Institute
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How financial products can work alongside the Care Act 2014 to help people pay for care

An Overview

By the Products Research Group of the
Pensions and Long Term Care Working Party

10 December 2015

Contents

Information on authors

This paper has been written by members of the Products Research Group of the Pensions & Long Term Care Working Party of the Institute and Faculty of Actuaries. The members are: Thomas Kenny (Chair), Jerry Barnfield, Linda Daly, Ailsa Dunn, Dave Passey, Ben Rickayzen and Audrey Teow.

Acknowledgements

We'd like to thank Rebecca Deegan, Steven Graham, Alison O'Connell and Sue Elliott for their help in putting the paper together.

Executive summary

In May 2014 the Institute and Faculty of Actuaries (IFoA) published 'How pensions can help meet consumer needs under the new Social Care regime'.[1] Since that report was produced, the Government has delayed the implementation of Phase 2 of the Care Act until 2020, which included the introduction of a *cap* on care fees of £72,000. The Government is looking to the pensions and insurance industry to help people make provision for the potential costs of *long term care*[2] *(LTC)* and other later life contingencies.

The Government has stated that it remains committed to implementing the *cap* and our intention is that this analysis will help the Government to use this delay to ensure these reforms meet the policy intention of protecting people from catastrophic care costs and facilitate individual understanding of their potential care funding requirements. In particular, we have set out to review options for product development and we have produced case studies to demonstrate the complexities of the care funding system. In addition, we have reviewed the potential impact on incentives for individuals to save for care costs.

In addition to the delay of Phase 2 of the Care Act, the *freedom and choice* agenda for pensions has come into force. It is therefore timely that we review potential market responses to help people pay for their care within the new pensions environment.

In Section 1 we provide a summary of the new pensions framework.

In Section 2 we provide an update on products covered in the previous report in light of the new pensions framework. In addition, as pensions are likely to be only part of the solution to meeting LTC costs, we have included non-pension products that could be used to fund care needs.

In Section 3 we have set out a number of scenarios to illustrate the impact of the new system of funding for social care costs for a series of individuals before and after they reach the *cap*, including an example of the interaction with the *universal deferred payment scheme* (UDPS).

In Section 4 we consider the interaction between additional savings and the impact on benefits paid under the means test to explore whether the means test thresholds might encourage, or act as a barrier to, saving to meet potential care costs.

Conclusions and recommendations

Conclusion 1: It is still too early to understand exactly how individuals will respond to the pensions freedom and choice agenda

It is not clear yet whether individuals will ring-fence funds to meet potential future care costs as this is not in keeping with the new flexibilities. However, there are a number of products that might complement the new flexibilities and help people make provision for care costs:

- products that are already in existence in the UK, such as income *drawdown* and equity release
- products that have had success in other countries, such as protection insurance; and
- new products, such as Disability-Linked Annuities and Care ISAs.

[1] The previous report can be found on the IFoA's website - http://www.actuaries.org.uk/research-and-resources/documents/how-pensions-can-meet-consumer-needs-under-new-social-care-regime-0

[2] Words in italics are defined in the glossary

Recommendation: A joint Government and industry approach to collecting data on how people are responding to the new system will help to assess whether education, the use of defaults, or incentives for long term care products, such as tax relief and employer contributions, could be effective in helping people to use their savings to meet care costs.

Conclusion 2: The new care funding system is complex making it difficult for people to understand their potential care costs

We have set out three case studies that show how care costs are determined both before and after the *cap* is reached for a range of circumstances. The case studies highlight the large number of factors that a person will have to consider should they need to enter residential care.

For example, there can be complexity in the calculation of an individual's contribution to care costs. There are three components - daily-living costs, Local Authority set care costs and any *top-up* costs. The calculation of a person's State support is also complex, not only because of the way the *means testing threshold*s work, but in taking account of the *Attendance Allowance*, *personal expense allowance* and the *NHS-funded allowance*. How a person's housing and savings are counted towards the means test is also impacted by whether their partner will continue to live in the house once they enter care as well as whether they decide to remain in their own home whilst receiving care. Finally, the individual will have to work out how they will combine their State Pension, private pension and any other private savings with their housing wealth to meet their care costs.

Recommendation: A national awareness raising campaign that helps people to understand what their potential care costs might be, what State support is available and possible products that might protect them from having to make a decision at the point of crisis.

Conclusion 3: The current means testing system is a disincentive to saving. The new means testing thresholds provide a greater level of reward for savers than the existing thresholds, and may increase the level of saving for care, but they could still act as a barrier

Individuals with assets of up to £110k at the point of entering care can expect their contribution to care costs to increase as they save a further £10k. This is most significant for individuals with between £20k and £40k[3] of assets at the point of entering care. For these individuals, under the current system, they will lose 80p in means tested benefits for every extra £1 saved. The increase in the means testing thresholds will reduce this amount to 50p for every extra £1 saved.[4]

This means that for individuals likely to have assets between £20k and £40k at the point of entering care there is a limited incentive to saving at any stage before going into care, should the individual consider it likely that they will need LTC. Any additional money put aside could lead to an increase in the amount that the individual has to contribute to their care costs with no change in the cost or quality of care received. This is because the additional savings replace the Local Authority funding that would have been provided under the means test.

[3] Figures are given in nominal terms
[4] This is based on the increase in personal contributions over a 3 year period from having an extra £10k in assets due to saving an extra £10k

Recommendation: To help incentivise people to save one solution could be to create a new product, or category of products, that allows savings to be exempt from the means test up to a specified threshold. This cost could be met by removing existing loopholes for investment bonds and life assurance products in the financial assessment, as these products can allow a person to qualify for financial help whilst having significant assets saved. New exempt products designated for long-term care saving could both encourage individuals to plan for the risk of needing long-term care, and fund care needs more fairly than the current rules allow.

Section 1: The new pensions framework

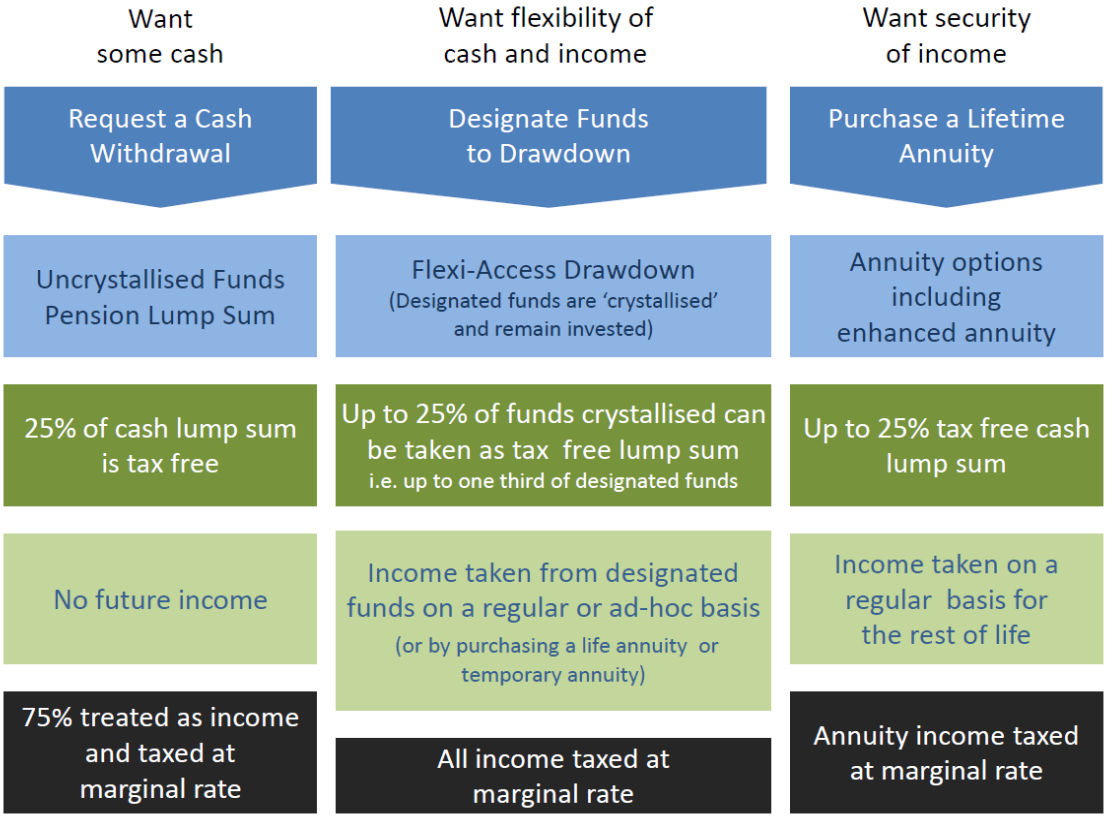
1.1 The Taxation of Pensions Act (2014)

The Taxation of Pensions Act (2014) introduced significantly greater flexibility in how individuals can take their *defined contribution* (*DC*) pension and removed the requirement for individuals to buy an *annuity*.

From 6 April 2015, the legislation allows individuals to access as little or as much as they want from their *DC* funds once they have reached normal minimum pension age (usually age 55). This means that individuals have the choice of

- taking their funds as an income for life, for example by purchasing a lifetime annuity, or
- accessing their funds flexibly, crystallising as much of their *DC* funds as they wish, whenever they like; or
- they can do a mixture of both.

Figure 1: The new options available for individuals over 55 from April 2015



If an individual accesses their *DC* funds flexibly they will be restricted in the amount of contributions payable thereafter. Flexibly accessing their funds will trigger new 'money purchase *Annual Allowance* rules' with an *Annual Allowance* of £10,000 limiting the amount of tax relief they can get on future contributions made to any money purchase arrangement.

Whilst the new legislation facilitates significantly greater flexibility in the way *DC* Funds can be accessed, a significant number of contract-based and trust-based pension schemes are not making the new flexibilities available within the scheme. The Government wants to ensure that people can access the new pension flexibilities easily and at reasonable cost by transferring their DC pot to

another pension scheme. HM Treasury are currently consulting on pension transfers and early exit charges.

1.2 Market Reaction

It is still too early to understand exactly how individuals will respond to this new environment. However, in looking at the products which might complement the new pensions flexibility, it is helpful to consider the possible market reaction.

- Initially, the removal of the requirement to annuitise *DC* pension saving could discourage individuals from buying any alternative products which, like an *annuity*, involve a permanent commitment of funds
- If consumers are reluctant to buy *annuity* style products, this would mean that products funding LTC would either need to retain the newly provided flexibility or significant incentives would need to be offered to overcome this additional resistance
- Incentives to overcome any aversion to commit funds permanently are unlikely to be commercially viable for product providers; they are more likely to be achievable through tax incentives

In the longer term, the demand for more structured products may re-emerge if people experience the difficulties and risks of managing their own funds during the decumulation phase. It may be that individuals will use annuities but, rather than buying them immediately upon retiring, the purchase may be deferred until later in retirement.

1.3 Accessing pension benefits

The potential opportunity to cash in existing annuities should a secondary *annuity* market be created, or should it become straightforward to convert *defined benefit* (*DB*) to *DC* arrangements, could help to facilitate the funding of LTC costs. The ability to replace a fixed level of income with a lower immediate income, together with a reserve fund that can be used flexibly to meet potential future contingencies could allow those who have lower immediate spending requirements to prepare more easily for potential LTC costs. However, this approach gives rise to many potential issues, including:

- the risk of selection by those taking the cash option;
- the assumptions on which the income stream would be valued; and
- the costs of the exercise in preparing the options for the individual.

It is likely that in order to minimise the selection risk, providers would need requests to transfer funds to be *medically underwritten*. This would increase the cost and the time taken for the process to be completed, as well as meaning that annuitants would need to make the decision to sell when they are still in good health, so as to ensure that they have the necessary funds to meet their LTC costs should they need it. If they miss this opportunity there could be no real advantage in taking the cash option.

1.4 Deprivation of assets in the means test for care home provision

Deprivation of assets is where an individual has intentionally decreased their assets in order to reduce the amount they will be charged towards their social care provision. In such cases, the individual must be proven to have known that they would need to provide for care and reduced their assets accordingly. The statutory guidance states that where the individual has used their assets to remove a debt, such a reduction in assets would not be considered as deprivation even if the debt is not immediately due.

