PENSION INSURANCE CORPORATION

# ESG Investment Approach

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# ESG Investment Approach

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Pension Insurance Corporation plc is registered in England and Wales under company number 05706720. It is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority (FRN 454345). Its registered office is at 14 Cornhill, London EC3V 3ND

# Our Philosophy & Approach

Given the purpose of Pension Insurance Corporation plc ("PIC") is to pay the pensions of our current and future policyholders, it is our responsibility to protect our assets from the impacts of both financial and non-financial risks. We recognise issues such as climate change, human rights and corruption can have very real social and financial implications.

ESG risks have always been an inherent part of PIC's investment process when assessing the suitability of long-term investments, and are a natural consequence of a focus on our purpose. Investing in a sustainable manner, which encompasses ESG factors, helps ensure we are able to fulfil that purpose over the long term.

PIC is a signatory to the United Nations' Principles for Responsible Investment ("UNPRI"), as are all of PIC's key external asset managers. As a signatory to the UNPRI we commit to enact the following six principles, recognising that we invest in credit and do not own equities:

1. to incorporate ESG issues into investment analysis and decision-making processes;
2. to be active owners and incorporate ESG issues into our ownership policies and practices;
3. to seek appropriate disclosure on ESG issues by the entities in which we invest;
4. to promote acceptance and implementation of the Principles within the investment industry;
5. to work together to enhance effectiveness in implementing the Principles; and
6. to report on activities and progress towards implementing the Principles.

**OVERSIGHT OF ESG RISKS AT PIC**

PIC's overall approach to ESG is set by the Board which has delegated day-to-day implementation to the Chief Investment Officer ("CIO") and the Investment Committee which includes the Chief Executive Officer and Chief Financial Officer as members. Our Head of Responsible Investment is responsible for coordinating ESG integration efforts across the business and embedding ESG into the overall investment strategy. Accountability for ESG sits with the CIO, with the Chief Risk Officer having special responsibility for risks related to climate change. There is a monthly ESG Oversight Forum to discuss and help integrate ESG across the business.

