Who cares?

the implications of a new partnership to fund long-term care

CII

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Who cares? the implications of a new partnership to fund long-term care

Long-term care is an issue of significant public importance. It is estimated that one in four of those aged 65 will require long-term care at some point in their life. Therefore it is vital for each of us, and for society as a whole to articulate a policy which, over the long-term, ensures affordable, good quality care and support for our citizens. Financial services can help in this regard by identifying and developing appropriate solutions to meet people's expected funding needs.

Unfortunately, the current long-term care funding system is broken. A significant number of individuals who enter the long-term care system end up losing the majority their assets when paying for it. Compounding the issue, the market for long-term care financial products and services suffers from low take-up stemming from substantial supply and demand barriers.

With increases in the number of people expected to live beyond 90, and concerns about the implied burdens on individuals and society as a whole, there is new momentum for reform. In July 2011, the final report of the Dilnot Commission on Funding of Care and Support set out its recommendations, which if fully implemented would change the face of long-term care by capping the total costs that individuals would have to pay from their assets. This would likely have significant public interest as well as financial services implications.

As the world's largest professional body for insurance and financial services with over 100,000 members, the CII is committed to protecting the public interest by guiding practitioners in the sector towards higher ethical and technical standards. The CII is particularly interested in the role that appropriate financial advice and insurance can play in supporting those needing long-term care. However, in order to understand this issue properly, a full and proper analysis of the current and potential future landscape for long-term care is required. This report is devoted to that analysis.

Our report consists of two sections. The first is an analysis by the CII that identifies the key issues and sets out their implications. The second section comprises a set of contributions from key players in the debate. Overall, we hope to tease out the main relationships between the care funding model, the market for care products and services and the drivers of consumer awareness and engagement. Inevitably it also discusses the current political climate for reform, as this remains a serious stumbling block for the whole project of delivering a sustainable and effective future funding system.

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Chairman of CII Life and Pensions Faculty

The Chartered Insurance Institute
12 September 2011

Executive Summary

Why is the current funding system outdated?

- With life expectancy increasing, disability rates are also likely to rise and by implication the cost of paying for long-term care (LTC).
- The current LTC funding model is generally thought to be outdated and has faced criticism for failing to adequately protect those individuals with limited wealth.
- Financial products can help individuals meet the cost of care but the current market is limited as a result of demand side barriers. These stem in part from low levels of public awareness about the care system as well as issues with consumer trust. The last provider of pre-funded LTC insurance exited the market in 2010. Today, whilst immediate needs annuities are one of the few LTC products experiencing growth, only 6% of self-funders use them.

What reforms have been proposed?

- The Dilnot Commission on Funding of Care and Support has set out its recommendations to reform the care system. Its most notable proposals are to cap the total amount that individuals will have to spend on care and to increase the threshold at which people become eligible for state support.
- There are two significant barriers to implementation of the recommendations: one is cost; the other is whether an appropriate financial services market can take root.

How big a barrier is cost?

- The cost implications of any reforms to long-term care funding must be viewed within the context of other Government reforms to the retirement landscape, such as automatic enrolment. If both these reforms help to incentivise an increase in the public's long-term saving, then the Government could actually recoup some of the money it spends on implementation over time due to fewer individuals requiring pension top-ups.
- Our survey of MPs suggests that there is some consensus over the adoption of a new approach to funding care, especially on the need to reform the system and that a new partnership model is the best way forward though there is still much to debate.

Will a new market for appropriate financial services develop?

- Dilnot's model may provide a more conducive environment for the development of financial services to help fund care. However, there remain questions about the viability of pre-funded insurance. A key determinant of a new LTC market is whether potential consumers will be convinced of the need to purchase relevant products in advance of their need for care and, in parallel, be willing to place their trust in providers, suppliers and the industry generally.

What is the problem of consumer awareness and what is being done to tackle it?

- Consumer awareness about LTC is currently very low with few understanding how much it costs or where to go for advice. This increases the likelihood that people will not find the right funding solutions to meet their prior expectations. A simpler funding model combined with a government-led information campaign would be an important step forward in this regard.

What is the problem of consumer engagement and what is being done to tackle it?

- Raising awareness through increased information will not be enough to ensure sufficient engagement with a new system. Research shows that many consumers are inert when it comes to financial services, failing to act even when presented with accurate information. Evidence suggests that this is, at least in part, due to an inherent distrust of the industry generally. It will therefore be important to build on key initiatives already underway such as the Retail Distribution Review to raise professional standards of advice in this area.

A multifaceted approach is needed

- In order for appropriate financial products and advice to take root and support those needing care, a multifaceted approach to solving the long-term care problem is required. Changing the funding model must be considered as part of a wider agenda to raise awareness and engage consumers about long-term care.

Long-term care: defining the problem

Disability rates are likely to increase over the next two decades leading to more demand for long-term care. Unfortunately, the current funding model is outdated, providing little protection from the sometimes 'catastrophic' costs of care. Compounding the problem, the market for long-term care financial products remains limited with only a few viable options to help individuals meet care home fees.

Longevity and disability

Continuing improvements to healthcare and changes to people's working lives are ensuring that an increasing number and proportion of the UK population lives well beyond retirement age. According to the Office of National Statistics (ONS), in 1981 life expectancy for women was 76.7. By 2004–2006 it had increased to 81.3.[1] Over the next twenty years it is estimated that this demographic trend is set to continue – the result being to increase the percentage of the UK's population that are 65 or over from 16–23%.[2]

As longevity increases, the proportion of people who are very old will grow the fastest. The number of people over 90 is expected to nearly treble over the next twenty years. Accordingly, it is expected that older people's demand for care and support will increase by around two-thirds over the next two decades, assuming that disability rates by age will remain constant.[3]

On average, around one in three women and one in five men aged 65 are expected to enter a care home with the risk of entering residential care increasing with age. Currently the average care home costs £26,000 per year and the average stay is two years – though a significant proportion stay for more than four years[4] and many care homes are significantly more expensive. Indeed, some surveys have estimated that average costs are closer to £35,000 rather than £26,000.

It is also difficult to predict the future cost of care home fees. The recent solvency problems experienced by Southern Cross have raised doubts over the sustainability of care home providers' business models and there is a significant concern that care home fees may continue to rise.

The relationship between longevity and disability

As noted in a recent paper published by Saga[5], there has been much debate over whether an increase in longevity will mean greater demand for long-term care. Of thirty-two different studies of people aged at least fifty five in high-income countries, only six found evidence of disability rates increasing, compared with twenty six which found disability rates to be decreasing.[6] Similarly, analysis of health expenditure has shown that health costs rise in the final years of life regardless of age. An ageing population may therefore just defer costs rather than increase them.[7] These studies suggest that disability rates may not therefore remain constant. If tomorrow's elderly leads a healthier life than today's, then disability rates may actually fall rather than rise.

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1 ONS statistics quoted in Swiss Re (Dec 2009), **The Insurance Report: The Cost of Doing Nothing**, p. 10

2 Ibid

3 The Commission on Funding of Care and Support (Dec 2010), **Call for evidence on the future funding of Care and Support**, p.8

4 Ibid

5 M. Weston, E. Winpeny and J. Manning (June 2011) **Take Care: The Future Funding of Social Care**

6 Ibid

7 Ibid

The current funding model

Under the current system most individuals have to pay something towards the cost of long-term care. The current rule is that anyone with assets worth £23,250 or above will be expected to pay for their care needs and the value of any property owned is included in most cases. There are important exceptions to this rule, such as if there is a surviving spouse living in the house, or if the homeowners alter the terms of property ownership.[8] There is also state support to help cover nursing home fees including Attendance Allowance (up to £71.40 per week)[9] and a Registered Nursing Care Contribution (up to £108.70 per week).[10] Nevertheless, even with these additional forms of State support, a large proportion of the population are expected to cover a substantial chunk of LTC costs.

The current funding model has come under significant criticism for **providing too little support** for those with only modest wealth with many spending a significant proportion of their assets when paying for long-term care. Research from the Local Government Intelligence Unit has found that a quarter of self-funders run out of money and ultimately fall back on the State to support their care needs.[11]

Another drawback of the means-tested system is that it reduces the incentives for individuals to accumulate assets and savings to pay for retirement. James Lloyd of the Strategic Society Centre has argued that a system where some pensioners must pay "catastrophic costs" for care, "does much to undermine pension saving." This is a major failing given the need for people to save an increasingly large proportion of their occupational income to ensure an adequate income in retirement as well as pay for the costs of long-term care.[12]

Private sector solutions and products

Since care is not free at the point of use, there is a market (albeit limited) for financial products to help fund care. There are two types of financial products specifically for this purpose, one of which must be purchased in advance of needing care, and the other purchased once the need for care has become established. They include:

Products in advance:

- **Pre-funded long-term care insurance (LTCI):** a pre-funded insurance plan involving regular or lump-sum payments by the policyholder before long-term care is needed.
- **Investment-based plans:** a way of paying for long-term care insurance. The consumer purchases an investment bond with a lump sum. The capital is then invested and the amount needed to pay for the insurance policy is withdrawn by the insurance provider each month from the value of the bond.

Products at the point of needing care:

- **Immediate needs annuities:** purchased with a lump sum to pay for immediate care. They provide a fixed level of payment towards care needs for as long as is necessary.
- **Lifetime mortgage schemes:** this is an equity release product whereby a mortgage charge is taken from a customer's home in exchange for a lump sum to the homeowner. The most preferred product is the Fixed Interest Lifetime Mortgage, where the interest is added at a fixed rate during the lifetime of the loan. Other 'draw-down lifetime mortgages' pay a regular income through an annuitisation process based on life expectancy. For both these classes of products, most providers offer a voluntary 'no-negative equity guarantee' to protect the consumer from the eventuality of having to owe more than the property is worth.

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[8] Emma Simon (July 2009), **Long-term Care: How to Beat the Meanest of Means Tests**, Telegraph

[9] Figures obtainable from DirectGov website: http://www.direct.gov.uk/en/MoneyTAXAndBenefits/BenefitsTaxCreditsAndOtherSupport/Disabledpeople/DG_10018710

[10] Brownlow Wealth Management Ltd (April 2010), **Factsheet: Registered Nursing Care Contribution**

[11] J. Carr-West and L. Thraves (March 2011), **Independent Aging: Council Support for Care Self-Funders**, Local Government Intelligence Unit, pp.7-8

[12] See our report - Chartered Insurance Institute (May 2011), **An age-old problem: developing solutions for funding retirement**

- **Home reversion schemes:** another type of equity release product whereby the provider buys a share in the value of a customer's home at a discounted price whilst the customer retains the right to remain in the home rent-free. Once the customer dies or moves into a care home, the property is sold and the share of the income goes to the reversion company. Again, most providers of this product class now offer a 'no-negative equity guarantee'.

Barriers to private sector solutions

Whilst the above products exist, take-up has been low – particularly for pre-funded schemes. Low take-up of LTCI is mainly due to demand side barriers including the **cost** of the products, **uncertainty** over the availability of care, **ignorance** of the risk of needing care, **inertia** and the **complexity** of products.[13]

Reputational issues also act as a barrier to equity release schemes, stemming from the consumer detriment caused by previous products. The notorious 'home income plans' of the late 1980s left borrowers facing both monthly arrears and negative equity whilst 'shared appreciation mortgages' of the late 1990s left homeowners with debts sometimes three times larger than when they originally entered the scheme.[14]

Trust in financial services, in general, is relatively low. The decline in levels of trust was well documented in a survey undertaken by the CII in late 2010 which found that one in five respondents will never trust financial services again and 72% of people have not very much trust or no trust at all in financial advisers and life insurance providers.[15]

Therefore, when delivering a future funding model which is not free at the point of use, the Government and industry must address issues associated with the **fairness of the system** (such as the potential for those with only modest wealth to lose the majority of their assets) and the **engagement barriers** that exist to deter people from seeking private sector solutions which can help to pay for care whilst protecting key assets.

[13] James Lloyd, (February 2011), Gone for Good? Pre-funded Insurance for Long-term Care, The Strategic Society Centre

[14] R. Dyson (June 2007), **Relief in sight for 'Sam' mortgage victims**, http://www.thisismoney.co.uk/money/mortgageshome/article-1611112/Relief-in-sight-for-Sam-mortgage-victims.html

[15] CII (February 2010) **What we talk about when we talk about trust**, p.12

Dilnot: towards a new model

On 4 July the Commission on Funding of Care and Support (Dilnot Commission) set out its final recommendations[16] to change the way in which long-term care is funded in England. It included proposals for a cap on costs and a new means test.

There are stumbling blocks to reform however – the first is the projected cost of reforming the system, the second is whether the new system will provide adequate incentives for long-term care financial products to take root.

