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Aged Care Quality and Safety Commission

Liquidity Standard

Overview of the development of
the Liquidity Standard



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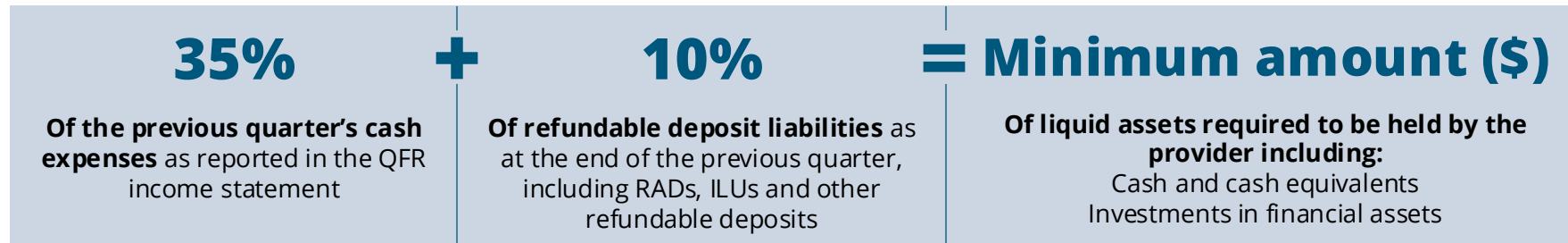
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Modelling the pre-consultation Liquidity Standard



Pre-consultation Liquidity Standard

The minimum liquidity amount taken to public consultation was calculated as follows:



Key facts about implementation of the liquidity standard:

- The formula calculates the amount of liquid assets a provider needs to hold in total.
- The amount held does **not** need to be split up into categories (e.g., 10% of RAD money does not need to be held in liquid assets, as long as the total liquidity is sufficient).
- The standard does not replace the rules around permitted uses of RADs.

Feedback on the above standard from public consultation is detailed in the next section.

Notes:

- Terms referred to on this slide include Quarterly Financial Report (QFR), Refundable Accommodation Deposit (RAD) and Independent Living Unit (ILU) Source: Quantum analysis based on Aged Care Financial Report (ACFR) provider data from the Department of Health, Disability and Ageing for FY22 and FY23.



Liquidity Standard methodology

A tailored liquidity standard was developed by applying actuarial principles and financial best-practices to aged care provider data.

Design principles

The Liquidity Standard was developed considering key needs of the sector through design principles.¹ The standard should:

- Be technically sound
- Be fit for purpose
- Balance over and under-regulation
- Ensure fairness across the sector
- Minimise complexity
- Maintain long-term relevance

Notes:

1. Detailed explanation of design principles can be found on slide 13.
2. Detailed stress assumption methodology can be found on appendix slide 14.

Source: Quantum analysis based on Aged Care Financial Report (ACFR) provider data from the Department of Health, Disability and Ageing using a combination of FY20-FY23.

Methodology

The Liquidity Standard was developed using regression modelling to predict the amount of liquid assets needed to cover the observed outflows in a stress scenario² for all providers based on two key inputs, cash expenses and refundable deposit liabilities.

Both components are important:

- **Cash expenses** are the largest source of regular cash outflow for providers. The cash expenses component is included to mitigate the risk of providers not being able to meet their regular expenses if faced with higher inflationary pressures.
- **Refundable deposit liabilities** can mean providers, unexpectedly, require large amounts of liquidity in short timeframes. The refundable deposit liabilities component is included to mitigate the risk of financial strain on the business under lower-than-expected occupancy rates.

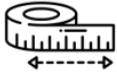


Liquidity Standard impact

The Liquidity Standard is equitable across market segments in the sector with providers in each cohort demonstrating it could be met.

The whole sector was divided into cohorts based on three characteristics:


Provider size



Providers are categorised by their dollar amount of total liabilities as:

- Small (<\$10m)
- Medium (\$10m-\$50m)
- Large (>\$50m)


Organisational type



Based on how their company is registered providers are separated into two groups:

- For-profit
- Not-for-profit

Regionality



Providers are scaled by their remoteness¹ factor as:

- Metropolitan
- Regional
- Remote

Across each provider cohort in the sector, it was demonstrated that many providers held liquidity above the standard.

