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Institutional Solutions

QUICK POLL:

Healthcare Executives Looking to Align Financial Management Process with Expectations

The **Financial Management Research Panel** recently conducted a Quick Poll specific to healthcare finance executives and investment committee members responsible for overseeing invested assets. The poll was completed by 40 organizations overseeing asset pools ranging in size from $25 million to more than $1 billion. None of the participating organizations were SEI institutional clients. Below is a summary of the key findings.

2009 Outlook for Healthcare Organizations

Like many sectors in the U.S., the healthcare industry has not been spared from a difficult economic environment in 2008 and 2009. In April 2009, Moody's Investors Service issued a report titled, "Not-for-Profit Healthcare Rating Roadmap: Hospitals Under Stress, but Strong Management and Federal Stimulus May Mitigate Risks." The report identified four particular risks that hospitals and healthcare providers face:

- Weaker Market Demand and Declining Cash Flow Margins
- Investment Losses and Weaker Balance Sheets
- Debt Structure and Liquidity Stress
- Capital Market Access Problems

The report identified two specific "risk mitigants" that would also be considered in the rating review process[1]:

- Management and Governance Actions
- Federal Government Stimulus

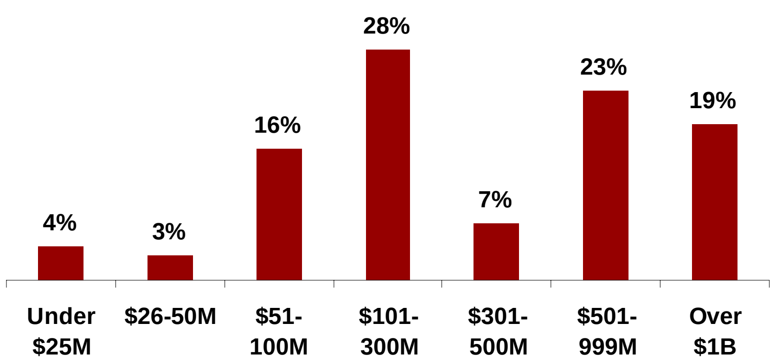
The 2009 report reiterated Moody's negative outlook on the healthcare sector, which the agency had previously detailed in November 2008. With that background, the SEI Quick Poll addresses some of the financial management challenges confronting healthcare organizations. Specifically, the survey polled financial executives and investment committees to gather their insights and experiences on topics including current state of credit ratings, new expectations and strategies around how finances are being managed and difficulties in overseeing retirement and non-retirement invested assets.

Organizations polled

Depending on the type and size of the organization, the challenges can differ greatly. Here are the types of participating organizations:

- 37% stand alone hospitals
- 24% part of a centralized health system
- 16% part of a moderately centralized system
- 13% part of a decentralized health system
- 7% part of an independent hospital system
- 3% other (hospice center, health plan, etc.)

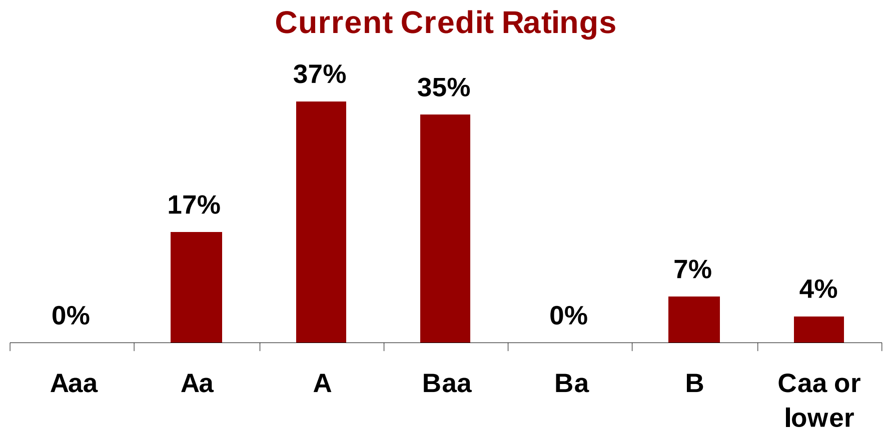
Respondents by Size of Asset Pools



[1] "Not-for-Profit Healthcare Rating Roadmap: Hospitals Under Stress, but Strong Management and Federal Stimulus May Mitigate Risks" Moody's Investors Service (April 2009)

