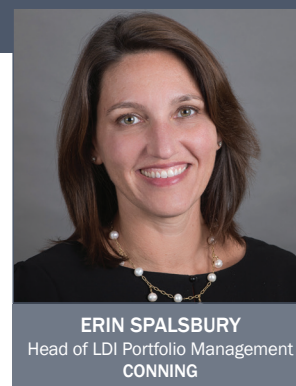


ADVANCEMENTSⁱⁿ Custom LDI



ERIN SPALSBURY
Head of LDI Portfolio Management
CONNING

Risk might not be the final frontier of investment management, but managing it even in times of low volatility is critical to success. And in the context of liability-driven investing, since every pension plan has a different liability obligation, risk appetite and balance sheet, money managers implementing LDI programs have to be especially flexible.

"The first step when a client is thinking of de-risking

is to buy long-dated bonds based on standard market indexes," said Owais Rana, head of investment solutions at Conning. "That's a somewhat blunt instrument and works at the initial stages because most plans are still equity-heavy, which drives a lot of funded status volatility."

However, as more pension plans de-risk and add more bonds (to match assets) to their portfolios, these standard long duration strategies don't al-

ways mirror a liability cash flow. Hence, the assets are not being used most effectively given the underlying risk management objectives.

That's where customization — and flexibility — comes in.

"Customization in the industry today is typically done by holding a portfolio of long-duration government bonds or corporate credit and adding other

products like Treasury STRIPS or derivatives in areas where there is less duration exposure against the liabilities," Rana said.

However, he added, the structure doesn't give the plan exposure to enough credit across the term structure to reflect the underlying liability. To address this, Conning created a series of investment grade credit sleeves reflecting Bloomberg Barclay's benchmark for appropriate credit maturities: 1-5 years, 5-15 years, 15-25 years and over 25 years.

Erin Spalsbury, head of LDI portfolio management at Conning, manages those investments.

"We need to make sure that these sleeves include a wide variety of names and sectors, and that they are fully diversified," Spalsbury said. "We also need to ensure that they are liquid buckets so we're able to continue to invest in those bucketed choices."

Liquidity has not been a problem.

"There's been a lot of talk in the market about whether there is sufficient liquidity in longer bonds," she said. "Right now there is, as corporate issuance this year has been just as strong as the past few years."

The key is that plan sponsors can mix and match allocations to these buckets, or sleeves, which are structured as a collective investment trust (CIT), to meet their individual needs, both on the hedging side and the growth side. The full range of options goes beyond the credit sleeves to include funds offering levered interest rate (Treasury futures/interest rate swaps) and passive U.S. large cap equity and multi-asset class funds. Both growth funds are available on a levered and unlevered basis.

"A pension plan can now cleanly mix and match among growth and hedging funds and customize further within the hedging fund suite to reflect a better match to its plan's liabilities," Rana said.

Now all plans have access to customization, Spalsbury said.

"Everyone will customize for the \$50 billion plan but maybe not for a smaller plan," she said. "Typically, small or medium-sized plans will not have enough assets to warrant a separate account to give them diversification in a customized manner. We can help build a customized strategy for such plans too by buying units into these funds that are benchmarked individually into these credit sleeves." ■

Getting you to your destination while avoiding turbulence along the way.

At Conning, our experienced Liability-Driven Investment (LDI) team delivers customized investment solutions for pension plans throughout their de-risking journey. For more than 30 years, we have delivered innovative, asset liability focused investment mandates for pension plan and insurance clients, and our commitment to disciplined pension risk management is the cornerstone of our LDI philosophy.

PLEASE CONTACT LDI@CONNING.COM TO SPEAK TO A MEMBER OF OUR LDI TEAM.

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