Macroprudential measures for GBP Liability Driven Investment Funds

CONSULTATION PAPER

Commission de Surveillance du Secteur Financier

Macroprudential measures for GBP Liability Driven Investment Funds

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Commission de Surveillance
du Secteur Financier

Macroprudential measures for GBP Liability Driven Investment Funds

Non-technical summary

The 2022 gilt market crisis highlighted vulnerabilities amongst GBP liability driven investment (LDI) strategies that pose a risk to financial stability. The scale, but especially the pace, of the increase in yields following the 'mini budget announcement' forced GBP LDI funds to sell gilts at a moment of market illiquidity, driving yields higher. To stop this self-reinforcing dynamic, the Bank of England undertook a temporary and targeted intervention in the gilt market.

Against this backdrop, the Commission de Surveillance du Secteur Financier ('CSSF') outlined in November 2022, via an industry letter [1], its supervisory expectations for GBP denominated LDI funds ('GBP LDI funds') in order to maintain an improved level of resilience. This letter was issued following coordination with the Central Bank of Ireland ('CBoI', Ireland's National Competent Authority (NCA)), after interaction with the European Securities and Markets Authority (ESMA). The industry letter outlined that GBP LDI funds were expected generally to maintain the enhanced level of resilience observed at the time, which was resilience to a 300-400 basis point increase in yields (referred to as a 'yield buffer').

This consultation paper outlines a proposal, following coordination with the CBoI, to codify the existing yield buffer measure via the use of Article 25 of the Alternative Investment Fund Managers' Directive ('AIFMD') on the use of information by competent authorities, supervisory cooperation and limits to leverage, as implemented into Luxembourg legislation by Article 23 of the Law of 12 July 2013 on alternative investment fund managers ('AIFM Law'). Building on the November 2022 industry letter, this consultation paper sets forth a policy proposal to strengthen the steady-state resilience of GBP LDI funds managed by Luxembourg Alternative Investment Funds Managers ('LU AIFMs'), specifically:

- GBP LDI funds must maintain a minimum 300 bps yield buffer.
- The yield buffer applies to all GBP LDI funds managed by LU AIFMs.
- All exposures of the funds are to be considered in the yield buffer's calculation. The CSSF contemplates requiring that only assets on the funds balance sheet are considered as components of the yield buffer.
- GBP LDI funds would be required to calculate their monthly average yield buffer at the end of each month. This would be calculated as the monthly average of the yield buffer based on the yield buffer at the end of each business day of the month. The monthly average yield buffer would then need to be reported as a single observation to the CSSF following each month-end and should be greater than or equal to 300 bps.
- In order to provide limited flexibility to facilitate buffer usability, one out of the last four reporting observations (i.e. monthly average yield buffer at the end of each month) can be below 300 bps on a rolling basis in exceptional circumstances. The use of this flexibility will be monitored, with the expectation that it is not used on a regular basis.

1 https://www.cssf.lu/en/2022/11/communication-from-the-cssf-on-liability-driven-investment-funds/

Following the review of the written feedback to this Consultation Paper, it is expected that the CSSF will publish a feedback statement/ announcement of the final measures in the first quarter of 2024. It is proposed that there will be an implementation period of three months following the announcement of the measures. As this is broadly a codification of existing measures, the CSSF does not anticipate that compliance will require substantial adjustments from GBP LDI funds managed by LU AIFMs. Counterfactual analysis suggests that GBP LDI funds would have been less vulnerable to the Gilt market shock of September 2022 if these measures were in place prior to the crisis.

The CSSF invites all stakeholders to provide comments on this Consultation Paper. Please provide feedback by filling in the response form and submitting it to the following address: opc_prud_risk@cssf.lu. The deadline for receiving feedback is **18 January 2024**.

Commission de Surveillance du Secteur Financier

Macroprudential measures for the GBP Liability Driven Investment funds

Following from its industry letter published in November 2022[2] on measures to be taken in relation to the management of LDI funds, the CSSF proposes to codify the existing yield buffer measure for GBP LDI funds managed by LU AIFMs, as outlined in the industry letter, to enhance their steady-state resilience. This codification aims at strengthening the resilience of GBP LDI funds and reducing the probability that such funds contribute to future crises primarily in the UK government bond (gilt) market, thereby mitigating also potential spill-over risks to the European financial system.

1. Understanding the impact of the Gilt market crisis and its implication for Luxembourg[3]

Defined benefit pension funds use LDI strategies for hedging purposes, in order to be able to provide the defined returns to future pensioners. Defined benefit pension funds structurally hold liabilities that have a long-term duration and are exposed to inflation. Against this backdrop, liability driven investment strategies allow pension funds to hedge their assets against the duration and inflation risks linked to their liabilities, whereby some pension funds rely on LDI funds to implement this strategy. To match the duration of the liabilities of their investors while seeking to limit the use of capital, LDI funds tend to use interest rate swap (IRS) positions with a long maturity and typically receiving a fixed rate meanwhile paying a variable rate. In parallel, LDI funds would use their investments in long-dated sovereign bonds as collateral in repo transactions to leverage their exposure and acquire additional sovereign bonds to further amplify their investment returns.

