

Views from the LDI Desk



Why Cashflow Match?

Many UK Defined Benefit (DB) pension schemes have seen significant improvements in their funding levels in recent years. However, as schemes have matured and benefit payments have increased, a growing number are now cashflow negative. At the same time, Trustees face a strategic crossroads: continue running on, prepare for a buy-out transaction, or maintain strategic flexibility. As explored in our recent [Mind the Surplus](#) paper, this choice has important implications for the investment strategy. Regardless of the endgame target, aligning benefit payments with predictable asset cashflows is becoming a central feature of low dependency investing.

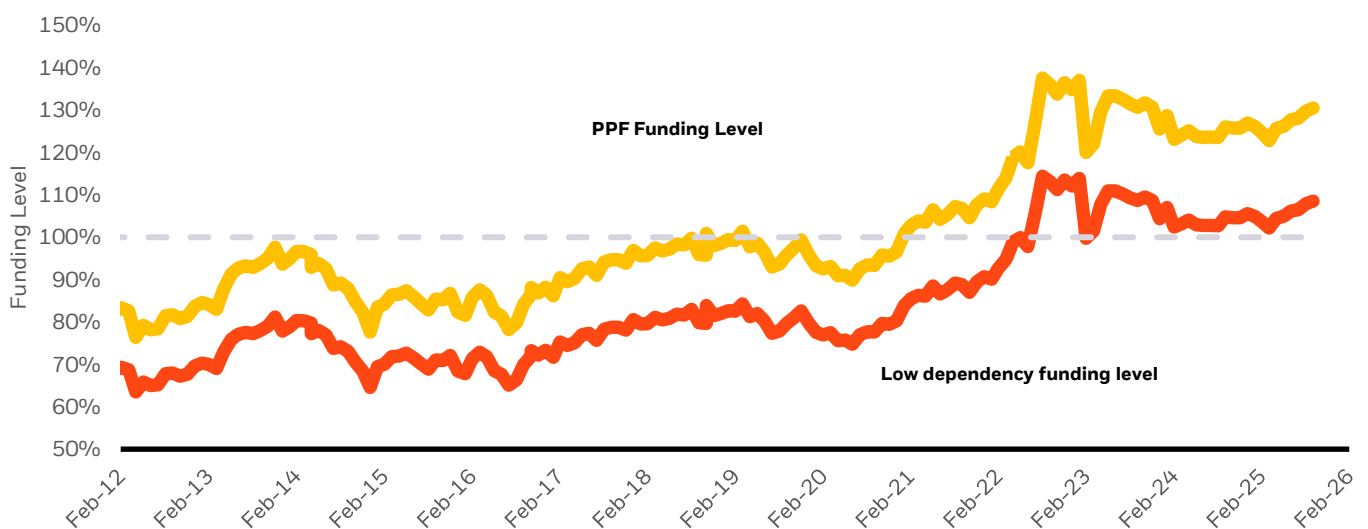
Contractual cashflows, such as bond coupons and principal repayments, can provide return certainty, ease liquidity pressures, and simplify governance. They reduce reliance on favourable market timing and mitigate the risk of forced asset sales. This approach is also aligned with the Pensions Regulator’s (TPR’s) new Funding Code, which emphasises liquidity resilience and credible journey planning. In short, cashflow matching gives Trustees more control over outcomes, supporting both smoother run-on strategies and efficient preparation for buy-out.

In this paper, we set out why schemes should adopt a robust liquidity and cashflow strategy, its alignment with the new Funding Code and outline a practical framework for doing so.

Why cashflow matching matters now

Improved funding levels have reshaped the DB landscape. Higher yields, past deficit contributions, and strong performance from risk assets have left many schemes in surplus. The scale of this transformation is striking. TPR [estimates](#) that around three quarters of UK schemes are now in surplus on a low-dependency basis, compared with only a quarter five years ago.

Figure 1: Significant improvement in funding levels over the last 5 years



Source: PPF 7800, BlackRock. March 2026. Low dependency funding level is approximated based on PPF 7800 data, assuming a parallel shift.

