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findings

INFORMING CHANGE

Options for financing private long-term care

Long-term care provision in the United Kingdom has been the subject of much debate and analysis over the past decade, yet the issue of how to fund the cost of that care for future generations remains unresolved. Much of the debate has revolved around how the State should address the problem. As a consequence, the general public are unsure as to where their responsibilities and liabilities lie. There is a perceived unfairness around the current system which leaves significant financial responsibility resting with the individual above basic income and asset levels. Sandy Johnstone has reviewed the current options:

- Insurance plans designed to cater for the cost of care in later life have not been popular. As a result, most insurers have now withdrawn from this market.
- Investment-based plans have failed to maintain protection levels and have now also been withdrawn from the market.
- Annuities specially designed to fund care fees and which recognise reduced life expectancy do provide a solution for some, but access to advice at a time of crisis may be difficult.
- Equity release or lifetime mortgages are popular but are not being used as a way to fund care.
- The current pensions 'crisis' bears many of the same hallmarks as those relating to long-term care planning.
- As with the Pensions Commission Report, there does not appear to be one single solution to the problems surrounding long-term care. A combination of measures may be more likely to succeed.

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Background

Long-term care insurance has been available in the UK for ten years. However, take-up has been lower than expected. Many reasons have been given for this: insurance products have been seen as complex, expensive and representing poor value for money. Until October 2004, their sale was unregulated and potential purchasers may have felt that products were unsafe. In addition, there was considerable uncertainty over what the State will provide. In 2004, the main providers of such insurance withdrew most of their products.

This study looks at why recent products have not worked and what possible future options might be, in particular for a public-private partnership between insurers and the State.

Existing products

Until 2004, four main options were available (see below). Apart from 'point of need' plans, the sales levels and the price of these options leave little doubt that they were unpopular. Virtually all the main insurers have withdrawn from the pre-funded market. Pre-funded long-term care insurance in its present form is not likely to help form a platform for self-provision for care of older people in the UK.

Insurance plans

Insurance plans paid a benefit when the policy-holder could no longer perform a number of Activities of Daily Living (ADLs). An annual benefit was selected at the start of the plan. Premiums were payable on a regular or lump sum basis. The insurer could review these premiums after an initial period or when the policyholder reached a predetermined age. So, while initial costs were known at the outset, future premiums could rise to become unaffordable. Some providers did guarantee rates, but only after age 75. Only one company currently provides this form of insurance in the UK.

Investment-based plans

These were intended to provide a lump sum, or return of capital, over and above the protection element of the plan. Due to recent market performance, these plans have failed to deliver the originally forecast returns. As a result, most policyholders must invest more to bolster their plans back up to their previously forecasted levels or accept a substantially reduced level of protection. All such plans are now unavailable.

Conversion policies

This option was tacked on to a mainstream protection policy such as a critical illness or a 'whole of life' plan. It is difficult to determine how many of these plans might ultimately be converted. Although sales were high, they are unlikely to evolve into measurable sales of long-term care insurance in the future. This option is now unavailable.

Immediate needs annuities plan

This covers the actual funding of care required immediately, say on discharge from an NHS bed and a move to residential care. This plan is described as a 'point of need' annuity and is the only one where sales growth is evident. These annuities offer enhanced rates because the purchaser has a lower life expectancy. An annuity is purchased and the income is paid gross, if it is paid directly to a service provider, normally a care home. It is extremely uncommon for such a plan to fund domiciliary care as usually the sale of the family home buys the annuity. Some funds may be retained after the annuity has been purchased, so as to produce extra income whilst the annuitant is alive and an inheritance for the family on death. This option is still available.

Alternative products

These could provide acceptable alternatives to the options described above. They would require some form of public/private partnership to fully protect the individual.

Insurance plans

- ***Insurance for the later years of dependency*** This plan would work on a deferment period, say 104 weeks (significantly longer than that of around 13 weeks incorporated in standard plans). This might prove to be attractive to the public, if there were some form of State protection at the early stages of disability. Premiums for this modified plan would be about half the cost of the standard form of insurance.

- ***Insurance for a limited period of disability*** This could reverse the deferment period, with the insurer dealing with, say, the first 104 weeks of disability leaving the State to deal with the costs thereafter. This model is the least expensive with premiums being around 70 per cent cheaper than the standard plan.

Some issues would have to be overcome if the private sector insurance plans were to compliment State provision perfectly:

- Insurers use ADLs as the gateway to benefit entitlement whereas the State uses a Single Assessment Process (SAP), applied with local variations around the UK.

- Insurers restrict cover in relation to cognitive impairment to that which has an organic basis.

- Insurers review premiums after a period of time, based on claims experience and investment conditions. This might not be acceptable in a public/private partnership designed to provide complete protection for the future.

- Insurers underwrite cases on an individual basis: those who do not represent a normal risk will either be charged higher premiums or will in some cases be declined. Unless such insurance were compulsory, insurers would not be prepared to accept all cases at a standard premium level.

In its current state, it is difficult to conceive of a national public/private partnership insurance deal evolving from such a small market. Initial discussion with some representatives from local authorities suggests that extensive consultation and planning would be needed before a seamless structure could be evolved.

