U.S. Pension Plan Update

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In this issue…

01 IDEA OF THE MONTH →	02 FUNDED RATIO UPDATE →	03 KEY STRATEGY HIGHLIGHT →	04 PRESS DIGEST HEADLINES →


Allspring
Doing LDI Well in 2023 and Beyond

BONUS INSIGHT

We recently issued a paper on our view of best practices in pension liability-driven investing (LDI) management. We outline key implementation issues.

DOWNLOAD PAPER

01 IDEA OF THE MONTH: Is smaller better?

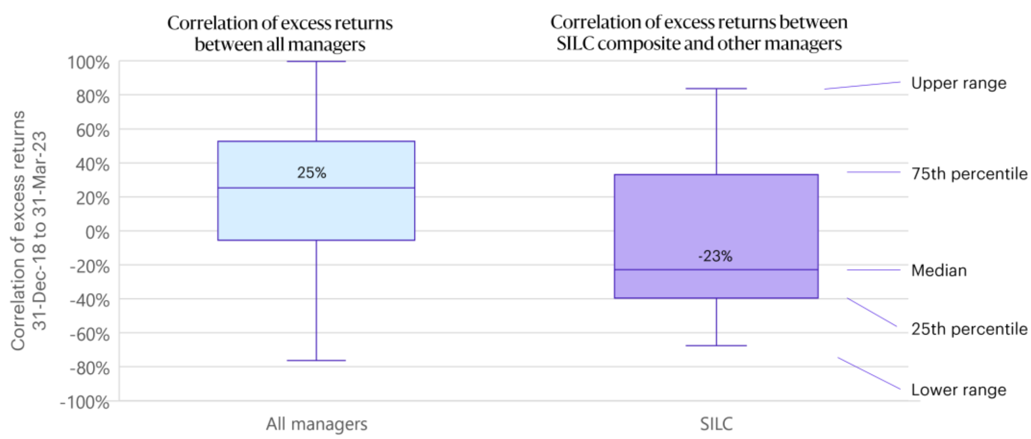
Effective implementation is key to LDI efficiency. The largest part of most LDI portfolios is long duration IG credit, and hence the focus is on generating consistent, risk-controlled and diversifying alpha. Effective manager diversification relies on finding meaningfully different manager styles. To this end we have designed and built a diversifying long credit strategy called Small Issuer Long Credit (SILC). The rationale is covered later in this note, but the effectiveness can be seen below – SILC offers more diversification (lower correlation) to the universe of other Long Credit managers in the eVestment database than can generally be found in other strategies.

The correlation of excess returns across all managers in the eVestment Long Credit universe is centered on 25%, with most pairs of managers between 52% and -5%.

Large managers are seen to exhibit higher correlations to each other.

But SILC offers a notably lower excess return correlation profile. It has a **median correlation to other peer managers of -23%**, and the bulk of its correlations are between 35% and -40%.

This suggests SILC can offer a **beneficial pairing to most other long credit managers.**

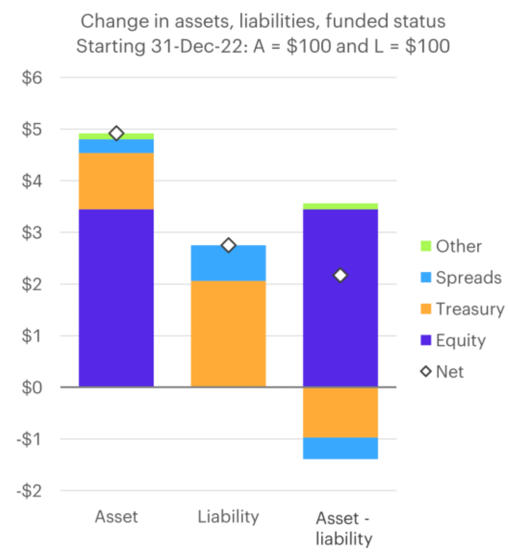


Source: eVestment, Long Credit Universe. Period 31-Dec-18 (SILC inception) to 31-Mar-23. Excess return versus Bloomberg Long Credit Index. Gross returns. The peer universe consists of 65 products (66 including SILC). Past performance is not a reliable indicator of future results. .

Additional information on the SILC strategy including standardized performance, strategy risks and the GIPS composite report can be found [here](#).

02 FUNDED RATIO UPDATE: May 31, 2023

Funded ratio has improved by around 2% year to date.



