

Risk assessment framework: addendum for assessing risk at independent providers of Commissioner Requested Services

About Monitor

Monitor is the sector regulator for health services in England. Our job is to protect and promote the interests of patients by ensuring that the whole sector works for their benefit.

Foreword

Monitor's main duty, as the sector regulator for health services, is to protect and promote the interests of patients. We do this principally through the Monitor provider licence. All eligible¹ providers of services for the purposes of the NHS must hold the licence and comply with it. A significant part of this duty is safeguarding essential health care services, known as Commissioner Requested Services (CRS), whenever a service provider gets into financial difficulties.

The financial elements of the [Risk assessment framework](#) apply to providers of CRS. The *Risk assessment framework* has applied to existing NHS foundation trusts since October 2013 and new ones as they become subject to Monitor's licensing regime. As they are due to be licensed at that date, the financial parts of the *Risk assessment framework* will also apply to all independent sector providers of CRS from 1 April 2014. We will then have a duty to monitor financial risk at those organisations. This expands the protection of services from those provided by NHS foundation trusts to all services designated by commissioners as CRS.

For both NHS foundation trusts and independent providers, our monitoring of financial risk aims to:

- identify any signs of a provider getting into financial difficulty early enough for all concerned to take steps to safeguard essential NHS services;
- allow commissioners to concentrate on securing health services for NHS patients, confident that Monitor will monitor any risks to the continuity of essential services; and
- be proportionate. We do not want our risk reporting requirements to discourage providers from moving into new NHS services or expanding their existing NHS services to benefit patients.

However, we propose to adapt the existing *Risk assessment framework* to monitor independent providers because:

- in contrast to NHS foundation trusts, which tend to have a limited number of commissioners, annually agreed standard contracts and relatively predictable income streams, independent providers are likely to have many customers, individual contracts and other less predictable, often non-NHS income. This may make their cash flow less regular;

¹ Exemptions from the need to hold a licence can be found [here](#).

- independent CRS providers have a variety of potential corporate and financial structures, ranging from subsidiaries of larger companies to local charities; and
- some also provide substantially lower levels of CRS as a proportion of their overall services than NHS foundation trusts.

The adaptations are intended to reflect these differences while still ensuring equivalent oversight of risk at all providers, making monitoring of independent providers neither stricter nor more lenient than that of NHS foundation trusts. This consultation puts forward our proposed approach. Following consultation we will modify the existing *Risk assessment framework* to reflect responses to this consultation.

We will need to develop our approach to risk assessment at independent providers over time, just as we do with NHS foundation trusts. It is not yet clear exactly how many independent CRS providers there will be, nor the types of organisation they will represent. However many there are, this form of regulation will be new for all of them. For these reasons, in line with regulatory best practice we will learn from our experience of applying the *Risk assessment framework* to independent providers through 2014/15, and review and refine our approach as necessary.



Adrian Masters

Managing Director of Sector Development

Contents

Foreword	1
1 Executive summary	4
1.1 About Monitor and our new role	4
1.2 About the <i>Risk assessment framework</i>	5
1.3 Monitor’s approach to financial risk at independent sector providers of Commissioner Requested Services	7
2 How to respond to this consultation.....	9
2.1 List of consultation questions	10
3 Assessing risk to the continuity of services at independent providers of Commissioner Requested Services	12
3.1 Continuity of services risk assessment framework.....	13
3.2 Implementing our risk assessment approach.....	15
3.3 Annual submissions: forward plan review	18
3.4 In-year submissions	19
3.5 Exception reports and financial overrides	19
Appendix 1: Continuity of Services Licence Conditions 3 and 4.....	24
Appendix 2: Continuity of Services definitions.....	26
Appendix 3: Proposed additional information requirements	28

1 Executive summary

1.1 About Monitor and our new role

Monitor was established in 2003 to act as the independent regulator of NHS foundation trusts. There were initially three elements to our role:

- (i) assessing NHS trusts' financial sustainability, governance and legal constitution to ensure they met the requirements to be authorised as an NHS foundation trust;
- (ii) ensuring NHS foundation trusts' ongoing compliance with the terms of that authorisation; and
- (iii) supporting the development of NHS foundation trusts' financial, governance and organisational capability.

As at 1 December 2013 there were 147 NHS foundation trusts.

The [Health and Social Care Act 2012](#) (the 2012 Act) makes changes to the way health care is regulated and has now given Monitor, as the sector regulator for health care in England, a number of new responsibilities. Monitor's main duty is now to protect and promote the interests of people who use healthcare services.

These changes to regulation include the introduction of an NHS provider licence, which means all providers of NHS services (unless exempt according to definitions within the Exemptions Regulations²) will need to be licensed by Monitor. The licence conditions are standard and can be found [here](#).

Licence holders must comply with the conditions of their licence, we will monitor their compliance with those conditions over time and we may take action where they do not comply. We began issuing licenses to NHS foundation trusts from 1 April 2013 and will commence licensing other eligible NHS service providers from 1 April 2014.

Monitor's regulatory principles

We will apply the same principles to our oversight of independent providers of CRS as we do to our oversight of NHS foundation trusts. We commit to a regulatory approach that is:

- **patient-focused** – where we identify issues at licence holders, we will be guided by the interests of patients in assessing the risks and the need for action;
- **evidence-based** – we will base our actions on the available and relevant evidence;

² National Health Service (Licence Exemptions etc.) Regulations 2013.

- **proportionate** – we will ensure that our actions address solely the material risks identified so that we do not overreach our regulatory remit;
- **transparent** – we will strive to communicate clearly and openly to licence holders, commissioners and other stakeholders the reasons for any actions we take in delivering the right outcomes for patients, commissioners and other stakeholders; and
- **co-operative** – we will work with other regulators and organisations and, to avoid duplication, we will take their conclusions into account when deciding our regulatory approach wherever this is possible and appropriate.

Further information on our role can be found on our website: www.monitor.gov.uk. The website also provides information on [who needs a licence](#).

1.2 About the *Risk assessment framework*

One of Monitor’s statutory duties is to assess risk to the continued provision of key services, or “Commissioner Requested Services” (CRS). These are services provided for the NHS and which NHS commissioners consider could not be replaced if their provider were to “fail” financially. Guidance on how commissioners should designate services as CRS can be found [here](#). In our oversight of a provider’s ability to continue providing CRS, we will primarily rely on two conditions in the NHS provider licence: Continuity of Services Licence Conditions 3 and 4.

Continuity of Services Licence Condition 3

Continuity of Services Licence Condition 3 (provided in Appendix 1) requires providers of CRS to maintain “systems and standards of corporate governance and of financial management”. In doing so, providers must have regard to Monitor’s risk-rating methodology and to maintaining a risk rating equal or greater to the level we consider acceptable.

