NAIC

National Association of Insurance Commissioners

& The Center for Insurance Policy and Research

2016 Mid-Year

Health Insurance Industry Analysis Report

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Disclaimer The NAIC 2016 Mid-Year Health Insurance Industry Analysis Report is a limited scope analysis based on the aggregated information filed to the NAIC's Financial Data Repository as of June 30, 2016, and written by the Financial Regulatory Services Department staff. This report does not constitute the official opinion or views of the NAIC membership or any particular state insurance department.

Health Industry Disclosure: In some states the health industry is regulated by a Department other than the Department of Insurance. Therefore, not all health insurers may be required to file financial statements with the NAIC.

National Association of Insurance Commissioners & The Center for Insurance Policy and Research

Health 2016 Mid-Year Insurance Industry Analysis Report

Table 1 below provides a 5-year quarterly snapshot of the U.S. health insurance industry's aggregate financial results for health entities who file with the NAIC on the health quarterly statement blank. The health insurance industry reported a 16.5% improvement in underwriting results to $3.6 billion from $3.0 billion for the same period in the prior year. However, net earnings remained at $1.3 billion as the industry reported only a slight 1.3% increase for the first six months of 2016 compared to net income in the prior year period. The modest increase is due to the increase in underwriting gains offset by an 8.2% ($318.1 million) increase in federal income taxes incurred. In addition to the increase in profitability, health entities reported a 5.5% increase in net investment income earned to $1.8 billion. The industry's profit margin remained at 0.4%, while the combined ratio improved slightly to 98.9% from 99.0%. **Figure 1** on the following page illustrates the decline in net earnings and the industry's drop in profit margin over the last five years. Notable items as compared to second quarter 2015 include the following:

- Net earned premium increased 7.4% ($21.6 billion).
- Total hospital and medical expenses increased 7.7% ($19.3 billion).
- Administrative expenses increased 3.7% ($1.6 billion).
- Enrollment increased 1.5%.
- Cash outflow of $844 million.
- Capital and surplus increased modestly, 1.3%, to $116.5 billion.

Table 1

Financial Summary: June 30, 2016-2012

(In Millions)	Chg	2Q 2016	2Q 2015	2Q 2014	2Q 2013	2Q 2012
Direct Written Premium	7.4%	$317,618	$295,610	$260,814	$228,458	$219,657
Net Earned Premium	7.4%	$314,461	$292,849	$257,739	$224,457	$214,502
Net Investment Income Earned	5.5%	$1,756	$1,664	$1,869	$1,631	$1,800
Underwriting Gain/Loss	16.5%	$3,551	$3,048	$2,919	$6,684	$6,316
Net Income/Loss	1.3%	$1,291	$1,274	$2,421	$6,576	$6,235
Total Hospital & Medical Exp.	7.7%	$267,973	$248,722	$219,131	$192,382	$184,621
Loss Ratio	0.5 pts	84.9%	84.4%	84.6%	85.4%	85.7%
Administrative Expenses	3.7%	$44,340	$42,746	$37,057	$26,329	$24,492
Administrative Expense Ratio	(0.5) pts	14.0%	14.5%	14.3%	11.7%	11.4%
Combined Ratio	(0.1) pts	98.9%	99.0%	98.9%	97.0%	97.1%
Profit Margin	0.0 pts	0.4%	0.4%	0.9%	2.9%	2.9%
Enrollment	1.5%	216	213	200	178	174
Premium PMPM	4.4%	$242	$231	$219	$211	$206
Claims PMPM	5.0%	$206	$196	$187	$181	$177
Cash Flow from Operations	62.3%	($844)	($2,238)	$4,339	$1,177	$14,137
# of Companies Filed	5	962	957	936	921	879
	6-mo. Chg.					
Capital & Surplus	1.3%	$116,507	$111,649	$111,632	$107,011	$100,190

***All figures only include health entities that file financial statements with the NAIC.**

Note: Adjustments to exclude affiliated amounts were made where appropriate.