For Trustees, this new environment brings a different set of questions. How can member benefits be best protected when the scheme is well funded? What level of flexibility should be retained around surplus use? These are not short-term tactical questions but structural ones that will define the next phase for schemes

Regulatory developments have reinforced the same direction of travel. The Department for Work and Pensions (DWP) has consulted on changes to allow the use and extraction of surplus in certain circumstances, opening the door for new forms of agreements between Trustees and sponsors. Any re-risking of assets to generate surplus needs to be coupled with a robust framework for ensuring cashflows can still be reliably met. TPR’s new Funding Code places greater emphasis on resilience and liquidity, requiring schemes at or near low dependency to be invested in assets that can reliably meet benefit payments without sponsor reliance. Together, these signal a shift towards more resilient, self-sufficient portfolios.

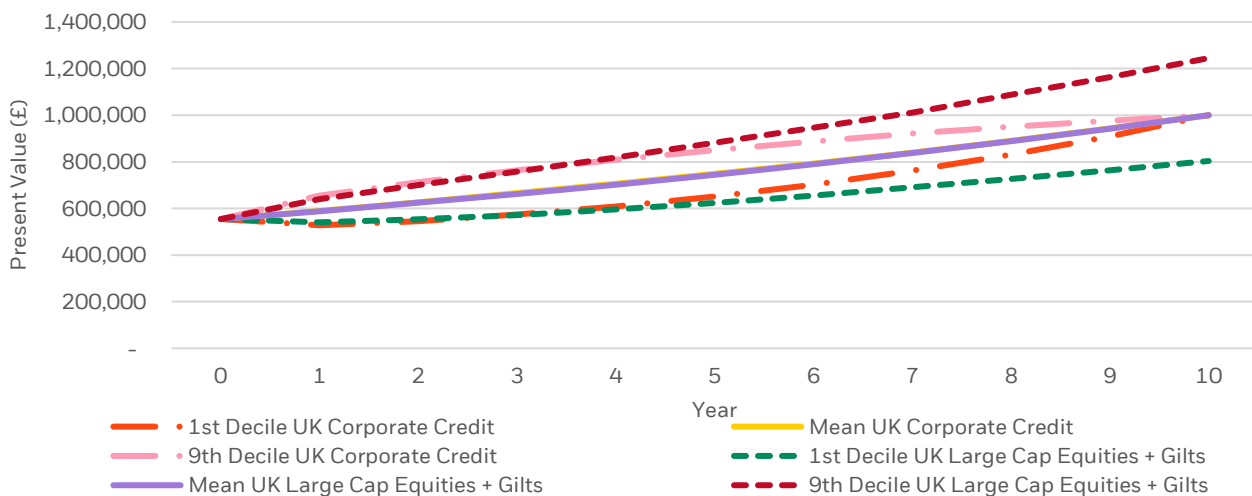
Against this backdrop, aligning asset and liability cashflows is increasingly seen as a defining feature of an effective investment strategy.

The investment case for cashflow matching

As schemes approach the endgame, the focus increasingly shifts to resilience, regardless of the route a scheme chooses. Whether targeting buy-out, low dependency or generating a surplus, the objective is the same: ensuring benefits can be paid, regardless of market conditions. As schemes mature, the time available to make up for any missteps or forced asset sales begins to shorten. Cashflow matching provides a practical way of supporting that resilience across different endgames. For run-on strategies, it helps insulate growth assets from forced sales following market drawdowns, allowing return-seeking assets to remain invested through short-term volatility. For schemes preparing for pension risk transfer, matching cashflows through to the expected transaction date stabilises funding levels and helps shape a portfolio that insurers can readily assess.

A cashflow matching strategy can deliver on two key portfolio objectives. The first is funding level predictability, where assets whose cashflow and discounting characteristics align closely with the liability benchmark can help to reduce funding level volatility, especially where a dynamic discount rate is used. The second focuses on the certainty with which these carefully selected assets, including private market assets, can deliver the cashflows that support benefit payments.

Figure 2: The asset allocation trade-off



This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even estimate – of future performance. Forecasts are not a reliable indicator of future performance. Source: BlackRock; CMA data as at 23 March 2026 Currency: GBP, Tenor 10-year. Using BlackRock Investment Institute’s [Capital Market Assumptions](#) and 10,000 simulated log-normally distributed paths of return.

The chart on the previous page illustrates this, comparing two portfolios designed to deliver similar outcomes after ten years: one holding credit, and another combining equities and gilts. While their central outcomes are the same, the equity and gilt portfolio has far greater dispersion. By contrast, although the value of a credit portfolio will fluctuate over time, its contractual income allows the final cashflow to be predicted with much greater confidence. Moreover, when the liability discount rate is aligned to the assets, these mark-to-market movements do not necessarily translate into comparable interim funding level volatility.

