Liability Driven Investment:
A £1 trillion market

Annual Survey 2019
Introduction

LDI market smashes through £1 trillion

History is littered with examples of conventional thinking proved wrong. In 1985, the New York Times reported on the demise of the laptop ‘fad’. The reasoning was that they were heavy, expensive and had poor battery life. The New York Times’ mistake was confusing the underlying concept which was sound, with the shortcomings of the early prototypes which needed significant work to appeal to the mass market.

Similarly, investors who initially dismissed LDI as being an elaborate solution to a theoretical problem weren’t seeing the bigger picture. LDI at its heart protects a pension scheme from a lower yield environment; exactly the environment we find ourselves in. Early approaches were only accessible to large schemes, were complex and weren’t necessarily explained using the clearest language. However, the benefits were there for the taking, albeit with limited initial adoption.

But like the laptop, LDI is now commonplace. The initial challenges are well and truly behind us with a fantastic range of intelligent, high quality and simply packaged products to suit differing needs.

The pensions mass market has overcome its initial reservations and LDI is now a £1 trillion market. This is a great achievement for fund managers, advisors and trustees, who are now firmly taking control of their schemes’ futures, not leaving it to chance.

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Simeon Willis
Chief Investment Officer

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LDI – delivering in practice:

*LDI isn’t about making money; it is about reducing risk, or ‘hedging’.*

The chart below illustrates the extent to which UK government bond yields have fluctuated over 2018. Liability values of a typical scheme* will have fluctuated by around 8% from the peak to the trough of these yield moves. LDI neutralises this impact, making funding levels more stable and pensions more predictable.

United Kingdom 20-Year Bond Yield over 2018

Source: Refinitiv

* Assumes 20 year duration
The LDI market in 2018

Notional amount of liabilities hedged

**Over £1 trillion** liabilities hedged

2018 saw the total notional value of liabilities hedged go over the £1 trillion mark. This is a £59bn (6%) increase from £965bn in 2017 to £1,024bn in 2018. Given the minimal movement in yields again this year, broadly all of this gain can be attributed to new LDI mandates.

Total mandates

**2,140** > **2,405** mandates

A 12% increase. Overall the number of mandates increased by 265, the biggest single contributor to this was directly accessed pooled funds (127), with a significant net contribution of 118 from platforms and fiduciaries (once double counting of underlying mandates has been adjusted for).

Proportion of UK liabilities hedged

**49%** > **54%** of liabilities hedged with LDI

Estimating that the UK private sector had a total DB pension scheme liability of approximately £1.91trn, on a low-dependency gilts+0.5% basis at the end of December 2018, over half of these liabilities are now hedged with LDI.

Gilts: the firm favourite

**86%** of notional liabilities hedged using gilt-based derivatives rather than swaps

A mere 14% of notional liabilities hedged using LDI are implemented through swap-based derivatives. Schemes choosing to use mainly gilts to hedge liabilities is reflective of the higher yields at longer maturities and that the majority of pension schemes are funded on a gilts based measure.

LDI proves popular on platforms

**52%** increase in the number of mandates accessed via the Mobius Life investment platform

The vast majority of new mandates are coming from smaller schemes. This is no doubt partly thanks to the growing success of investment platforms and fiduciary management.

The Big Three still dominate

**87%** of overall liabilities hedged estimated to be managed by LGIM\(^2\), Insight and BlackRock

Insight accounted for the vast majority of growth in overall liabilities hedged this year. Whilst BMO now have the largest number of mandates, they remain 4th largest by notional liabilities hedged.

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1 Estimated as at 31 December 2018 based on data from the PPF Purple Book (2018) and discount rates of gilts + 0.5% pa. We note 54% is likely to underestimate the actual level of hedging as it excludes hedging achieved through holding bond assets outside of a specific LDI hedging program.

2 LGIM declined to participate in this survey, data based on KPMG LDI survey 2017.
Who’s doing what?

The market continues to grow at a pace.

Total hedged liabilities up from £965bn to £1,024bn

![Graph showing total hedged liabilities for different companies in 2017 and 2018.]

Total LDI mandates up from 2,140 to 2,405

![Graph showing total LDI mandates for different companies in 2017 and 2018.]

Fiduciary managers and platforms rallied this year with a 28% increase in the number of clients employing LDI through these approaches. As at 31 December 2018 there were 600 schemes accessing LDI via fiduciary management or via a platform, which accounted for 178 mandates at underlying managers. We have adjusted the total mandates to account for this.

BMO added a further 93 new mandates over the year, with an increase of £67bn notional liabilities hedged across 30 new mandates.

