S&P Global Ratings

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

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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 brand strength and leading market position in five core markets.	Modest adjusted EBIT margin of 2%-4%.
Diversified health insurance portfolio combined with life insurance and ancillary product offerings.	Geographic concentration in five states (Illinois, New Mexico, Oklahoma, Texas, and Montana).
Consistent 'AAA' capital redundancy with a conservative investment portfolio.	Commercial segment concentration relative to similarly rated peers.

HCSC is a market leader throughout its five core states and we believe recent partnerships and acquisitions present it with growth opportunities. HCSC, through its Blue Cross and Blue Shield operating divisions dominates the health insurance market within its five states. It has 45%-70% commercial market share in the fully-insured large group segment (based on premiums) in each of these states as well as 30%-90% market share within the fully insured small group segment and 30%-60% market share in the self-funded group segments. Targeted growth and successful retention strategies help to drive an over 90% renewal rate across its commercial segments. Additionally, its investment in Collective Health, which enhances HCSC's digital platform capabilities for its employer groups, and its acquisition of Trustmark Health Benefits (recently rebranded as Luminare Health Benefits), a third-party administrator (TPA) of health benefits, enhances its ability to tailor its offerings to meet employer preference while expanding beyond its core five states.

We think HCSC is committed to government segment expansion, despite some industry headwinds. HCSC is expanding its Medicare Advantage (MA) and Medicare Supplement presence within its five states and is committed to reaching an additional 344 counties from 2022-2024, with 152 counties added in 2023 and 99 counties targeted for 2024. This amplified presence (serving over 700,000 members as of June 2023) also comes with necessary investment in the product offering, marketing, brand awareness, and the provider network to support its long-term competitive position in MA. In 2024, HCSC will need to contend with weaker MA rates, which could affect its ability to meet its long-term profitability targets. Additionally, recently released Star Ratings for 2024 highlight the majority of HCSC's MA members (46%) fall within 3-Star plans with only 1% in 4-Star or better plans, resulting in a significantly diminished revenue bonus for 2025, which could cause HCSC to re-evaluate its product offerings and growth strategy. (The Centers for Medicare & Medicaid Services rate Medicare plans from 1 to 5 Stars, where 5 is the highest.)

HCSC's Medicaid and Dual Special Needs segment reached 1.17 million members as of June 2023. However, with the restart of Medicaid redeterminations--which began in May for New Mexico, in June for Texas, and in July for Illinois--we expect a slowdown in growth by year-end and into 2024 as members' Medicaid eligibility is verified. HCSC anticipates it will lose about 10%-12% of its Medicaid members through 2024, though we expect it may recoup a portion of these members within its individual and commercial business segments.

We select the higher of the split anchor of 'aa-/a+' to reflect HCSC's business and financial strengths. As the sixth largest health insurer in the U.S. (based on health premiums), we believe HCSC's market strengths reflect its leadership in core markets, strong Blue brand recognition, and growing business segment and earnings diversification. Additionally, HCSC is very well capitalized, with capital levels materially redundant at 'AAA', per our risk-based capital (RBC) model. Its enterprise-level regulatory RBC ratio of 1,192% at year-end 2022 is one of the highest among our rated health insurers. We believe these distinguishing characteristics support HCSC holding one of the highest ratings among our rated U.S. health insurers.

Table 1

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

Outlook: Stable

The stable outlook on HCSC reflects our expectation that it will maintain its leading market positions in the commercial segment while focusing on enhancing its position in government programs. Moreover, we expect HCSC will continue to demonstrate very strong capitalization and balance-sheet strength. We expect HCSC's revenue will grow 8%-12% in 2023 and in the mid-single digits in 2024, owing to strong membership growth and retention with an adjusted EBIT return on revenue (ROR) of 2%-4%. In 2023-2024, we also expect HCSC will maintain 'AAA' capital redundancy and financial leverage of less than 15%.

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 and financial risk profiles.

