01 HEALTH INSURER CARBON PEER STUDY

Time for a Checkup? ESG Impact on Health Insurer Bond Portfolios

Our insurance clients are keenly aware of climate change, whether from direct exposure to weather events or preparing for the National Association of Insurance Commissioner's (NAIC's) climate-related financial disclosures.[1] Most have heard from their asset managers that environmental, social, and governance (ESG) and climate goals can be a component of portfolio strategy, but they express frustration:

- How can they assess where their portfolio stands?
- Can they validate their efforts to build a "clean" portfolio or maintain a strong ESG profile?

Of those who would like to decarbonize their portfolio, many wonder about the opportunity cost and exactly what steps are needed to achieve this goal.

In this three-part series, we seek to provide some practical insight into these questions using a set of peer data we compiled for the health insurance industry. This article focuses on high-level metrics for portfolios. The second will dive deeper into the drivers of the overall ratings, and the third will present some specific thoughts on how to improve the carbon emissions in a portfolio.

> At Allspring, we run both equity and fixed income strategies with climate or ESG goals.

We'll do a deep dive into the corporate bond portfolios of these insurers because of their significant size in insurer portfolios and good data coverage.

As a whole, health insurers have conservative portfolios. By year-end 2021, health insurers had about 56% of their investments in bonds and 28% of their invested assets in cash and short-term investments. At the same time, the total bonds held by health insurers amounted to $189 billion at the end of 2021,[2] so there is a significant opportunity to consider the carbon impact of portfolios.

We'll contrast two Blue Cross Blue Shield (BCBS) entities and show the kind of analysis we are discussing with some of our clients. We compare them with a peer group of the largest health entities—about 20 companies with total assets over $5 billion each—and also with a second group representing the universe of BCBS plans.

To perform this analysis, we used year-end 2021 statutory statement data on the individual bonds held by these insurers. We combined this holdings information with carbon and ESG data from industry standard

1. NAIC, 8-Apr-22
2. MSCI and S&P Trucost, as of 31-Dec-21

providers MSCI and S&P Trucost (Trucost), plus an additional proprietary climate transition view by Allspring. The output is a comparison with industry peers regarding ESG characteristics as well as carbon emissions.

MSCI issues ESG ratings for companies to help investors understand ESG risks and opportunities and integrate these factors into their portfolios. There are separate scores for the E, S, and G pillars. In addition, there is an industry-adjusted overall ESG score that normalizes the pillar scores so that the ratings are relative to peers within each industry, thereby facilitating apples-to-apples assessments.

Trucost is well known for its environmental data. We use its carbon emissions data to calculate the weighted-average carbon intensity for a portfolio, which is the metric tons of CO_2e per $1 million of revenue of each company.[3]

The two BCBS plans we chose for our case study are outwardly similar. Both are in populous states and rank in the top 20 health care providers, but one ranks higher in terms of ESG and carbon metrics in its credit portfolio. While both have strong community emphasis, only one has environmental sustainability as an explicit goal in its annual report.

ESG scoring of the corporate bond portfolio

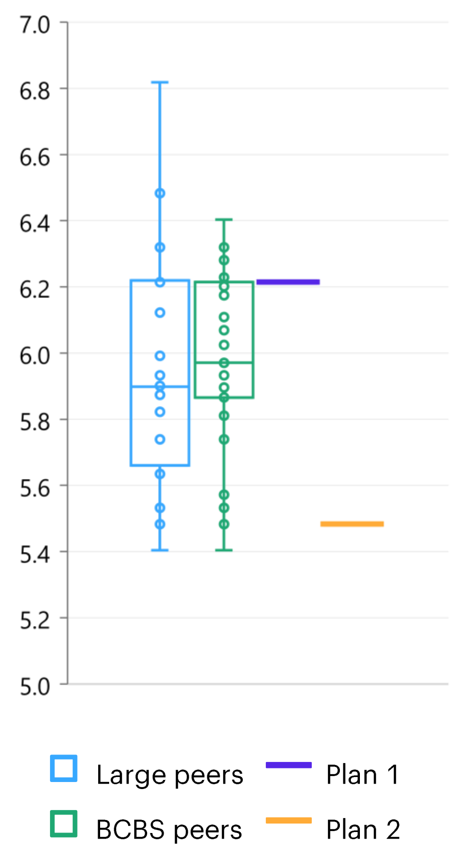
The chart to the right shows the MSCI industry-adjusted ESG score for the corporate bonds owned by the two companies, as well as the range for the large company peer group and the universe of BCBS plans. Higher scores are better, with 10 being the best possible rating and 0 being the worst. (See Appendix for detailed explanation.)

