

Highlights of the Discovery Health Medical Scheme's financial results for 2010



Please notify the Principal Officer of any motions.

The 17th Annual General Meeting of the Discovery Health Medical Scheme will be held soon.
Here are the details if you would like to attend:
Date: 23 June 2011
Time: 10:00
Venue: Multi-purpose Room B, Ground Floor, 16 Fredman Drive, Sandton
This invitation serves as the official notice of the event.

The rules of the Discovery Health Medical Scheme require attendees to notify the Principal Officer of any motions for discussion at least seven days before the date of the meeting. Send your email to principalofficer@discovery.co.za or post your motion to PO Box 786722, Sandton, 2146.

Agenda for the meeting

1. Welcome and quorum
2. Confirmation of the minutes of the 2010 Annual General Meeting (for the year ended 31 December 2009)
3. Tabling of the annual financial statements
4. Acceptance of the annual financial statements
5. Governance
 - 5.1 Appointment of Auditors
6. General

The 2010 Audited Annual Financial Statements, the Trustees' report and 2009 minutes will be available on our website www.discovery.co.za from 3 May 2011 as well as at the following Discovery offices on 3 May 2011:

Johannesburg

Discovery Health
16 Fredman Drive
Sandton

Pretoria

Discovery Health
Corner of Oak and Tegel
Avenues
Highveld Techno Park
Centurion

Cape Town

Discovery Health
Century City Boulevard
Century City
Milnerton

Durban

41 Imvubupark Place
Riverhorse Valley Business Estate
Durban

Key financial and service metrics

	2010	2009
Members' funds	R 6,8 billion	R 6,1 billion
Solvency ratio	24.66%	25.45%
Membership (lives)	2,24 million	2,04 million
Gross contribution income	R 27,65 billion	R 23,84 billion
Risk contribution income	R 22,12 billion	R 19,05 billion
Average net contributions per member per month	R 1,876	R 1,777
Average net claims per member per month	R 1,527	R 1,423
Average accumulated funds per member at year end	R 6,970	R 6,795
Average return on investments as a percentage of investments	7.49%	9.57%
Number of hospital events	506,434	479,337

Principal Officer's report

The Discovery Health Medical Scheme achieved solid financial performance during the 2010 financial year. The Scheme had an exceptionally strong membership growth rate, growing total membership by 15.97%. The rate of members leaving the Scheme was also exceptionally low at 4.2%. These are remarkable performances, considering that this was off an already high base, and that this occurred during a period of significant economic challenge for employers and individuals. We attribute this excellent growth rate to the clear perception in the market that the Discovery Health Medical Scheme is efficient, well governed, and financially strong and stable, and that it will provide a solid and secure health insurance home for members, in contrast to many other schemes which have shown significant financial and governance weaknesses in recent years, leaving hundreds of thousands of members vulnerable. Overall, the Scheme added 101 839 new members, and ended the year with 2 245 million lives, resulting in a 48% share of the open medical schemes market, and a 38% share of the total medical schemes market.

The scale and financial strength of the Discovery Health Medical Scheme allowed for major benefit improvements for members during the 2010 financial year, focusing on removing gaps in cover that members may have experienced in the past. The Discovery Health Medical Scheme's contribution increase of 9.8% for 2010 was one of the lowest in the industry, and was within the guideline of the Council for Medical Schemes.

The higher than expected membership growth experienced during the 2010 financial year had a slight negative impact on the solvency ratio of the Discovery Health Medical Scheme. The required statutory solvency ratio, in terms of the Medical Schemes Act, is 25% of annual contribution income and the Discovery Health Medical Scheme ended the 2010 financial year with a solvency ratio of 24.7%, slightly lower than the required level. This is due to the fact that when members join the Scheme, the Scheme is immediately required to hold 25% of their gross annual contribution income in reserves, although members do not bring these reserves with them when they join. Growing schemes therefore always experience temporary downward pressure on their solvency margins. However, the Board of Trustees of the Discovery Health Medical Scheme is convinced that this ongoing pattern of strong growth in membership is unequivocally positive for Scheme members. Not only does this increase the size and hence stability of the Scheme, but also each year the average age of new joiners is lower than that of the existing Scheme members, thus improving the overall risk profile of the Scheme. The Global Credit Rating has reaffirmed the Discovery Health Medical Scheme's credit rating (AA+), the highest possible for a medical scheme in South Africa. This rating supports the financial strength and scale of the Discovery Health Medical Scheme in the private healthcare industry.