Key Assumptions

- U.S. real GDP growth of 2.3% in 2023 and 1.3% in 2024
- U.S. core Consumer Price Index growth of 4.7% in 2023 and 2.6% in 2024
- U.S. unemployment rate of 3.6% in 2023 and 4.1% in 2024
- Ten-year Treasury rate of 3.9% in 2023 and 4.0% in 2024

Source: "Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted," Sept. 25, 2023

HCSC--Key metrics

	--Year ended Dec. 31--							
(Mil. $)	**2024f**	**2023f**	**2022**	**2021**	**2020**	**2019**	**2018**	**2017**
Total revenue	59,000-61,000	56,500-57,500	50,993.51	47,229.10	45,354.30	39,627.70	37,982.40	34,409
Medical loss ratio (%)	87-89	87-88	87.1	89.1	81.3	85.3	81.2	84.8
EBIT-adjusted	1,600-1,800	1,950-2,150	1,697.00	1,167.80	3,386.32	1,237.30	2,766.46	1,760
EBIT-adjusted return on revenue (%)	2.0-4.0	3.0-4.0	3.3	2.5	7.5	3.1	7.3	5.1
S&P Global Ratings capital adequacy/redundancy	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA

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

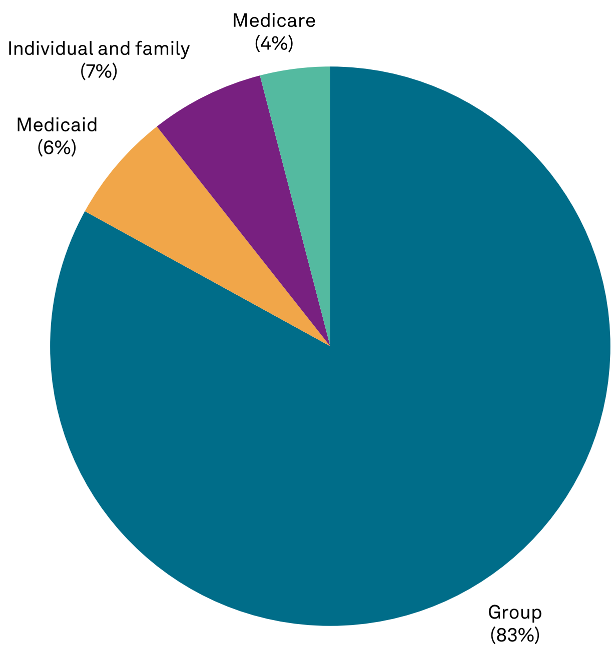
Business Risk Profile: Strong

HCSC is a mutual legal reserve company and Blue Cross Blue Shield Assn. licensee that provides health insurance and related services through its Blue Cross Blue Shield-licensed health plans. The company expects to cover approximately 17.7 million medical members by year-end 2023, an increase of 1.5% relative to 17.5 million as of year-end 2022.

HCSC primarily operates within the commercial segments, including individual under 65, small/large employer group, and national accounts (about 90% of membership). The company also participates in government segments such as Medicaid, MA, Medicare Supplement, Medicare Part D, and Dual-Eligibles (about 10% of membership). For year-end 2022, HCSC reported total consolidated statutory revenue of $51 billion, including net investment income.

Chart 1

HCSC membership by line of business (as of June 30, 2023)

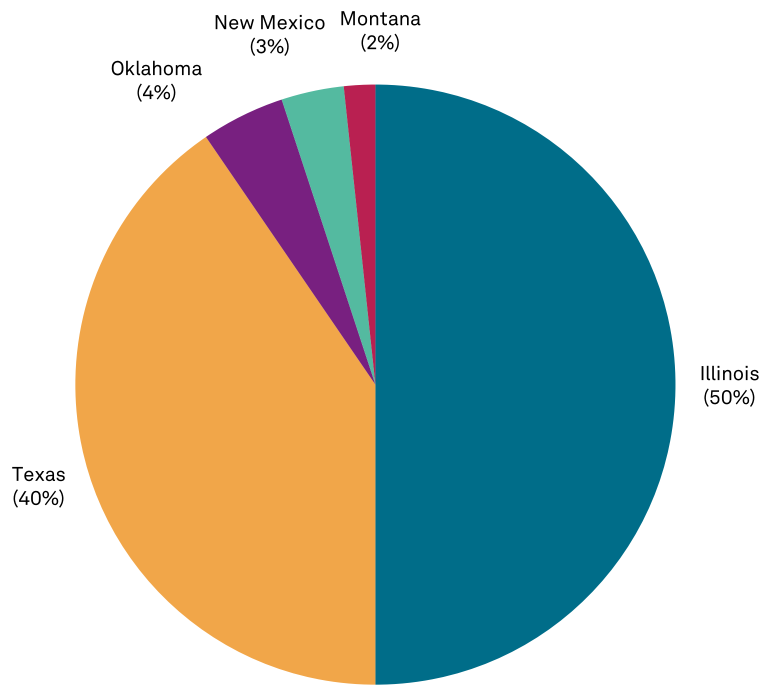


Source: Company reports.

