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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-	+	Modifiers	0	=	SACP	aa-

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

Governance	Neutral
Liquidity	Adequate
Comparable ratings analysis	0

+

Support	0
Group support	0
Government support	0

=

AA-/Stable/--

Financial strength rating

IIICRA--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	Medical cost uncertainty relating to the ongoing effects of the pandemic
Product diversification beyond health insurance in life insurance and other ancillary lines	Geographically concentrated in five states (Illinois, New Mexico, Oklahoma, Texas, and Montana)
Very strong balance sheet strength with 'AAA' capitalization and moderate financial leverage (9% as of Sept. 30, 2021)	Small but expanding exposure in government lines of business including Medicare and Medicaid

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 in Illinois, Texas, New Mexico, Oklahoma, and Montana. Similar to other large health plans, HCSC 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. 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.

Health Care Service Corp. is one of the highest-rated and largest non-public health insurers in the U.S. HCSC's credit strengths come from its leadership in core markets with strong HCSC and Blue brand recognition positioning the company as the fifth largest health insurer in the U.S, based on medical membership as of year-end 2020. The company leads the group market in its five states (Illinois, New Mexico, Oklahoma, Texas, and Montana) but is also strong in the national account segment, which gives further scale to its business. Additionally, HCSC is very well capitalized, with capital levels comfortably redundant at 'AAA', per our risk-based capital (RBC) model.

Table 1

Rating Comparison: HCSC Is Among The Largest And Highest-Rated Non-Publicly Traded Health Insurers

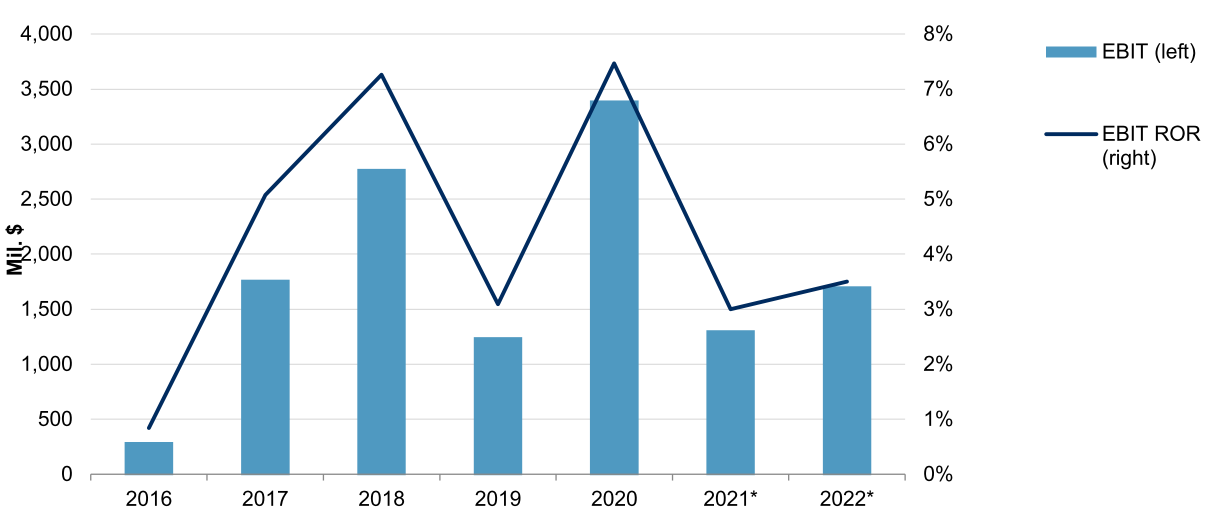
	Health Care Service Corp.	Blue Cross & Blue Shield of Florida	Blue Cross & Blue Shield of North Carolina	Blue Cross & Blue Shield of Tennessee
Financial strength ratings on core subsidiaries	AA-/Stable	A+/Stable	A+/Stable	A+/Stable
Business risk profile	Strong	Strong	Strong	Strong
Financial risk profile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

Source: S&P Global Ratings.

