Discovery
Health Medical Scheme

MEDICAL SCHEME PRICING STRATEGIES DURING COVID-19

ANNUAL MEDICAL SCHEME CONTRIBUTION INCREASES

Every year, medical schemes increase their contributions to ensure that they can meet the expected cost of their members' claims in future and that they remain solvent. COVID-19 is having a significant impact on medical scheme member claims leading to different claims experience compared to pre-COVID-19 periods.

It has also increased the uncertainty regarding expected future claims, given that the future impact of COVID-19 remains unknown. In dealing with this uncertainty regarding future claims, medical schemes have adopted very different pricing strategies. The aim of this paper is to explain the differences between the different strategies, and provide insight into the short-term and long-term impact of these strategies on members. Financial advisers should consider the impact of these strategies when advising clients regarding their choice of medical scheme.

Healthcare costs for a medical scheme increase each year in line with medical inflation. As healthcare costs increase over time, so do the claims paid by the medical scheme. To ensure sustainability, medical schemes are required to increase contributions to match the expected healthcare claims of members in the following year.

Medical inflation consistently increases at a higher rate than consumer price inflation. These increases are driven by additional utilisation of healthcare services from medical scheme members each year. Various factors contribute to increasing utilisation, such as ageing, increasing chronic condition prevalence and the introduction of new healthcare supply. Medical inflation in prior years provides a strong anchor to predict future medical inflation. Historically, medical inflation has been three to four percent in excess of CPI per annum.

IMPACT OF COVID-19 ON MEDICAL SCHEME CONTRIBUTION INCREASES

Since the start of the COVID-19 pandemic, the Discovery Health Medical Scheme has seen a reduction in demand for healthcare services. In some cases the reduction is real, such as trauma or alcohol and drug related hospital admissions. These cases were avoided while strict mobility restrictions remained in force over 2020. In most cases, though, the reduction in demand for healthcare services arose from deferred elective, non-urgent healthcare, such as major joint replacements, cataract surgery and tonsillectomies. These cases have not been avoided, but will rather return as COVID-19 becomes an endemic infection.

The reduction in the demand for healthcare services, or **utilisation discontinuities**, is persisting as a result of ongoing COVID-19 infection, however there are clear trends emerging in 2021:

- Claims for non-COVID-19 healthcare services in between COVID-19 waves are now higher than that experienced before COVID-19.
- The strength of the disruption of COVID-19 on healthcare utilisation is waning as the virus gets closer to endemic infection levels. Health-seeking behaviour is returning as more people are vaccinated, and projections for future COVID-19 peaks are lower than before.

These trends must be considered when increasing contributions to ensure that Discovery Health Medical Scheme can meet future member claims, while maintaining its reserves at statutory solvency levels.

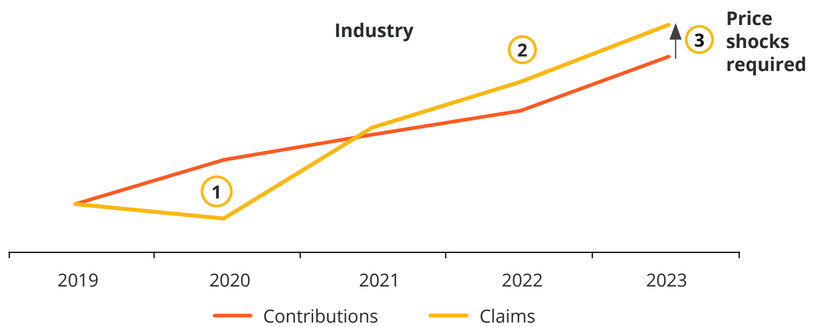
Pricing strategies to allow for utilisation discontinuities

To ensure sustainability, medical schemes price contribution increases to account for future healthcare utilisation. Historically, this has led to contribution increases of between 3% to 4% above Consumer Price Inflation. In an environment of utilisation uncertainty, medical schemes can follow various strategies, including:

- Adopt a **SHORT-TERM PRICING APPROACH**, assuming temporarily suppressed utilisation persists over time.
- Adopt a **SYSTEMIC INFLATION MATCHING APPROACH**, assuming suppressed utilisation will not persist, but will rather return to previous levels.