Where a *DC* pension pot is used to buy an *annuity*, the *annuity* income could not be reduced. The Department for Work & Pensions (DWP) has confirmed that if an individual has used the new pension freedoms to take out a lump sum from their *DC* pot and spends, transfers or gives away the money,

the DWP will consider whether they had deliberately deprived themselves of that money in order to improve their entitlement to means tested welfare benefits, including the social care means tested benefits (DWP, 2015).

If it is decided that the individual has deliberately deprived themselves of assets, the individual will be treated as still having the corresponding assets as income or *cap*ital when their benefit entitlement is determined.

Conclusion 1: It is still too early to understand exactly how individuals will respond to the pensions freedom and choice agenda

It is not clear yet whether individuals will ring-fence funds to meet potential future care costs as this is not in keeping with the new flexibilities. However, there are a number of products that might complement the new flexibilities and help people make provision for care costs:

- products that are already in existence in the UK, such as income *drawdown* and equity release
- products that have had success in other countries, such as protection insurance; and
- new products, such as Disability-Linked Annuities and Care ISAs.

Recommendation: A joint Government and industry approach to collecting data on how people are responding to the new system will help to assess whether education, the use of defaults, or incentives for long term care products, such as tax relief and employer contributions, could be effective in helping people to use their savings to meet care costs.

Section 2: Products

In this section we consider the new regulatory and commercial environment and what this means for product development to support LTC needs. We review the products identified in our previous report, in addition to a number of non-pension products.

2.1 Products previously identified

In our previous paper, we identified the following products which might prove useful in supporting particular cohorts of the population in providing for their LTC costs:

- Protection insurance
- Income *drawdown*
- Pension care fund
- Disability-linked *annuity*
- Immediate and deferred needs annuities
- Variable annuities

This section gives an update on the potential use of these products to fund LTC costs under the new pensions regime.

2.1.1 Protection insurance

The general benefits of risk insurance (pooling of risk) do apply to this product group, but they are somewhat reduced by the relatively high likelihood of an individual requiring funding for LTC needs, which can be tailored to include domiciliary care needs. This means that the cost of cover can be a relatively high proportion of the eventual maximum benefit payable.

The insurance of LTC costs was a product previously marketed in the UK as a standalone pre-funded product, offering protection against uncertain costs. The standalone products are no longer marketed due to a lack of demand, possibly due to the cost of the products. However, more affordable protection products could be offered to provide cover for the care costs incurred before reaching the *cap*. In 2014 a small number of product providers added an LTC rider to their whole of life plans to provide some protection against care costs. This is discussed in more detail below in Section 2.2.2.

The greater access to cash sums could promote the use of lump sum funding of this insurance. However, this is only likely to be popular once the risks of individuals managing their own funds are fully appreciated and there is an increased awareness of the probability of requiring LTC and the consequential costs.

2.1.2 Income Drawdown

It is likely that many people will make use of *drawdown* arrangements to manage their retirement income, at least during the initial phase of retirement. This could clearly be very helpful in facilitating the funding of LTC costs as and when they arise. However, this will depend on the rate at which income is drawn from the invested retirement savings and the investment policy adopted. Here it will be vital that individuals take appropriate advice not only at the outset, but also throughout the lifetime of these arrangements. Failure to do so could result in the exhaustion of the funds available and the individual having to rely wholly on state benefits or there being tax consequences.

2.1.3 Pension Care Fund

Our previous suggestions around the establishment and operation of Pension Care Funds have been substantially overtaken by the increased flexibility now available to all *DC* pension savings. In the new flexible world any allocation of savings to a particular use may be perceived as a backward step. We

did anticipate this problem and suggested some tax incentives to encourage the adoption of this approach. Given that pension savings can now be used for any purpose, and not just for buying an *annuity*, giving tax relief to savings in a Pension Care Fund would only be helpful for those who have already maximised their pension saving within the *Lifetime Allowance* regime. Our additional suggestion of allowing the Pension Care Fund to be handed down to a subsequent generation without any deduction of Inheritance Tax has now been brought into the *drawdown* rules and so would not provide any extra incentive to invest in a Pension Care Fund.

For existing pensioners we also anticipated the possibility of transferring funds from existing *DB* or *DC* savings. As announced by the Government during 2015, it is possible that pension rules could change further in future to allow the surrender of annuities in a secondary *annuity* market. Assuming that this is also extended to *DB* pensions, this would also reduce this potential incentive to move money into a Pension Care Fund.

2.1.4 Disability-Linked Annuity

As mentioned in Section 1.1 above, whilst the pension reforms are new, individuals might be reluctant to buy an *annuity* - including disability-linked annuities (DLAs) - preferring instead the freedom to use their pension assets to suit their own circumstances. However, once the reforms have been established for some time and new retirees have seen the experience of pensioners who opted not to buy an *annuity*, they might decide that they prefer the certainty and security which annuities provide. In addition, *annuity* rates are currently unattractive due to the low interest rate environment which prevails at the moment. However, if interest rates increase, then annuities may become more attractive. If annuities do come back into favour then the flexibility of a combined lifetime and LTC *annuity* product could appeal.

In our previous report, we acknowledged that fairly substantial funds would be required to buy a DLA. However, under the pension reforms, the ability to cash in *DB* as well as *DC* arrangements should mean that many more people will have the necessary funds to buy a DLA should they wish to do so. For some individuals, the idea of receiving a steady *annuity* whilst being healthy, knowing that it would increase substantially if LTC is ever required, could be very attractive. As noted in our previous paper, we estimated that such an individual would need to sacrifice around 10% of their initial *annuity* income in order to provide for a substantially increased level of *annuity* if LTC were needed (e.g. an *annuity* which triples once the individual requires LTC).

A second type of DLA might be even more appealing. Once again, the individual buys it when in good health at retirement. However, with this variation no benefit is paid until the individual requires LTC (i.e. no standard lifetime *annuity* is paid while the individual is in reasonable health). The benefit is then solely an *annuity* payable if and when the individual's health has subsequently deteriorated to a point where care is required. The level of premium payable even for a substantial income from this DLA would be expected to be relatively small for three reasons:

- the *annuity* is not expected to commence for many years if bought whilst the member is in good health at retirement (i.e. would not commence until the individual requires LTC which may well not be for several years);
- the *annuity* would not be expected to be paid for a long period (e.g. typically around 3 years) since, by definition, the individual would be in a very poor state of health when it commenced; and
- the fact that no income is paid to the policyholder for many years should allow the insurer to invest in a wider range of assets (e.g. equities) than just fixed interest stock before the *annuity* comes into payment. This then offers a higher expected investment return.

This second type of DLA is similar to the Protection Insurance product mentioned above.

2.1.5 Immediate needs annuity plus temporary annuity

An immediate needs *annuity* is a 'point of need' product that can now be funded by cashing in any remaining pension.

An immediate needs *annuity* could be purchased to provide income to cover any *hotel costs* or *top-up* costs that continue even if the *cap* is reached. This could be purchased alongside a temporary *annuity* to cover the Local Authority assessed costs incurred during the period up to the point the *cap* is reached. A temporary *annuity* would stop paying income on the earlier of reaching the *cap or death*. The monthly benefit could initially be equal to the Local Authority costs and set to increase with RPI.

2.1.6 Variable Annuity

A variable *annuity* is a *drawdown* product with optional income and *cap*ital guarantees. It can provide income flexibility with the underpin of a guaranteed minimum level of income. The product is likely to appeal to individuals wanting a flexible income in retirement. This product can potentially be offered with a LTC option where the guaranteed income increases to meet care costs on failing a specified number of *activities of daily living (ADLs)*.

2.2 Non-pension products for the new flexible savings market

Alongside the opportunities now available to use accumulated *DC* pension savings, there are also opportunities to establish alternative saving vehicles focused on LTC costs.

2.2.1 Care ISA

A Care ISA would take the shape of a savings vehicle to encourage people, old and young, to increase their savings for the future funding of their LTC costs. It would be used specifically for funding *care home* fees or domiciliary care costs. An inheritance tax incentive would be needed to allow this to pass on to the next generation free of inheritance tax if unused before death. The recipients (i.e. the children) could then use it to help fund their own LTC needs.

Product features

The main attraction would be the tax incentives, and long term savings prospects, where the fund would be ring-fenced for LTC costs. It could be used for the individual's own care costs, or those of their spouse, elderly parents, siblings or children. If unused, it could be passed on to the next generation without any tax implications, within the Care ISA environment.

How funded?

An *Annual Allowance* could be provided, say £10,000pa, up to a lifetime limit of £50,000 per person. This could be funded from regular savings contributions or re-directed pensions savings.

Product design and future development potential

It could increase the funding amounts dedicated to LTC costs and reduce the corresponding requirements of the state.

2.2.2 Accelerated whole of life policy for long-term care

Several insurance companies have introduced a new product which adds a protection style benefit for LTC to existing *whole-of-life assurance* products. Such a product was proposed by Mayhew et al (2010). The product works by making an accelerated payment to a policy holder should they require LTC, be it receiving care at home or in a *care home*. The lump sum paid on death is reduced by this accelerated payment.

Product features

In return for an extra premium, the accelerated payment feature sits alongside a *whole-of-life assurance* policy. It pays the assured amount (or some reduced amount) in the event that LTC were required. This is likely to be linked to some *ADL*/cognitive impairment measure.

The level of funding available for LTC would be based on the sum assured for the *whole-of-life* policy, rather than actual LTC costs. Although, for large policies, the amount could be reduced in line with what was needed, with a corresponding reduction in premium.

How would it be funded?

Whole-of-life policies tend to be taken out by people already in or near retirement. They are not policies that are likely to generate increased savings, but rather facilitate a transfer of an individual's wealth. It is unlikely that this accelerated version will encourage assets to be put aside to meet LTC needs. However, it would allow assets that otherwise would have been transferred to an individual's descendants on death in a traditional *whole-of-life* policy to be used to pay for LTC instead should this be needed.

From a consumer's point of view, it is not clear that the product will fill a need for those looking for LTC protection that do not already have the means to provide for themselves. The product could instead be regarded as a way of entering into a *whole-of-life assurance* policy, but with the ability to access the savings if they are needed for their LTC provision. As such, it may be attractive to individuals who are already considering a *whole-of-life* policy but who are concerned about unexpected costs which might mean they have a need for the cash prior to their death. While it is unlikely to have majority market appeal, or significantly solve the LTC funding question for most people, this development could serve a subsection of the population extremely well.

Product design and future development potential

From a provider's point of view, such a policy could be seen as a relatively low risk way to enter the LTC protection market. The only additional risk to providers is that payments that would have been made upon death are accelerated to a greater degree than anticipated if more policyholders require LTC than expected. Since the typical time period between needing LTC and eventual death is, the additional risk presented to an insurance provider is much smaller than the risk presented by a standalone LTC protection product. It could make an excellent foundation for insurers building up experience and data which may lead to other LTC protection policies becoming viable in the future.

2.2.3 Personal Care Savings Bonds

Financial building blocks are needed to pay for social care that will be sustained for decades and provide extra security for the individual. Mayhew and Smith (2014a) have also proposed a new savings product called Personal Care Savings Bonds (PCSBs). The bonds are designed to encourage saving for social care by providing extra money at the time of greatest financial need. PCSBs are likely to be attractive to older people who have only a basic pension and modest savings, but also to other age groups as they not only attract interest but also pay prizes.

It is evident that Premium Bonds remain one of the most popular ways of saving with over 13m subscribers. Based on reasonable assumptions, the paper shows how the fund could build into a substantial investment worth £70bn with regular monthly prize pay-outs. In concept PCSBs are similar to Premium Bonds, a UK personal savings product which has been successfully operating since 1956.

Unlike Premium Bonds, the PCSB fund would pay out once care needs begin (usually linked to an assessment or benefit entitlement such as Attendance Allowance). PCSBs would attract a small rate of interest, in addition to prize money which would be paid at monthly intervals throughout the duration of the holding. This would help to incentivise their purchase throughout adult life.

The introduction of such a product could be managed and operated by National Savings & Investments and could work from the existing Premium Bonds platform.