Relative to 2020, profitability is expected to decline in 2021, as pandemic-related costs impact performance in the second half of the year. While 2020 was a strong year for HCSC as the company benefited financially from the decline of medical utilization and care deferral, we expect it to face more pressure on underwriting margins this year, specifically in the second half of 2021. In 2020, HCSC's medical loss ratio (MLR) was 81.3% with EBIT-adjusted return on revenue (ROR) of 7.5%. During the first half of 2021, the company saw some return of care with MLR increasing to 84.5%, however, it remained below baseline owing to lower COVID-19 claims and lower medical utilization in Texas and Oklahoma because of severe winter weather combined with a lower expense ratio relative to 2020. For full year 2021, we forecast MLR will increase to 88%-89%, with the impact of the Delta variant affecting utilization and an uptick in non-COVID-19 utilization resulting in EBIT-adjusted ROR declining to 2.0%-3.0% for the year.

Chart 1

HCSC's Earnings Are Forecasted to Moderate in 2021-2022



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

HCSC's renewed focus on its government programs business reflects the shift in market dynamics and the company's goals to capture significant untapped opportunity in a fast growing market segment. HCSC holds a leading market position in the commercial segment consisting of individual and group, with more than 30% market share within its five states. Approximately 60% of the company's members are in group self-funded accounts, where HCSC has less direct exposure to medical cost trend spikes, which, in our view, is a credit positive. While continuing to retain and grow commercial membership through enhanced and integrated product solutions is key to strategy, we believe its government lines of business (Medicare and Medicaid), represent among its best opportunities for long-term growth. HCSC's past learnings in this segment, a new government leadership team, and continued investment in this segment to build a sustainable operational foundation combined with favorable market dynamics, should support the company's strategy.

Outlook: Stable

The stable outlook on HCSC reflects S&P Global Ratings' expectation that it will sustain its leading market position in its core markets in the commercial segment, while strengthening its presence in government programs and continuing to show balance-sheet strength supported by 'AAA' capital redundancy and profitability in line with similarly rated peers over the next 12-24 months. We forecast revenues to grow by 4%-7%, with adjusted EBIT ROR of 2%-4% in 2021-2022.

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, 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.

Key Assumptions

- U.S. real GDP growth of 5.5% in 2021, 3.9% in 2022, and 2.7% in 2023
- U.S. core Consumer Price Index growth of 3.4% in 2021, 3.5% in 2022, and 2.6% in 2023
- U.S. unemployment rate of 5.4% in 2021, 4.0% in 2022, and 3.7% in 2023

Table 2

HCSC Key Metrics						
			--Year ended Dec. 31--			
(Mil. $)	2022*	2021*	2020	2019	2018	2017
Total revenue	49,000-50,000	47,000-47,500	45,354.30	39,627.70	37,982.40	34,409
Medical loss ratio (%)	86-88	88-89	81.3	85.3	81.2	84.8
EBIT-adjusted §	1600-1800	1200-1400	3386.3	1237.3	2766.5	1760.1
EBIT-adjusted return on revenue (%)	3.0-4.0	2.0-3.0	7.5	3.1	7.3	5.1
S&P Global Ratings capital adequacy/redundancy	AAA	AAA	AAA	AAA	AAA	AAA

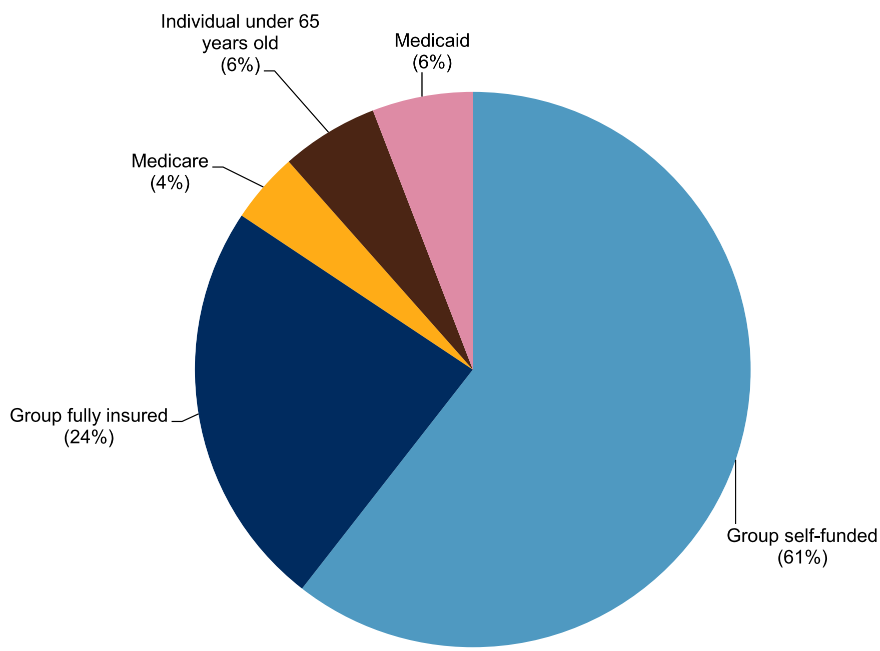
*Forecast data reflect S&P Global Ratings' base-case assumptions Source: S&P Global Ratings.

