

What's next for LDI? Preparing for the End Game

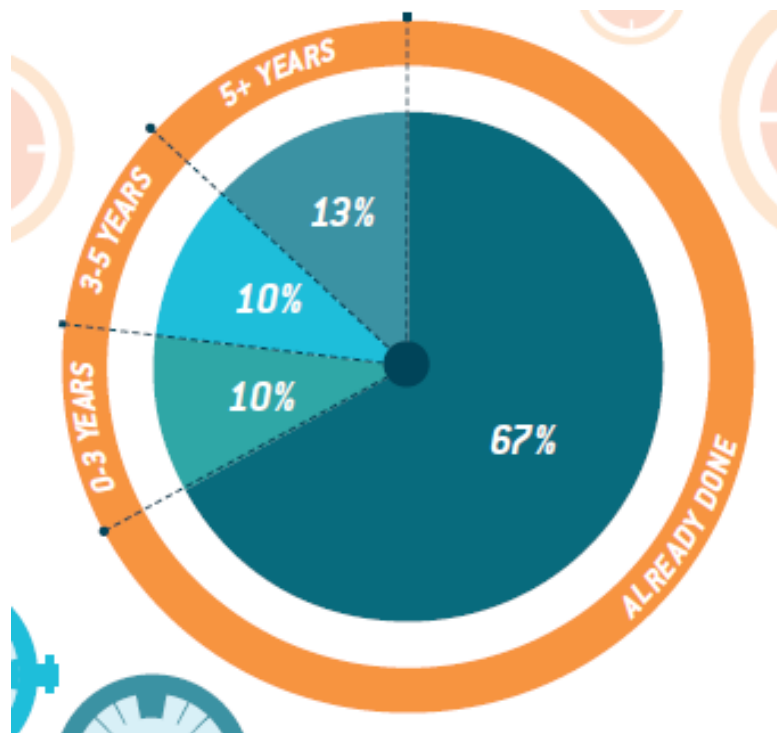


Helping clients meet their objectives

Laura Brown, Head of LDI Distribution. Legal & General Investment Management

What's next for LDI?

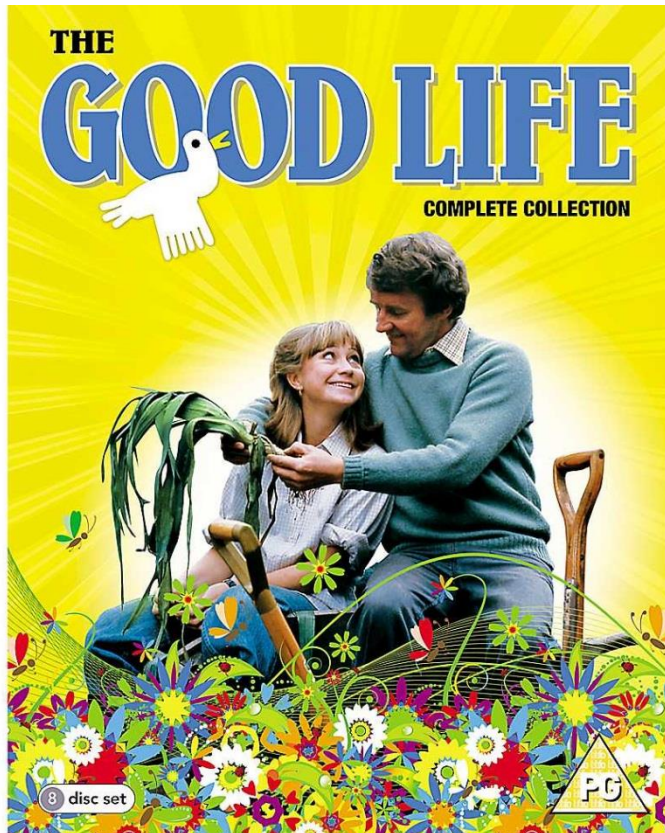
Time horizon for implementing LDI



1. Corporate bonds are going to be more important than you think
2. LDI is not a set and forget strategy, it needs management over time
3. Liability benchmarks will include a corporate bond based discount rate

Where are we heading?

Self-sufficiency – the Good Life?



