COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

COMMUNITY AFFAIRS LEGISLATION COMMITTEE

Reference: Aged Care (Bond Security) Bill 2006; Aged Care (Bond Security) Levy Bill 2006; Aged Care Amendment (2005 Measures No. 1) Bill 2006

THURSDAY, 2 MARCH 2006

C A N B E R R A

BY AUTHORITY OF THE SENATE

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

To search the parliamentary database, go to:
http://parlinfoweb.aph.gov.au

SENATE

COMMUNITY AFFAIRS LEGISLATION COMMITTEE

Thursday, 2 March 2006

Members: Senator Humphries *(Chair)*, Senator Moore *(Deputy Chair)*, Senators Adams, Barnett and Polley

Substitute members: (As per most recent Senate Notice Paper)

Participating members: Senators Abetz, Allison, Bartlett, Mark Bishop, Boswell, Bob Brown, Carol Brown, George Campbell, Carr, Chapman, Colbeck, Coonan, Crossin, Eggleston, Evans, Faulkner, Ferguson, Ferris, Fielding, Forshaw, Heffernan, Hogg, Hurley, Joyce, Lightfoot, Ludwig, Lundy, McEwen, McGauran, McLucas, Milne, Nash, Nettle, O'Brien, Parry, Patterson, Payne, Robert Ray, Siewert, Stephens, Stott Despoja, Watson, Webber and Wong

Senators in attendance: Senators Adams, Allison, Humphries, Moore, McLucas, Polley

Terms of reference for the inquiry:

Aged Care (Bond Security) Bill 2005; Aged Care (Bond Security) Levy Bill 2005; Aged Care Amendment (2005 Measures No. 1) Bill 2005.

WITNESSES

Committee met at 4.35 pm

DAVIES, Mr Benedict, Technical Services Manager, OFM Investment Group

CHAIR (Senator Humphries)—The Senate Community Affairs Legislation Committee is considering the Aged Care (Bond Security) Bill 2005, the Aged Care (Bond Security) Levy Bill 2005 and the Aged Care Amendment (2005 Measures No. 1) Bill 2005. The committee will be taking evidence on the bills, which propose to strengthen the existing protections surrounding aged care residents' accommodation bonds by establishing a scheme to guarantee the repayment of bond balances if a provider defaults and by introducing new prudential regulatory arrangements. I would like to thank witnesses who have made themselves available to the committee for today's hearings, including some by teleconference.

Our first witness is by teleconference. I welcome Mr Benedict Davies, Technical Services Manager representing OFM Investment Group. Information on parliamentary privilege and the protection of witnesses and evidence has I think been provided to you. The committee prefers evidence to be given in public but we can take evidence in camera if you consider that evidence to be of a confidential nature. We have before us your submission. We would be happy to ask you some questions about that. Would you like to make an opening presentation based on that submission before we ask you those questions?

Evidence was taken via teleconference—

Mr Davies—Thank you. I thank the committee as well for the opportunity to contribute to this inquiry. OFM supports this policy to protect residents' bonds. But, instead of the guarantee scheme proposed in these bills, we suggest an alternative policy. Our policy is for aged care providers to use a special investment vehicle known as an income bond to hold accommodation bond balances. I should point out that, when the minister circulated the explanatory memoranda for these bills, only three options had been considered. We now see in the department's submission to this inquiry that they had considered other options, one of which is individual insurance. Our proposal is similar to this but avoids all of the problems outlined in the department's submission. We ask that the committee in its report recommend that the department should reconsider this option in light of our submission. I am happy to answer your questions.

CHAIR—Can you run through briefly how you see income bonds working? You indicate in your submission that there are some advantages, including government not being required to step in to guarantee accommodation bond balances. But I do not understand what happens if an income bond is not honoured in some way. I understand that essentially it is an arrangement between an investor and the bonds issuer. There is surely the potential for that to break down. If it does break down, how is it that the person leaving the accommodation or their estate will be guaranteed the return of the bond?

Mr Davies—An income bond is based on an investment bond, which itself is based on a life insurance policy. These things have been around for a very long time, so we are not proposing anything that does not already exist. Like a life insurance policy, these proposed ideas will have an owner, which will be the aged care provider, but the owner will hold that bond in trust on the life of the resident, who will be the life insured, and for the beneficiaries potentially nominated. The way these products work is that, when held in trust, they are not an

asset of the person who owns or controls the bond. If something happens to that person—perhaps they become insolvent—I have proposed here that the bond is not their property and cannot be called upon by creditors.

CHAIR—Yes, but that is still an arrangement that operates in the private sector, isn't it? It is an arrangement between individuals or corporations in the private sector that results in that investment being returnable effectively to the provider of the bond in the first place. Is that correct?

Mr Davies—I am not quite sure that I follow. We are saying that, were the aged care provider to become insolvent, this investment income bond should not be considered property of the aged care provider that a creditor can call on.

CHAIR—You say that it should not be, but could it be?

Mr Davies—No, I do not believe that it could be either. It could not be. These arrangements currently work this way with investment bonds and so on. There are some protections already for them under the Bankruptcy Act.

CHAIR—So are you saying that there could not be any circumstances where a person would not be able to recover the value of their bond or the balance of their bond under these arrangements?

Mr Davies—When you say 'a person', do you mean a creditor of the aged care provider, or—

CHAIR—No, I mean an aged person leaving that accommodation, or their estate. Are there any circumstances where they could not receive their entitlement by virtue of using these income bonds?

Mr Davies—I cannot see any circumstances. These investment bonds are technically a life insurance policy, but on the death of the life insured the bond is payable to the beneficiaries, whether it be back to the estate or to nominated beneficiaries, and, if they wanted to withdraw it, they could withdraw it.

CHAIR—Yes, but take the example of life insurance: if a life insurance company goes belly up then you do run the risk of not getting your benefit unless there is some sort of fidelity fund or arrangement.

Mr Davies—There is no risk component as you would have with a traditional life insurance policy. All of the moneys are held in benefit funds. The rules are determined and regulated by APRA.

CHAIR—Thank you for that.

Senator McLUCAS—I will just continue from where Senator Humphries finished. Can you explain to me how a benefit fund operates and why there is almost a 100 per cent guarantee that that money is safe?

Mr Davies—I will just say that we are not proposing anything new. This already exists. I am probably not the best person to ask about the exact detail of a benefit fund—you might ask someone from the Friendly Societies Association. But, broadly, the moneys are held in benefit funds, as with a trust arrangement, so that they are separated assets and quite separate from

any risk taking by any parties such as persons managing the funds or the aged care providers themselves.

Senator McLUCAS—So essentially you are saying that there is no risk to these moneys?

Mr Davies—Correct. They are held prudentially—

Senator McLUCAS—It sounds too good to be true, I am afraid.

Mr Davies—The risk is investment risk. When moneys are held in a capital guaranteed environment, you are exposed to very minimal investment risk. We are talking about investment risk there. In terms of any other type of risk, we are saying that these products exist, are widely used and have not had any history of risk, with benefit fund structures that have been used by life offices and by friendly societies for a very long time. If you think also of the way that our funeral industries use prepaid funerals, it is the same type of arrangement.

Senator McLUCAS—I now go to the costs. What costs would an aged care provider have in using the model you are proposing as opposed to the model the government is proposing?

Mr Davies—The costs of this type of product are not really any different from the costs of holding a bank account. The management expense ratio, which is the cost of one of these managed investments, could be from 0.8 per cent to 1.5 to two per cent of the cost of the underlying investment. It is not going to cost a great deal—particularly to the aged care provider where there would be no cost. They are probably facing a cost of one per cent for holding a bank account. With this they will be facing the same type of cost but with our proposal they are outsourcing the administration of the payment of retention amounts to us, so they are potentially saving money there. We are taking over the administration and they can divert resources to caring.

Senator McLUCAS—You say that the costs of holding a bank account are one per cent—that is without the interest earned, of course.

Mr Davies—Correct. Something like a cash management trust effectively has a management expense ratio of something like one per cent. These types of products that have been around for a long time cost perhaps one per cent, depending on how it is structured—perhaps 1.5 per cent. It is not a more expensive option.

Senator McLUCAS—Have you any idea of the difference between the sort of interest on investment that would be recouped through your proposal compared with current proposals or current activity?

Mr Davies—Are you asking me to compare returns from our proposal with the returns aged care providers are getting from investing these moneys themselves?

Senator McLUCAS—Yes. I suppose it is hard to answer that. You may not know.

Mr Davies—It is hard to answer. I have read the Department of Health and Ageing submission, which is very good, but that does not really suggest how these moneys are being used so it is hard to say. We are talking about moneys invested prudentially with a view to securing the capital so that it can be returned on death of the resident or perhaps when the resident moves to another facility or leaves. These types of secure returns would be prudent—capital guaranteed and capital stable. They are the sorts of traditional investments in the

industry that may return something slightly ahead of inflation. The moneys are very conservatively invested so there is not a great risk to the capital. We are looking at between three per cent and six per cent as long-term figures for these types of products.

Senator McLUCAS—With a very low risk base?

Mr Davies—Yes, absolutely.

Senator McLUCAS—In the development of these prudential arrangements, were you, or was anyone in the area you work in—as far as you are aware—consulted about your views on the best way to protect accommodation bonds?

Mr Davies—No, we have not been. I do note that we have become increasingly involved in the aged care industry by supplying services in the last 18 months, but we have not been consulted.

Senator McLUCAS—Have you taken the opportunity to provide your submission to the department following the announcement of their policy?

Mr Davies—We certainly intend to. We have been looking at this to develop a type of product that we think would become the preferred option or best practice to hold these accommodation bond moneys. When we saw this inquiry we thought it was an opportune time to make our contribution. Certainly, we would be looking to pass this on to the department and have them look at the insurance option again, which is similar to ours. We would ask the committee to recommend that to the department, as well.

Senator McLUCAS—Have you spoken with aged care providers about your ideas? What sort of response have you had?

Mr Davies—We have. We have only started promoting it. We are involved in sponsoring certain parts of the industry with an education campaign over the next 12 months. So perhaps I can report back in 12 months as to how successful it has been. There are already suggestions that these types of options are attractive to those who want to carefully and conservatively invest their residents' accommodation bond moneys. Some are currently holding these things in bank accounts, earning five per cent. We are hoping to provide that type of service but to also outsource the administration so that we pay their retention amounts.

Senator McLUCAS—I will leave it there; maybe if there is time I will come back to it. Thank you.

CHAIR—I come back to the statement you made about the income bonds proposal having no risk at all to the person who pays the bond. I put to you this situation: Mrs X goes into a nursing home and pays her bond to the operator of the nursing home. The operator of the nursing home is in some financial difficulty and cashes the cheque and takes the money to Brazil. Since no bond has actually been purchased by the operator at that point, surely the regulator has no power to offer any prudential protection to that particular person. Where is the security for Mrs X in those circumstances?

