November 26, 2024

Market Segment Outlook: US Health Insurance

The outlook for the segment remains at Stable, owing to good capitalization and liquidity, favorable net investment income, and profitability, despite declining underwriting results

AM Best is maintaining its outlook for the US health insurance industry at Stable based on the following factors:

- Good capitalization and liquidity
- Solid commercial segment underwriting and earnings
- Moderating rate pressures at provider contract renewals
- Continued favorable net investment income, albeit at lower levels

Overall operating results remains favorable despite the following headwinds:

- Pressured Medicare Advantage and Medicaid managed care earnings
- Ongoing growth in the use of specialty medications and GLP-1s

In 2023, the US health insurance industry reported favorable overall earnings supplemented by positive net investment income, positioning plans to navigate the headwinds and narrowing profits margins in certain product lines. This trend continued through the first half of 2024, although declines in underwriting income were offset by a rise in net investment income and realized capital gains. We expect to see similar earnings trends in 2025, with a decline in overall underwriting income driven by lower results in Medicare Advantage (MA) and Medicaid managed care and by favorable earnings in the commercial segment. AM Best expects the US health industry to remain profitable overall in 2024 and 2025, although net income is expected to decline. Premium generation will continue to be supported by business expansion, the ongoing ageing-in of seniors into MA and premium rate increases, countered partly by a decline in Medicaid managed care due to a drop in enrollments.

Industry Remains Well Capitalized

Persistently favorable earnings have allowed the industry to accumulate capital, bolstered by the five-year compounded annual growth rate in 2023 for capital, which outpaced net premium, further improving risk-adjusted capitalization. However, we expect this trend to reverse for full-year 2024 and 2025.

Growth in MA membership and premiums, a more capital-intensive product, as well as growth in the individual ACA (the Patient Protection and Affordable Care Act) product, is expected to continue. This premium growth will be partly counterbalanced by a decline in Medicaid managed care due to lower enrollment. Additionally, earnings are expected to fall. These factors will likely result in premium growth outpacing capital growth and cause a slight drop in risk-adjusted capitalization in 2024 and 2025. However, AM Best expects the industry to remain well capitalized overall.

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Solid Commercial Segment Results

Underwriting results reported in 2023 for the commercial segment were the highest in three years, driven by fewer COVID claims and higher rate increases to reflect greater medical cost trends. Furthermore, growth in the individual ACA segment has helped improve the segment's results. We expect profitability to remain stable as rate increases are likely to keep pace with medical trend. Favorable results have been supported by administrative expense management, pharmacy rebates, and medical care management.

Although health insurers have reported volatile revenue development over the past few years, growth in the commercial segment accelerated in 2023 and overall premium expansion has been reported through 2024. This is the result of enrollment growth, premium rate increases, and solid retention rates, trends we expect will continue in 2025.

The group segment has not experienced substantial enrollment gains, the individual segment experienced enrollment growth due to a shift in members from Medicaid, for which some individuals are no longer eligible because of redeterminations. Furthermore, individual membership has benefited from increased subsidies for the individual ACA product, which led to coverage becoming more affordable for some. The increased subsidies will continue through 2025.

AM Best remains concerned about some regional, smaller, and less diversified health plans. Historically, these plans have been challenged by industry headwinds, pricing pressures, a lack of underwriting discipline, and a reimbursement lag. These plans may lack the financial wherewithal or support of a financially strong parent to provide capital support for the challenges that they may face.

Investment Income Supplements Underwriting

The industry's investment income grew substantially in 2023 due to solid growth in invested assets. Liquidity and cash flow from operations has been solid, which we expect will continue into 2025. Higher interest rates helped bolster investment income, as health insurer's reinvested new money at higher rates through 2023. Furthermore, the industry took actions to de-risk its investment portfolios, with a slight improvement in the credit quality of bond portfolios the past few years.

Given the short-tailed nature of claims, health insurers generally hold conservative asset allocations in support of their insurance liabilities, mainly investment-grade fixed income and cash and short-term investments. Strong performance in investment-grade fixed income and equities drove favorable returns. Investment income remains a favorable contributor to overall net income in 2024 and is expected to supplement earnings in 2025.

Moderating Rate Pressures at Provider Contract Renewals

With provider contracts being multiyear, many contracts have been renewed and renegotiated the past few years to reflect inflationary pressures, which pushed rates higher. The recent decline in inflation has led to moderating rate pressure at contract renewals. However, industry providers continue to face headwinds, including supply cost increases and staffing shortages in certain specialties, which is expected to continue into 2025.

Strained Medicare Advantage and Medicaid Managed Care Earnings

The MA and Medicaid managed care lines of business account for a substantial portion of health insurers enrollment/revenues, and these segments have been quite profitable the past few years. These segments accounted for over half of new premiums written and major medical enrollment in 2023. However, both segments are facing pressures that will negatively impact operating performance in the near term. Historically, these segments are high-volume with narrower margins. Recent trends suggest the outsized profitability of recent years is declining and could fall to levels below historical norms. AM Best still expects overall profitability for these segments, but margins are expected to narrow, and profitability may be difficult for some carriers. Still, health insurers in these segments have been challenged before and have demonstrated their ability to withstand difficult operating conditions.

Pharmaceutical and Specialty Medications Create Cost Pressures

Innovative new specialty drugs and GLP-1s are unlocking new possibilities for patients but are resulting in cost pressures for health insurers. The various use cases of GLP-1s, including highly prevalent patient medical conditions such as diabetes and obesity, have expanded usage, especially in the US, which accounts for a large percentage of global utilization of GLP-1s. Furthermore, the lack of competitive alternatives to many of these drugs has allowed prices to remain elevated; generic alternatives to GLP-1s are not expected until at least 2026.

Additionally, insurers are seeing cost pressures from gene therapies and other specialty drugs, which can be very expensive and required for lifetime treatment. The increased usage of high-cost specialty pharmaceuticals to treat a growing number of medical conditions is also elevating pharmaceutical spend. The introduction of biosimilars for drugs such as Humira may provide a lower-cost alternative. As more biosimilars are introduced and gain acceptance, insurers may see some cost reprieve. However, with the continued introduction of new high-cost drugs, including specialty drugs and gene therapy, the health insurance industry will continue to face pharmaceutical cost pressures.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies.

A Best's Market Segment Outlook can be Positive, Negative, or Stable.

Best's Market Segment Outlook	
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We update our market segment outlooks annually but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

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BEST'S MARKET SEGMENT REPORT

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