Combining a dynamic discount rate for the liabilities that is aligned to the asset mix with realistic assumptions about default and recovery on the underlying assets can support a more stable and resilient funding journey.

What is a dynamic liability discount rate?

A dynamic liability discount rate links the liability discount rate to the characteristics of the asset portfolio, rather than using a fixed spread relative to gilts (or swaps) set at a single point in time. In practice, this means that changes in asset spreads are (at least partially) reflected in the valuation of liabilities.

Illustrative example

Consider a scheme invested 60% in gilts and 40% in credit (0.75% spread, 10-year credit duration), with a starting funding level of 100%. The total asset spread is then 0.3%.

Now assume a 0.5% widening in credit spreads. This reduces asset values by c. 2.0% and increases the asset spread by 0.2% (from 0.3% to 0.5%).

If the liabilities are discounted on a fixed spread to gilts, they remain unchanged and the funding level falls from 100% to 98%. By contrast, under a dynamic discount rate and assuming the same spread duration for the liabilities, the liability discount rate increases by 0.2%, reducing liabilities by 2.0% and leaving the funding level broadly unchanged at 100%.

Key takeaway

A dynamic discount rate better reflects the economics of holding spread assets by allowing liability values to adjust as asset spreads move, reducing funding level volatility. However, it does not eliminate credit risk. Schemes still need to make explicit allowance for defaults and downgrades within their asset portfolio, as these represent real losses that are not offset through the liability valuation.

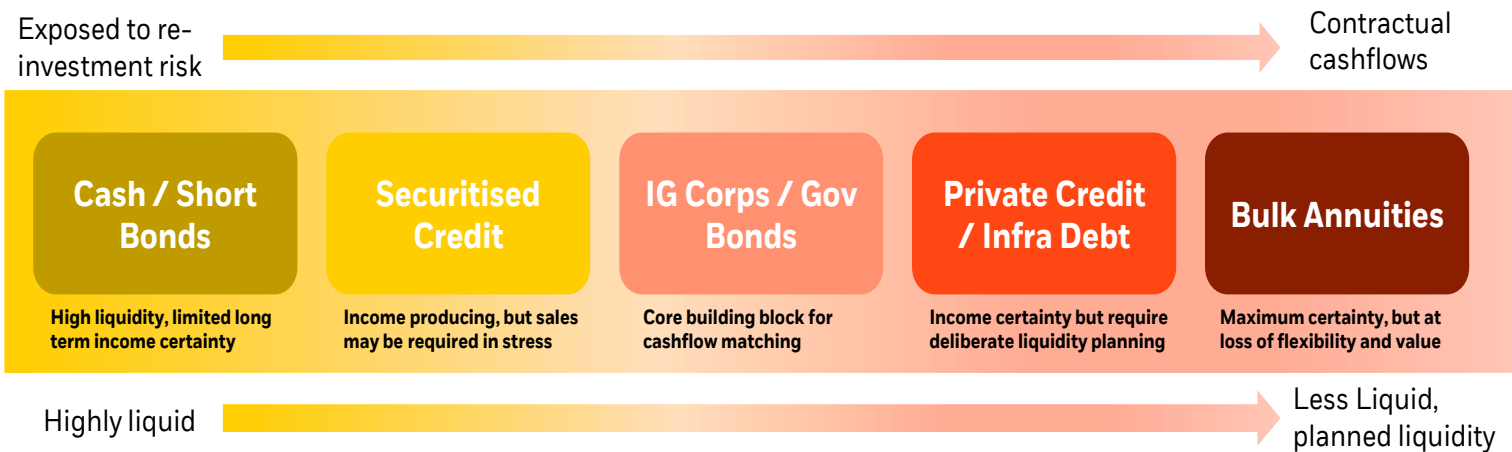
The regulatory case for cashflow matching

TPR's [Funding Code](#) defines a low-dependency investment allocation as one that is highly resilient to short-term market movements and provides a high degree of alignment with the scheme's cashflow profile, or that uses assets "unlikely to be affected by significant price volatility." It also cautions that schemes relying on asset sales to meet benefit payments risk having to sell during periods of market stress, potentially crystallising a fall in funding level.

