first actuarial

First Briefing, June 2020 –
The impact of COVID-19 on pension schemes

The COVID-19 pandemic continues to cause unprecedented disruption across the globe.

In this bulletin we look at the impact on UK pension schemes of the following areas:

- The impact of excess deaths; and
- the economy, markets & investments.

We also include a brief summary of the update TPR has just issued to the guidance we covered in our March briefing.

The impact of excess deaths

The chart at the top of the next column compares the number of weekly deaths in England and Wales for 2020 (solid blue line) to the 5-year average (red dotted line).

The impact of COVID-19 from late March is clear, with the number of deaths double the average for most of April.

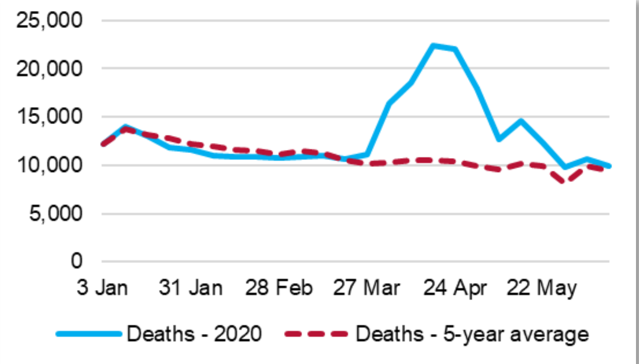
> *"Since the start of the pandemic, the UK has seen around 63,500 excess deaths"*

Short-term mortality experience

COVID-19 disproportionately affects older people, with around 9 in 10 of the deaths involving COVID-19 being in those aged over 65.

When looking at the results of the next actuarial valuation, schemes may see a slight improvement in their funding position as a result of these additional deaths.

However, any impact is likely to be offset by the impact of the pandemic on investment returns and market conditions.



Source: ONS weekly death data for England & Wales

Longer-term mortality experience

It's too early to say with any confidence how COVID-19 will impact on future mortality.

Pressures on the NHS during outbreaks, delays in diagnosis & treatment and the economic and health impacts of the lockdown could all result in future experience being worse than previously assumed.

However residual impacts of the lockdown, such as more exercise and less pollution, combined with a healthier population post-COVID could mean higher increases to life expectancy than assumed.

Impact on mortality improvement models

Most pension schemes use the CMI's mortality improvement models when setting mortality assumptions.

The experience of 2020 will be reflected in the CMI's next model, CMI_2020, due to be released in March 2021. When designing their model, the CMI "smooth" recent experience to distinguish between "trends" and "shocks".

This *could* mean that users of this new model may not see as much of a change in projected life expectancies as you would expect.

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The economy, equity markets & investments

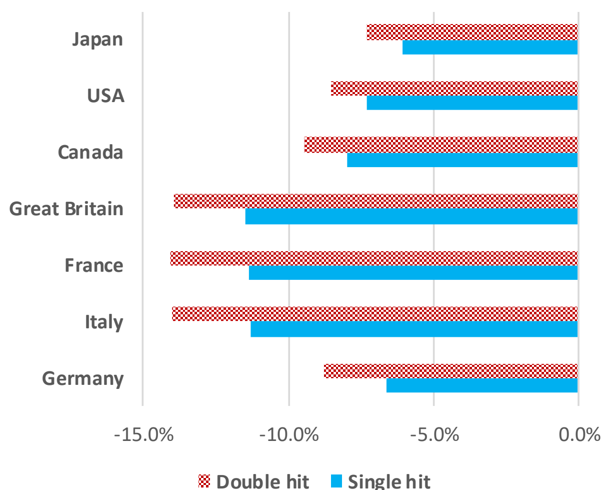
Fears over the impact of COVID-19 on the global economy precipitated the return of volatility to markets and the fastest ever 'bear' market on record as global equities fell sharply during March.

Unprecedented central bank and government actions across the world then prompted a startling recovery in equity markets, with US equities closing in on their historic peaks of early 2020.

With upbeat investors looking through the future uncertainty there appears to be a disconnect between the markets and immediate prospects for the global economy.