Business Risk Profile: Strong

HCSC is a mutual legal reserve company and Blue Cross Blue Shield Association licensee that covered about 17.16 million health members (as of Sept. 30, 2021), an increase of 3% versus 16.63 million as of year-end 2020, in Illinois, New Mexico, Oklahoma, Texas, and Montana. HCSC primarily operates in commercial segments such as 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 2020, it reported total revenue of $45.35 billion and a statutory surplus of $21.8 billion.

Chart 2

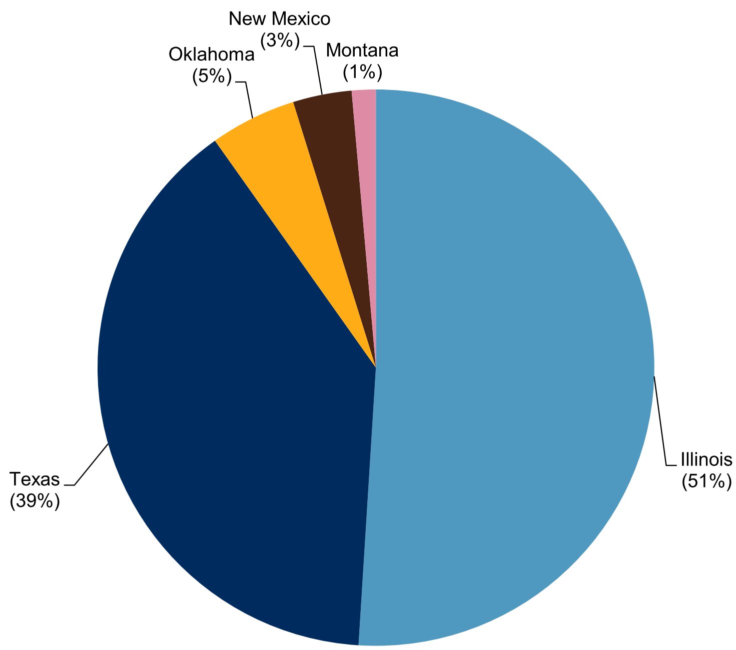
HCSC Membership By Line Of Business (As Of Sept. 30,2021)
(in thousands)



Source: Company reports

Chart 3

HCSC Membership By State (As Of Sept. 30,2021)
(in thousands)