The [Risk assessment framework](#) for NHS foundation trusts (published in August 2013) includes a framework for assessing compliance with Continuity of Services Licence Condition 3. This framework went “live” for NHS foundation trusts from October 2013. Monitor uses an assessment of liquidity and the ability to service debt in considering the financial risk at NHS foundation trusts. Where our approach indicates a potential risk, we may request further information, open an investigation or require the trust to co-operate in developing a solution to the problem it faces.

Continuity of Services Licence Condition 4

Unlike NHS foundation trusts, independent providers of CRS may be part of larger corporate structures who have the ability to influence the operations of the provider. This could be via intercompany guarantees or drawdown arrangements, for example. Continuity of Services Licence Condition 4 (provided in Appendix 1) enables Monitor’s to gain assurance regarding the influence (or potential influence) of an

“ultimate controller” on the financial stability of the licensee and consequently on its ability to continue to deliver CRS. Where licensees have such ultimate controller(s), we can use this condition to complement any direct risk assessment of the licensee.

The purpose of this document

This document seeks your views on how we should adapt the processes in the *Risk assessment framework* to address financial risk at independent sector providers of CRS.

Our intention is to use as straightforward a framework as possible and to focus our resources on the providers of greatest concern in a proportionate fashion. Where we identify that CRS are at *potential* risk, Monitor will apply judgement in deciding whether further investigation into the provider is warranted. This document describes our proposals for:

- annual and in-year monitoring processes for independent providers of CRS;
- the composition of an initial assessment of risk to the continued delivery of CRS (the continuity of services risk rating) – recognising that this will change as we consider the actual dynamics of risk at independent providers during 2014/15;
- other elements of our oversight regime, including submissions, forward financial information, other information and exception reporting; and
- using the above to assess potential issues of compliance with the relevant aspects of the licence at independent providers of CRS.

For an overview of how Monitor intends to investigate problems that come to light through application of the *Risk assessment framework*, please refer to our [Enforcement Guidance](#), which describes in full the principles that guide our decisions on taking regulatory action and what action we may take.

When will the *Risk assessment framework* come into force for independent providers?

Pending responses to this consultation, the updated *Risk assessment framework*, with an addendum for independent sector providers of CRS, will apply from 1 April 2014.

Who does the *Risk assessment framework* apply to?

The *Risk assessment framework* applies to NHS foundation trusts and in part to other providers of CRS, as designated by NHS commissioners. This consultation considers the application of the framework to independent providers. The approach once finalised will sit as an addendum to the framework.

Those licence holders **that do not provide Commissioner Requested Services will not be subject to Monitor's Continuity of Services Regime** as set out in the *Risk assessment framework*.

Monitor and independent providers of Commissioner Requested Services

As a group, NHS foundation trusts have similar organisational and financial operating models. They provide a mixture of elective and non-elective services to NHS commissioners which form the bulk of their activity and income. On the other hand, independent providers represent a more diverse set of operating models, with varying levels of exposure to NHS services and in many cases a wider range of customers. Unlike NHS foundation trusts, independent providers are not public bodies and will have different ownership and governance arrangements.

Monitor will use 2014/15 to learn more about risk factors at independent providers, and will subsequently revise its financial risk assessment methodology it uses at them. Consequently, while we propose to collect similar information as we currently do for NHS foundation trusts (as set out in the *Risk assessment framework*), we will, given their differences described above, collect other information from independent providers to gain a comparable overview of drivers of risk. For the most part, the information we intend to collect will have already been generated by the provider for its own use and includes:

- information to allow us to use the revised definitions of liquidity and capital servicing capacity currently in place for NHS foundation trusts (see Appendix 2);
- forward-looking and in-year I&E, balance sheet and cash flow information (see Appendix 3);
- where applicable, information to assess the impact of debt on providers, including forward-looking debt maturity profiles and banking covenants; and annual reports and accounts (including auditors' opinions); and
- other information such as planned transactions.

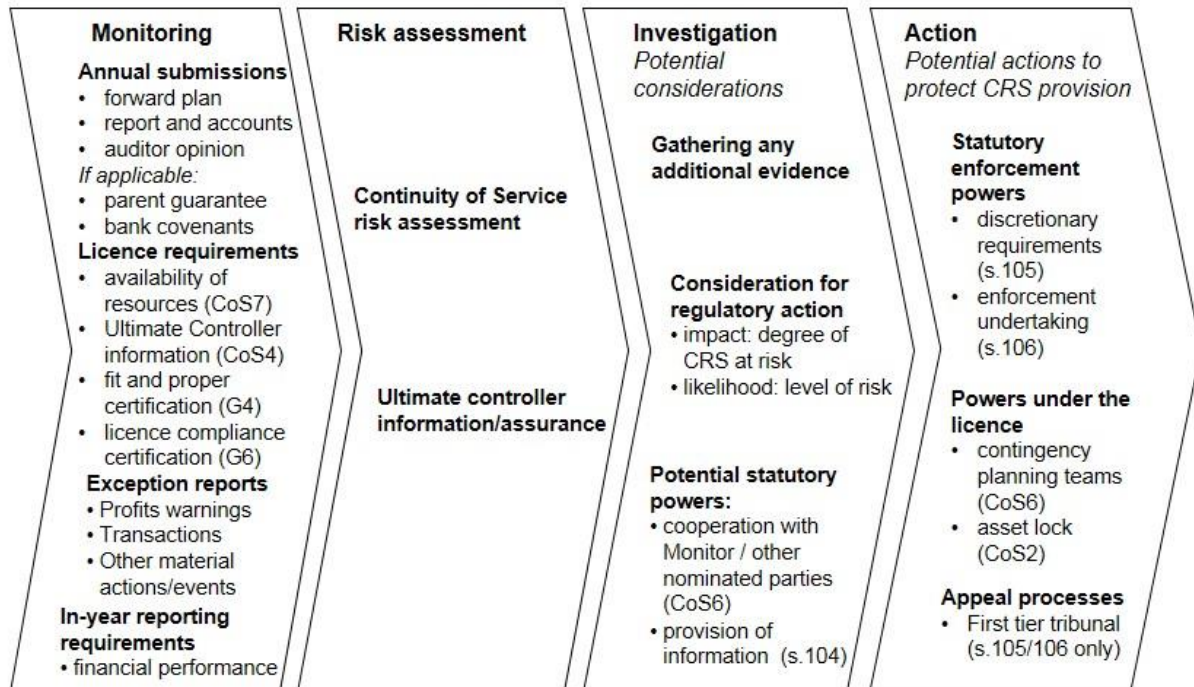
1.3 Monitor's approach to financial risk at independent sector providers of Commissioner Requested Services

The 2012 Act gives Monitor powers to ensure the continued delivery of NHS services ("continuity of services"). These powers are expressed by the inclusion of continuity of services conditions within the provider licence.

