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Pension Management Research Panel

7th Annual

Global Liability Driven Investing (LDI) Poll

Over the past decade, pension investment management has undergone a sophisticated transformation, with increased focus on creating a holistic strategy that incorporates not just asset allocation, but also plan liabilities and goals, corporate finance, and enterprise risk. Many plan sponsors are looking to portfolio strategies that more closely match liabilities and protect plan funded status through difficult market environments.

The Pension Management Research Panel conducted its 7th annual global liability driven investing (LDI) poll to examine how strategies have evolved over the years through varying market environments, changing regulations, and new philosophies of pension investment management. The poll was completed by 130 corporate pension executives from the U.S., Canada and the U.K. None of the participating organizations are institutional clients of SEI. Please note that totals are rounded and may not always equal 100 percent.

FIGURE 1 PARTICIPANTS BY PENSION ASSET SIZE

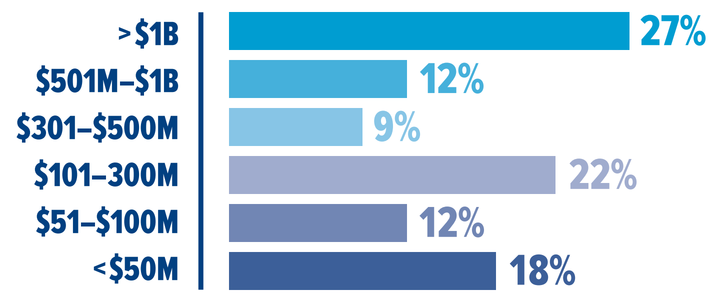
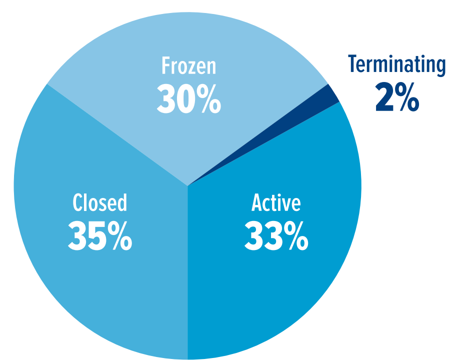


FIGURE 2 PLAN DESIGN STAGE IN 2013



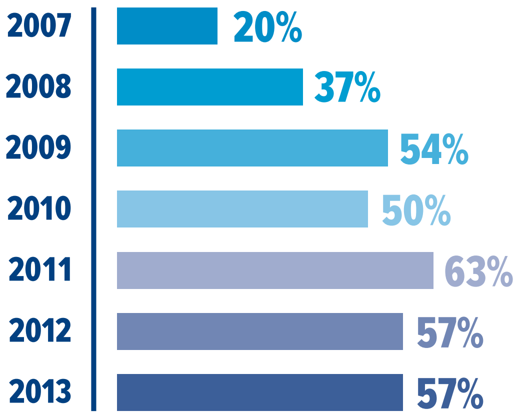
Finding 1—Use of Liability Driven Investing Remains Steady in 2013

Pension plan sponsors worldwide have faced an interesting investment environment year-to-date. Equity markets across the globe have continued to rally throughout 2013, with international equities returning 21 percent since January.[1] In the U.S., capital markets encountered increased uncertainty again as investors reacted to Washington policy confusion. Upon the U.S. Federal Reserve's announcement regarding quantitative easing in May, bond yields rose and then leveled off in early October, remaining at relative low yields.

These factors could be impacting the overall stagnant move into LDI so far this year even in the face of improved funded status levels. While more than half (57 percent) of the poll participants said their organization currently uses an LDI strategy in the pension portfolio, this percentage is unchanged from last year's poll. A significant portion of plans continue to use LDI; however, the overall percentage remains slightly below the highest level of 63 percent reported in 2011.

[1] As of November 30, 2013; MSCI EAFE Index.