The 2022 gilt market crisis, triggered by the UK government's 'mini-budget', highlighted vulnerabilities among GBP LDI strategies. Following the announcement of an expansionary budget by the UK Chancellor, gilt yields spiked with the 30-year yield increasing by more than 130 basis points between 22 and 29 September (Chart 1). Investors who used LDI strategies faced possible cash flow problems because of this surge. These investors not only included UK-defined benefit pension funds, but also EU-domiciled GBP LDI funds used by those UK pension funds as investment vehicles.

This created pressure for GBP LDI funds to deleverage in order to ensure that their net asset values (NAVs) would not turn negative (forcing them to wind down). Where sufficient capital was not forthcoming from investors to deleverage, funds were forced to sell gilts. However, as pension funds and LDI funds are typically purchasers of long-dated gilts, these forced sales occurred while liquidity in the gilt market thinned, leading to further increases in yields. To halt this self-reinforcing dynamic, the Bank of England engaged in a temporary and targeted intervention to stabilise the gilt market. On 14 October 2022, the Bank of England ended its intervention as volatility of UK gilts interest rates normalised.

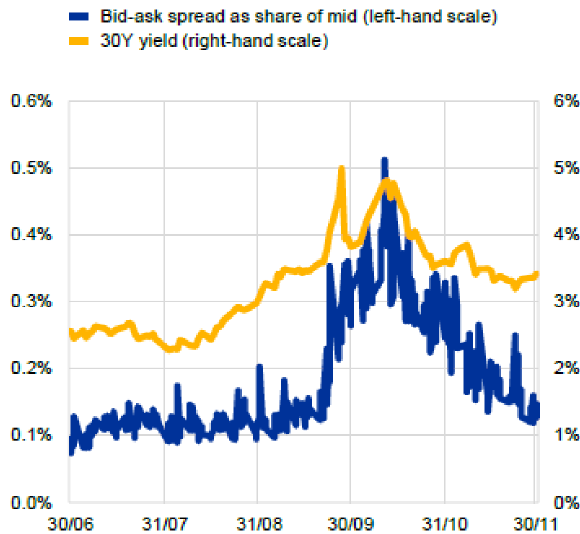
2 https://www.cssf.lu/en/2022/11/communication-from-the-cssf-on-liability-driven-investment-funds/

3 This section is partially based on the section 3.1 – Stress associated with liability driven investment strategies – of the EU Non-bank Financial Intermediation Risk Monitor, ESRB, June 2023

The stresses that GBP LDI funds faced resulted from their use of leverage and larger than usual margin/collateral calls. LDI funds that entered repurchase agreements (repo) and IRS positions needed to provide additional collateral to maintain these positions when gilt yields (or interest rates) increased during the gilt market shock. Given the magnitude and swiftness of the shock, liquid asset buffers (mainly cash and Money Market fund shares), normally sufficient under normal market conditions, depleted rapidly. This created liquidity stress for funds, as they either may not have had sufficient cash or cash equivalents to meet swap margin calls, or may not have had sufficient unpledged assets to meet repo collateral calls (Chart 2). In addition, due to their leverage, declines in the value of assets led to the risk of funds' NAV (i.e. assets - liabilities) turning negative. At this point, a fund would no longer have been able to receive subscriptions and would have had to wind down.[4]

Chart 1: 30-year UK government bond bid-ask spreads and yields (in %).

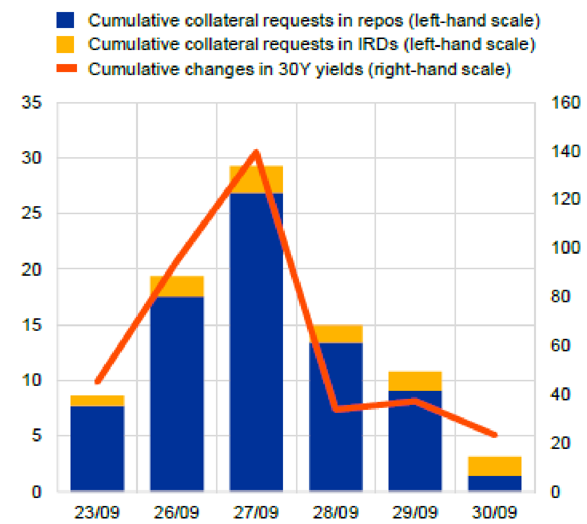
(Percentages)



Source: ESRB, EU NBFI Risk monitor 2023.

