ACA Northern Conference 2017

To De-Risk or not De-Risk

22 September 2017

Bobby Riddaway FIA

Head of Investment Consulting

65 Gresham Street, London, EC2V 7NQ
Tel 020 7709 4500 Fax 020 7709 4501

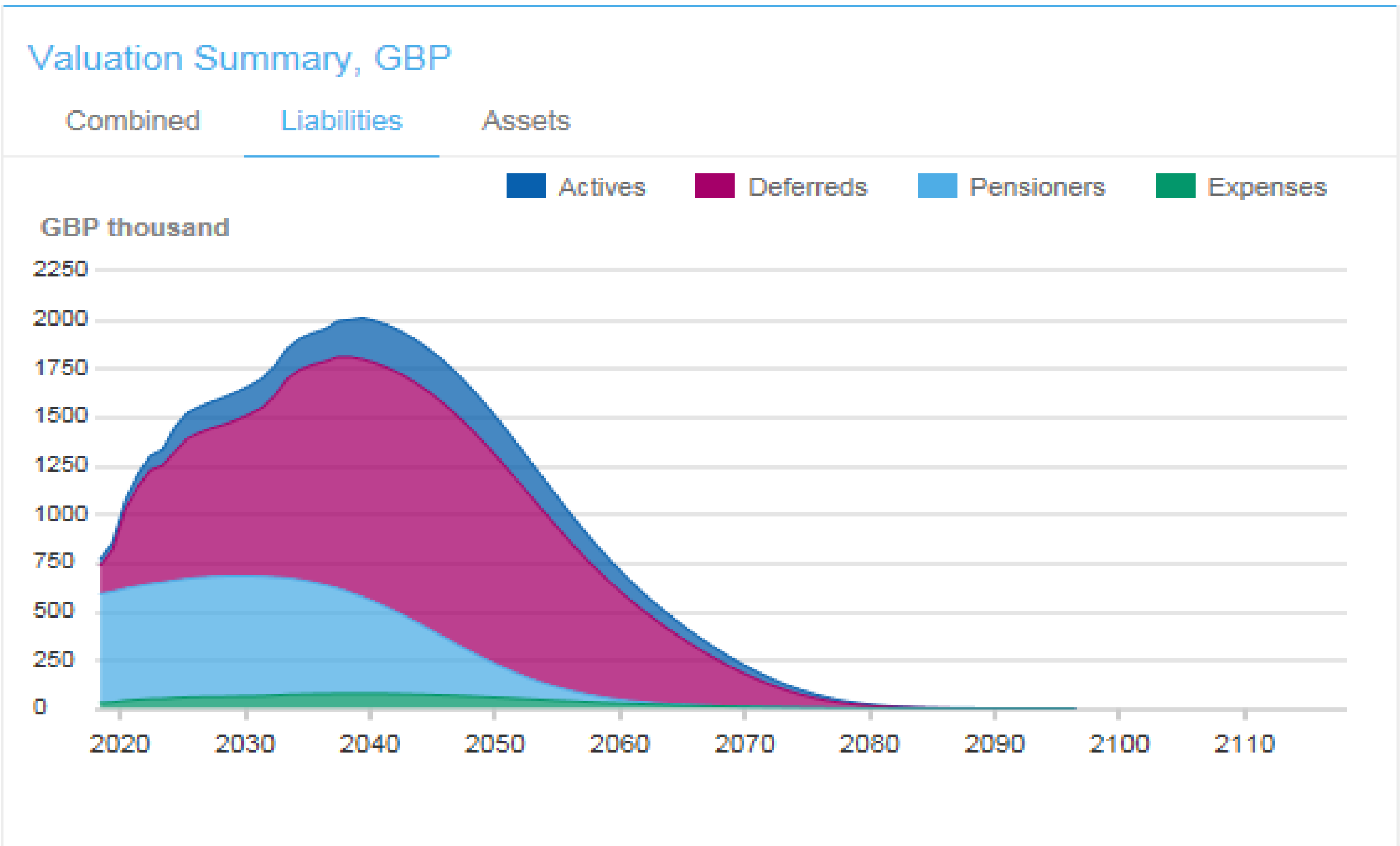
For Professional Clients Only

Introduction

- Why De-risk
- How to De-Risk
- When to De-Risk

CAPITA

Increasing Maturity of Schemes



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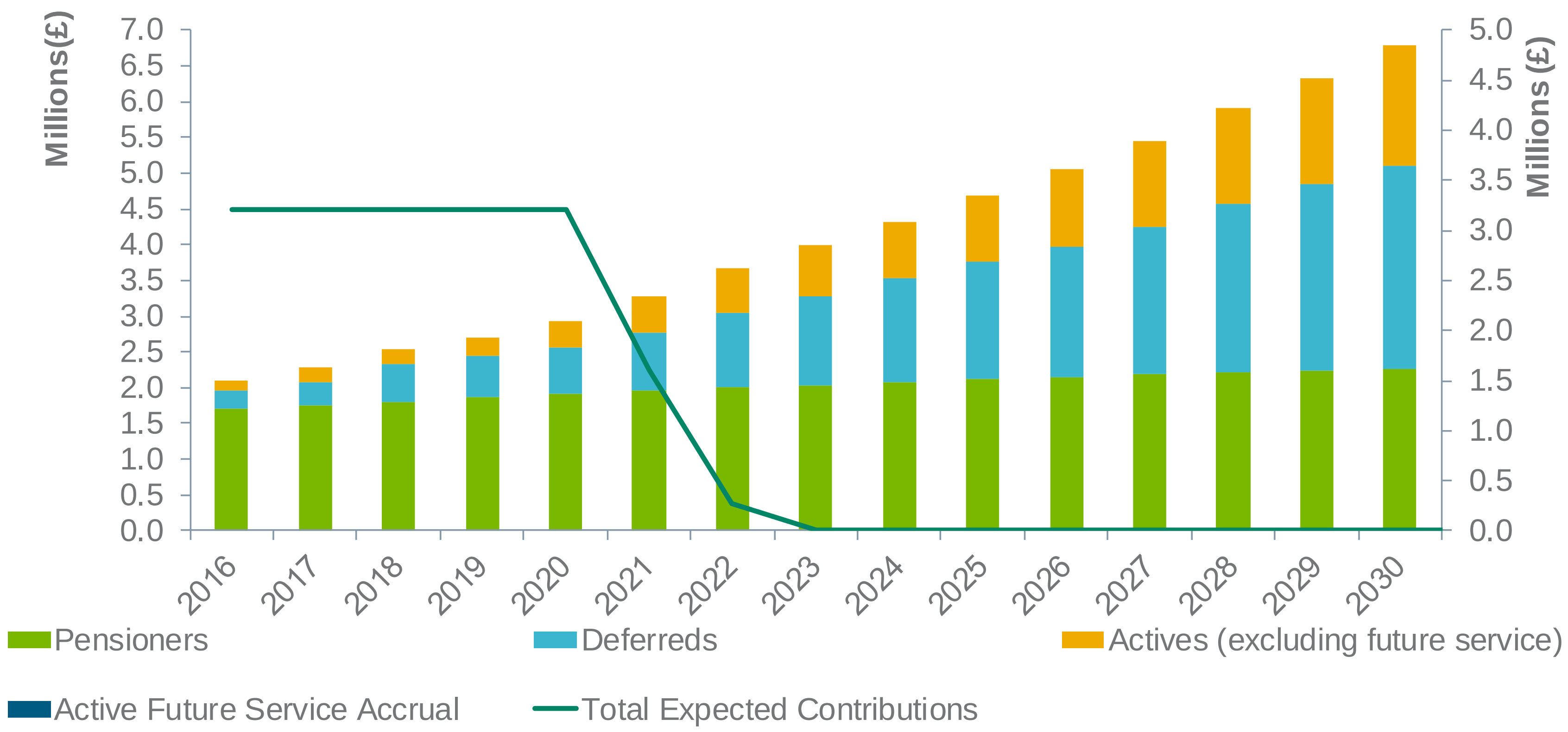
Cashflow needs



