

CDI – a new dawn

▶ Lynn Strongin Dodds looks at how CDI strategies are evolving in the context of today's pensions landscape

Cash-driven investing (CDI) remains an important tool in the pensions space, especially as larger schemes are considering run-ons over buyouts.

Surpluses and changing market conditions have meant schemes are shortening their time horizons and diversifying. The biggest risk remains default, which is why DB schemes need to be prepared and conduct stress, and scenario, testing.

CDI, in this context, is still considered an important plank in a UK DB scheme, but strategies are evolving due to better funding levels, increased volatility and widening credit spreads. Views differ as to the best approach, but many agree that diversification and shorter duration are the way forward.

WTW portfolio manager, Chris Thompson, argues that CDI adoption is accelerating because many DB schemes are now materially better funded than even a few years ago and, as a result, have much lower levels of investment risk. “At

the same time, regulatory developments and increased flexibility around surplus are forcing more purposeful discussions about a scheme’s mission and endgame,” he adds.

A surplus of interest

Mercer senior investment consultant, James Brundrett, echoes these sentiments. Many are taking a “purposeful pause and asking what we should do with our surpluses”. CDI, he adds, “is part of the process, especially now because it can dampen the effects of volatility”.

There is no doubt that schemes are in a healthier state than in 2022, when the then Prime Minister, Liz Truss, introduced a mini-Budget that almost derailed the gilt market. This triggered a liquidity crisis for those schemes using liability-driven investing (LDI), prompting the Bank of England to stage an emergency intervention.

Fast forward to today and the latest PwC Pension Funding index reveals

▶ Summary

- CDI strategies are evolving amid improved funding, higher volatility and wider credit spreads.
- Views differ on the optimal CDI approach.
- Pension schemes are adopting insurer-style strategies to secure predictable cashflows.
- The shift toward a holistic CDI approach has strengthened.
- Income-generating assets are key to endgame strategies, while growth still plays a role.

that UK DB schemes recorded aggregate surpluses estimated between £175 billion and £300 billion on a buyout basis during 2025 and early 2026. While handing over to an insurer still remains the most popular route, the bountiful coffers have also led to a shift in focus from deficit repair to considering run-on strategies.

This trend is also being encouraged by the DB Funding Code, which came into effect in 2024, and lowers the threshold for surplus release from the current buyout to a low-dependency level. This translates into a strategy that is highly resilient to short-term market shocks and matches asset cashflows to benefit payments.

Unsurprisingly, size is the main determinant regarding which route to take. A separate PwC study, which canvassed UK DB schemes with assets totalling more than £100 billion, found many are at a

crossroads, with four out of five unsure whether to choose a buyout or run-on.

The UK's largest schemes, though, seem to be taking a more decisive stand with 70 per cent opting for the latter, nearly double the 38 per cent just 12 months ago, according to the *Endgame & Surplus Report 2026* from Brightwell and Mallowstreet.

Schroders global co-head of client solutions, Ajeet Manjrekar, notes that pension schemes are increasingly thinking like insurers to implement portfolios that provide high levels of certainty and security of cashflows. The challenge is that the current landscape is trickier to navigate today, with the current conflict in Iran loosening credit spreads that had been unusually narrow for several years.

Analysts expect oil prices to remain high for the foreseeable future, which is stoking fears that inflation will return with a vengeance. This explains why many schemes are looking to shorten their CDI horizons.

Shortening horizons

As Manjrekar puts it, the past few years have seen the additional return or spread over government bonds trending lower on investment grade corporate bonds, making the de-risk to CDI strategies appear more expensive to implement or purchase today.

However, he adds that with recent uncertainty, credit spreads have widened slightly, making these assets marginally more attractive. This was similar post Liberation Day last April and the introduction of a plethora of tariffs. Schemes were able to move quickly, or by having delegated these decisions to an implementation partner, topped-up allocations at more attractive levels.

"Ultimately," he says, "in periods of heightened volatility, the key questions that trustees and their advisers need to assess are whether these generally lower credit spreads relative to government bonds – given perceived risk in sovereign debt markets as fiscal positions are

strained – are here to stay and what can be done in the meantime."

A holistic approach

The current climate has also reinforced the move to a more holistic approach to CDI, which took hold four years ago. Thompson advocates looking at CDI as a broad concept with assets being selected based on how well they support the scheme's objective and not because they fit a particular label.

"This is aligned to the Total Portfolio Approach (TPA), which is a hot topic across the industry right now," he adds.

"Maintaining optionality and pricing discipline remains key, rather than fully committing to long-horizon CDI at compressed spreads"

In contrast to the more traditionally used strategic asset allocation framework, which depends more on setting a portfolio policy and fixed asset class benchmarks, the TPA emphasises flexible, objective-driven allocation managed by integrated teams. The theory is that portfolios will not only be more in sync with an investor's objectives but will also withstand and adapt to changing market conditions.

In practice and within a CDI context, Thompson says that income-generating assets are central to most endgames, including short-term insurance, running on for a period to generate surplus and more, but portfolios should not be constrained to income alone. Growth assets, he thinks, also have a role to play where upside potential supports the objective.

Russell Investments associate director EMEA, Aqib Merchant, is also seeing greater demand for CDI solutions to meet short-to-medium-term cashflow needs, helping schemes avoid selling growth assets at depressed prices and

improving liquidity management. "Maintaining optionality and pricing discipline remains key, rather than fully committing to long-horizon CDI at compressed spreads, especially when insurer balance sheets have fewer credit assets in them," he adds.

He also concurs that many schemes have moved beyond evergreen investment with a greater use of maturing buy-and-maintain strategies and more diversified income sources across fixed income, real assets and private markets.

Brundett concurs, adding that "pension funds have greater flexibility to invest where the returns are, but they still need to cater for any unexpected shocks". "Also, as more schemes look at run-on, in the current environment, they will be more interested in shorter duration contractual income assets that match cashflows rather than longer dated, 20-year illiquid assets," he adds.

Liquidity, of course, will always be the main goal and, as Insight Investment head of solution design, Jos Vermeulen, notes the ultimate goal for DB schemes is to have enough liquid assets to pay pensions and not be a forced seller. The biggest risk is default, which is why DB schemes need to be selective and diversify their credit risk as well as conduct regular stress and scenario testing.

DB schemes should also remember the lessons learnt during the turmoil created by the mini Budget, according to M&G head of insurance solutions, global client group, Russell Lee. This means being able to meet collateral calls linked to LDI hedging.

"Many therefore maintain high gilt allocations or rely on mechanisms such as repo facilities, bank arrangements or sponsor backstops to raise cash quickly when needed," he adds.

Larger schemes are also giving LDI managers broader tools to support efficient liquidity generation, a trend that accelerated after the gilt volatility of 2022."

 Written by Lynn Strongin Dodds