FOR PROFESSIONAL CLIENTS AND QUALIFIED INVESTORS ONLY

iShares by BlackRock

iSHARES INSTITUTIONAL ETF INSIGHTS

How institutional investors use ETFs

MKTGM0924E/S-3834407-1/18

Contents

Introduction **3**

Section 1
The role of ETFs in defined benefit pension management **4**

Section 2
The role of ETFs in defined contribution pension management **8**

Section 3
The role of ETFs in managing insurance funds **12**

Section 4
How iShares can help **16**

INTRODUCTION

Over the past 30 years, exchange traded funds (ETFs) have emerged as a new financial instrument, offering institutional managers a versatile and efficient way to navigate an increasingly complex and challenging investment landscape.

Since the financial crisis of 2009, the global ETF market has grown from $1.1 trillion to £11.5 trillion.[1] It is no coincidence that this growth followed a period of market instability; ETFs have become the go-to vehicle for transferring risk, particularly in times of volatility. This was seen with the surge in ETF trading during the global financial crisis as well as the more recent stock market turbulence following the Covid-19 pandemic.

The money flowing into these instruments has driven innovation. There is a far wider range of ETF options available to investors, with ETFs now covering both index and active strategies across all major geographic markets, and offering both equity and fixed income exposures, as well as other asset classes, such as commodities. Innovation has also seen growth in sustainable ETFs helping institutional managers integrate sustainable and transition considerations into wider asset allocations. This breadth of choice means that ETFs have many use cases within institutional portfolio management.

For those managing pensions and insurance funds, ETFs can be utilised in a number of ways to support investment and risk management strategies. ETFs can enhance diversification, improve liquidity and help managers run portfolios more efficiently — ultimately helping them deliver better outcomes for their beneficiaries.

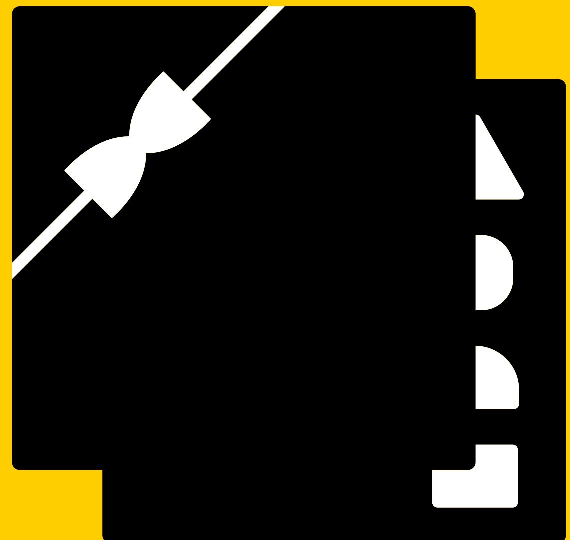
iShares has been a key player in the ETF market for the past three decades, leading product innovation as well as developing research and thought leadership to benefit institutional investors. iShares has defined the distinct ways that institutional investors use ETFs in support of diverse investment strategies, be it in strategic or tactical asset allocation, transition management, or to improve cash and liquidity management.

The following articles highlight how ETFs can be used to meet the specific investment challenges faced by managers of defined benefit (DB) and defined contribution (DC) pension schemes, as well as insurers.

[1] Source: BlackRock Global Business Intelligence, 31 December 2023. All $ values are in USD.

Section 1

THE ROLE OF ETFs IN DEFINED BENEFIT PENSION MANAGEMENT



MKTGM0924E/S-3834407-4/18

Section 1

The role of ETFs in defined benefit pension management

Defined benefit (DB) pension schemes are a cornerstone of retirement saving in Europe. But as these large schemes mature, managing them becomes more complex. Among those challenges are:

- **Maintaining liquidity**
- **Enhancing diversification**
- **Ensuring effective risk management**

ETFs can help DB schemes navigate these issues, supporting asset managers in delivering the best outcomes for their members.

Challenges ahead for DB pension schemes

Changing economic conditions, marked by rising interest rates globally, have benefited many DB schemes. This has moved some from deficit to surplus and potentially accelerated endgame plans. For those targeting an insurance buyout, this creates its own challenges around portfolio realignment to ensure a cost-effective and efficient transfer. Such transitions can be expensive and slow, with managers required to shift toward lower-yielding cash until the transfer can proceed.

