A changing landscape: financial oversight in the social care sector
Market context

There have been a number of issues both in relation to financial stability and care quality that have hit the social care sector since the unwinding of Southern Cross just over three years ago.

Over the last 12 months there have been a number of positive developments, with improved financial performance of a number of operators, refinancings of several major operators' balance sheets and an increasing number of transactions in the sector at strengthening values.

However, both the trading and regulatory environment remains challenging with the Care Quality Commission (CQC), the English regulator, soon to commence its newly designed market oversight approach with a responsibility for reviewing both quality of care and financial sustainability.

In this paper we outline how this new regime could impact providers and key questions for them to consider as they prepare for these changes. More importantly, in addressing these questions providers will be able to assess their financial resilience as they continue to face uncertain market conditions.

Timeline of key events

- April 2011: Southern Cross Healthcare Plc approaches landlords to renegotiate rental agreements
- September–December 2011: Southern Cross creditors and the group agree restructuring, sees all homes transferred
- October 2011: UK Department of Health (DoH) publishes a discussion paper analysing the issue of market oversight as a direct result
- July 2012: From the discussion paper, the White Paper ‘Caring for our future’ is published
- December 2012–March 2013: Government launches a consultation on a number of proposals to improve market oversight
- May 2013: DoH issues a paper outlining the response to the consultation
A new reporting regime

It is generally accepted that UK regulators did not anticipate the Southern Cross situation. Indeed, financial review of providers, after an operator becoming licensed initially, was not their responsibility.

The failure of a social care provider clearly creates significant problems for those in their care, their relatives and the local authorities charged with ensuring continuity of care. In order to try and prevent provider failure and thereby ensure continuity of care for service users, the DoH has introduced a new regime that will assess the financial viability of a provider according to a number of key performance metrics. The new regime discussed here applies in England only, given the nature of UK devolved government.
This new reporting regime arises from a review and public consultation by the DoH that considered measures to strengthen and clarify the role of local authorities in relation to care users in the event of provider failure, and whether central oversight was required and, if so, what form such oversight should take.

The resulting model of oversight aims to ensure the financial sustainability of social care providers that are considered ‘difficult to replace’. That determination isn’t simply related to a provider’s size, but also its regional concentration or the fact that it provides a highly specialised service essential to communities. Other factors may also be taken into account at a later date as the new regime finds its feet. These might include local market share, the number of people served or the number of local authorities to which a provider offers service.

If a provider falls into the ‘difficult to replace’ category – and the DoH estimates that between 50–60 providers will do at any one time – the provider will need to report a set of key indicators. These will be used to determine a provider’s ability to manage key business risks. If risks are identified, the provider will need to put a plan in place that will demonstrate sustainability to the regulator. The regulator will also have the ability to ask for an independent review of a provider’s sustainability; carried out at the provider’s expense.

The regulator responsible for this regime will be CQC, rather than Monitor (the economic regulator of the NHS).

The graphic overleaf highlights the steps involved in the process of determining ‘difficult to replace’ status, through to actions that may be taken if a provider is deemed to be unable to return to sustainability.
### Determining ‘difficult to replace’ status

<table>
<thead>
<tr>
<th>Test 1: Would the provider be ‘difficult to replace’ if it failed?</th>
<th>Test 2: Does the regulator assess any threats to provider sustainability (finance and quality)?</th>
<th>Test 3: Has the threat to provider sustainability become more significant?</th>
<th>Test 4: Has the organisation failed to return to sustainability?</th>
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</thead>
<tbody>
<tr>
<td><strong>Yes</strong></td>
<td><strong>Yes</strong></td>
<td><strong>Yes</strong></td>
<td><strong>Yes</strong></td>
</tr>
<tr>
<td>Metrics to regulator</td>
<td>Sustainability planning/quality scrutiny</td>
<td>Escalate oversight, e.g., produce Sustainability Plan and consider Independent Business Review</td>
<td>Continuity enforced including local authority duty activated</td>
</tr>
<tr>
<td><strong>No</strong></td>
<td><strong>No</strong></td>
<td><strong>No</strong></td>
<td><strong>No</strong></td>
</tr>
<tr>
<td>No monitoring required</td>
<td>Metrics to regulator</td>
<td>Metrics to regulator</td>
<td>Metrics to regulator</td>
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Source: Care Quality Commission report February 2014 – the Stability of the Care Market and Market Oversight in England
Roles and responsibilities of the CQC

The CQC is the independent regulator of health and adult social care services in England. Historically, the CQC’s role has been to ensure that care provided by hospitals, dentists, ambulances, care homes and home-care agencies meets government standards of quality and safety. The CQC currently has five outcome categories which they assess against:

► Standards of treating people with respect and involving them in their care
► Standards of providing care, treatment and support which meets people's needs
► Standards of caring for people safely and protecting them from harm
► Standards of suitability of staffing
► Standards of quality of management

From 6 April 2015, in addition to continuing to be responsible for overseeing quality the CQC will also be responsible for market oversight, including:

► Monitoring financial sustainability and assessing the likelihood of business failure of ‘difficult to replace’ adult social care provider organisations
► Identifying and responding to risks in respect of financial sustainability
► Providing early warnings of business failure to local authorities
► Co-ordinating a national response in the event of business failure
How will the new regime impact providers?