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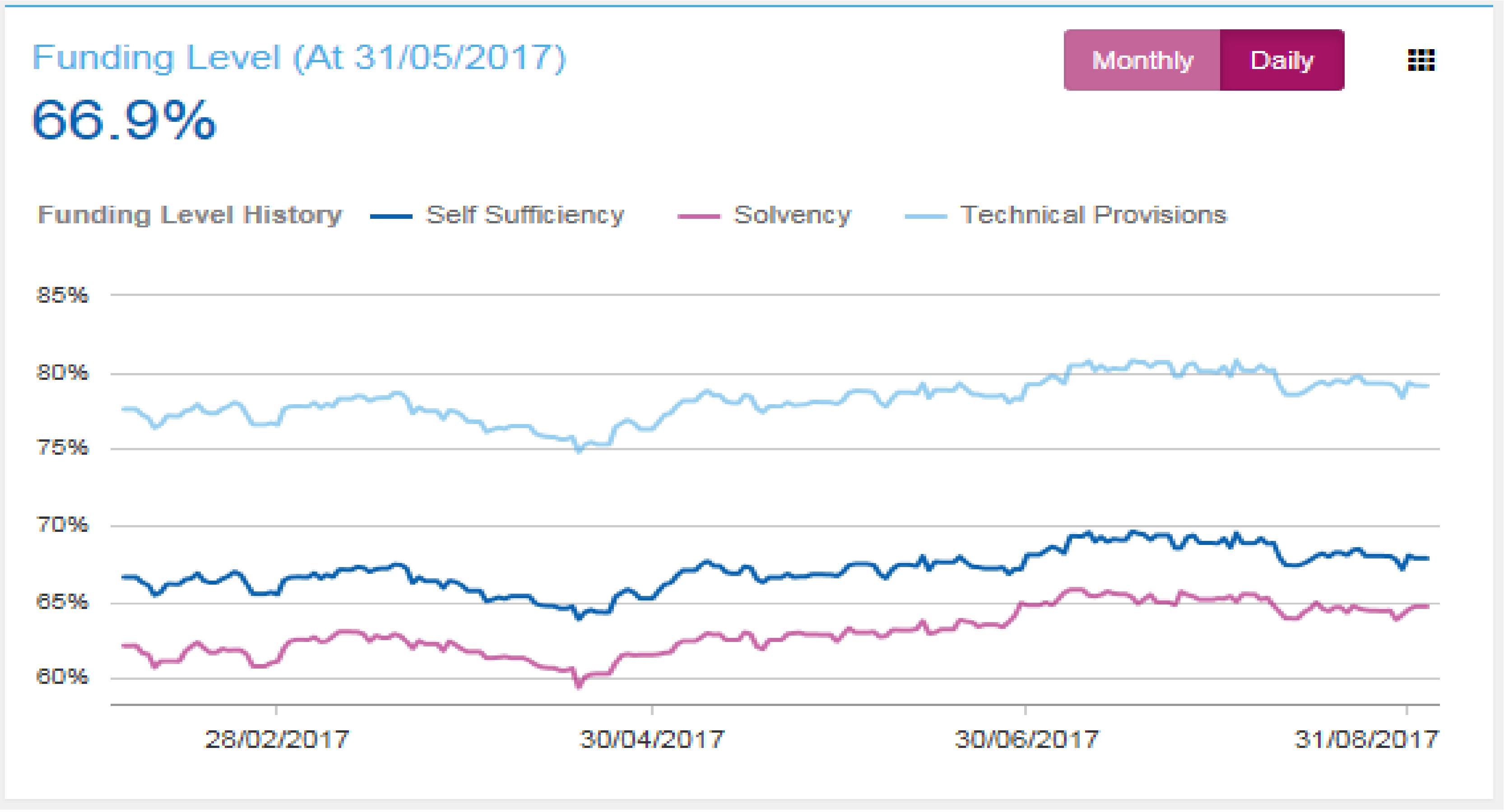
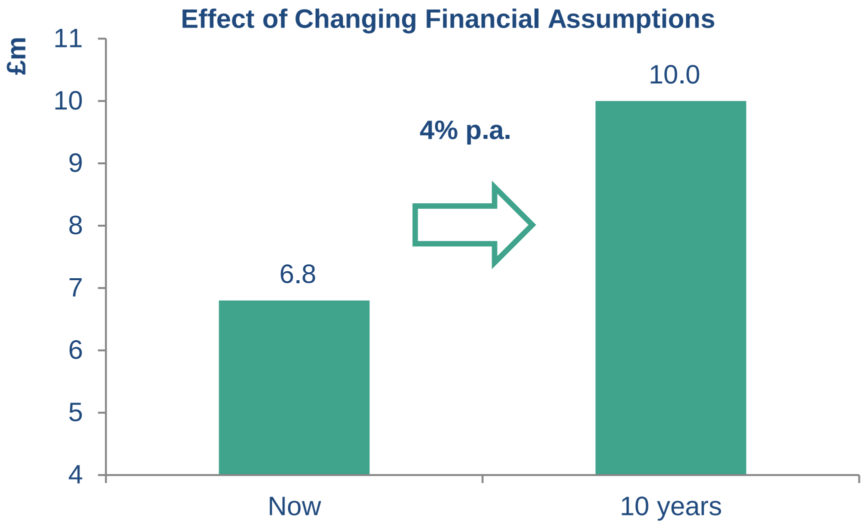
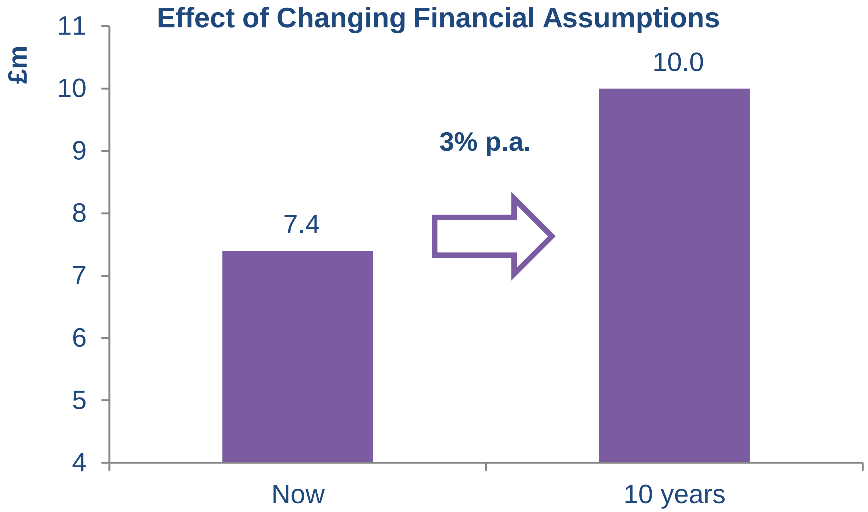
Need to eliminate funding issues



De-risking is costly?