Underwriting Results

The 16.5% increase in the industry's underwriting results can be attributed primarily to a 7.4% ($21.6 billion) increase in net earned premium to $314.5 billion. However, the industry partially offset this with a 7.7% ($19.3 billion) increase in total hospital and medical expenses to $268.0 billion and a 3.7% ($1.6 billion) increase in claims adjustment expenses and general administrative expenses. **Figure 1** below illustrates a significant drop in profitability from a high of $6.6 billion and profit margin of 2.9% through the second quarter of 2013 to net income of $1.3 billion and profit margin of 0.4% for the first six months of 2016.

Figure 2 below illustrates the increase in total hospital and medical benefits and the 0.5 percentage point increase in the loss ratio to 84.9% for the first six months of 2016 but has decreased from 85.7% in 2012. While the loss ratio has fluctuated modestly over the last five years, historically, from year to year, the industry has reported significant increases in hospital and medical benefits. Additionally, as indicated on **Table 1**, the industry reported a 3.7% ($1.6 billion) increase in administrative expenses and a moderate decrease in the administrative expense ratio to 14.0% from 14.5% in the prior year period. **Figure 3** illustrates the significant increase in administrative expenses to $44.3 billion from $24.5 billion in 2012 and the increase in the expense ratio over the last five year quarters to 14% from 11.4%.

Although not associated with underwriting, the industry recorded realized capital gains of $414.6 million through the first six months of 2016 compared to realized capital gains of $941.4 million in the prior year.

Enrollment

As shown in **Figure 4**, the industry has experienced an incremental increase in total enrollment of 24.3% (42.3 million) over the last five years. The increase is due primarily to a 63.8% (15.4 million) increase in Medicaid, a 47.1% (10.1 million) increase in policies that provide Medicare Part D Drug coverage, a 26.5% (8.6 million) increase in dental coverage, a 70.3% (6.4 million) increase in individual comprehensive, a 65.3% (5.6 million) increase in Medicare, and a 21.7% (5.3 million) increase in vision coverage. However, these items were partially offset by a 22.8% (9.7 million) decrease in the group comprehensive line of business from the first six months of 2012.

Figure 1
Net Income & Profit Margin (ROR)