The Discovery Health Medical Scheme's annual budget is based on a break-even scenario and it has achieved this result for the financial year under review. With net investment income of R615 million, the net surplus of the Scheme for the 2010 period is R594 million. Non-healthcare expenses

have been managed prudently and are decreasing year-on-year, measured as a percentage of total annual contribution income. The Scheme values the efficiencies that its administrator, Discovery Health (Pty) Ltd, is effecting on an annual basis, resulting in lower delivery costs, while continuing to improve service levels and additional services for Discovery Health members.

The Discovery Health operating model plays an important role in the financial performance, competitive advantage and sustainability of the Scheme. Product and service innovation are core focus areas of this model which ensures continuous service improvement and sustainable, cost-effective and quality healthcare delivery for our members. Discovery Health (Pty) Ltd has invested extensively in building healthcare systems, skills, expertise and relationships to enhance the healthcare system for our membership. This strategy is dynamic and recognises healthcare professionals as key partners in developing sustainable healthcare delivery strategies for the Discovery Health Medical Scheme.

The Discovery Health Medical Scheme continues its commitment to provide exceptional value to its members through strong stakeholder alliances and constructive supplier partnerships. The partnership with Vitality, for example, is yielding very encouraging results for members and the Scheme through access to wellness and lifestyle benefits, which further contain healthcare costs. In this context, there is growing scientific evidence to demonstrate that active participation in the Vitality programme reduces the rate of hospital admissions, reduces long-term healthcare costs, and reduces mortality rates, relative to non-Vitality members.

The Discovery Health Medical Scheme will focus on contribution and benefit stability as well as enhancing the quality of care for our members as key future strategic objectives. The Discovery Health Medical Scheme Board of Trustees, through its best practice governance commitment, and Discovery Health (Pty) Ltd, supporting the Scheme through its innovation, skills and expertise, will navigate the complex private healthcare system optimally, to ensure continuous value for members.

Milton Streak

Milton Streak

Extracts from the Annual Financial Statements

STATEMENT OF FINANCIAL POSITION as at 31 December 2010

	2010 R'000	2009 R'000
ASSETS		
Current assets	9,791,908	8,597,933
Financial assets at fair value through profit or loss	7,383,719	6,645,016
Derivative financial instruments	15	-
Trade and other receivables	1,135,271	828,861
Cash and cash equivalents	1,272,903	1,124,056
Total assets	9,791,908	8,597,933
FUNDS AND LIABILITIES		
Members' funds	6,847,076	6,070,680
Accumulated funds	6,847,076	6,070,680
Non-current liabilities	-	334
Members' trust funds	-	334
Current liabilities	2,944,832	2,526,919
Outstanding claims provision	560,597	473,512
Members' savings accounts	1,718,442	1,544,102
Trade and other payables	665,443	508,969
Members' trust funds	350	336
Total funds and liabilities	9,791,908	8,597,933

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2010

	2010 R'000	2009 R'000
NET CONTRIBUTION INCOME	22,121,964	19,053,756
Net claims incurred	(17,999,084)	(15,259,820)
Claims incurred	(18,089,129)	(15,298,448)
Third party claim recoveries	90,045	38,628
Net (expense)/income on risk transfer arrangements	48,924	(360)
Risk transfer arrangement fees	(169,965)	(95,022)
Recoveries from risk transfer arrangements	218,889	94,662
Relevant healthcare expenditure	(17,950,160)	(15,260,180)
Gross healthcare result	4,171,804	3,793,576
Managed care: management services	(787,872)	(565,273)
Broker service fees	(633,601)	(538,275)
Expenses for administration	(2,666,663)	(2,451,633)
Other operating expenses	(108,561)	(143,547)
Net healthcare result	(24,893)	94,848
Investment income	615,406	700,125
Net fair value gains on financial assets at fair value through profit or loss	22,837	17,830
Sundry income	9,020	11,345
Other income	647,263	729,300
Expenses for asset management services rendered	(8,469)	(8,421)
Interest paid	(19,829)	(24,895)
Other expenditure	(28,298)	(33,316)
Net surplus for the year	594,072	790,832
Other comprehensive income	-	-
Total comprehensive income for the year	594,072	790,832

STATEMENT OF CHANGES IN FUNDS AND RESERVES

for the year ended 31 December 2010

	2010 R'000	2009 R'000
	Accumulated funds	Accumulated funds
Balance at beginning of the year	6,070,680	5,279,848
Total comprehensive income for the year	594,072	790,832
Reserves transferred from other medical schemes	182,324	-
Balance at end of the year	6,847,076	6,070,680