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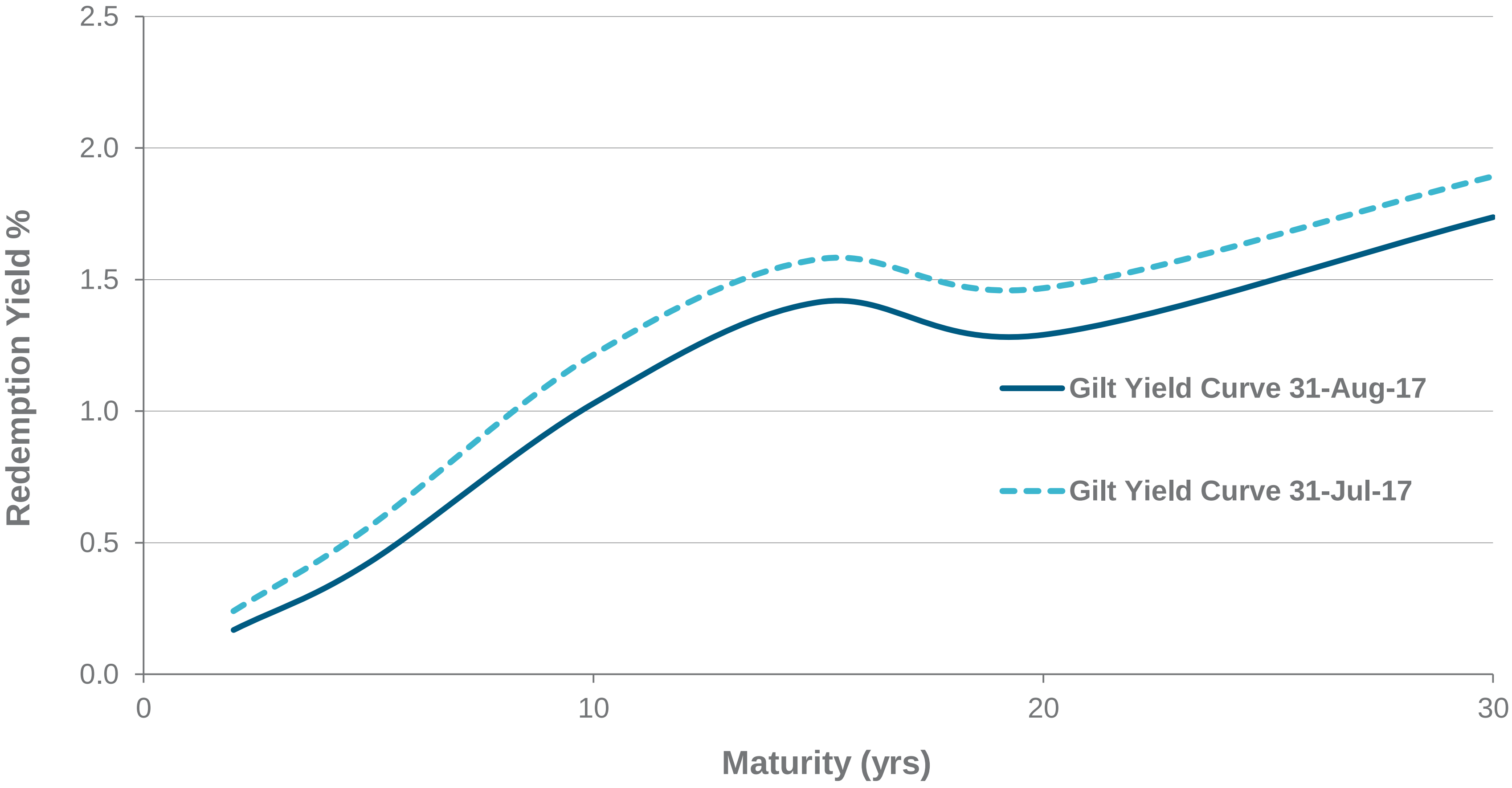
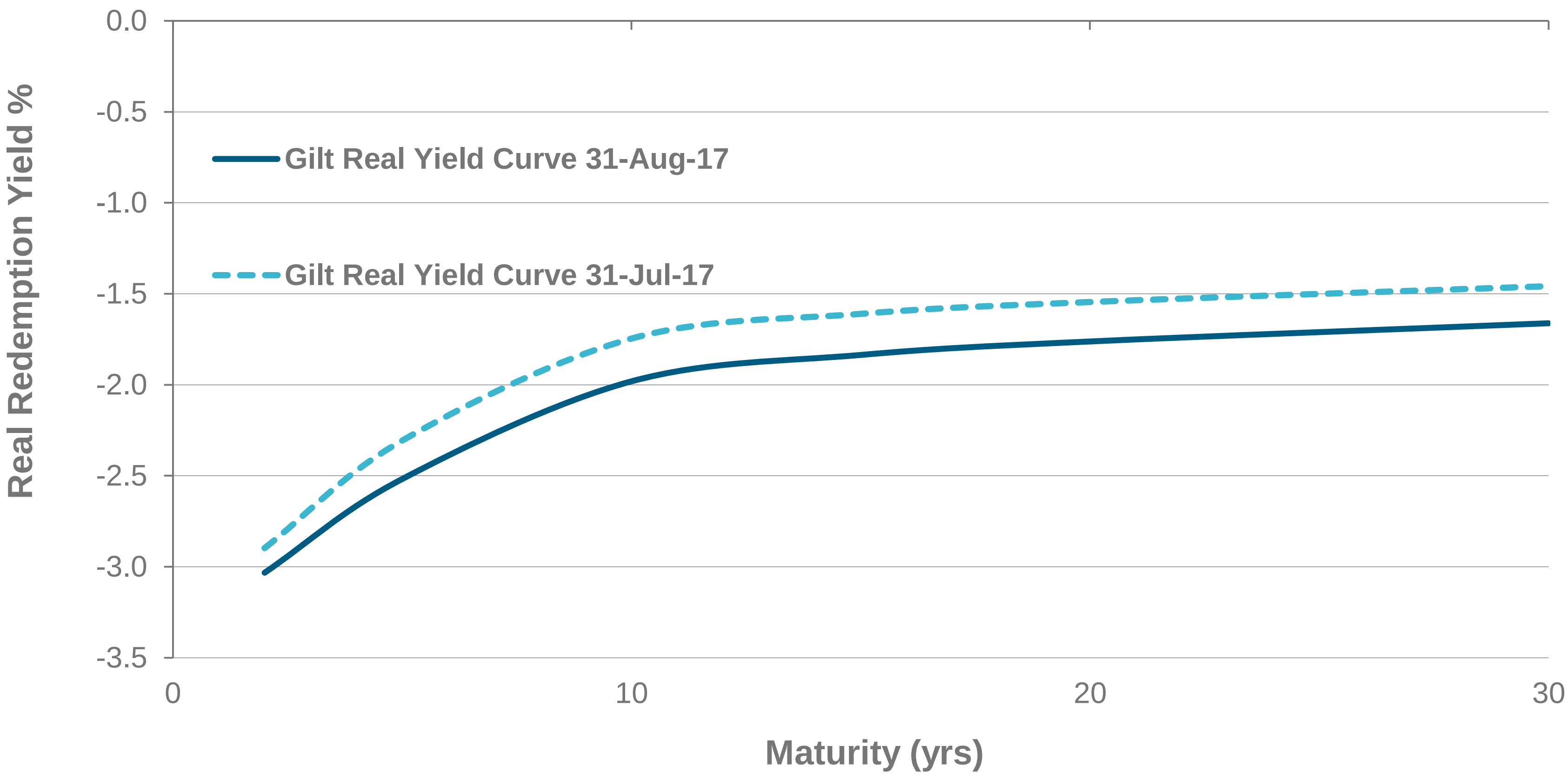
Nominal Gilt Yield



Real Gilt Yield



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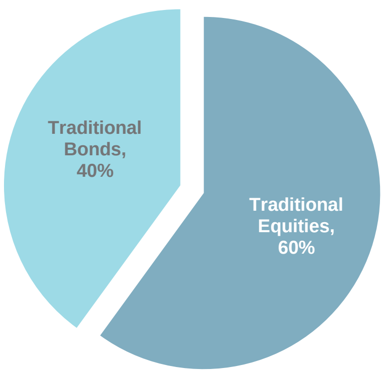
Equity-Linked Bond Funds

