

Research Update:

Health Care Service Corp. And Dearborn Life Ratings Affirmed; Outlook Stable

August 16, 2019

Overview

- HCSC has met our expectations related to its operating performance, capitalization, and market position.
- Dearborn Life is a strategically important subsidiary to HCSC, providing additional employee benefit insurance products to the group's portfolio.
- We are affirming our ratings on HCSC and Dearborn Life.
- The stable outlook reflects our view that the group will maintain its financial strengths while defending its market position in its core states.

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Rating Action

On Aug. 16, 2019, S&P Global Ratings affirmed its 'AA-' financial strength and long-term issuer credit ratings on Health Care Service Corp. (HCSC). At the same time, we affirmed our 'A+' financial strength and long-term issuer credit ratings on HCSC's strategically important subsidiaries, Dearborn Life Insurance Co. and Dearborn National Life Insurance Co. of New York (collectively Dearborn Life). The outlook is stable.

Outlook

The stable outlook reflects our expectation that HCSC will retain its leading market position in its core markets and its balance-sheet strengths. During the next 12-24 months, we expect modest single-digit enrollment and revenue growth with underlying pretax EBIT return on revenue of 4%-5%.

Downside scenario

We may lower our ratings by one notch in the next 24 months if HCSC underperforms our current operating performance expectations. We may also lower the ratings if we view the new

management team as having a strategic direction that leads to a meaningful deterioration of the insurer's capitalization levels or overall credit profile.

Upside scenario

An upgrade is unlikely in the next 12-24 months as the company isn't likely to have the broad business diversification that is common among higher-rated insurers.

Rationale

HCSC's credit strengths come from its leadership position in its core markets, capitalization that is stronger than its peers, and brand reputation supported by the underlying Blue brand. HCSC is the leading player in the group market in its five core states (Illinois, New Mexico, Oklahoma, Texas, and Montana). It also has a presence in the national account space, which provides further scale to its business profile. Supporting its business strengths are the company's capital levels that are comfortably redundant at the 'AAA' level as per our capital model. HCSC had some hiccups in its operating performance in 2015 and 2016, but since then has made adjustments to its pricing, products, and networks to recover to a level of profitability (about 6% return on revenue in 2018) that supports our current ratings.

We view HCSC to be more diversified than most other rated Blue Cross Blue Shield plans. HCSC has greater geographical diversity and scale than most Blue plans that usually concentrated in a single state. However, HCSC is less diversified than some of the large publicly traded health insurers that have more product diversity and national reach. HCSC has been increasing in product diversity by expanding into government-sponsored products (e.g., Medicare and Medicaid). But progress has been somewhat slow in our view, and the performance in its government segments isn't the same as in its commercial (group) segment. Despite the strain from its government segments, we expect the insurer to maintain its core credit strengths that support the rating.

A recent development at the insurer was the exit of its CEO and CFO. As we mentioned in our bulletin ("Health Care Service Corp. CEO And CFO Exit May Indicate A Strategic Shift, But Its Credit Strengths Should Persist", published July 29, 2019), sudden departures of senior executives can often raise questions about the possibility of deeper problems at the organization. The unexpected changes give us pause because they may indicate a strategic shift for the future of the company. HCSC's performance has been strong of late, which indicates to us that it was most likely strategic direction and not operating performance that was the reason for the leadership change. We will monitor the management transitions at HCSC closely, and interact with the new team on strategic priorities for the insurer. We will track any meaningful changes to its credit strengths that may have a negative impact on the ratings.

We continue to view Dearborn Life as being strategically important to the HCSC group. Although Dearborn Life does business outside of HCSC's five home states, most of its sales and earnings come from the home states. We expect Dearborn Life to remain focused on growing in those home states, while maintaining and growing its relations with other Blue Cross Blue Shield plans where possible.

Ratings Score Snapshot

Business Risk Profile	Strong
Competitive position	Strong
IICRA	Low Risk
Financial Risk Profile	Excellent
Capital and earnings	Excellent
Risk exposure	Moderately low
Funding structure	Neutral
Anchor*	aa-
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating	AA-

*This is influenced by our view of HCSC's diversification and pre-tax margins are stronger than lower rated peers.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria - Insurance - General: Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- Criteria | Insurance | General: Methodology For Calculating The Convexity Risk In U.S. Insurance Risk-Based Capital Model, April 27, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

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

Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Strength Rating	

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Ratings Affirmed

Local Currency	AA-/Stable/--
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Dearborn Life Insurance Co.

Dearborn National Life Insurance Co. of New York

Issuer Credit Rating	
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Local Currency	A+/Stable/--
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Financial Strength Rating	
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Local Currency	A+/Stable/--
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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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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