

ESG in the UK bulk purchase annuity provider market

Key sustainability themes to consider
when selecting a bulk purchase
annuity provider

February 2024



Why you should consider ESG in the bulk annuity process

Environmental, social and governance (ESG) risks can be material at every stage of a pension scheme's lifecycle. Often ESG has not been a focus for schemes close to their "endgame", however by not considering ESG in decision-making in relation to buy-ins or buy-outs introduces risks to sponsors, trustees and members including:

- ▶ **Greenwashing or reputational risk** for the sponsor where they have made public ESG commitments before a buy-out or buy-in.
- ▶ Trustees won't have fulfilled their **fiduciary duty** if they don't seek to protect members from ESG risks after buy-out.

The increase in yields since September 2022 has had a significant impact on the market, accelerating journey plans for many schemes. The market is currently seeing high demand from schemes and stretched insurer capacity. The total volume of buy-ins and buy-outs over 2022 was just under £30bn (the third highest year for volumes). This trend has continued and it is expected that the volume will have exceeded £50bn for the first time in 2023.

This is our first industry-wide survey looking at how ESG factors are considered by bulk purchase annuity (BPA) providers, covering the year ending 31 December 2023. We assessed **all nine** UK BPA providers against five key pillars: governance, risk management and integration, stewardship, climate change and reporting. In our capacity as an independent oversight and selection adviser, EY teams are well placed to build a picture of the entire industry and assess the different stages of ESG maturity exhibited by different BPA providers.

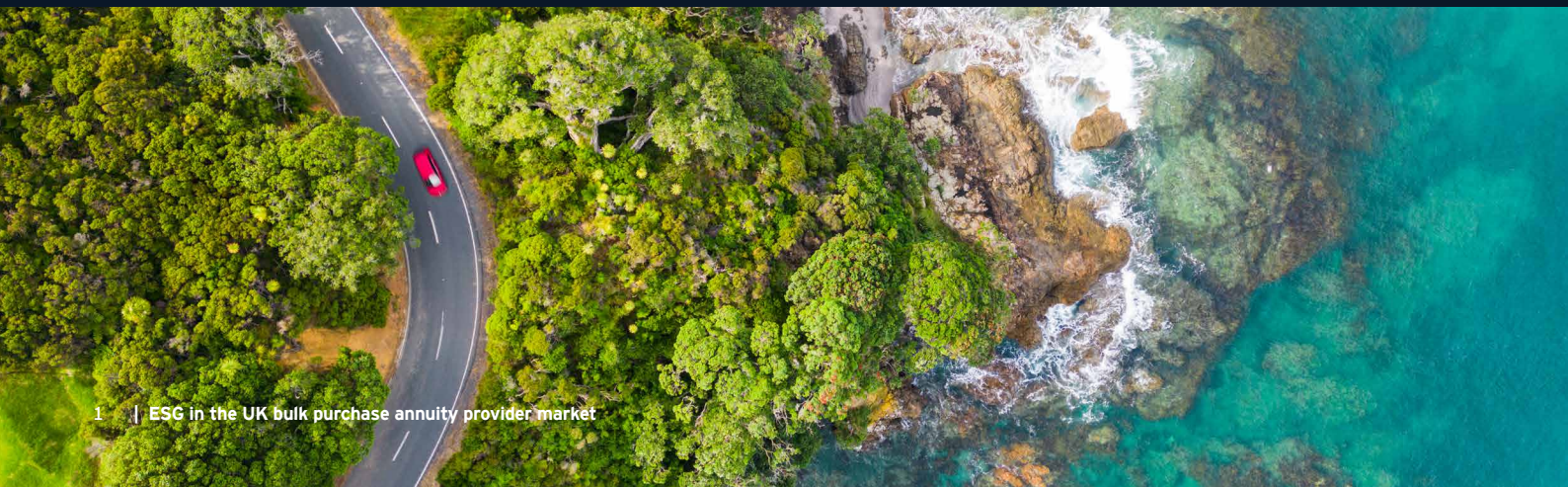
Research found that some providers are leading on ESG, but others consider it only to a moderate extent. This demonstrates that it is important for trustees and sponsors to build ESG into their provider selection decision.