FIGURE 3 GLOBAL USE OF AN LDI STRATEGY



For the 43 percent of global plan sponsors not currently using LDI, reasons given were plan underfunding, the low interest rate environment, and, most commonly, hesitation to give up investment returns. One pension plan sponsor in the U.S. emphasized, "we are not willing to forego return and can accept the volatility." Mirroring this sentiment, a pension Trustee in the U.K. said, "strong covenant means that we can carry more risk and obtain higher returns; thus, a greater investment in equities rather than bonds."

Finding 2—Primary Goals for LDI Are Changing

While the primary goal of an LDI strategy—to control funded status volatility—has consistently ranked first since the poll's inception, this year plan sponsors placed increased emphasis on improving funding levels and advancing the pension toward termination.

Last year, controlling contributions and pension expense ranked second in importance for measuring LDI success but has fallen to fourth this year. Likewise, minimizing plan impact on corporate liquidity and cash fell from third to last place. These changes might be a result of plan sponsors increasingly pairing LDI with accelerated contribution strategies in order to more aggressively improve funding levels. As the global economy recovers, plan sponsors with available capital and balance sheet flexibility may now be able and willing to make accelerated payments as part of a de-risking strategy and, in turn, might be more accepting of the corresponding impact on overall corporate finance.

FIGURE 4 RANKING OF LDI GOALS 2013 VS. 2012

2013		2012
Control funded status volatility	1	Control funded status volatility
Improve funding levels	2	Control cash contributions/plan expense
Progress toward termination	3	Minimize plan impact on corporate liquidity/cash
Control cash contributions/plan expense	4	Improve funding levels
Provide predictability of annual costs	5	Progress toward termination
Minimize plan impact on corporate liquidity/cash	6	Provide predictability of annual costs

As you can see in Figure 5, the survey continued to ask participants to identify the primary benchmark for success of their overall pension investment strategy. In 2007 and 2008, the top two benchmarks—“absolute return of the portfolio” and “improved funded status”—were within five and two percentage points of each other, respectively. Over the past five years, that gap has widened to favor the benchmark of “improved funded status,” which incorporates both assets and liabilities. This year, 51 percent of participants ranked this as the top benchmark for pension success, with “absolute return of the portfolio” falling to a historic low of nine percent.

FIGURE 5 TOP FIVE BENCHMARKS FOR PENSION STRATEGY SUCCESS

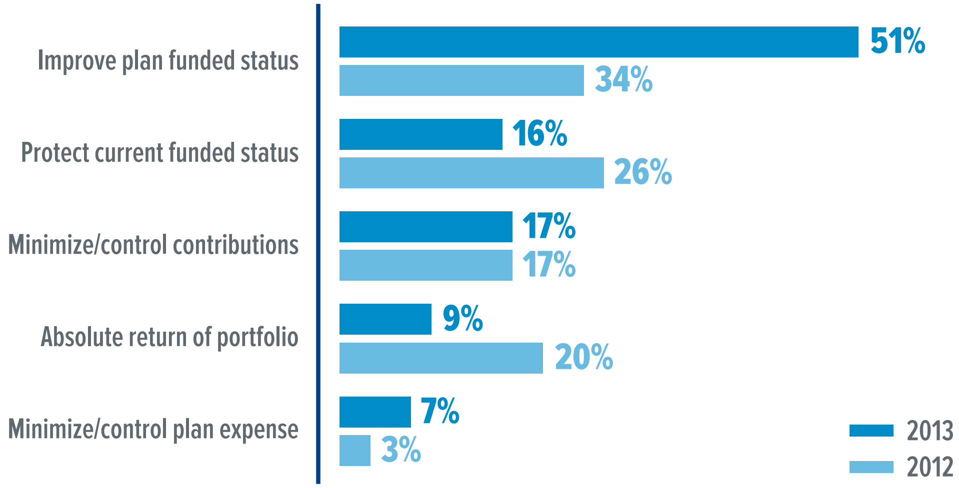
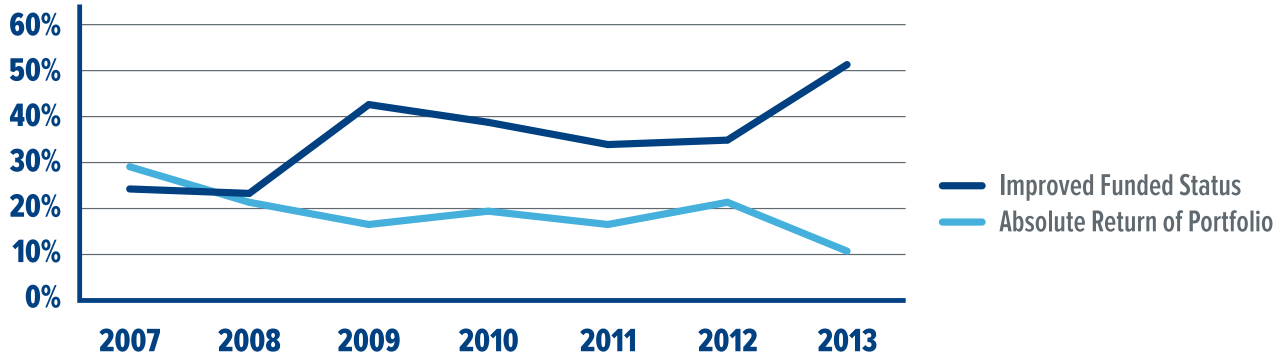


