

## PENSION MANAGEMENT RESEARCH PANEL

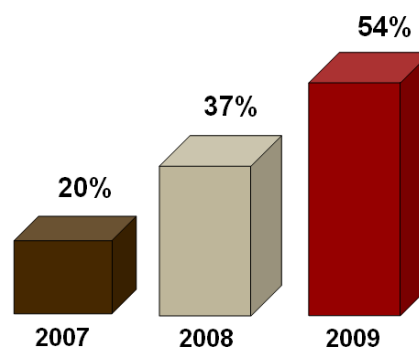
## Third Annual Liability Driven Investing (LDI) Poll: Globally, LDI Has Entered the Mainstream

The **Pension Management Research Panel** recently conducted the 3<sup>rd</sup> Annual Global Quick Poll on Liability Driven Investing (LDI). The poll was completed by 150 pension executives from Canada, Netherlands, United Kingdom and United States. The executives oversee pensions ranging from US \$30 million to more than US \$5 billion in assets. The aim of this poll was to examine how attitudes around LDI strategies have changed over the past three years. Additionally, the poll sought to understand what, if any, impact the economic environment has had on LDI strategies.

### The State of Liability Driven Investing

- Adoption of LDI strategies has increased steadily and significantly during the past three years**  
 In 2007, 20 percent of polled organizations said they were employing an LDI strategy within pension investments. In 2008, more than one-third (37 percent) employed LDI strategies, and in 2009 more than half (54 percent) utilized some form of LDI strategy.
- Many LDI strategies recently implemented**  
 More than one-third (37 percent) of organizations polled currently using an LDI strategy said they implemented this tactic within the past twelve months.
- Recent market volatility increases value of LDI**  
 Nearly three quarters of those polled (70 percent) agreed that the market volatility over the past year has increased the benefits of an LDI approach when it comes to pension management.
- Not many moving away from LDI**  
 Of the poll participants that are *not* currently employing an LDI approach, 90 percent have never done so in the past. This means that only 4 percent of all poll participants have had an experience with an LDI approach yet stopped using it.
- What are the objectives of LDI?**  
 The market turmoil of late 2008 and early 2009 caused funding-level volatility due to asset depreciation and a bumpy path toward recovery. In addition, interest rates have pushed toward record highs and lows, adding to the havoc with funding levels. As a result, many pensions have increased their consideration and adoption of LDI strategies.

Percentage of pensions employing a Liability Driven Investing (LDI) strategy



For the third consecutive year, poll participants were asked to identify what they felt were the primary objectives of an LDI strategy, and for the third straight year the most popular response was to “control year-to-year volatility of funded status.” While this remains the main objective, it is important to recognize how this response has grown over recent years. In 2007 and 2008, slightly more than three-quarters (79 percent) said controlling year-to-year volatility of funded status was the key concern. In 2009, that figure jumped to 90 percent. In fact, of the five objectives of LDI, four saw increased percentages. The only objective that decreased was “avoiding the minimum funding liability”.

Below is a breakdown of what poll participants felt were the primary objectives of an LDI strategy by year:

	TREND	2009	2008	2007
To control year-to-year volatility of funded status	↑↑	90%	79%	79%
To control contribution and/or pension expense	↑	51%	45%	46%
Minimize or maximize impact on corporate liquidity/cash flow	↑	35%	30%	31%
Improve funding levels	↑	24%	14%	19%
Avoid the minimum funding liability	↓	9%	13%	14%

- How do pension executives define LDI?

