Legal & General Investment Management
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Health of UK DB schemes now far stronger than pre-COVID-19 levels

DB schemes in the UK can expect to pay 98.2% of accrued pensions benefits

This marks the fourth consecutive quarter of improvement and is up nearly 7% from the market lows in March 2020

The health of the UK's Defined Benefit (DB) pension schemes has continued to improve from the sharp decline experienced at the start of the pandemic and is now far stronger than even their pre-COVID levels, 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 98.2% of accrued pension benefits as of 31 March 2021, up 6.8% from 31 March 2020[2].

The health of the UK's DB pension schemes has also shown a 1.1% improvement quarter on quarter against the funding level of 97.1% at 31 December 2020[3]. This latest improvement means LGIM's measure has shown a continuing improvement in each of the last four quarters.

However, it is important to note that these figures may yet still understate the negative impact of the pandemic, due to a weakening of covenants that many schemes will have endured.

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

"The first quarter of 2021 was yet another good period for our Expected Proportion of Benefits Met (EPBM) measure of scheme health, with the ratio rising by 1.1% from 97.1% at 31 December 2020 to 98.2% at 31 March 2021. The change was largely driven by a rapid rise in nominal interest rates, the sharpest three month increase seen in years, benefitting schemes that haven't fully hedged their interest rate risk.

These benefits were partially offset by a rise in expected inflation (increasing inflation-linked liabilities) but growth assets also posted a strong quarter, boosting asset values. One notable feature of our EPBM measure is that it cannot exceed 100%. As the EPBM figure edges closer to 100%, continued positive experience for schemes has a smaller marginal impact on our measure.

From a covenant perspective we chose to retain a typical sponsor rating assumption of BB in our calculations as confidence in the recovery improves. Whilst the long-term impact of the pandemic remains unclear, fiscal and monetary actions have been extremely supportive. We noted that if a rating of B was assumed, the EPBM figure at 31 March 2021 would be around 1.1% lower."

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

"The global reflation trade played out in force during the first quarter. The consensus continued to mark up its 2021 growth outlook on the back of fiscal stimulus and the vaccine roll-out. US Treasury yields rose more in Q1 than any quarter since 2016 Q4. There are clear parallels with that episode: a sharp move higher in US sovereign funding costs driven by political transition that dragged up yields everywhere.

Risk assets remained immune to that reset in discount rates with equity markets supported by a stronger earnings backdrop, and credit markets enjoying abnormally low default rates. There are a few hints of inflation concern entering the market narrative with breakeven inflation and commodities moving higher since the turn of the year. The fate of inflation as economies around the world reopen will make or break the market dynamic over the rest of the year".

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 (revised upwards from previous assumptions) and no future accrual or deficit contributions.

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

[3] As of 31 December 2020, the LGIM DB Health Tracker found that pension schemes could expect to pay 97.1% 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 £1.3 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.

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1 LGIM internal data as at 31 December 2020. 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.