We aim to improve the transparency of providers' ESG capabilities so that it is easier for trustees and sponsors to differentiate between providers. In this publication we explore the key themes of our research, along with some barriers providers face in improving their allocations to ESG-focused investments.

We hope this report provides insights to help you navigate the market and consider how your member outcomes are protected from an ESG perspective.

We would like to thank all respondents who participated in our survey.

EY teams also conduct annual ESG surveys into the UK fiduciary management ([which you can read here](#)) and Defined Contribution Master Trust markets ([read here](#)).





Key themes

The survey responses show that governance and stewardship are the strongest areas, with mature approaches taken by most providers.

8/9 providers are signatories to the FRC's UK Stewardship Code.

8/9 providers have a dedicated ESG and Sustainable Finance team.

Climate change is another area that providers have dedicated significant time and resources to, but they are at different stages of their journey to net zero.

There was mixed progress towards integrating ESG into risk and investment management decisions and on diversity, equity and inclusion.

EY teams have observed a range of reports provided online by providers. Many of these reports include extensive information, but can only be understood by investment or sustainability professionals. The industry has some way to go before reporting is provided that is clear, concise, and understandable to members.

ESG risk management and integration

To gain a full picture of the scheme's exposure to climate risks one should look at both the assets and factors that influence the benefits members will receive such as longevity. Whilst all providers integrate ESG to some extent into their investment process, there remain only a few providers that have a strong approach to considering ESG in their **liability profile**. Leading providers quantify the impact of various environmental factors on longevity, including:

- ▶ Temperature rises due to climate change
- ▶ Levels of pollution
- ▶ Increase in green transport

Risk of litigation arising from ESG factors (such as achieving climate targets, community impact of investments, and governance standards) are also included in risk analysis by some providers.

Journey to net zero

It is important for providers to have a decarbonisation strategy for both their own organisation, as well as for their investment portfolios.

Most providers have a net zero strategy for their investment portfolio, including interim targets, but the coverage of these targets and their tangible progress varies significantly. We view it as critical that providers should be engaging with climate change seriously as they will be responsible for paying member's benefits for potentially decades. Therefore, it is important that trustees and sponsors are acting as responsible stewards for future outcomes of current members.

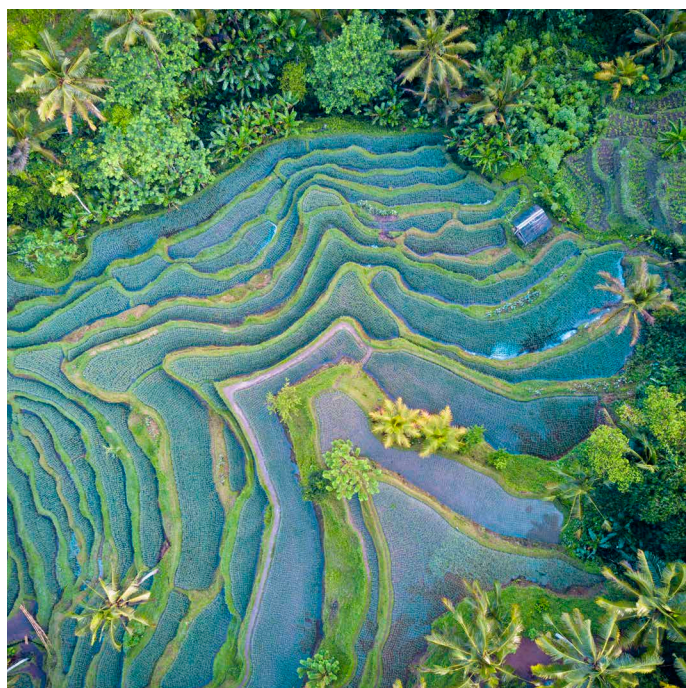
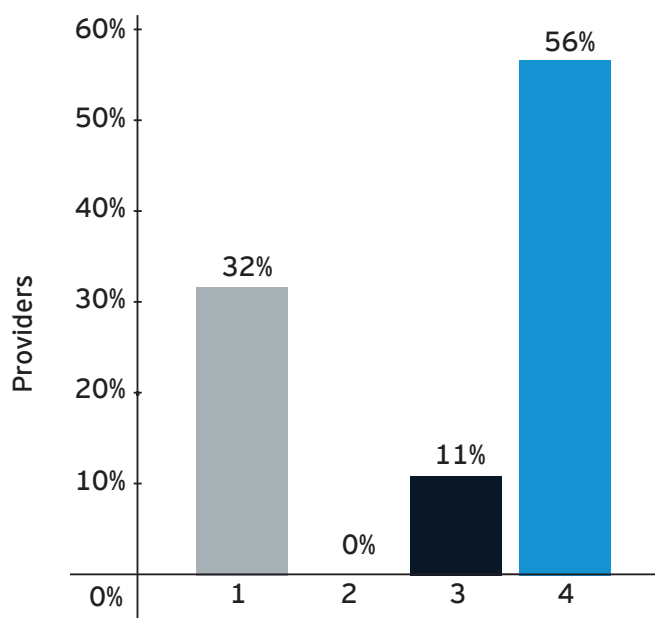
100% providers have made carbon commitments for their organisation.

