COVID 19 – Pension considerations

"buying equities at discounted prices is one of the few silver linings"

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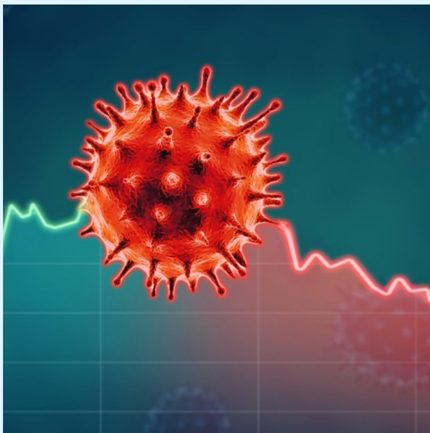
Big Economic Unknowns Remain

- the speed of development of a vaccine, its subsequent production and adequate distribution;
- the number of lockdowns required to ensure health services are not overwhelmed;
- whether there will there be sufficient supply of reagents to allow adequate levels of testing;
- employer failures and resulting unemployment levels



Market crash: the same, but different

Financial markets have been predictably volatile over the last few months following the gradual realisation that there was the potential for the COVID 19 pandemic to be devastating, not only from a health perspective, but also due to the economic consequences.

Stock markets started to tumble in late February. Market crashes prompt very similar concerns, no matter their cause. And one thing that they have in common is how the latest one is different from all the others. Spanish Flu, with its heavy death toll, wrought havoc following on the heels of the First World War.

To unpick the implications of the COVID-19 market impacts, we might ask:

- what happened to markets in the first quarter of 2020?
- what can we sensibly conclude about COVID-19's ultimate economic impact?
- what does it mean for pension schemes?

What's happened to markets?

- Most markets fell in the first quarter of 2020. Broad-based equity benchmark indices fell between 16% and 25%, with the UK performing worse than global equities.
- A benchmark long-dated bond index, popular with pension plans, fell around 5%.
- A cash benchmark rose 0.1%.
- Historical "safe haven" investments, such as fixed interest gilts, rose about 7% in value, as did the dollar price of gold.

But how did your scheme's own investment managers perform? Now is a good time to check if the promised outperformance of active management paid off, and whether tracking funds actually tracked.

COVID-19's ultimate economic impact?

The country which has progressed furthest with COVID-19 is China. It has seen a 6.8% GDP downturn (the worst since the 1970s). Its progress towards business as usual was marred by significant upward revisions to its numbers for deaths and infections, but it seems to have turned the corner. The UK is projected to have a worse hit to GDP, and the OBR[1] estimates net debt remaining at about £260bn (10% of GDP) into 2024-2025: this to alleviate the stresses from an almost warlike state of disruption.

Impact on pension schemes

Regulators have been quick off the blocks to alert trustees to a wide range of considerations, but in particular to:

- protect members from scammers
- protect defined benefit ("DB") schemes from transfers out strains
- review the robustness of scheme strategy and governance structures, particularly around investments

Not every company is suffering from lockdowns (think Amazon and Zoom) but a significant proportion are. Maintaining pension contributions may be difficult for employers, which is a cruel twist, since buying equities at discounted prices is one of the few silver linings for pension plans in the current environment.

DB scheme trustees may not want to wait up to 3 years for the next formal actuarial valuation to review funding levels; they need to be pro-active in assessing the impact to the employer covenant. They may also want to review their asset liability projections and opportunities for the significant protection to funding levels offered by leveraged LDI[2] funds. Even small DB schemes can now benefit from these. Consequently, we expect that reviews of investment strategies and funding levels will be high up on trustees' to do lists.

DB scheme members with liquidity concerns may wonder about transferring pension benefits or taking benefits early. For most people, exiting a DB scheme is a poor idea: these schemes are referred to as "gold-plated" for a reason. However, exceptions to this general rule abound, which is why careful consideration of individual circumstances is essential.

Defined contribution ("DC") scheme members generally find themselves invested in their scheme's default option. Some members choose the funds themselves, but they are assumed to know what they are doing. The good news is that very many scheme trustees use a form of "lifestyle" as their default option. This is an automated facility which moves members' investments as they approach retirement from higher growth, higher risk equities to bonds and cash, which are more suitable for retirement benefit provision.

Therefore those members hardest hit are likely be 10 years or more from retirement. That is a long time is the context of previous market recoveries, and contributions are now buying equities at much reduced prices.

There are clearly opportunities and potential actions that trustees may wish to consider further, and your usual BWCI contact will be ready to discuss these in more detail.

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[1] Office for Budget Responsibility
[2] Liability Driven Investment