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The ACA Individual Market: 2016 Will Be Better Than 2015, But Achieving Target Profitability Will Take Longer

Primary Credit Analyst:

Deep Banerjee, New York (1) 212-438-5646; shiladitya.banerjee@spglobal.com

Secondary Contacts:

James Sung, New York (1) 212-438-2115; james.sung@spglobal.com

Joseph N Marinucci, New York (1) 212-438-2012; joseph.marinucci@spglobal.com

Research Assistant:

Jacqueline Unverrich, New York

Table Of Contents

Most Blue Plans Have Lower MLRs In 2016 Than In 2015

From 2014 To 2018-And-Beyond

Related Criteria And Research

The ACA Individual Market: 2016 Will Be Better Than 2015, But Achieving Target Profitability Will Take Longer

The Affordable Care Act (ACA) individual market has proven a tough nut to crack for U.S. health insurers. On one hand they had strong premium growth as the U.S. uninsured rate dropped to historic lows. On the other hand, most insurers so far have suffered persistent underwriting losses in the ACA individual market. 2014 was painful in terms of profitability, and 2015 only aggravated those losses for most insurers. But 2016 is going to be the first year to start reversing the trend.

S&P Global Ratings expects U.S. health insurers to report improved underwriting performance in the individual market in 2016 versus 2015. Although most insurers will still report an underwriting loss for 2016, the losses will be smaller than in 2015. This means the changes made to network design and premium pricing are gaining traction, though more still needs to be done. For 2017, we expect continued improvement, with more insurers reporting close to break-even or better results for this segment. Our 2017 forecast takes into account the impact of a maturing risk pool, premium rate increases, network changes, and regulatory changes such as stricter rules around special enrollment periods (SEP). Of course, unanticipated consumer behavior, such as higher-than-priced medical service utilization in response to uncertainty around the future of healthcare could throw a wrench in works.

Overview

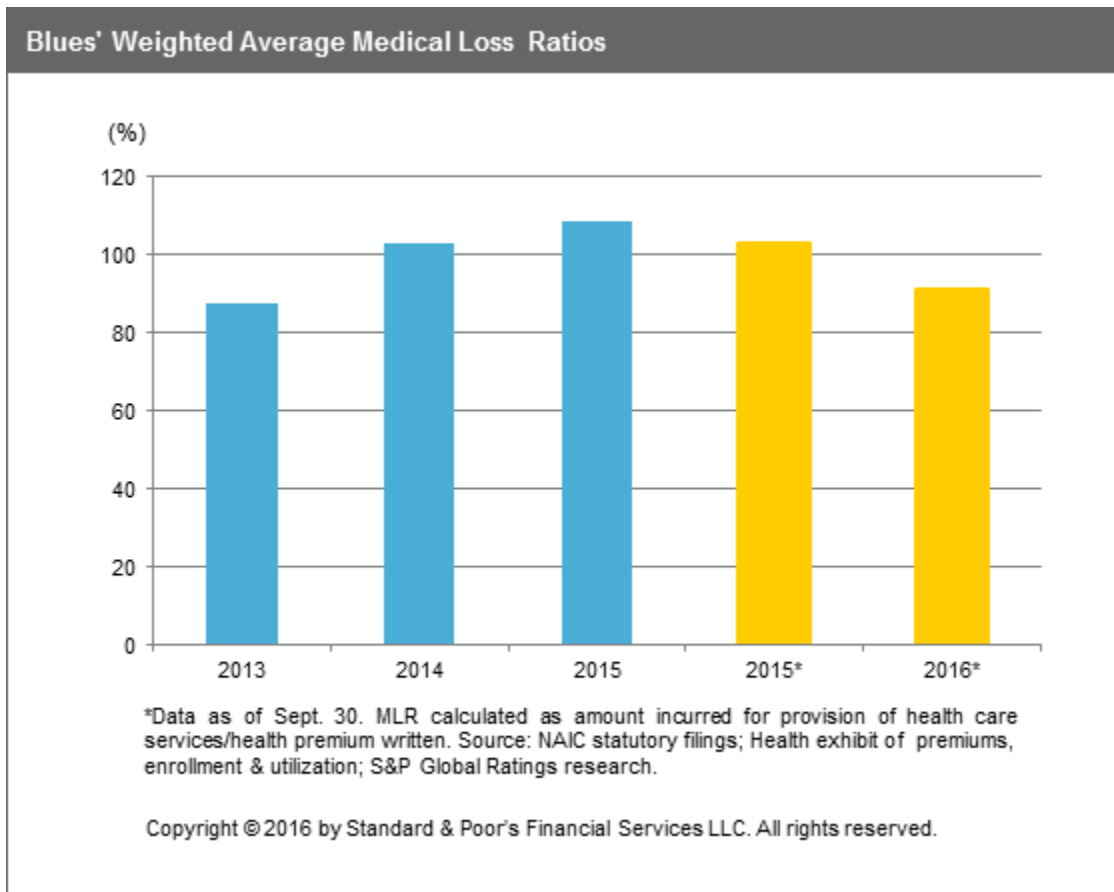
- We expect insurers' underwriting performance in the ACA individual market, in aggregate, to be better in 2016 than in 2015.
- 2017 will likely see continued improvement, with more insurers getting close to breakeven or better.
- Insurers didn't price for repeal, so if consumer behavior is contrary to pricing expectations as result of the uncertainty around the future of healthcare, then 2017 results may be weaker than we expect.
- 2018 and beyond will depend on the specifics of "repeal and replace," timing of its implementation, and insurers' ability to adapt to it.