Chart 2: Estimated cumulative additional collateral request and cumulative changes in 30-year UK government yields since 23 September 2022.

(left-hand scale: EUR billions; right-hand scale: basis points)



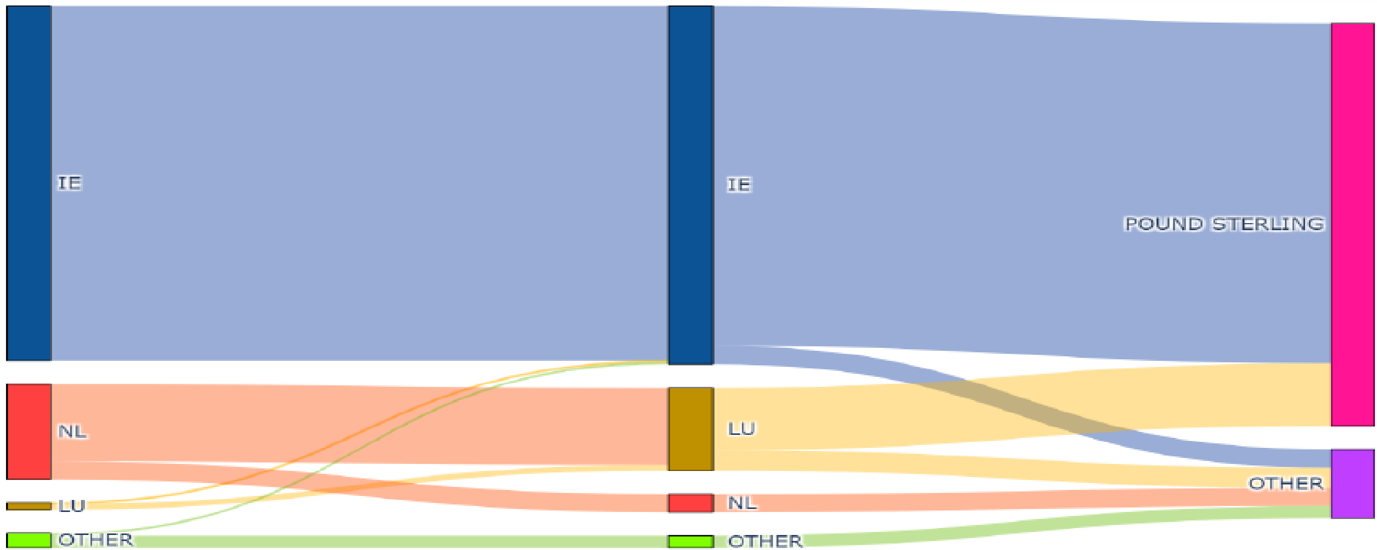
Source: ESRB, EU NBFI Risk monitor 2023.

4 The risk of a negative net asset value (NAV) and a fund running out of assets to meet additional demands for collateral occur simultaneously.

A significant cohort of GBP LDI funds are domiciled in Ireland and, to a lesser extent, in Luxembourg. In its last EU NBFI Risk monitor 2023[5], the ESRB referred, on the basis of the AIFMD data, to around 500 LDI AIFs domiciled in the EU. Those funds are mainly domiciled in Ireland and Luxembourg, whereas their managers are mainly established in Ireland and the Netherlands (Chart 3). The ESRB also highlighted the high concentration of the LDI fund sector as the top three AIF managers account for 90% of the number of LDI funds. The ESRB estimated the total NAV of LDI funds to €250 billion at the end of 2021, the vast majority being denominated in GBP (approximately €230 billion according to the ESRB).

Chart 3: Most EU LDI funds are denominated in GBP to cater to UK investors. Links between domiciles of LDI AIF managers, AIFs and AIF base currency.

(net asset value)



