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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

AGED CARE (BOND SECURITY) BILL 2005

EXPLANATORY MEMORANDUM

(Circulated by authority of the Minister for Ageing, the Honourable Julie Bishop MP)

AGED CARE (BOND SECURITY) BILL 2005

OUTLINE

The Aged Care (Bond Security) Bill 2005 establishes a scheme to guarantee the repayment of aged care residents' bond balances in the event that an approved provider of a residential aged care service or a flexible care service becomes insolvent (a default event) and is unable to meet his/her financial obligation to repay residents' bond balances.

This Bill forms part of a suite of Bills, including the Aged Care Amendment (2005 Measures No. 1) Bill 2005 and the Aged Care (Bond Security) Levy Bill 2005, which together strengthen protection of residents' accommodation bonds, as announced by the Government in September 2005, by enhancing prudential regulatory requirements and by guaranteeing the repayment of bond balances to residents in the event that an approved provider becomes insolvent and is unable to repay bonds.

This Bill enables the Commonwealth to pay to a person an amount that is equal to a bond balance, and interest, owed to the person by an approved provider. In exchange for the payment, the Bill provides that any rights that a person paid such an amount by the Commonwealth had to recover the amount from an approved provider are transferred to the Commonwealth.

Provisions in the accompanying Aged Care (Bond Security) Levy Bill 2005 allow the Commonwealth to recoup costs it incurs from other approved providers (to the extent that costs are unable to be recovered from the defaulting approved provider).

FINANCIAL IMPACT STATEMENT

There will be no cost to approved providers of residential aged care unless a provider becomes bankrupt or insolvent and the Commonwealth has to pay outstanding bond balances owed to residents. The magnitude of costs that flow to approved providers of residential aged care will be determined by the monetary value of the outstanding bond balances (including interest) repaid by the Commonwealth on behalf of the defaulting approved provider, whether any part of this cost can be recovered from the defaulting approved provider and the costs incurred by the Commonwealth in administering the default event (including the repayment of the bond balances). In the event that an approved provider becomes bankrupt or insolvent and defaults on their financial obligation to repay residents' bond balances, the Commonwealth will assess the impact of recovering costs from all approved providers holding accommodation bonds. The Commonwealth will have the legislative capacity to recover costs from approved providers holding bonds in a series of instalments over a number of years. This will minimise the potential impact on approved providers.

REGULATION IMPACT STATEMENT: STRENGTHENED PROTECTION OF RESIDENTS' ACCOMMODATION BONDS

A: Background

Accommodation bonds

Under the *Aged Care Act 1997* ('the Act'), an accommodation bond (bond) is an initial payment that an approved provider (provider) may charge a resident of aged care services (resident) for entry to low level residential aged care, or to high level residential aged care in an 'extra service' facility. Some aged care residents in Multipurpose Services (MPS) may also be charged accommodation bonds. The balance of a bond that is paid to a provider when a resident enters a facility (minus certain deductions and any investment returns retained by the provider) is refunded to the resident upon their exit from the facility.
For lump sum bonds, providers can draw down a certain amount from the capital sum each month for five years from the date of entry. This is the retention amount. The retention amount is calculated monthly and fixed on entry to a service (that is, it never changes during the life of the bond). The Government regulates the maximum retention amount and this is currently $265.50 per month or $3,186 per annum for residents who pay a bond of more than $31,860. Maximum retention amounts set by the Government vary depending on the size of the bond and are indexed annually. After five years, no further retention amounts can be deducted from the bond.

Prior to commencement of the *Aged Care Act 1997*, some residents of aged care services were charged entry contributions. These entry contributions are akin to bonds.

Industry use of bonds and industry structure and trends

Around 74 per cent of aged care services levy bonds on residents. Based on 2004 data, around $3.7 billion in bonds is held across the industry. The average total bond holding of providers in 2003-04 was $3.96 million with about 10 per cent of bond holders holding $10 million worth of bonds or more. Total holdings have increased from $500 million in 1996. The average new bond has also increased from $26,000 in 1996-97 to $127,600 in 2004-05.

In 2004 a *Review of Pricing Arrangements in Residential Aged Care* ('the Review' or 'the Hogan Review') was undertaken. One of the recommendations of the Review was that appropriate prudential arrangements be established, to ensure the protection of residents' bonds, noting that bonds do not qualify as preferential debts under the *Corporations Act 2001*.

In the 2004-05 Budget, the Australian Government ('the Government') committed $0.8 million (through the *Investing in Australia's Aged Care: More Places, Better Care* initiative) to develop proposals, in consultation with the community and providers, for strengthening the level of security for bonds, both currently held by providers and any taken in the future.

Current prudential arrangements

Under the Act, providers must not use an accommodation bond for a purpose that is not related to providing aged care to care recipients. Providers must also comply with a limited set of prudential requirements set out in the Act.

Under the current limited prudential arrangements, providers holding bonds are required to:

- submit an annual prudential statement to the Department of Health and Ageing (the Department) confirming whether the provider can repay, in accordance with the Act, liabilities for accommodation bond balances that can be expected to fall due in the following financial year and whether the provider has had enough insurance, throughout the year, to cover losses arising from fraud, loss of earnings, fire, flood, or other reasonably insurable events that may affect the ability of the provider to refund bond balances;
- give a copy of the statement described above to any resident who has a bond held by the provider; and
- give the resident, or a prospective resident, the most recent statement of the service's audited accounts, or if the service is operated as part of a broader organisation - the most recent statement of the audited accounts of the organisation's aged care component.

Sanctions for non-compliance include, for example, prohibiting the charging of accommodation bonds, restricting the provider's approval and revoking or suspending the allocation of places. However, such sanctions are infrequently exercised in relation to prudential matters as the current focus of the aged care legislation is on ensuring quality of care rather than ensuring the financial viability of providers.