2.3 The use of housing equity

There is a sizeable group of older people on low income for whom moving house would be impractical but for whom a higher income could significantly help improve their day to day life and hence wellbeing – particularly older retirees who live alone and may have impending care needs. For this group we have set out two products, equity release and an Equity Bank product which would allow them to stay at home whilst also contributing to their LTC costs.

2.3.1 Equity Release

Equity release mortgages enable a residential property owner to release part of the value of their property without having to sell the home immediately and they can continue to live there until they die or go into residential care. The released equity in the property could be used to fund LTC costs, or pay for improvements that enable people to live independently in their home for longer.

Product features

The market is mainly dominated by lifetime mortgage products. The home owner receives a lump sum and in return transfers a charge on their property to the equity release provider. The lump sum amount then rolls up with interest and the lump sum plus interest is paid back to the provider on the sale of the home. In the meantime, the individual can still live in their property until death or entry to a *care home*.

Many products have a *drawdown* facility which gives the individual the option to take further sums out of the property. A guarantee option is available on most products which means that the loan to be repaid cannot exceed a pre-agreed percentage of the value of the sale proceeds of the property.

How would it be funded?

Property is the most substantial asset available in retirement. The ability to release equity in the home opens up a realistic option to fund LTC. For example, it can be used early in retirement to fund home improvements to help with independent living in the home for longer.

Product design and future development potential

Currently equity release mortgages are repayable on entering residential care of the last surviving spouse. However, if a version of the product could be available for individuals entering care then it could be used to provide funds for LTC costs. However, there would need to be conditions in place to protect the property against dilapidation risks e.g. the property must be rented out.

The *drawdown* facilities on equity release mortgages could be extended to allow the products to be used to provide a regular income.

2.3.2 UK Equity Bank

Mayhew and Smith (2014b) have set-out proposals for a UK Equity Bank. This would be a state agency that would help people release income from their homes in the form of a lifelong *annuity* in return for selling a portion of the equity in their home to the State. The value of the *annuity* would be recovered on the death of the recipient.

For the Equity Bank to make a real difference to an individual's well-being, it would be important that the financial benefits were not eroded through higher taxes or the withdrawal of benefits. The paper suggests how this could be done. The scheme is targeted at people from age 75 and above, since this is the age that care needs tend to begin and it would help keep the scheme affordable for individuals and the State, with relatively short pay back periods. The report's demographic analysis

shows that there are 1.2m people in the UK age 75 and above, of whom around 400,000 are estimated to live alone. However, if we restrict the market to the number turning 75 each year then this could yield up to 40,000 new policies each year which compares with approximately 20,000 equity release sales being made in total at the time of writing (Source: Equity Release Council).

2.4 Application of products to domiciliary care

Domiciliary care can provide personal care, medication, meals, home security and other practical household tasks should a person become frail or require LTC. An individual may initially need some help if they become unable to meet one or two *ADL*s, and this may increase if they become more frail. Home care costs will vary dependent on need and could include nursing and night cover.

Most of the products listed above could be tailored to include provision for domiciliary care at home. The income could be used to make home modifications and disability adaptations.

- Accelerated whole-of-life policies could be tailored to make small lump sum payments as more *ADL*s are failed.
- Income *drawdown* could be used when the care need arises and varies.
- Income from immediate annuities could cover the care cost of home carers' services.
- Disability-linked annuities could meet the increasing costs as more hours of paid care were required, or if more complex medical care were needed at home.
- An equity release scheme could be drawn up to meet the needs accordingly as well for homeowners.

These products could complement other benefits such as the *Attendance Allowance*.

Local authorities will assess care needs and contribute towards payments to allow the individual to employ their own carers or services, taking into account means testing. The ability to pay will be determined by income, expenditure and savings and excludes the value of the home.

2.5 Consistency of State benefit triggers and product claim triggers

For products that start making a benefit payment based on meeting a state of health criteria, such as failing a number of ADLs, it may not match the criteria used to determine if an individual qualifies for state benefits such as *Attendance Allowance* or *Local Authority* support. It is possible to design products which have benefit payment triggers tied to state benefit eligibility criteria, but this can lead to a mismatch overtime if the eligibility criteria changes.

Section 3: Case studies

We have developed a number of case studies to illustrate how care costs are made up before and after the care cost *cap* is reached.

These case studies were prepared prior to the Government announcing that the *cap* on care costs would be postponed to 2020. The assumptions used were projected to 2016 and were intended to be broadly appropriate then. In the absence of further information on the likely values in 2020, we believe these will still serve as a suitable illustration of the mechanics of the proposals. Other assumptions used in the case studies are as follows:

- Where applicable all figures are inflated to 2016 using an assumed inflation rate of 3.5% p.a , in line with the previous report.
- The weekly figures are converted to yearly figures assuming 52.18 weeks per year.
- The state pension is assumed to be £151.25 per week (i.e. the current base level of the new single-tier UK state pension effective from 6 April 2016)
- The *Attendance Allowance* is assumed to be at the higher level of £85.18 per week (the 2015/16 rate of £82.30 inflated to 2016)
- The NHS-funded nursing care allowance is assumed to be £115.92 per week (the 2015/16 rate of £112.00 inflated to 2016)
- The total cost of care of £42,985 p.a. is the average care fee for *care homes with nursing* in England and is based on the Laing & Buisson Care of Older People UK Market Report 2013/2014 inflated for 3 years to 2016. The *Local Authority rate* of £32,649 p.a. is based on the Laing and Buisson Annual Survey of UK Local Authority Baseline Fee rates 2013/2014 inflated for 3 years to 2016.
- The *Daily living costs* are assumed to be £12,000 p.a. as set by the Department of Health
- The *Personal expense allowance* is £25.77 per week (the 2015/16 rate of £24.90 inflated to 2016)
- The care cost *cap* is £72,000 and the *means testing threshold* and upper limit are £17,000 and £118,000 respectively as set by the Department of Health.

3.1 Example 1:

An example of a single older woman who enters residential care (with nursing) towards the end of her life.

Mary had a fall at the age of 80, which hindered her mobility. She could no longer manage at home and entered a *care home with nursing*. The *care home* costs of £42,985 consist of the *Local Authority rate* of £32,649 p.a. (including *daily living costs* of £12,000 p.a.) and additional care costs in excess of the *Local Authority rate* of £10,335 p.a. Prior to entering care, Mary lived on her own in a house worth £200,000 that she owned outright and had £30,000 in savings.

On entering the *care home* she had a total income of £21,000 p.a. which consisted of her state pension, her own private pension, *NHS-funded allowance* and an *Attendance Allowance* benefit.

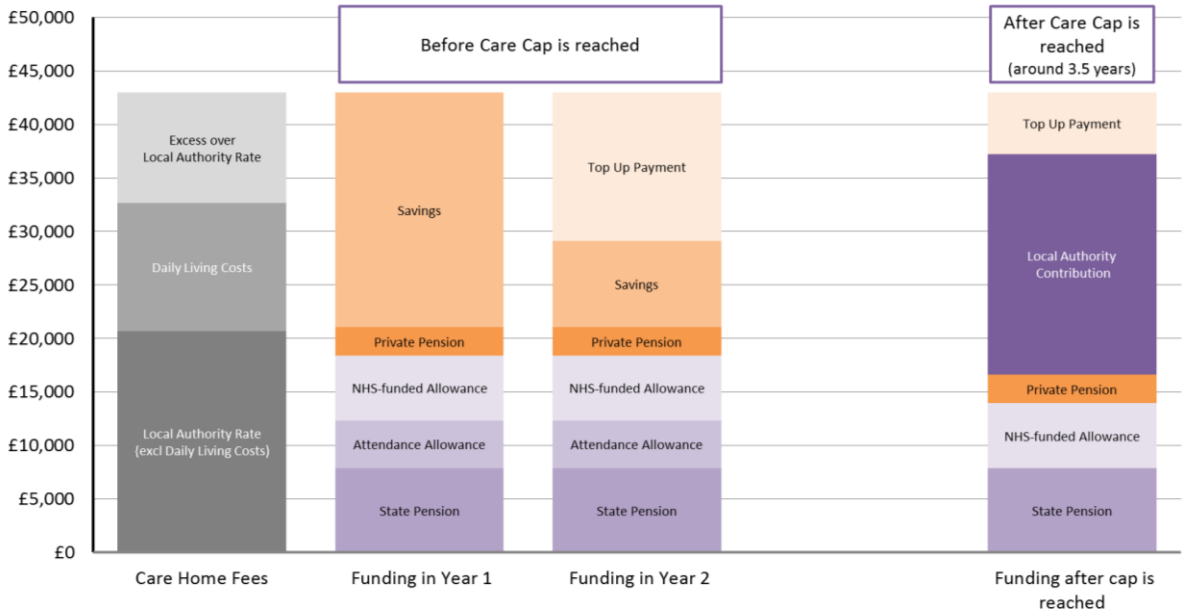
Case (a): No Deferred Payment Option Included

Mary is worried about the affordability of the *care home* given that her annual income is much less than the annual *care home* costs. She was informed that she would not be eligible for *Local Authority* financial support given that the value of her house was greater than the £118,000 *means test upper limit* and it would not be possible for her to enter a deferred payment arrangement given that she had more than £23,250 in non-housing assets. Note that if her non-housing assets ever fell below the

£23,250 threshold, she would subsequently be eligible for the deferred payment scheme. The chart below illustrates the costs Mary is faced with on entering the *care home* as well as the costs after about 3.5 years once the care *cap* is reached. By that time, Mary or her family would have paid a total of £129,276 towards her care costs; £72,000 of that towards the *Local Authority rate* element of the costs.

This scenario assumes she does not enter a deferred payment arrangement at any stage. It is assumed that Mary uses her pension income and any savings to meet the cost of care and, once her savings are depleted, the shortfall in income to cover the care costs is made by a third party such as a family member (shown on the graph as a "Top Up Payment"[5]). As shown in the chart, the 'Local Authority Contribution' equal to the *Local Authority rate* element of the cost is met by the Local Authority only after the *cap* is reached.

Figure 2: Progression of care costs for a single person owning a house valued at £200,000 and with savings of £30,000



Case (b): Deferred Payment Option Included

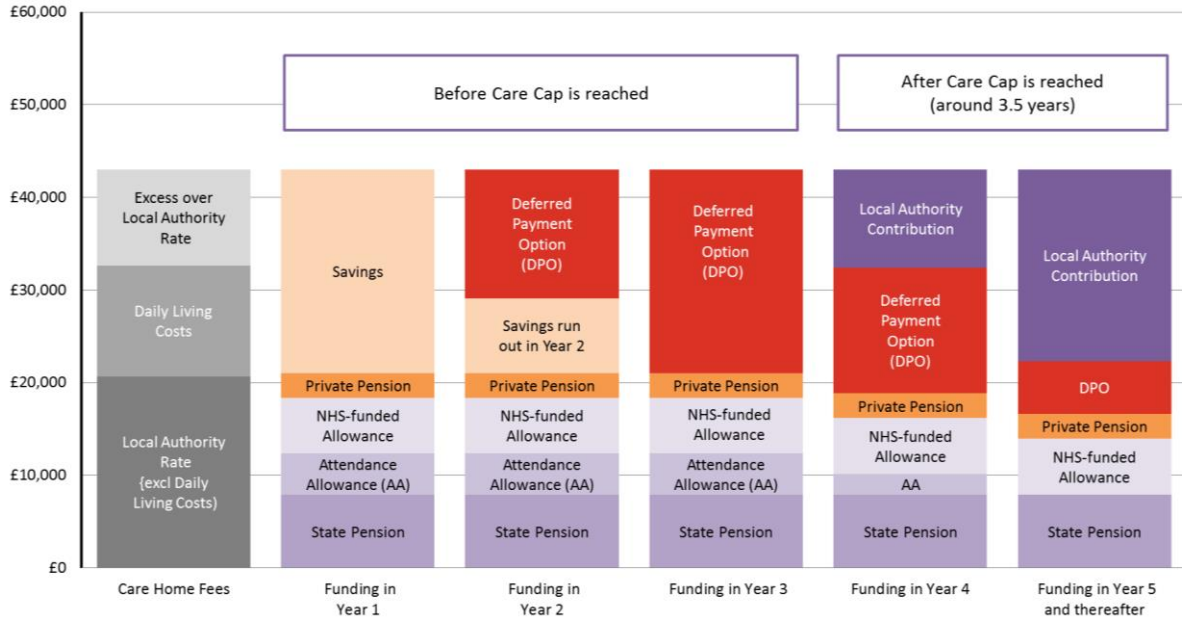
In this case, Mary decides to enter a *deferred payment scheme* to help meet the costs of care when she is eligible. It is assumed that Mary uses her pension income and any savings to meet the cost of care and once her savings are depleted she enters into a deferred payment scheme. Any rental income from the property is ignored and may be assumed to meet any supplementary living costs (not included in the care costs) as well as any costs of maintaining the property. It is also assumed the Local Authority charges 2.25% p.a. compound interest on any loan amounts outstanding at the end of each year under the deferred payment scheme.

