August 2020

# Navigating to your DB endgame

## Creating bespoke solutions

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**Our Liability Aware fund range now includes a series of pooled Buy & Maintain credit funds and pooled LDI profile funds. The fund range allows pension schemes of all sizes to create a bespoke solution to meet their specific objectives by combining allocations across the fund range.**

## Case Study – holistic endgame solution

The XYZ pension scheme is a mature, cashflow negative pension scheme that is closed to new entrants and future accrual. The scheme has total assets of £100 million, and is fully funded on a "gilts + 1%" funding basis. The trustees are looking to adopt an investment strategy to meet the pension scheme's future income requirements and to transition towards an "endgame" investment strategy over time as the scheme's funding level improves.

Our approach is to work closely with trustees and their advisers to construct a tailored solution using our Liability Aware pooled fund range to meet the scheme's specific objectives.

**Overview of proposed investment strategy**

- **15 year cashflow match:** Tailored cashflow profile created using high quality investment grade corporate bonds managed on a buy and maintain basis.
- **Full hedge of interest rate and inflation:** Pooled LDI funds used to provide a close hedge to reduce the scheme's residual interest rate and inflation risks.
- **Limited exposure to traditional growth assets** (mixture of equity and diversified growth funds) to provide additional expected return.

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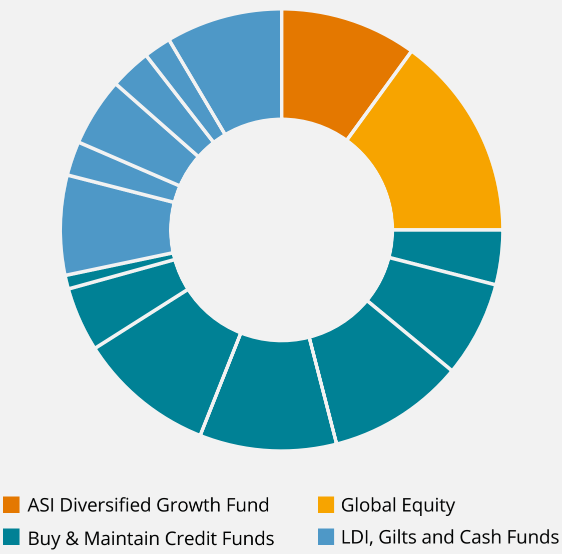
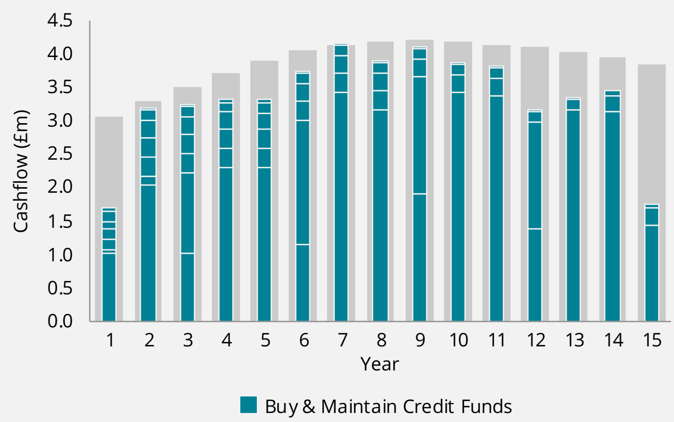
**Future evolution over time**

- **No reinvestment into credit in central scenario:** Assets expected to be sufficient to meet all future benefits without additional support / contributions.
- **Clear journey plan to naturally de-risk the investment strategy,** reducing the reliance on the sponsoring employer over time.
- **Alternative strategy also created for consideration** incorporating an allocation to private credit, reducing exposure to traditional growth assets.