SHORT-TERM PRICING APPROACH

Short-term pricing sets 2022 contribution increases based on currently suppressed utilisation levels and does not account for systemic increases in pricing. The strategy ignores the fact that, irrespective of the extent to which utilisation discontinuities persist, healthcare claims will continue to increase with systemic utilisation increases.



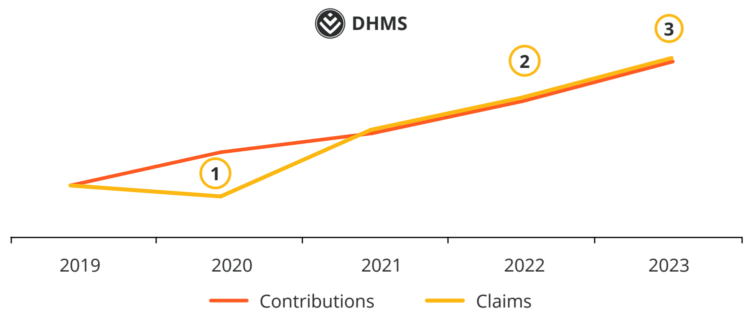
01 **Medical schemes generate surplus while healthcare utilisation levels remain temporarily suppressed.**

02 **As COVID-19 becomes an endemic infection, claim levels increase in line with the systemic inflation over 2020 and 2021, but beyond the contribution levels that have not been increased by systemic inflation.**

03 **Contribution levels are not sufficient to cover expected claims, and require ‘price shocks’ to return to required levels.**

SYSTEMIC INFLATION MATCHING APPROACH

Systemic inflation matching sets contributions to account for systemic utilisation increases, and uses historic medical inflation trends to predict the 2022 systemic medical inflation. This maintains contribution levels in line with expected healthcare claims. Should utilisation discontinuities persist in 2022, the medical scheme will still have priced contributions to match the expected systemic increases in healthcare claims.



01 **Medical schemes continue to generate surplus while COVID-19 utilisation discontinuities persist. Surplus is used to defer contribution increases to reduce the financial impact on members.**

02 **As COVID-19 becomes an endemic infection, claims levels increase in line with the systemic inflation over 2020 and 2021, and contribution levels match the claims levels.**

03 **Contributions have already been gradually adjusted to account for the utilisation corrections and do not require significant adjustments.**

Under systemic inflation matching, members are significantly less exposed to future price shocks. If medical schemes can find innovative ways to maintain affordable increases while matching systemic inflation, members enjoy significant improvements in both short-term and long-term affordability.

Use of surplus to support affordability

Medical schemes have seen an increase in their reserve levels as a result of the COVID-19 utilisation discontinuities. Medical schemes can use the reserves to support short-term affordability for members in the following ways:

01 | Fund the gap between contributions and healthcare claims, by increasing contributions by less than what is required, and paying the shortfall from member reserves.

02 | Defer the contribution increase, by increasing contributions in line with what is required, but only implementing the increase later in the year to reduce the impact of the increase on members.

FUNDING THE GAP BETWEEN CONTRIBUTIONS AND HEALTHCARE CLAIMS

Medical schemes can temporarily reduce contribution increases, to support member affordability, funding the gap between medical inflation and contribution increases through reserves in the short-term.

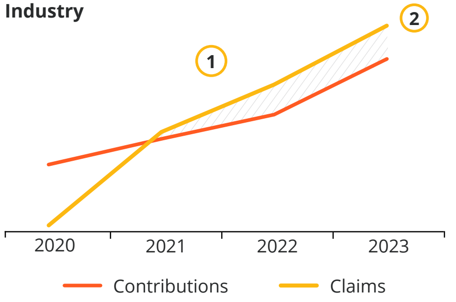
Under this scenario:

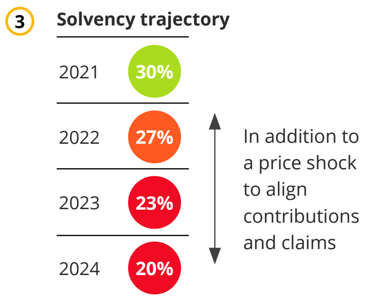
01 Healthcare claims increase to the underlying systemic levels with no utilisation discontinuities. Contributions increase by less than the healthcare claims increase.

