

HOW LYXOR'S ENHANCED ARCHITECTURE PROGRAM CAN BOOST EUROPEAN PENSION FUNDS' PERFORMANCE

LEAP—Designed to Empower— Europe's pension funds face significant challenges as a result of low interest rates, volatile markets and regulatory constraints. Lyxor's Enhanced Architecture Program (LEAP) helps institutional investors address these challenges. The program offers its participants significant cost reduction, reporting, risk management, governance and return benefits. Amber Kizilbash, Global Head of Sales and Client Strategy at Lyxor Asset Management, explains how LEAP works and why operational effectiveness is such a hot topic.



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>> SPEED READ

- >> Pension funds face significant challenges in meeting their investment targets.
- >> Lyxor's Enhanced Architecture Program (LEAP) meets these challenges by empowering pension funds to achieve a step change in their infrastructure and investment effectiveness.
- >> LEAP is a modular program—it can be adopted in part or via a full fiduciary management solution.

LEAP EMPOWERS PENSION FUNDS TO IMPROVE EFFECTIVENESS

Pension funds face increasingly urgent demands to improve their overall performance. Lyxor's Enhanced Architecture Program (LEAP) empowers them to achieve a step change in their infrastructure and investment effectiveness, via a collaborative, top-down approach. It is a modular, open architecture program from which investors can choose either a comprehensive fiduciary management solution or individual modules.

Our experts offer clients a range of specialist skills, such as the design of the legal and infrastructure framework, the negotiation of service provider agreements, risk management, fund selection and management.

A successful LEAP implementation can result in significant efficiency gains, offering better value for money for the pension funds' ultimate clients saving for retirement.

PENSION FUNDS FACE SIGNIFICANT CHALLENGES

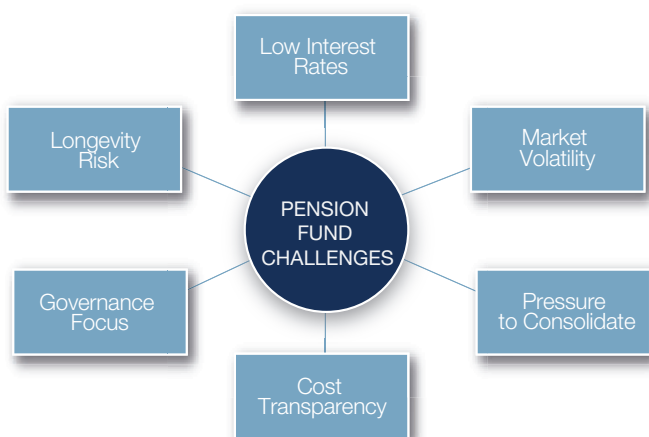
European pension funds currently face significant challenges in meeting their long-term objectives.

The average European occupational pension scheme currently has a shortfall of assets relative to its liabilities. The European Insurance and Occupational Pensions Authority (EIOPA) estimated in January 2016 that occupational schemes are underfunded by an aggregate €428 billion.

Under less optimistic assumptions, pension funds' actuarial deficits could rise even further. One recent stress-test conducted by EIOPA, involving increased longevity, a lower risk-free interest rate and a decline in equity and real estate prices led to a near-doubling of the Europe-wide shortfall.

Improved pension fund governance and enhanced transparency are key requirements of the draft Institutions for Occupational Retirement Provision (IORP) II Directive, which is likely to come into force in 2017 or 2018.

Clearly, pension funds cannot influence factors like longevity, inflation or the level of long-term interest rates. But in other areas—governance, efficiency, costs, risk management, for example—there are often opportunities to improve the way things are run. This is where LEAP can help.



>> **LEAP: A Step Change in Operational Effectiveness**

Lyxor's Enhanced Architecture Program (LEAP) is a modular, open architecture program enabling pension funds to:

- >> Reduce costs
- >> Enhance reporting and transparency
- >> Manage risk better
- >> Improve governance
- >> Enhance investment returns

LEAP'S BENEFITS

LEAP benefits pension funds in two ways.

The first is by enhancing funds' infrastructure, thereby increasing operational effectiveness. Many pension funds suffer from a duplication of roles amongst service providers, both across schemes and across countries. This duplication of efforts leads to a sub-optimal cost structure and a challenge in ensuring effective governance.

LEAP helps pension funds to review the structure of their investment vehicles, a process which facilitates reducing the overall number of service providers. LEAP can help funds create pooled, tax-efficient investment vehicles which are at the disposal of all member schemes, even those operating across borders. The updated structure enables easier, real-time consolidated reporting across asset classes. In turn, this improves the quality of pension funds' risk management, aiding effective governance.

The second way in which LEAP helps investors is by providing access to state-of-the-art investment solutions. Many large pension funds have access to sophisticated in-house investment resources as a matter of course. LEAP puts these capabilities at the disposal of small and medium-sized pension funds, which may lack the scale to run such investment programs on their own. Via LEAP, Lyxor accompanies clients in implementing advanced tailored solutions along the full investment value chain, from liability-driven investment (LDI) and strategic asset allocation up to fund selection and management.

SOLUTIONS MEETING INVESTORS' NEEDS

HOW LEAP WORKS:

>> Investment infrastructure

LEAP helps clients to streamline the roles of service providers on pension funds' behalf. Lyxor's scale and our pre-existing master service agreements often enable us to renegotiate existing contracts on better terms for clients. LEAP's experts can advise clients on how best to optimise the legal structure of their investment vehicles, also taking into account fiscal efficiency (withholding taxes).

