The long view

Summary
• A spike in mortality during 2020 does not yet appear to have had a significant impact on longevity risks for private sector DB schemes.
• The longer-term outlook for longevity and scheme liabilities remains uncertain.
• Positive market trends mean funding and the possible route to an endgame have improved for many schemes.
• The most significant impact of the pandemic may prove to be a change in sponsors' views of schemes and trustees' views of the strength of sponsors.

What consequences has the pandemic had for private sector DB pension schemes, in terms of longevity risks, funding, investment strategy and progress towards an endgame? David Adams investigates

As is the case for so many other aspects of our lives, it is still too soon to be sure what the long-term impact of the Covid-19 pandemic on private sector DB pension schemes will be. One obvious place to start is the impact on mortality and longevity. The Office for National Statistics (ONS) National Life Tables show a deep decline in annual increases in life expectancy in 2020, caused by a rise in excess deaths during the first wave of the pandemic. Mortality in 2020 was 13.5 per cent higher than expected, according to Public Health England. UK-wide figures hide regional and other demographic variations; and the challenge of discerning the longer-term effects on DB schemes is made more complex by other factors, but we can draw some conclusions.

"Tragically, the pandemic had a

dramatic but short-lived impact on pensioner mortality," says Prudential Financial head of international reinsurance strategic initiatives, Amy Kessler. "People with the highest starting mortality rates have been most likely to succumb to the virus, including the frail elderly, those with significant co-morbidities and the most *[economically]* deprived."

However, Kessler continues, people in these groups only account for a relatively small fraction of overall DB scheme liabilities, usually either because they are quite elderly or because their pensions are small. As a result, "for most pension schemes, the *[short-term]* impact on overall liabilities has been very small". The spike in mortality among people in older age groups seen in 2020 has been replaced in 2021 by below average mortality, as the vaccine roll out has protected vulnerable people.

But what happens next is still far from certain. In March 2021, longevity risk specialist Club Vita published a white paper outlining several possible scenarios for the impact of the pandemic on longevity. They included the 'Bump In The road' scenario, in which longevity trends recover by 2022, leaving a typical pension fund's liabilities reduced by 0.9 per cent; and a 'Healthcare Decline' scenario, where further waves of infections continue throughout the 2020s, damaging healthcare systems, so increasing deaths due to other health conditions; and stunting economic growth. In the latter scenario, a typical fund's liabilities would be reduced by 5.3 per cent and those with less affluent members by 6.2 per cent.

In the most socially and economically positive scenario, 'Innovation in Adversity', a swift recovery from the pandemic acts as a catalyst for improved outcomes for other health issues as well, leading to above average increases in longevity during the next 10 years and beyond. In this scenario the liabilities of pension funds would increase: by 2.1 per cent for the average fund, 2.8 per cent for those with less affluent members and 1.3 per cent for those with wealthier members.

"These are only some of a range of potential outcomes," says Club Vita head of client delivery Mark Sharkey. "The scales are still finely balanced." He stresses the need for trustees and sponsors to "understand the regional and socioeconomic characteristics of scheme members and how life expectancies are affected for those different subsets".

"We're scanning our dataset to understand mortality, but overlaying that with our understanding of the regional and socioeconomic experience for those groups," says Sharkey. "We are using longevity analytics to provide clients with early warning signals as to which way the tide is beginning to turn."

A changed outlook

Meanwhile, despite much volatility and uncertainty in the markets, trends for scheme funding were fairly positive during the first half of 2021. The accounting deficit for DB schemes of FTSE 350 companies fell by £9 billion during June, as asset values rose from £803 billion to £814 billion and liabilities grew by £2 billion to reach £886 billion. By then, equity markets were 20 per cent higher than a year earlier and index-linked bonds were higher by 25 basis points, helping to reduce liabilities.

"A number of schemes are better funded now than they were at the start *[of the pandemic]*," says Buck Pensions senior consulting actuary, Michael Bartlet. "I think in a couple of years' time, people might say, 'Yes, 2020 was a bad year, but we recovered in 2021 and we're back on an even keel."

But the pandemic has been very difficult for some sponsors. Their views of their company DB scheme and trustees' views of a sponsor may both have changed, says Pensions and Lifetime Savings Association (PLSA) deputy director of policy, Joe Dabrowski.

