TRANSCRIPT
PENSIONS FOR PURPOSE PODCAST, SERIES 2, EPISODE 15
SUSTAINABILITY IN PENSIONS INSURANCE

Laasya Shekaran, Pensions for Purpose: Hello everyone, and welcome back to the Pensions for Purpose Podcast. I'm your host, Laasya Shekaran, and on today's episode, we're going to be talking all about sustainability when a pension scheme goes to an insurer. I'm really excited that I'm joined by not one, but two brilliant guests from EY today, to get into all of this. My first guest is Tatiana E von Petersdorff, ESG and Sustainability Lead for the EY UK Pensions and Actuarial Team. Welcome to the podcast, Tatiana.

Tatiana E von Petersdorff: Hi Laasya.

Laasya Shekaran, Pensions for Purpose: My second guest is Matt Foley, who is a Pensions Actuary in the Risk Transfer Team at EY. Welcome, Matt.

Matt Foley: Hi, Laasya, thanks for having me.

Laasya Shekaran, Pensions for Purpose: Brilliant, let's start at the beginning. Why are we talking about this in the first place, and why does sustainability in insurance actually matter for pension schemes?

Tatiana E von Petersdorff: With over one trillion pounds held in UK defined benefit (DB) pensions assets, and the percentage of schemes in a technical provision surplus around 77%, there really is a huge pool of capital that has the potential to bring about meaningful, real-world impact if invested responsibly. So, even if only a very small proportion of these pensions assets are passed onto an insurer during a buy-in or buy-out transaction, this is still a massive market, and indeed, we've seen transaction volumes at all-time highs throughout 2024.

Also, with only around ten bulk purchase annuity (BPA) insurers operating in the UK, the concentration of pensions assets after buyout are in the hands of a few insurers. This also means that trustees and corporates should be mindful of where each of these insurers will hold this money after the transaction, and how it will be invested over the long-term.

Particularly because long-term capital is affected by systemic risks, like climate change and other sustainability risks, which are likely to play out over the longer term, sustainability and insurance is a key risk, as well as an opportunity for pension schemes to be aware of when they're selecting an insurer for a buy-in or buy-out transaction.

Laasya Shekaran, Pensions for Purpose: That's quite a shocking number, isn't it? Just ten insurers that are covering a trillion pounds of assets, it really puts things into perspective quite a lot. You mention this is long-term capital, where they are affected by systemic risks like climate change.

This topic of sustainability and insurance is clearly really important, especially when we talk about that concentration and the long-term risks. How is this actually coming up in the conversations that you're having with your clients?

Matt Foley: I think it's coming up in conversations earlier in the process. From our perspective, we're seeing trustees and sponsors wanting to understand more about the insurer's environmental, social and governance (ESG) capabilities.

I'll go as far as to say, it's now almost always included in any due diligence exercise that's conducted on the insurers as part of choosing a preferred provider. It will be done alongside administration capabilities and the other, what you might consider, more traditional due diligence areas. A few years ago, perhaps ESG didn't carry as much importance in these conversations than it does now, and should do, but it's certainly part of those insurer selection criteria conversations and discussions.

From our experience, we think trustees and corporates want to know more. We had a recent case where there was actually quite a bit of back and forth with insurers as a result of the trustees' questions, so real proactive engagement. That is just one example, but it really does highlight the interest that these parties have in ESG relative to a few years ago, where if the exercise was conducted, it would have been probably a bit more of a reporting tick box than we're seeing now. I'd go as far as to say it's not specific to the professional trustees either, so we are seeing this across the board on the cases that EY are working on.

Laasya Shekaran, Pensions for Purpose: What do you think has driven that change, as you say, over time, with this getting so much more focused now?

Matt Foley: I think it's in part due to the improvement in funding level, so perhaps where the schemes didn't have the buyout or the buy-in decision was perhaps seen as an aspirational goal, and once that became achievable, the price really dictated the transaction. I think societal impacts are probably at play as well there, and I think, outside of pensions, people are a lot more aware of ESG and its importance. I think there's probably a few factors, but certainly the improvement in funding level is key there.