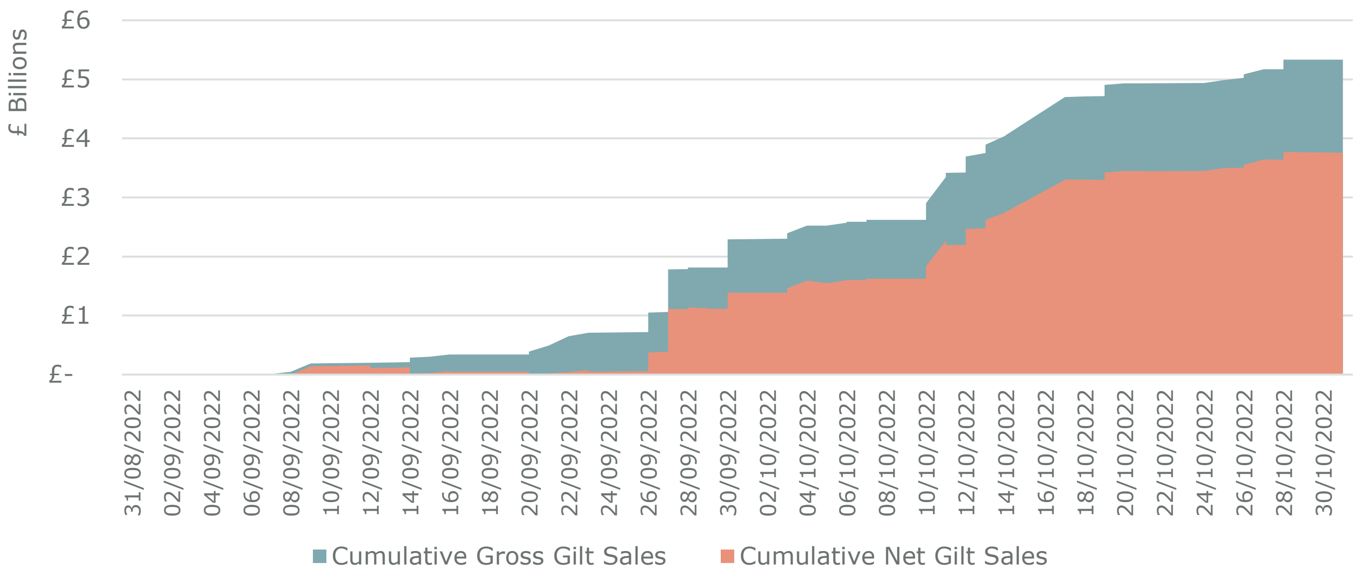
Source: ESRB, EU NBFI Risk monitor 2023.
Notes : The first column represents the AIF manager domicile, the second column shows the AIF domicile and the third column denotes the base currency. The width of the link between columns represents the sum of net asset values. Data are for the end of 2021.

GBP LDI funds, either managed by a Luxembourg AIFM or domiciled in Luxembourg, account for a total NAV of € 20,3 billion as at the end of 2022 and a total NAV of € 27,4 billion as at the end of 2021. This would approximately represent around 12% of the total GBP LDI funds, as at the end of 2021.

[5] https://www.esrb.europa.eu/pub/pdf/reports/nbfi_monitor/esrb.nbfi202306~58b19c8627.en.pdf

Luxembourg-domiciled GBP LDI funds own a noticeable share of UK gilts. During the gilt market crisis, GBP LDI funds, either managed by a LU AIFM or domiciled in Luxembourg, reported £3,7 billion of net gilt sales, with most of those sales being made between the 26 September 2022 and the 14 October 2022 (Chart 4). This represented approximately 10,3% of the total of the estimated total[6] of net gilt sales made by LDI funds and their investors.

Chart 4: Cumulated Gross and Net sales of Gilts recorded in GBP LDI funds domiciled or managed from Luxembourg during the crisis period.