AberdeenStandard Investments

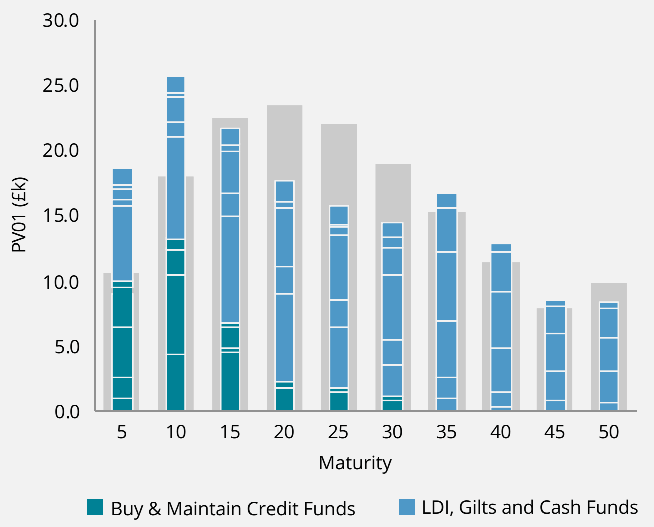
## Working in partnership to create the optimal solution

Our Pension Solutions team works closely with pension schemes and their advisers and can perform detailed analysis looking at the scheme's liability cashflows to construct a tailored solution for the scheme.

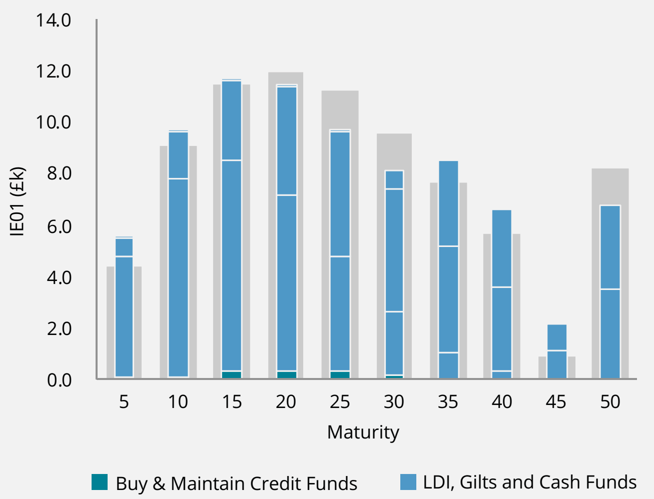
In this example, the solution provides the scheme with a precise hedge of its interest rate and inflation risks, taking into consideration the contribution from both the corporate bond holdings and also the pooled LDI funds. This is illustrated in the charts below.

The full breakdown of the funds used in the strategy are set out in the Appendix to this note.

**Interest rate hedge ratio 100%**




**Interest hedge ratio 100%**




**Evolution of investment strategy over time**

As part of our analysis, we also created a journey plan of how the investment strategy can be de-risked further over time.

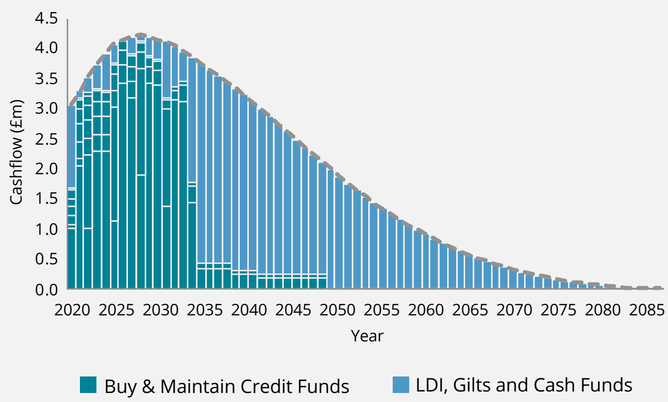
The "run-off" analysis shown below highlights how the total asset value is changing over time through the remaining life of the scheme. As the scheme is cashflow negative, the asset value is falling every year until all of the benefits are paid.

The journey plan illustrates how the DGF and Equity allocations can be reduced gradually over time, with the scheme naturally de-risking into a gilt strategy over time.

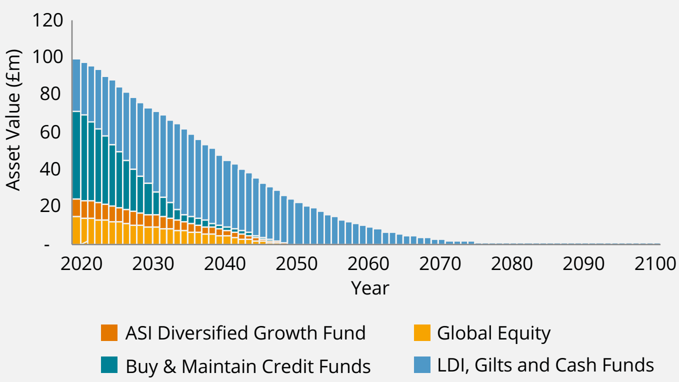
Under the central projections, no further investment in corporate bonds is expected (no "re-investment risk"), and the assets are expected to meet all future benefits without needing additional support/contributions.

