LDI differentiator: the benefits of an integrated solution with credit

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This mini-series of short articles shines a light on often under-discussed but important factors to think about when structuring your LDI portfolio framework. Here we look at the benefits of an integrated solution of LDI and credit.

In our previous 'LDI differentiator' papers we focused on governance structures and how pension schemes can look to simplify these[1], while potentially improving investment outcomes and reducing trustee risk.[2] In this third paper we are shifting our focus to discuss the benefits of an integrated solution of holding investment grade credit with the LDI manager.

Historically, pension schemes have had different portfolios for different purposes, which were often run by different managers. Consolidation starts to happen when schemes get closer to their endgame, but we would argue there is also great benefit in reducing the governance burden when the investment strategy is more complex.

This is especially true for the fixed income part of the portfolio. The reason why pension schemes hold investment grade credit in their portfolios is to: a) complement the hedging obtained from the LDI portfolio; b) act as collateral support; c) provide an additional return above gilts; and d) generate cashflows for benefit payments. The level of crossover with the LDI portfolio is significant, so separating the credit from the LDI portfolio is sub-optimal.

[1] Columbia Threadneedle Investments, LDI differentiator: the holding of third-party funds, March 2025

[2] Columbia Threadneedle Investments, LDI differentiator: the implementation manager role, April 2025

Hedge profile

While there is some nuance between pooled and bespoke solutions, in both instances a full toolkit helps the LDI manager create a better hedge profile by incorporating credit into the solution. In a fully bespoke LDI and credit portfolio, there is also more freedom for the investment manager to optimise the scheme's credit holdings as the LDI toolkit can be used to smooth cashflows.

Greater resilience

Allowing the LDI manager discretion to trade on a scheme's behalf, as would be the case when combining investment grade credit with the LDI manager, significantly streamlines the transaction process. This is especially key under stressed market conditions and was particularly beneficial for clients during the 2022 'mini-budget' crisis.

It is also worth noting that for schemes that have a segregated fixed income portfolio with their LDI manager, there is a further benefit via the ability to use credit sale and repurchase or 'repo' agreements.

Return above gilts

Although returns are an important component of any investment, the scope for higher return (in excess of a well-diversified and carefully selected portfolio of bonds that deliver broad market beta) in investment grade credit is limited. Instead, the focus for pension schemes should be on how this allocation fits within their wider strategy. **The credit strategies held by Columbia Threadneedle Investment's LDI clients are specifically designed to meet the unique requirements** we have highlighted.

Integrated reporting

There is an additional benefit of integrated reporting. It can be quite cumbersome to piece together information from different sources, likely calculated with different methodologies and potentially at different dates. With an integrated LDI and investment grade credit solution, **schemes would receive one consolidated report that includes every hedging asset they hold, as well as a clear holistic picture of collateral/headroom.** This allows for better informed investment decisions.

Closing thoughts

So, the merits of an integrated solution of LDI and investment grade credit are substantial, both from an investment and governance perspective. This allows Trustees to focus more time on the key issues affecting their pension scheme. At Columbia Threadneedle, we have extensive experience in delivering flexible and tailored LDI and credit solutions for our clients, both in terms of pooled and bespoke funds.

In the next paper of this mini-series we will talk about LDI Reorganisation funds: what they are and when they should be used.

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