

Highlights of the Discovery Health Medical Scheme's financial results for 2011

The 18th Annual General Meeting of the members of the Discovery Health Medical Scheme will be held soon.

Here are the details if you would like to attend:

Date: 21 June 2012

Time: 10:00

Venue: Auditorium, 155 West Street, Sandton

This invitation serves as the official notice of the event.

Please notify the Principal Officer of any motions:

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. Email to principalofficer@discovery.co.za or post to PO Box 786722, Sandton, 2146 or deliver to 16 Fredman Drive, Sandton, 2146.

Agenda for the meeting

1. Welcome and quorum
2. Confirmation of the minutes of the 2011 Annual General Meeting (for the year ended 31 December 2010)
3. Tabling of the Annual Financial Statements
4. Acceptance of the Annual Financial Statements
5. Governance
 - 5.1. Appointment of Auditors
 - 5.2. Ratification of Trustee appointment
6. Scheme Amalgamations
7. General

The 2011 Annual Report, including the audited Annual Financial Statements and the Trustees' report, as well as the minutes of the previous AGM (for the year ended 2010) are available on the Discovery website (www.discovery.co.za) as well as at the following Discovery offices on 21 May 2012:

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

Discovery Health
41 Invubupark Place
Riverhorse Valley
Business Estate
Durban

Port Elizabeth

Discovery Health
BPO Building
Coega IDZ
Zone 4

Key Financial and Service Metrics

	2011	2010
Members' funds	R 7,4 billion	R 6,8 billion
Solvency ratio	23.50%	24.66%
Membership (lives)	2,35 million	2,24 million
Gross contribution income	R 31,19 billion	R 27,65 billion
Risk contribution income	R24,97 billion	R 22,12 billion
Average net contributions per member per month (pmpm)	R 1,985	R 1,876
Average net claims per member per month (pmpm)	R 1,640	R 1,527
Average accumulated funds per member at year end	R 6,896	R 6,970
Average return on investments as a percentage of investments	6.31%	7.49%
Number of hospital admissions	547,705	506,434

Principal Officer's Report

The 2011 financial year was a complex and challenging one, characterised by continuous economic uncertainty, escalating healthcare costs, and considerable public debate around healthcare issues. The Discovery Health Medical Scheme nonetheless achieved strong financial performance over the period. The Scheme's gross contribution income was higher than expected at R31,19 billion, with a net surplus of R570 million. The Scheme had another period of exceptionally strong membership growth, increasing total membership by 5.9% off an already high base. In total, 109,457 new members joined the Scheme, which ended the year with 2,354,351 million lives covered. The Scheme now has a 50% share in the open medical schemes market, enhancing its position as the largest open medical scheme in South Africa.

Non-healthcare expenses continue to reduce as a percentage of total annual premium income and when considering the drivers of medical inflation over the past five years, administration expenditure is the only component of the Scheme's expenditure which has been reducing consistently in real terms. While medical inflation has averaged 10.5%, administration fees have had a deflationary effect of 4% for the past five years.

The significant membership growth of the Discovery Health Medical Scheme continues to put pressure on Scheme solvency, which is regulated at 25% of gross annual contribution income. Statutory solvency declined 1.16% to 23.5%. A business plan detailing the timeline over which the Scheme will increase solvency to 25% has been approved by the Council for Medical Schemes. The value of Scheme reserves has increased to R7,4 billion, which is significant and indicative of the financial strength of the Discovery Health Medical Scheme.

During the 2011 financial year, the Discovery Health Medical Scheme continued its efforts to rebalance benefit structures to eliminate waste and abuse, and to increase benefits in areas of critical care. This process led to public debate around the restructuring of the Allied and Therapeutic Benefit. However, the Scheme views it necessary to redirect spend towards coverage where the need is the highest. The Discovery Health Medical Scheme benefits are comparable to the best private health systems in the world, and provide access to superior quality healthcare. The Scheme's contribution increase of 8.9% for 2012 was one of the lowest in the industry, and within the guidelines set by the Council for Medical Schemes.

In addition to the strong growth achieved by the Scheme during 2011, the number of members leaving the Scheme (the lapse rate) reduced to 4.3% during the calendar year. This lapse rate is among the lowest in the industry. 98% of members opted to remain with their current benefit plans or bought up to higher benefit plans. This is indicative of a remarkably stable and sustainable system. Also supporting the strength and scale of the Scheme in the private healthcare industry is the AA+ credit rating of the Scheme by Global Credit Ratings Co – the highest possible rating for a medical scheme in South Africa.

