# Press release

16 November 2020

## DB schemes continue recovery in Q3 but covenant risks remain

- **DB schemes in the UK can expect to pay 95.5% of accured pensions benefits**
- **This is just one percentage point below the pre-COVID levels of December (96.5%) and a significant improvement on the figures from March (91.4%)**
- **However, LGIM warns of new threats to funding ratios, with DB schemes facing weakening covenants from corporate sponsors due to the ongoing recession**

**London, 16th November 2020** – The health of the UK's Defined Benefit (DB) pension schemes has almost returned to their pre-COVID levels as they continued to recover through Q3 2020, 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 95.5% of accrued pension benefits as of 30 September 2020, up 2% from 30 June 2020[2].

This compares to the pre-COVID level of 96.5% from 31 December 2019[3] as well as the lows of 31 March 2020[4] which saw funding levels drop to 91.4%.

The latest quarterly analysis, which takes into account the risk that a sponsor might default and the impact that would have on scheme members, means that 4.5% of accrued pension benefits would not be paid on average across their scenarios in Q3 2020, compared to 6.5% in June 2020.

The most significant market movements behind the improvement include strong performance of growth assets and a rise in nominal interest rates, whereas inflation expectations remained broadly the same.

**John Southall, Head of Solutions Research at LGIM comments on the findings:** "It's great to see things improving once again this quarter. As previously, however, we would caveat that these higher ratios may understate the negative impact of COVID since the start of the year, due to a weakening of covenants that many schemes will have endured. The extent of covenant deterioration is not yet clear. Our calculations are based on a typical sponsor rating of around BB. If this were to fall to B, for example, we would anticipate an Expected Proportion of Benefits Met (EPBM) value around 2% lower, wiping out the gain seen this quarter."

**Christopher Jeffery, Head of Rates and Inflation Strategy at LGIM adds:** "Since March, global risk assets and nominal yields have been driven higher by anticipation of an economic recovery as the world learns to cope with COVID. In recent weeks, those trends have been given an additional fillip by the US election and news of a breakthrough in the search for a vaccine. As a consequence, the gilt market has downgraded the likelihood of negative interest rates from the Bank of England in 2021 and beyond. RPI reform is now around the corner, with an announcement pending in late November, which constitutes the next major event risk for DB schemes to navigate."

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Legal & General INVESTMENT MANAGEMENT

## 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 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] As of 30 June 2020, the LGIM DB Health Tracker found that pension schemes could expect to pay 93.5% of accrued pension benefits.

[3] As of 31 December 2019, the LGIM DB Health Tracker found that pension schemes could expect to pay 96.5% of accrued pension benefits.

[4] 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 £1.2 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.

LGIM internal data as at 31 December 2019. The AUM disclosed aggregates the assets managed by LGIM in the UK, LGIMA in the US and LGIM Asia in Hong Kong. The AUM includes the value of securities and derivatives positions.

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