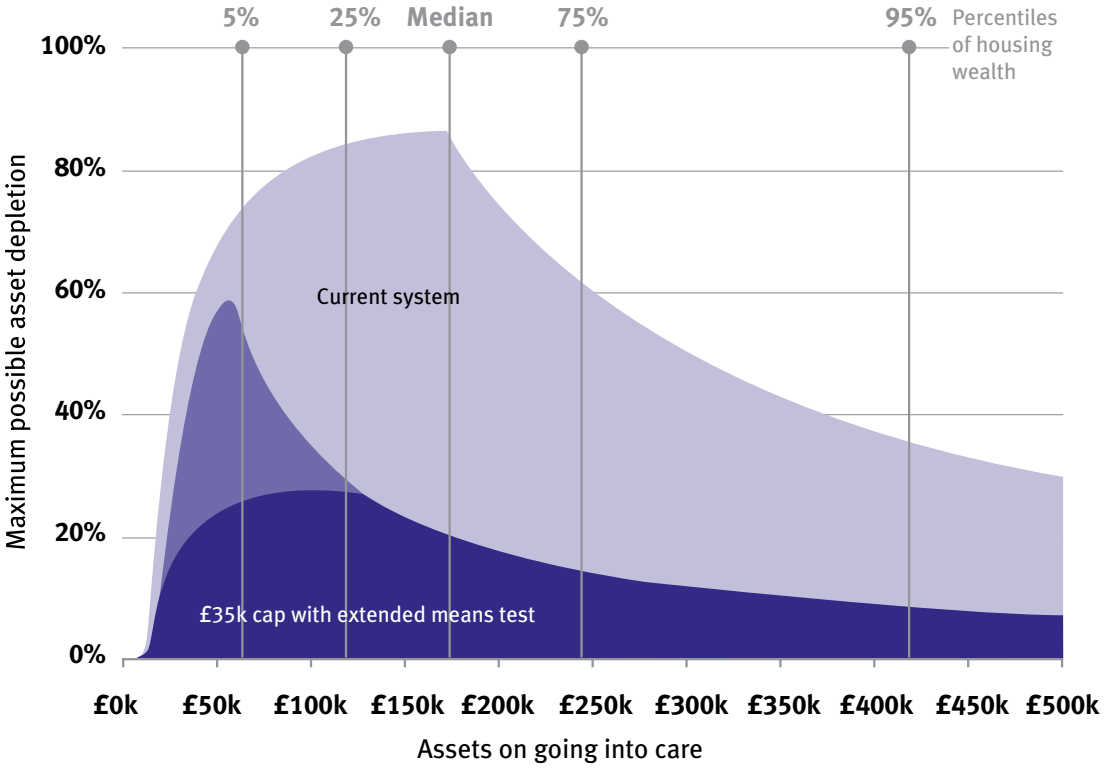
Background

The Dilnot Commission (chaired by economist Andrew Dilnot) was set up by the Government to investigate how to achieve an 'affordable and sustainable' funding system for long-term care. The final report outlines the Commission's proposals after a year-long consultation process.

The 'new' funding model

Dilnot proposes to limit the maximum amount that people would have to pay for care to between £25,000 and £50,000 with the **Commission favouring a cap of £35,000**. Dilnot also recommends that **only those with assets (including property) worth over £100,000 should pay for the full cost of care**. Individuals will still however, have to contribute something towards their general living costs (e.g. food and accommodation) of up to £10,000 a year. The planned effect of these measures is to ensure that **no one loses more than 30% of their assets**.

Figure 1. Maximum possible asset depletion



Source: Dilnot Commission Final Report

[16] Commission on funding of care and support (July 2011), **Fairer Care Funding – Report**

Alongside the cap and new means test, the Commission also recommends that there should be a **national eligibility and assessment framework** to ensure consistency across local authorities in the way that individual's needs are assessed. This new approach would allow individuals to take their assessment with them should they move from one local authority to another.

Cost

Cost is the main potential stumbling block for reform. The Commission estimates that the recommended changes to the funding system would cost from between **£1.3bn for a cap of £50,000** and **£2.2bn for a cap of £25,000 per annum**. If the Commission's recommended cap of £35,000 was introduced this would cost an estimated **£1.7bn per annum**. The cost of the cap is then projected to increase over time reaching £3.6bn by 2025/2026, though Dilnot argues that this cost could be offset by a partial increase in the cap.

Dilnot argues that the reforms are actually relatively low cost at 0.14% of GDP and suggests a number of ways to pay for them. These include taxation, reprioritising current expenditure or a specific tax increase which would target, at least in part, those who are over state pension age.

The complex cost implications of Dilnot

The Commission calculates the implementation cost of its proposals by adding together the cost of introducing a cap, to the cost of increasing the means test and applying this to the year 2010/11. The estimated cost of the new model then increases over time relative to the projected costs of the current system. This is for two reasons: firstly, assuming disability rates remain constant, improving life expectancy will lead to increasing demand for care. Secondly, rising home ownership amongst the elderly is forecast to rise, increasing the number of people who will be ineligible for the current means tested support and who therefore derive greater benefit from the Dilnot cap.

Interaction with pensions reform

The cost of any proposals to reform long-term care funding should also be viewed in the wider policy context of pensions reform. Many developments are taking place in this area, of which arguably the most important is automatic enrolment bringing an estimated 8 million people into formal long-term saving.[17] As mentioned above, the current long-term care system does much to undermine pension saving as only those with minimal wealth are guaranteed some state support. By moving to a system where costs are capped, individuals can preserve a greater proportion of their assets providing an incentive to accumulate wealth over the long-term. A well designed long-term care funding model could therefore complement pensions reforms such as auto-enrolment – helping to ensure that less people require State provided top ups to pension income in retirement.

Currently nearly 3 million people are being paid an average of £50 per week in pension credit[18] which guarantees pensioners a minimum level of weekly income. If the current range of reforms to the retirement landscape successfully reduces the number of people in need of such support by a third (due to greater savings), the government would save around £2.6bn per annum – roughly equivalent to the cost of Dilnot's proposals. The Government must therefore think carefully about the cost implications of any long-term care proposals as part of the wider question around the future of retirement planning.

[17] Pensions Policy Institute (Jan 2011), **Towards more effective savings incentives: a report of PPI modelling for AEGON** estimates that the introduction of auto-enrolment will significantly increase the number of individuals saving in a pension from 14 million in 2012 to around 22 million by 2015.

[18] T. Rutherford (June 2011), **Pension Credit statistics**, House of Commons Library, p.3

Political reaction to the report

Against the backdrop of Government spending cuts, and a challenging economic environment, these reforms may be hard to sell politically and it has been rumoured that the Chancellor and Treasury would like to "kick the proposals into the long grass".

Indeed, in response to the recommendations, Health Secretary Andrew Lansley was noticeably reserved saying that Government has to "consider carefully additional costs to the taxpayer [of the proposals] against other funding priorities"[19] and that the report would be used "as a basis for engagement".

Anticipating a push-back from the Government (or at least HM Treasury), opposition politicians, industry, consumer groups and charities broadly welcomed the reforms requesting that Government act quickly in forging a consensus and implementing the changes.

Richard Humphries, Senior Fellow at the King's Fund, neatly summed up the mood when he said "politicians from all parties must now seize the best opportunity in a generation to ensure that people can access care and support they deserve in later life".[20]

The Government has since committed to publishing a White Paper in Spring 2012 and in the interim there is likely to be fierce arguments about the proposed funding arrangements. Ahead of Dilnot's final recommendations, we conducted a survey of MPs to see whether there was a consensus emerging on the characteristics of an ideal funding model for long-term care. We asked:

Following the Dilnot Commission' s recommendations, the Government will be tasked with reforming the funding of long-term care. What do you think is the most appropriate method of funding long-term care?

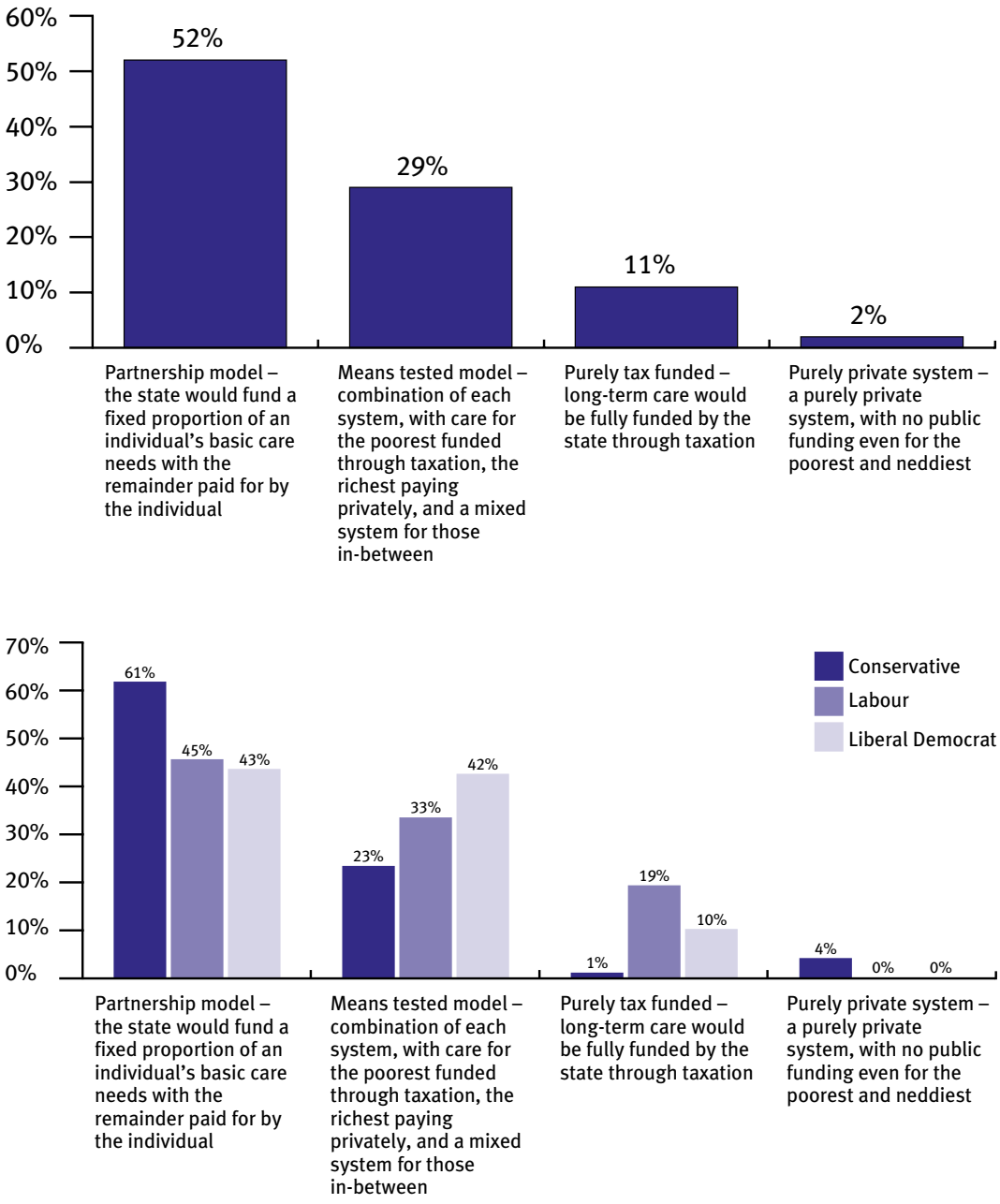
- **Partnership model** – the state would fund a **fixed proportion** of an individual's basic care needs with the **remainder paid for by the individual** (This was a rough approximation of the Dilnot model)[21]
- **Means tested model** – combination of each system, with care for the poorest funded through taxation, the richest paying privately, and a mixed system for those in-between (the current system)
- **Purely tax funded** – long-term care would be fully funded by the state through taxation
- **Purely private system** – a purely private system, with no public funding even for the poorest and neediest.

[19] Delivered to the House of Commons on 4 August: http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110704/debtext/110704-0001.htm#1107044000628

[20] Press Release (4 July) **The King's Fund Responds the Dilnot Report** http://www.kingsfund.org.uk/press/press_releases/the_kings_fund_33.html

[21] The survey questions were written well in advance of the Commission's final recommendations so the description of a Partnership Model is only a rough approximation of Dilnot's final proposal.

Figure 2. MP support for LTC funding models (overall and split by party)



Source: ComRes for the Chartered Insurance Institute. Survey was conducted in May 2011, 158 respondents across the political spectrum.

The majority of MPs favoured the model most closely resembling the Commission's proposition – and it was the favoured option across all parties (albeit marginally for the liberal democrats). This suggests that there is some consensus both on the need for reform and on a new partnership model being the best approach. The results do at least then, provide some hope that broad-based support for proposals to reform long-term care can be found and a lasting settlement achieved. Nevertheless, the political battles are likely to be fought over the new system's parameters (something we could not test at the time of writing), in terms of the proportion of an individual's care bill that government will cover and an individual's eligibility for state support.

A role for the private sector?

Dilnot argues that when the state provides a stable offer which caps 'tail-end risks' and where people are made aware of the need to plan for care needs, a new market can develop.

