LDI Strategies

FINCAD

Transparent Scenarios for Full Visibility into Risk

Asset managers use FINCAD's powerful F3 technology to produce accurate valuation and risk analytics with full visibility into how their strategy will perform under different market environments.

Overview

Liability driven investment (LDI) mandates are increasingly being utilized in rising rate environments as an effective method for capturing yield while also still meeting ongoing liability obligations. This approach can be critically important in specific rate environments or for pensions with unique funding profiles.

One major challenge in the marketplace for LDI managers is that they lack sufficient valuation and risk analytics capable of providing visibility into how their strategy will perform under different market environments.

This article describes the most important components of a successful LDI strategy and how our clients have achieved this using F3.

Granular Duration Analysis

One common challenge is that organizations may be able to derive duration information but not at a granular level. F3 provides granular duration information at the instrument level, which is important for asset managers managing LDI mandates.

Combining the ability to view duration on any instrument in your portfolio with the ability to model virtually any fixed income instrument or derivative, users of F3 can conduct duration analysis to see how the portfolio's value changes under different market conditions. This provides a more thorough analysis for making informed hedging decisions.

Detailed Risk Analysis

Risk analysis is at the heart of an effective LDI program. A key part of LDI risk analysis includes the evaluation of the different risk factors that can influence a portfolio's funded status and the ability to meet ongoing liability obligations. These components can have significant impact on investment strategy, hedging and rebalancing decisions. A thorough risk and pricing analysis for LDI teams can yield significant visibility into the riskiness of different strategies.

F3's risk capabilities take into account sensitivities across all currencies and asset types, allowing users to evaluate multiple risk factors (rates, inflation, credit, etc.) for a multi-dimensional, realistic analysis.

In addition to the sensitivities for all market data points and various Value-at-Risk measures, F3 also includes a powerful scenario engine with the ability to perform fine grained scenario analysis and the ability to capture all simulation paths as part of the output. When all of the different types of risk analyse' are combined, teams are armed with an extremely powerful tool to more effectively understand the aggregate impact of different risk factors on their portfolios and make informed decisions.

Cash Flow Representation of all Instrument Types

The ability to see the cash flows is an important component of understanding the riskiness of meeting the funds liability obligations. Being able to model cash flows provides LDI managers with the information necessary to best model the risks that must be hedged including rate, equity, inflation, and credit linked components.

Cash Flow Representation of all Instrument Types (continued)

F3 offers the ability to model all instrument types as streams of cash flows where flows can be indexed to any market observable component.

Also, since F3 offers the ability to model both par and zero rates in one system, F3 can be used as a way to compute hedging strategies to best meet liabilities on an ongoing basis.

Unified Assets and Liabilities

Unified assets and liabilities are an important concept allowing organizations to understand the interrelationship between assets and liabilities without adding additional layers of effort for ad-hoc optimization processes.

F3 has the ability to price off of both zero rates and par rates. This offers teams a solution for the LDI business that takes a fine grained approach to managing risks while at the same time offering a more efficient workflow to manage asset and liability portfolios for on demand LDI analysis.

Powerful Curve Building Capabilities

Curve building is an essential component as market practices and regulations change. For example, over the past few years LDI teams have shifted to OIS discounting and the inclusion of collateral in investment decisions.

Flexible curve building is critical for LDI teams trying to achieve the most competitive pricing when executing their investment strategy.

F3 offers the ability to build curves across multi-asset and multi-currency portfolios while including components such as OIS discounting and CSA multi-curve discounting.

In addition, F3 provides detailed customization capabilities for volatility modeling as well as different curve smoothing options. This gives companies the flexibility to customize curve building all the way from the organization level to individual teams and team members.

FINCAD's F3 Technology Scales for Enterprise-Wide Analysis

In addition to the areas mentioned above, FINCAD's LDI solution provides mark-to-market and portfolio attribution capabilities, offering teams the capability to best understand both liability and asset based drivers of risk and valuation.

Finally, for larger computation demands, F3 enables computationally intensive operations such as CVA, VaR and profit and loss to be scaled across on-premise and cloud computing grids.

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Contact Sales or Support Toll-Free:

USA/Canada 1 800 304 0702 **Europe** 00 800 304 07020 **Email** info@fincad.com