The Profitability of Health Insurance Companies

The Council of Economic Advisers

March 2018

Executive Summary

March 2018

Despite significant initial financial losses in the individual market after the key provisions of the Affordable Care Act (ACA) took effect, health insurer profitability in the individual market has risen due to substantial premium increases, government premium tax credits that pay for those premium increases, and the large, government-funded, Medicaid expansion. Since ACA implementation on January 1, 2014, health insurance stocks outperformed the S&P 500 by 106 percent. Insurers remaining in the individual and small group markets seem to have recently accounted for ACA regulations and an older, more costly risk pool than they expected by charging higher premiums that have largely been covered by federal government premium subsidies. Stable year-over-year enrollment, despite large premium increases suggests a distorted market that involves large transfers from taxpayers to insurers. Large insurers, many of whom left the individual market, are profiting from the Medicaid expansion, which is largely provided through private managed care and paid for by the federal government. All health insurers can expect to become more profitable this coming year due to the recent tax reform.

The Affordable Care Act (ACA) created new opportunities for insurance companies by subsidizing the purchase of health insurance and expanding eligibility for subsidies. In the individual and small group market, the ACA provided subsidies to lower the cost of premiums for lower income people who purchase insurance on the newly created health insurance exchanges. About 6 percent of Americans obtain health insurance in the individual and small group market and about half of them buy policies on the exchanges. Approximately 85 percent of exchange purchasers receive a premium subsidy (ASPE 2017). These subsidies are computed so that enrollees do not pay more than a prescribed portion of their income for a common plan, thereby ensuring that insurance companies receive subsidies regardless of how high the premiums go and reducing incentives for price competition as taxpayers fund almost all of the higher premiums.

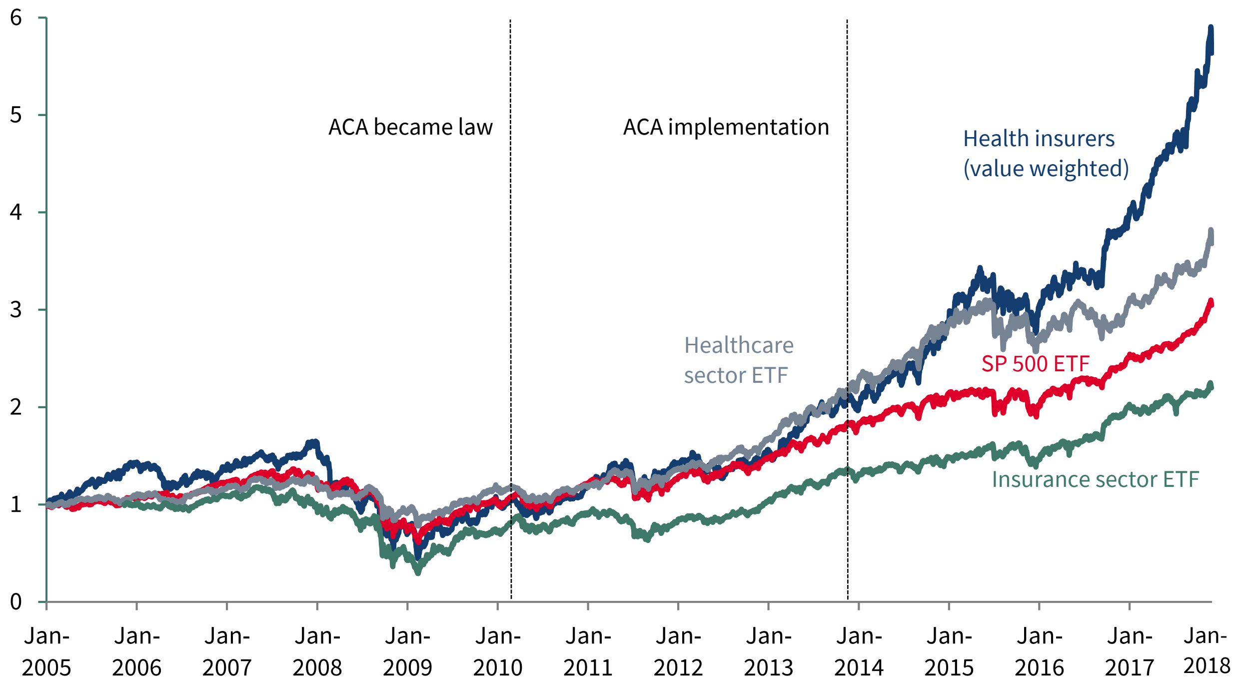
Many lower-income, able-bodied, working-age adults gained Medicaid coverage after the ACA Medicaid expansion. Coverage was primarily provided through contracts with private managed care organizations (CMS 2016; KFF 2017a). From 2014 to 2016, the federal government paid for all of the premiums for Medicaid expansion enrollees and this year pays for 94 percent of the premiums. Spending per newly eligible Medicaid enrollee was higher than projected by the Congressional Budget Office (CBO 2017). Average costs for expansion adults were 28 percent higher than costs for non-newly eligible adults in 2015 (CMS 2016).

