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Investing for the End Game

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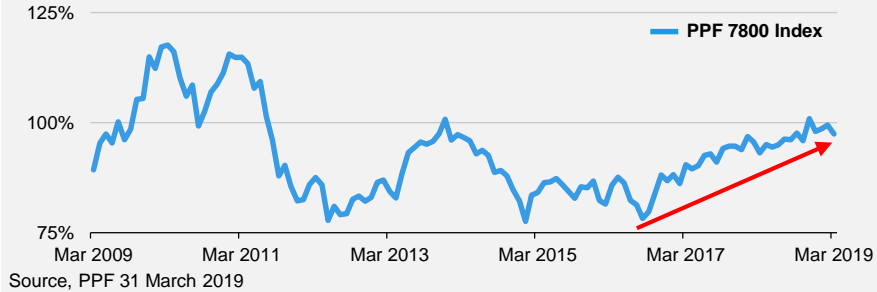
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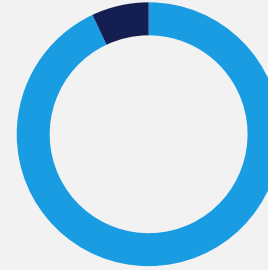
The UK DB pension scheme landscape

A sharper focus on the End Game

Funding levels improving...on average



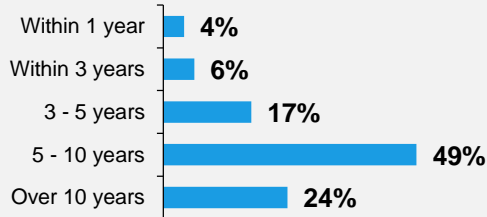
Proportion of schemes that are cashflow negative



93%
of UK DB pension schemes
expected to be cashflow
negative by 2027

Source: Mercer, European Asset Allocation Survey 2018

When will schemes reach their "End Game"?

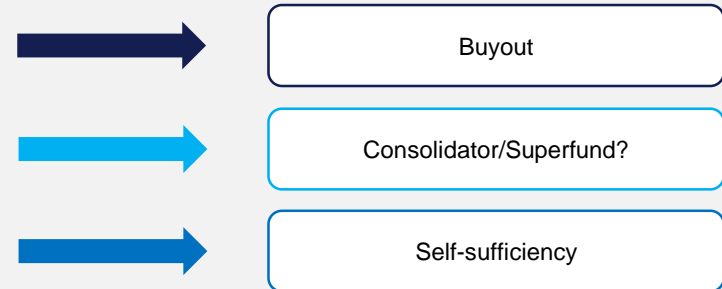


>75%
Expect to reach their long-term objective within next ten years

When will you reach full buy-out or self-sufficiency?

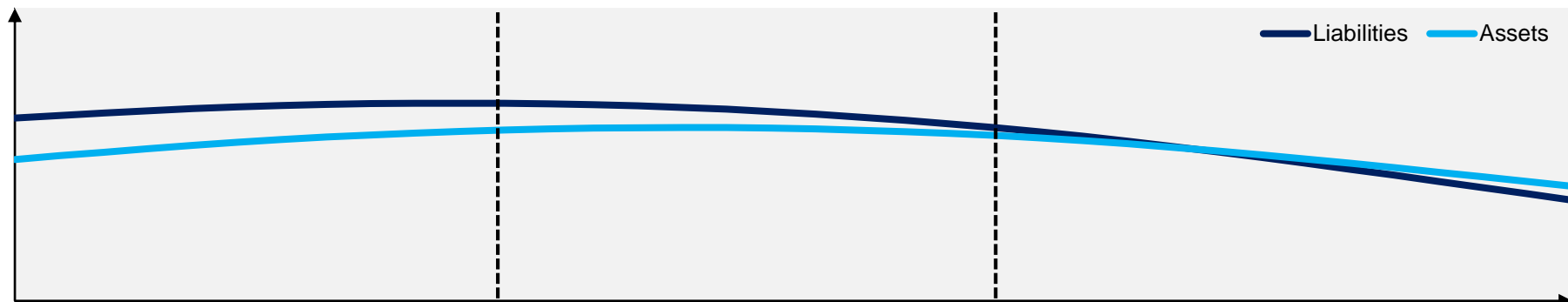
Source: LCP pensions de-risking report 2019

What are the options for the end game?



