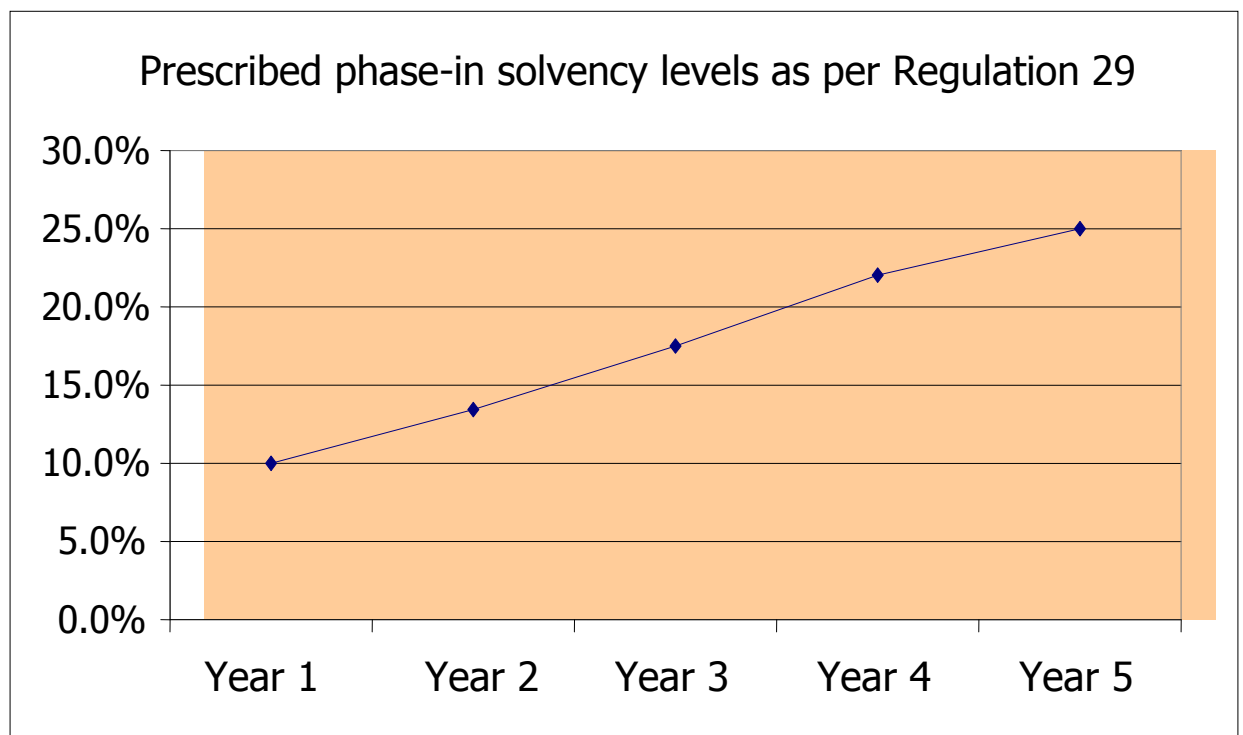




**COUNCIL FOR MEDICAL SCHEMES**

**Guideline for the preparation of a business plan where a medical scheme is not meeting the statutory solvency requirements as per Regulation 29 of the Medical Schemes Act 131 of 1998, as amended**



**September 2009**

## **Guideline for the preparation of a business plan where a scheme is not meeting the statutory solvency requirements**

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# **Guideline for the preparation of a business plan where a scheme is not meeting the statutory solvency requirements**

## **1. Introduction**

Regulation 29(2) of the Medical Schemes Act 131 of 1998 (Act) states that a medical scheme must maintain accumulated funds when expressed as a percentage of gross annual contributions for the accounting period under review which may not be less than 25.0%.

Regulation 29(3A) further indicates that a medical scheme which is registered for the first time after the coming into operation of the Regulations must maintain accumulated funds, expressed as a percentage of gross annual contributions, of not less than:

- 10.0% during the first year after the scheme was registered;
- 13.5% during the second year;
- 17.5% during the third year; and
- 22.0% during the fourth year.

