ACTUARIAL SOCIETY OF SOUTH AFRICA

SAP 302: ADVICE TO SOUTH AFRICAN MEDICAL SCHEMES ON REINSURANCE

Classification

SAP 302 is a Standard of Actuarial Practice (SAP) and compliance with it is mandatory. SAP 302 replaces PGN 302. Where legislation or other documentation refers to PGN 302 it should be interpreted as SAP 302.

Abstract

SAP 302 sets out the considerations that bear to an actuary's professional work in advising medical schemes on reinsurance.

Purpose

It is intended to describe a minimum level and quality of actuarial attention that is necessary to ensure that a reinsurance arrangement is appropriate.

Legislation or Authority

Actuarial Society of South Africa Health Care Committee.

Application

SAP 302 applies to members (fellow as well as other members) of the profession offering advice on reinsurance to medical schemes.

Author

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Status

Version 1.0 Effective from 1 March 2003

1 DEFINITIONS

1.1 **Reinsurance Agreement:**
A reinsurance agreement is any contractual agreement whereby some element of risk contained in the rules of the medical scheme is transferred to a reinsurer in return for some consideration.

1.2 **Reinsurer:**
A registered long-term insurer or short-term insurer registered in terms of the relevant South African legislation.

1.3 **Reinsurance Transaction:**
A transaction pursuant to a reinsurance agreement.

1.4 **Brokerage:**
A fee payable to a party other than the reinsurer or the medical scheme as a result of the existence of the reinsurance agreement.

1.5 **Profit commission:**
A payment from the reinsurer to the medical scheme dependent on the financial performance of the reinsurance agreement.

2 BACKGROUND AND HISTORICAL ISSUES

The Medical Schemes Act has been amended to include a requirement for a reinsurance contract to be approved by the Registrar. The application for such approval needs to be accompanied by an evaluation of the need for the proposed contract prepared by an independent person with the necessary expertise.

3 ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES

3.1 The actuary needs to consider that a proposed reinsurance agreement is appropriate in that:
- The agreement is in the interests of the medical scheme and its members;
- The agreement is appropriately priced;
- The terms of the agreement are such that the agreement operates as intended.

3.2 The actuary must ensure that any associations with any reinsurers, medical scheme administrators or any conflicts of interest are properly disclosed.

3.3 The actuary should be provided with a written guarantee from the Trustees that he/she has been supplied with full details on all agreements between the medical scheme and the reinsurer.

3.4 The actuary should make it clear to the Trustees of the medical scheme that they are responsible for the decision to purchase reinsurance and that the actuary's role is adviser in this regard. The actuary should ensure that the format of the advice including the report is adequate to facilitate the decision-making process.

3.5 The actuary should apply his/her mind to the application of the actuarial control cycle to the reinsurance process. The environmental assessment should include legislative requirements and risks.

3.6 In terms of assessing the appropriateness of the particular reinsurance arrangement and reasonableness of reinsurance premiums, the following should be considered. These factors will determine the type of information which needs to collected from the scheme in order to make an evaluation:

3.6.1 What is the existing solvency level and membership size of the scheme?

3.6.2 What level of solvency reduction can the scheme cope with and what is the likelihood of solvency dropping below such levels? This should include consideration of the statutory requirements and member expectations.

3.6.3 Is the scheme an open or restricted membership medical scheme? Generally, due to open enrolment and restricted underwriting, open schemes face greater risks of adverse claims fluctuations. Restricted membership schemes are less exposed with closed schemes being the least exposed. There may be exceptions to these relative risk classifications.

3.6.4 What is the risk profile (in terms of age/gender/income levels, etc) of the scheme currently and is there a risk that this might change in the future resulting in adverse fluctuations in claims experience? What levels of membership turnover have been experienced?

3.6.5 New Products or significant changes to existing products. It may be prudent to reinsure a larger proportion of the underlying risk in respect of a new product or when a product has been significantly altered. A relatively large risk transfer may be appropriate until the experience on the product has settled and the scheme has a clearer understanding of the underlying risks. This is also relevant to a large scheme introducing a new product onto the market.