Many institutions run multiple legacy pension schemes, which makes real-time reporting a challenge. Even single-scheme pension funds struggle to achieve timely consolidated reporting across the full range of asset classes. Via a single portal called MyLyxorMAP.com, LEAP helps consolidate pension funds' global investment positions on a real-time basis, with customised reporting on any level, including a look-through to the holdings of external mutual funds⁽¹⁾.

Pension funds may not have access to state-of-the-art risk management tools. LEAP clients gain real-time exposure analysis, automated stress testing and scenario analysis, together with access to bespoke advice from Lyxor's 20 risk management professionals.

Together, the simplification of structures and better reporting and risk management help pension funds to improve internal governance.

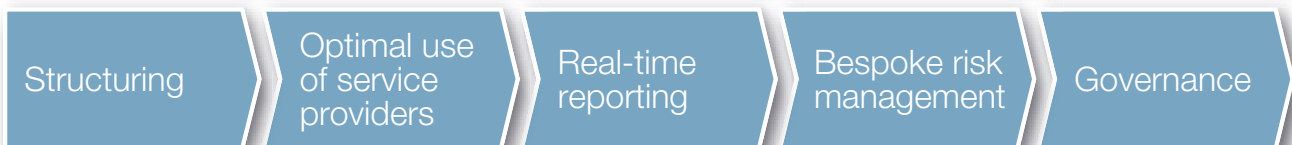
>> Investment solutions

Lyxor offers a full range of capabilities for pension funds seeking to optimise their portfolio with regards to their liabilities under a liability-driven investment (LDI) program. LEAP also provides access to Lyxor's in-house cross-asset research team, helping clients benefit from tactical asset allocation opportunities throughout the business cycle.

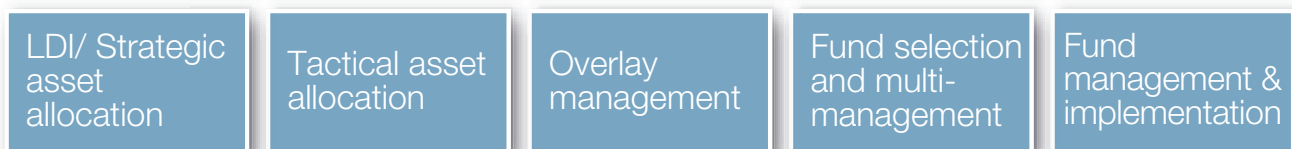
Many pension funds wish to use a derivatives overlay, whether to manage risks or to seek extra returns. However, funds may face significant management and operational challenges when entering into derivatives contracts themselves. Lyxor has the know-how, infrastructure and scale to act efficiently in the derivatives markets with or on behalf of clients.

LEAP draws upon the long-standing expertise of Lyxor's fund selection team in the selection of external mutual and alternative funds, via one of Europe's largest fund selection teams. And Lyxor's in-house fund management teams, which specialise in passive fund management and diversifying alpha strategies, can help optimise the investment portfolio.

Enhanced infrastructure



A modular and comprehensive suite of performance engines



LEAP is a modular offering: pension funds can choose any combination of elements. By selecting the whole program the client effectively opts for a full fiduciary management approach.

⁽¹⁾ Subject to the fund manager's agreement

LEAP IN PRACTICE

A case study shows how LEAP can be used to improve efficiency, governance and pension scheme risk management.

>> Before LEAP

A corporation runs several pension schemes in different countries — a legacy of past acquisitions. The assets of each scheme are managed by different external asset managers, while the pension schemes also employ multiple consultants, custodians and other external service providers.

The overall set-up appears sub-optimal for a number of reasons. The funds have limited economies of scale, implying relatively high operating and management costs. The legal wrappers used may fail to generate the maximum post-tax income stream. Meanwhile the processes used for risk management and governance are subject to improvement. The capacity of the fund to generate enhanced investment performance is also hampered by the duplication of investment managers' roles within individual asset classes.

>> After LEAP

After the implementation of LEAP, the pension schemes' operations are streamlined, with significant benefits for the sponsoring entity and its future retirees. All the schemes' assets are brought under a single reporting and risk management framework, enabling easier oversight and better governance. Rather than contracting with multiple external asset managers, the schemes invest in a small number of pooled funds, organised by asset class. In turn, the pooled funds contract with external managers, benefiting from economies of scale to negotiate lower fees. Any investment for one scheme is also at the disposal of all the other schemes.

The number of service providers involved in custody and fund administration is also reduced, generating further cost savings. The management of overlays (such as currency, interest rate, inflation, or credit hedges) also becomes much easier.

We estimate that this implementation of LEAP resulted in operational cost savings of up to 40 percent for the asset owner. That translates into a reduced burden on corporate profitability and direct benefits for the pension schemes' members.

>> LEAP DRAWS ON LYXOR'S PROVEN EXPERTISE:

- >> Economies of scale generated by €118bn in assets under management or advisory;
- >> Our background in running external managed accounts ensures that we maintain the highest levels of legal and fiscal structuring expertise;
- >> Via our fund reporting portal, MyLyxorMap.com, we provide over 1,000 investment professionals with a consolidated, real-time view of their investments;
- >> Our 20 in-house risk management professionals oversee €28bn in externally managed and €76bn in internally managed assets;
- >> We have one of Europe's largest open architecture fund selection teams, advising or managing €28bn in assets;
- >> We run more than €17bn in customised solutions for clients.

Note: numbers are as of December 2015

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