Confidential

Legal & General Investment Management
10 November 2021

DB schemes at their healthiest since COVID-19 - but pandemic may cast long shadow

DB pension schemes in the UK can expect to pay 98.3% of accrued benefits

The UK's Defined Benefit (DB) pension schemes are at their healthiest since before the onset of COVID-19, as of Q3 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 98.3% of accrued pension benefits as of 30 September 2021. This is a rise of 0.1 percentage points from the figure of 98.2% recorded three months before on 30 June 2021[2].

The health of the UK's DB pension schemes had been gradually improving since March 2020, when it had dropped as low as 91.4%[3] as a result of the immediate impact of the pandemic on financial markets.

However, while these figures suggest that the health of UK DB schemes has been improving since the initial spread of Covid-19, it is important to note that these figures may yet still understate the negative impact of the pandemic, due to weakening covenants from pension scheme sponsors, which many schemes have endured.

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

"Inflation expectations rose to their highest levels since 2008 with the bond markets implying a substantial risk that the rise in inflation may be more than transitory."

"This has made it more challenging for DB schemes to meet their unhedged inflation-linked liabilities. However, a relatively modest (but still substantial) rise in nominal interest rates, combined with respectable growth asset performance, meant that overall our Expected Proportion of Benefits Met (EPBM) measure still managed to post a small gain."

"As for previous quarters, we chose to retain a typical sponsor rating assumption of BB in our calculations. This assumption reflects current covenant strengths. 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 1.2% lower."

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

"Since the end of the second quarter, yields on short-maturity government debt around the world have risen sharply as markets prepared for the turn in the monetary policy cycle. That same dynamic has played out in the UK with increasing focus on when, not and if, the Bank of England raises interest rates. However, long maturity bond yields have confounded widespread expectations of a material sell-off. At the end of the third quarter, 30 year gilt yields were only marginally higher than in Q2 and that was before the sharp falls in recent weeks triggered by the reduction in government bond supply and the Bank of England's "wait and see" decision in November. Yet again, the rumours of the death of the gilt market have been greatly exaggerated.

"Risk asset markets suffered a small wobble towards the end of the third quarter before quickly recovering their poise. Investor risk appetite remains robust in spite of increasing headlines about supply chain disruptions crimping growth and lingering pandemic concerns. With high household savings as a

critical shock-absorber, we find it hard to worry too much about the economic outlook and remain comfortable with equity risk over the medium-term."

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 June 2021, the LGIM DB Health Tracker found that pension schemes could expect to pay 98.2% 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*. 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.

*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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