To mitigate this, TPR encourages schemes to consider assets in two categories, although in practice some may span both:

- **Cashflow Generative Matching Assets** – Assets for which the income and capital payments are predictable and provide either fixed cashflows, or cashflows linked to reference rates such as interest and inflation rates.
- **Liquid and Low Volatility Matching Assets** – Assets that are expected to be liquid and experience low price volatility in unstressed as well as stressed market environments.

Figure 3: Matching assets across cashflow certainty and liquidity

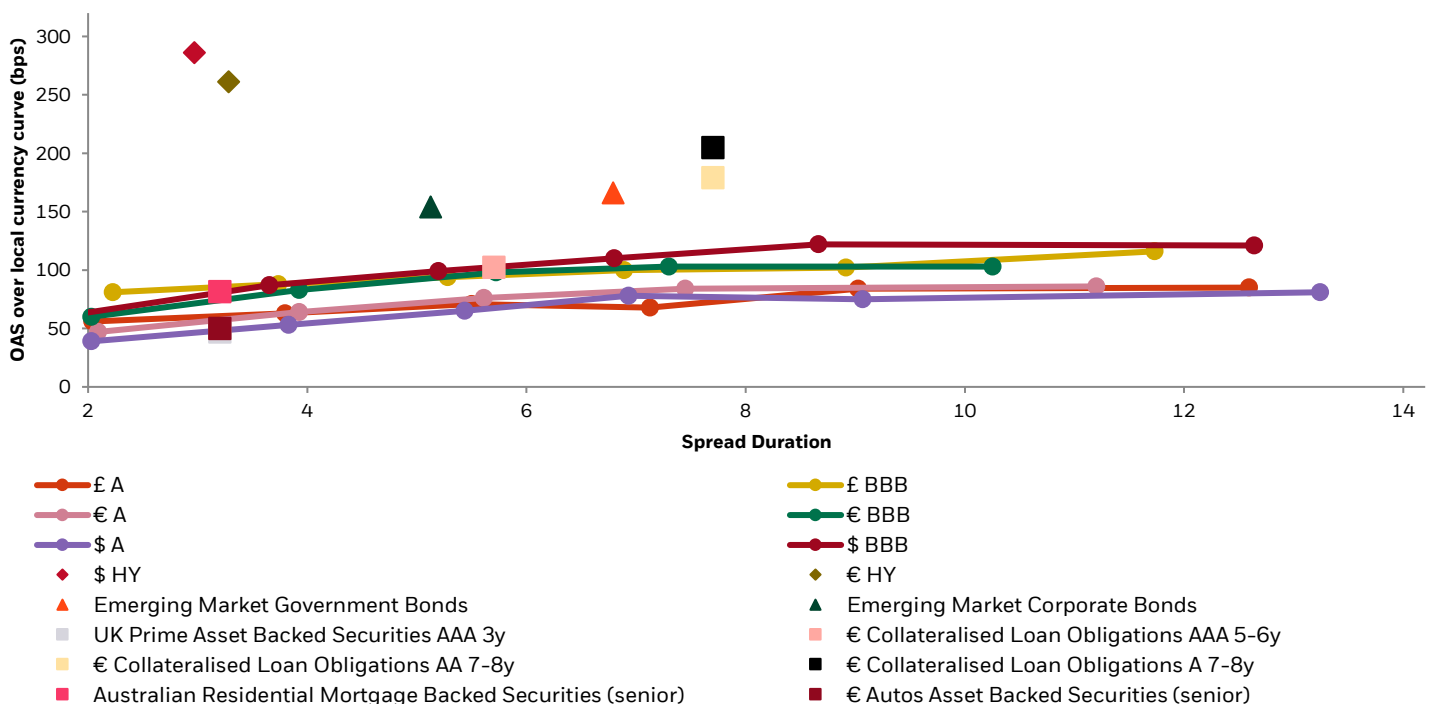


Source: BlackRock. For illustrative purposes only and based on BlackRock's views.

Many liquid and low volatility assets will also come with re-investment risk, the risk that when the asset matures and proceeds are re-invested they cannot achieve the same spread or yield, meaning that the mix of liquidity and aligning with future cashflows should also consider any views on future spread levels.

Outright levels of spreads and steepness of spread curves will be key to determining this trade off.

