CIRCULAR

Reference	:	Circular 38 PMSA clarification
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CLARIFICATION OF CIRCULAR 38 OF 2011 REGARDING PERSONAL MEDICAL SAVINGS ACCOUNTS

The Office has received a number of representations regarding the contents of the above circular, its interpretation and certain practical constraints relating to the implementation by 1 January 2012.

A meeting was held with a representative number of administrators and schemes to discuss the issues raised. The matter was then referred to Council and the following clarification is provided and should be read in conjunction with the requirements imposed by Circular 38 of 2011.

Exemption requests in terms of Section 8(h) of the Medical Scheme's Act 131 of 1998 (MSA)

Several medical schemes applied for exemptions from the requirements of Circular 38 of 2011. These were duly considered and Council granted exemptions where difficulties with implementation were demonstrated, with the proviso that interest earned on savings account balances from 1 January 2012 may not be taken to scheme funds (see Section 2(c) of The Financial Institutions (Protection of Funds) Act (FI Act)).

The interest earned must be ring-fenced and held in a suspense account until systems have been developed to allocate such interest to members' savings accounts. This must be credited to members' savings accounts by 31 December 2012.

The rate to be used, if savings funds are not invested separately, is the actual rate earned on cash and bank deposits.

Legal status of Omnihealth Judgment[1] and Circular 38 of 2011

Schemes were advised of the decision of the Omnihealth Judgment via Press release no 1 of 2007. Schemes have therefore had five years to comply with the requirements of the judgment and Regulation10 of the Medical Schemes Act 131 of 1998 (the MSA).

The background to the judgment is that the intention of the Regulations was always to ring-fence the savings balances and to protect them from creditors of the scheme. The Registrar applied for the declaratory order to confirm this interpretation of the MSA. The judgment confirmed the Registrar's interpretation of the Act and Regulations.

The legal position is clear and therefore no useful purpose will be served in engaging in further discussions on the implications of the judgment. The nature of the savings accounts as trust monies that do not belong to the scheme is confirmed by the Omnihealth judgment and the requirements as set out in Circular 38 of 2011 are requirements of the MSA and the FI Act.

It is important to note that the Registrar is tasked with ensuring compliance with the law regarding medical schemes. It is to ensure such compliance that Circular 38 and this clarification have been issued.

The Nature of the trust monies

The Trust Property Control Act 57 of 1988 does not apply to the savings funds.

In section 1 Definitions, it states: "trust" means the arrangement through which the ownership in property of one person, is by virtue of a trust instrument made over or bequeathed- (a) to another person…."

Savings monies are not bequeathed and ownership is not made over. The monies were and remain the property of the member. Also there is no trust instrument creating a trust.

The creation of separate trust structures with trustees, trust deeds and separate accounting records is therefore not required.

The Financial Institutions (Protection of Funds) Act 28 of 2001

These monies do however fall under The Financial Institutions (Protection of Funds) Act 28 of 2001(FI Act). This was the finding in the Omnihealth judgment.

The following sections in particular support the requirements set out in Circular 38 of 2011:

The purpose of the FI Act is to provide for "…….the investment, safe custody and administration of funds and trust property by financial institutions".

Section1 Definition of "financial institution"-: -means (b) any medical scheme contemplated in section 1 of the Medical Schemes Act 131 of 1998".

Trust property means "…any corporeal or incorporeal, moveable or immovable asset invested, held, kept in safe custody, controlled, administered….by any person….for, or on behalf of, another person……"

[1] Judgment of Du Plessis J in the matter of the Registrar of Medical Schemes and Lazarus Mpanana Ledwaba N.O., Alta van Wyk N.O., KwaZulu-Natal Medical Scheme and the Master of the High Court, case number 18545/06, Transvaal Provincial Division of the High Court.

Section 2(c) "A director …official, employee…of a financial institution who invests, holds, controls,…administers any funds ot trust property: (c) may not alienate, invest,…or make use of the funds or trust property,…in a manner calculated to gain directly or indirectly any improper advantage for himself…or any other person to the prejudice of …the principal concerned.

Section 4(2) requires that trust property may not be invested "…otherwise than in the name of- (b) the financial institution in its capacity as administrator, trustee….."

Section 4(4) states that "A financial institution must keep trust property separate from assets belonging to that institution and must in its books of account clearly indicate the trust property as being property belonging to a specific principal (i.e member)."