Notes:

1. The remoteness level allocated to a provider is based on their most remote facility, based on data received by the Department of Health, Disability and Ageing.





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Incorporating sector feedback



Key themes from sector feedback

Sector feedback was duly considered to ensure the standard is appropriate.

Feedback theme	Supporting analysis	Outcome
Separate treatment of retirement deposits	<ul style="list-style-type: none"> Undertook analysis and conducted an assessment of risk, treating retirement deposits as having a different liquidity risk profile 	Retirement deposits will be treated separately from residential accommodation deposits in the formula
Alternative modelling approaches	<ul style="list-style-type: none"> Assessed modelling submissions through conducting analysis and an assessment of risk in comparison to the liquidity standard 	No alternative models were determined suitable to protect the sector from key liquidity risks
Softer stress assumptions	<ul style="list-style-type: none"> Investigated the suitability of stress assumptions by assessing occupancy changes with latest available data 	Original occupancy assumptions remain relevant and represent a realistic financial risk to providers
Including receivables as liquid assets	<ul style="list-style-type: none"> Evaluated the appropriateness and impact of including trade receivables as liquid assets 	Trade receivables will be included as liquid assets

Notes:
1. See appendix slides 15-18 for detailed sector feedback



Change made



No change required

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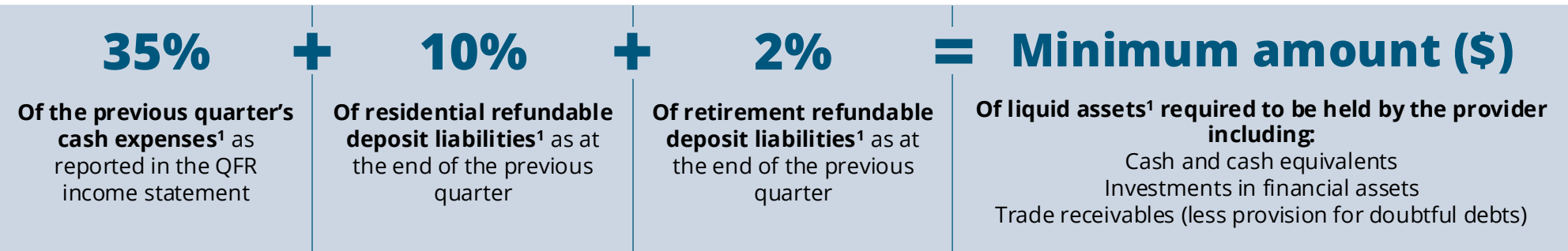
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Overview of the final Liquidity Standard



Final Liquidity Standard

The minimum liquidity amount is calculated for each provider as follows:



The Liquidity Standard was developed:

- In line with actuarial principles and financial best practice tailored to aged care provider data.
- With due consideration to sector feedback from the consultation period.

The Liquidity Standard is built to be adapted to future sector changes and the Commission will monitor and undertake appropriate modelling accordingly. Any arbitrary changes from 35%, 10% & 2% would compromise the principles and modelling integrity of the Liquidity Standard.

Notes:

1. See detailed breakdown of line items on appendix slide 12.

Source: Quantum analysis based on Aged Care Financial Report (ACFR) provider data from the Department of Health, Disability and Ageing using a combination of FY20-FY23, and Quarterly Financial Report (QFR) data for FY25.



As at Q2 FY25, **84% of residential providers already held liquid assets exceeding the minimum amount** without being aware of this Liquidity Standard.



Other arrangements that mean providers have access to sufficient liquidity will be scripted into the Liquidity Standard.



The Commission are aware and taking measures to identify and monitor providers with higher risk profiles who may need support.





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Appendix



Breakdown of included categories

The QFR line items included in the final Liquidity Standard are as follows:

Cash expenses	Residential deposit liabilities	Retirement deposit liabilities	Liquid assets
<ul style="list-style-type: none"> Salaries and Employee Benefits Management Fees Finance Expenses Interest on Lease Liabilities - AASB 16 Rent - Not Captured by AASB 16 Other Expenses 	<ul style="list-style-type: none"> Residential - Refundable resident loans receivable Residential - Refundable resident loans payable 	<ul style="list-style-type: none"> Retirement - Refundable resident loans receivable Retirement - Refundable resident loans payable 	<ul style="list-style-type: none"> Cash and cash equivalents <p>For example, bank accounts and term deposits</p> <ul style="list-style-type: none"> Financial assets <p>For example, investments in bonds, securities, and equity</p> <p>Trade receivables (less provision for doubtful debts)</p>

Notes:

- Changes include the inclusion of trade receivables (less provision for doubtful debts) and the separate treatment of residential and retirement deposit liabilities.
- The Liquidity Standard formula will use a provider's net amount of residential and/or retirement deposit liabilities. Any payments not yet received (receivables) are subtracted from deposit liabilities (payables) to find this net amount.