In addition, providers wishing to remain eligible for the Conditional Adjustment Payment (CAP) are now required to prepare General Purpose Financial Reports (GPFRs) in accordance with accounting standards, subject to limited exemptions and transitional arrangements. The GPFRs must be audited and must be provided, on request, to residents, prospective residents, or any other person or agency authorised by the Department.

B: Problem

In the event that a provider becomes bankrupt or insolvent, the resident is not guaranteed return of their bond because the resident ranks as an unsecured creditor under corporations law. Further, there is no capacity in the aged care legislation to give priority to bond balances. While to date there have been no cases where a resident's bond balance has not been repaid, the risk of this is increasing because of the increased reliance of providers on bonds and the increasing value of bonds [as discussed in the Background to this Regulation Impact Statement (RIS)].

The main problems to be addressed are:

- the current prudential arrangements in place to protect bonds, while they have worked well to date, cannot guarantee the full refund of residents bond balances;
- bonds are uncapped fees in a market in which supply is constrained and can represent a significant proportion of residents' life savings;
- a range of risks arise that may prevent residents from receiving a refund of the bond moneys due to them on leaving a residential aged care facility. A provider may fall into financial difficulty and be unable to repay residents' bonds, either because of short term

liquidity problems or net financial default. Currently, if a provider becomes bankrupt or insolvent, residents who are owed bonds rank with other unsecured creditors. Bonds are currently unsecured debts owed to older people; and
- the large sums of money held in bonds and the lack of a comprehensive arrangement for the monitoring and supervision of the management of these funds are of concern to the Government and the community.

Justification for action by the Government to address the problem

The need for stronger prudential regulation and for a guarantee arrangement is becoming more pressing as the industry's collective holdings of bonds increase and as the average size of bonds – that is, the level of loss to which a resident would be exposed if their provider defaulted – also increases. The industry is unable to respond to this problem independently of the Government at this time because providers rely on bonds for capital-raising. Bonds could be protected if they were placed in trust funds by providers. However, this option is not viable at this time because most providers are dependant on bonds as a source of capital funding, and there would be a significant adverse impact on industry if the bonds had to be realised and placed in trust funds. Also, in the event of a default, corporations law operates such that residents will always be unsecured creditors.

C: Objectives

In recognising the level of risk to which residents' bond moneys are currently exposed, and the inherent risk to the Government, the key objectives are to:
- improve the efficiency and sustainability of the industry and strengthen the management of bond moneys to reduce the likelihood of providers becoming insolvent or bankrupt and defaulting on repayment of bonds;
- strike a balance between the added security for residents that is provided by this strengthening and the financial impact of the new arrangements on the industry's viability and its standing with the capital markets, including its ability to construct and maintain aged care homes, and pressures that might flow on to subsidies, user charges, and the quality and continuity of care; and
- ensure that residents receive their full entitlement to the balance of aged care bonds that they have paid, in the event that a provider becomes insolvent or bankrupt.

D: Options for prudential regulation of providers holding bonds and options for securing residents' bonds

This RIS proposes a number of options for: (a) increasing prudential regulation of providers holding accommodation bonds; and (b) guaranteeing the security of residents' bonds. These two sets of options are inter-related because, as prudential regulation is increased it is expected that the need for the Government to guarantee the security of residents' bonds will decrease. Similarly, if residents' bonds are guaranteed from the outset, this enables a staged approach to prudential regulation to be introduced over time (cognisant of the impact of prudential regulation on the sector). In the short term, in the absence of strong prudential regulation there is a need to couple prudential requirements with a guarantee arrangement for securing residents' bonds.

Options for prudential regulation

Option A1: Retain the status quo

As detailed in the Background to this RIS, the status quo is that providers are required to submit an annual prudential statement confirming whether they have sufficient insurance and capacity to repay bonds likely to be owing in the following year.

Option A2: Staged introduction of prudential standards as part of a prudential regulatory framework

Under this option, a prudential regulatory framework would be established. The framework would require providers holding bonds to comply with an initial set of prudential standards, based largely on existing requirements under the Act. New standards would be developed over time following consultation with stakeholders and appropriate research and analysis.

Initially the prudential regulatory framework would establish three mandatory prudential standards for providers:

(a) a **liquidity standard** would require each provider holding bonds to confirm that the provider has sufficient liquidity to be able to repay liabilities for bonds and a liquidity management strategy to minimise the risk of not being able to refund accommodation bond balances because of losses arising from, for example, loss of confidence in the service, an epidemic, fraud, flood, fire and other events;

(b) a **records standard** would require providers holding bonds to maintain an up-to-date register of their bonds, and related information, in a prescribed form and to have it audited annually; and

(c) a **disclosure standard** would require a provider holding bonds to give:
- the Department information about the provider's compliance with the liquidity standard, records standard and disclosure standard including information from the bonds register. The information provided to the Department must be audited.
- a resident (or the resident's representative) a copy of the bond agreement, an annual extract of the transactions in the bond register for the resident and information on the provider’s compliance with prudential requirements; and, on request, a copy of the financial report and any audit report on it, a copy of the entry on the register that relates to the resident and a copy of the audit report on the register; and
- a prospective resident of the provider's service (or the prospective resident's representative), on request, information on the provider’s compliance with prudential requirements and a copy of the financial report and any audit report on it, and a copy of the most recent audit report on the register.

The Department would monitor compliance with the prudential standards and impose sanctions as appropriate.

The Department would be responsible for developing any necessary additional prudential standards in consultation with all stakeholders to reduce risks to residents and the Government.

It is proposed that the prudential regulatory framework would be administered by the Department by a relatively small team with 10 staff or less.

Option A3: Introduce comprehensive prudential regulation as soon as possible

Under this option, providers holding bonds would be required to comply with comprehensive prudential requirements, modelled on those administered by the Australian Prudential Regulatory Authority (APRA) in respect of financial services. Such standards would include those detailed against Option A2 but would also include prudential standards relating to, for example, governance, risk management and capital requirements.