Section 4(5) states that "…trust property invested, held, kept in safe custody, controlled or administered by a financial institution…under no circumstances forms part of the assets or funds of the financial institution…"

Based on the above what is required is that a separate bank account be opened by the scheme. It will be in the name of the scheme (in its capacity as trustee); operated by the scheme, with the same signatories, controls and procedures applicable to any other bank account operated by the scheme (Section 4(2) of the FI Act)

By way of example, the account will be called "ABC Medical Scheme: Members savings trust account". This clearly and legally ring-fences the funds and indicates that the funds are held on behalf of members.

These funds do not form part of the scheme's assets and may not be used for paying scheme expenses or risk claims. They may only be used for savings account claims as provided for in the scheme rules (Section 4(5) of the FI Act).

Scheme rules

There were concerns that changes to the scheme rules would not be able to be made and registered before 1 January 2012.

The scheme rules would need to be changed if these are in conflict with Circular 38 of 2011, e.g. where the scheme rules provided for the allocation of interest on a fixed percentage basis or for interest not to be paid at all. It is not envisaged that any changes would be necessary to accommodate the normal day to day operations of savings plan monies. In the event that the scheme rules cannot be changed in time for implementation, it should be noted that the MSA and the law would take precedence over the scheme rules.

Additional rules will be necessary to inform on certain processes for transparency/clarification purposes:

- The scheme should for instance include a rule on how it proposes to allocate interest income to the savings plan balance, i.e. on a pro rata allocation based on beginning of the month/month-end balances, or on a day-by-day basis. The rule should also inform how resigned members would be affected.
- The scheme should provide details on what type of investments the savings plan balances should be invested. Owing to the short-term nature of the trust funds and the risk of longer term assets or assets subject to market fluctuations, schemes should invest savings funds in bank accounts and deposits.
- In the event that the scheme decides to levy interest on advances to the members directly (such interest may not be charged to the savings plan accounts), details of such interest and how it will be recouped from the member must be provided.
- As individual savings plan accounts may not be debit balances, the scheme rules should provide detail on how costs such as bank charges and investment management fees would be recovered; for example bank costs and investment management fees incurred may be offset against the investment income before the pro-rata allocation thereof is done. This will result in a member who does not have a savings plan balance not going into a debit, but also not receiving any income.

Contribution and benefit tables for 2012

It was contended that changes would need to be made to the contribution tables to adjust for the effect of the loss of investment income to the scheme. The Office has reviewed the effect on a number of schemes and it is our view that the financial impact on the majority of schemes occasioned by the loss of interest previously earned by schemes on the savings account money is not material and does not justify re-costing of contributions for 2012.

A similar argument was advanced regarding the cost of bad debts on advances made during the year which used to be off-set against the investment income accrued on savings plan accounts. Again the amounts involved seem to be, in the main, immaterial.

There may be additional costs of systems changes and operating procedures that would result in extra costs to the scheme and which would justify a re-costing of contributions, but no evidence or quantification of such costs has been presented. That being said, a few schemes indicated that they wanted to assess whether it would be viable to continue with their savings plan accounts, in anticipation of the major system changes necessary to give effect to the requirements of Circular 38 of 2011. These arguments were taken into account in the granting of exemption until December 2012..

Furthermore, in those instances where a material difference which justifies re-costing is indeed effected, schemes should approach the Registrar so that evidence and representations in this regard be presented and considered.

Clarifying notes on the accounting for savings balances

Transfers between scheme and trust bank accounts

The transfers between bank accounts are based on cash transactions only. These transfers are not affected by notional credits, such as the crediting of savings contributions in advance.

Transfers between the trust and scheme bank accounts do not need to take place with every individual cash transaction. They can be done in bulk after claims runs or the bulk receipt of contributions/transfer of monies from other schemes, but still adhering to the requirements of Circular 38 0f 2011.

Any additional bank costs incurred in the scheme's bank account due to the increase in the number of bank transfers should be priced for in the risk contributions of the savings plan options.

Savings contributions

In the event that short-payments are received, the scheme would be able to allocate it first against risk, and then against the savings component. As the savings plan contribution forms part of the registered contribution (and as such part of the contract between the member and the scheme), the scheme would be able to suspend the member until full payment is received.

Costs incurred in respect of savings plan balances

It was noted earlier that trust balances cannot be in debit. It is therefore not recommended that additional costs relating to the implementation of Circular 38 of 2011 and the administration of the savings plan balances be recovered from the savings plan balances, but that it should be included in the pricing of the risk contributions of these benefit options as savings are part of the registered contributions.

