Agenda Item 6

Coronavirus Update

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Falkirk Council

Subject: **Coronavirus Update**

Meeting: **Joint Meeting of Pensions Committee and Pension Board**

Date: **19 March 2020**

Submitted by: **Director of Corporate and Housing Services**

1. Purpose of Report

1.1 The purpose of this report is to provide comment and reflection on the significance of the Coronavirus (Covid-19) outbreak for the Pension Fund.

2. Recommendation

2.1 The Pensions Committee and Board are asked to note the contents of the report.

3. Background

3.1 Amidst mounting global concerns about the Coronavirus, recent weeks have seen financial markets suffer their worst loss since the great financial crisis of 2008.

3.2 With the virus spreading beyond China, and the prospect of a longer-lasting global pandemic, markets have reacted adversely with the MSCI All Countries World Index down by 5.7% (in sterling terms) in the first two months of 2020. This reflects the high degree of market uncertainty about the severity of the crisis, its longevity, and its ultimate impact on the global economy

3.3 The likelihood of an economic slowdown has also pushed up the cost of credit and is expected to put further pressure on company financing - the collapse of Flybe being an example. Moreover, the expected fall in demand is hitting oil prices which in turn is unsettling markets.

3.4 Governments and Central Banks can be expected to try and maintain economic and social stability using all means at their disposal, such as cutting interest rates and investing heavily in economies. The difficulty is that interest rates are already at low levels and that priming the economy will take time to feed through.

3.5 Scott Jamieson, who is a member of the Joint Investment Strategy Panel, is attending today’s meeting and will be able to provide further insight into possible developments. Scott’s reflections thus far are attached as an appendix to this report.

4. Pension Fund Impact

4.1 The value of the Fund at 31 December 2019 was £2.68bn. The estimated value of the Fund at 6 March was £2.55bn - a fall of 5%. This means that, in effect, the fund has returned to the value it stood at around May, 2019.

4.2 With the end of the "crisis" not yet in sight, it is inevitable that the Fund's assets at 31 March 2020 are going to be depressed when compared to the pre-Virus position. This is significant as 31 March 2020 is the date of the next formal Fund valuation where the value placed on assets is a key component. All other things being equal, a lower aggregate asset position means upward pressure on employer contribution rates. The Valuation is considered in a separate report on today's agenda.

4.3 Whilst the fall in Fund value is substantial, the following points are worth bearing in mind:

- A loss is only crystallised if and when assets are actually sold
- The Fund receives more by way of contributions than it pays out in benefits (i.e. it is "cashflow" positive). It is therefore under no pressure to sell any assets.
- The Fund is a long term investor with underlying employers who have strong covenants. The Fund therefore has the ability to continue to pay its benefits as they fall due and to sit out the market turbulence.
- Whilst the fall in equity markets has been pronounced, the Fund holds other asset classes including bonds, infrastructure, property and cash all of which are income generative.
- Without downplaying the challenges of Covid-19, severe market corrections are a regular feature of history (e.g. 1987 Black Monday, 2008 Financial Crisis). These – as now – generally occur after periods of strong market performance with markets eventually bouncing back.
- The market disruption is being discussed by the Joint Investment Strategy Panel.

5. Pensions Section Operational Arrangements

5.1 The effects of a pandemic and the potential loss of staff and systems is addressed in the Pension Fund's risk management arrangements.

5.2 In particular,

- The pensions administration system (Altair) which is key to operational continuity is hosted by a third party provider with their own contingency arrangements. Altair is a web-based system which can be accessed from any location which has internet facilities.

- A number of the pensions team are equipped with laptops and are able to work from home. In the event of an extreme situation where normal service standards cannot be achieved, priority would be given to the payment of monthly pensions and retirement lump sums.

5.3 The health and well-being of the Pensions team and wider Council colleagues is of paramount importance. To that end, an information page has been set up on the Council's intranet site with information about identifying symptoms, when to self-isolate and restrictions on travelling to the most severely affected countries and regions.

5.4. Any relevant information to scheme members and pensioners will be disseminated through the Falkirk Council website and/or the Falkirk Pensions website.

6. Implications

Financial

6.1 The downturn in equity markets is a factor which will impact negatively on the results of the valuation.

Resources

6.2 Should staff be unavailable due to the spread of Covid-19, it may be necessary for other Finance staff to be re-allocated to the Pensions team. Additionally, it may be appropriate to increase the level of homeworking.

