

Is your LDI portfolio providing the protection you expect?

Liability Driven Investment (LDI) is an essential part of any DB pension scheme's investment strategy

If your scheme invests on a bespoke (ie non-pooled) basis, this typically involves the use of a custom LDI benchmark, unique to the cashflows of your own scheme. This ensures a more precise “match” to your liabilities.

Generally speaking, the higher your hedge ratio, the more important it is to ensure that your LDI benchmark remains an accurate representation of your liabilities.

A bespoke benchmark can quickly “drift” away from the liabilities it was intended to match, due to changes in assumptions, member actions and experience.

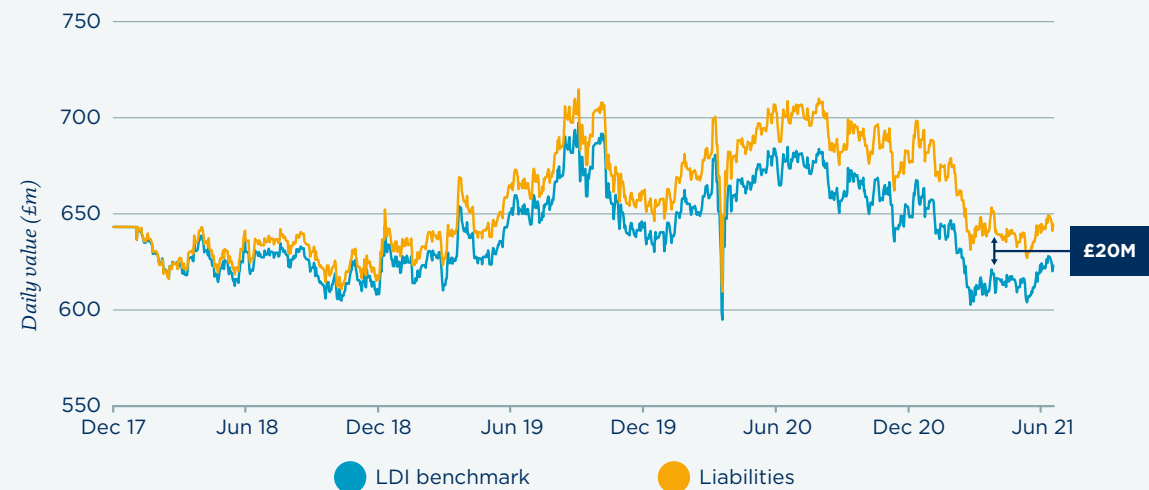
If not updated regularly, you may find that your LDI portfolio is not providing the level of protection you expected against movements in interest rates and inflation expectations - this could lead to a nasty surprise in the form of an emerging deficit.

Case study – reality not matching expectations

The pension scheme in this case study was fully funded at its last actuarial valuation date, with a target 100% liability hedge ratio.

Over the subsequent 3-4 year period, the chart below shows how the value of the LDI benchmark would have drifted vs the liabilities, had it not been updated regularly.

The result was that **a deficit of c£20m would have emerged due to movements in interest rates and inflation expectations** even though the LDI benchmark was designed to protect against 100% of these movements.



Source: LCP Visualise

When and how should you review your LDI benchmark?

It's a good idea to review your LDI benchmark if one or more of the below has occurred for your scheme

Triennial valuation	New assumptions for discount rate, mortality or inflation expectations can fundamentally change the shape, size and/or sensitivity of your expected cashflows.
Member option take up	A significant increase in transfer values could fundamentally change the shape and size of your cashflows.
Market movements	A significant change in inflation expectations can impact the sensitivity of your liabilities to future changes in inflation.
Closure to accrual	Closing a scheme to accrual will shorten the average term of your cashflows.
Change in benefit structure	A change in pension increase types, can impact the sensitivity of a scheme's liabilities to future changes in inflation.
Change in investment strategy	A change in allocation to bond-type assets and/or liability hedge ratios can change the characteristics required of an LDI benchmark.
Change in valuation model	If your Scheme Actuary changes its model for valuing the Scheme's liabilities (or you appoint a new Scheme Actuary), it's important to reflect these valuation changes in the LDI benchmark.

As your Scheme Actuary, we are well placed to help you with a review of your LDI benchmark, as your scheme cashflows are already available to us and we have all the necessary scheme knowledge to perform this technical task

In addition to this, our LDI benchmark review offering gives you access to the following:

- A consultancy with decades of experience providing both actuarial and investment advice, meaning we understand DB pension scheme liabilities, and how best to “hedge” them.
- Our in-house modelling tool (LCP Visualise), is capable of designing, reviewing and monitoring your LDI benchmark through time (including warning you to portfolio deviations, and the reasons for this) – this includes more complex valuation approaches, such as “inflation+” approaches to discounting liabilities.
- Alongside your usual LCP team, a dedicated LDI expert is assigned to your benchmark design.
- We have designed and implemented LDI benchmarks with all the established LDI managers, meaning we know how to work with them to get things done efficiently.
- We offer a competitive fee, tailored to your needs, available on a fixed fee basis if preferred to provide certainty of cost.

Contact us

If you would like more information please contact your usual LCP adviser or one of our specialists below.



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