As shown in the chart below, Mary enters the *deferred payment scheme* in the second year of care once her savings are depleted.

The loan amount stabilises after the *cap* is reached and the 'Local Authority Contribution' element of the cost is met by the Local Authority. In this case this is after about 4 years in care.

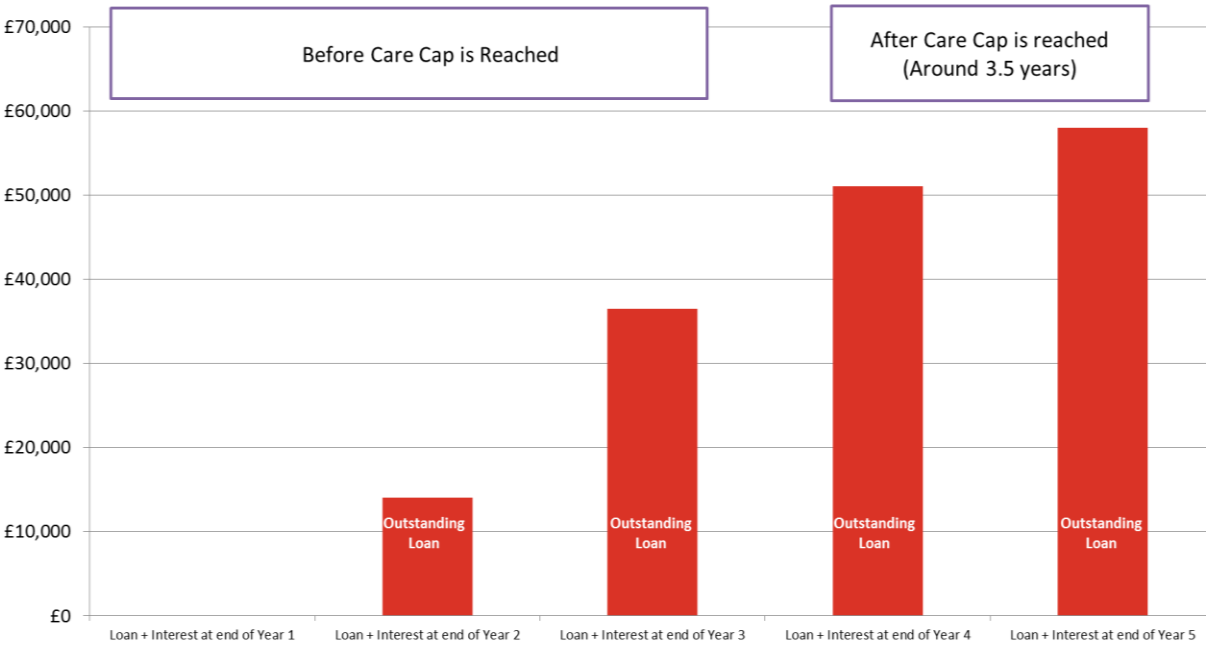
[5] It should be noted that the "Top Up Payment" is optional and Mary could choose to move to a cheaper care home to avoid needing to make this payment.

Figure 3: Progression of care costs for a single person owning a house valued at £200,000 and with savings of £30,000 using the Deferred Payment Option



This progression of the deferred payment loan and interest for the first 5 years of care is shown in the following chart.

Figure 4 : Progression of Deferred Payment Loan for a single person owning a house valued at £200,000 and with savings of £30,000



The amount Mary borrows is repayable with interest out of her estate when she dies and her house is sold.

3.2 Example 2:

An example of a single woman, living in rented accommodation who enters residential care (with nursing) towards the end of her life.

Joan has dementia and can no longer manage at home. She enters a *care home with nursing* costing the *Local Authority rate* of £32,649 p.a. (including *daily living costs* of £12,000 p.a.). Prior to entering care, Joan lived on her own in a rented flat and had £5,000 worth of savings.

After entering the *care home* she has a total income of £13,941 p.a. comprising the state pension and an NHS-funded nursing care allowance, with no additional private pension savings.

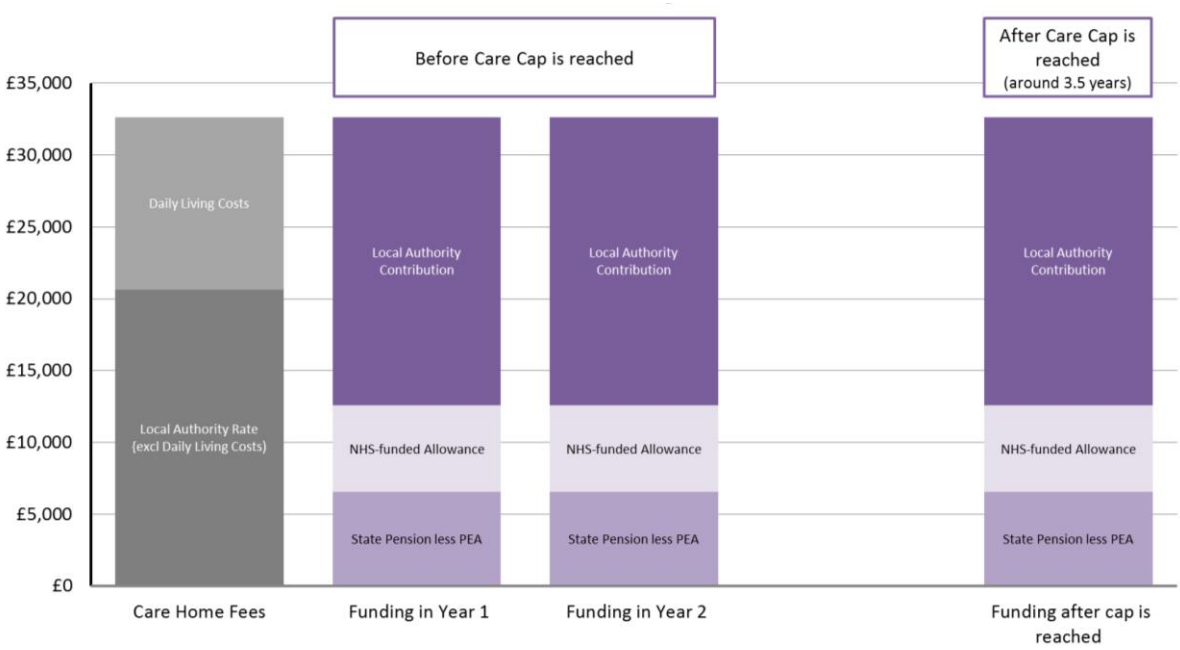
Joan is worried about the affordability of the *care home* given that her annual income is much less than the annual cost of the home. She is informed that she would be eligible for Local Authority financial support (under the means test before reaching the *cap*) given that her savings were only £5,000 and that she did not own her own home (her savings are ignored by the Local Authority because they are less than £17,000).

The table below illustrates how much Joan must contribute to the cost of her care:

Local Authority Financial Assessment	**Weekly Figures**	**Yearly Figures**
State Pension	£151.25	£7,892
Less *Personal expense allowance* (PEA)	£25.77	£1,345
Joan's Contribution	£125.48	£6,547
Care home costs	£625.71	£32,649
Local Authority Contribution to Care Costs (including NHS-funded nursing care allowance)	£500.23	£26,102

The chart below shows how Joan's care costs are met in the first and second year of requiring care and how the care costs are funded after the care *cap* is reached.

Figure 5: Progression of care costs for a single person living in rented accommodation with £5,000 of savings



3.3 Example 3:

An example of a married woman who enters residential care (with nursing) towards the end of her life.

Susan aged 82 and her husband John live in a house worth £200,000 which they jointly own and have combined savings of £50,000.

Unfortunately Susan's recent hip replacement operation was unsuccessful and her mobility is greatly reduced. She can no longer manage at home and enters a *care home with nursing* costing the *Local Authority rate* of £32,649 p.a. (including *daily living costs* of £12,000 p.a.). On entering the *care home* she had a total pension of £15,000 p.a. comprising the state pension and her own private pension.

Susan is worried about the affordability of the *care home* and the impact that the care costs may have on her husband's on-going living requirements. She is informed that the house would be excluded from the financial assessment of what she would be required to pay given that it is jointly owned with her husband and he continues to live there. She is also informed that 50% of their joint savings of £50,000 would be included in the financial assessment of what she was required to pay towards the care costs. However, given that 50% of their joint savings is less than the *upper capital limit* of £27,000, she would qualify for some financial support towards meeting the cost of her care needs.

The table below sets out the financial assessment of what Susan is required to pay towards the cost of care in the first year. She is required to contribute all of her income (except for a minimum *Personal expense allowance*) towards the cost of care as well as a contribution from her savings above a threshold level of £17,000. This contribution (referred to as *Tariff Income*) is based on a fixed formula - for every £250 in savings above the £17,000 threshold level, an individual is required to contribute an additional £1 per week towards their care costs.

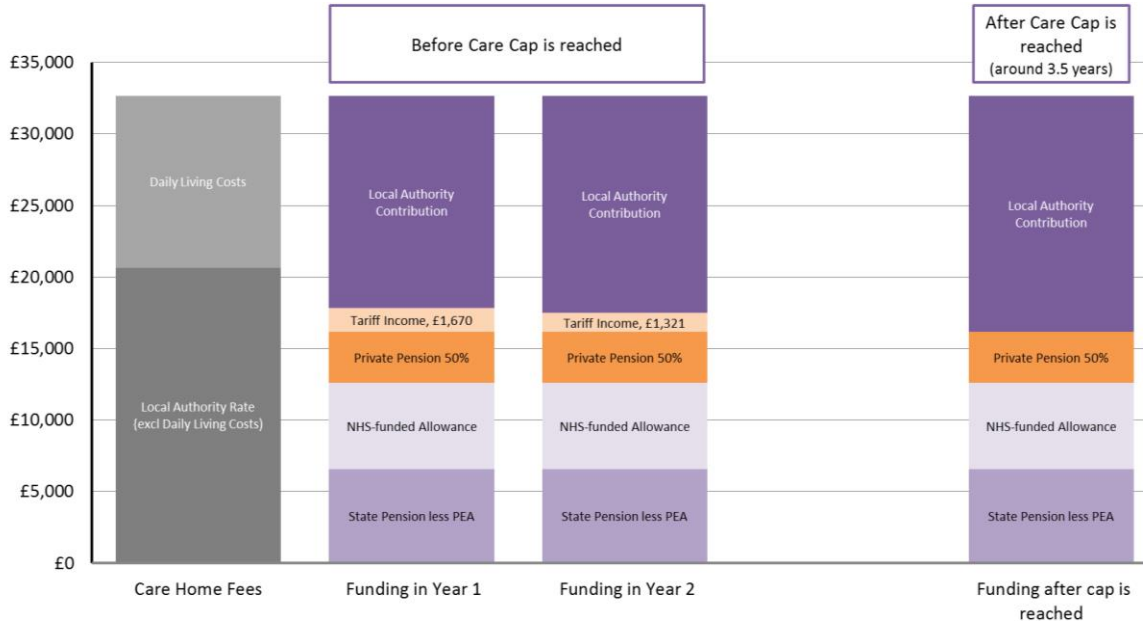
Local Authority Financial Assessment	**Weekly Figures**	**Yearly Figures**
State Pension	£151.25	£7,892
50% private pension	£68.11	£3,554
Tariff Income from savings in the first year	£32.00	£1,670
Less *Personal expense allowance*	£25.77	£1,345
Susan's Contribution from income	£225.59	£11,771
Care home costs	£625.71	£32,649
Local Authority Contribution to Care Costs (including NHS-funded nursing care allowance)	£400.12	£20,878

As can be seen from the chart, Susan needs to contribute a portion of her savings, known as *Tariff Income*. The following table illustrates how the Tariff Income that Susan is required to pay reduces prior to the care *cap* being reached.

