SEI Institutional Solutions

PENSION MANAGEMENT RESEARCH PANEL

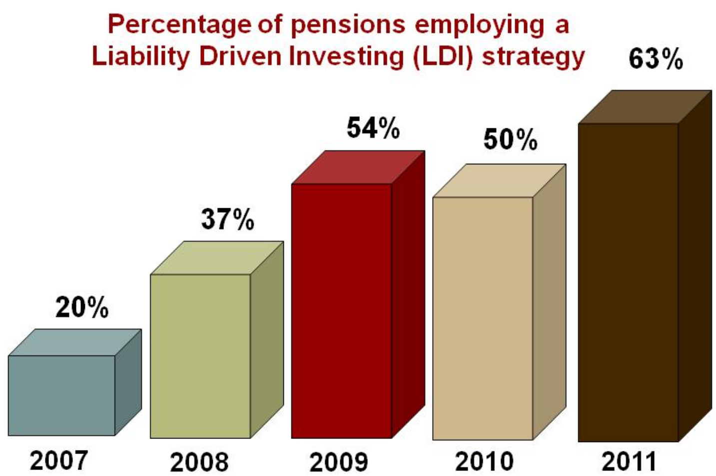
5th Annual Liability Driven Investing (LDI) Poll: More Plan Sponsors Using LDI than in Years Past

The **Pension Management Research Panel** recently conducted the 5th Annual Global Quick Poll on liability driven investing (LDI). The poll was completed by 100 pension executives from the United States, Canada, the United Kingdom, and Netherlands. The executives oversee pensions ranging from U.S. $30 million to more than U.S. $5 billion in assets. None of the participating organizations are institutional clients of SEI. The goal of the poll was to examine how perceptions around LDI strategies have changed during the past five years.

Section I - The Current State of Liability Driven Investing

- Adoption of LDI strategies is the highest it has been in the past five years

In 2007, 20 percent of polled organizations said they were employing an LDI strategy within pension investments. In 2008, that number grew to more than one-third (37 percent), and in 2009 more than half (54 percent) employed LDI strategies. In 2010, the number dipped a little to 50 percent. This year, the number of polled organizations currently employing an LDI strategy is the highest it's been in the five-year history of the poll, with almost two-thirds of all respondents (63 percent) now using this type of pension investment strategy.



- What is the mindset of those not currently employing an LDI strategy?

Of the 37 percent of poll respondents not currently using an LDI strategy, 23 percent said their organizations are considering employing such an approach in 2012. Only 14 percent of poll participants responded that they are not considering an LDI approach at this time.

If those organizations considering an LDI strategy follow through on implementation, and if current users stay the course, it would mean nearly all (86 percent) of the poll participants could be using an LDI investment model by the end of next year.

Section II - The Goals and Objectives of LDI

- How do pension executives define LDI?

The first year this poll was conducted (2007), one of the ongoing industry debates was around whether or not LDI is a specific strategy or if it is a broader context under which a number of different strategies would qualify. Over the past five years, poll participants validated that LDI is widely considered a variety of strategies customized to a specific organization and its goals.

The trend of the previous years had been two definitions being more popular than the others – “a portfolio designed to be risk managed with respect to liabilities” and “matching duration of assets to duration of liabilities” – with the percentage difference between the two relatively close each year.

However, in 2011, poll respondents made a more definitive choice between these two descriptions, with almost half of respondents (46 percent) selecting “matching duration of assets to duration of liabilities” as the proper definition of LDI. This is the highest all-time percentage for any one definition. At the same time, while it was still the second most popular definition, “a portfolio designed to be risk managed with respect to liabilities,” saw a decrease in popularity by 15 percent.

The following chart shows a breakdown of the popularity of these definitions, with the highest-ranking definition each year highlighted in orange.

	TREND	2011	2010	2009	2008	2007
Matching duration of assets to duration of liabilities	⇧	46%	30%	40%	30%	41%
A portfolio designed to be risk managed with respect to liabilities	⇩	24%	39%	32%	34%	38%
Immunizing the plan’s liabilities with fixed income securities	⇧	12%	7%	5%	6%	2%
Forcing asset performance to mimic liability performance	⇧	9%	3%	8%	6%	4%
Consideration of liability pool and/or costs in setting asset allocation strategy	⇩	5%	12%	7%	14%	12%
Use of derivative instruments such as interest rate swaps with the plan’s assets	⇩	2%	4%	1%	1%	2%
Other	⇩	2%	5%	7%	9%	1%

- What are the objectives of LDI?

Ongoing market volatility coupled with fluctuations in interest rates has led those overseeing pensions to consider a variety of investment strategies to gain more control of funding levels. As pensions consider the adoption of LDI strategies, the objectives of those strategies must be aligned with the objectives of the pension and the plan sponsor. For the fifth consecutive year, poll participants were asked to identify what they felt were the primary objectives of an LDI strategy and for the fifth straight year, the most popular response was to "control year-to-year volatility of funded status." The number of respondents identifying this as an objective has remained close to the same as the first year of the poll; however, the overall percentage decreased eight percentage points from last year.