In the Commission's view, **pensions, ISAs and housing** are the most likely vehicles through which people will privately fund care though there may also be increased opportunities to convert **critical illness cover** of life insurance policies to bridge the gap. However, Dilnot thinks the pre-funded market will remain stagnant as "products are expensive, and there are significant reputational risks to insurance companies if they are unable to deliver on their contracts".

Since publication of Dilnot's final report, James Lloyd has published arguably the most extensive piece of analysis on the report's recommendations. He questioned the ability of insurance providers to price care policies under the proposed new system.[22] He argues that insurers can only price such policies on the basis of trends in disability and longevity yet under the 'capped cost model' a "person's £35,000 liability is determined by the **availability of informal care** and **how much a council gives individuals with a defined level of need**". Lloyd argues that these additional elements are things insurers cannot price for.

Lloyd also picks up on the Commission's recommendation for an extension to the current **deferred payment scheme** which allows local authorities to pay an individual's care bill if they cannot afford to do so without selling their home. The local authority then recoups the money when the house is sold. The Commission believes it sensible to roll this out nationally and allow local authorities to charge interest to remove the disincentive they currently face in promoting the scheme. Lloyd argues that one effect of this proposal may be to crowd out the **equity release market**.

It seems then, that whilst the new proposals may give the private sector more of an opportunity for involvement than previously, this may be limited to a few products that are purchased at the point of use rather than pre-funded schemes. Lloyd estimates that the number of self-funders using **immediate needs annuities** may increase from 6% of self-funders to 20%.[23] A key determinant, however, of whether financial products become an appropriate and widely used solution to fund care, is whether there is sufficient **consumer demand** which is, in part, a function of **consumer awareness and engagement**.

[22] See J. Lloyd (Aug 2011), The First Step? A Response to the Commission on Funding of Care and Support, The Strategic Society Centre

[23] J. Lloyd (Aug 2011) p.8

Consumer awareness

Public awareness about long-term care is very low with few understanding how much it costs or where to go for advice. This needs to change if people are able to identify the most appropriate solutions to their funding needs. However, on its own, a new funding model will not be enough to reverse this trend.

Using property to fund care

An example of the lack of awareness in action is the question of using property to fund care. Property is likely to remain a big part of the funding picture even though consumer surveys suggest that a significant proportion of the population are reluctant to use it to meet this cost. In an ICM BBC poll, 80% of all respondents thought that it was unfair to have to fund basic care through selling their home.[24] Without raising awareness of the fact that property will remain a key feature of the system, many will end up funding care in a way that fails to meet prior expectations. The public, with the help of advice from Government and the private sector, will need to plan ahead if they wish to minimise losses on what they hold most dear.

Property will remain part of the picture

Many may well have to use non-pension assets such as property to pay for long-term care even if the Dilnot Commission's recommendations are implemented. This can be shown through a simple example of the average pensioner requiring a care home for four years.

Currently the average UK pensioner gets a retirement income of around £10,000 per annum.[25] Whilst this is far below what the OECD would consider an adequate replacement rate, for the sake of simplicity we assume that this income is just sufficient to cover day-to-day living expenses and nothing more up to the point at which they need long-term care. Once in care they will have to pay care home fees of £26,000 a year.

Now supposing the Government opts to **cap** the amount that the public must contribute to care to around £50,000. For the first two years of care in an average nursing home, the average pensioner would have to fund this cost independently. However, an average person's pension income will not be enough to meet this cost on its own and would leave an individual with a shortfall of at least **£30,000** which will need to be met through **non-pension assets or some kind of insurance**. The ONS' Assets and Wealth Survey 2008 indicates that the **financial wealth** (e.g savings accounts, ISAs, bonds etc) of pensioners is not enough to cover this cost – median financial wealth for the 65–74 age range is just £13,900.[26] As a result, many pensioners may have to use their physical wealth (e.g. any collectables, vehicles etc) and/or their property to cover the shortfall.

[24] ICM and BBC (2010) **77% 'oblivious to social care cost** http://www.ageuk.org.uk/latest-news/archive/77-oblivious-to-social-care-cost/

[25] OECD (2009), **United Kingdom: Highlights from OECD Pensions at a Glance**

[26] ONS (2009), **Main Results from the Assets and Wealth Survey**, Edited by C. Daffin, p.33

It is worth stressing that the above assumptions about the adequacy of average pensioner income to cover costs before care and the cost of a care home are relatively optimistic. The reality is that for many, £10,000 will not be enough to live off day to day and so pensioners may be building up debts or using non-pension assets to fund retirement well before they even enter a care home. In addition, some commentators have estimated that the average cost of a care home is closer to £35,000 a year rather than the £26,000 assumed above. The overall shortfall may therefore be significantly greater.

Recent research from Partnership[27] focuses on this last point. Dilnot's proposals will not result in the state covering 'hotel costs' – the cost of living day to day which excludes basic care needs. Partnership argues that since nursing homes can charge up to £50,000 a year – nearly double the costs of basic care – individuals will still be left facing substantial costs (above the £50,000 cap) that the state will not be willing to cover.

Awareness of the cost of care

One previous consumer survey found that **nearly eight out of ten people** have no idea how much they will have to pay for care in old age.[28] A separate study commissioned by the Local Government Association found that 63% of individuals wrongly estimated the average cost of a care home as less than £25,000 per year.[29] And a survey for the Department of Health found that 54% of the public think that care services are free at the point of use.[30]

Will the proposed model close this perception gap?

The proposed funding model should help to close the perception gap by increasing the State's contribution towards the provision of care relative to the individual's – bringing it more in line with people's expectations that the State covers most of the costs. Similarly, fixing the maximum amount that people will have to pay towards their own care should improve awareness of personal responsibility and, to a certain extent, reduce complexity.

Planning for care

Few have begun to think about how they will pay for long-term care. In 2008 a poll found that 87% of people had not made any plans to pay for personal care in older age, while just 5% of people had plans already in place. Only 6% said that they were currently arranging plans to finance their care.[31] Similarly a survey conducted by ICM for the BBC found that more than two in five people had not made any plans for care in their old age.[32] Perhaps these results are unsurprising given that many individuals believe the State will foot the bill when they need care. The proposed funding model may help in this regard by setting a **clear limit** on what an individual needs to contribute.

Worryingly however, many people do not even know where to begin when looking for advice on long-term care. One poll of the **over 50s** found that a quarter of the population have no idea who to contact for advice. Only 11% said they would contact their local authority while **only 4% said they would contact a financial adviser**.[33]

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[27] Partnership press release (Aug 2011), **Following Dilnot - Self Payers Still Pay 90% of all their Care Costs...**

[28] ICM and BBC (2010) **77% oblivious to social care cost**

[29] **Local Government Association (March 2009) Call to make the care of our ageing population a priority for all political parties**

[30] Department of Health/Ipsos MORI (2010) **Public attitudes towards care and support**

[31] Counsel and Care, Carers UK and Help the Aged (2008) **Right care, Right deal Scary, depressing and confusing: Voter's view of Social Care Revealed**

[32] ICM and BBC (2010)

[33] Partnership (2010) **Over 50s drastically under estimate the cost of long-term care**

Insurance to fund care

Just one previous consumer study has looked at what incentives may encourage people to contribute to an insurance scheme to fund their social care needs (it only looked at London and was therefore not necessarily representative of the nation as a whole). Over half the respondents agreed that 'matched contributions' from the Government would encourage people to participate – making it the most popular of the suggested options. Other options included more Government information on how to plan for the future, making contributions tax free and special high interest rates.[34]

By providing more certainty around what individuals must pay to meet the cost of long-term care, the new model should, as Dilnot has acknowledged, make it more likely that individuals will seek private sector solutions. Consumers and industry will, however, need to have confidence that any new rules will last if they are to effectively plan ahead.

Some tentative implications

In short, the new approach may provide improved incentives for people to consider funding long-term care in advance. This could provide more opportunities for financial services to prove its worth in developing solutions to help consumers meet their long-term care needs. However, there is still likely to be a worryingly low level of awareness about the costs of care and where to go for advice, increasing the likelihood that people will fail to find funding solutions to meet their expectations and protect assets.

[34] CELLO mruk Social & Market Research (2009) Cost and Provision Adult Social Care Survey Prepared for London Councils

Engaging the public

More information and education is needed to raise awareness about long-term care. However, this will not be enough to tackle the associated problem of inertia. As the survey results above show, whilst nearly half the population appears to understand that care services are not free, nearly 90% are doing nothing to prepare for the costs. Securing a simple and sustainable funding model as well as raising the level of trust in financial services are important ways to reverse this trend.

In a paper published ahead of Dilnot's final report, we called for a widespread, government-led education campaign to raise awareness about long-term care[35] – something which the Commission has also pressed for. We also argued that industry and consumer groups will have important roles to play in informing the public about the options that are available to make the process of paying for care less painful.

However, more **education and information** may not be enough to ensure that consumers are willing to engage with long-term care issues including financial products and services. Another crucial barrier to engagement cited in the literature is inertia – many consumers are doing nothing despite the fact they understand some of the potential risks of inaction.

In part, inertia is likely to be a function of the regularly changing landscape for retirement. There is a general recognition that people expect the long-term care system – as with pensions – to change on a regular basis. People cannot be expected to effectively plan for the future without a stable environment in which to operate, particularly when there are so many other variables, such as the macroeconomic environment which remain uncertain. In this context, the Dilnot report will actually help to fuel uncertainty about near term future costs as people wonder what funding system will ultimately emerge.

However, this does not, on its own, explain why the public appears to be reluctant to engage with financial services on the issue of long-term care funding. In this context it is worth referring to a recent report by the Social Market Foundation which neatly explains why distrust of financial services may be **the most** important cause of inertia:

> "A pervasive sense of distrust among consumers means they are likely to write financial service providers off as 'all the same', without even checking what is on offer on the market. Furthermore, behavioural economics suggests that consumers become disengaged in the face of market complexity: they are therefore less likely to check the market if they cannot easily understand or compare products on it.[36]"

Therefore, in order for the public to view financial services as a key part of the solution, initiatives are required to raise the level of trust and confidence in the industry.

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[35] CII Issues Paper (June 2011) **Who Cares? The Implications of a new partnership to fund long-term care**

[36] Social Market Foundation (July 2011) **A Confidence Crisis? Restoring Trust in Financial Services** edited by John Springford, p.13

Tackling distrust

There is evidence to suggest that practitioners that commit to best practice in terms of qualifications, continuing professional development and a code of ethics benefit from greater levels of public trust.[37] Current initiatives to raise the professional standards of those working in the industry may therefore help to improve levels of public confidence across the board.

The Retail Distribution Review (RDR) is one such project. Its specific objective is to improve public trust in retail financial services by raising the mandatory qualification level for financial advisers and banning commission payments. This enhanced qualification requirement could mean that eventually more practising advisers undertake specialist learning related to long-term care.[38] New rules on commission will also ensure that advisers can only receive payment following upfront agreement with the customer on the cost of financial advice. The measures are designed to reassure consumers about the competence of financial advice and the transparency of the distribution process.

[37] CII (Polling by YouGov) (2009), **Consumer Views of Chartered Status**: http://www.cii.co.uk/downloaddata/Consumer_views_of_Chartered_status.pdf See also Wells and Gostelow (Nov 2009, updated 18 March 2011) **Professional Standards and Consumer Trust**, Prepared for the FSA: http://www.fsa.gov.uk/pubs/other/psct.pdf

[38] The CII currently has 5000 members qualified to provide financial advice on long-term care.

Long-term care: solving a multifaceted problem

From the above analysis, it is clear that developing a fairer long-term care system where the public actively seeks appropriate financial products and advice to help meet their funding needs, requires a multifaceted approach focusing on a number of key, related areas.

The funding model

The funding model can only limit what an individual is required to pay for care and determine the type and size of the risk to be covered by the insurance industry. As such, the model has some important implications for the types of financial products that the industry can offer and whether consumers are able to understand what they are expected to pay for.

The market for financial products

However, stimulating consumer demand for long-term care financial products is not just a function of the funding model. A thriving market will only be achieved by substantially raising awareness about the cost of care and the degree to which consumers are willing to engage with the industry.

