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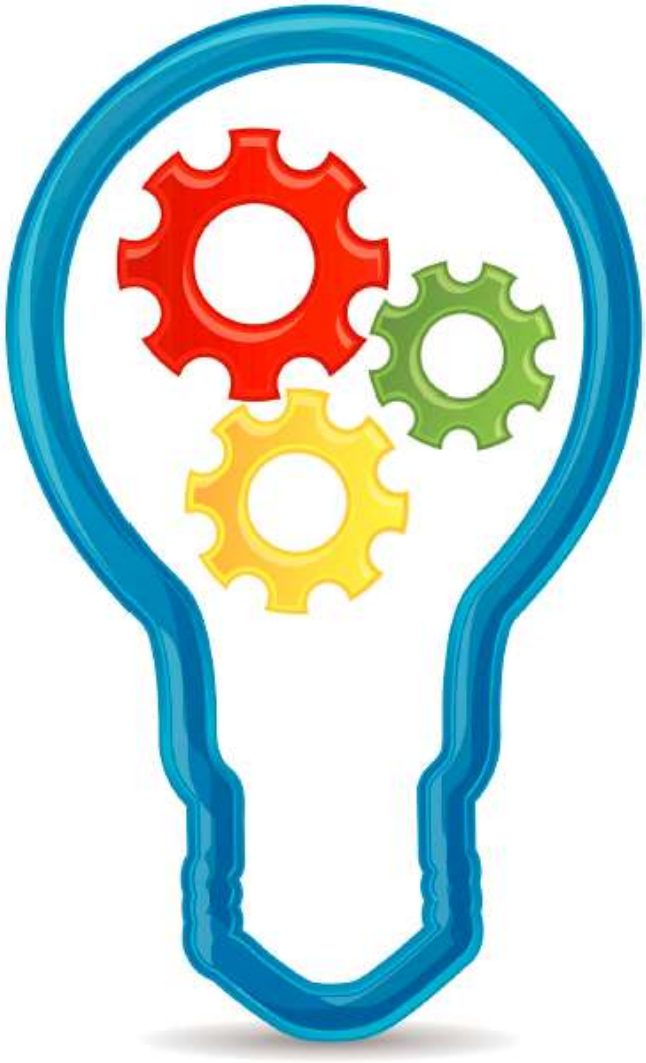
Discovery Health Medical Scheme

Operating Model and Governance Review



20th June 2013

Agenda

Background

Background to the Review

Objectives

The main objectives:

1. Relational Governance:
   - The effectiveness of the Board's governance role and responsibilities in relation to the outsourcing and oversight of the Scheme's administration and managed healthcare services

2. Transactional Governance:
   - Review the value received for the administration and managed healthcare fees paid

3. Review of the Operating Model:
   - Assess whether the current operating model is in the best interest of the Scheme and its members

Review Approach

Deloitte was provided with access to a range of information:

- Presentations, site visits, interviews and discussions
- Publicly available information (e.g. Council of Medical Schemes (CMS)) and confidential information

Independence and Review:

- Team members are independent from both the Scheme and the Administrator
- Team members, had skills in actuarial, clinical, risk management, legal, governance, economics etc.
- Mike Comber (Deloitte Risk and Reputation Leader) continually assessed and ensured independence was maintained
- Over 5,100 professional hours were used by 20+ the Deloitte Team (local and international) over a period of 9 months
- Health Monitor conducted an independent peer review of the actuarial work performed

Relational Governance

Relational Governance

The Scheme Board

Governance structures comply with the Act and have evolved over time

The Scheme is led by a strong, competent and independent Board who:

- Considers members' interest and the Scheme as a whole in decision-making
- Independence taken seriously by Trustees; views openly expressed without restraint
- Trustees
  - Are Independent, fit and proper and have no conflicts of interest
  - Are not dependent on their Trustee position for their livelihood
  - Actively participate in Board deliberations
  - Have sufficient understanding of context and content of information provided
  - Provide constructive suggestions and direction to Board, Scheme office and Administrator
- Board is sensitive to issue of solvency and ensures sufficient focus is placed on this