In this case, Plan 2 is near the bottom of the peer group and Plan 1 is near the 75th percentile. The majority of the difference between the two plans can be accounted for by the securities selected rather than differences in industry allocation.

There are separate scores for the E, S, and G pillars and it's possible to go a level deeper to see an additional level of detail. In this case, the environmental scores are the most divergent and the social/governance scores are closer.

While climate often gets the most attention, some of our health insurance clients are focused on the social aspect of the ESG score as a complement to their corporate mission to improve their communities. MSCI identifies certain key issues, such as labor management or health and safety, that may be the source of unanticipated costs for a company. This may differ from the social goals of a health insurer, which may be focused on enhancing the well-being of the local population.

MSCI industry-adjusted ESG score



3. Carbon emissions include operational and first-tier supply chain greenhouse gas emissions. A weighted-average carbon intensity is calculated using simple weighted average, excluding holdings without coverage. The market value weights of the covered issuers are rescaled to sum to 100%. Data is presented in CO_2e/$1 million revenue.

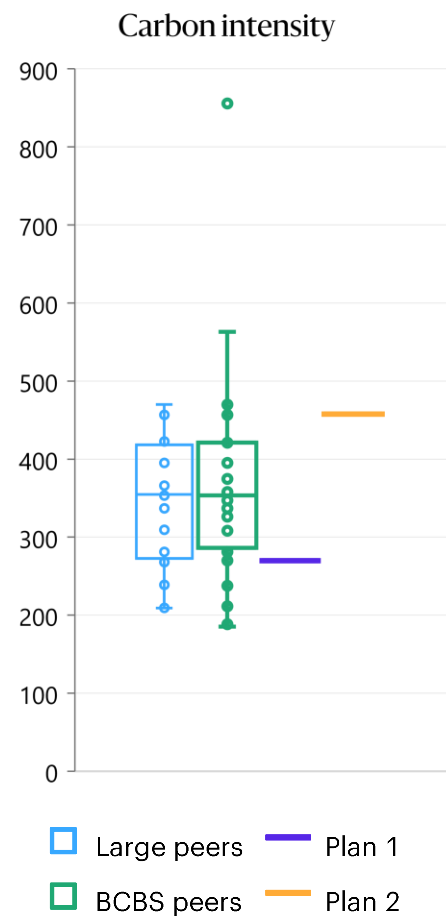
Climate concerns—carbon intensity of corporate bonds

With unprecedented droughts, heat waves, and other climate-linked physical hazards, along with private sector decarbonization efforts and various policy measures to facilitate the low carbon transition, carbon emissions continue to make news. The next area we are going to compare is CO_2 emissions for the portfolios of the two companies and the peer groups.

Carbon emissions can be measured in different ways, but we use the weighted average of Trucost's metric tons CO_2e emissions per $1 million of revenue, which is referred to as "carbon intensity."[4] In this case, a higher number is worse, representing a portfolio with more carbon emissions.

Here again the BCBS Plan 1 is in the top quartile and Plan 2 is in the bottom quartile. This implies that if there were to be a rapid shift in decarbonization due to technological change, shifts in consumer preference, and/or policy supports, Plan 2 would be disadvantaged.

Another way to look at these results is to compare them with the investment-grade bond market. The Bloomberg Barclays Corporate Bond Index has a weighted average carbon intensity of 374. Plan 1, with a score of 270, is somewhat better than the overall index, and Plan 2, at 458, has a significantly more-carbon-emitting group of companies in its portfolio.



