



## GCR affirms DHMS's national scale financial strength rating of AAA<sub>(ZA)</sub> on sustained credit profile strength; Outlook Stable

### Rating action

Johannesburg, 16 April 2021 - GCR Ratings ("GCR") has affirmed Discovery Health Medical Scheme's ("DHMS") national scale financial strength rating of AAA<sub>(ZA)</sub>, with a Stable Outlook.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Discovery Health Medical Scheme	Financial strength	National	AAA <sub>(ZA)</sub>	Stable Outlook

### Rating rationale

DHMS's national scale financial strength rating reflects the scheme's sustained credit profile strength, supported by a large membership base and strong financial profile. The scheme's membership profile remained robust, despite the slight contraction in the membership base, in line with the industry, due to economic challenges. Positively, net healthcare results and net surpluses increased substantially, resulting in reserve accumulation beyond statutory compliance requirements. In this respect, the scheme's credit profile exhibits increased buffers within the current rating range, supporting the Stable Outlook.

DHMS registered strengthened earnings following low claims frequency in FY20, which supported a review period peak net healthcare surplus of R7.5bn (FY19: R136m). Furthermore, sound investment income of R1.3bn (FY19: R1.4bn) increased the net surplus to R9.0bn in FY20 (FY19: R1.6bn). We view the review year earnings uplift as a temporary positive impact from low benefit utilisation due to the Covid-19 pandemic, with a possible gradual normalisation in claiming trends projected over the medium term. This, combined with a low average contribution increase, is expected to result in a reversion of earnings margins to historical trends over the outlook period.

The robust net surplus resulted in increased reserve accumulation surpassing growth in the contribution base. As such, the statutory solvency margin spiked to 37% at FY20 (FY19: 28%). Given accumulated reserve buffers, the scheme's solvency is likely to tolerate potential moderation due to expected earnings reduction from higher claims and operating expenses. As a result, the reserve buffer is expected to maintain solvency comfortably above the statutory minimum over the rating horizon.

Liquidity strengthened, driven by strong operating cash flows generated in FY20. In this respect, cash and stressed financial assets coverage of average monthly claims and operational cash coverage registered at 6 months and 1.1x at FY20 (FY19: 4 months and 0.9x) respectively. However, GCR expects liquidity levels to normalise due to higher operational cash flow requirements in FY21.

DHMS's membership profile is viewed to be very strong, underpinned by a large membership base and a favourable age profile. Furthermore, the scheme has a good spread of members across provinces and high granularity, with the largest corporate accounting for 0.7% of scheme members whilst the largest broker accounts for 8%. Going forward, the membership profile is expected to remain positive to the rating, supported by continued growth initiatives.

### Outlook statement

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The Stable Outlook reflects expectations that DHMS's solvency and liquidity will be maintained within strong levels, given the currently high surpluses, which are expected to absorb an expected increase in the claims experience. The membership profile is expected to be unchanged over the outlook horizon, with continued growth initiatives likely to partly counterbalance economic challenges.

### Rating triggers

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The national scale financial strength rating is at its ceiling. Downward rating action may arise from sustained earnings strain and/or a weakening in membership profile below expectations over the longer term, given that the rating has sufficient buffers to tolerate short term risks at current levels.

### Analytical contacts

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<b>Primary analyst</b>	Linda Matavire	Analyst: Insurance Ratings
Johannesburg, ZA	LindaM@GCRratings.com	+27 11 784 1771
<b>Committee chair</b>	Godfrey Chingono	Deputy Sector Head: Insurance Ratings
Johannesburg, ZA	GodfreyC@GCRratings.com	+27 11 784 1771

### Related criteria and research

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Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Insurance Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, March 2021
GCR South Africa Medical Scheme Sector Risk Score, July 2020

### Ratings history

#### Discovery Health Medical Scheme

Rating class	Review	Rating scale	Rating class	Outlook/Watch	Date
Claims paying ability	Initial	National	AA <sub>(ZA)</sub>	Stable Outlook	April 2000
Financial strength	Last	National	AAA <sub>(ZA)</sub>	Stable Outlook	August 2020

### Risk score summary

Rating components & factors	Risk scores
<b>Operating environment</b>	<b>14.75</b>
Country risk score	7.00
Sector risk score	7.75
<b>Business profile</b>	<b>2.50</b>
Membership profile	2.50
Management and governance	0.00
<b>Financial profile</b>	<b>3.50</b>
Earnings	0.75
Capitalisation	2.00
Liquidity	0.75
<b>Comparative profile</b>	<b>0.00</b>
Peer analysis	0.00
<b>Total score</b>	<b>20.75</b>

### Glossary

Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Reserves	A portion of funds allocated for an eventuality.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Security	One of various instruments used in the capital market to raise funds.
Senior	A security that has a higher repayment priority than junior securities.
Solvency	With regard to insurers, having sufficient assets (capital, surplus, reserves) and being able to satisfy financial requirements (investments, annual reports, examinations) to be eligible to transact insurance business and meet liabilities.
Spread	The interest rate that is paid in addition to the reference rate for debt securities.
Statutory	Required by or having to do with law or statute.
Systematic Risk	Risk attributed to market factors that cannot be eliminated through diversification.

## **SALIENT POINTS OF ACCORDED RATING**

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the rating is based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such rating is an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit rating has been disclosed to the rated party. The rating was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating. The rated entity participated in the rating process via virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has



been independently verified where possible.

The information received from the entity and other reliable third parties to accord the credit rating included:

- Audited financial statements to 31 December 2020;
- Four years of comparative audited financial statements to 31 December;
- Full year budgeted financial statements to 31 December 2021;
- Unaudited management accounts to 28 February 2021;
- Other relevant documents