Response to Bank of England discussion paper on gilt repo market resilience

Insight Investment

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Executive summary

Insight Investment is one of the largest investment managers in the UK, managing assets for UK defined benefit (DB) pension schemes, as well as insurers, sovereign wealth funds and financial institutions.

In this response to the Bank of England discussion paper on measures to enhance gilt repo market resilience[1], we will focus only on the relevance to and implications for UK DB pension schemes, which make extensive use of gilt repo. Our response applies to DB schemes' use of repo in general, whether through segregated portfolios (regulated by The Pensions Regulator) or pooled arrangements (regulated by local authorities). With regard to UK DB schemes, we would like to highlight the following key points.

- **DB pension schemes are safe, long-term investors:** DB scheme liabilities are long term and closely matched by their assets, and any gilt repo they use are collateralised daily. From a credit risk perspective, DB pension schemes present a much lower risk profile than other leveraged market participants.
- **Centrally cleared gilt repo are a positive development with regard to market resilience, and an additional market tool that can be helpful for DB schemes, but mandating clearing of gilt repo for DB schemes would have significant negative consequences.** For similar reasons, DB schemes are exempt from mandatory clearing of derivatives.
- **A one-size-fits-all approach to minimum haircuts on gilt repo would lead to unintended consequences, especially for DB schemes.** We do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial, and they could lead to significant additional costs and other undesirable risks; schemes could, for example, bear significant increased risk exposure to counterparties.

Insight is delighted to provide this response to the discussion paper, and hope that any resulting measures serve to enhance resilience in the gilt market as intended.

Background: How DB schemes use gilt repo

A DB pension scheme can invest so that the value of its assets changes in line with changes in the value of its liabilities in response to movements in interest rates and inflation. This is typically known as liability hedging, or hedging liability risks.

Many pension schemes invest in bonds to hedge their liability risks. Bonds, such as gilts, offer a predictable schedule of future payments and, like liabilities, they change in value in response to movements in interest rates (and inflation too, for certain bonds). However, the more that a scheme invests in bonds to hedge liability risks, the less it can invest elsewhere for growth to close any funding deficit or grow any surplus.

As a result, many pension schemes have adapted their bond portfolios and supplemented them with partially funded instruments such as repurchase agreements (repo). For example, an illustrative DB scheme may have £100 of liabilities. If the scheme holds £50 in gilts and £50 in growth assets, to increase its liability hedge, it may repo the £50 of gilts in order to fund the purchase of £50 more gilts. This would be a prudent approach to hedging all £100 of its liabilities.

Our estimates suggest that DB schemes' use of gilt repo could be as much as £300 billion, which is much larger than centrally collected data suggest. As a result, the impact of introducing either central clearing or minimum haircuts for gilt repo used by DB schemes could amount to billions of pounds of additional costs for schemes, and could be very significant for the wider financial system.

[1] Enhancing the resilience of the gilt repo market, 4 September 2025, Bank of England.

Questions and answers

Q1. Do you agree with assessment of the gilt repo market dynamics described in Section 2? Are there any further dynamics that you would highlight, beyond those identified above? Which of the issues described in Section 2 do you see as key risks to gilt repo market resilience, given current market structure?

Insight Investment broadly agrees with the assessment presented in Section 2 of the Bank's discussion paper.

With regard to gilt repo market dynamics, we would like to highlight the following points.