As for Option A2 the prudential regulatory framework would be administered by the Department. Given the expanded role under Option A3 it is anticipated that the staff required would be in excess of 15.

Groups likely to be affected

Residents

In 2003-04 there were 189,929 residents. The Department does not currently hold data on the total number of residents paying bonds. However, in 2003-04, there were 48,222 new entrants to permanent care and of these approximately 37.6 per cent paid (or agreed to pay) an accommodation bond.

Providers

In 2004, there were 2,493 services and 1,309 providers. Providers include private incorporated bodies, community based organisations, religious organisations, State/Territory Government organisations, charitable organisations, local government bodies, private non-incorporated entities and publicly listed companies.

Of the 1,309 providers, approximately 57 per cent received bond moneys, indicating relatively wide use of bonds within the industry.

The Government

The Government currently funds providers through a range of subsidies paid under the Act. The legislation also enables providers to require residents to deposit bonds with them.

Impact analysis

Option A1: To retain the status quo

Impact on residents
There would be no positive impact on residents if current arrangements were retained.

While some prudential protections exist in the Act currently, the absence of strong prudential regulation increases the risks to residents that may arise as the result of poor financial management by providers.

Impact on aged care providers
There would be no positive impact on providers if current arrangements were retained. However, there would be no increased cost to providers under this option.

Under current arrangements, there is limited encouragement for providers to take responsibility for their own financial risk and to develop a more prudent approach to the management of bonds held. It could be argued that over time, the industry will be able to develop a more prudent approach without the intervention of the Government. However, the Hogan Review did not support this notion.

Impact on the Government
As the Act enables providers to raise bonds, the Government may be exposed to moral hazard under the current arrangements. It could be considered that the Government is obliged to ensure that risk of loss of these funds is minimised. The deficiencies in the current prudential regulatory framework mean that, in the event of a provider being unable to repay residents' bonds the Government would face considerable criticism for failing to put measures in place designed to mature industry and decrease the likelihood of such an event occurring. There is a risk that the Government would be accused of inadequate monitoring of the financial management and operations of providers holding residents' bonds.

Option A2: Staged introduction of prudential standards as part of a prudential regulatory framework

Impact on residents
Option A2 would have a positive impact on residents and prospective residents and their representatives, with deficiencies in the current arrangements being addressed.

An increase in prudential regulation is likely to increase the financial security of providers. In turn, this is likely to decrease risks to residents' bonds over time. To the extent that there are increased compliance costs for providers, these increased costs may be passed on to residents. However, the advantage of a staged approach to the introduction of prudential standards is that the Department would assess the costs and benefits (the regulatory impact) of each standard as it was developed (including the cumulative cost and benefit of the standards in total).

An additional benefit of this option is that the disclosure standard would ensure that all residents and prospective residents and their representatives would have access to detailed information about the financial status of any provider holding accommodation bonds.

Option A2 would result in residents being better informed about the financial health of their provider and allow them to judge the safety of their bonds. This may be a less significant consideration where there is a shortage of residential care places or limited choice.

Impact on providers
This option would have a positive impact on providers with some of the deficiencies in the current arrangements being addressed.

The current prudential arrangements already include a liquidity requirement. However, the requirement in the liquidity standard to a produce a liquidity management strategy is new.

In addition, the records standard is a new standard that would require that providers document details of each bond held in a database in a prescribed form determined by the Department, ie. in the bonds register. There would be some additional cost to providers including in terms of reporting to the Department in a standardised format. However, the new requirements should not be a significant impact as providers are currently responsible for the appropriate management of bonds, and should already be keeping appropriate records.

The Department already conducts a voluntary annual survey of aged care homes which includes gathering information on accommodation bonds, and although the response rate is not 100 per cent, it is substantial. Response rates of more than 80 per cent were obtained for the surveys conducted between 2001 and 2004 inclusive. In responding to the survey, most providers already provide the type of data that would be required under the new standards.

The Government bear the cost of administering the new prudential arrangements for the first three years of operation. A further submission to the Government, on cost recovery of these functions, would be considered at a later date.

Impact on the Government
Option A2 would have a positive impact for the Government, with some of the concerns with the current arrangements, in light of the increasing value of accommodation bonds, being addressed.

This option would enable a strong information base to be developed (including through the information provided by industry, and the associated analysis and research) which would inform the future development of the prudential regulatory regime over time, but in a way that would not inadvertently or adversely affect the viability of services in the short term.

This option would ensure that future policy development would be based on a sound understanding of industry viability and financial health. The moral hazard to the Government should be reduced as the Government will have taken steps to protect bonds from exposure to risk of loss. This option imposes additional costs on the Government until such time as the regulatory scheme is cost recovered from industry.

The estimated cost of administration of prudential arrangements is not expected to exceed $3 million per year in any of the first three years. This cost will be met by the Government. This arrangement would be reviewed with the intention to introduce cost recovery from industry from the fourth year of operation of the new prudential regulatory framework.

Option A3: Introduce comprehensive prudential regulation as soon as possible

Impact on residents
Option A3 would have a positive impact on residents, prospective residents and their representatives with deficiencies in the current arrangements being addressed.

However this option would also introduce new risks to residents, prospective residents and their representatives. If parts of industry are unable to meet the stringent prudential requirements in the short term, the availability, quality and continuity of care may be adversely affected, with providers exiting from the industry. This would be of particular concern in areas where supply of services is limited (eg. some rural and remote areas). Strong prudential regulation is likely to minimise the risk to residents' bonds in the longer term.

Impact on providers
As with Option A2, this option would have a positive impact on providers with deficiencies in the current arrangements being addressed.

This option would generate significant additional costs to industry and the impact of this cost on the industry’s viability (including its ability to construct and maintain aged care homes, and pressures that might flow on to subsidies, user charges, and the quality and continuity of care) is not known. However, the impact is likely to be far more significant for smaller and rural and remote services.