Mr Davies—Our security comes in when Mrs X pays the bond to the operator and the operator then takes out the appropriate investment product. Once that is in place, with benefit fund rules we would not be paying it back to the operator unless we had been notified of the death of Mrs X or unless something akin to a rollover in superannuation were to occur.

CHAIR—That is not the situation I am talking about. I have not purchased a bond at all.

Mr Davies—With this proposal we cannot do anything about an operator not actually investing the moneys as suggested.

CHAIR—That is where the government proposal would be superior. It would protect Mrs X from the point where she pays the bond, not the point where the income bond has been purchased.

Mr Davies—I can see the two proposals working together. In those circumstances where a person has been defrauded or there has been a misadventure the government could guarantee the moneys. Once the moneys were invested in the appropriate structure the government would not be exposed to that type of risk any longer. I see them as being complementary.

Senator McLUCAS—Do you see that it would be possible for your proposal to operate in concert with the current legislation that is in front of us?

Mr Davies—Absolutely. We support this legislation as the fallback option. In circumstances such as the operator not passing on Mrs X's money to the approved fund or in a misadventure situation the government would have to step in. Our proposal could certainly work alongside that. Once the moneys had been invested prudently and appropriately there would not be the types of risk that currently exist.

Senator McLUCAS—You are saying that it would essentially deliver an added layer of protection. It may make the proposal from the government to recoup moneys should a provider fall over redundant.

Mr Davies—Correct. The model to look at is prepaid funerals in the funeral industry. A person deposits the money with a funeral director who is then obliged to deposit those moneys into an appropriate investment. It varies from state to state. That gives protection once the money is invested but there is still the risk that the funeral director does not make that deposit. That risk will exist in these situations but once it is invested with the regulations in place it is now regulated.

Senator McLUCAS—Let us take that a step further to cover Senator Humphries's concern. If a person goes into a residential aged care facility and is required to pay a bond, there would need to be, I imagine, some sort of regulation to stop the Brazilian escapade. When the person goes into the facility there must be some sort of communication between the facility and the department to say that this is where the bond has been deposited.

Mr Davies—Correct. It could be like rollovers and superannuation or contributions into superannuation—that type of reporting—which are resident entered, and then the deposit is received by the registered bond supplying entity, absolutely. I do not know about quarterly reporting but superannuation has numerous examples of that type of reporting back to government.

Senator McLUCAS—Finally, in terms of funeral funds—I do not know a lot about them—have there been examples where they have been unsuccessful where they have fallen over or there has not been protection of moneys that have been held there?

Mr Davies—I will not say I am an expert, although I have just held up the industry as a model, but I am not aware of any particular examples. It has very similar types of

arrangements. It varies from state to state though so that is the problem. I am in Victoria. There may be instances in different states. It is not generally a matter for federal law.

CHAIR—Thank you very much for your evidence today and for your submission.

Proceedings suspended from 4.56 pm to 5.10 pm

YOUNG, Mr Rod, Chief Executive Officer, Aged Care Association Australia

CHAIR—Welcome, Mr Young. You have been a victim of Canberra's slightly capricious airline timetables, I understand, so thank you for coming. Information on parliamentary privilege and the protection of witnesses and evidence has been provided to you. The committee prefers evidence to be heard in public, but evidence can also be taken in camera if you consider that such evidence would be of a confidential nature. The committee has received your submission; thank you for that. We would like to ask you some questions about the submission, but before we do so would you like to make an opening statement?

Mr Young—Just generally, Chair, to reiterate that we have been extremely supportive of a scheme of this nature. We were instrumental in bringing some of our concerns to government nearly three years ago now, commissioning a report by PricewaterhouseCoopers at that time to undertake an analysis of potential risk. I emphasise that it is a small risk. In the report that was produced at the time, the risk of any failure was considered to be quite small. At the same time it was considered that if a failure were to occur and bonds were to be outstanding, that had the potential to cause considerable damage to us as an industry, to the government and to the public standing of aged care providers.

Consequently, we went through that process and looked at various schemes and have been working with the government on this scheme for the last 12 months. We have been highly supportive of such a scheme coming into place to achieve those objectives. Whilst we are very conscious of the fact that the original entry contribution scheme started in the mid-eighties and the bond scheme in 1997, so there has been almost 20 years of life of a scheme of this nature and there has not been an ultimate failure of any provider to repay the bonds or entry contributions they have received from residents in aged care facilities, nonetheless we feel that a scheme such as this gives that added weight of confidence by the community in the scheme and an assurance that bonds will always be repaid.

CHAIR—If it became apparent to the industry or to an association like yours that there were dodgy providers somewhere in the system—people who were cutting corners or playing fast and loose with the rules or something of that kind—what capacity would you have as an industry to bear the consequences of a failure on that provider's part to repay a bond if you had to pay a levy? What would you be able to do about that to bring those sorts of people into line?

Mr Young—We do not have any substantial legal capacity to bring a provider into line in those circumstances. However, I think we need to recognise the quite significant changes that have occurred in the last couple of years—things like the requirement of all aged care providers to now produce audited financial accounts, the fact that those accounts are required to be audited by registered company auditors, the fact that those accounts can be sought by prospective or existing residents. I think that is one aspect of how the industry is becoming far more business disciplined in its approaches.

The fact that in this scheme, for the bonds that are held by providers, the declaration each year will be required to be signed off by the same auditor I think is starting to put together a scheme which has quite significant substance to it and a degree of discipline surrounding it,

which will avoid us getting into that situation. As an industry association, we are already in the process of putting in place a code of conduct—and we have already done so in some of our states—which members must adhere to and to which they must sign up to be a member of the association and basically to get the association's tick of approval. But probably that is the extent of our capacity, because we are a voluntary body and we cannot guarantee that all industry members will belong to us. We can only take that to the extent of its being voluntary for our members, and not everybody in the industry deigns to belong.

CHAIR—Presumably you would have the capacity to report providers that you were concerned about to the Department of Health and Ageing or to the accreditation agency?

Mr Young—The capacity would exist amongst us and providers, yes. In the interplay between the department and the industry, sometimes there is an exchange of information on that, bearing in mind the relevant confidentiality provisions, particularly from the department's side—because most of the information that we might have would be industry-general information rather than industry specific. But it would be a very loose arrangement, where that may occur, and you could not put it within the framework of a scheme.

CHAIR—In terms of refining this legislation, you ask for:

A clearer definition of the administrative rules surrounding the recovery provisions ... in the event of a failure by an aged care provider

What sort of thing are you looking for there? Obviously it is very hard to be prescriptive about what might constitute a failure, but would your concerns be satisfied, for example, if the regulations were to provide that a provider who does not refund a bond within three months is deemed to be in default, or something of that kind? Is that what you are looking for?

Mr Young—There is a clear definition in the legislation as it is currently proposed of an event that causes the legislation to come into play. There is then an endeavour to say that, once that event is declared, we will move back 10 days prior to that to determine who will then be part of any levy scheme in the future. We still have some concerns about what happens between the date of the event and the 10 days, and events that might occur in that process. I am not sure from my reading of the legislation that it actually clarifies that. If, for instance, somebody as a provider exits the industry in that 10-day phase, are we saying that the 10 days will apply to that provider even though they have exited in the meantime? The legislation is quiet on that. So we are just trying to ensure that we do not have grey areas of difficulty in the future and that we provide greater clarity on issues like this one: if you are there at 10 days, even though you have exited the industry, sold to another provider and transferred beds or bonds, it will be your responsibility at a point down the path, even though you are no longer a provider, to take account of that—or you will have to have made provision in a sale document, a contract document, for how that would be treated by an incoming provider taking over your responsibilities.

CHAIR—Thank you.

Senator MOORE—I have a couple of questions, Mr Young, and then I will pass over to people who speak the language better. In your document, you have said that you strongly support the legislation—

Mr Young—We do.

Senator MOORE—and I note that you are on one of the reference groups that have been involved in working on the process. You talked about the number of members that your organisation covers. What percentage of the homes that could be involved in this process does your membership involve?

Mr Young—That is a very—

Senator MOORE—Vaguely? You can take that on notice.

Mr Young—Very much off the top of my head: in the industry we have about 67 or 68 per cent of providers who have a bond of one or more bonds. The reason is that, even though they might be in high care, if a resident transfers from low care to high care and decides to leave their bond in place, which many do, then that bond and the rules that surround the holding of that bond will apply to the high-care nursing home. My rough guess is that we represent about 40 per cent of the beds in the industry. About 40 per cent of our members are voluntary; about 60 per cent are private. My gut feeling is that about 40 per cent of that 40 per cent of that 40 per cent hold bonds, so we are probably talking about something in the order of 15,000, I would think.

Senator MOORE—I was just trying to get some idea of the people for whom you speak. You talked about your association being strongly supported and I was trying to get an idea of how many were involved in that. Senator Humphries raised one of the questions that your submission raises, but you have a couple of others in dot points on the back. They seem quite specific to me. The process now is for you to clarify those things with the department, because I know you are in negotiations with the department. Have you raised with the department the questions that you have raised in dot points in the submission you have given to the committee?

Mr Young—We are in the process of doing so.

Senator MOORE—Are they straightforward?

Mr Young—I believe they probably are. I guess we raised them for the committee's purposes, to ensure that they are included in your discussions today—particularly, perhaps, your discussions later this evening with the department, if they were issues you wanted to pursue.

Senator MOORE—I will attempt to do that. I do not know whether I have the full knowledge, but I have noted that these are direct questions that you have about the operation, in much the same way as the response you gave to Senator Humphries' question about how it would fit. I just wanted to find out what stage you were at in your discussions with the department on that.

Senator McLUCAS—I would like to go through those dot points with you if that is possible. The first comment you make is that you need a clearer definition of what an insolvency situation is and how that would be conveyed to the minister. Can you explain to us what is unclear in the legislation and how you would fix it to provide greater clarity?

Mr Young—Part of what we were looking at is in part 2, entitled 'Insolvency event declaration', and in the definition of 'insolvency event' in the primary Aged Care (Bond Security) Bill. We had some concerns that the connection between the two needed some

further clarity. When you go through the definition of 'insolvency event', what is covered there is fairly comprehensive. But when you go to clause 7 it says that the minister may make an insolvency event declaration in relation to an approved provider where that is a company or a personal insolvency situation and there is a bond outstanding in respect to that provider. On my reading of that, it means that the minister may make that declaration whenever, without actually referring to the insolvency event definition back in the definitions component. We are just conscious that that needs to be clarified. In what circumstances is that insolvency event able to be declared or is it based only upon the declaration or information in respect of one of the aspects of the insolvency event definition? I am not making myself clear.

Senator McLUCAS—I am sorry, no.

Mr Young—The insolvency event definition says there are things that will be covered within an insolvency event, and they are listed in (a) through (g). This is on page 5. Then, on page 7, under part 2, clause 7, entitled 'Making of insolvency event declaration', seems to give to the minister carte blanche to call an insolvency event without necessarily having reference to the definition. I am just trying to put those two together.