Figure 4: Spread duration versus OAS



Source: BlackRock, Bloomberg. As at 10 February 2026.

A practical framework for cashflow matching

While both the investment and regulatory backdrop for implementing a cashflow matching strategy is strong, implementing it effectively requires a balance between precision and practicality. In essence, successful strategies treat cashflow matching as a dynamic process rather than a one-off exercise. They are built around portfolios that recognise that the appropriate level of precision will vary across different time horizons and market environments. The objective is to meet liabilities as they fall due without overengineering the process.

In our view, schemes that meet the following criteria are best placed to implement a cashflow matching strategy:

Well-defined liability cashflows and visibility of asset cashflows for the manager	This enables close alignment between expected in- and outflows, simplifies oversight, and supports more accurate monitoring of progress.
A dynamic discounting approach to valuing liabilities	Aligning the liability valuation with the cashflow matching assets ensures consistency and can reduce unwanted trading driven by short-term spread volatility.
Are, or will soon become, cashflow negative	Schemes where benefit payments exceed income and sponsor contributions could benefit the most from restructuring their assets to provide more predictable income.
A strong funding position	Well-funded schemes have the flexibility to shift focus from return generation to certainty of outcome.
Ability and willingness to invest in a broad range of matching assets	Having a wider investment universe than gilts is helpful to achieve effective cashflow matching.

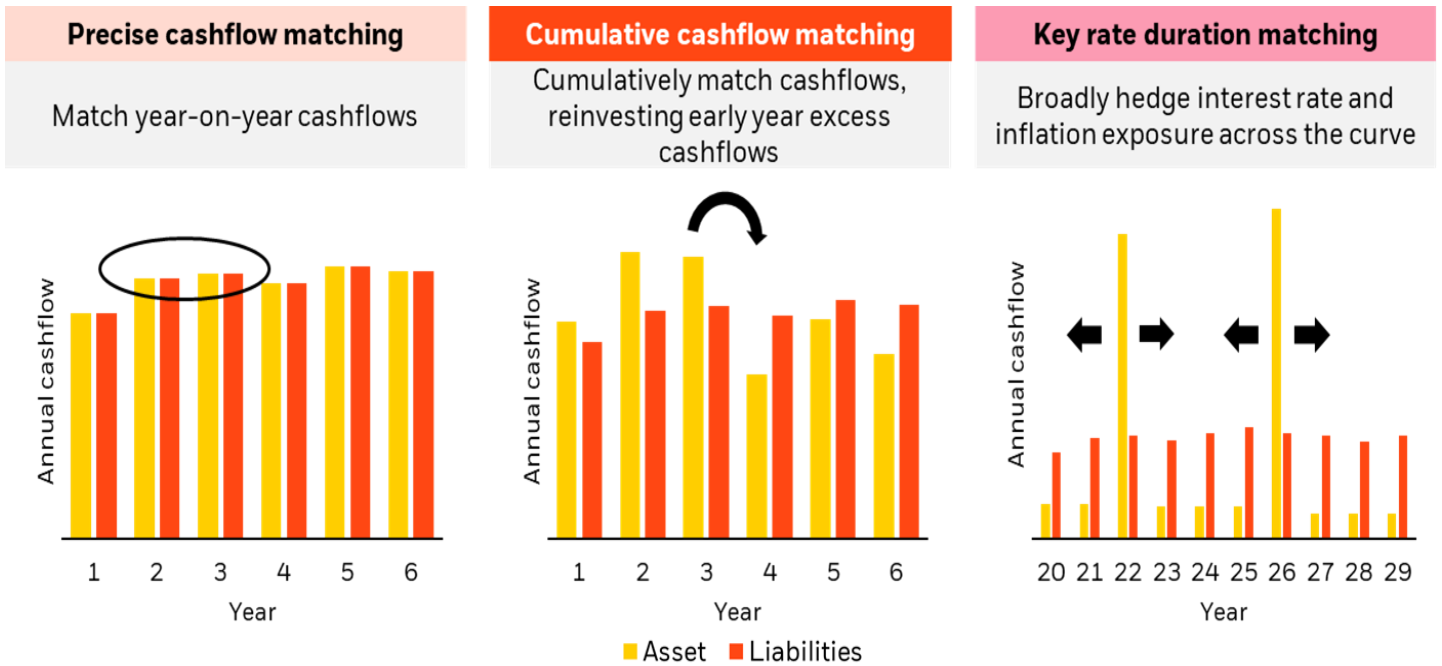
For these schemes, we believe a pragmatic time-bucketed framework offers the most effective way to implement a cashflow matching strategy.