HCSC also provides various noninsurance health care services through its subsidiaries and joint ventures and is 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.

Chart 2

HCSC membership by state (as of June 30, 2023)



Segments may not total 100% due to rounding. Source: Company reports.

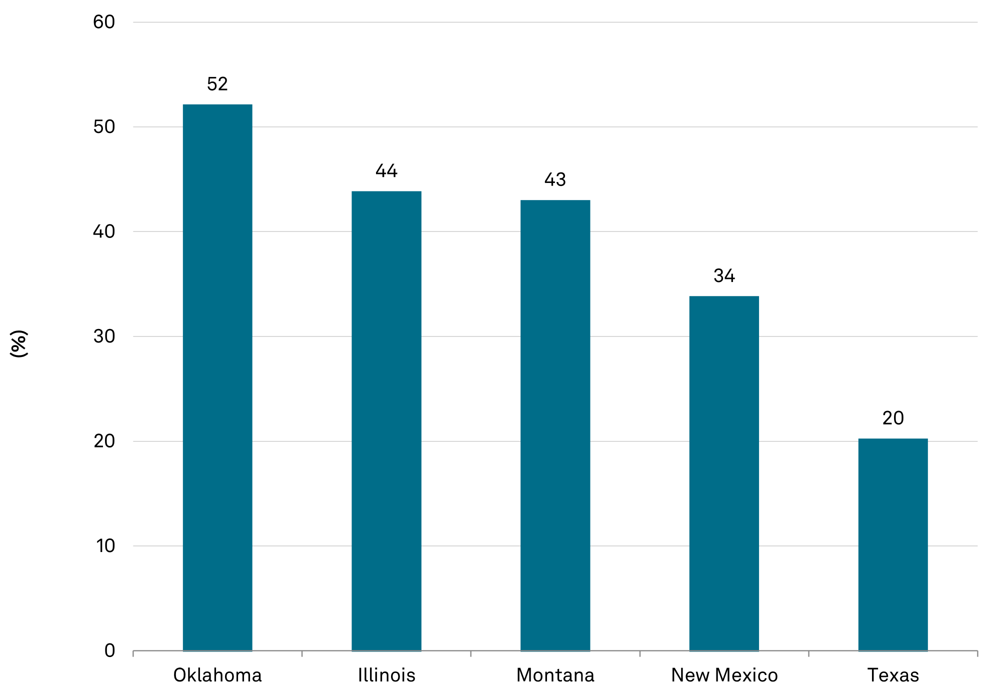
HCSC's strong competitive position reflects its material size and scale, its well-known Blue Cross Blue Shield brand, and its leadership in core markets with a significant market presence in national accounts. Despite being a regional health plan focusing primarily on five states, HCSC is the fifth-largest health plan nationally in terms of membership and sixth-largest based on premiums (for year-end 2022).

The company anticipates year-end 2023 membership to reach 17.7 million with expected revenue of approximately $57 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 premium are: 72% in Oklahoma, 70% in Texas, 69% in Illinois, 60% in Montana, and 52% in New Mexico (based on statutory financial statements for year-end 2022).

Chart 3

HCSC total market share within its key states

As of year-end 2022



HCSC remains 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 position is a priority. The company had nearly 16 million commercial members as of June 2023. We expect the company's investment, innovation, ancillary service integration, and competitive pricing to differentiate it from competitors.

While the company's commercial segment is rather mature relative to its government products, we think the partnership with Collective Health and acquisition of Trustmark's Health Benefits provide HCSC with additional expansion opportunities and address HCSC's organic growth initiatives. These TPAs expand HCSC's addressable market (beyond its five core states) and offer a more customized, integrated, and digital health care experience within its benefit plans, which is resonating with various employer groups and fostering growth and retention.

We think this also positions HCSC well to further expand its national accounts business as it is prepared to respond once the second Blue bid goes into effect. This is likely to occur once the subscriber settlement is finalized as part of the longstanding Blue Cross Blue Shield antitrust multi-district litigation.