Senator McLUCAS—You want to connect those two parts of the act. I understand.

Mr Young—The minister would make a declaration in the event of one of the events occurring that are set out in the definition—that is, in (a) through (g)—and not in any circumstance open to the world.

Senator McLUCAS—We will put that to the department later this afternoon. The issue that you explained to Senator Humphries was the one about going back in time 10 days. Let us think of the worst-case scenario, which I do not presume by any stretch would happen. But I suppose this is how you make legislation, by thinking what could be the worst thing that could happen. If a very large operator became insolvent—and I do not think they will—and if people realised that there was a potential for a liability, they have 10 days to sell, haven't they?

Mr Young—That would be one reading. If the act and the administrative arrangements behind it allow the 10 days to be instated as a fact without any variation or cognisance of what has happened in the meantime—in other words, you would revert everything back to 10 days no matter what you have done in the meantime—then my reading of it would be that it would protect the situation.

Senator McLUCAS—So the snapshot would be at 10 days prior to the declaration of the solvency event.

Mr Young—Yes. And my reading is that we are making it 10 days—it has to be a period before—so that there can then clearly be a population of providers who hold bonds who can then have a levy levied against them at a point in time.

Senator McLUCAS—Sorry, I misunderstood the point you were making.

Mr Young—But the first part of it is, yes, what happens in that intervening period—that is, 10 days before the event is declared?

Senator McLUCAS—If someone were to depart the industry but be caught in that window, you are not sure what would happen to them.

Mr Young—That is right. I just want to make sure that we do capture that because we want this to work effectively and not have areas of greyness in the future. We need to be certain that that 10 days will reinstate anything that has occurred in the meantime, such as a sale or transfer, and/or the sale or transfer will make the new owner absolutely responsible for the circumstances that existed 10 days prior to the event being declared.

Senator MOORE—When you make that transaction it would all be part of the package.

Mr Young—Yes.

Senator McLUCAS—You are suggesting that in any transfer there would have to be a clause about potential liability for a levy.

Mr Young—I think it would be essential to protect both vendor and purchaser and to quite clearly define who is responsible should that event occur.

CHAIR—Presumably, the liability could be attached to the licence the person has to operate the aged care facility. Whoever owns the licence has the obligation to pay the levy.

Mr Young—It could, but I think it would need to be clearly spelled out in the contract because it would not automatically flow with the licences—not within the current legislative framework nor in anything in commercial law—unless the contract specifically makes provision for it.

Senator McLUCAS—The third dot point you make is that ACCA does not believe that an additional inspectorial process to confirm compliance with the legislation is necessary. How does the government then ensure that they are operating a bond register and that it is all happening?

Mr Young—I have taken a degree of editorial licence because it does not quite fit within the provisions that are in the bills at the moment. I am aware the department is planning at this stage to have a scheme which would inspect the bond registers of aged care providers. From our perspective, as we consider ourselves already to be a highly regulated industry, we want to try to avoid any more regulation. As I outlined to Senator Humphries a moment ago, we now have audited financial account requirements that are undertaken by registered company auditors that are satisfactory for the rest of commercial Australian as highly skilled professionals. The same company auditors are going to be required to sign-off on the prudential declaration that goes to the department about the documentation being maintained by facilities. One of those is obviously going to be the bond register requirement of the legislation, the prudential capacity and capacity of aged care providers to meet their bond outgoings. In our opinion, the fact that an auditor is involved in both of those steps and in this process is more than adequate to satisfy the department or the government that the bond register has been maintained, the prudential scheme is working and the financial capacity to repay bonds has been verified by an auditor undertaking that task.

Senator McLUCAS—What happens now with the auditing of bonds and where they are kept?

Mr Young—Currently, there is a less rigorous scheme—the declaration is made but it is less demanding than what is being proposed in this scheme.

Senator McLUCAS—Is it audited?

Mr Young—It is supposed to be audited, yes. Until there was a requirement of aged care providers to have audited accounts, the linkage between the audited accounts and the auditing of the declaration by a registered company auditor was not, I believe, happening in all cases. It is often an accountant or some other lesser professional in the auditing process.

Senator McLUCAS—You ask what form of written notification is expected.

Mr Young—That really is a clarification. It says 'written' but we are assuming that fax, email and other forms of delivery are quite acceptable.

Senator McLUCAS—I see: it is how you send the letter. You ask the question: what is meant by corporate governance?

Mr Young—It simply mentions corporate governance without any clearer definition of what we are talking about. That can mean a raft of things to a raft of different organisations. There is a list of activities down there; there needs to be some slightly greater clarity about what we are talking about by corporate governance, or a reference to ASIC's definition of corporate governance or some other defining document that gives a little more clarity to that.

Senator McLUCAS—You are suggesting we should define corporate governance in the definitions.

Mr Young—Either define it in the definitions or make a reference to something that clearly defines it as per Australian Corporations Law.

Senator McLUCAS—You asked why we picked 10 days and not seven or 15.

Mr Young—I do not quite know why it is 10 days. I suppose it does in the main give you almost two working weeks—but not always, it depends on public holidays and longer breaks like Christmas and Easter. It could be 10, it could be seven, it could be 14. I do not think there is any actual explanation I am aware of for 10 as opposed to some other number.

Senator McLUCAS—We will ask the department. Earlier this afternoon we had a submission from OFM Investment Group talking about a proposal they have which, as suggested in the evidence from Mr Davies from that group, could work in concert with the proposed legislation. He is suggesting that the government would consider using income bonds, which essentially, I think, work like life assurance policies and, he suggests, provide a greater level of protection. Does ACCA have a view on the proposal from OFM?

Mr Young—I declare a vested interest—OFM is a sponsor of the association. I put that on the table before we start. I cannot possibly, however—even if they are a sponsor of the association—imagine that OFM would be a more secure and responsible organisation for the ultimate security of these bonds than the Australian government. That is the scheme on the table at the moment; the government would stand in the stead of a failed provider. I am unfamiliar with the scheme that OFM is proposing but from the little you have described I do not think we would be strongly in favour of going down that path as opposed to the scheme that is on the table.

The scheme that is on the table is the best scheme. We have to go back to the PwC report I mentioned a while ago. It was in fact our first option and for a variety of reasons we looked at various other alternatives because we did not think the government would be in favour of such a scheme. At the end of the day the government is in favour of it. We are delighted with

that. We cannot think of having a better scheme that favours the industry and protects our consumers who pay bonds than the one that is on the table at the moment.

Senator McLUCAS—I wonder if you would mind having a look at their submission. To put their submission in a nutshell, they are saying that, if you bring in this protection by using income bonds, you would never have to struggle in the future because the protection would be so sound. If you have a minute it would be good if you could have a look at the submission and make some further comments. That would be very valuable.

Mr Young—I would be happy to.

Senator McLUCAS—Thank you.

CHAIR—In fairness, they modified their submission somewhat to admit that there may be a stage in the process of paying a bond—between when the bond is paid by the person entering the home and before an income bond is purchased—when there may be a need for government guarantee or protection to ensure there is no period of danger to the consumer.

Senator McLUCAS—Yes.

Mr Young—We did look at a variety of different arrangements and all of them were going to cost the industry a considerable amount of money—an up-front contribution to a scheme and then an ongoing contribution to maintain it of anything from half a per cent to three per cent. I would not think that an income bond of this nature was going to be free, so I would assume that there is probably something in the order of one to 1½ per cent attached to its cost for its operation and its provision to the industry. In that case, that scheme, just on that particular item alone, as opposed to this scheme which is going to cost the industry nothing other than a small administrative cost in a couple of years time, unless a levy has to be levied in the future, almost speaks for itself and, before looking at the document, I think we would much prefer this one than that one. But I shall have a look at it in a moment and give you my thoughts.

Senator McLUCAS—Thanks. Mr Davies said that the cost of purchasing an income bond would be the same as operating a bank account. That is just by way of information. I am truly seeking information; I do not have a view.

Senator ALLISON—I would like to put to you the three main issues that Professor Hogan puts forward in his submission. Have you had a chance to look at that?

Mr Young—No, I have not seen Professor Hogan's submission.

Senator ALLISON—I hope I paraphrase him correctly. He draws attention to the fact that there is not an independent body designated to monitor and supervise this arrangement, despite him having made that recommendation, but that nor is that precluded. Would you like to see an independent body identified?

Mr Young—Professor Hogan put that forward as one of his proposals when he did his major report to government in 2004. At that stage, government did not accept the proposal. We considered it and we considered that there were even more costs associated with its administration than what had been looked at in the various schemes I mentioned a moment ago. You had to actually tie that to his comments regarding the extension of bonds to the whole industry, so that this would be a scheme that would apply across the whole of aged

care. Government did not accept that component of Professor Hogan's recommendations either. I always had difficulty understanding entirely how the scheme he outlined would operate, because it almost smacked of having to have a scheme that would actually manage the bonds in their entirety, which would entirely change the structure of the capital creation of this industry. We do need to recognise that industry is spending nearly a billion dollars a year on its upgrading and new building stock, and without the bonds in the industry that would simply have been impossible.

Senator ALLISON—Are you suggesting that the $4½ billion or so currently in bonds is not a sufficiently large amount to warrant this independent body doing the monitoring?

Mr Young—No, that is not what I am saying. It is my understanding from part of what Professor Hogan had recommended in 2004 in his main report—and I assume that he is recommending something similar, but I am not certain because I have not seen his submission—

Senator ALLISON—No. This is a submission on the basis of the government's legislation.

CHAIR—He has not pressed what he originally proposed. He has made some alternative suggestions based on the government's new legislation.

Senator ALLISON—The other point he makes is that the levy bill talks about differentiation between classes of providers and gives just one example of remoteness or otherwise. He says it is not at all clear how the process for that differentiation would work. Is that something you have thought about?

Mr Young—On that issue I agree with Professor Hogan. My understanding of how the scheme is to operate is that any levy would be based upon the financial value of bonds held. An operator who had a $100,000 bond would be levied, let us say, at 100 per cent of the levy, but an operator who had a $1 bond would have a proportionate levy for that amount of money that they were holding. It would be a levy based proportionately upon the dollar value of the bonds held by individual providers at the given event date. That in itself creates a classification based upon the financial capacity.

Senator ALLISON—You believe that is the differentiation being referred to?

Mr Young—I think so; I am not certain.

Senator ALLISON—It is differentiation between providers.

Mr Young—That is correct. That is where I agree with Professor Hogan. That particular aspect needs to be clarified. My understanding of the scheme is that the levy is to be levied based upon the bond holding, so that creates a multilayered differentiation based upon bond holdings. I do not see why you need to differentiate, then, between other components of ownership, geography or whatever, because that would already occur by that strategy.

