The Actuarial Profession
making financial sense of the future

What is the future for long-term care?
Jules Constantinou

The Challenge for the Industry

Timeline

General Election	• 6 May 2010
National Commission	• 20 July 2010
Call for Evidence	• 1 December 2010
National Commission Report	• July 2011
White Paper	• Q4 2011

ToR of National Commission

- How best to meet the costs of care and support as a **partnership** between individuals and the state;
- How people could choose to protect their assets, especially their **homes,** against the cost of care;
- How, both now and in the future, **public funding** for the care and support system can be best used to meet care and support needs; and
- How any option can be delivered, including an indication of the timescale for implementation, and its impact on local government (and the local government finance system), **the NHS**, and - if appropriate – financial regulation.

"Any suggestions should cover both working-age and older people – although it is possible to recommend **different funding options** for the different demographic groups. "

Call for Evidence

- Any recommended options must focus on how to reform **the funding** of care and support.

http://www.dilnotcommission.dh.gov.uk/files/2010/12/1.1-Call-for-Evidence-FINAL-pdf.pdf

- Biggest driver of uncontrolled costs is aging:
  - Over 65s will increase by 50% over the next 20 years;
  - Over 90s is expected to treble.
- Another worthwhile statistic to bear in mind:
  - State £14.8bn
  - Private £8.3bn

Cost of aging

Table 2: Office for Budget Responsibility projections for age-related public expenditure (per cent of GDP)[4]

	2009-10	2019-20	2029-30	2039-40
Health				10.2
Long Term Care	1.2	1.4	1.7	2.0
Education				5.8
Pensions	5.5	5.3	6.1	6.8
Public Service Pensions	1.8	1.9	2.0	1.9
Total	**22.5**	**23.1**	**25.1**	**26.6**

Note: Figures are for UK. Long-term care covers social care expenditure on working-age and older people and excludes long-term care provided within the NHS which is included under health.

Criteria for potential options

- Choice: “prepare and plan”
- Fair: “individuals, families, carers and wider society”
- Value for money: “highest quality services for the limited resources available”
- Easy to understand: “clear and simple”
- Sustainable: “costs to the state are sustainable in the face of an aging population”

National Commission in Public Eye I

Lord Norman Warner: 15/02/11

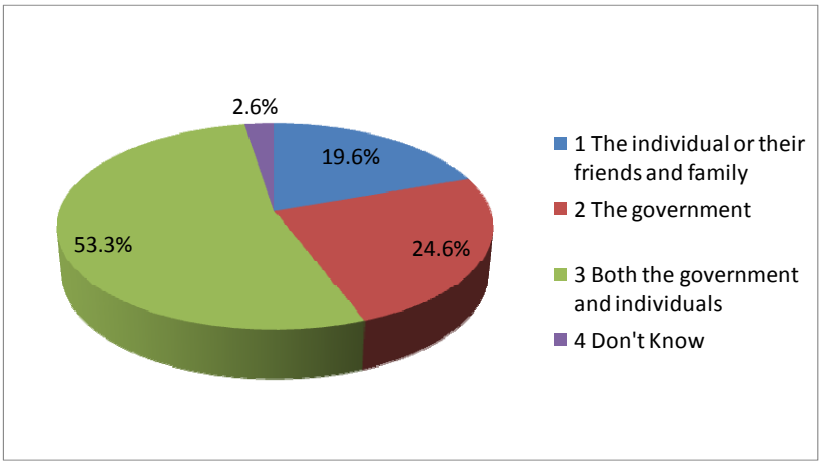
- “no silver bullet”
- “insurance industry has not produced fit for purpose products”
- “no appetite for compulsion”
- “no interest in involving employers”
- “better means testing trigger” / “not such a steep cut-off”

National Commission in Public Eye II

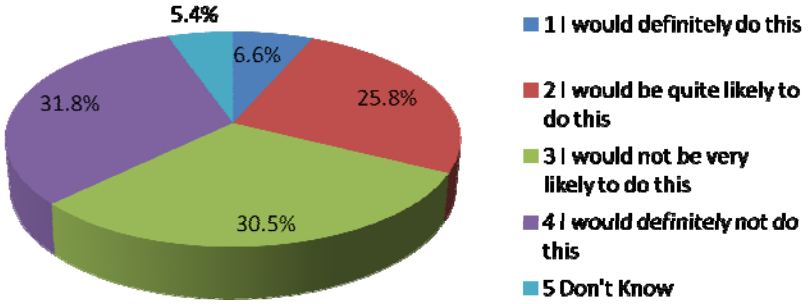
Andrew Dilnott: chair of Commission: 08/03/11

