

FOR PROFESSIONAL CLIENTS ONLY. NOT TO BE DISTRIBUTED TO RETAIL CLIENTS

Liability driven investment (LDI) is established as a leading investment approach for defined benefit pension schemes, aiming to provide a more effective framework for managing pension risks than traditional approaches. LDI puts the unique liability characteristics of each pension scheme at the heart of the solution and in its simplest form seeks to reduce unrewarded risks such as variation in inflation and interest rates. Insight has been at the forefront of developing and evolving LDI in the market by creating innovative strategies that go further than simply matching the duration of a bond portfolio to the liabilities. The wide ranging expertise of our 30-strong dedicated team of LDI specialists covers every component of the design, implementation and ongoing management of a successful risk management strategy. Insight's innovative approach has been rewarded with significant business wins and industry awards.

## Introduction

The recent financial crisis reduced funding levels within the majority of pension funds globally, resulting in those with traditional asset strategies experiencing significant funding level volatility, largely due to the mismatch between assets and liabilities. In the majority of cases, falling asset rates were experienced at a time when the economic value of liabilities increased. Consequently, investment strategies are being revised to better manage this asset/liability mismatch.

Insight is at the forefront of developing risk management solutions that seek to better manage the volatility of funding levels whilst retaining scope for improvements in the overall funding position through investment returns.

LDI is a strategic approach used to address the asset/liability mismatch by mitigating inflation and interest rate risk. We tailor our solutions to a scheme's individual funding level, liability profile and willingness or capacity to take on risk. Our role in LDI assignments typically involves us taking full responsibility for modelling, design and implementation as well as the ongoing management of solutions. A key component of this is an 'intelligent' management approach that enables us to proactively add value through implementation and effective execution. Fundamental to this process is our expertise in recognising market conditions where we have found significant value can be either added or destroyed during the hedging process.

We have extensive experience of managing risk on both sides of a pension fund balance sheet: the longevity, interest rate and inflation risk of the liabilities as well as active and passive physical and synthetic management of assets covering equities, credit, government bonds and absolute return strategies.

Insight's innovative approach has been rewarded with significant business wins and industry awards.

Please note past performance is not a guide to the future. The value of investments and any income will fluctuate and is not guaranteed (this may be partly due to exchange rate fluctuations). Investors may not get back the full amount invested.

➤ A BNY MELLON COMPANY<sup>SM</sup>

## Key benefits

- Insight has a dedicated team of professionals with extensive expertise in every area of risk management solutions
- LDI approaches seek to reduce unrewarded risks to better match assets to liabilities, thereby reducing funding level volatility
- Where possible, the LDI solution leaves the underlying return-seeking investment strategy undisturbed
- Once implemented, we review, rebalance and evolve our clients' LDI solutions on an ongoing basis

## Awards and ratings

### Pension and Investment Provider Awards

LDI Manager of the Year 2011

### European Pensions Awards

LDI Manager of the Year 2010

### Financial News Awards

LDI Manager of the Year 2010

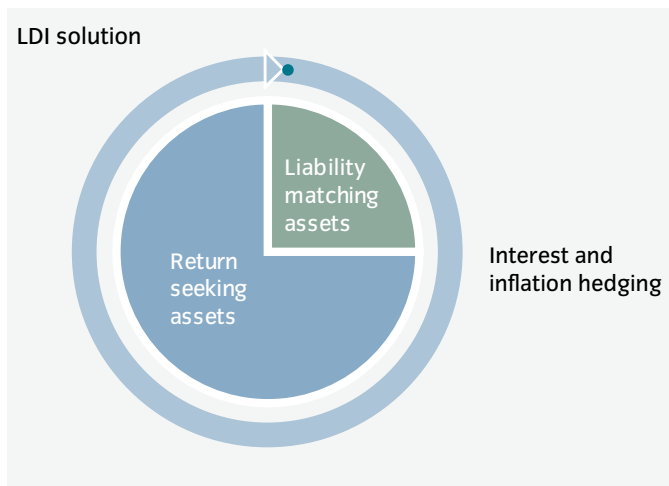
# Insight's approach

We believe that the most effective investment strategies for pension schemes are those where:

- The client's investment benchmark is directly related to its unique liability cash flow profile;
- Unintended, uncompensated risk is minimised; and
- Active investment risk is managed with diversification and precision, to generate the return required to meet the funding target.

We have been at the forefront of the development and evolution of LDI strategies by creating innovative solutions that go further than simply matching the duration of a bond portfolio to the liabilities:

- Our LDI solutions form part of the ongoing risk management process that is fully integrated into a scheme's overall funding strategy.
- Flexibility is a key requirement, we recognise the need to evolve the solution as market conditions and a scheme's circumstances change.
- Where possible, our LDI approach leaves the underlying investment strategy undisturbed whilst assisting a scheme in the reduction of any deficit or increase in a surplus. We also offer a broad range of return-seeking strategies including market risk premia ('beta') and manager skill ('alpha') that can be used in combination with interest rate and inflation risk management programmes to create 'cash plus' returns, e.g. in excess of Libor/Euribor.