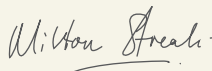
The unique Discovery Health (Pty) Ltd operating model continues to ensure the competitive advantage of the Scheme in the private medical scheme

industry. The strong focus of Discovery Health (Pty) Ltd on product and service innovation has ensured continuous service improvement and has enabled the Scheme to manage care and costs effectively, minimise abuse and fund the best quality healthcare for members. The scale of the operations of Discovery Health (Pty) Ltd is substantial, with over 200,000 member interactions a day, and claims volumes of 3,7 million a month. Independent industry surveys have verified that the services provided by Discovery Health (Pty) Ltd are among the most highly rated in the industry.

Using its world-class risk management capabilities and provider partnerships, Discovery Health (Pty) Ltd has built a number of important healthcare provider assets within the healthcare system. This robust approach to health risk management, and the assets deployed in the healthcare system, have brought down the cost of healthcare for both Scheme members and the industry, contributing to the continued sustainability of the Scheme.

The Discovery Health Medical Scheme remains acutely aware of its fundamental role in building a sustainable healthcare system, not only for its members, but for all South Africans. In this regard, the primary strategy of the Scheme and Discovery Health (Pty) Ltd has been to use the Scheme's scale and expertise to introduce a range of technological and service innovations aimed at improving the quality and efficiency of the healthcare system for the benefit of both its members and healthcare professionals.

Going forward, the Discovery Health Medical Scheme will focus on providing Scheme members with continued healthcare value, ensuring that all stakeholder needs are balanced in a responsible fashion and that innovation in the delivery of healthcare remains a key strategic imperative. The Discovery Health Medical Scheme Board of Trustees and the Administrator, Discovery Health (Pty) Ltd, will continue to navigate the complex private healthcare system to ensure the continued provision of exceptional value for members.



Milton Streak

Extracts from the Annual Financial Statements

STATEMENT OF FINANCIAL POSITION

as at 31 December 2011

	2011 R'000	2010 R'000
ASSETS		
<i>Current assets</i>	10,580,460	9,791,908
Financial assets at fair value through profit or loss	8,012,078	7,383,719
Derivative financial instruments	23,424	15
Trade and other receivables	1,318,307	1,135,271
Cash and cash equivalents	1,226,651	1,272,903
Total assets	10,580,460	9,791,908
FUNDS AND LIABILITIES		
<i>Members' funds</i>	7,419,231	6,847,076
Accumulated funds	7,419,231	6,847,076
<i>Current liabilities</i>	3,161,229	2,944,832
Outstanding claims provision	567,845	560,597
Derivative financial instruments	2,218	-
Members' savings accounts	1,930,591	1,718,442
Trade and other payables	660,564	665,443
Members' trust funds	11	350
Total funds and liabilities	10,580,460	9,791,908

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2011

	2011 R'000	2010 R'000
Net contribution income	24,972,943	22,121,964
Net claims incurred	(20,651,339)	(17,999,084)
Claims incurred	(20,777,150)	(18,089,129)
Third party claim recoveries	125,811	90,045
Net (expense)/income on risk transfer arrangements	142,036	48,924
Risk transfer arrangement fees	(229,132)	(169,965)
Recoveries from risk transfer arrangements	371,168	218,889
Relevant healthcare expenditure	(20,509,303)	(17,950,160)
Gross healthcare result	4,463,640	4,171,804
Managed care: management services	(882,883)	(787,872)
Broker service fees	(688,812)	(633,601)
Expenses for administration	(2,863,572)	(2,666,663)
Other operating expenses	(105,973)	(108,561)
Net healthcare result	(77,600)	(24,893)
Investment income	565,296	615,406
Net fair value gains/(losses) on financial assets at fair value through profit or loss	109,248	22,837
Sundry income	4,930	9,020
Other income	679,474	647,263
Expenses for asset management services rendered	(11,956)	(8,469)
Interest paid	(19,508)	(19,829)
Other expenditure	(31,464)	(28,298)
Net surplus for the year	570,410	594,072
Other comprehensive income	-	-
Total comprehensive income for the year	570,410	594,072

STATEMENT OF CHANGES IN FUNDS AND RESERVES

for the year ended 31 December 2011

	2011 R'000	2010 R'000
	Accumulated funds	Accumulated funds
Balance at beginning of the year	6,847,076	6,070,680
Total comprehensive income for the year	570,410	594,072
Reserves transferred from other medical schemes	1,745	182,324
Balance at end of the year	7,419,231	6,847,076

