



QUANTIFYING RISK, ENABLING OPPORTUNITY

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Medical Scheme Solvency Framework

Overview

Introduction

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Ideal solvency framework

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Proposed Risk Based Capital (RBC) Framework

Progress to date and way forward

Introduction

- Medical Schemes Act no 131 of 1998 (MSA):
 - requires a medical scheme to “*maintain its business in a financially sound condition*”
 - Allows the minister in consultation with the Council to make regulations in relation to “*the nett assets to be held by the scheme*”
 - CMS in its strategic plans for 2015-16 included a requirement to being research into the structure of solvency regime in the MSA
 - As a result we have produced Circular 68 of 2015 and discussion document into the proposed framework
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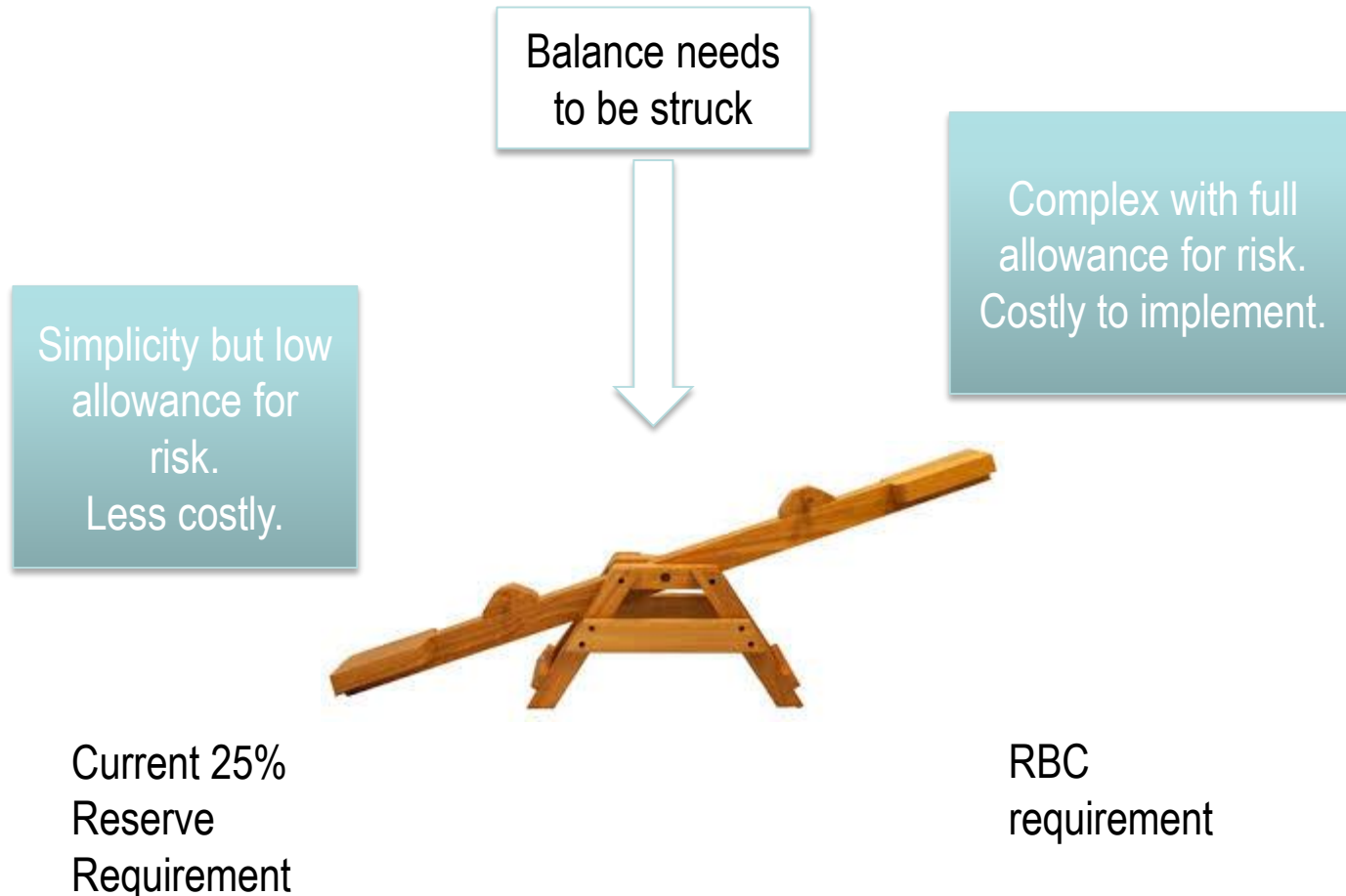
Objectives of Solvency Requirements