Beyond HCSC's dominant market position in the commercial segment, part of HCSC's strategy involves repositioning and strengthening its government platform. As of the first half of 2023, MA and Medicare Supplement membership has grown past 700,000 within its five states, representing growth of nearly 5% from year-end 2022. Like the rest of the industry, HCSC's MA business faced elevated utilization trends in the first half of 2023, particularly within the outpatient setting as seniors began exhibiting signs of pent-up demand post-pandemic.

Despite this headwind--which will likely continue into 2024--and the impact of weaker rates next year, we think HCSC will look to provide benefit stability to its members to retain and attract new members. Also, HCSC is continuing to expand and will enter 99 counties next year. By 2024, HCSC expects to cover about 82% of its service areas through its MA offerings.

While fewer of its plans have ratings of 4 Star or above for 2024, we think HCSC is still committed to improving its Star ratings. A likely continued need for material investment into the product will be necessary but may pressure operating margins and HCSC's ability to build a cost-efficient operating platform that will support profitability.

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.

Throughout the pandemic, HCSC's Medicaid business has materially expanded in membership, up over 50% as of second-quarter 2023 from year-end 2019. However, as the Medicaid redetermination process has now restarted, we expect a slowdown in membership growth for the remainder of 2023 and 2024.

While the redetermination process has been slow to start, the company forecasts a loss of 60,000-70,000 Medicaid members in 2023 and a total of 130,000 members lost once the process concludes. While MA utilization is up year-to-date, the Medicaid segment is seeing lower utilization, which we expect to support favorable profitability for this segment in 2023. We think the risk in maintaining profitability for 2024 will be based on whether Medicaid rates are sufficient to cover adverse changes to the risk pool given redeterminations.

Beyond organic growth opportunities within the states where HCSC already manages Medicaid, the company continues to look for ways to expand this business segment through state requests for proposals over the next several years. Recently, HCSC won the re-bid on the New Mexico Centennial Care program, now named Turquoise Care, which will go live in July 2024.

HCSC was unsuccessful in its attempt to secure a contract for Oklahoma's new statewide program as it transitions to managed care in April 2024. Separately, HCSC participates in Texas STAR & CHIP and STAR Kids programs, which are up for re-bid. HCSC concluded its bid for the Texas STAR & CHIP program in late summer 2023 and is currently awaiting scoring results in early 2025, based on the Texas Health and Human Services publicly disclosed timeline. HCSC currently operates STAR & CHIP in one service area with the potential to be awarded several additional service areas. The STAR Kids start of operations is anticipated for early 2027. Lastly, the Illinois HealthChoice contract, which HCSC already participates in, is expected to be up for re-bid in early 2024 and go live in 2026.

In 2022, HCSC's revenue increased by 7% to $51 billion, driven by premium and membership growth and strong retention. The Medicaid segment benefited from the ongoing pause on redeterminations and HCSC's Medicare expansion initiatives. Additionally, the individual segment picked up greater than expected membership as Bright

HealthCare and Friday Health Plans exited the individual market after financial weaknesses. HCSC is in a risk adjustment receiver position for 2022 (due to higher actuarial risk than other plans), which will be paid by other plans to HCSC in 2023, per the Affordable Care Act's risk adjustment program. However, the Centers for Medicare and Medicaid Services recently announced that Bright HealthCare will not be able to make its complete payments in Texas, Illinois, and Oklahoma, where HCSC operates, as well as some additional states. Friday Health Plans also is not able to fully pay its risk-adjustment charges in New Mexico, Oklahoma, and Texas.