Investing for the End Game

A changing focus as schemes move along their de-risking journey



ACCUMULATION

PROTECTION

Growth:

- Typically a requirement for growth to close funding deficit

Preservation:

- Increasing hedging level to reduce interest rate and inflation risks

Income:

- Matching cashflows not a significant focus

Growth:

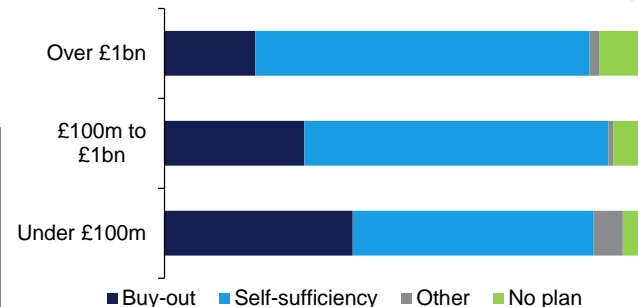
- Lower growth requirements as funding level improves

Preservation:

- Hedging precision has increased with a high level of interest rate and inflation protection

Income:

- Higher focus on “sequencing risk” and cashflow matching (e.g. pensioners)

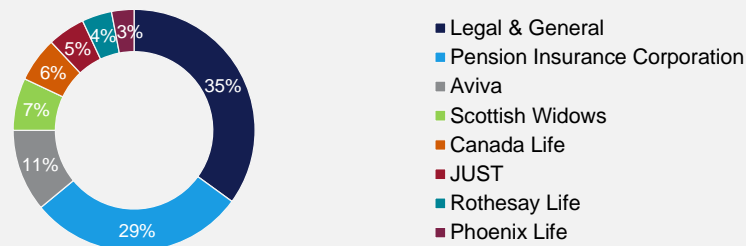


Source: Aon Hewitt, December 2017

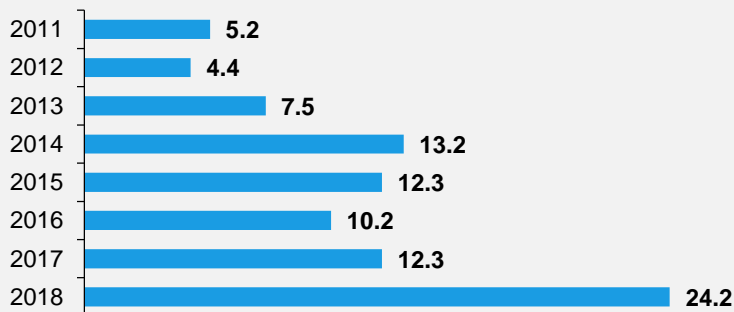
Recent Insurance company buy-in and buy-out activity

How can your “End Game” destination shape your investment strategy?

2018 transaction volume by insurer



Volume of buy-ins and buy-outs (£' billion)



LCP pensions de-risking report 2019

Some key considerations when investing for the End Game



Buy-in / Buyout



- Timescales for buy-in/buy-out?
- Hedging insurance company buy-in/buy-out annuity pricing
- Creating “insurance-friendly” investment portfolios
- Identifying opportunities within illiquid assets



Self-Sufficiency



- Investing like an insurance company
- Identifying non “insurance-friendly” assets
- Potential benefits of a holistic approach
- Holistic reporting and servicing

Navigating to your End Game

Partnering with an “expert in these waters”



ACCUMULATION

Investment growth, and removing “unrewarded risks”

Full breadth of return generating assets, plus LDI
focused on removing funding deficit



PROTECTION

Minimising risk, and increasing certainty of outcome

Predominantly low risk, income yielding, assets focused on your
ultimate End Game objectives



Different skillset is required when investing for the End Game

Source: Aberdeen Standard Investments, 31 March 2019

Navigating to your End Game

What skillsets do you need from your investment manager?