Board is supported by a committee structure that is tailored to its specific needs

Board and committee members have the necessary skills, knowledge and experience to fulfil their mandate

Relational Governance

Provision of Information

Information provided by Administrator is detailed, technical and of a high quality

Principal Officer (through Scheme office) drives the provision of the right level and kind of information from the Administrator – includes receiving multiple reports and attending the Administrator's Exco and other relevant meetings

Information is then conveyed and reported to the Board

Measured metrics have continually evolved over time

Process underway to formalise detailed service levels between Scheme and Administrator

Reporting requirements continuously being developed and refined

Reporting supported by a combined assurance model tailored to Scheme's needs

Gaps in combined assurance by Administrator (identified as part of review) being addressed by Scheme office with Administrator

Relational Governance

The Scheme Office

Led by an experienced and highly competent Principal Officer

Team of resources have key competencies and experience in critical areas to ensure effective monitoring of the Administrator

Purposefully very lean on resources - preference for a small, flexible team needs to be weighed against the benefits, and should not be guided by cost alone

Once new SLA's are formalised, Trustees and Scheme office need to consider capacity of Scheme office to fully manage the relationship and monitor all additional performance criteria

There is capacity for enhancing the oversight function of the Scheme office

Additional Scheme office functions have been approved by Board and further additions have been recommended

Relational Governance

Balance of Power and Oversight

Balance of power is maintained by Board having ultimate decision-making power for Scheme

Board requests information as required for decision-making purposes

Currently, Principal Officer has operational insight into Administrator through

- Attendance at the Administrator's Exco and other relevant meetings
- Access to the Administrator's own performance monitoring

Intention is to further maintain balance of power through Scheme developing more formalised performance monitoring mechanisms

- Scheme will develop SLAs underlying performance which are to be monitored
- Aligning of the new service levels to international outsourcing best practice (underway)

Scheme has relied on Administrator for stakeholder engagement framework

- Current established and monitored Communication Framework should be extended to include a stakeholder engagement framework
- Plans already underway to best structure greater oversight and reporting of marketing services
- Information requirements are continuously being refined, Scheme office and Board should continue this to ensure effective oversight

Transactional Governance

Transactional Governance

Approach

Transaction between the Scheme and the Administrator can be summarised as:

"*In return for a payment of a predetermined fee, the Administrator provides the Scheme with administration and managed care services governed by Service Level Agreements*"