PRI | Principles for Responsible Investment

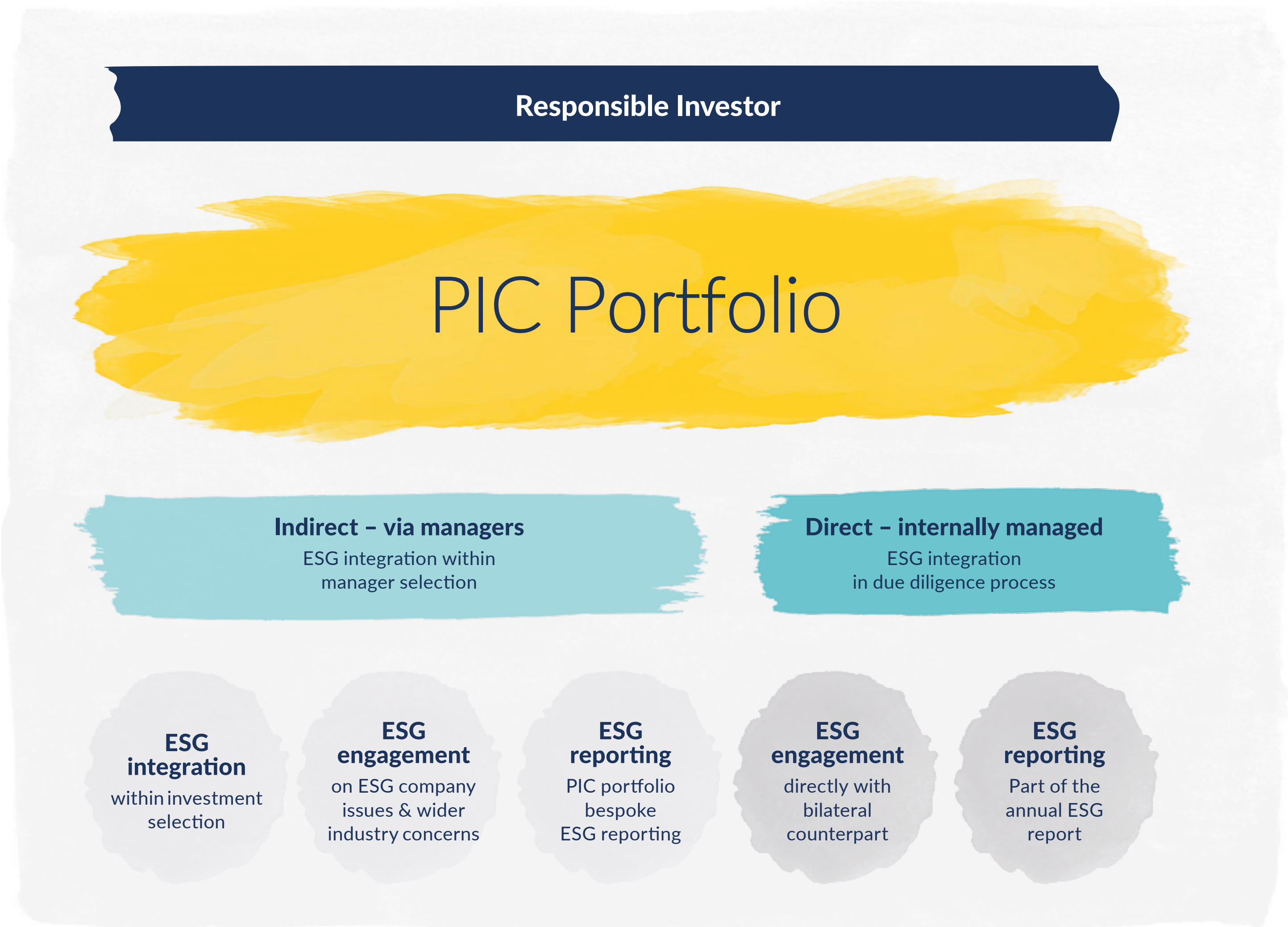
# Defining ESG Integration

PIC defines **Environmental, Social & Governance (ESG) integration** as the investment analysis of ESG factors alongside financial factors in the investment decision-making process. It explicitly and systematically includes the analysis of a range of risks related to ESG drivers. In principle, this leads to a broader assessment of the environment in which companies operate and their performance in managing different stakeholders, giving a fuller understanding of risks over the long term than traditional financial analysis alone. These ESG related risks may vary by country, by industry and by characteristics specific to that issuer. In the context of Fixed Income investing, which is the asset class in which PIC invests, this means looking at those ESG aspects of an issuer's operations that may influence its ability to meet its financial obligations.

# ESG Integration Process

We believe that organisations which demonstrate positive sustainability characteristics are better placed to maintain cash flows and service their debt over the long term. These characteristics include factors such as managing the business for the long term, recognising its responsibilities to its customers, employees, suppliers and society, and respecting the environment.

PIC has delegated a portion of its portfolio to external managers and manages the rest of its assets internally. Nearly all of our assets are invested in debt instruments consisting of public corporate credit, sovereign debt, and privately-sourced debt, which encompasses a broad range of sectors, including housing associations, education and student accommodation, renewable energy, infrastructure, equity release mortgages and real estate.




**SOVEREIGN BOND INVESTING**

As a low-risk insurance investor which is required by regulation to tightly cash flow match our liabilities, a large portion of our portfolio is invested in UK Government gilts. Nevertheless, the ESG position of UK gilts is assessed at a relatively high level by our in-house credit analysts. We aim to enhance our ESG integration into all sovereign investments this year. The lack of timely, accurate and relevant data around ESG at a country level is a challenge we are working with our managers to overcome. We aim to leverage the internal capabilities of our managers and other data providers to further our ESG integration in this area.