This consultation seeks your input on our proposed approach to evaluating the financial risk at providers of CRS, principally by (i) monitoring their compliance with the Continuity of Services Licence Condition 3 and (ii) using Continuity of Services Licence condition 4 to gather information related to any "ultimate controller" that may affect the financial risk of the licensee.

We propose using two measures for assessing risk to the continuity of services – liquidity and capital servicing capacity – measure a provider’s ability to meet their operational and financing cash demands, and so to continue as a going concern.

Diagram 1: Monitor’s proposed Continuity of Services regime for independent providers



2 How to respond to this consultation

We welcome your responses to this consultation. We are very interested to hear any comments that you wish to make on our proposals. We have posed a number of questions which we believe address important aspects of the proposals (these appear in each section of the main consultation document and a complete list can be found below). Alongside responding to our specific questions, please provide any further comments as you may wish.

Please submit your responses to the questions and any further comments by **5pm on Thursday 6 February 2014**. There are a number of ways to send us your comments:

Online

You can find a response form on our website at www.research.net/s/3T7VPRG. This is our preferred way of receiving your comments. However you are also welcome to send your response by email or post.

By email

You can email your response to raf@monitor.gov.uk

By post

Send your response to:

Risk assessment framework consultation
Monitor
Wellington House
133-155 Waterloo Road
London SE1 8UG

Confidentiality

If you would like your name, or the name of your organisation, to be kept confidential and excluded from the published summary of responses or other published documents, you can request this on the online response form. If you send your response by email or post, please do not forget to tell us if you wish your name, or the name of your organisation, to be withheld from any published documents.

If you would like any part of your response – instead of or as well as your identity – to be kept confidential, please let us know and make it clear by marking in your response which parts we should keep confidential. An automatic computer-generated confidentiality statement will not count for this purpose. As we are a public body and subject to Freedom of Information legislation, we cannot guarantee that we will not be obliged to release your response or name even if you mark it as confidential.

What we will do next

We hope and expect that we will receive a lot of responses to this consultation, so we do not intend to write back individually to everyone who contacts us. However we will read and consider all responses received and, when we publish the addendum to the *Risk assessment framework* for independent providers in 2014, we will explain in summary how the comments and views we have received have influenced our approach.

You can sign up [here](#) to receive emails alerting you to the publication of other engagement and consultation opportunities on our website.

2.1 List of consultation questions

We have developed nine specific questions in areas where we are considering options. These appear throughout the consultation document and are listed in full below.

Consultation question 1:

Given that we are developing our approach to assessing risk at these providers during 2014/15, what are your views as to whether Monitor should publish its risk ratings for independent sector providers of CRS in 2014/15?

Consultation question 2:

Do you agree with the proposed approach to assessing risk at independent sector providers of CRS? If not please provide your reasons.

Consultation question 3:

Do you agree with the proposed

- i. components of the risk rating?
- ii. definitions (see Appendix 2)?
- iii. thresholds?
- iv. consequences for each risk rating?

Consultation question 4(i):

Do you agree with the proposed approach to using the risk ratings in conjunction with other financial information to assess risk?

Consultation question 4(ii):

Do you agree with the proposed additional:

- i. financial information; and
- ii. other information

Monitor will request to assess risk to ongoing provision of CRS?

Consultation question 5:

Do you agree with the proposed approach to making our oversight of independent sector providers of CRS proportionate to the amount of CRS they provide and their level of risk?

Consultation question 6:

Do you agree with the proposed approach to monitoring forward-looking and in-year financial performance at independent sector providers of CRS?

Consultation question 7:

Do you agree with the proposed approach to requiring exception reports from independent sector providers of CRS?

Consultation question 8:

What do you think of the proposed approach that independent sector providers of CRS with acceptable investment grade credit ratings should not also need to be risk rated by Monitor?

Consultation question 9:

Do you agree with the proposed minimum areas in which Monitor may request “ultimate controller” related information from independent sector providers of CRS?

Consultation question 10:

What are your views of the overall regulatory processes associated with the proposed framework in relation to financial risk, relative to that in place for NHS foundation trusts?

Do you have any further comments on our overall regulatory approach to tailor the Risk assessment framework for independent providers in the manner proposed in this consultation?

3 Assessing risk to the continuity of services at independent providers of Commissioner Requested Services

The 2012 Act requires Monitor to assess risk to the continued delivery of key NHS services covered by the licence. The Act also gives us powers to support the ongoing delivery of these services through enforcement of the continuity of services conditions in the provider licence. To meet this requirement, we will assess risk to the ongoing provision of Commissioner Requested Services (CRS), which are likely to be a subset of the services commissioned from a particular provider.

For independent providers, the *Risk assessment framework* will be used to assess any risk to the continued delivery of. Monitor may, where we judge the risk is sufficiently great, act to:

- use our powers to investigate whether there has been a breach and the extent of a breach of the continuity of services licence conditions;
- depending on the outcome of an investigation, undertake enforcement action to address or pre-empt financial failure (see our [Enforcement Guidance](#) for more detail); or
- put in place a “contingency planning team” to advise Monitor on the implications of failure at distressed providers on the CRS they provide.

Our financial monitoring will therefore have a focus on the ultimate risk of independent providers of CRS no longer being a going concern.

It is not yet clear how many independent sector providers of CRS there will be, nor the types of those organisations. As different types of organisations are likely to have different drivers of financial risk, we will develop further our approach to assessing risk at independent providers of CRS during 2014/15. While we propose to use an adapted version of our approach to foundation trusts as a starting point, we are aware that this may not provide a full picture of risk at independent providers. We will therefore use the other information above to complement the metrics we use to assess risk at NHS foundation trusts.

As our approach will be developed during 2014/15, we are interested to hear your views about whether we should publish our risk ratings in that financial year. Where our monitoring identifies material financial risk at an independent provider, irrespective of whether we have published the risk ratings or not, we will use the information we have to consider the appropriate actions to take to maintain the ongoing provision of key services.

Consultation question 1:

Given that we are developing our approach to assessing risk at these providers during 2014/15, what are your views as to whether Monitor should publish its risk ratings for independent sector providers of CRS in 2014/15?

3.1 Continuity of services risk assessment framework

In order to assess risk, we propose to collect financial information from independent providers of CRS to support our risk assessment in 2014/15. This will take the shape of:

- i. Two financial measures underpinning the continuity of services risk rating (see Diagram 2 below):
 - **liquidity:** this measure is intended to assess the underlying cash position of the provider, ie, is its liquidity (expressed in days of liquid assets) a concern?; and
 - **capital servicing capacity:** this measure indicates whether the provider can meet its **financing obligations**, ie, is its ability to service debts or other financing obligations (including interest and debt repayment and non-elective dividend payments) a concern?

