Insights
Defined Benefit

Enhancing Your LDI Solution

The Advantages of Precision, and a Liquid, Low-Cost Portfolio

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How State Street created and managed dynamic de-risking allocation for a corporate DB plan that achieved and sustained surplus funded status.

The dramatic improvement in corporate pension plan funded status over the past decade has opened up new opportunities for de-risking. Yet companies still need to monitor the impact of equity returns and interest rate fluctuations on their plan's funded status to identify the best de-risking approach for their plans — and the right time to implement those strategies.

In 2015, a US-based technology firm with a partially active plan came to State Street Global Advisors for help developing a de-risking strategy after realizing it had just missed a good window to make important changes to its portfolio. The plan had achieved approximately 95% funded status, but still held a 62% allocation to return-seeking assets and was relying on an internal team to manage funded status oversight and asset allocation changes.

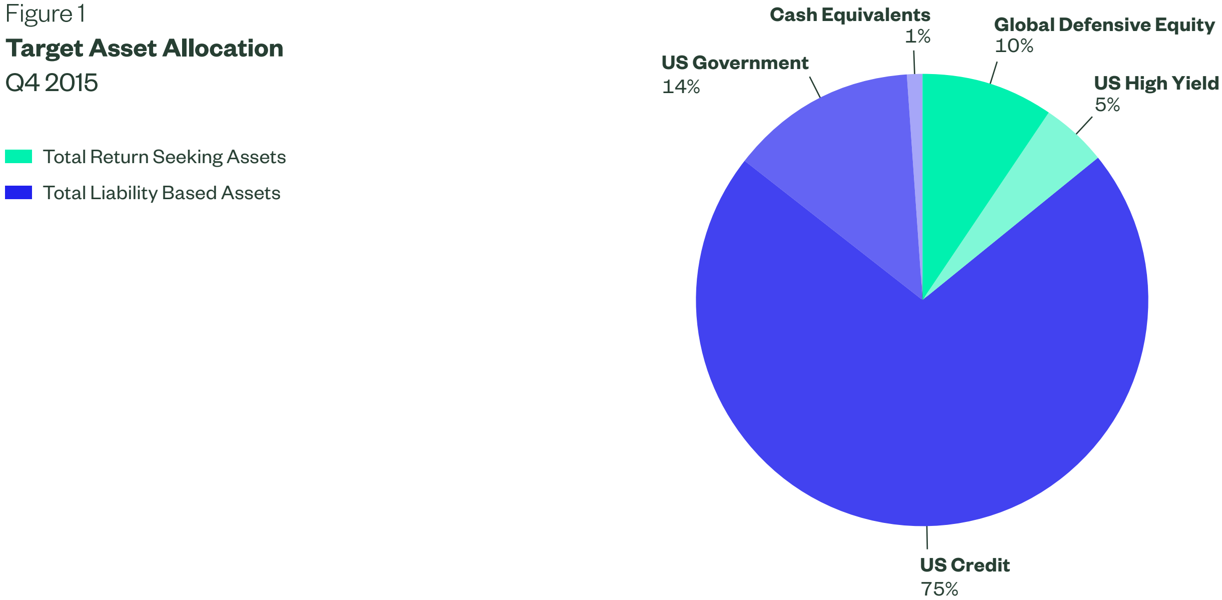
The company wanted State Street to identify a future state strategic asset allocation road map that would incrementally de-risk the plan while continuing to improve its funded status. At the same time, the CFO and pension team wanted help redesigning, implementing, and overseeing a new return-seeking allocation and dynamic LDI portfolio to minimize funded status volatility while still offering an excess return buffer over liability growth rates.

Managing an LDI Portfolio That Offers Precise and Efficient Hedging

After analyzing the plan's liabilities, State Street recommended a new asset allocation of 85% liability-based assets and 15% return-seeking assets. An allocation to "defensive" growth assets, such as global defensive low-volatility equity and US high yield, would help provide the additional return that the company sought, with lower total risk and limited drawdown exposure compared to typical cap-weighted equities. High-yield exposure would also provide additional spread income to offset yield give-up from the plan's long duration US Treasury exposure. A new custom and dynamic LDI allocation, developed by State Street, would target an 85%–90% hedge ratio to plan liabilities at the early stage of the glidepath.

To implement the custom LDI portfolio against the strategic LDI benchmark, State Street used a selection from its LDI building blocks, a collection of 17 highly liquid, commingled fixed income strategies that cover a range of duration, credit, and curve exposures to provide a more efficient and precise asset-liability hedge ratio. The LDI portfolio included index fund exposure to intermediate and long-term US Treasuries, as well as Treasury STRIPS. But for credit exposure, State Street used actively managed, intermediate, and long-duration high-quality corporate strategies measured against a benchmark representing securities with credit ratings of A- or better. The systematic, actively managed strategies offered credit risk management and an additional source of potential return above and beyond the plan's liabilities, further supporting the company's goal to continue boosting its funded status.

Figure 1
Target Asset Allocation
Q4 2015



Source: State Street Global Advisors, as of September 30, 2024. Weightings are as of the date indicated, subject to change, and should not be relied upon as current thereafter.