Not all schemes have reached this stage or are aiming for insurance buyout; for many managers, the focus remains the day-to-day, as they strive to maintain liquidity and diversification amid volatile bond markets. Events such as the Covid-19 pandemic, the Ukrainian conflict and the gilt crisis that followed the UK's 'mini-budget' in 2022 highlight the need for flexible risk management strategies that can adapt to changing conditions.

Managers also face investment challenges when changing or initiating new mandates. These include significant opportunity costs from holding larger cash allocations for extended periods or maintaining outdated asset allocations, while custodian arrangements are set up or capital is deployed into private markets or allocated to longer-term strategic assets.

MKTGM0924E/S-3834407-5/18

Section 1

How ETFs can help DB pension scheme managers

The breadth and depth of ETFs available mean they can be used in a variety of ways to help managers navigate the challenges throughout the lifecycle stages of a DB scheme. These include maintaining liquidity, diversifying assets within the portfolio or facilitating more immediate and cost-effective transfers when setting up new mandates or as part of an endgame insurance buyout.

1

Strategic asset allocation

The choice of exposures available to DB managers via ETFs offers an efficient way to access different geographies, sectors and asset classes. As a result, they can have a role to play in strategic asset allocations decisions, be it targeting precise exposures or diversifying across core portfolios. The breadth of ETFs available offer easy market access for managers from core equity exposures to bond ETFs, including innovative short-dated bonds. This also includes a range of sustainable and transition investments, which are now at the core of many scheme portfolios. This wide range of liquid and precise ETF options can also help with tactical asset allocations, allowing managers to quickly shift allocations in time of market turbulence.

2

Liquidity management

Liquidity management enables managers to replicate the portfolio's beta using ETFs and strategically liquidate those ETF positions when greater cash flow is needed. This method tends to be more efficient, both in terms of cost and ease of trading, compared to managing liquidity across a large number of single line holdings.

This was clearly demonstrated during the market turbulence in bond and gilt markets in recent years, following first the Covid pandemic, and then rising inflation and interest rates. Holding bond ETFs allowed managers to liquidate their holdings quickly, helping shore up positions and manage risk.

THE BREADTH OF ETFs AVAILABLE OFFER EASY MARKET ACCESS FOR MANAGERS FROM CORE EQUITY EXPOSURES TO BOND ETFs, INCLUDING INNOVATIVE SHORT-DATED BONDS.

MKTGM0924E/S-3834407-6/18

Section 1

3 Cash management

Mature DB pension schemes often require higher allocations to fixed income and cash to meet investment objectives, maintain liquidity or prepare for a mandate change or insurance buyout.

ETFs – particularly short-dated fixed-income ETFs – can enhance cash management strategies. By delivering risk-adjusted returns without sacrificing liquidity, they reduce the cash drag on returns during periods of volatility and transition.

The large range of short-duration ETFs now available also covers a broad spectrum of yield profiles, catering to a variety of risk tolerances and income needs. Short-duration iBonds (fixed maturity ETFs), for example, can generate income during mandate changes and the interim of capital calls.

4 Transition management

Transferring funds within DB schemes can incur high costs and take time, whether you're setting up or modifying a mandate or adjusting portfolios before an insurance buyout. ETFs can help investors during portfolio transitions, providing continuous market exposure.

ETFs offer cost-effective access to a wide range of geographies and asset classes, including everything from emerging market fixed income to short-dated bonds and gold. This use case is therefore available to DB managers regardless of their investment strategy. ETFs are also more easily transferable to insurers than many other investment wrappers, and their daily pricing ensures transparent, up-to-date and easy-to-confirm valuations.