After an initial adjustment period, insurers' financial health, as measured by their stock prices, surpassed earlier levels. As shown in Figure 1, prior to ACA implementation, health insurers' stock values moved with the S&P 500 index, but after implementation, they diverged significantly. As government policy amplified eligibility and per-enrollee spending, the stock prices of health insurance companies rose by 272 percent from January 2014 to 2018 resulting in improved profitability and outperforming the S&P 500 by 106 percent (Figure 1).

Health insurance companies initially struggled to make a profit in the post-ACA individual and small group markets. Insurers were unsure how to price insurance with the new ACA requirements such as, guaranteed-issue, modified community rating, and an expansive minimum essential benefits requirement. They underpriced their products relative to their enrollees' health risks. Many insurers left the market altogether. But the remaining insurers, despite the expiration over a year ago (2016) of the reinsurance and risk corridors programs which were meant to financially protect insurers, have started to make higher profits again (McCue & Hall 2017). Figure 2 shows that, after narrowing in the initial years of ACA implementation, the gap between individual market premiums and claims payments was much higher in 2017 than pre-ACA. As of 2017, most Blue Cross Blue Shield regional insurers, the main insurers left in the ACA-compliant individual and small group markets, have better profit margins than during the initial years of offering plans in marketplaces and have returned to pre-ACA profitability (Farrah 2018).

Figure 1: Health Insurance Stock Index vs. Benchmarks

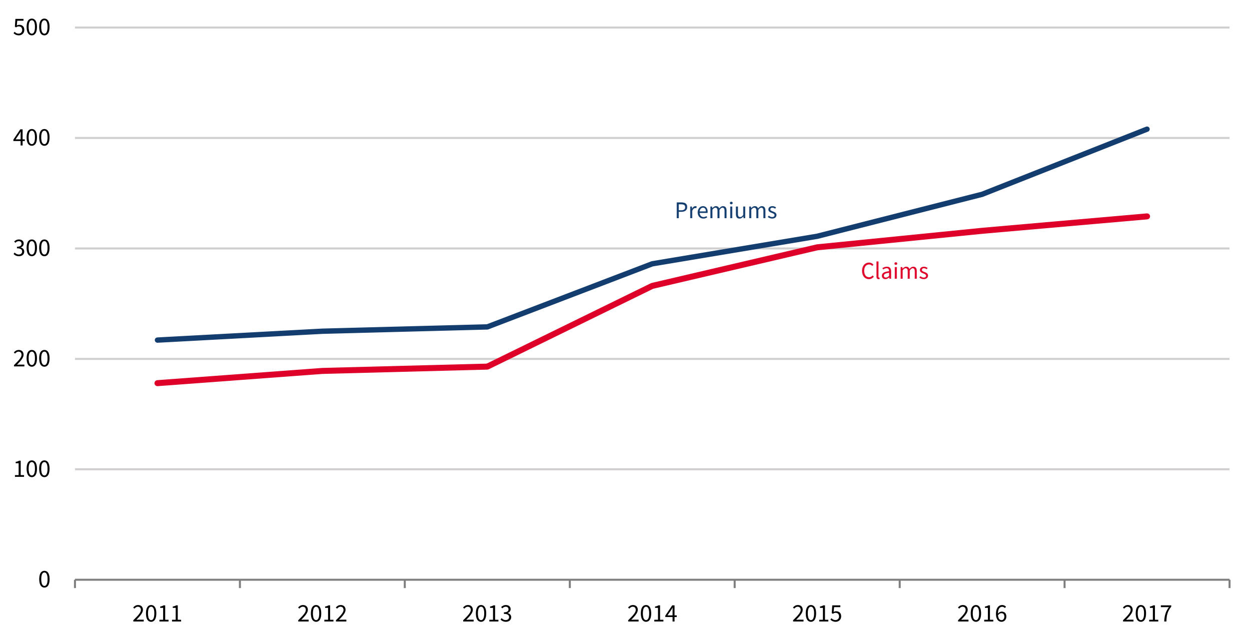
Index levels. Jan-2005 = 1



Source: Compustat.

Figure 2: Individual Market Monthly Premiums and Claims Per Enrollee

Nominal Dollars



Source: Kaiser Family Foundation; Mark Farrah Associates.
Note: Each year consists of average third quarter data from Jan 1 to Sept 30.