- “first priority is to provide for those who cannot provide for themselves”: safety net / means testing;
- “unmet need”
- “we can’t find a (single) solution”
- “no compulsory insurance scheme”
- “partnership between State and financial services sector” / “can’t take all of the risk” / “not much engagement”
- FT (29/3/11): state must find more money / cap on amount people have to pay in old age.
- Most people have two big assets: home and their pension fund
- Role for pre-funding

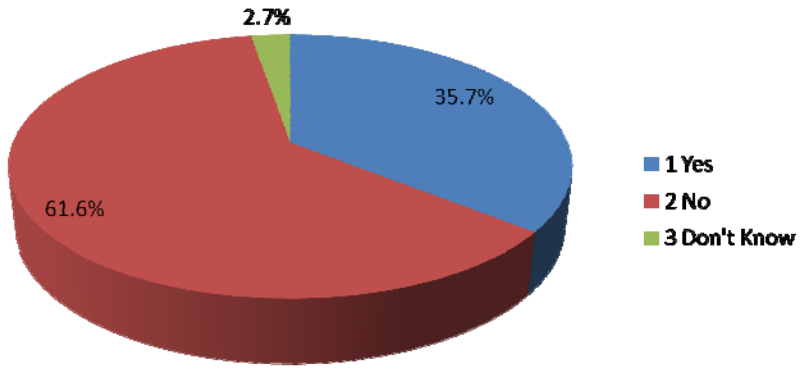
Client survey: partnership question



Client Survey: insurance question



Client Survey: use of the home question



conclusion

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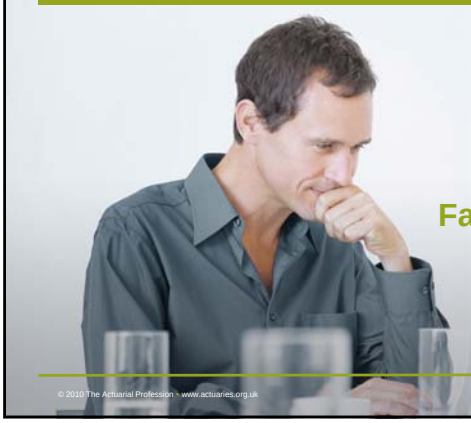
Private Finance Products in Partnership Model



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May 2011

Key questions

Partnership model

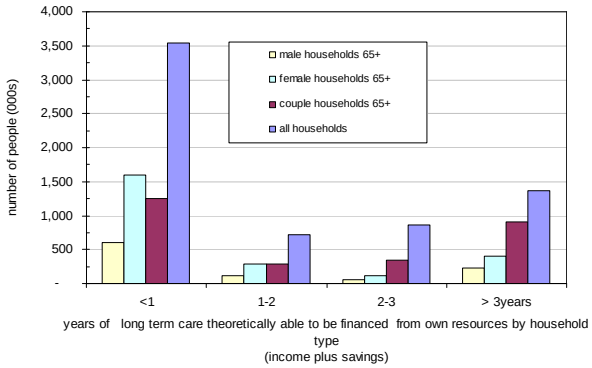
- How individuals can meet the costs of care and support from their own resources
- How public funding for the care and support system can be best used to meet needs
- How the state and industry support these aims together
- How to deliver the preferred option including implementation timescales

Strategic issues arising

- The number aged 65+ will increase from to 9.8m in 2009 to 12.4m 2020 and the number aged 80+ from 2.8m in 2009 to 3.6m in 2020
- A female reaching 80 in 2001 had a 2.7% chance of reaching 100 whereas a female of the same age in 2020 has a 12.3% chance
- Male and female life expectancies at age 50 appear to be converging at ~35 years by 2020
- The gap between Healthy Life Expectancy and Life Expectancy is increasing and so potentially more years will be spent needing care