Over half of UK private sector DB liabilities are now hedged using LDI. A fantastic achievement.

Mark Minnis
Head of LDI

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Segregated and bespoke pooled solutions

Segregated and bespoke pooled solutions account for 89% of the overall LDI market by value of liabilities.

In 2018 the ‘big players’ in the segregated and bespoke market (LGIM*, Insight and BlackRock) held an estimated 89% of the market by notional amount hedged, with an average mandate size of £1.9bn. River & Mercantile also showed their popularity with smaller schemes in this space by holding the third highest number of mandates with a lower average mandate size of £145m.

As mentioned last year we expect to see the focus of growth continue to shift towards pooled mandates as more and more smaller schemes enter the market.

The segregated and bespoke pooled LDI market continues to be dominated by the Big Three for the big ticket mandates.

Rebecca Barton
Associate

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Pooled solutions

2018 was another strong year for the pooled LDI market. 92% of this year’s new mandates were from pooled solutions, which is an increase from 87% in 2017.

Notional amount of liabilities hedged in pooled mandates

73% of all LDI mandates are now in pooled LDI solutions highlighting the efforts made by managers and advisers to bring accessible LDI solutions to all schemes.

Tim Miller
Consultant

Number of pooled mandates

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Accessing LDI

There were many different ways to access the LDI market in 2018, to suit all schemes.

Platforms (Mobius Life)

**143 ➔ 217**

*Growth in mandates accessed through the Mobius Life Platform over 2018*

A platform provides a means for pension schemes to access a wide range of investment funds, whilst having the administrative simplicity of dealing with one manager. Our analysis focusses on Mobius Life again this year as they dominate the non-fiduciary DB platform market. **We have seen a 52% increase in the number of mandates accessed via the Mobius Life investment platform over 2018.**

There are a number of other platforms available, often associated with fiduciary management and DC investment. We cover fiduciary management separately below.

Fiduciary management

**325 ➔ 383**

*Growth in mandates accessed through fiduciary management over 2018*

We saw an 18% increase in the number of mandates accessed through fiduciary management in 2018, which compares to 22% in 2017.

Segregated vs Bespoke pooled vs Pooled mandates

*Proportion of mandates by number*

2017

- Pooled: 70%
- Segregated: 24%
- Bespoke Pooled: 6%

2018

- Pooled: 73%
- Segregated: 21%
- Bespoke Pooled: 6%

Rachel Titchen
Consultant

Platforms and fiduciary managers help make it possible for schemes of almost any size to access LDI so it’s great to see these markets doing so well.

Rachel Titchen
Consultant
Pension schemes can achieve LDI hedging using gilt-based derivatives (such as gilt total return swaps, gilt repo or gilt futures) or swap-based derivatives (such as interest rate swaps, inflation swaps and real rate swaps). Swaps are tailored to individual requirements and therefore can provide a closer fit to a scheme’s cashflows compared to gilt derivatives which are only available at specific maturities and require regular ‘rolling’ into new contracts. **Despite this only 14% of notional liabilities hedged using LDI are implemented through swap-based derivatives.** This is reflective of the higher yields available on gilts at longer maturities and that the vast majority of pension schemes are funded on a gilts basis so are more closely matched.

**LIBOR vs SONIA**

Swap contracts have traditionally been based on LIBOR interest rates. However following the severe shortcomings of LIBOR which were identified and widely acknowledged following cases of high profile manipulation, LIBOR has been replaced by SONIA as the reference risk free rate. Further LIBOR will effectively cease to exist beyond 2021.

Given swap contracts last for many years they will outlive the availability of a reliable LIBOR figure which has necessitated a program of switching from LIBOR swaps to SONIA swaps. This is a market sensitive issue given that some fund managers are yet to trade from LIBOR to SONIA swaps and have a decreasing window of opportunity. Therefore some managers declined to provide this information.

From the range of managers that we received updates from there are examples of managers that have fully removed their LIBOR exposure as at December 2018, and a number that still had a majority of exposure to LIBOR swaps which will need to be transitioned.

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Given the wide disparity of approaches being taken to transition away from LIBOR swaps before 2021, it is important to be aware of your manager’s approach and progress to date.

Nick Harvey
Principal
How we define LDI

This survey relates to the UK institutional pensions market only. It does not include insurance market capital or non-UK pension investment. Mandates have been included where there is a defined liability cashflow benchmark or derivatives are used to hedge exposure for the purposes of reducing risk relating to nominal, inflation or real interest rate risk. Broad bond market benchmarked funds or single stock gilt funds have not been included.

Our thanks

We would like to thank the following organisations for their involvement in this year’s survey:

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