1. Example Plan Assets

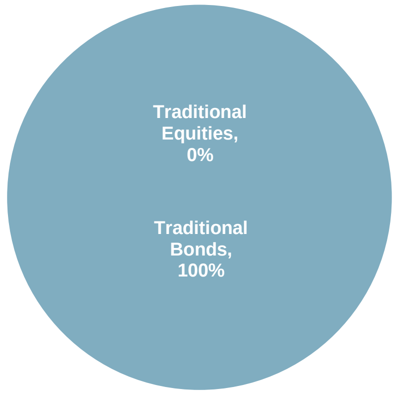


Required Return*	2.0%
Expected Return*	2.0%
Liability Duration	25 yrs
Asset Duration	8.8 yrs

* In excess of Gilts

- Assets are expected to achieve the required return
- Considerable interest rate risk

2. Replace Equities with Bonds

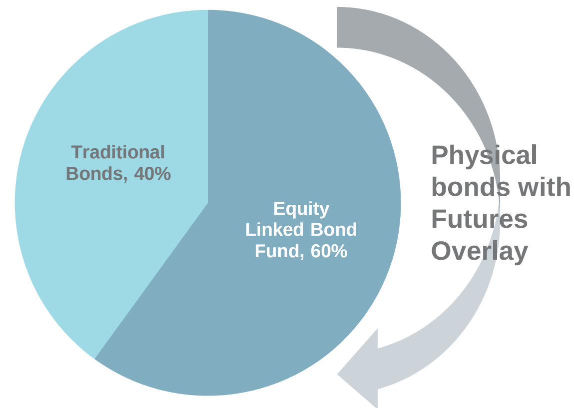


Required Return*	2.0%
Expected Return*	0.0%
Liability Duration	25 yrs
Asset Duration	16 yrs

* In excess of Gilts

- Reduced interest rate risk through better duration match
- Reduced expected return on investments

3. Replace Equities with ELBFs



Required Return*	2.0%
Expected Return*	2.0%
Liability Duration	25 yrs
Asset Duration	13.6 yrs

* In excess of Gilts

- Reduced interest rate risk through better duration match
- Maintained expected return on investments

Leveraged Liability Driven Investment

£300,000
house

£100,000
deposit

£300,000
bond portfolio

£100,000
investment

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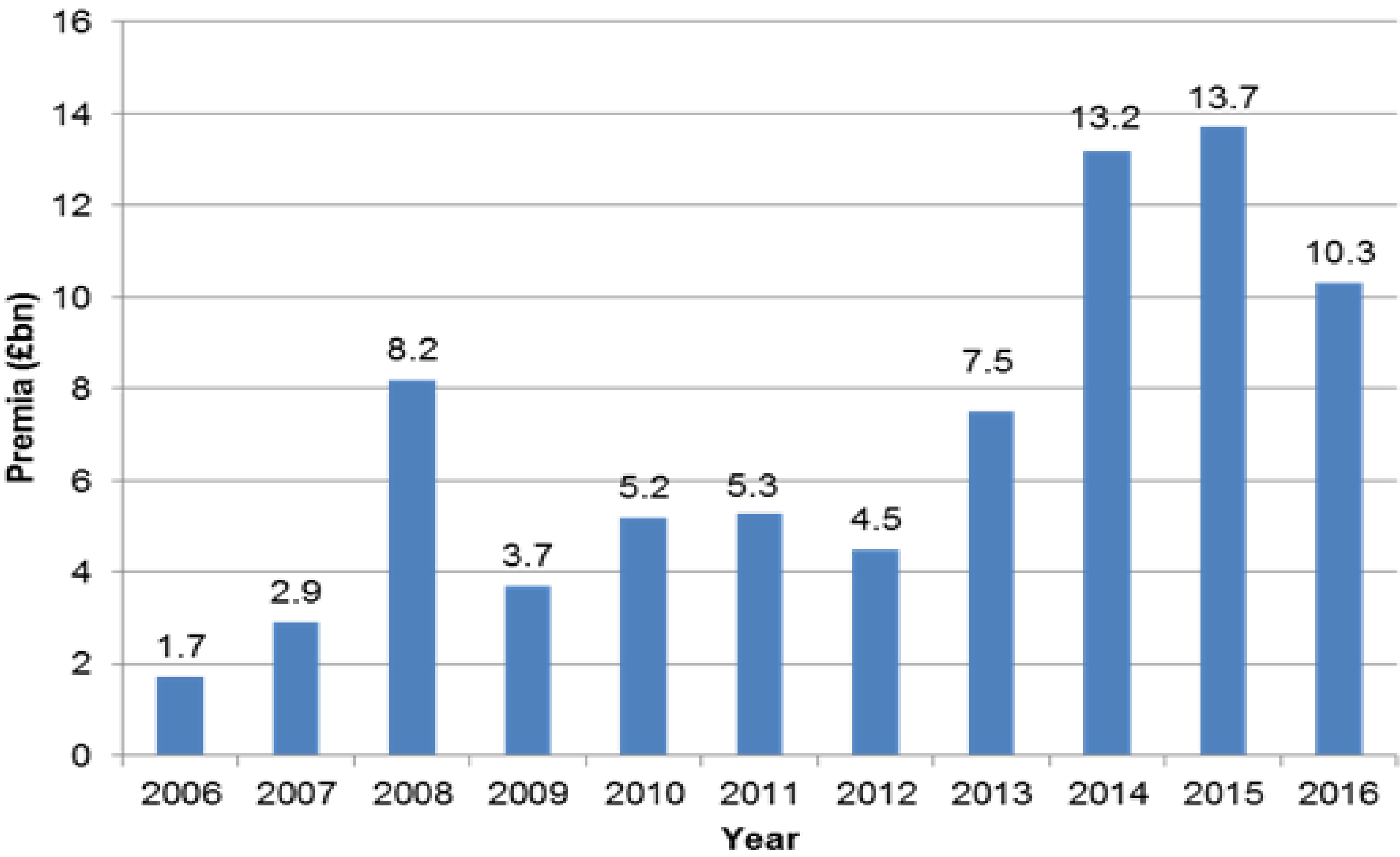
Innovation in buy-in/buy-out market



