

# Who Cares?

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

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## Summary

The Commission on Funding of Care and Support (the Dilnot Commission) is due to set out its final recommendations in early July, to overhaul the way long-term care is funded in the UK. In advance, this short paper assesses the possible implications for consumers and financial services of a likely new partnership model.

Our central argument is that whilst the new model is likely to address many of the **fairness** issues associated with the current system, **engagement** problems will still persist. This could have serious consequences for consumers by preventing them from building and preserving their wealth in the most effective way. For example, many individuals will still need to consider using assets to fund long-term care in the 'new world' even though many appear to be reluctant to using their home as a means to fund this cost. It is therefore essential that people plan in advance in order to minimise losses on non-pension assets.

To counteract this lack of engagement we set out the following recommendations:

- 1. Education** is key to winning the battle to raise awareness - currently nearly **8 in 10** people have no idea how much they will have to pay for care. The Money Advice Service will be able to help in this regard but the Government should do more. A large scale information campaign about the need to save for retirement and plan for long-term care costs may help to close the perception gap and ultimately lead to less people falling back on the state for support. Industry and consumer groups will also have vital roles to play in informing consumers **appropriately** about the options that are available to make the process of paying for care less painful.
- 2. Trust:** Just providing more information will not be sufficient to improve engagement with financial services and the private care sector. Consumers must have trust that the products and advice that they invest in will deliver outcomes in line with their preferences and future expectations. This will be a challenge given the complex empirical relationship between disability and longevity, making predictions around future care needs harder to model than life expectancy. Similarly, many customers will continue to buy products related to long-term care as a 'distress purchase'. Providers and distributors must continue to work hard to develop and deliver products to consumers with due care and attention to these additional sensitivities.
- 3. Certainty around future rules:** For the private sector and consumers to be able to plan effectively for the future, they must be confident that the funding model the Government ultimately chooses will be here to stay. Government and opposition therefore must do their best to provide certainty around future rules – making cross party support for Dilnot's recommendations vital.

The Commission's proposals are likely to provide the building blocks from which a new and fairer system can emerge. Without improving levels of engagement however, the public could still be left 'out to dry'. It is not enough just to have a new public policy vision for care – it must be backed by the government, consumers and the relevant private sector and voluntary sector partners. Only then will we have a Beveridge-style plan for the 21<sup>st</sup> century.

# Long-Term Care: Defining the Problem

## Longevity

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.<sup>1</sup> 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 to 23 percent<sup>2</sup>.

As longevity increases, the proportion of people who are very old will grow the fastest – with the number of people over 90 expected to nearly treble over the next twenty years. As a result of this trend, 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.<sup>3</sup>

### Box 1. The relationship between longevity and disability

As noted in a recent paper published by Saga<sup>4</sup>, there has been much debate over whether an increasing proportion of older people will mean greater demand for long-term care. One report found that of thirty-two different studies of people aged at least 55 in high-income countries, only six found evidence of disability rates increasing, compared with twenty six which found disability rates to be decreasing. 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<sup>5</sup>. These studies suggest that disability rates may not therefore remain constant. If tomorrow's elderly has led a healthier life than today's, then disability rates may actually fall rather than rise.

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<sup>6</sup> and many care homes are significantly more expensive (some surveys have estimated that average costs are closer to £35,000 rather than £26,000). It is also difficult to predict the cost of care home fees going forwards. 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 grow.

## 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 in most cases, the value of any property owned will be included. There are important exceptions to this rule such as if there is a surviving spouse living in the house or if the home owners alter the terms of ownership of the property<sup>7</sup>. There is also state support which can amount to a maximum of £71.40 per week<sup>8</sup> in Attendance Allowance and a Registered Nursing Care Contribution of £108.70<sup>9</sup> per week to help cover nursing home fees. Nevertheless, even with these additional forms of State support a large proportion of the population are expected to cover a substantial chunk of the costs of long-term care.

The current funding model has come under significant criticism for providing too little support for those with only modest wealth with many losing a significant proportion of their assets when paying for long-term care.

