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COVID-19 effect on the health insurance sector

The below is an excerpt from the April 2020 Conning Commentary prepared by Conning's Insurance Research team.

Key Takeaways

- Health insurers are covering the cost of testing without cost to insureds as well as waiving deductibles.
- Insurers with significant Medicare Advantage blocks of business could be hit harder because the Medicare population is older.
- As layoffs and unemployment increase, a decrease in group benefit plan enrollments is likely. Meanwhile, individual comprehensive and Medicaid may see increases in enrollment.
- At the time of publication, the World Bank's pandemic bond has still not triggered.

Claims and expense effects

COVID-19 will create medical costs for health insurers as the number of cases and hospitalizations in the U.S. increase. Currently, there are regions across the U.S. that are experiencing high rates of hospitalization. While initially predicted to have costs similar to "an extended flu season" earlier in the month, as the infection rates continue, total costs for insurers could be significantly higher. Most health insurers are covering the cost of testing without any out-of-pocket cost to the insured, and some are waiving out-of-pocket expenses for COVID-19 related hospitalizations and telehealth visits. There will also be additional doctor and hospital costs associated with the more severe cases. So far, mild cases are being treated with over-the-counter medications, so extra medical costs for mild cases will likely consist of office or telehealth visits plus the cost of testing.

S&P Global Ratings performed hypothetical stress tests on health insurers to measure the MLR (medical loss ratio) under a moderate or severe scenario. With average industry MLRs at 85%, under the moderate scenario, MLRs increase to 89%; under the severe scenario, they increase to 97%. While insurers may not necessarily be on the hook for all of these losses as some businesses self-insure, there is a risk on the profitability of the companies. Depending on whether companies are in heavier-hit areas, they may see their MLRs increase well above this 97%. Aetna has found a way to try to limit this MLR risk. Through an insurance-linked security named Vitality Re, the company has issued eleven transactions that use the medical benefit ratio as a trigger. Should the ratio rise above a predefined attachment point for either tranche, the notes trigger. In the most current notes, the Class A tranche has a medical benefit claims ratio limit of 102%, and the Class B tranche is set at 96%.

Insurers with significant Medicare Advantage blocks of business could be hit harder because the Medicare population is, by definition, older. The MLR for Medicare Advantage was 85.2% in 2018 and resulted in an underwriting margin of 2.3%. Under the S&P Global Ratings moderate scenario, if the MLR increased to 89%, the resulting underwriting margin would drop to -1.5%. Under the severe scenario with an MLR of 97%, Medicare Advantage would have a -8.7% underwriting margin, essentially wiping out almost four years of profits.

The impact on Medicaid is likely to be much less. The managed care version of Medicaid typically covers single parents and children, a demographic that is more likely to have a milder case of COVID-19. Medicaid programs also cover the "medically indigent" population with more severe health conditions, but that population is covered under fee-for-service Medicaid, which is not an insurance product.

Health care providers could also be affected by the additional costs, depending on their contractual arrangements with insurers. Some health care providers are on-risk for some claim costs, giving them a financial incentive to manage health care efficiently by aligning the incentives of the health insurer and provider. Health care providers, especially the larger hospital/physician chains, may end up bearing some the additional COVID-19 costs through the cost-sharing mechanisms of their contracts with health insurers.

Finally, larger employers will have higher employee benefit costs because most self-insure their employee plans. This additional cost will flow directly to their bottom line, adding to reduced revenue from forced closures and lost productivity.

Revenue effects

With industries shutting down for quarantine and the potential for layoffs, a decrease in group benefit plan enrollments is likely. Sectors expected to be hardest hit include travel and tourism, restaurant and entertainment, and transportation. In the Great Recession, as unemployment increased, it led to a decrease in group comprehensive enrollment through 2009 and a decrease in net premium growth. While enrollment levels may decrease for group comprehensive, individual comprehensive and Medicaid may see increases in enrollment. The impact on enrollments, positive or negative, will also depend on how quickly the economy recovers. A short recession will result in little discernible impact on enrollment.

During the prior recession, Medicaid enrollment increased as unemployment rose. In a study by the Kaiser Family Foundation, every one percentage point rise in unemployment led to a 1.1 million increase in the uninsured population and a one million person increase in Medicaid and CHIP enrollment. During that recession, the U.S. government also provided $87 billion of additional federal funding for Medicaid programs as part of the economic stimulus package.

For those who may not qualify for Medicaid, or the Medicaid expansion in those states that have expanded, individuals may purchase insurance through state or federal exchanges. While open enrollment for 2020 is closed, individuals can enroll or change their plan based on qualifying life events. A loss of health insurance is covered as a qualifying life event, which includes losing job-based coverage, losing eligibility for Medicaid, CHIP, or Medicare, as well as losing coverage through a family member. Multiple states have also issued new special enrollment periods for those individuals who are currently uninsured.

With an economic recession and rising unemployment, individuals will have a greater ability to stay enrolled in health insurance. While group comprehensive enrollment and premiums are expected to decrease, those companies offering products on the exchanges and Medicaid contracts could see increases in enrollment and premiums, although the increase in enrollment may be delayed a few months as people shop for coverage. For Medicaid, it may take several months for newly unemployed workers to become eligible for Medicaid, also delaying any increase in eligibility.

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