Despite the expansionary fiscal & monetary policies around the world, the OECD has predicted a significant hit to Real GDP for the G7, with the UK predicted to perform worst over 2020 in the event of a single or repeat wave of the virus. However, investors & commentators are divided on the course of the potential recovery; V, U, W or L shaped?

Real GDP Per Capita Forecast, Year on Year

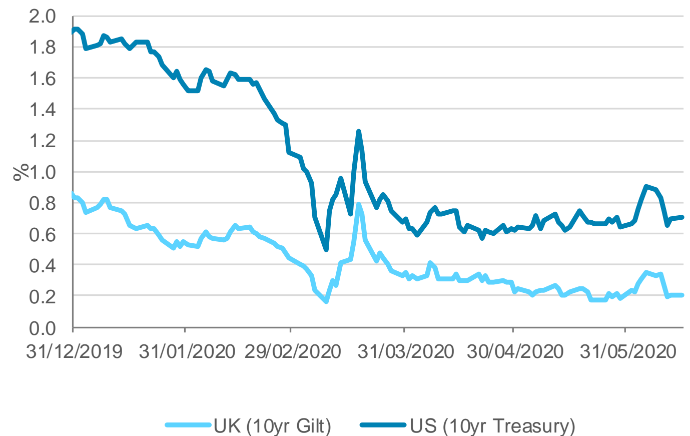


Source: OECD Economic Outlook: Statistics and Projections

Markets remain volatile, reacting sharply to positive and negative news and schemes with significant equity exposure can expect to witness volatility in scheme valuations.

How have gilt yields been affected?

UK gilt yields hit all-time lows during 2020, recovering slightly during March before falling again after the Bank of England (BoE) announced further quantitative easing and lowered the base rate to 0.1% (an historic low for the BoE base rate).



Source: Thomson Reuters DataStream

The impact of the movements in gilt yields on pension schemes will have depended on the level of hedging through Liability Driven Investment (LDI) or other matching assets.

Whilst schemes with a high level of liability hedging will have been relatively well protected, those with low levels will have witnessed volatility in their funding levels.

LDI managers also found the volatility challenging as leverage whipsawed in response to gilt yield movements.

What does all this mean for Pension Schemes?

With the outlook uncertain, markets are set to remain volatile and it is important that pension schemes carefully consider their ongoing investment arrangements.

The volatility in gilt markets highlighted the need for effective liability hedging and schemes should take the opportunity to ensure their liability hedging arrangements remain appropriate.

When it comes to growth assets, understanding risk exposures in a more volatile environment is essential. Incorporating appropriate diversification can help manage these risks. And carefully considered de-risking strategies and triggers can help capitalise on opportunities that arise amidst the volatility.

The Regulator's updated guidance

Breach reporting

From 1 July, TPR expects trustees to resume the reporting of breaches in relation to the following:

- suspended or reduced contributions – TPR will expect a revised recovery plan or a report of missed contributions;
- late valuations and the failure of the trustees and employer to agree a recovery plan; and
- delays in CETV quotations and payments beyond statutory deadlines.

Contribution suspensions or reductions

Some schemes will be reaching the end of agreed three-month contribution suspensions. TPR suggests that visibility of the employer's financial position will have improved in many cases – particularly in understanding the short-term availability of cash in the business. Trustees should undertake due diligence before agreeing an extension to any contribution suspension or reduction. The updated guidance includes questions trustees might ask the employer, and examples of protections and mitigations trustees might seek to put in place. TPR suggest that trustees' negotiating positions may be stronger than they think, and that they should seek relevant specialist advice.

That said, TPR acknowledges that there will be cases where the employer's financial position remains unclear, and where it may be reasonable to agree a further suspension, but only for a short period.

Where the employer is suffering cashflow problems and trustees or employers are concerned about the cost of advice, TPR suggests that trustees check whether their trust deed and rules allows for expenses to be met from the scheme, if the employer usually pays.

Transfer values

Whilst reporting of breaches is required from 1 July, TPR does highlight one option - having taken advice, trustees are allowed an extra three months to issue quotes, where the delay is beyond their control.

"We will continue to regulate pragmatically and sympathetically."

Further information

For further information, please contact your usual First Actuarial consultant