

IHS Markit Benchmark Administration Limited Consultation on the LGIM Matching Plus and Core Indices – Updated

LONDON, AUGUST 17, 2023: IHS Markit Benchmark Administration Limited (IMBA UK) is conducting a consultation with market participants on potential changes to the LGIM Matching Plus and Core indices.

BACKGROUND

LGIM Matching Core Indices. The indices are designed for pension schemes seeking simple access to a Liability-Driven Investment strategy (LDI) solution in order to reduce funding level volatility caused by changes in sterling interest rates and inflation rates. Each Matching Core index is constructed to hedge a liability cashflow profile.

LGIM Matching Plus Indices. The indices are designed for use by pension schemes to create tailored LDI solutions to hedge sterling interest rate and sterling inflation risk of pension liabilities. Each Matching Plus index is composed of one, two, or four interest rate instruments, including gilt, Inflation-linked gilt, GBP interest rate swap, and GBP inflation swap. The Matching Plus Indices cover the full maturity range and offer both derivatives-based (or swap-based) and bond-based (or gilt-based) hedging solutions.

LDI is an investment strategy for a company or individual based on the cashflows needed to fund future liabilities and is designed for situations where future liabilities can be predicted with some degree of accuracy.

The tables below list the impacted indices:

LGIM Matching Core Indices:

Index Name	Ticker	Formula Categorisation
LGIM LONGFIXED Index	LGIM_LONGFIXED_Portfolio	Type A
LGIM LONGREAL Index	LGIM_LONGREAL_Portfolio	Type A
LGIM SHORTFIXED Index	LGIM_SHORTFIXED_Portfolio	Type A
LGIM SHORTREAL Index	LGIM_SHORTREAL_Portfolio	Type A

LGIM Matching Plus Indices:

Index Name	Ticker	Formula Categorisation
2024 Leveraged Linker Index	LGIM2024LL	Type A
2025 Fixed Swap Index	LGIM2025FS	Type A
2025 Inflation Swap Index	LGIM2025IS	Type A
2025 Real Swap Index	LGIM2025RS	Type A
2030 Fixed Swap Index	LGIM2030FS	Type A
2030 Inflation Swap Index	LGIM2030IS	Type B
2030 Leveraged Linker Index	LGIM2030LL	Type A

Index Name	Ticker	Formula Categorisation
2030 Real Swap Index	LGIM2030RS	Type A
2034 Leveraged Linker Index	LGIM2034LL	Type A
2035 Fixed Swap Index	LGIM2035FS	Type A
2035 Inflation Swap Index	LGIM2035IS	Type B
2035 Real Swap Index	LGIM2035RS	Type A
2037 Leveraged Linker Index	LGIM2037LL	Type A
2038 Leveraged Gilt Index	LGIM2038LG	Type A
2040 Fixed Swap Index	LGIM2040FS	Type A
2040 Inflation Swap Index	LGIM2040IS	Type B
2040 Leveraged Linker Index	LGIM2040LL	Type A
2040 Real Swap Index	LGIM2040RS	Type A
2042 Leveraged Gilt Index	LGIM2042LG	Type A
2042 Leveraged Linker Index	LGIM2042LL	Type A
2045 Fixed Swap Index	LGIM2045FS	Type A
2045 Inflation Swap Index	LGIM2045IS	Type B
2045 Leveraged Gilt Index	LGIM2045LG	Type A
2045 Real Swap Index	LGIM2045RS	Type A
2047 Leveraged Linker Index	LGIM2047LL	Type A
2049 Leveraged Gilt Index	LGIM2049LG	Type A
2050 Fixed Swap Index	LGIM2050FS	Type A
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2055 Leveraged Linker Index	LGIM2055LL	Type A
2055 Real Swap Index	LGIM2055RS	Type A
2060 Fixed Swap Index	LGIM2060FS	Type A
2060 Inflation Swap Index	LGIM2060IS	Type B
2060 Leveraged Gilt Index	LGIM2060LG	Type A
2060 Real Swap Index	LGIM2060RS	Type A
2062 Leveraged Linker Index	LGIM2062LL	Type A
2068 Leveraged Gilt Index	LGIM2068LG	Type A
2068 Leveraged Linker Index	LGIM2068LL	Type A

PROPOSAL

IMBA is considering updating the leverage check method within the methodology of the LGIM Matching Plus and Core indices including the upper, lower, and optimal hedging multiples used. The proposed new method aims to increase the headroom on the funds capturing the impact of the initial margin held within the Matching Plus and Core funds more accurately. The proposed changes are described in the following tables.