Laasya Shekaran, Pensions for Purpose: Yeah, that makes a lot of sense. What about, challenges? Do you see any challenges when you talk to trustees about ESG and their ability to address this, when it comes to buyout and insurance?

Matt Foley: Yeah, I think that's probably a bit of a tricky question, I guess in the context of, when does the trustee's duties end with regards to ESG within a transaction framework? Ultimately, I think as we're all aware, beyond the point of buyout, those trustees don't have that duty anymore, but they certainly do think about the long-term future for the schemes, and of course, members' benefits that will remain being paid by the insurer, and how the assets backing those benefits are being used.

Laasya Shekaran, Pensions for Purpose: It sounds like if pretty much everyone's having this ESG discussion as part of their due diligence process, then clearly they do see it as being part of their duty, at least when they're selecting an insurer, so that's a really positive sign, I think.

Matt Foley: I definitely agree.

Laasya Shekaran, Pensions for Purpose: This seems to have been quite a big development in the pensions industry more generally, where there is quite a lot of collective focus on the insurance industry, buyout and bulk annuities. One of the recent developments in the industry is the bulk annuity Charter for Sustainability. Can you tell us a bit more about this, and your involvement with it?

Tatiana E von Petersdorff: Sure. Accounting for Sustainability launched this charter last year, so the Sustainability Principles Charter for the bulk annuity process – quite a mouthful, that title. The Charter is centred around four key principles, so looking at transparency, decision-making, reporting and engagement, and collaboration in the insurance market. We became signatories last year, and contribute to this really important initiative through our participation in the working group and the steering group, as well as upholding the values and aims of the Charter. It was really great to also see that The Pensions Regulator (TPR) specifically mentions this Charter during their 2024 annual statements, so encouraging trustees to take sustainability into account during their due diligence when considering an insurance solution, and urging trustees to familiarise themselves with the Charter.

What was positive to see so far, is the really great group effort and collaboration amongst insurers and advisors in supporting the Charter, and being actively involved with the work with the Charter. Even those insurers that aren't signatories to the Charter, which there aren't many of, they've been very responsive to, for example, filling out the bulk annuity sustainability survey, which is a survey that came out of the work done with a group of signatories. This survey was launched earlier this year to make sure that there's standardised questions from advisors to insurers, which really helps improve the quality of information that's passed on to both advisors and then to their clients. We've seen this as a really great step forward in terms of getting more transparency and sustainability-related information out there.

As Matt mentioned, ESG and sustainability are a really important part of our due diligence process, and we incorporate it through all our client advice, so it's just made it a lot easier for advisors like us to collect this information and present it to our clients. The thing with sustainability also is that it's not just a tick box exercise. It's really important for trustees and corporates to understand the sustainability credentials of potential insurers, both from a reputational risk, but also a financial risk perspective. It's really important for trustees to be comfortable with the sustainability approach that the insurers take, as I think I mentioned earlier that climate change and sustainability risks play out over the longer term. That's long after the buyer transaction is completed, and the responsibility has shifted away from the insurer. So, understanding how insurers' comparative strengths and weakness looks amongst different insurers is key, because we're still seeing quite a spread in terms of that amongst different insurers.

What we also found is that it's not always so easy to put one value or figure onto sustainability. It's quite a nuanced topic, there isn't an easy, does your insurer have a sustainability approach, yes or no. Do they do XYZ, or having a single statistic in place that looks at how you can compare your insurers with other metrics, solvency ratio, BPA, transaction volume? That's a lot easier to put a figure on and then compare, whereas with sustainability, there's a lot of nuance that you have to distil. So we try our best to make sure that the in-depth research that comes from talking to insurers about their approach, and is distilled into something that trustees and corporates can grasp without being overwhelmed with detail, and provide a clear picture on the overall sustainability credentials. So, overall, it feels like there's been quite a lot of work being done in the last year specifically, looking at improving the information that clients and advisors get from insurers on their sustainability approach. It has been good to observe that.