It is suggested that bank costs and investment management fees incurred should be off-setted against the investment income before the pro-rata allocation is done. This will result in a member who does not have a savings plan balance not going into a debit, but also not receiving any income. As mentioned earlier this should also be clarified in the scheme's rules.

The costs recovered and interest earned should be shown separately in the members' statement and the financial reporting.

Statements

Savings account statements would need to be sent to the members indicating all entries made on the savings accounts.

Financial statements and disclosure requirements

An asset is defined in the Framework to International Financial Reporting Standards (IFRS) as "A resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity." The medical scheme acts as a trustee of these monies on its members' behalf, and is not entitled to any future economic benefits associated with savings plan monies:

- The court in the OmniHealth Judgment found the savings plan accounts to constitute trust property as defined in Section 1 of the Financial Institutions (Protection of Funds) Act, 28 of 2001.
- Regulation 10 to the Act limits payments that may be made from these accounts.
- Investment income accrued on the savings plan balances is for members' benefit only.
- The risk of bad debts on advances is carried by the scheme itself and may not be recovered from the savings plan monies.
- Unclaimed balances must be paid over to the Guardian's Fund.
- Upon liquidation the savings plan monies do not form part of the scheme assets.

Furthermore, when the substance of the relationship between the medical scheme and the savings plan monies are evaluated, it is clear that the trust accounts are not set up for the benefit of the scheme, and that the scheme is not able to obtain any financial benefits from the savings plan monies' (trust's) operations or their funds. Accordingly these funds should not be consolidated by the medical scheme as they do not constitute a special purpose entity in terms of SIC 12

Based on the above-mentioned factors, the savings plan monies should be treated off-balance sheet, and transactions should presented net of savings transactions in the statement of comprehensive income.

The operating of savings accounts is however an integral part of the scheme's operations. It forms part of the schemes rules, contributions and benefit tables and is an integral part of the product offering by schemes. The scheme is responsible for those funds and the good management thereof. The scheme also has risks relating to the proper management of those funds on behalf of members. As these are material matters in assessing the financial position and performance of the scheme, the scheme's financial statements would in fact be misleading if they did not report on those operations.

It is therefore determined that additional disclosure is required to enable the users of the financial statements to understand the impact of the transactions on the financial position and financial performance of the scheme; such disclosure being provided in terms of paragraph 17 of IAS 1 *Presentation of financial statements* of IFRS. Annexure A to this circular provides examples of additional disclosure required to give effect to the requirements of paragraph 17.

Prior period error

IAS 8 paragraph 5 defines prior period errors as misstatements in financial statements of prior periods due to failing to use information (i.e. Press Release 1 of 2007 on the Omnihealth Judgment) which was available at such stage and which should have reasonably been used in preparing the financial statements.

The retrospective correction of the savings plan monies previously included as an asset (as well as the corresponding liability) in the financial statements will result in the exclusion of these balances from the financial statements of the medical scheme (for the year and the prior year comparison). Schemes are referred to paragraphs 42 and 49 of IAS 8 for more detail on the disclosures required in terms of IFRS.

Audit of trust accounts

Due to the fact that the savings plan monies disclosures in the financial statements constitute essential information to members (in respect of whom these monies are held in trust by the scheme), and as it is considered to be material due to its nature, it is clear that these disclosures need to be included in the scope of the section 37(3) statutory required audit.

All entries regarding contributions and claims are already audited as part of the scheme's annual audit, as it forms part of the scheme's registered contribution and benefit tables. No additional audit procedures are required other than to insure the money is retained separately and only used for the purpose intended.

Solvency calculation

The argument regarding the suitability of the present solvency calculation has been debated for a number of years, especially whether the calculation should be based on net or gross contributions. Solvency requirements are to protect members against future events that may affect the performance of the scheme. It is not an exact predictor of a schemes ability to survive or not; it is merely a warning sign that the scheme's financial stability is at risk.

Changes to the accounting for savings contributions occasioned by this circular does not in any way change the basic risk of the scheme. Savings contributions and claims have been excluded from the scheme's income statement since 2007 (Circular 39 of 2007)

The net assets of the scheme have also not altered.

The debate around the adequacy or not of the existing solvency levels and requirements may continue in the future, but in the meantime the basis of the calculation will continue as provided for in the MSA and based on the registered contribution tables.

Guardian's fund

This matter is dealt with in the Administration of Estates Act 66 of 1965.