If a scheme is registered during the year, the first year of operation will be the following financial year. Therefore, if a scheme was registered on 15 July 2008, they need to obtain a 10.0% solvency level during the year ended 31 December 2009; as 1 January 2009 to 31 December 2009 will be the first full year of operation after the scheme was registered. From this follows that the solvency at year-end should not be lower than 10.0% and that the solvency level should not drop below this level during the subsequent year (2010).

In addition, Regulation 29(4) states:

*"A medical scheme that for a period of 90 days fails to comply with sub regulations (2), (3) or (3A) must notify the Registrar in writing of such failure, and must provide information relating to-*

*(a) the nature and causes of the failure, and*

*(b) the course of action being adopted to ensure compliance therewith".*

The purpose of this document is to guide and assist medical schemes in submitting the information / business plan as is required by Regulation 29(4).

## **2. Business plan format**

### **2.1. Executive Summary**

#### **2.1.1 Nature and causes of failure**

The scheme must supply detailed information relating to the nature and causes for failure to meet the required solvency level, which could include amongst others:

- Low/high membership growth.
- Change in demographic profile of membership.
- Under pricing of contributions.
- Complexity of benefit options.
- Excessive claims.
- High non-health expenditure

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In supplying the reasons for the scheme's failure to comply with the minimum required solvency levels, the scheme must ensure that all relevant/appropriate information is disclosed to enable the Registrar to fully understand the exact nature and causes of the problems encountered by the scheme.

### **2.1.2 Course of action proposed to meet the required solvency**

The scheme should provide the Office with all the actions to be taken by the Board of Trustees to ensure that the scheme complies with the minimum required solvency level in due course. Full details of the proposed action should be provided in the strategy and implementation as set out in part 2.3 of this document.

The trustees should be specific regarding the timeframes within which the scheme will reach the minimum required solvency level of 25%.

Further, it should be noted that until such time that the Risk Equalisation Fund (REF) legislation has been passed; no reference to it can/should be made by schemes in their business plan submission i.e. projections should not incorporate monies received / paid into REF.

## **2.2 Medical Scheme Summary**

### **2.2.1 Background information in respect of the medical scheme**

The scheme should provide a brief history of its operations, which should include at least the following information:

- Name and registration date of the scheme.
- The number and names of benefit options offered by the scheme.
- A brief description of the current options (objective of each individual option) and the target market (e.g. low cost).
- Summary of the membership profile per option for example:
  - Number of members.
  - Number of beneficiaries.
  - Average age of beneficiaries.
  - Pensioner ratio (65+ years).
  - Number of chronic patients.
  - Membership mix on different income bands.
  - Family size.
- Developments within the scheme over the past few years (e.g. previous amalgamations etc.).
- Names of participating employer groups (only major groups for open schemes).
- Name of administrator (only for third party administered schemes), including an organogram of the administrator and its related parties.

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- Name of managed care provider(s) and services delivered, including an organogram of the managed care provider(s) and its related parties.
- Names and relationships with all related parties of the scheme, including an organogram where applicable.
- A full list of all the guarantees that the scheme has in place.

### **2.2.2 Governance of medical scheme**

Every medical scheme shall have a Board of Trustees consisting of persons who are fit and proper to manage the business contemplated by the medical scheme in accordance with the applicable laws and the rules of the scheme (as stipulated in Section 29(1)(a) of the Act).

In this regard, the scheme should provide *inter alia* the following information:

- A brief description of the direct duties of the Board of Trustees as well as details regarding the constitution of the Board of Trustees i.e. the number of Board of Trustee members, their duties, terms of reference etc.
- A brief description of the sub-committees established in order to manage the scheme, for example audit committee, risk committee, remuneration committee etc.
- Details of the members and their responsibilities on these various committees.
- Investment strategy/policy of the scheme.
- The short and long term goals for the scheme/Board of Trustees.

