SEI Institutional Solutions

Pension Management Research Panel

PENSION MANAGEMENT RESEARCH PANEL

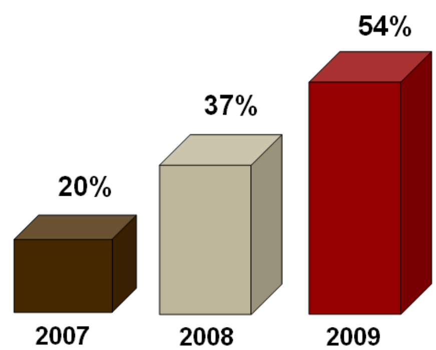
Third Annual Liability Driven Investing (LDI) Poll: Globally, LDI Has Entered the Mainstream

The **Pension Management Research Panel** recently conducted the 3rd 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 and this summary is to examine how feelings around LDI strategies have changed over the past three years. Additionally, the poll sought to understand what, if any, impact the recent 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 LDI strategies.
- 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.

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



- 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.

U.S. Highlights:

In the US, more than half (51 percent) of the poll participants said they are currently implementing an LDI strategy. During the past three years, there has been a steady shift toward utilizing an LDI strategy. In 2007, less than one-fifth (17 percent) used LDI and in 2008, that percentage grew to more than one-third (36 percent). This trend is supported by the fact that more than half (59 percent) of the US pensions polled that use an LDI approach said they implemented their LDI strategies within the past two years.

- ## What are the objectives of LDI?

  The market turmoil of late 2008 and early 2009 has caused funding-level volatility because assets depreciated and have had a bumpy path toward recovery. In addition, interest rates have pushed toward record levels at both the highs and the lows, adding to the havoc with funding levels. As a result, many pensions have increased their consideration and adoption of LDI strategies.

  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 percentage jumped to 90 percent. In fact, of the five objectives of an LDI, four saw increased percentages. The only objective that decreased was avoiding the minimum funding liability.

  Here 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:

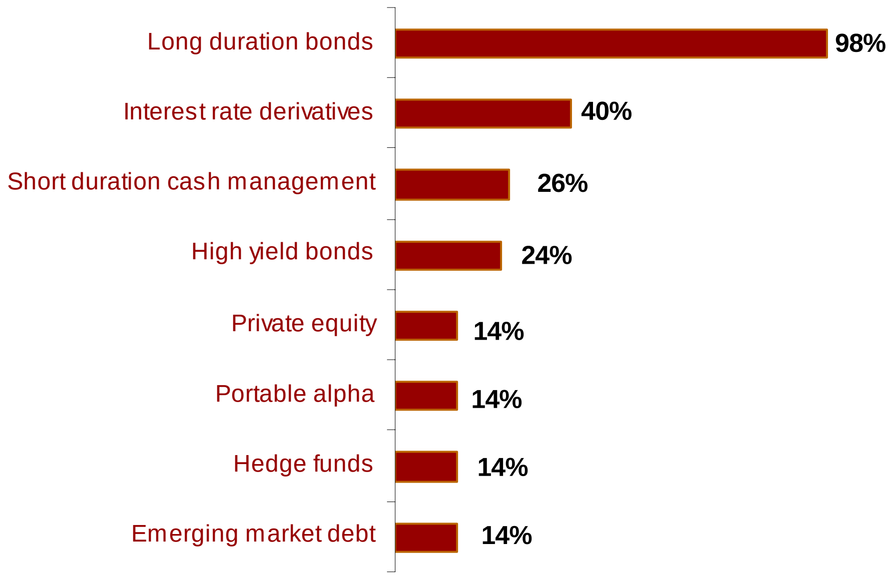
	TREND	2009	2008	2007
Matching duration of assets to duration of liabilities	⇔	40%	30%	41%
A portfolio designed to be risk managed with respect to liabilities	⇩	32%	34%	38%
Consideration of liability pool and/or costs in setting asset allocation strategy	⇩	7%	14%	12%
Forcing asset performance to mimic 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%

U.S. Highlight:

Nearly half (52 percent) of US participants chose “matching duration of assets to duration of liabilities” as the best definition of LDI, greater than any other participating country.

- Long duration bonds are the LDI product of choice

Nearly every poll participant employing LDI (98 percent) said they are using long duration bonds as part of their LDI strategy. While long duration bonds are widely used, the second most common product was interest rate derivatives as 40 percent of participants chose this tactic. This means twice as many pensions are using long duration bonds than any other investment product in their LDI strategy. Other strategies being used by a significant portion of participants included short duration cash management and high yield bonds. Here is a breakdown of the percentage of poll participants using the following products as part of their LDI strategy:



U.S. Highlights:

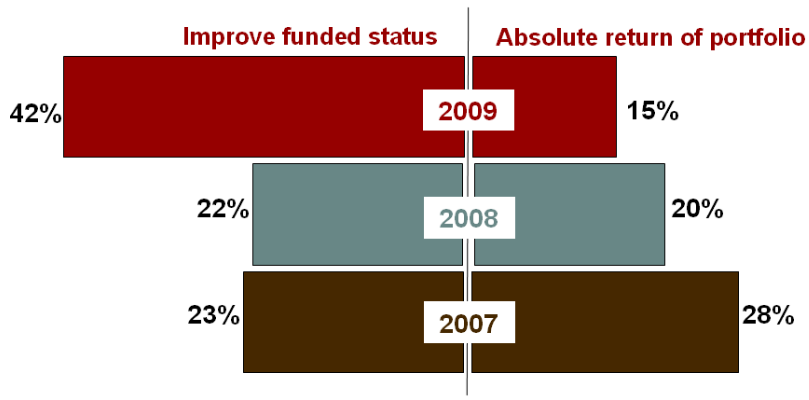
US participants paralleled global results regarding use of long duration bonds. However, there were higher percentages of US participants using interest rate derivatives (46 percent), high yield bonds (27 percent) and portable alpha (17 percent) than any other country.

- 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 and 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:

Which best describes your organization's benchmark for the success of the pension investments?



U.S. Highlights:

In the US, nearly one-quarter (24 percent) of participants felt improved funded status was the benchmark for success, which was lower than in any other country. A nearly equal portion (23 percent) of US participants felt "minimize or control contribution requirements" was the best benchmark and 20 percent felt it was "absolute return."

Conclusion

Liability Driven Investing (LDI) continues to be a strategy utilized by pension plans in the countries polled. When effective, this approach can provide organizations with some protection against the volatile liabilities within the plans. As more organizations attempt to improve funded status and design long-term strategies, LDI has emerged as one of the key strategies embraced by pensions to achieve that goal. The results of this poll show an ongoing shift in attitudes regarding the primary benchmarks for pension success as well as the overall implementation of these strategies.

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