Senator ALLISON—We will check that with the department, but it is your view that this is the basis you should be on. Professor Hogan also talks about the skills that might be required. We talked earlier about defining what insolvency is. He says that the skills within a department in terms of insolvency would be a lot narrower than, say, APRA. Do you agree with that? Are we looking for skills that go beyond just insolvency in this monitoring process?

Mr Young—The scheme as a whole is not asking the department to become insolvency experts. That will happen out in the broader arena, in the commercial world.

Senator ALLISON—How?

Mr Young—Through ASIC, through insolvency activities, through part 10 arrangements or whatever. The activities in the scheme that is here are generated by bankruptcy experts, by bankruptcy courts, through ASIC consideration of insolvency or otherwise. I do not see the department being experts and I do not think they have the expertise to call themselves insolvency experts.

Senator ALLISON—But who do you understand as being responsible for deciding whether a facility would need to shut down or whether an administrator needs to be called in? There is insolvency and there is insolvency, isn't there? It may be possible to rescue the facility with some careful management. Is that skill available within the department? Do you understand that it is the department's job to make that call?

Mr Young—No, I do not. I do not believe the skill is there. Nor do I believe it is the role of the department to become another APRA or anything of that nature.

Senator ALLISON—No, I am talking about insolvency—the decisions that will be made around whether or not a facility is shut down, whether or not a course of action is taken. Who do you understand takes that decision?

Mr Young—I understand that will be taken by ASIC, by insolvency practitioners, by bankruptcy courts et cetera in the normal milieu of the commercial world as it operates today. Those practices already occur. There are already processes in place for them to happen. There does not need to be a replication of that in the Department of Health and Ageing, and it would be quite inappropriate for it to be there.

Senator ALLISON—So you are not worried about that perspective?

Mr Young—I think all of us worry about any facility that gets into financial difficulties.

Senator ALLISON—No, that was not my question. It is about the ability and the flexibility to make the right decision. Do you see that there is flexibility in the bill for allowing all those processes to happen within government agencies, prudential agencies and the insolvency sector?

Mr Young—The department's responsibility is the overall scheme, quality care and to ensure that services are being provided to residents. That is where the core of their services is. If a provider of whatever ownership gets into financial difficulties then there are other commercial entities, such as bankruptcy courts, ASIC et cetera, depending upon the nature of the ownership, to actually take care of that and determine whether we have reached a situation where an administrator must be appointed—that is, an administrator for commercial operations of the facility as opposed to the ongoing maintenance under the Aged Care Act. I do not think you can actually put those two together under the Aged Care Act. You have to accept that there is a whole raft of commercial entities that operate in that environment. I would be loath to see that commercial supervision somehow or other brought entirely within the Aged Care Act and not remain part of ASIC's or other entities' supervision as it currently is.

Senator ALLISON—Just in case I have not paraphrased that accurately, you might consider looking at the Hogan submission on pages 9 and 10.

Mr Young—Certainly.

Senator ADAMS—Is there any provision in the accreditation of aged care facilities whereby they can check the financial auditing of bonds and see if they are held in the right place or anything like that, just to shortcut it as they are going in there anyway?

Mr Young—There is in part. You are asking whether there is any provision. Obviously, the agency assessors, when they visit a facility, are looking at the systems. They are looking to see that there is a bond register, they are asking whether facilities are making that information available to residents on the required basis in the required time frame and whether that financial information is made available if requested to incoming and existing residents. Those systems are what the agency assessors look at. They will not be looking at the investment strategy arrangements of an aged care facility—that would be outside the assessors' expertise—but they will certainly be looking to ensure that the bonds are there, that the auditing has taken place, that the register is maintained and that the information is provided on a regular and timely basis to residents when required or on an annual basis if required. Assessors are actually looking to see that those systems are all in place.

Senator ADAMS—So it is the next step, isn't it? I am just trying to shortcut the cost and expense to the facility of having this done. I am wondering whether, as you have already got those people going in, there is any way that they can extend what they are looking at a little bit further to cover it.

Mr Young—As I said, most assessors would not have the skills. I would prefer to leave that task to the accountants and then to the auditors, who actually review the accountants' work. They have got that sort of expertise. Amongst the whole 400—or whatever it is—assessors around Australia, there might be a couple who are accountants but most are not. So I am much more comfortable with them actually just looking to see that the systems are there, when they carry out their review audits or site visits, and making sure that those systems are functioning operations, that the residents and their relatives are being protected in the context that the information is available, accessible and made available in a timely fashion to the residents or their relatives.

Senator ADAMS—With that system would they be able to pick up that something is wrong?

Mr Young—If an assessor went in and said, 'I'd like to see your bond register,' and there is not one—alarm bells.

Senator ADAMS—This is really what I am trying to come back to, that the basics of it are there so there is a system that possibly could set off alarm bells as something is going wrong.

Mr Young—Absolutely. If a resident or their relative says to an assessor, 'Six months ago I asked for a statement on the bond balance and activity for the previous six months and I am still waiting,' there would be alarm bells as to why. That should be a 30-second print job—'Here you go, Mrs Jones'—and there is no reason why it should not be made available. So assessors are looking for those sorts of signals and if they come up they ring alarm bells for

all of us and the agency would be taking action fairly quickly. Part of the agency's action is to report back to the department that the prudential scheme in that particular instance seems to be not working effectively.

CHAIR—I presume you would regard the standard of financial probity in the aged care sector in Australia as being fairly high.

Mr Young—I believe it is.

CHAIR—So you would not say there was any sort of crisis of confidence in the sector at the moment as far as financial probity is concerned or, for that matter, as far as the standard of care that is being provided in homes is concerned?

Mr Young—We are very confident about what we are doing. We know we have come a long way in the last 15 years in terms of services, quality building stock and the range of services being provided. I think that the level of morale that you actually see around the industry is extremely positive these days. I am not saying that we cannot do more, because we always can. I am not saying that we cannot do things better and more efficiently, because of course we always can. When you actually look around the industry, you see there is a high level of confidence and a great deal of reward and pleasure in what people do for our older and frail residents. As for what I see from the broader provider perspective, I think the best evidence is the comment I opened with: there has not been a failure in this scheme for 20 years. I think that in itself is a darn good indication of the industry's probity and business discipline in being able to provide good quality business operations.

CHAIR—Thank you very much, Mr Young, for your evidence today.

[5.50 pm]

HOGAN, Professor Warren Pat, Private capacity

Evidence was taken via teleconference—

CHAIR—Welcome, Professor. Information on parliamentary privilege and the protection of witnesses has been provided to you. If you wish to provide information or evidence of a confidential nature you can do that in camera. We have your submission, which we have numbered 7. Thank you for that. Would you like to make an opening statement based on that submission before we ask you questions?

Prof. Hogan—Certainly. Some of the themes I dealt with in my statement have already been covered as I have been listening to the examination of the previous witness. I support the three bills. The main issues, apart from some relatively minor queries, lie in the implementation. The statement comprises three parts, the first of which is introductory. It reflects the judgment on my part that I have to state some positions in view of my role in the conduct of the aged care review. The second part is the central focus, with most emphasis on the prudential issues, because of what are found to be some confusions in the explanatory memoranda. The third segment is about longer term issues. I suppose the thrust there is to get some recognition for reviewing the experience over the next two or three years to see what needs might be better dealt with in the future. I am seeking to raise a number of issues which bear upon implementation much more than the principles of what is on offer.

CHAIR—Thank you. Could you clarify what you are saying about the capacity of the department to assess the state of solvency of providers so as to trigger the operations of these bills, especially as far as the levy is concerned. You make the point that bodies like APRA have a higher level of skills in this area and that perhaps the department, with a relatively small staff in this area, would not have the capacity of APRA to assess insolvency issues as well.

Prof. Hogan—The point I was making was not so much the black and white contrast between viability and bankruptcy, but rather that, most importantly, if one is to protect the issues of the levy in relation to industry, and the position of both the users of the services and the providers, there might be a searching out of intermediate positions where there are significant signals that the entity concerned is running into severe difficulty. But one would like to find the means by which one could investigate the possibilities of avoiding bankruptcy by recognising illiquidity emerging and therefore seek new owners, rather than get to the position where you do have bankruptcy, with all the attendant difficulties that flow from that, which may involve, at the most drastic level, shutting down the facility. Those are the themes I had in mind in terms of that quality.

On the issues of insolvency there is no question that the department can recruit an insolvency specialist, and they themselves say that in explanation of this issue in relation to the levy. But in terms of the wider practice of prudential regulation I think the issue is really whether you look in advance for signals of distress emerging rather than wait for bankruptcy, which you then have to deal with after the event, with all the additional consequent dislocations.

CHAIR—Thank you.

Senator McLUCAS—Professor Hogan, thank you for your submission and for making your time available. Can I pick up the discussion that you have just had with Senator Humphries. How do you imagine that either this legislation or legislation generally could do the work you propose—that is, start to be a bit more proactive in ascertaining the viability and financial standing of an aged care provider?

Prof. Hogan—The issue is to look at the returns, essentially, from the auditors and look at the potential for illiquidity. Certainly one would be concerned at any time if there were any sense of qualification in any of the auditor's reports. One is assuming of course that the auditors have an ongoing relationship with these entities, and that applies particularly to the question of accommodation bonds.

It would be perfectly feasible for the department to secure consultancy arrangements with accounting firms to undertake some of this work in terms of examination, and they would then have a decent potential to look ahead and see what is happening. I am really seeking here to try to reduce the prospects for a really deserving situation arising with bankruptcy and, rather, looking for other ways to ease people out of predicaments.

The reason I say that is one of my major motivations, which also lay behind my report in relation to all these things, is that which I mentioned very briefly in the submission: we are dealing with the very elderly, and they have no prospect of recompense. That is the purpose of this levy: to ensure that they have to be recompensed for the loss of value of assets. Equally, one does not want to see the same thing emerge as an impost on the industry. I believe that is the real motivation behind my thoughts. We need to ensure that we can ease the predicament of the industry if anything should happen.

As has been said by others, we have had a long period in which we have not had difficulties. But on the other hand this has been a very benign period, as I say in my statement, and I think one would be very foolish to think that we can continue with that general situation.

Senator McLUCAS—We will put those views to the department and see what they say. I am not sure that this is the legislative instrument to achieve that outcome. There may be other ways to achieve that outcome, rather than looking at accommodation bonds and their treatment.

Prof. Hogan—I can understand that view, but if you are talking about prudential standards I think it is the way you manage those prudential standards that is really quite critical. If it is not here, then I do not know where it would be.

Senator McLUCAS—Thank you. That is a good point. Professor Hogan, on page 7 you talk about there being a potential for differentiation in the application of the levy. You say, 'This aspect of the bill calls for clarification.' There is potential in the application of a levy to differentiate, and I think the explanatory memorandum talks about rural providers. Do you want to expand some more on that?