One objective that saw a notable increase in popularity this year was to "minimize or maximize impact on corporate liquidity/cash flow." Never previously having more than 35 percent of poll respondents identifying this as a goal, the objective saw an increase of 18 percent of respondents from last year's total (23 percent) and may signal that this has become an increased priority.

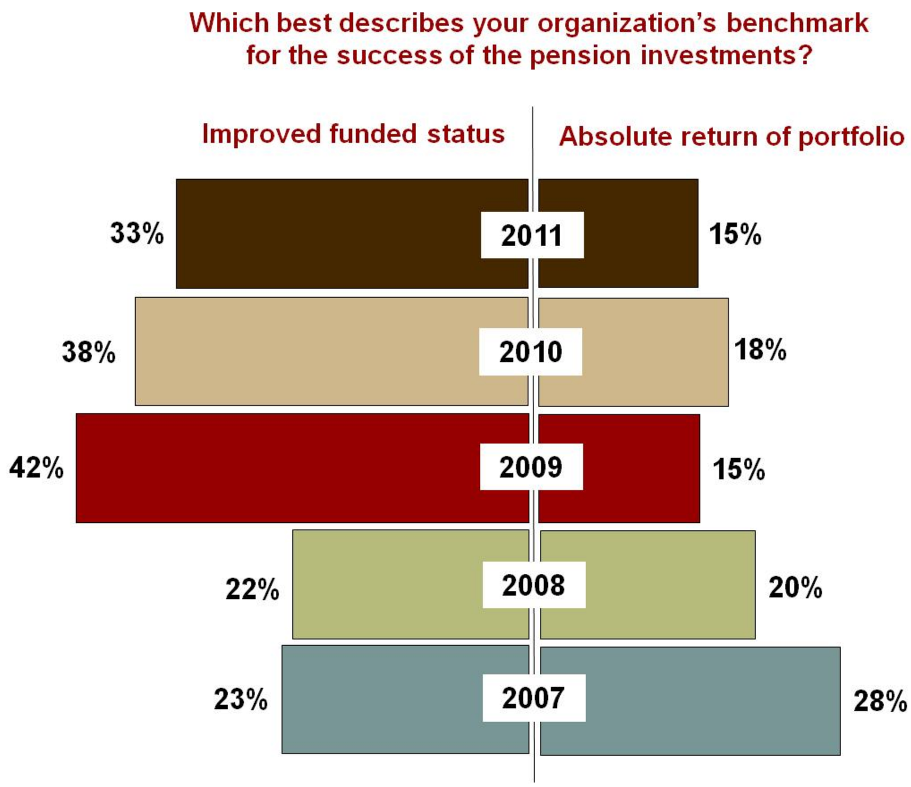
The following chart illustrates what poll participants felt were the primary objectives of an LDI strategy and how the overall percentage that selected each objective has changed year by year:

	TREND	2011	2010	2009	2008	2007
To control year-to-year volatility of funded status	⇩	78%	86%	90%	79%	79%
To control contribution and/or pension expense	⇧	46%	43%	51%	45%	46%
Minimize or maximize impact on corporate liquidity/cash flow	⇧	41%	23%	35%	30%	31%
Improve funding levels	⇩	26%	28%	24%	14%	19%
Avoid the minimum funding liability	⇩	5%	7%	9%	13%	14%

- What are the benchmarks for pension success and are they changing?

Over the past five years, this poll has asked participants to identify the primary benchmark for success of the pension's investments. In 2007, the highest percentage of poll respondents viewed the primary benchmark as "absolute return of the portfolio" and ranked it first. This measure is singularly focused on assets and was generally the historical focus of pension investments. However, as an increased emphasis has been placed on the liability portion of the pension, the consensus has changed. Over the past three years, the benchmark of "improved funded status" – which considers both assets and liabilities – has become the most popular choice by a greater margin.

The graphic below illustrates the contrast of poll respondents selecting the benchmarks for pension investments as "improved funded status" or "absolute return of portfolio" in 2007 versus 2011:



This year, 85 percent (vs. 82 percent in 2010) of respondents indicated that their benchmark was tied to whether or not the asset pool provided some level of support to the liabilities. "Improve funded status" remains as the most popular choice (33 percent) and is followed by "minimize or control contribution requirements" (25 percent), which saw a three percent increase from 2010. Additionally, 20 percent of all poll respondents said the primary benchmark for success of pension investments was to either "protect" the current funded status or "maintain" the funded status despite market changes.

