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Research Update:

Health Care Service Corp. d/b/a Blue Cross Blue Shield of Illinois, New Mexico, Oklahoma, Texas and Montana Downgraded

Primary Credit Analyst:

Neal I Freedman, New York (1) 212-438-1274; neal.freedman@spglobal.com

Secondary Contact:

Hema Singh, Hightstown (1) 212-438-7254; hema.singh@spglobal.com

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Overview

- We expect HCSC's full-year 2016 operating results to be about breakeven, which is below our expectations and would be the third year of marginal to weak profitability.
- We are downgrading HCSC to 'A+' from 'AA-' and Dearborn National Life Insurance Co. to 'A' from 'A+'.
- The stable outlook reflects our view that HCSC will maintain its strong business risk profile and extremely strong risk-based capital position.

Rating Action

On May 27, 2016, S&P Global Ratings lowered its long-term counterparty credit and financial strength ratings on Health Care Service Corp. (d/b/a Blue Cross Blue Shield of Illinois, New Mexico, Oklahoma, Texas, and Montana; HCSC) to 'A+' from 'AA-'. We also lowered our long-term counterparty credit and financial strength ratings on HCSC's strategically important subsidiaries, Dearborn National Life Insurance Co. and Dearborn National Life Insurance Co. of New York (collectively Dearborn) to 'A' from 'A+'. The outlook is stable.

Rationale

The rating action reflects HCSC's persistent marginal to weak operating performance. The company established a \$431.5 million premium deficiency reserve increase in first-quarter 2016, which was largely driven by expected continued underwriting losses on its Affordable Care Act (ACA) exchange business. This would mark the third consecutive year of marginal to weak statutory results following statutory losses of \$65.9 million in 2015 and \$281.9 million in 2014. These expected results are also below our prior expectations of the company reducing its ACA exchange-related losses to the point of restored profitability. We currently expect HCSC to return to profitability in 2017 as the company takes corrective action on its ACA-related business.

HCSC is one of the largest health insurers in the U.S. based on revenues and membership, and has the leading market share in each of its five Blue Cross Blue Shield licensed states. The company has one of the strongest balance sheets in the industry based on size and quality of statutory capital, significant 'AAA' capital redundancy, and modest leverage. HCSC also has

exceptional liquidity from its sizable, relatively short-duration investment portfolio, a \$400 million revolving credit facility, and access to the Federal Home Loan Bank.

We affirmed our 'a-' stand-alone credit profile on Dearborn. However, per our group rating methodology, we lowered our counterparty credit and financial strength ratings on the company to 'A' from 'A+'. The stable outlook is based on our lowering the ratings on HCSC.

Outlook

The stable outlook reflects our view that HCSC will maintain its strong business risk profile and significant 'AAA' capital redundancy over the next 18 to 24 months.

Downside scenario

Although unlikely, we may lower the ratings by one notch if over the next 18 to 24 months it becomes apparent that marginal to weak operating performance will persist in 2017 and beyond. However, even in a downside scenario, we would not expect HCSC's capital adequacy to fall below 'AAA' given current levels.

Upside scenario

Also unlikely, we may raise the rating if over the next 18 to 24 months it becomes apparent that HCSC will restore the company's profitability to at least a 2% return on revenue on a consistent basis.

Related Criteria And Research

- Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology For Calculating The Convexity Risk in U.S. Insurance Risk-Based Capital Model, April 27, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

To From
Health Care Service Corp. d/b/a Blue Cross Blue Shield of Illinois, New

Research Update: Health Care Service Corp. d/b/a Blue Cross Blue Shield of Illinois, New Mexico, Oklahoma, Texas and Montana Downgraded

Mexico, Oklahoma, Texas and Montana

Counterparty Credit Rating

Local Currency

A+/Stable/--

AA-/Negative/--

Financial Strength Rating

Local Currency

A+/Stable/--

AA-/Negative/--

Senior Unsecured

A+

AA-

Dearborn National Life Insurance Co.

Dearborn National Life Insurance Co. of New York

Counterparty Credit Rating

Local Currency

A/Stable/--

A+/Negative/--

Financial Strength Rating

Local Currency

A/Stable/--

A+/Negative/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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