Consumer awareness and engagement

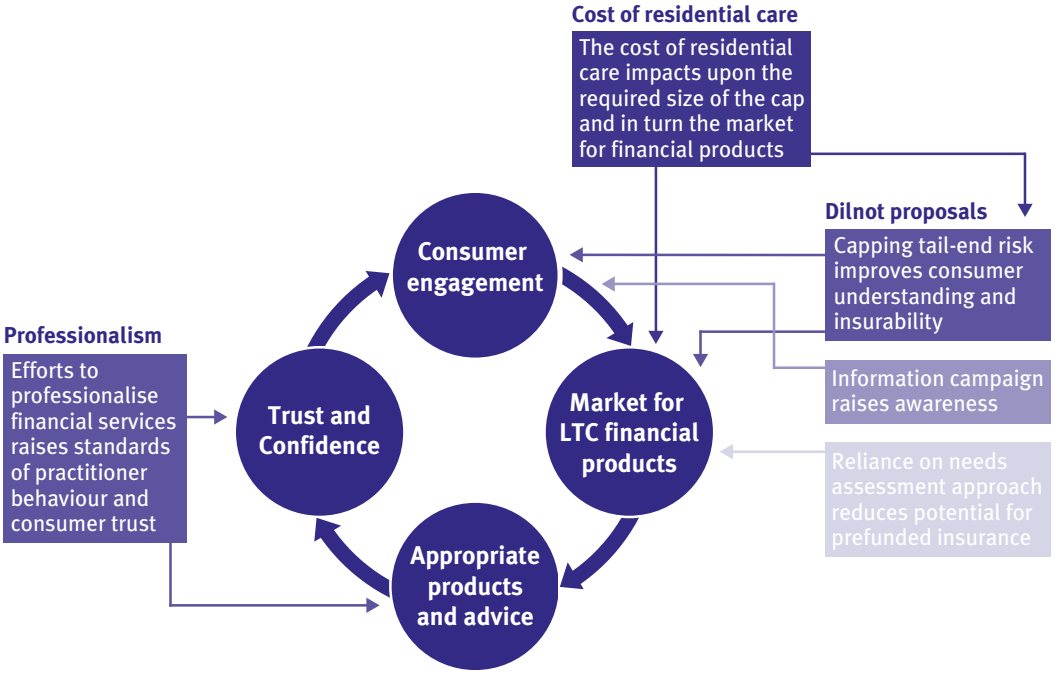
The level of public awareness about care costs is currently so low, and level of public inaction so high, that measures outside of those recommended by Dilnot need to be considered. Improving the durability of long-term care policy and the trustworthiness of financial services will be key to tackling these issues.

The cost of care homes

Whilst the future cost of care homes is outside the scope of this report much depends on it. If the average cost of care homes suddenly increases well beyond £26,000 a year, then government might have to rethink the level of the funding cap and this could have knock on effects for the market for long-term care products and the level of consumer awareness and engagement.

The diagram opposite sets out the relationships between some key parts of the puzzle.

Figure 3. A multifaceted approach to long-term care



Source: Chartered Insurance Institute

With the debate ensuing about a new funding model, now is an opportune moment to consider the long-term care funding problem as something more than just the sum of its parts. The following section contains short essays from key stakeholders in the debate, who identify possible solutions to the wide-ranging issues discussed above.

Summary

In order to gain a better understanding of the key issues surrounding the funding of long-term care and the role of the private sector, we asked a number of experts to provide their considered views:

Paul Lewis
Freelance Financial Journalist and Presenter of BBC Money Box

Paying for care in old age

We all agree that the present system of paying for care in our old age is confusing and unfair. We all agree it should be changed. We all agree that more money is needed. We all agree that someone should pay. And we all agree that it should not be us.

Andrew Dilnot was set the task of finding a fairer way to pay for care. His report Fairer Care Funding published in July proposed shifting the balance of paying away from those with property wealth and towards taxpayers as a whole. No-one would be worse off and many would gain. But the Government has shown feeble support for his ideas and agreed only to publish its own report early next year.

The cost of making care free for all elderly people would be around £4 billion.[39] There are only two places that money for care can come from.

First, you could raise taxes. To pay the entire £4 billion a year, would require a rise of about 1p on the basic rate of income tax, currently 20p in the pound. Those who think that is impossible should remember that income tax basic rate was 22p in the pound as recently as 2007/08. Or it could be done by adding about 1% to the 20% rate of VAT – taking it up to the level rate charged in Ireland or Belgium and well below that in countries such as Greece (23%) or Norway (25%).

But it is hard to see any politician giving such a commitment when the cost is expected to rise sharply over the next few years and further rises in tax may be needed. And it is harder still to see HM Treasury allowing them to raise a specific tax to meet a specified expense. Hypothecation – as it is called – always causes apoplexy among Treasury civil servants.

Andrew Dilnot suggested his more modest proposals – which would cost around £2bn or ½% on basic rate of income tax or on VAT – were so small they could be lost in the Treasury's margins or error. He pointed out that £2 billion is a mere 1/400th of total government expenditure so it would not be noticed. But the guardians of the nation's purse point out that while any particular proposal is always affordable by itself, it would inevitably lead to other similar demands and before you know where you are the country would have a debt of £950 billion. Oh. We do.

But has Dilnot got it entirely wrong to propose shifting the cost away from individuals towards taxpayers? There is another source of money that could certainly be used to pay for care for most people for at least the next generation – the estimated £2.5 trillion locked up in owner occupied housing.[40] This wealth is mainly owned by the baby boomers who bought their homes cheap and have seen them change from a place to live to a lottery win in little more than the time their children have taken to become adults.

There are very strong arguments to say that those who own this wealth should use it to pay for their

[39] Dilnot, Fairer Care Funding – analysis and evidence p.82
[40] Halifax press release 15/5/2010 UK Household Wealth
[41] www.nationwide.co.uk/hpi

own care. Take a typical couple, Joan and Michael Curwen, who live in Cornwall. Their home is worth £260,000. When they bought it in 1981 they paid £34,225.[41] Even when their children were young Joan and Michael both worked, often long hours, to make sure the mortgage was paid.

When they bought their home it was worth around six times the average wage of £5600.[42] Today the house is worth about 10 times average earnings[43] and they have made a gain of £225,775. Even if the cost of borrowing is taken into account, which roughly doubles the amount they paid, the windfall is still close on £200,000.

Joan and Michael believe they earned this money. But in reality it is simply a windfall derived from the economy they have been fortunate enough to live in. And it only seems fair that they should be expected to pay some of this windfall gain to pay for their own care.

At the moment they generally will not have to do so. If they are the first to go into care leaving their partner behind, then the value of their home will be ignored. It will also be ignored when the second goes into care if there is a relative aged 60 or more living there and, at the local authority's discretion, if a younger person who has been a carer is living there. Figures from care specialists Laing & Buisson and the Department for Work and Pensions indicate that only about one in eight of the elderly people living in a care home have sold their home to pay the fees.

The average time in a care home is about 2.5 years.[44] The average fee is around £30,000 a year.[45] That puts the average cost of care for an individual at around £75,000 – or £150,000 for a couple. That is below the average value of a home – which is just over £160,000.[46] So a simple mechanism to take a charge against the value of a home to pay for care would see the costs covered in most cases.

Of course many older people will ask why those carefully nurtured assets should be taken when others get care free? But the people who would lose from this policy are not those in care but their heirs who would no longer inherit the windfall their parents have made from the economic times they lived through. And why should taxpayers as a whole foot the bill so that middle aged adults can inherit more?

[42] Calculated 1981-2011 using ONS index LNMM and 2% rise in 2010 and 2011

[43] 2010 Annual Survey of Hours and Earnings, 2010 table 1.1a tab 4, Office for National Statistics website

[44] Laing & Buisson

[45] £700 a week with nursing care, £500 a week without. Laing & Busisson 2011.

[46] Land Registry House Price Index August 2011

Dr Ros Altmann
Director General, Saga Group

The current system of long-term care funding is haphazard, inefficient and unsustainable. Even though it has been obvious for many years that an ageing population will mean spending more money on care, neither Government, nor individuals, have prepared properly for future care costs. Several major official reviews since the 1990s have been parked in the political long grass, hopefully the Dilnot Commission will not suffer the same fate.

The Dilnot report highlights how failure to adjust social care policy over time has left care under-funded across the board – at national, local and individual level. The welfare state was designed in the 1940s, when the idea of millions of people living to advanced old age was unheard of. The few who did, would have a pension and be looked after by the health service if they were very ill or by their families. Such assumptions no longer hold. Times have changed: more women work, families are living further apart and the NHS does not provide ongoing social care. Past Governments have failed to help people prepare for care, even though around one in four of us will require expensive care in later life.

Dilnot describes how care is the poor relation of public spending on the over 65s. Government spends over £100bn on benefits, over £50bn on the health service and just £8bn on care, leaving millions of vulnerable older people at risk.

As social care is largely provided from local, rather than national, budgets, Council cost-cutting means reductions in care spending are leaving even more individuals with unmet needs.

What has gone wrong?

The 'problem' is that people are now living so much longer than before, which is actually great news, but our support systems are being overwhelmed. Inadequate funding is inextricably linked with poor care delivery. Recent headlines of care home failings, result partly from Council cost cuts, and such problems will only worsen without reform.

Dilnot's prime focus was on improving private provision for care in England – but his recommendations can extend to the whole UK. He highlighted the current system's confusing and inconsistent rules, with payments and assessments being something of a 'postcode lottery'. The current means-test operates very harshly. Anyone needing residential care, who has assets worth over £23,250 (including the value of their home, unless their spouse still lives in it) must pay for their care home costs in full themselves. So most people's whole life savings are at risk, but many do not realise this at all. It is important to help them understand and prepare for care, just as we encourage people to save for their pension.

Unlike with pensions, not everyone will need care, so insurance against future care costs is one obvious potential solution. However, potential costs are unlimited, so it is impossible to find affordable insurance to give full peace of mind.

How could an insurance market be encouraged?

Dilnot recommends a cap of £35,000–£50,000 which individuals must pay for their own care needs, before the state steps in. He also recommends a higher means-testing cut-off with a gentler taper up to £100,000, to protect those with modest assets from using all their savings. With a maximum amount of, say, £50,000, people can take out an insurance policy or a savings plan to cover care needs. They could also add extra savings or insurance if they want more than the minimum state provision. Currently, however, because potential care costs are unlimited, it is difficult to devise policies that will provide real peace of mind.

Dilnot's solution is not perfect (especially as residential home accommodation costs are not included) however, his framework would be a significant improvement on the current situation. Encouraging an insurance market could also help cut future care costs by incentivising more telehealth and telecare services, as well as home aids to help prevent or detect accidents or injuries. For example, insurers may insist on people having handrails, electronic monitors or other devices to keep them safer and prevent them needing care, just as home insurance companies increasingly demand householders have alarms and secure locks to prevent burglary or fire.

A cap on care costs could also facilitate a market in new savings products to prepare for care, if they prefer this to insurance.

At the moment, however, Government incentives for private financial provision in later life focus almost exclusively on pensions. The best tax incentives, mandatory employer contributions, extensive financial products are all focused on pensions. Of course, too few people are saving enough for their pensions, but at least many are making some provision, with financial firms managing billions of pounds for people's pensions. But care needs can be far more costly than pensions, and yet there is almost nothing set aside for this. Money has to be found urgently at the point of need, causing individuals and their families significant distress.

Measures to encourage care saving could include Care ISAs, allocating an annual pension-style allowance to provide for care, incentivising employer care plans and adapting annuity rules to allow pension funds to be used to buy 'Care Pension Annuities', with a lower starting income but can then provide much larger sums in later life if care is needed.

Greater use of Equity Release is inevitable, since most people needing care will have to access the value of their property – especially for those receiving domiciliary care.

Another potential savings product that would be facilitated by a cap on private care costs would be 'Family Care Plans'. Part of the problem putting people off saving for care, is that not everyone will actually need it so it is tempting to just hope they will not be affected. But, statistically, within a family of four, one person will probably need care – however they don't know in advance which one. Four family members could club resources together and save in a joint-account to ensure, say, that one of them will have their care needs covered up to the cap. Such accounts could also be tied in with additional insurance, so that if more than one in four actually needs care, they will be insured against the extra costs. By joining together, each individual's costs will be much lower than saving for care separately.

What will happen with Dilnot?

The Coalition has committed to trying to deal with social care in this Parliament. It has promised a White Paper in Spring 2012, although that will be about delivery of care, not just funding.

One obvious problem with Dilnot's proposals is their cost – an extra £1-£2bn a year – which might explain the Government's initial lukewarm response. It is hard to imagine the state being less generous than under the current stark means-test, so the Treasury may be in no hurry to implement change. However, the caps and thresholds of Dilnot's framework could be adjusted to operate in a more cost-neutral manner, and money could be earmarked from the NHS budget to pay for care. This could actually save the health service huge amounts in future.

Reform is essential. Care funding must improve and the more people can provide for their own care needs, the more they will have peace of mind that they will be well looked after if required.

Whether it is for ourselves or our loved ones, we would all be better off knowing that care will be there if we need it, rather than hoping that the day will never come and failing to be prepared, or finding that the standard of care is inadequate because of lack of funds. Our care system is not designed for 21st Century realities. The sooner we bring it into the modern world, the better all our futures will be.

Andrea Rozario
Director General, Safe Home Income Plans (SHIP)

There are many problems facing the current social care funding system, but the biggest of these problems is lack of clarity. People do not know what is expected of them and what Government will provide for them. They do not know what support they are entitled to or how their efforts to provide for themselves will affect their entitlement to benefits. Government too suffers from a lack of clarity – not knowing how much the state will have to contribute because the system is ill-defined and ill-equipped to meet the needs of an ageing population.