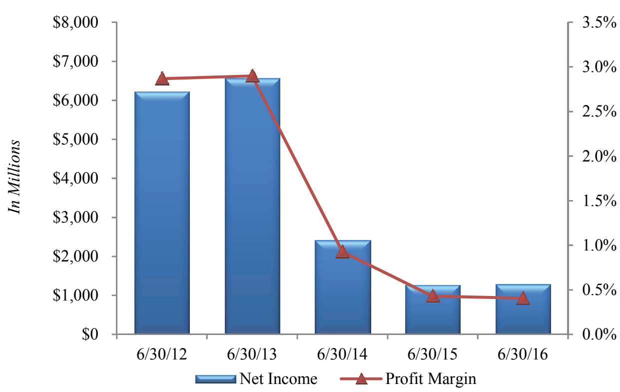


Figure 2
Total Hospital & Medical + Loss Ratio

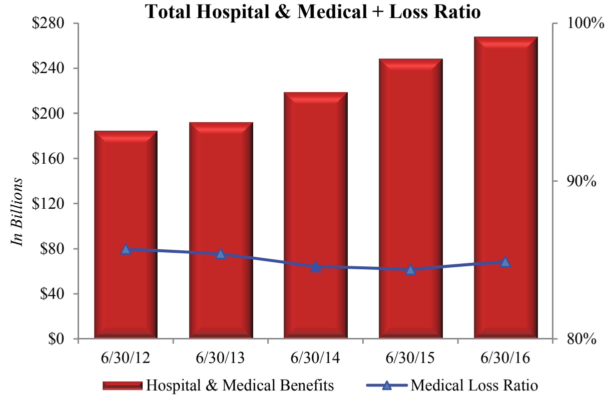


Figure 3
Admin Expenses & Admin Expense Ratio

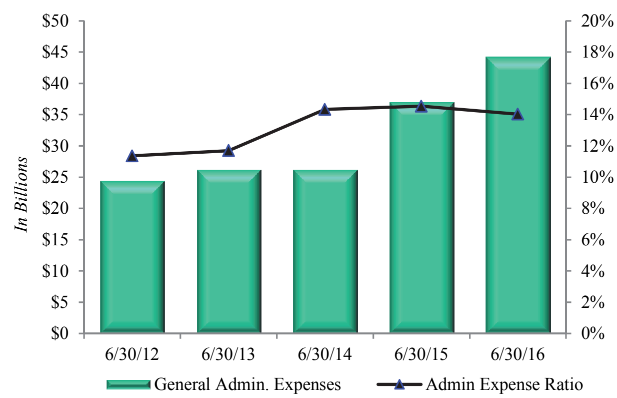
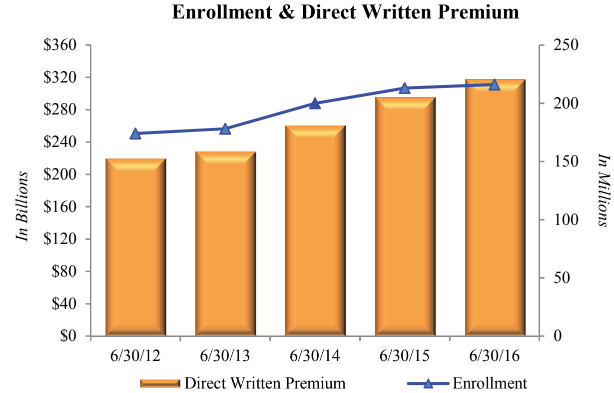


Figure 4
Enrollment & Direct Written Premium



As depicted in **Figure 5**, health entities premium per member per month (PMPM) increased 17.4% to $241.7 from $205.9 for the first six months of 2012, while claims PMPM increased 16.2% to $206.1 from $177.3.

Premium Revenues

Figure 4 also illustrates the growth in direct written premium. In comparison to the first six months of 2012, the industry reported a 44.6% ($98.0 billion) increase in direct written premium to $317.6 billion from $219.7 billion. The increase is most evident on the Medicaid, Medicare, and comprehensive medical lines of business.

Figure 6 illustrates the mix of direct written premium for the first six months of 2016. As insureds have become eligible for either Medicare and/or Medicaid as evidenced by increases in enrollment in these lines, there has been a gradual shift in the allocation of premium between the lines of business over the last five years. In comparison to the first half of 2015, as shown in **Figure 7**, direct comprehensive medical decreased to 42.9% of total written premium from 44.7%, Medicare decreased to 25.3% from 25.4% and FEHBP decreased to 5.7% from 5.9%, while Medicaid increased to 26.1% from 24.0%. In further comparison to the first half of 2012, direct comprehensive medical decreased from 53.1% while Medicare increased from 22.5% and Medicaid increased from 17.0%.

Table 2 provides a break out of direct written premium by line of business. The largest dollar increase in written premium from the first six months of 2015 was a $9.6 billion (13.2%) increase in the Medicaid, a $7.0 billion (9.6%) increase in the Medicare, and a $3.6 billion (12.1%) increase in the individual comprehensive line of business.