	Savings Balance at Start of Year	**Tariff Income**
Year 1	£25,000	£1,670
Year 2	£23,330	£1,321
Year 3	£22,009	£1,045
Year 4	£20,964	£414
Year 5	£20,550	Not required

The chart below show's how Susan's care costs are met in the first and second year of requiring care and how the care costs are funded after the care *cap* is reached.

Figure 6: Progression of care costs for a married person owning a home valued at £200,000 with £50,000 of joint savings



Conclusion 2: The new care funding system is complex making it difficult for people to understand their potential care costs

We have set out three case studies that show how care costs are determined both before and after the *cap* is reached for a range of circumstances. The case studies highlight the large number of factors that a person will have to consider should they need to enter residential care.

For example, there is complexity in the calculation of care costs as they have three components - daily-living costs, Local Authority set care costs and any *top-up* costs. The calculation of a person's State support is also complex, not only because of the way the *means testing threshold*s work, but in taking account of the *Attendance Allowance*, *personal expense allowance* and the *NHS-funded allowance*. How a person's housing and savings are counted towards the means test is also impacted by whether their partner will continue to live in the house once they enter care as well as whether they decide to remain in their own home whilst receiving care. Finally, the individual will have to work out how they will combine their State Pension, private pension and any other private savings with their housing wealth to meet their care costs.

Recommendation: A national awareness raising campaign that helps people to understand what their potential care costs might be, what State support is available and possible products that might protect them from having to make a decision at the point of crisis.

Section 4: Incentive to save

4.1 Analysis of the means testing thresholds

One of the aims of a reformed funding system proposed in the Dilnot Commission report ('Fairer Care Funding: The Report of the Commission on Funding of Care and Support') was "to support everyone in making their personal contribution". This section looks at the potential impact of the increased means testing thresholds on incentives to save based on the assumption that the primary reason an individual might choose to save for their LTC needs is so that they have more control over the type and quality of care they receive.

Our analysis below shows that the *means testing thresholds* as set out in the Care Act 2014 provide a greater level of reward for savers than the existing thresholds, and may increase the level of saving for care, but they could still act as a barrier.

The analysis is based on the means test limits set out as part of Phase 2 of the Care Act and assumes that the other elements of Phase 2 are implemented, including the £72,000 *cap*. The analysis considers an individual entering care without nursing at age 85 incurring the average care costs for England and found that incentives to save for LTC varies according to the wealth of an individual.

It should also be noted that any disincentive to save created by means testing long term care support is a disincentive to save in general. Therefore the scope of the incentives created by long term care policy will extend to any other retirement funding policy.

The examples in this section illustrate the impact of additional savings for a person who goes on to need LTC. It is clear that any incentives or disincentives to save will likely apply long before an individual knows whether they will need LTC. As such, the illustrations given here should be considered in the context that the person would weigh up the financial impact of means testing described here against their perceived likelihood of entering LTC.

Figure 7 shows that individuals with assets of up to £110k at the point of entering care can expect their contribution to care costs to increase if they save a further £10k.[6] This is most significant for individuals who have between £20k and £60k in assets at the point of entering care. If they make additional savings of £10k before entering care, then they can expect to see their personal care costs increase by at least £5k by the time they have been in care for 3 years.[7] The costs increase to up to £9k over a 10 year period.[8] Further details of the methodology can be found in Appendix 3.

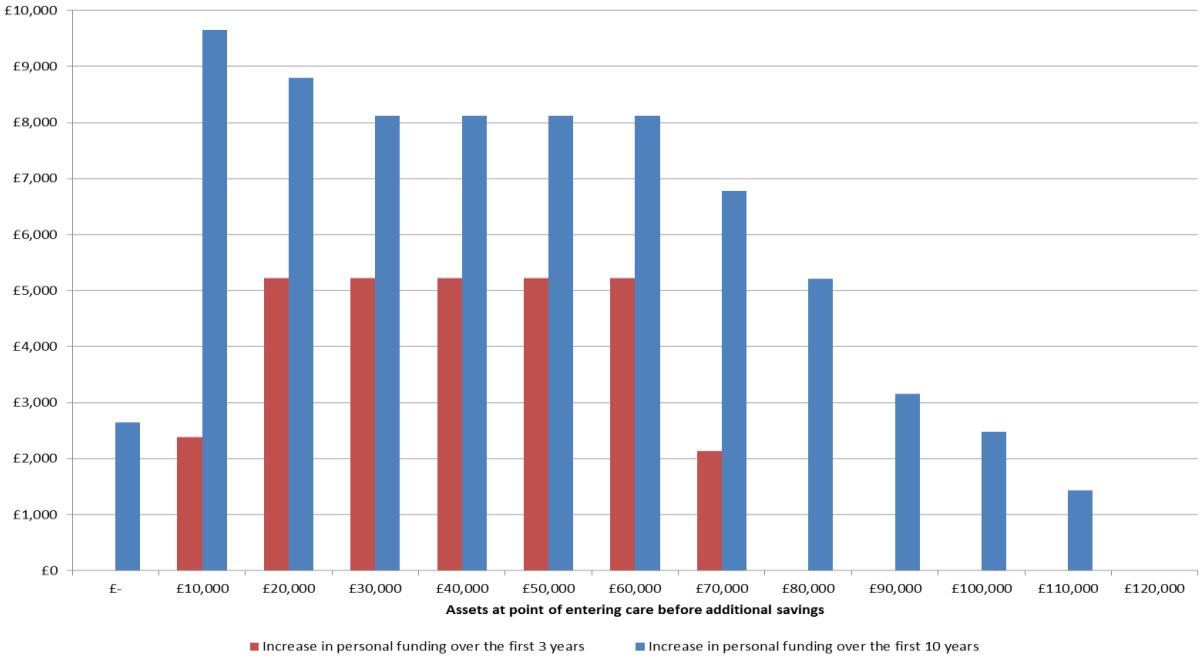
If an individual has £20k in assets on entering care they can expect to pay £35k in personal contributions towards care costs over 3 years. If they have saved an extra £10k and therefore have £30k in assets on entering care instead of £20k then they can expect to pay approximately £40k in personal contributions i.e. by saving an extra £10k they have to pay an extra £5k towards their care costs – they therefore only have an extra £5k to spend on improving the type and quality of care they receive.

Figure 7 demonstrates that it is only individuals with assets above £110k where additional savings do not directly replace Local Authority funding. This is the point at which no means tested support is

[6] Amounts shown are in real terms.
[7] The average length of time in care (Forder and Fernandez, 2011)
[8] There is a 1% chance of surviving this long in care (*ibid*).

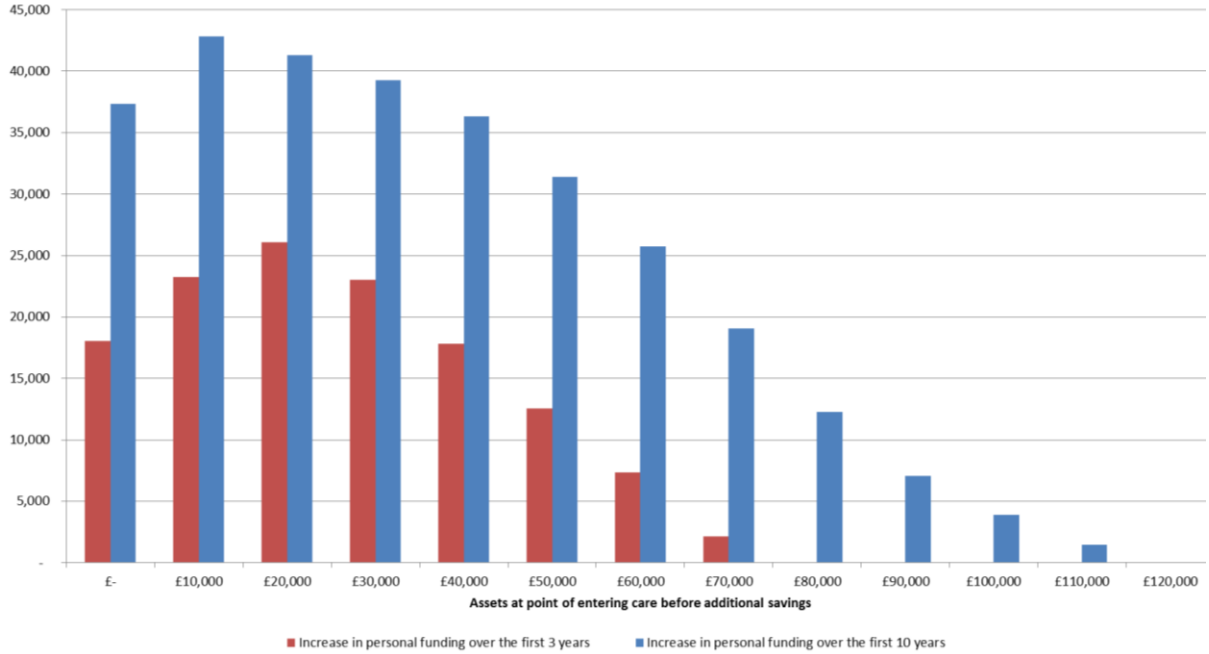
received even over a 10 year period. Above this level of assets the extra savings are fully available to be used for other reasons such as improving the standard of care received or leaving a larger inheritance.

Figure 7: Increase in personal costs from saving an additional £10k towards care costs



A similar picture is seen for higher levels of additional savings. For example, with £50k of additional savings (rather than £10k) then over 50% of the extra savings must be put towards personal care costs as a result of reduced means tested support over a 10 year period – see Figure 8.

Figure 8: Increase in personal costs from saving an additional £50k towards care costs



In summary, this analysis demonstrates that for individuals with assets up to £110k there is a reduced incentive to save specifically to meet eventual LTC costs. Any additional money put aside leads to an

increase in the amount that the individual has to contribute to their care costs because a proportion of the additional savings replace the Local Authority funding that would otherwise have been provided under the means test arrangements.

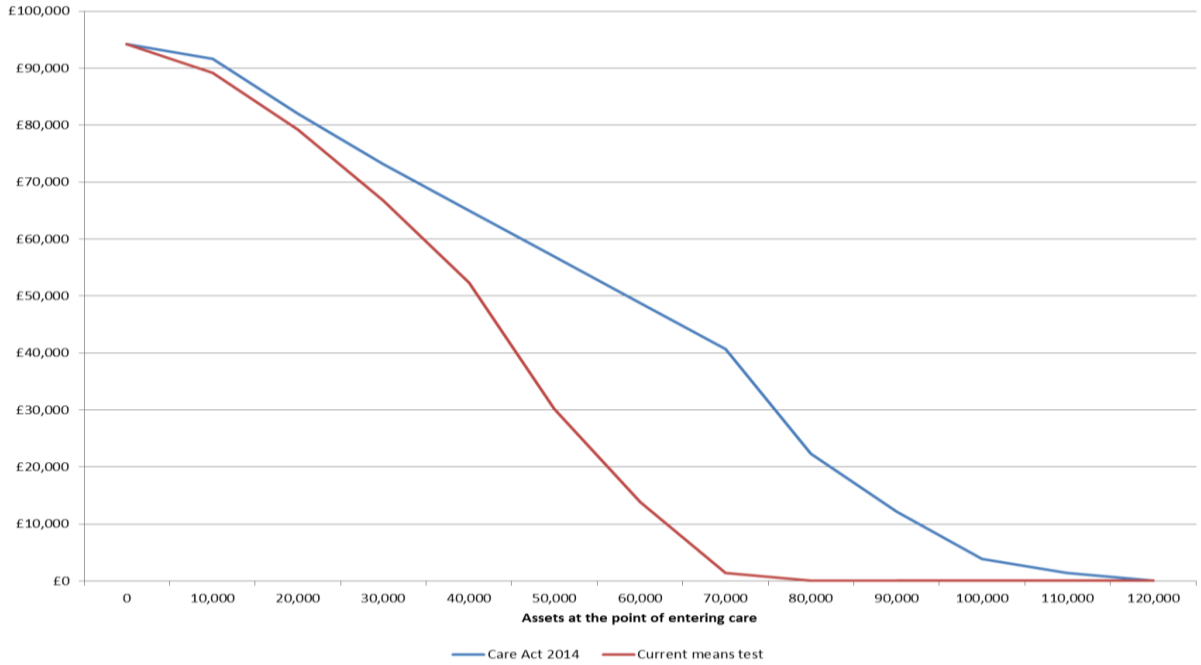
There are several factors affecting the total personal costs of an individual receiving a given level of care at a given cost:

1. Level of means tested support provided
2. Level of *top-up* care costs (assuming that individual opts for higher quality care than that funded by the Local Authority)
3. Level of contribution to care costs from the Local Authority as a result of the care *cap*

For the purpose of the analysis in this section we have assumed that only point 1. varies with the level of assets that an individual has available to them. In practice the assets available to an individual will affect their ability to fund top-up costs. For the purposes of this analysis we have assumed that the *top-up* costs are being funded by a third-party.

