S&P Global Ratings

RatingsDirect®

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

Primary Credit Analyst:
Francesca Mannarino, New York + 1 (212) 438 5045; francesca.mannarino@spglobal.com

Secondary Contacts:
James Sung, New York + 1 (212) 438 2115; james.sung@spglobal.com
Divya Shastry, Mumbai; divya.shastry@spglobal.com

Table Of Contents

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

Anchor	aa-
Business Risk	**Strong**
Competitive position	Strong
IICRA	Low
Financial Risk	**Excellent**
Capital and earnings	Excellent
Risk exposure	Moderately low
Funding structure	Neutral

+

Modifiers	0
Governance	Neutral
Liquidity	Adequate
Comparable ratings analysis	0

=

SACP	aa-

+

Support	0
Group support	0
Government support	0

=

AA-/Stable/--

Financial strength rating

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Strong Blue Cross Blue Shield (BCBS) brand and leading market position in five core markets	Modest operating margins
Product diversification beyond health insurance in life insurance and other ancillary lines	Geographic concentration in five states (Illinois, New Mexico, Oklahoma, Texas, and Montana)
Excellent balance sheet strength with 'AAA' capitalization and moderate financial leverage	Underweighted government business (Medicare, Medicaid) relative to long-term growth opportunities

Chicago-based Health Care Service Corp. (HCSC) is a mutual legal reserve company that provides health insurance and related services through its Blue Cross Blue Shield-licensed health plans. HCSC also provides various non-insurance health care services through its subsidiaries and joint ventures. For example, HCSC has an ownership stake in Prime Therapeutics, a pharmacy benefit manager jointly owned by 19 BCBS health plans. In 2022, HCSC acquired Trustmark Health Benefits, a third-party administrator of health benefits that will expand capabilities to better serve self-funded employers. Separately, HCSC is also active in the broader group benefits market. HCSC provides life, dental, disability, and ancillary insurance products through its Dearborn Group subsidiary business. We view Dearborn as a strategically important subsidiary of the HCSC group.

HCSC is one of the highest-rated and largest non-public health insurers in the U.S. Its credit strengths come from its leadership in core markets, with strong Blue brand recognition positioning the company among the top five health insurers in the U.S., based on medical membership as of year-end 2021. The company leads the commercial group market in its five states (Illinois, New Mexico, Oklahoma, Texas, and Montana) but also has a strong presence in the national account segment, which gives further scale. Additionally, HCSC is very well capitalized, with capital levels redundant at 'AAA', per our risk-based capital (RBC) model. Its enterprise-level RBC ratio of 1,247% at year-end 2021 is one of the highest among our rated health insurers.

Table 1

HCSC--Peer Comparison

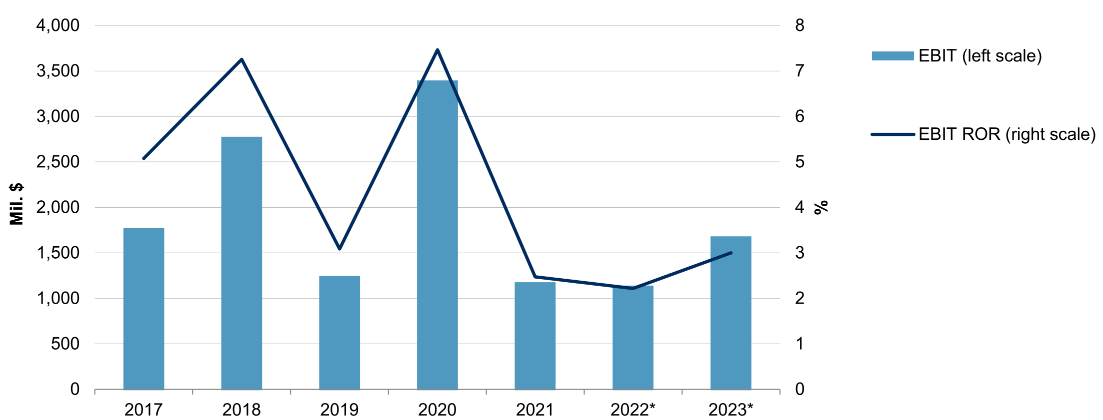
	Health Care Service Corp.	Blue Cross & Blue Shield of Florida	Blue Cross & Blue Shield of North Carolina	Blue Cross & Blue Shield of Tennessee
Financial strength ratings on core subsidiaries	AA-/Stable	A+/Stable	A+/Stable	A+/Stable
Business risk profile	Strong	Strong	Strong	Strong
Financial risk profile	Excellent	Very strong	Very strong	Very strong

Source: S&P Global Ratings.