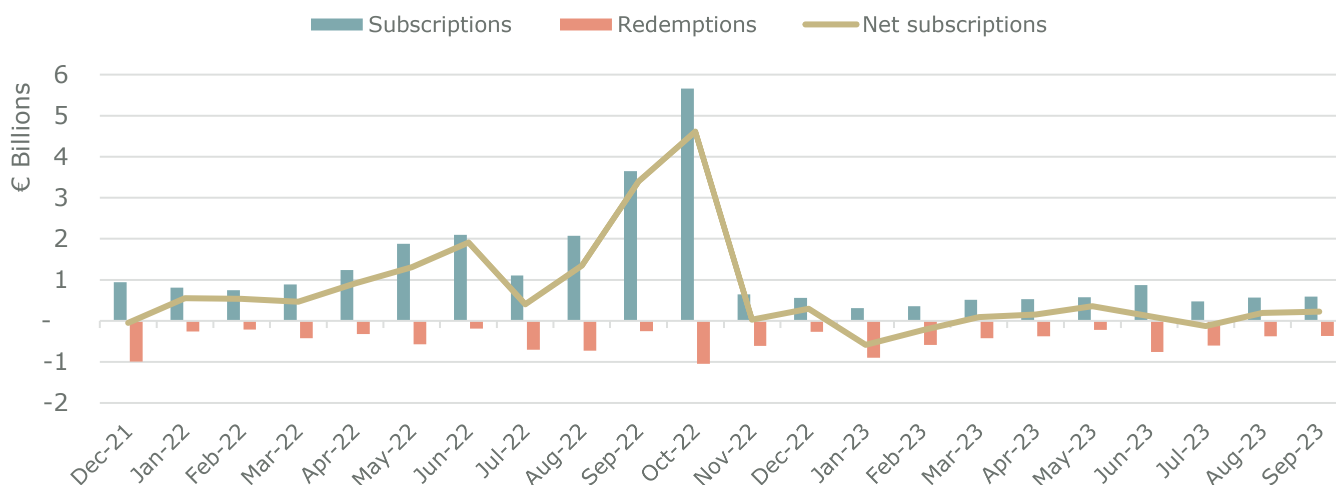


Source: CSSF, Industry survey

GBP LDI funds domiciled in Luxembourg or managed by an LU AIFM were also impacted by this crisis. Managers of those funds experienced larger in size/volume margin/collateral calls to cover their interest rate derivatives exposures or their repo agreements. Higher than usual recapitalisation processes were triggered over the period of September-October 2022 causing the investors to subscribe in the LDI funds (Chart 5). Furthermore, in some cases, managers had to revisit and enhance their capital call processes. At the peak of the stress, some funds had to suspend their NAV for a very short period of time. Few funds also reported an abnormal level of settlement failures with various counterparties, notably resulting from a larger volume of sales of securities within a short timeframe (to cover collateral calls).

[6] In its working paper "An anatomy of the 2022 gilt market crisis", the Bank of England estimated that, between the 23 September 2022 and the 14 October 2022, the total net sales of gilts by the LDI funds and their investors (i.e. pension funds or insurances) amounted to over £36 billion.

<u>Chart 5:</u> Capital flows recorded in GBP LDI funds domiciled or managed from Luxembourg during crisis peak.



Source: CSSF, UCI reporting (U.1.1)

2. The Regulatory Responses to the Gilt Market Crisis

In this context and as initial answer, an industry letter issued in November 2022 by the CSSF, following a series of interactions with the CBoI and the European Securities and Markets Authority (ESMA), outlined a supervisory expectation that GBP LDI funds maintain resilience to a 300-400 basis points (bps) increase in yields. The letter noted the improved resilience to further increases in yields observed at the time and stated that industry participants are expected to maintain that level of resilience. This expectation required that the capital of an LDI fund is not exhausted if yields increase by 300-400 basis points (i.e. its NAV will not turn negative). Any reduction in this resilience needs to be communicated to the relevant NCA, and accompanied by a series of risk assessment and risk management plans. The yield buffer was introduced as a minimum safeguard to maintain the operational and financial resilience of GBP LDI funds, and to reduce the probability that GBP LDI funds would amplify any future shock in the gilt market.

Subsequently, UK regulatory authorities have outlined their own recommendations and guidance on enhancing the resilience of various entities in the LDI sector. On 29 March 2023, the Bank of England staff paper stated recommendations for NCAs to improve the resilience of LDI funds, including a yield buffer recommendation. The CSSF noted the Bank of England staff paper and reaffirmed its expectations that the yield buffer in the region of 300-400 bps, referred to in its November 2022 industry letter, should continue to be observed for GBP LDI funds. The Pension Regulator (TPR) largely adopted the recommendations of the FPC into their guidance for pension fund trustees, including a minimum yield buffer of 250 bps plus an additional (undefined) operational buffer.

Building on the November 2022 industry letter, this consultation paper outlines a policy proposal to strengthen the steady-state resilience of GBP LDI funds managed by Luxembourg-domiciled Alternative Investment Funds Managers ('LU AIFMs'). The CSSF is of the opinion that providing further policy proposal on the yield buffer can address LDI funds' vulnerabilities as it is directly determined by funds' portfolio duration and leverage. The yield buffer is defined as the level of increase in yields that a fund can withstand before its NAV turns negative. It will be codified as an 'other restriction' under Article 23[7] of AIFM Law to address systemic risk posed by leverage. Unlike the November 2022 letter, this measure will therefore only cover the GBP LDI funds managed by LU AIFMs, and not Luxembourg-domiciled GBP LDI funds managed by an EU AIFM.

As was the case with the supervisory measures taken in November 2022, this proposed codification of the yield buffer is being undertaken in conjunction with the CBoI. This will help to keep the yield buffer requirements consistent across the two main places where GBP LDI funds are based, and to follow up on the letter they sent to the industry in November 2022. Engagement on the proposed measures has also occurred with other international and European partners working on LDI fund issues.

3. Key Elements of the Yield Buffer Proposal

3.1 The level of the buffer and its calculation

It is proposed that the yield buffer is set at a 300 bps minimum. This calibration is guided through a combination of analytical evidence and judgement[8] and is consistent with the range of 300-400 bps as set out in the November 2022 letter by the CSSF.