A significant amount of uncertainty for 2018 and beyond remains for the individual health insurance market. The timing and specifics of "repeal and replace"--and insurers' ability to adapt to the changes--will play a pivotal role in influencing their underwriting performance.

Most Blue Plans Have Lower MLRs In 2016 Than In 2015

We focused on the U.S. Blue Cross Blue Shield insurance companies (Blues) as a case study for our analysis. In most states, Blues have leading shares of their local individual markets and are participating on and off the ACA marketplace (exchanges). Our analysis of the Blues' earnings trend indicates that medical loss ratios (MLRs), on average, have improved meaningfully in 2016 from 2015 (first nine months of each year; see chart 1).

Chart 1



Of course, three quarters don't make a year. Additionally, MLRs generally deteriorate in the fourth quarter of the year as members tend to increase their utilization after having reached their health plan deductibles. In line with historic trends, we expect the MLRs for the Blues to increase through year-end, but remain, on average, lower than those for full-year 2015.

(We included 32 Blues in our study. We did not include the for-profit Blue plans that are part of the publicly traded Anthem Inc. group. Also, we did not include Blue Shield of California because statutory filing templates in California differ significantly from those in the remaining states.)

From 2014 To 2018-And-Beyond

2014: A weak start

Although an individual market existed before the ACA, the size and potential growth opportunities were significantly smaller. Post-ACA, especially with the opening of the exchanges, we view the individual market as a new market with unknown risks. Therefore, insurers' premium pricing for 2014 was a combination of their best estimate of the morbidity risk of the newly insured individuals, the size and competitive make-up of the market, their market-share goals, and the financial impact of the ACA premium stabilization programs (also referred to as the 3Rs).

Insurers reported strong premium and membership growth in 2014. However, most ended the year with worse-than-expected underwriting performance. Multiple factors, including higher-than-priced claims experience, aggressive pricing by some to gain share in this new marketplace, and after-the-fact regulation changes related to the "transitional" plans, led insurers to report higher-than-expected underwriting losses in the individual segment for 2014.

2014 underwriting data. Based on annual statutory supplemental filings of health insurers, 2014 aggregate underwriting losses for the U.S. health insurance industry were over \$3 billion in the ACA individual-insured business line. The aggregate underwriting losses for the Blues included in our study were a little over \$2 billion in their individual business line. Of the 32 Blues included in this study, only six reported an underwriting gain in 2014 (see table 1).

