Making pensions last a lifetime

Gareth Collard explores the link between sustainable investments and sustainable pension payments

Sustainability has become a watchword of our times. From climate strikers to governments, sustainability is higher on the agenda than ever before.

For Just, sustainability is at the heart of what we do – but for us it has a dual meaning.

For almost 25 years, individuals have entrusted us to pay their annuities. Since we started DB derisking, trustees and employers have joined them, and we now pay out well over £1 billion of retirement income each year.

With liabilities stretching out 50 years or more, we need to ensure the assets we hold in our portfolios will still be generating income to meet the guarantees we have made to all our policyholders.

To achieve that, sustainability is key.

Sustaining our promises

Economic cycles come and go, but pension promises remain, and our role is to keep paying incomes, regardless of the economic climate. This means making sure our asset allocation will produce the necessary cashflow.

To do this, we employ a technique that has been used by insurers for decades. Cashflow-driven investing entails analysing profiles of our liabilities and the schedule of payments we must make. We then seek out assets that generate a cashflow that's a close match to our commitments and add a buffer for defaults. The closer we can match the liability profile, the less vulnerable we are to changes in interest rates and investment returns.

The assets that best suit this cashflow-matching technique are fixed interest investments. From the moment we buy the asset, we can determine how it supports our income-generating target. Some of our pension promises have inflation benefits so we select fixed interest investments such as bonds, which can be issued with coupons or payments that are linked to inflation. As our pension promises have a certain linkage to inflation, this helps us manage this factor of our liabilities without the need to enter complex hedging arrangements.

We have long-term liabilities and so we need long duration assets. Short-dated, easily tradable, government-issued bonds have their place in insurance-like portfolios such as ours, but the majority of our assets need to last much longer.

Sustaining our investments

Sustainability is at the heart of our investment strategy to meet our long-term liabilities.

Our strategy aims to future proof our assets to ensure they deliver the investment performance we need over the next 50 years.

There are many ways to analyse securities and while some investors consider sustainability and environmental, social and governance (ESG) factors as incidental, we think they are a vital part of fundamental credit analysis.

Looking at the separate components of ESG, each offers specific risks to any potential asset. While governance has always been key to assessing a security, the environmental and social have become increasingly important for investors who buy bonds, with the purpose of matching cashflows.

Using the 'E' and 'S' elements allows us to explore industry-specific risks and look ahead to where problems may lie in future.

There are certain things society will always need. For example, we will always need water and to have our sewage taken away. So, organisations providing these services can be expected to have a secure, long-term future.

But all companies are not created or run in the same way. Using an ESG lens, we are able to examine issuers on a case-by-case basis and critically determine which are likely to go the distance.

Taking motor manufacturing as an example, it is pretty certain that people will still be travelling in 50 years, but how they do it might look very different. Even if a car maker is already taking radical steps to stop selling diesel vehicles and is focusing on producing electric cars, we don't know that the concept of car ownership will still be around in even 10 years' time.

If you are considering investing in a motor manufacturer that doesn't have a plan for what it's going to do after it's switched from diesel to produce only electric cars, vans and trucks, you might conclude that you do not want to lend it money.

There are knock-on aspects to this, too. If car ownership falls dramatically and car sharing becomes the norm, then traffic volumes are likely to fall. This might impact infrastructure assets, such as toll roads, as fewer cars means lower revenue.

Evaluating investment with sustainability at the focus throws up plenty of questions that may not have previously considered and helps us to be more confident identifying companies that have a long-term future.

Sustaining the future

We were one of the first institutional investors to pull out of the tobacco sector at a time when it was seen as a 'cash cow' by many of our peers.

In our view, along with the moral argument, we took the pragmatic stance that the tobacco industry did not have a future and this was a risk to us.

A few years on from this decision, the world of tobacco has clearly changed. In the west there has been a huge decrease in smoking, and even the safety of vaping is being questioned.

Now, many people see tobacco investment as a financial risk that they did not identify in previous years, when those of us who were looking at it through an ESG lens had long held this view.

Let's be clear on something though – we are not attempting to be a green fund.

For example, if we identified an issue with the governance of a company, we'd investigate what actions it was taking to resolve these rather than immediately selling its bonds.

Importantly, sustainable investment is not just about screening out what we cannot invest in – it is about finding new opportunities.

Sustainable opportunities

We hold about £400 million of investments that target energy generation infrastructure, and this is set to grow.

For example, we own a significant amount of the private debt issued against two large windfarm projects operating in the waters off the UK. Although it is technically not a bond, the fixed interest coupons match our liabilities nicely. We are also invested in some solar power operations in Spain.

We were the first pension insurer to sign the United Nations Principles for Responsible Investment and are working through our entire portfolio to see where we can make improvements using a sustainability and ESG lens.

The Just Group board and investment team are embracing this transition towards a fully sustainable future, not just because it is the right thing to do, but also as it is the most financially prudent approach.

We are in the early stages of embedding sustainability to analyse our investments. We have improved the level of due diligence around our fundamental credit analysis and are taking a more systematic approach to the analysis of the risks associated with sustainability.

The challenge for us, as for all pension funds and insurers, is finding and securing assets that will last the lifetime of our beneficiaries. As responsible investors, we understand the best way to fulfil that need is to consider sustainability when evaluating investment decisions.

We want to help people enjoy a better later life. Sustainability can help us deliver this for all our policyholders: securing their pension benefits in a world they want to live in.

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