What this means in practice is that providers will need to assess their business and prepare themselves for the new regime. This will require a comprehensive set of business and financial metrics fit for regulatory inspection. In the case of the largest providers some of this information has been provided over the last year on a voluntary basis to the DoH directly, however for most providers that qualify, this will be a new requirement.

If the process of reporting and monitoring reveals risks to a care provider’s sustainability there are a number of likely impacts.

As a minimum, management effort will be expended dealing with regulatory questioning, providing data and analysis. If concerns remain, a Sustainability Plan may need to be prepared or the provider may be subject to a more comprehensive Independent Business Review.

Any heightened perception of risk associated with a provider may well prompt local authorities to cease referring residents to that care home or even consider doing so provider-wide.

In addition, the consequence of adverse regulatory scrutiny may well impact on a provider’s ability to secure financing and so the impact of the regime on refinancing plans should be considered.

Getting prepared

So what should providers do to make sure they are ready for the new regime?

In EY’s view they need to take two critical steps:

1. Understand whether their market position today may identify them as ‘difficult to replace’.

2. Providers should then ask themselves a number of key questions that go to the heart of ascertaining the possible risks facing their business and their ability to mitigate them.

While the precise questions that the regulator will ask providers are not yet known, the following pages set out a number of key questions to consider. These are based on our experience of restructuring or refinancing many national, mid-market and specialist care providers over the last four years.
## Key questions for providers to answer

<table>
<thead>
<tr>
<th>Area of focus</th>
<th>Key questions to answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Financial position and balance sheet resilience</td>
<td>A What is the company’s current capital and debt structure and how resilient is it?</td>
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<td></td>
<td>B Is there an upcoming debt maturity?</td>
</tr>
<tr>
<td></td>
<td>C Are key financial stakeholders supportive of the business and its strategy?</td>
</tr>
<tr>
<td></td>
<td><strong>Forecast financial performance</strong></td>
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<tr>
<td>2</td>
<td>A What leading indicators of potential stress are you monitoring?</td>
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<td></td>
<td>B What is the provider’s ability to withstand the current difficult trading conditions (revenue and costs)?</td>
</tr>
<tr>
<td></td>
<td>C How is the company performing in terms of earnings and cash flow generation?</td>
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<tr>
<td>Area of focus</td>
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<td>-------------------------------</td>
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<tr>
<td><strong>3 Risk of financial failure</strong></td>
<td><strong>A</strong> What are the key risks facing the business, the likelihood of each transpiring and the severity of the potential impact?</td>
</tr>
<tr>
<td></td>
<td><strong>B</strong> Is the business and capital structure resilient enough to withstand quality, trading and funding risks?</td>
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<td></td>
<td><strong>C</strong> What provider specific factors could create a failure risk?</td>
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<td></td>
<td><strong>D</strong> What external or industry wide factors could impact the business so much that they could result in a failure?</td>
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Our experience

EY leads the market in the social care and private healthcare sectors, having worked with the largest national groups and many specialist care and middle market providers over recent years. We understand the range of capital structures of providers and regularly help businesses in the sector to assess their financial position and key risks in order to understand and enhance their stability and support transaction activity, capital raising and refinancing events.

As well as advising providers themselves, we have extensive experience of working with Government, regulators, shareholders and financial stakeholders, enabling us to understand their concerns and the approach they are likely to take to the social sector.

Some of our relevant experience includes:

► EY took a leading role in the restructuring of Southern Cross in 2011 on behalf of NHP, Southern Cross’ major landlord and largest creditor, which led to the creation of HC-One on 1 November 2011 avoiding any disruption to care quality or operations and thereby creating the third largest provider overnight

► EY continued as advisor to NHP and Capita, the Special Servicer of the group’s complex capital structure, throughout 2012 to 2014 advising on HC-One’s turnaround strategy and was a key advisor in achieving the successful sale of HC-One to Formation Capital for c£478mn in November 2014

► An independent EY team also prepared an integrated commercial, financial and operational Vendor Due Diligence report on HC-One, which helped the vendor retain competitive tension through the process

► EY carried out a comprehensive independent business review of Barchester in 2012 and advised on the subsequent refinancing. EY’s analysis of the financial position of the business and the challenges it faced, facilitated a successful £1bn refinancing in September 2013 followed by an onward syndication which was completed in May 2014

► EY advised a diverse syndicate of lenders of Care Management Group through a successful full balance sheet restructuring of the group in 2014, creating a platform for future growth

► EY advised on the creation and subsequent debt restructuring of Akari Care in 2012 creating a new 40 home group. EY reviewed the management’s operational and financial strategy and financial position to support a major capex plan
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