Summary
• LGPS schemes' investment values have been hit by coronavirus, but diversification has lessened the blow.
• In the short to medium term, LGPS cashflows should hold up, but employers' ability to make contributions may be an issue.
• LGPS processes can easily handle the return to work of retired staff such as social workers.

Weathering the storm

The LGPS, being open, cashflow positive and with a long-term investment horizon, should be in a better position than many schemes to overcome the Covid-19 difficulties, Maggie Williams finds

As financial analysts and pension scheme trustees have watched the coronavirus pandemic take a wrecking ball to the value of their investments, the common comparison has been with the financial crash of 2008. We've seen the 'worst quarter since the financial crash', the 'biggest one-day falls on markets since the crash' and many other similar headlines.

But beyond returns, the current situation is very different from 2008. It is not just affecting markets but decimating entire industry sectors (at least in the short term), as well as potentially remodelling day-to-day education, work and social culture. And, it has put public-sector workers under pressure like never before.

That, in turn, has affected the Local Government Pension Schemes (LGPS) in many different ways, from the inevitable impact on the value of schemes' assets, through to how it handles the effect of frontline staff, such as social workers, coming back out of retirement.

Investment

The investment headline remains the same, that recent falls in stock markets have seen LGPS schemes' equity holdings plummet in value, just as they have for other types of pension funds. But as open, cashflow-positive schemes, the LGPS has the benefit of being able to take a long-term view.

"The LGPS schemes' timespans are 40 to 50 years, so they are in a good position to ride out a market fall of this type," says Hymans Robertson head of LGPS, Catherine McFadyen. She adds that the investment approach of individual schemes will have made a difference, "and it will be interesting when we have analysed fund returns at end of March to see how much difference diversification strategies and hedging will have made to schemes."

"The extent to which each scheme is affected will depend on their exposure to global equity markets, as well as the level of diversification and the liability risk management they have employed," says Redington senior vice president global assets, Tara Gillespie. "Assuming an allocation of 50 per cent equities, diversified with bonds, liquid alternatives and private assets, the assets could have suffered a 15 to 20 per cent fall since the start of the year, versus the equity market which is down 20 to 25 per cent."

"Investment diversification will definitely have helped," adds Aon partner, Colin Cartwright. "Equity exposure in LGPS funds has come down from around 80 per cent to 40 or 50 per cent in some cases. And while other assets may not have gone up in value, they may not have fallen as much as equities. However, as a global investor, LGPS schemes will be affected by the worldwide nature of the crisis."

"I don't think the current situation

will change the journey towards diversification," he adds, "but it will remind everyone why we are on it."

Pensions and Lifetime Savings Association (PLSA), policy lead for DB and LGPS, Tiffany Tsang, says that the robustness of the investment approach is in part testament to the hard work the LGPS has put into its structures and sharing risk through pooling. "When that was set up, no-one dreamed of something this awful, but it has shown the strategy is effective."

Cartwright adds that the crisis will inevitably also create some buying opportunities that, given their long-term investment horizons, LGPS schemes will be able to take advantage of. "All assets were expensive prior to the crisis, and some will now become cheaper," he says. "Although schemes will be looking at rebalancing funds in the short term, there will also be a focus on buying opportunities."

Cashflow

Tsang says that in general LGPS members are not concerned about cashflow at present. "There is sufficient cash reserve to pay what has been promised to pension members for at least the next six months to a year, although it varies from fund to fund."

However, she cautions that beyond that time point, when the full impact of coronavirus should be clearer, "we may start to hear more from employers about whether they are in a position to meet their contribution rates. They may either be asking for an extension or saying they can't make the payments."

"There will be some employers in the schemes, such as charities and leisure centres, who will have been hit hard by the current situation and may struggle to make contribution payments as usual," agrees McFadyen. "Although they are a relatively small proportion of the LGPS funds, the schemes may need to work out how to support them and their members."

"The LGPS has been set up to mitigate worst-case scenarios and risk is evenly spread," adds Tsang. "If the worst happens and an employer can't make contributions, the first step would be to liaise with the employer and decide whether they want to exit the scheme or delay contributions. Members have nothing to worry about as benefits are guaranteed in legislation, so if in, say, 18 months cashflows are buckling, there is a government underpin." She adds: "Hopefully we are a long way from that scenario but there may need to be questions asked about how to deal with a situation where a lot of employers are doubting whether they can make the contribution rates."

The wider picture

But, the long-term effect of coronavirus on LGPS schemes could be subject to far greater forces. The UK will shoulder a huge amount of government debt to meet the cost of the current job retention scheme (covering 80 per cent of the salary of some UK employees), as well as commitments to pay self-employed workers, for example. And, while there will be some industry sectors that will benefit from the pandemic, it is still too early to understand longer-term shifts in consumer behaviour and whether it will drive permanent changes in economic outlook.

Other difficult topics may inevitably have to be addressed. "It is probably too early to say if there will be an effect on life expectancy within the funds," says McFadyen. "We still haven't seen the full effect of fatalities and whether coronavirus will have a longer-term impact on mortality analysis."

Another issue for local authorities to consider has been how to manage the pensions of employees such as social workers who are returning from retirement to work through the pandemic.

Under usual circumstances, employees returning from retirement would be required to abate their LGPS pension. However, with services struggling to cope and a pressing need to encourage experienced staff back into front line roles wherever possible, LGPS Scheme Advisory Board chair, Roger Phillips, wrote to administering authorities on 19 March calling on them not to apply abatement rules in the current circumstances. "Each authority will have its own approach to abatement, but this letter asks that if there is an abatement policy, it should be suspended," says Tsang. "If we need more workers in some roles to ease the current situation, then anything that can be done to incentivise that is a good thing."

McFadyen adds that removing the abatement process could, in fact, simplify administration for schemes. "Schemes will simply be paying out the pensions they expected to anyway – so if anything, it's less administration work." She also believes that as there are no changes to future assumptions as a result of removing abatement, there should be no major cost impact to the scheme either.

As the pandemic crisis continues to unfold and the full economic effects become known, the wider implications for the LGPS will become clearer. Heavy government borrowing, a potentially changed economic landscape and an uncertain outlook for markets will all inevitably have an impact. Gillespie concludes that "as open schemes, LGPS have a long time over which to recover losses and manage the funding level back up". However, she adds, "it is in triennial valuations that funding impacts can result in higher contributions from the underlying employers. With the next valuation date in March 2022, we would hope to see a recovery before then".

Written by Maggie Williams, a freelance journalist