Legal

6.3 There are no legal implications arising from the report.

Risk

6.4 The loss of staff and therefore the ability to provide the full range of pensions related services is a key risk. Some mitigations are in place including the hosted nature of the Pensions Administration System and the capacity for staff to work from home.

Equalities

6.5 There are no equality issues arising from this report.

Sustainability/Environmental Impact

6.6 There are no sustainability/environmental issues arising from this report.

Director of Corporate & Housing Services

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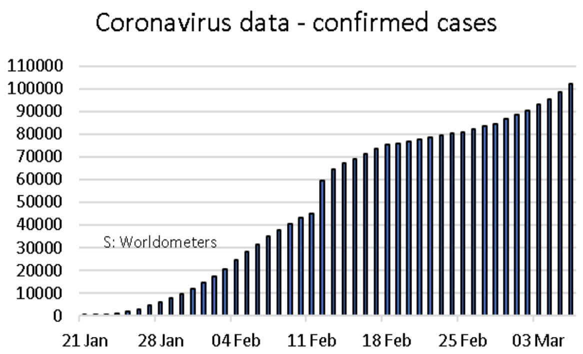
Date: 9 March 2020

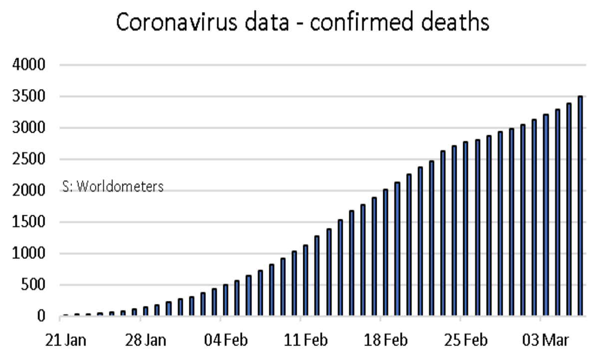
Appendices
Appendix 1 – Market Update following the Coronavirus Outbreak, Scott Jamieson

List of Background Papers:
None

Market Update following the Coronavirus Outbreak

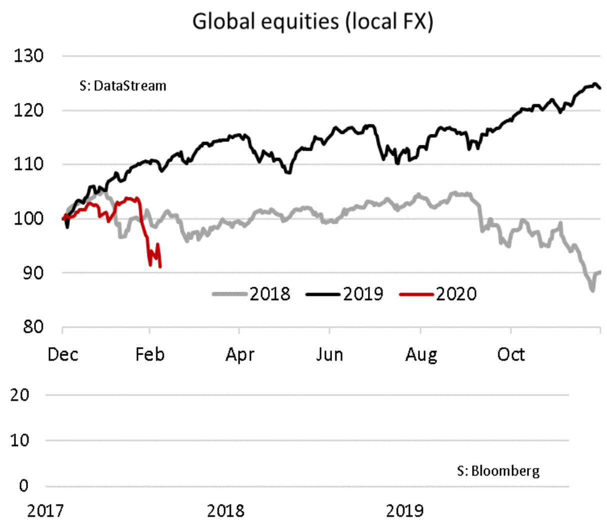
At the time of writing (March 7), cases of infection from the 2019-nCoV virus have been found in 97 countries and the total number of infections has exceeded 100,000. The World Health Organisation estimate a fatality rate of 3.4%, three-quarters of which will be patients with existing health conditions. Based on these statistics and assuming, in an epidemic, one third of the UK population contract the virus then the impact on the pension could be a 1% reduction on projected liabilities.