In the recent report from his Commission on Funding of Care and Support, Andrew Dilnot makes proposals to address this problem. He recommends laying out a clear definition of how much people will have to contribute to their care costs and how people will be supported if they are not in a position to contribute. The state cannot afford to pay for universal free social care. Dilnot accepts that. Nor can the state afford not to support people when they need social care provision. Dilnot accepts that too. What he proposes is a defined balance of responsibility – a framework that says Government pays for this much, you pay for this much and those who absolutely can't pay their share will be supported to do so.

Commentators have said that Dilnot's proposals will prove too expensive for Government. They are right that it is not a cheap solution. But social care funding is not a cheap problem and there is no cheap solution. This is an opportunity for Government to finally address what is a growing, and ever more costly, problem. Otherwise, this will just end up being kicked into the long grass, as has happened so many times before, and the problem will get worse and more people will suffer.

So, if the Government takes this on, what else needs to be considered? A key aspect, and one that the Government can help to address by working with the financial sector, is how people will pay their share. The means testing for this will take into account a person's income and their assets, to some, as yet undefined, extent. How their housing wealth is taken into account will be important. As too will be how people are supported to access their housing wealth, especially given the desire of Government to ensure that people aren't forced out of their homes by their need to access cash to pay for social care and the increased focus on domiciliary care.

Equity release is one of a range of financial services products that can help to address this question. Equity release products allow people to release some of the equity from their homes without having to move. There are no repayments to make during the life of the loan and both members of a couple are covered. The loan is generally repaid when the house is sold after the death of the individual or couple covered.

SHIP is the trade body that represents the equity release industry, currently representing around 90% of the equity release market in terms of volume. SHIP was formed to ensure that the sector provides the best possible protection and security for people considering releasing equity from their homes. To this end, all SHIP members sign up to SHIP's code of conduct, which includes pledges for customer protection. These pledges include a guarantee that customers can live in their homes for life as long as it remains their main residence and a no negative equity guarantee, so that customers will never owe more than the value of their home and no debt will ever be left to the estate.

Despite these guarantees, there is a significant barrier to people accessing these and other retirement financial services: there is a lack of reliable independent information. People either do not know about the products that are available, do not recognise how they could be used to help them or find it difficult to know which products represent a safe option for them. These people, understandably, do not feel comfortable getting all their information about financial services from the financial services sector.

If people are going to have confidence in financial services products to help them make their contribution to care costs, they have to have independent information about what their options are, clear guidance on if and how financial services products will affect their benefit entitlements and what kind of care costs they should be planning for. This is where Government has an important role to play.

Government should provide people with unbiased and independent information about the various options available to them in terms of retirement and social care funding, including the types of financial services that are available; information on the types of care services available, how to access them and where to view assessments of specific services, as well as a guide to choosing the right service; and a guide to the benefits that are available to people and how they are affected by various methods of saving and accessing equity.

Government should also be working with the retirement financial services sector to define what products are available, or could be developed, to meet the needs of people who want to access funding to pay for social care. Innovative products have been and could be developed to specifically address just this type of need; this can be done much more effectively in the future with Government and the sector working together.

With Government's support, we can ensure that people have access to the right solutions for them and their specific situations and that they have the confidence to make use of them.

James Lloyd
Director, The Strategic Society Centre

By proposing that the state provides protection to the population against the 'catastrophic costs' of long-term care, the Commission on Funding of Care and Support has laid the ground for a debate about how individuals could use products provided by the financial services industry to meet the cost of their remaining liability.

The 'capped cost' model is perhaps best described as a 'capped exclusion from means-tested support' model: individuals would have their needs assessed by local authorities and be allocated a financial value for the support they require. If the person being assessed falls below the means-test threshold, they will receive this money. If the person is above the threshold, this support will remain 'notional', and it is only when a person's accumulated notional support reaches a total of £35,000 that they will then be entitled to actual support.

However, throughout this process, local authorities will – as now – be undertaking so-called 'carer-sighted' needs-assessments: if a person can have their needs met fully or partly through informal care, they will not be entitled to local authority support – including notional packages of support – even if they are experiencing relatively high levels of disability. The 'capped cost' model is therefore built around 'need' defined as a financial value by local authority resource allocation systems, rather than disability or expenditure on care services.

So what will the 'capped cost' model mean for financial services?

The Commission pinpoints equity release products as one way in which families could fund their liability; with their liability capped, individuals may be less averse to spending down their housing wealth through the use of equity release. This may well be true, although individuals may still be concerned about the adequacy of future support from the state. But the biggest issue for the equity release market would actually likely be the Commission's proposal for placing a duty on all councils to offer 'deferred payment schemes', whereby councils pay the residential care fees of 'self-funders' and reclaim this amount after a person's home is sold. Where these schemes have previously been available, they have effectively amounted to subsidised, publicly run equity release schemes. If all councils are to offer deferred payment schemes, even charging a basic rate of interest, the interaction with the equity release market will have to be thought through; crowding-out would be a clear risk. Given many councils may struggle to offer 'deferred payment schemes', it may be that a hybrid solution is arrived at in which more councils provide deferred payment schemes with financial services partners.

At present, the only active market for care insurance products is immediate needs annuities, bought at the point of entering residential care. Given most purchasers pay significantly more for their residential care than those funded solely by local authorities, this market would survive under the 'capped cost' model, as these individuals will always be left paying out-of-pocket for some of their fees, even after they reach the £35,000 threshold of state support. Indeed, this market would most likely grow. With self-funders knowing that financial support from their council would jump at a certain point in the future, by definition, a greater proportion of the 120,000 self-funders in residential care will have an actuarial interest in purchasing an immediate needs annuity. Affordability would be greater for more people, and the current market of around 7–8000 policies might increase to 15,000–20,000.

Turning to various 'pre-funded' insurance-based care products, the picture becomes substantially more complicated. Would individuals be able to purchase pre-funded insurance against their £35,000 liability? No. This is because the liability is, strictly speaking, uninsurable. Insurers can price products on the basis of trends in longevity and disability. But, under the 'capped cost' model, a person's £35,000 liability is also determined by the availability and receipt of informal care, and local authority decisions on entitlement proportional to different levels of need. These are factors that insurers cannot price for.

What would be the result? Any pre-funded insurance products would likely be limited to offering a £35,000 lump-sum when a person experiences a defined level of functional impairment. This may or may not be when a person begins being allocated notional support by their local authority. It is possible to imagine someone making a successful claim on their care insurance, receiving a £35,000 lump-sum, but being told that they are not entitled to notional support from their council because their partner is judged able to meet all their needs. In such a situation, it would be left to individuals to spend down the lump-sum as they saw fit.

Ultimately, such a situation may be rather unsatisfactory for customers, and is certainly inefficient in insurance terms and from the perspective of policymakers. However, assuming such a product cost £10,000 per premium, recent analysis by the Strategic Society Centre found that take-up would be unlikely grow above 6% of new retirees (those still working would always be better off putting money into a pension).[47] At around 45,000 new policies per year, this would not represent a significant new market for providers.

A similar set of issues face disability-linked annuities, which would also likely have to offer lump-sum payouts under the 'capped cost' model. Among defined-contribution pension savers, relatively few have such a big pot at retirement that they would be willing or able to allocate £10,000 to protection against care costs. Pension policymakers might also have something to say about this given ongoing problems arising from so few annuitants purchasing inflation-protection or dual-life policies.

So overall, the 'capped cost' model would likely result in increased take-up of decumulation vehicles like equity release, and point-of-need products like immediate needs annuities.

However, pre-funded insurance protection under the 'capped cost' model is likely to be very limited indeed. This is perhaps inevitable when two very different systems for allocating resources – private insurance and local authority resource allocation mechanisms – seek to interact. It would be left to individuals to resolve the contradictions that would flow from this interaction, but the effect would also likely be to further inhibit take-up.

Does this matter? If the government were to implement the 'capped cost' model with a generous, low cap of £35,000, then probably not. But, if a cap were in fact set higher – £50,000 to £100,000 – the inability of individuals to protect themselves from this liability in a satisfactory way would likely become much more of a headache for policymakers.

[47] Lloyd J (2011) The First Step? A response to the Commission on Funding of Care and Support, The Strategic Society Centre, London

Clive Bolton
At Retirement Director, Aviva UK Life

Consumer attitudes to long-term care funding

We know paying for care in later years is a significant concern to people thinking about, or in retirement, and public interest in the topic of social, residential and nursing care in later life has been particularly high in recent months. The BBC's investigation into standards of care at residential homes, the financial difficulties facing Southern Cross, and lastly July's report from the Commission for the Funding of Care and Support has focused sustained attention on the issue.

As a leading provider of annuities, equity release, and advice for customers approaching or in retirement, Aviva is only too aware of the financial concerns people have around care. To help add to the debate in this important discussion paper from the Chartered Insurance Institute, I want to share our insights into how customers view paying for care, and how they may respond to the new proposals.

Aviva's Real Retirement Report research series analyses the financial issues facing the over 55s, and we supplemented this with a survey of over 4000 people in early July (through ICM Research) investigating attitudes to care funding.

Firstly it's worth noting that care and health worries regularly appear in retirees' top financial concerns in our quarterly survey, but there's a real age divide. One in three over 75s is worried about paying for care – but the figures are significantly lower in the 'younger retiree' group of 55–64 year olds.

It therefore seems individuals and families are yet to personalise this issue and translate it into their own financial plans and attitudes. The Government may have a challenge on its hands to educate the average UK family that social care (whether in their own home or in a residential home) is not free, and a new system that attempts to fairly apportion the costs of care is necessary.

Whilst the majority of the over 55s we surveyed accepted care costs should be divided between government and individuals, there is a clear divide between people believing only the 'better off' should make a contribution (51%) and those thinking this would be the responsibility of 'most people/or their families' (19%). Over a quarter expect care to be fully covered by government spending (27%).

This suggests the recommendation for a higher means test threshold should be popular, though Government will need to clearly communicate that those under the threshold will still have to make some contribution, and that the recommended cap applies to costs incurred only for care that is required under the national assessment criteria, no matter how it is paid for.

The reality of finances in retirement

Aviva's research suggests people have a reasonable understanding of the current costs of care but have no plan for how they might meet such costs. 72% of all respondents did not know how they might pay for their own care in future, and amongst the 1300 who anticipated a family member would need care in the near future, 59% had no plan. So even as reality starts to bite, inaction is common. Any reform needs to make it easier for people to know what they need to pay, and the options they have about how to do so. The Commission's recommendations for a new awareness campaign and better information advice should help address this.

When we asked the over 55s how they might pay for their care if needed, about a third would use savings/investments and a quarter would consider equity release. But how likely is it that average retirees could meet the costs of care using these solutions alone? The June 2011 Real Retirement Report showed median savings among the over-55s stand at £11,907 – clearly there will be households with far greater savings but the 'average' retired family or individual is unlikely to have enough in the bank to easily cover care costs despite the recommended cap.

Further, one in four homeowners over 55s still has outstanding mortgage debt, with the average amount owed standing at £61,370. For people in this situation, using equity release or downsizing in the face of care costs may not be an option. However, the average price of homes owned by the over 55s is £231,306 (May 2011) – much higher than the national average house price (£160,519) despite falling property values. For retirees with average levels of savings and housing equity, paying for care looks within reach if a lifetime cap is introduced, even considering the potential residential bills this may involve.

How can the insurance industry help?

So where do insurers come in to help people who will need to pay for care? Different age groups will need different solutions – those at or close to needing care now will have different options to those at retirement, and younger groups able to make longer term plans. The system must work for each of these groups.

Those consumers already in or approaching retirement have limited opportunities to save more or change their financial plans, and so existing products coupled with a more straightforward system and better access to advice is crucial. We see a clear role for equity release here, which works well with a proposed cap that may become an incentive to seek care and support earlier, and to remain in the home for longer to avoid uncapped residential care costs.

The proposed cap could foster insurance products paying a fixed sum or income in specific events rather than being tied to paying all care costs. This removes the political uncertainty, becomes a simpler customer proposition and could be easier for insurers to price, reserve for and underwrite. But with the risk of catastrophic costs removed (at least for social if not residential care), it is likely the incentive for people to insure in advance will reduce.

The Commission's proposals provide some certainty and a more stable framework for current retirees and those approaching retirement. A cap on costs and sliding payment scale coupled with a higher means testing threshold should make long-term social costs appear more affordable for average families – one of the key objectives of reform.

It remains to be seen how many of the Commission's more costly proposals will be adopted by the Government, and the kind of products consumers may wish to turn to under the new system. Until then, it's hard to define what new insurance solutions could look like. It's still early days in what could be a long political debate, but we're starting to see opportunities to help customers plan and pay for care. A clear picture of current consumer attitudes, wealth and assets is crucial in ensuring the political and industry response meets its goals.

Steve Groves
Chief Executive, Partnership

Partnership is the largest provider of Long-term Care Annuities in the UK.

Partnership has been campaigning for self-funders to receive appropriate financial advice. Self-funders are those in the current care system with assets (including property) of more than £23,250 in England who have to pay for their own care.

