

# Central Bank of Ireland finalises macroprudential measures for GBP denominated LDI funds

May 2024

## Introduction

On 29 April 2024, the Central Bank of Ireland (**Central Bank**) announced the introduction of a macroprudential policy framework for Irish-authorized GBP-denominated liability driven investment funds (**LDI Funds**) aimed at making these funds more resilient to shocks to interest rates in the United Kingdom. In doing so, the Central Bank published its finalised rules for Irish-authorized GBP-denominated LDI Funds (**Framework Document**), as well as publishing its feedback statement to Consultation Paper 157 (**Feedback Statement**).

## Background

In September 2022, GBP-denominated LDI Funds faced acute stress as a result of the sharp increase in GBP yields following the UK's mini-budget announcement, which forced the selling of gilts at a moment of market illiquidity. The subsequent fire sale of gilts by those funds further shocked the market and drove yields higher. In response to this, the Bank of England

intervened in the gilt market which allowed LDI Funds more time to reduce their leverage in an orderly manner.

Against this backdrop, in November 2022, the Central Bank outlined its supervisory expectations for LDI Funds to maintain an improved level of resilience to a 300-400 basis point increase in yields (referred to as a "yield buffer"). In November 2023, the Central Bank consulted on a proposal to codify and augment the yield buffer in order to strengthen the resilience of LDI Funds to reduce the probability that they would amplify any future stress in the UK gilt market.

## Scope of the Framework

The Central Bank has clarified that the new framework applies to Irish-domiciled GBP-denominated funds "whose investment strategy looks to match the sensitivity of their assets to UK interest rates or inflation to that of their investors' pre-defined liabilities".





It has also confirmed that the following funds will fall within the scope of the framework:

- Those funds which combine a GBP-denominated LDI strategy and another strategy; and
- Irish-authorized GBP denominated LDI funds with non-Irish AIFMs.

The Feedback Statement confirms that LDI funds with a GBP-denominated share class but with no GBP exposure will not fall within the scope of the framework. Helpfully, the Framework Document provides a non-exhaustive list of the various different ways in which the Central Bank has seen LDI investment strategies being described in offering documentation/financial statements which is intended to assist managers in assessing whether or not their fund falls within the scope of the new rules.

## Summary of macroprudential policy measures for Irish-authorized GBP-denominated LDI Funds

- **Yield Buffer:** As expected, in-scope funds will be required to maintain resilience of a minimum of 300 bps increase in UK yields with the Central Bank noting in the Framework Document that this should be viewed as a minimum rather than a target and that in certain cases, it may be prudent to maintain a higher yield buffer.
- **Yield Buffer Composition:** The Central Bank has confirmed that (i) "external assets" or "third-party assets"<sup>1</sup> cannot be included in the yield buffer; and (ii) where assets are included in the buffer which are not sensitive to UK rates the risks associated with such assets should be appropriately considered and managed, which includes regular assessments of the fund's resilience to simultaneous shocks to UK rate sensitive and non-UK rate sensitive segments of its portfolio.

<sup>1</sup> These assets are owned by LDI fund investors that the LDI Fund is authorised to use but which are external to the fund.

- **Yield Buffer Liquidity:** The Central Bank has confirmed that assets held within the yield buffer must be sufficiently liquid under both normal and stressed market conditions. Where such assets are not eligible to meet margin or collateral calls, they must be capable of being "transformed into such eligible assets with requisite speed under normal and stressed market conditions".
- **Reporting:** Monthly averages of daily yield buffer and monthly minimums must be reported at month-end.
- **Yield Buffer Usability:** On a rolling basis over the last four reporting observations, one of those reporting observations can report a figure of below 300bps in exceptional circumstances, provided that the fund returns to a 300bps (or higher) monthly average in the following month.
- **Disapplication:** The Central Bank may temporarily disapply the yield buffer requirement should there be a significant, market-wide shock to financial stability.
- **Notification:** A real-time notification to the Central Bank that an in-scope fund's yield buffer has fallen below 300 bps is only required where the AIFM expects the deviation to be prolonged and/or substantial.

## Timeframe for Compliance

Existing Irish GBP-denominated LDI Funds must comply with the new framework by 29 July 2024 while newly approved LDI Funds are required to comply immediately.

Going forward, the Central Bank will require any new funds seeking authorisation as GBP-denominated LDI Funds to notify it that they are in the scope of the framework when they are seeking authorisation from the Central Bank.

If you would like to discuss any of the topics discussed in this publication, please contact the authors or your usual contact in Dillon Eustace.

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