Figure 6
2nd Qtr 2016 Direct Health Premium Written by Line

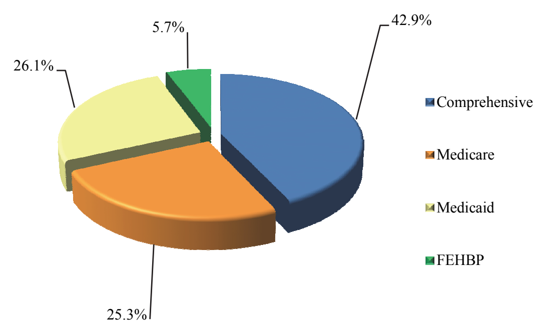


Figure 5
Premium PMPM vs Claims PMPM

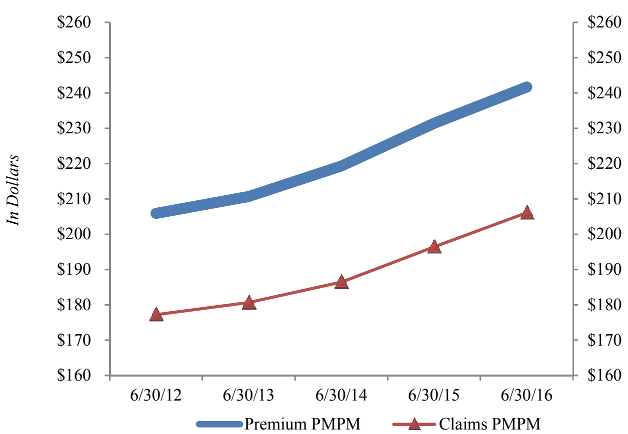


Figure 7
2nd Qtr 2015 Direct Health Premium Written by Line

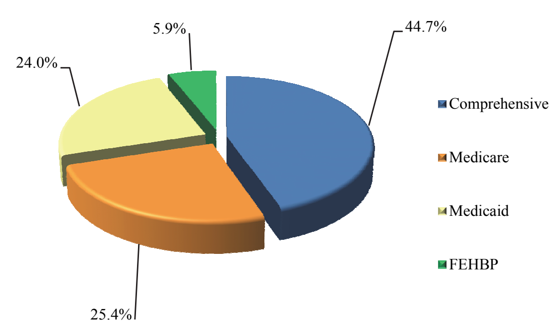


Table 2
Direct Written Premium by Lines of Business

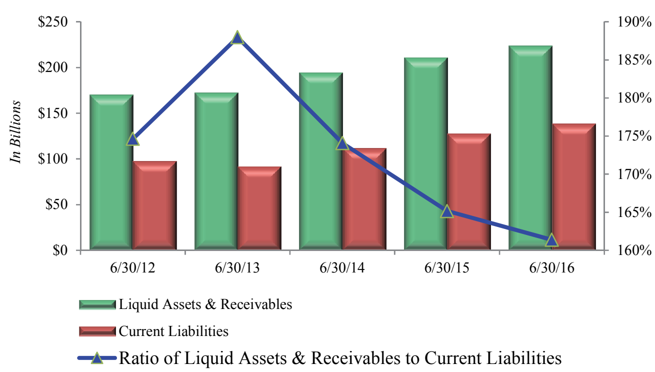
(In Millions)	Chg.	2Q 2016	2Q 2015	2Q 2014	2Q 2013	2Q 2012
Individual Comprehensive	12.1%	$33,125	$29,544	$20,581	$12,224	$11,602
Group Comprehensive	(1.0)%	$80,783	$81,559	$84,678	$86,133	$87,660
Medicare Supplement	4.3%	$5,051	$4,844	$4,669	$4,311	$4,285
Vision	12.3%	$1,201	$1,070	$965	$836	$789
Dental	1.3%	$6,568	$6,483	$5,458	$5,122	$5,215
FEHBP	3.4%	$18,010	$17,424	$17,126	$16,130	$15,836
Medicare	9.6%	$80,355	$73,322	$65,372	$52,623	$49,860
Medicaid	13.2%	$82,703	$73,060	$53,901	$43,273	$37,034
Other Health	5.2%	$9,434	$8,972	$8,783	$7,408	$7,199

Liquidity

The health insurance industry showed improvement in operating cash flow with cash outflow of $844 thousand in the first half of 2016 as compared to operating cash outflow of $2.2 billion in the first half of 2015. The considerable increase in positive cash flow is due primarily to a 7.1% ($20.1 billion) increase in premiums collected partially offset by a 7.4% ($18.4 billion) increase in benefits and loss-related payments.