## INDIRECT – VIA MANAGERS
### PIC integrates ESG into our externally managed portfolio in the following ways:

An initial sustainability due diligence is performed when considering a manager to partner with. This includes an assessment of managers at the firm level, to understand if sustainability is a central part of their culture and capabilities. We only choose to partner with managers who demonstrate strong credentials in terms of sustainability and can demonstrate a track record of doing so. It is important that our managers are responsible stewards of their clients' capital, as our reputation can be directly linked with their actions.

Given we have specific mandates with each manager, the application of ESG criteria will vary between them. Each of our managers has their own in-house ESG integration framework which is used when establishing our investment universe.

PIC's specialist credit analysts have always considered governance factors in their analysis and have over the last few years expanded this to consider E&S factors as well. They use a blend of Sustainalytics' ESG risk score, as well as their own analysis to identify high-ESG risk factors within the portfolio. Sustainalytics has been carefully selected as our data provider of choice, given its focus on the downside risks of a company, which is most in line with a credit investor's investment perspective.

Managers are asked to provide their own ESG assessment of identified ESG risks and evidence of any engagement carried out with these companies. We compare any high-risk issuance both within sectors and against other sectors to understand if all risks have been factored into the bond's terms.

Once holdings are in the portfolio, we monitor their ESG risk profile over time and ask managers to comment on any controversies and include forward looking thoughts on ESG matters.

Our managers each provide us with a bespoke ESG report every quarter, and ESG is a standing agenda item in our monthly portfolio review meetings.

## DIRECT – INTERNALLY MANAGED INVESTMENTS
### We integrate ESG into our internally managed portfolio in the following ways:

For private debt into listed companies, we use data from our various data sources such as Sustainalytics, Bloomberg, Credit Sights and the company's public sustainability reports to analyse exposure to ESG risks.

For our privately-sourced debt investment, typically into unlisted organisations, we liaise directly with the issuer to determine their ESG position, and attribute an in-house risk score. Some examples of this are:

**Housing associations:**
- We send ESG questionnaires which assess individual factors such as those detailed in the Good Economy's "Building a Sector Standard Approach for ESG Reporting" for social housing, an initiative of which we were founders and early adopters.
- We apply our in-house ESG risk assessment framework and assign a Low/Medium/High ESG Issuer Score. Absent any unusual events, we review this rating on an annual basis as part of our ongoing monitoring.
- We engage with each housing association on responses given, and work with them on setting targets where we feel material ESG risks have been identified and not sufficiently addressed.

**Real estate:**
- We engage in dialogue with our property developers in the early stages of investment to influence where possible the sustainability features of buildings so that they offer the most up-to-date level of health and safety requirements, wellbeing, and social value considerations, to optimise our future tenants' living conditions.
- We apply our in-house ESG risk assessment framework and assign a Low/Medium/High ESG Issuer Score. Absent any unusual events, we review this rating on an annual basis as part of our ongoing monitoring.

**Renewable energy:**
- Detailed information is requested around community impact, environmental disruption, staff health and safety and project accountability both at the point of investment and on an ongoing basis at least annually.
- We apply our in-house ESG risk assessment framework and assign a Low/Medium/High ESG Issuer Score. Absent any unusual events, we review this rating on an annual basis as part of our ongoing monitoring.

# Stewardship & Active Ownership

**ESG engagement describes the interaction between investors and issuers. Given our very long-term investment horizon, it is in our interest to work with companies to ensure more sustainable practices so that they maintain strong industry positioning, healthy credit ratings and stable cash flows over time, acknowledging the limitations on this as a debt investor.**

For our direct investments, we engage directly with organisations both at the point of capital raise and during the tenure of the investment on various ESG-related issues such as health and safety, climate change, modern slavery, and environmental and social impact.

For our indirect holdings we work closely with our managers to ensure that important ESG topics – both company specific and industry wide – are engaged on with companies. Our managers are also involved in thematic ESG research which helps identify important emerging or prominent topics and recognise sector leaders and laggards. Larger-scale industry engagements with identified laggards are done by our managers. This research, together with findings from engagements, complements our forward-looking analysis and helps us ensure our portfolio is correctly positioned for any long-term industry changes.