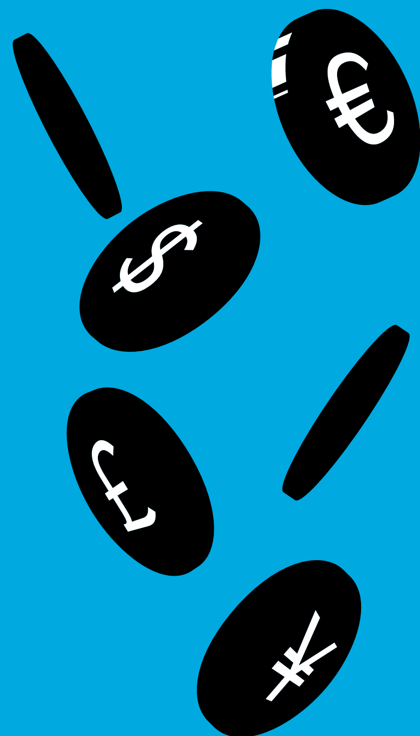
5 Derivative alternative

DB scheme managers will often use hedging tools to dial down risk and the potential for losses, particularly ahead of changing a mandate or initiating an insurance buyout. A subset of ETFs, typically large and liquid, can offer efficient and cost-effective alternatives to derivatives, such as credit default swaps. These frequently serve as proxies for the underlying market and can be used as a risk-management overlay, depending on the scheme's specific objectives and current market conditions.

MKTGM0924E/S-3834407-7/18

Section 2

THE ROLE OF ETFs IN DEFINED CONTRIBUTION PENSION MANAGEMENT



MKTGM0924E/S-3834407-8/18

Section 2

The role of ETFs in defined contribution pension management

The pension industry has undergone significant structural changes, with a shift toward defined contribution (DC) schemes. In many parts of the world, increased longevity has driven a move away from state- or company-backed 'guaranteed' pensions and encouraged private retirement savings. Many governments in Europe now compel – or 'nudge' – workplace pension contributions, leading to large inflows into DC schemes in recent years. This trend looks set to continue. European DC schemes, for example, are expected to manage €10 trillion in assets by 2030.[2]

Challenges ahead for DC pensions

DC pension schemes have three distinct phases: accumulation (growth), at-retirement and post-retirement stage (decumulation). Managers face specific challenges during each of these phases to deliver the best outcomes for members.

In the growth phase, managers often take a higher risk approach to deliver higher returns, often through larger equity allocations or, in some cases, greater diversification which might include allocations to private markets. Managers also have to meet increased regulatory demands in many jurisdictions around cost, liquidity and sustainability requirements and reporting.

As members approach retirement age, managers need to ensure there is sufficient flexibility to enable benefit withdrawals. Schemes need to balance liquidity with long-term growth strategies for those taking a more graduated approach to retirement.

The decumulation stage has become more important as people live longer and increasingly rely on investment savings as one of their main sources of retirement income. Managers must provide predictable near-term income streams while delivering the long-term growth needed to combat inflation and longevity risk.

[2] Source: Perspectives | Indefi. 2021.

MKTGM0924E/S-3834407-9/18

Section 2

How ETFs can help DC pension managers

ETFs offer a broad range of options with low charges, making them useful across the DC scheme lifecycle.

1

Strategic asset allocation

The breadth of ETF choice gives DC pension managers an efficient way to diversify portfolios during accumulation. More nimble and diversified portfolio allocations can reduce risks against today's more volatile economic backdrop, with more persistent inflation.

ETFs also enable DC schemes to diversify into sustainable and transition investments. Using ETFs can help DC schemes improve cost efficiency, ultimately helping them deliver better outcomes for their beneficiaries.

2

Tactical asset allocation

The liquidity and breadth of choice of ETFs allows for swift asset allocations shifts. This can help managers to respond quickly during periods of market volatility, and can be used defensively as a risk management tool or to take advantage of attractive opportunities to boost returns during the accumulation stage.

3

Cash management

As members approach and move into retirement, DC schemes typically require higher allocations to fixed income and cash to meet shorter-term liquidity needs. ETFs, particularly short-dated fixed income ETFs, can enhance cash management strategies by delivering attractive yields over the longer term without sacrificing liquidity. This also reduces drag on returns during periods of volatility and transition.

The breadth of short-duration ETF options available, covering a broad spectrum of yield profiles, allows investors to better tailor their portfolio and offers diversification benefits given the number of securities typically held within each ETF wrapper. This allows investors to put their cash to work, while still being able to tap into these funds when needed.