STATEMENT OF CASH FLOWS

for the year ended 31 December 2011

	2011 R'000	2010 R'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash flows from operations before working capital changes	(47,125)	13,151
Working capital changes		
Increase in trade and other receivables	(220,563)	(344,194)
Increase in outstanding claims provision	7,248	87,085
Increase in members' savings accounts	212,149	174,340
(Decrease)/increase in trade and other payables	(4,878)	156,474
Cash (utilised)/generated by operations	(53,169)	86,856
Purchases of financial instruments	(2,032,830)	(6,190,385)
Proceeds from sale of financial instruments	1,492,527	5,474,504
Interest received	554,426	609,240
Dividend income	10,896	6,457
Interest paid	(19,508)	(19,829)
Net cash flows from operating activities	(47,658)	(33,157)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments out of members' trust funds	(339)	(320)
Reserves transferred from other medical schemes	1,745	182,324
Net cash flows from financing activities	1,406	182,004
NET INCREASE IN CASH AND CASH EQUIVALENTS	(46,252)	148,847
Cash and cash equivalents at beginning of year	1,272,903	1,124,056
CASH AND CASH EQUIVALENTS AT END OF YEAR	1,226,651	1,272,903

CASH FLOWS FROM OPERATIONS BEFORE WORKING CAPITAL CHANGES

Net surplus for the year	570,410	594,072
Adjustments for:		
Impairment losses	37,527	37,784
Interest received	(554,426)	(609,240)
Dividend income	(10,896)	(6,457)
Interest paid	19,508	19,829
Net losses on financial assets at fair value through profit or loss	(109,248)	(22,837)
	(47,125)	13,151

Matters of non-compliance

for the year ended 31 December 2011

During the year the Scheme did not comply with the following sections and regulations of the Medical Schemes Act, No 131 of 1998, as amended:

Statutory Scheme Solvency

In terms of Regulation 29(2) 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 2011, the Scheme's accumulated funds expressed as a percentage of gross annual contributions was 23.5% (2010: 24.66%), which is less than the statutory requirement of 25%. The Scheme advised the Council for Medical Schemes during 2011 that one of the main reasons for this remains continuous high membership growth.

The Scheme has submitted a business plan to the Council for Medical Schemes in terms of Regulation 29(4) of the Medical Schemes Act, No 131 of 1998, as amended. The business plan provides that the Scheme will increase the statutory reserves to the required level of 25% by 31 December 2015. The business plan takes into account several assumptions such as membership growth, investment returns and medical inflation. The Council for Medical Schemes has approved the business plan.

Sustainability of benefit plans

In terms of Section 33(2) of the Medical Schemes Act, No 131 of 1998, as amended, each plan is required to be self-supporting in terms of membership and financial performance and be financially sound.

At 31 December 2011 the following plans did not comply with Section 33(2):

Plan	Net underwriting deficit R'000	Net (deficit)/surplus R'000
Executive	(274,569)	(266,874)
Classic Comprehensive	(714,328)	(592,862)
Foundation Core	(2,364)	(1,896)
Coastal Saver	(23,930)	69,085
KeyCare Plus	(354,238)	(240,338)

The Trustees continue to monitor these plans with a view to improving their financial outcomes, and will evaluate different strategies to address the deficits in these plans. The different financial positions reflect the different disease burdens in each plan, among many other factors, and are due in large measure to the continued pattern of sicker members of the Scheme buying up to higher plans when they develop a serious illness. This is reflected in the much higher disease burden and risk profile of the top plans relative to the rest of the Scheme. The Scheme's strategy on the sustainability of plans has to balance short- and long-term financial considerations with considerations of fairness to both healthy and sick members, and with continued affordability of cover for members with different levels of income and different healthcare needs. 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 plans.

Investments in employer groups

Section 35(8)(a) of the Medical Schemes Act, No 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 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, No 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) of the Medical Schemes Act, No 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. The balance remaining in these reserves at year end was R10,887 and will be fully utilised during the first half of 2012.

Broker fees paid before contributions are received

In terms of Regulation 28(5) to the Medical Schemes Act, No 131 of 1998, as amended, the Scheme broker fees must be paid monthly and on receipt by the Scheme of the relevant monthly contribution. In some instances brokers were compensated prior to receipt of the relevant monthly contribution. The Scheme has implemented additional controls to address this matter and continues to monitor the resulting instances where this requirement was contravened.