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

<sup>2</sup> Ibid

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

<sup>4</sup> M. Weston, E. Winpeny and J. Manning (June 2011) *Take Care: The Future Funding of Social Care*

<sup>5</sup> Ibid

<sup>6</sup> The Commission on Funding of Care and Support (Dec 2010), *Call for evidence on the future funding of Care and Support*, p.8

<sup>7</sup> Emma Simon (July 2009), *Long Term Care: How to Beat the Meanest of Means Tests*, Telegraph

<sup>8</sup> Figures obtainable from DirectGov website:

[http://www.direct.gov.uk/en/MoneyTAXAndBenefits/BenefitsTaxCreditsAndOtherSupport/Disabledpeople/DG\\_10018710](http://www.direct.gov.uk/en/MoneyTAXAndBenefits/BenefitsTaxCreditsAndOtherSupport/Disabledpeople/DG_10018710)

<sup>9</sup> Brownlow Wealth Management Ltd (April 2010), *Factsheet: Registered Nursing Care Contribution*

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Research from the Local Government Intelligence Unit has found that 25% of self-funders run out of money and ultimately fall back on the state to support their care needs<sup>10</sup>.

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.<sup>11</sup>

### 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

- **Prefunded Long-term care insurance (LTCI):** A pre-funded insurance plan involves 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 providers 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 home owner. The most popular product is Fixed Interest Lifetime Mortgages, 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.
- **Home reversion schemes:** Another type of equity release product where 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.

### Barriers to private sector solutions

Whilst the above products exist, take up has been relatively low – particularly for prefunded schemes. James Lloyd argues that 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.<sup>12</sup>

**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<sup>13</sup>.

**Trust** of financial services in general is pretty low. The decline in levels of trust was well documented in a survey undertaken by the CII in late 2011 which found that one in five respondents will never trust financial

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<sup>10</sup> J. Carr-West and L. Thraves (March 2011), *Independent Aging: Council Support for Care Self-Funders*, Local Government Intelligence Unit, pp.7-8

<sup>11</sup> See our report - Chartered Insurance Institute (May 2011), *An age-old problem: developing solutions for funding retirement*

<sup>12</sup> James Lloyd, (February 2011), *Gone for Good? Pre-funded Insurance for Long-term Care*, The Strategic Society Centre

<sup>13</sup> 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>

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services again and 72% of people have not very much trust or no trust at all in financial advisers and life insurance providers<sup>14</sup>.

Therefore, when delivering a future funding model which is not free at the point of use, the Government and industry must address both the **fairness of the system** and the **barriers** that exist to prevent people from seeking private sector solutions.

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<sup>14</sup> CII (February 2010) *What we talk about when we talk about trust*, p.12

## Dilnot: towards a new partnership

The Commission on Funding of Care and Support (the Dilnot Commission) was set up by Government as an independent body to make recommendations on 'how we can achieve an affordable and sustainable funding system for care and support'.

Whilst the Commission is yet to publish its final recommendations there are strong indications as to what the new funding model will look like and its **Call for Evidence** sets out its four main aims:

1. People should have the **opportunity to be protected** against the future cost of care and support
2. People need to **understand** how the care and support system works and be encouraged to plan accordingly
3. People need to be **clear** about the **role of the wider system of public support** (including the NHS and social security)
4. Increased resources – **public, private and voluntary** – will need to be dedicated to care and support in the future.

The four aims allude to a system which is easier to understand and where the private and the public sector will have crucial roles to play in funding care.

The Chair of the Commission (Andrew Dilnot) was recently interviewed by Saga Group Director General Dr Ros Altmann<sup>15</sup> in which he reiterated and developed some of these ideas. Within the interview he made clear that the contribution of the public sector towards paying for care would need to rise:

***“My own view is that the system we have at the moment is as ungenerous as it could be – I can’t imagine less state funding.”***

However Dilnot noted that people would have to take individual responsibility for paying for care and that assets such as property could be used as a way of covering the costs.

***“I don’t think it is unreasonable to expect people to pay something towards the cost of their care. After all, it seems to be accepted that we may use our house to pay for part of our pension needs.”***

Dilnot also revealed that the Commission was considering a cap on the contribution that anyone could make towards the cost of care.