- Maintain financial stability
 - I. Ensuring that schemes have enough Capital for them to operate as a going concern – the individual circumstances of the schemes must be considered
 - II. Healthy market competition helps ensure financial stability – solvency requirements should minimize barriers to entry and help ensure fair competition within the market.
- Provide the regulator with early warning signs that a scheme faces potential financial difficulties
 - I. To allow enough time for corrective action to be taken

Objectives of Solvency Requirements

- Alternative approaches to developing a solvency framework
 - Market solutions – self regulation or rating agency approach
 - Minimum capital rules
 - Contribution based solvency - current
 - Claims experience based solvency
 - Risk based capital approach
 - Statutory professional involvement

Ideal Solvency Framework



Ideal Solvency Framework

- Capture the essential risks of schemes to determine appropriate capital
- Simple to implement and monitor – a framework that is uniform across all schemes but still capture the individual circumstances of the scheme.
- Cost effective to both the regulator and the schemes
- Promote the efficient use of capital
- Promote and reward schemes for engaging in good risk control mechanisms
- Complement other regulatory functions

Current Framework

- Schemes need to keep at least 25% of Gross annual contributions as reserves.
- This includes members savings account contributions – in essence do not increase or reduce risk

Current Framework

Pros & Cons

- Pros of current solvency requirement
 - Simplicity
 - 1) calculate
 - 2) communicate
 - 3) Implement & monitor
- Cons of current solvency requirement
 - Takes no account of actual scheme risk
 - Schemes do not get credit for effective risk management
 - Larger schemes have less claims volatility yet they have to hold the same solvency reserves as small schemes

Current Framework

Pros & Cons

- Schemes with different asset mixes have to hold the same solvency reserves
- Schemes underpricing, are required to hold lower reserves
- It's a barrier to entry – makes start up schemes difficult and is contrary to the objective of trying to expand membership base
- Growing schemes have to hold higher reserves while shrinking schemes do not, yet their risks are higher
- Schemes have no source of capital other than member contributions.
 - 25% may be inefficient use of member funds
 - An extra increase in contributions required every year to maintain 25% solvency

RBC Framework

- Should be simple to implement and monitor
- Account for major risks
 - I. Business Risk (day to day capital requirements for a scheme)
 - II. Assets Risk (fall in market values in extreme events)
 - III. Operational Risks (Failures in People, Systems & Processes)
- Investment guidelines to be kept (Annexure B) – will help minimise liquidity risks
- Three year time horizon – avoids a short term view
- Low probability of Ruin: 1 in 100 over a 3 year period

Business Risk

- A model has been developed to determine probability of failure over 3 year horizon
- Risks allowed for include:
 - Moderate fluctuation in asset values
 - Claims volatility risk
 - Pricing risk
 - Non-health care expenditure
- This model gives the minimum capital required such that insolvency occurs at most once in a 100 cases over a three year period.

Asset Risk

- Extreme market events occur very rarely but may have dire consequences
- These are not included in the business risk section
- The proposal is to require capital in line with the riskiness of assets held
- The capital could be the maximum loss in a year for each asset class multiplied by actual asset holding in the specific asset class
- Example values could be:
 - Cash: - default risk can be set at 1 %
 - Bonds: -15%
 - Equities: -36%
- These values are only illustrative (based on returns from 2002)

Operational Risk

- This is very difficult to estimate accurately
 - There are various reasons for failure of schemes and reasons for failure are unique with the few cases been reviewed by CMS
- CMS has a few tools that may shed light on specific schemes' operations
 - Complaints – highlight failures in systems, people & processes
 - Compliance investigations – gives more details on operations of the scheme (unfortunately not carried out for every scheme annually)
 - There is much value in including these when measuring scheme risk – a positive spin off could be influence behavior of schemes

Operational Risk

- How to use this data to set capital against operational risk
 1. Propose to set capital requirements at a band of say, 5% to 15% of annual contributions
 2. Set up an index measuring complaints per 1 000 beneficiaries (may be split into type of complaints)
 3. Develop an index based on compliance reports (after each investigation)
 4. Use these 2 indices to determine capital requirements
 5. Indices should be such that a scheme with low complaints /complies with most of areas investigated then it needs to keep less capital
 6. Credit will be given for positive reports while higher capital will be required for negative & resistance to compliance & investigation