Laasya Shekaran, Pensions for Purpose: It's great to see that people are coming together and working on this collaboratively, because I think that makes things better for everyone. You have a standardised approach, so the insurers don't have to do loads of different sets of information for everyone, but also you can work together to make sure that you are collecting that correct information that has the nuance, as you say, which is quite hard to capture sometimes.

It's also great to hear that TPR has picked this up as well. I hadn't realised that, so clearly it's quite mainstream and is seen as the go-to for considering sustainability. You mentioned the values and aims of the Charter more generally. Can you tell us, what those values are and what the focus is?

Tatiana E von Petersdorff: There are four key principles that the Charter is centred around. Transparency looks at the values, principles, investment beliefs in relation to sustainability of ongoing commitments that might guide future policy and practices affecting sustainability approaches. The second one is around decision-making, so really evidencing and understanding how sustainability considerations are incorporated into the broader investment decision-making process.

Then, reporting and engagement – obviously it's important to have ongoing reporting and engagement with key stakeholders on sustainability commitments, so that goes beyond the transaction. The final principle is around collaboration, a commitment to having ongoing engagement across the pension sector, as responsible investment practices evolve amongst the investment community and broader regulatory regimes.

Laasya Shekaran, Pensions for Purpose: That's amazing. Is the idea that the survey reflects those core principles overall?

Tatiana E von Petersdorff: Exactly. It's a very detailed survey, and it's structured around those four principles and there's loads of information provided in those surveys.

Laasya Shekaran, Pensions for Purpose: Brilliant, I'm looking forward to seeing all the results at some point. Let's talk a little bit about sustainable investments. Trustees of DB schemes who have decided that their end game is that they want to go to an insurer, often have restrictions on what assets they can hold, because they need to be holding assets that the insurer can accept and there's a whole regulatory regime around that. I think that trustees can sometimes see this regime and these restrictions, as being a barrier to investing sustainably and impactfully. So I'm really keen and curious to get your take on this. How can we encourage more investment into sustainable assets from those DB schemes that are planning to go to an insurer?

Matt Foley: That's a really good question. From the research EY do in the UK fiduciary management market, we totally agree that the common barrier that we find is that the allocations to those ESG-focused investments was the challenge of making the portfolio attractive to an insurer. We spoke a little bit earlier about the funding level improving, so for more pension schemes, this focus then shifts towards making that investment portfolio as attractive as possible to insurers, by which we mean more gilts and investment-grade public credit.

I think it can be challenging to integrate those impact solutions into these insurer-suitable asset classes and find that overlap. A way to bridge that gap is needed, I totally agree. I think support from the Government, the Prudential Regulation Authority (PRA) and other regulators would be really helpful there. Just more broadly, EY are in active discussion with some of our largest clients and the pensions community, by which I mean advisors and providers, just to see how more allocation can be made to ESG-focused investments. For illiquid assets, we'd like to see some more support from the regulator to make them suitable for a buyout transaction. I think that would really encourage pensions to invest in both liquid and illiquid ESG-friendly investments.

Laasya Shekaran, Pensions for Purpose: I think that makes a lot of sense, and I guess there's two sides of it. There's what can you do under the current regime within those asset classes that you described – so your gilts and your IV credit, how can you make those more sustainably aligned? – but then also how can we change the regime, so that you can hold some of these more illiquid assets, as you say, as well.

Matt Foley: Definitely.

Laasya Shekaran, Pensions for Purpose: There are also questions around the kind of policy environment for insurers, and whether that should change. As you mentioned, Matt, engaging with government and the PRA, who's the regulator for the insurers, is really important. What are your thoughts on the policy environment, and how we can address some of these barriers?

