

Fund managers should think twice about offering LDI products

London, 23 August 2006 – A new report by Investit Intelligence suggests that while LDI is here to stay, there are obstacles to investment management companies thinking of entering this marketplace for the first time. New staff skills, technology and business processes required to build and support LDI are costly to acquire, increasing the competition in the marketplace. Liability immunisation products are likely to move to a lower fee structure, which many investment managers may find unattractive.

Investit interviewed investment management companies, investment consultants and independent trustees. The research focused on the commercial, operational and technological issues associated with offering LDI. Investit identified three main LDI approaches being offered by investment managers: immunising (purely matching liabilities), gap closing (filling pension deficits) or funds that are hybrids of the two.

LDI products can create new commercial opportunities for fund managers, allowing them to compete for a real role in liability matching. However, there is also more competition; offering immunisation funds and cashflow modelling invades the space of the actuaries and investment consultants. Investment banks and insurance companies are also approaching trustees and plan sponsors directly with offers of LDI products.

Investment management companies may need completely new skillsets to offer LDI, from liability advice to full scheme reporting. The front office needs financial engineering skills, while operations and technology staff need expertise to deal with OTC derivatives, used in liability immunisation products and hybrids. Performance and reporting teams will need skills above and beyond those of dealing with physical assets and legal teams must be capable of dealing with the new requirement for derivative agreements with multiple counterparties.

The key IT obstacle to running LDI is the integration of systems that can deal with derivatives with the conventional fund management systems. For most firms, a move to using OTC derivatives requires new technology, changes to existing technology and new skillsets across a broad range of IT functions. Some of these, such as risk and accounting, can be very complex and expensive.

Investit's research suggests that liability immunisation products will become a utility, like indexation, and there will be little margin in it for any but the big volume providers. Launching an LDI immunisation, or hybrid, product - particularly if the manager has little or no complex instrument experience - will call for a significant investment or scaling up of existing operations: more contracts, more counterparties and, because there is little in the way of systems support, more expensive people.

Commenting on the findings of the research, Richard Phillipson, Principal at Investit said:

“Our research suggests that the provision of a single integrated product necessary for the new world of LDI, combined with the service and advice as to exactly how to use it will be a massive leap. Whilst there are firms with the capability to offer an

entire LDI service conceptually, the competition amongst those firm's component businesses and the cost associated with combining them represents a huge barrier.

“As such, the LDI provider market is likely to focus on different players offering distinct liability immunisation products and gap-closing products. The change in how sponsors and schemes think about their liabilities and assets still represents a major opportunity for some fund managers. Other managers should think twice about joining in.”

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About Investit

Investit is the leading investment management consultancy. It has a unique range of services, providing expert advice across all areas of investment management companies, from front to back office. Investit also offers detailed research and benchmarking services. Investit was founded in 1998 and includes five core expertise areas: investments, client management, performance and risk, operations and technology. In 2002, Investit People was added to provide specialist recruitment services to support project work. In 2006, Investit Technology was created from an alliance with US investment management systems consultancy, InvestTech Systems. Investit Intelligence completes the offering with a range of specialist surveys and detailed research papers. For more information, go to www.investit.com

About Investit Intelligence

Investit Intelligence is a customised information tool for all people concerned with turning high-level business plans into reality. Investit Intelligence consists of a number of research and survey services.

- Investit Intelligence Member Service

The member service is an interactive service where members take an active role in selecting, shaping and researching topics by voting on new discussion and research ideas.

- Investit Intelligence Business Process Assessment – defining best value

BPA is a service where Investit works closely with COOs of investment management companies to identify the value output of all business processes and how that compares with peers – it's an essential decision-making tool.

- Investit Intelligence IT Value Survey

The IT Value Survey looks in detail at the spend, effectiveness and plans of companies IT departments. It is an annual survey particularly designed for COOs and Heads of IT.

- Investit Intelligence Performance & Risk Survey

The Performance & Risk Survey is the only tool specifically designed for, and by, Performance heads in Investment Management companies. It looks at performance and risk systems, performance roles and remuneration, future trends and benchmarks against peers.