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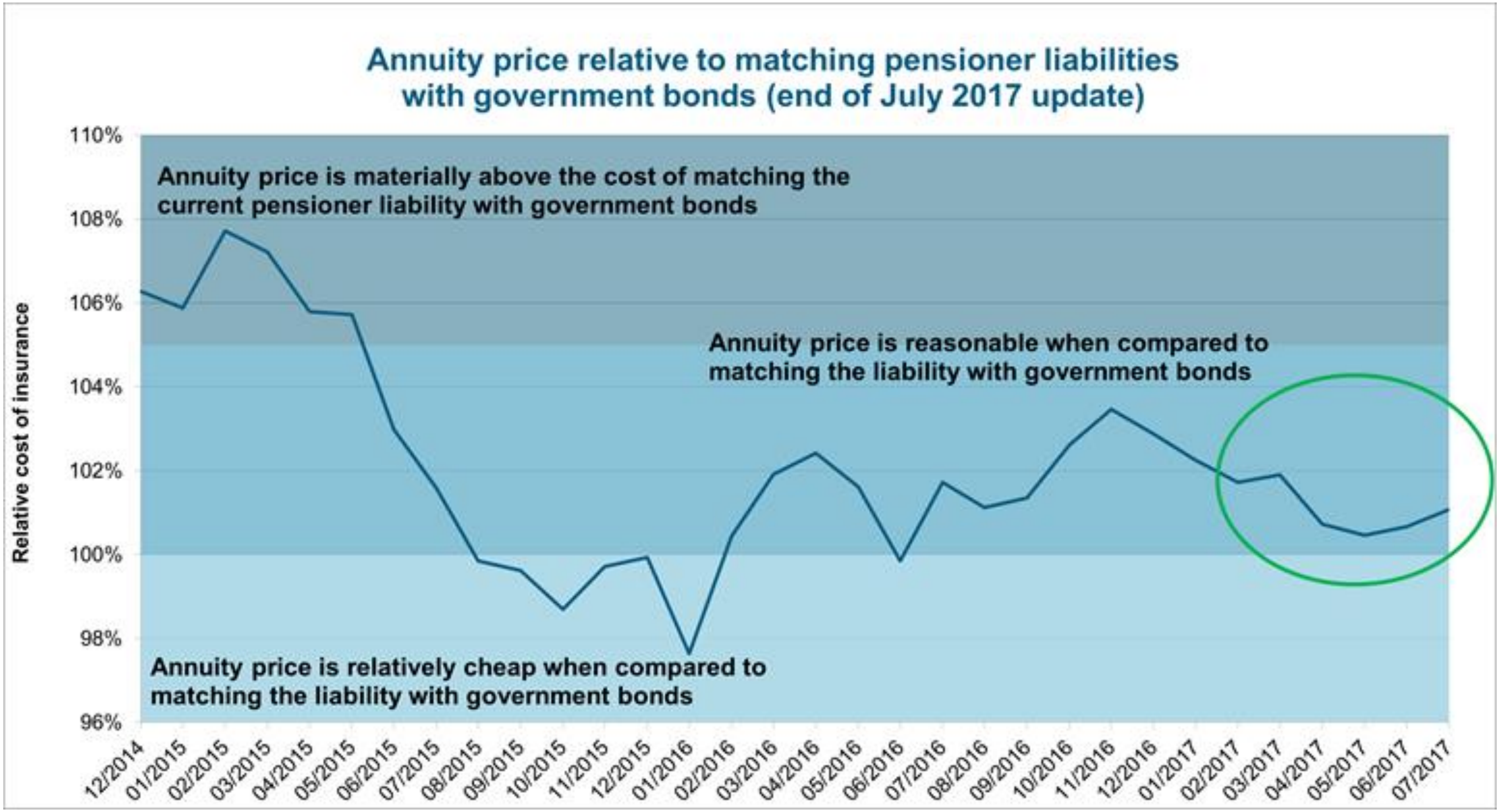
Source: bulk annuity insurers and Capita analysis

Annuity cost versus gilt value of liabilities



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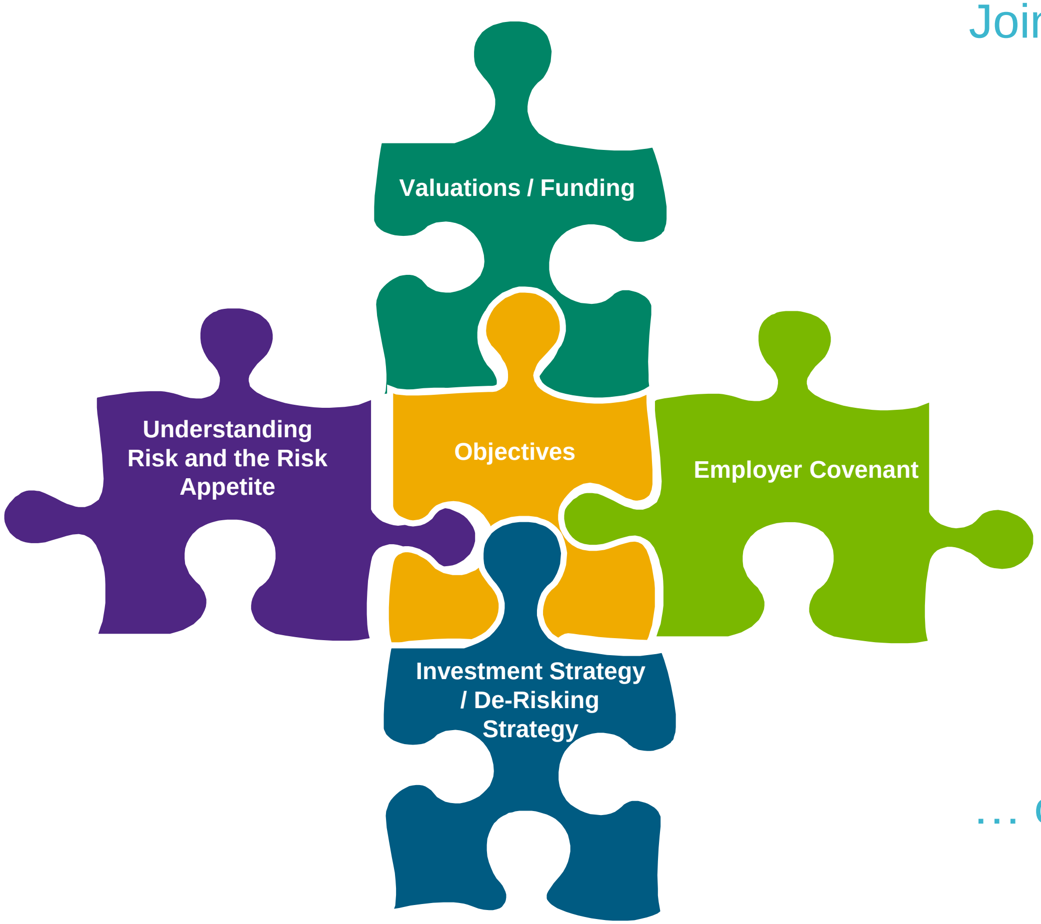
How to De-risk



Joined-up thinking…

Trustees	Sponsor
Member security	Impact on P&L
Employer's views	Impact on b/sheet
Employer covenant	Costs: level & volatility
The end game?	Compliance/ running costs
TPR guidelines	Risk budget
Risk management, including liability management	Trustees ultimately in control

