An tÚdarás Pinsean
The Pensions Authority

Investment strategy (liquidity risk) guidance for trustees

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Introduction

This guidance concerns investment strategies that may give rise to significant liquidity risks.

Strategies that may give rise to such liquidity risks include Liability Driven Investment (LDI), leveraged LDI, sale and repurchase agreements (repos), swaps, currency hedging and inflation hedging.

The liquidity risks that may arise from such strategies include the requirement, in certain market conditions, to urgently post collateral so that a derivative or hedging exposure can be maintained.

Such strategies involve more complexity than traditional strategies and may incur losses requiring the liquidation of scheme assets. Therefore, greater understanding and proactivity is required on the part of trustees in managing the risk.

This guidance note sets out areas where, in the Pension Authority's view, special attention is needed to fulfill the requirements of the Authority's Code of Practice for trustees (the Code).

Trustee responsibilities

In the Pensions Authority's view, trustees pursuing an investment strategy which may give rise to significant liquidity risk should:

- particularly with regard to derivative instruments and borrowing, ensure that their investment strategy complies with legislative restrictions on investment[1],
- set out detailed information on the investment strategy in their statement of investment policy principles (SIPP)[2],
- be particularly mindful of the distinct roles of investment advisers and investment managers[3],
- satisfy themselves that their investment managers have the necessary expertise and operational capability[4],
- in conjunction with their advisers, establish a target level of liquidity appropriate to the collateral and cash call requirements that may arise and have a liquidity

[1] Pensions Act, 1990, as amended, sections 59(1)(b), 61B; Occupational Pension Schemes (Investment) Regulations 2021 [S.I. No. 636 of 2021]; Code of Practice for trustees, paragraphs 71, 72, 74, 75, 76.
[2] Pensions Act, 1990, as amended, section 59AB; Occupational Pension Schemes (Investment) Regulations 2021 [S.I. No. 636 of 2021]; Code of Practice for trustees, paragraph 75.
[3] Code of Practice for trustees, paragraphs 72, 80.
[4] Code of Practice for trustees, paragraph 25.

preparedness plan in place to restore the target level of liquidity following adverse market movements or during periods of decreased market liquidity.

The plan could include:

- a prepared asset liquidation program,
- a support agreement with the sponsoring employer[5],

- have operational arrangements in place that ensure that the scheme's decision-making process can cope with rapid market movements[6],

- closely monitor the risks and performance of their investment strategy and include information on these in the trustee annual report[7].

[5] Code of Practice for trustees, paragraph 75.
[6] Code of Practice for trustees, paragraph 70.
[7] Pensions Act, 1990, as amended, section 55; Occupational Pension Schemes (Investment) Regulations 2021 [S.I. No. 636 of 2021].