As with Option A2, the Government would bear the cost of administering the new prudential arrangements for the first three years of operation.

Impact on the Government
As with Option A2, Option A3 would have a positive impact for the Government, with deficiencies in the current arrangements being addressed. However, the option introduces new risks to the Government in terms of the possible flow on effect that it would have on the viability of services and hence, the availability of services (including small services or those operating in remote/rural locations).

The Government considered the risks and benefits of this option when formulating its response to the Review. The Government concluded that the high degree of regulation recommended by the Review cannot be justified, including because of the high cost of additional regulation and administrative burden to providers. This conclusion formed part of the Government's response to the Review in 2004.

Administrative costs to government are likely to be higher under Option A3.

Options for guaranteeing security of residents’ bonds

Option B1: Retain the status quo

Currently, in the event of a provider becoming insolvent or bankrupt and defaulting on the repayment of bonds to residents, aged care residents rank as unsecured creditors of the defaulting provider.

Option B2: Guarantee scheme based on post-payment model

Under this option, the Australian Government would pay bond balances owed to residents by a defaulting provider (including interest). Residents would, in return, sign over their rights as creditors to the Government following receipt of their bond entitlements from the Government. The Government could then pursue the defaulting provider and if there was any shortfall, could recover the funds paid out by imposing a levy on the industry (all other providers charging accommodation bonds).

Option B3: Guarantee scheme based on pre-payment model

Under this option, providers who hold bonds would be required to deposit an up-front percentage of the bond balances they hold, into a guarantee fund that would be managed by the Department and drawn upon to pay amounts owed to residents in the event of a default.

Residents would, in return, sign over their rights as creditors to the Australian Government following receipt of their bond entitlements from the Government. The Government would then pursue the defaulting provider and if there was any shortfall, would top up the guarantee fund by imposing a levy on the industry (all other providers charging accommodation bonds).

Groups likely to be affected

The groups likely to be affected are the same as the groups detailed in relation to Options A1, A2 and A3.

Impact analysis

Option B1: Retain the status quo

Impact on residents
There would be no positive impact on residents if current arrangements were retained, and deficiencies in the current arrangements would remain in place.

In the event that a provider becomes bankrupt or insolvent and is unable to repay a bond, the resident ranks as an unsecured creditor of the defaulting provider. This means that in these circumstances the resident may not ever receive their full bond entitlement. This can have a significant negative impact, given that bonds are increasing (the average new bond agreement in 2004-05 was $127,600) and given that they can represent the life savings of older people.

Impact on providers
There would be no positive impact on providers if current arrangements were retained, and deficiencies in the current arrangements would remain in place. However, there would be no increase in costs to providers.

Impact on the Government
There would be no positive impact for the Government if current arrangements were retained, and deficiencies in the current arrangements would remain in place. In the event that a provider becomes bankrupt or insolvent and fails to repay bonds, the Government may come under pressure to repay the bonds.

Option B2: Guarantee scheme based on post-payment model

Impact on residents
This option would ensure that aged care residents would recover 100 per cent of bond moneys owed to them in the event that a provider became bankrupt or insolvent. In return for receipt of the bond money, residents would be expected to sign over their rights as creditors to the Australian Government.

Impact on providers
This option imposes minimal cost on the sector, as there are no up-front payments. The scheme only comes into operation in the event of a default. The levy on the sector to recoup the amounts paid to residents may never have to be imposed.

However, this option would not allay provider concerns that good providers would be liable for poor financial and risk management of defaulting providers.

Impact on the Government
This option is administratively simple. The Government would initially bear the costs of repaying bonds. The extent of the exposure would depend on the size of the bond holdings held by the defaulting provider. In 2004, seven providers that held more than $37 million in bonds. The three largest bond holdings are $220.3 million, $81.4 million and $78.4 million.

Under this option, the defaulting provider would not have contributed anything to the guarantee scheme.

Option B3: Guarantee scheme based on pre-payment model

Impact on residents
This option would ensure that aged care residents would recover 100 per cent of bond moneys owed to them in the event that a provider became bankrupt or insolvent. In return for receipt of the bond money, residents would be expected to sign over their rights as creditors to the Government.

Impact on providers
This option would ensure that the defaulting provider would make some contribution to the repayment of bonds, through their initial contribution to the guarantee fund. This option reflects the real cost to providers of securing bonds compared with the cost of using conventional capital-raising mechanisms. The payment of a deposit by all providers holding bonds would reinforce to providers the individual and collective responsibility attached to holding bonds.

Under this option, providers would not have access to the amount contributed to the guarantee fund. Any interest earned on the money deposited would be used to offset the cost of the scheme and any excess would be used to top up the fund to increase the amount available to cover payouts in the event of a default.

As for Option B2, Option B3 would not allay provider concerns that good providers would be liable for poor financial and risk management of defaulting providers.

Impact on the Government
Because the scheme would be pre-funded, the Government would already have "the money in the bank" from providers to enable payments to be made to residents. This option would minimise the financial risk to the Government. However, there would be an additional administrative cost associated with managing a multimillion dollar fund.

E: Consultation

Initial consultation with the industry and consumers

As part of the Hogan Review, extensive consultation was undertaken with consumers and providers about issues within the Review's Terms of Reference (including prudential regulation and the security of bonds).

Professor Hogan, the reviewer, undertook consultation in all States and Territories from May to October 2003. Further consultation was undertaken through the Industry and Consumer Reference Group, which was established during the Review.

Supplementary discussions were held with peak bodies, Government agencies and other stakeholders as part of the Review, and a number of aged care services were visited.

External stakeholder consultation following the Hogan Review

Consultation regarding options for establishing a guarantee scheme for repayment of residents' bonds was undertaken through the Minister's Implementation Taskforce (MIT) between September 2004 and April 2005. The Conditional Adjustment Payment and Prudential Reference Group (the Reference Group) was also established and consulted following the Review.