For assets at the point of entering care of up to £70,000, the driver of increases in personal costs is the reduction in means tested support. Figure 9 shows how means tested support varies with different levels of assets at the point of entering care and how this level of support would change as a result of the Care Act 2014. A greater level of means tested benefits would be provided under the Care Act 2014 since the means test thresholds are being increased. The means tested support under the Care Act 2014 thresholds reduces at a slower rate with increasing wealth than with the existing means test limits.

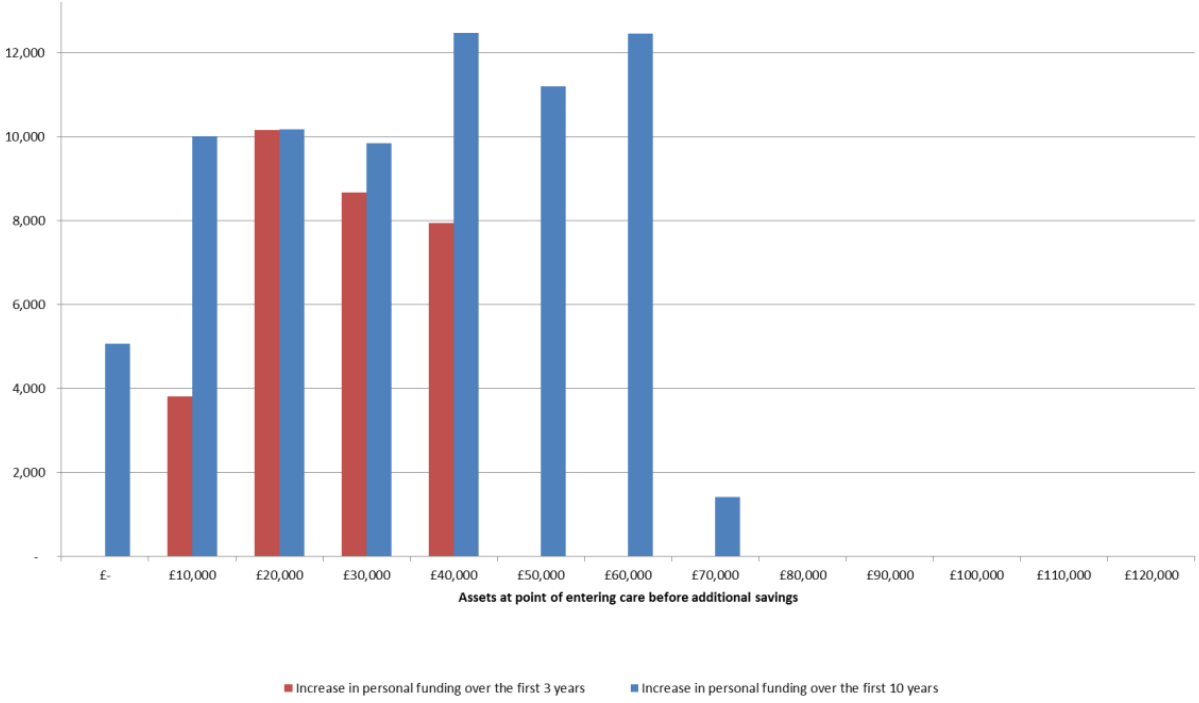
Figure 9: Means tested support over 10 years



To understand the impact that the means test thresholds have on the change in personal costs as a result of additional saving and on the incentive to save, we have carried out a similar analysis for the existing means test thresholds. The existing regime has a lower means test limit. The lower threshold is £14,250 and the upper threshold is £23,250. This creates a potential greater disincentive to save as can be seen in Figure 10. For example, an extra £10,000 in savings can lead to an increase in personal costs of over £10,000. In other words, the individual is effectively being taxed at over 100%

on these extra savings. Therefore the system set out in the Care Act 2014 is a welcome improvement on current arrangements; however; they could still act as a barrier for those with initial assets of up to £110k.

Figure 10: Increase in personal costs from saving £10k towards care costs with current means test thresholds



4.2 Top-up fees

There needs to be greater awareness among the general public of the potential benefits of having some money set aside to pay for *top-up* fees.

4.3 Possible ways to create an incentive to save whilst retaining the means test

It could be possible to create a greater incentive to save for potential care needs by introducing a social care branded product or category of products that allow individuals to save money for potential care costs without the money saved being included in the means test. This would address the issues raised above for the specific purpose of LTC saving, but would do nothing to address the wider disincentives presented to saving. It might also lead to greater awareness among the general public of the options if these products are marketed by product providers and potentially endorsed by the Government. There would probably need to be limits placed on the amount that can be set aside in these products in order to prevent the products being used as a mechanism for qualifying for means tested support.

4.4 Existing ways of saving money for care costs without affecting means tested benefits

The above analysis has assumed that all savings are invested in assets that are included in the financial assessment. However, there are existing savings products that are not included in the financial assessment. These include investment bonds and life assurance products such as whole of life plans. These savings and insurance products provide a vehicle for individuals to save money

outside of the means test. This could lead to individuals qualifying for financial help under the means test even when they have significant assets saved in these insurance and savings products.

Conclusion 3: The new means testing thresholds provide a greater level of reward for savers than the existing thresholds, and may increase the level of saving for care, but they could still act as a barrier

Overall, individuals with assets of up to £110k at the point of entering care can expect their contribution to care costs to increase as they save a further £10k. This is most significant for individuals with between £20k and £60k[9] of assets at the point of entering care. For these individuals, at their current level of saving if they save an additional £10k to meet potential care costs they can expect to see the contribution they are required to meet their care costs increase by at least £5k by the time they have been in care for three years.[10] In other words, half of this extra saving would need to be used to cover LTC costs. If the same individual saves an additional £50k instead of £10k then it is a similar story, and again over half of the extra savings are spent as a result of reduced means tested support over a 10 year period.[11]

This means that for individuals likely to have assets between £20k and £60k at the point of entering care there is a limited incentive to saving at any stage before going into care, should the individual consider it likely that they will need LTC. Any additional money put aside could lead to an increase in the amount that the individual has to contribute to their care costs with no change in the cost or quality of care received. This is because the additional savings replace the Local Authority funding that would have been provided under the means test.

Recommendation: To help incentivise people to save one solution could be to create a new product, or category of products, that allows savings to be exempt from the means test up to a specified threshold. This cost could be met by removing existing loopholes for investment bonds and life assurance products in the financial assessment, as these products can allow a person to qualify for financial help whilst having significant assets saved. New exempt products designated for long term care saving could both encourage individuals to plan for the risk of needing long term care, and fund care needs more fairly than the current rules allow.

[9] Figures are given in real terms
[10] This is the average amount of time for which a person will be in care (Forder and Fernandez, 2011)
[11] Since there is only a 1% chance that someone will live this long, this is should be considered an extreme example (Laing & Buisson, 2013)

Appendix 1: Overview of changes in Care Act 2014

The Care Act 2014 includes care funding reforms as recommended in the 2011 Dilnot Report. The second phase of implementation includes the introduction of a *cap* on Local Authority set care costs of £72,000 and an increase in the *means testing thresholds*. The Government has announced that the implementation of these reforms will be delayed until 2020.

The purpose of these reforms is to protect individuals from facing catastrophic care costs and facilitate individual understanding of their potential care funding requirements. It is hoped that this will create demand for financial products that will help people to save for potential LTC needs.

Below we have set out further detail on each of these four reforms:

The introduction of a cap on Local Authority set care costs of £72,000

There are three aspects of an individual's care costs:

- Local Authority set care cost – this is the rate that the Local Authority would pay for care if the individual is eligible for state funding. This is the portion of an individual's care costs that counts towards the *cap*
- *Daily living costs* – individuals will be expected to contribute towards their *daily living costs* when in care. This amount is currently set at £230 per week. This sum will not count towards the *cap* and will still have to be paid by the individual after the individual reaches the *cap*
- *Top-up* costs – should the individual be receiving care that is charged above the *Local Authority rate,* the individual will have to meet this cost. *Top-up* costs will not contribute towards the *cap* and the individual will still have to pay for them after they reach the *cap*.

An increase in the means testing threshold to £118,000 where property is included and £27,000 where property is excluded

Where a person is in a *care home* and the value of their property is to be taken into account, they will be eligible for Local Authority financial support if they have assets of £118,000 or less. Those in *care home*s where the property is not included, for example because their spouse continues living there will be eligible for Local Authority financial support if they have assets of £27,000 or less.

Universal eligibility criteria across England

Local authorities can no longer set local eligibility criteria for example at "critical" or "substantial" needs. National eligibility criteria are now in place similar to the previous substantial care needs criteria. This greater clarity around eligibility should help individuals to understand their saving needs for LTC. Consistency across England will also be helpful to companies offering financial products, where the pay-out of benefits might be linked to eligibility criteria.

The requirement for local authorities to provide independent personal budgets and care accounts

The introduction of care accounts means that individuals will be able to track their personal expenditure and progress towards the £72,000 care *cap*. The independent personal budgets provides a mechanism for individuals to monitor their contributions to their care account.

We anticipate this will increase the visibility of personal contributions needed to meet care costs, thereby helping individuals understand their potential care costs and consider how they will meet them.

Universal deferred payment scheme from April 2015

The deferred payment scheme is designed to help individuals with 'eligible needs' who have been assessed to pay the full cost of their *care home* fees, but who cannot afford to pay the full amount immediately because their *cap*ital is tied up in their home. By agreeing to a deferred payment, the individual can delay paying the cost of their *care home* fees until a later date.

To qualify for a deferred payment the individual must have no more than £23,250 in savings and other *cap*ital, and the property would not be disregarded for charging purposes. The Local Authority may require a contribution from the individual's income, savings or other assets but must leave them with up to £144 per week if they wish to retain this sum. All other costs, including *top-ups* and extra care costs can be deferred, subject to the level of equity in the property.

The scheme uses a national maximum interest rate, which changes every six months on 1 January and 1 June and is determined by the market gilts rate specified in the most recently published report by the Office of Budget Responsibility; a default component (0.15% p.a.) is then added to give the final maximum interest rate. In addition to charging interest the Local Authority may charge reasonable legal and administrative costs of setting up, maintaining and terminating the deferred payment.

Most people can use around 80% to 90% of the equity available in their home under the deferred payment arrangements.

Appendix 2: Probability of individuals 'reaching' the Care Cap

The likelihood of individuals needing care provision in later life is significant. It has been estimated that there is a 25% chance of a 65 year old male needing eligible care at some point in their life (35% for females) (Rickayzen, 2007).

This section explains how, under the new *cap*ped cost regime, individuals with assets of more than £17,000 will still need to self-fund significant levels of their care costs, albeit at a lower level than before the changes introduced by the Care Act. '*Top-up'* costs will continue after reaching the *cap* and will vary significantly by region.

Our previous report estimated the probability of someone having eligible care needs reaching the care *cap* based on the age and gender of the individual and the region in England where the *care home* is based.