Prof. Hogan—The reference in the explanatory memorandum is actually to remoteness or otherwise. That is about the location of services. I was seeking clarification on what is going to be the basis for determination of classes of providers, because it is a term which could raise

all sorts of difficulties. For example, as I say in my submission, the concept of rural providers is a very difficult one, because some rural providers are really very close to metropolitan areas—indeed, they are supported greatly by services almost akin to those of metropolitan and other major urban areas—whereas other rural providers are not all that much different from the remote people. Indeed, if I had continued the review for much longer, frankly I would probably have sought to differentiate the whole category of rurals to cover this. It is those distinct possibilities that I think need to be clarified. Obviously, it is a suggestion about differentiation regionally and geographically. Would you distinguish, for example, between those who are within 50 kilometres of the coastal regions of Australia and those who are inland? All sorts of possibilities can arise. I would have thought, really, that if you are dealing with accommodation bonds, the only real feature is: who holds accommodation bonds and what is their value? The levy should be placed on them on a parity basis, which I thought was the basis of this levy proposition.

Senator McLUCAS—Can you imagine why the department would have taken that step to identify in the EM that remoteness or otherwise is important.

Prof. Hogan—No, I do not, because I cannot imagine, from my own experience, that there are very many bonds in remote areas.

Senator McLUCAS—That is my understanding as well.

Prof. Hogan—It could be that this discussion is redundant, because we do not have information on the extent to which accommodation bonds apply in these areas. My own judgment would be that the vast majority of accommodation bonds do apply in the metropolitan areas of Australia and some of the very substantial rural areas which are by no means remote.

Senator McLUCAS—Thanks, Professor Hogan. Once again, we will put that to the department as well. My final question goes to your comments on page 10 about consultants. You make the point and, I think, agree with the department that they will have to employ consultants to do a lot of the work that would happen as a result of these bills being passed. But you do make the point that those who are recruited as consultants must be required to act on any matters related to prudential standards solely for the department and not for other parties. Are you concerned that the pool is not large enough, shall we say, to ensure that people do not end up in compromising positions?

Prof. Hogan—No, I think that we have a great proliferation of accounting and related financial services in this country. My concern here is in matters of prudence, where it goes to the heart of confidentiality and issues about stability and probity of individual entities—that, in fact, people acting in circumstances related to those highly confidential and delicate matters cannot really afford to be working in circumstances other than for dealing with the department. Otherwise, as I say in my submission, the issues about conflict of interest would be ever present.

Senator McLUCAS—I do not want to sound completely naïve on this, but doesn't that happen in business now? What protection does any entity have, if they are employing a consultant, to be assured that they are not working for another entity that is associated with the issue at hand?

Prof. Hogan—Firstly, it is part of the responsibility of consultants to declare their interests. Secondly, people who involve themselves where they can face a conflict of interest still have the prospect of running into some legal predicaments, I would have thought.

Senator McLUCAS—Is there anything we can do in the legislation to protect the department against that?

Prof. Hogan—Not in the legislation, but in the practice, and I think what is important in all of this is what is going to be the flesh on the bare bones of this legislation.

Senator McLUCAS—Yes, I take your point.

Senator ALLISON—UnitingCare Australia made a submission saying:

The lack of data or financial modelling available to indicate what the levies on providers are likely to be in the event they are responsible for bonds unable to be paid by a defaulting provider ...

Is that a concern that you share?

Prof. Hogan—No, it is not really. I would have thought that the extent to which the levies would arise would not be onerous, and there would be provision in terms of the judgment of the department that the question of the recovery of the levy might take place over more than one fiscal year. If it became in any way something that was looked upon as one per cent or less of the accommodation bonds outstanding, I think even that would be a substantial sum.

Senator ALLISON—What about the discrepancy in the requirement to repay bonds within 14 days and the potential difficulty of doing so when a bond is repaid in the event of a person dying and the legal requirement of the provider having to wait to refund the amount until probate has been obtained?

Prof. Hogan—The only way in which, in the event of death, the bond can be repaid is through the formal and legal recognition of where that bond is due for repayment. Therefore, the provisions in the act that essentially require that when probate is granted, or some similar legal measure, the 14 days give the provider time to make judgments on this matter. If the argument is that the provider needs to check that the request is in fact a valid one and that the provider would wish to seek advice from that provider's legal advisers, then an argument could be made that it should not be 14 days but 21. But all of those things seem quite reasonable to me.

Senator ALLISON—Thank you so much for that. I just point out that the department was nodding while you were answering our question. You cannot see that, obviously.

Prof. Hogan—That is one of the disadvantages of teleconferences; I find one cannot read the body language.

Senator McLUCAS—You may not be aware, but we received a submission from an organisation called the OFM Investment Group proposing that another way of protecting bonds would be through income bonds. The gentleman who gave us evidence earlier today suggested that this would be as an adjunct to the proposal that the government has before us at the moment. You may not have had an opportunity to see that submission. If you have, you might want to make some comment to us about it, but if you have not, we would value your comments on whether or not that sort of proposal would be useful.

Prof. Hogan—No, I have not seen this, so I will communicate with Mr Humphery and get access to it. Would you like some communication after that?

Senator McLUCAS—That would be terrific, if you can. I am sorry to put you to another piece of work.

Prof. Hogan—I am accustomed to it in aged care.

CHAIR—Professor Hogan, thank you very much indeed for appearing today, for the submission you have made to us and for the work you have done in connection with this. We are very grateful for that effort.

Prof. Hogan—Thank you very much, Mr Chairman.

[6.10 pm]

CAIN, Ms Liz, Assistant Secretary, Pricing Review Implementation, Department of Health and Ageing

CULLEN, Dr David John, Executive Director, Financial and Economic Modelling and Analysis Group, Department of Health and Ageing

MATTHEWS, Ms Andrea, Consultant (MP Consulting), Department of Health and Ageing

MERSIADES, Mr Nick, First Assistant Secretary, Ageing and Aged Care Division, Department of Health and Ageing

CHAIR—I welcome witnesses from the Department of Health and Ageing. Thank you for sitting through today's testimony in order to be able to give us feedback on other evidence as well as speak to your own submission. As you are aware, no doubt, evidence given to the committee is protected by parliamentary privilege. As departmental officers, you will not be required to answer questions on the advice you may have given in the formulation of policy or to express a personal opinion on matters of policy. We have a fairly comprehensive submission in front of us; thank you very much for that. Would you like to make an opening statement around that submission before we ask you questions?

Mr Mersiades—Firstly, thank you for the opportunity to appear before the committee. I will make a few opening points. I would just like to highlight a couple of points—that is, that the current prudential arrangements have served the community well to date and that there has never been any instance where bonds have not been repaid. That is an important point. But, as Professor Hogan has highlighted in his review of pricing arrangements, residents who have paid bonds rank as unsecured creditors in the event of insolvency or bankruptcy. Taken together with the large increase in bond payments, the large increase in the average size of each bond, the increase in the number of bonds held and the large increase in the number of aged care providers holding bonds, some details of which are in the submission, it was considered prudent to further strengthen the current arrangements.

Recognising these developments, the government had invited and funded the aged care industry to develop its own system for guaranteeing the security of bonds, but unfortunately agreement was not forthcoming across the entire sector. The proposed arrangements now in the bills are the result of very extensive consultations with the aged care sector and other stakeholders, and I am pleased that these arrangements are generally supported. The attributes as they are proposed are that they would guarantee the timely repayment of bonds to residents in the event of insolvency or bankruptcy; they envisage a capacity to improve the prudential arrangements over time as necessary to further reduce the risk that the guaranteed fund will ever need to be activated; they are relatively low-cost and administratively streamlined in that the guarantee arrangement will only be activated in the event of a default; and, finally, we are very conscious of the need to ensure that the detail around the implementation of the scheme is developed in close consultation with the sector. Accordingly, we intend to ensure that the close consultation with the sector, which has been a hallmark of processes to date, will continue.

CHAIR—Would it be fair to describe the philosophy behind this legislation or package as light-touch regulation which nonetheless gives complete security and peace of mind to people who pay bonds?

Mr Mersiades—That is a fair description, in the sense that it has tended to not be onerous in a regulatory sense. It is also intended to complement existing corporations and bankruptcy provisions. We are not in the business of duplicating that or creating confusion through overlaps.

CHAIR—A number of issues arose during the earlier testimony which we might get you to go through. I just have one question before we do that. I might throw to Senator McLucas to go through some of the issues that she has raised with other witnesses. Referring to page 8 of your submission, in the table entitled 'Proportion of homes holding accommodation bonds, by location and sector' I see that 86.3 per cent of homes in the not-for-profit sector hold bonds but only 48.6 per cent in the private sector hold bonds. I am curious about that. I would have thought that the private sector—the profit sector, if you like—would have been much more likely to require bonds of their residents than the not-for-profit sector.

Mr Mersiades—It partly reflects the history of which sector of the aged care area the various sectors have been operating in. Dr Cullen can give you some figures on that.

Dr Cullen—Until very recently the private sector was not permitted to operate in the hostel sector, the former low-care sector. The private sector has about 50 per cent of the high-care sector but only about four per cent of the low-care sector. That is a statistic which was true in 1997; it has changed a little bit since then. This reflects the fact that there are many fewer low-care residents as a proportion in private homes than there are in not-for-profit homes.

Senator McLUCAS—While we are looking at that page, how do you describe major city, inner regional and outer regional? Do you use RRMA classifications for that?

Dr Cullen—I believe the table was based on ARIA.

Senator McLUCAS—Why ARIA and not RRMA?

Dr Cullen—ARIA is the department's preferred method.

Senator McLUCAS—I thought RRMA was.

Mr Mersiades—I think there has been a change in recent times.

Senator McLUCAS—Just on a point of clarification, in paragraph 2.3.7 you use the term 'big accommodation bonds', which is a bond 10 times the annual basic single pension. So that is a bond of over a million dollars. I don't understand your definition.

Dr Cullen—The Aged Care Act says that if a resident pays a bond greater than 10 times the pension, their fees change. They are no longer eligible for the pensioner supplement and they pay the nonpensioner fee even if they are a pensioner. The value of that bond at the moment is $122,500. That number of $122,500 is the 10 times number.

Senator McLUCAS—It is 10 times $12,500?

Dr Cullen—Yes.

Senator McLUCAS—I thought the pension had gone up really quickly, and then I thought maybe I was not reading it correctly.

Mr Mersiades—We just used a big bond as a threshold, to give you a reference point.

Senator McLUCAS—I understand. With respect to your table on page 5, once that table is photocopied we can't see the difference between 'upgrading' and 'new building'.

Ms Cain—We will retable it, Senator, with shading in it. I apologise for that.

Mr Mersiades—The top colour represents the new building, the middle one is the upgrading and the bottom one is the rebuilding.

Senator McLUCAS—But we can't pick it up at all. We can see 'rebuilding' but we can't see the difference between 'upgrading' and 'new building'.