Tatiana E von Petersdorff: I guess it's quite a similar question to what Matt has just answered, so I'll just add that this is definitely an area that we need policymakers to provide more guidance on and make it easier to pass across ESG-friendly assets from the pension scheme to an insurer during a buyer transaction.

We have seen from the research that we've done, that's a very common barrier to increasing allocations to ESG-focused investments for pension schemes, so before they're even considering buyout, is that they want to make the portfolio more attractive to an insurer. As the funding levels improve, they're less likely to shift towards a portfolio asset allocation that has a lot of impact or ESG-friendly investments if they're not suitable for the insurer, so we're trying to bridge that gap, to still encourage pension schemes to invest in ESG-friendly assets, but that they also are suitable for the insurer.

These days sustainability is more centre stage during a bio transaction, and this is a once-in-a-lifetime deal, so both the pensions and the insurer have the opportunity to be joined up here and invest for the transition. But we do need more clarity and guidance from policymakers around that; at the moment. no one's acting on it, because that's what wouldn't fit within the requirements needed.

Laasya Shekaran, Pensions for Purpose: How are policymakers engaging with the pensions community? So, for example, with the bulk annuity Charter, you mentioned that TPR picked that up and has referred to it. Are you getting any engagement from the PRA, and are they receptive to the group?

Tatiana E von Petersdorff: Not directly that I'm aware of; it's possible, but we haven't had any conversations that I'm aware of at this point.

Laasya Shekaran, Pensions for Purpose: It would be good for them to also engage with you guys, because it sounds like there's a lot of alignment there with what you're thinking. Another big update in not just the pensions world, but the finance world in general, is this idea of transition plans. There's a consultation currently out on that. How do you think transition plans fit into this discussion?

Tatiana E von Petersdorff: It will be really interesting to see what comes out of this consultation. It's currently underway, so it is obviously not clear yet what it will mean, but for now, the kind of wording in the consultation talks about larger schemes potentially being required to have in place a plan for net-zero by 2050.

I guess the challenge here is still around what is defined as a larger scheme. It doesn't say in the consultation what that is. If we go by previous rollouts of climate reporting, for example, it might mean just that $5bn plus tranche of pension schemes, in which case, our average client is about half a billion, so they're unlikely to be caught up by this new regulation, so it's probably not very likely that they'd have a direct impact.

Also, it is unlikely that the size of our clients currently will be focusing on and having an approach to net-zero in place. There will be a few, but not loads. Also, the point around working towards net-zero, so just focusing on decarbonisation, but you don't want to be doing that in isolation of allocating to ESG-focused investments – so there isn't really a clear link between targeting net-zero, but also focusing on allocating to ESG-focused investments. A question mark at this point, is what the outcomes of that consultation will be, and what the impact will be on pension schemes and the insurer market.

Laasya Shekaran, Pensions for Purpose: It's a great point about portfolio decarbonisation, because I do think that pension schemes are quite often focused on just what does their own carbon footprint look like. I think that's been encouraged by the current rules within the Task Force on Climate-related Financial Disclosures (TCFD)'s reporting requirements, but actually, that's not necessarily the same as having a positive real-world impact and global decarbonisation. It will be interesting to see if transition plans help to shift that mindset a little bit.

You're right, it's likely, at least to start with, that those transition plans will apply just to the larger pension schemes. I guess most of those insurers themselves are pretty big, if there's only ten of them covering the whole DB market. So perhaps they'll be setting their own transition plans, and that might be helpful as well.

Tatiana E von Petersdorff: Exactly, and quite a few of them actually already have transition plans in place, or are currently producing them to be published, so you still have the point of some people have much more detailed transition plans than others, and more detail around their short-term and medium-term targets. The quality of transition plan also matters.

Laasya Shekaran, Pensions for Purpose: That's so true, and it's interesting to hear that they're already doing that. I guess another thing that's interesting is that this is not an bulk annuity climate Charter, it's an bulk annuity sustainability Charter. Are you looking at how the insurers are perhaps considering social factors as well as part of that workstream?