If a licensee can demonstrate a sufficiently robust corporate guarantee replicating a wholly unconditional working capital facility, Monitor will consider incorporating this in the liquidity component above.

- ii. An assessment of other financial information, including
 - forward-looking and in-year I&E, balance sheet and cash flow information (see Appendix 3);
 - where applicable, information to assess the impact of debt on providers, including forward-looking debt maturity profiles and banking covenants and the extent to which the provider is meeting these commitments;
 - annual reports and accounts (including auditors' opinions); and
 - other information such as planned transactions.

This information should be commonly available to boards and senior management teams. While we will use the information in (i) to calculate the risk rating in 2014-15, we will also use (ii) to consider the overarching risk at the provider. Appendix 2 sets out the proposed definitions of these measures for independent sector providers of CRS, while Appendix 3 sets out proposed additional financial information.

Our framework is intended to flag material concerns regarding the above information, or variance from planned projections. Where we have such concerns we may, generally following discussions with the licensee, choose to override the risk rating and consider investigation.

Diagram 2: Calculating the continuity of services risk rating

Metric	Definition	Rating categories			
		1	2	3	4
Liquidity ratio (days)	$\frac{\text{Working capital balance} \times 360}{\text{Annual operating expenses}}$	< 0	0	10	30
Capital servicing capacity (times)	$\frac{\text{Revenue available for capital service}}{\text{Annual debt service}}$	< 1.25	1.25x	1.75x	2.5x

Continuity of Service Risk Assessment

We propose four levels of risk to the continuity of services³:

Risk rating	Description and Consequences
4	Low risk - Monitor continues to monitor performance based on the size and risk.
3	Emerging or residual financial concern. We may perform monthly monitoring.
2	Financial performance is such that the provider of CRS may be subject to investigation to see if it could be in breach of its continuity of services licence condition. In addition to or instead of an investigation, if Monitor considers the provider is displaying cause for financial “concern”, we may start taking an active role in ensuring the continuity of services using provisions in the relevant licence conditions, eg, requesting the co-operation of the provider in order to assess risk to services; monitoring on a monthly basis; and using enforcement powers if necessary.
1	As level 2 above. In extreme cases Monitor may consider the level of risk represents financial distress and initiate contingency planning and/or other action to ensure continuity of services and access.

³ Unlike for NHS foundation trusts, where Monitor aggregates both liquidity and CSC into a single rounded risk rating, we will consider each separately in assessing risk in 2014/15.

Consultation question 2:

Do you agree with the proposed approach to assessing risk at independent sector providers of CRS? If not please provide your reasons.

Consultation question 3:

Do you agree with the proposed

- i. components of the risk rating?
- ii. definitions (see Appendix 2)?
- iii. thresholds?
- iv. consequences for each risk rating?

Consultation question 4(i)

Do you agree with the proposed approach to using the risk ratings in conjunction with other financial information to assess risk?

Consultation question 4(ii)

Do you agree with the proposed additional:

- i. financial information; and
- ii. other information

Monitor will request to assess risk to ongoing provision of CRS?

3.2 Implementing our risk assessment approach

Monitoring frequency

We collect information from NHS foundation trusts on at least a quarterly basis. We collect a significant amount of monitoring data from NHS foundation trusts in addition to that set out in the equivalent section of the Risk assessment framework applicable to them. Monitor has, for NHS foundation trusts, a range of other requirements, including the

- oversight of an additional governance licence condition,
- preparation of annual consolidated reports & accounts for the sector
- supporting guidance for NHS foundation trusts, including the code of governance and the quality governance framework; and
- monitoring capital expenditures.

While NHS foundation trusts are large NHS bodies, providing a high volume of NHS services, independent providers of CRS may be more diverse, with varying levels of CRS and different ownership structures. Consequently, we propose varying the level of oversight as a result of:

- **the level of CRS provided** – the greater the value of CRS that a licensee provides, the more complex any effort to address the risk of financial failure of

that provider is likely to be, with a corresponding need to capture issues sooner. Consequently, we propose to link monitoring frequency and the range of forward risk assessment to the value of CRS.

- **the level of risk** – as with NHS foundation trusts, the greater the level of risk the greater the need for timely information. Where a provider of CRS is shown to have a greater degree of financial risk, we will require financial information on a more frequent basis or in greater detail.

The table below indicates (i) the proposed frequency of monitoring and (ii) the degree of forward-looking information we propose to incorporate in our assessment.

Table 1: Proposed monitoring frequency/forward-planning for independent providers of CRS

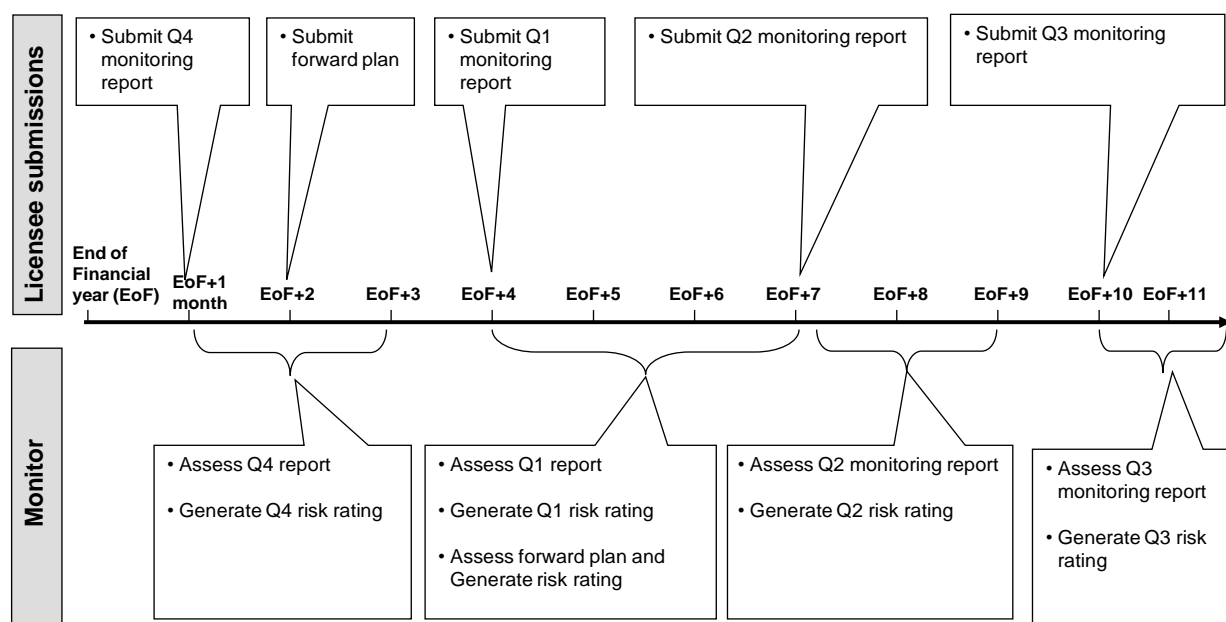
CRS Value	Forward-looking	Risk rating			
		4	3	2	1
≥£15m	3 years	<i>Quarterly</i>	<i>Monthly (discretion)</i>	<i>Monthly</i>	<i>Monthly</i>
<£15m	2 years	<i>Six-monthly</i>	<i>Quarterly</i>	<i>Monthly</i>	<i>Monthly</i>
<£5m	12 months	<i>Annually</i>	<i>Six-monthly</i>	<i>Monthly</i>	<i>Monthly</i>