Long-term Care annuities or Immediate Needs Annuities provide an income for life to fund care costs in return for a one off premium. Provided the income is paid to a registered care provider it is tax free. This product is portable and provides peace of mind. Any residual assets can be left, typically as a bequest, to family, safe in the knowledge care costs have been met.

What are the problems with the current funding system?

- A chronic lack of awareness among consumers has lead to a failure of demand for long-term care insurance products. This covers a chronic lack of awareness of:
  - The costs of care
  - How long people will live in care. While average life expectancy in residential care is 2 years our policyholders live on average for 4 years
  - How many people will need care. We believe between 1 in 2 and 1 in 3 women aged 65 today will need care during their lifetime
  - Where to get financial advice. Of the 130,000 people who entered residential care in 2009, 41% or 53,000 were self-funders. However only 7% received appropriately qualified financial advice[48]
  - The types of financial products which are available Most people do not know about any of the funding products available (76%). Only 12% had heard of a long-term care annuity[49]
  - 80% of care homes had never heard of Immediate Needs Annuities and most social workers and Directors of Adult Social Services are equally ignorant of the products available to help self-funders. 79% of care homes have no relationship with an appropriately qualified financial adviser.

Other significant issues include:

- Limited numbers of financial advisers with CF8 (estimated at approximately 8,000) who are appropriately qualified to provide financial advice in this area. Lack of access to suitably qualified advice has a significant impact on the ability for people to purchase the appropriate financial product
- Extremely few local authorities sign-post self-funders to appropriate financial advice – despite those self-funders being entitled to it. Without appropriate financial advice and failure to purchase an appropriate financial product it is inevitable that self-funders prematurely deplete their capital and fall back on the state. Partnership estimates that the cost to local authorities (in England) from self-funders who deplete their assets prematurely is nearly £1bn a year. The Local Government Information Unit (LGiU) estimates that 25% of self-funders deplete their capital and fall back on the state.[50]

[48] Oliver Wyman research for Partnership

[49] GfK NOP research for Partnership

[50] Independent ageing: council support for care self-funders March 2011

- Many local authorities complete a financial assessment (means test) prior to a care needs assessment in an effort to avoid the cost of carrying out the latter if the elderly person is a self-funder – even though it is an entitlement!
- Transparency and standardisation of local authority contributions are necessary to stop distortions in the market greater demand management would reduce overall public sector costs.

Are Dilnot's recommendations well designed to solve these issues?

We believe the following recommendations by Dilnot will play a significant role in addressing the chronic lack of consumer awareness about care and where to receive advice which we believe is fundamental to the growth of an insurance market for Long-term Care:

- A major campaign promoting awareness of the system
- Better information and advice to be made available

We believe that distortions created by different approaches to the funding of LTC by local authorities will start, in part, to be addressed by the following recommendation:

- Introduction of consistent national assessment criteria

Also we must not lose sight of the importance of the Law Commission's response on Adult Social Care (which will feed into the Social Care White Paper). This is a much needed rationalisation which provides a clear, modern and effective legal framework for the provision of adult social care services. Previously, by its own assessment, there was "an often incoherent patchwork of legislation, which makes interpretation and application of the law complex and time consuming".

Of particular note is recommendation (6) that the "statute should place duties on local authorities to provide information, advice and assistance services in their area and to stimulate and shape the market for services". This of course needs clarity about what services are and how they are delivered – however appropriate financial advice for self-funders is critical!

What might a Consumer Engagement Strategy Look Like?

Partnership has spent significant time working with local authorities and other public facing organisations to ensure that people who need information and advice receive them. Focusing resources to these existing sources of consumer information is clearly important.

It is clear that providing a 'one size fits all' booklet or generic website is not sufficient. Consumers (the elderly and people with powers of attorney) will be making care funding decisions, typically at a time of distress, following an accident. They need help and advice tailored to their needs!

- **Local authorities**, which are a key point of contact for consumers – require systems which are focused on individual needs. Ideally they should identify self-funders well in advance of their need for care. Partnership is working closely with over 30 local authorities to generate awareness of these issues, and help them develop consumer focused processes to sign post self-funders to independent financial advice

- **payingforcare.co.uk** Partnership launched this site in response to a serious information gap about where to get advice on care options and in particular where to get qualified financial advice. This site also provides opportunities to directly 'chat' with qualified care fees advisers. Partnership pioneered this when it recognized that 29 million people 'Googled' the term 'paying for care' and that 69% turn to the internet for information on care for older people.

What preconditions are necessary for the development of a healthy market for long-term care financial products and services?

As the Policy Exchange set out in its report – 'Careless, Funding Long-term Care for the Elderly' June 2010

> **"Political uncertainty about the future of social care funding over the last 12 years has caused the private care insurance market to fail. Why pay for something that the State will provide for free."**

> **"This requires a clear statement from the Coalition Government that free personal care for the elderly cannot be provided entirely by the State."**

Partnership believes that clarity about what the consumer is required to pay for and what the individual has to pay for is critical. Without this consumers will be unable to plan effectively for their care provision.

This is, in our opinion, the principal pre-condition. However it is worth noting that the Retail Distribution Review (RDR), will require more advisers to achieve high levels of qualification, which for many will include CF8, enabling more advisers to advise on care products.

How can we ensure that consumers have trust and confidence in financial advice and products related to long-term care?

Partnership believes that access to appropriately qualified financial advice is key to this.

Advisers must get CF8 qualifications to provide advice on care and ideally ER1 for equity release.

Another valuable consumer benchmark in the provision of care financial advice is SOLLA (the Society of Later Life Advisers), which is an independently audited society of advisers skilled in providing advice to the elderly.

Tish Hanifan
Joint Chair, Society of Later Life Advisers

The Dilnot Commission has highlighted some key aspects of the current shortcomings of the care system; the complexity of the state provision for care funding and the resulting lack of clarity for the older person or their family who are trying to navigate their way through a myriad of options with no clear signposts.

Much has been said of the 'postcode lottery' both in the provision of NHS care and for local authority funded social care. This lottery is also true in relation to the pathways by which the older person enters the system and finds their way through it.

The need for much of middle England to fund their care in whole or in part has been in place for over 18 years yet there is still much confusion in the mind of the consumer as to who pays for what and when. Part of this confusion is a historic accident in that government has carved out care funding into two discrete areas; continuing care provided by the NHS and social care funded by the Local Authority.

With the social imperative being that NHS care is free [or seen to be] and legal and financial constraints of Local Authority provision of social care requiring that the individual contribute to the cost of their care, the financial implication of falling into one category rather than another are very different and potentially costly. However the boundaries between these categories are blurred and indistinct even to those who work within them or provide legal advice as to entitlement.

Against this background it is little wonder that the consumer finds the system difficult to understand. They experience care within the context of their needs and are bewildered at the financial implications of being designated into categories. This confusion leads to what Dilnot and others have identified; a feeling of injustice based on poor management of expectations.

A success of DIlnot and the debate it has engendered will be if the public are helped towards a greater awareness of the universal need to consider the prospect of both needing care in the future and the recognition that, for many of them, this will also involve a financial burden which they must factor into their retirement planning. Financial services has a key role to play in this by working along side government departments to ensure that consumer education is given a high priority within the forthcoming White Paper. Government departments are well positioned to provide access to information and to help with signposting the individual through the system and the options available.

Dilnot refers to the possibility of a national website as a possible vehicle for delivery of this information. Whilst duplication of public sector, NFP and commercial sites is almost certainly a waste of resources and potentially increases complexity, there are inherent problems with the provision of just one 'approved' resource. Not least of these is the potential for a prescriptive and narrow approach. There are a number of organisations from both the public and the charity and NFP sector who all provide clear information in an accessible way.

The evident need is for good coordination of these resources in order to balance wide ranging advice with clarity of information. The pivotal role of Local Authorities in signposting their self-funders is increasingly being recognised. There have been a number of departmental initiatives to try and assist Local Authorities to meet their responsibility to self-funders.[51]

[51] J. Carr-West and L. Thraves (March 2011), Independent Aging: Council Support for Care Self-Funders, Local Government Intelligence Unit

Dilnot supports the recent Law Commission recommendation that this responsibility to self-funders should be mandatory. However Dinot also highlights that it is not only information and signposting that the individual needs but also advice. In this regard, financial services has an important role to play. The financial sector can and will rise to the challenge of providing products and solutions to meet the need of an ageing population. In all aspects of retirement planning this is already being achieved and the sector will continue to make progress. However, if the individual is to benefit from the innovation which financial services can provide then they must be helped to understand the options, make decisions and act on them.

Behavioural economics continues to provide much enlightening research in the area of decision making. One aspect of this which is a constant is that complexity and uncertainty leads to inertia. Faced with trying to make sense of many new factors and a system which is usually unknown territory, the ability of people to take clear decisive action is understandably often compromised. Factor into this decision making, the additional problem that, in the current system, decisions are often made at a time of crisis and it becomes apparent how difficult clear decision making is for the individual. Whatever options are available, these will only be beneficial if the decision maker knows about them at the appropriate time, and is guided through them so that they feel confident in the decision they need to make.

A well informed consumer who then has access to good and clear financial advice will be able to make the important decisions needed in relation to care planning and other aspects of retirement planning, both for themselves, and for those for whom they may act as attorneys.

However, a barrier to the take-up of financial advice by the consumer is the lack of trust that many people have in the financial services sector. Much research supports this view. The CII for example, found that one in five respondents will never trust financial services again and 72% of people have not very much or no trust at all in financial advisers and life insurance providers.[52]

The Society of Later Life Advisers was founded in 2008 as a not for profit organisation, to assist consumers and their families in finding trusted accredited financial advisers who understand financial needs in later life. It was established to address this need by enabling the consumer to find specialist independent financial advice in whom they could have confidence. The Later Life Adviser Accreditation (LLAA) was developed in conjunction with the Financial Services partnership (then the Financial Services Skills Council). In establishing the appropriate standards for this accreditation, the working group included Age Concern and Which? who both stressed the need for advisers to be able to demonstrate their soft skills and evidence their ability to understand the specific needs of this sector. The standards for this accreditation can be found at:

http://www.societyoflaterlifeadvisers.co.uk/PDF/Prospectus_Brochure-v.07.pdf

By ensuring continued consumer access to initiatives such as this and by developing specialist financial advice to meets the need of an ageing population as well as the implementation of the increased professionalism underpinning the RDR, financial services will be able to to provide the consumer with a key product for a successful retirement – **high quality advice**.

[52] CII (2010) What we talk about when we talk about trust

Otto Thoresen
Director General, Association of British Insurers[53]

Long-term care affects us all. It is highly likely that many of us will require some form of special assistance later in life, when through frailty or disability, we find it increasingly difficult to carry out normal daily activities such as eating, dressing and shopping. Even those fortunate enough not to need this support will almost certainly know someone in their family or circle of friends who does.

The fact that we are living longer is one of the great achievements of the last century. However, this is placing new pressure on society to meet the additional costs of an ageing population. The state alone cannot pay the bills involved. The average cost of care in a residential home is £25,000 a year. This rises to nearly £39,000 per annum when nursing is required. Despite this potential future expenditure, most people are failing to plan ahead for the full range of needs they may have in retirement.

What contribution can the insurance sector make?

1) We need to help people better prepare. We are developing policies and actively engaging with key stakeholders to promote the importance of building a more financially resilient society. The insurance industry is uniquely placed to relieve some of the burdens on the state by providing savings and insurance protection products that help people plan for retirement and any unexpected events that may result in a loss of income. By encouraging individuals to take more personal responsibility for their own and their family's financial security we can help construct a society that is less dependent on the welfare state.

2) The ABI supports the recommendations by the Dilnot Commission as a framework for a sustainable solution to funding long-term care. It is essential that MPs from all parties work towards a sustainable settlement and that the issue is not put on the shelf. There needs to be clarity over the respective contributions which government and individuals will be expected to pay. Once this framework is in place, insurers can develop the necessary financial products to enable a person to cover their share of care costs.

3) Most importantly, we need to get people saving. Around half the population are either not saving in a pension at all or are not saving enough for a decent retirement income. The ABI is therefore a strong supporter of automatic enrolment into workplace pension savings, starting from 2012. It will be a social revolution for retirement savings, the importance of which is hard to underestimate.

Insurers are ready to work in partnership with government and other key stakeholders to ensure Britain is a resilient society. We will continue to explore ways the private sector can fill the gap between people's protection needs and the services offered by the state.

[53] The text was first published on Epolitix here: http://www.epolitix.com/latestnews/article-detail/newsarticle/building-a-more-financially-resilient-society/

Jules Constantinou
Head of Marketing, Gen Re

How should the insurance industry respond to Dilnot?