- Trustees have an expectation of meeting cashflows as they fall due
- Without the need for further sponsor contributions
- With an acceptable risk of failure

Like an insurer?



Buy-out – time to sell out?



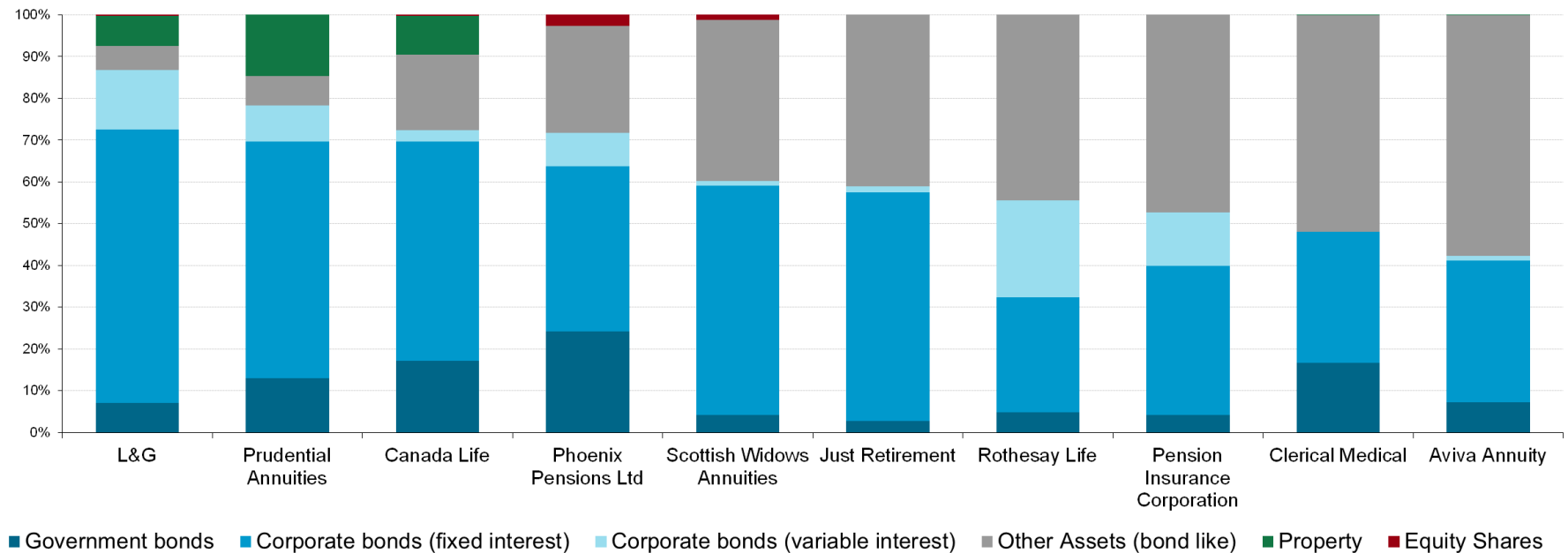
- Buy-in all or part of the liabilities with an insurance company
- Remove longevity and market risk
- Ultimate goal of a full scheme buy-out

How to get there?



How do insurers invest? Annuity books

How insurance companies invest in respect of existing annuity policies

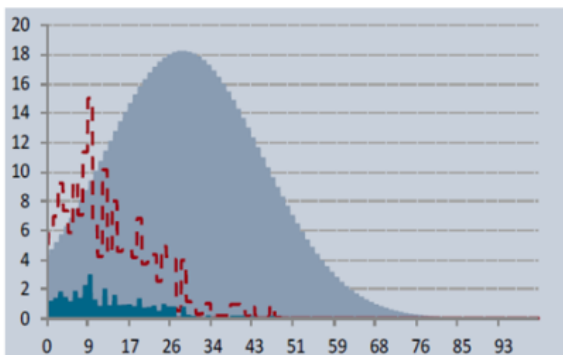


Other assets (bond like): assets in the fixed income bracket, including loans backed by mortgages, social housing loans, commercial real estate debt, equity release mortgages

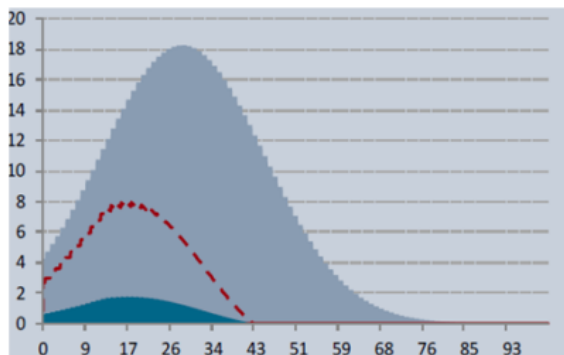
Preparing for buy-out...