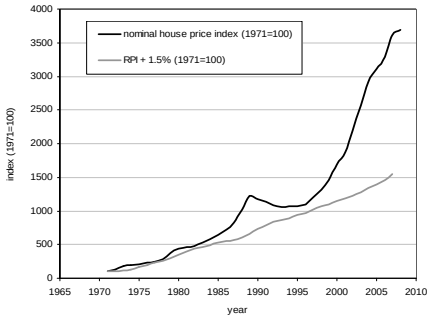
Affordability of long term care based on income and savings by household type

Only 400k out of 6.5m 65+ households can afford institutional care for more than *1 year* on the basis of income alone, but this increases to 3m if savings are included



Assumed cost of LTC £500 p. wk.

House prices versus the RPI



House prices versus RPI:

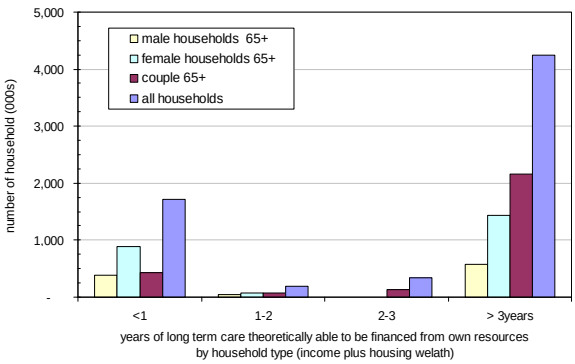
Chart shows how house prices have moved relative to the RPI. In 1971 the value of a house would have roughly pay for 3.7 years worth of care. In today's prices it would pay for approximately 8.8 years.

But not everybody will wish to sell up…

Affordability of long term care based on total wealth by household type

If housing wealth is included then 4.6m households could afford care for more than *1 year*

Of the 1.8m households that cannot afford care for more than one year if housing wealth is included, 0.9m are female



Financial products for LTC

3 classes of product: 'point of need', 'point of retirement', 'any time'

- Equity release products
- Top up insurance
- Immediate needs annuities
- Accelerated life insurance
- LTC bonds/trust fund
- Disability Linked Annuities

Why LTC bonds?

- There is a large population that cannot afford any LTC
- Would pay out only if LTC needed, otherwise go to estate or pay for funeral expenses
- Would pay monthly prizes e.g. like premium bonds
- Would accrue interest just as in a bank
- Evidence tells us that people on low income buy premium bonds, lottery tickets etc.
- Would at least be a contribution and would attune the population to saving for care in old age

How do DLAs work?

- Works likes a pension annuity and is actuarially fair
- But:
  - Higher payments if become disabled
  - Even higher payments if go into care
- Can apply to any kind of pension – defined benefit or defined contribution, public sector and state pension alike

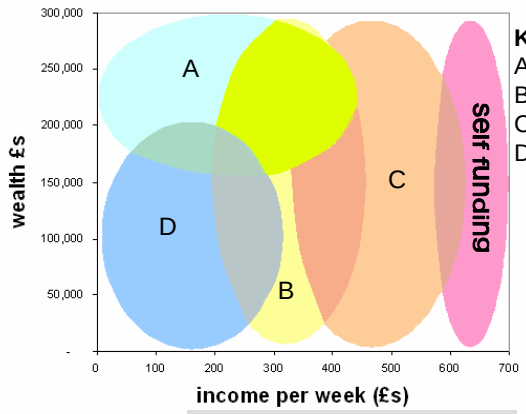
Example of a DLA based on an initial lump sum of £100k

	uplift	healthy	Failed 2 ADLs	Failed 3 ADLs
male	1/1/1	6.73	6.73	6.73
	1/1.5/2.5	6.03	9.04	15.07
	1/2/2	6.08	12.17	12.17
	1/2/3	5.76	11.51	17.27
female	1/1/1	6.07	6.07	6.07
	1/1.5/2.5	5.28	7.92	13.20
	1/2/2	5.34	10.68	10.68
	1/2/3	4.99	9.97	14.96