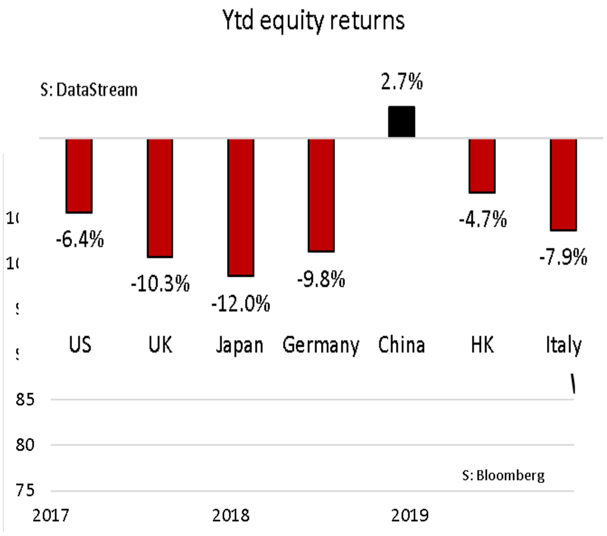




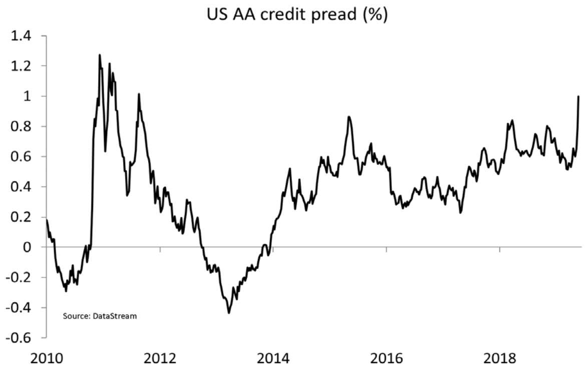
The impact on economic growth from measures to contain/avoid infection will prove significant and could generate a recession in many countries. The ‘hard’ economic data is too lagged to capture what is currently happening; ‘soft’ sentiment data has collapsed (to record lows in China) and points to very weak economic data to come.

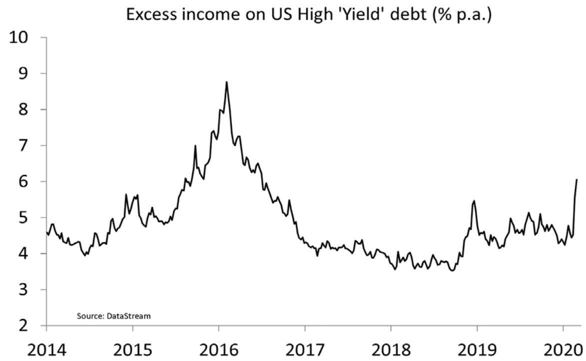
As it became clear that the world economy was going to slow significantly, equity markets, having started the year so well, turned sharply lower, producing some of the most severe falls since the Great Financial Crisis of 2008/09. Corporate earnings will surprise if they emerge from 2020 unscathed. The anomaly perhaps is the Chinese market where investors believe the outbreak is close to over. Having been the original source of the infection few seem worried about re-infection from the rest of the World (which could be hard to avoid).





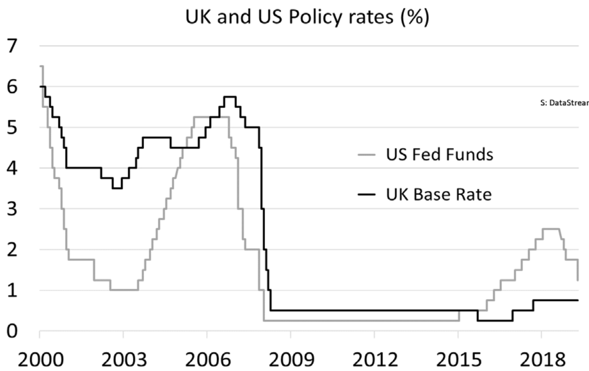
The prospect of a pronounced slowdown has fuelled worries around the health of many businesses. As a result, the price for credit risk on investment grade and sub-investment grade bonds has risen sharply raising concerns that the virus could create havoc within the financial system; the demise of Flybe is just one

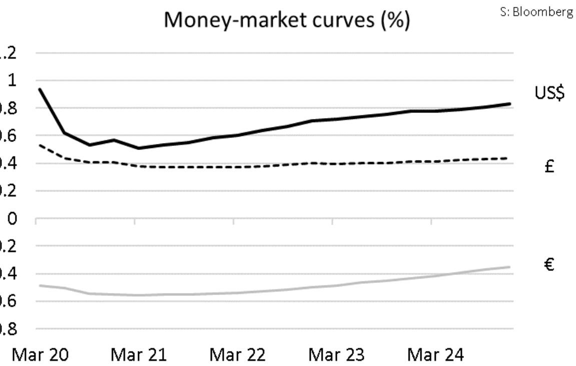




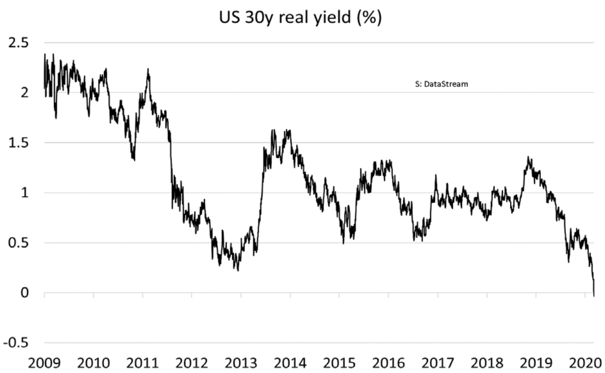
example.