Operating performance is expected to remain modest in 2022 as elevated expenses and pandemic-related costs pressure performance. In 2021, higher medical utilization strained HCSC's profitability, resulting in its medical loss ratio (MLR) increasing to 89.1%, relative to 81.3% in 2020, with adjusted EBIT return on revenue (ROR) of 2.5%, compared with 7.5% in 2020. During the first nine months of 2022, lower-than-expected COVID-19 claims and the favorable runout of 2021 claim reserves supported MLR declining to 85.8%, with an ROR of 5.0%. Relative to 2021, we expect more normal utilization combined with adequate pricing actions in 2022 to result in a full-year MLR of 87%-88%. Elevated expenses related to one-time investments into the business, as well as Trustmark Health Benefits acquisition integration costs, will pressure margins. We expect adjusted EBIT ROR of 2%-3% in 2022.

Chart 1

HCSC's Earnings Will Remain Modest In 2022-2023



*Forecast data reflect S&P Global Ratings' base-case assumption. Source: S&P Global Ratings.

HCSC's efforts to strengthen its government programs support revenue diversification but are dragging on profitability. HCSC's strengths lie in the commercial segment, where it holds a leading market position, with 35% or better market share in its five states, based on enrollment. The pause on Medicaid redeterminations in 2022, upcoming Medicaid Request for Proposal (RFP) opportunities, the company's meaningful Medicare Advantage (MA) county expansion within its five states, and goals of achieving four stars (for its MA products) will support HCSC's government segment growth. While HCSC is not as mature of a player in this segment as its for-profit peers, its government business strategy is its best opportunity for long-term growth. Past learnings in this segment and continued investment to build a sustainable operational foundation--combined with favorable market dynamics--should support the company's growth strategy.

Outlook: Stable

The stable outlook reflects our expectation that HCSC will maintain its leading market position in its core markets while strengthening its presence in government programs. Moreover, we expect HCSC will continue to show balance-sheet strength supported by 'AAA' capital redundancy. In 2022, we expect revenue growth in the upper single digits, mainly owing to membership growth and strong retention efforts. We also expect the normalization in utilization trends and lower COVID-19-related costs to translate into an MLR of 87%-88%. Increased expenses related to technology and system upgrades, as well as integration costs due to the Trustmark Health Benefits acquisition, will result in adjusted EBIT ROR of 2%-3%. In 2023-2024, while we anticipate lower COVID-19 costs over time, we expect adjusted EBIT ROR to remain 2%-4%.

Downside scenario

We may lower our ratings by one notch in the next 12-24 months if HCSC underperforms and demonstrates weakened operating performance relative to expectations and peers, or if capitalization erodes below 'AAA'.

Upside scenario

An upgrade is unlikely in the next 12-24 months given the company's stable business profile and moderate financial policy.

Assumptions

- U.S. real GDP growth of 1.6% in 2022 and 0.2% in 2023
- Average unemployment of 3.7% in 2022 and 4.3% in 2023
- Core Consumer Price Index (CPI) at 6.2% in 2022 and 3.8% in 2023

Source: "Economic Outlook U.S. Q4 2022: Teeter Totter," published Sept. 26, 2022

Table 2

HCSC--Key Metrics

	--Year ended Dec. 31--						
(Mil. $)	**2023***	**2022***	**2021**	**2020**	**2019**	**2018**	**2017**
Total revenue	54,000-56,000	50,500-51,500	47,229.1	45,354.3	39,627.7	37,982.4	34,409.0
Medical loss ratio (%)	87-89	87-88	89.1	81.3	85.3	81.2	84.8
EBIT-adjusted§	1,500-1,700	1,000-1,200	1,167.8	3,386.3	1,237.3	2,766.5	1,760.1
EBIT-adjusted return on revenue (%)	2.0-4.0	2.0-3.0	2.5	7.5	3.1	7.3	5.1
S&P Global Ratings capital adequacy/redundancy	AAA	AAA	AAA	AAA	AAA	AAA	AAA

