

CREDIT RATING ANNOUNCEMENT

GCR affirms Fedhealth's national scale financial strength rating of AA-(ZA); Outlook Stable

Rating action

Johannesburg, 28 June 2023 – GCR Ratings ("GCR") has affirmed Fedhealth Medical Scheme's ("Fedhealth") national scale financial strength rating of AA-(ZA), with a Stable Outlook

Rated entity	Rating class	Rating scale	Rating	Outlook / Watch
Fedhealth Medical Scheme	Financial strength	National	AA-(ZA)	Stable Outlook

Rating rationale

The rating of Fedhealth medical scheme reflects a strong financial profile, supported by sound capitalisation and liquidity. These strengths are offset by a moderation in earnings within an intermediate range, due to limited contribution increases for the purposes of reserve utilisation, and pressures on the business profile arising from economic pressures and structural changes to the scheme.

Capitalisation remained strong with the GCR capital adequacy ratio and statutory solvency measuring at 1.78x and 43.4% (2021: 1.8x and 42.8%) respectively. GCR expects capitalisation to remain credit positive, albeit likely to moderate to the 37%-40% range over the next 12 months as Fedhealth aims to balance high reserves with option affordability.

The scheme's liquidity is sound, with the gross claims cash coverage ratio at 6.0 months in 2022 (2021: 5.7 months) while operational cash coverage registered at 1.0x (2021: 0.9x). The scheme's investment portfolio remains conservative but with good investment yield at 10.2% in 2022 (2021:15.9%) being comparatively higher than peers. GCR expects the scheme's liquidity to remain at similar levels in the next 12 months.

Earnings remained under pressure in 2022 as the scheme deferred contribution increases to the first quarter with the effective contribution increase for the year registering at 5.5%, which was lower than peers. The claims experience was also fairly higher than the pre-covid average at 94.6% (pre-covid average 92.0%). Consequently, despite fairly good investment performance, the scheme recorded a net deficit of R59.7m (2021: R104.6m). GCR expects the claims ratio to stabilise in the 92%-94% range, translating to net deficits over the short term as the scheme continues to manage solvency towards a lower targeted band.

The business profile remained under pressure in terms of membership growth with the average membership contracting by 8.2% in 2022 (2021: 6.8%) partly because of the economic strain affecting affordability and challenges with attracting new younger members on the backdrop of competition from cheaper medical insurance products. Consequently, the scheme's share of the open industry membership base reduced to

2.9% at 2022 (2021: 3.1%). The age profile however remained constant as terminating members were mostly older than the new members with the overall beneficiary age remaining at 42.3 years in 2022 while the pensioner ratio was 20.7% (2021: 20.4%). Fedhealth aims to implement new marketing initiatives to boost growth, focusing on younger membership as well as fostering strategic partnerships with employer groups, as this is an important driver of the scheme's longer-term credit profile.

Outlook statement

The Stable Outlook reflects expectations that capitalisation and liquidity will be maintained at strong levels over the next 12 to 18 months as accumulated reserves are viewed to be sufficient to tolerate earnings pressure. We do not expect the business profile to change materially over the outlook horizon, although there is some risk of further reductions in members.

Rating triggers

Upward rating movement is unlikely, although material and sustained earnings strength supporting a solvency of above 50% as well as strong liquidity could lead to an upgrade over the longer term. Downward rating action could follow material deterioration in membership, coupled with a sustained deterioration in earnings, resulting in solvency and/or liquidity moderation beyond expectations.

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Insurance Companies, July 2022
GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, May 2023
GCR South Africa Medical Schemes Sector Risk Score, September 2022

Ratings history

Fedhealth Medical Scheme					
Rating class	Review	Rating scale	Rating	Outlook / Watch	Date
Claims paying ability	Initial	National	BB _(ZA)	Stable Outlook	October 2001
Financial strength	Last	National	AA _{-(ZA)}	Stable Outlook	June 2022

Risk score summary

Rating Components & Factors	Score
Operating environment	14.50
Country risk score	7.00
Sector risk score	7.50
Business profile	(1.25)
Competitive position	(1.25)
Management and governance	0.00
Financial profile	2.25
Earnings	0.00
Capitalisation	1.50
Liquidity	0.75
Comparative profile	
Group support	0.00
Peer comparison	0.00
Total Risk Score	15.50

Glossary

Beneficiary	Nominated person or institution in the policy document that is entitled to receive the proceeds stated in the policy.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
Claim	1. A request for payment of a loss, which may come under the terms of an insurance contract (insurance). 2. A formal request or demand (corporate finance).
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Downgrade	The rating has been lowered on its specific scale.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
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.
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.

Statutory Solvency Margin	Gives an indication as to whether the minimum regulatory solvency margin is being met, based on the net statutory assets to statutory net premiums ratio.
Statutory	Required by or having to do with law or statute.
Upgrade	The rating has been raised on its specific scale.

For a detailed glossary of terms please click [here](#)

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 was based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such rating was 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 entities. The rating above 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 face-to-face management meetings, as well as other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from the rated entity and other reliable third parties to accord the credit ratings included:

- Audited financial statements to 31 December 2022;
- Full year budget to 31 December 2023;
- Year to date management accounts to 30 April 2023;
- Other relevant documents.

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