02 The gap between healthcare claims and contributions is funded by excess reserves. The scheme will need to set increases for 2023 in line with the return to systemic medical inflation levels.

03 Assuming reserve levels are adjusted to account for latent non-COVID-19 demand, current reserve levels will only be sufficient to fund the gap between healthcare claims and contributions for 18 months on average, with a price shock for members from year 2.

Industry





This strategy places strain on the multi-year affordability of members. While strengthened reserve levels are released gradually, contributions still require a substantial future shock or a series of above medical inflation increases to align contributions and claims.

DEFERRED CONTRIBUTION INCREASE

Medical schemes can ensure member affordability by deferring the implementation of contribution increases. Contribution levels are increased in line with medical inflation, while the strengthened reserve position is leveraged to defer implementation of increases. This strategy enables short-term affordability for members by reducing the real increase in contributions felt by members across years.

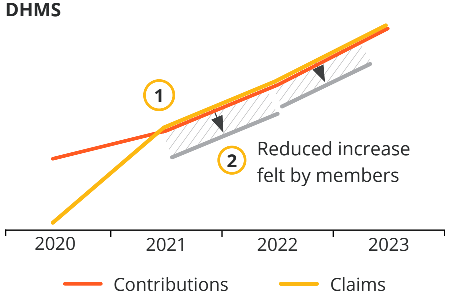
Under this scenario:

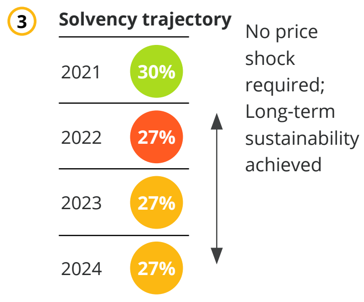
01 Healthcare claims increase to underlying systemic levels. Contributions are already set at these levels and require limited adjustment.

02 The strengthened reserve position of the scheme is used to defer the implementation of the contribution increase in years where utilisation discontinuities persist. For example, DHMS members' short-term affordability is strengthened with contribution increases that have been reduced by 50% in 2021 and 33% in 2022.

03 Solvency position of the scheme has been balanced, ensuring long-term sustainability despite utilisation volatilities. Reserve levels remain stable after the deferred increase period.

DHMS





Strengthened reserve position of the scheme has been leveraged to lower the real increase experienced by members per annum and smooths future increases. This ensures the correct expectations and budgeting is set to maintain long-term member affordability, without price shocks, while ensuring members still enjoy short-term affordability relief.