Although all providers have carbon commitments in place for their organisation, not all have clearly defined Climate Transition Plans detailing how they plan to achieve these commitments.

56% of providers have published a Climate Transition Plan.

At a bare minimum, providers are reporting on carbon emissions for some of their assets, with leading providers reporting up to four metrics across all assets. Other metrics include Climate Value at Risk, Implied Temperature Rise, and proprietary metrics such as Thermal Coal Policy alignment.

Number of climate metrics used by BPA providers



Diversity, equity, and inclusion (‘DEI’)

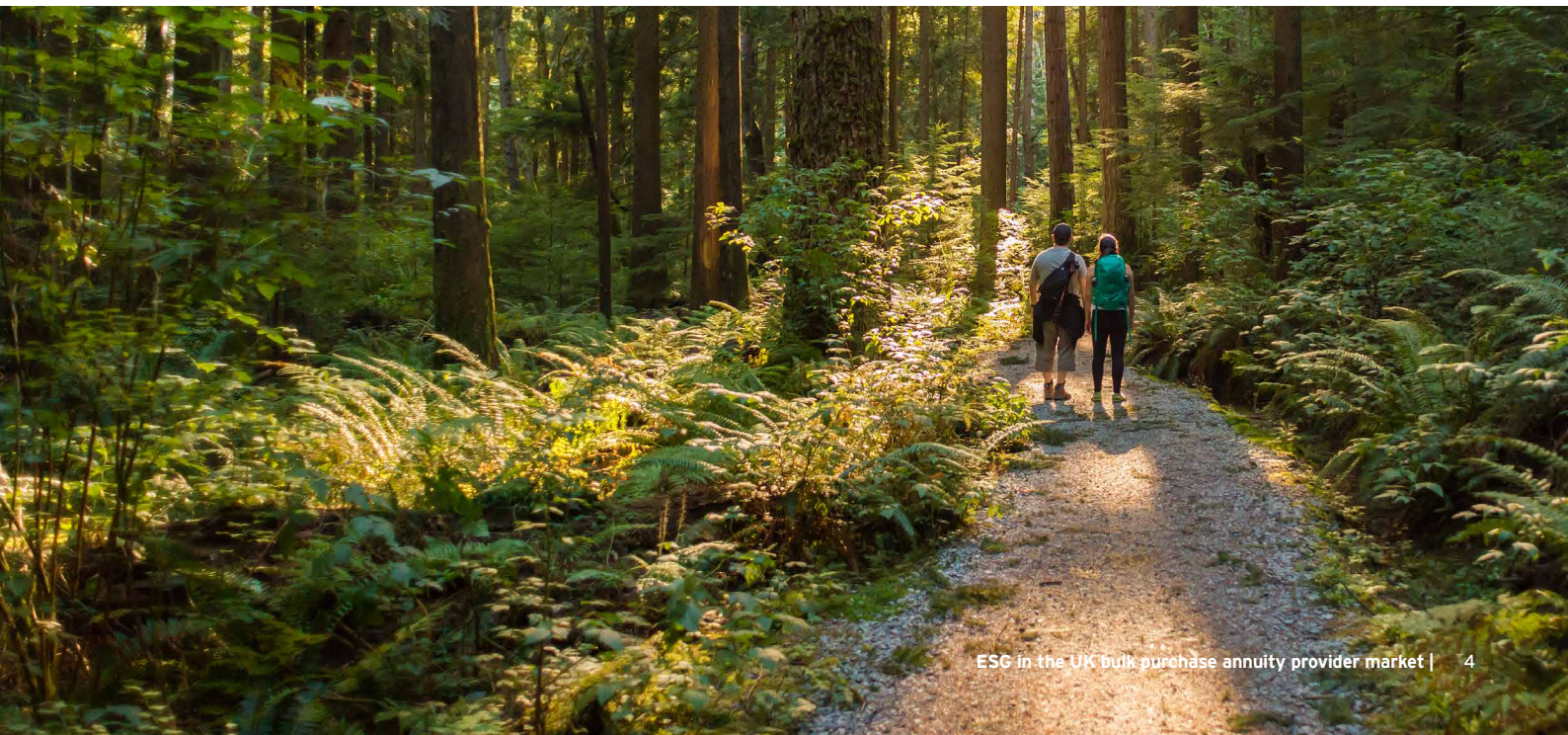
Although all participants consider DEI at the firm leadership level, there is a spectrum in maturity of approaches taken. We show the scale of maturity in approach below, from least to most mature going from top to bottom. Disclosure of diversity statistics is still relatively poor. More advanced respondents are participating in bodies such as the [Asset Owner Diversity Charter](#) and the [HM Treasury's Women in Finance Charter](#).