Members of MIT and the Reference Group were also consulted on the content and approach proposed for the legislative framework for the guarantee scheme and the prudential regulatory arrangements.

Consultation with Government agencies

There has been extensive consultation with relevant Government agencies including the Departments of the Prime Minister and Cabinet, Finance and Administration and the Treasury.

Views of those consulted

There has been lengthy discussion of prudential regulation generally in the context of the Review. The Review recommended comprehensive prudential regulation overseen by a Guarantee Fund Authority with powers to examine the financial affairs of providers, review the assets of providers, apply to court for the winding up of insolvent providers and require a provider to dispose of assets to meet bond claims.

In relation to the options for guaranteeing the repayment of bonds to residents, industry has expressed support for both Options B2 and B3 (with a preference for B2). In relation to the prudential regulatory arrangements, members of MIT and the Reference Group provided positive feedback.

F: Conclusion and recommended options

Prudential regulation of providers holding bonds

Option A2 (staged implementation of prudential regulation) is preferable to Options A1 (retention of the status quo) and A3 (implementation of comprehensive prudential regulation).

Option A2:
- would allow all residents and prospective residents to be better informed about the financial health of providers, and allow them to judge the security of their bonds;
- would create a strong information base to enable the development of further standards over time;
- would minimise the risk to residents of a loss of their bond and may also improve overall management of aged care homes (a benefit that would also apply to Option A3).

However, Option A2 is preferable, as the sudden increase in prudential regulation proposed under Option A3 may adversely impact providers; and

- is appropriate given the current information base available to the Government to inform the development of prudential standards at this time.

Guaranteeing repayment of residents' bonds

In relation to the options for repayment of residents' bonds in the event of a provider default:

- Option B1 (retention of the status quo) is not supported as it does not ensure the repayment of bonds;
- Option B2 (guarantee scheme based on a post-payment model) is preferred because of its lower administrative costs. The combination of establishing the guarantee scheme at the same time as prudential regulation is strengthened further reduces the risk of default.
- Option B3 (guarantee scheme based on a pre-payment model), meets the objective of protecting residents' bond balances. However, this option has higher administrative costs and a greater regulatory impost that was not considered necessary given the lower risk of a provider default in the light of increased prudential regulation.

G: Implementation and review

Implementation

The preferred options for prudential regulation of the industry (Option A2) and operation of the guarantee scheme (Option B2) would be implemented through legislation. Stakeholders were consulted during the development of the legislation via MIT and the Reference Group.

Review

The prudential regulatory framework and the guarantee scheme would be subject to review. The Department will evaluate the impact of a prudential regulatory framework and a guarantee scheme on industry and consumers.

H: Cost recovery issues

Prudential regulatory framework

It is proposed that the prudential regulatory framework would ultimately be fully cost recovered from providers holding bonds. However, the Government will meet the costs of the framework for the first three years. There would, therefore, be no cost recovery impacts for providers or residents in the first three years.

During the first three years of operation of the framework, a full cost analysis regarding the detail of the cost recovery regime would be undertaken, and the cost recovery mechanism developed in accordance with the cost recovery policy of the Department of Finance and Administration.

A full Cost Recovery Impact Statement (CRIS) would then be prepared in accordance with the *Cost Recovery Guidelines*.

The CRIS would examine key issues such as the link between charges and the costs of undertaking the proposed scheme; the detail of how the fees and charges would be structured and calculated; legal requirements for the imposition of fees and charges; the consultation process and the views of those consulted about the cost recovery mechanisms; and the monitoring and review of cost recovery arrangements. Particular attention would be given to the arrangements for handling under- or over-recovery of costs. It is expected that this would be a particularly complex issue. In developing the CRIS, it would also be important to balance the need for review of fees and charges against the industry's need for some level of certainty about the fees and charges they would be liable to pay.

The CRIS would be considered by the Australian Government prior to implementation of cost recovery.

Guarantee scheme

There will be no cost to industry associated with the guarantee scheme unless a provider becomes bankrupt or insolvent and the Australian Government has to pay outstanding bond balances. Costs will only be realised in the event of a default. It should be noted that, while aged care residents in Australia have paid bonds for many years, there has, to date, never been a circumstance where a resident's bond balance has not been refunded.

AGED CARE (BOND SECURITY) BILL 2005

NOTES ON CLAUSES

PART 1 - PRELIMINARY

Clause 1 – Short title
This clause provides that the Act may be cited as the *Aged Care (Bond Security) Act 2005.*

Clause 2 - Commencement
This clause provides that sections 1 and 2 of the Bill will commence on the day on which the Bill receives Royal Assent and sections 3 to 22 of the Bill will commence at the same time as Schedule 5 to the Aged Care Amendment (2005 Measures No. 1) Bill 2005. Schedule 5 to the Aged Care Amendment (2005 Measures No. 1) Bill 2005 will commence on a day to be fixed by Proclamation or, at the latest, 6 months after Royal Assent.

The commencement of sections 3 to 22 of the Bill is timed to coincide with the commencement of Schedule 5 of the Aged Care Amendment (2005 Measures No. 1) Bill 2005 which gives the Secretary the power to require people to give information about bonds. This information informs determinations and declarations that the Secretary will make under the guarantee scheme.

Clause 3 – Simplified outline
This clause briefly explains the operation of the Aged Care (Bond Security) Bill 2005. It provides that in certain circumstances the Commonwealth will pay a person an amount that is equal to their bond balance (and interest). These circumstances are described in the Bill and in summary, are circumstances where an approved provider becomes insolvent and has not repaid outstanding bond balances to aged care recipients. Once the Commonwealth commits to repay the outstanding bond balance (with interest) to a person, the rights of the person to recover their bond balance (and interest) from the approved provider transfer to the Commonwealth. This enables the Commonwealth to attempt to recoup that money from the defaulting approved provider (standing in the shoes of the care recipient as a creditor of the approved provider). The Commonwealth may also make determinations which (through the imposition of a levy by way of regulations made under the Aged Care (Bond Security) Levy Bill 2005) will enable it to recover the following from other approved providers:

- refund amounts (which the Commonwealth has not recovered from the defaulting approved provider); and
- associated administrative costs.

