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Morgan Stanley

Productivity Commission - Inquiry into Aged Care

Please accept this submission on behalf of Morgan Stanley Australia Limited.

1. **Introduction**

Morgan Stanley was founded in 1935 and has had a presence in Australia for over 50 years. Morgan Stanley commenced operations in Australia when it was appointed by the Australian Federal Government to lead bond raisings on international markets for the Commonwealth of Australia. Since then Morgan Stanley has been regularly involved in significant corporate and financial market activity.

Morgan Stanley has 350 employees in Australia and offices in Sydney and Melbourne. Morgan Stanley provides a full range of services to local and international clients including:

- Corporate finance;
- Mergers and acquisitions;
- Initial public offerings;
- Advisory;
- Capital markets;
- Capital raisings and placements;
- Sales and trading (Equity, Fixed Income, Commodities and Derivative products, Prime Broking);
- Research (coverage of the Australian financial institutions, media, telecommunications, retail, consumer, health, biotechnology, industrial and resources sectors); and
- Investment management (international funds, strategies and products for Australian investors covering equities, property, private equity and debt markets).

Since the global financial crisis, Morgan Stanley Asia Pacific has been the debt financing (Fixed Income) partner of choice because of its strong market leadership, conservative reputation and long term relationships.

Morgan Stanley is currently ranked first in Asia ex-Japan USD bonds and major under writings (over US$15.1 billion of volume), the market leader in Fixed Income capturing close to 13% of market share, and is known for its ability to complete complex liability management transactions for numerous blue chip clients including key Australian issuers (like Westpac, Commonwealth Bank, Asciano).[1]

2. Background

Morgan Stanley is considering the establishment of a financial product which is specifically designed for Aged Care approved providers who wish to invest their Accommodation Bonds held on trust in a prudent and more productive way. It is proposed to call this product The Healthcare Accommodation Bond Fund (**the Fund**). The Fund is designed for investment of accommodation bonds in a manner compatible with the legislative requirements of approved providers. Morgan Stanley has engaged Piper Alderman, a leading law firm in Australian health care and health care regulation, to provide advice on the structuring of the Fund to ensure that it will meet the existing prudential standards and User Rights Principles under the Aged Care Act 1997.

The Fund will have the following characteristics:

- The Fund's primary objective would be to provide a better than long term cash yield with a prudent measure of liquidity;
- The Fund will align with the liquidity standards of the Act (all underlying securities can be sold on the open market);
- The Fund will consist of mostly fixed term floating/fixed rate securities;
- The Fund will primarily invest in investment grade corporate bonds, short term paper and/or government securities;
- The Fund will be strategically diversified and constructed with a low risk profile investor in mind;
- The Fund will offer full transparency of all underlying investments;
- Fees will be reflected in the net yield to investor and will be in line with industry standards.

3. Current Legislative Requirements and Aged Care Industry Needs

Morgan Stanley submits that the Fund would address Aged Care industry needs and current legislative requirements in the following ways:

3.1 Only available for approved providers

(a) Only an approved provider in accordance with Part 2.1 of the Act will be eligible to invest in the Fund.

3.2 Liquidity standard

(a) Subdivision 3.2 of Division 3 User Rights Principles requires that approved providers must maintain sufficient liquidity to ensure that they can refund

1 Dealogic, as of October 25, 2010. Includes USD deals > US$100mm, excluding sovereign issuers.

bond balances as they fall due.[2] The liquidity of the Fund would meet that requirement.

3.3 Repayment requirements

(a) Holders of accommodation bonds may invest in and redeem funds within the time periods specified by sections 57-21 and 57-21AA of the Act.

(b) The Fund will allow investors to determine their own cash to bond allocation in order to fit best each operators individual requirements.

3.4 Industry needs

(a) The diversification of the Fund will be conservative and constructed with a low risk profile investor in mind.

(b) The Fund will offer full transparency of all underlying investments recommended in the Department of Health and Ageing "Protecting Aged Care Residents' Savings" Consultation Paper.[3]

4. Productivity Commission Recommendation 6.4

4.1 **Morgan Stanley agrees with the recommendation to remove regulatory restrictions on accommodation charges in high care.** Morgan Stanley submits that the cost of bonds in low care and extra service is artificially high as these bonds are cross-subsidising the capital costs of providing high care accommodation. By allowing bonds on high care, it is expected that whilst there will be more bonds, the average bond cost will reduce, and more accurately reflect the cost of supply of aged care accommodation.

4.2 **Morgan Stanley agrees with the recommendation to tie the cost of a bond to the actual cost of supply of accommodation**, thereby reducing the so called "super bond". However, more detail needs to be provided to ensure that the total cost of supply that an approved provider bears is included, and not an incremental cost. It is also important that an amount is included that represents a return on capital invested. Without this, attracting capital investment in the industry will be difficult.

4.3 **Morgan Stanley agrees with the recommendation to deregulate accommodation charges to reflect the quality of accommodation offered.** This provides capital investment with more flexibility and certainty of return.

4.4 **Morgan Stanley disagrees with allowing those entering residential care a choice of accommodation payments or a lump sum bond.** The benefit of the bond is that the approved provider has access to capital to retire debt and increase their return on investment. This allows the industry to be attractive to capital investors, and in turn, a higher quality service offering to the resident.

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2 Sections 57-3 and 57-4 of the Act require that providers must comply with Prudential Standards set out in the User Rights Principles 1997.

3 Australian Government Department of Health and Ageing (2011) "Enhanced Prudential Regulation of Accommodation Bonds", *Consultation Paper*, p. 7.

5. Other recommendations

5.1 **There should be tighter controls on where accommodation bonds can be invested.** Ideally they should be held in a separate protected fund held with a bank or registered financial services organisation (i.e. only bodies that with an Australian Financial Services Licence (**AFSL**)). This secures the bonds on behalf of the aged care resident. It prevents misuse, and in the case of liquidation, provides ready identification of the funds held on behalf of residents.

5.2 **There should be standards imposed on banks or registered financial services organisations** to ensure that they manage the bonds invested consistent with the prudential standards under the Act. For example, fund managers should be required to maintain a detailed record of the funds invested on behalf of the approved provider, and be able to provide a report to the approved provider on a regular basis. In addition, use of debt to meet the liquidity standards should be regulated in more detail.

5.3 **Banks and registered financial services organisations should be required to register with the Commonwealth for approval to hold accommodation bonds,** and demonstrate that they are able to meet prudential standards to ensure that the funds are not mismanaged.

5.4 **Bond holders should not be required to hold their bonds with their servicing bank by their bank at non-competitive terms.** For example, if the Aged Care Provider is able to earn a better interest rate for their bonds (in another cash/investment like product) with another AFSL holder, they should be able to do so without penalty from their servicing bank in order to enhance the return of the bonds to better service their facilities.

5.5 **It is recommended that tighter controls be applied to the use of lines of credit versus actual cash holdings** (for the liquidity requirements for accommodation bonds) **be reviewed.** Our consultations in the industry suggest that there is a wide interpretation of what can qualify, and this puts in issue whether or not a line of credit should even be used to meet these requirements.

Yours faithfully

MORGAN STANLEY AUSTRALIA LIMITED

Per: Lyndon Badham

Date: 24 March 2011