

**Queen Mary, University of London
The Centre for Commercial Law Studies**

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**LDI Strategies: The Pensions
Regulator on Trial**

**discussant's comments
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Discussant's Comments

Issues

- **What is LDI?**
- **What did LDI become?**
- **How big was/is the problem?**
- **Who should have been regulating it?**

What is LDI?

Very Simply: LDI = pension funds' assets should match their liabilities

- DB pension funds make promises
 - post “Maxwell affair” > contractual obligations
- Liabilities = requirements to pay fixed income stream that is indexed
 - discount at corporate bond rate (contractual obligation is “bond like”) – tPR, IASB, FRS
- Asset should match and be stable (high cost of “guarantees” inc. “put” options)
 - not relying on “growth” assets to meet future liabilities
 - avoiding equities, investing in UK plc, infrastructure
 - but could involve interest rate swaps and currency swaps

What did LDI become?

Very Simply: A complex, “leveraged” product

- Borrowing against gilt holdings to invest in “growth” assets (e.g., equities)
 - leveraging = gearing (so multiples borrowed)
 - rocketing gilt rates > collateral calls > “vicious circles of selling”
 - also falls in in global equity markets and upsets to (commercial) property markets
- But gilt rises had positive impact, too
 - discount rate increased (gilt rate from 0.7% to 3.7% March 2030 to Sept 2022)
 - value of liabilities declined
 - remember: it’s about assets and liabilities matching

How big was/is the problem?

The question: was it a whale or a minnow, a minnow or a fugu?

- Huge values (whale-like)
 - £1tn - £1.4tn of LDI (against £1.5tn of DB assets) (see BoE, Investment Association)
 - £0.5tn losses to DB funds (see CK and IC)
- Small values (minnow-like)
 - £0.2tn in “pooled LDI funds” (see BoE)
 - but pooled funds most open to sudden collateral calls (so also fugu-like)
 - £3bn (£0.03tn) or so of CLOs bought up from UK pension funds (Apollo estimates)

Who should have been regulating it?

The question: Did it fall between silos (pace Gillian Tett)?

- QE11 at LSE (and BoE), re GFC
 - “did nobody foresee this?”
 - multiple SD events
- Role of tPR, BoE, FCA
 - all said, “it wasn’t my job” (see CK and IC), so a real failure at all levels
- Did it involve borrowing, and so illegal?
 - looks like it (CK and IC), and so action needed
- Building nuclear power plants on fault lines in California?