Table 1

Blue Plans With Individual Segment Gains In 2014

	State of domicile	2014 total individual members*	2014 ACA individual underwriting gain/loss (mil. \$)
Horizon Blue Cross Blue Shield	NJ	127,573	29.0
Guidewell Mutual Holding	FL	96,824	7.0
Blue Cross & Blue Shield of Massachusetts	MA	52,184	16.1
Noridian Mutual Insurance Co.	ND	43,446	2.0
Blue Cross & Blue Shield of Rhode Island	RI	36,173	11.3
HealthNow New York Inc.	NY	4,588	1.7

*Individual members are commercially insured individual members, and do not include Medicare or Medicaid enrollees. Source: NAIC statutory filings; 2014 Annual Supplement Health Care Exhibit; Health Exhibit of Premiums, Enrollment & Utilization; S&P Global Ratings research.

2015: Hitting bottom

Underwriting losses intensified for the industry in 2015. Insurers had to file their rates for 2015 before enough market experience could inform their pricing in 2014. Generally, insurers didn't make adequate pricing or network design changes for 2015.

Additionally, the ACA risk corridor program, which insurers had assumed would be a stabilizer, proved instead to be a disruptor. The risk corridor was designed to offset large swings in insurers' profitability in the early years of the ACA marketplace (2014-2016), thus avoiding large premium increases by insurers. But budget appropriations in 2015 required the program to be budget-neutral, resulting in the risk corridor being materially deficient (see "The ACA Risk Corridor Will Not Stabilize The U.S. Health Insurance Marketplace In 2015," published Nov. 5, 2015, on RatingsDirect). The risk corridor had a cumulative shortfall of close to \$8 billion for 2014 and 2015--money that would have helped offset much of the underwriting losses during the volatile early years of the marketplace.

2015 underwriting data. For 2015, aggregate underwriting losses for the industry were over \$4.5 billion, and the aggregate losses for the Blues remained close to \$2 billion in the ACA individual market. Of the 32 Blues, 10 reported an underwriting gain in 2015 (see table 2). More Blues had an underwriting gain in 2015, but as noted, the aggregate losses for the group remained about the same. The new gains were offset by increased losses by some of the others in the group, highlighting the potential volatility in this new market.

Table 2

Blue Plans With Individual Segment Gains In 2015

	State of domicile	2015 total individual members*	2015 ACA individual underwriting gain/loss (mil. \$)
Horizon Blue Cross Blue Shield	NJ	168,226	33.9
Blue Cross Blue Shield of Michigan	MI	129,024	11.6
Cambia Health Solutions (Regence BCBS group)	UT, WA, ID	120,601	5.8
Guidewell Mut Holding Grp	FL	90,291	4.7
Excelsus Health	NY	53,856	14.1
Noridian Mutual Insurance Company	ND	42,809	7.9
Blue Cross Blue Shield of Massachussets	MA	34,176	0.3
Blue Cross Blue Shield of Vermont	VT	26,942	10.5
Blue Cross & Blue Shield of Rhode Island	RI	23,582	6.1
Blue Cross Blue Shield of Wyoming	WY	21,309	4.4
HealthNow New York Inc.	NY	11,324	3.9

*Individual members are commercially insured individual members, and do not include Medicare or Medicaid enrollees. Source: NAIC statutory filings; 2015 Annual Supplement Health Care Exhibit; Health Exhibit of Premiums, Enrollment & Utilization; S&P Global Ratings research.

2016: Signs of improvement

With better data supported by actual individual market experience, most insurers put in for increased premium pricing for 2016. Also, several insurers introduced narrower network products to control medical costs. Regulatory changes such as tightening the SEP rules also helped this year-over-year improvement. We expect the full-year 2016 underwriting losses to be lower than in 2015 and 2014. But we believe profitability will remain out of reach for most insurers in the individual segment this year because the changes made weren't enough to offset higher-than-expected claims trend in this segment.

2016 underwriting data. The weighted average MLR for this group of Blues improved to approximately 90% for the first nine months of 2016, compared to 103% during the corresponding period in 2015. Specifically, 75% of the Blues (see table 3) included in our study had an improved MLR through the first nine months of 2016 compared to the same period in 2015. Despite the year-over-year improvements, MLRs remain high for most of the Blues. Twenty-one of the 32 Blues included in this study had MLRs above 90%, which generally would translate into underwriting losses (after factoring in administrative costs) for the segment.