***“That’s one of the ideas we are looking at...A scheme like that would be one way of balancing responsibility between individual and state.”***

It appears then that the Commission is moving towards a new partnership model, where the State provides a greater proportion of funding, but where it is clear that individuals must also contribute. In this 'new world' individuals would not be penalised so severely for accumulating savings and assets in advance of retirement. By providing certainty around these new rules, Dilnot believes the private sector will be more willing to engage in the funding of long-term care:

***“[As things stand] the financial services industry can’t really provide cover in this area because the uncertainty is too great. So what we are looking for is something between those two [privately funded and fully state funded].”***

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<sup>15</sup> R. Altmann and A. Dilnot, (7 June 2011), *The Shape of Future Care*, Interview with Andrew Dilnot: <http://www.saga.co.uk/ros-altmann/care/the-shape-of-future-care.asp>

***Something which, by changing what the state does, makes it easier for the private financial sector.”***

### **New funding models**

In 2010, the Kings Fund set out a partnership based model which broadly meets the Commission’s criteria. They proposed that all those in need of care have 50% of their basic needs funded by the state. Co-payments would pay for the remainder, with every pound matched by a pound from the state ‘until the benchmark care package is achieved’. The maximum the state would have to fund is 67% of an individual’s basic care needs.<sup>16</sup>

It now looks likely that the Commission will not opt for the above and instead decide to put a cap in monetary terms on the amount that people must contribute towards their own care at around £50,000. This would represent an increase in the proportion of care paid for by government and should provide more certainty about what individuals must pay. However, whether the recommendations will be enacted by government at a time of austerity remains to be seen.<sup>17</sup>

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<sup>16</sup> R. Humphreys, J. Forder and J. Fernández (2010), *Securing good care for more people: Options for reform*, The King’s Fund

<sup>17</sup> P. McMillan (June 2011) *Fears Govt could reject Dilnot’s radical LTC cost cap*

## Engagement in the ‘new world’

Engagement in the new world will be crucial if people want to preserve their assets and find the right solutions to their funding needs. An example of this is the use of property to fund care. Property is likely to remain a big part of the funding picture after Dilnot even though the majority of the public appears to be against using property to meet this cost. Early engagement on this issue is therefore crucial if individuals wish to avoid losing a proportion of their non-pension assets. This chapter begins by reflecting on the issue of property after Dilnot, before reviewing consumer research<sup>18</sup> in an attempt to understand how changing the funding system is likely to impact upon levels of awareness and engagement.

### Private finance

#### Using assets

Whilst some of those surveyed in an ICM BBC poll were already expecting to use their property to fund care, 80% of all respondents thought that it was unfair to have to fund basic care through selling their home<sup>19</sup>. However, as discussed above, it appears that Dilnot believes that property should be an important contributor in paying for care going forward. Individuals may therefore continue to have to factor in their assets as a means of paying for long-term care when pension income and savings are not sufficient. The public - with the help of advice from Government and the private sector - will need to understand how to plan ahead if they wish to minimise losses on assets such as property.

#### Box 2. Assets will remain part of the picture

Our analysis of the situation for individuals entering retirement suggests that many may well have to use assets to pay for long-term care even if the Dilnot Commission's recommendations are implemented. Currently the average UK pensioner gets a retirement income of £9,702 per annum<sup>20</sup> which would equate to £171,000 over an 18 year period (average life expectancy for a man aged 65). Whilst this is far below what the OECD would consider an adequate replacement rate<sup>21</sup>, for the sake of simplicity we assume that this income is just sufficient to cover day to day living expenses and nothing more. Supposing the individual then needs to go into a care home for four years. Assuming that they have assets worth over £23,250 this would mean that they would have to pay care home fees of up to £104,000 (assuming costs of £26,000 per annum for a care home). Their pension would cover some of this cost but not all - the end result being that they would have to **fund at least £65,000** through non-pension assets or insurance (this calculation does not factor in registered nursing allowance or attendance allowance).

Now supposing the Dilnot Commission opts to **cap** the amount that the public can contribute to care to around £50,000. Presumably 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 these costs on its own and would leave an individual with a shortfall of at least **£30,000** which may need to be met through non-pension assets or insurance.

It is worth stressing that the above assumptions about the adequacy of average pensioner income to cover costs before care and the total cost of a care home are relatively optimistic. The reality is that for many, £9,702 will not be enough to live off day to day and so pensioners may be building up debts or using 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 greater.