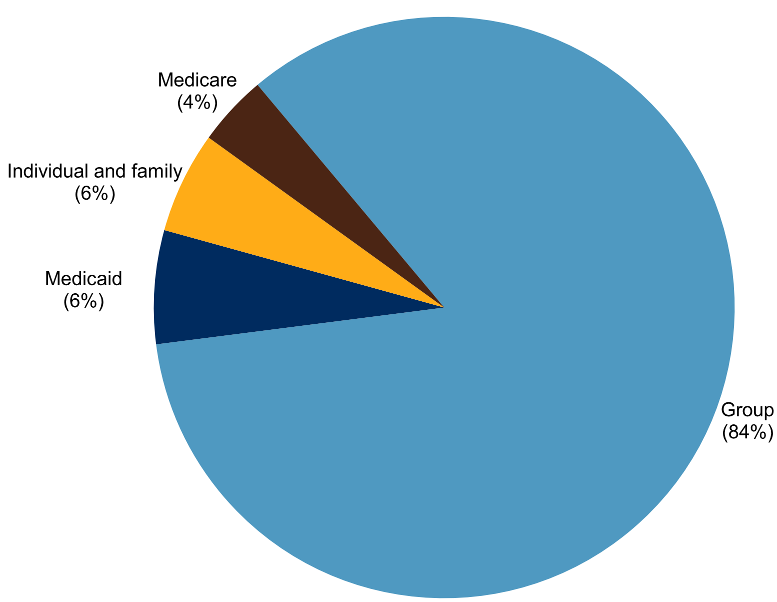
*Forecast data reflect S&P Global Ratings' base-case assumptions. Source: S&P Global Ratings.

Business Risk Profile: Strong

HCSC is a mutual legal reserve company and Blue Cross Blue Shield Association licensee that covered about 17.4 million medical members (as of Sept. 30, 2022), an increase of 1.1% versus 17.2 million as of year-end 2021. HCSC primarily operates within the commercial segments, including individual under 65 and small/large employer group (about 90% of membership). The company also participates in government segments such as Medicaid, Medicare Advantage, Medicare Supplement, Medicare Part D, and Dual-Eligibles (about 10% of membership). For year-end 2021, HCSC reported total revenue of $47.2 billion.

Chart 2

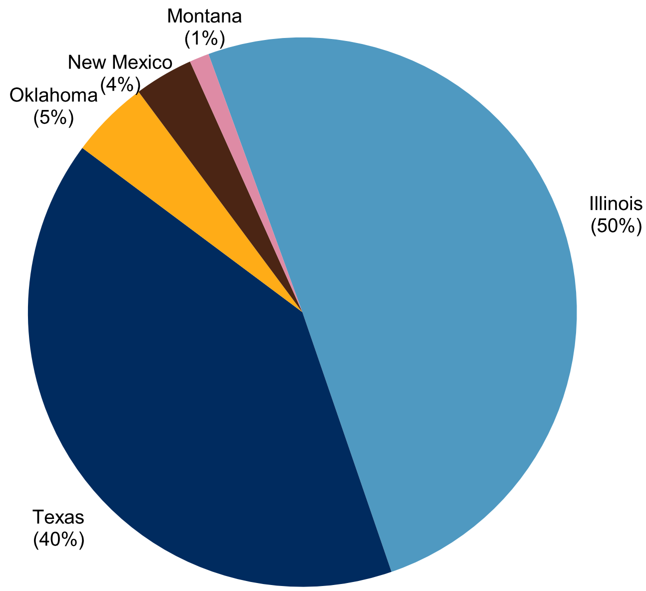
HCSC--Membership By Line Of Business (As Of Sept. 30, 2022)



Source: Company reports.

Chart 3

HCSC--Membership By State (As Of Sept. 30, 2022)

