Summary
- ESG and PRT have been topics of conversation in the pensions space in recent years, but the two have rarely met.
- Trustees looking to transfer their schemes to insurers are increasingly talking about ESG, even if it is not yet a deciding factor.
- The nature of ESG conversations have shifted in recent years from what a firm invests in to how it conducts its business.

The next great coming together?

Pension risk transfer (PRT) and environmental, social, and governance (ESG) considerations have been subjects in the pensions landscape for years. But until now, the two have rarely become intertwined

There are two topics within pensions and investments that have been separately visible for the past three or four years: Pension risk transfer (PRT), when a scheme opts for a buy-in or a buyout with an insurer of their obligations, and environmental, social, and governance (ESG) investing. But little has been said about how the two meet, if at all.

Firstly, some context: Recent research put out by Hymans Robertson indicates that total pension schemes buy-ins and buyouts in the first half of 2022 reached almost £12 billion.

The research, as *Pensions Age* wrote in mid-October, indicated that the value of these deals was actually much lower than those (£21 billion) during the same period in the preceding year. The number of deals, Hymans Robertson observed in its *Buyouts, Buy-ins, and Longevity Hedging—H1 2022*, fell from 97 in H1 2021 to 78 in H1 2022.

And as Legal & General observed in its *Overview of the Pension Risk Transfer Market* in August 2021: "Relative to the first half of 2020, it has been a quieter start to the year across the market. Nonetheless, appetite from trustees and sponsoring companies to reduce their pension risk exposures remains strong and competition among insurers has been fierce, with well-prepared pension schemes taking advantage of attractive opportunities to secure their members' benefits."

The growing conversation

In contrast, the noise around ESG investing has grown ever-louder. And that conversation increasingly encroaches on the pensions industry, especially since the Pension Schemes Act 2021 required schemes with assets of over £5 billion to produce their own Task Force on Climate-Related Financial Disclosures (TCFD) reports (schemes with assets of over £1 billion were included in this from the beginning of October).

As Dalriada Trustees a lead trustee, Tiziana Perrella, puts it: "ESG-related topics are evolving even more rapidly, partly driven by regulations and partly

by growing concern among the public of issues such as climate change. Bulk annuity providers have positive stories to tell, for example around investment in infrastructure projects with an environmental bias in fields such as renewable energy."

There is evidence that the ESG conversation is becoming more common amongst schemes seeking to transfer risk.

In September, pensions insurance specialist Rothesay released a report called *The Journey to Buyout 2022*. There, the authors asked 69 respondents (schemes pursuing buyouts) about the importance of ESG considerations. Nearly four in five (79 per cent) said that ESG considerations were somewhat or very important when choosing a transaction counterparty.

"Two years ago," says Cardano managing director, Adolfo Aponte, "we would get one or two questions around ESG. These days, that's over 60 per cent of schemes that are looking to transfer their obligations. The reviews are generally at a fairly high level. Some of the defined benefit schemes take it very seriously and have a checklist of policies where they have a target because they've been through the process of developing their climate change policies and want to know how an insurer compares."

These remarks are echoed by Hymans Robertson head of ESG for risk transfer, Paul Hewitson. He says that there is a variance amongst schemes as to their level of interest around ESG. The larger schemes, he says, have had a greater focus on this area.

"Those with their own ESG views in their investments probably care more," he says. "And there are always going to be sceptics in the trustee community. But most – and especially professional trustees – are taking notice and making it a thing that they consider."

The nature of the interest has also changed, says Perrella. "Five or six years ago," she says, "it would have come down to not investing in tobacco or weapons, or not supporting regimes. But now, it's about how embedded the principles are within the firm."

But while ESG may have become a more-commonplace conversation, says Perrella, it is not decisive for schemes in choosing between one insurer and another.

"Seventy-nine per cent *[of schemes purchasing buyouts]* said that ESG considerations were somewhat or very important when choosing a transaction counterparty"

"The key factor," she says, "is price. And the second is the quality of the administration. If you're giving all your money to an insurer, you want to make sure that your members are going to get the right benefits over the next 40-60 years. And you want to do it in the best way you can. You want members to be able to call you and ask about the insurer."

Pensions Age asks those interviewed if ESG was ever a decisive factor in whether a transfer went ahead or not with a particular insurer. Their answers indicate that it was a rare occurrence.

"Yes," says Aponte, acknowledging that ESG considerations have been a factor in some cases, "but that's the exception."

If anything, it had become a dealbreaker when all other things are considered equal, says Hewitson.

He explains: "We had a transaction last year when we put forward the ESG ratings of the insurer. And there was pushback when we were speaking to the scheme. They said that if the prices had been level, then they would have gone with one insurer over the ESG issue rather than the other insurer. So it does factor in."

The role of trustees

The discussion around ESG is still a nascent one. Hewitson says that most trustees that approach Hymans Robertson do so with a lack of knowledge around these issues. They are, he says, looking for guidance. "The standard trustee board is not that up to date on the details," he confirms.

"Part of the process is looking at the underlying processes and culture within the firm or insurer in order to understand what they do and how they do it. There are things like exclusions that will evolve over time. It's looking at the targets set and the attitude on things such as reaching net zero. In the long term, we hope that these firms will keep up with the longer trends that emerge," Hewitson adds.

There is also a conflict that arises with the fiduciary duty of trustees. Legally, the overriding priority for a trustee is to get the best returns for the members of their scheme. Does focusing on ESG impinge on that?

According to Hewitson, that is the million-dollar question. And he says, honestly, that he does not have an answer to that. It will come down, he says, to the impact of ESG on a firm's bottom line.

Aponte expands on that idea, taking a more-sanguine view.

"Many trustees," he says, "will try to do the right thing that delivers ultimately for their fiduciary responsibility. I think they ultimately need to weigh relevant factors and the impact on their members. It's something that's relevant and a lot depends on how much focus the trustee places on it. Most will try and find that joining of perspectives. But there are those who will take it further and are committed to do that while getting their membership to go on that journey with them."

Written by Pete Carvill, a freelance journalist