- Compared with hedge funds and some other financial institutions active in the repo market, DB pension schemes operate under fundamentally different incentives and regulatory constraints. Their liabilities are long term and closely matched by their assets; any gilt repo they use are collateralised daily; and they are closely regulated by The Pensions Regulator.
- DB pension schemes are incentivised to minimise overall balance sheet risk and increase the certainly of being able to pay member benefits. This means that any leverage taken via the repo market is calibrated to reduce overall balance-sheet risk rather than maximise returns.
- Our estimates suggest that DB schemes' use of gilt repo could be as much as £300 billion, which is much larger than centrally collected data suggest.
- Since the 2022 gilts crisis, DB schemes have undertaken substantial measures to strengthen their resilience. They have increased operational liquidity buffers, implemented stricter collateral management practices, and enhanced governance around liquidity and counterparty risk. These built on regulation that already restricted the amount of leverage DB schemes might take on.
- To address challenges that remain, DB schemes have developed and use corporate bond repo and total return swaps to offer greater flexibility in accessing secured funding and managing collateral.
- Low haircuts on gilt repo reflect, in our view, netting relationships and commercial conditions; they do not indicate market failure.
- We welcome the introduction of the Bank of England's Contingent Non-Bank Financial Institution Repo Facility (CNRF): it is an important development that is positive for the market. However, it is important to note that the CNRF would not have prevented the September 2022 crisis, which was a result of the scale and speed of collateral calls, to which DB schemes struggled to respond. The CNRF would not have helped schemes to respond to this challenge.

Q2. What is your view on the potential benefits, risks and broader market implications of greater central clearing of gilt repo? To what extent do you expect greater central clearing, especially in the dealer-to-client segment, would expand dealers' gilt repo intermediation capacity in normal times and in stress? To what extent would greater central clearing reduce counterparty credit risk exposures as well as uncertainty during periods of stress and counterparty defaults, and increase market participants' appetite to extend further gilt repo lending? How do you expect dealers would deploy any additional capacity, both in stress and in stable market conditions?

Centrally cleared gilt repo are a positive development with regard to market resilience, and an additional market tool that can be helpful for DB schemes.

For certain DB schemes, particularly those with more sophisticated operational capacity or a desire for reduced counterparty risk, the ability to access cleared repo provides valuable flexibility. Cleared gilt repo have the potential to help enhance overall market liquidity and resilience, by encouraging broader participation and standardisation without imposing uniform operational costs and liquidity constraints across all DB pension funds.

However, whilst clearing offers some benefits, for buy-side entities it can concentrate counterparty risk in a limited number of clearing providers, particularly in a principal-to-principal model. For DB schemes these risks could be mitigated by:

1. enabling DB schemes to manage risk by diversifying and spreading trading between cleared and non-cleared repo,

2 providing meaningful incentives for clearing service providers to enter and support this market, and

3 innovation at clearing houses to encourage the development of alternative cleared models that better balance risk between participants.

Separately, we note that mandating central clearing of gilt repo for DB pension schemes would not be appropriate given significant negative consequences: for similar reasons, DB schemes are exempt from mandatory clearing of derivatives. We summarise these reasons below.

- **Initial margin requirements:** Mandatory central clearing introduces significant liquidity risks for DB schemes. The requirement to post collateral for initial margin ties up valuable liquid assets, which could otherwise be used to support ongoing scheme operations or target investment growth.
- **Variation margin requirements:** The need to provide cash for variation margin, particularly in volatile market conditions, would force DB schemes to hold a larger proportion of assets in cash or liquid government bonds. This inevitably reduces their ability to allocate assets toward higher-returning, growth-oriented investments, potentially undermining long-term funding objectives.
- **Another potential outcome is that DB schemes have to then extend their gilt repo exposure to fund increased variation margin requirements – exacerbating the very risk identified by the system-wide exploratory scenario.**
- **Clearing fees:** A clearing house (central counterparty) charges central clearing fees to cover the costs of clearing, risk management, settlement and default management, which are not required in a bilateral agreement.

The discussion paper notes that the costs of clearing for DB schemes are likely to be higher in paragraph 44:

> "In general, we expect the impact [of higher repo trading costs resulting from central clearing] may be largest for market participants with directional repo positions such as pension schemes and LDI funds, who take positions in longer-dated gilts to hedge long-dated liabilities for pensioners and therefore are likely to incur greater margin costs under central clearing."