The Dilnot Report was published on July 4th 2011 and outlines the National Commission on the Funding of Social Care's recommendations on funding and support.[54] Since its publication the focus of debate has been around the 'three' numbers; 35,000, 100,000 and 10,000 referred to in the report. £35,000 represents the maximum that any individual would contribute to the cost of their social care. £100,000 is the proposed maximum value of assets an individual could hold before their entitlement to full state funding disappears and they would be responsible for the full £35,000. This is a significant change from the current level of £23,250 and much fairer given that the assets of most who require social care are tied up in bricks and mortar. Although this represents a significant shift for the individual, most commentators believe this will not materially add to the costs for the state. Finally, £10,000 is the recommended maximum cost per month for food and accommodation whilst requiring social care. There will be a continued focus on these numbers over the next few months, as the debate about turning the broad framework set out by the Commission into a practical structure develops. The devil will be in the detail and already there are signs that the "three" numbers are inherently misleading in that the public are likely to pay a lot more than £35,000 before the State takes full responsibility.

Despite these caveats there are two messages from the Commission of particular importance. Firstly, everyone will pay something for their social care unless they are unable to do so financially. This is an important message as it creates a distinct difference between the funding for social care and the NHS, which is currently free for all at the point of entry. Secondly, that the State will assume responsibility for the potentially catastrophic costs that attend someone requiring social care for many years (currently, self-funders whose funds become exhausted are costing local authorities between £500m and £1bn per annum).

Both these messages should reinvigorate the private insurance industry and provide a platform for insurers to develop products to assist the public to meet their commitments under a new system. So far the industry has underperformed with only 30,000 pre funded policies in force by the end of 2010 and no more than 1500 new immediate needs policies being bought per annum.

In order to make the most of the opportunities there are a number of issues that still need to be clarified before the market will gain momentum and advisers will develop the confidence to recommend Long-term Care (LTC) policies.

Fundamental to the process is the development of a funding system that is based on a national assessment framework with a clear expectation of the care that can be expected as a result of that assessment. The current system, in which the availability of local authority resource leads to differing levels of care for similar needs dependent upon where an individual lives, has led to great difficulty in giving clear advice to potential purchasers. The Commission has made recommendations on the need for portable assessments, but it is the practical delivery of these that will also have a bearing on the future of any private products.

[54] https://www.wp.dh.gov.uk/carecommission/files/2011/07/Fairer-Care-Funding-Report.pdf

The purchase of LTC policies in the past have mostly been 'distressed purchases'. The development of an illness often panicked families into making quick, uninformed decisions on the provision and the financing of care for their loved ones. The lack of clear signposting to advice on both the provision and the financing of social care has been highlighted by the Commission who made recommendations for a State education campaign to address these issues.

In addition to these structural issues that can be addressed by the State, the insurance industry itself needs to closely examine and address criticisms of the existing suite of products so they become more attractive to advisers and their clients.

The main criticism of prefunded LTC products has been the lack of long-term premium guarantees. Most of the products had premium reviews built in every ten years in order to manage the uncertainty of the underlying experience. This resulted in large premium increases or benefit reductions on policies for ageing policyholders. Those whose assets were tied up in their property often lacked the fluid resources to restore the cover to the level they had planned for years in advance. As the experience of those polices has begun to emerge, pricing actuaries have gained greater confidence which, coupled with the State's appetite for the catastrophic claims, should create an environment where premium guarantees are easier to price.

The other major challenge is the difference between the public perception of how the industry provides cover and the actual processes that allow it to do so. Only around 25% to 33% will require LTC eventually. Looking at this from a different perspective, 67% to 75% of us will not! The aesthetic appeal of pre-funded products is vastly different from these two contrasting viewpoints. The majority of people will feel that they will not benefit from their hard earned money and that the insurers will. Whilst those in the industry understand that insurance relies on homogeneous pools to spread risk across the population and that the people who eventually claim are benefiting from those who don't, this is not the perception of the man in the street. Insurers cannot be complacent and should seek to design products that provide benefits to those who do not claim as well as those who do. Examples of these are disability linked annuities that pay a lesser initial amount to the policyholder and then pay a multiple of that amount if they required care. The United Sates market has seen the growth of intergenerational products where any unused benefits are bequeathed to spouses or heirs. In other spheres (term assurance) products promising a full or partial return of premiums to policyholders that haven't claimed or lapsed have been developed.

Should the proposals of the Commission be adopted, the insurance industry needs to be ready to take advantage of the new environment. The uncertainties that have attended the funding of social care for so long have meant that it has been difficult to develop products that meet people's needs and are attractive to buy. Whilst these potential changes lead to optimism, it is clear that any insurance product is not the panacea that will provide complete indemnity against the public's social care costs but one of range of tools or funding mechanisms that people can access to get better financial peace of mind.

Ron Wheatcroft
Technical Manager, Swiss Re

Has Dilnot loosened the ties stifling long-term care funding?

It is generally accepted that the current social care system is no longer fit for purpose. It is complex, poorly understood, and creates extra stress for families trying to cope with emotive issues in funding and arranging care for their loved ones. Hence, the Dilnot Commission report is both timely and welcome.

Funding increasing longevity, whether in good or poor health, will be a challenge. Research published at the end of 2010 by the Department for Work and Pensions, based on ONS population projections and life expectancy estimates, suggests that nearly one in five people currently in the UK will live to 100.

Despite increased longevity, the average person will spend a greater proportion of their life in poor health. ONS data show that a male born between 2004 and 2006 can expect to spend 11.2% of his life in poor health, compared with 9.0% for someone born in 1981. For females, the proportion has remained broadly stable at 13.2%.

We need to address the financial consequences of increased longevity generally to achieve the appropriate cost balance between those in work and those not working. Increases to the state pension age, auto-enrolment and the removal of the default retirement age will start to address this.

While these initiatives will help, there is a great risk that people making any provision will think it sufficient to provide the retirement income and lifestyle to which they aspire. Realistically, we cannot get away from the fact that a significant increase in funding to meet the cost of later years is essential.

The Commission's recommendations

Short of compulsion, there is no single way to meet care costs. It is possible that the Commission's recommendations may be accepted by the government in whole, in part, or even rejected as too costly. Nonetheless, they set out some strong indicators which, if adopted, should encourage the financial services sector to design and deliver products that dovetail with state provision.

The commission proposes a partnership model, based on a cap on care costs of around £35,000, tiered for those aged between 40 and 65. The means-tested threshold, set at £100,000, should encourage the creation of savings and insurance products to cover some, or all, of the cost of care for people whose assets exceed this limit.

Currently, no insurers offer pre-funded long-term care protection policies. The cap on costs, particularly if uprated in line with the basic state pension, could encourage providers otherwise worried about the possible long-term liability for claims costs. This supports the development of specific care products, or care being covered as part of a wider package. One example might be an extension to cover under a critical illness or income protection policy. For pure protection products, and in order to maximise consumer access, the regulatory regime for pure protection business (ICOBS) should be used.

Equity release products should also have a place for people who are cash-poor but asset-rich. In the absence of other provision, many people will still need to draw on the value of their property to meet their care costs.

It is appropriate that those who are unable to provide for themselves through savings or other means should be protected. Consequently, the proposed safety net for those for whom care costs are unaffordable is welcome.

Linkage with pensions

Greater flexibility and closer links with pension provision should be explored. Pensions have become more flexible in response to changing consumer needs. For example, there is a growing market for annuities which recognise reduced life expectancy and other characteristics at the point of vesting.

Impaired life and enhanced annuities are now common. The market does not, however, provide a natural vehicle which recognises and addresses the need for extra money including paying for care when circumstances change after vesting.

The Commission recommends that further consideration be given to disability-linked annuities where payments increase when the annuitant becomes eligible for care. Currently, this design will not be approved by HMRC under the pension tax rules.

Meanwhile, the government should consider allowing pre-funding of care costs to sit alongside pension savings, with tax relief on contributions as an extension to, or within, the annual allowance.

Engaging consumers to prepare for possible care needs

Although some complexity remains, the simpler system proposed by the Dilnot Commission should help to clarify where personal responsibility lies. A government campaign to help people understand the new system is essential, with industry promotion complementing this messaging.

We need to encourage consumers to look holistically at their funding requirements and the financial consequences of not being able to meet them. The solutions may include drawing on savings, income – where consumers are effectively self-insuring the risks – and insured benefits. This has similarities with the way that consumers are looking beyond traditional pension products and using ISAs and property as part of their retirement income planning.

Access to high-quality advice that helps people plan will be vital. There are already a number of excellent advisers providing a top-class service for people entering care and for their families. A high standard is appropriate here given the range of other distressing issues which can emerge. The proposals, if adopted, should create further demand for advice services for care and estate planning.

We need to recognise that some consumers will not want to use advisers, but will instead buy directly from an insurer. This is most likely to be the case where care benefits form part of a protection package. Making people aware of the options will be key here. There is also an important role for the Money Advice Service in clarifying people's responsibilities, irrespective of whether they use an adviser or not. This should be an integral part of the Financial Health Check.

Overall, these proposals are positive news for the industry. If implemented, our response will need to be one that will deliver results and the planning towards that should start now.

Brian Fisher
LTC Marketing Manager, Friends Life

The Dilnot Commission report on the funding of long-term care has raised the public awareness of the need to consider how future care will be funded. Against a demographic background of increasing numbers of people living longer and being likely to need care later in life, it is essential that this issue is addressed.

The report throws up a number of positive proposals:

- There should be a universal eligibility criteria for care to end the 'post code lottery' and care packages should be 'portable' if individuals move – although there is also a school of thought that local authorities should be free to deliver solutions to local situations
- The Government should invest in an awareness campaign and develop a new strategy to improve access to information and advice for the public. This is a vitally important area. Funding long-term care is complex by its very nature so a robust information and advice process is essential.
- There should be better support for carers.

Following publication of the report, there was much focus on the proposals regarding the means test threshold and the respective caps on the amount that the public will be expected to contribute towards their own care.

These areas are fundamentally important and they are also the areas of greatest complexity. A number of headlines following the report suggested that the means test threshold will be £100,000, with a £35,000 cap on the cost of care and a £10,000 cap on the cost of accommodation. However, there is a level of complexity beneath this which needs careful consideration.

Regarding the means test thresholds, the proposals recommend changing the upper means test threshold leaving the lower means test figure – the capital disregard – at £14,250. Capital between the upper and lower figures is converted into tariff income at the rate of £1 per week for every £250. This means that full local authority support becomes available when an individual's assets are down to £14,250.

The £35,000 cap on the cost of care is accrued at the rate of a local authority assessed need and not the amount that an individual may have paid for their care. This is an important area as it is only the cost of care that the local authority deems necessary that will accrue towards an individual's cap.

Similarly, for an individual paying for their own care in a private care home, irrespective of what they pay in fees, the cap will only accrue at the local authority's contract rate (which is likely to be less than the rates charged by a private care home) less the £10,000 p.a. accommodation charge.

In the area of means testing there may be some useful experience we can draw on. Wales removed the gap between the two thresholds in April 2010, leaving a single means test figure. There may be some value in looking at this with a view to developing a system that is very easy to understand and cost-effective to administer.

Encouraging public engagement is crucial as we know anecdotally that many people still prefer to think that they will not need care in the future. The Dilnot Commission plays a vital role here in raising awareness and putting forward proposals for improving the system in the future.

In addition, local government and the NHS have the infrastructure to facilitate the flow of information to the public through a range of public touch points. Consumer organisations like the Society of Later Life Advisers can work with local authorities to provide access to specialist independent advice to those requiring care and their families. All of this can help to boost awareness and knowledge.

All of those active in the provision of long-term care have a duty to engage in shaping the proposals put forward by the Dilnot Commission. Consideration also needs to be given to the State benefits system and how this relates to the funding of long-term care.

Dr Matthew Connell
Principal, Government and Industry Affairs, Global Life, Zurich

The current system of long-term care in England and Wales is not satisfactory – it tries to muddle through with means tested benefits that can be particularly harsh on people who have saved hard throughout their lives.

However, experience around the world shows that state social insurance for long-term care can be very expensive, putting significant upward pressure on labour costs.

Dilnot's plans seem to be a sensible middle way between these two extremes, setting out the role of the individual and the state in a way that they can both manage. However, there are still three major challenges:

- Any increase in state expenditure, however modest, will be difficult in the current economic environment
- Over time, it will be difficult to maintain the balance between state and individual responsibilities – an external body may be needed to monitor and reinforce any settlement that comes out of this process
- Dilnot's proposals do not include much scope for individuals to 'top up' the long-term care services that apply to them – they could be made more flexible, so that individuals can, for example, make provision for 'hotel' services that extend beyond the standard offering.

Long-term Care Insurance – The Challenges

At first sight, long-term care is perfectly suited to insurance, for three reasons:

- First, it affects a significant minority of people. Around 20% of men and 30% of women need long-term care during their lives
- Second, for those who do need it, the cost can be huge – around £39,000 a year for someone who needs nursing care in a nursing home
- Third, the health conditions that force people to rely on long-term care are varied and only partly influenced by family history, so it is hard for individuals to know whether they will need it or not.

It is this kind of distribution of risk that usually makes for a successful insurance market – it enables a large number of people who potentially face a catastrophic cost to share the burden between them.

