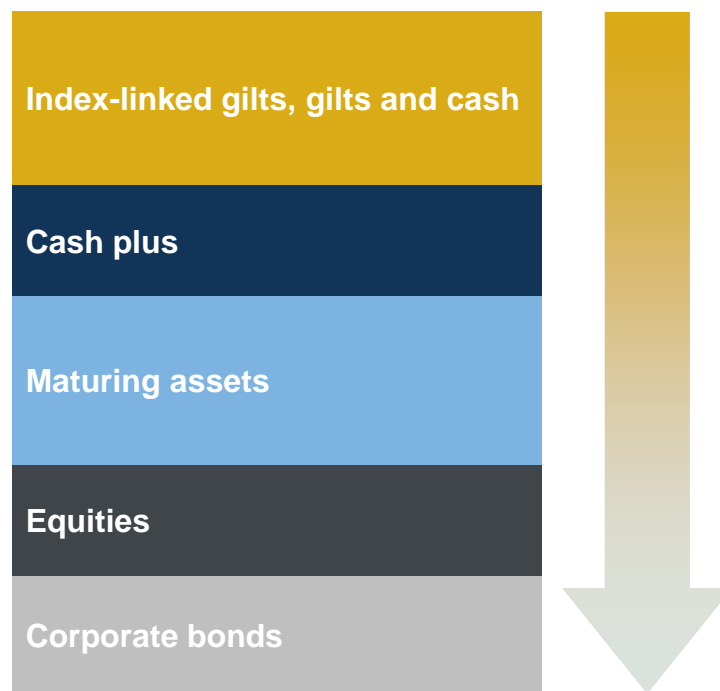


Institute  
and Faculty  
of Actuaries



# Use investment toolkit available

- Liquid assets
- Use repo to generate cash
- Cash plus assets
- Maturing assets
- Physical equities replaced with 'synthetic' equities
- Physical credit can be replaced with 'synthetic' instruments
- Use single collateral pool



For illustrative purposes only.



Institute  
and Faculty  
of Actuaries

# Dealing with lower liquidity?

- Focus on cash flow management
- Investing in maturing assets
- Use investment toolkit available



# Agenda

1

What does 'liquidity' mean?

