

An independent review of liability driven investment (LDI) arrangements

On the 7 February 2023 the House of Lords shared its recommendations to Government on improvements that can be made to avoid similar disruption in future following the gilts crisis. This follows guidance issued by The Pensions Regulator in November 2022 to pension scheme trustees on how they should be managing leveraged LDI strategies in light of the lessons learnt.

These guidelines apply to **pooled, segregated and fiduciary management arrangements**, and highlight the importance of trustees comprehensively reviewing their arrangements.

Trustees must now question their managers on their approach and the changes they have made to fully understand risk exposure and manage it effectively.

To help trustees with this complex and technical area we have developed the **XPS LDI Oversight Service** to help trustees or scheme sponsors understand the best way forward and have confidence in their LDI arrangements, by delivering **any combination** of the following:

1. Regulatory health check

2. Hedge construction review

3. LDI manager benchmarking

These independent reviews are available to all pension schemes and can be provided on a stand-alone basis alongside advice from an incumbent investment consultant. To achieve best outcomes we do encourage all stakeholders to have joined up conversations incorporating trustees, investment consultants, sponsor and scheme actuary.

Helping trustees or scheme sponsors have confidence in LDI arrangements by:

1

Independently identifying and addressing any issues relative to the regulatory guidance

Regulatory LDI health check:

- **Analysis** of portfolio liquidity and ability of the scheme to withstand future gilt market shocks (including stress testing).
- **Comment** on appropriateness of LDI arrangements.
- **Review** the trustees' LDI governance arrangements.
- **High level review** of the Investment Management Agreement or Terms of Business in place with the LDI manager.
- **Review** the extent that the scheme is operating in line with recent guidance from The Pensions Regulator 'maintaining liability driven investment resilience' including a particular focus on operational robustness.

2

Independently evaluating your LDI arrangements to ensure they are tailored for your needs

Hedge construction review:

- **Utilising** our specialist LDI knowledge and in-house tools to provide an independent hedge construction review.
- **Work with** the Scheme Actuary to receive liability information and independently calculate interest rate and inflation sensitivities.
- **Calculate** the interest rate and inflation sensitivities of the cashflow benchmark used by the LDI manager and compare its matching characteristics to the liabilities.
- **Comment** on the actual versus target level of hedging and the shape of the hedge.
- **Detailed review** of the Investment Management Agreement or Terms of Business in place with the LDI manager. Focussing on how the hedge and leverage is managed.
- **Advise** on areas of concern and possible enhancements and compare our review to your current allocation to offer an investable way forward.

3

Helping you understand how your manager compares to the wider market

Independent LDI research and manager benchmarking:

- **We have undertaken** detailed due diligence on all mainstream LDI managers to review how they navigated the crisis and any changes to their process and commercial terms.
- **We can apply** this knowledge to your specific circumstances and provide our views on the ongoing suitability of your LDI provider. This includes cost assessment, risk management and operational robustness.

Please note: The scope of work provided above is indicative and can be further tailored to your requirements.

For further information, please get in touch with **André Kerr** or **Ben Gold** or speak to your usual XPS contact.



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