LDI differentiator: the holding of third-party funds

Adil Gulamali,
Client Director, UK Institutional

Simon Bentley,
Head of Solutions CPM

Over the coming months we will publish a mini-series of short articles that will shed light on overlooked but important factors to think about when structuring your LDI portfolio framework. First up is the integration of third-party funds.

An often under-discussed but hugely important factor that pension schemes need to consider when structuring the framework around their LDI portfolio is the integration of third-party funds. This is the ability of the LDI manager to integrate funds managed by other investment managers.

Why is this important?

Under both bespoke pooled and segregated LDI portfolios[1] it is possible to integrate third-party funds – but not all investment managers offer this service. However, there are three key reasons why pension schemes should factor this in, which we will go into in more detail:

1. The **governance benefits** associated with an integrated structure
2. The **independence factor** in retaining the ability to choose a preferred fund
3. The significant **cost savings** of not being a forced seller

[1] Columbia Threadneedle Investments, **Our stance on bespoke and segregated LDI portfolios**, November 2024

Governance benefits

During the 2022 'mini-budget' crisis, some of the biggest challenges pension schemes faced were accessing external assets outside of those managed by their LDI manager (in some instances, even accessing those was a problem), and then executing trades in a timely fashion to bolster LDI collateral. There are significant governance benefits to giving the LDI manager discretion to transact third-party funds, as it reduces risk and effort for the Trustee. For instance, this would **negate the requirement for Trustees to deal with the operational challenges of executing transactions** (especially under stressed market conditions when timing is key).

Independence factor

The ability to integrate in-house non-LDI funds within the LDI portfolio framework is a service most LDI managers provide, but what Columbia Threadneedle Investments offers in addition is the ability to integrate all third-party funds. This means pension schemes retain the flexibility to pick the funds they want to invest in, and thus **retain their independence over the structure and design of their investment strategy**. They will not be 'forced' into buying products from the LDI manager that the Trustees or investment advisors may not consider 'best-in-class'.

Cost savings

Most pension schemes will have a large allocation to fixed income funds, especially as they get closer to their endgame. As such, being a forced seller of such assets is sub-optimal for pension schemes – in fact, the round-trip costs of selling and buying investment grade credit may, in some cases, be prohibitive. But **by allowing pension schemes to fully migrate all their holdings on to the LDI platform, significant transaction costs can be avoided**.

Closing thoughts

So, the merits of having an LDI manager able to integrate third-party funds into their LDI portfolio framework are significant. As well as providing benefits from a governance perspective, it also allows pension schemes to retain full independence in designing their investment strategy and can allow for very significant cost savings.

But this is just one example of how we have developed a flexible, effective and tailored LDI offering that is adapted to a constantly moving marketplace. The next article in this mini-series will explore the concept of implementation manager services and the benefits of delegating the implementation of investment strategy to a market-facing practitioner.

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