State Street's oversight of the plan's funded status and discretionary authority to make allocation changes upon reaching a de-risking trigger allowed the company to more quickly take advantage of de-risking opportunities. Further, in 2016 the company undertook a partial annuitization of the plan's retired population, which boosted the plan's funded status above 110% thanks to favorable annuity pricing.

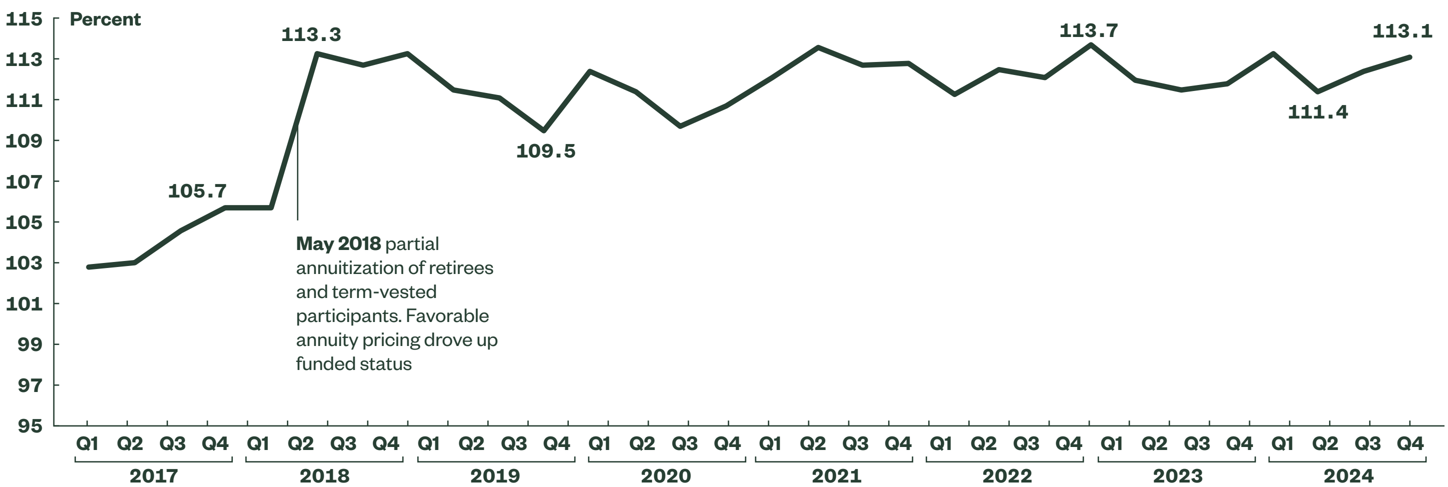
The liquid LDI building blocks made it easy for State Street to reallocate the portfolio after hitting a de-risking trigger and to adjust for liability risk profile changes post-annuitization. With the increase in funded status, State Street shifted to a 90% liability-based allocation/10% return-seeking allocation, targeting a 97.5%–100% hedge ratio for the plan's new liability profile.

Through continual monitoring of funded status and market conditions, the company was able to move down its de-risking glidepath over the next several years, finding additional pension risk transfer opportunities and making the necessary adjustments to its LDI portfolio assets and growth assets to maintain the plan's surplus.

Improved Funded Status, Despite Market Volatility

Engaging State Street to develop and oversee its de-risking glidepath and favorable annuitization activity has helped the company improve its funded status considerably. The combination of dynamic hedge ratio monitoring, LDI building block allocations, and lower-risk return-seeking assets has maintained the pension surplus within a very narrow corridor — even through extreme swings in equity market performance and interest rates, particularly post-2019. In the last five years, for example, the plan's funded status volatility has averaged 1.6% even as markets have experienced extreme peak to trough moves in equities, an aggressive Fed tightening cycle, and sharp changes in the shape of the yield curve.

Figure 2
Estimated Pension Benefit Obligation Funded Status



Source: State Street Global Advisors. Estimated pension benefit obligation funded status, as of June 30, 2024, based on pension accounting and actuarial assumptions derived from annual disclosure statements. Past performance is not a reliable indicator of future performance. The above metrics are estimates based on certain assumptions and analysis. There is no guarantee the estimates will be achieved.

For the past five years, the plan has been in hibernation, maintaining a funded status surplus hovering around 113% with no contributions. The increased certainty around funding volatility management through a cost-effective and transparent solution has allowed the company to continue on its planned path of liability downsizing via partial annuitizations.

This successful and collaborative transition reflects the benefits of a multipronged de-risking approach: developing a custom LDI benchmark based on the plan's actual liabilities; implementing a highly liquid LDI portfolio that allows for dynamic management of the asset-liability hedge ratio; surplus volatility management that keeps pace with liability growth of remaining active participants; seizing pension risk transfer opportunities based on favorable annuity pricing; and active oversight of both growth-seeking and liability-based assets that includes thoughtful rebalancing to ensure the plan remains on track through changes in its liability risk profile.

Please contact us if you would like to discuss how we might help develop and manage your de-risking glidepath.

About State Street Global Advisors

For over four decades, State Street Global Advisors has served the world's governments, institutions, and financial advisors. With a rigorous, risk-aware approach built on research, analysis, and market-tested experience, and as pioneers in index and ETF investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager* with US $4.72 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2023.
† This figure is presented as of December 31, 2024, and includes ETF AUM of $1,577.74 billion USD of which approximately $82.19 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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