#### Buying insurance

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 Londoners and was therefore not representative of the nation as a whole). Over half the respondents agreed that ‘matched contributions’ from

<sup>18</sup> For a comprehensive review of all consumer research on long-term care see: Ipsos Mori (Feb 2010) *Public opinion research on social care funding*: A literature review on behalf of the Commission on the Funding of Care and Support

<sup>19</sup> ICM and BBC (2010) *77% 'oblivious to social care cost'*  
<http://www.ageuk.org.uk/latest-news/archive/77-oblivious-to-social-care-cost/>

<sup>20</sup> OECD (2009), *United Kingdom: Highlights from OECD Pensions at a glance*

<sup>21</sup> The OECD defines an adequate retirement income as equating to 70% of pre-retirement income. A retirement income of around £10,000 amounts to a replacement rate of just over 30%.

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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<sup>22</sup>.

The Kings Fund model of provision would reward people through copayments when individuals make a private contribution towards the cost of care though it remains to be seen whether Dilnot will recommend something similar. Nevertheless, by simply providing more certainty around what individuals must pay, 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 the new rules will last if they are to effectively plan ahead.

### Awareness of the cost of care

One consumer survey found that **nearly eight in 10 people** have no idea how much they will have to pay for care in old age<sup>23</sup>. 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.<sup>24</sup> 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.<sup>25</sup>

*Will the new model close this perception gap?*

The new 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 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.<sup>26</sup> 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.<sup>27</sup> Perhaps these results are unsurprising given that many individuals believe the state will foot the bill when they need care. The new funding model may help in this regard by setting a **clear limit** on what an individual need 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** suggests that a quarter of the population have no idea who to contact for advice. Only 11% said they would contact their local authority while **just 4% said they would contact a financial adviser**.<sup>28</sup>

### Some tentative implications

In short, the new approach may provide improved incentives for people to consider funding long-term care in advance and become better informed about the costs that they may face. 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 will remain massive engagement challenges and if, as consumer research suggests, people are not willing to use their house to fund care, then they must start planning now for how they can minimise overall losses on non-pension assets.

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<sup>22</sup> CELLO mruk Social & Market Research (2009) *Cost and Provision Adult Social Care Survey*  
Prepared for London Councils

<sup>23</sup> ICM and BBC (2010) *77% oblivious to social care cost*

<sup>24</sup> Local Government Association (March 2009) *Call to make the care of our ageing population a priority for all political parties*

<sup>25</sup> Department of Health/Ipsos MORI (2010) *Public attitudes towards care and support*

<sup>26</sup> 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*

<sup>27</sup> ICM and BBC (2010)

<sup>28</sup> Partnership (2010) *Over 50s drastically under estimate the cost of long term care*

## Challenges for Government and industry

Dilnot's recommendations are likely to represent a significant shift of direction in the funding of long-term care. The Government and industry will need to build on this start to ensure more individuals actually seek advice on care and plan in advance. **Education** is key to winning the battle to raise awareness and the Money Advice Service can help in this regard but the Government can also do more. A large scale information campaign about the need to save for retirement and plan for long-term care costs may help to close the perception gap and ultimately lead to less people falling back on the state for support. Industry and consumer groups will also have vital roles to play in informing consumers **appropriately** about the options that are available to make the process of paying for care less painful.

However, just providing more information will not be sufficient to improve engagement with the financial services industry. Consumers need to be able to **trust** that the products and advice that they invest in will **deliver outcomes** in line with their preferences and future expectations. This will be a challenge given the risks associated with ill health later in life, which are likely to be harder to model than future longevity. Similarly, many customers will continue to buy products related to long-term care as a 'distress purchase'. Providers and distributors must therefore work hard to deliver products to consumers with due care and attention to these additional sensitivities.

But for consumers and the private sector to be able to plan effectively for the future, they must be confident that whatever funding model the Government ultimately chooses, it will be here to stay. Government and opposition must therefore do their best to provide **certainty around future rules** – making cross party support for Dilnot's recommendations vital.

The Commission's proposals are likely to provide the building blocks from which a new and fairer system can emerge. Without improving levels of engagement however, the public could still be left 'out to dry'. It is not enough just to have a new public policy vision for care – it must be backed by the government, consumers and the relevant private sector and voluntary sector partners. Only then will we have a Beveridge-style plan for the 21<sup>st</sup> century.

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