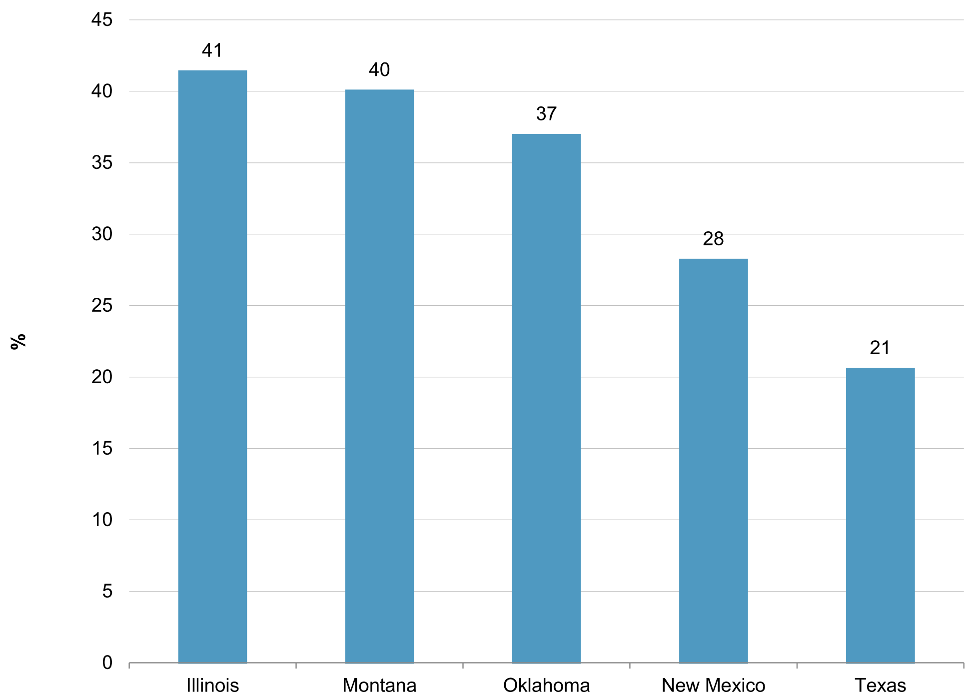


Source: Company reports.

HCSC has a strong competitive position stemming from the well-known Blue Cross Blue Shield brand, its leadership in core markets with significant size and scale, and its meaningful national accounts market presence. Despite being a regional health plan focusing primarily on five states, HCSC is the fifth-largest health plan nationally in terms of membership (for year-end 2021), with projected year-end 2022 membership of 17.5-17.6 million members and expected revenues of about $50 billion. In each of its key states, HCSC is the leading provider in the commercially insured group and individual markets. Its estimated risk-based commercial market shares based on membership are: 81% in Oklahoma, 77% in Illinois, 56% in Texas, 54% in Montana, and 36% in New Mexico (based on statutory financial statements for year-end 2021).

Chart 4

HCSC--Total Market Share Within Its Key States (Year-End 2021)



Sources: S&P Capital IQ Pro and statutory filings.

HCSC is committed to enhancing its strategic initiatives over the next few years to drive growth. While HCSC is a leader in the commercial segment, retaining its market strength is a priority. We expect the company's investment, innovation, ancillary service integration, and competitive pricing provided to its members to differentiate it from competitors. Most recently, HCSC acquired Trustmark Health Benefits and invested in a partnership with Collective Health, focused on enhancing the digital health care experience. We believe these investments support HCSC's competitive advantages in the commercial segment and its national accounts business by driving a more integrated, tailored, and digital health care experience.

We think that HCSC being a diversified market player, by offering both commercial and government products, is a competitive strength. In 2022, HCSC expanded its MA presence within its states by adding new zero premium plans and expanding its addressable market of Medicare-eligible individuals by entering 90 new counties. The company also has plans to expand to an additional 152 counties in 2023. The company's MA health plans maintained 3.5 stars in 2022 but has goals to reach four stars, which would lead to further reinvestment back into the product through additional revenue bonuses. We expect these actions will bolster revenue growth and diversification, with margins dependent on HCSC's ability to build a cost-efficient operating platform that will support profitability.

HCSC's Medicaid business has grown during the pandemic because of the pause on Medicaid reverifications (tied to the national public health emergency period). We expect HCSC will have more than 1 million Medicaid members by year-end 2022. HCSC's operating results in Medicaid have been favorable because of lower-than-expected medical utilization, which is being offset by higher risk corridor accruals. Once the public health emergency ends, possibly in 2023, Medicaid reverifications will restart and HCSC will lose Medicaid membership during 2023-2024.

We believe HCSC will have opportunities to expand its Medicaid business through state requests for proposals (RFPs) during the next several years. The New Mexico Centennial Care program, which HCSC already participates in, is up for re-bid and will go live in January 2024. Additionally, Oklahoma's new statewide program, as it transitions to managed care, should be awarded soon and will go live in October 2023. Lastly, HCSC also participates in Texas STAR & CHIP and STAR Kids programs, which should go to RFP in 2023-2024 and go live in 2025-2026.