STATEMENT OF CASH FLOWS

for the year ended 31 December 2010

	2010 R'000	2009 R'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash flows from operations before working capital changes	13,151	139,278
Working capital changes		
Increase in trade and other receivables	(344,194)	(55,401)
Increase/(decrease) in outstanding claims provision	87,085	(36,924)
Increase in members' savings accounts	174,340	113,358
Increase in trade and other payables	156,474	62,481
Cash generated by operations	86,856	222,792
Purchases of financial assets	(6,190,385)	(1,178,095)
Proceeds from sale of financial instruments	5,474,504	312,649
Interest received	609,240	697,039
Dividend income	6,457	3,413
Interest paid	(19,829)	(24,895)
Net cash flows from operating activities	(33,157)	32,903
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments out of members' trust funds	(320)	(278)
Reserves transferred from other medical schemes	182,324	-
Net cash flows from financing activities	182,004	(278)
NET INCREASE IN CASH AND CASH EQUIVALENTS	148,847	32,626
Cash and cash equivalents at beginning of year	1,124,056	1,091,431
CASH AND CASH EQUIVALENTS AT END OF YEAR	1,272,903	1,124,056

CASH FLOWS FROM OPERATIONS BEFORE WORKING CAPITAL CHANGES

Net surplus for the year	594,072	790,832
Adjustments for:		
Impairment losses	37,784	41,833
Interest received	(609,240)	(697,039)
Dividend income	(6,457)	(3,413)
Interest paid	19,829	24,895
Net (gains) / losses on financial assets at fair value through profit or loss	(22,837)	(17,830)
	13,151	139,278

Matters of non-compliance

for the year ended 31 December 2010

During the year the Scheme did not comply with the following:

Statutory Scheme Solvency

In terms of Regulation 29 (2) to the Medical Schemes Act 131 of 1998, as amended, the Scheme must maintain accumulated funds expressed as a percentage of gross annual contributions for the accounting period under review which may be no less than 25%.

At 31 December 2010, the Scheme's accumulated funds expressed as a percentage of gross annual contributions was 24.66% which is less than the statutory requirement of 25% and the Scheme has advised the Council for Medical Schemes.

The Scheme is in the process of planning and implementing a comprehensive risk management strategy for all benefit options in order to improve the Scheme's solvency position during 2011.

Sustainability of benefit options

Section 33 (2) of the Medical Schemes Act 131 of 1998, as amended, stipulates that each option shall be self-supporting in terms of membership and financial performance and be financially sound. At 31 December 2010 the following options did not comply with Section 33 (2):

Option	Net underwriting deficit R'000	Net (deficit)/surplus R'000
Executive	(249,031)	(241,529)
Classic Comprehensive	(633,273)	(511,038)
Coastal Saver	(9,182)	80,172
KeyCare Plus	(286,034)	(186,340)

The Trustees continue to monitor these options with a view of improving their sustainability. At the same time, it should be pointed out that it is a structural reality of all open medical schemes that the higher options are loss making. This is the simple result of the medical scheme environment that allows sicker members of the scheme to upgrade to higher options at the beginning of the benefit year, with no underwriting applied. As it almost always makes sense for sicker members to upgrade (since claims from the scheme will more than make up for higher contributions), all open schemes face a situation in which their top-end plans have a majority of sicker members, resulting in overall negative loss ratios. While the Trustees are committed to complying wherever possible with the applicable legislation, we also focus intensively on the overall stability and financial position of the Scheme as a whole and not only on individual benefit options.

Investments in employer groups

Section 35(8) (a) of the Medical Schemes Act 131 of 1998, as amended, states that a medical scheme shall not invest any of its assets in the business of an employer who participates in the Scheme or any administrator or any arrangement associated with a medical scheme. Due to the large number of the Scheme's employers being listed on the JSE, investments were made in certain of its employers listed on the JSE. The Council for Medical Schemes has granted the Scheme an exemption from this section of the Medical Schemes Act.

Contributions received after due date

Section 26(7) of the Medical Schemes Act 131 of 1998, as amended, states that all subscriptions or contributions shall be paid directly to a medical scheme not later than three days after payment thereof becoming due. There are instances where the Scheme received contributions after three days of becoming due. However, there are no contracts in place agreeing to this arrangement. The procedures that the Scheme follows regarding these contributions are set out in Note 31 to the annual financial statements.

Ring-fenced reserves

Regulation 4(4) to the Medical Schemes Act 131 of 1998, as amended, prohibits ring-fencing. The funds transferred from the CNA Gallo Medical Scheme (Note 5) meets the definition of ring-fencing. The Scheme has submitted a request for exemption from this regulation to the Council for Medical Schemes.

Broker fees paid before contributions are received

In terms of Regulation 28(5) to the Medical Schemes Act 131 of 1998, as amended, the Scheme broker fees shall be paid on a monthly basis and upon receipt by the Scheme of the relevant monthly contribution. In some instances brokers were compensated before receipt of the relevant monthly contribution. The Scheme has implemented additional controls to address this matter, and continues to monitor instances where this requirement is contravened.