Section 93 of the Act states "(1) Every person carrying on business…shall in the month of January each year prepare ….and publish in the Gazette a detailed statement in respect of all amounts of R100 or more which were held by him …on the thirty-first day of December of the (previous) year and which were not his property…but at the time…have remained unclaimed for a period of five years or more by the rightful owners"

Section 93(3) states "After the expiration of three months from the date of publication of the said statement, such person shall forthwith …..deposit in the Guardian's fund to the credit of the rightful owners all such amounts remaining unclaimed by the rightful owners.

The requirement in Circular 38 OF 2011 is therefore corrected and schemes must now pay over the money after five years.

Other legal issues

National Credit Act 34 of 2005

The National Credit Act (NCA) specifically excludes from the application of the Act policies of insurance (section 8(2)(a)) and transactions between a stokvel and a member of that stokvel (section 8(2)(c)).

Medical schemes contracts are policies of insurance and medical schemes' activities have been likened to stokvels where members' funds are pooled for the benefit of members.

The NCA is concerned with the activities of those whose business is to provide credit to the public and who seek to profit by way of fees, charges and interest. (see JMV Textiles (Pty) Ltd v De Chalain Spareinvest 14 CC and others 2010 (6) SA 173 (KZD) at paragraphs 16 and 19 as to what the NCA regards as a credit provider for the purposes of the Act). A medical scheme's focus is not the provision of credit and the securing of profit therefrom.

The NCA does not therefore apply to loans and advances made to members of medical schemes.

Banks Act 94 of 1990

The Banks Act regulates and supervises the business of public companies taking deposits from the public.

In section 1 Definitions the definition of a deposit states: "… But does not include an amount of money- (viii) paid to a benefit fund, as defined in section1 of the Income Tax Act 58 of 1962, as a contribution by …a member of that fund.

Section 1 Interpretation states that a "benefit fund means…- (b) any medical scheme registered in terms of the Medical Schemes Act.

Therefore as savings contributions are still contributions in terms of the MSA and the rules of the scheme the Banks Act does not apply to these monies.

Financial Intelligence Centre Act 38 of 2001

This Act applies to all Accountable Institutions' listed in schedule 1.

Institution 2 is " a person who invests, keeps in safe custody, controls or administers trust property within the meaning of the Trust Property Control Act 57 of 1988". We have seen above that savings account monies do not fall under the Trust Property Control Act.

Institution- 11 includes "A person who carries on the business of lending money against the security of securities". A medical scheme does neither of those two things.

Therefore the Financial Intelligence Act does not apply to medical schemes.

Schemes are required to keep the Office updated on a regular basis on progress made in implementing the changes as clarified in Circular 38 of 2011.

Tebogo Maziya
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Annexure A

Illustration of additional financial statement disclosures required in terms of paragraph 17 of IAS 1 relating to Personal Medical Savings Accounts

		20xx R'000	20yy R'000
1.	**Savings account trust monies managed by the scheme on behalf of its members**		
	Balance of savings account balances at the beginning of the year		
	Add: Savings account contributions received		
	Interest and other income earned on trust monies invested		
	Transfers from other schemes in terms of Regulation 10(4)		
	Less: Claims paid out of savings		
	Transfers to other schemes in terms of Regulation 10(4)		
	Refunds on death or resignation in terms of Regulation 10(5)		
	Balances due to members on savings account balances held in trust at the end of the year		
2.	**Investment of trust savings balances**		
	Bank account		
	Fixed deposits		
	Total trust monies invested		
3.	**Gross contributions**		
	Gross contributions per registered rules		
	Less: Savings contributions received*		
	Net contributions per statement of comprehensive income		

* The savings plan contributions are received by the scheme in terms of Regulation 10(1) and the scheme's registered Rules and held in trust on behalf of its members. Refer to note 1 to the financial statements for more detail on how these monies were utilised.

		20xx R'000	20yy R'000
4.	**Relevant Healthcare Expenditure**		
4.1	**Claims incurred excluding claims incurred in respect of risk transfer arrangements**		
	Current-year claims		
	Services provided to members in own facilities		
	Movement in outstanding claims provision		
	Over/ under provision in prior year		
	Adjustment for current year		
	Movement in provision arising from liability adequacy test		
	Over/ under provision in prior year		
	Adjustment for current year		
	Claims paid from savings accounts*		
	Managed care: healthcare services benefits		

* Claims are paid on behalf of the members from their savings plan accounts in terms of Regulation 10(3) and the scheme's registered benefits. Refer to note 1 to the financial statements for a breakdown of the movement in these balances.