The trustees will look to monitor the journey plan over time as part of an integrated risk management framework as the scheme moves towards its ultimate endgame. The investment strategy is extremely liquid, providing the trustees with full flexibility if a decision is taken to secure the liabilities with an insurance company in the future.

**Cashflow projection**




**Asset projection**




"The investment strategy is extremely liquid, providing the trustees with full flexibility if a decision is taken to secure the liabilities with an insurance company in the future."

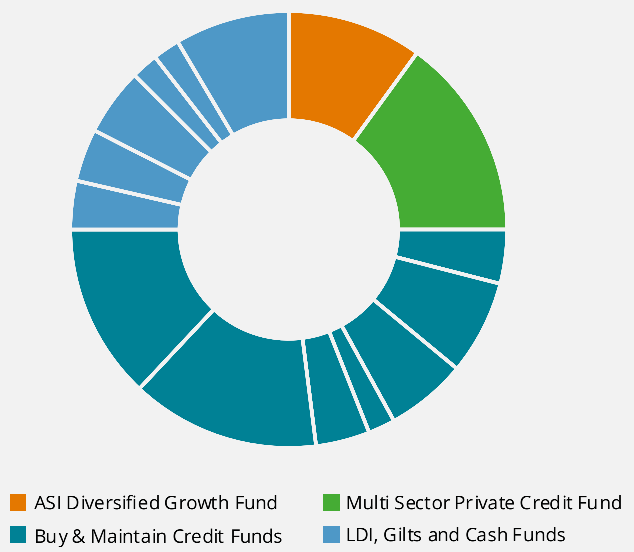
## Alternative investment approach accessing private credit

As can be seen on the previous page, the pension scheme is reducing in size over time as benefits are paid out to its members. If there is a significant market crash, the scheme can be impacted heavily – a large monetary loss in the short term will be very hard to recover from in future years when the scheme is smaller where even significant positive performance has less overall impact.

With this in mind, the trustees also wanted to consider taking additional risk off the table now by reducing exposure to the traditional growth assets. An alternative strategy could involve using alternative sources of contractual income, such as private credit, as a way to generate the required return.

In this alternative strategy, the 15% equity allocation is replaced with a 15% allocation to private credit using ASI's Multi-Sector Private Credit fund ("MSPC"). MSPC provides exposure to a range of private credit assets such as commercial real estate debt, private placements and infrastructure debt.

- The private credit allocation provides contractual income, contributing to the cashflow matching strategy
- The public credit (Buy & Maintain) allocation can therefore be invested in longer-dated credit which will provide higher return
- The longer dated public credit allocation also contributes to interest rate and inflation hedge, reducing the required allocation to pooled LDI funds



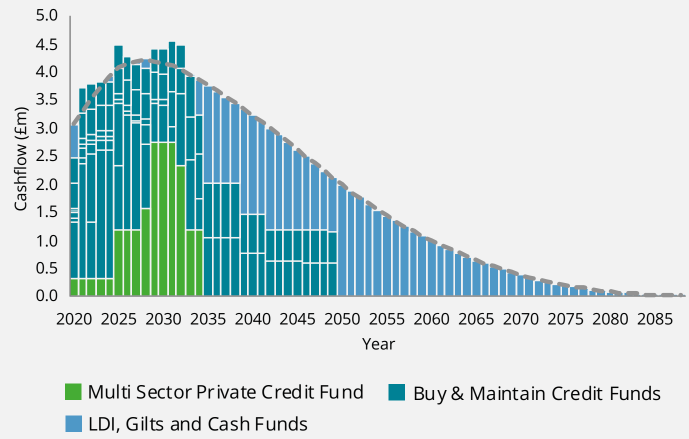

### Evolution of alternative investment strategy over time

The charts below show that under the alternative strategy (as in the previous strategy), no further investment in corporate bonds is expected (no "re-investment risk") and the assets are expected to meet all future benefits without additional support/contributions.