… consider **objectives** and **constraints** of key stakeholders

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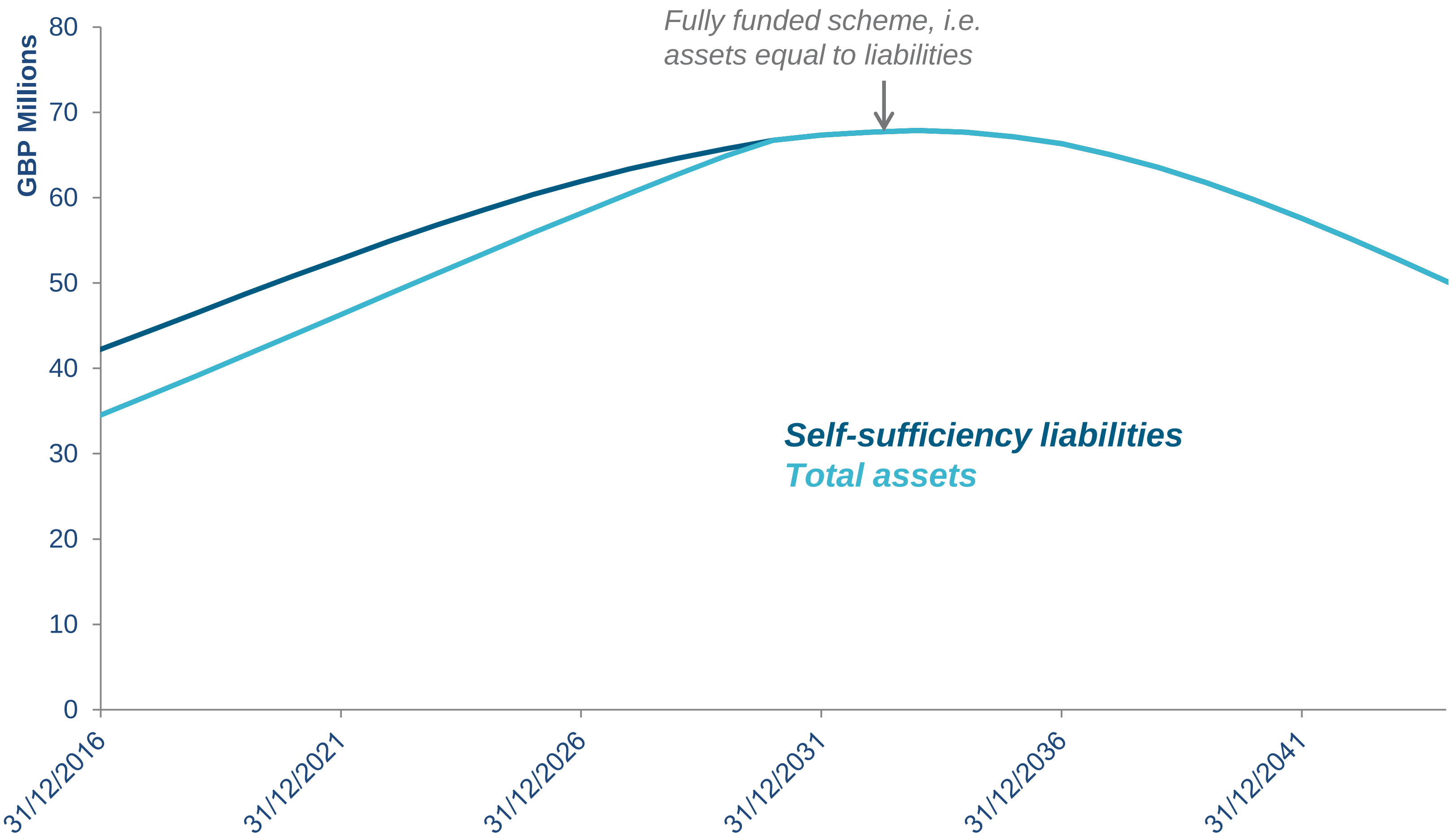
Flight Plan Example



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Alternative Strategies

Asset class	Current benchmark %	Strateg[illegible] %	Strategy 2 %	[illegible]	Strategy 4 %
UK equities	17.5				
Overseas equities	17.5				
Equity linked bond funds - inflation		[illegible]	35.0	30.0	
Diversified growth funds	15.0	[illegible]	30.0	[illegible]	50.0
UK corporate bonds	25.0				
UK index-linked Gilts	15.0				
Property	10.0				
Real LDI		25.0	25.0	19.0	20.0
Buy-in				21.0*	
Absolute return bonds		15.0	10.0		30.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Expected returns (abo[illegible]	**2.1**	**2.1**	[illegible]	[illegible]	**2.0**
Years until full funding	**26**	**26**	[illegible]	**30**	**30**
Year in which full funding achieved	**2041**	**2041**	**2038**	**2045**	**2045**
Asset duration	**7.6**	**20.6**	**23.5**	**21.9**	**13.4**
95% 1yr VaR (£m)	**21.4**	**9.4**	**9.6**	**10.9**	**12.0**

35% Equity

50% DGF

40% Bonds

20% LDI

VAR £21.4m

VAR £12.0m

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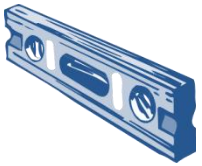
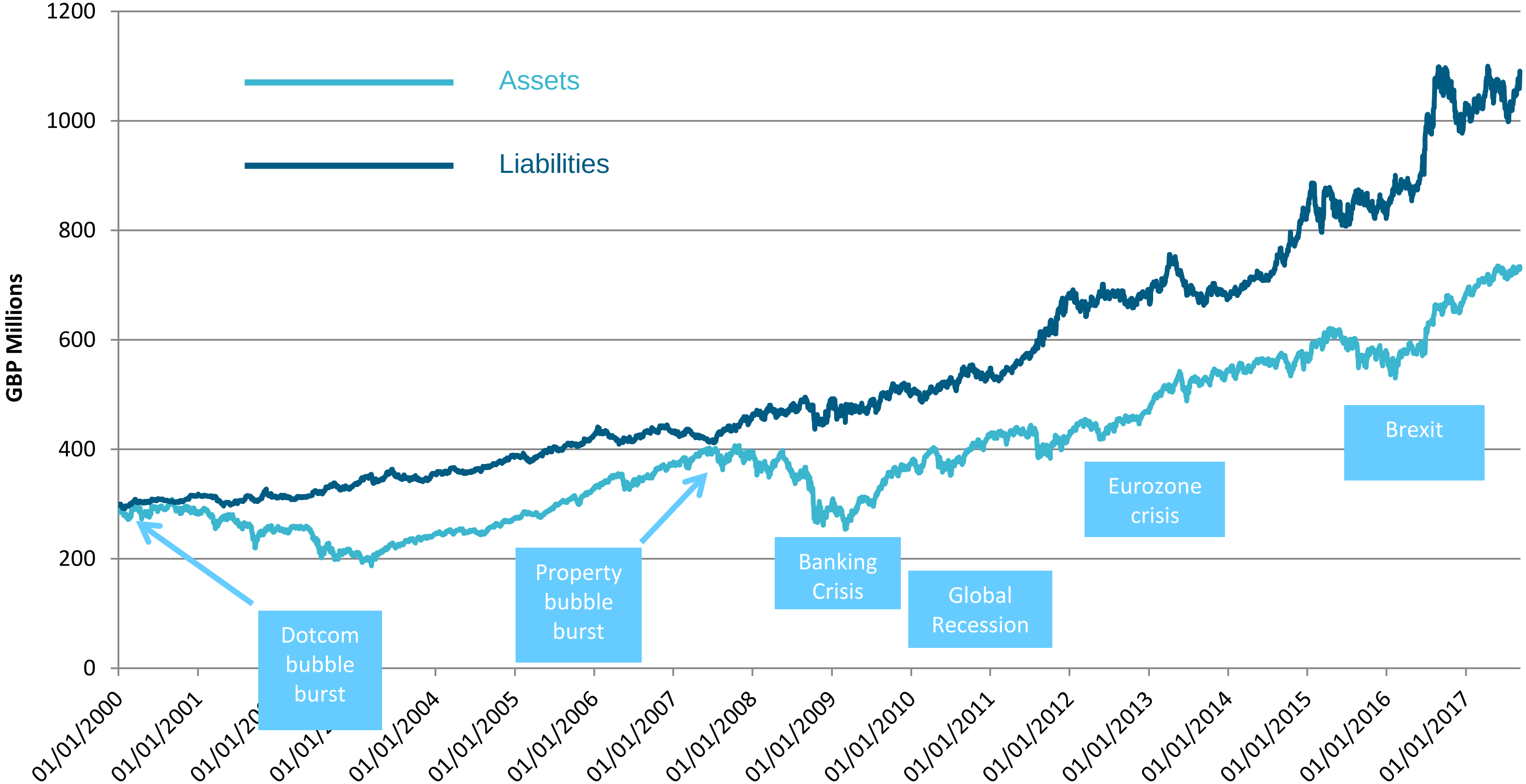
When to de-risk

Did tools exist in the noughties





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Approaches to de-risking

Broadly three approaches which are not necessarily independent.