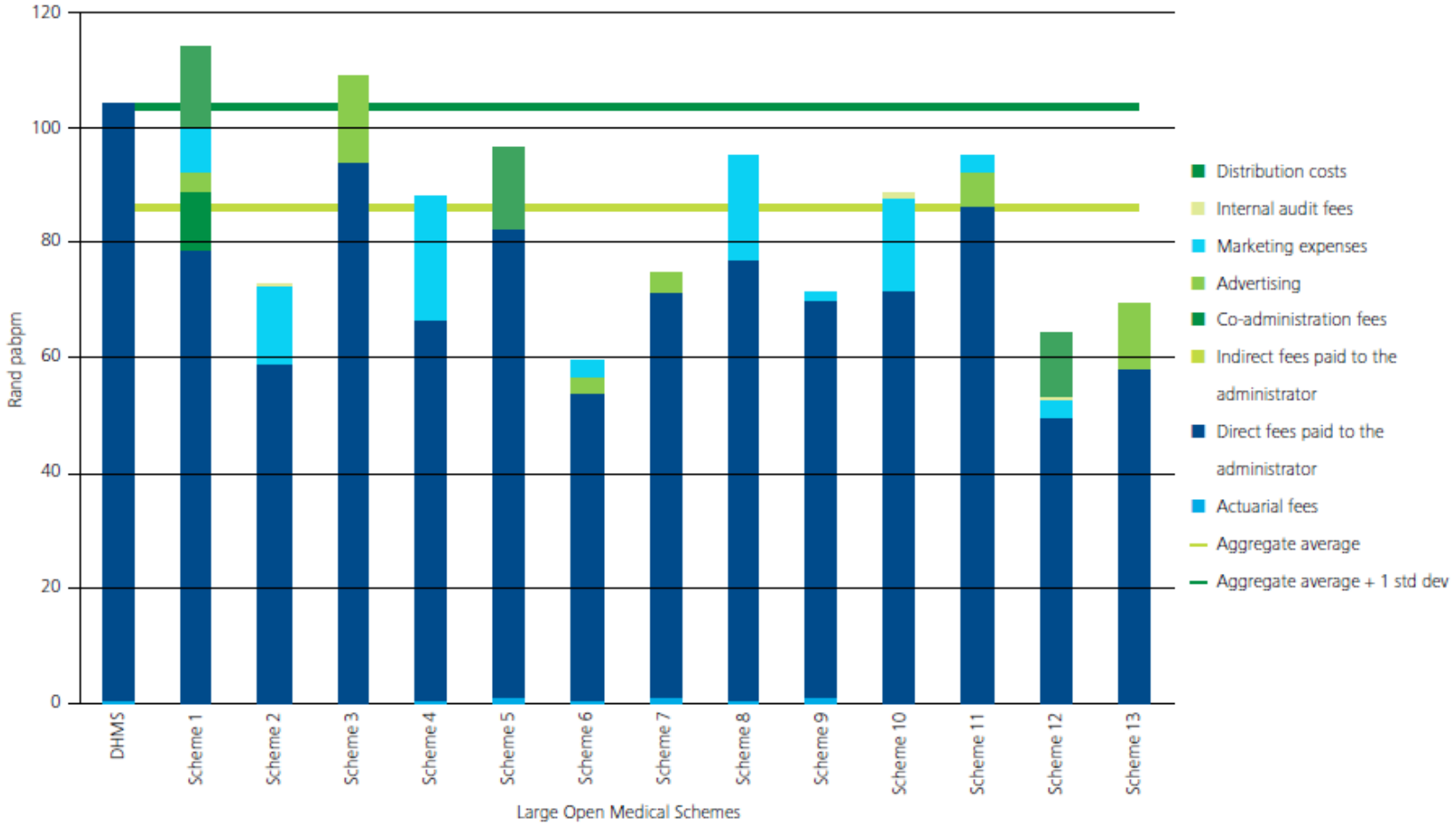
The purpose of the transactional review aims to:

- Assess the level of non-healthcare fees paid by the Scheme
- Assess how the Scheme performs relative to other benchmark entities
- Establish the level of Value-for-Money from this transaction
- Whether the members of the Scheme benefit from the scale of operations