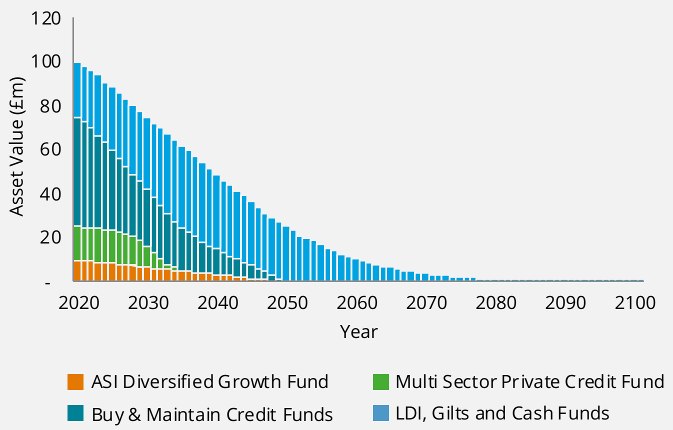
Under the projections, the allocation to MSPC will be reduced over time, so that by year 15, the allocation to illiquid assets has been removed.

In order to evaluate the pros and cons of the two different investment approaches, it is essential for the trustees to have a clear vision of their long term objectives for the pension scheme. For example, if there is a potential opportunity to buyout the entire pension scheme within say the next 5 years, then the trustees should consider carefully if they should invest in private credit due to the illiquid nature of this asset class.

**Cashflow projection**




**Asset projection**



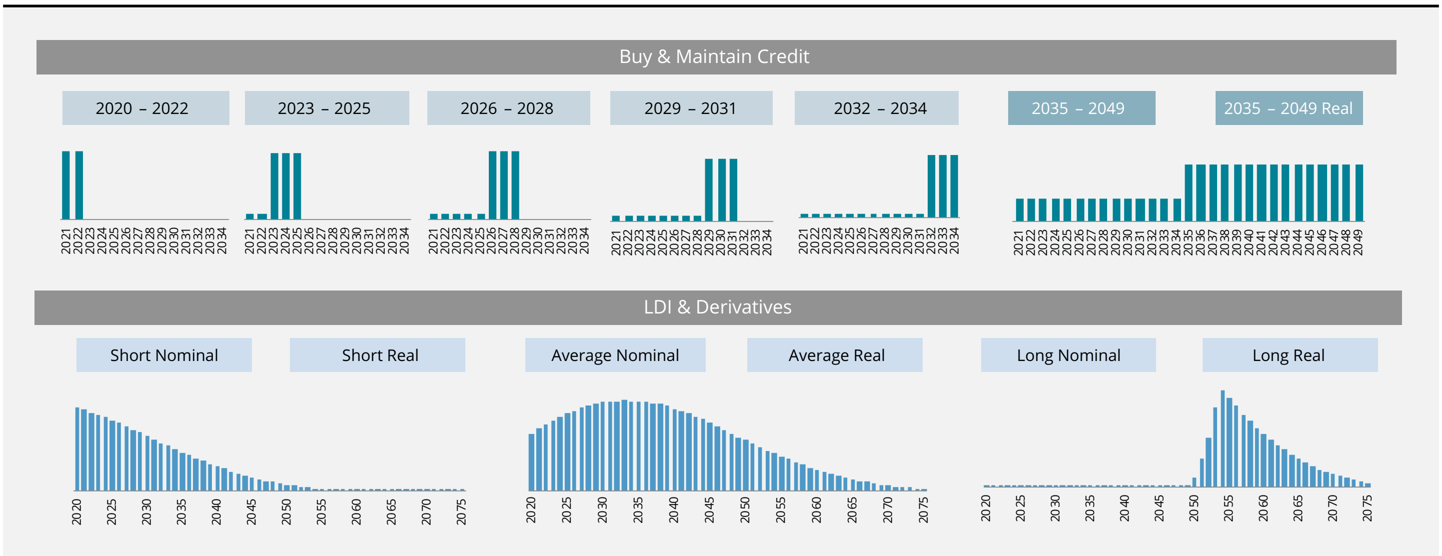

"An alternative strategy could involve using alternative sources of contractual income, such as private credit, as a way to generate the required return."

## ASI's Liability Aware pooled fund range

Our Liability Aware pooled fund range has been designed to be flexible – with a series of building blocks that can be used to create a bespoke solution for pension schemes of all sizes.

The range includes:

- A series of Buy & Maintain credit funds, which each invest in a well-diversified portfolio of high quality corporate bonds (overall A rating), providing income to pension schemes to help meet their benefit payments; and
- A range of six pooled LDI profile funds (with a gilt-based benchmark) which roll down over time, providing a low cost and low governance approach to hedge interest rate and inflation risks.




