

CORE CAPABILITIES

LIABILITY DRIVEN INVESTMENT

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 RESULTING FROM MOVEMENTS IN INFLATION AND INTEREST RATES.

Insight has been at the forefront of developing and evolving LDI approaches 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 dedicated team of LDI specialists covers every component of the design, implementation and ongoing management of the risk reduction strategy.

INTRODUCTION

In recent years, pension funds with traditional asset strategies have experienced significant funding level volatility, largely due to the mismatch between assets and liabilities.

Insight is at the forefront of developing risk management solutions that seek to 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 responsibility for modelling, design and implementation as well as the continuing management of solutions. A key component of this is an 'intelligent' management approach that enables us to proactively add value through the implementation and management of LDI mandates. 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 experience managing risk on both sides of a pension fund balance sheet: the longevity, interest rate and inflation risk of the liabilities as well as management of assets, covering equities, credit, government bonds and absolute return strategies.

Insight has won significant recognition from the wider industry, and our clients are our strongest advocates. In 2021, Insight was ranked in first place for Overall LDI Quality for the 11th consecutive year with UK Investment Consultants¹.

KEY FEATURES

- **Insight has a dedicated team of professionals with extensive expertise in every area of risk management solutions**
- **LDI approaches seek to reduce unrewarded risks by more closely matching assets to liabilities, thereby reducing funding level volatility**
- **If required, the LDI solution can leave the underlying return-seeking investment strategy undisturbed**
- **LDI solutions are dynamic: we review, rebalance and evolve our clients' LDI solutions on an ongoing basis**
- **Insight's fixed income expertise enables the combination of liability hedging with fixed income investments to improve overall certainty of returns and cashflows for clients**

¹Source: Greenwich Associates 2021, GICF LDI-21 LDI overall. Results are based on interviews with 11 UK consultants evaluating LDI.

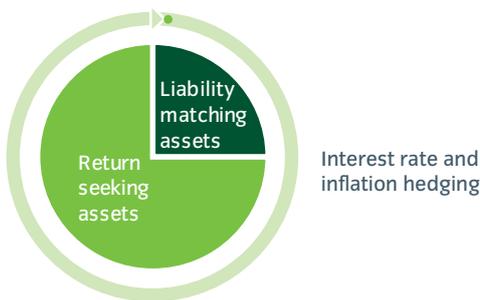
INSIGHT'S APPROACH

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 a continuing 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 return-seeking strategies undisturbed to assist a scheme in the reduction of any deficit or increase in a surplus. We also offer a broad range of return-seeking strategies targeting market risk premia ('beta') and manager skill ('alpha') that can be used to create 'cash-plus' returns.

Increasingly, as pension schemes mature, the certainty of cashflows becomes a priority, meaning a cashflow-driven investment (CDI) strategy may become more appropriate. We believe LDI is a useful building block alongside cashflow-generating assets to build a CDI solution for clients.

Basic structure of an LDI solution



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

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 below.

Initial review

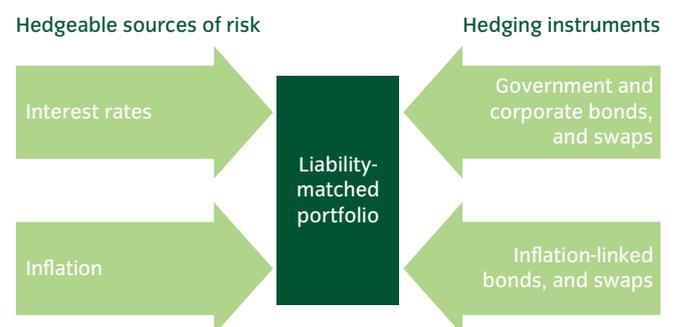


Designing and modelling the solution

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 could be structured using gilts and index-linked gilts or interest rate and inflation swaps. We typically design the hedge in conjunction with other bonds to bring the economic exposure of the assets in line with the liabilities. Subject only to the limits of available market liquidity, inflation and interest rate exposure would be addressed along the full term structure of the liabilities. Our approach considers the two components of real rate hedging, interest rates and inflation, separately and clients can target separate hedge ratios for each.

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.

Building the liability-matched portfolio



'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 and could be expected to reverse over the long-term. In many mandates we are permitted to 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.

The timing of implementing the LDI solution is a key consideration. We offer to work with clients to establish a trigger-based framework which can help clients to de-risk progressively with the passage of time, and/or as funding levels or market conditions improve.

Our approach does not stop there; we continue to evolve client solutions as market conditions change. Whilst some active positions may be removed as a market anomaly is corrected, others will emerge with the aim of taking advantage of these new opportunities which we again seek to implement in an intelligent manner.

The dynamic nature of the relationship between gilts and swaps has meant that opportunities emerged for us to create 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 scheme 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. The breadth of Insight's trading relationships provides us with comprehensive access to all of the significant counterparties in the gilt and swap markets, and has enabled us to develop unique and innovative approaches to accessing market liquidity.

We pride ourselves in ensuring our clients gain appropriate access to repo markets, via relationships with a large number of bank repo counterparties, along with the development of innovative repo sources including the use of non-bank counterparties.

Ongoing management

Insight undertakes an active and continuous 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 cashflow data, schedule of deficit recovery contributions and changes in the characteristics of any underlying asset cashflows being factored into the solution.

