



Credit Rating Announcement

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

Rating action

Johannesburg, 03 June 2022– 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

Fedhealth's rating reflects a healthy financial profile supported by sound capitalisation and liquidity, although there was a moderation in earnings as the scheme utilised reserves to limit contribution increases. The business profile remained within an intermediate level but is under pressure from further contraction in membership attributable to economic pressures and structural changes in the scheme.

The business profile remained moderate, albeit with pressure from a 7.6% membership contraction in FY21 (FY20: 6.7% contraction) partly as a result of the economic strain affecting affordability as well as termination of ex-Topmed members after the amalgamation in 2019. Consequently, the scheme's share of the open industry membership base reduced to 3.1% in FY21 from 3.4% in FY20. The overall beneficiary age of the scheme rose slightly to 42.3 years in FY21 (FY20: 41.1 years), while the pensioner ratio was 20.4% (FY20: 19.3%). Fedhealth aims to implement new marketing initiatives to boost growth focusing on younger membership, with its ability to implement the growth strategy likely to be an important driver of its longer-term credit profile.

The scheme experienced pressure on earnings as the claims ratio increased to 96.9% in FY21 (FY20: 84.3%) owing to normalisation of business post-COVID lockdowns, and utilisation of higher reserves to implement low contribution increases. Consequently, despite stronger investment performance, the scheme recorded a net deficit of R104.6m (FY20: R189m surplus). GCR expects the claims ratio to stabilise in the 95-97% range, translating to net deficits over the short term as the scheme continues to manage solvency towards a lower targeted band.

Capitalisation remained sound despite a moderation in the GCR capital adequacy ratio and statutory solvency to 2.0x and 42.8% (FY20: 2.1x and 44.7%) respectively. GCR expects capitalisation to remain credit positive, albeit likely to moderate towards pre-FY19 levels over the next 12 to 18 months as Fedhealth aims to balance high reserves with option affordability.

The scheme's liquidity remains sound, although also reflecting moderation in FY21 in line with higher operational cash flow requirements. The gross cash and stressed financial assets coverage of claims normalised to 4.6 months from a high 5.5 months at FY20, while operational cash coverage registered at 0.9x (FY20: 1.0x). GCR expects the scheme's liquidity to remain at similar levels going forward, with the stressed financial assets coverage of gross claims expected to be above 4.3x.

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 membership profile to change materially over the outlook horizon, although there is some risk of weakening if membership growth remains under pressure.

Rating triggers

Upward rating movement is unlikely over the outlook horizon, although material and sustained earnings strength positively impacting on capitalisation could lead to an upgrade over the longer term. This would need to be accompanied by strong liquidity levels. Downward rating action could follow material deterioration in the membership profile and/or sustained reduction in earnings, resulting in solvency and/or liquidity moderation beyond expectations.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Insurance Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2022
GCR Country Risk Scores, May 2022
GCR South African Medical Schemes Sector Risk Score, April 2021

Rating 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	August 2021

Risk score summary

Rating components & factors	Risk scores
Operating environment	14.75
Country risk score	7.00
Sector risk score	7.75
Business profile	(1.25)
Membership profile	(1.75)
Membership Diversification	0.50
Management and governance	0.00
Financial profile	2.25
Earnings	0.00
Capitalisation	1.50
Liquidity	0.75
Comparative profile	0.00
Peer analysis	0.00
Total score	15.75

Glossary

Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Release	An agreement between the creditor and debtor, in terms of which the creditor release the debtor from its obligations.
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.
Short Term	Current; ordinarily less than one year.
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.

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 entity. 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:

- The audited financial results to 31 December 2021
- Four years of comparative audited financial statements to 31 December
- Unaudited interim results up to 31 March 2022
- Budgeted financial statements for 2022 - 2023
- Other related documents.

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