Table 3

Blues Plans With Lower MLRs In 2016 Than In 2015

(%)	2016.Q3	2015.Q3	Full-year 2015	Total individual members (2016.Q3)
Health Care Service Corp group	89	106	118	1,246,663
Blue Cross and Blue Shield of North Carolina	79	101	103	395,548
CareFirst Inc. group	94	102	103	321,748
Arkansas BCBS	97	90	94	273,976
Guidewell Mut Holding Grp	78	89	89	244,776
Blue Cross and Blue Shield of Tennessee	96	111	123	213,903
Highmark Group	98	129	134	178,496
Blue Cross and Blue Shield of Alabama	99	101	120	175,770

Table 3

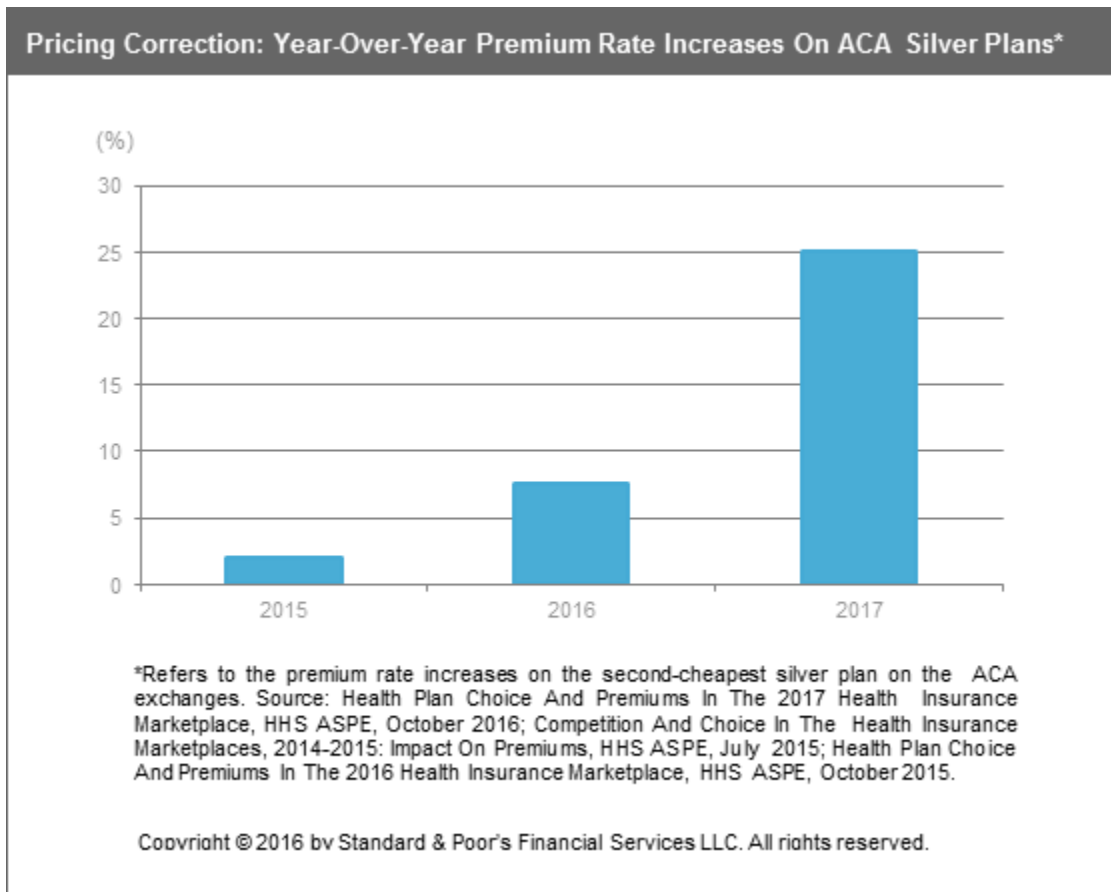
Blues Plans With Lower MLRs In 2016 Than In 2015 (cont.)				
(%)	2016.Q3	2015.Q3	Full-year 2015	Total individual members (2016.Q3)
Louisiana Health Service group	94	96	102	160,157
Blue Cross Blue Shield of Arizona, Inc.	91	98	105	138,002
Blue Cross Blue Shield of Michigan	75	81	83	125,648
Premera Blue Cross Group	99	109	114	115,158
Blue Cross and Blue Shield of Minnesota	105	127	135	110,645
Blue Cross and Blue Shield of Kansas City	92	99	105	100,241
Wellmark Inc Grp	89	92	102	99,096
Capital Blue Cross Group	90	98	105	89,581
Cambia Health Solutions (Regence BCBS)	90	91	94	88,152
Blue Cross and Blue Shield of Idaho	94	110	113	71,491
Blue Cross and Blue Shield of Nebraska	100	107	115	59,850
Mississippi Insurance Group	86	86	90	55,387
Blue Cross Blue Shield of Kasas	117	128	132	50,197
Blue Cross Blue Shield of Vermont	95	95	95	29,224
Blue Cross & Blue Shield of Rhode Island	86	89	89	28,429
Hawaii Medical Service Association	117	124	117	25,537