Transactional Review

Non-healthcare expenses

Comparisons of administration and managed care fees



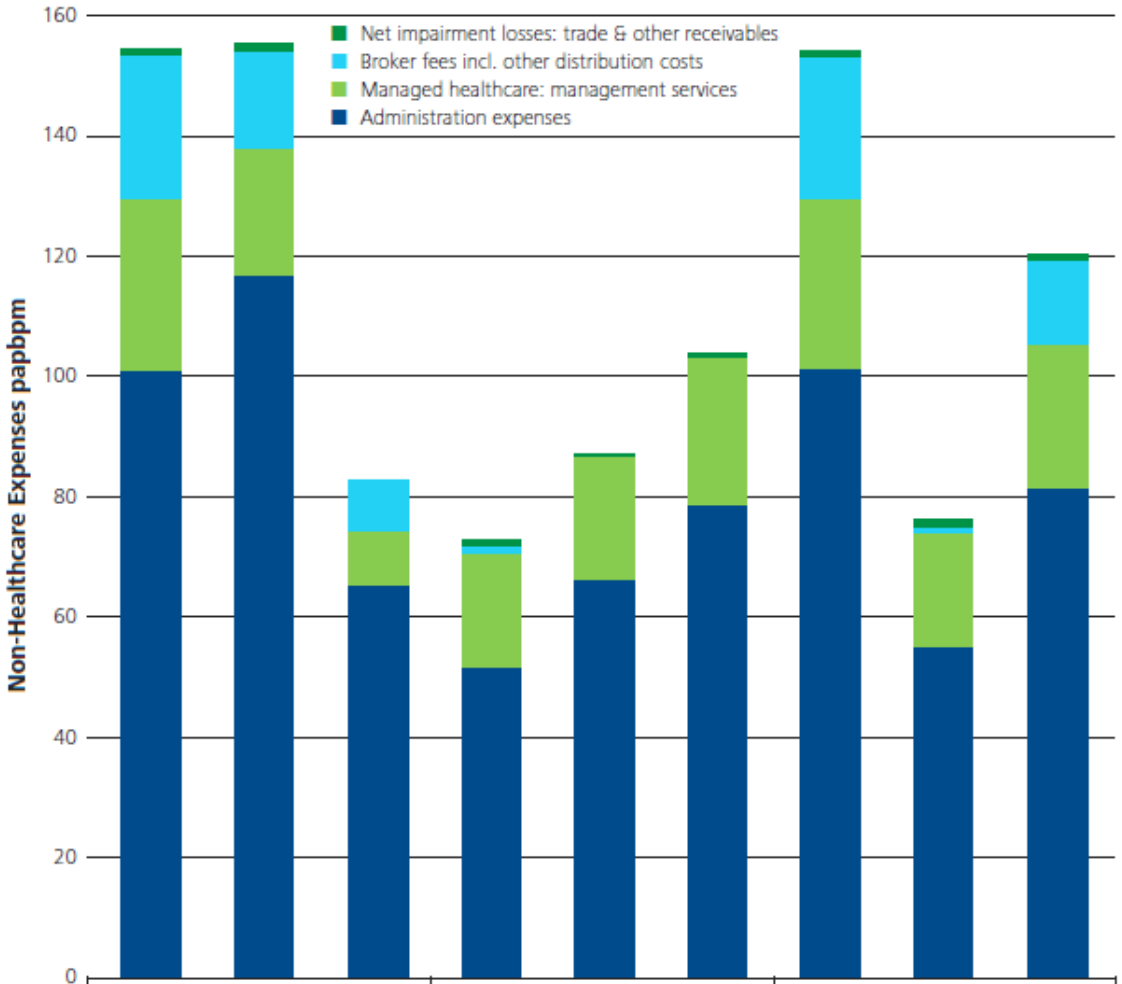
Source: 2011 CMS Statutory return information

Transactional Review

Non-healthcare expenses

Non-healthcare costs for open schemes (R154.09) are significantly higher than that of restricted schemes (R76.08)

Differences in the scope (e.g. broker fees, marketing) of non-healthcare activity renders a direct comparison flawed



	Large	Medium	Small	Large	Medium	Small	Open	Restricted	Total
		Open			Restricted			All	
	1.08	1.34	0.00	1.11	0.29	0.48	1.08	0.99	1.04
	24.05	16.31	8.43	1.06	0.00	0.05	23.69	0.90	13.76
	28.28	21.03	9.24	18.77	20.21	24.25	27.93	19.26	24.15
	100.98	116.76	65.06	51.79	66.25	78.73	101.39	54.93	81.16
	154.39	**155.44**	**82.73**	**72.73**	**86.75**	**103.51**	**154.09**	**76.08**	**120.11**

Source: 2011 CMS Statutory return information

Performance

Deloitte Medical Scheme Performance Model

Medical Scheme Performance Model to assess five main performance areas:

1. Financial strength and compliance
2. Growth and sustainability
3. Non-healthcare expenditure
4. Governance and reputation
5. Quality and value for money

Limitations:

- Based purely on publicly available data, predominantly the CMS Annual Reports. Deloitte has neither verified nor audited the data and relied on the accuracy of these reports
- Supplemented with information from medical scheme annual reports and statutory returns, and information from their websites
- Not all scheme performance areas and performance metrics could be measured and analysed (data not available publicly for all or most of the schemes analysed)