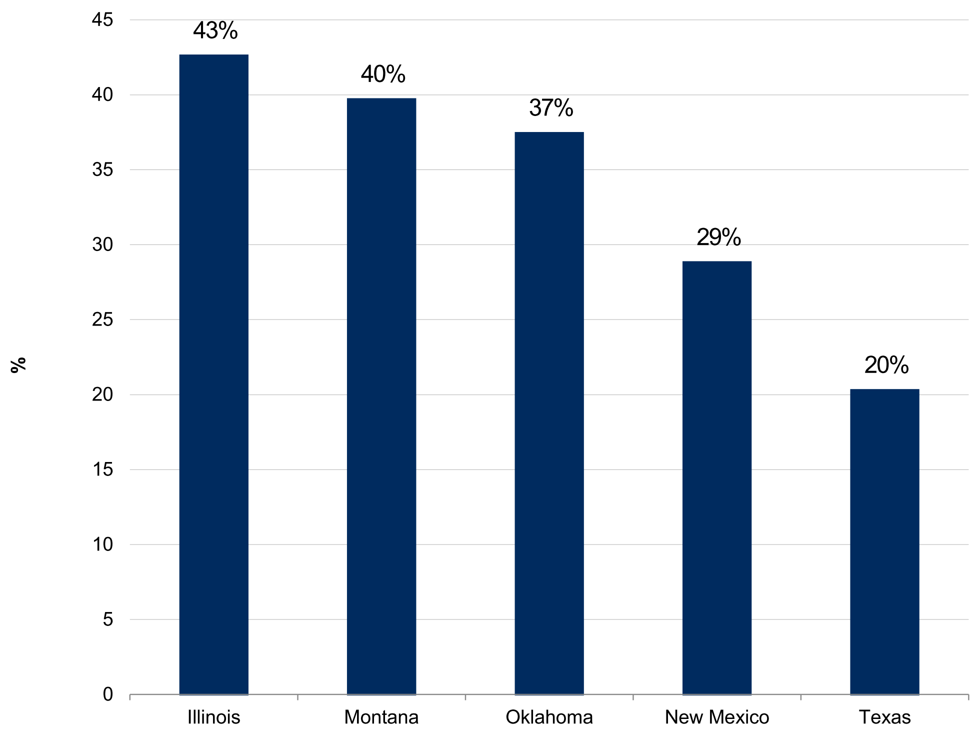


Source: Company reports

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 2020), with projected year-end 2021 membership of 17.2 million and expected revenues in excess of $45 billion. In each of its key states, HCSC is the leading provider in the commercially insured group and individual markets; its estimated market shares based on membership are: 82% in Oklahoma, 78% in Illinois, 57% in Texas, 54% in Montana, and 40% in New Mexico and (for year-end 2020).

Chart 4

HCSC Total Market Share Within Its Key States (Year-End 2020)



Source: Capital IQ Pro and Statutory Filings.

To remain a top health insurer in the United States, HCSC is committed to enhancing its strategic initiatives over the next few years to drive growth. While HCSC is a leading player in the commercial segment, retaining its market strength is a priority that will be directed by the level of investment, innovation, ancillary service integration, and competitive pricing dynamics that HCSC looks to provide its member base to drive differentiation among competitors. Most recently, HCSC has invested in a partnership with Collective Health. We believe this will support their competitive advantage in the commercial segment and its national accounts business by driving a more integrated and digital health care experience.

We believe that HCSC, being a diversified market player by offering both commercial and government products, is a competitive strength for the company. However, while government program revenue is forecasted to expand by 15%-20% in 2021, this business represents nearly 25% of premium through the third quarter of 2021 with ample opportunity to expand market share. HCSC's government strategy is centered on capturing market share in Medicare Advantage and making key investments to enhance the platform to improve administrative costs. Star ratings have improved with close to 40% of its members enrolled in four-star plans for 2022. We also expect better risk scoring accuracy will support enhanced revenue going forward. In 2022, HCSC is expanding its Medicare Advantage footprint within their states and adding new zero premium plans and expanding its addressable market of Medicare-eligible individuals. 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 drive profitability.

Like other health insurers, HCSC had strong operating performance in 2020, with EBIT-adjusted ROR of 7.5%, owing to the deferral of elective procedures and medical utilization resulting from the pandemic. Additionally, material Medicaid membership growth driven by states' temporary pause on redeterminations, as well as a $1.9 billion risk corridor payment from the U.S. Department of Health and Human Services (HHS) for coverage provided in the ACA line of business between 2014-2016, supported revenue growth of nearly 15% in 2020.

Even with the resumption of elective procedures through the first half of 2021, lower COVID-19 related claims, combined with less non-COVID-19 utilization because of severe winter weather, has continued to drive favorable performance with EBIT-adjusted ROR of 6.5%. While the company has seen increased medical utilization through the third quarter year-to-date, with a MLR of 87.4%, operating performance remains favorable at 4.5% ROR. Additionally, while membership continued to expand, the extended pause on Medicaid redeterminations is driving growth that is somewhat offset by a slower return of lost commercial group membership. For the remainder of 2021, we expect continued higher medical utilization as members use their benefits and demonstrate pent-up demand, and for the Delta variant to drive a pickup in COVID-19 related utilization. This combination will result in an elevated MLR between 88%-89%, and a lower ROR of 2%-3%.