Our estimates suggest that DB schemes' use of gilt repo could be as much as £300 billion (which is much larger than centrally collected data suggest). Assuming an initial margin requirement of 3%-5% (in line with the average levels we observe in the market), this would equate to £9 billion to £15 billion.

If a DB scheme seeks to generate 1%-4% on non-hedging assets, and it gives up £9 billion to £15 billion of such assets to fund this initial margin requirement, this would equate to giving up £90 million to £600 million of returns per annum. Over a decade, this would amount to £900 million to £6 billion. Such figures illustrate how large the impact of introducing mandatory clearing for DB schemes could be for the wider financial system.

Q3. How do you expect greater central clearing would impact the build-up and unwind of highly leveraged, concentrated trading strategies in the gilt repo market? Which market activities and types of participants do you expect would be most affected?

In principle, central clearing could dampen the build-up of highly leveraged or concentrated positions by increasing transparency and imposing consistent risk management standards.

However, as noted in our response to Question 1, compared with hedge funds and some other financial institutions active in the repo market, DB pension schemes operate under fundamentally different incentives and regulatory constraints. Their liabilities are long term and closely matched by their assets; any gilt repo they use are collateralised daily; and they are closely regulated by The Pensions Regulator.

Therefore, mandatory central clearing would introduce significant risks for DB schemes, as outlined in our response to Question 2. An example was provided in the gilts crisis of 2022, when a dramatic increase in the margin required on cleared swaps forced some DB schemes to sell gilts.

Q4. What would the largest impacts of greater central clearing be for market participants? How would it affect your business model/trading strategies and what actions would you take in response? How would greater central clearing impact cash gilt market liquidity and pricing? Please provide worked examples or quantitative evidence where possible.

Mandatory central clearing would introduce significant risks for DB schemes, as outlined in our response to Question 2. An example was provided in the gilts crisis of 2022, when a dramatic increase in the margin required on cleared swaps forced some DB schemes to sell gilts.

Q5. To what extent do you think market participants would be prepared to manage the potential increases in liquidity needs that could come with greater central clearing in the gilt repo market? Which policy initiatives might be able to help mitigate this risk?

Mandatory central clearing would introduce significant risks for DB schemes, as outlined in our response to Question 2. An example was provided in the gilts crisis of 2022, when a dramatic increase in the margin required on cleared swaps forced some DB schemes to sell gilts.

Most DB pension schemes are operationally prepared for increased liquidity requirements, especially following recent episodes of market stress.

However, to mitigate the potential impact of funding initial margin requirements on cleared gilt repo, DB schemes might decide to hold additional liquidity. This would sit on top of additional buffers already established in the aftermath of the gilts crisis, reducing their ability to allocate assets toward higher-returning, growth-oriented investments, potentially undermining long-term funding objectives.

Q6. Do you see any risks to financial stability generated by an increase in centrally cleared gilt repo activity at CCPs and, potentially, a limited number of sponsoring banks? In your view, how material are these risks, and how could they be best mitigated?

As noted in our response to Question 2, whilst clearing offers some benefits, including netting and operational efficiencies, for buy-side entities it can concentrate counterparty risk in in a limited number of clearing providers, particularly in a principal-to-principal model.

For DB schemes these risks could be mitigated by:

1 enabling DB schemes to manage risk by diversifying and spreading trading between cleared and non-cleared repo,

2 providing meaningful incentives for clearing service providers to enter and support this market, and

3 innovation at clearing houses to encourage the development of alternative cleared models that better balance risk between participants.

On the latter point, we note that there is some innovation occurring in the US as clearing houses compete for business ahead of the 2027 implementation of mandated central clearing.

Q7. In your view and given your business model, what are the costs and benefits of different clearing models? What are the key features of a central clearing model which maximises benefits to market resilience and financial stability while minimising any potential increase in trading costs?

Broadly speaking, there are three different clearing models in the market for buy-side entities: direct membership, the intermediated model, and the sponsored model.