Consultation question 5:

Do you agree with the proposed approach to making our oversight of independent sector providers of CRS proportionate to the amount of CRS they provide and their level of risk?

Although some independent providers will have financial year-ends and planning cycles that are aligned with those of NHS foundation trusts, ie, 1 April to 30 March, we propose basing in-year submissions (either quarterly or six monthly) from the provider’s year-end. Diagram 3 below describes when we propose to generate our in-year and annual risk assessments for independent providers of CRS.

Diagram 3: Proposed annual planning and monitoring cycle for independent providers of CRS



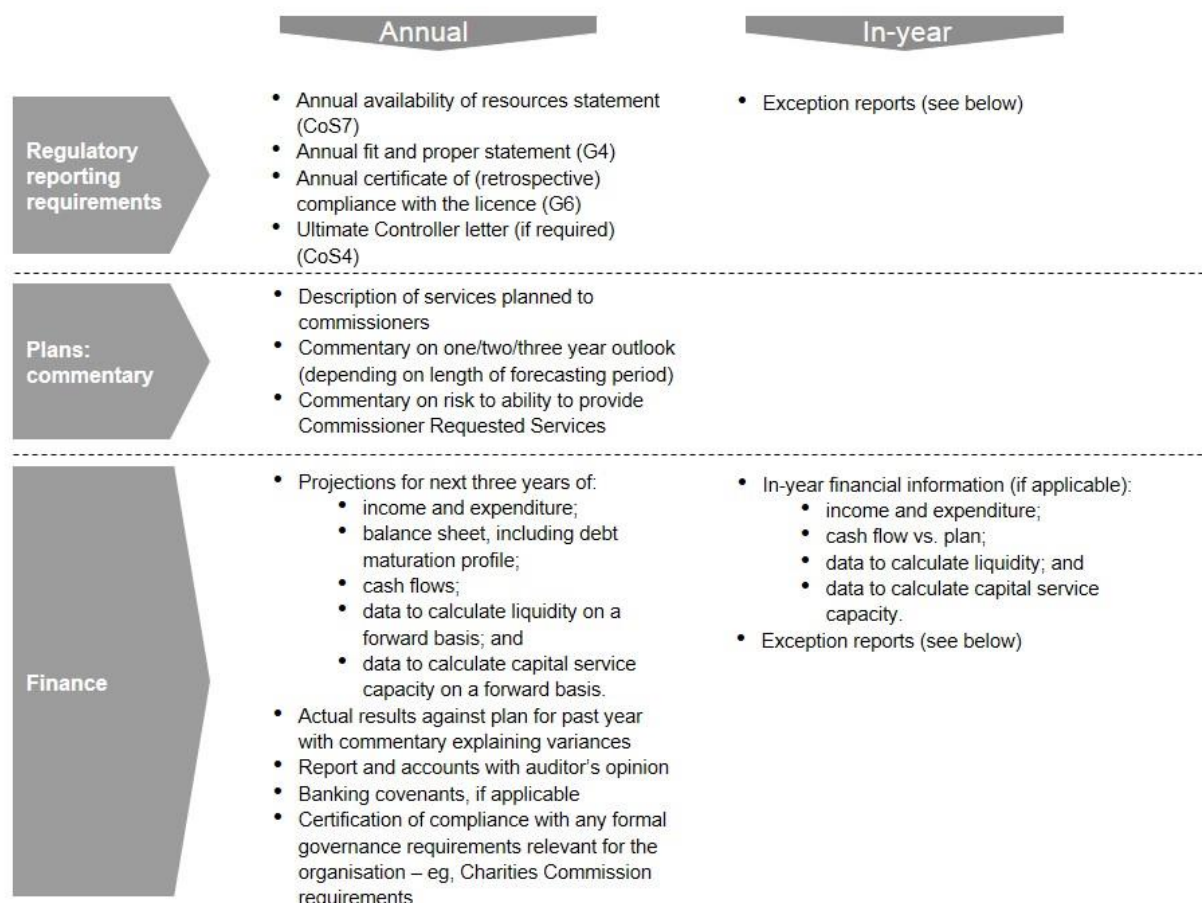
We propose to calculate the continuity of services risk rating on up to three occasions:

1. **annually**, when we receive historic and forward financial information from licensees;
2. **in-year**, for providers meeting the criteria in Table 1 above when we receive year-to-date financial information⁴ during the provider’s financial year; and
3. **by exception**, should a provider of CRS inform us of a material financial event or we receive relevant information through another source, and which may lead to an override of the provider’s risk rating.

These mirror the reporting requirements of NHS foundation trusts. Diagram 4 (below) details the proposed annual and in-year information submissions.

⁴ In some cases monthly or even more frequently, depending on the level of risk presented by a provider.

Diagram 4: Monitoring requirements for independent providers of CRS



3.3 Annual submissions: forward plan review

We propose that independent providers of CRS submit forward financial projections (a forward plan) on an annual basis to assist Monitor in assessing forward risk to their financial stability.

What Monitor will do with the information

Where the forward plan reveals potential risk to the continuity of those services, it may be subject to a more intensive review focusing on areas of greatest concern. Arriving at an evaluation of financial risk may involve our consideration of further financial information, over and above the two measures that inform the continuity of services risk rating.

If a forward plan gives rise to a risk rating of 1 or 2 at any stage over the plan period, either based on the original submission or on Monitor's review, we may open an investigation and consider whether to take any action in relation to compliance with the provider licence.

3.4 In-year submissions

Monitor will use financial submissions from independent providers of CRS meeting the criteria in Table 1 above to calculate the year-to-date continuity of services risk rating.

What Monitor will do with the information

Where the actual rating for the past monitoring period is a 1 or 2, it will serve to trigger consideration as to whether Monitor should investigate a potential breach of the provider licence.

