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

DB pension schemes in the UK can expect to pay 98.4% of accrued benefits

The health of the UK's Defined Benefit (DB) pension schemes continued to edge upwards in the fourth quarter of 2021, reaching a new high as of 31 December 2021, 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 the average[1] DB scheme can expect to fund 98.4% of accrued pension benefits as of 31 December 2021. This is a rise of 0.1 percentage points from the figure of 98.3% recorded three months before on 30 September 2021[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.

While these figures demonstrate a continued improvement in the health of UK DB schemes, the next 12 months will remain crucial for both pension schemes and other investor groups, as we move into an era of tighter monetary policy, as evidenced by today's interest rate hike.

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

"The final quarter of 2021 saw continued strong performance from growth assets which helped our measure of UK scheme health edge to its strongest recorded position yet. Scheme health also benefitted from a modest drop in inflation expectations, falling back from the elevated levels we saw in the third quarter (the highest levels since 2008). However this was offset by a slight decrease in long-term interest rates. Overall, 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."

"As for previous quarters, we chose to retain a typical sponsor rating assumption of BB in our calculations. This assumption reflects current covenant strength. However, the long-term impact of the pandemic on DB schemes' health remains unclear. It is worth noting that if a B rating was assumed instead, the EPBM figure would be around 1.1% lower."

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

"The fourth quarter of 2021 had plenty of twists and turns, but the ultimate outcome in financial markets was more of the same: equity market buoyed by the ongoing economic recovery, short-dated interest rates rising, and inflation overshooting expectations. Despite those headwinds, long-dated gilt yields which matter the most for discounting pension fund liabilities were almost totally unfazed."

"For sterling investors, the most important news came towards the end of the quarter with the first hike in interest rates by the Bank of England for four years. Followed by a further increase in rates today, the Old Lady of Threadneedle Street has signalled that the days of benign neglect about the inflation outlook being over, 'forward guidance' has been abandoned as a policy tool, and balance sheet reduction will soon be upon us. 2022 looks to be a pivotal year for investors as the market navigates the transition from easy to tightening policy conditions both at home and abroad."

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 30 September 2021, the LGIM DB Health Tracker found that pension schemes could expect to pay 98.3% of accrued pension benefits.

[3] As of 31 March 2020, the LGIM DB Health Tracker found that pension schemes 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 £1.33 trillion (€1.55 trillion; CHF1.70 trillion, $1.8 trillion; JPY204 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 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 2021. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor. Data includes derivative positions.

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