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Dear Dr de Villiers

Circular 68 of 2015: Review of the Solvency Framework

Introduction

Thank you for the opportunity to provide input on Circular 68 of 2015. We welcome the proposals to change the current solvency regime to better reflect the risks faced by Schemes.

The framework has proposed three broad risk categories, namely Business Risk, Asset Risk and Operational Risk. We provide feedback on each of these below.

Business Risk

The proposed framework for the calculation of Business Risk uses projections of various future cashflow components of a medical scheme.

We appreciate that the proposed model is looking to use a prospective approach for assessing the level of capital required, as opposed to a retrospective approach that was proposed in previous models prepared by the Industry Technical Advisory Panel ('ITAP'). It may be possible to allow for a combination of prior results as well as future budget projections as part of the overall framework as this would allow for historical deterioration or improvements in positions.

It is important to consider Schemes that are currently looking to correct deficit positions. Using industry average claim and contribution increases going forward without taking account of Council for Medical Scheme ('CMS') approved recovery plans may result in projections that do not reflect actual expectations.

The use of monthly claims ratios rather than annual claims ratios introduces additional complexities and variance in terms of the measurement of claims patterns. Seasonality of claims due to for example the start of winter, the timing of public and private school holidays and significant (and random) high costing events will have a significant impact on claims ratios in any given month. However, this becomes less volatile when measured over a year. We therefore propose that less focus is placed on the monthly volatility of claims and more on the claims ratios over an annual period.

The framework could also look to normalise the ratios to allow for the current surplus/(deficit) position of a scheme. This could be done by using past claims ratios and adjusting for first year claims and contribution increases.

We support the notion that there should be a requirement for managed care organisations to hold capital or some form of reinsurance when there is risk transfer to the organisation from a medical scheme. There should then be a reduction in the solvency that is held by the scheme that passes across the risk.

Asset Risk

We support the introduction of an Asset Risk component to the overall solvency measurement.

We agree with the principles of the proposed method of determining an additional solvency requirement should the Scheme choose to invest in more volatile asset classes. However, using this method to produce an additional solvency requirement is more suitable when there is a base level of assets required to meet a set of liabilities, as is the case with a life insurer. We propose that the chosen method be used to rate down the asset values that can be used to test whether the Scheme is achieving its solvency requirements.

Operational Risk

We support the introduction of capital requirements for Operational Risk relating to governance and overall management of the affairs of the scheme.

We note the comment "Non-payment of claims is a strong indicator of financial strain on the scheme". For the majority of schemes the payment of claims will be done in terms of the Rules of the scheme and non-payment of a claim is more likely to be an interpretation of benefits covered by the scheme rather than the decision not to pay due to the financial condition of the scheme. This type of measurement may negatively impact on schemes that apply appropriate managed care protocols.

Complaints submitted through to CMS will be influenced by a number of different factors. Significant factors include:

- The use of a knowledgeable broker who is willing to assist the member in understanding the Rules of the scheme and whether or not certain benefits should be covered
- The extent to which members will "take a chance" and submit a complaint to the CMS despite having received the correct answer from the scheme
- The complexity of the case - for example a small scheme with a number of rare disease patients may interact with CMS rather than having a formal complaint lodged.

Our view is that complaints in which the CMS has ruled against the scheme should hold the largest weighting in the index.

We also welcome the compliance monitoring aspect of the framework. There is expected to be some lead time until the revised framework is implemented. This will give schemes an opportunity to fully understand the requirements.

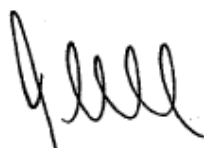
Conclusion

Overall, the proposed framework allows for the key aspects for assessing the overall risk faced by medical schemes. There are more detailed aspects of the framework that we have not addressed in this letter. We would welcome a discussion with the Council for Medical Schemes to discuss these further once the submissions from industry have been considered.

Kind regards



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