Performance

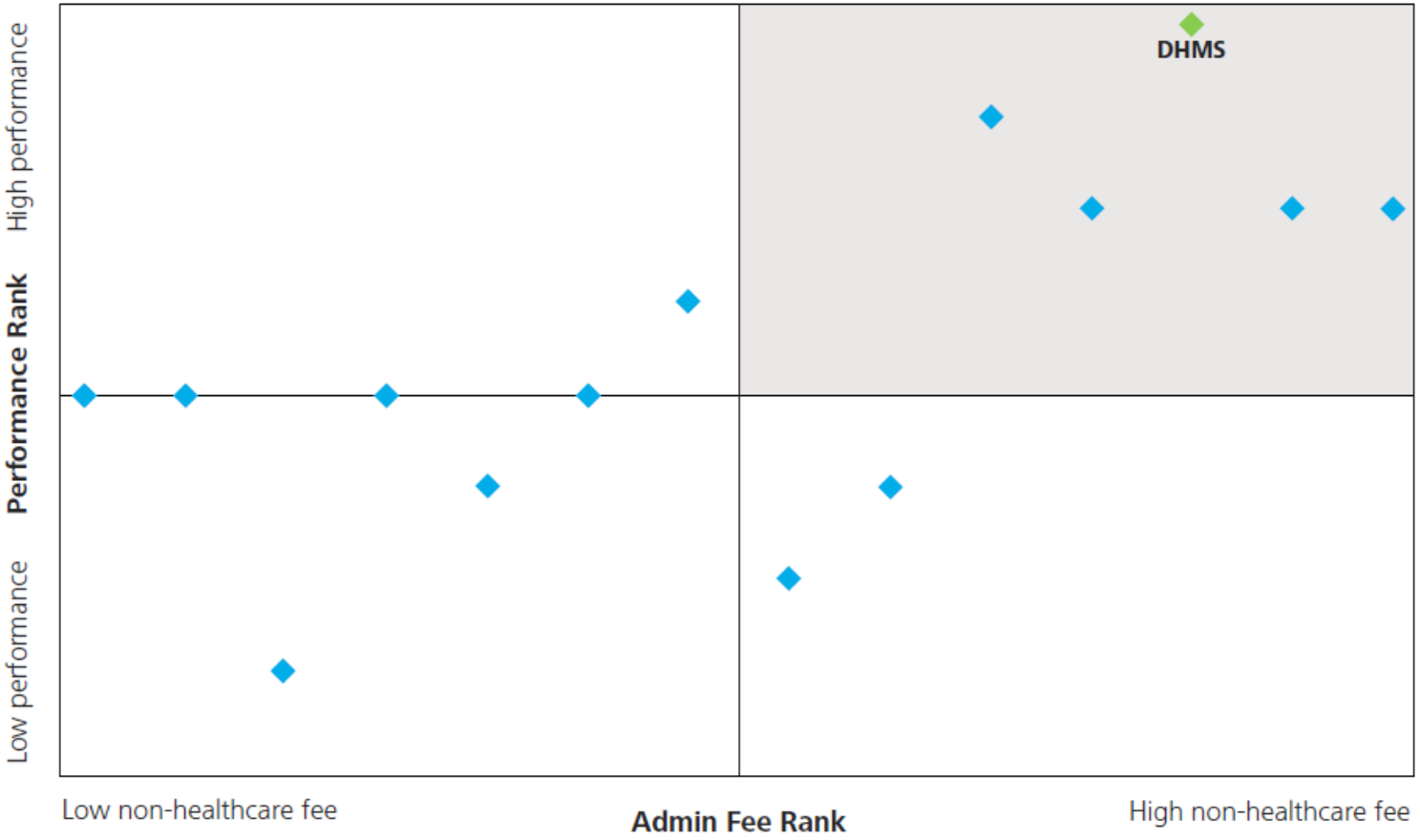
Medical Scheme Performance Model

The Scheme performed the best compared to its benchmarked peers i.e. 13 large open medical schemes