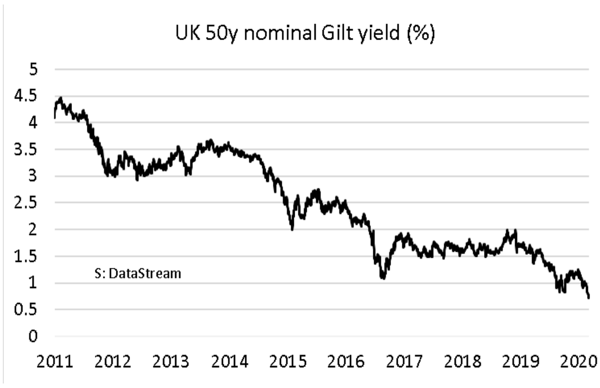
In response, Central bankers have agreed on concerted action to ease monetary policy. A range of measures have been implemented in China in recent weeks; the US, Canada and Australia have recently cut (already ultra-low) policy rates by 0.5% with the UK expected to follow after the Budget. The outlook for policy rates is that they will stay close to zero, or below, for a very long time. Speculation that interest rates would ‘normalise’ was widespread not that long ago; such talk has completely gone. In addition to rate cuts, widespread relaxation of fiscal policy is expected.





Reflecting lower policy interest rates, sharply weaker economic growth, continuing dis-inflationary pressures and the slump in risk appetite, long term bond yields (discount rates) have collapsed to record lows. $14.6 trillion of Government bonds across the World now stand on a negative yield. All major market inflation protected bonds now guarantee buyers a loss in real terms.





Comment

Ever since the Great Financial Crisis, central bankers have done what was needed to avoid a recession. Their concern was not a recession per se but, with memories of the GFC still fresh, that a slowdown would quickly morph into something much more severe. In this, central bankers have succeeded; the current economic expansion is the longest in living memory.

Desperation to avoid a recession is consistent with concerns that the world economy never really resolved the problems of the GFC: of over-indebtedness, deflation and weak institutional structures (nowhere more so than across the €-zone). Even as the World economy grew, hostility to perceived inequity intensified; what might populism demand if economies shrink and unemployment rises?

There are several important problems with the stance adopted by policymakers. From an economic perspective, the occasional recession is a good thing. It sustains a sense of jeopardy that keeps decision-making 'honest' across businesses, householders and investors alike. Defer the correction and the eventual pressure-release becomes all the more dramatic.

From a policy perspective, the 'cost' of sustaining the expansion has been the near exhaustion of options available to central banks. Only the US was able to establish any altitude on interest rates from which future rate cuts would have potency; most everywhere else, central banks will enter the next recession on near zero or negative policy rates and with nowhere to go. The poverty of monetary policy options is critical if the next recession is created by a shock outside the financial system; in such a scenario any monetary policy response must be large if it is to have a material impact.

Now in the virus we face the threat of a global recession as the world economy experiences a shock, the like of which we haven't seen before. Central Bankers of the World's major economies have committed to a co-ordinated response deploying what few weapons they retain. The best that this might achieve is to buy time for politicians to formulate a strong fiscal response. The problems with large infrastructure projects – needed everywhere – is that they take time to get up and running; cash give-aways are likely. Most of these will come through tax cuts, but some governments may take their lead from Hong Kong where authorities recently handed out HK$10,000 per adult to offset the disruption caused by the riots of last year.

The classical concern about fast and loose fiscal policy is the damage done to inflation. With few investors understanding why, since the GFC, inflation has remained so low, most have come to believe that it will stay low, regardless. So, even as unbridled fiscal expansion looms ever larger, global bond yields continue to plunge, setting new records almost every day. Whether down to the prospect of the current slowdown moving inexorably to a deep recession or in anticipation of a massive QE (Quantitative Easing) programme, appetite for (now, very thin but secure) yield is soaring.

The enduring take-away is that the macro-economic regime of the past forty years is about to change. Monetary rectitude will soon give way to true 'helicopter' money. Central Banks were already laying the groundwork for periods in which higher inflation would be indulged. Under Modern monetary Theory (the technical term now used for fiscal proclivity) the assumption is that politicians will freely raise taxes when times are good; I wonder! After many years of excellent returns, bond investors now need to start worrying about what they have wished for.

Scott Jamieson, 7 March 2020