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Pensions Endgame: Better Decisions

Doing Your Homework on Bulk Annuity Providers — ESG is Key

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Environmental, Social, and Governance (ESG) concerns have been gaining increased focus in recent years, including in the pension risk transfer market.

Most trustee boards now have their own ESG targets and considerations factored into their investment policies. So, when it comes to investing a significant amount of a scheme's capital into a bulk annuity policy, ESG factors will come into play.

Risk Transfer Counterparties

More and more, we see trustee boards wanting to hold their potential pension risk transfer provider to the same ESG standards as their other investments. On top of this, occupational pension schemes may often have corporate sponsors with their own ESG policies, who are keen for their pension scheme to follow suit.

ESG can be a significant, differentiating factor for trustees when selecting a risk transfer counterparty, whether that be a bulk annuity insurer or longevity swap reinsurer, alongside more traditional strands of due diligence such as financial strength, administrative capability and operational resilience. We have been advising our clients on the latter areas since 2006 and have widened our focus to include ESG in recent years. By leveraging our expertise across insurance and responsible investment, we're able to look beyond the headlines and interrogate insurers' approaches to their investment responsibilities. This analysis goes beyond investments alone, looking into the alignment of insurers' business operations to sustainable goals.

It is important that trustees understand that the demonstration of strong ESG risk awareness and mitigation is not just a nice to have, but that it is likely to be a critical feature of the 'future-proofing' of an insurer's business. Integrating security and sustainability is key in long-term investing, and so plays a vital role in the future security of members' retirement benefits.

Businesses who do not keep up are faced with significant costs:

- The repercussions of the physical risks of climate change — such as damage to property investments due to extreme weather events, or in the case of multi-line insurers, the additional cost to their business of increasing climate-related claims; and
- The consequences of the transition of the economy towards a low-carbon and climate-resilient future — for example, the resulting fall in value of high-carbon investments.

ESG Risk Reporting

Many insurers and reinsurers are now producing their own dedicated ESG reporting, to demonstrate their credentials to prospective counterparties and investors.

There are significant differences between various insurer approaches, with some being much more developed in their analysis and reporting compared to others. We maintain an open dialogue with insurers, ensuring that their latest developments in ESG are reflected in conversations with our clients. We have seen insurers increasing the adoption of more advanced and detailed ESG policies, as well as utilising climate risk scenario analyses to steer decisions around assets and operations.

Task Force on Climate-Related Financial Disclosures

It is now mandatory for pension schemes with over £5 billion of assets to publish disclosures annually, in line with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations. All schemes with over £1 billion of assets will have to do this from 1 October 2022.

Among other actions under the TCFD requirements, trustees are expected to report the carbon emissions of their investment portfolio — which includes insurance policies. This requires them to include a proportionate amount of their insurer's emissions data in their reporting.

Recently we have seen several insurers publish their first emissions metrics in line with the TCFD recommendations. While the goal of the TCFD is to encourage informative disclosures that will support investors in assessing risks, there is still a large amount of flexibility in the initial guidelines.

The TCFD has acknowledged that having a consistent set of metrics is important but recognise that the ability of different businesses to report on different metrics will vary at present, needing to evolve over time.

Aon is working with insurers to obtain data and encourage consistent reporting of emissions metrics, with a view to enabling easier provider assessment and ongoing reporting for trustee boards in the risk transfer space.

Making A Difference

We have seen cases where our ESG analysis has proved critical to risk transfer transactions — such as a trustee board who were not satisfied with their chosen provider's ESG credentials and so engaged in specific negotiations on this topic. This resulted in the provider making significant, public ESG-related commitments before the transaction could proceed.

While there are still challenges in the specifics, increased scrutiny of ESG practices for pension schemes and insurers alike is here to stay. By factoring ESG into the risk transfer process, trustees can ensure compliance, yes — but also that they are part of a valuable conversation around climate resilience and effective risk management in the pension risk transfer market.

Click here for further information on factoring ESG into risk settlement decision making.

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