Conclusion

Each company has a different emphasis when it comes to ESG concerns. Most health plans have ESG goals of some kind, often focusing on engendering the health and well-being of the communities in which they operate or serve. Some include sustainability and environmental priorities such as waste reduction as part of these wider organizational goals, in part because gains here can contribute to positive health outcomes. Property and casualty companies are increasingly thinking about environmental aspects of their business as property damage from weather-related events increases.

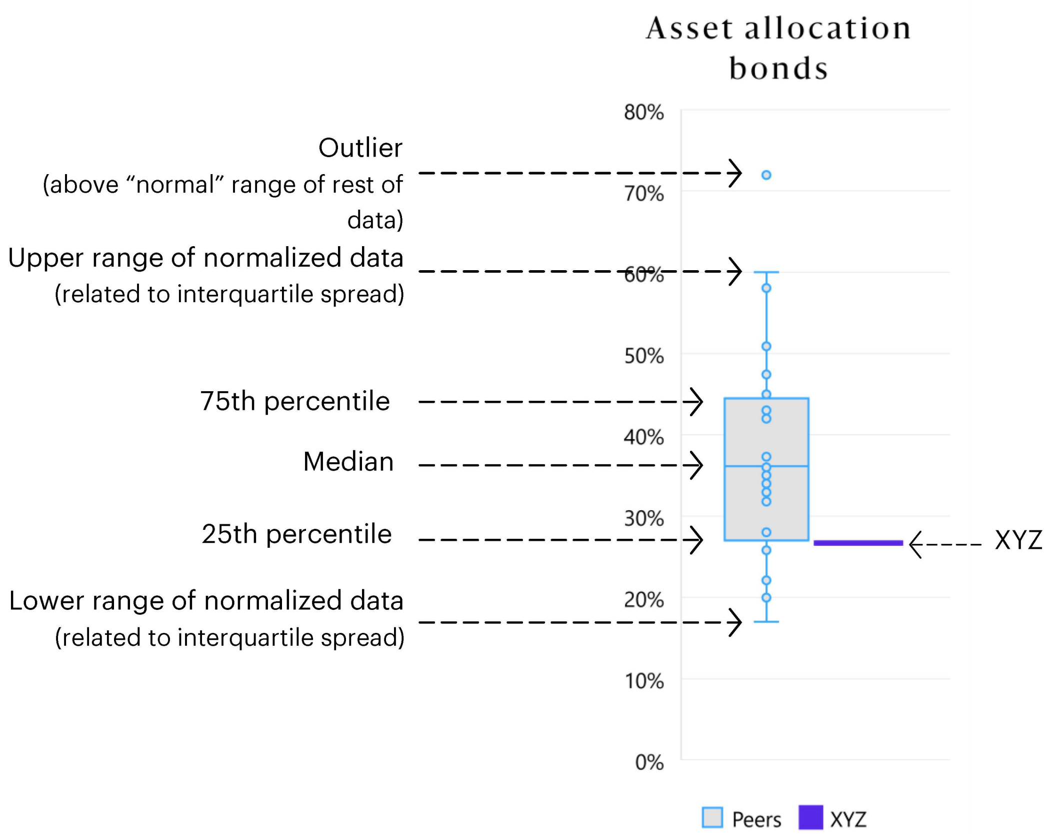
The analysis we've presented helps companies get a feel for how they stand with respect to their goals. While this article focused on summary-level statistics, our next article will show how to break down the next level of detail to show the drivers of these summary measures. The final article in this series will show what companies can do to reduce carbon intensity in their portfolios and the trade-offs that can be made.

4. Carbon intensity is a gauge of how carbon-efficient a company or portfolio is relative to others or a benchmark index. Because company greenhouse gas emissions are normalized by revenues, carbon intensity facilitates comparisons among emitters of different sizes.

Appendix

Displays the median, quartile range, and wider distribution of a range of data

The whiskers extend up from the top of the box to the largest data element that is less than or equal to 1.5 times the interquartile range (IQR) and down from the bottom of the box to the smallest data element that is larger than 1.5 times the IQR. Values outside this range are considered to be outliers and are represented by dots.



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For more information, please contact:

- To reach our U.S.-based investment professionals, contact your existing client relations director, or contact us at AllspringInstitutional@allspring-global.com.
- Visit our website at allspringglobal.com.

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