The yield buffer, and its estimation, should consider all exposures that a fund's portfolio contains. This will require funds to develop a weighted average of the interest rate sensitivity of all their exposures to calculate their portfolio duration (and convexity).[9] The yield buffer is approximately equivalent to the assets of a fund not committed to maintain their leverage (i.e. collateral/margin for repo/gilts). The current proposal does not seek to be prescriptive on what these assets should be, but instead supports providing high-level guidance on asset liquidity. Such a high-level approach is consistent with the supervisory expectations set out in the November 2022 letter by the CSSF.

[7] *Article 23(3) AIFMD: "the CSSF (…) shall impose limits to the level of leverage that an AIFM are entitled to employ or other restrictions on the management of the AIF (…)*
[8] *The Bank of England staff paper "LDI minimum resilience – recommendation and explainer" for instance recommended a 250 bps buffer and an additional undefined buffer.*
[9] *Where exposures = assets (excl. m-t-m derivative positions) + net notional of derivative positions.*

It is proposed that targeted guidance on liquidity also accompanies the yield buffer codification proposal, recognising the particular circumstances of LDI funds. The proposed high-level 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.*"

QUESTION 1: Do you consider that the proposed calibration of the minimum yield buffer is appropriate and the calculation of the actual yield buffer sufficiently clear?

QUESTION 2: Would you see merit in setting a minimum speed for the transformation 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)?

3.2 Scope of Measures

It is proposed that the yield buffer will apply to all GBP LDI funds managed by a Luxembourg AIFM. At this point, the CSSF is of the view that these funds, as part of the cohort of EU domiciled GBP LDI funds, can pose a systemic risk given their leverage and concentrated ownership position in the gilt market. Euro-denominated LDI funds managed by a Luxembourg AIFM are out of scope as they do not pose the same risk to the European sovereign debt market given that they hold a much smaller share of the overall market.

The population of GBP LDI funds that the codification would apply to will be identified from their investment strategy. The proposed definition of the LDI strategy is "*Any fund whose investment strategy seeks to match the interest rate or inflation sensitivity of their assets to that of their investors' liabilities*". It will be the responsibility of fund managers to determine whether LDI funds they manage are in scope of the measures.

New funds seeking authorisation as GBP LDI funds managed by a Luxembourg AIFM will be required to notify the CSSF that they are in scope of the measures. The CSSF may conduct thematic analysis on the in-scope population of funds, so managers will need to ensure that this is up-to-date for the funds they manage.

QUESTION 3: Do you agree with the proposed definition of LDI funds? In particular, do you consider that the definition is sufficiently clear and specific (i.e. only covering LDI funds)?

3.3 Third Party Assets

The CSSF is considering to what extent assets owned by LDI funds' investors that the LDI fund is authorised to use can be part of the yield buffer. The inclusion of assets external to the fund's balance sheet could form a potential contagion channel in times of stress. For example, if assets external to the fund are considered as part of the yield buffer, shocks to LDI fund portfolios will be rapidly transmitted to the assets that the LDI manager is authorised to use. In addition, the feasibility of applying a haircut to such external assets is uncertain. Future shocks may not share the same pattern as those that have occurred to date, such that the impact of a given crisis on external assets could be much greater than anticipated by a haircut.

QUESTION 4: Do you agree that LDI funds should not be allowed to consider for the yield buffer calculation any assets that are not part of their balance sheet? If not, please elaborate. In this case, what safeguards should in your view be considered?

3.4 Buffer Usability

A key objective in the design of the yield buffer is that it should be usable and should not lead to procyclical dynamics. It would be counterproductive if funds sell gilts in times of stress in order to meet the yield buffer. If such procyclicality occurred, the replenishment of the yield buffer could replicate the forced sale dynamics observed in the gilt market crisis during a future stress, amplifying any initial shock.

To promote usability of the buffer, the CSSF proposes to adjust how the yield buffer is applied. It is proposed that GBP LDI funds managed by Luxembourg AIFMs would be required to calculate their yield buffer at the end of each month. This would be calculated as the monthly average of the yield buffer based on the yield buffer at the end of each business day of the month. The monthly average yield buffer would then need to be reported as a single observation to the CSSF following each month-end and should be greater than or equal to 300 bps. In order to provide limited flexibility to facilitate buffer usability, it is tolerated that, on a rolling basis, one out of the last four reporting observations (i.e. monthly average yield buffer at the end of each month) be below 300 bps in exceptional circumstances. The use of this flexibility will be monitored, with the expectation that it is not used on a regular basis.

Additionally, the CSSF may temporarily disapply the yield buffer requirement should there be a significant, market-wide shock to financial stability. Disapplication of the yield buffer would be considered in the case of a severe market wide shock or event, where it is anticipated that it may take a substantial period for funds to return to the required levels of resilience, and that forcing them to expedite this process would further amplify the shock. This would ultimately be a judgement, based on the review of a range of data and external indicators, coupled with ongoing market intelligence and firm engagement.