3.6.6 Is the scheme intending to actively market for growth or acquire new membership? In the current environment, it is difficult to predict the expected risk profile of new members, which in turn creates further uncertainty in expected claims experience. This will also be a function of marketing strategies and target markets. Generally, the greater the expected new business growth, the greater the need for reinsurance.

3.6.7 Are new markets being targeted where little is known about the expected claims experience?

3.6.8 What has been the trend in claim patterns and are these trends likely to continue into the future?

3.6.9 Currency Risks. What is the exposure to imported inflation through items such as medication and technology?

3.6.10 What steps have been taken to mitigate risks to the scheme? This may include current reinsurance contracts and other risk management programmes.

3.7 The following considerations should be given to the reinsurer and other parties involved:

3.7.1 Is the reinsurer non-specialist or specialist?

3.7.2 Is the reinsurer local or offshore based?

3.7.3 What is the credit rating of the reinsurer? This is important particularly for reinsurance into the London market.

3.7.4 Have a number of reinsurers been approached and has the best possible arrangement in terms of structure and pricing been achieved?
3.7.5 What is the level of brokerage payable?
3.7.6 Is a profit share payable and is the level reasonable? Profit share normally varies according to the size of the reinsurance transaction, the potential volatility of experience and the level of service to be provided.
3.7.7 Has sufficient data and information been given to the reinsurer in an attempt to obtain the most favourable arrangement?
3.7.8 Have the relevant areas where the reinsurer can add value been considered, such as knowledge and expertise, ongoing service and support.

3.8 The following consideration should be given to the reinsurance agreement:
3.8.1 Is the reinsurance structure appropriate given the scheme specific considerations above? Structures might include, quota share, individual excess of loss or stop loss arrangements.
3.8.2 Is the reinsurance premium reasonable given the scheme specific risks above? The actuary should consider the expected claim costs, the appropriate margin to provide for variance in claim costs and scheme-specific risks and the margin to provide for reinsurance expenses in order to make such an assessment. The cost of capital of the reinsurer is a further factor for the actuary to consider.
3.8.3 What are the criteria for premium adjustments?
3.8.4 Does the objective of the reinsurance agreement meet the intention of the Trustees in entering into such an agreement?
3.8.5 Contract details. What is the term of the contract, renewal terms and cancellations clauses? What are the terms of any profit share payment? The actuary should pay particular attention to the termination provisions for termination by either party.

3.9 The actuary should undertake a quantitative analysis of the impact of the reinsurance contract on the underwriting result and solvency level of the medical scheme. This should include an analysis under a number of scenarios and the associated likelihood of each. The actuary should disclose and justify the methodology and assumptions employed.

4 REPORT

4.1 The actuary should provide a report to the Trustees of the Medical Scheme in a format consistent with the requirements of the Medical Schemes Act.

4.2 The information contained in the report should be sufficient to the extent that an external independent actuary could formulate an independent opinion.

4.3 Significant departures from this Standard of Actuarial Practice should be noted in the report and the reasons for such departures fully explained.

4.4 The report should include the following:
4.4.1 A statement as to whom the report is addressed and the date at which the report was prepared.
4.4.2 Confirmation that the actuary is acting in an independent capacity.
4.4.3 A general description of the proposed reinsurance agreement.
4.4.4 A description of the information reviewed by the actuary.

4.4.5 A description of the medical scheme risks to be addressed by the proposed reinsurance agreement.
4.4.6 A description of the terms and price of the proposed reinsurance agreement, with particular reference to the termination and renewal conditions.
4.4.7 A statement of any brokerage and/or profit commission payable.
4.4.8 A description of the process followed in obtaining reinsurance quotations and a summary of these quotations.
4.4.9 A comment on the likely impact on the accumulated funds of the medical scheme.
4.4.10 An opinion on the appropriateness of the proposed reinsurance agreement.
4.4.11 An opinion on the appropriateness of the reinsurance premium and the methodology which has been followed to make this assessment.

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