Clause 4 – Application of this Act
This clause provides that the Bill applies in all States and Territories but does not apply in any external Territory (for example, Norfolk Island, the Australian Antarctic Territory, Heard Island, the McDonald Islands and the Coral Sea Islands). This is consistent with the *Aged Care Act 1997.*

Clause 5 – Binding the Crown
This clause provides that the Bill binds the Crown in each of its capacities and that the Bill does not make the Crown liable to be prosecuted for an offence.

Clause 6 – Definitions
This clause sets out a number of definitions for words and phrases used in the Bill. These definitions determine the meaning that is to be attributed to certain words or phrases whenever they are used in the Bill. Key definitions, which are essential to defining the scope of the legislation and describing how it will be administered, include the following:

"approved provider" – This term has the same meaning that it has in Schedule 1 of the *Aged Care Act 1997.* That is, an approved provider means a person or body in respect of which an approval under Part 2.1 of the *Aged Care Act 1997* is in force, and, to the extent provided for in section 8-6, includes any State or Territory, authority of a State or Territory or local government authority.

"bond" – This definition ensures that both "accommodation bonds" as defined in the *Aged Care Act 1997* and entry contributions made to aged care operators prior to 1 October 1997 are both covered by the guarantee scheme. The term "entry contribution" is further defined in the Bill and is consistent with its definition in the Aged Care Amendment (2005 Measures No. 1) Bill 2005.

"bond balance" – A bond balance is defined as:
(a) in relation to an accommodation bond - an "accommodation bond balance" within the meaning of the *Aged Care Act 1997* (that is, a bond less amounts that have been legally retained by an approved provider); or
(b) in relation to an entry contribution - an "entry contribution balance" within the meaning of the Aged Care Amendment (2005 Measures No. 1) Bill 2005 (that is, the amount of the entry contribution less any amounts permitted to be deducted under a formal agreement entered into between the aged care recipient and the operator prior to 1 October 1997).

"outstanding bond balance" – The effect of this definition is to identify when a bond balance becomes outstanding and may therefore be refundable by the Australian Government in the event of approved provider insolvency. In essence, a bond balance is an outstanding bond balance if the time within which it should have been refunded by the approved provider has passed, or part of it hasn't been refunded. In the case of accommodation bonds (as defined in the *Aged Care Act 1997)*, this is the time detailed in Subdivision 57G of the *Aged Care Act 1997* or the User Rights Principles and in the case of entry contributions this is the time detailed in the formal agreement entered into between the aged care recipient and the operator prior to 1 October 1997.

"insolvency event" - This definition describes the events that signal that an approved provider has become insolvent (and therefore the circumstances in which the guarantee scheme will potentially be activated). There are a number of different ways that an approved provider may become insolvent. For example, a corporation may be wound up under the *Corporations Act 2001* (either by court order or the passing of a special resolution) or an incorporated association may be wound up under a State or Territory law dealing with incorporation of associations.

"administrative costs" – This definition sets out administrative costs that may be associated with the operation of the guarantee scheme and therefore costs that the Commonwealth may recover from approved providers.

PART 2 – INSOLVENCY EVENT DECLARATION

Clause 7 – Making of insolvency event declaration
Sub-clause 7(1) provides for the circumstances in which the Minister may make an insolvency event declaration. An insolvency event declaration may be made if an approved provider has at least one outstanding bond balance and either:

(a) the approved provider is an externally administered body corporate (within the meaning of the *Corporations Act 2001*); or

(b) a personal insolvency agreement under Part X of the *Bankruptcy Act 1966* is in effect in relation to the approved provider or the approved provider's property.

This power is necessary because there may be circumstances where an approved provider is not insolvent (as provided for in paragraphs (a) to (f) in the definition of insolvency event) but is nonetheless unable to repay bond balances and unlikely to be about to trade out of difficulty. For example, both the *Corporations Act 2001* and the *Bankruptcy Act 1966* enable a person or corporation to enter into arrangements with creditors in an attempt to resolve financial difficulties and avoid being declared bankrupt or wound up. This provision enables the Minister to use his or her discretion to determine whether the guarantee scheme should be activated in these circumstances. Sub-clause 7(1) would only be used where there is no likelihood that the bond balances will be returned to the care recipients.

Sub-clause 7(2) provides that an insolvency event declaration must be in writing.

Sub-clause 7(3) is included to assist readers, as the insolvency event declaration is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. Accordingly, it is not subject to the requirements that apply to legislative instruments under that Act.

Clause 8 – Notice of insolvency event declaration
Sub-clause 8(1) provides that once an insolvency event declaration has been made by the Minister under clause 7, then the Secretary must provide written notice of the declaration to the approved provider to which the insolvency event declaration relates. Section 28A of the *Acts Interpretation Act 1901* specifies how documents must be "given". For example, in relation to a body corporate—by leaving it at, or sending it by pre-paid post to, the head office, a registered office or a principal office of the body corporate.

Sub-clause 8(2) ensures that if the Secretary fails to provide such a notice to the defaulting approved provider, then this does not affect the validity of the insolvency event declaration. This means that the guarantee scheme can operate regardless of administrative delays.

PART 3 – REQUIREMENT TO NOTIFY SECRETARY OF CERTAIN INSOLVENCY EVENTS

Clause 9 – Notice of certain insolvency events
This clause provides that should an approved provider be in a situation where an insolvency event has occurred, other than one that is declared under section 7, (as defined in the Bill) then the approved provider must notify the Secretary in writing by the end of the first business day after the day on which the insolvency event occurs.