Buy & Maintain Credit with a strong track record of avoiding downgrades and defaults



Alternative sources of contractual income to access illiquidity premia and diversify risk exposures



ESG embedded across investment capabilities to generate the best long-term outcomes



LDI and derivatives expertise for hedging residual risks including interest rates, inflation and currency risks



Insurance heritage and a track record of delivering **holistic pensions solutions** through connected teams



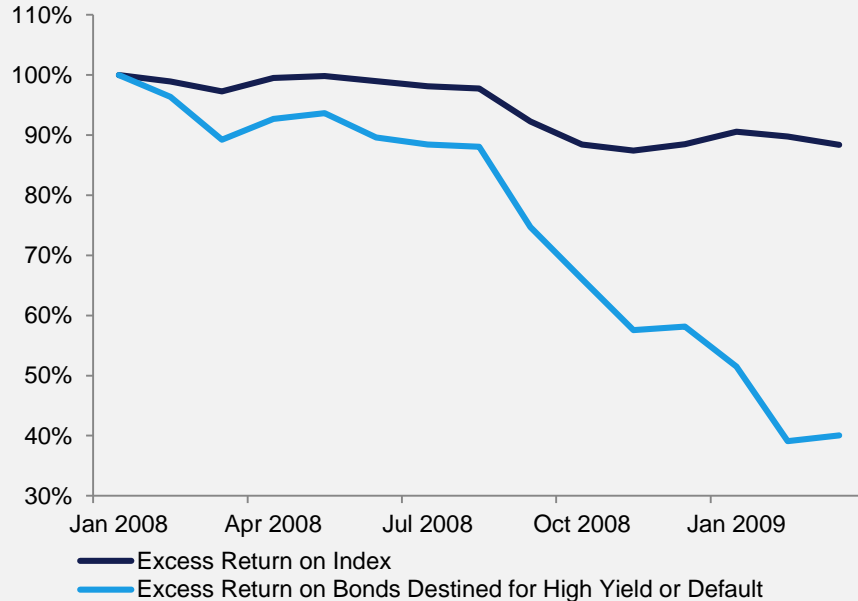
Genuine partnership working with a manager who helps you understand your options and who will implement the optimal solution for you

Source: Aberdeen Standard Investments, 31 March 2019

Cornerstone of the investment strategy is an allocation to fixed income assets

Potential benefits of taking a holistic approach?

Relative Performance of Index vs. bonds that downgraded or defaulted in the last credit crisis



Source: Aberdeen Standard Investments, April 2019

Potential benefits of a holistic approach?

- **Efficient development of the optimal asset allocation via one team**
 - Optimising exposure to sectors and risk factors
 - Assessing impact of different credit allocations on hedging costs, collateral requirements and importantly the portfolio yield
- **Efficient implementation/reduced operational risk**
 - Optimising exposure to individual credit name
 - Timely adjustment of hedges as portfolio is adjusted
- **Collateral efficiencies**
 - Central collateral pool for all derivatives exposures
- **Lower governance burden**
 - With clear ownership of responsibilities
- **Holistic reporting**
 - Covering both the progress your overall strategy and your manager's effectiveness in implementing that strategy

Case Studies

Schemes becoming more “cash flow aware”

Scheme with an increasing focus on becoming “cash flow aware”

Background:

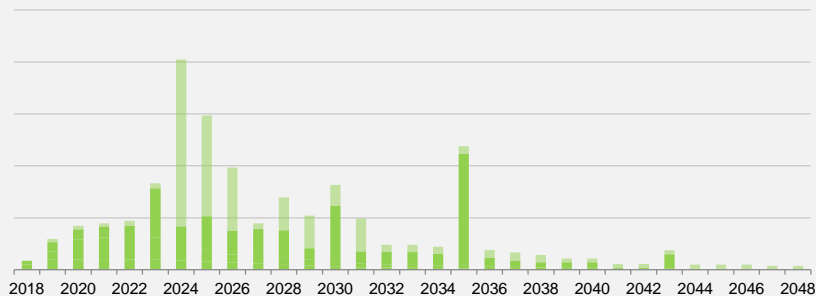
- £3.5 billion scheme which is cashflow positive, but maturing