Name of medical scheme	Financial strength	Growth and sustainability	Non healthcare expenditure	Compliance, Governance & Reputation	Quality and value	All Performance Areas	Overall Rank
	Scheme Rank						
Scheme 1	1	5	2	1	2	11	3
Scheme 2	2	5	2	4	2	15	6
Scheme 3	1	5	1	1	3	11	3
Scheme 4	2	4	2	2	3	13	5
Scheme 5	2	6	2	2	4	16	7
Scheme 6	2	4	2	2	2	12	4
Scheme 7	2	2	3	1	2	10	2
Scheme 8	2	4	1	3	3	13	5
Scheme 9	2	3	2	2	1	10	2
Scheme 10	3	5	2	4	3	17	8
Scheme 11	3	5	2	2	3	15	6
Scheme 12	3	3	2	2	3	13	5
Scheme 13	2	6	1	1	3	13	5
Discovery Health Medical Scheme	1	1	3	2	1	8	1

Performance

Non-Healthcare Expenses



- Most large schemes have (incl. the Scheme) been reducing total NHE relative to GCI
- Scheme's Board and the Administrator have committed to reducing NHE (excluding broker fees) to 10% of gross contribution income by December 2014

Value for Money

Value for money is a relative term and needs to capture both cost and quality of services rendered.

Value = Third Party Administrator (TPA) Management

+ Out-of-pocket savings

+ Impaired loss savings

+ Free Pharmaceutical Benefit Management

+ Non-Quantifiable Benefits*

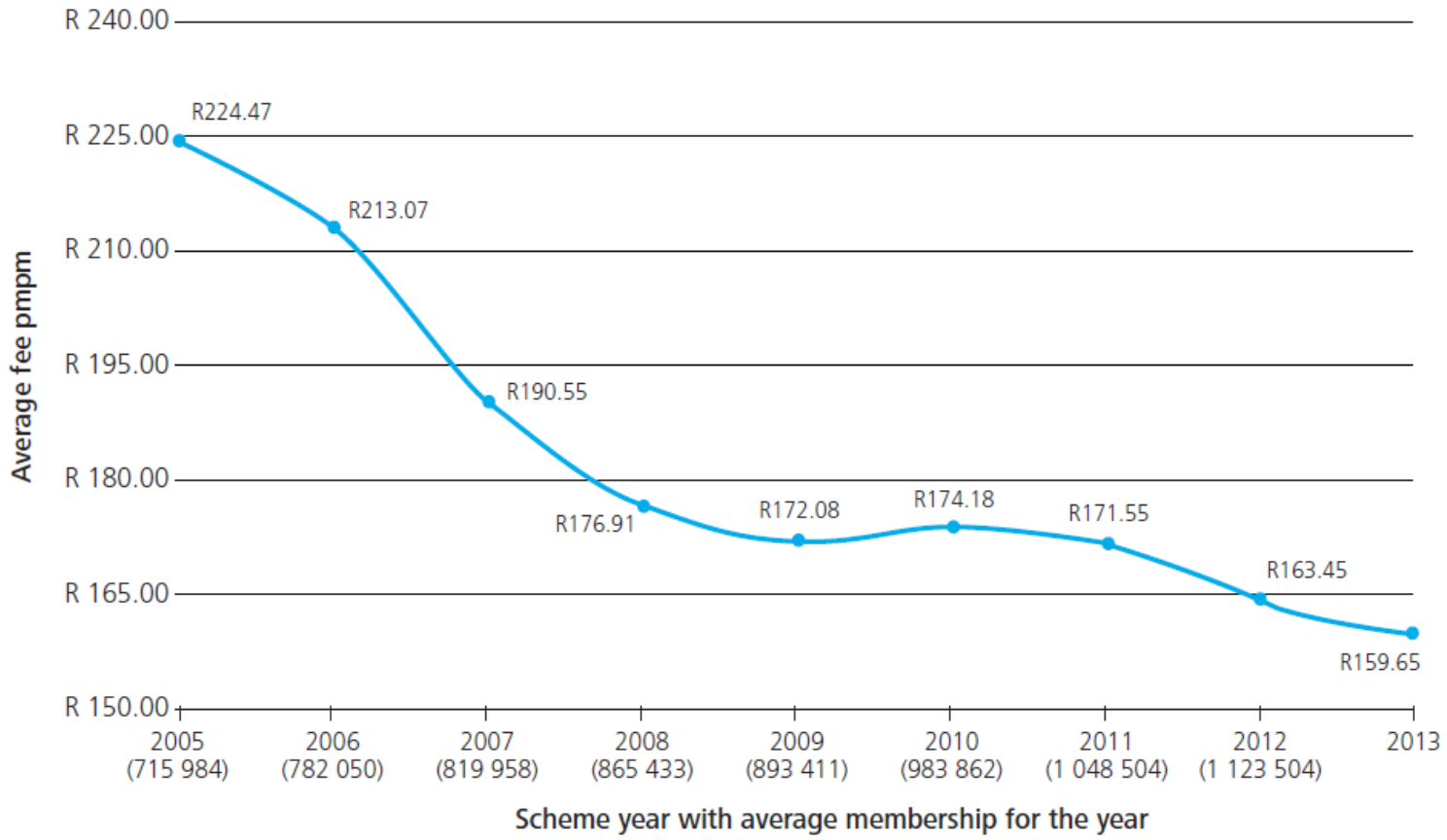
*Non- Quantifiable Benefits include:
Vitality membership discounts, external healthcare delivery system e.g. co-ordinated networks improvements in quality of care projects