We take great care to protect clients' interests with respect to counterparty risk management and the changing regulatory landscape. We have a rigorous approach to collateralisation, and have established a legal and operational platform that provides

future-proofing for, among other things, central clearing. Where appropriate, we also use Insight's extensive range of cash-plus fixed income strategies to ensure our clients' collateral pools strike an effective balance between ensuring liquidity and seeking modest additional returns.

LONG-TERM PARTNERSHIP

Perhaps our greatest priority 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.

MANDATE EVOLUTION

In recent years, Insight has evolved many clients' LDI mandates into the next generation of risk management solutions. Moving beyond conventional LDI approaches which have focused narrowly on interest rate and inflation hedging for a scheme's liabilities, we provide integrated management covering the full range of risk factors and objectives across both the liability and asset components of the pension scheme balance sheet, including CDI solutions and longevity risk management. As defined benefit pension schemes mature and the focus sharpens on how they will achieve their endgame, we have developed integrated solutions that aim to maximise the certainty of achieving their long-term objectives.

Insight LDI solution development



RESPONSIBLE INVESTMENT AND LDI

Insight's approach to responsible investment for all asset strategies, including LDI, is underpinned by the belief that environmental, social and governance (ESG) issues can be important drivers of risk and investment value.

Specifically for LDI strategies, ESG considerations are important factors in respect of the investment securities and instruments held, and the derivative counterparties used. Insight embeds ESG analysis in our LDI portfolio management process and we engage actively with bond issuers and counterparties.

Analysis and engagement are important in helping mitigate investment risk for clients, but perhaps most impactful is our work

for clients in supporting sustainable markets. We work with regulators and policymakers to help manage costs and risks effectively, seeking to protect clients' interests for the ultimate benefit of both pension scheme beneficiaries and scheme sponsors. Recent examples include our proactive engagement on UK government proposals to reform the RPI measure of inflation², our extensive response to The Pensions Regulator's proposals to revise the defined benefit funding code of practice, efforts to manage the impact of the transition away from LIBOR, and our collaborative engagement alongside pension fund peers to inform the development of European derivative clearing regulations.

ABOUT INSIGHT INVESTMENT³

- Insight Investment has over the past 15 years built a unique investment platform that delivers to clients outcome-oriented investment solutions. We currently manage £570bn.
- Our clients are among the most sophisticated institutional investors in the world and include leading pension funds, sovereign wealth funds, corporations and insurers.
- We build portfolios aimed at an outcome, in partnership with clients. Our investment strategies are designed to evolve to meet changing needs and stay ahead of market developments.
- We were among the first asset managers to bring institutional-quality processes and transparency to absolute return investing.
- Insight is at the forefront of developing new ways of investing, providing institutional investors with access to innovative investment strategies, coupled with robust risk management techniques. We were a pioneer in recognising the unrewarded

nature of currency risk and the importance of liabilities. Liability driven investment (LDI) has been a significant contributor to protecting funding levels for pension funds over the past decade.

THE TEAM

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 one of the few major companies to have restructured its entire investment platform specifically to provide clients with access to effective investment solutions. We are widely acknowledged as a market-leader in the provision of LDI and related solutions to pension funds. In 2021, Insight was ranked in first place for Overall LDI Quality for the 11th consecutive year with UK Investment Consultants⁴. The team's expertise includes the management of liability risks including interest rate, inflation and longevity risks as well as asset risks including those relating to equity, credit, currency, commodities and property. Supported by Insight's proprietary 'market tools' platform, our market strategy specialists continuously review market conditions to identify market opportunities. This group includes four specialist LDI teams: fund management, quantitative analysis and modelling, derivative execution and market strategy. The team works side-by-side in close collaboration with members of the Solution Design Team, who form part of the broader, client-facing Client Solutions Group.

OUR AWARDS⁵

We have been recognised as a market leader in LDI with successes marked by industry awards and accolades.

Professional Pensions UK Pensions Awards

CDI Manager of the Year 2018, 2019

LDI Manager of the Year 2013, 2014, 2017 and 2019

CIO European Innovation Awards

Winner in LDI category, 2013, 2014, 2015 and 2016

European Pensions Awards

LDI Manager of the Year 2014, 2015, 2016, 2018 and 2019

Financial News Awards

LDI Manager of the Year 2010, 2011⁶, 2012, 2013, 2014, 2015, 2016, 2017 and 2020

UK Pensions Awards

LDI Manager of the Year 2017, 2019 and 2020

Global Investor Awards

LDI Manager of the Year 2017, 2018 and 2019

Pensions Age Awards

LDI Manager of the Year 2017

Professional Pensions Investment Awards (PPIA)

UK LDI Manager of the Year 2015, 2017 and 2020

FT Business Pension and Investment Provider Awards

LDI Manager of the Year 2020

²For more information see our dedicated website www.rpireform.com. ³As at 30 June 2021. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services. ⁴Source: Greenwich Associates 2021, GICF LDI-21 LDI overall. Results are based on interviews with 11 UK consultants evaluating LDI. ⁵Source: Awarding bodies' website, where such awards have been certified by each representative body. Provided for information purposes and should not be relied upon to indicate any level of skill or future performance. ⁶In 2011, the award was named LDI and Structured Solutions Manager of the Year.

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

ASSOCIATED INVESTMENT RISKS

Liability-driven investment

A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

FIND OUT MORE

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