## How we can work with your scheme

If you would be interested in finding out more about how ASI's Liability Aware pooled fund range could help your pension scheme to achieve its objectives, then please get in touch with us.

- **Dedicated Pension Solutions team** – consisting of actuaries and former investment consultants, is experienced in working with pension schemes, sponsors and their advisers.
- **Modelling and scheme specific analysis** – we can provide scheme specific analysis for pension schemes, including an analysis of how the strategy can evolve as the pension scheme matures. Please note that there is no charge for carrying out this analysis for your scheme.
- **Client Service** – our approach is constructed around developing partnerships with our clients and their advisers, and we have extensive experience to ensure we deliver the highest standard.

"Our Liability Aware pooled fund range has been designed to be flexible – with a series of building blocks that can be used to create a bespoke solution for pension schemes of all sizes."

## Appendix – asset allocation breakdown

The tables below show the asset allocation across the Liability Aware pooled fund range that has been used in the two investment strategies shown in the case study.

**Strategy 1**

| Pooled Fund | Allocation | Amount (£) |
|---|---|---|
| **ASI Diversified Growth Fund** | **10.0%** | **10,000,000** |
| **Global Equity** | **15.0%** | **15,000,000** |
| **Buy & Maintain Credit Funds** | **46.7%** | **46,700,000** |
| Liability Aware CDI 2020-2022 Fund | 4.0% | 4,000,000 |
| Liability Aware CDI 2023-2025 Fund | 7.0% | 7,000,000 |
| Liability Aware CDI 2026-2028 Fund | 10.0% | 10,000,000 |
| Liability Aware CDI 2029-2031 Fund | 10.0% | 10,000,000 |
| Liability Aware CDI 2032-2034 Fund | 10.0% | 10,000,000 |
| Liability Aware Credit Nominal 2035-2049 Fund | 4.7% | 4,700,000 |
| Liability Aware Credit Real 2035-2049 Fund | 1.0% | 1,000,000 |
| **LDI, Gilts and Cash Funds** | **28.3%** | **28,300,000** |
| Liability Aware Real Short Profile Fund | 7.3% | 7,300,000 |
| Liability Aware Nominal Profile Fund | 2.5% | 2,500,000 |
| Liability Aware Real Profile Fund | 5.0% | 5,000,000 |
| Liability Aware Nominal Long Profile Fund | 3.0% | 3,000,000 |
| Liability Aware Real Long Profile Fund | 2.0% | 2,000,000 |
| UK Government Bond Index Pension Fund | 8.5% | 8,500,000 |
| **Total** | **100%** | **100,000,000** |

**Alternative investment approach accessing private credit**

| Pooled Fund | Allocation | Amount (£) |
|---|---|---|
| **ASI Diversified Growth Fund** | **10.0%** | **10,000,000** |
| **Multi Sector Private Credit Fund** | **15.0%** | **15,000,000** |
| **Buy & Maintain Credit Funds** | **50.0%** | **50,000,000** |
| Liability Aware CDI 2020-2022 Fund | 4.0% | 4,000,000 |
| Liability Aware CDI 2023-2025 Fund | 7.0% | 7,000,000 |
| Liability Aware CDI 2026-2028 Fund | 6.0% | 6,000,000 |
| Liability Aware CDI 2029-2031 Fund | 2.0% | 2,000,000 |
| Liability Aware CDI 2032-2034 Fund | 4.0% | 4,000,000 |
| Liability Aware Credit Nominal 2035-2049 Fund | 14.0% | 14,000,000 |
| Liability Aware Credit Real 2035-2049 Fund | 13.0% | 13,000,000 |
| **LDI, Gilts and Cash Funds** | **25.0%** | **25,000,000** |
| Liability Aware Real Short Profile Fund | 3.6% | 3,600,000 |
| Liability Aware Nominal Profile Fund | 3.9% | 3,900,000 |
| Liability Aware Real Profile Fund | 5.0% | 5,000,000 |
| Liability Aware Nominal Long Profile Fund | 2.0% | 2,000,000 |
| Liability Aware Real Long Profile Fund | 2.0% | 2,000,000 |
| UK Government Bond Index Pension Fund | 8.5% | 8,500,000 |
| **Total** | **100%** | **100,000,000** |

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