We first need to differentiate between the different ways in which the assets can be aligned with the liabilities:

- **Precise cashflow matching** aims to match cashflows exactly, on e.g. a year-on-year basis.
- **Cumulative cashflow matching** aims to cumulatively match cashflows ensuring there is not a shortfall.
- **Key rate duration matching** aims to align the interest rate and inflation sensitivity of the assets and liabilities across the curve, even if cashflows are not matched.

Cumulative matching usually provides the best balance of predictability and flexibility, ensuring cashflows are met while allowing allocations to shorter-dated assets where more attractive. However, this can introduce reinvestment risk and requires the overall duration profile to be carefully managed, often using derivatives, to maintain alignment with liabilities.

Figure 5: Duration, precise and cumulative matching



Source: BlackRock. For illustrative purposes only and based on BlackRock's views.

We then define a framework that differentiates liability cashflows by time horizon, reflecting both the certainty with which the liabilities can be predicted and the practical constraints of the investable asset universe. In the near term, benefit payments are highly predictable and there is a deep and liquid supply of contractual cashflows, making a high degree of matching both feasible and desirable. Further out, the availability of suitable assets narrows, liability projections become more uncertain, and the cost of precision rises, requiring a more pragmatic approach.

The framework is also informed by drawdown and recovery considerations at the total portfolio level. Ensuring several years of benefit payments are met from contractual asset cashflows materially reduces the risk of forced asset sales following market shocks, allowing growth and return-seeking assets elsewhere in the portfolio time to recover. Beyond this window, the emphasis naturally shifts away from cashflow precision and towards maintaining appropriate interest rate and inflation exposure, flexibility, and robust risk management.

The figure below summarises how these considerations translate into different cashflow matching objectives across three phases, recognising that its application and the duration of the phases will be scheme specific rather than one size fits all.

Figure 6: Cashflow objective should vary by maturity

Phase	Objective	Description	Rationale
Phase 1 (E.g. first 3 years)	Cashflows must be cumulatively matched	Benefit payments must be cumulatively matched by contractual cashflows, ensuring that benefit payments can be met directly from income and principals without the need to sell assets.	This level of precision is achievable at minimal trade-offs in terms of flexibility and asset selection, as a wide range of short-dated assets are available. Maintaining cumulative coverage gives the wider portfolio time to recover from drawdowns or shocks, with growth assets typically regaining value within this window.
Phase 2 (E.g. Years 4 - 20)	Aim to cumulatively match cashflows	The assets should aim to cumulatively match benefit payments, accepting small mismatches where availability limits precision.	Maintaining cumulative alignment across longer maturities provides continuity, as maturing assets naturally replenish the short-term cashflow pool and support overall stability.
Phase 3 (E.g. Year 20+)	Key rate duration match cashflows	Cashflows can only be matched pragmatically at these maturities, as perfect matching is not achievable. The focus is therefore on maintaining appropriate interest rate and inflation duration to manage funding level volatility.	Perfect matching not possible at these maturities. Asset supply is limited and liability projections are more uncertain, reflecting factors such as longevity, transfers out and LPI. Flexibility and strong risk management therefore take precedence over cashflow matching.

By structuring portfolios around the timing of liabilities rather than seeking absolute precision, the assets can deliver predictable cashflows while preserving flexibility to adapt as circumstances change and market opportunities arise.

Conclusion

Cashflow matching can be an important tool for schemes in the endgame, helping manage liquidity, reduce reliance on asset sales and support a more stable funding journey. It can strengthen run-on strategies and aid preparation for a buy-out transaction, and it aligns well with the Funding Code’s focus on resilience, liquidity and governance discipline.

Whether cashflow matching is appropriate and how it is implemented will depend on each scheme’s circumstances, including how well its asset and liability cashflows can be defined, the use of dynamic discounting, its cashflow position and the strength of its funding level.

The aim should not be to eliminate all uncertainty but to manage it in a way that supports long-term resilience and protects funding levels. A pragmatic approach that matches where it matters while retaining flexibility can help Trustees deliver their chosen endgame with confidence while reflecting any market views or opportunities.

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