As illustrated in **Figure 8**, liquid assets and receivables increased 6.0% ($12.6 billion) to $223.8 billion in the first six months of 2016 from $211.2 billion in the prior year period. This was partially offset by an 8.4% ($10.8 billion) increase in current liabilities. This resulted in an unfavorable decrease in the ratio of liquid assets and receivables to current liabilities to 161.4% from 165.1%.

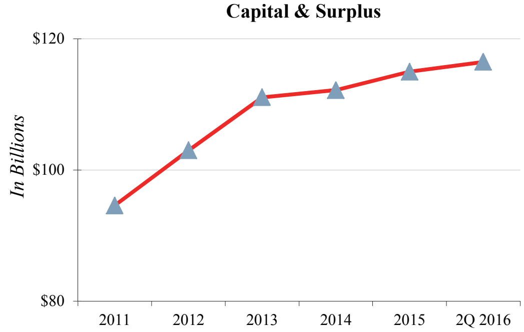
Figure 8
Ratio of Liquid Assets & Receivables to Current Liabilities



Capital and Surplus

Health entities reported a 1.3% ($1.5 billion) increase in capital and surplus to $116.5 billion from $115.0 billion at Dec. 31, 2015 as illustrated in **Figure 9**. The increase is due primarily to paid in surplus of $2.6 billion, net income of $1.3 billion, and unrealized capital gains of $350 million, partially offset by dividends of $2.3 billion paid to stockholders, and a $1.0 billion increase in non-admitted assets during the first six months of 2016.

Figure 9
Capital & Surplus



Merger Update

In merger updates, Anthem Inc. was to acquire Cigna Corp for $54.2 billion which would have created the nation's largest health insurer surpassing UnitedHealth Group. Ten states had approved the transaction.

Aetna and Humana Inc. had also entered into an agreement under which Aetna would've acquired all outstanding shares of Humana for a combination of cash and stock valued at $37 billion or approximately $230 per Humana share. Twelve states had signed off on Aetna's proposed acquisition. Both transactions were expected to close in the second half of 2016.

On July 21, 2016, it was announced that the U.S. Department of Justice rejected the proposed mega-mergers between Anthem Inc. and Cigna Corp., and Aetna Inc. and Humana Inc., stating that the consolidations would reduce competition, reshape the health care market and give an unfair advantage to the merged firms. The DOJ filed the lawsuits in federal court in Washington, D.C. Eleven states and the District of Columbia have joined the Department's challenge of the Anthem-Cigna proposed merger, while eight states and the District of Columbia have joined the Department's challenge of the Aetna-Humana transaction. (*Bestwire: 7/21/2016*)

The DOJ alleges the mergers would reduce competition for Medicare Advantage and national plans sold to large employers covering employees throughout the country. Reaction from the insurers was instantaneous. Aetna, Humana, and Anthem all have vowed to fight the DOJ action in court. Cigna is still evaluating its options. (*Bestwire: 7/21/2016*)

Terms in the Anthem and Cigna 2015 merger agreement state that it can be terminated by either party after January 31, 2017, although that deal could be extended to April 30, by one party if "regulatory restraint" prevents an earlier closing. Anthem has stated that the merger must close by April 30, 2017, or Cigna will declare termination and as a result could receive a $1.9 billion break-up fee. (*Bestwire: 8/12/2016*)

Terms in the Aetna-Humana agreement state that Aetna could owe Humana a $1.0 billion "break up" fee if their transaction is not closed by year-end 2016. (*American Health Line: 8/05/16*)

The Anthem-Cigna trial has been set for November 21, while the trial date for Aetna-Humana is set for December 5, with a decision expected in mid-January 2017. (*Bestwire: 8/11/16*)