AS MEMBERS APPROACH AND MOVE INTO RETIREMENT, DC SCHEMES TYPICALLY REQUIRE HIGHER ALLOCATIONS TO FIXED INCOME AND CASH.

MKTGM0924E/S-3834407-10/18

4 Transition management

ETFs' high degree of liquidity can be beneficial when transferring assets as it reduces the need to move assets into lower yielding cash, which can act as a drag on returns. This can be particularly important for those managing DC glidepaths towards retirement, when there is often the need to transfer member's assets from equities into bonds as a way of reducing risk across the portfolio. ETFs can also be used in this way during the decumulation phases, when managers may be switching into longer-term fixed income allocations to ensure robust cash flow strategies.

Maintaining market exposure during these times can potentially enhance portfolio performance and increase total returns.

5 Liquidity management

ETFs provide managers with an additional safety net during unplanned market volatility. Managers can use ETFs to achieve allocations similar to their existing holdings in listed bond and equity markets without sacrificing returns.

This 'liquidity sleeve' can help managers navigate unplanned liquidity events, which occur during periods of market volatility. Volatility in bond prices, for example, has led two-thirds of institutions to use fixed-income ETFs.[3] These can provide more robust risk management, particularly during the decumulation stage when managers may need to access high levels of cash at short notice. However, market exposure is also needed to mitigate longevity and inflation risks.

By investing in a range of fixed-income ETFs, DC managers can balance income generation with long-term capital preservation during both the at-retirement and decumulation stages.

ETFs' HIGH DEGREE OF LIQUIDITY CAN BE BENEFICIAL WHEN TRANSFERRING ASSETS AS IT REDUCES THE NEED TO MOVE ASSETS INTO LOWER YIELDING CASH.

[3] Source: Institutional Investor and BlackRock global survey of 760 investment decision makers at asset-owning institutions and asset managers around the world conducted in Q2 2023.

MKTGM0924E/S-3834407-11/18

Section 3

THE ROLE OF ETFs IN MANAGING INSURANCE FUNDS

MKTGM0924E/S-3834407-12/18

Section 3

The role of ETFs in managing insurance funds

Insurers have traditionally managed their assets through a combination of unit-linked funds and direct shareholdings.
Recently, however, general and life insurers have increasingly been turning to ETFs to manage their assets. This shift is driven by the desire for:

- **Precise and cost-effective access to global markets**
- **Enhanced portfolio diversification**
- **Liquidity during market volatility**

Challenges ahead for insurers

General insurers face the challenge of tactical asset allocation against an increasingly volatile economic background. Their usually short-dated liabilities necessitate investment solutions that deliver attractive yields while maintaining liquidity for quick adjustments should market conditions change. However, they must balance this against longer-term strategic asset allocations, which require cost-effective solutions to run diversified portfolios.

Life insurers face similar challenges, with the added complexity of pension risk transfers, which take considerable time to complete after price agreement. Managing liquidity requirements during this process often leads to an over-reliance on government bonds and short-term credit spreads.

After completing a transfer, life insurers taking over the DB pension liabilities typically need to swiftly reinvest a portfolio of cash and government bonds into credit and other securities for the long term. This process can be time-consuming and costly, reducing portfolio efficiency.

GENERAL INSURERS FACE THE CHALLENGE OF TACTICAL ASSET ALLOCATION.

MKTGM0924E/S-3834407-13/18

How ETFs can help insurers

ETFs offer versatile solutions for those managing both general and life insurance schemes, addressing various portfolio management challenges.

1

Tactical and strategic asset allocation

ETFs provide cost-effective diversification across a broad range of geographies, sectors and asset classes, improving risk efficiency and enabling the building of dynamic portfolios that target precise asset allocations and more diversified core holdings. ETFs are also highly liquid investment wrappers, making them an ideal way for managers to access more niche markets or areas where they have less expertise.

2

Transition management

ETFs can support life insurers handling pension liabilities in several ways. DB schemes using ETFs can support in-kind transfers to insurers, and then the liquidity of ETFs can provide quick market access when transferring assets into longer-term bond portfolios that will support the delivery of pension commitments. Critically, however, ETFs retain market exposure during this transition process, potentially reducing losses associated with moving assets into cash during these periods. This can help enhance portfolio efficiency.