Mr Mersiades—I apologise for that.

Senator McLUCAS—It is not your fault; it is just that it has been photocopied. I will go through some comments that have been made by other witnesses today. Your staff were here when Mr Davies from OFM gave evidence to us about the potential of using an income bond as a further protection, to paraphrase what he said. Can you tell us whether you considered that as a proposal and what you thought of it.

Mr Mersiades—Not specifically that proposal but proposals that raised similar issues. I guess there are two question marks I would have about the proposal, having been introduced to it not too long ago. Firstly, at the end of the day, it does not guarantee repayment of the bonds in the event that whoever the person holding the bonds is gets into jeopardy, whether it is an insurance company, an investment broker or whatever it is. So you are still looking at the need for some sort of guarantee arrangements. Secondly, it is not clear to me what the cost would be, given that whoever is holding the bonds and is liable to repay the bonds in the event of an insolvency, he, she or the entity is going to have to have some arrangement in place to be able to cover that risk. Similar issues have been raised in other insurance type arrangements. My colleague might want to elaborate on that.

Ms Cain—There were a couple of elements in the model that OFM proposed which, as Mr Mersiades said, were common in other systems we looked at. One of the problems with the proposal is that essentially—if I understand it correctly—it ties up the capital of the bond so that the approved provider cannot access it. That is one of the propositions that we did explore. We covered it in the submission, in part 5, I think. As Mr Rod Young said earlier, that would create a problem for the sector. As Mr Mersiades also mentioned, it is a relatively more expensive option even from a day-to-day administrative perspective than the option that is presented in the bill.

I think that the person who was representing OFM, Mr Davies, suggested that the administrative costs would be around one per cent. I think the variation was between 0.8 per cent and maybe up to three per cent. Even at one per cent I think we would be looking at annual administration fees of over $40 million, whereas with the proposition that is in the bill at the moment there are no administrative fees unless a default event occurs. There are some problems there.

The third point that might be worth the committee's further consideration is that, while OFM supported the legislation that is on the table, they proposed, I think, that it might be possible for the committee to consider the OFM proposal coexisting with the bill's proposal. There is nothing that would stop that occurring at the moment and certainly an amendment to the legislation is not necessary to enable that to happen. It would just be a decision that an approved provider and the residents would make at the time. Having said that, it would—as I think Mr Young noted—be unnecessary to provide the additional security for bonds, because that is an absolute in the bills that are on the table.

Senator McLUCAS—So you do not concur with his comment that there was no risk?

Dr Cullen—To be fair to him, I do not believe he said there was no risk. He said there was no investment risk. In other words, the money will be held in a bank account. It is not being invested in the stock market or the first horse or something like that. So there is no investment risk. There is always the risk of the company that holds the income bond going broke.

Senator McLUCAS—I think he did say no risk—

Dr Cullen—He did at one stage.

Senator McLUCAS—and that is when I said that sounds too good to be true.

Dr Cullen—I think he later tried to say that he meant no investment risk.

Senator McLUCAS—Thanks, Dr Cullen. Moving to the comments that the Aged Care Association made: Mr Young talked about needing a clearer definition of what event would cause the minister to declare an insolvency situation.

Ms Cain—I think that I can provide the clarity that you are seeking there. The way the scheme operates in the legislation hinges around the definition of what an insolvency event is. The insolvency event definition is quite detailed. It is set out in section 6 on page 5 of the bond security bill. As Mr Mersiades referenced earlier, we have been very careful in the construct of the definitions in this bill to make sure that they interface seamlessly with the existing definitions under the Corporations Law and bankruptcy law.

We also recognise that, in some limited circumstances, an approved provider may be in financial difficulty and may be in a situation where they are being externally administered, and that might be okay because they might still be able to repay their bonds. We do not want to broaden the definition of an insolvency event to capture those earlier events, because if the approved provider can continue to repay their bond balances as they fall due then the approved provider should have every opportunity to work with the administrator, work their way out of their financial difficulties and continue.

If, however, an approved provider is under external administration and cannot repay their bond balances when those bond balances fall due, that would be a concern to us and that would be the limited circumstance under which, under section 7 of the bill, the minister would make an insolvency event declaration.

Senator McLUCAS—So it is slightly different because you are really looking at only one element of the business, and that is the potential for the bonds to be repaid.

Ms Cain—That is right.

Senator McLUCAS—I think Professor Hogan was suggesting a more proactive approach—and I think it was very well intended—that the department, through your auditing processes and the monitoring of the prudential circumstances of any entity, could intervene early, so to speak.

Mr Mersiades—Again, it gets back to the basis of the legislation—that is, it is meant to be complementary to the Corporations Law and the bankruptcy law. As I understand it, when an entity gets into financial difficulty there is not an automatic conclusion that the company has wound up. In fact, they go out of their way with the creditors to try to resuscitate the company and find a way through. We are saying there is an established process for doing that, and we will work with that in the way we have done in the past. It is not the first time an aged care provider has got into financial difficulties. That has been successful, and we are comfortable in following that model.

Senator McLUCAS—Then how do you know that someone is in difficulty in the current situation?

Mr Mersiades—We hear through the complaints resolution scheme very quickly if someone is overdue in receiving their bonds. As well as that there are legal provisions in company law about trading when you are insolvent. It is not unusual for providers to volunteer their situation.

Senator McLUCAS—I think Professor Hogan was talking about some event earlier than a person not being able to receive a bond back—that is a point further down the track than what he is describing. I am not sure that the department would have a way to know that a person was getting into trouble rather than facing insolvency.

Mr Mersiades—Bond payers are creditors like everybody else. In that sense, the Corporations Law makes provision for dealing with those situations as they arise. I am not sure that we need a duplicate system that tries to intervene even earlier in this instance.

Senator MOORE—Are they the kinds of things that are dobbing?

Mr Mersiades—I mentioned the complaints resolution scheme. When organisations have been in trouble it is not unusual to hear about it through the complaints resolution scheme.

Senator MOORE—Someone thinks there is something wrong and feeds through the normal process.

Mr Mersiades—As well as that, one of the conditions under the conditional adjustment payment is preparation of these general-purpose financial statements, which are quite rigorous and robust financial accounting arrangements. That is also a signal to the whole community, or not the whole community—

Senator McLUCAS—Not quite.

Mr Mersiades—but whoever can get access to them. It is open to the interested parties to know what is going on.

Senator McLUCAS—Does the department see those audited financial—

Ms Cain—We can access the general-purpose financial reports that Mr Mersiades referenced, which are audited.

Mr Mersiades—We have the power to ask for those now.

Senator McLUCAS—But you do not see the audited accounts that are provided and de-identified. How are they different?

Mr Mersiades—In the normal course of events with that analysis we are seeking to establish benchmarks of performance across the sector.

Senator McLUCAS—But that is a different type of accounting.

Mr Mersiades—That is different. But at the same time, within the Aged Care Act we have the power to ask for that information.

CHAIR—Given that you have not had any failures to pay bonds in 20 years, you would argue, I assume, that there is not really a pressing need for the department to be sending inspectors to fan out through the sector to look for shaky providers in financial terms.

Mr Mersiades—That is one of the considerations. We are also seeking to do other things which would reduce the risk of financial difficulty. I instanced improving the financial management of the sector through the requirement of these general purpose financial statements. There is also a capacity to improve the prudential standards. At the moment they are at a particular level which is consistent with the level of financial sophistication in the sector. Over time we would seek to review those, in consultation with the sector, because I think it is in the sector's best interest to have good, robust prudential standards. We would like to put our emphasis on that as a way of further reducing the risk of having to activate the guarantee fund. But, as you say, it is a fairly low-risk industry. History tells you that.

Senator McLUCAS—Mr Young made a comment about how to link the making of the insolvency declaration and the insolvency event. Do you recall Mr Young's comments?

Mr Mersiades—Is this the 10-day issue?

Ms Cain—No, that is another issue. As I was saying earlier, the guarantee scheme will always be activated where an insolvency event, as defined by the bill, occurs and there are bond balances outstanding. That is very clear, on the face of the legislation. In addition to that, if there is a circumstance where a precursor event has occurred—for example, the external administrator is in administering the home—and a technical insolvency event has not yet occurred but there are bond balances owing, you want to be able to repay those bond balances to the resident who is owed them. You do not want the resident to wait until technical insolvency, as defined by the bill, occurs, because that could be in a number of years. That is when the minister would make the default insolvency event declaration.

Senator McLUCAS—I understand what you are saying. In your mind, is that absolutely clear in the legislation?

Ms Cain—Yes.

Senator McLUCAS—Can you point me to where I would understand that they are not insolvent but an event is declared?

Ms Cain—Yes, it is in section 7 of the bill, at page 7, 'Making of insolvency event declaration'. Forgive me if I am misunderstanding the question, but the section says:

(1) The Minister may—

so the minister is not required to; there is just the option—

make an insolvency event declaration ... if:

(a) either:

(i) the approved provider is an externally-administered body corporate (within the meaning of the Corporations Act 2001); or—

the equivalent under bankruptcy legislation, and—

(b) there is at least one outstanding bond balance of the approved provider.

Senator McLUCAS—So it is actual (1)(b)—that, if there is one bond balance outstanding, that is an insolvency event?

Ms Cain—That is correct.

Senator McLUCAS—That is pretty clear to me, thank you. Can I go to the question about 'remote or otherwise'? Why was that element put into the legislation?

Ms Cain—It was written into the legislation, recognising that there has never been a default event and therefore any future default event could have quite different characteristics from any other default event. It could be quite a small default event with not a significant amount of money involved or it could be quite large. It seemed appropriate to give a certain amount of discretion in the legislation to deal with the fact that approved providers are not a like group. There is a lot of variation, as you know, between approved providers. So it may well be that the government of the day decides that in a particular circumstance there are classes of approved providers. For example, a class of approved providers could be approved providers with 10 or fewer funded beds—they are very small; they might have a smaller margin for error. What we do not want to do by imposing a levy to recoup costs is to cause any interruption in the delivery of care in other services to residents. This gives the minister of the day the capacity to recognise that there might be classes of approved providers that need to be dealt with differently. They might have a different level of levy imposed on them. What we have done is make that discretion a regulation-making power to ensure that there is the appropriate scrutiny of parliament at the time. We are not anticipating that it would be used routinely, but if the minister did choose to use that discretion to recognise that there was a justifiable class of approved providers that should be dealt with differently, it would be done through a reg and subject to the scrutiny of parliament.

Senator McLUCAS—Do you say specifically that it will not be done by the state?

Ms Cain—That would be a constitutional breach, and parliament is not allowed to do that.

Senator McLUCAS—I am interested in the fact that you talk about remoteness rather than the size of the entity as a descriptor.

Ms Cain—It could have been small communities, in the way that the ATO distinguishes between various things. I appreciate with hindsight that that particular description has caused confusion. Maybe we should have used the number of beds or 'small communities,' but that is very much how—

Senator McLUCAS—Are there some inner metropolitan services that are far less viable than some larger services on the edge of a large city?