However, viable private markets in long-term care insurance have not sprung up spontaneously. Even in the US – a country with a long tradition of private health insurance – only about 4% of long-term care costs are funded from private insurance. Most people are unwilling to plan for distant, costly and often unpleasant scenarios.

One way to overcome this is through a compulsory insurance scheme, and several countries have set up such schemes over the last twenty years. However, they have been expensive. A compulsory long-term care scheme set up in Germany in the mid-1990s was €500 million in deficit by 2005, and in 2008 contributions to the fund had to be raised. A similar scheme in the Netherlands saw a rise in costs of 37% in four years.

Dilnot's Solution

Given the challenges that face attempts to build purely state-run systems of long-term care insurance, Dilnot has attempted to create a mixture of private and state funding in setting out a system of care for the UK.

Recognising the need to cap the highly uncertain costs of long-term care, he has chosen a model where individuals make a set contribution (with means-tested help for those who cannot), and then the state picks up the rest.

This is a bit like the model that is emerging for university funding, with individuals paying a set fee for tuition, and the state covering the rest. It is very different from the models in pension and medical provision, where the state offers a basic benefit that individuals can top up with private savings and insurance.

Given that people tend not to prepare for events like moving into a care home, the kind of financial products that are most likely to flourish in this kind of environment are savings products or equity-release products.

Dilnot's plans seem like a practical middle way between high-cost social insurance, which puts high burdens on labour costs, and the current system in England and Wales of means testing and muddling through, which can leave people who have saved hard through their lives all but destitute.

However, there are three outstanding issues:

- At a time when governments are fighting hard to keep coveted credit ratings, the UK Treasury will be wary about signing up to new spending commitments, even though the costs of Dilnot's scheme, at around £2bn, are small compared to the UK's overall spending on social security benefits of £170bn
- It will be difficult to maintain a steady boundary between the state and the individual. In the pensions arena we have seen unexpected changes to tax and benefit rules that have changed the boundary over time, undermining public confidence in the system as a whole. The same could be true with the Dilnot settlement if, for example, the Government tinkers the 'hotel' cost contribution or the levels at which means-testing kicks in. It will probably be necessary to set up an independent body to oversee long-term care policy, to ensure that decisions are made according to technical considerations rather than political expediency
- Currently, there is not a great deal of choice in Dilnot's proposals. For example, there is no scope for people to pay extra 'hotel' costs to get a higher level of accommodation, yet some people might want, say, a suite of rooms in a long-term care establishment that allow visiting relatives to stay with them overnight. Without this kind of flexibility, people may feel that they need to sink the lion's share of their life savings into completely private options, in order to get the level of service that they and their relatives feel is important.

Dilnot's proposals on long-term care are flexible and intelligent. The challenge for policymakers and the industry is to turn them into a workable system that individuals understand and trust, and that will take many years to accomplish.

Dr Patrick Nolan
Chief Economist, Reform

Time for an honest conversation

With people living longer and birth rates decreasing the population as a whole is getting older. By 2050 it is projected that 22.9% of the population will be aged 65 and over. People are living in retirement longer, living with more complex illnesses and requiring more specialised care towards the ends of their lives.

Yet too many people are unprepared for the costs necessary to live comfortably through longer periods of retirement. Governments are also wary of introducing real reform to age related spending given the influence of older voters in elections. In short, there is a lack of an honest conversation over the real costs of an ageing population and how to address them. This is a gamble as, as the CII has previously argued, in many cases it is not possible to be confident that state benefits will provide a comfortable lifestyle in retirement or cover the costs of long-term care.[55]

This is also not just a problem for people facing retirement but affects younger members of families too. As Aviva has shown, middle aged people (from aged 35 upwards) are increasingly bearing some of the cost of their parents' ageing.[56] Around half of those in this "Sandwich Generation" are providing financial support like contributing to household bills or paying the fees for care homes. Many people in this cohort are also facing the costs of raising children, greater levels of student debt to pay off and lower levels of housing affordability. Too often this financial squeeze comes as a surprise.

The need for an honest conversation over the costs of an ageing population can perhaps be shown most clearly in the case of funding long-term care. The latest instalment in the long running debate on how to fund the costs of long-term care was released in early July 2011 (the report of the Commission on Long-term Care). But we have been here before. In 1997 the Labour Government made reforming the funding of care a priority. A Royal Commission reported in in 1999 and it took until 2009 for the Government to set out options for fundamental reform.

This time the response has to be different. Change has to take place. Without reform long-term care will only become more costly and delay will reduce the time people have to prepare for changes in policy. By proposing a model built around the need for people to take responsibility for their own costs of care the Commission's report makes an important contribution to debate. Yet the proposals it contains are too expensive and will require revision to be seriously considered.

The Commission's report is right to emphasise that people should make provision for their own long-term care needs. There is sufficient wealth held in assets (especially homes) to adequately fund care. These assets should play a part in any funding base. As the Pensions Policy Institute has noted the value of housing wealth owned by people over State Pension Age is already £907 billion and will be likely to increase to £1,274 billion by 2030 (in 2009 earnings terms).[57]

The Commission proposes capping how much people are required to pay towards the costs of their care at £35,000. The idea of capping contributions is right. This would provide greater clarity over entitlements and expectations. It would mean that people could pay for the bulk of the costs of the care that they need but when these costs rise to catastrophic levels the State provides support. This certainty would encourage people to look to vehicles like insurance, annuities and equity release to help manage

[55] The Chartered Insurance Institute (2011), An age-old problem: developing solutions for funding retirement.

[56] Aviva (2008), Understanding the Sandwich Generation.

[57] Pensions Policy Institute (2008), Retirement income and assets: how can housing support retirement?

these costs and make the market more attractive for private providers. But the level of the cap is too low. Increasing the cap from £35,000 to £50,000 would reduce the immediate cost of the proposals from £1.7 billion to £1.1 billion. Going even higher should be considered.

The report's proposals to reform the current means test are also a good start. The current means test operates with a sharp cliff edge so once a person has assets over £23,250 they face the full costs of their care. Again, however, the proposals in the report are too expensive, with people with assets below £100,000 being exempted from some of the cost of their care. This £100,000 threshold is too high and shifting the threshold lower would help reduce the costs of these proposals.

These costs must be reduced as the longer term outlook for the Government's accounts is bleak. As Reform illustrated earlier this year the fiscal time bomb of population ageing is already exploding with the baby boomer generation retiring and the proportion of the population of working age falling.[58] As a result the cost of health and care (before today's proposals) is projected to increase by £40 billion (in today's money) by 2041 and the cost of pensions is projected to increase by £32 billion. Adding the Commission's proposals onto this (projected to account for an additional £3.6 billion by 2025) will mean a total increase of cost around £75 billion a year. This is money that the Government simply does not have.

[58] Cawston, Haldenby, Nolan, Parsons and Trewhitt (2011), Old and Broke, Reform.

Dr Ben Rickayzen, Cass Business School and Professor Philip Booth, Institute of Economic Affairs

Helping customers with new products - will the EU get in the way?

A disability-linked annuity is an innovative product which could be developed within the insurance industry as a means for individuals to help meet their long-term care costs . This type of annuity was acknowledged within the Dilnot Report as being potentially very attractive to consumers (see page 21 of "Summary of responses to the call for evidence" April 2011 and page 40 of the main report). It was also given a high profile in the press following the publication of the Dilnot Report (for example, see The Times on 4th July 2011).

A disability-linked annuity is a special type of annuity where the product is purchased by a policyholder who is in reasonable health at the outset. The key feature of the product is that the income paid increases if the policyholder becomes disabled and, for example, requires long-term care. As such, a disability-linked annuity could be useful in providing for both pension and long-term care needs from one savings "pot".

This policy is an easy one for the insurer to underwrite, unlike conventional disability and long-term care insurance. The reason for this is that the risk that the insurer has to pay the enhancement to the annuity if the policyholder becomes disabled is likely to be negatively related to the risk of the annuitant living for a long time. If the annuitant becomes disabled, their expected lifespan is shorter. As such, the two main risks to the insurer tend to pull in opposite directions. With a conventional disability or long-term care product, an insurance company is very exposed to anti-selection by customers who are poor risks – in order to reduce that exposure expensive underwriting procedures have to be followed. With this product, if a customer were likely to become disabled, they will tend to have a shorter life expectancy.

From the point of view of the policyholder, the annuity enhancement would help to meet the additional care costs associated with severe disability and thereby support any bequest motive. At the very least it would make the amount of any bequest a policyholder is likely to be able to leave more predictable and help in personal financial risk management.

The annuity is also more flexible than a standard annuity since it increases to help meet long-term care costs when required. Indeed, such an annuity could enable the purchaser to receive care in their own home rather than having to move into an institution such as a residential home because it would help resolve the problem of individuals being "income poor and capital rich".

In our research into this product, we also find that the pricing is relatively insensitive to assumptions about how likely policyholders are to become disabled. Again, this is because a poorer disability outlook is likely to give rise to a shorter lifespan. Because of this, the product should be quite easy to price, though the insurer is still at risk from increased longevity in general, or from the development of new treatments that would increase the expected lifespan of those with disabilities.

One rather worrying finding – something that should concern the Dilnot Commission and the government – is that the male/female pricing differential is wider than for a standard annuity. Women should pay more for this product because they have a longer life expectancy, a higher probability of a condition that would give rise to an enhancement of the annuity and also tend to spend longer with that condition when it arises. The recent judgement of the European Court of Justice (1 March 2011) requiring the elimination of male/female pricing differentials could therefore be damaging to this form of product.

To give an indication of how much initial income must be sacrificed from a standard life annuity in order to convert to a disability-linked annuity, we looked at a disability linked annuity that pays £10,000 per annum at the outset whilst the policyholder is in good health, £15,000 per annum if the policyholder fails two of the standard six activities of daily living (ADLs) and £25,000 per annum if the policyholder fails three or more ADLs (i.e. is deemed to require long-term care). Assuming that the annuity increases in line with price inflation, we estimate that a male aged 65 would need to pay around 10% more for the disability-linked annuity than for an index-linked standard annuity paying £10,000 per annum. This extra premium is, perhaps, surprisingly low given the high level of disability benefits being provided. The reason for this is that individuals who are healthy at outset are expected to spend relatively short periods in a state of moderate or severe disability in the future. Furthermore, such periods will tend to be at the end of the individual's life and therefore the annuity enhancements will be heavily discounted.

So, what needs to be done? Firstly, as noted in the Dilnot Review (and in an earlier paper by one of the authors of this article), the tax treatment of disability-linked annuities needs to be clarified before insurers undertake work in product design. It is important that the pension fund tax regime is not a barrier to the marketability of the product. It is especially important that such annuities can be bought with the proceeds of pension funds, for example. It would be helpful if defined benefit pension funds could offer them too. Insurance companies might then wish to examine and market variants of these products. It is also possible that they could be combined with those forms of equity release product that provide annuities. But, all this work could be wasted if the products were strangled at birth by the recent ECJ ruling. Given that the market in these products has not really got off the ground, insurers may not be aware that this is likely to be an issue. It is difficult to imagine what good can come from the sex discrimination ruling if it prevents the development of a product that could allow people to insure for long-term care cheaply and easily and receive care whilst continuing to live in their own homes.

Conclusion and CII view

Dilnot's recommendations are a good start – setting out a fairer approach to the funding of long-term care which will, if implemented, help prevent self-funders spending the majority of their assets on paying care home fees. The proposals would also provide improved incentives for the development of financial products such as immediate needs annuities, and could lead to greater demand for financial advice as the cost of care becomes clearer. However, on its own a new funding model cannot resolve the chronic problems of a lack of consumer awareness and engagement which will, if left unresolved, deter people from adequately protecting their assets through financial services as they grow old. From the CII's perspective, there are three areas in particular where more effort must be made to reverse these detrimental behavioural trends.

- **Political consensus** on the long-term care funding model is crucial. Government and opposition must do their best to provide certainty about future rules – making cross party support for the eventual settlement vital. People cannot be expected to effectively plan for the future without a stable environment in which to operate.
- **Trust** is a key issue and the industry must embrace reforms such as the Retail Distribution Review (RDR) which is aimed at improving levels of confidence around financial services and products. There is a concern however, that without actively publicising the RDR's aims and successes, the project will pass unnoticed by the public. Recent CII research found that just 20% of adults were aware of the RDR but once informed were more likely to consider seeking financial advice.[59] Those with an interest in raising the level of consumer trust and engagement must therefore do more to improve public awareness about efforts to professionlise financial services.
- **Education and easy access to understandable information is also important**. In this regard, we would reiterate our earlier call for a government–led education campaign and back Dilnot's proposals in this area.

There is general consensus that the current funding system is outdated. Now all interest groups must ensure that the momentum for reform created by Dilnot is sustained, and a new lasting settlement formed, which delivers much improved financial security and peace of mind for our elderly.

[59] CII Issues Paper (June 2011) **Financial Capability: The Money Advice Service and Educating the Public on the RDR**

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