Bond Case Briefs

Municipal Finance Law Since 1971

Moody's: Entrance of U.S. Not-for-Profit Hospitals into Health Insurance Will Continue to Rise.

New York, September 25, 2015 — More US not-for-profit hospitals are likely to venture into the commercial health insurance business in the next few years either to gain market share or reduce costs through improved healthcare management, Moody's Investors Service says. However, starting a new plan or acquiring an existing business carries significant credit risks as managerial skills shift, competition intensifies, and start-up costs rise.

"Different management expertise is needed to operate a commercial health insurance business versus an acute care hospital. Health plans require actuarial skills for pricing models and specific marketing and service acumen, for example," says Moody's Vice President — Senior Analyst Mark Pascaris.

Despite substantial risks to cash flow margins, the trend is expected to persist, especially among larger systems which can absorb the costs. Drivers include the Affordable Care Act (ACA), which encourages care coordination and population health management; continued focus on cost reductions, synergies through greater economies of scale, and creating new revenue streams, Moody's says in "Hospitals Entering Insurance Business Gamble on Long-Term Payoff."

"Not-for-profit hospitals with a health insurance business (often known as an integrated delivery system, or IDS) tend to operate at noticeably lower operating cash flow margins than similar health systems without insurance," Pascaris says. "Entering the insurance business inevitably suppresses hospital system margins from the beginning."

Moody's says this is due to the inevitable mismatch between expense ramp-up and premium reserves essential to meet cash reserve requirements to execute the plan. The effect on credit will largely be driven by the pace and magnitude of the strategy and management's ability for rapid adjustment, if needed.

Aside from new managerial skills, competition from other national and regional health plans is intense. Moreover, this is compounded by recent merger and acquisition activity among Anthem Inc. (Baa2, under review possible downgrade) reached an agreement to acquire Cigna Corp . (Baa1, possible downgrade), following Aetna Inc.'s (Baa1, possible downgrade) deal to buy Humana Inc. (Baa3, possible upgrade) which has skewed negotiating leverage between commercial payors and hospitals decidedly toward the insurance companies.

There are some hospitals with long-standing health insurance plans that have developed an expertise in managing both the underwriting and delivery sides of the business. These health systems have ample cash reserves to weather insurance cycles and regulatory changes that come with the line of business.

The report is available to Moody's subscribers here.