Low/negative interest rates self-assessment workshop

Developing versus *advanced* categorizations vary greatly depending on the type of asset owner and their geography. For example, liability-driven investors e.g., defined benefit pension funds and insurers have different considerations than cash-plus investors e.g., sovereign wealth funds, endowments and defined contribution pension funds. For certain currencies, there are not suitable interest rate hedging assets as interest rate hedging often requires a long-dated government bond or interest rate swap. Hedging can also be challenging in markets in which interest rates are negative as hedging long-dated liabilities can be very expensive.

Vision	Developing	Advanced
Mission, Beliefs, Values	- Senior leadership gaining understanding of risk and return implications of low/negative rates on organization's mandate and their ability to achieve objectives and constraints - Senior leadership understands that their beliefs related to interest rates and fixed income assets (and their role in liability management) must allow for regime changes, which can have different impacts on expected return, risk and correlation. - Senior leadership does not yet fully recognize that diversifying impact of duration is dependent on level of yields, and can be unstable over shorter time horizons. - Organization recognizes the role of interest rate hedging in ensuring risk remains within risk appetite - Limited ability for the organization to adapt its vision, beliefs and values in light of market environment changes - Senior leadership beginning to consider whether to take more risk, or accept lower expected outcomes, in a lower rate environment	- Senior leadership understands risk and return implications of low/negative rates on its mandate and ability to achieve objectives and constraints - Senior leadership recognizes that duration does not provide the same level of diversification given starting yields and the sensitivity that different segments of the portfolio have to interest rate changes. - Organization is able to adapt its vision, beliefs and values as needed to support its agility and responsiveness to market environment challenges - Senior leadership has formally redefined the allocation of the organization's risk budget in order to balance expected return and risk in a lower rate environment - Organization incorporates interest rate risk management within its risk budgeting framework, and understands balance sheet impact of interest rate movements. Hedging techniques used to ensure risk remains within risk appetite in a range of market environments - Senior leadership appreciates the need for an advanced understanding of the interrelationships between different drivers and implications of interest rates e.g., impacts on interest rates from deglobalization and unwinding global supply chains - Senior management provides clear guidance about translation of views for different layers of organization e.g., risk team and fund managers

Vision	Developing	Advanced
Competitive Advantage	- Organization understands implications for the level of interest rates on ability to meet liabilities (e.g., maintain funded status) and on expected returns in different asset classes - Incorporation of certain alternative strategies enables expression of macro views relative to more constrained peers - Senior leadership has understanding that conventional tools and metrics may not fully capture impact of low/negative interest rates	- Relative to peers, organization has strong self-awareness of implications for the level of interest rates on ability to meet liabilities and on expected returns in different asset classes - Organization understands opportunities and is able to take advantage of them - Portfolio flexibility e.g., multi-asset, alternatives, leverage and derivatives overlays. - Strong breadth of research e.g., internal and external support capabilities and asset class specialists to manage investments through extended low/negative rate environment - Interest rate hedging techniques used to manage balance sheet risk. Organization uses a variety of techniques such as yield triggers and derivatives. Robust operational framework in place to manage leverage and collateral requirements. - Capacity to potentially benefit from a long-term time horizon - Highly sophisticated tools

Governance	Developing	Advanced
Accountability by Internal Stakeholders/ Leadership	- Limited accountability and vague delegations of authority between investment risk/return results and stakeholder remuneration - Vague alignment of incentives between what teams are responsible for and organization's time horizon	- Clear delegations of authority, accountability and control linking investment risk/return results to remuneration of leadership, employees, and other key investment support functions. - Clear alignment of incentives linked to what teams are responsible for and organization's time horizon e.g., bonuses tied to long-term performance and holdbacks - Compensation incentives for employees who devise solutions to overcome challenges
Policy & Procedures	- Clear awareness of 'house view' but limited clarity about how it translates into relevant policies and procedures across different layers of organization - Investment team is beginning to consider adoption of interest rate hedging program and triggers - Investment team is considering pursuit of more aggressive diversification into asset classes such as private debt, infrastructure and real estate which may provide higher real yields than publicly traded fixed income	- Clear translation of 'house' views into relevant policies and procedures for different layers of organization e.g. liability matching, multi-asset strategy, asset class specialist portfolio management delegations, risk management, derivative overlays, strategic and manager research agendas - Senior leadership fully integrates fixed income alternatives into investment opportunity set. - Senior leadership has established return spread objectives and other criteria for investment in asset classes such as private debt, infrastructure and real estate, which reflect appropriate comparison to available yields on publicly traded fixed income instruments