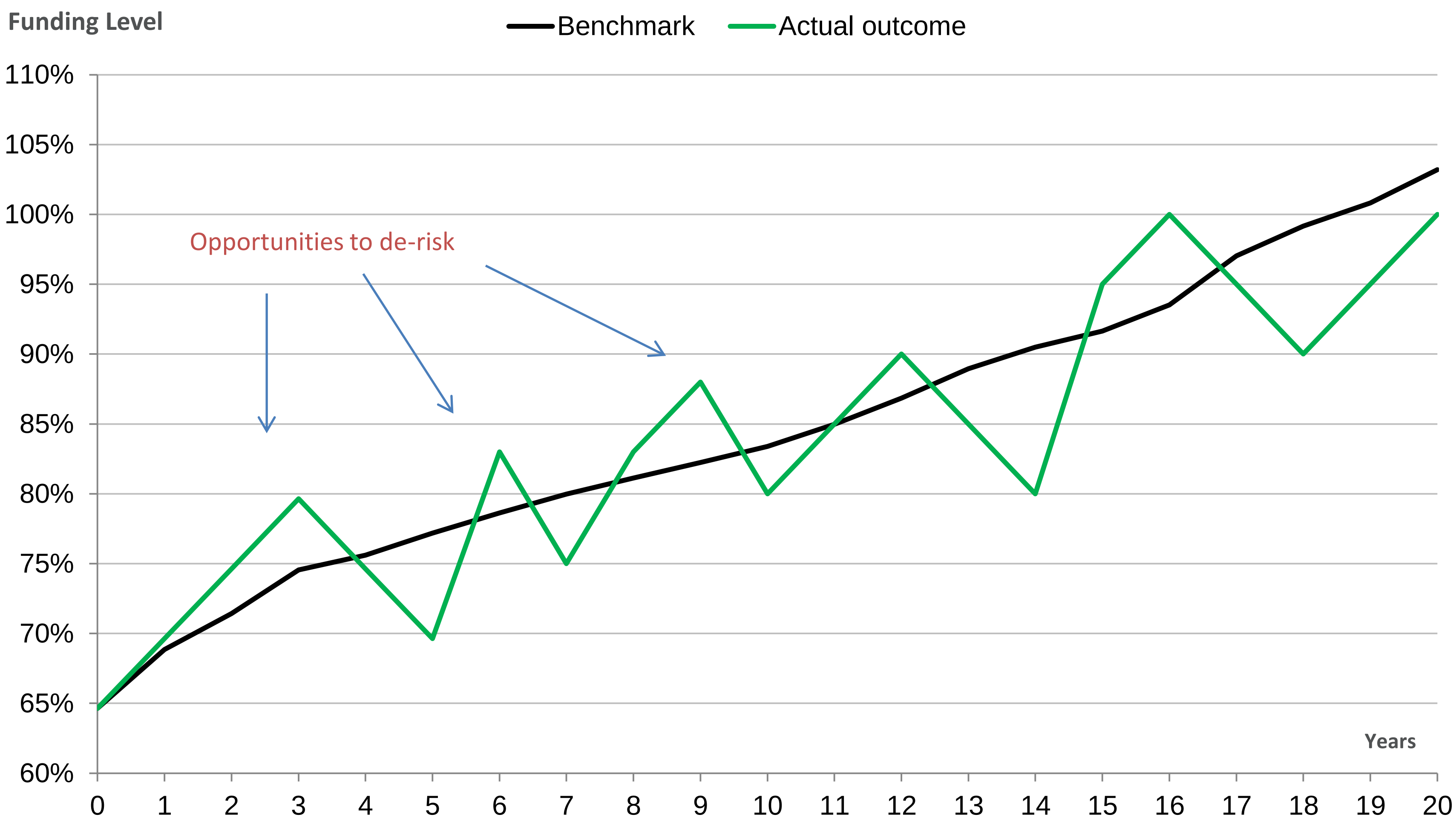
1. Funding level triggers: when the funding level hits a predetermined level, return-seeking assets are sold for matching assets.

2. Step de-risk: reduce market risk via a step change in investment strategy. For example, sell return-seeking assets for matching assets.

3. Calendar-year de-risking: de-risk the asset allocation from say 80% in return-seeking assets to 20% in return-seeking over a pre-determined time period. Involves selling growth assets for matching on an annual basis.

Approach 1: de-risking based on funding level triggers

Opportunities to de-risk when actual funding level is above the expected funding level



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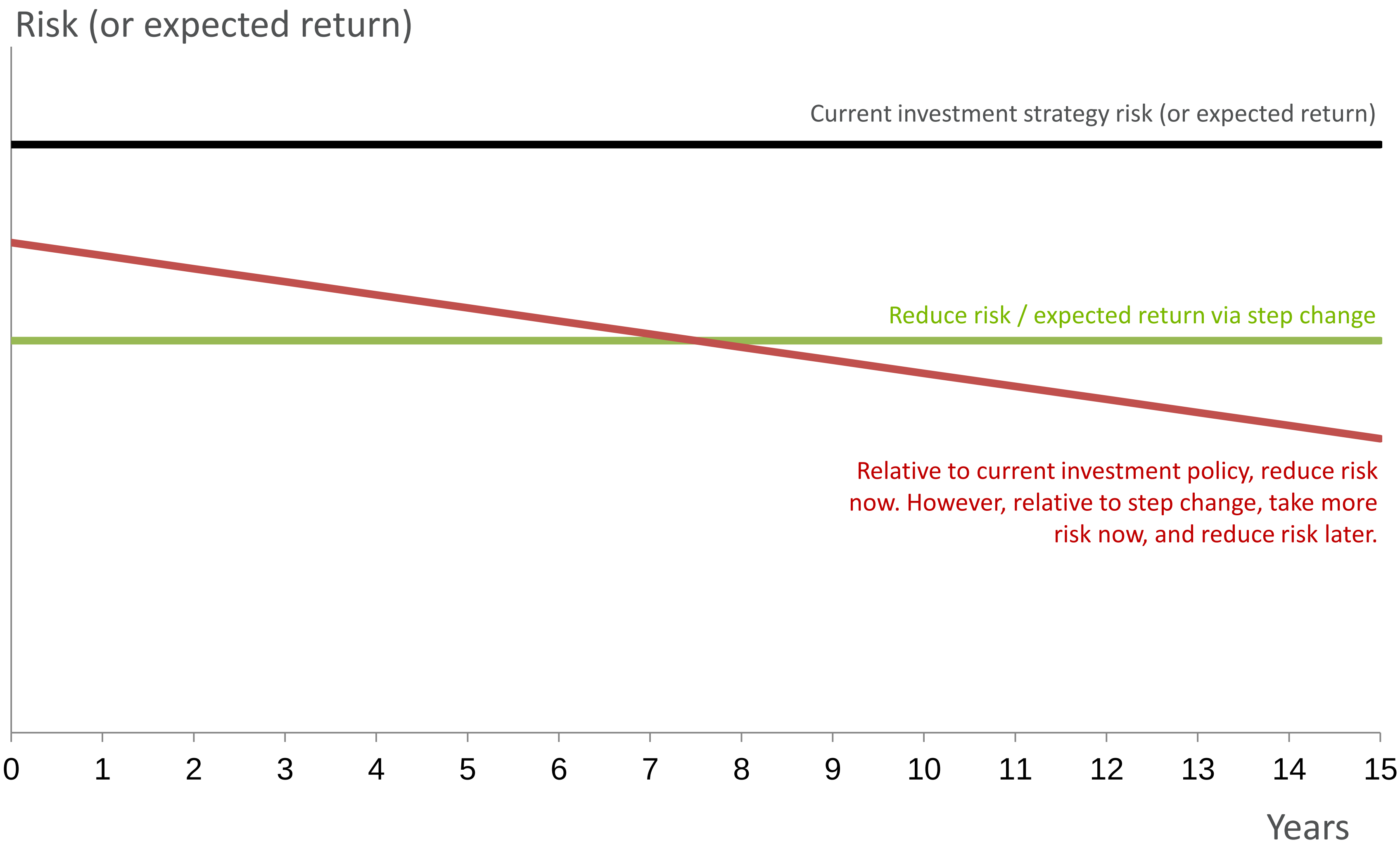
Approach 2 and 3: step change and gradual de-risk