Ms Cain—Exactly.

Mr Mersiades—There are small services in metropolitan areas.

Senator ALLISON—Is this about full cost recovery for the management and, if so, if you make special arrangements for certain classes of providers, how is full cost recovery dealt with?

Mr Mersiades—There are two elements to the scheme: one is the guarantee scheme itself, and they are the prudential arrangements—

Senator ALLISON—I am talking about the levy.

Mr Mersiades—It is a matter of discretion for the government of the day as to the level of recovery that it chooses to make. There is flexibility in the legislation for that to happen.

Senator ALLISON—But is it the intention that it be full cost recovery?

Mr Mersiades—That would certainly be the starting point.

Senator ALLISON—If cost recovery is the starting point then what happens if you make special considerations for a large number of providers? Is it anticipated that the moneys will come out of general revenue or the department's budget or some such thing? I realise it is all very hypothetical. But, if there is a class of providers, like all those in rural areas who are paying a levy which is much less than the levy in metropolitan areas, would it be expected that this cost would be spread across all providers?

CHAIR—I do not quite understand the question. Could you just explain your question for my benefit. I do not quite understand what you are asking.

Senator ALLISON—In the levies there is provision for differentiation between classes of providers. My question is: is the purpose of the levy to provide the department with sufficient moneys for the cost recovery of the operation of this scheme within the department? That is the purpose of the levy, is it not?

Ms Cain—No, the levy is to recover the cost paid out by the Commonwealth from a standing appropriation to any residents who are owed their bond balances, plus interest. That is one levy. You are quite right: the intention is that all of those costs would generally be recovered through the levy. As I was saying, there is some discretion through the government of the day to say—as Mr Mersiades was saying—'We might waive some or all of the cost, given the consideration of the impact on classes of approved providers.'

Senator ALLISON—Who makes up that waiving? You waive something, but does that mean the estate of the person concerned does not receive—

Mr Mersiades—No, the residents receive their bond balances in full, 100 per cent.

Senator ALLISON—So who pays for this waiving?

Ms Cain—If the government of the day decided to waive some of the recovery then the money would have been paid out of the standing appropriation. It would be the decision of the government of the day to not recover those costs from industry, so it would be a cost from—

Dr Cullen—Consolidated revenue.

CHAIR—The tax payer.

Mr Mersiades—That would be a decision for the government of the day.

Senator McLUCAS—Mr Young's submission suggests that the additional inspection to confirm compliance with the establishment and maintenance of a bond register is not required. Can you explain why the view of the department is that it is required?

Ms Cain—We agree that there is definitely a role for registered company auditors to work with the providers to confirm some of the information that will be held by approved providers in the bond register, but it is also the responsibility of the Department of Health and Ageing to ensure that the legislative framework passed by parliament is implemented as parliament intended. So the suite of monitoring and compliance activities that parliament would expect of any regulatory regime will be utilised for this one. We cannot rely solely on third party auditors to deliver on our responsibilities or accountability in that area.

Senator McLUCAS—Do you imagine that there are significant costs of the compliance with the maintenance of the bond register and then the auditing—

Ms Cain—To in principle approved providers. We would expect—and this is our understanding from the discussions that we have had with industry to date—that approved providers who choose to hold accommodation bonds would have good records of the bonds that are held. They would know who they took the bonds from, how much the bond was worth when it was taken, what deductions were made from the bonds and therefore what the bond balance owing to the approved provider should be. So, no, we would not expect that there will be significant additional compliance costs, because we would expect providers to have that information at their fingertips already.

Senator McLUCAS—Is there a cost in the auditing process of that?

Ms Cain—If there is an additional cost, we are working with industry to try to ensure that the auditing process around the accommodation bond register would align with the auditing requirements, for example, with the general purpose financial reports, to minimise any costs.

Senator McLUCAS—Mr Young asked: what form of written notification is expected?

Ms Cain—We are in the process at the moment of preparing detailed guidelines on the implementation of the scheme. Those guidelines are the subject of discussions with industry tomorrow, and then we would expect a further set of discussions. They will include details about the form of the notification, including I would expect some helpful guide that an approved provider who needed to notify insolvency could just top and tail and send in to the secretary if that is what they wanted. But Mr Young is right, we will accept faxes, but not smoke signals though.

Senator McLUCAS—That is good. I am pleased that is happening. That will not be reflected in the legislation, or is it a significant enough issue that it should be reflected in either the EM or the legislation in some form?

Ms Cain—We understand from discussions with the Office of Parliamentary Counsel, who drafted the legislation, that it would be usual to just say, as it does, 'written notification', and we did not want to be too prescriptive in the legislation without consulting on the detail with industry.

Senator McLUCAS—Mr Young also asked the question of what is meant by the term corporate governance. Is that something that needs to be defined in the definition?

Ms Cain—We believe not. Firstly, the reference to corporate governance is part of an indicative list of potential prudential standards that might be developed. We had anticipated that if a need arose for a prudential standard on corporate governance that would be as a result of ongoing discussions with industry that identified the need for that sort of standard and therefore the definition would be developed collaboratively with the sector as the need arose. We are not even saying at this point in time that there is a need for it, so we certainly did not want to go so far as to define what it would be.

Mr Mersiades—The background to it is that APRA is in the process of negotiating the possibility of this sort of governance standard in their standards. Depending on how that and our consultations with the sector go, there may or may not be a need for a similar standard in this sector as well. It is really just an illustration of the types of things that we will be looking at together.

Senator McLUCAS—Mr Young explained quite well the need for clarity over that 10-day period. The two questions are: why 10 days and not another number, and do you think there needs to be further specificity and more clarity on what would happen in that 10-day period? What might have to happen is that anyone who is transferring or selling their entity would have to have a clause in that contract to cover that off.

Ms Cain—There are two things that we have covered off that are relevant to the 10-day period. I think you referenced it earlier, Senator. We needed to determine who might be affected by any future levy. We wanted to make sure that, at the time of the default event or in reasonable proximity to the default event, any approved provider who was holding bonds at that time would potentially have some liability to meet the costs of repaying those bonds, because that is the intention of the scheme. We then need to make sure that, when the levy is subsequently imposed, the right people—the people who are still operating in the system—are caught. The 10-day period is just a moment in time. It seemed like a sensible moment after consultation with corps law and people who administer similar schemes to say, '10 days before a default event, if you were operating and holding bonds, you are potentially liable to pay this levy.' That means that it avoids the situation where, when the default event occurs, some approved providers might say, 'Golly, I would really like to avoid any future levy; I'll divest myself of my holdings.' We also wanted to make sure that newcomers into the sector were not unnecessarily burdened by a levy for an event that occurred before they began operating in the sector, so that is when the regulations are made to impose the levy. They can only be made in relation to people operating, so the 10 days prior to the default event being called acts in concert with the regulation-making power to define who is caught by the levy.

Senator McLUCAS—I am not quite clear on the last point you made. When the levy is struck, the minister can make a determination that it is only those people who are currently holding accommodation bonds. Is that what you just said?

Mr Mersiades—Essentially, it is designed to set a time which activates who will be affected into the future, recognising that, when the levy is actually applied could be a couple of years in the future. Either we make it on the day that the minister declares the insolvency

event or pick some earlier day. I think one of the key objectives of going a bit earlier is to ensure that there can be no manipulation going on.

Senator McLUCAS—I see the intent of the 10 days.

Mr Mersiades—That is what it is primarily about.

Senator McLUCAS—Ms Cain, I think you confused me or I was not listening properly.

Ms Mathews—Basically, it sets the ultimate size of the class who might be liable to pay the levy. If they subsequently divest themselves of bonds, that does not avoid the need for them to pay the levy. However, if they subsequently leave the industry before the levy is determined in the regulations, they would not be captured.

We are trying to account for three different scenarios: (1) where new people come into the sector after a default event has been declared; (2) where people leave the sector after a default event has been declared but before a levy has been imposed; and (3) where people remain in the sector but who might change their arrangements in relation to their bonds to attempt to avoid paying the levy.

So we have done that by saying: 10 days before the default event people will not know to divest themselves of the bonds because they will not yet know that a default event has occurred. So that is the maximum class of people who might be potentially liable to pay the levy. Over the course of the next year or two, before the levy is actually imposed, there may be comings and goings from the industry. If you come into the industry you are not liable, because you did not exist back here. If you leave the industry you are no longer liable, because you were not in the industry at the time the levy was actually imposed. Does that make sense?

Senator McLUCAS—Yes it does, but it is different from what I understood. Doesn't that encourage movement in the industry? The scenario that Mr Young and I talked about was one in which a major provider, and I am not suggesting this would happen, causes quite a substantial levy to be struck, shall we say—and this is absolutely the worst case scenario. Wouldn't that encourage some people to move out of the industry if that group from 10 days prior—you are in the group at the beginning, but if you happen to sell to your husband, for example, you might get out.

Ms Mathews—The problem is that if someone leaves the industry you cannot impose a levy after they have left the industry. For example, at the time they leave the industry there is no liability to pay the levy. The government may never impose the levy. There is an unknown quantity for the levy. When the levy is eventually imposed, that cannot retrospectively capture those people who have left the industry. It would be a pretty drastic move for people to leave the industry purely to avoid the levy. The more likely consequence might be people divesting themselves of bonds to avoid the levy or to reduce the amount that they pay. That is what we are preventing by having the 10 days before the default event.

Ms Cain—We are aware that it is quite likely that the government of the day would want to move reasonably swiftly, without wasting time, to impose the levy so that there is more correlation between—

Ms Mathews—So that it is not moved around the industry.

Ms Cain—Yes.

Dr Cullen—Remember: you cannot just transfer bed licences without the permission of the department. So if husband were to sell to wife, new corporation, in order to become a different provider and avoid the levy they would have to give a reason. That transaction of trying to change the approved provider is one that the department would need to approve before it could occur. So there would be some check on the sort of scenario that you are presenting.

Senator McLUCAS—Did you contemplate having the liability run with the bed licences?

Mr Mersiades—The issue there is that value of the bed licences on the secondary market may not be sufficient to cover the bonds. If I understand the point you are making, that would be the shortcoming of using that approach.

Senator McLUCAS—No. I am saying that an insolvency event has been identified and that, between that point and the point of levy being struck, there is a potential for someone to sell their bed licences and sell their operation. Why then does the person coming into the industry at that point not have to carry the levy? It is an equity question. That person has come into the industry, has purchased an operation, but in comparison with someone who has maintained in the industry they are at an advantage of some sort because they do not have the cost of the levy. I am asking: why wouldn't the department, when one entity sells to another entity, say that the potential liability travels with that sale?

CHAIR—That is consistent with general business practice. When you buy a business—which is what the licence really is—you buy the assets and liabilities of that business.