Governance	Developing	Advanced
	- Internal stakeholders review policies and procedures on an ad hoc basis - Certain metrics align with the overarching goal of improving the probability of meeting objectives regardless of the interest rate environment. - Procedures include forums for informational sharing	- Internal stakeholders regularly review policies and procedures - Strategic asset allocation sets factor targets for new dimensions of risk e.g., duration, credit and inflation - Metrics collectively align with overarching goal of improving probability of meeting objectives regardless of interest rate environment - Procedures include forums for discussions about information as well as sharing and collaboration
Trend-Specific Staff (and research capability)	- Broad internal resources, allowing for research and portfolio management and strategy e.g., risk management, head of strategy, chief investment officer and fixed income professionals - External specialists engaged as needed e.g., consultants, multi-asset credit and/or private debt specialists	- Engaged and experienced internal team researching and quantifying alternative investment solutions, leveraging learnings from markets with history of low/negative rates, and presenting alternative approaches to leadership to maintain risk/return objectives - Engaged and experienced liability hedging specialists, strategists and economists inform 'house' view and support investment teams - External specialists in liability hedging and strategy development engaged as needed, most importantly for alternative and/or contrarian views

Implementation	Developing	Advanced
Strategic/ Scenario Analysis	- Modelling allows for current environment and future potential regime changes in which performance of, and interaction between, different strategies can be quite different from traditional market behavior - Team factors in increased role of both monetary and fiscal policy in distorting the level and direction of interest rates as well as influence of low or negative rates on risk premium - Limited use of deterministic modelling around low/negative rate environments	- Balanced assessment of scenario comprehensiveness, plausibility and probability - Sophistication of modelling extends to integrated assessment modelling, allowing for interaction of interest rates and other major trends e.g., climate change (potentially inflationary) as well as asymmetric correlations (reduced potential for fixed income assets to diversify equity assets during low interest rate environments) - Team understands and analyzes impact of higher inflation scenarios on the ability to meet objectives
Benchmarks/ Target Metrics	- Use of generic industry benchmark to assess and monitor performance - Limited consideration of separation of duration, credit and inflation sensitive exposures	- Board and management collaborate to define relevant benchmarks that achieve trend-related strategic objectives - Benchmarking framework provides transparency on return and risk, inclusive of risk premium, liquidity premium, alpha and cost management - Benchmarks and target metrics refer specifically to opportunity set and teams' relevant performance hurdles

Implementation	Developing	Advanced
Portfolio Integration	- Existing risk management and portfolio discipline not fully adapted to address low/negative rate environment - Limited ability to reduce costs and optimize cash management - Limited incorporation of alternative strategies to manage downside, inflation, income and other risks	- Strong focus on risk management and portfolio discipline (e.g., responsiveness to market changes) - Robust ability to reduce costs and optimize cash management - Disciplined duration management, if needed in a highly tailored manner and potentially as relative value trades (and/or derivatives - Alternative strategies (e.g. private debt, distressed debt and/or gold) assessed methodologically and potentially included in the asset allocation for their downside risk management characteristics - Closely manage holdings in currencies exposed to medium to long-term depreciation from debt deflation
Engagement	- Engage with external parties e.g., specialist managers and research houses to monitor changing (nominal and real) rate environment - Limited to no direct engagement with borrowers	- Liaise with quasi-governmental organizations and academics to better understand, anticipate and address capital market stabilization mechanisms - Directly engage with borrowers e.g., on terms and pricing - If relevant, engage with policymakers and regulators to enable an expanded fixed income opportunity set
Measurement/ Monitoring	- Regularly measure and track projected cost/benefit relationship of maintaining liquidity and diversifying fixed-income exposures - Periodically track and measure interest rate effects on projected returns and risks (e.g., expected shortfall and market risk) - Limited awareness and/or measurement of low/negative interest rate return implications for alternative portfolio investment exposures. - Analyze portfolio's interest rate, inflation and credit spread exposures across investments - Team adjusts exposures tactically when needed	- Regularly measure and track projected cost/benefit relationship of maintaining liquidity and diversifying fixed-income exposures - Understand and report measurement implications on commercial objectives to stakeholders and key decision makers - Understand inherent risk of loss of more complex strategies e.g., illiquidity for private assets and/or development risk of green-field investments over different time periods - Incorporation of hurdles, triggers, stop losses/exit criteria and tactical adjustments of exposures when needed

Important Notices