Objectives:

- Looking for sources of income from alternative asset classes
- Supplementing existing credit mandates

Solution

- Allocations to Long Lease Property and Private Credit funds



Scheme looking to implement a “cash flow matching” strategy

Background:

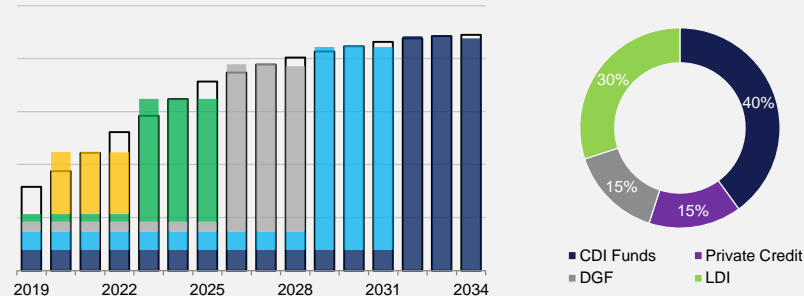
- £150 million, cash flow negative scheme

Objectives:

- Targeting return over gilts to close funding gap over time
- Match shorter dated cash-flows to remove sequencing risk

Solution

- Cash-flow matching at short-end, LDI completion, whilst retaining allocation to growth assets to close funding gap