When the first LDI poll was conducted in 2007, one of the ongoing public debates about LDI was whether it is a specific strategy or if it is a broader context under which a number of different strategies would qualify. Each year, poll participants continue to validate that LDI is widely considered a variety of strategies customized to a specific organization and its goals. However, it is important to recognize that a definition of “addressing interest rate risk” has moved significantly ahead of other definitions. Here is a breakdown of the popularity of these definitions with the highest-ranking definition each year highlighted in orange:

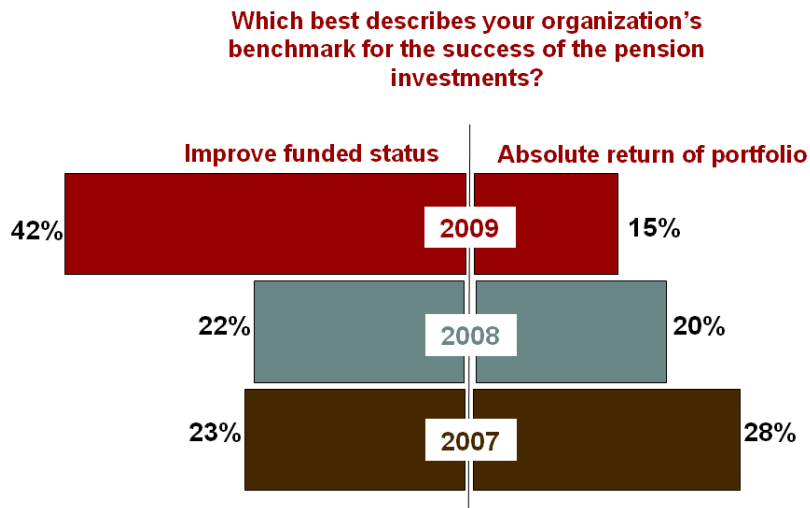
	TREND	2009	2008	2007
Matching duration of assets to duration of liabilities	↔	40%	30%	41%
A portfolio designed to be risk managed with respect to liabilities	↓	32%	34%	38%
Consideration of liability pool and/or costs in setting asset allocation strategy	↓	7%	14%	12%
Forcing asset performance to mimic liability performance	↑	8%	6%	4%
Immunizing the plan's liabilities with fixed income securities	↔	5%	6%	2%
Use of asset classes with reduced volatility	↓	1%	1%	2%

- Pension benchmarks are shifting

Critical to the implementation of an LDI strategy, or any investment strategy, is the success benchmark to which the pension is measured. Two years ago, in 2007, “absolute return” was the highest ranked benchmark with 28 percent of poll participants, last year that dropped to 20 percent. This year, only 15 percent of the poll participants identified “absolute return of the portfolio” as the primary success metric marking the second straight year this has decreased.

When asked to identify the primary benchmark for success of the pension investments this year, 85 percent of respondents indicated their benchmark was tied to whether or not the asset pool provided some level of support to the liabilities. The most popular benchmark for pension success identified in this year's poll was “improved funded status,” chosen by nearly half (42 percent) of the poll participants. The

graphic below illustrates the contrast over the past three years between the percent of participants saying “absolute return” was the primary benchmark versus those saying it is “improved funded status.” As the chart indicates, there is a clear shift towards the latter as the measure of success for pension investments:



## Conclusion

Liability Driven Investing (LDI) continues to be a strategy utilized by pension plans in the countries polled. As more organizations attempt to improve funded status and design long-term strategies, LDI has emerged as one of the key approaches embraced by pensions to achieve that goal.

The mix in attitude towards the overall objective and definition of LDI stems from the fact that LDI is not a single strategy. SEI believes LDI is a framework that focuses on considering risk on a relative basis versus liabilities when making asset allocation decisions, and varies from plan to plan depending on funding status and the sponsoring organizations' unique overall needs. Thus LDI is a dynamic strategy, one that evolves as funding status evolves and organizational goals change over time.

Poll results show that the primary success metric to measure pensions is funded status. The market gains year-to-date have shown kindness to this benchmark, however for those organizations that remain concerned about underfunding, SEI advises a judicious approach to designing a strategy that will avoid locking-in significant expenses. For example, an LDI strategy that increases the allocation to fixed income securities could lock-in losses, requiring the sponsor to make up the difference through future contributions.

Adopting an LDI strategy requires a full understanding of proper implementation and the selection of a correct benchmark is key. Sponsors are advised to work closely with their investment management providers to ensure their LDI strategy provides the desired level of protection against the volatile liabilities within the plans.



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