The following example describes how the CSSF envisions these elements combining. Consider a 5-month period. A GBP LDI fund has been maintaining a monthly average yield buffer of 300 bps in each of months 1-3. In month 4 a shock occurs such that the fund expects that there will be a prolonged and/or substantial deviation of the buffer below 300 bps. At this point, the fund should notify the CSSF that such a deviation in the yield buffer has occurred. The fund may be able to recapitalise by month-end such that the monthly average equates to 300 bps. However, if this is not feasible, then the proposed measures provide some limited flexibility that does not require the fund to procyclically deleverage to return to a 300 bps monthly average. In month 4, their monthly average buffer can remain below 300 bps. In month 5, it is expected that by the end of this month the monthly average yield buffer should have returned above 300 bps, unless the CSSF temporarily authorised the dis-application of the yield buffer limit for a longer period of time.

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The 300 bps yield buffer level should be viewed as a minimum, rather than a target. The CSSF anticipates that to avoid the yield buffer deviating below the minimum, GBP LDI funds managed by LU AIFMs should consider maintaining their yield buffer above the 300 bps in order to manage idiosyncratic variations in the value of their portfolio. The CSSF considers that maintaining a yield buffer above the minimum requirement would be prudent, particularly where operational challenges may prevent investors being able to meet capital calls quickly (e.g. if a fund needs to co-ordinate amongst a large number of investors and believes it may be operationally challenging for some investors to meet capital calls in a stress situation). 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.

It is proposed that fund managers will only notify the CSSF that their yield buffer has fallen below 300 bps in real time if they expect the deviation to be prolonged and/or substantial. Minor deviations of the yield buffer below the minimum 300 bps do not need to be reported in real time, thus providing LDI funds with the incentive to re-build their buffers appropriately and without resorting to fire sales of gilts to immediately replenish their yield buffers.

QUESTION 5: Do you consider that the mechanism driving the buffer usability is appropriate and sufficiently clear?

3.5 Reporting

The buffer usability proposal will require changes to the existing LDI data template utilised by peer NCAs, including the CSSF. Following the gilt market crisis, a data template was jointly introduced by the CSSF, the CBoI and the Financial Conduct Authority (FCA) to monitor GBP LDI funds on a weekly basis. In addition to the fields in the existing template, LDI funds will also have to report the monthly average of the yield buffer as described above. This will form part of the ongoing monitoring process by the CSSF and will be used for ongoing supervisory engagement with relevant funds.

4. Implementing the Yield Buffer

The yield buffer will be codified under Article 23 of the AIFM Law transposing Article 25 of the AIFMD**.** Article 23 of the AIFM Law gives powers to impose restrictions on the leverage that AIFMs are entitled to employ with respect to the AIFs they manage, where leverage is judged to contribute to systemic risk or disorderly markets.

It is proposed that the yield buffer would be codified as an 'other restriction' under Article 23 of the AIFM Law, rather than as a single leverage limit. As previously highlighted, the yield buffer will limit each fund's leverage based on the duration of their portfolio. This necessitates the use of an alternative power under Article 23 of the AIFM Law as the CSSF does not intend to codify the yield buffer as a single leverage limit.

The proposed yield buffer would be imposed through Article 23 of the AIFM Law.

Article 23 of the AIFM Law notes: "*The CSSF shall assess the risks that the use of leverage by an AIFM with respect to the AIFs it manages could entail. If the CSSF deems such action necessary in order to ensure the stability and integrity of the financial system, it shall, after having notified ESMA, the ESRB and, if applicable, the competent authorities of the relevant AIF, impose limits to the level of leverage that an AIFM is entitled to employ or other restrictions on the management of the AIF with respect to the AIFs under its management to limit the extent to which the use of leverage contributes to the build up of systemic risk in the financial system or risks of disorderly markets. The CSSF shall duly inform ESMA, the ESRB and, if applicable, the competent authorities of the AIF, of actions taken in this respect, through the procedures set out in Article 50 of Directive 2011/61/EU.*"

It is proposed that there will be an implementation period of 3 months following the finalisation of the codification process. As this is largely a codification of existing measures the CSSF does not anticipate that that compliance will require substantial adjustments for those LDI funds in scope of the measures.

5. Expected Impact of Yield Buffer

The benefits of a yield buffer to investors arise from the reduced probability of a similar crisis reoccurring. If LDI funds are not forced to sell gilts to unwind their leverage, unrealised losses on gilt positions will not be realised by their investors. Equally, other investors in gilts will see less volatility in the performance of their gilts, which is preferable. As gilt yields are core to credit markets generally, there should also be less volatility in rates.

LU AIFMs managing GBP LDI funds have already undertaken significant adjustments to comply with the measures outlined in November 2022's letter. LDI funds now have yield buffers that are above 300 bps, with this adjustment largely coming via deleveraging. In addition, they have incorporated 300 bps as a trigger point at which they request recapitalisations and target a yield buffer level in excess of 300 bps after recapitalisation.

