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CP 157 – Macroprudential measures for GBP Liability Driven Investment Funds

Insight Investment response

January 2024

BNY MELLON | INVESTMENT MANAGEMENT

Executive summary

Insight Investment is one of the UK's largest asset managers. We manage c.£400bn of assets for over 450 UK defined benefit (DB) pension funds, of £607bn in total across our global business.[1] In Ireland Insight Europe is AIFM to a large number of both pooled and single investor LDI sub-funds.

We welcome this opportunity to respond to the Central Bank's consultation on CP 157 – Macroprudential measures for GBP Liability Driven Investment Funds. Since September 2022 we have engaged with the CBI, the FCA, the Bank of England and The Pensions Regulator on the issues experienced by LDI funds in 2022 and the evolving regulatory framework both in Ireland and the UK.

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[1] As at 30 September 2023. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Figures shown in GBP. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services.

Questions and answers

Question 1: Do you have any specific feedback on the scope of the measures and the proposed definition of LDI funds as set out in the consultation paper?

We agree that the definition appropriately defines LDI funds, however, Insight's view is that the scope of the definition should be updated to make the measures only apply to funds with GBP real and nominal rate exposures but should exclude funds with inflation-only exposures. Inflation-only LDI funds differ to interest rate LDI funds as their sole exposure is the future expectation of inflation rates. The table below shows the 7-day worst-case moves across nominal, real and inflation rates and helps illustrate why a different framework is applied to inflation-only funds versus real and nominal rate funds.

7 Day WC	5-year	10-year	20-year	30-year
Nominal	1.57%	1.37%	1.46%	1.54%
Real	1.78%	1.72%	1.84%	1.95%
Inflation breakeven	-1.06%	-0.87%	-0.87%	-0.56%

We are interpreting the reference in 3.2 applying to all GBP-denominated LDI funds as referring to the assets within the portfolio, it would be helpful to clarify this is the intention to prevent Euro or USD LDI funds with GBP-denominated share classes being captured.

We are also assuming all exposures in 3.1 only refers to nominal and real interest-rate sensitivity and not other types of assets where we would have more relevant internal measures and risk frameworks.

Question 2: For the liquidity guidance, would you see merit in setting a minimum speed for the transformation of non-eligible assets into eligible assets (in days)? What would you consider the right minimum number of days, considering the settlement period for posting collateral to maintain leverage (repurchase agreements and/or derivatives)?"

Our view is that requisite speed is sufficient guidance and there is no need to set a minimum speed, the timing as to when margin/collateral must be posted will be influenced by individual managers' ISDA and GMRA terms and managers should be able to justify their chosen approach to the Central Bank.

Question 3: Do you have any specific feedback on the proposed calibration of the measures, including the proposed treatment of third party assets in the yield buffer, the buffer usability proposal and the level of the yield buffer?

We agree that third-party assets should not form part of the yield buffer which should comprise of only assets within the fund.

While we note the 300bp level is consistent with the Central Bank's November 2022 guidance, the proposal is higher than the 250bp level recommendation by the Bank of England and The Pensions Regulator in March 2023.

We suggest the 300bp minimum yield buffer is explicitly defined as the minimum below which funds are expected to promptly initiate a de-leverage process. Without explicit clarity, the reference to a minimum yield buffer is likely to prompt clients to expect managers to initiate recapitalisation processes far above 300bp to ensure 300bp is never breached – negating the point of the buffer.

We support the buffer usability proposal as managers will retain responsibility for de-leverage processes but it will enable the Central Bank to monitor if any managers have inadequate de-leverage processes. For example, if a de-leverage process is too slow the manager runs the risk of being under 300bp for too long; or if a manager does not have a high enough target leverage level post de-leverage (i.e., it does not target an adequate operational buffer), the manager runs the risk of an average falling below 300bp.

Question 4: Do you have any specific feedback with the proposed approach to the implementation of the measures?

We agree with the approach to implementation of the proposals.

Question 5: In addition to the analysis provided in the consultation paper, what potential unintended consequences do you see from the proposed measures, and how could these be mitigated?

The buffer usability proposal seeks to avoid unintentional pro-cyclical dynamics by allowing for one reporting observation to be below 300bp in any four-month period in exceptional circumstances. If that is breached managers may feel they need to de-leverage in a non-routine manner for the following three months to prevent no further breaches, thereby potentially introducing pro-cyclical dynamics.

Question 6: Do you have any further feedback on the proposals outlined in the consultation paper?

The following text in 3.4 should be revised. A fund cannot undertake to **ensure** the position of the investor outside the fund:

> *Furthermore, funds should ensure that their investors are prepared and able to meet capital calls that can be expected in both normal and stressed market conditions.*

We would suggest:

> *Funds should ensure investors are aware that they will need to meet capital calls in both normal and stressed market conditions.*

In terms of liquidity guidance, we suggest increased clarity may be helpful on the following points:

- It would be helpful to make clear that this requires managers to exclude assets already committed to the maintenance of leverage (initial margin, repo haircuts, collateral or margin already posted).
- We also believe it would be useful to have explicit guidance on the requirement for prudence in terms of the valuation of any assets whose realisable value may not be certain. For example, a daily dealing T+1 settlement equity asset may be an asset that can be transformed into eligible assets (cash) with requisite speed, but whose full value should not be relied upon.

Regarding the text in 3.4 (LDI funds should consider **maintaining their yield buffer above 300bp**), we understand the intent is that when funds are at ideal levels of leverage they will have an operational buffer in addition to the minimum buffer. Our view is the word 'target' should be used instead of 'maintain' as maintain could prompt clients to expect managers to initiate recapitalisation processes far above 300bp to ensure 300bp is never breached – negating the point of the buffer.

As was the case with the November 2022 letter we would emphasise the importance of a co-ordinated approach with other European fund domiciles to ensure consistency of requirements.

Contact

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