Tatiana E von Petersdorff: Yeah, absolutely. Well picked up that it is broader than just climate change, so also moving away from the word ESG, but towards sustainability to encompass things like climate, nature, social factors, so there's quite a lot covering specifically nature and social factors in the questionnaire. Certainly from the results, we haven't seen advanced approaches to these topics yet, but definitely there is a spread in terms of maturity: some insurers are doing a lot more thinking around it, whereas others are at the beginning stages of looking at that.

Laasya Shekaran, Pensions for Purpose: That sounds really interesting, and these are really important questions to be asking. There's clearly a lot to get your head around here, though, and there's a lot of a pension scheme trustees to think about, and they are also probably considering so much other stuff at the same time. How do you and your team at EY help pension scheme trustees with this?

Matt Foley: I think early engagement is absolutely key, we find it can be useful to have workshops and regular training sessions to educate trustee board members on this topic and have that ongoing dialogue. This isn't just a one-and-done exercise.

We spoke a little bit earlier about the work we've been doing, with regards to insurer due diligence. I think it's important to establish and agree those frameworks for evaluating ESG performance. The EY team can support in both these areas, the former, of course, being part of a business as usual (BAU) operation and not just relating to a risk transfer project.

Laasya Shekaran, Pensions for Purpose: That early engagement point is really interesting. I'm curious to know how the insurers are actually engaging with you on this. When you ask them these questions about sustainability for your due diligence, for example, are they receptive and what are those conversations like?

Matt Foley: Tatiana, why don't I bring you in here, because I know you have those conversations directly with the insurers?

Tatiana E von Petersdorff: It's been really helpful to have the FOS charter, just because a lot of the insurers – the vast majority – are signatories, so it's really demonstrating that they're very happy to have these conversations. It has also been really helpful to have a standardised questionnaire now, because it's just a process. They are all agreed on the questions we came up with this together, so they're happy to provide that information, and they only have to do it once. Whereas before, they may have had to fill out 20, 30, or maybe even more questions, all in a slightly different format, now it's just one set of questions, and they're very happy to be forthcoming with that information.

Of course, it also benefits them to provide as much information as possible to highlight their strengths in this area, because this is what we're ultimately sharing with clients. They have definitely been really collaborative environments. We have, as I mentioned the working groups and steering groups, where we all get together discussing what areas to focus on for future years, and projects to work on, and then which areas need a bit more attention. It's been really good interaction so far between advisors, insurers and pension schemes.

Laasya Shekaran, Pensions for Purpose: It is really nice to hear a positive sustainability and ESG story, especially with the year we've had with so many less positive announcements. It's really nice to hear that actually, we've got the pensions industry coming together, different advisors and insurers working together to try and improve standards and collaborate on this. I think there's some really positive news here, and lots for us to look out for in terms of developments. This has been a really fascinating discussion. If there was one thing you wanted listeners to take away from this discussion, what would it be?

Tatiana E von Petersdorff: I think our main thing that we would want is a call to policymakers to make it easier to pass on these ESG-friendly assets from pension schemes to an insurer during a buyout or buy-in transaction, because it is a really great opportunity to start actively encouraging allocations towards ESG-focused investments, and it seems like an unnecessary barrier to have.

Laasya Shekaran, Pensions for Purpose: I think so too, and I'm sure that there needs to be some regulations and restrictions in place to protect the insurance regime – but then also there are other risks associated with sustainability if you are not investing for impact. I think it aligns quite well with the growth agenda that the Government has at the moment as well, to be thinking about this carefully.

Thank you so much, both of you, for joining me today. It's been a really great discussion. Listeners, if you want to make sure that you never miss an episode, do hit the follow button and remember that you can find us wherever you get your podcasts. Thanks for listening, and we'll see you on the next one.