This is a similar requirement to that under section 470(1) of the *Corporations Act 2001* and will alert the Secretary to the fact that an insolvency event has occurred (at the earliest possible time). Following on from this, the Secretary can then determine whether a default event has occurred such that the Commonwealth will need to refund outstanding bond balances to care recipients of the approved provider. This clause does not preclude the Secretary from becoming aware of an insolvency event through other means including, for example, through notification by an insolvency practitioner, a resident or a resident's representative.

Sub-clause 9(2) provides that failure by an approved provider to comply with this requirement to provide notice attracts a maximum penalty of 30 penalty units. This is consistent with other penalties for like offences in the *Aged Care Act 1997.*

PART 4 – DEFAULT EVENT DECLARATION

Clause 10 – Making of default event declaration

Sub-clause 10(1) provides that as soon as practicable after the Secretary first becomes aware that an insolvency event has occurred and that there is at least one outstanding bond balance, the Secretary must make a default event declaration. In effect, the making of a default event declaration by the Secretary triggers the chain of events that lead to payments being made by the Commonwealth to care recipients under the guarantee scheme.

Sub-clause 10(2) establishes what a default event declaration must contain. It provides that the default event declaration must be in writing, must state that an insolvency event has occurred in relation to the approved provider and must state that the Secretary considers that there is at least one outstanding bond balance.

Sub-clause 10(3) is included to assist readers, as the default event declaration is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. Accordingly, it is not subject to the requirements that apply to legislative instruments under that Act.

Clause 11 – Notice of default event declaration

Sub-clause 11(1) provides that the Secretary must give a copy of the default event declaration to the approved provider in relation to which an insolvency event has occurred and to each person that the Secretary considers may be entitled to receive a refund of an outstanding bond balance by the approved provider (for example, a care recipient).

The intention of providing notification is to inform the approved provider and care recipients (or their representatives) that a default event declaration has been made, and any information that was contained in it. This is to ensure that approved providers and care recipients (or their representatives) are made aware that actions are being taken by the Department to ensure outstanding bond balances will be refunded.

Subclause 11(2) provides that the default event declaration will also be published in a national newspaper. This will alert residents (and/or their representatives) of the defaulting approved provider that a default event has occurred and they may be entitled to a refund. It will also inform other approved providers holding accommodation bonds that a default event has occurred and that the guarantee scheme has been activated.

Sub-clause 11(3) makes it clear that if the Secretary fails to comply with all of the notification requirements this does not affect the validity of the default event declaration. For example, if the Secretary is not able to identify and notify all potential care recipients who may be entitled to a refund of their bond balance at this time, they will not be precluded from being refunded their outstanding bond balance.

PART 5 – REFUND DECLARATION

Clause 12 – Secretary to determine certain matters

Sub-clause 12(1) provides that once the Secretary has made a default event declaration the Secretary must identify each outstanding bond balance and each bond balance that later becomes outstanding.

Once a default event declaration has been made, there may be instances where more bond balances become outstanding. This provision ensures that the guarantee scheme can cover not only those bond balances that are outstanding at the time a default event declaration is made, but also those bond balances that subsequently become outstanding.

Sub-clause 12(2) the Secretary must also determine, in relation to each bond balance, the date that the bond balance was due to be repaid, an amount equal to the amount of the bond balance at that date, an amount equal to any interest that has accrued on the bond balance, the person the refund should be made to, and the most appropriate means for refunding the bond balance.

Gathering information in order to determine refunds to be made

For the purposes of sub-clause 12(2), there is a considerable amount of information that must be gathered by the Secretary. The Secretary may use a range of means for gathering such information including working with any insolvency practitioner who may be involved and working with the defaulting approved provider. In order to ensure that the Secretary has access to necessary information, the Aged Care Amendment (2005 Measures No. 1) Bill 2005 inserts a new provision (section 9-3A) in the *Aged Care Act 1997* requiring an approved provider to give the Secretary information about bonds, if requested, within 28 days after the request was made, or within a shorter period as is specified in the request. The provision is accompanied by a criminal penalty for non-compliance that can be imposed on corporations. Approved providers have a responsibility under Part 4.3 of the *Aged Care Act 1997* to comply with this obligation. Failure to comply with a responsibility can result in a sanction being imposed under Part 4.4 of that Act.

Date for determining bond balance

The date on which the accommodation bond balance becomes an outstanding bond balance will vary between care recipients as it will be depend on when they have left the service. For example, a care recipient may have left the service before the default event and the accommodation bond may still be outstanding. In other cases, at the time that the default event declaration is made, some recipients may still be in the service of the approved provider and may not leave until some time after the default event declaration is made. In this case the bond balance would not become outstanding until a certain time after the care recipient leaves the service. The legislation ensures that regardless of when the bond balance became outstanding, the guarantee scheme is able to repay the bond balance.

Clause 13 – Making of refund declaration
Sub-clause 13(1) provides that as soon as practicable after the Secretary has determined all of the matters in sub-clause 12(2) relating to an outstanding bond balance, the Secretary must make a refund declaration in relation to the outstanding bond balance.

Sub-clause 13(2) provides that the refund declaration must be in writing, specify the defaulting approved provider and detail the amount that the Commonwealth is to pay to the person named in the determination (that is, the person to whom an outstanding bond balance and interest is owed).

The Secretary may make multiple refund declarations. For example, if only four care recipients' bonds are outstanding at a point in time, the Secretary may make a declaration in relation to these four bonds only. If at a later time, more bonds become outstanding (as care recipients leave the service or as bonds become payable upon probate or the granting of letters of administration) the Secretary may make further refund declarations. The Secretary can continue to make refund declarations until all outstanding accommodation bonds have been acknowledged.

Sub-clause 13(3) is included to assist readers, as the refund declaration is not a legislative instrument within the meaning of Section 5 of the *Legislative Instruments Act 2003*. Accordingly, it is not subject to the requirements that apply to legislative instruments under that Act.

Clause 14 – Notice of refund declaration
This clause provides that the Secretary must give the defaulting approved provider and the refund recipient a copy of the refund declaration.

