Legal & General Investment Management
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Health of UK DB schemes reaches new high as rates rise again

DB pension schemes remain well positioned for endgame, expecting to pay 98.8% of accrued benefits

The health of the UK's Defined Benefit (DB) pension schemes continued to edge upwards in the second quarter of 2022, reaching a new high as of 30 June 2022, according to Legal & General Investment Management (LGIM).

LGIM's DB Health Tracker, a monitor of the current health of UK DB pension schemes, found that a typical[1] DB scheme can expect to meet 98.8% of accrued pension benefits as of 30 June 2022. This is a rise of 0.3 percentage points from the figure of 98.5% recorded three months earlier on 31 March 2022[2].

The health of the UK's DB pension schemes has been gradually improving since March 2020, when it had dropped as low as 91.4%[3] because of the immediate impact of the pandemic on financial markets. This gradual improvement is a timely reminder that 'endgame' is in sight for the majority of DB pension schemes in the next five to ten years. The high value indicates that many DB schemes are in a strong position as they approach endgame and decide the best strategy to ensure their members' benefits are met.

LGIM's measure of scheme health doesn't just look at pension scheme solvency in terms of deficits but also considers factors like the 'Expected Proportion of Benefits Met'. This offers a powerful lens through which to understand scheme solvency and guide investment strategy, such as when to move into cashflow matching strategies and how to adapt the strategy to allow for sponsor risk.

While these figures demonstrate a continued improvement in the health of UK DB schemes, the months ahead remain crucial for both pension schemes and other investor groups.

John Southall, Head of Solutions Research at LGIM comments on the findings:
"Despite the significant short-term inflationary headwinds, the second quarter of 2022 saw a substantial rise in both long-term nominal interest rates coupled with a fall in long-term expected inflation, leading to an increase in long-term real interest rates. The increase in both nominal and real interest rates benefitted a typical scheme due to underhedged liabilities. This was largely offset by poor performance of growth assets relative to expectations. Overall, however, our Expected Proportion of Benefits Met (EPBM) measure managed to post a small gain and reach a new high."

"The fact that the measure means it is impossible for schemes to be more than 100% healthy makes large increases in EPBM challenging. However, it is encouraging to see the security of members benefits continue to improve."

Christopher Jeffery, Head of Rates and Inflation Strategy at LGIM adds:
"The big rise in inflation-adjusted (or real) interest rates comes in the aftermath of the Ukrainian invasion and the associated shock to natural gas prices. That has triggered a policy pivot from major central banks, including the Bank of England, to focus on fighting inflation as the primary policy priority. Risk assets have been volatile as markets digest that changing backdrop, with global credit and equities both suffering in the second quarter."

"Recessionary clouds are, unfortunately, gathering in both Europe and the UK. That would normally precipitate significant downward pressure on yields, but the inflationary backdrop currently trumps such concerns."

-ENDS-

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. Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

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. We are tracking a 'typical' scheme we set up in 2018 when we estimated its funding position based on data from the PPF. For illustration, we currently 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 2022, the LGIM DB Health Tracker found that our typical pension scheme could expect to pay 98.5% of accrued pension benefits.

[3] As of 31 March 2020, the LGIM DB Health Tracker found that our typical pension scheme could expect to pay 91.4% of accrued pension benefits.

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 £1.290bn trillion*. We work with a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

Throughout the past 50 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.

*LGIM internal data as at 30 June 2022. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor. Data includes derivative positions.

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