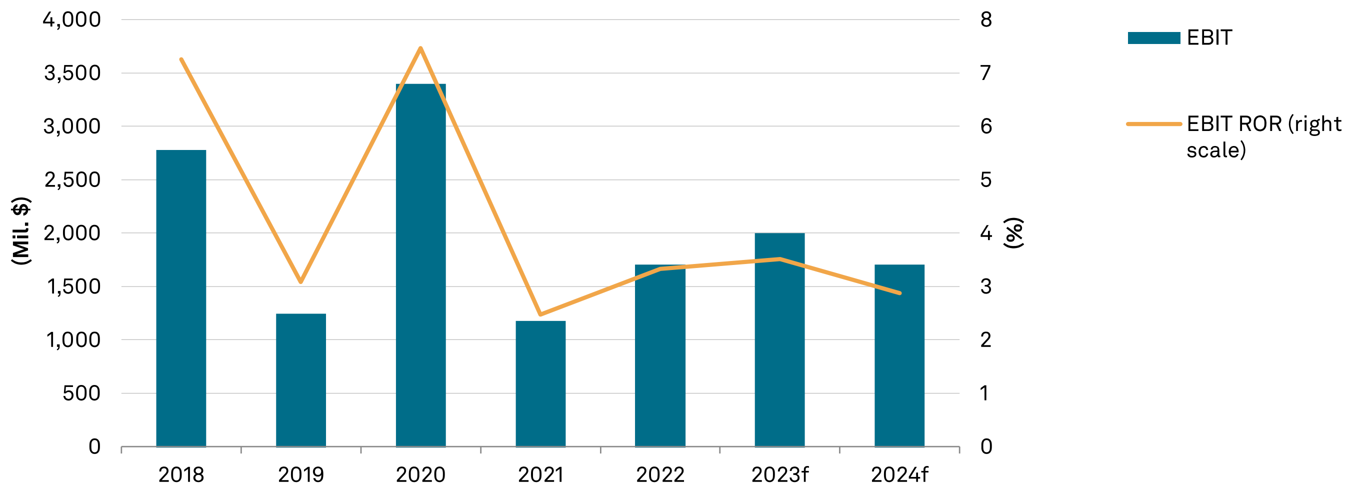
The company's improved medical loss ratio (MLR) of 87.1% in 2022 reflected more normalized utilization with lower COVID-19-related costs relative to 89.1% in 2021. Both the commercial and individual segments saw favorable claims runout from 2021 boosting MLR performance. At the same time, operating expenses ticked up for the year due to one-time investments into the business and in Medicare along with integration costs related to the Health Benefits acquisition. Overall, HCSC's ROR increased to 3.3% in 2022 (compared with 2.5% in 2021).

Through second-quarter 2023, HCSC's performance has remained strong, with revenue increasing by 10% (relative to the second quarter year-to-date in 2022) based on ongoing favorable membership growth and strong retention. The MLR as of second-quarter year-to-date was 85.1% with a ROR of 5.7%. The MLR was slightly elevated from the second-quarter year-to-date 2022 (84.2%) and reflected the higher utilization trends within MA as well as higher member usage of drugs to treat diabetes and obesity using glucagon-like peptide 1 (GLP-1) agonists within the commercial segment, offset by favorable claims runout from 2022 and lower claims volume in Medicaid.

For 2023, we anticipate 8%-12% revenue growth, driven by membership growth from the company's meaningful MA county expansion initiatives and competitive pricing within the commercial segment to retain and gain market share. However, we also factor in the impact of Medicaid redeterminations impacting membership and revenue. Furthermore, we expect claims seasonality during the second half of the year and continued elevated utilization in MA will result in an MLR of 87%-88% and full-year adjusted EBIT ROR of 3%-4%.

Chart 4

HCSC's earnings to remain modest in 2023-2024



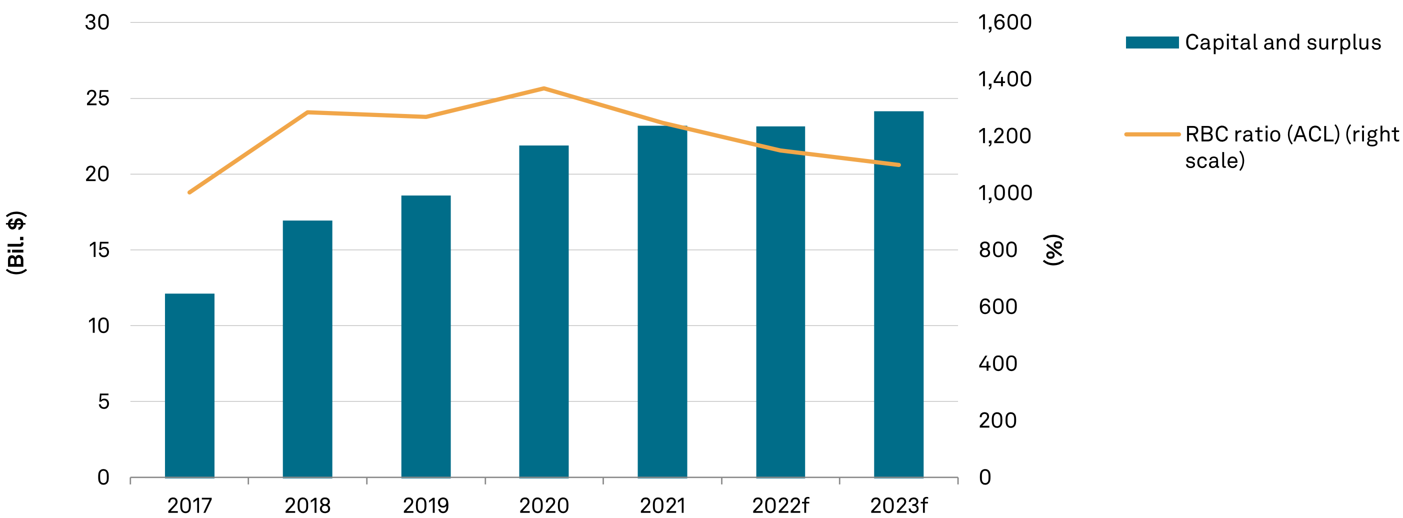
f--Forecast. Forecast data reflect S&P Global Ratings' base-case assumptions. ROR--Return on revenue. Source: S&P Global Ratings.