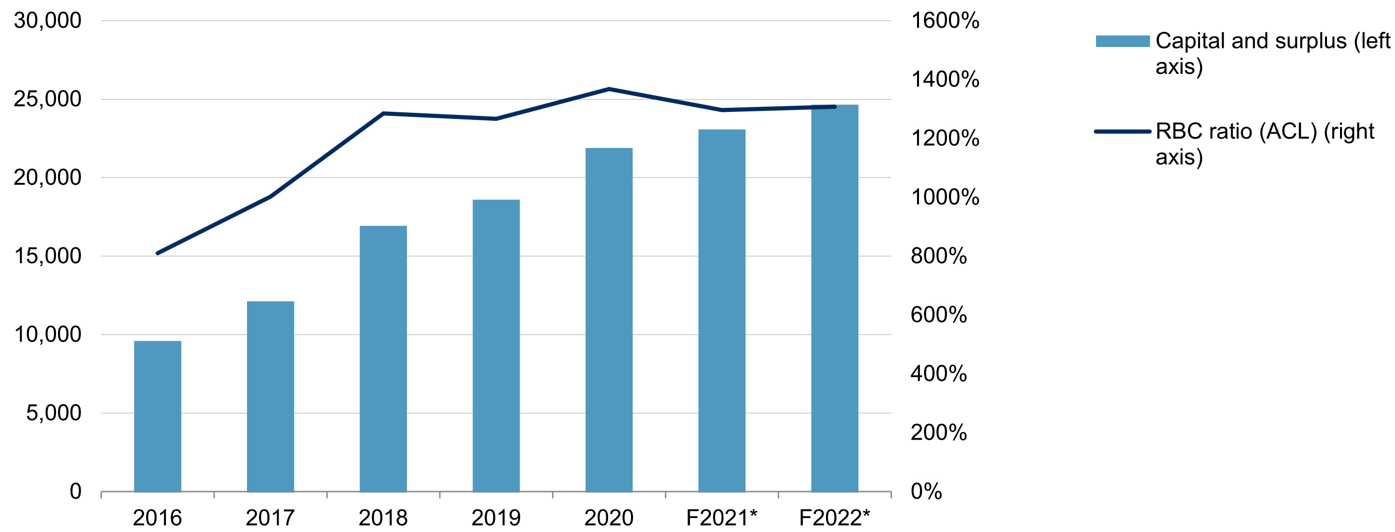
In our base-case forecast for 2022, we anticipate for revenues to expand by approximately 5%-7%, driven by membership expansion and competitive pricing in efforts to retain and gain market share. We think more normalized levels of medical utilization should support MLR between 86%-88%, and for EBIT-adjusted ROR to stabilize between 3%-4%. However, lingering pandemic-related costs may affect overall profitability.

Financial Risk Profile: Excellent

HCSC's excellent financial risk profile is supported by capitalization that is 55% redundant at 'AAA' per our risk-based capital model, with an RBC ratio of 1368%, one of the highest among health insurers. At year-end 2020, the company's capital and surplus of $21.8 billion increased by almost 18%, driven primarily by very strong net income of more than $3.8 billion, from $18.5 billion in capital and surplus as of year-end 2019. As of the third quarter of 2021, capital and surplus exceeded $23 billion, and we expect capital to be maintained around this level at year-end, and for HCSC to sustain capital redundancy at 'AAA' through 2022, with RBC stabilizing at approximately 1300%.