2

Liquidity management for defined benefit (DB) pension schemes

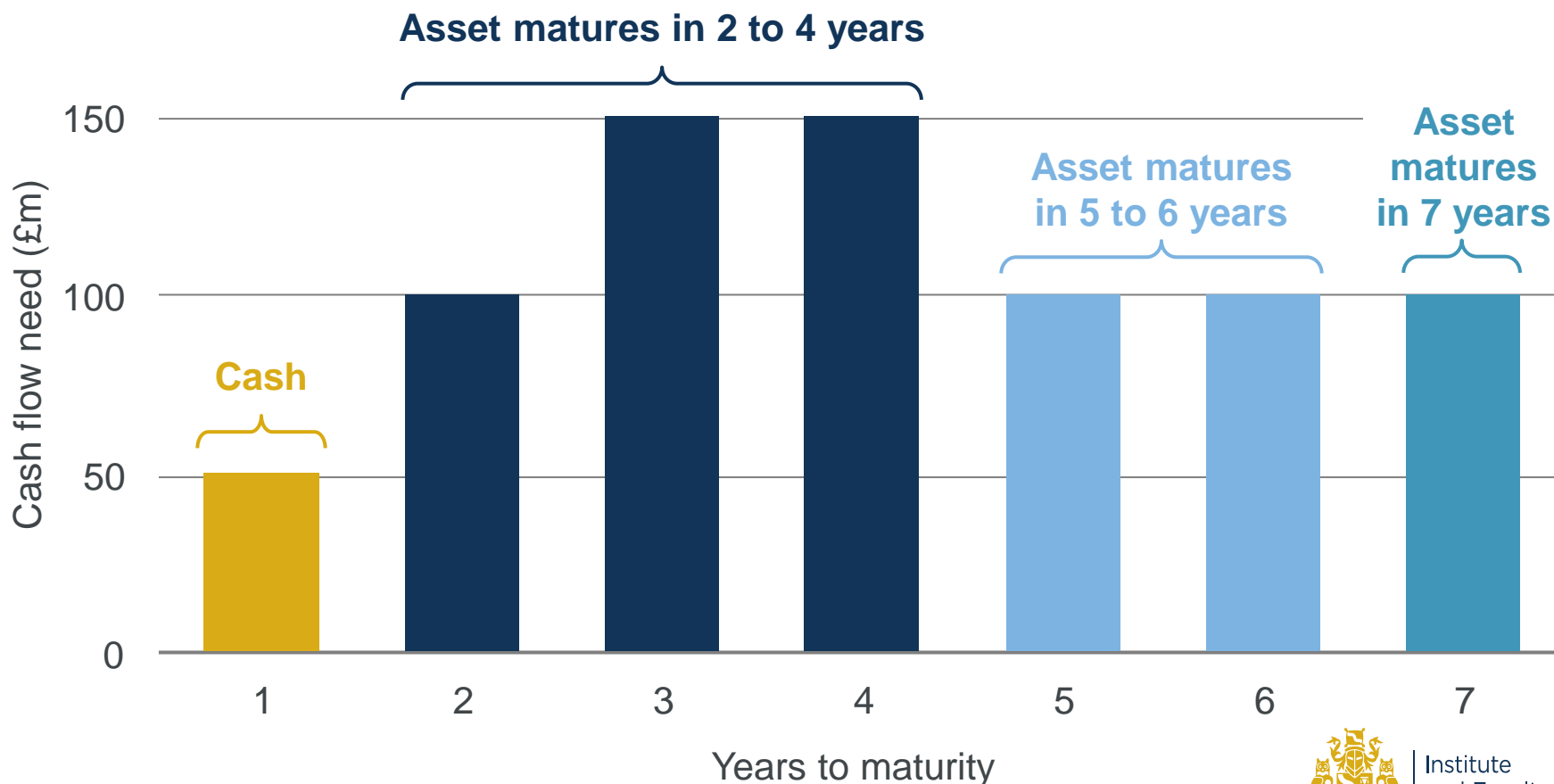
3

Is it an opportunity?



# Use illiquid assets to meet liquidity needs

Structure a 'maturity ladder' of illiquid assets



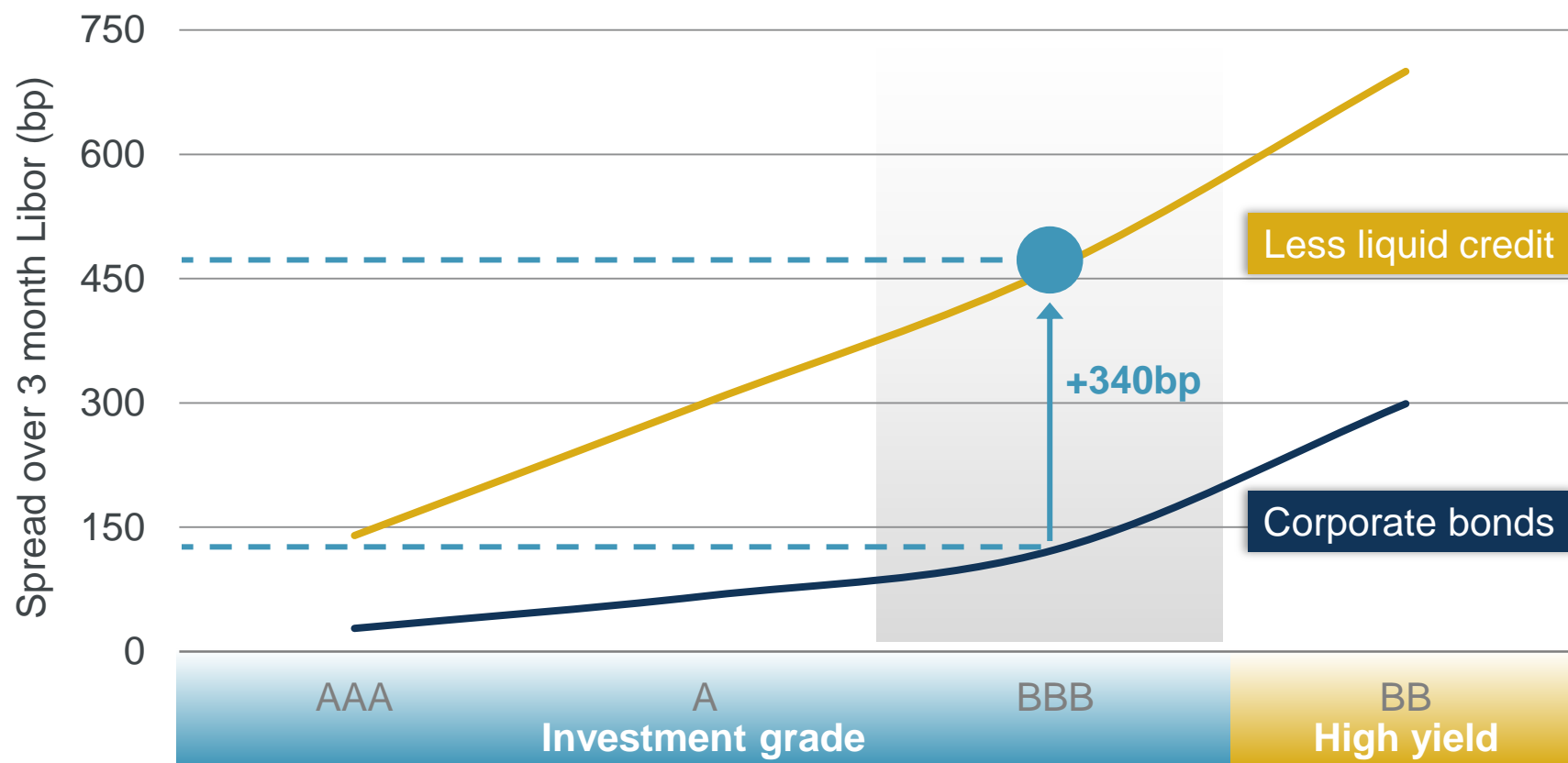
For illustrative purposes.