1 **Direct membership with a clearing house:** This leads to obligations that DB schemes are typically less equipped to manage (such as daily management of cash margin).

2 **Intermediated model, where the buy-side entity uses the services of a clearing member bank:** Under this model, DB schemes are exposed to credit risk through its relationship with the clearing member bank, and overall risk is concentrated given the small number of clearing members.

3 **Sponsored model, where the buy-side entity joins a clearing house with the support of a clearing member bank:** Under this model, while the buy-side entity faces the clearing house directly, the bank provides some of the essential services such as management of daily cash margin and the clearing house default fund.

We favour the sponsored model for our DB scheme clients, as it allows them to clear without the additional obligations of a direct member, and without the additional risk exposure that comes with facing a clearing member bank.

Cleared repo can be competitive in normal market conditions, when coordinated with counterparty/market appetite and there is a dependence on having economically viable collateral available for a trade. Cleared repo levels are rarely advantageous over standard bilateral trades when these factors do not apply. However, in stressed market conditions, we have observed wider bid-offer spreads on bilateral repo, and on occasion these have been wide enough for cleared repo to be cheaper. As noted in our response to Question 2, whilst clearing offers some benefits, including netting and operational efficiencies, for buy-side entities it can concentrate counterparty risk in in a limited number of clearing providers, particularly in a principal-to-principal model.

For DB schemes these risks could be mitigated by:

1 enabling DB schemes to manage risk by diversifying and spreading trading between cleared and non-cleared repo,
2 providing meaningful incentives for clearing service providers to enter and support this market, and
3 innovation at clearing houses to encourage the development of alternative cleared models that better balance risk between participants.

On the latter point, we note that there is some innovation occurring in the US as clearing houses compete for business ahead of the 2027 implementation of mandated central clearing.

Q8. To what extent could incentives achieve a sufficient expansion in central clearing to deliver meaningful benefits to the resilience of the gilt repo market? Would a clearing mandate be necessary?

As stated in our response to Question 2, mandating central clearing of gilt repo for DB pension schemes would not be appropriate, for similar reasons to why mandatory clearing of derivatives is unsuitable. DB schemes are exempt from the latter given the negative implications of mandatory central clearing, and we believe DB schemes should also be exempt from a mandatory requirement to clear gilt repo.

However, as also noted in our response to Question 2, centrally cleared gilt repo are a positive development with regard to market resilience, and an additional market tool that can be helpful for DB schemes.

Q9. What is your view on the potential benefits, risks and broader market implications of introducing minimum haircut on non-centrally cleared gilt repo transactions? To what extent could minimum haircuts effectively address observed market failures around margining practices in the non-centrally cleared gilt repo market? To what extent would this measure reduce counterparty credit risk and uncertainty during periods of stress, and bolster market participants' appetite to extend further repo lending?

Overall, we believe a one-size-fits-all approach to introducing minimum haircuts on gilt repo will lead to unintended consequences, especially for DB schemes.

- **We do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial, and they could lead to significant additional costs and other undesirable outcomes.**
- **Unlike hedge funds and some other financial institutions active in the repo market, pension schemes operate under fundamentally different incentives and regulatory constraints.** Their liabilities are long term and closely matched by their assets, and any gilt repo they use are collateralised daily. From a credit risk perspective, DB pension schemes present a much lower risk profile than other leveraged market participants.
- **If haircuts are mandatory for DB schemes, their exposure to credit risk would increase.** This is because when a DB scheme conducts a gilt repo, it lends gilts to a counterparty bank in return for cash, which the scheme typically uses to purchase more gilts. If a material haircut is paid to the bank and the bank fails, the pension scheme will be financially exposed (due to overcollateralisation), because the amount of cash it has received only reflects the value of gilts delivered on the initial transaction – not the additional value of the haircut. DB schemes invest mostly in long-dated gilts, which would bear larger haircuts, so this amount could be substantial. The resulting loss of collateral would reduce the security of members' benefits.
- **An increase in exposure to credit risk could lead DB schemes to pursue sub-optimal approaches that would not add resilience to the financial system.** For example, they may pursue shorter repo terms, reducing funding