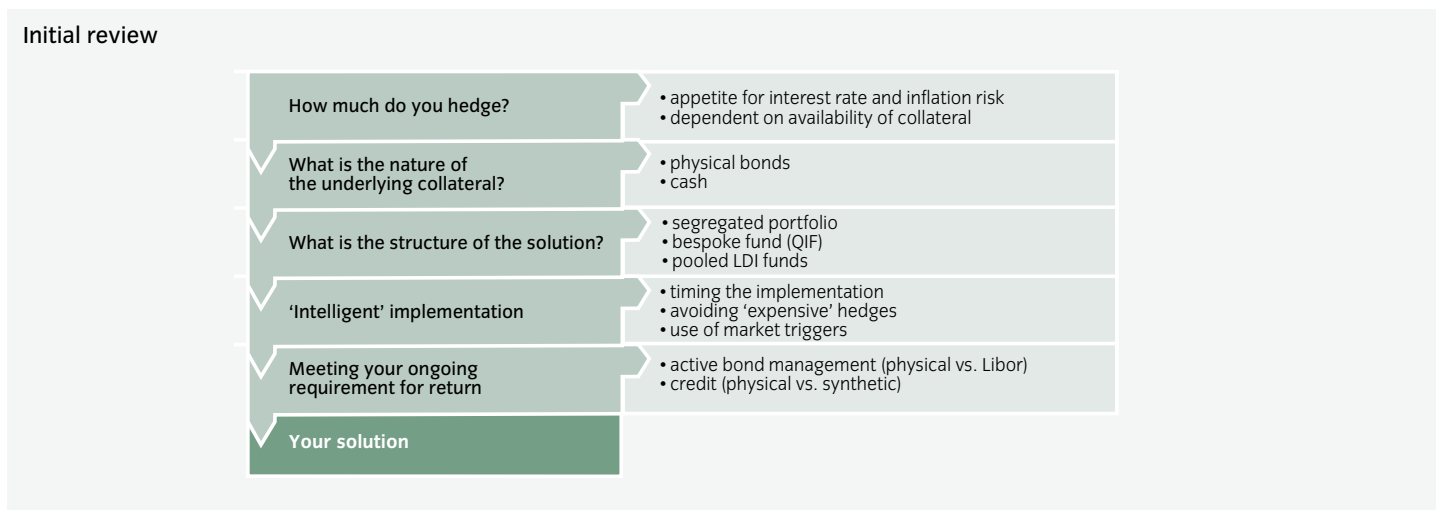


Our role in LDI assignments typically involves our taking full responsibility for modelling, design, implementation as well as the ongoing management of solutions. We are fully accountable for our solutions as we do not rely on any third parties (such as investment banks) for assistance in the modelling and construction of our strategies.

We consider the implementation of LDI solutions as being part of an ongoing risk management process, not a one-off hedging transaction. Our approach is both continuous and dynamic, responding to changes in the requirements and to changes in the liabilities arising from non-financial risks including longevity and experience.

## Discovery

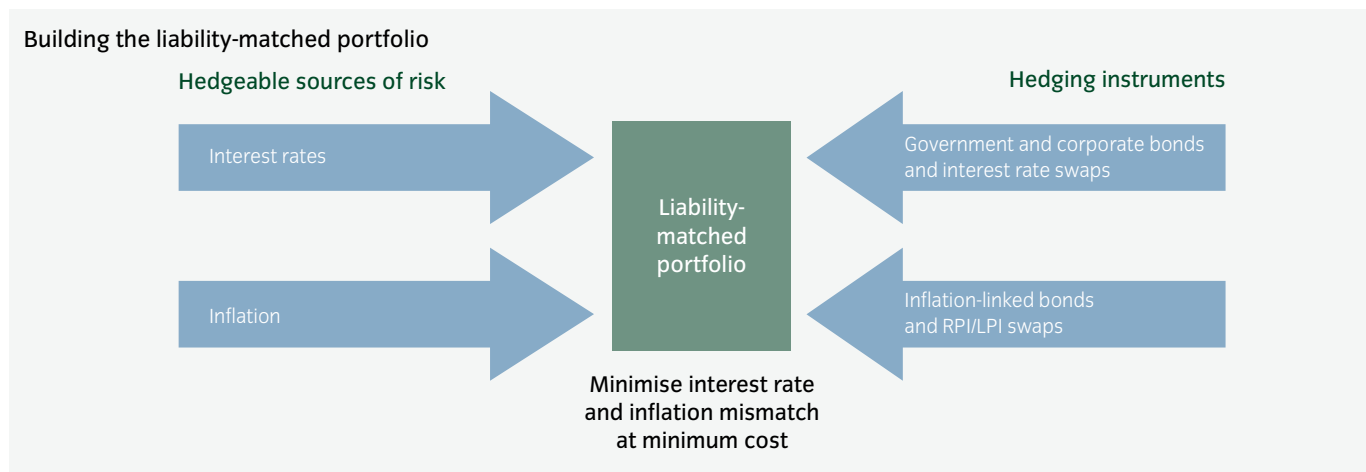
One of the most important phases of the process for Insight is 'discovery' – understanding a client's particular requirements, their funding position, objectives and risk tolerances before considering potential strategies. We aim to establish a close working relationship with a scheme's representatives, their advisers and all parties involved in the decision-making process to help identify the key issues and most appropriate solution. The typical key issues discussed are illustrated overleaf.