Finding:

For every R1 spent on TPA fees, a member receives between R1.77 and R2.02 in terms of additional value created through the activities of the Administrator

Economies of Scale

Fees charged by Administrator have decreased over time compared to 2005, the average fee pmpm is 27% lower in 2012 and 29% in 2013



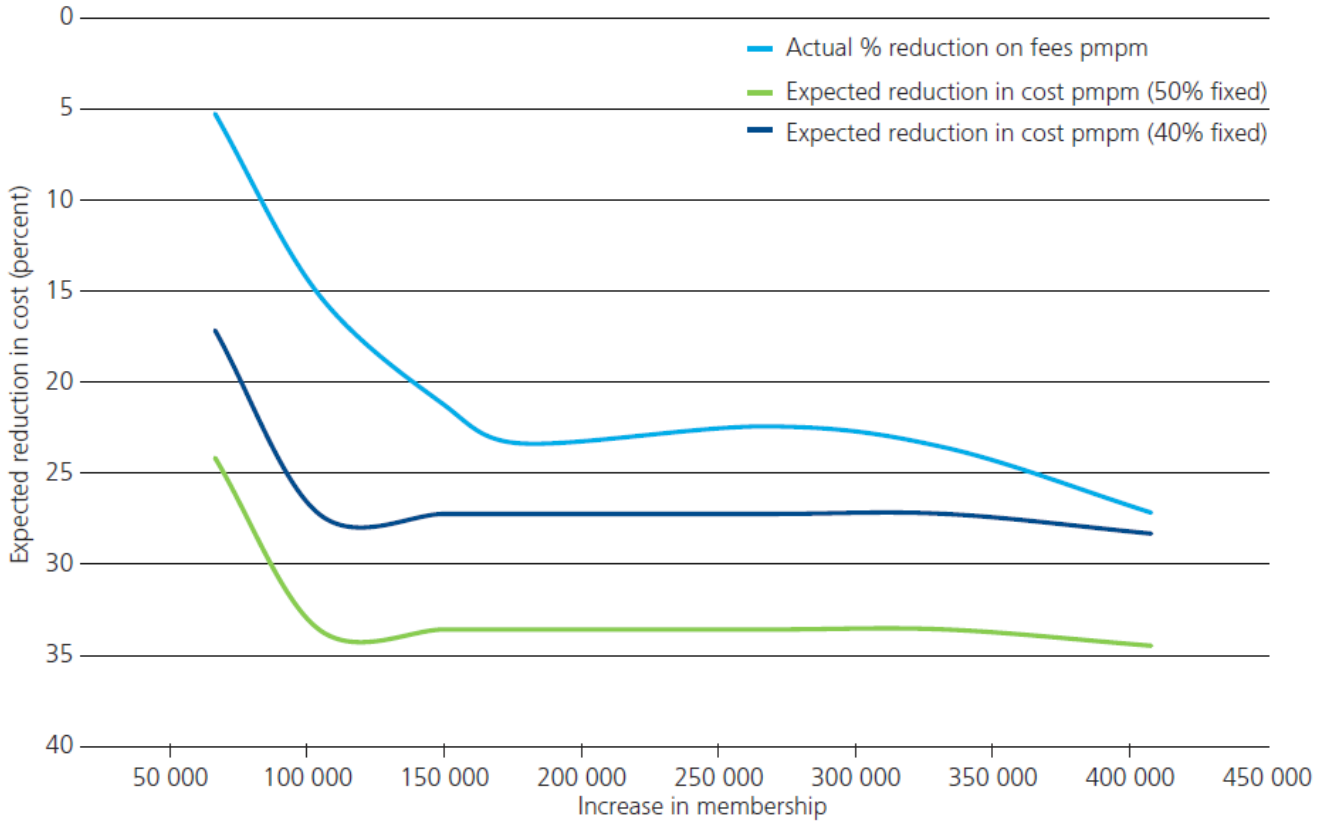
Scheme has benefited from economies of scale (reduced administration fee)