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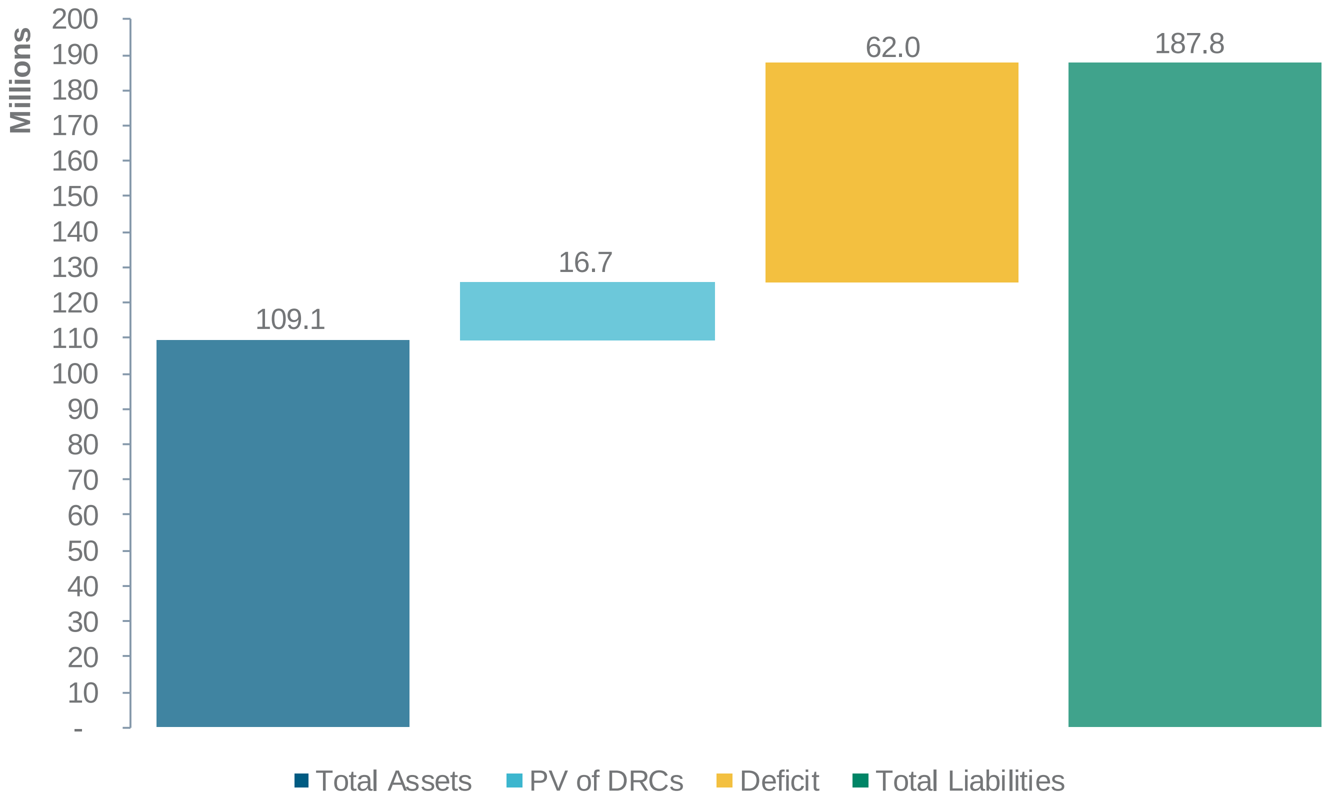
Re-risking – to recover deficit?



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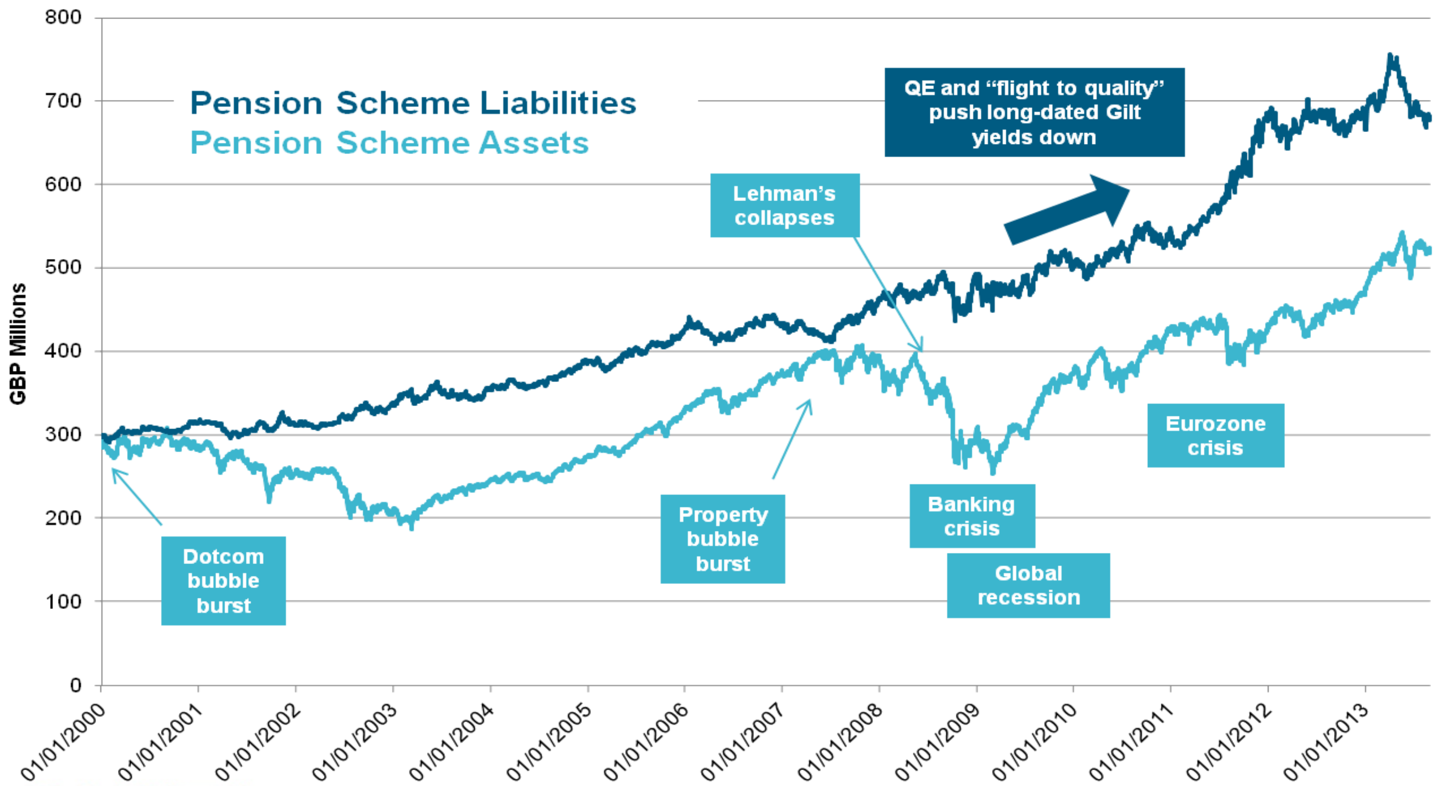
Re-risking – markets are cheap?



Summary

Why De-risk

How to De-Risk

When to De-Risk

Questions?