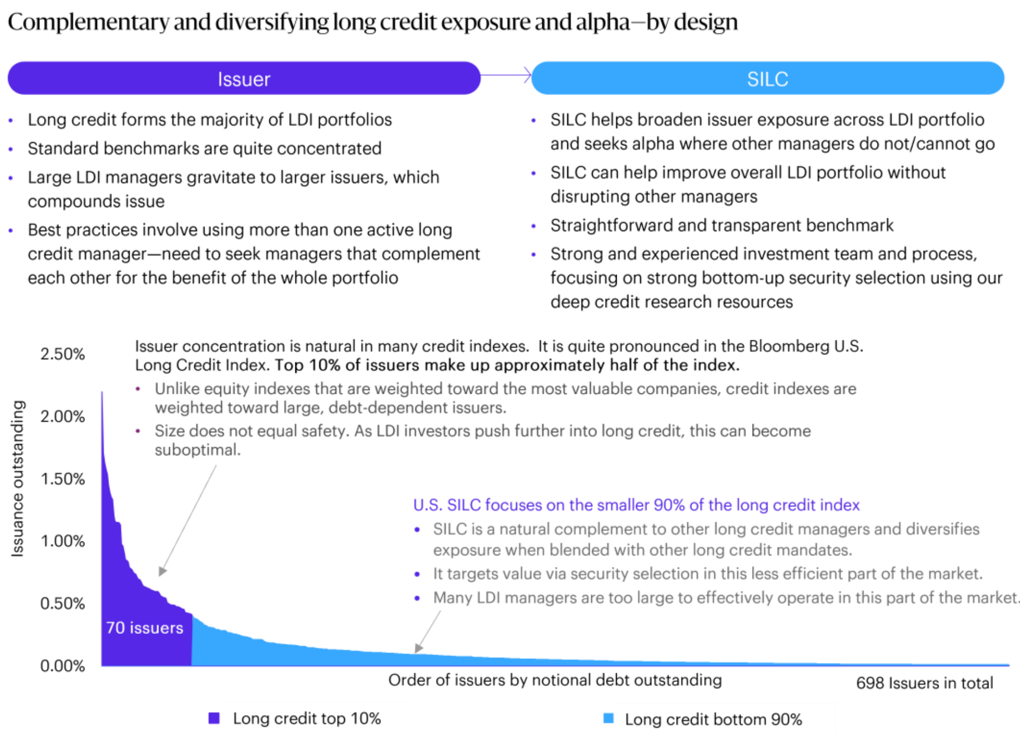
- Most of the improvement is due to strong equity returns.
- Falling Treasury yields have been a modest cost, with volatility seen around the banking mini crisis.

Sources: Allspring and Bloomberg, 01-Jan-23–31-May-23
We use a simplified model of a typical pension plan. Liabilities modeled using PUMC = ICE BofA's liability index for a mature pension plan. Assets = 55% Bloomberg Long Government Credit + 45% MSCI ACWI global equities.
We started the plot at 100% at the beginning of 2023, which is broadly consistent with various industry sources. Estimated data is not a promise or guarantee of future results.

03 KEY STRATEGY HIGHLIGHT: Small Issuer Long Credit (SILC)

Why SILC? It is known that the long credit market is quite concentrated, with 50% of the market in only 10% of issuers. Compounding this potential concentration is the fact that the largest LDI managers find it hard to access small issuers in sufficient size to have a meaningful impact on their portfolio—largely due to liquidity concerns. Bottom line, smaller issuers are generally underrepresented in LDI portfolios, despite them offering comparable quality and often higher yields. Also, as these smaller issuers tend to be less covered by Wall Street analysts and less followed by the large LDI managers, we also believe they offer potential for enhanced alpha.

These are the reasons we developed our SILC strategy—specifically focused on the smaller 90% of issuers in the standard Bloomberg Long Credit index. It has a live track record of over four years and is delivering on its intended promise of consistent, low-risk alpha that is diversifying from the alpha developed by other large LDI managers. In our view, SILC is the ideal complement to established players when building out a well-structured LDI portfolio. It is an easy-to-understand yet effective credit and alpha diversifier. Find more information here.