Financial Risk Profile: Excellent

HCSC's capitalization is among the strongest relative to peers based on the size of its statutory capital and very healthy regulatory RBC ratio, which stood at $23.4 billion and 1,192%, respectively, at year-end 2022. Accordingly, HCSC's capital was materially redundant at 'AAA' at year-end 2022, per our model, and we continue to anticipate 'AAA' capital through our forecast horizon. Through the second-quarter 2023, capital increased by 6% to $24.7 billion, primarily based on strong net income of nearly $1.3 billion. We expect HCSC to maintain capital around this level at year-end 2023 with RBC stabilizing at about 1,100%-1,200%.

Chart 5

HCSC capital and surplus and risk-based capital trend



f--Forecast. Forecast data reflect S&P Global Ratings' base-case assumptions. RBC--Risk-based capital. ACL--Authorized control level. Source: Statutory filings.

HCSC maintains a high credit quality, well-diversified, and conservative investment portfolio that supports capital stability and has no outsize exposure to volatility. At year-end 2022, on a statutory basis, the group had total invested assets of $20.9 billion, concentrated mostly in investment-grade fixed-income securities (79%), followed by 11% in speculative-grade bonds, 6% in public equities, and 4% in private investments. As of June 30, 2023, HCSC maintained total invested assets of $21.8 billion. The investment portfolio contained no significant obligor or sector concentrations.

As a mutual legal reserve company, HCSC has limited access to external capital sources. As of year-end 2022, the company had $2 billion of debt outstanding, representing its senior unsecured notes issued in three tranches due 2025, 2030, and 2050. It maintains a $1 billion undrawn line of credit, supported by 11 high-profile banks, that matures in 2026 and it is a member of the Federal Home Loan Bank of Chicago, with board-approved access to borrow up to $1.75 billion.

The company's high-quality balance sheet and low financial leverage support financial flexibility. At year-end 2022, financial leverage, which includes the net present value of operating lease and unfunded pension deficit adjustments, was approximately 9% with fixed-charge coverage exceeding 20x.

Other Key Credit Considerations

Governance

HCSC's strategic planning process aligns with its core capabilities, and management has demonstrated its ability to execute strategic decisions. HCSC's management team has an average of over 20 years of health insurance industry experience and exercises prudent control of operations by maintaining financial strength and efficient administrative expense controls, expanding and optimizing network provider relationships, and improving systems technology platforms to support all its business segments.

Liquidity

We expect HCSC's liquidity to remain adequate, with a liquidity ratio exceeding 150%. The company's primary liquidity sources include its cash and cash investments and investment portfolio, operating cash flow, and debt facilities, which include HCSC's revolving credit and capital facilities totaling $2.75 billion to provide short-term funding. As of June 2023, the company had $1.99 billion in borrowed money and no outstanding balance on its facilities.

Environmental, social, and governance

Environmental and governance 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 pandemics. Moreover, the company faces social risks relating to the affordability and access of health insurance products and changing consumer preferences. These social risks are reflected in the health insurance industry's persistent public policy and regulatory risks.

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

Related Research

- Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted, Sept. 25, 2023
- Health Insurance Sector View 2023, Jan. 26, 2023

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 November 9, 2023)*

Health Care Service Corp. d/b/a Blue Cross and 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/--
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.