Chart 5

Capital And Surplus And RBC Trend

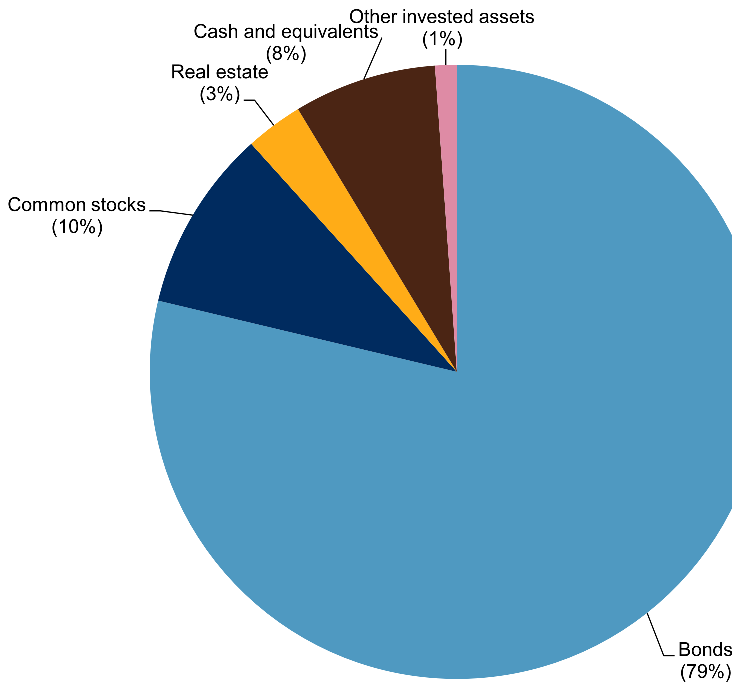


*Forecast data reflect S&P Global Ratings' base-case assumptions Source: statutory filings.

HCSC's investment portfolio is conservative and has high credit quality, benefitting its risk position and supporting overall capital stability. As of year-end 2020, on a statutory basis, the group increased total invested assets by close to 50% to $25.4 billion, with 79% in bonds with an 'A+' average rating, 5.3% in equity investments, 7.5% in cash and cash equivalents, 3% in real estate, and 5.4% in investments in affiliates. As of Sept. 30, 2021, on a statutory basis, HCSC had total consolidated invested assets of nearly $27 billion. Its strong capital reserves give the company flexibility to withstand the risk associated with its higher-risk asset-allocation strategy in equity that remains within the maximum allocation set by the company's investment policy. The investment portfolio contained no significant obligor or sector concentrations.

Chart 6

Invested Assets (As of 2020 Year-End)



Source: Statutory filings.

HCSC has limited access to external capital sources as a mutual legal reserve company. However, it has issued debt in the past, including $2 billion in senior unsecured notes issued in 2020 where a portion of the proceeds were used to repay outstanding Federal Home Loan Bank borrowings and for other corporate purposes. HCSC 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 10% as of year-end 2020 and was 9% as of the third-quarter 2021, with fixed-charge coverage significantly above 8x.

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, 2021, the revolver is un-drawn. HCSC is also a member of the Federal Home Loan Bank of Chicago and has the ability to access up to $1,750 million in secured credit products.

Other Key Credit Considerations

Legal

While the subscriber case of the Blue Cross Blue Shield multi-district litigation (MDL) antitrust litigation still awaits final approval by the courts, we believe the non-monetary subscriber settlement could have positive implications for HCSC. Among the tentative terms, certain large self-funded national employers will have the ability to request a bid for coverage from a second Blue Plan, in addition to its local Blue Plan. While still early to call, HCSC's size and expertise in the National Accounts business could be a competitive advantage in winning more "second bid" business.

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.

Chief Executive Officer, Maurice Smith, was promoted to this role in 2020, and worked for HCSC for more than 25 years. He has deep industry experience and a record of accomplishment with strong leadership at the company. James Walsh was promoted to Chief Financial Officer in early 2021 and has worked for HCSC for more than 12 years. Arun Prasad joined HCSC in January 2021 as the company's chief strategy officer. His experience in leading equity and debt transactions and investment banking within health care position the company well for strategic expansion. Additionally, a recently renewed government programs-focused leadership team led by Senior Vice President, Nathan Linsley, should support the company's key strategic priority of strengthening its government programs.

Given the changing competitive health care landscape and persistent political and regulatory risks, we believe top management will continue to 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 2020.

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
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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 8, 2021)*

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/--
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.