Master trust authorisation

Cash and near-cash assets

September 2018

The Pensions Regulator

Background

This guide is aimed at those who have a strong grip on financial issues, and who will be dealing with these issues in the master trust. This may be a scheme funder, strategist or the trustees.

Our **Code of Practice 15 on the Authorisation and supervision of master trusts** (the code) sets out our expectations in relation to the financial resources that a master trust must be able to demonstrate that it has[1]. The code states that we are unlikely to be satisfied by a scheme which has cash or near-cash assets that are:

- less than 25% of projected running costs (if reserved for), or
- less than 15% of the calculated financial reserves[2]

This guide is intended to help schemes understand our interpretation of the assets covered by the phrase "cash or near-cash". Cash is an asset that retains its face value, is highly liquid and can be called upon for immediate use. Near-cash assets are financial instruments that exhibit similar characteristics to cash. We refer to both cash and near-cash as "cash" in this guide.

We may update this guide from time to time to reflect changes in financial markets. If we do, we will allow schemes a transitional period so they can comply with any new expectations, and we'll define the transitional period when we publish any updates.

The purpose of holding cash

The principal aim of holding cash is because the element of a scheme's reserves held in cash may be required at short notice, and then on a regular basis, following a triggering event. We accept that schemes may be willing to take on a degree of risk in relation to realisable value and are prepared to accept an allocation to short dated UK government debt.

Cash can be held directly or through money market funds which invest in the assets listed below.

Our preference is for schemes to hold cash in one or more of the forms listed below:

- Short-term money market funds
- Cash held in a UK deposit account
- Time deposits

1 Paragraphs 202-307
2 Paragraph 276

For directly held portfolios, we are likely to consider the following assets as appropriate:

- Floating rate notes
- Certificates of deposit
- Overnight repurchase agreements
- Commercial paper
- Asset-backed commercial paper
- Medium-term notes
- Short-dated UK government bonds

Investment guidelines

We expect that, to achieve 'stable value or low volatility', cash management would typically require a maximum weighted average maturity of 60 days and a weighted average life of 120 days at the fund level. In addition, we would not expect the final maturity of the underlying assets to exceed 397 days (13 months). We also expect instruments to be marked to market on a daily basis and portfolios of directly held assets or money market funds to hold assets offering 10% overnight liquidity and a minimum of 30% of assets providing weekly liquidity.

Appropriate benchmark for money market funds

Seven day SONIA[3] in GBP.

Instrument or security rating

In relation to money market securities, we expect a minimum of 50% will be invested in A1+ /P1 issue, with the remaining balance invested in securities rated no less than A1/P1.

Maximum exposure to any one issuer

We expect directly managed portfolios to avoid concentration of risk and to include sufficient diversification. We also expect fund structures to ringfence assets from the funding institution and ideally to be UCITS[4] or equivalent compliant.

In terms of fund and direct holdings, we expect that the maximum exposure to any one issuer would be limited to 5% of cash holdings (increasing to 10% if maturity within 7 days). We also expect that investments in any single issuer would be limited to 5% but could go up to 10% as long as, in total, such holdings do not equate to more than 40% of the portfolio or fund.

3 Sterling Overnight Index Average
4 Undertakings for collective investment in transferable securities

Other risk management criteria

- Investment should be in UK GBP-Sterling issuance only
- No shorting of securities
- No lending of directly held securities

Haircuts[5]

In assessing haircuts, trustees should allow for different asset classes contained within pooled funds for the purpose of the total haircut to be applied to them. This may mean that schemes have to consider carefully the amount they hold in particular asset classes.

Background to the range of permissible assets

In reaching our conclusions around the range of permissible assets, we have considered the market characteristics of a number of cash and fixed interest instruments. These included UK and European (hedged and unhedged) government and investment grade and high yield corporate bonds in a range of market conditions. Key features we considered were:

1. performance in the worst twelve-month period
2. the worst uninterrupted drawdown
3. the worst quarter, and
4. the worst month experienced for each asset class in terms of the available data set

We analysed data for the period 1986-2018 (inclusive) and, where available data for certain assets related to a shorter period, we examined the maximum amount of data available. We acknowledge that the past is no guarantee of how securities will perform in the future but consider that this gives us a robust base for our conclusion.

Corporate bonds demonstrated an unacceptable drawdown profile and we are therefore excluding them from this definition. Our examination of over three-year UK Government bonds shows that, although these instruments are predictable, they can exhibit falls in value, which we consider inappropriate for a master trust's short-term, highly liquid reserving requirements.

5 Defined in paragraph 278 of the code

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