"From a trustee perspective, given that the funding position for lots of schemes is now pretty good, it might make them think, 'For how long can I rely on my employer?'" he says. "And for employers, we're seeing lots of restructuring, to deal with cashflow and other challenges. That's going to make them think about whether they want to seek to secure the pension scheme somewhere else."

Research from Barnett Waddingham suggests that attitudes towards de-risking may have been influenced by trends in the financial markets. It found that by the end of May 2021 the aggregate buyout deficit of FTSE 350 DB schemes was £130 billion, £80 billion less than a year earlier. And whereas in December 2019 average time to buyout for a FTSE 350 DB scheme was nine years and three months, in May 2021 it was seven years and five months.

Kessler points out the influence of interest rates and asset values on buyout pricing. "Pensioner longevity and liabilities have held quite steady, but interest rates and asset values have been incredibly volatile," she says. "At various points in the crisis, rates fell and spreads widened. Since insurers put together buy-in and buyout portfolios with spread bearing assets, when spreads blew out, pricing on buy-ins and buyouts got quite a bit better. Pension schemes that were prepared could transact at the most attractive prices we have seen in years."

The crisis has also influenced investment strategies, particularly in relation to management of longevity risk and use of LDI strategies. Dabrowski highlights a need identified by some trustees to look carefully at the health of companies or sectors in which the scheme is invested, or in trends relating to asset classes like real estate, which may have been permanently altered as a result of the pandemic.

Health concerns

But scheme strategies and funding might also be affected by other factors, such as the still unknown long-term effects of Long Covid.

"We don't know whether it will lead to long-term health problems," says Pensions Institute director, Professor David Blake. "Are there going to be people who suffer from permanent damage to their kidneys, lung scarring, problems like that? If so, they may not be able to work to a normal retirement age. If a pension plan does not give a full actuarial reduction for them retiring earlier, then that increases scheme liabilities."

But Long Covid may have a bigger overall impact on other schemes, says Bartlet. "If it doesn't have much of an effect on life expectancy then it's probably not going to have much of an impact on DB schemes," he explains. "With the vast majority of DB schemes being closed, Long Covid isn't going to affect liabilities very much. Some people may unfortunately end up with a lower quality of life, but they're still going to be paid their pensions."

More uncertainty surrounds the impact of increased mortality from other health conditions that went untreated during the pandemic. A 2020 study completed by NHS experts and based on NHS data suggested this could lead to significant increases in deaths from different types of cancer up to five years after diagnosis, including increases of between 7.9 per cent and 9.6 per cent for breast cancer, between 15 and 17 per cent for colorectal cancer and 5 to 6 per cent increases for both lung and oesophageal cancers.

The pandemic has also had detrimental effects on mental health, which may be linked to other negative impacts, such as increases in alcohol or drug addiction. And at the time of writing there are concerns that under-exposure of the general population to the flu virus during the past two years could lead to a spike in flu infections and deaths this winter.

But the pandemic may also have driven improvements in health. "If we see behaviours that we've learned through the pandemic continue, like better hygiene, shielding elderly relatives – all those behaviours could lead to fewer flu deaths in future," says Sharkey. "The pandemic could also be the catalyst that nudges individuals into healthier lifestyles." Methodologies and technologies developed or improved during the pandemic, such as mRNA, may also be used to combat other diseases in future."

But if the longer-term impact on longevity remains difficult to discern, Barnett Waddingham partner and head of employer DB consulting, Simon Taylor, thinks the real significance of the pandemic may be the way it changes sponsors' and trustees' views of these schemes.

"The past 18 months will have focused the sponsors more on the endgame," he says. "Many sponsors would rather not have to worry about their DB scheme. I think there will be a focus now on thinking about whether the sponsor can get it off their balance sheet at an acceptable cost. If something like the pandemic happens again sponsors will want to be focused on their day jobs, not the pension scheme."

Kessler agrees. "Every crisis increases our understanding of the risk and volatility in DB schemes," she says. "Given that the pandemic has modestly impacted liabilities but vastly impacted rates and assets, we see it reinforcing the path toward a lower risk future."

Written by David Adams, a freelance journalist