As the CSSF is proposing to codify a yield buffer that funds have already installed following the industry letter, it is anticipated that the initial costs of such a policy have in principle already been absorbed. As funds have already adjusted their yield buffer level, they do not have to sell any additional gilts to deleverage, nor do investors have to provide additional capital to the fund. Any secondary impact from funds and investors activity to come into compliance with the yield buffer will also have been absorbed.

There may be costs that will accrue over time from the immediate costs imposed. If investors have allocated more capital to their LDI funds to maintain the same level of hedging, this capital will not be receiving a superior return on other assets elsewhere. Thus, there may be an opportunity cost for investors, in the form of lower returns for scheme members. Likewise, if LDI funds have less demand for long-ended gilts, then future crises may demonstrate that there is even less liquidity in long-ended gilts.

QUESTION 6: What potential unintended consequences or other impacts (including costs) do you see from the proposed measures, and how could these be mitigated?

QUESTION 7: Do you have any other comment on the proposal?

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6. Providing Feedback

The CSSF invites all stakeholders to provide comments on this Consultation Paper. Please provide feedback by filling in the response form and submitting it at the following address: opc_prud_risk@cssf.lu. The deadline for receiving feedback is **18 January 2024**.

The CSSF requests that reasons are given for the responses to all questions answered and that submissions that suggest changes to the proposals in the Consultation Paper be supported, where possible, by evidence, which will aid our consideration of the issues.

The CSSF intends to make feedback available on its website after the deadline for receiving responses has passed. Please do not include commercially sensitive material in your response, unless you consider it essential. If you do include such material, please highlight it clearly, so that reasonable steps may be taken to avoid publishing that material. This may involve publishing feedback with the sensitive material deleted and indicating the deletions.

While as indicated above, the CSSF will take reasonable steps to avoid publishing confidential or commercially sensitive material, the CSSF makes no guarantee that it will not publish any such information and accepts no liability whatsoever for the stakeholders' consultation responses that are subsequently published by the CSSF. Please be aware that you are making a submission on the basis that you consent to us publishing it in full.

Summary list of questions:

- QUESTION 1: Do you consider that the proposed calibration of the minimum yield buffer is appropriate and the calculation of the actual yield buffer sufficiently clear?
- QUESTION 2: Would you see merit in setting a minimum speed for the transformation 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)?
- QUESTION 3: Do you agree with the proposed definition of LDI funds? In particular, do you consider that the definition is sufficiently clear and specific (i.e. only covering LDI funds)?
- QUESTION 4: Do you agree that LDI funds should not be allowed to consider for the yield buffer calculation any assets that are not their balance sheet? If not, please elaborate. In this case, what safeguards should in your view be considered?
- QUESTION 5: Do you consider that the mechanism driving the buffer usability is appropriate and sufficiently clear?
- QUESTION 6: What potential unintended consequences do you see from the proposed measures, and how could these be mitigated?
- QUESTION 7: Do you have any other comment on the proposal?

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7. Annex – Summary table of measures

Item	**Description**
Buffer level	GBP LDI funds must maintain resilience to a minimum of 300 bps increase in yields.
Scope of buffer	The yield buffer applies to all GBP LDI funds managed by a Luxembourg AIFM.
Definition of GBP LDI funds	The population of GBP LDI funds that the codification would apply to will be identified from their investment strategy: *Any fund whose investment strategy seeks to match the interest rate of inflation sensitivity of their assets to that of their investors' liabilities.*
Buffer composition	The CSSF considers requiring that only assets on the funds balance sheet are included in the calculation of the buffer, and not assets its investors own (but the fund is authorised to use). All fund's exposures considered are to be considered in calculating the buffer.
Reporting	Monthly averages of daily yield buffer are reported at month-end.
Buffer usability	The yield buffer in each reporting observation should be greater than or equal to 300 bps. In order to provide limited flexibility, one of the last four monthly reporting observations can be below 300 bps in exceptional circumstances.
Buffer dis-application	The CSSF may temporarily disapply the yield buffer requirement should there be a significant, market-wide shock to financial stability. This would ultimately be a judgement, based on market intelligence, firm engagement and external indicators.
Liquidity guidance	It is proposed that targeted guidance on liquidity also accompanies the yield buffer. The proposed high-level 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."*

Notification to the CSSF	If funds in scope of the measure anticipate substantive and/or prolonged deviations below 300 bps, they must notify the CSSF.

Commission de Surveillance du Secteur Financier
283, route d'Arlon
L-2991 Luxembourg (+352) 26 25 1-1
direction@cssf.lu
www.cssf.lu