ADLs = Activities of daily Living

Units £000s p.a

What is the market?
Income-wealth map and market penetration



Key
A= Equity release
B= Top up insurance
C= DLA
D= LTC bonds

Something for everybody……

Interfacing products with means testing

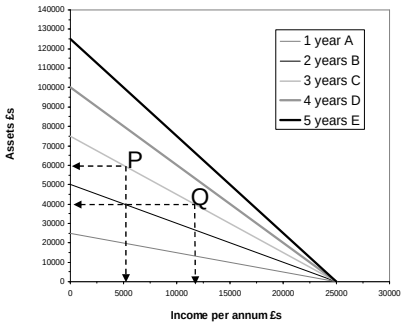
- Current system too complex and not equally applied
- Disincentive to save and deters low cost private finance solutions
- Unfair because people just above the threshold have no state support or limited means to insure against risk
- Its not what people want! (Green Paper consultation)

Principles underpinning new system of public support

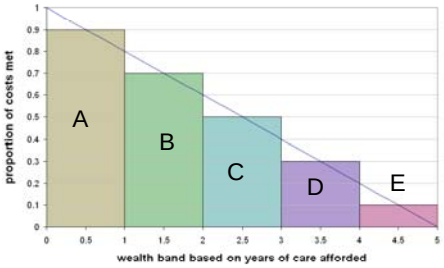
- All people should receive something unless they are fully self-financing
- It should be based on income and assets
- It should not dis-incentivise people to save or purchase products
- It must be fair and transparent!
- It should be affordable in terms of public expenditure
- People can by-pass system if they wish

Proposed system

Stage 1



Stage 2



1. People are placed into 'wealth bands' according to the years of LTC they can afford based on both income and assets.
2. People needing LTC receive a proportion of their LTC costs based on which band they are in as shown in example

Example

- Assume value of the state pension and other benefits is worth £10k per year and that care costs £25k a year.
- For illustration, assume no other reckonable income.
- Based on the rates shown a person in each band would receive:
  - A: £13.5k (£25k-£10k) x 0.9 shortfall £1.5k
  - B: £10.5k (£25-£10k) x 0.7 shortfall £4.5k
  - C: £7.5k (£25k-£10k) x 0.5 shortfall £7.5k
  - D: £4.5k (£25k-£10k) x 0.3 shortfall £10.5k
  - E: £1.5k (£25k-£10k) x 0.1 shortfall £13.5k
  - >E nothing (£25k-£10k) x 0.0 shortfall £15.0k

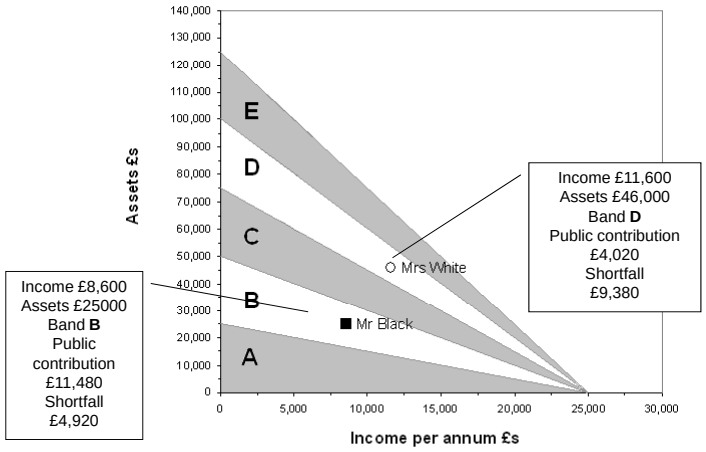
Rates are illustrative and actual rates would need to be affordable in public expenditure terms

Case studies

Cost of care limit £s per yr		
Assets	**Mrs White**	**Mr Black**
House	40,000	0
Savings	6,000	25,000
Total	46,000	25,000
Income		
State pension	5,000	5,000
Occupational pension	3,000	0
Attendance allowance	3,600	3,600
Total	11,600	8,600
Notional years of care afforded	3.43	1.52
Band	D	B
Public contribution	4,020	11,480
Income shortfall	9,380	4,920
Top up options		
Top up insurance	Y	Y
LTC bonds	Y	Y
Equity realease	Y	N
Immediate needs annuity	N	N
DLA	N	N