MLR calculated as amount incurred for provision of health care services/health premium written. Source: NAIC statutory filings; Health Exhibit of Premiums, Enrollment & Utilization; S&P Global Ratings research.

2017 will likely be another step in the right direction

Insurers have put in meaningful premium rate increases for 2017. For example, the average benchmark plan (second-cheapest silver plan) on the exchanges saw a 25% premium rate increase for 2017, which was significantly greater than increases from previous years (see chart 2).

Chart 2



Other than correcting for morbidity risk, the pricing increases also attempt to cover for the end of the ACA reinsurance program. Contrary to the risk corridor, the ACA reinsurance program proved fairly effective for the insurers. Funded by reinsurance contributions by eligible insurers, the ACA reinsurance program paid out close to \$16 billion for 2014 and 2015. The reinsurance program expires after 2016.

We view 2017 as a one-time pricing correction. So although we would expect insurers, on average, to put in another round of premium increases for 2018, the average level of increase requested will be well below the 2017 hike of 25%.

For 2017, we believe the continued pricing correction and network design changes, along with regulatory fine-tuning of ACA rules, will result in closer to break-even results, in aggregate, for the individual market, and more insurers reporting profits in this segment. But most will remain below their target profitability levels (low single-digit margins for the Blues) in 2017. It will take another year or two of continued improvements to get to that target.

Although we assume that any legislative changes to the ACA law will not affect the insurance market in 2017, insurers didn't price for repeal. So, if the uncertainty around the future of healthcare affects consumer behavior such that it is contrary to pricing expectations, then 2017 results may be weaker than we expect.

2018 and beyond remains a big unknown

At the beginning of the expansion in 2014, the expectation was three years of volatility (2014-2016), followed by a comparatively stable individual market. However, the weak results in 2014 and 2015 proved that insurers would need a longer runway to reach their target profitability in this market. Thus, in April 2016, we revised our expectations and stated that it would take five (rather than three) years for the market to get closer to stability. That meant slow but sustained improvements in 2017 and 2018, with insurers likely reaching their target profitability in 2019.

What will happen in 2018 and beyond is somewhat uncertain at this time. "Repeal and replace" will likely create structural changes to the individual marketplace. The specifics and the timeline of the replacement health insurance law--and insurers' ability to adapt to the changes--will be key to underwriting performance in 2018 and beyond.

Related Criteria And Research

- U.S. Presidential Election: Individual And Medicaid Health Insurance Businesses Will Likely Be Most Affected By "Repeal And Replace", Nov. 10, 2016
- Slowing Down: ACA Insurance Marketplace Growth May Halt in 2017, Oct. 13, 2016
- Deal Or No Deal: What Effect Could The DOJ Decision On U.S. Health Insurer Mega-Mergers Have On Credit Quality?, July 21, 2016
- Growth At A Cost: A Look At U.S. Insurers' Expansion And Profitability In The Individual Market, April 12, 2016

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