

**Senate Community Affairs Committee**

**Statement**  
**On**  
**Aged Care Accommodation Bonds Proposals**

**by**

**Warren Hogan**

1. Introduction

This statement relates to certain proposals about the guarantee and management of funds deposited by entering residents with entities providing residential aged care services, familiarly known as accommodation bonds. The value of those bonds in the 2004-05 fiscal year was about \$4.3 billion. These proposals are contained in three bills before the Australian Parliament namely Aged Care (Bond Security) Bill 2005, Aged Care (Bond Security) Levy Bill 2005, and Aged Care Amendment (2005 Measures No. 1) Bill 2005.

Attention is directed to the proposals embodied in the draft legislation to determine immediate future arrangements to give certainty of repayment of balances of these funds. The great bulk of residents end their lives in aged care so issues about repayment are matters for the executors and trustees of their estates. Nonetheless there are residents who change aged care locations so immediacy of repayment is essential to ensure funding requirements for entry to their new location are met without recourse to additional drawings on their resources or those of their families. A further concern, largely theoretical or academic in contemporary settings, could arise with bankruptcy of an existing provider without capacity to

repay thus bringing potential harm to residents' prospects for entering a comparable facility.

There are some longer term issues arising from the proposals. This is most apparent from the then Minister, Hon Julie Bishop, in her remarks on 8<sup>th</sup> December, 2005 when stating,

“The government will assess the effectiveness of the new prudential arrangements and further strengthen them, should this be required. The government will consult widely with the sector in developing and strengthening the new regulatory requirements.

We expect that these arrangements for securing bonds can be adapted further in the future, with industry taking a greater responsibility for ensuring bonds are secure.”

These and similar comments indicate the proposals in the draft legislation are not immutable but perhaps something more than interim. This perception is stated clearly in the *Explanatory Memorandum* to the Aged Care (Bond Security) Bill 2005 when reasons for the choice of procedures are advanced favouring Option A2; see pages 7 to 10 and 12-13.

Longer term considerations bear upon matters of prudential supervision of these funding arrangements in residential aged care. These reflect the nature and implications of the risks to which residents of aged care facilities are exposed. Understanding that exposure is at the heart of any analysis of the necessary steps for monitoring and supervising the conduct of entities offering residential aged care and accepting accommodation bonds for funding capital requirements. Attention to these issues at this time is most appropriate in view of the expectation of

longer term themes soon to be considered. This stance was conveyed by the then Minister when stating on 8<sup>th</sup> December last year,

“As foreshadowed in the government’s response to the pricing review undertaken by Professor Hogan, consultation on longer term reform of the aged care sector will soon be under way.”

The main sources of information on residential aged care themes treated in this statement are the two reports from the Aged Care Review and the later report from this Committee about aged care. The two reports from the Review comprise an initial summary document covering recommendations with some introductory comments presented in February, 2004 and then the comprehensive main report lodged in April, 2004. These are listed in the references as Hogan 2004a and 2004b. The report from this Committee on these matters was presented last year and treating a most comprehensive range of issues.(Senate, 2005)

When treating the reports from the Review, two features should be understood. First, the title of the Review as the *Review of Pricing Arrangements in Residential Aged Care* is a misnomer. While the term “pricing” appears in the title, there is no mention of price or pricing in the terms of reference for the Review. Pricing matters could only be inferred from the efficiency and productivity themes.

Secondly, my recommendations on revising the ways bed allocations are made to aged care providers are now superseded in my thinking in favour of investment decisions being left to the boards and management of entities providing residential aged care services. The reasons for this shift in position are explained in a recent paper.(Hogan 2005; pp. 33-36) The implications of this revised view are powerful because the relative influence of users of these services and their families would be enhanced

relative to the roles of government and providers.<sup>1</sup> Existing arrangements are dominated by government-provider parleys.