Current industry pricing

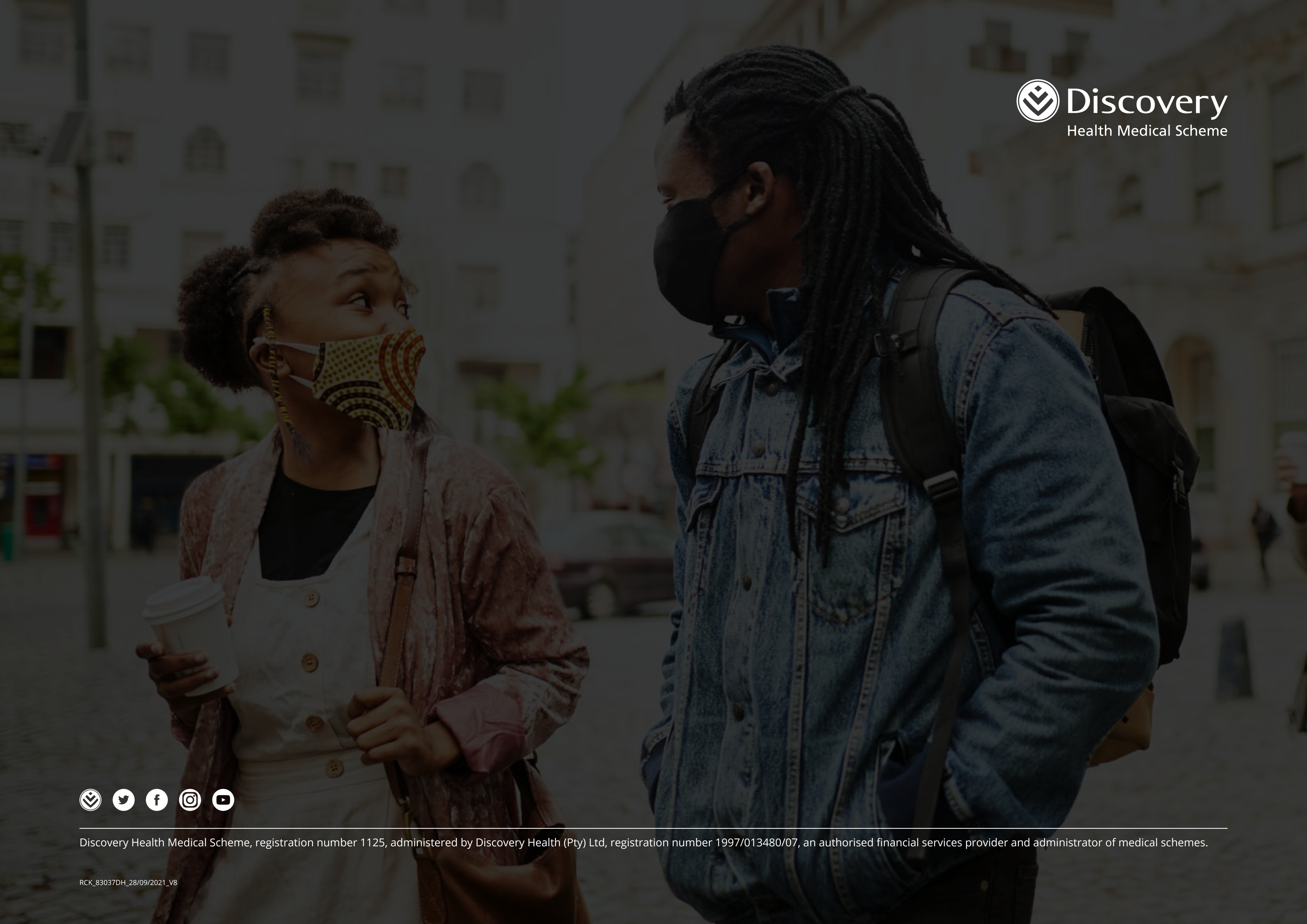
For 2021 and 2022, most medical schemes in the industry have followed a short-term pricing approach, while Discovery Health Medical Scheme follows a systemic medical inflation matching approach. These strategies create complexities when comparing across medical schemes. Financial advisers must look to the medium-term impact of these pricing strategies for their clients.

Analysing historic contribution increases across the industry for various schemes, provides guidance on the underlying systemic medical inflation that the industry is experiencing.

These trends can be used to estimate the potential future price shocks required across the industry, assuming that systemic utilisation trends return in 2022.

	2021 AND 2022 INCREASE	REQUIRED INCREASE BASED ON HISTORIC MEDICAL INFLATION	FUTURE PRICE SHOCK REQUIRED IN 2023
DHMS	CPI + 3.1%	CPI + 4.1%	CPI + 4%
Industry	CPI + 1.0%	CPI + 5.0%	CPI + 11%
Scheme A	CPI + 1.0%	CPI + 5.1%	CPI + 11%
Scheme B	CPI + 0.2%	CPI + 4.4%	CPI + 11%

The table above illustrates the impact of underestimating future systemic utilisation increases as a result of COVID-19 utilisation discontinuities. Financial advisers should be aware of the implications of short-term pricing strategies and the impact on longer term affordability, should systemic utilisation levels return after the COVID-19 pandemic. With 2021 experience showing clear evidence of these trends, Discovery Health Medical Scheme has prioritised a balanced contribution strategy to support long-term sustainability while ensuring short-term and long-term affordability for members.



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