Section III – Asset Allocation Decisions

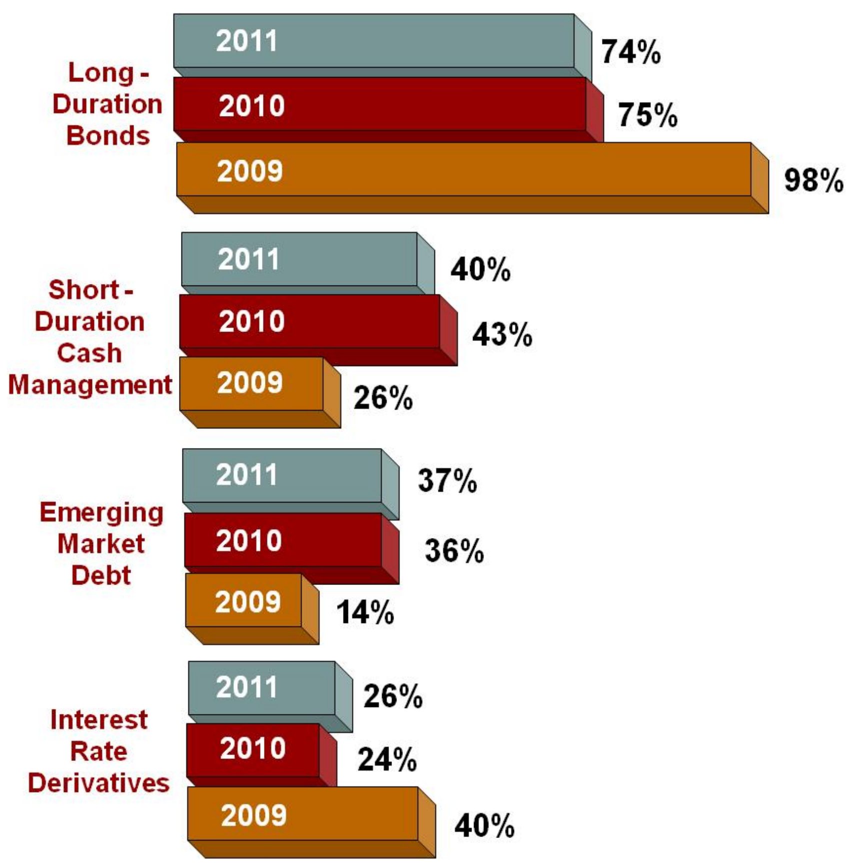
- Which investment products are being used or considered?

  Of the options provided in the poll, long-duration bonds are still the most commonly used investment product by a far margin, as bonds and liability values are similarly sensitive to interest rates. This year, 74 percent of poll participants said their organizations are currently using this product, a slight one percent decrease from 2010, but still the most popular choice for the third consecutive year.

  The second most common product this year was again short-duration cash management, despite a slight decrease in usage (40 percent this year vs. 43 percent last year). The use of emerging-market debt continued to be strong with 37 percent of the poll respondents saying this is a strategy currently in use. This product saw a one percent increase from last year and is close to matching short-duration cash management as the second most popular choice.

  The use of hedge funds as an investment product also grew this year to 34 percent from 29 percent in 2010. There was a slight decrease (6 percent) in the number of poll respondents using private equity in 2011, but it remained a solid choice with 28 percent saying that they use this product. Use of interest rate derivatives as an investment product in 2011 remained about the same as 2010 (26 percent versus 24 percent) and continues to be used less than in 2009 (40 percent).

  The below graphic shows how some investment products have trended over the past three years:



Conclusion

During the past five years, liability driven investing (LDI) has grown in popularity worldwide as pension plan sponsors continue to shift focus away from return of assets alone and look toward the liability portion within pension investments. According to the poll, global implementation of LDI strategies has more than tripled since 2007. There is also growing consensus in the industry this year around the often disputed definition of LDI - signaling that such an approach has become a standard pension investment strategy.

Since the start of the poll, respondents continue each year to identify the top goal of an LDI investment strategy as "controlling the volatility of funded status." The consistent emphasis on funded status has also changed the success metric for pension investments with the "absolute return of the portfolio" as the top measure in 2007 and now "improved funded status" as the top measure in 2011.

Pension portfolios use a variety of strategies to best meet the goal of maintaining or improving funded status of pension funds. Of the options provided in the poll, long-duration bonds continue to be the most common strategy each year, as bonds and liability values are similarly sensitive to interest rates. Short-duration cash management is also a popular choice for asset allocation. Newer investment products such as emerging market debt are growing in popularity, but common use of interest rate derivatives remains low again this year.

As more organizations work to improve the funded status of their pension plans and implement long-term strategies in a complex market, more plan sponsors are consistently using LDI as a key strategy in meeting these goals. The results of this poll show a trend towards global acceptance and continued overall support of investment strategies that consistently consider the liabilities in the pension.

If you have any questions or comments about the results of this poll, please feel free to contact us via email at SEIRESEARCH@SEIC.COM.

Pension Management Research Panel