Self sufficiency: matching portfolios to pay pensions

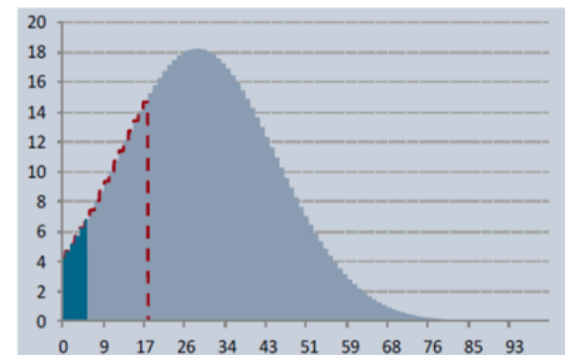
Contribution of credit portfolios to cashflows



Typical benchmark approach



Shaped to liabilities



Focused on delivering cashflows

Holistic management essential to ensure long-term stability



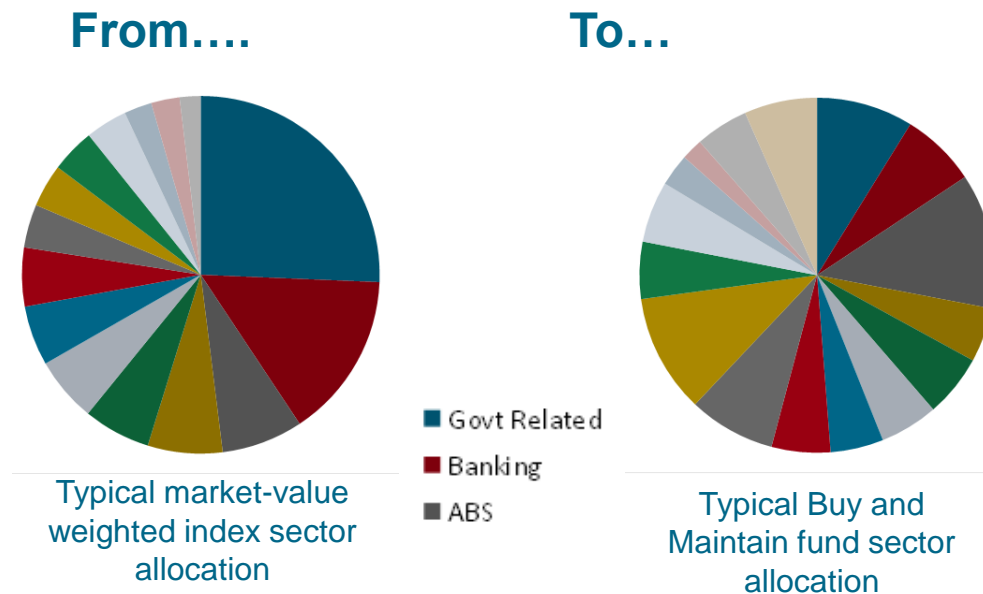
Our investment process



Making LDI and fixed income assets work together to pay pensions

Paying pensions: Buy and maintain credit

- **Better diversification:** Access to global markets; avoid index pitfalls
- **Liability-aware:** Focus on bonds which will help you pay pensions
- **Avoid unnecessary costs:** Low turnover; scale/access matters



LGIM's fund is managed similarly to £40bn annuity book

Buy-out: what really matters?

1

Improve buy-out **funding level**

...by investing in credit assets to generate an expected yield above the evolution of the buy-out price

2

Minimise buy-out funding level **volatility**

...by investing in assets that reflect the primary drivers of buy-out pricing 100% hedged for rates/inflation

3

Minimise buy-out transition **costs**

...by investing in assets which can be transferred efficiently at low cost to the life insurer



Investing in gilts only?