In 2021, HCSC increased revenues by 4.1% to $47.2 billion, mainly because of higher Medicaid and commercial individual membership and rate adequacy actions. MLR was elevated at 89.1%, with underwriting results under pressure because of the resumption in medical utilization, pent-up demand, and an uptick in COVID-19 costs from the various surges through the year. HCSC's ROR declined to 2.5% (compared with 7.5% in 2020).

Year-to-date third-quarter 2022 revenue increased by 8.1% based on favorable membership retention and the pause on Medicaid reverifications. Additionally, improved final 2021 ACA risk adjustment and Medicaid risk corridor results supported revenue growth. ROR margins were elevated at 5.0% as of year-to-date third-quarter 2022, supported by lower utilization trends, somewhat offset by higher expenses. For 2022, we forecast higher medical utilization in the last quarter of the year as members utilize their benefits and demonstrate pent-up demand. Expenses are elevated owing to one-time investments and integration costs. We expect this to result in an MLR of 87%-88% and ROR remaining steady between 2%-3%.

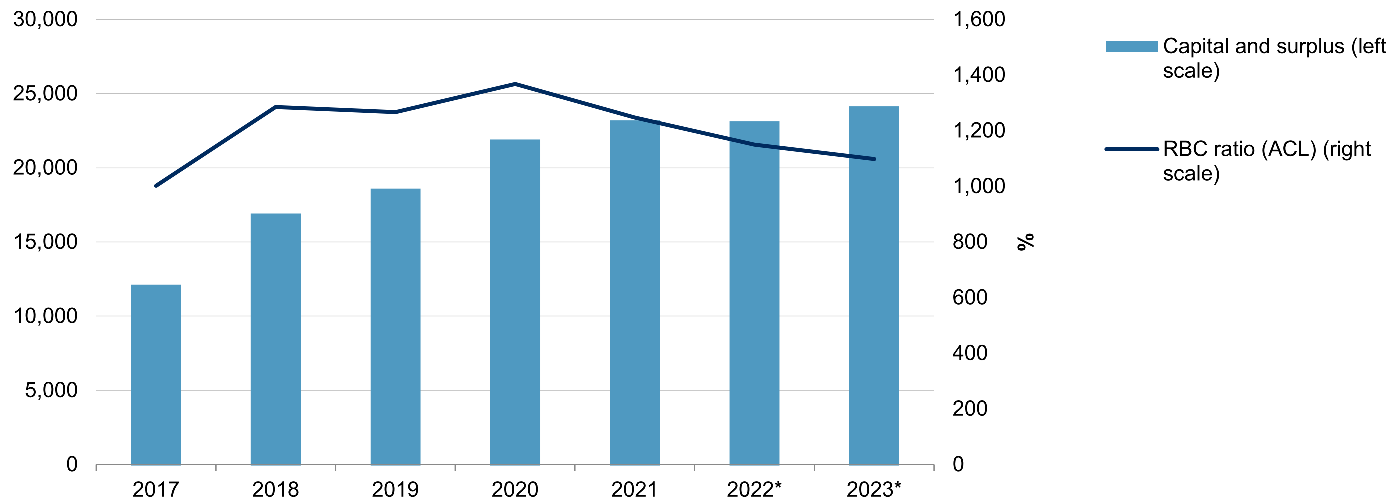
In our base-case forecast for 2023, we anticipate mid- to upper-single-digit revenue growth, driven by membership growth stemming from MA expansion initiatives and competitive pricing in an effort to retain and gain market share. However, we also factor in the impact of Medicaid redeterminations to restart some time in 2023, impacting membership and revenue. We think more normalized levels of medical utilization should support slight MLR improvement, but the MLR to remain between 87%-89%, and adjusted EBIT ROR to be sustained between 2%-4%. Macroeconomic uncertainties and a looming recession could affect these performance expectations. While commercial membership may decline, HCSC could pick up these members within the Medicaid and individual ACA segments. Additionally, medical utilization could diminish during a recession as members curtail their spending.