# Investment Restrictions

**Given the underlying nature of our investments, our very long-term time horizon, and the tight parameters that regulate our industry, we must give careful consideration when applying sector exclusions. We have nevertheless taken the view that investing in the following sectors is unsustainable and have imposed the below restrictions:**

**Coal Extraction & Burning and Tar Sands**
No new purchases in companies that derive more than 10% of turnover from coal extraction & burning and tar sands. We aim to divest from all of our holdings in these areas by 2025.

**Oil & Gas sector**
Including exploration and production, drilling and field services: No new purchases in companies in these sectors and we aim to divest from these holdings.

**Controversial Weapons**
We will never knowingly hold any security that is involved in the production of controversial weapons, including cluster munitions, anti-personnel landmines, or chemical and biological weapons.

# Socially Beneficial Investments

**We define a Socially Beneficial Asset as an asset whose primary purpose establishes a net positive outcome to society.**

The investments which we make into Socially Beneficial Assets are in line with PIC's purpose, in that the greater the socially beneficial outcomes, the higher likelihood of long-term stability needed to back future pension payments. More details of our investments into such assets can be found in our ESG Brochure.

We have mapped some of our Socially Beneficial Investments to the United Nations Sustainable Development Goals:

| UN Sustainable Development Goal | Category | Description | Examples of Investments |
|---|---|---|---|
| 7 Affordable and clean energy; 13 Climate action | Climate change alignment | Investments into organisations, companies and projects contributing to the transition to a cleaner economy. Example of sectors such as renewable energy and electric utilities | Solar panels, offshore wind farm, Ørsted, E.ON, Iberdrola |
| 11 Sustainable cities and communities | Affordable housing | Investments into registered housing associations and social housing providers | Accord Housing, Livin Housing Association, Soha, Pobl/Welsh Housing, Yarlington, Trident, North Star, Halton |
| 4 Quality education | Education | Investments into educational institutions or the infrastructure that complements such facilities | Various universities (Durham, Exeter, York) and student accommodation |
| 6 Clean water and sanitation; 11 Sustainable cities and communities | Basic essentials | Investments into organisations that help provide basic essentials to society. Examples: water utilities, waste management, local authorities | Thames Tideway, Anglian Water, City of London, Glasgow City |
| 3 Good health and well-being | Wellbeing | Investments into organisations that provide goods and services which promote good health and enhance wellbeing | Private investment into children's healthcare, private healthcare providers, life science companies |
| 1 No poverty; 2 Zero hunger; 3 Good health and well-being; 10 Reduced inequalities; 14 Life below water; 15 Life on land; 16 Peace, justice and strong institutions | Charitable sector | Provision of capital to not-for-profit establishments whose core purpose lies in trying to solve societal or environmental problems | Royal College of Surgeons, National Trust, The Mercers' Company |

# Other ESG Considerations

**Our Approach to Climate Change**
PIC is committed to ensuring that climate change considerations are integrated throughout the organisation's decision-making processes. PIC has appointed its Chief Risk Officer as the Senior Management Function Holder responsible for ensuring this objective. To this end, the identification, measurement, management, monitoring and reporting of the financial risks associated with climate change are of utmost importance. PIC is focused on ensuring these activities are embedded particularly with respect to the assets in which we invest.

To support an understanding of how these risks will develop over the medium-to-long term PIC is developing a wide range of scenario analyses into its assessment. Furthermore, PIC is updating its risk management framework, risk appetite and risk taxonomy to give due regard to the influence climate factors will have on the organisation from a physical and transition risk perspective. The Board will be provided with regular reporting with regard to the current and future exposures PIC may face from climate change, alongside specific reporting for various elements of the governance structure.

**Responsible Conduct**
Whilst we encourage companies to move towards best practice, we accept that with large multinational companies there are occasionally ESG-related controversies. Where these do occur, we seek evidence that the company has understood the cause of the issue and has been proactive in strengthening its management systems to ensure that probability of future controversies has been minimised.

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