## **2.3 Strategy and implementation**

### **2.3.1 SWOT analysis**

#### **2.3.1.1 Strength and opportunities**

The scheme must give a brief overview of factors considered being strengths and those being opportunities, as well as reasons why the scheme considers these factors as such, and in what way these factors will assist the scheme to perform satisfactorily.

Possible strength factors could include, *inter alia* the following:

- A competitive product offering, including the reasons for the scheme being competitive.
- Effective risk management (e.g. capitation arrangements with managed care networks).
- Quick hassle free claims turn around as a result of type of system utilized; thus pleased members.
- Reduced administration expenditure per beneficiary, compared to the industry average.

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- Improved age profile as a result of new options or better marketing; thus lower claims ratio compared to industry average.
- Stable risk pool due to younger, healthier members.
- Good investment strategy.

Possible opportunity factors could include but are not limited to the following:

- Member communication.
- Good risk profile member growth.
- Compulsory membership.
- Advertising / branding.

The factors listed merely serve as an example of some of the weaknesses and threats that the scheme faces. Each scheme's circumstances will be different and schemes should not feel obliged to concentrate on or limit their analysis to only the above mentioned factors.

### **2.3.1.2 Weaknesses and threats**

Similarly, an overview of factors considered being weaknesses and threats to the scheme must be provided. The scheme should also indicate how it plans to deal with those weaknesses and threats (i.e. risk mitigation plan).

Factors that could be a threat or even a weakness could include but are not limited to the following:

- Existence of the Government Employees Medical Scheme (GEMS) and the resulting loss of membership.
- Poor risk pool due to higher age profile of members.
- Higher than average claims pattern due to higher pensioner ratio.
- Dissatisfied members due to late claims processing and payments.
- Failure to attract sufficient members to increase the size of the risk pool.
- Spiralling cost of medication and private hospital costs; thus threatening the solvency and viability of the scheme.
- Potential/looming retrenchment in the industry where most of the members of the scheme operate (economic factors).
- Statutory regulations/ amendments (i.e. PMB's being paid at cost).
- Threat of HIV/Aids and other chronic diseases.
- Fraud and corruption.
- Quality of management information.
- Poor investment returns.

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The above factors merely serve as an example of what could affect the survival of a medical scheme. Each scheme's circumstances will be different and schemes should not feel obliged to concentrate on or limit their analysis to only the factors mentioned above.

### **2.3.2 Market analysis**

#### **2.3.2.1 Membership/Target market strategy**

If membership growth was identified as one of the courses of action to be adopted to improve the scheme's solvency level, the following minimum information (but not limited to) should be submitted with the business plan:

- A detailed marketing strategy.
- Analysis of main competitors (i.e. market comparison) including the reasons why they were chosen.
- Customer needs analysis.
- Forecast in terms of membership growth including reasonability testing.
- Detailed demographic profile analysis of current and projected beneficiaries (i.e. average age and pensioner ratio defined as 65 years and older).
- Illustrate the impact of the risk profile of the new members on the existing membership and the scheme's solvency level.
- The scheme's communication strategy (i.e. road shows, pamphlets, advertising etc).
- Letters of intent supporting the projected membership growth.

#### **2.3.3 Risk management**

Risk management is a key area of scheme management. A clear policy on how the scheme plans to minimise its exposure to risk can take countless forms that could include any of the following:

- Risk transfer arrangements with managed health care providers where an element of risk is transferred to the provider or shared between the scheme and the provider.
- Capping of claims payable to contracted providers in return for unlimited services to members, thus reducing exposure to high inherent claims risk.
- For schemes that do not have large membership, reinsurance can afford them an effective vehicle to manage and contain risk. It should be noted that it is the responsibility of the Board of Trustees to consider the need for such reinsurance and to comply with Section 20(3) of the Act, in this regard.

The scheme should provide full details of both risk management tools currently in place, as well as those risk management tools to be implemented to improve the solvency levels of the scheme, including the copies of all agreements. Any proposed risk sharing arrangements

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should be supported by appropriate reasons for implementation thereof (i.e. needs analysis).