Consultation question 6:

Do you agree with the proposed approach to monitoring forward-looking and in-year financial performance at independent sector providers of CRS?

3.5 Exception reports and financial overrides

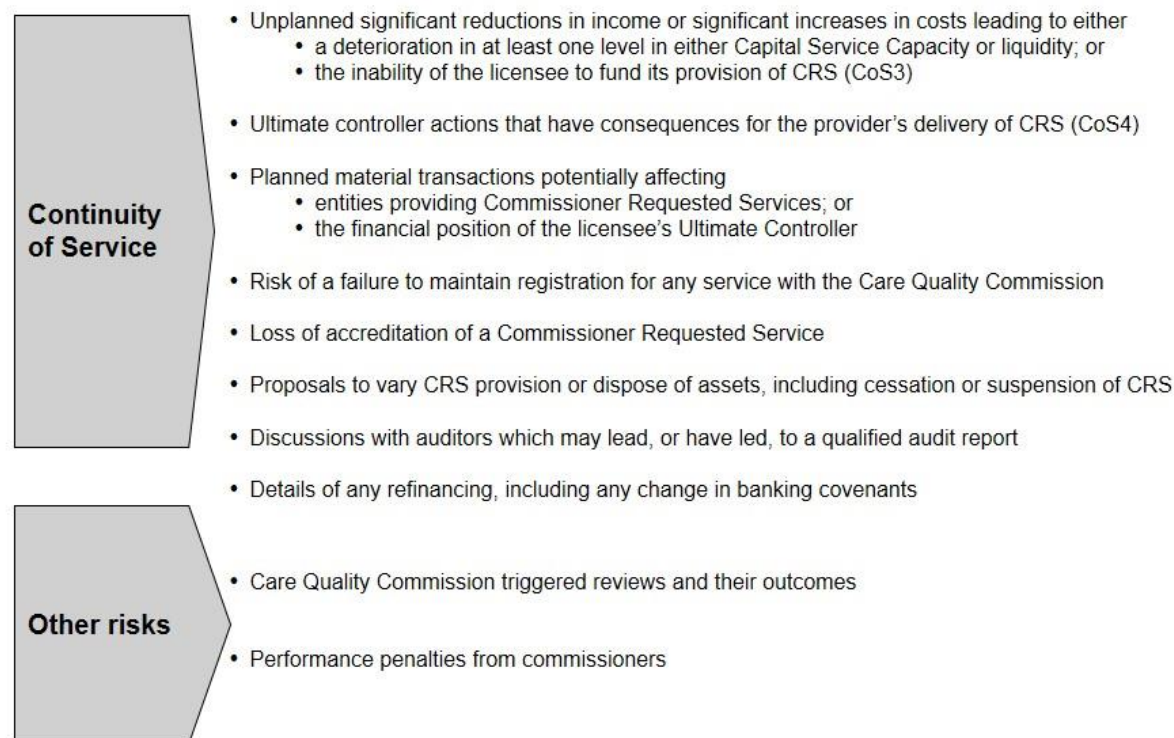
We know from experience that material in-year changes in providers' financial and other circumstances can have significant implications for their financial stability. For example:

- CQC warning notices or other regulatory requirements can require healthcare providers to spend significantly more to meet safety/quality requirements;
- material transactions can have far-reaching consequences for revenues and costs;
- losing a major contract can leave a provider organisation with significant "stranded" assets and costs, at least for a period;
- refinancing may affect a provider's ability to service its financing costs; and
- exceptional or one-off income may conceal the provider's true financial position.

In addition, providers may experience multiple smaller factors that may result, cumulatively, in greater risk to the ongoing provision of services. We propose that any of the circumstances above should trigger an exception report to be made to Monitor (see Diagram 5 for more information).

Diagram 5: Examples of exception reporting triggers (non-exhaustive)

(CRS providers should report to Monitor any information that may, in their view, compromise their ability to continue providing Commissioner Requested Services)



Regarding such exception reports we will consider what response would be reasonable and proportionate without necessarily automatically requiring a re-plan for every CQC warning notice, every transaction, change in contract or refinancing. For example, some CQC warning notices may require little financial investment to fix, others will require considerable sums. We therefore propose that providers making exception reports to Monitor of the above should, in the first instance, indicate:

- the amount of CRS affected;
- the potential impact on the provider's income or costs, with reference to the provider's EBITDA⁵ margin; and/or
- any changes to the provider's ability to finance its operations, eg, as a result of a change in cash flows, banking covenants or forward debt repayment profile.

Where Monitor is made aware of such issues we may request additional information in order to assess the appropriate actions to take and when.

⁵ Earnings before interest, taxes, depreciation, and amortization.

Transactions

It is proposed that, where a provider of CRS carries out a transaction amounting to greater than 10% of either its net assets, total revenue or capital, the provider should inform Monitor of the transaction. Monitor may request further information to assess any risk to CRS.

What Monitor will do following an exception report

Monitor may, following receipt of an exception report, consider whether further action is merited, eg, requiring further information or closer co-operation with us to identify the degree of risk to CRS.

Consultation question 7:

Do you agree with the proposed approach to requiring exception reports from independent sector providers of CRS?

Alternative financial assurance mechanisms

As set out above, we propose gaining assurance regarding the sustainability of CRS through regular submissions of financial information, in order to both calculate a risk rating as well as using other financial information to inform the assessment. We recognise that some providers of CRS may, separately, have ratings from credit ratings agencies. We are considering whether it would be appropriate to use such risk ratings as an alternative.

Consequently, we propose to consider whether an independent provider can maintain an investment grade credit rating from a main credit ratings agency,⁶ we could use that rating. We would track the ratings of these providers. If we proceed in this way, we would expect that should a provider become aware of any reason why the rating may deteriorate below investment grade, it would inform Monitor immediately as part of the exception reporting process above. In addition, while we may not publish a risk rating if we accept an external credit rating, we will still collect financial information in order to be able to quickly assess the potential impact of any financial issues on CRS should the provider lose its investment grade rating for whatever reason. We would consider the appropriate nature of our monitoring oversight in these cases.

Consultation question 8:

What do you think of the proposed approach that independent sector providers of CRS with acceptable investment grade credit ratings should not also need to be risk rated by Monitor?

⁶ For the purposes of the proposed *Risk assessment framework*, we would propose accepting investment grade credit assessments from Standard & Poors, Moody's, Fitch or Dunn & Bradstreet.

Ultimate controller and Monitor's use of Continuity of Services condition 4

In some cases, licensees may form part of larger structures, and any assessment of risk to the ongoing provision of CRS will need to consider the extent to which intra-group financial and legal arrangements could affect the financial position of the licensee in a way that could impact on the provision of CRS.

