

Press release

For immediate release

Pension deficits grow 5.1% in Q1 amidst market turmoil – LGIM Defined Benefit Health Tracker

London, 11 May 2020 – The overall health of the United Kingdom’s defined benefit (DB) pension schemes deteriorated during Q1 2020, 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 average¹ DB scheme can expect to pay 91.4 per cent of accrued pension benefits as of 31st March.

This measure of the ‘Expected Proportion of Benefits Met’ (EPBM) has deteriorated by 5.1 percentage points during the first three months of the year, down from 96.5 per cent as recently as December 2019².

John Southall, Head of Solutions Research at LGIM comments on the findings: “The 5.1% fall was mainly attributable to a fall in the value of return-seeking assets due to Covid-19. A typical scheme is also under-hedged on rates and inflation risk so the fall in gilt yields led to an increase in nominal liabilities relative to their hedging assets. Real yields were broadly flat, however, due to a commensurate fall in expected inflation.

“Given the current market environment, the EPBM measure is also currently volatile, albeit less volatile than traditional funding level measures. As the situation evolves we will update our estimate, and experience since 31 March has generally been positive. However as the negative impact of the crisis on typical covenant strength becomes clearer, we will also look to incorporate this into our figures.

“Schemes with significant allocations to credit may be able to help close these gaps by moving towards more cashflow matched strategies if they haven’t already done so, as well as increasing their rates and inflation hedging levels.”

The quarterly analysis, which takes into account the risk that a sponsor might default and the impact that would have on scheme’s members, found that 8.6 per cent of accrued pension benefits would not be paid on average across potential scenarios. This compares to just 3.5 per cent in December 2019.

“A number of factors determine how manageable a pension scheme’s deficit is, not just its 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.

Christopher Jefferey, Head of Rates and Inflation Strategy at LGIM commented: “The first quarter delivered exceptionally weak returns across a broad range of risk assets. The coronavirus pandemic, and the associated shutdown in economic activity, has led to a sharp reappraisal of expectations for both earnings growth and default risks. Global equity markets dropped by a third from their mid-February peak and spreads on major corporate bond indices widened by over 250bp. Despite the pending deluge of government bond supply to fund stimulus programmes, yields dropped sharply as central banks cut interest rates and reactivated bond purchase programmes”

Equity and credit markets served up a lesson that volatility was only hibernating during recent years. The benefits of diversification in managing that risk become most apparent in such difficult conditions. Government bond markets once again defied expectations that yields had hit their lower bound with the short-end of the gilt market trading briefly through zero in March. Mitigating the risks associated with further shocks to discount rates remains important.

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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 at 31 December 2019, the LGIM DB Health Tracker found that pension schemes could expect to pay 96.5% 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 trillion¹. 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 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.