Case Study – £2 billion scheme considering options for the End Game

Constructing a cash flow investing strategy

Key facts

A

Average credit rating

146bps

Spread (over gilts)
at implementation

£1.79bn

Required investment

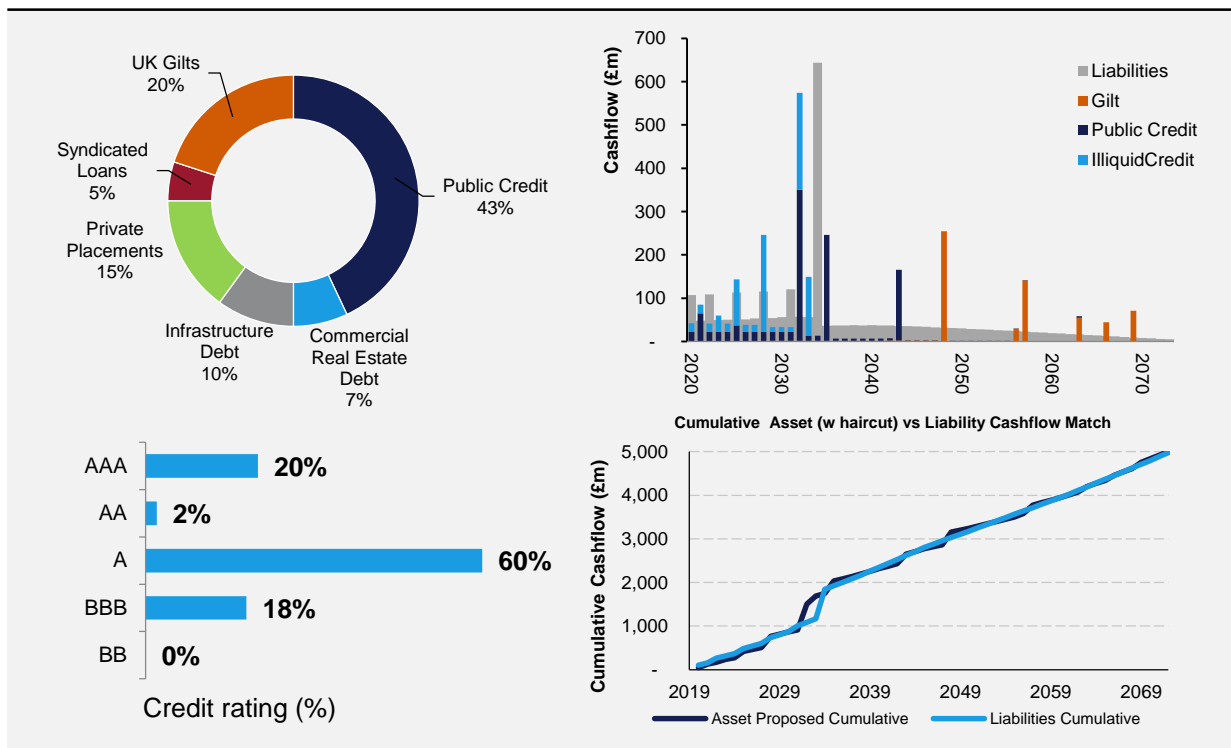
£1.58bn

Required investment under
self-sufficiency approach

Summary

- ✓ Cashflow matching of the expected payments from the scheme
- ✓ Holistic credit allocation (public & private)
- ✓ Inflation risk hedging
- ✓ Residual interest rate risk hedging
- ✓ Proxy hedge for future movements in the buyout premium

Source: Aberdeen Standard Investments, 31 December 2018

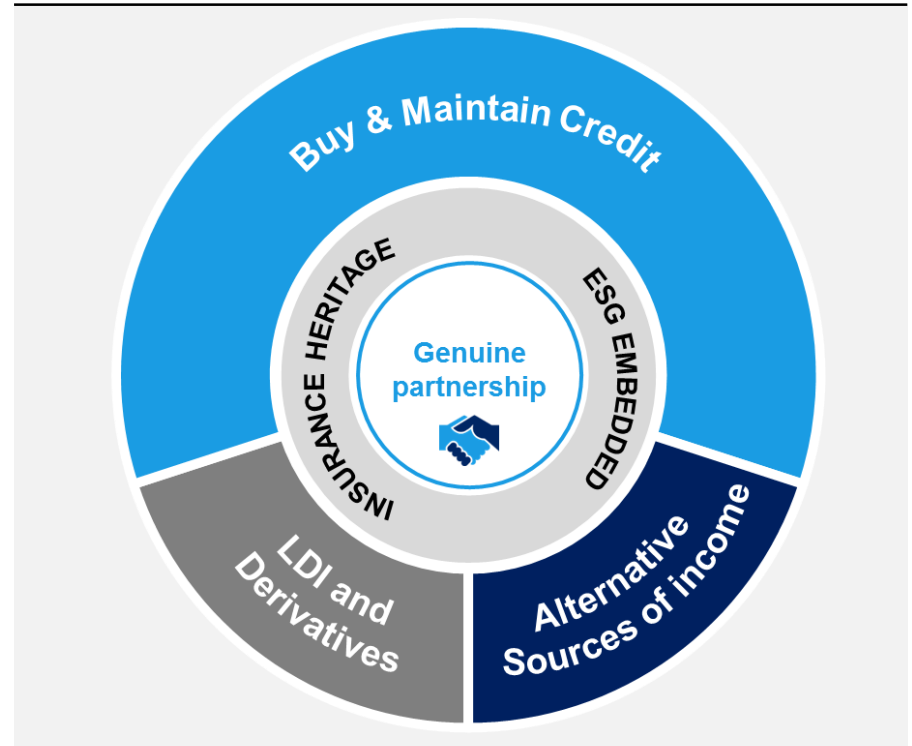


Investing for the End Game

Summary

- **Increased focus on the End Game and cashflow matching**
 - Being more cashflow aware avoids selling assets at inopportune times
 - Protecting the strong funding position that has been established
- **No “one size fits all” solution**
 - Need to understand what is the right solution for your scheme
 - Important to think about the holistic view of your investment strategy
- **Navigating to End Game requires more precision**
 - Crucial to have the right investment toolkit to meet evolving needs
 - Growing trend of schemes working with one strategic investment partner

Source: Aberdeen Standard Investments



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