FIGURE 6 PRIMARY BENCHMARK FOR PENSION STRATEGY SUCCESS



This year, 51 percent of participants ranked “improved funded status” as the top benchmark for pension success, with “absolute return of the portfolio” falling to a historic low of nine percent.

Finding 3—Many Plan Sponsors Are Pairing LDI with a Glidepath Strategy

On average, poll participants are allocating 49 percent of the portfolio to what they would define as "LDI strategies." This includes use of a variety of fixed-income products, with the most popular being long-duration bonds in the U.S. and Canada (used by 72 percent) and gilts and index-linked gilts in the U.K. (89 percent).

The allocation to LDI will continue to evolve, as many pension plan sponsors have established or considered some form of glidepath strategy.

This type of strategy is called many things across the globe (journey planning, dynamic de-risking), but in its most basic form, it is an active approach to asset allocation. It involves setting acceptable levels of risk within portfolios and establishing key trigger points to shed risk, or de-risk, as the plan funded status improves. According to the survey, more than two-thirds (69 percent) of plan sponsors currently use or are planning to implement a glidepath strategy.

FIGURE 7 GLOBAL USE OF A GLIDEPATH

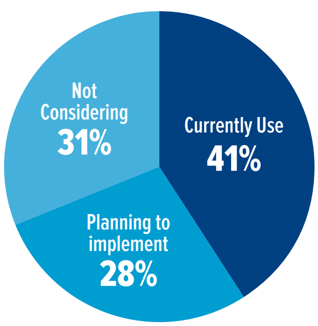
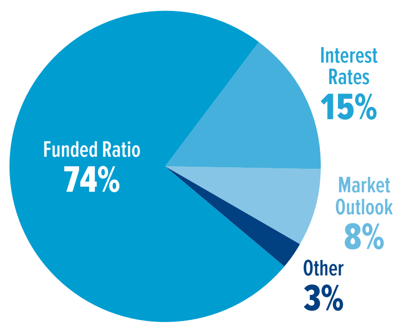


FIGURE 8 COMMON GLIDEPATH TRIGGERS



The majority (74 percent) of glidepath strategies rely on funded status as the key trigger for de-risking the portfolio; however, it's critical that plan sponsors continue to assess current market conditions when considering asset allocation decisions. As markets move, the current glidepath or allocation strategy may not meet the plan's current hurdle rate, and require either additional contributions or longer periods of outperformance to catch up. Plan sponsors should consider not only de-risking, but also re-risking when appropriate, as part of an active glidepath strategy.