Where there is such an ultimate controller as defined in Continuity of Service licence condition 4 (CoS4), this licence condition requires an undertaking from the controller(s) to refrain from causing the licensee to contravene its obligations in either the 2012 Act or the licence. Additionally, the controller should provide the licensee with any information that it possesses or can obtain to enable the licensee to comply with its obligation to provide information to Monitor. Monitor will consider what the appropriate form of this for licensees is and, if it considers necessary, discuss the appropriate information required from specific licensees.

In any event, where a licensee has an ultimate controller for the purposes of CoS4, Monitor proposes to request from the Licensee information on, amongst others:

- intercompany guarantees underpinning the liquidity of the licensee;
- “cash sweep” and other group treasury management practices affecting the cash and other liquid assets held by the licensee; and
- any calls that the controller has over the assets (liquid or otherwise) of the licensee.

Consultation question 9:

Do you agree with the proposed minimum areas in which Monitor may request ultimate controller-related information from independent sector providers of CRS?

Summary of our overall approach

Taking account of what we aim to do in monitoring financial risk at independent CRS providers, and of the differences between these organisations and NHS foundation trusts and our respective regulatory roles towards both groups, we would welcome your views on the proposed regulatory framework.

Consultation question 10:

What are your views of the overall regulatory processes associated with the proposed framework in relation to financial risk, relative to that in place for NHS foundation trusts?

Do you have any further comments on our overall regulatory approach to tailor the Risk assessment framework for independent providers in the manner proposed in this consultation?

Appendix 1: Continuity of Services Licence Conditions 3 and 4

Continuity of Services Licence Condition 3

The Licensee shall at all times adopt and apply systems and standards of corporate governance and of financial management which reasonably would be regarded as:

- suitable for a provider of the Commissioner Requested Services provided by the Licensee, and
- providing reasonable safeguards against the risk of the Licensee being unable to carry on as a going concern.

In its determination of the systems and standards to adopt for the purpose of paragraph 1, and in the application of those systems and standards, the Licensee shall have regard to:

- such guidance as Monitor may issue from time to time concerning systems and standards of corporate governance and financial management;
- the Licensee's rating using the risk rating methodology published by Monitor from time to time; and
- the desirability of that rating being not less than the level regarded by Monitor as acceptable under the provisions of that methodology.

Continuity of Services Licence Condition 4

1. The Licensee shall procure from each company or other person which the Licensee knows or reasonably ought to know is at any time its ultimate controller, a legally enforceable undertaking in favour of the Licensee, in the form specified by Monitor, that the ultimate controller ("the Covenantor"):
 - (a) will refrain for any action, and will procure that any person which is a subsidiary of, or which is controlled by, the Covenantor (other than the Licensee and its subsidiaries) will refrain from any action, which would be likely to cause the Licensee to be in contravention of any of its obligations under the 2012 Act or this Licence, and
 - (b) will give to the Licensee, and will procure that any person which is a subsidiary of, or which is controlled by, the Covenantor (other than the Licensee and its subsidiaries) will give to the Licensee, all such information in its possession or control as may be necessary to enable the Licensee to comply fully with its obligations under this Licence to provide information to Monitor.
2. The Licensee shall obtain any undertaking required to be procured for the purpose of paragraph 1 within 7 days of a company or other person becoming an

ultimate controller of the Licensee and shall ensure that any such undertaking remains in force for as long as the Covenantor remains the ultimate controller of the Licensee.

3. The Licensee shall:

- (a) deliver to Monitor a copy of each such undertaking within seven days of obtaining it;
- (b) inform Monitor immediately in writing if any Director, secretary or other officer of the Licensee becomes aware that any such undertaking has ceased to be legally enforceable or that its terms have been breached, and
- (c) comply with any request which may be made by Monitor to enforce any such undertaking.

4. For the purpose of this Condition, subject to paragraph 5, a person (whether an individual or a body corporate) is an ultimate controller of the Licensee if:

- (a) directly, or indirectly, the Licensee can be required to act in accordance with the instructions of that person acting alone or in concert with others, and
- (b) that person cannot be required to act in accordance with the instructions of another person acting alone or in concert with others.

Appendix 2: Continuity of Services definitions

Cash for Liquidity Purposes

<p>NHS Foundation Trusts Cash for liquidity purposes: Committed working capital facility * PLUS total current assets PLUS total current liabilities ADD BACK inventories ADD BACK available for sale financial assets ADD BACK derivatives (current) ADD BACK PFI related current prepayments ADD BACK non-current assets held for sale ADD BACK current assets held by charitable funds ADD BACK liabilities held by charitable funds</p>	<p>IFRS / UK GAAP accounts Cash for liquidity purposes: Committed working capital facility * PLUS total current assets ** PLUS total current liabilities ** ADD BACK inventories ADD BACK available for sale financial assets ADD BACK derivatives (current) ADD BACK non-current assets held for sale ADD BACK current deferred tax assets and liabilities</p>	<p>Charities SORP accounts Cash for liquidity purposes: Committed working capital facility * PLUS total current assets ** (including unrestricted listed or quoted investments ***) PLUS total current liabilities ** ADD BACK inventories ADD BACK available for sale financial assets ADD BACK derivatives (current) ADD BACK non-current assets held for sale ADD BACK current deferred tax assets and liabilities</p>
---	--	--

* It is proposed that working capital facilities are only included where unconditionally committed. As with Foundation Trusts, this is expected to be very rare for other organisations.
 ** Current assets and liabilities include current intercompany balances. Due to the varied practice in presentation of intercompany balances, it is proposed that intercompany or other related party liabilities should only be treated as long-term balances where there is a contract or loan agreement in place specifying this is the case. This may differ to the treatment adopted in the statutory financial statements, depending upon the interpretation of individual entities and auditors.
 *** Charitable investments typically include listed investments which are liquid assets. It is proposed that listed or quoted investments should be included within the calculation unless they are restricted from sale as part of a permanent endowment or similar restriction.