Medical Schemes Compliance

- CMS has introduced a governance and compliance instrument for medical schemes – Circular 16 of 2016
- The GCI will provide CMS greater assurance in this regard by:
 - Completeness & diligence of applied framework
 - Evidence
 - Proficient in usage and outcome
 - Transparency

Medical Schemes Compliance



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2 Demo GCI Scheme-1.GCI.Demo

Directory

IoDSA GAI: Medical Schemes



Category	Question Count
Board composition	1/17
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Remuneration	0/10
Governance office bearers	0/15
Board role and duties	0/83
Accountability	0/52
Board committees	0/4
Performance assessment	0/6

Click here to go to an unanswered question(s) in

"Board composition"

Questionnaire



Ref no: 33-966-6916

Procedures for appointments to the board of trustees are all of the following:

- formally set out in a policy;
- transparent; and
- a matter for the board as a whole (although the board of trustees may be assisted by a nomination committee).

☒ Yes ☐ No ☐ Needs improvement ☐ Explained

Comment for internal use:

Comment for Reporting:



Medical Schemes Compliance

Dashboard View: IoDSA GAI: Medical Schemes

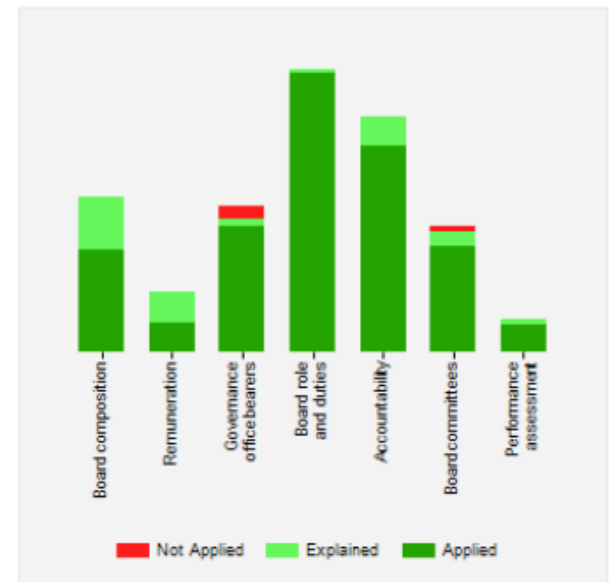
Overall Score

AA

Application Meter

Status	Category	Score
●	Board composition	AA
●	Remuneration	AA
●	Governance office bearers	AA
●	Board role and duties	AAA
●	Accountability	AAA
●	Board committees	BB
●	Performance assessment	AAA

Weighting Graphic



Completeness Meter



Scoring Key

AAA - Highest Application	AA - High Application
BB - Notable Application	B - Moderate Application
C - Application to be Improved	L - Low Application

RBC Framework

Pros & Cons

Pros of RBC

- Is relevant to risks of the scheme
- Prospective (forward looking through the use of models for future projections)
- Encourages more efficient use of capital
- In line with solvency frameworks being used in rest of the world

Cons of RBC

- Not as simple as current 25%
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RBC Framework

Pros & Cons

Cons of RBC

- Implementation may be difficult due to market considerations – maintaining the required competition among schemes
- Barriers to entry may exist if transition not properly managed

Effect of Proposed framework

1. Number of schemes expected to fail to meet minimum capital requirements falls from 9 to 7 (Using position at 31 December 2013)
2. Some of the nine under supervision drop from the list while some not being supervised will need supervision – this is due to individual risks considered as well as the early warning detection
3. Significant reserves freed up – may be used to members benefit
4. Schemes would be more concerned about risk management

Considerations on transitional arrangements

- Due to the nature of the proposals and alternatives the Council will need to adopt a transitional approach to implementing the RBC
- This can only be considered once a version of the RBC has been developed in consultation with the industry and the NDoH
- Phased in approach or shadow RBC could be considered as was done for REF

Progress to date and way forward

- Develop a potential RBC proposal for comment and input
- Publish proposal inviting comments – Circular 68 of 2015 and Circular 19 of 2016
 1. Is there need to change framework?
 2. Comparison between the two and other alternatives – Scott and Lowe
 3. Transitional arrangements to be considered
- Comments should address issues raised in discussion document – deadline 20 May 2016
- Prepare discussion document and summary of comments and submit to Council review

Questions??