### **2.3.4 Pricing strategy**

The pricing of the existing benefit options must be evaluated in order to establish the reason for solvency problems. In a case where (a) benefit option(s) is not financially sound, there might be a need to deregister or restructure the option(s). The scheme would then have to demonstrate how the resulting shift in membership to other options will affect its financial position and that of other options.

The scheme should also provide the composition of the current contributions per member/ per beneficiary per month per option and the underlying assumptions and reasons at arriving at such figures. Information should be provided for at least the following:

- A description of the data used.
- Price inflation.
- Age adjustments.
- Utilisation adjustments.
- Benefit changes.
- Non-health expenditure.
- Investment return.
- Reserve loading.
- Demographic profile of member
  - Average age.
  - Average family size.
  - Income profiles.
  - Pensioner ratio (65+ years).
  - Chronic profile.
- Buy-ups/downs.
- Subsidy (if any) assumptions and the impact thereof on the proposed contribution tables.

Amongst other factors, if a scheme has identified contributions to be under priced, they should demonstrate actions on how the problem will be resolved. This may be in the form of increasing contributions, reducing benefits, reducing non-health expenditure, restructuring of options or any other alternatives.

The scheme will therefore have to outline where possible, all those factors and their overall effect on the reserves of the scheme. Further, the resultant changes may or may not improve the existing solvency levels immediately, in that case, a synopsis of how and when the scheme intends restoring the solvency to the required level will be helpful in evaluating the entire business plan.



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It should be noted that the Registrar prefers a gradual approach to a single extreme contribution increase or benefit cut.

### **2.3.5 Financial Plan**

The scheme must provide financial projections following the introduction of controls aimed at improving the solvency and liquidity of the scheme. The projections must cover the number of years that it will take for the scheme to reach the minimum required solvency level. It should however be noted that the scheme will need to revise and resubmit their budgets if it is not in line with the initial plan.

Projections shall comprise of at least the following information in respect of all the years until the statutory solvency level is reached (this should be submitted electronically as well):

- a) A detailed consolidated statement of comprehensive income per month. Please refer to Annexure A.
- b) A detailed statement of comprehensive income per benefit option per month. Please refer to Annexure A.
- c) A detailed consolidated year to date statement of comprehensive income. Please refer to Annexure B.
- d) Projected reserve level and solvency ratio.
- e) Projected membership targets (both principal members and beneficiary numbers).
- f) Projected average age of beneficiaries, pensioner ratio (defined as 65 years and older) and family size.
- g) Sensitivity analysis, illustrating:
  - Impact of different membership mixes relating to the benefit options' different income bands on the projected solvency levels.
  - The impact of different membership targets on the projected solvency levels.
  - The impact of buy-downs/ups on the membership and projected solvency levels.
  - Impact of different risk profiles of members on the projected solvency levels.
  - The impact of different utilisation patterns on the projected solvency levels.
- h) A break-even analysis, illustrating the minimum required income to cover all claims and non-health costs and also indicating the minimum number of members required to ensure a stable risk pool in terms of section 33(2).
- i) All the projections should be accompanied by detailed assumptions:
  - Membership growth rate and average family size.
  - Average age and pensioner ratio (defined as 65 years and older) per option.
  - Contribution per member/ beneficiary per month per the registered table.

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- Average contribution per principal member/ beneficiary per month.
- A detailed calculation of claims costs on the basis of per member/ beneficiary per month. This should also include all assumptions used for year on year increases.
- Average claim per member/ beneficiary (this should include a detailed calculation of the average claim).
- Inflation rates where applied. Please explain the use and need where different inflation rates were used.
- Non-health expenditure per member/ beneficiary per month. This should include a detailed breakdown of all non-health expenditure per member/ beneficiary.
- Broker fees and the basis of compensation.
- All reinsurance assumptions.

Once again, this merely serves as a guide and is not in anyway exhaustive of the assumptions that may be used. A detailed explanation of both the assumption and the basis or impact these will have on the financial position needs to be submitted.

