Bank of England

The Rt Hon Sir Stephen Timms MP
Work and Pensions Committee
House of Commons
London
SW1A 0AA

Sarah Breeden
Executive Director for Financial Stability Strategy and Risk and member of the Financial Policy Committee

9 March 2023

Dear Sir Stephen,

Liability Driven Investments (LDI)

Thank you for your letter of 13 February 2023 and for inviting me to give evidence to the Committee as part of its inquiry on defined benefit pensions with Liability Driven Investments (LDI).

I have included answers to the three questions posed in your letter below. During the session, there was also a discussion of the Bank of England's Pension Fund, which I could not answer given my responsibilities as Executive Director for Financial Stability Strategy and Risk, and my position on the Financial Policy Committee (FPC). The Chair of Court, David Roberts, will write to you in due course to address the points raised.

1. **Do you agree that if the Bank of England made a profit of nearly £4 billion on the sale of the gilts it had purchased during its temporary programme, then it follows that pension schemes must have lost by a commensurate amount?**

There is no direct read across from the Bank's profits to any losses for pension schemes. There were many active participants in the gilt market other than the Bank and pension schemes, meaning not all gilts bought by the Bank were sold by pension schemes, and not all gilts sold by pension schemes were bought by the Bank. In addition, the Bank only stepped in on 27 September, whereas schemes and LDI funds were already engaged in forced selling in the days before that. The Bank's profits will also only capture changes to the valuation of the asset side of pension scheme's balance sheets, and so will not capture changes in the value of their liabilities during this period. Because of the impacts on the value of liabilities, the increase in gilt yields in this period actually improved DB pension schemes' overall funding positions, and reduced deficits.

Had the Bank not intervened, losses to pension schemes from forced sales would have been higher. Further falls in gilt prices would have meant a large number of pooled LDI funds could have been left with negative net asset values and faced shortfalls in the collateral posted to banking counterparties. In other words, schemes' investments in those pooled vehicles could have fallen to zero. Had LDI funds then defaulted, the gilts held as collateral by the banks that had lent to LDI funds would then potentially have been sold on the market. This would have further amplified the stresses on the financial system and added to self-reinforcing falls in asset prices, which in turn would have reduced the value of pension scheme holdings of those assets.

2. **You told us that for steady state resilience you would need to have the following data routinely available: "the size of funds, the assets held, their exposure or the leverage and how that associates with the schemes' growth assets." Can you get this information directly from LDI funds? What information can only come from TPR?**

Improving data and closing data gaps is a key aspect of the regulatory response to the LDI episode and will be important in monitoring and enforcing steady state resilience. TPR and other regulators have started work on expanding their data collection with a view to closing existing data gaps.

While in principle the Bank could collect data directly from pension schemes and investment funds, it is more appropriate that TPR and the fund regulators, given their remit as the microprudential/sectoral regulators for these firms, collect data from industry, and that the Bank and FPC can access this data where appropriate, consistent with the approach used in regulating other financial firms.

In determining what additional data will need to be collected as part of steady state resilience, the benefits of additional data will need to be balanced against the burden to schemes and funds in providing this data, which can often be resource intensive (especially for smaller schemes). The FPC is considering what a steady state resilience standard should look like and is working with regulators to ensure data gaps are addressed and resilience maintained in LDI funds.

3. **The earlier panel talked about whether assets could be 'pledged', so that schemes do not need to sell them to meet collateral calls. Is this an option**

you think should be made more widely available in future? If so, what steps are you taking to bring this about?

‘Pledging’ assets is used as part of repurchase agreements (or ‘repo’), whereby a scheme will ‘pledge’ assets as collateral when borrowing, with the lender applying an appropriate haircut. Repo agreements thus allow the pension scheme counterparty to borrow against collateral, rather than forcing the scheme to sell assets which could contribute to market dysfunction.

Many schemes and LDI funds do use repo to borrow at present, and the FPC is currently considering the range of liquidity options including repo that might best support steady state resilience. However, many schemes lack the operational and legal infrastructure to enter into this market, and it can be expensive and resource intensive to set up, particularly for smaller schemes. In addition, repo is not always accessible in practice in stressed markets, and firms may have limited collateral to draw upon quickly in a stress. These factors may form a barrier to repo being more widely used across the market, and its potential to be used as a tool in stress, so any benefits of encouraging repo as a liquidity tool would need to be balanced against these costs.

More broadly, the FPC is working with relevant regulators to consider a range of options to ensure the resilience of LDI funds given the clear systemic impact of their forced asset sales during the September 2022 stress.

Yours sincerely,

Sarah Breeden
Executive Director for Financial Stability Strategy and Risk

Work and Pensions Committee

Sarah Breeden
Executive Director, Financial Stability Strategy and Risk and member of the Financial Policy Committee
Bank of England

Thursday, 9 March 2023

Dear Sarah,

Thank you very much for giving evidence to the Work and Pensions Committee session on defined benefit pensions with Liability Driven Investments. We are grateful to you for being willing to set out your views to us. In particular, we were interested in what you had to say about the importance of understanding what is going on at structural level and the challenges to doing so.

We would be grateful if you could provide further information on the following points:

- Do you agree that if the Bank of England made a profit of nearly £4 billion on the sale of the gilts it had purchased during its temporary programme, then it follows that pension schemes must have lost by a commensurate amount (Q219).
- You told us that for steady state resilience you would need to have the following data routinely available: "the size of funds, the assets held, their exposure or the leverage and how that associates with the schemes' growth assets." (Q261). Can you get this information directly from LDI funds? What information can only come from TPR?
- The earlier panel talked about whether assets could be 'pledged', so that schemes do not need to sell them to meet collateral calls (Q220). Is this an option you think should be made more widely available in future? If so, what steps are you taking to bring this about?

During the course of the evidence session you may not have made all the points that you wished to on the topics we covered. If there is anything further that you would like the Committee to consider, please do email us at workpencom@parliament.uk. We would usually expect to publish anything you send us.

Committee staff will be in touch separately to seek your feedback on the meeting you attended and your experience of the session as a whole. It would be very helpful if you completed the survey, to assist us in improving how we work.

House of Commons
Palace of Westminster
London
SW1A 0AA

workpencom@parliament.uk
+44 (0)207 219 8976

Work and Pensions Committee

Thank you again for your contribution to the Committee's work.

Yours sincerely,

Rt. Hon. Sir Stephen Timms
Chair
Work and Pensions Committee

House of Commons
Palace of Westminster
London
SW1A 0AA

workpencom@parliament.uk
+44 (0)207 219 8976