Finding 4—U.S. Poll Highlight: The LDI Portfolio Continues to Evolve

LDI continues to be most popular among U.S. pension plan sponsors, with 71 percent of U.S. survey participants currently implementing an LDI strategy. Below is a breakdown of average asset allocations within U.S. pension portfolios, with a heavy (44 percent) average allocation to fixed-income strategies.

As can be seen in Figure 10, 43 percent of the poll participants reduced their allocations to U.S. equities in 2013, despite the strong equity performance throughout 2013. The assets being removed from equities appear to be transitioning into alternatives and fixed income. One-third (33 percent) of the participants said they increased their allocations to alternatives in 2013. Even with the discussion around tapering, 35 percent of poll participants still increased their fixed-income allocations.

FIGURE 9 AVERAGE PENSION PORTFOLIO ASSET ALLOCATIONS

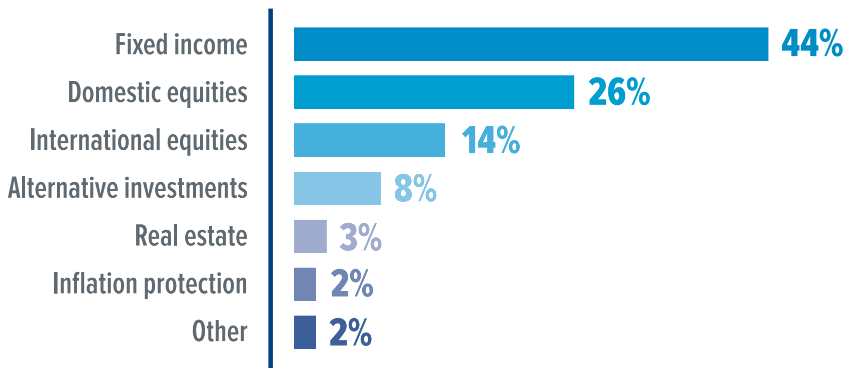
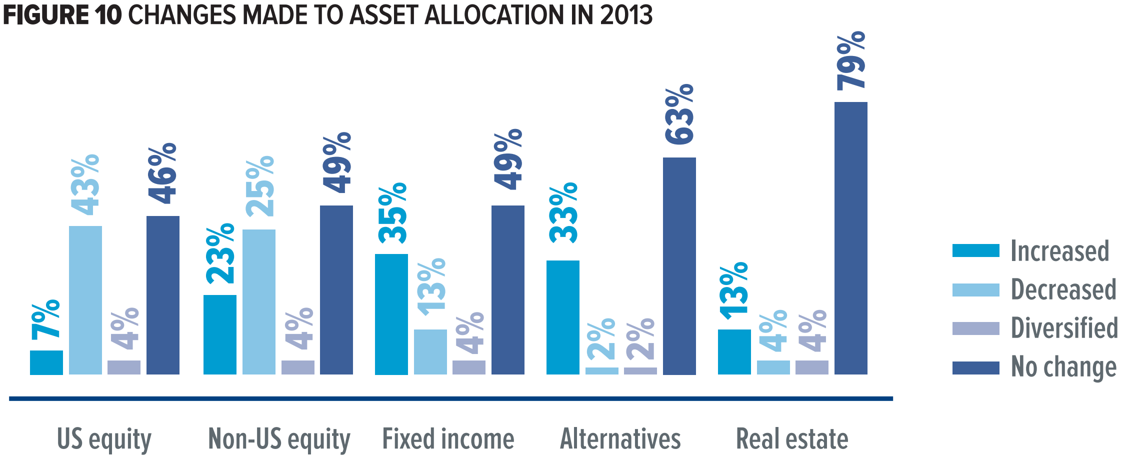
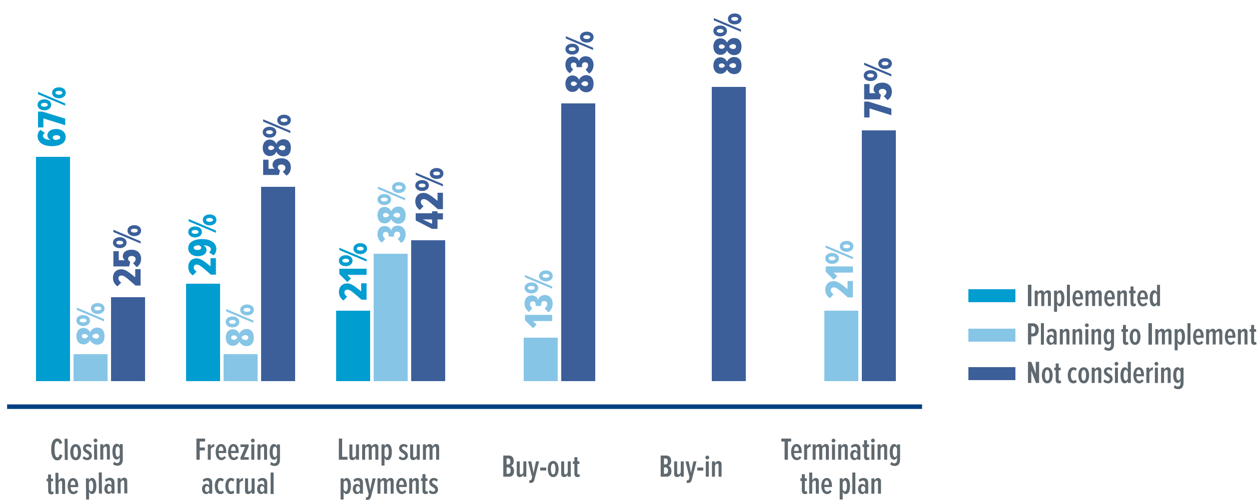