Operating Expenses

<p>NHS Foundation Trusts Operating expenses within EBITDA: Total operating expenditure *** ADD BACK depreciation ADD BACK amortisation ADD BACK impairment losses / reversals ADD BACK restructuring costs (if agreed by Monitor) *</p>	<p>IFRS / UK GAAP accounts Operating expenses within EBITDA: Total operating expenditure (including exceptional items such as restructuring costs *) ADD BACK depreciation ADD BACK amortisation ADD BACK impairment losses / reversals ADD BACK non-recurring exceptional items if and only if agreed in advance with Monitor * ADD BACK profit/(loss) on sale of fixed asset (if included in operating expenses) ADD BACK share based payments (if a share settled scheme) ** ADD BACK current/past service cost (for defined benefit pension schemes) *** LESS total defined benefit pension contributions due for the period ***</p>	<p>Charities SORP accounts Operating expenses within EBITDA: Total resources expended (including exceptional items such as restructuring costs*) ADD BACK depreciation ADD BACK amortisation ADD BACK impairment losses / reversals ADD BACK non-recurring exceptional items if and only if agreed in advance with Monitor* ADD BACK profit/(loss) on sale of fixed assets (if included in operating expenses) ADD BACK current/past service cost (for defined benefit pension schemes) *** LESS total defined benefit pension contributions due for the period ***</p>
---	--	--

* Restructuring and other one-off items are excluded for Foundation Trusts, with any items falling into these categories reviewed by regional teams. Corporate entities will typically incur higher levels of restructuring costs, which may or may not be reported within operating profit. It is proposed that exceptional costs are included within operating expenses, unless approved by Monitor.
 ** Share based payment schemes can be cash settled (in which case they impact on continuity of service risk) or share settled (which do not impact on cashflows). It is proposed to allow companies to add back the costs of share settled schemes.
 *** The income statement/profit and loss impact of defined benefit pension schemes can differ significantly from the cash contributions due. The proposed definition reverses out the service cost included in operating expenses and replaces with the cash contributions due to reflect this impact on continuity of service risk.

Revenue available for debt service

NHS Foundation Trusts Revenue available for debt service Surplus/(Deficit) after tax ADD BACK depreciation ADD BACK amortisation ADD BACK impairment losses / reversals ADD BACK restructuring costs ADD BACK gain/(loss) on asset disposals ADD BACK gain/(loss) from transfer by absorption ADD BACK total interest expense ADD BACK other finance costs ADD BACK PDC dividend expense ADD BACK non-operating PFI costs ADD BACK donations/Grants for PPE and intangibles	IFRS / UK GAAP accounts Revenue available for debt service Profit after tax (including exceptional items such as restructuring costs) ADD BACK depreciation ADD BACK amortisation ADD BACK impairment losses / reversals ADD BACK gain/(loss) on asset disposals ADD BACK total interest expense ADD BACK other finance costs ADD BACK share based payments (if a share settled scheme) ADD BACK current/past service cost (for defined benefit pension schemes) ADD BACK expected return on pension assets (for defined benefit pension schemes) LESS total defined benefit pension contributions due for the period ADD BACK capital grants ** ADD BACK restricted capital donations **	Charities SORP accounts Revenue available for debt service Net incoming / (outgoing) resources before other recognised gains/losses (including exceptional items such as restructuring costs) ADD BACK depreciation ADD BACK amortisation ADD BACK impairment losses / reversals ADD BACK gain/loss on asset disposal ADD BACK total interest expense ADD BACK other finance costs PLUS taxation charge/credit * PLUS share of JV results * ADD BACK current/past service cost (for defined benefit pension schemes) ADD BACK expected return on pension assets (for defined benefit pension schemes) LESS total defined benefit pension contributions due for the period ADD BACK capital grants ** ADD BACK restricted capital donations **
--	---	---

Comments
 * Due to the differing presentation of charitable results, taxation and JV results need to be included to be shown on an equivalent basis to FTs.
 ** The proposed definition excludes capital grants and restricted capital donations due to their volatile impact on income. This is equivalent to the FT treatment of donations and grants for PPE and intangibles. Corporate entities are not expected to have equivalent items, but this may arise in some circumstances, particularly for Community Interest Companies.

Capital Service Costs

NHS Foundation Trusts Capital service costs: PDC dividend expense PLUS interest expense PLUS other finance costs PLUS non-operating PFI costs PLUS PDC repaid PLUS repayment of loans PLUS capital	UK GAAP / IFRS accounts Debt service: Preference share dividends PLUS interest expenses (including bank and loan interest; intercompany interest; finance lease interest, unwinding of discounts, amortisation of issue costs*) PLUS other finance costs ADD BACK interest charges from unwind of discount on defined benefit pension schemes ** PLUS repayment of loans **** PLUS capital element of finance lease rental payments LESS proceeds from borrowings / draw down of debt / issue of convertible loan notes / related items ***	Charities SORP accounts Debt service: Preference share interest/dividends PLUS Interest expense (including bank and loan interest; intercompany interest; finance lease interest, unwinding of discounts, amortisation of issue costs*) PLUS other finance costs ADD BACK interest charges from unwind of discount on defined benefit pension schemes ** PLUS repayment of loans **** PLUS capital element of finance lease rental payments LESS proceeds from borrowings / draw down of debt / issue of convertible loan notes / related items ***
--	---	---

* Unwinding of discounts and amortisation of issue costs are explicitly included in the definitions as more common than for Foundation Trusts. These are included for comparability and as they reflect longer term cash requirements despite often being non-cash items in the period reported.
 ** See section 2.2 for discussion of pension costs.
 *** Due to the more complex financing arrangements of other entities, it is relatively common to have refinancing of debt or rolling use of facilities which would not be appropriately reflected if only repayments of debt are considered.
 **** The definition of debt service combines income statement interest charges with cash repayments of loans. For FTs this is relatively unlikely to give rise to issues, but corporate entities in particular may have debt issued at a discount or where interest accumulates on the loan without repayment. In those circumstances, the interest charged may be counted twice in the calculation. We propose excluding from the calculation payments of amounts previously charged as interest or other financing charges and reflected within the calculation.

Appendix 3: Proposed additional information requirements

Additional annual and in-year financial reporting

Financial lines (provided on annual forward-looking and in-year year-to-date bases)

Cashflow

- *Operating cashflow*
- *Capital Expenditure*
- *Free cash flow*
- *Financing cash flow*
- *Investment cash flow*

Balance sheet

- *Fixed Assets*
- *Current Assets*
- *Short- and long-term debt*
- *Current liabilities*
- *Other LT liabilities*

I&E

- *Total licensee revenue*
- *CRS revenue*
- *Total NHS revenue*
- *Total operating expenses*
- *EBITDA*
- *Depreciation*
- *Amortisation*
- *EBIT*
- *Interest*
- *Tax*

Other financial information

Banking covenant arrangements

Annual report and accounts, including auditor opinion

Certification of compliance against relevant accounting or governance standards (eg, Charities Commission accounting guidance)

Stock exchange announcements



Making the health sector
work for patients

Contact us

Monitor, Wellington House,
133-155 Waterloo Road,
London, SE1 8UG

Telephone: 020 3747 0000
Email: enquiries@monitor.gov.uk
Website: www.monitor.gov.uk

This publication can be made available in a number of other formats on request. Application for reproduction of any material in this publication should be made in writing to enquiries@monitor.gov.uk or to the address above.