We have updated the model to accommodate changes in the average *care home* costs and Local Authority standard rates based on the more recent Laing & Buisson reports[12]. The figures are based on 2013/14 values and therefore have been inflated to 2016/17. We have continued to use an annual inflation rate of 3.5% in the model.

The model allows for the means test and we have illustrated a central scenario where the individual is a single homeowner with assets (including the value of their property) of £150,000, and has an income of £12,000 p.a.

The model has flexibility to allow for different genders, the age at which the individual is admitted to the *care home* and the region in England where the *care home* is based.

The model projects costs out for 10-years, allowing for the probability of survival for each year. A 10-year projection horizon was used as the data for individuals surviving in a *care home* for over 10 years is relatively sparse – the probability of surviving for 10 years is very low, at around 1% (Forder and Fernandez, 2011).

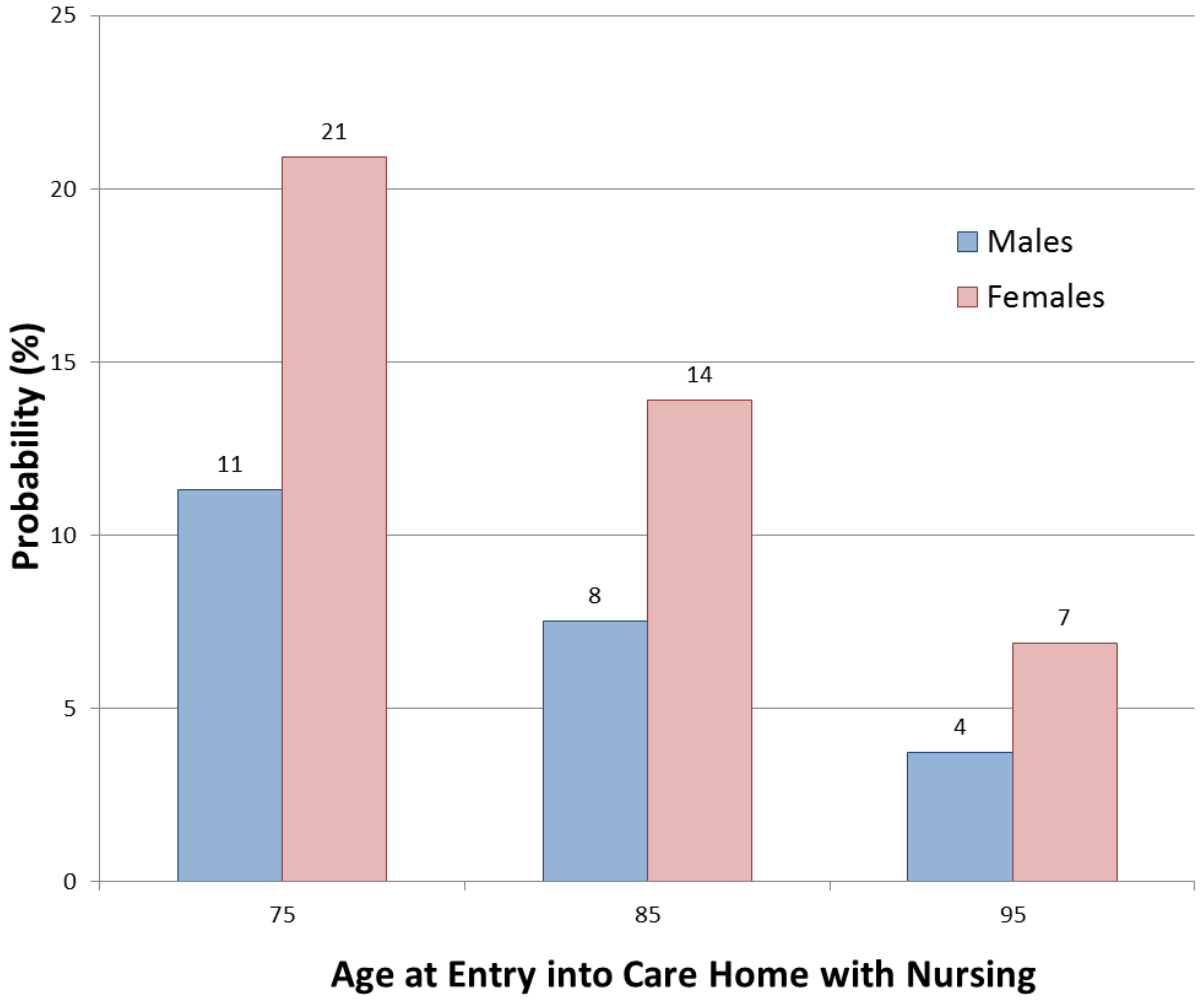
The survival rates are based on a comprehensive survey carried out by the Personal Social Services Research Unit (PSSRU) of *care home* residents in England, that died from November 2008 to May 2010. The mean age at entry to the *care home* was 85 and around two-thirds of the residents were female (*ibis*).

[12] Laing & Buisson Care of Older People UK Market Report 2013/2014. The *Local Authority rate*s are based on the average mid-range *Local Authority rate*s published in the Laing & Buisson Community Care Market News report (2013) adjusted for the average *Local Authority rate* increases by region published in the Laing & Buisson Care of Older People report (2014).

Probability of reaching the cap by age and gender

The chart below shows the probability of reaching the *cap* depending on the gender of the individual and the age at which they are admitted to the *care home*.

Figure 13: Approximate probability of reaching the cap by age and gender



Care costs and probability of reaching cap by region

The following charts are based on an individual entering a *care home* at age 85 and the potential costs incurred over the 10 year future 'lifetime' period. The charts show how the probability of reaching the *cap* and the number of years before the *cap* is reached vary by the region in which the *care home* is located.

Separate charts show the results for *care home*s with and without nursing respectively.

Figure 14: Personal funding of care costs by region in England– care home with nursing – 85 at entry into care

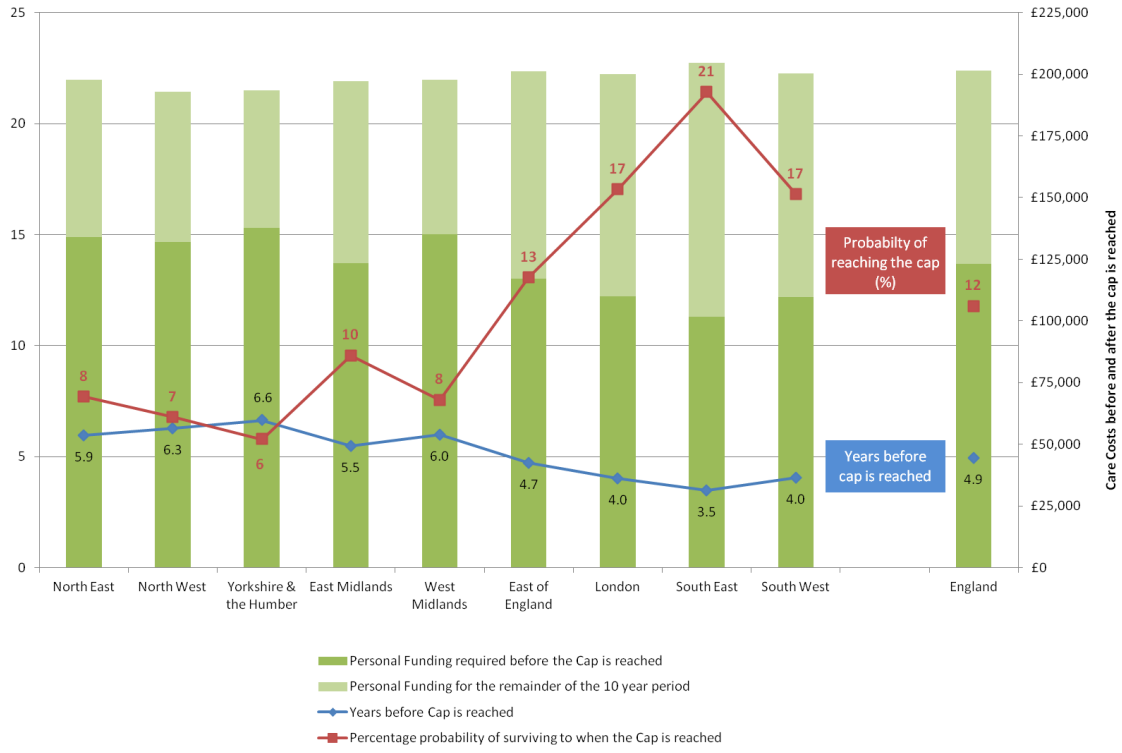
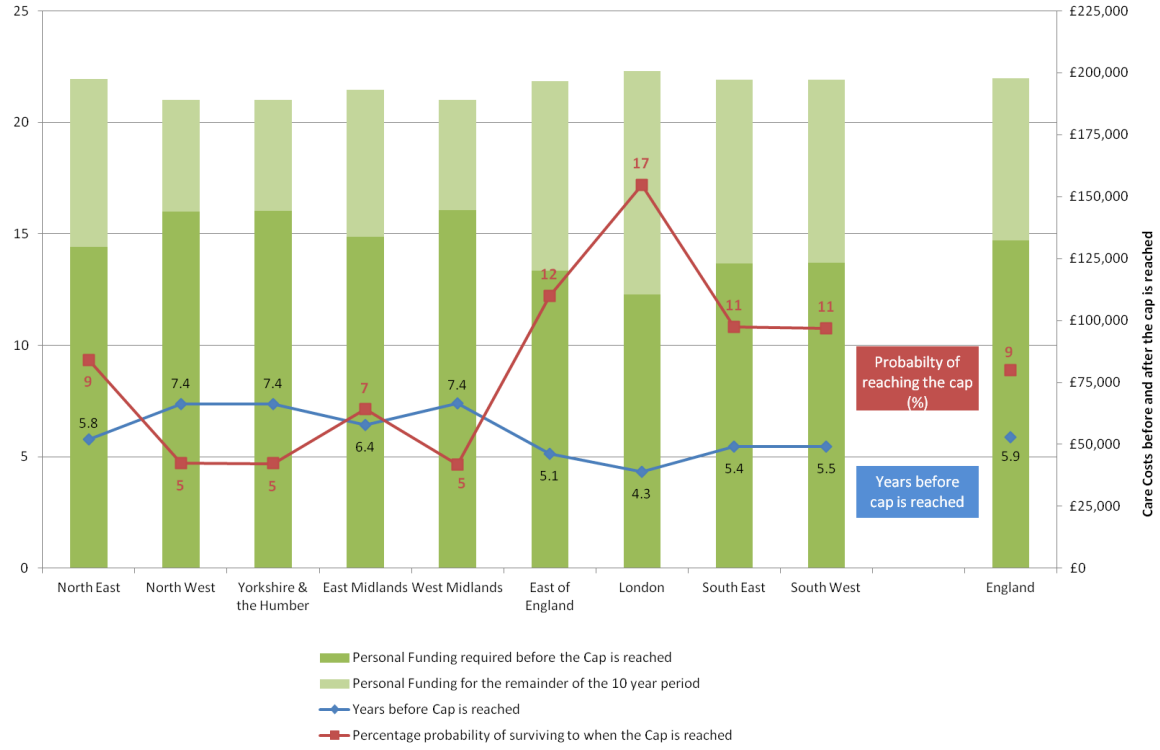


Figure 15: Personal funding of care costs by region in England– care home (without nursing) – 85 at entry into care



Is the regional variation in care costs sustainable?

The regional variations in care costs result from differences in labour and property costs and the general cost of living, across England. As such, from an economic approach, the variations are understandable but consumers may find the variations confusing and perceive them to be unfair. Having a universal amount across England for the *daily living costs* and for the *Attendance Allowance*, *Personal expense allowance* and NHS-funded nursing care payments exacerbate the issue.

We doubt whether individuals with eligible care needs would want to relocate to a different region to save costs but we believe there is an argument for looking again at having more consistent care costs across England, or potentially having a care cost *cap* that varies across regions.

Key assumptions in the model

The current version of the model uses survival rates based on Table 15 in the PSSRU/BUPA Report on Length of Stay in Nursing Homes in England (Forder and Fernandez, 2011). The survey had a mean age of entry to a *care home* of 85. The survival rates for varying gender, age and type of *care home* have been extrapolated linearly from the survival rates shown in Table 15 and Figure 1 in the PSSRU/BUPA Report. This enables us to give an indication of the impact of gender, age and type of care on the probability of reaching the *cap*.