> stability; halt trading and remove exposures to counterparties with deteriorating credit quality, which could exacerbate market stresses; or introduce break clauses in repo terms, re-risking the financial sector. Demand may also increase for short and medium-term gilts for financing purposes, which might impact longer-dated issuance even further. It would also potentially increase risk by concentrating the gilt market among fewer counterparties.

The International Capital Market Association (ICMA) draws attention to relevant dynamics in its paper Demystifying Repo Haircuts (link). It states (emphasis in original):

> When thinking about policy interventions with respect to haircuts, perhaps the starting point should be to ask the question: *what are we trying to solve?*
>
> If the aim is to constrain leverage, is regulating haircuts on individual transactions the most effective and direct policy tool? It is true that in the case of financing trades repo can provide leverage, and that haircuts, or any form of initial margin, naturally reduce the quantum of leverage. However, different entities have very different leverage profiles, the appropriateness of which can vary over time, and that can only be measured meaningfully at a holistic entity level. Furthermore, haircuts are not intended to curb leverage: they are primarily a management tool for liquidation risk.
>
> It has also been touted that applying minimum haircuts in the non-centrally cleared market would create a level playing field for CCPs in the bid to attract more repo into clearing. But comparing bilateral transactions with central clearing is a misleading parallel, with a different set of risk management considerations and objectives. If anything, a better solution would be to work on removing any unnecessary barriers to central clearing, such as capital costs for sponsors, counterparty concentration limits with CCPs, collateral eligibility, or limitations on collateral re-use by certain entities.
>
> Since haircuts are effectively an opaque additional transaction level cost for one of the counterparties, they potentially have a distortive effect on pricing and activity, which has implications for market efficiency. This needs to considered in light of the many uses of repo, which is far broader than leveraged finance, and includes funding market making and liquidity provision in the underlying market, as well as central bank monetary policy transmission. A further unintended outcome could be to incentive market participants to transition from using repo to economically equivalent products.

Q10. To what extent could minimum haircuts help dampen procyclical increases in haircuts in stress? What is your view on the materiality of this benefit in the context of broader liquidity shocks that repo market participants may face?

As noted in our response to Question 9, we do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial.

Q11. How do you expect minimum haircuts would impact the build-up of leveraged, concentrated trading strategies in the gilt repo market? Which strategies and types of market participants do you think would be most affected?

As noted in our response to Question 9, we do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial, and they could lead to significant additional costs and other undesirable consequences.

Q12. What would the largest impacts of minimum haircuts be for market participants? How would they affect your business model/trading strategies and what actions would you take in response? How would minimum haircuts on gilt repo impact cash gilt market liquidity and pricing? Provide worked examples or quantitative evidence where possible.

As noted in our response to Question 9, we do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial, and they could lead to significant additional costs and other undesirable consequences.

Take a scheme with £100 of liabilities. If the scheme holds £50 in gilts and £50 in growth assets, to increase its liability hedge, it may repo the £50 of gilts in order to fund the purchase of £50 more gilts. This would be a prudent approach to hedging all £100 of its liabilities.

However, if a haircut of 10% were applied, the pension scheme would have to hand over £50 of gilts along with £5 funded by selling other assets – reducing its investment in growth assets and increasing liquidity risk. The pension scheme would use the cash received to buy £50 of gilts.

All else being equal, if the counterparty then failed, the pension scheme would have received £50 of cash, which it could then use to buy £50 of gilts; however, it would be £5 out of pocket. This is a significant amount for a DB scheme looking to fulfil its promises to members.