Current credit ratings among healthcare organizations

Traditionally, healthcare organizations have relied on strong credit ratings to provide stability around the interest rate on their debt or on future borrowing. The majority of credit ratings for healthcare organizations appear to be hovering around "A" to "Baa;" more than two-thirds (72%) reported a credit rating in this range. The following graph illustrates the credit ratings of the poll participants:



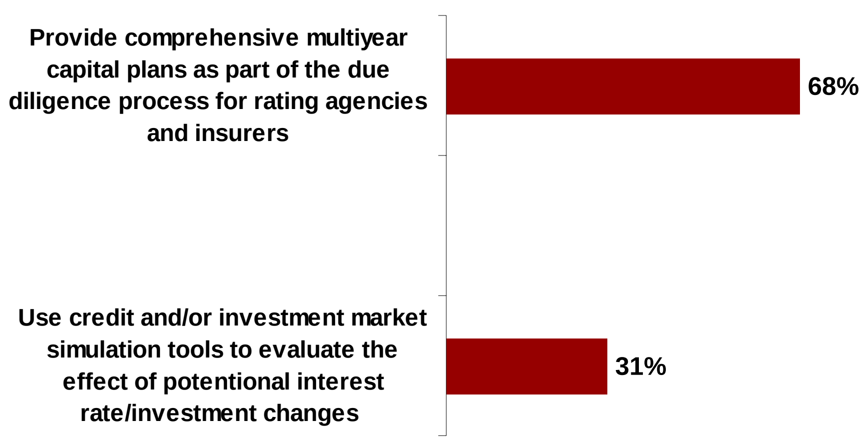
Of those that said their organization experienced a credit downgrade in the past 12 months, 72% said the reason provided for the downgrade was "operating performance." Other reasons provided were "multiple or large borrowing programs (45%)" and "lack of liquidity in non-retirement investment portfolios" (27%).

The poll identified a disparity around the importance of diversification in the investment portfolio. A total of 92% of the poll participants said they did not feel the organization could be at risk for a rating downgrade as a result of lack of diversification in investment portfolios. However, the Moody's report specifically cites "strong diversification of investment managers and funds" as part of the debt structure and liquidity stress guidance provided for achieving or maintaining an "A" rating or higher.

An interesting sidebar is the variation of credit ratings when comparing the two largest types of organizations participating in this poll. More than three-quarters (78%) of the centralized health systems had credit ratings of Aa or better. In comparison, only 44% of the stand alone hospitals could say the same.

Healthcare finance executives say expectations have changed

The Moody's report suggests that "decisive action taken by a hospital management team and its board of trustees to promptly identify current and looming financial problems and implement immediate corrective strategies is a strong factor in avoiding rating downgrades." As a result, poll participants were asked how expectations around the financial management of their organization have changed because of ongoing economic volatility. Their responses highlighted the following two actions:



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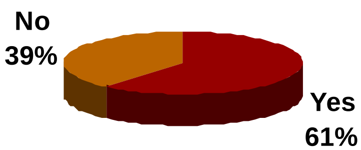
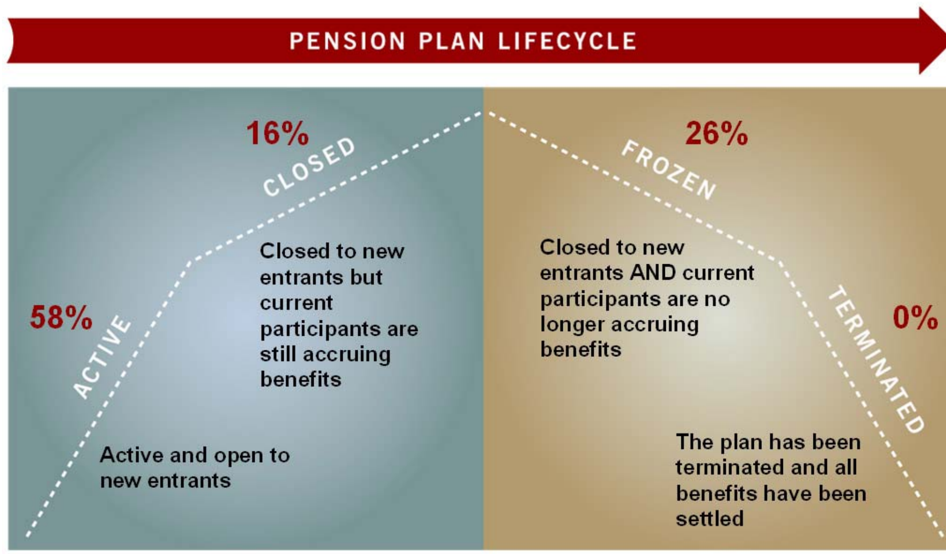
Defined benefit pension plans continue to challenge healthcare organizations