Institute  
and Faculty  
of Actuaries

# Attractive risk-adjusted returns

Giving up liquidity can improve returns



Source: Insight. Data as at 30 June 2016. The spreads shown are for illustrative purposes and actual results may differ.



Institute  
and Faculty  
of Actuaries

# Examples of less liquid credit

Public and private asset backed securities

	Residential and consumer	Commercial real estate	Secured corporate
Public	<ul style="list-style-type: none"><li>• Residential mortgage backed securities (RMBS)</li><li>• Buy-to-let RMBS</li><li>• Non-conforming RMBS</li></ul>	<ul style="list-style-type: none"><li>• Collateralised mortgage backed securities (CMBS)</li></ul>	<ul style="list-style-type: none"><li>• Collateralised loan obligations (CLO)</li><li>• Whole business securitisations (WBS)</li></ul>
Private	<ul style="list-style-type: none"><li>• Mortgage warehouse</li><li>• Bridge lending</li><li>• Auto/credit card warehouse</li></ul>	<ul style="list-style-type: none"><li>• Office</li><li>• Retail</li><li>• Hotel</li></ul>	<ul style="list-style-type: none"><li>• Corporate loan warehouse</li><li>• SME warehouse</li></ul>



# Summary

- Liquidity in financial markets has decreased
- Pension schemes can deal with lower liquidity through:
  - Focus on cash flow management
  - Investing in maturing assets
  - Use investment toolkit available
- Attractive opportunities are available to those managing liquidity well



# Questions

# Comments

The views expressed in this [publication/presentation] are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this [publication/presentation].

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this [publication/presentation] be reproduced without the written permission of the IFoA [*or authors, in the case of non-IFoA research*].



Institute  
and Faculty  
of Actuaries



# Notes

This is a marketing document intended for professional clients only and should not be made available to or relied upon by retail clients. Unless otherwise stated, the source of information is Insight Investment. Any forecasts or opinions are Insight Investment's own at the date of this document (or as otherwise specified) and may change. Material in this publication is for general information only and is not advice, proper advice (in accordance with the UK Pensions Act 1995), investment advice or recommendation of any purchase or sale of any security. It should not be regarded as a guarantee of future performance. The value of investments and any income from them will fluctuate and is not guaranteed (this may partly be due to exchange rate changes) and investors may not get back the amount invested. Past performance is not a guide to future performance. This document must not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such offer or solicitation is unlawful or otherwise not permitted. This document should not be amended or forwarded to a third party without consent from Insight Investment.

Telephone calls may be recorded.

**For clients and prospects of Insight Investment Management (Global) Limited:**

Issued by Insight Investment Management (Global) Limited. Registered in England and Wales. Registered office 160 Queen Victoria Street, London EC4V 4LA; registered number 00827982.

**For clients and prospects of Insight Investment Funds Management Limited:**

Issued by Insight Investment Funds Management Limited. Registered in England and Wales. Registered office 160 Queen Victoria Street, London EC4V 4LA; registered number 01835691.

**For clients and prospects of Pareto Investment Management Limited:**

Issued by Pareto Investment Management Limited. Registered in England and Wales. Registered office 160 Queen Victoria Street, London EC4V 4LA; registered number 03169281.

Insight Investment Management (Global) Limited, Insight Investment Funds Management Limited and Pareto Investment Management Limited are authorised and regulated by the Financial Conduct Authority in the UK. Insight Investment Management (Global) Limited and Pareto Investment Management Limited are authorised to operate across Europe in accordance with the provisions of the European passport under Directive 2004/39 on markets in financial instruments.

**For clients and prospects based in Singapore:**

**This material is for Institutional Investors only.**

This documentation has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, it and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of Shares may not be circulated or distributed, nor may Shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor pursuant to Section 304 of the Securities and Futures Act, Chapter 289 of Singapore (the "SFA") or (ii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

**For clients and prospects based in Australia:**

**This material is for wholesale clients only and is not intended for distribution to, nor should it be relied upon by, retail clients.**

Insight Investment Management (Global) Limited is exempt from the requirement to hold an Australian financial services license under the Australian Securities and Investments Commission Corporations Act 2001 in respect of the financial services it provides. Insight Investment Management (Global) Limited is authorised and regulated by the Financial Conduct Authority under UK laws, which differ from Australian laws.

© 2016 Insight Investment. All rights reserved.



Institute  
and Faculty  
of Actuaries