## 2. The Three Bills

### a) General themes

The main reason for bringing forward these proposals is the moral hazard to which the Australian Government, and thus taxpayers, have been exposed by the legislative recognition given to accommodation bonds. In turn this reflects the lack of any measure to secure repayment in the event of misadventure bringing liquidation to the provider or an associated entity holding the bond. The need for an urgent remedy to this exposure was prominent in the main Report. (Hogan, 2004b; chapter 8)

The importance of measures to protect the value of accommodation bonds provided by residents cannot be overstated. The great bulk of residents are very elderly with few having any prospect of earning incomes to replace losses arising from failure to repay the balance of accommodation bonds due to them. In effect their risk aversion is complete in nearly all cases. This circumstance is sufficient ground alone to justify a prudential arrangement to guarantee this repayment.

Moreover, the failure to offer some form of guarantee could mean a resident reverting to concessional or assisted status entirely reliant on government support rather than contributing some portion of total costs

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<sup>1</sup> Other major implications include the distribution of government funding through the users of services rather than to providers as at present. The determination of the category of need associated with each resident would remain dependent on assessments by Aged Care Assessment Teams (ACATs). Promotion of facilities in remote and similar areas as well as for other special groups, such as the homeless, would be met by seeking tenders for the capital support and additional revenue support providers would need to establish facilities.

through accommodation bonds and related charges. This feature is reason for government to meet costs, wholly or partially, of any scheme for monitoring and supervision of prudential requirements placed upon providers.

There has been a rapid expansion in the value of accommodation bonds raised during the past decade. Notable is the rapid increase in the proportion of aged care providers accepting bonds. Total outstandings at about \$4.3 billions at the end of the 2004-05 fiscal year is a huge sum being a specific corporate debt owed by the bulk of providers in what has been a cottage industry. No failure to repay has occurred as yet.

This is not a reason to reject proposals to relieve the moral hazard of the Australian Government and taxpayers. The past decade and more has been remarkably benign in its economic and financial performances. Historically, this period has been unmatched by any other of similar duration in over a hundred years. Interest rates whether expressed in real or nominal terms, have been low. Credit markets have not been strained by harsh restraints witnessed from time to time in decades after World War 2. The Asian economic and financial crisis of 1997-98 scarcely made a dent in the Australian performance.

There are no grounds for judging Australians to have discovered the pot of gold at the end of the economic rainbow. Any reasonable assessment of prospects would accept the probability of a general economic malaise arising at some time ahead. Given the strong risk aversion of the very elderly, there are good reasons to have in place measures protecting their monetary and financial claims. These steps are prudent in relation to potential risk. Quite apart from these concerns about the impact of

weakened economic circumstances, there is always the possibility of individual entities failing often reflecting poor management.

#### b) Details

The Aged Care (Bond Security) Bill 2005 sets the basis for the new provisions whereby the Australian Government guarantees the outstanding balances associated with accommodation bonds. The basic elements are set out systematically establishing the formal conditions for insolvency and the declaration of an insolvency event. The Department of Health and Ageing in the person of the Secretary or a delegated officer, must be notified of an insolvency event by the provider involved. This means the Department must have the capacity to understand the circumstances of the provider or providers exposed in this way. Thus the workings of default declarations and refund declarations require departmental skills akin to some associated with administrators or liquidators of failed corporate entities. This perception is reinforced by the cost recoupment determinations. This aspect is recognised in the *Explanatory Memorandum* with provision for using external practitioners in insolvency.

The transfer of recovery rights to the Commonwealth from the bondholders who have been recompensed for their losses through failure to repay on the part of the provider, places the Australian Government in the same class of priority as the resident. There is no provision in these proposals to advance the seniority of the Australian Government's claims

on the residual assets of the insolvent provider. Other creditors of the insolvent provider are not disadvantaged by this proposed legislation,<sup>2</sup>

The provisions of the Aged Care (Bond Security) Levy Bill 2005 flow from the previous Bill. Indeed the operative clauses are brief while the working arrangements for the levy will be reflected in regulations to be determined by the Governor-General. Under Clause 9 regulations imposing a levy differentiating between classes of providers are authorised. The wording may be suitable for legislation but the *Explanatory Memorandum* for this Bill is silent on where the decision about regulation for differentiation lies.