It should be noted that the survival rates are based on residents in *care home*s across England. We have not at this stage tried to accommodate regional survival rates.

The care costs are based on Laing & Buisson (2013) average *care home* costs and Local Authority standard rates in 2012/13 values and have been inflated to 2016/17.

When Local Authority support reaches the maximum limit (the *cap*), it is assumed that individuals' assets are depleted. When no assets are left it is assumed a *top-up* is provided by a third party.

In the charts shown in this report, it is also assumed that:

- the means test is re-assessed each year based on updated asset and income values
- care costs, the care *cap*, the means test limits, the *Attendance Allowance* and the NHS funded nursing care contribution all increase in line with inflation at a rate of 3.5% per annum.
- assets and income increase at a rate of 3.5% per annum
- as the *cap* increases the percentage of the *cap* achieved remains constant
- individuals continue to make *top-up* payments after the care *cap* is reached.

All of these assumptions can be adjusted in the model.

Appendix 3: Incentives to save – Model

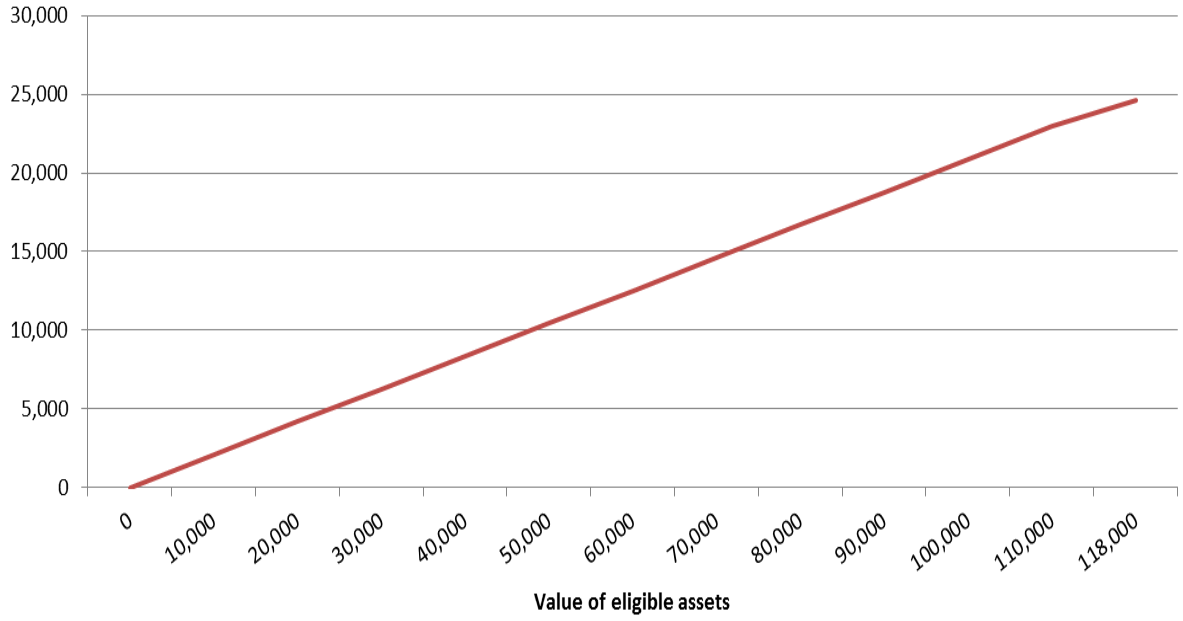
How is tariff income calculated?

The chart below shows how tariff income varies according to different levels of eligible assets. This is based on the lower threshold being £17,000 and the upper threshold being £118,000.

If the value of eligible assets is between 17,000 and 118,000 then the weekly tariff income is calculated equal to $\frac{Value\ of\ Assets - 17{,}000}{250}$

We have multiplied the weekly tariff income by 52.18 to give an annual figure.

Figure 16: Annual tariff income (figures in £)



The following tables show the detailed breakdown of the financial assessment as modelled for starting assets of £20k and £30k. It can be seen that the increase in personal contribution of £9k over 10 years by saving an extra £10k from assets of £20k is driven by the change in the contribution from the means test.

The item "Means test contribution to care costs" is calculated as the difference between:

- Total care costs excluding *top-up* costs and
- The sum of "Personal budget" and "Local Authority contribution to care costs as a result of the *cap* being reached" less "Unused personal budget".

Incentive to save examples

£20k starting assets

Financial Assessment	Ref	Value at end of 3 years	Value at end of 10 years
Means testing threshold	A	£18,848	£23,980
Means testing upper limit	B	£130,829	£166,451
Assets including house	C	£24,075	£32,580
		Total paid during 3 years	**Total paid during 10 years**
Income	D	£37,275	£140,777
Attendance Allowance	E	£0	£0
Tariff Income	F	£2,381	£12,299
Personal expense allowance	G	£4,177	£15,776
Personal budget	H	£35,479	£137,300
Unused personal budget	X	£0	£0
Means test contribution to care costs	**I**	**£39,803**	**£81,943**
Total care fees	J	**£101,173**	**£382,105**
Top-up fees	K	**£25,892**	**£97,787**
LA *cap* contribution	L	**£0**	**£65,076**

H = J if C>B else D+E+F-G,
I = J-K –H– L+X

£30k starting assets

Financial Assessment	Ref	Value at end of 3 years	Value at end of 10 years
Means testing threshold	A	£18,848	£23,980
Means testing upper limit	B	£130,829	£166,451
Assets including house	C	£29,642	£35,401
		Total paid during 3 years	**Total paid during 10 years**
Income	D	£37,275	£140,777
Attendance Allowance	E	£0	£0
Tariff Income	F	£7,598	£22,889
Personal expense allowance	G	£4,177	£15,776
Personal budget	H	£40,695	£147,890
Unused personal budget	X	£0	£1,788
Means test contribution to care costs	**I**	**£34,586**	**£73,141**
Total care fees	J	**£101,173**	**£382,105**
Top-up fees	K	**£25,892**	**£97,787**
LA *cap* contribution	L	**£0**	**£65,076**

H = J if C>B else D+E+F-G,
I = J-K –H– L+X

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Glossary

Term	Meaning
Activities of daily living (ADLs)	Basic personal tasks of everyday life such as bathing, dressing, using the toilet, eating etc.
Annual Allowance	The *Annual Allowance* is the maximum amount of 'pension input' to registered pension schemes in a year. For a *DC* scheme the pension input includes contributions made by anyone else into an individual's pension such as an individuals employer. For a *DB* scheme, the pension input is basically the increase in pension benefit accrued in the year. If an individuals pension input exceeds the *Annual Allowance* they will have to pay a tax charge and give details in their Self Assessment tax return. HMRC rules allow an individual to carry forward any unused *Annual Allowance* from the three previous tax years to offset this charge. From 6 April 2014 the *Annual Allowance* is £40,000.
Annuity	An insurance product that pays a fixed sum of money to someone each year, typically for the rest of their life.
Attendance Allowance	The *Attendance Allowance* is if a benefit for those who are 65 or over and have a physical or mental disability such that they need help caring for themselves.
Care home	Residential *Care home*
Care home with nursing	Nursing home
The '*Cap*'	Part of the Governments proposals to limit the amount of personal expenditure on care from the point that long term care is needed. This was proposed to be £72,000 before the implementation date was postponed to 2020.
Daily living costs	Those in *care home*s will pay a contribution of around £12,000 yearly towards general living expenses such as food and accommodation. Also known as '*Hotel costs*'.
Defined benefit (*DB*) pension scheme	In a *DB* scheme the amount of pension an individual will get when they retire does not depend on the size of their pension pot. Under this arrangement an individual is promised a certain amount of pension at retirement. The amount of an individuals pension is usually based on your pay and length of service. *DB* arrangements are normally only found under occupational pension schemes. Examples of a *DB* arrangement are: • final salary - where an individuals pension is based on their final salary and period of employment • a career average scheme where an individuals pension is based on the average of their earnings over your period of

	employment • lump sum only schemes that do not provide a pension but only a lump sum - for example 3/80ths (3.75 per cent) of an individuals final pay for each year of employment or scheme membership
Defined contribution (*DC*) pension scheme	The employer and employee agree on a set amount (normally expressed as a percentage of salary) to be contributed to an individual pension fund. This may be monthly, annually or dependent on pay schedule. The contributions are invested to provide a fund for retirement. The employee contribution comes from their salary, before tax is applied. Unlike *defined benefit* pension schemes (sometimes referred to as final salary schemes), the level of retirement income for the member is not guaranteed.
Disability	Disability is defined as a person having: • any health problems or disabilities that will last for more than a year and/or • health problems or disabilities, when taken singly or together, substantially limit the person's ability to carry out normal day to day activities.
Disability free life expectancy	Measure of the number of years an individual can expect to live free from illnesses or impairments which restricts their ability to carry out normal day to day activities.
Drawdown	Refers to the flexible withdrawal of pensions savings in retirement in addition to or instead of using pension savings to purchase an *annuity*.
Freedom and choice	From April 2015 the Government has lifted restrictions on people's ability to drawdown from their defined contribution pension pots after age 55 and simplified the tax rules. This gives retirees greater choice over how they access their *defined contribution* pension savings.
GAD limit	The maximum that an individual can withdraw from a *drawdown* pension plan based on relevant factors, like age, gender and 15-year gilt yield index – calculated by the Government Actuary's Department.
Hotel costs	See *Daily Living Costs* above.
Lifetime Allowance (LTA)	The value of benefits within registered pension schemes which will have no additional tax charges. From 6 April 2014 the *Lifetime Allowance* is £1.25m, but will reduce to £1 from April 2016.
Local Authority rate	The assessment by the Local Authority of the weekly cost of meeting the assessed LTC needs. This is the amount net of *Daily living costs* that accrues towards the *cap* once an individual has eligible needs.

Long term care *(LTC)*	In this paper Long Term Care refers to the care needs of the over 65s. This can include help with their medical needs or daily activities over a long period of time.
Means testing threshold	The extent to which an individual will be asked to contribute towards their care needs depends on the level of their assets – an assessment known as means testing. The asset levels (or thresholds) at which a contribution is expected and at which full payment is required vary by region.
Medical underwriting	A process by which in insurance company makes an assessment of the health of an applicant for an insurance policy before agreeing to issue a policy or determining a suitable premium.
Minimum income requirement	Under the previous pensions regulatory regime there was a requirement to demonstrate a minimum regular income before flexibility to *drawdown* on pensions savings was allowed.
NHS-funded allowance	NHS-funded nursing care is care provided by a registered nurse for people who live in a care home. The NHS will pay a flat rate contribution directly to the care home towards the cost of this registered nursing care.
Personal expense allowance	The *Personal expense allowance* is the minimum amount a person in a *care home* must be left from their income after charging for care and support.
Substantial need	*Substantial need* arises when any of the following apply: • there is, or will be, only partial choice and control over the immediate environment • abuse or neglect has occurred or will occur • there is, or will be, an inability to carry out the majority of personal care or domestic routines • involvement in many aspects of work, education or learning cannot or will not be sustained • the majority of social support systems and relationships cannot or will not be sustained • the majority of family and other social roles and responsibilities cannot or will not be undertaken
*Top-up*s	An individual can choose to receive more expensive LTC than that provided by the Local Authority providing they "*top-up*" their care fees.
Uncrystallised funds pension lump sums (UFPLS)	A means of taking lump sum pension benefits without going into *drawdown* or buying an *annuity*. It can be used to deplete the fund in one go, taking 25% tax free and the remaining 75% taxable, or used to take a series of lump sums.

Universal deferred payments scheme (UDPS)	The universal deferred payment scheme allows individuals with 'eligible needs' who have been assessed to pay the full cost of their *care home* fees but cannot afford to pay the full amount to defer *care home* fees. If their *cap*ital is tied up in their home – see Appendix 1.
Whole-of-life assurance	An insurance policy which pays a lump sum upon the death of the policyholder. Such a policy is typically held for the lifetime of the policyholder from policy inception.