CONSULTATION

Matching Plus Indices:

Proposed Change – Matching Plus Leverage Check																													
Proposed Methodology	<p>Section 4.6.1 Hedging Multiples</p> <p>Index Family categorisation used in calculating Hedging Multiples:</p> <table border="1"> <thead> <tr> <th>Index Family</th> <th>Formula Categorisation</th> <th>Effective Interest Rate Curve</th> </tr> </thead> <tbody> <tr> <td>Leveraged Gilt, Fixed Swap</td> <td>Type A</td> <td>OIS Curve</td> </tr> <tr> <td>Leveraged Linker, Real Swap</td> <td>Type A</td> <td>OIS Curve MINUS Inflation Swap Curve (real swap curve)</td> </tr> <tr> <td>Inflation Swap</td> <td>Type B</td> <td>Inflation Swap Curve</td> </tr> </tbody> </table> <p>Parameters used in calculating Hedging Multiples:</p> <table border="1"> <thead> <tr> <th>Parameter</th> <th>Value</th> </tr> </thead> <tbody> <tr> <td>d</td> <td>PV01/10K of the index at Index Business day t</td> </tr> <tr> <td>r</td> <td>Interest rate from Effective Interest Rate Curve calculated at Index Business day t, effective at d at Index Business day t</td> </tr> <tr> <td>ca</td> <td>collateral adjustment, set to 1.1% for Fixed Swap, Real Swap 0.6% for Inflation Swap 1.1% - Leveraged Gilt, Leveraged Linker</td> </tr> <tr> <td>ohr</td> <td>optimal headroom rate, set to 3.50%</td> </tr> <tr> <td>llr</td> <td>lower limit rate, set to 0.50%</td> </tr> <tr> <td>l</td> <td>lagged IM buffer, set to 1%</td> </tr> <tr> <td>f</td> <td>% of fund risk from swaps set to 100% for Fixed Swap, Inflation, Real Swap 0.00% for Leveraged Gilt, Leveraged Linker</td> </tr> </tbody> </table>	Index Family	Formula Categorisation	Effective Interest Rate Curve	Leveraged Gilt, Fixed Swap	Type A	OIS Curve	Leveraged Linker, Real Swap	Type A	OIS Curve MINUS Inflation Swap Curve (real swap curve)	Inflation Swap	Type B	Inflation Swap Curve	Parameter	Value	d	PV01/10K of the index at Index Business day t	r	Interest rate from Effective Interest Rate Curve calculated at Index Business day t, effective at d at Index Business day t	ca	collateral adjustment, set to 1.1% for Fixed Swap, Real Swap 0.6% for Inflation Swap 1.1% - Leveraged Gilt, Leveraged Linker	ohr	optimal headroom rate, set to 3.50%	llr	lower limit rate, set to 0.50%	l	lagged IM buffer, set to 1%	f	% of fund risk from swaps set to 100% for Fixed Swap, Inflation, Real Swap 0.00% for Leveraged Gilt, Leveraged Linker
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Proposed Change – Matching Plus Leverage Check

Current Methodology (continued)	Parameters used in calculating Hedging Multiples:	
	Parameter	Value
	d	Modified Duration of the underlying asset at Index Business day t
	r	Interest rate from Effective Interest Rate Curve calculated at Index Business day t, effective at d at Index Business day t
	ohr	optimal headroom rate, set to 3.00%
	llr	lower limit rate, set to 0.50%
	ulr	Upper limit rate, set to 0.50%
	<u>Section 4.6.2 Hedging Multiple Upper Bound</u>	
	The Hedging Multiple Upper Bounds are defined as below for various index families.	
	Categorisation	Upper Bound
Type A	$MAX(1.2, MIN\left(1 - \left(\frac{1+r}{1+r+ohr-ulr}\right)^d, 7.7\right))^{-1}$	
Type B	$MAX(1.2, MIN\left(1 - \left(\frac{1+r-ohr+ulr}{1+r}\right)^d, 7.7\right))^{-1}$	
<u>Section 4.6.3 Hedging Multiple Lower Bound</u>		
The Hedging Multiple Lower Bounds are defined as below for various index families.		
Categorisation	Lower Bound	
Type A	$MAX(1.0, MIN\left[1 - \left(\frac{1+r}{1+r+ohr+lrr}\right)^d, 5.6\right])^{-1}$	
Type B	$MAX(1.0, MIN\left[1 - \left(\frac{1+r-ohr-llr}{1+r}\right)^d, 5.6\right])^{-1}$	

Matching Core Indices:

Proposed Change – Matching Core Leverage Check

Proposed Methodology	<u>Hedging Multiples</u>	
	Optimal, Upper, and Lower Hedging Multiple formulas:	
	Term	Formula
	Optimal HM	$MAX(1.1, MIN\left[1 + (1+r)^d \cdot \left(ca.f. \left(\frac{1}{(1+r+ohr-l)^d} - \frac{1}{(1+r+ohr-l+0.0001)^d}\right) - \frac{1}{(1+r+ohr)^d}\right)\right]^{-1}, 6.5))$
	Upper HM	$MAX(1.2, MIN\left[1 + (1+r)^d \cdot \left(ca.f. \left(\frac{1}{(1+r+ohr-ulr-l)^d} - \frac{1}{(1+r+ohr-ulr-l+0.0001)^d}\right) - \frac{1}{(1+r+ohr-ulr)^d}\right)\right]^{-1}, 7.7))$
Lower HM	$MAX(1.0, MIN\left[1 + (1+r)^d \cdot \left(ca.f. \left(\frac{1}{(1+r+ohr+lhr-l)^d} - \frac{1}{(1+r+ohr+lhr-l+0.0001)^d}\right) - \frac{1}{(1+r+ohr+lhr)^d}\right)\right]^{-1}, 5.6))$	

Proposed Change – Matching Core Leverage Check		
Proposed Methodology (continued)	Parameters used in calculating Hedging Multiples:	
	Parameter	Value
	d	PV01/10K of the index at Index Business day t
	r	Interest rate from Effective Interest Rate Curve calculated at Index Business day t, effective at d at Index Business day t
	ca	collateral adjustment, set to 1.10%
	ohr	optimal headroom rate, set to 3.50%
	llr	lower limit rate, set to 0.50%
	ulr	Upper limit rate, set to 0.50%
f	% of fund risk from swaps set to 25% for Matching Core Fixed Short 20% for Matching Core Real Short 10% for Matching Core Real Long 0% for Matching Core Fixed Long	
Current Methodology	<u>Index Leverage Rebalance Process – Hedging Multiples Calculation</u>	
	Term	Formula
	Optimal HM	$MAX(1.1, MIN(1 - \left(\frac{1+r}{1+r+ohr+ca}\right)^{d-1}, 6.5))$
	Upper HM	$MAX(1.2, MIN(1 - \left(\frac{1+r}{1+r+ohr+ca-ulr}\right)^{d-1}, 7.7))$
	Lower HM	$MAX(1.0, MIN(1 - \left(\frac{1+r}{1+r+ohr+ca+llr}\right)^{d-1}, 5.6))$
	Parameters used in calculating Hedging Multiples:	
	Parameter	Value
d	Modified Duration of the underlying asset at Index Business day t	
r	Interest rate from Effective Interest Rate Curve calculated at Index Business day t, effective at d at Index Business day t	
ca	collateral adjustment, set to 0.0%	
ohr	optimal headroom rate, set to 3.00%	
llr	lower limit rate, set to 0.50%	
ulr	Upper limit rate, set to 0.50%	

IMBA UK is also considering updating the methodology of the LGIM Matching Core regarding the choice between gilts and swaps. The proposed methodology aims to allow for a more accurate cost evaluation of holding interest rate swaps and inflation swaps.

Matching Core Indices:

Proposed Change – Matching Core Gilts vs. Swaps	
Proposed Methodology	<u>Section 4.1.5</u>
	For each tenor point, the choice between Nominal/Index-linked gilt or Interest Rate/Inflation Swap is made by comparing the Gilt adjusted Z-Spread of the Nominal/Index-linked gilt to the Equivalent Swap Z-Spread . For each tenor point, either a Nominal/Index-linked gilt or a Swap, but not both, is selected. The selection criterion is as follows: a) Fixed Indices: 1. if (Gilt adjusted Z-Spread > Equivalent Swap Z-Spread Fixed), then choose Gilt; 2. if (Gilt adjusted Z-Spread <= Equivalent Swap Z-Spread Fixed), then choose swap. b) Real Indices: 1. if (Gilt adjusted Z-Spread > Equivalent Swap Z-Spread Real), then choose gilt; 2. if (Gilt adjusted Z-Spread <= Equivalent Swap Z-Spread Real), then choose swap.