Design principles

The liquidity standard was developed considering key needs of the sector

The design principles of the liquidity standard included:

- **Technical soundness:** The standard should be based on actuarial principles and draw from sectors facing similar risks
- **Ensuring the solution was fit for purpose:** The standard should be tailored to the aged care sector, based on related context and data drawn directly from providers
- **Balancing over and under-regulation:** The standard should ensure providers are sufficiently protected by the standards without requiring the sector to hold excessive amounts of liquid assets
- **Ensuring fairness across the sector:** The standard should be risk-based and fair across the sector, without bias or unreasonable impact to any type of provider
- **Minimising complexity:** The standard should be as simple for the sector to understand and implement as possible
- **Maintaining long-term relevance:** The standard should have flexibility to accommodate changes in the sector and be consistent over time

Failing to comply with these underpinning principles may risk establishing an unsuitable Liquidity Standard.

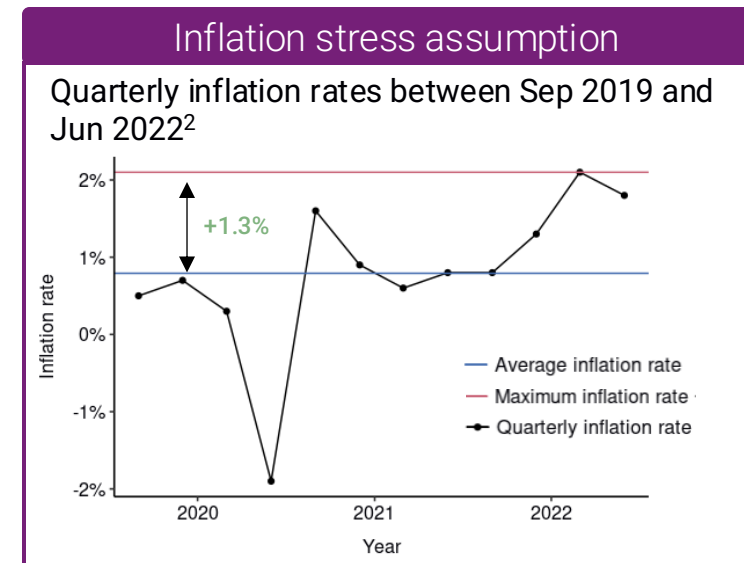
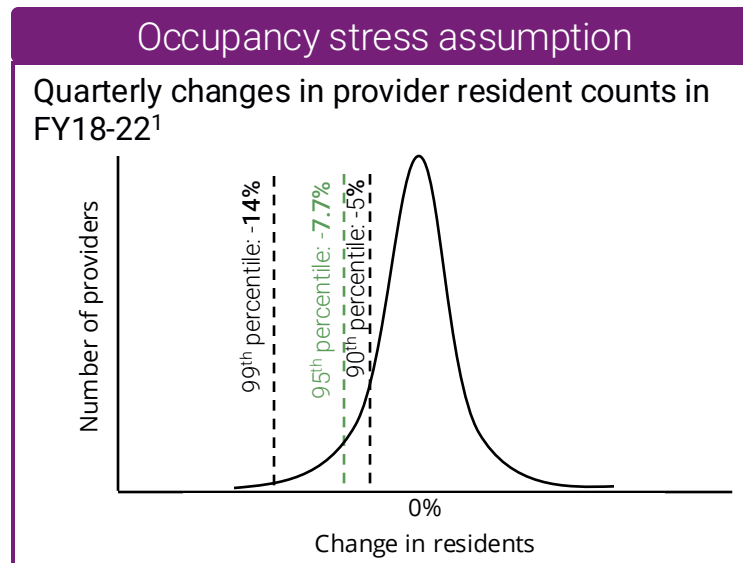


Stress testing

Real occupancy and inflation impacts were applied to model a liquidity stress scenario

There were two stress assumptions, relating to occupancy and inflation, applied to develop the standards. Actual occupancy drops, from residential provider data, and actual inflation figures were observed across FY18-FY22 to assess a suitable stress scenario.