Importantly, what does “classes of providers” mean. The only example is about “remoteness or otherwise” of the location of services; see page 3 in that information script. But many providers are comprehensive in their geographical spread and, with industry consolidation, are likely to increase in number. Then the concept of rural providers, as often used with the industry, covers a very wide range of experiences between providers close in to defined metropolitan areas with support services to match. Other rural providers are much differently placed without ready access to a substantial range of support services within reasonable proximity. This aspect of the Bill calls for clarification. Discriminatory practices by regulation should not be opaque.

The Aged Care Amendment (2005 Measures No. 1) Bill 2005 is about prudential standards rather than an extension of the requirements

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<sup>2</sup> Improved seniority would mean these other creditors were contributing to the recouping of residents’ losses with the further implication of a reduced levy on all aged care providers holding bonds should the funds available from the insolvent provider still be insufficient. Thus these alternative ways of approaching claims come down to how the distribution of costs of insolvency risk is to be made.

associated with bond repayment guarantees and provision for levies on the aged care industry. Thus this third Bill serves a much different purpose from the first two already reviewed.

The *Explanatory Memorandum* to this Bill offers substantial coverage of the numerous clauses in it. The reasons for those clauses are not explained. This comes about because the reasons for the choice of approach to prudential standards are offered in connection with discussions of issues related to the first Bill. There is to be a staged introduction of prudential standards mainly because the imposition of rigorous standards immediately would place undue strains on many providers in their efforts to meet such standards. In light of the economic and financial circumstances of many providers revealed in the analyses undertaken for the Aged Care Review this position is understandable. The costs of implementation of these standards are being subsidised by the Australian Government so additional cost considerations do not explain the bases for financial strains.

What emerges from various explanations associated with the three Bills is the expectation for the guarantee scheme embodied in the first and second Bills to become redundant when rigorous prudential standards are applied some years hence, sooner perhaps than 2012. Practical considerations about the workings of the less robust initial standards and understanding of the extent of potential risk associated with the guarantee provisions, should bring sustained scrutiny of arrangements and thorough public reporting of them.

The Australian Government chose not to accept recommendations for an independent authority to undertake monitoring and supervision of



prudential arrangements as advanced in the Report of the Review. Those proposals were comprehensive in their purpose, more so than anything under consideration in these Bills. Nonetheless, the proposals for prudential standards advanced here could be administered by a separate authority; an example from existing practices is the role of the Standards and Accreditation Agency in relation to quality and integrity of care offered by providers.

### c) Implementation

Lacking is coverage of the means by which the supervision of prudential standards is to be implemented. There is an explanation of the approach to treating the insolvency issues related to the guarantee scheme with the stated intention to draw upon the skills of insolvency specialists. Yet this aspect is a relatively narrow one when compared with the skills bearing upon the appraisal of prudential standards as is evident from the work of the Australian Prudential Regulatory Authority (APRA). Experiences across the financial services sector would point to prospects for very testing judgements to be exercised about intervention to shut down a facility or secure new owners ahead of illiquidity let alone insolvency. These features must be understood if preservation of services is to be achieved and losses to bondholders arising from bankruptcy are to be minimised.

This theme is not some idle conjecture. The proposed three pieces of legislation and the various commentaries upon them are couched largely in terms of bankruptcy or otherwise with an immediate focus on measures not too demanding as to risk financially weak providers being pushed into bankruptcy. There is a lack of subtlety in this stance because the astute supervisory authority may ponder intermediate positions whereby change

can be brought about at no expense to the bondholders and their guarantors while bringing about restructuring of board and management without gross losses to the original ownership. These possibilities do not appear to be on the proposed agenda for prudential supervision because of the judgement that the work can be done “... by a relatively small team with 10 staff or less.”<sup>3</sup> A Government Department however well advised by consultants, does not have as its main purpose the achievement of these goals or the experiences for deciding on these outcomes.