Financial Risk Profile: Excellent

HCSC's capitalization is highly redundant at 'AAA', per our risk-based capital model, with an RBC ratio of 1,247% at year-end 2021. Additionally in 2021, the company's capital and surplus of $23.1 billion increased by almost 6%, primarily because of strong net income of more than $1.2 billion, from $21.9 billion in capital and surplus as of year-end 2020. As of the third quarter of 2022, capital and surplus increased further to $23.9 billion. We expect HCSC to maintain capital around this level at year-end, as well as sustain capital redundancy at 'AAA' through 2023, with RBC stabilizing between 1,100%-1,200%.

Chart 5

HCSC--Capital And Surplus And RBC Trend



*Forecast data reflects S&P Global Ratings' base-case assumptions. Source: Statutory filings.

HCSC's investment portfolio is conservative and has high credit quality, benefiting its risk position and supporting overall capital stability. As of year-end 2021, on a statutory basis, the group increased total invested assets by 2.5% to $26.0 billion, with:

- 84% in bonds with an 'A' average rating,
- 5.8% in equity investments,
- -0.2% in cash and cash equivalents,
- 3% in real estate, and
- 7.1% in investments in affiliates.

As of Sept. 30, 2022, HCSC maintained total invested assets of $26 billion. The investment portfolio contained no significant obligor or sector concentrations.

HCSC has limited access to external capital sources as a mutual legal reserve company. The company maintains $2 billion in senior unsecured notes, issued in 2020, but has no other long-term senior debt outstanding. Both the company's high-quality balance sheet and low financial leverage support financial flexibility. Financial leverage was approximately 11% as of year-end 2021, with fixed-charge coverage of 18x.

In July 2021, the company entered into a new five-year senior unsecured $1 billion revolver with 11 U.S. banks that matures in 2026. As of Sept. 30, 2022, the revolver is undrawn. HCSC is also a member of the Federal Home Loan Bank of Chicago and has the ability to access up to $1.75 billion under its secured lending program. As of Sept. 30, 2022, the company has borrowed $500 million.

Other Credit Considerations

Governance

We view governance as a neutral factor to the rating. HCSC's key strategic priorities are in line with its core capabilities, and we believe management can execute effectively. HCSC's management team has an average of 20 plus years of health insurance industry experience and is structured to support key lines of business and geographies with subject matter experts.

In April 2022, former chief operating officer Dr. Opella Ernest was promoted to executive vice president of commercial markets. She has worked for HCSC since 2012 and has had increasing responsibility leading the company's clinical strategy and operation. She also served as divisional senior vice president, chief medical officer of Blue Cross and Blue Shield of Illinois. Dr. Opella Ernest reports to CEO Maurice Smith.

Additionally, Mike Frank, senior vice president of the pharmacy and ancillary business was promoted to chief operating officer. In his new role, he will lead HCSC's IT and customer service organizations. Frank joined HCSC in 2013 when BCBSMT became part of the company. Mike Frank also reports to CEO Maurice Smith.

Given the changing health care landscape and persistent political and regulatory risks, we believe the management team will preserve financial stability in operating earnings and capital adequacy, even as the company continues to face pandemic-related uncertainties, combined with investments to secure long-term growth.

Liquidity

HCSC has adequate liquidity to meet its obligations, as reflected by a liquidity ratio slightly exceeding 200%, as of year-end 2021.

Environmental, social, and governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

Environmental factors have no impact on the rating.

Social factors have a net neutral impact on the rating. HCSC is exposed to health and safety factors, such as those relating to the pandemic. The company also faces social risks relating to the affordability and access of health insurance products and changing consumer preferences. These social risks can result in persistent public policy and regulatory risks. These risks are currently neutral to the rating since we expect future public policy and regulatory changes will likely be incremental or manageable.

Governance factors have no impact on the rating. HCSC operates in a highly regulated industry. We think HCSC has managed its regulatory and compliance risks well.

Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Insurers Rating Methodology, July 1, 2019
- Group Rating Methodology, July 1, 2019
- Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	**aa-/a+**	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of December 2, 2022)*

Health Care Service Corp. d/b/a Blue Cross Blue Shield of Illinois, New Mexico, Oklahoma, Texas and Montana	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Senior Unsecured	A+
Related Entities	
Dearborn Life Insurance Co.	
Financial Strength Rating	
Local Currency	A+/Stable/--

Ratings Detail (As Of December 2, 2022)*(cont.)	
Issuer Credit Rating	
Local Currency	A+/Stable/--
Dearborn National Life Insurance Co. of New York	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
Holding Company	HCSC Group
Domicile	Illinois

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.