The stress assumptions applied when determining the liquidity standard were an 7.7% decline in occupancy and a 1.3% increase in inflation.



Notes:

1. Resident data sourced from the Aged Care Data Warehouse as at 30 June 2023.
 2. Quarterly inflation data sourced from the Australian Bureau of Statistics (ABS); Period of September 2019 to June 2022.
- Source: Quantum analysis based on data from the Aged Care Data Warehouse and ABS.



Separate treatment of retirement deposits

Feedback

Retirement deposits carry a lesser liquidity risk than residential accommodation deposits which should be reflected in the Liquidity Standard

The rationale underpinning this feedback indicated:

- There is less need for liquidity to cover unexpected cash requirements because retirement deposits have a lower turnover rate.
- Standard industry practice is to payout the previous resident upon tenancy of a new resident into the unit/village.

Analysis

To understand whether retirement deposits carry a lesser liquidity risk, analysis was undertaken to determine the impact of reducing the liquidity requirement for retirement deposits from 10% to 2%.¹

It was agreed that retirement deposits present a lower liquidity risk compared to residential accommodation deposits. Given this lower risk profile, liquidity requirements for retirement deposits should be lowered to ensure the standard remains fair in principle for providers holding retirement deposits.

Outcome

The amount of retirement deposits required to be held under the Liquidity Standard will be changed to 2%

Notes:

1. A 2% retirement coefficient was established based on advice from the sector.



Alternative modelling approaches

Feedback Other alternative modelling approaches and liquidity standards should be considered

A range of different Liquidity Standard scenarios were tested, to understand the:

1. Impact on the sector (how many providers already meet/do not meet the standard) and,
2. Underestimation risk (how many providers are still at risk of not meeting their liquidity needs despite meeting their required minimum liquidity amount)

Analysis

Results indicated that alternative models recommending lower liquidity requirements exposed the sector to higher levels of risk, as they:

- Increased the number of providers already meeting the standard, potentially not surfacing providers in positions of actual financial risk
- Increased the sectors underestimation risk, with minimal benefits for providers not meeting the standard
- Deviated from the core intention of a liquidity standard

Outcome

At this point in time, any further changes from the 35%, 10% and 2% are arbitrary in nature and risk compromising the modelling integrity of the Liquidity Standard. No alternative models proposed were determined suitable to use as a Liquidity Standard.



Softer stress assumptions

Feedback Stress assumptions should be relaxed to match the experience of the sector

To investigate this claim, latest available data was used to test occupancy changes across the sector. It was determined that:

- Occupancy drops around 7-8% are realistic for providers, including pre- and post-COVID, and can reasonably be justified as a stress assumption for the sector.
- Drops of this nature are a 1 in 5-year event for 46% of the sector using data from the latest 5-year period.

Analysis

Time period	Historical occupancy change %		
	Original model calculations (Quarters from FY18 - FY22)	Latest 5-year period (Quarters from Dec 19 – Dec 24)	Post-COVID (Quarters from Jul 22 – Dec 24)
95 th percentile	-7.7% <i>Selected model scenario</i>	-7.6%	-7.0%

Outcome The selected occupancy drop of 7.7% is a realistic assumption for stress-testing

Source: Quantum analysis based on resident data from the Aged Care Data Warehouse from FY18 to the end of 2024.



Including receivables as liquid assets

Feedback	Trade receivables should be included in the calculation of liquid assets
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This feedback centred around three key considerations:

- **Certainty:** The majority of trade receivables are government provisions and thus not subject to the same default risk as other operating trade receivables.
- **Timeliness:** These trade receivables typically convert to cash well within 12 months
- **Future readiness:** This change may assist in preparing for 'payments in arrears' changes to government subsidy payments to be introduced in 2026.

Analysis

Following review of these considerations, analysis was conducted to assess the impact of this proposed change. Based on these findings, it was agreed that trade receivables should count towards the calculation of liquid assets.

Outcome	Include trade receivables in the calculation of liquid assets
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