3

Cash management

Life insurers and general insurers both hold large cash allocations at key times to support cash flow and payouts, especially during periods of market volatility. By laddering their cash flow requirements in order to deliver higher yields than cash holdings without sacrificing liquidity, short-dated fixed-income ETFs can reduce the drag on returns during these periods. ETFs also offer enhanced liquidity to general and life insurance managers, thus enabling them to access cash in a timely fashion during planned liquidity events.

ETFs ARE HIGHLY LIQUID INVESTMENT WRAPPERS, MAKING THEM AN IDEAL WAY FOR MANAGERS TO ACCESS MORE NICHE MARKETS.

MKTGM0924E/S-3834407-14/18

4

Liquidity management
ETFs provide managers with an additional safety net during unplanned market volatility. Managers can use ETFs to achieve allocations similar to their existing holdings in listed bond and equity markets without sacrificing returns. This 'liquidity sleeve' enables quick market exits while maintaining exposure to longer-term returns, potentially delivering higher overall returns than lower-yielding cash or short-term bonds.

5

Sustainability
Sustainable ETFs offer insurers an effective way to incorporate sustainable and transition objectives in their portfolios as part of their wider strategic asset allocation. This has become increasingly important as large insurers continue to develop net zero transition pathways and set sustainability targets incorporating a range of environmental and social issues. The breadth of sustainable & transition ETFs available can help insurers integrate sustainable investment objectives within their own portfolios and more bespoke mandates.

ETFs PROVIDE MANAGERS WITH AN ADDITIONAL SAFETY NET DURING UNPLANNED MARKET VOLATILITY.

MKTGM0924E/S-3834407-15/18

Section 4

HOW iSHARES CAN HELP

MKTGM0924E/S-3834407-16/18

Section 4

How iShares can help

iShares has been a leader in the ETF marketplace for more than two decades. As part of BlackRock, our products are engineered by investment professionals with deep discipline and risk management expertise. We work closely with institutional investors globally to support the implementation of ETFs in their portfolios.

Learn more about how we can support institutional investors in the guides below, or sign up to stay up to date with our latest insights and events.

ETF guide for institutional investors
In this guide, BlackRock experts discuss common uses for ETF and examine the ETF market from the institutional investor perspective.
Download guide

Unlock ETF access
In this paper, we explore the different ways institutional investors can access ETFs.
Download paper

Portfolio consulting
Our portfolio consultants can help you adapt to the new market regime and assist with the implementation and strategic use of ETFs.

Contact your BlackRock relationship manager to learn more about our portfolio consulting services.

MKTGM0924E/S-3834407-17/18

© 2024 BlackRock. All Rights Reserved.

This document is marketing material: Before investing please read the Prospectus and the PRIIPs KID available on www.blackrock.com/it, which contain a summary of investors' rights.

RISK WARNINGS

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

IMPORTANT INFORMATION

This material is for distribution to Professional Clients (as defined by the Financial Conduct Authority or MiFID Rules) only and should not be relied upon by any other persons.

In the UK and Non-European Economic Area (EEA) countries: this is Issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: + 44 (0)20 7743 3000. Registered in England and Wales No. 02020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock.

In the European Economic Area (EEA): this is Issued by BlackRock (Netherlands) B.V., authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded.

In Italy

For information on investor rights and how to raise complaints please go to https://www.blackrock.com/corporate/compliance/investor-right available in Italian.

For investors in Switzerland

This document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: www.blackrock.com/finsa.

Any research in this document has been procured and may have been acted on by BlackRock for its own purpose. The results of such research are being made available only incidentally. The views expressed do not constitute investment or any other advice and are subject to change. They do not necessarily reflect the views of any company in the BlackRock Group or any part thereof and no assurances are made as to their accuracy.

This document is for information purposes only and does not constitute an offer or invitation to anyone to invest in any BlackRock funds and has not been prepared in connection with any such offer.

© 2024 BlackRock, Inc. All Rights reserved. BLACKROCK, BLACKROCK SOLUTIONS and iSHARES are trademarks of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

iShares
by BlackRock