Mr Mersiades—That would come into play in the way that we manage the approval of the transfers.

CHAIR—In what way?

Mr Mersiades—It would become known to the person who is buying. It would be a condition that we could put on the transfer.

Senator McLUCAS—I don't think so.

CHAIR—The person leaving the industry would avoid that liability, so the person purchasing that licence would know that they would not have to pay the levy, because you said that they were not going to be liable for that levy if they were new to the industry.

Ms Mathews—The difficulty legally is that it is an unknown potential liability. If the levy had already been imposed and the government was giving providers two years to repay it, then that would transfer to the provider as an existing liability. In this case, there is no absolute legal liability because no levy has been imposed. The government may never impose a levy, or it may pose a levy at this amount or that amount. There is no potential known liability to transfer at the time that the transfer occurs, before the time the levy is actually imposed. We are talking about the interim period between the default event and the actual levy being imposed. When the default event occurs and all the payments are made, it may be some time later before the Commonwealth knows its total costs and then seeks to levy from industry.

CHAIR—If you buy a business, and say the business is being sued by a customer who fell over on the floor of your business, you have got a liability, the extent of which you do not know. Businesses always have that situation where they do not know the extent of a liability that they might purchase. They might get an estimate, but they do not actually know what the extent is. That is a common situation—not to know what the exact quantum is. I think the point is well made that it is easier to simply say: you are a licensee in the industry, and your liability as a licensee is to share in any levy that is levied for any default in that sector.

Ms Mathews—The other issue is that it is not only around the potential liability. When you are subject to a legal action the amount might be unknown but a liability potentially exists. In this case we are also talking about a tax being imposed by the Commonwealth. So it is not actually a liability at general law, in the sense that you are talking in terms of a business risk where you might be involved in a legal action that might subsequently result in a payment being required to be made. It is the Commonwealth taxing, essentially.

Dr Cullen—The event which causes the liability has not yet occurred. In the case where the person has fallen over, the event that may or may not lead to the liability has occurred, but the event that causes the liability here is the making of the levy.

Senator McLUCAS—The declaration has occurred.

CHAIR—That is right. That is what causes the liability: the declaration.

Mr Mersiades—It creates a contingent liability. I think that is more appropriate. It does not crystallise the amount of it.

CHAIR—That is the same as when a person slips over on your floor, isn't it? That is a contingent liability.

Mr Mersiades—Yes.

Senator McLUCAS—Ms Mathews, you said it was a tax. Is it technically a tax or a levy?

Ms Mathews—It is a tax.

Senator McLUCAS—I am not very good at tax law. Why is it a tax and not a levy—even though it is called a levy?

Mr Mersiades—A levy and a tax are similar.

Senator McLUCAS—But they are technically very different in tax law. That is the one thing I know about this.

Ms Mathews—It is quite complicated. As you know, tax is a compulsory exaction of money by a public authority. The relevant factors are whether it is a compulsory exaction, and it would be in this case; whether it has a revenue raising purpose, and generally, if it is associated with legislation, the assumption is that it has a revenue raising purpose. It does, in this case, and that is to repay the standing appropriation. Taxes are generally imposed for public purposes; in this case it is being imposed for a public purpose. And it is generally not a fee for a service. In this case, that also appears to be the case. So while it would be up to a court ultimately to determine whether it was a tax or not, on most indices this would very much appear to be a tax.

CHAIR—If you are a business and you owe taxes to local government or another government body, the sale of the business does not obviate those taxes.

Ms Mathews—No.

CHAIR—You are still liable for those taxes. It transfers with the business.

Ms Mathews—That is right. But this is more akin to, for example, the introduction of GST in 2000. If you sold your business in 1998, you knew it might be coming but you were not sure what percentage it would be. You cannot be liable for that thing that occurred in 2000. Similarly here, you do not know that it is absolutely coming. It is subject to the government of the day putting it in legislation. Not until it actually occurs does the tax exist, nor are you liable to pay it until actually exists. It is a difficult one conceptually, because we are not establishing it from scratch; we are establishing it in response to a particular situation.

Senator McLUCAS—Have you tested whether or not the idea that Senator Humphries and I are exploring is possible legislatively? For example, could you attach a condition of transfer by which any potential liability travels with these licences?

Ms Cain—If the committee is willing we should probably talk further with Australian Government Solicitor about this. The whole issue of how the levy bill was constructed, the situations in which the liability does or does not transfer and what is being bought and sold as opposed to transferred—so the buying and selling of the whole entity as opposed to the transfer of individual beds—were things that Australian Government Solicitor went through in fine detail. If we could talk to them some more we can get back to you with a bit more information, perhaps tomorrow or Monday.

Senator McLUCAS—That would be terrific. I actually think there is an equity question, the way I now understand it.

Ms Cain—I am fairly confident that it was looked into, but I should check with them first. We will provide the detail to the committee.

Senator McLUCAS—I have one more question, but I feel as if I have dominated a bit.

CHAIR—Please go ahead, Senator. You are on a roll.

Senator McLUCAS—Thank you. I have a question about ascertaining risk. When we established this inquiry, the reason for doing it was that a number of providers and provider representative organisations had said to me that they really did not know what the level of risk was that they were signing up to. A number of the submissions have identified that as well. It is a bit like how long is a piece of string. What sort of actuarial work did you do? It is a bit hard, given that this event has not occurred, but if a very large provider were to hit the wall there could be quite considerable risk to some operators. What did you think about for how that risk would be ascertained?

Dr Cullen—We engaged PwC and undertook with them a considerable actuarial study of what the possible liability of this scheme would be. The basis of that study was the data which had been gathered by the pricing review on the financial reports of 900 or so aged care homes. On the basis of those reports it was possible to essentially create a risk profile for every single home in the country—if you like, a Standard and Poor's rating: were they AAA+, CCC and so on. The analysis associated with such risk ratings is then always standard across the economy.

There are actuarial tables which tell you that an entity which has a certain risk rating has a certain probability of defaulting and that, if it does default, it has a certain probability of loss given default. To give you one example, a AA+ company has a 0.005 per cent chance of defaulting. That is the historical record. Moreover, when they do default, AA+ companies tend to lose 34 per cent of the amount of money. In other words, they tend to return 66c in the dollar to people.

Senator McLUCAS—Is that just on the bond or on that total entity?

Dr Cullen—This is the entire operation. And this is on an economy-wide level.

Senator McLUCAS—So this is not aged care specific?

Dr Cullen—I am not talking about aged care; I am talking about how the economy as a whole has worked. This is a historical record. So we rated every aged care home in the country. We then needed to make some adjustments to that because this industry is not like the economy as a whole. Providers have a guaranteed income stream. Many providers are religious and charitable organisations which do not seek to make a profit; therefore, the rates of return that they need to make are much lower than for other organisations.

In consultation, PwC adjusted the risk profile of the industry upwards for the fact that it was a regulated industry which had very little risk of default, and came up with what it thought was an incredibly conservative model of the industry, in the sense that we were still assuming far more default than ever has occurred. Essentially this model says that for every single aged care home, we now know the probability that it will default and how much money is going to be lost when it does default. We also had to adjust in there for the fact that bed licences are a particular feature of this industry, and bed licences have a peculiar characteristic in that they have a value but it is not a value which can be accessed if the department does not agree to it. This means that in a sense it is an amount of money which can be held to repay the bond with. There was a further adjustment which needed to be made for that.

Senator McLUCAS—I understand the licence cannot exist on the books anymore as an asset.

Dr Cullen—That is under the new IFRS, yes. We then ran a few thousand Monte Carlo simulations, which is basically where you randomly toss a coin and decide who is going to fall over and who is not. Having run a few thousand simulations—and, again, I stress this a very conservative model assuming a lot more risk than actually exists out there—what came out is the average payout in every year, the average number of bonds not repaid would be 0.2 per cent. If that is the average that is not repaid, and the levy is the proportion of the total bond holdings, if you own five per cent of all bonds therefore you will pay five per cent of the 0.2 per cent. What that comes down to is that the levy is 0.2 of a per cent of the bonds that an individual provider holds. That is the average result.

Senator McLUCAS—So 0.2 per cent of $4.3 billion as a total is the potential liability on an annual basis.

Dr Cullen—It is the average liability that is expected each year on very conservative assumptions. The average provider at the moment in a major city holds $2½ million. So their

liability would be 0.2 per cent of that $2½ million, if you use the standard methodology of calculating their liability—the pro rata figure.

Senator McLUCAS—Is that on an annual basis? Is that how that model works?

Dr Cullen—The 0.2 per cent is the amount of default which will occur every year—let us say $9 million. Clearly that is not the case. That is what I mean when I say this is an incredibly conservative model. We have had 15 years where the answer has been zero. The model we have built is overstating the risk, but it has come out with a cost of 0.2 per cent on average annually, which is much lower than any other product that is available. Bank guarantees, for example, cost between one and two per cent. OFM said that the product they were discussing would be about at least one per cent. To go further in the modelling, not only can I tell you on average that it would be 0.2 per cent but only once in 20 years would it be more than 0.8 per cent of bond holdings. The amount of default that one would incur, again on these very conservative assumptions, would be less than 0.8 per cent except once in every 20 years.

Senator McLUCAS—What is the average over 20 years?

Dr Cullen—0.2 per cent is the average over 20 years.

Senator McLUCAS—And the worst scenario would be 0.8 per cent.

Dr Cullen—0.2 per cent a year is the average that will occur every year. Only once in the 20 years would the number for that particular year be greater than 0.8 per cent. I hope that helps. That is what the modelling indicates and, as I say, it is an incredibly conservative model. The numbers are much lower than that, almost certainly.

Senator McLUCAS—I am going to pretend to be an actuary. Is it possible for us to get a copy of that PricewaterhouseCoopers report? It will not have the names of facilities in it.

Mr Mersiades—I have not looked at the report for some time. I will have to take that on notice to see that there is nothing of commercial-in-confidence in it; otherwise, I do not see a problem.

Senator McLUCAS—Thank you.

Dr Cullen—In developing this model, we developed a number of different models each of which had different risk profiles.

Senator McLUCAS—I suppose I am interested in the analysis of what the risk profile is. I understand your point that this is the worst possible scenario, but you have to come up with a figure at some point, and that is what you have done.

Dr Cullen—That is right.

Senator McLUCAS—I would like to understand that, if I could.

Mr Mersiades—It was very challenging for PwC and their people to do this sort of actuarial model for this industry. It is the first time round. They could not come up with a figure based on history which said there was no default and therefore there is no risk.

Senator McLUCAS—'There is no risk. Go away.'

Mr Mersiades—They had to come up with something.

Senator McLUCAS—Thank you, I appreciate that.

CHAIR—Thank you very much for your appearance today and the evidence you have given. And thank you for the submission, which is very comprehensive. That was a very useful and interesting session. We look forward to that extra information coming back to us in the next couple of days.

Committee adjourned at 7.10 pm