Source: Allspring and Bloomberg, as of 31-Mar-23

04 PRESS HEADLINES DIGEST: News that matters

CORPORATE PLANS		ALLSPRING COMMENT
01	AT&T Inc. announced an agreement to purchase group annuity contracts from two Athene Holding subsidiaries to transfer $8.1 billion in U.S. pension plan liabilities. AT&T Dials Up Deal to Transfer $8.1 Billion in U.S. Pension Liabilities (Pensions & Investments)	*This is a large transfer, amounting to approximately 20% of AT&T's liabilities (covering about 50% of current retirees). Across the U.S., corporate pension plan buyout sales totaled $6.3 billion in the first quarter of 2023 according to LIMRA—more than double the volume from the same period last year.* *We observe that where PRT is happening it tends to be only for a portion of a plan's liability and amounts to a modest outflow from pension plans as a whole (of the order of 1% to 2% per year).*
02	Corporate defined benefit pension funds are in fine fettle: Goldman Sachs Asset Management says its funded status topped 100% last year, even as its investments lost 18%. Now the question is: What's next for the funds? Corporate Pensions Are in Good Shape, So What's the Worry? (ai-cio.com)	*It is true that most pension plans are enjoying life post-COVID. Funded ratios are better than they have been for 15 years. So being clear on goals and sticking to investment policies that reflect those goals are important. The planning done through the years of pain when underfunding was persistent should be remembered and steps should be taken to capitalize on the newfound financial security. For closed plans, that might mean moving toward further de-risking. For open plans, it might mean more targeted growth investing. But for all, it is probably not a time for being in a set-and-forget strategy.*

MULTIEMPLOYER PENSION PLANS (MEPPs)		ALLSPRING COMMENT
03	The Pension Benefit Guaranty Corp. approved special financial assistance (SFA) applications totaling more than $600 million to aid three struggling multiemployer pension plans. PBGC Approves Special Financial Assistance for 3 Multiemployer Plans (Pensions & Investments)	*There have been 79 approvals of SFA so far for $46 billion, with 37 currently under review for a further $22 billion—interesting that only one application has officially been declined.* *The application website has moved to a waiting list structure.*

PUBLIC PLANS		ALLSPRING COMMENT
04	The Actuarial Standards Board now requires public pension plans to begin disclosing a new liability measure that assumes the pension plan is invested solely in high-quality bonds. NCPERS has collated a fairly comprehensive array of information on the topic. What Pensions Need to Know LDROM (ncpers.org)	*The newly revised ASOP(4) debuts LDROM, a new mark-to-market liability value alongside the established forms of liability measurement that govern official funded status and contribution numbers. While significant changes to public pension plan investment strategy are unlikely, we believe LDROM will have implications for how public pension plans think about and invest their fixed income portfolios. For more information, see our blog here.*

05 Recent market volatility and the rising interest rate environment have made private debt a less risky and more appealing asset class to public pensions, especially as banks are lending less, according to staff and officials.

[Public Pensions Develop Appetite for Private Debt (FundFire)]

Private credit investing has been maturing from niche to fairly mainstream across many types of institutional investors—pensions included—over the past few years. On one hand, this can make it less "special" and dilute the beneficial return characteristics of the past. But on the other, there is an opportunity presented by the recent banking turmoil that might reduce the flow of conventional bank lending into the economy.

NON-U.S. | ALLSPRING COMMENT

06 Consultants welcomed potential changes from the U.K. Treasury that would allow struggling defined benefit plans to opt in to the London-based Pension Protection Fund in an effort to grow assets and steer more investments toward funding the U.K. economy.

[U.K. Government Considering Expanding PPF to Include Struggling Pension Plans (Pensions & Investments)]

The idea is to aggregate the assets in small plans to gain the investment benefits of scale. While cost efficiency and professionalization of the investment oversight process might be wins, the path to this benefiting the U.K. economy via investments in "UK PLC" (which is another rationale being put forward) is not so clear.

07 The Pensions Regulator in the U.K. has warned defined benefit pension fund trustees to ensure they have an appropriate understanding of employers' financial positions and potential future challenges, following significant turbulence recently that the U.K. economy has had to endure.

[Pensions regulator calls on DB trustees to brush up on employers' financial positions | News | IPE]

This is a timely reminder to trustees to keep apprised of plan sponsor "covenants" given inflation and economic changes. After all, the ability to take investment risk stems from the ability of the plan sponsor to accommodate any negative consequences if poor returns materialize. This should not be taken for granted, and it is also not necessarily constant over time.

08 "There is every chance that 2022 will be a last hurrah for cash injections into DB schemes," says WTW.

[FTSE 350 DB pensions schemes shift £5bn deficit to £38bn surplus | News | IPE]

A summary of funded status spanning 2020 to 2022 showing the change from deficit to surplus for FTSE350 companies is based on accounting information. Interestingly, two-thirds of companies disclosed having surpluses in their pension plans but almost three-fourths were still paying deficit contributions. This is because funding targets agreed with trustees are often more onerous than the measure of liabilities disclosed in accounts and because there can be a lag between funding levels improving and deficit contributions being switched off.

We also note the comments made related to keeping well-funded plans open, which joins a similar voice we have started to hear in the U.S.

Contact us

Thank you from the Allspring Global Investments Pension Solutions and LDI team!

Please feel free to contact us with any questions or to let us know if you would like to be removed from this mailing list.

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