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Perspective

Schroders Fiduciary Management

Cashflow Driven Investing

April 2020

Cashflow Driven Investing (or CDI) is becoming increasingly topical as pension schemes progress to their endgame. Not only this, but market events in the first quarter of 2020 have seen credit spreads widen significantly, which has improved the feasibility of implementing a CDI solution for schemes with funding positions that have weathered the crisis.

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Why does it work well in a Fiduciary Management framework?

We incorporate CDI into our Fiduciary Management clients' journey plans. By allocating a large proportion of scheme assets to hold-to-maturity credit, we deliver more certainty in deficit repair for our clients while ensuring liquidity is available to meet pension payments as they fall due.

Seamless part of the Flight Path

We integrate CDI into Flight Paths by gradually increasing the allocation to a CDI solution as the scheme funding level improves. This combination can be seen as a natural two-stage evolution from traditional 'growth + matching' to CDI, which sees both the funding risk and governance burden decline as the solution develops over time.

Building a Flight Path to the endgame

Our clients' long term objectives are central to the Flight Paths we create. For schemes whose endgame objectives are buy-out and/ or self-sufficiency on a low risk basis, the journey plan will typically involve a CDI approach where we increase the allocation to hold- to-term assets with known cashflows as funding levels improve, allowing us to increasingly 'lock-in' future asset returns providing more certainty as our journey evolves. Aside from the increased certainty of outcome, such solutions also benefit from their natural evolution into a 'buy-out ready' portfolio which is more attractive to insurers.

Delegated approach

CDI solutions need to be implemented as efficiently and in as timely a manner as possible. This is so that market spreads incorporated into the strategy design can be secured. Once the trustees have made the high level decision to proceed, a delegated Fiduciary Management approach ensures the scheme can act quickly and reduces the risk that market conditions change and the solution is no longer feasible. The current volatility in credit markets has provided an opportunity for schemes to secure a higher spread on credit assets. We have worked closely with our clients to take this opportunity, where relevant in their journey plans, to make a timely allocation to investment grade credit. Timeliness has been key as we have witnessed spreads grind tighter over recent weeks, reducing the opportunity.

Truly integrated

By sitting within the Portfolio Solutions division, we are uniquely placed as Fiduciary Managers to deliver CDI strategies to our clients and improve endgame certainty. This is because there are three crucial elements in adopting a CDI solution:

- Solutions Managers with a detailed understanding of your scheme and the architecture of a CDI solution
- An experienced global Investment Grade Buy & Maintain credit team
- A flexible and well resourced LDI team able to tailor LDI solutions to complete CDI strategies

All of these capabilities sit closely together within Portfolio Solutions at Schroders and already work successfully together on a number of existing CDI mandates. As Fiduciary Managers, we sit side-by-side with CDI solutions managers ensuring we can deliver a robust endgame solution, implemented with timeliness.

Conclusion

CDI is an essential component in our Fiduciary Management portfolios.

A CDI strategy has one fundamental aim: to improve the certainty with which a pension scheme meets its liabilities. A key advantage of our approach for trustees is that the solution advice, design and implementation of a CDI solution can be done in a holistic manner; benefitting from our ability to create, deliver and blend the right tools at the right time for our clients.

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