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Response to the Central Bank of Ireland's Consultation Paper 157 - Macroprudential measures for GBP liability driven investment funds

Executive Summary

Thank you for offering the opportunity to comment on the Central Bank of Ireland's proposal to codify and in certain cases, augment the existing yield buffer measures, including via the use of Article 25 of the Alternative Investment Fund Managers Directive (AIFMD).

Firstly, we would like to acknowledge that we welcome the proposal to strengthen the resilience of Irish authorised GBP denominated LDI by introducing potential enhancements to address specific vulnerabilities amongst GBP denominated liability driven investment (LDI) funds that were highlighted during the 2022 Gilt Crisis.

LGIM Managers (Europe) Ltd. offers investment products and individual client portfolio management services across all the main asset classes via various fund ranges and individual client mandates. The LGIM (Ireland) Risk Management Solutions plc ("LIRMS") fund range offers pension schemes and clients LDI solutions and represents a significant portion of LGIM Europe's overall assets under management (AUM).

Pension funds have used LDI strategies for over two decades years to protect themselves from adverse movements in interest rates and inflation and to reduce the volatility in the funding level of defined benefit pension schemes. LGIM were one of the first asset managers to offer to offer LDI strategies to pension schemes in the UK. LGIM are a prominent entity in the LDI arena responsible for a significant share of the UK LDI pension market.

Responses to the Questions for Considerations are set out below.

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?

The Consultation Paper 157 proposes the following definition for GBP LDI funds:

"Any fund whose investment strategy seeks to match the interest rate or inflation sensitivity of their assets to that of their investors' liabilities."

The definition is reasonable in our view. We note that the definition:

- Doesn't capture stand-alone fixed income funds that use derivatives on a stand-alone basis. For example, an Active Corporate Credit Fund would be excluded.
- If, however, a Fund's Investment Strategy had both an LDI objective sub-fund and a sub-fund which uses other interest rate derivatives (such as the example above), then the whole Fund would be captured.

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)?

We note that the liquidity guidance is as follows, "Funds should ensure that they maintain sufficient holdings of assets which are eligible to meet margin or collateral calls that result from adverse market circumstances, or assets which can be transformed into such eligible assets with requisite speed."

We recognise that additional liquidity guidance for assets that count towards the 300bps would be beneficial; we suggest that the transformation of assets can be used to complete the 300bps buffer, but that it should not include selling assets e.g., it can include repurchase agreements (including repo of corporate bonds).

We don't believe a formal threshold or regulation is required, and instead suggest that parties should consider within their investment framework that:

- There should be an appropriate level of assets that are already eligible assets (without requiring transformation)
- There should be an appropriate allowance for the haircut applied for instruments such as repurchase agreements

Finally, we note that the above comments are consistent with the UK Pension Regulator's (TPR) LDI guidance published in April 2023 which provides specific reference to the issue of liquidity of assets stating that: *"Only assets that can reliably be sourced or converted to eligible collateral in a timely manner should be held in the buffer."*

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 concur with the CBI that only assets held within the Fund should count toward the buffer requirements i.e., no third-party assets. The buffer usability is acceptable however please see further comments in our response to Q6.

We would welcome further clarification as to whether the yield buffer refers just to a change in GBP rates? If, for example, a Fund held non-GBP fixed income assets, are these expected to be stressed as well (and if so, to the same extent that the GBP assets are stressed)?

Question 4

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

We note the proposed timeline and have no major concern regarding the proposed implementation period of three months following the announcement of the measures assuming the guidance remains similar to that which has been proposed in the consultation document.

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?

We note that the proposed measures differ to the recommendations set out by the TPR, who have also provided detailed guidance, and would welcome stronger linkage with the other similar guidance, thereby reducing conflicting or competing requirements. We would raise concerns that the differences between these regimes have the potential to create arbitrage opportunities such that some clients could move away from mandates regulated by the CBI to segregated mandates regulated by the FCA.

Question 6

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

We would welcome further detail in relation to actions required if a Fund falls below the required buffer intra month (if not substantially below the 300bps) and whether any reporting is required of minor deviations of the yield buffer below the 300bps minimum in situations where real-time notification to the CBI was not required (i.e. where the deviation was not substantial or prolonged, and the average over the month was above 300).

Additionally, the paper specifies that "fund managers will only notify the Central Bank that their yield buffer has fallen below 300bps in real time if they expect the deviation to be prolonged and/or substantial".

We note that different fund managers may interpret "prolonged" and "substantial" differently, and this may lead to inconsistent reporting to the Central Bank, therefore it would be useful for the CBI to provide more definitive guidance in these circumstances in terms of their expectations and appropriate actions required. As per above, in these circumstances, what speed of rectification would be needed.

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