SHDR
STANLEY, HUNT, DUPREE & RHINE, INC.
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ASSET LIABILITY MODEL LEADS TO SUCCESSFUL IMPLEMENTATION OF LIABILITY-DRIVEN INVESTMENTS

OVERVIEW

With the passage of the Pension Protection Act (PPA) of 2006, CFOs and retirement plan committees are challenged more than ever to manage the effects their defined benefit pension plan can have on company budgets and balance sheets. Streitling Specialty Textiles faced this challenge. But rather than use the asset mix that “everyone else” was using, the company CFO turned to SHDR Actuarial Services for a custom-fit asset allocation that would match his plan’s unique liabilities.

CHALLENGE

Streitling Specialty Textiles, like many mid-sized companies, was struggling to bring predictability and lower risk to funding their plan. Funding requirements have tightened under the PPA and good communication between the investment advisor and the actuary is more important than ever. Streitling struggled with how best connect the two equally important sides of the equation. SHDR provided the right solution.

SOLUTION

SHDR used Asset Liability Modeling (ALM) to make a connection between Streitling’s defined benefit pension plan asset allocation and the plan’s liabilities. The result?

- An asset allocation that synchronized exactly with the plan’s liabilities
- Opportunity to reduce the downside risk in the plan portfolio
- A liability-driven investment strategy for the plan’s fixed-income investments
- A CFO who, as fiduciary to the plan, appropriately turned to experts to help manage the portfolio

The ALM performed by SHDR Actuarial Services was designed to connect the investment and actuarial disciplines in a way that has never been seen by many CFO and investment committees. Investment review has always looked at past asset performance while the actuarial valuation “smooth” plan liabilities into the future.

Capital market assumptions and Streitling plan’s specific liabilities were input into specialized software that runs thousands of iterations of “what-if” scenarios to get the most likely range of investment outcomes for various asset allocations. When combined with the plan’s liabilities, these outcomes provide the effects of each allocation mix on the plan’s funded status, contribution levels, and impact on the firm’s balance sheet.

RESULT

In the case of Streitling, the results of the modeling showed that the equity portion of the portfolio should be reduced to only 40%. The resulting higher fixed-income portion was put into a liability driven investment (LDI) strategy to match the duration of the bonds to the liabilities of the plan. The effect was immediately seen when the reduced risk of the new allocation greatly outperformed the old asset allocation during the recent market downturn — accomplishing exactly what it was designed to do.

The expertise of SHDR Actuarial Services in applying ALM, together with the skill to choose the right asset manager to implement the LDI strategy, are abilities that our more than 100 clients depend on as we advise on over $1.2 billion in retirement plans and foundation funds.