Translating this into actual figures shows how significant this overall cost could be. Our estimates suggest that DB schemes' use of gilt repo could be as much as £300 billion (which is much larger than centrally collected data suggest). Applying a mandatory haircut of 5%-10% to this amount would equate to £15 billion to £30 billion.

If a DB scheme seeks to generate 1%-4% on non-hedging assets, and it gives up £15 billion to £30 billion of such assets to fund haircuts, this would equate to giving up £150 million to £1.2 billion of returns per annum. Over a decade, this would amount to £1.5 billion to £12 billion. Such figures illustrate how large the impact of introducing haircuts for DB schemes could be for the wider financial system.

The discussion paper notes in paragraph 67:

> "Minimum haircuts could be structured and designed in different ways: they could be calibrated according to different risk sensitivities or vary by maturity; they could apply only to certain subsets of the gilt repo market or to certain participant types (eg, only on dealer-to-client trades); they could be applied at the level of individual trades, or to portfolios as a whole."

In line with this, we believe a one-size-fits-all approach to minimum haircuts on gilt repo would be sub-optimal. In the event that a minimum haircut is put in place, we believe DB schemes should be exempt from such a requirement.

Q13. Is there a particular model or calibration of minimum haircuts which maximises benefits to financial stability while minimising potential costs to market participants?

For a minimum haircut to have a meaningful impact on financial stability, it will have to be a meaningful size – a minimum haircut of, say, 1% would likely be too low to affect market behaviour. In terms of models for haircuts, one approach may be to apply minimum haircuts for users who exceed a certain amount of leverage.

However, as noted in our response to Question 9, and expanded upon in our response to Question 12, we do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial, and they could lead to significant additional costs and other undesirable consequences.

The discussion paper notes in paragraph 67:

> "Minimum haircuts could be structured and designed in different ways: they could be calibrated according to different risk sensitivities or vary by maturity; they could apply only to certain subsets of the gilt repo market or to certain participant types (eg, only on dealer-to-client trades); they could be applied at the level of individual trades, or to portfolios as a whole."

In line with this, we believe a one-size-fits-all approach to minimum haircuts on gilt repo would be sub-optimal. In the event that a minimum haircut is put in place, we believe DB schemes should be exempt from such a requirement.

Q14. Aside from greater central clearing and minimum haircuts in non-centrally cleared transactions, what are the measures, or combination of measures, that you think could effectively alleviate different constraints to the expansion of gilt repo lending in a stress?

With regard to clearing gilt repo, as stated in our response to Question 2, mandating this for DB pension schemes would not be appropriate, for similar reasons to why mandatory clearing of derivatives is unsuitable. DB schemes are exempt from the latter given the negative implications of mandatory central clearing, and we believe DB schemes should also be exempt from a mandatory requirement to clear gilt repo.

However, as also noted in our response to Question 2, centrally cleared gilt repo are a positive development with regard to market resilience, and an additional market tool that can be helpful for DB schemes.

With regard to minimum haircuts on gilt repo, as noted in our response to Question 9, and expanded upon in our response to Question 12, we do not believe that mandatory minimum haircuts on gilt repo conducted by DB schemes are necessary or beneficial, and they could lead to significant additional costs and other undesirable consequences.

We therefore believe DB schemes should also be exempt from such a requirement.

Q15. In particular, what are the risks and benefits associated with greater private and public disclosures of leveraged positions generated via gilt repo? How do you expect market participants' behaviour to evolve as a result of these potential measures?

No comment.

Q16. In your view, what is likely to be the most effective combination of potential reforms to effectively address the vulnerabilities in the gilt repo market and enhance its resilience?

Measures to address vulnerabilities in the market are welcome, but we believe that neither central clearing nor minimum haircuts for gilt repo used by DB schemes should be mandatory. It is unnecessary and would lead to negative consequences for DB schemes, and the system as a whole, as outlined in our other responses above.

Positive steps would include for the CNRF structure to be made less restrictive – we welcome the facility but it will need to evolve to have a major impact.

Important information

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