Lifetime mortgages

There is very little evidence of people using 'lifetime mortgages' to pay for care or for long-term care insurance. The challenge of persuading homeowners to use home equity to help pay for care is considerable. Domiciliary care could be funded through a lifetime mortgage, but the prospect of residential care being needed later may deter individuals from this option. In addition, the implementation of a lifetime mortgage could result in benefits being curtailed.

There is the potential to link lifetime mortgages with point of need plans to provide funding, especially for domiciliary care and for the installation of ramps, grab rails and stairlifts etc.

For those facing an immediate need for care funding, there could be a much stronger role for lifetime mortgages. Re-examination of benefit entitlements would greatly assist in this area: much of the target market will be in the asset-rich, cash-poor sector of society.

Pension products

The concept of pensions converting into long-term care benefits is fine in theory, but in reality most people would put this option very low on their priorities, especially if their basic pension was modest. However, for those who have secured a relatively good pension, a facility for accelerated benefits in the event of long-term care being needed could be helpful, especially if the accelerated element could be paid gross.

Compulsion

The public's track record in voluntary planning for future care costs is very poor. Past history has shown that the public does not perceive long-term care insurance as an acceptable solution, so any form of voluntary scheme is unlikely to succeed. Various bodies have proposed that an element of compulsion is required. This approach has been considered but not adopted by Government.

It has been suggested that any form of compulsion - whether through direct taxation, hypothecated tax, or a national care insurance scheme - would be regarded as another form of 'stealth' tax. However, the current system leaves only the unfortunate to pay for their own care. Whether we describe the individual contribution to the risk pool as a premium (similar to any other form of insurance) or as a tax is really academic.

In 1996 the JRF Inquiry into the Costs of Continuing Care proposed the creation of a form of national care insurance, with contributions being made by all working people up to the age of 65. A prime concern expressed was that a National Care Insurance Plan would require a double contribution from younger people; they would not only be funding future care but current care. The possibility of phasing-in the scheme does not appear to have been reviewed. If such phasing could be achieved, whereby current and imminent care costs could be funded as they are now with future care being addressed by the new model, this approach may be considered more generally acceptable.

The consumer perspective

With no advice or direction available either from the State or from the Financial Services Industry on how to plan for future care costs, consumers must make 'uninformed' decisions. They will almost certainly decide to wait and see and to hope for the best.

There is a need for a system of intervention which ensures that residents and their families have the opportunity to make 'informed choices' over the funding of care home fees. The entire care market would stand to benefit: state funding would be conserved, local authorities would avoid the difficult issue of dealing with top-ups, and some inheritance would have been conserved for future generations.

Point of need annuities provide an example of what might be done. Although sales are relatively low, these annuities are nevertheless providing a reasonable funding solution for care home fees. Discussions with local authorities, however, reveal that self-funders regularly find that their

funds have run out and then turn to the local authorities for financial assistance. This finance from local authorities could be saved if the residents of care homes received professional financial advice at the time of entering a home. From a local authority perspective, the problem is that they will never see the residents at the point of entry to the home. Care home operators do not envisage their role to be the educator either. There is a need for the care industry, the financial services industry, and government departments to work together.

The researcher makes the following recommendations:

- The Pensions Commission could address cost issues arising from the potential need for long-term care. This might include the concept of accelerated tax-free pension benefits being paid when the need for long-term care arises.
- The Government should highlight clearly the need for people to plan for their future care requirements in old age.
- Care users and their families urgently need adequate support and guidance to help them navigate their way around a very challenging and complex system.
- The regulation of insurance plans by the Financial Services Authority is welcome. However, the insurance industry needs both reassurance that their role is endorsed by the public sector, including government, and encouragement to reintroduce forms of long-term care insurance which provide consumer confidence.
- The concept of a public/private partnership, where an initial period of disability might be covered by private insurance with the State providing a safety net thereafter, could be investigated further. The key issues are the need for a seamless link between both partners and sustainable public finance over the long term.
- If public/private partnerships are to be developed for care planning then common assessment tools are needed to determine when benefit entitlement is triggered and to ensure it is consistent.
- Immediate needs annuities and lifetime mortgages could play a key role. Regulation may hamper the clear dissemination of information of such plans; the Financial Services Authority could identify simple methods by which this might be achieved.
- Various tax disincentives and benefit entitlement issues need to be addressed to ensure that the public do not suffer financially as a result of accepting personal accountability for their care costs. This has particular relevance where lifetime mortgages are being deployed to generate care funding.

The researcher concludes that the government should seriously consider introducing a form of compulsory provision. Introducing this in a phased manner could avoid the prospect of some of the population having to pay for the current generation of people in care as well as for the future funding of care.

About the project

This review was written by Sandy Johnstone of Careful Decisions Ltd. The full discussion paper examines in detail the financial services options which have been available to individuals as routes to pay for their care over the last ten years.

For further information

The full report, **Private funding mechanisms for long-term care** by Sandy Johnstone, is published by the Joseph Rowntree Foundation (ISBN 1 85935 351 7, price £9.95).

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