Does your organization currently have a defined benefit plan?



The financial executives participating in this poll oversee a combination of invested assets; for 61% that includes a defined benefit (DB) plan. Given last year's widespread investment losses and low or flat interest rates, many DB plans have funding deficiencies. In response, healthcare organizations are being forced to make decisions on the long-term strategy for these plans. The following graphic illustrates the current status of DB plans in the healthcare organizations polled:



Regardless of whether or not a plan is active, closed or frozen, the current environment has created numerous challenges for financial executives including increased scrutiny from the Board of Directors and senior management, the need for a better risk management process and the ability to limit a pension plan's impact on overall corporate finances.

- ***79%** of executives overseeing a defined benefit pension plan said there has been increased scrutiny by Board and senior management wanting details for the long-term strategy*
- ***79%** said that as a result of the market downturn, the organization's interest in risk management and a goals-based approach to pension management has increased*
- ***63%** felt that additional funding relief (beyond relief provided in December 2008) is needed for plan sponsors to be able to make necessary contributions*
- ***58%** said the pension plan is negatively impacting the organization's capital structure and overall finances*

Concerns around investment management strategies

While the financial metrics listed above were of concern to poll participants, the greatest challenge stems from the organization's investment strategy and its potential impact on overall finances. The Moody's report offers mitigants for avoiding rating downgrades and they specifically focus on management and governance actions. Healthcare organizations need to show evidence that management and the Board plan to take defensive actions around investment, capital and liquidity strategies.

Defensive actions on the investment management front include looking for increased transparency, improving diversification and liquidity and re-evaluating the overall current process.

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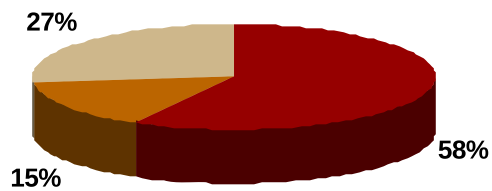
68% of poll respondents said the organization is now expected to make asset allocation decisions around operating pools in conjunction with corporate finance decisions

According to the poll results, most healthcare organizations use external experts in making investment management decisions. More than three quarters (85%) of those polled use either an investment consultant or an external fiduciary partner, such as a Manager of Managers.



However, as the expectation is that healthcare organizations improve their overall management and governance processes, those polled indicated concerns around accomplishing this within the current model for investment management. In recent months, headline risk has become prominent as some institutional investors were victims of fraudulent money managers. These events have created a greater awareness for increased transparency, more thorough and accurate due diligence by consultants and a clear line of fiduciary accountability.

- ***Almost half (48%) of those using a consultant said they are concerned with the consultant model for investment management and they are looking into other options***
- ***37% said the organization is looking for increased transparency when it comes to investment management***

Conclusion

The recent Moody's report highlights the extremely challenging economic environment healthcare executives are facing. The results of this poll indicate that some executives are already making changes in response to ongoing market volatility. However, all healthcare organizations need to outline clear and decisive actions to further protect their financial health and specifically credit rating. These steps include aligning investment decisions with overall corporate finance strategies and reevaluating and altering a number of processes. Healthcare executives and organizations have seen that traditional methods and tools once applied with success are requiring adaption and refinement in today's economic environment. Requests for more information or questions can be emailed to seiresearch@seic.com.

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