Economies of Scale

International Experience

International research indicated that proportion of fixed expenses within a TPA (% of total expenses) ranges significantly (avg. assumption is between 40% & 50%)

If 40%, then Administrator passing on a significant proportion (if not all) of cost reductions arising from scale



Economies of Scale

Findings

The Administrator's expense breakdown:

Fixed:	16%
Fixed (of total semi-fixed%):	25%
Total Variable:	59%

Total Fixed Approximately: 41%

Since 2005:

- Reduction in administrator fees paid by the Scheme (i.e. 27.18%)
- Expected reduction in cost (i.e. 28.34%)

The Scheme should continue to explore scope for further savings in administration fees

Review of the Model

Assessment of the Model

Findings

Schemes that have administration and managed care outsourced to the same provider (integrated model) = have on average 15% lower NHE than fragmented model (outsources administration and managed care to different providers)

Performance of type of model also needs to be considered.

Based on Deloitte Performance Model, schemes that have an integrated outsourced model achieved better results relative to schemes that adopted a fragmented outsourced model.

Conclusion

Conclusion

Findings

Collectively and individually, the Board, Committee members and Principal Officer have the necessary skills, knowledge and experience to fulfil their mandate

Scheme is led by a strong, competent and independent Board that considers members' interests and Scheme's interest as a whole in decision-making process

Scheme office is purposefully very lean on resources, and is led by an experienced and highly competent Principal Officer

Scheme office has key competencies and experience in critical areas to ensure effective monitoring of the Administrator

There is capacity for enhancing of the oversight function of the Scheme office

Principal Officer monitors service levels and this information is then conveyed and reported to the Board

Balance of power is maintained by the Board having ultimate decision-making power for the Scheme

Conclusion

Findings

The Scheme is benefiting from Economies of Scale, however the Scheme should continue to explore scope for the Administrator to pass on further savings

Scheme members are benefiting from Value for Money

Admin fees	⇑	R 11.43
Contributions	⇓	R 158.24
Overall	⇓	R 146.81 (members are R 146.81 papbm better off)

Deloitte Performance Model results of 14 large open medical schemes:

Discovery Health Medical Scheme: Ranked best out of all the comparator schemes

- High: Financial Strength, Growth & Sustainability, Quality & Value for Money
- Average: Governance and Reputation
- Below average: Non-healthcare Expenditure

For every R1 spent on TPA fees, a DHMS member receives between R1.77 and R2.02 in terms of additional value created through the activities of the Administrator

In the open medical scheme market, integrated outsource models are on average 15% lower NHE than fragmented outsource models