Press release

28 November 2019

Pension Scheme Health Worsens over the Quarter

LGIM Defined Benefit Health Tracker

London 28 November 2019 - The Legal & General Investment Management (LGIM) DB Health tracker – a monitor of the current health of UK DB pension schemes – has found that a typical DB pension scheme[1] can "expect" to pay 93.7% of accrued pension benefits as at 30 September 2019, a drop of 1.3% on the previous quarter[2] in their "expected proportion of benefits met" (EPBM) metric.

The analysis for this quarter, which takes into account the risk that a sponsor might default and the impact that would have on scheme's members, found that 6.3% of accrued pension benefits would not be paid on average across their scenarios.

How manageable a pension scheme's deficit is depends on a number of factors, and not just size. This includes the strength of the sponsor, the size of the deficit relative to the size of the assets, the quality of the investment strategy, and the economic and demographic risks in the scheme.

John Southall, Head of Solutions Research, Legal & General Investment Management said: "Over the quarter there was an overall decrease in our EPBM metric for a typical scheme of around 1.3%. This was mainly driven by a substantial fall in interest rates, which had a negative impact on schemes that haven't fully hedged themselves against moves in bond yields. We believe that trustees could stand to benefit from revisiting their LDI strategies, using leverage where appropriate."

John Roe, Head of Multi-Asset Funds, Legal & General Investment Management added: "The collapse in global bond yields, driven by the Federal Reserve's pivot to cut interest rates, is an unwelcome reminder that UK interest rates and inflation remain outsized risks for many UK defined benefit pension schemes. In these circumstances, trustees and their advisers shouldn't focus on what they think will happen in those markets, but whether they can afford the cost of being wrong – a close parallel with the questions active managers have to ask when assessing the risk of any one view, no matter how high their conviction.

"With global equities close to all-time highs and sterling still relatively weak, returns from pension scheme growth assets remain strong. At the end of the quarter, economic pessimism was close to its peak for the year, pushing down on bond yields. But as yields recover, so too should average funding levels and more schemes will likely turn to further de-risking through liability hedging. When doing this, schemes should bear in mind that credit spreads on corporate bonds remain close to mid-2018 lows, which in turn might justify gradually averaging into any further credit allocations."

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 most recent Purple Book from the Pension Protection Fund, a typical pension scheme currently holds approximately 25% in equities, 60% in bonds/LDI, 5% in property and 10% in other assets. For illustration, we assume a hedge ratio of 50% of liabilities on a gilts basis and no future accrual or deficit contributions.

[2]In June 2019

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Notes to editors

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 £1.1 trillion[1]. 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 2019. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor. Data includes derivative positions.