

Memo:

To: Interested Parties

From : Dean Baker, Center for Economic and Policy Research

Topic: The Impact of Health Care Reform on Insurance Company Stock Prices

Date: December 18, 2008

The recent Lewin analysis of the impact of a public sector health insurance plan on private insurance enrollment

(<http://www.lewin.com/content/publications/OpeningBuyInPublicPlan.pdf>, p 5) provides some basis for predicting what could happen to the stock prices of health insurance companies in the wake of health care reform.

The Lewin analysis assumes three possible payment schedules for a public plan with corresponding impacts on private insurance enrollment. They calculate that if the public plan uses private payer levels then enrollment in private sector plans will fall by 12.5 million, if the public plan pays Medicare rates then enrollment would fall by 118.5 million, and at a midpoint payment level enrollment would fall by 67.5 million. Kaiser estimates that there are roughly 180 million people covered by private plans, so these declines translate into reductions of 8.3 percent, 37.5 percent, and 65.8 percent, respectively. (The sharpest declines in private enrollment occur when the public plan pays the lower Medicare reimbursement rates, since in this case it will be able to charge lower premiums and therefore provide tougher competition for the private plan.)

It in addition to losing customers, the insurance companies will also be forced to cut their profit margins. As a crude approximation, suppose that in the first case profit margins fall by 10 percent, in the midpoint case they fall by 40 percent, and with the Medicare payment schedule they fall by 70 percent.

We can then project the change in profit that would result in each case:

	Lost Enrollment	Reduced Profit Margin	Decline in Profits
Private payer levels	8.3%	10.0%	17.5%
Midpoint payment levels	37.5%	40.0%	37.5%
Medicare payment levels	65.8%	70.0%	89.7%

The stock prices for the insurance companies should decline in proportion to their profits. In other words, we should expect that if there is a public plan that pays providers in accordance with private payer levels, then the stock price of private insurers would fall by roughly 17.5 percent. In the event that a public plan uses Medicare payment schedules then the stock price of private insurers should fall by 89.7 percent.

For example, we can project the following:

Stock Prices in Various Scenarios

	Current Price	Private payer rates	Public Plan with Midpoint payment rates	Medicare payment rates
Unitedhealth	\$24.00	\$19.80	\$15.00	\$2.50
Cigna	\$15.90	\$13.10	\$9.90	\$1.60
Aetna	\$24.25	\$20.00	\$15.20	\$2.50

Of course these calculations assume that the markets have not already priced in any possible reduction in profits due to the passage of health care reform. It seems likely that the markets would not have yet priced in this possibility given how slow they generally are to anticipate events. After all, the markets were surprised by the extent of the problems in the financial industry as recently as October. Clearly market actors are not very good at thinking ahead.