Institute and Faculty of Actuaries

Regulatory Board

Noting report

Subject	Actuarial issues arising out of Liability Driven Investments (LDI)	
Regulatory Board meeting	21 February 2023	
Previous Board Update/Steer/Approval	16 November 2022	Update provided to Board
International issues considered?	UK only	
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Reviewer	Emma Gilpin, Head of Regulatory Policy	
Purpose	Noting	

A: Executive summary

1. This Paper provides an update to the Regulatory Board ('the Board') on the actuarial perspective in relation to recent public scrutiny of the use of Liability Driven Investment (LDI) strategies.

2. Following the briefing on issues provided at the November Board meeting, this paper provides an update on the various steps that have been, or will be, taken in response by the IFoA.

B: Background

3. As Board members are aware, there was significant fallout from the impact of the UK Government's 'mini budget' on 23 September 2022 which included volatility in the gilt markets, an impact on UK pension funds and a subsequent debate arising on the use of Liability Driven Investment ("LDI") strategies.

4. As summarised in the briefing report provided at the November 2022 Board meeting, the IFoA took various steps in response to the debate, including participating in discussions with the Joint Forum for Actuarial Regulation ("JFAR"), consideration of a Risk Alert, and submission of a response to the Parliamentary Work and Pensions Select Committee inquiry.

5. Whilst the outcome of the Parliamentary inquiry is awaited, an IFoA review of the circumstances and any actuarial issues that ought to be considered further has commenced and the findings will be presented to the May Regulatory Board.

C: Response of Regulators

6. The Pensions Regulator ("TPR") issued guidance in October 2022 asking pension schemes to review their liquidity and liability hedging and asked that funds consider their plans for increasing resilience to market volatility.

7. On 30 November 2022, a series of co-ordinated statements were published. The regulators in Ireland and Luxembourg (where many pooled LDI investment funds are domiciled) issued statements setting clear expectations for the resilience of LDI portfolios, in particular relating to leverage. The TPR issued a guidance statement in response setting out expectations for trustees on use such pooled LDI funds. A further update is due to be published in the TPR Annual Funding Statement in April. The Financial Conduct Authority ("FCA") also issued a statement, confirming that it expects asset managers "to take any necessary or appropriate action following these communications, and that they operate their products and services in a way that will not create risks to market integrity or financial stability" and has advised that it would publish a further statement on "good practice" in Spring 2023.

8. In its December financial stability report, the Bank of England welcomed the above TPR and FCA guidance, and recommended that, given the identified shortcomings in previous levels of resilience and the challenging macroeconomic outlook, further steps should be taken to "ensure regulatory and supervisory gaps are filled" and make sure LDI funds remain resilient to the higher level of interest rates that they can now withstand. The Bank of England will set out resilience measures for the LDI market in March 2023.

9. The issue of LDI was discussed at the December meeting of JFAR. These recent LDI issues were also used to illustrate in the JFAR Risk Perspective 2022 (published in December) how the interplay between different risks can impact the work of actuaries, investment consultants and others. JFAR concluded that actuaries may wish to reflect, in particular, on: i) whether the models that are being used are fit for purpose; ii) whether there are protections that can be put in place to mitigate unexpected or low probability risks with significant impacts; and iii) whether risks which were identified were clearly communicated.

10. As outlined in the report to the November Board, the Parliamentary Work and Pensions Select Committee conducted an inquiry on 'Defined benefit pensions with liability driven investments'. The inquiry heard from relevant regulators and the IFoA provided a submission. The hearings continued in February 2023 and the Committee has issued a further call for evidence for views on the Bank of England's recommendation (see above), to be submitted by 3 March.

11. The House of Lords Industry and Regulators Committee has also been considering LDI investment. The Committee recently wrote to ministers suggesting "the fundamental issue is that leveraged LDI has been created as a solution to an artificial problem created by accounting standards". It recommended that accounting standards should be reviewed and investment consultants should be further regulated. It also called on the Government to investigate the continuing use of leverage, to collect more information and to give the

Pensions Regulator a statutory duty to consider the impacts of the pensions sector on the wider financial system.

D: IFoA Update

12. The Executive is currently scoping its own review into LDI matters, to explore further potential steps that the IFoA might take to address any issues and support members working in this area. This will focus in particular, on how the Actuaries' Code informs the work of members, whether they are advising pension scheme trustees, working for asset managers providing LDI investment products, or are themselves acting as pension scheme trustees. The results of this review, together with a summary of any outcome from the Work and Pensions Select Committee inquiry will be presented to the Board at its May meeting.

E: CONCLUSIONS

13. The Board is asked to note this paper and provide any initial thoughts on steps to consider.