Consultants must play a most significant role in the work of the Department of Health and Ageing when monitoring and supervision of prudential standards for aged care providers. The various tasks associated with prudential regulation are most sensitive for the stability of the entities providing aged care and the preservation of bondholders’ assets. In these circumstances those recruited as consultants must be required to act on any matters related to prudential standards solely for the Department and not for other parties involved in prudential matters such as providers or the associations representing them. Otherwise severe conflicts of interests would be ever present.<sup>4</sup>

Given the complicated setting in which these initial prudential standards are to be implemented, confidence in their workings should be secured by a thorough public reporting of activities. This is all the more important when the official perception is for the task to be undertaken by some relatively small unit. This stance is reinforced further by the past

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<sup>3</sup> See *Explanatory Memorandum* for the Aged Care (Bond Security) Bill 2005 of page 6.

<sup>4</sup> Given the widespread use of consultants on a range of matters bearing upon aged care arrangements, potential conflicts of interest should be avoided by not engaging those individuals, entities and associates having established affiliations with providers and other participants.

experiences with monitoring of existing prudential requirements, revealing a lack of focus.<sup>5</sup> An informed critic might well argue the new requirements embodying a liquidity standard, a records standard and a disclosure standard are not very different from what appeared to have been expected in the past. Given past shortcomings most compelling reasons may be advanced for a public reporting to engender confidence in the efforts to foster prudential standards, even if there are relatively modest goals including stabilising positions of providers.

### 3. Longer Term Issues

The longer term requirements for prudential standards are not likely to be reviewed for some years. These are said to include provisions about governance, risk management and capital requirements.<sup>6</sup> The staff requirements would exceed 15. This observation suggests a unit no more than twice the size of that to deal with the initial proposal advanced with the three Bills under review.

Given the testing issues linked to the three topics listed in the preceding paragraph, the numbers thought necessary for the conduct of more stringent standards associated with longer term goals, there are no reasons for thinking the need for active management of circumstances associated with entities strained in their efforts to meet requirements, is understood. Recent experiences in the financial services sector in Australia would point the need for an approach which stressed the value of early warnings

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<sup>5</sup> See *Explanatory Memorandum* for the Aged Care (Bond Security) Bill 2005 on page 3. The view about the current focus of the aged care legislation being on quality as an explanation for the lack of attention is trite if not disingenuous because the existing legislation does provide for reporting in prudential standards. More correctly, the administrative process determines the focus not the legislation.

<sup>6</sup> The same page reference as for footnote 3 applies.

of potential failures and the need to circumvent their realisation. This is all the more important in an activity where the recipients of services are often lacking the capacity to adapt readily to changes in the ways those services are made available.

While the legislation provides for monitoring and supervision of prudential standards to be undertaken within the Department of Health and Ageing, this commitment should not be considered immutable. The evidence for effective supervision should be sought especially in light of past shortcomings associated with a lack of focus on the task. An independent watchdog would allow greater flexibility in the choice and selection of staff while alleviating an inevitable great reliance on consultants with the scheme under the proposed legislation.<sup>7</sup> That watchdog might draw a wider range of government departments to support its strategic direction of prudential efforts.

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<sup>7</sup> Under existing structures the Aged and Aged Care Division of the Department of Health and Ageing is directed by a First Assistant Secretary. The most senior prudential supervisor could rank no more than an Assistant Secretary which places a ceiling on the salary and conditions for recruitment of a person from outside the public service. An independent authority would not be in that position should it be established with the full confidence of the government of the day.

## References

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