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Senator the Hon. C Fierravanti-Wells MP
Shadow Minister for Ageing
Shadow Minister for Mental Health
PO Box 886
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Dear Senator Fierravanti-Wells,

It was a pleasure to meet you today at the lunch regarding Aged Care and Retirement Living.

With respect to the comprehensive package of reforms proposed for aged care referred to as "Living, Longer Better" the challenge appears to be delivering the increased required level of services for an ageing population whilst balancing the public purse.

In this regard, it would seem logical for the Australian and State Governments to work in partnership with the private sector to deliver the increased level of services required to meet this growing demand in the Australian healthcare market.

Australians are very fortunate though. As a nation we have a strong regulatory and banking system, a healthy superannuation model, a Medicare system which balances good access to healthcare with a user pays element and an Australian Government which has low levels of debt, particularly relative to GDP.

With respect to the aged care industry, past Australian Governments have been progressive. They have successfully "rented" its balance sheet to the aged care industry via the bonded model, thereby guaranteeing payments to residents, assisting the industry to meet demand and providing the private sector with certainty around a business model which provides access to capital and development finance. This model has been very successful to date, but has now entered a period of flux.

As I understand, one of the key concerns for any Australian Government is the potential for the quantum of its balance sheet that is "rented" to the industry increasing exponentially. This is a significant contingent liability risk which needs to be managed. As such, it is rightfully seeking to address this issue up front, rather than faced with a "Freddie Mac" or "Fannie Mae" style event in the future. Over the next generation cycle, some estimates show there being a real likelihood that the Australian Governments contingent liability will grow from $12 billion to $30 billion if left unchecked.

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However, without a bankable and a stable business model, the Australian aged care industry is unlikely to grow at the rate required to meet the demands of an ageing population.

From a commercial perspective, it would seem that the Australian Government has a range of options which it could pursue to re-align the risk/reward of its exposure to the sector and encourage participation from the private sector.

Currently, it is proposed to cap the bonds charged by the sector at (say) $495,000. Whilst this has the benefit of reducing the potential contingent liability the Australian Government has in "renting" its balance sheet, it also has the impact of reducing the price that operators may charge in the future. The current proposed level may not be sufficiently attractive for private capital to flow into the sector without a material increase in its earnings/profits from the price charged for services. Therefore, the funding model going forward therefore needs to balance the growth capital required to re-model and build new facilities as well as price the payment for services at a sufficient level for operators to increase their suite of services to better serve the community.

Question: ***Could the Australian Government separate the level of accommodation bond indemnity from the price charged by the operator?***

One suggestion is for the Australian Government to consider separating:

1. The level of bond liability that it guarantees from
2. The price of the bond charged by the operator.

This would be similar to the bank guarantee model. Under the bank guarantee model, the Governmen initially insured deposits up to $1m but investors were still able to deposit more than $1m with the bank. Over time the level of guarantee was reduced to $250,000 and then removed altogether.

Question: ***What is the appropriate financial level for the Australian Government to guarantee accommodation bonds? Could operators charge a top up amount?***

For example, the Australian government could guarantee all bonds up to $495,000 but the amounts charged by the operator's above this amount would revert back to the credit risk of the individual operator.

Hence if an operator charged an accommodation bond of $750,000 it would be reflected as follows:

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Bond Liability protected by Australian Government	495,000
Bond liability at risk of operator credit*	255,000
Total Bond Liability	**750,000**

*There are various ways to protect the consumer against the operator credit risk e.g. external credit rating for operators, consumer insurance, etc. If this has merit, further discussion can occur around these mechanisms at a later date.

The benefit of this "hybrid" model would be:

1. The Australian Government's contingent accommodation bond liability could be maintained at an appropriate level and even reduced over time.

2. The private sector is free to price its accommodation bonds to meet the market, thereby attracting more capital to the sector.

3. Residents will have greater choice.

4. The market can adjust more easily to fluctuations in demand and supply in local areas by adjusting the "at risk" level of accommodation bond liability charged by the operator.

5. Operators with better financials and better credit worthiness will be rewarded in the long run.

6. With respect to the $255,000 operator accommodation bond liability in the example, the reality is that in many cases when the bond becomes due to be repaid there are a number charges and expenses which will reduce the payout value. These should first be deducted from the operator accommodation bond liability component to safeguard the maximum amount of the protection to the resident or his/her beneficiaries with respect to the Australian Government guarantee.

Question: ***Does the Australian Government wish to attract more private capital to the sector?***

Based upon above, this would allow the government to attract capital into the sector faster, whilst demand is at its greatest, with the potential to reduce its level of guarantee overtime, if required.

Question: ***Would the Australian Government consider allowing the insurance industry to underwrite the operator accommodation bond liability risk?***

The operator credit risk element may attract interest from the insurance industry which may allow the resident to purchase operator credit risk insurance i.e. the insurance company would pay out in the case of default on the operator bond component. Alternatively, the aged care operator could purchase this insurance and pass it on in the cost of the bond.

Question: ***Would the Australian Government like to reduce its contingent liability to the sector over time?***

Once the insurance industry was able to gain sufficient comfort around these risks, the Australian Government would have the option to "wind-back" its exposure moving the risk towards the private sector. This insurance could potentially be purchased up front at the time of submitting the bond.

Therefore, based upon the above:

a. Is there any legal impediment to the Australian government providing a guaranteed accommodation bond floor for individual accommodation bonds rather than a cap on what operators can charge?

b. If operators can charge accommodation bonds above the level the guaranteed government accommodation bond floor, what issues does this cause for the government?

c. If the government is not guaranteeing the amounts above the guaranteed accommodation bond floor, does this remove the need for the government to cap accommodation bond prices charged by operators?

In summary, there is a multitude of ways that the Australian government can facilitate growth in the sector, it is a matter of balancing the risk/reward and the speed of growth required.

I hope you find this submission relevant.

Please feel free to contact me directly if you would like to discuss further.

Best regards

BRADY P SCANLON