### **2.4 Independent Review**

The scheme may wish to seek the services of an expert to evaluate the proposed changes, especially if they involve redesigning/ restructuring of benefit options. The evaluation must be addressed to the Board of Trustees of the scheme.

The "expert" evaluation is not limited to an actuary. An evaluation can be performed by any person with the appropriate skills in statistics, health economics, actuarial science, etc.

Detailed calculations are required. The evaluation shall, at a minimum, report on the appropriateness and adequacy of the following:

- a) Contributions, taking into account the level of benefits offered by the scheme.
- b) The level of contribution to be utilised towards reserve building.
- c) The level of non health expenditure.
- d) Brokerage commission.
- e) Overall risks faced by the scheme and the extent to which the scheme is vulnerable or covered against these risks.
- f) Sensitivity analysis.

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### 3. Annexures to the Business Plan

#### Annexure A – specimen monthly statement of comprehensive income (consolidated & per option)

Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Total

#### Net contribution income

##### Relevant healthcare expenditure

Net claims incurred

Claims incurred

Third party claim recoveries

Net income/(expense) on risk transfer arrangements

Risk transfer arrangement fees/ premiums paid

Recoveries from risk transfer arrangements

Profit/(loss) share arising from risk transfer arrangements

#### Gross healthcare result

Net income/(expense) on commercial reinsurance

Commercial reinsurance premiums paid

Recoveries from commercial reinsurance

Profit/ (loss) share arising from commercial reinsurance

Managed care: management services

Broker service fees

Administration expenses

Net impairment losses on healthcare receivables

#### Net healthcare result

##### Other income

Investment income

Income from use of own facilities by external parties

Grants

Sundry income

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### Other expenditure

Asset management fees  
Cost incurred in provision of own facilities to external parties  
Interest paid on savings accounts  
Sundry expenses

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### Net surplus/ (deficit) for the year

#### Other comprehensive income

Fair value adjustment on available-for-sale investments  
Reclassification adjustment\*  
Land and buildings revaluation

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### Total comprehensive income for the year

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The reclassification adjustment relates to gain/loss on sale of available-for sale investments which us taken to the statement of comprehensive income within "Investment income".

Projected accumulated funds  
Projected solvency ratio

Number of principal members  
Number of beneficiaries  
Pensioner ratio (65+ years)  
Average age per beneficiary

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### Annexure B – specimen year to date statement of comprehensive income

(Please note that the scheme should forecast until the year they reach 25.0% solvency level).

	Year1	Year 2	Year 3
<b>Net contribution income</b>			
<b>Relevant healthcare expenditure</b>			
Net claims incurred			
Claims incurred			
Third party claims recoveries			
Net income/(expense) on risk transfer arrangements			
Risk transfer arrangement fees/ premiums paid			
Recoveries from risk transfer arrangements			
Profit/(loss) share arising from risk transfer arrangements			
<b>Gross healthcare results</b>			
Net income/(expense) on commercial reinsurance			
Commercial reinsurance premiums paid			
Recoveries from commercial reinsurance			
Profit/ (loss) share arising from commercial reinsurance			
Managed care: management services			
Broker service fees			
Administration expenditure			
Net impairment losses on healthcare receivables			
<b>Net healthcare result</b>			
<b>Other income</b>			
Investment income			
Income from use of own facilities by external parties			
Grants			
Sundry income			

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### Other expenditure

Asset management fees  
Cost incurred in provision of own facilities to external parties  
Interest paid on savings accounts  
Sundry expenses

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### Net surplus/(deficit) for the year

### Other comprehensive income

Fair value adjustment on available-for-sale investments  
Reclassification adjustment\*  
Land and buildings revaluation

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### Total comprehensive income for the year

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\*The reclassification adjustment relates to gain/loss on sale of available-for sale investments which us taken to the statement of comprehensive income within "Investment income".

Projected accumulated funds  
Projected solvency ratio

Number of principal members  
Number of beneficiaries  
Pensioner ratio (65+ years)  
Average age per beneficiary