If the Secretary does not provide either the defaulting approved provider or the refund recipient with a copy of the refund declaration, this does not affect the validity of the refund declaration. This means that the guarantee scheme can operate regardless of administrative delays.

PART 6—TRANSFER OF RIGHTS AND PAYMENTS OF REFUND AMOUNTS

Clause 15 – Transfer of recovery rights to Commonwealth
This clause provides that once the Secretary has made a refund declaration (which guarantees repayment of the outstanding bond balance to the care recipient by the Commonwealth), the rights (including the right to prove the bond balance amount as a debt in liquidation or bankruptcy) of the care recipient to attempt to recover the refund amount from the defaulting approved provider are transferred to the Commonwealth. The only rights that are transferred to the Commonwealth are the rights to recover any money equivalent to the amount paid out by the Commonwealth. Rights for any additional amounts, for example any interest that is not included in the refund amount, are not transferred from the refund recipient to the Commonwealth.

By transferring the rights to recover from the defaulting approved provider, this means that the Commonwealth can take action against the defaulting approved provider in an attempt to recover all or part of the money paid to care recipients by the Commonwealth. In any action against the defaulting approved provider, the Commonwealth will be in the same position (relative to other creditors) as the care recipient would have been.

Clause 16 – Payments by the Commonwealth
This clause provides that the Commonwealth must pay the refund recipient the amount specified in the refund declaration within 14 days of the refund declaration being made.

This timeframe will ensure refunds are made promptly and will allow for administrative processes to be carried out in order to make the refunds.

Clause 17 – Appropriation
This clause provides that any refund amounts are to be paid from the Consolidated Revenue Fund (which is appropriated accordingly).

PART 7 – COSTS RECOUPMENT DETERMINATIONS

Clause 18 – Making of refund costs recoupment determination
Sub-clause 18(1) provides that the Minister may make a refund costs recoupment determination detailing the amount that the Commonwealth will recoup (through the Aged Care (Bond Security) Levy Bill 2005) from other approved providers holding bonds. The cost recoupment determination may only relate to amounts that the Commonwealth has not already recovered including, for example, from the defaulting approved provider.

Before making a refund costs recoupment determination the Minister must inform the Treasurer and the Finance Minister that he or she intends making a cost recoupment determination.

Sub-clause 18(2) provides that each refund costs recoupment determination must, in writing, state which refund declarations the determination is in relation to, the amount that the refund costs recoupment determination is for and the default event determination to which it relates.

Sub-clause 18(3) provides that the Minister cannot make more than one refund costs recoupment determination relating to the same amount. A refund costs recoupment determination may relate to more than one refund declaration. The Minister may make more than one refund costs recoupment determination in relation to a single default event declaration. This may be the case, for example, where there are still bond balance amounts held by an approved provider that are not yet outstanding (for example, where a care recipient has died and there is a delay in obtaining a grant of probate or letters of administration). Therefore, the Minister may make a refund costs recoupment determination and then at later points in time make further refund costs recoupment determinations, as other bond balances become outstanding.

Sub-clause 18(4) is interlinked with sub-clause 18(2). The purpose of this sub-clause is to ensure that the refund declaration and the default event declaration under sub-clause 18(2) must be related.

Sub-clause 18(5) is included to assist readers, as the refund costs recoupment determination is not a legislative instrument within the meaning of Section 5 of the *Legislative Instruments Act 2003*. Accordingly, it is not subject to the requirements that apply to legislative instruments under that Act.

Clause 19 - Making of administrative costs recoupment determination

Sub-clause 19(1) provides that the Minister may determine amounts to be recouped (through the Aged Care (Bond Security) Levy Bill 2005) from other approved providers holding accommodation bonds to reimburse the Commonwealth for administrative costs associated with a refund declaration.

Prior to making an administrative costs recoupment determination the Minister must inform the Finance Minister and the Treasurer.

Sub-clause 19(2) provides that the administrative costs recoupment determination must state, in writing, the default event that the administrative costs recoupment determination relates to and the administrative costs recoupment amount.

Sub-clause 19(3) provides that the administrative costs recoupment amount should be no more than the amount of the administrative costs and the amount that is likely to cover the costs of recovering the levy from approved providers holding accommodation bonds.

Sub-clause 19(4) provides that, as for refund costs determinations, administrative costs recoupment determinations is not a legislative instrument for the purposes of the *Legislative Instruments Act 2003.* Accordingly, it is not subject to the requirements that apply to legislative instruments under that Act.

PART 8 - MISCELLANEOUS

Clause 20 – Delegations by Minister
This clause provides that the Minister may delegate to the Secretary all or any of the Minister's powers or functions under the Bill. The delegation must be in writing and the Secretary must comply with any directions of the Minister in relation to the delegation.

Clause 21 – Delegations by Secretary
This clause provides that the Secretary may delegate to an SES employee or acting SES employee (as defined in the *Public Service Act 1999*) within the Department, all or any of the Secretary's powers or functions under the Bill. The delegation must be in writing and the delegate must comply with any directions of the Secretary in relation to the delegation.

The Secretary cannot delegate any powers that have themselves been delegated to the Secretary from the Minister.

Clause 22 – Regulations
This clause empowers the Governor-General to make regulations prescribing matters required or permitted to be prescribed by the Act, or necessary or convenient to be prescribed, for carrying out or giving effect to the Act. In particular, regulations may be made prescribing matters necessary or convenient to be prescribed for the purpose of enabling or facilitating the collection of levy imposed by regulations under section 6 of the Aged Care (Bond Security) Levy Bill 2005.

Regulations may prescribe, among other things, persons who are liable to pay the levy, the time when the levy is due and payable and the methods by which the levy may be paid (including by instalments over a period of time). Regulations prescribing these matters would not be made until after an insolvency event declaration has been made.

The regulations may also prescribe penalties for offences against the regulations.