# Have your cake and eat it

## Optimising value with combined LDI and CDI management

**Brightwell employ a novel, open-architecture Cashflow Driven Investment (CDI) working model where holistic cashflow management and credit collateralisation of Liability Driven Investment (LDI) exposures is delivered using chosen credit managers alongside in-house LDI rather than operating both under one roof.**

Selecting the right CDI strategy is key to the journey plan — whether that be run-on, buyout or maintaining medium term optionality.

Our solution is beneficial for Brightwell clients as it:

- reduces manager concentration
- the collateral pool is widened, and liquidity risk is reduced
- allows for nimble reactions under stress scenarios
- provides full exposure and data visibility
- enables appointment of best credit managers to deliver on the Trustees investment objectives and makes it easier to change them if required.

Seamless credit collateralisation of LDI exposures and cashflow management is possible without all relevant assets sitting with the same manager. It requires a sophisticated set up, technology and position level data sharing, all of which we have put in place and successfully operate.

Trustees should be questioning their Fiduciary Manager on potential conflicts of interest if they are allocating to internal credit mandates under the guise of improved liquidity and flexibility. The same liquidity and flexibility benefits can be achieved, without compromising on selecting the best credit managers.

LDI and its high derivative usage has always been a driver of the collateral needs of pension schemes. Necessitated by the 2022 gilt crisis, it is being widely discussed that collateral management is more important than ever. Fortunately, LDI managers, such as Brightwell, are well placed and experienced to manage collateral on behalf of pension schemes.

Driven by the higher liquidity requirements post-2022, liability-driven investors are exploring additional sources of collateral. An untapped source are the corporate bonds in portfolios that constitute a scheme's CDI strategy. The bonds in these portfolios can be used for Repurchase Agreement (repo) or posted as collateral under corporate bond Credit Support Annex (CSAs). This is what we do at Brightwell.

It is a received wisdom in the industry to combine LDI and credit under one roof for credit collateralisation and holistic cashflow management. However, this can result in manager concentration as the majority of a scheme's portfolio sits with a single investment manager. The usual argument is that this is the only way to use credit as collateral for LDI and manage the operational requirements of cashflow management.

At Brightwell, we strongly disagree with this approach. There is another way for schemes that are utilising segregated LDI arrangements. Our in-house LDI portfolio managers have access to externally managed credit portfolio as a source of collateral. This enhances client outcomes by enabling us to allocate to a range of best-of-breed credit, adding diversification, increasing alpha potential, and reducing single manager concentration risk. However, it requires a fit-for-purpose operating model and suitable infrastructure. Large LDI managers face some practical hurdles to putting these in place and furthermore, commercially it is not necessarily in their best interests.

Brightwell advocates a model whereby the key risk drivers, namely rates, inflation, liquidity and longevity, are managed directly by the Fiduciary Manager's in-house team, who also have full cashflow visibility of the CDI assets.

For example, it is unlikely that a good LDI manager is also the best-in-class credit manager. Managing LDI and credit under one roof to deliver CDI, not only means potentially forgoing the returns that a credit specialist could offer and as such a loss of value, but also the loss of future flexibility. Moreover, it increases manager concentration risk due to the greater reliance on a single manager, who is often running many mandates to similar objectives, potentially creating additional operational and market risks.

As we have mentioned, ensuring the right CDI strategy is in place is key to the journey plan and a scheme's approach to endgame. As such, the starting point should be selecting the optimal credit managers, with LDI and overlay management then carrying out a completion role in client portfolios. We believe that Trustees should challenge their Fiduciary Managers on potential conflicts of interest where they are allocating to internal credit mandates to enable liquidity and flexibility. We know, and have experience in ensuring, that those benefits can be achieved whilst maintaining allocations to preferred credit managers.

We have built and use a hybrid platform that allows us to manage LDI and CDI as one portfolio without directly managing corporate bonds. We believe that we are uniquely positioned as a Fiduciary Manager who only manages LDI, overlays and longevity risk in-house. We do not have proprietary funds or strategies to allocate to and as such do not compete with other asset managers. Other asset managers see us as investors and there is a mutual desire to co-operate. Close collaboration between all parties is vital for managing LDI and CDI under separate roofs. We have seen how difficult it is to build a hybrid platform and that it requires seamless integration.

Brightwell already use externally managed CDI portfolios for corporate bond repo and corporate bond CSA facilities. We are demonstrating that LDI and CDI can be efficiently managed under multiple roofs. Our approach to Fiduciary Management offers several advantages when it comes to liquidity and collateral.

1. LDI, overlays and CDI assets are managed with best-in-class managers and seamlessly connected with centralised in-house LDI and overlay management.
2. The collateral pool is widened and liquidity risk is reduced.
3. The portfolio looks across all assets at the same time. This is crucial as CDI assets also hedge liabilities.
4. It helps to produce better and faster reporting for management and Trustees. For example, information during a gilt crisis replay would be readily available.
5. Concentration, Market and Operational risk is reduced by having less reliance on a single investment manager.

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