Better options for funding level and volatility...

What should a buy-out aware portfolio look like?

ILLUSTRATIVE

KEY INPUTS

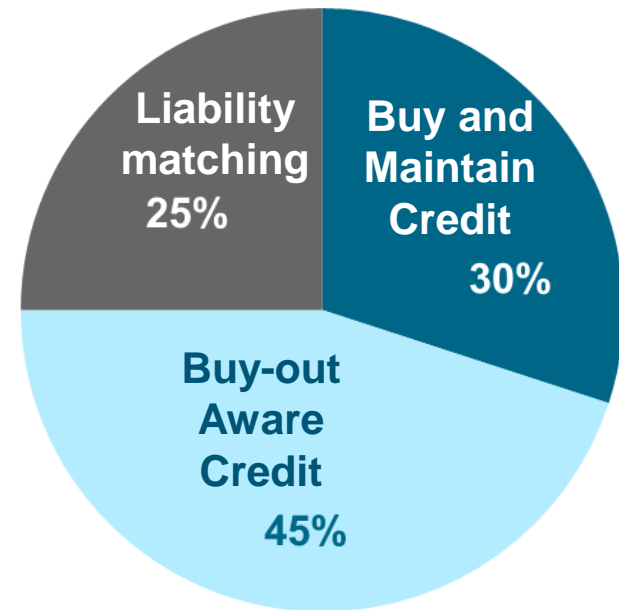
Annuity pricing from range of insurers

Insurance industry regulatory and investment constraints

Corporate bond and gilts market data



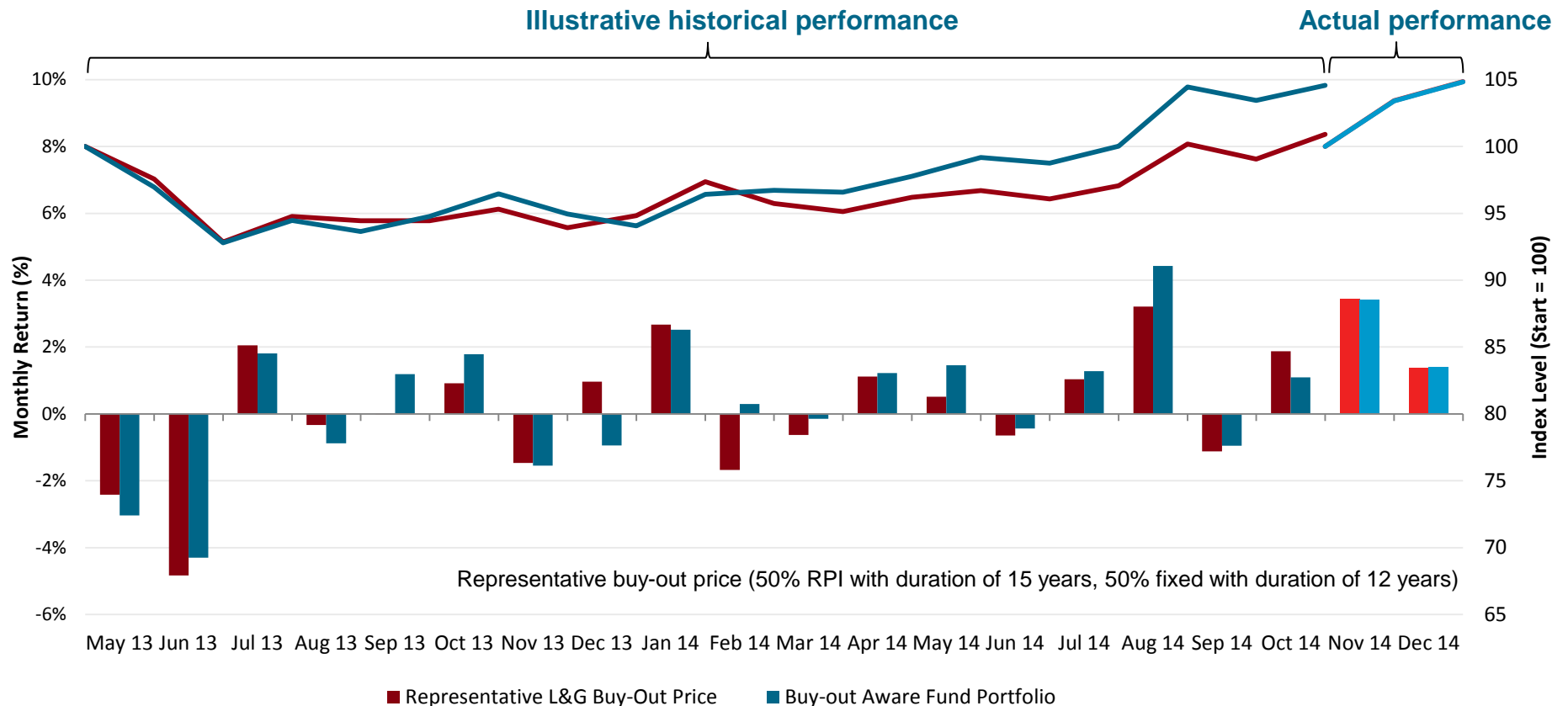
BUY-OUT AWARE PORTFOLIO



...buy-out aware portfolio to provide return over liabilities



Closing the gap to buy-out over time



...combined with liability benchmarks allowing for credit

Source: LGIM; Note: Using model points that are provided by L&G to various consultants we have approximated the evolution of the L&G buy-out price since May 2013, together with an estimate of the historical monthly performance of the proposed strategy compared to the current strategy; to give a non-subjective back-test we assumed that the proposed allocation was not adjusted through time whereas in practice this would not be the case. We note that part