Gross profit margins (premiums less claims) have increased as the small number of remaining companies gained experience with the individual and small group market risk pool and set higher premiums while government subsidies cover most of the rising insurance costs on the exchanges. The fact that low-income individuals are enrolling at high rates, while at the same time premiums are rising dramatically, is a clear sign of a distorted market that involves larger transfers from taxpayers to insurers (KFF 2017b).

Overall, while many of the largest U.S. health insurers left the individual market because of losses in the state and federal marketplaces, they had increased revenues in the Medicare and Medicaid markets (Schoen and Collins 2017). Medicaid enrollment more than doubled among the largest insurers (Schoen and Collins 2017) as spending soared. Net profit margins at many large health insurance companies have returned to pre-ACA levels. In addition, some of the largest health insurers expect earnings (net income) to increase by 8.7 to 19.6 percent in 2018 from 2017, with a significant portion of the increase due to tax reform (UnitedHealth Group, Inc. 2018; Humana, Inc. 2018).

Conclusion

Despite an initial rough patch in the ACA marketplaces, the ACA Medicaid coverage expansion and subsidies to insurers have resulted in a large increase in health insurer profits. Health insurers' stock prices more than doubled the impressive gain in the S&P 500 since the law's main provisions took effect on January 1, 2014. Much of insurers' increased profitability has resulted from increased Medicaid enrollment and increased payments per enrollee in Medicaid expansion states where the federal government pays nearly all the costs. While insurers initially incurred losses in the ACA marketplaces as they adjusted to new regulations and a relatively unhealthy risk pool, insurers are now profiting on the individual market as well, with higher premiums that are largely covered by federal premium subsidies.

References

ASPE (Assistant Secretary for Planning and Evaluation). 2017. "Health Plan Choice and Premiums in the 2018 Federal Health Insurance Exchange." https://aspe.hhs.gov/system/files/pdf/258456/Landscape_Master2018_1.pdf.

CBO (U.S. Congressional Budget Office). 2017. "CBO's Record of Projecting Subsidies for Health Insurance Under the Affordable Care Act: 2014 to 2016." https://www.cbo.gov/publication/53094.

CMS (Centers for Medicare and Medicaid Services, Office of the Actuary). 2016. "2016 Actuarial Report on the Financial Outlook for Medicaid." https://www.cms.gov/Research-Statistics-Data-and-Systems/Research/ActuarialStudies/Downloads/MedicaidReport2016.pdf

Cox, C., A. Semanskee, and L. Levitt. 2018. "Individual Insurance Market Performance in Late 2017." Kaiser Family Foundation. https://www.kff.org/health-reform/issue-brief/individual-insurance-market-performance-in-late-2017/.

Farrah Associates. 2018. Improved Profit Margins for Leading Blue Cross & Blue Shield Plans in Third Quarter 2017. http://www.markfarrah.com/healthcare-business-strategy/Improved-Profit-Margins-for-Leading-Blue-Cross-and-Blue-Shield-Plans-in-Third-Quarter-2017.aspx

Humana, Inc. 2018. "Humana Reports Fourth Quarter 2017 Financial Results; Provides 2018 Financial Guidance." http://press.humana.com/press-release/humana-reports-fourth-quarter-2017-financial-results-provides-2018-financial-guidance

KFF (Kaiser Family Foundation). 2017. "Share of Medicaid Population Covered Under Different Delivery Systems." https://www.kff.org/medicaid/state-indicator/share-of-medicaid-population-covered-under-different-delivery-systems/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D

——— 2017b. "Key Facts About the Uninsured Population." https://www.kff.org/uninsured/fact-sheet/key-facts-about-the-uninsured-population/

McCue, M. J. and M. A. Hall. 2017. "How Have Health Insurers Performed Financially Under the ACA's Market Rules?" The Commonwealth Fund Issue Brief. http://www.commonwealthfund.org/~/media/files/publications/issue-brief/2017/oct/mccue_how_have_hlt_insurers_performed_financially_aca_market_ib.pdf

Schoen, C. and S. R. Collins. 2017. "The Big Five Health Insurers' Membership And Revenue Trends: Implications For Public Policy." *Health Affairs* 36, no. 12: 2185-2194.

UnitedHealth Group, Inc. 2018. "Form 10-K 2017." Retrieved from SEC EDGAR https://www.last10k.com/sec-filings/unh/0000731766-18-000005.htm

ABOUT THE COUNCIL OF ECONOMIC ADVISERS

The Council of Economic Advisers, an agency within the Executive Office of the President, is charged with offering the President objective economic advice on the formulation of both domestic and international economic policy. The Council bases its recommendations and analysis on economic research and empirical evidence, using the best data available to support the President in setting our nation's economic policy.

www.whitehouse.gov/cea

March 2018