Proposed Change – Matching Core Gilts vs. Swaps	
Proposed Methodology (continued)	<p><u>Section 4.1.6</u></p> <p>For each tenor point, compare the selections in step 5 to the corresponding instrument of the tenor in the Current Portfolio to determine the Optimal Selection, only where the asset determined by step 5 is not already present in the Current Portfolio:</p> <p>a. Fixed Indices:</p> <ol style="list-style-type: none"> 1. If $(\text{Gilt_adjusted_Z-Spread} - \text{Equivalent_Swap_Z-Spread_Fixed}) > 2.5\text{bps}$, then switch from swaps to gilts; 2. if $(\text{Gilt_adjusted_Z-Spread} - \text{Equivalent_Swap_Z-Spread_Fixed}) < -2.5\text{bps}$, then switch from gilts to swaps. <p>b. Real Indices:</p> <ol style="list-style-type: none"> 1. If $(\text{Gilt_adjusted_Z-Spread} - \text{Equivalent_Swap_Z-Spread_Real}) > 3\text{bps}$, then switch from swaps to gilts; 2. if $(\text{Gilt_adjusted_Z-Spread} - \text{Equivalent_Swap_Z-Spread_Real}) < -3\text{bps}$, then switch from gilts to swaps.
Current Methodology	<p><u>Section 4.1.5</u></p> <p>For each tenor point, the choice between Nominal/Index-linked gilt or Interest Rate/Inflation Swap is made by comparing the Z-Spread of the Nominal/Index-linked gilt to its funding cost. For each tenor point, either a Nominal/Index-linked gilt or a Swap, but not both, is selected. The selection criterion is as follows:</p> <p>a. if $(\text{Z-Spread} > \text{Long Term Repo Funding Spread})$, then choose gilt;</p> <p>b. if $(\text{Z-Spread} \leq \text{Long Term Repo Funding Spread})$, then choose swap.</p> <p><u>Section 4.1.6</u></p> <p>For each tenor point, compare the selections in step 5 to the corresponding instrument of the tenor in the Current Portfolio to determine the Optimal Selection, only where the asset determined by step 5 is not already present in the Current Portfolio:</p> <p>a. Fixed Indices:</p> <ol style="list-style-type: none"> 1. If $(\text{Z-Spread} - \text{Long Term Repo Funding Spread}) > 2.5\text{bps}$, then switch from swaps to gilts; 2. if $(\text{Z-Spread} - \text{Long Term Repo Funding Spread}) < -2.5\text{bps}$, then switch from gilts to swaps. <p>b. Real Indices:</p> <ol style="list-style-type: none"> 1. If $(\text{Z-Spread} - \text{Long Term Repo Funding Spread}) > 3\text{bps}$, then switch from swaps to gilts; 2. if $(\text{Z-Spread} - \text{Long Term Repo Funding Spread}) < -3\text{bps}$, then switch from gilts to swaps.

IMPACT ANALYSIS

IMBA UK has analyzed the impact of the proposed changes for the period between June 30, 2023 and July 31, 2023, for selected indices and found:

- the proposed leverage check approach reduced the leverage of the index at the beginning by an average of 10% and controlled the leverage at a low level over time.
- the proposed rule on the choice of gilts and swaps promoted an increase in the usage of gilts and inflation-linked gilts in the portfolio for the month-end rebalance of July 2023.

A theoretical pro-forma portfolio incorporating the proposed methodology changes above can be found [here](#).

IMPLEMENTATION TIMING

IMBA UK is proposing to implement the previously described methodology changes, if adopted, in conjunction with the August 2023 month-end rebalancing, which takes effect prior to the market open on **September 1, 2023**.

CONSULTATION

QUESTIONS

Please answer the following questions and provide IMBA UK with the reasoning behind your answers:

1. **Should the proposed methodology change for the Matching Plus Leverage Check be adopted?**
2. **Should the proposed methodology change for the Matching Core Leverage Check be adopted?**
3. **Should the proposed methodology change for the Matching Core Gilts vs. Swaps evaluation be adopted?**
4. **Do you agree with the proposed implementation date?**
5. **Do you have any other comments or feedback regarding the proposed changes outlined above?**

Your participation in this consultation is important as we gather information from various market participants in order to properly evaluate your views and preferences on the proposal herein and the suggested timetable for its implementation. Please respond to this survey by **August 21, 2023**. After this date, IMBA UK will no longer accept survey responses. Prior to the Index Committee's final review, IMBA UK may request clarifications from respondents as part of that review.

To participate in this consultation, please visit the online survey available [here](#).

Please be advised that all comments from this consultation will be reviewed and considered before a final decision is made; however, IMBA UK makes no guarantees nor is under any obligation to comply with any of the responses. The survey may result in no changes or outcome of any kind. If IMBA UK decides to change the index methodology, an announcement will be posted on our website.

Thank you for taking the time to complete this survey.

For further information about this consultation, please contact IMBA UK at SPDJI_Index_Governance@spglobal.com.

FOR MORE INFORMATION:
indices@ihsmarkit.com