Legal & General Investment Management
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UK DB funding levels improve since the onset of Covid-19, but sponsor health remains top concern – LGIM

DB schemes in the UK can expect to pay 98.2% of accrued benefits

For the first quarter since the onset of the pandemic, the health of the UK's Defined Benefit (DB) pensions schemes failed to improve, ending what had been four consecutive quarters of growth. However, it should be noted that funding levels remain far stronger than their pre-Covid levels, according to Legal & General Investment Management (LGIM).

LGIM's Health Tracker, a monitor of the current health of UK DB pension schemes, found that the average[1] DB scheme can expect to pay 98.2% of accrued pension benefits as of 30 June 2021, the same figure recorded on 31 March 2021[2].

The health of the UK's Defined Benefit (DB) pension schemes had originally dropped as low as 91.4% as of 31 March 2020[3], following the onset of the pandemic, having previously been at 96.5% as of 31 December 2019[4]. LGIM's monitor has since shown a continuing improvement in each of the last four quarters, which has been brought to an end with the latest data.

This suggests that UK's Defined Benefit (DB) pension schemes may well have completed their initial recovery from the pandemic. However, it is important to note that these figures may yet still understate the negative impact of the pandemic, due to a weakening of covenants that many schemes will have endured.

John Southall, Head of Solutions Research at LGIM comments on the findings:

"Over the second quarter, growth assets continued to outperform but interest rate levels fall back somewhat. This partly reversed the very sharp rise seen in Q1 – the largest quarterly increase in nominal rates seen in years. However, interest rates remain substantially higher than at the end of 2020. Other factors including relatively high experienced inflation and some technical revisions to our assumptions also led to some modest losses in Expected Performance of Benefits Met (EPBM), such that overall, it was flat over the quarter.

"Sponsor health remains a key concern as we move forward. As for the previous quarter, we chose to retain a typical sponsor rating assumption of BB in our calculations. This assumption reflects covenant strength, impacting the security of benefits and our EPBM measure. The long-term impact of the pandemic remains unclear, however, we noted that if a rating of B was assumed, the EPBM figure on 30 June 2021 would be around 1.2% lower."

Christopher Jeffery, Head of Rates and Inflation Strategy at LGIM adds:

"Global bond markets recovered some of their poise in the second quarter despite unexpectedly high inflation prints across Western economics. Investors are buying into the narrative from central banks that price pressures will be transitory rather than permanent. In turn, that has allowed equity investors to shrug off concerns about the spreading delta variant and focus instead on the continued strength in the profit recovery. With earnings growth so strong, we think the positive tailwind to risky assets is set to persist."

Notes to editors

Past performance is not a guide to the future.
The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested.

The philosophy underlying LGIM's approach is that schemes should focus on long-term success, defined as the assets outlasting the liability cashflows. Schemes face many hurdles to achieving this goal including covenant risk. LGIM calculated EPBM for a typical scheme as the average proportion of benefits met across the lifetime of the scheme over many different economic scenarios of the future.

[1] Based on the Purple Book from the Pension Protection Fund, a typical pension scheme holds approximately 20% in equities, 70% in bonds/LDI, 5% in property and 5% in other assets. For illustration, we assume rates and inflation hedge ratios of 70% of liabilities on a gilts basis and no future accrual or deficit contributions.

[2] As of 31 March 2021, the LGIM DB Health Tracker found that pension schemes could expect to pay 98.2% of accrued pension benefits.

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About Legal & General Investment Management

Legal & General Investment Management is one of Europe's largest asset managers and a major global investor, with total assets under management of £1.33 trillion. We work with a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

Throughout the past 40 years we have built our business through understanding what matters most to our clients and transforming this insight into valuable, accessible investment products and solutions. We provide investment expertise across the full spectrum of asset classes including fixed income, equities, commercial property and cash. Our capabilities range from index-tracking and active strategies to liquidity management and liability-based risk management solutions.

[1]LGIM internal data as at 30 June 2021. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor. Data includes derivative positions.

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