of the above outperformance is due to buy-out pricing improvements over the last 12-18 months due to non market factors, including the impact of the UK Budget in March 2014

Don't miss the boat!



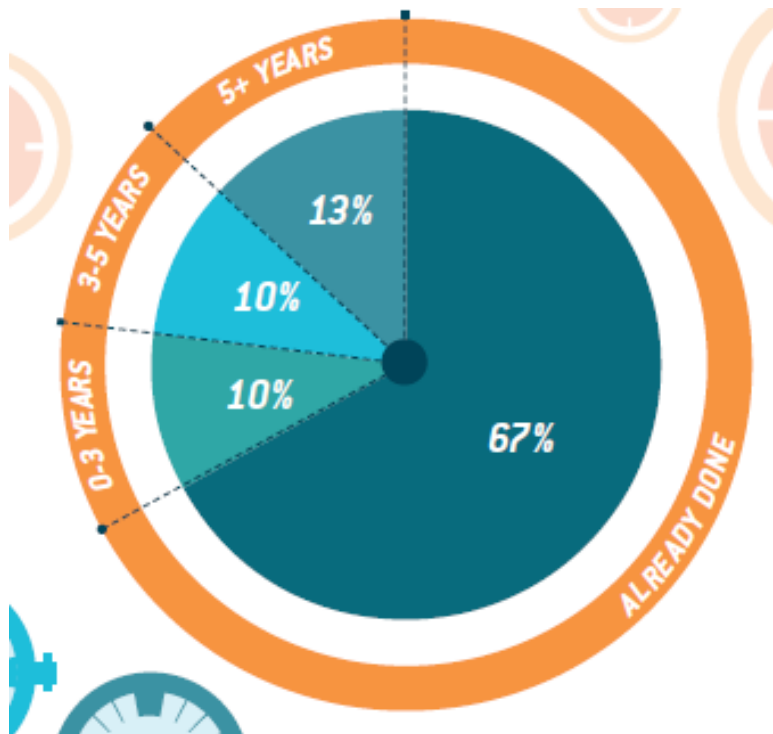
Have a plan and be ready to implement

- Get plumbing in place to be ready to capture opportunities
- Focus on long-term strategy rather than short-term tactics
- Have a Plan B for when things don't go according to Plan A
- Combination of (related) options commonly used by clients:
 - Market level
 - Funding level
 - Timing

Volatility could bring opportunities

Summary: What next for LDI strategies?

Time horizon for implementing LDI



1. Corporate bonds are going to be more important than you think
2. LDI is not a set and forget strategy, it needs management over time
3. Liability benchmarks will include a corporate bond based discount rate

Focus on the ultimate objective, paying pensions

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