FIGURE 10 CHANGES MADE TO ASSET ALLOCATION IN 2013



In addition to LDI and glidepath strategies, plan sponsors are considering other options to decrease their liabilities and improve the funding health of their pension plans. More than two-thirds of U.S. plan sponsors (67 percent) have closed their plans, meaning that new employees will not have the option to participate. Offering lump-sum payments to term-vested employees is also another popular risk-reduction strategy; 59 percent of poll participants have either implemented or are planning to implement lump-sum payments. Despite media emphasis in 2013, no plan sponsors reported purchasing or planning to purchase an annuity through an insurance buy-in or buy-out, which could be indicative of the high price tag accompanying such transactions.

FIGURE 11 ADDITIONAL RISK-REDUCTION STRATEGIES



While no plan sponsors are currently terminating their pension plans, 41 percent said that their organization has at least investigated the current cost for termination. Of those, one-third said the total cost was more than they anticipated and 67 percent said the cost was about what they expected. No one responded that it was less.

Conclusion

Corporate pension plan sponsors across the globe continue to look for risk-management strategies that work to reduce volatility and improve pension funding status. LDI continues to be a popular strategy, with more than half (57 percent) of organizations currently using it within pension portfolios, though 2013 saw a stagnant growth rate, likely due in part to stronger equity performance and historically low interest rates.

More plan sponsors are pairing LDI with a glidepath strategy, with automatic triggers for improved active management and increased focus on improving funding status and progressing the plan toward termination. Survey participants indicated that their organizations are also increasingly turning to external partners to help implement these complex, custom LDI strategies. More than half (51 percent) said they currently use or would consider using a fiduciary manager or investment outsourcer for pension investment management.

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PENSION MANAGEMENT Research Panel

The Pension Management Research Panel, sponsored by SEI's Institutional Group, conducts industry research in an effort to provide members with current best practices and strategies for the investment management of pension plans.

For more information, please contact SEI at **1-866-680-8027** or **SEIResearch@seic.com**

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