Member communications

Although some providers have strong communication strategies in place, others have weak or no member communication on ESG.

On the stronger end of the spectrum, providers host policyholder events, including giving policyholders the opportunity to ask senior management directly about any sustainability-related topics. More advanced providers seek to engage with their policyholders on ESG via member magazines, dedicated social media platforms and video case studies and then report progress on how they are tackling climate change and transitioning to a low-carbon economy.





ESG-focused investments and barriers to increasing allocations

Investment in ESG-focused investments is still relatively low, but it is encouraging to see various providers with allocations greater than **10%**, **with some as high as 45%**. Popular themes for such investments include social housing, renewable energy, or linked to United Nations Sustainable Development Goals.

As part of the research, we explored what was preventing providers from further increasing their allocations to ESG-focused investments.

Nature of investment strategy

Due to the nature of some BPA providers' investment strategies, i.e., investing in a cashflow-based strategy for their portfolio, some providers explain that they cannot invest into funds that focus on 'sustainable' assets as this would significantly impact their investment universe. Despite this, however, most providers with a strong approach to ESG integration, will provide an ESG overlay to 100% of their portfolio through various ESG integration tools, including exclusions and engagement activity.

Some providers also go further to invest their annuity book capital into alternative assets with themes including urban regeneration, clean energy, and affordable housing, with the aim of driving real-world positive impact.

Lack of opportunities

There remains low availability of suitable assets that have a suitable risk-return profile appropriate for the provider's risk appetite requirements and regulatory constraints. Although some providers are actively decarbonising their portfolio and increasing their financing of low-carbon solutions (via investment into clean energy projects and debt for nature swaps within their annuity book), it is hard to achieve investment at scale. Credit quality can be a challenge, as many providers have investment grade requirements that are often not met by green or social impact opportunities.

Potential UK regulatory changes, such as reforms in Solvency II, may potentially increase the opportunity set for the UK insurance sector, allowing for a further range of low-carbon solutions.

Supply by asset managers

Where suitable investments do exist, the providers' particular asset manager may not offer sufficient green or sustainability investment options. Encouragingly, some providers are trying to improve this by actively engaging with their asset managers, helping them understand what the provider's sustainability goals and requirements are, and encouraging asset managers to show them more green and sustainable deals.

How EY teams support pension schemes with the risk transfer process

We support trustees and sponsors of pension schemes from less than £1mn to greater than £1bn by:

- ▶ **Advising through the buy-out process**, from developing a strategy to engaging with the insurance market to eventual wind-up of the scheme.
- ▶ **Selecting a suitable insurance provider** to meet your objectives. Through rating the ESG capabilities of providers, we build ESG into your decision.
- ▶ **Advice on a wide range of risk transfer strategies**. This includes defined benefit superfund, captive reinsurance, consolidators, longevity swaps and capital backed arrangements.



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