## Designing and modelling the solution

In designing the solution, our starting point is to build the 'least-risk' hedge; the selection of tradable instruments which most closely matches the liabilities of the scheme. The 'least-risk' hedge would typically be structured using interest rate and inflation swaps often in conjunction with physical bonds to bring the economic exposure of the assets in line with the liabilities. This goes beyond simply matching the duration of the portfolio to the duration of the scheme's liabilities. Subject only to the limits of available market liquidity, inflation and interest rate exposure would be addressed along the full term structure horizon of the liabilities. Our approach considers the two components of real rate hedging, interest rates and inflation, separately and contrasts with broader 'bullet' style solutions that can leave significant yield curve risk unhedged.

Whilst it is important to identify the 'minimum risk' hedge we do not believe that it then necessarily makes sense simply to implement it. The relative attractiveness of alternative hedging instruments and approaches must be considered in order to implement the most cost-effective liability hedge. This is what we refer to as 'intelligent' implementation.



## 'Intelligent' implementation

We constantly monitor current market conditions and seek to take advantage of any situations where the valuation of assets may have been driven out of line by explicable factors which could be expected to reverse over the long-term. We therefore deviate from the 'least risk' hedge by building in our views in a size commensurate with agreed risk tolerances and with a view to returning to the 'least risk' hedge when market conditions are attractive to do so. Such decisions can generate significant cost savings for clients.

Timing of implementing the LDI solution is a key consideration. Execution can be pursued for either a 'least risk' or an active hedge objective as we are simply looking for attractive market levels at which to implement the hedge. By entering into the positions at the right time, a significant benefit in value can accrue to clients.

Our approach does not stop here; we continue to evolve the solution as market conditions change. Whilst some active positions may be removed as a market anomaly is corrected, others will emerge and enable us to take advantage of these new opportunities which we again seek to implement in an intelligent manner. Market developments leading to opportunities in instruments other than swaps can also be captured as new approaches can be built into hedges. For example, where bonds offer better value than swaps as hedging instruments, we would look to incorporate them into our hedge where possible. Over the last couple of years, such positions have created real value for clients relative to the 'least risk' hedge. Moreover, the dynamic nature of the relationship between gilts and swaps has meant that opportunities emerged for us to 're-load' the trade when market conditions became attractive, thereby often creating extra value for clients through the careful active management of this position.

## Best execution

Efficient execution of the hedging strategy is a key issue and one that can result in very substantial unnecessary costs being incurred by a fund if it is not handled effectively. We have developed specific processes, procedures and technology to assist us in delivering best execution for our clients. Executing the optimal implementation strategy requires access to a broad range of market counterparties to maximise the possibility of exploiting specific market positions with potential counterparties, particularly in the inflation markets. The breadth of Insight's counterparty relationships combined with our agency ISDA coverage provide us with comprehensive access to all of the significant counterparties in the interest rate and inflation swap markets.

## Ongoing management

Insight undertakes an ongoing risk management process as part of our approach. We do not view an LDI solution as a set of one-off transactions. We re-model and rebalance each solution on a regular basis to account for changes to the liability cash flow data, schedule of deficit recovery contributions and changes in the characteristics of any underlying asset cash flows being factored into the solution.

We also take great care to ensure that the collateralisation process, which mitigates the risk of counterparty default, works effectively. Our standard policy is to subject swaps to daily bilateral collateralisation. Our collateral management capability is able to support the full range of eligible credit support. Typically, clients use their existing bond portfolio and/or cash.

Perhaps our greatest priority, however, is developing a long-term partnership with our clients. Client focus and liaison are key components to building a successful partnership. We seek to provide our clients not only with successful solutions but also with first-class client service.

## About Insight Investment

Insight Investment is a specialist asset manager at the forefront of designing investment solutions to meet our clients' needs. Launched in 2002, Insight is responsible for assets under management of £137.3 billion<sup>1</sup> across fixed income, liability driven investment, cash management, multi-asset, absolute return and specialist equity strategies.

We manage money for pension funds, sovereign wealth funds, insurance groups, local government, charities, private investors and other financial institutions.

<sup>1</sup> As at 30 June 2011 represented by the value of physical securities and liability benchmarks.



**Andrew Giles**  
Head of Financial  
Solutions Group

Our capabilities and credentials in relation to the design and implementation of LDI solutions are exceptionally strong. Insight stands out in the investment management industry as perhaps the only major company to have restructured its entire investment platform specifically to provide clients with access to effective investment solutions. Our 30-strong Financial Solutions Group (FSG), headed by Andrew Giles, and created in 2003 manages all aspects of the design, implementation and ongoing management of liability risk management solutions. The team's specialist skills encompass risk management, derivatives, quantitative analysis and modelling as well as actuarial and fund management expertise.

## Find out more

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