Capital at risk. For investment professionals only

You choose the endgame we'll build the bridge

LGIM highlights how it can help schemes develop their optimum investment strategy, no matter the endgame destination

Many schemes are now talking about run-on as their preferred endgame strategy.

This is where they pay pensions and run on the scheme until the final member benefit is paid in full, with a potential surplus to be shared between the scheme members and the sponsor.

So, what does this mean for the scheme's investment strategy?

Overall, there are likely to be three key objectives in a run-on investment approach:

1) Paying pensions and any other expenses

2) Managing risks to maintain a strong funding position

3) Targeting a surplus to keep a funding level buffer, with the potential to distribute capital at a future date

We believe these three objectives lend themselves to a renewed interest in CDI or cashflow-driven investment. Credit-based assets can seek to address all three goals of generating cashflows, hedging interest rate risk and capturing the 'long-term credit premium'.

However, due to the longer investment horizon, schemes may be open to more illiquid asset classes, such as property and private credit, to seek an 'illiquidity premium' as a long-term investor.

Also, some schemes may only need to invest a proportion of assets to match expected pension payments. This means their residual assets can be invested in a cash or growth-based strategy to target an increased surplus that can be used as a rainy day fund or to distribute capital, depending on the risk appetites of the scheme and sponsor.

We are also seeing that schemes may want to run on, with the option of buyout in the future should circumstances change.

For example, as the size of the scheme decreases, running costs can outweigh the benefits of running it on, the support from the sponsor deteriorates, or to target attractive buyout pricing.

Therefore, we believe holding credit in a run-on strategy can potentially be helpful as it can help schemes to hedge changes in buyout pricing. While targeting a buyout down the line may limit the amount of very long-term illiquid assets schemes wish to hold, we believe there is still scope for some shorter-term illiquid exposure.

Whatever your scheme's preferred endgame – buyout, run-on or both – LGIM is here to help your scheme to build a bridge to your chosen destination.

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In association with LGIM

Key Risk Warnings

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