Illustrative public support rates: A = 90%; B=70%;C=50%;D=30%;E=10%; others: self funding

Income asset map with bands



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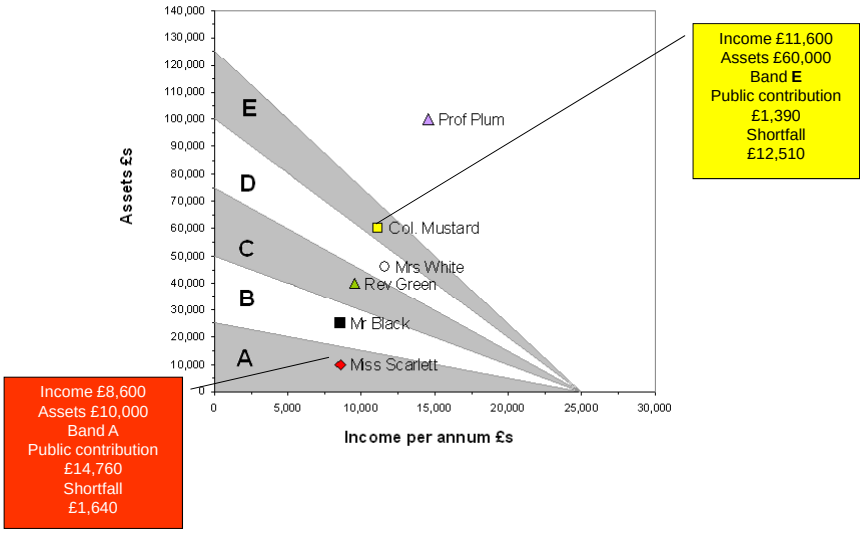

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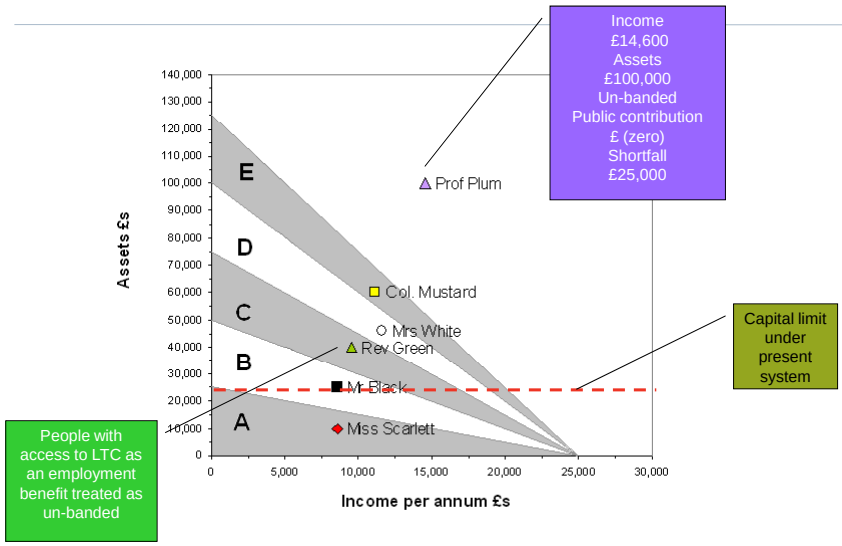

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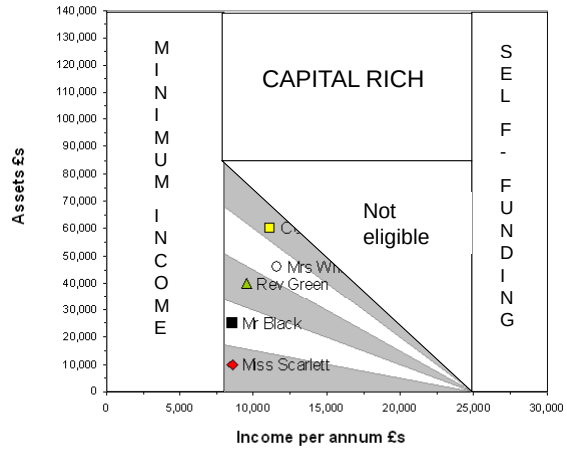
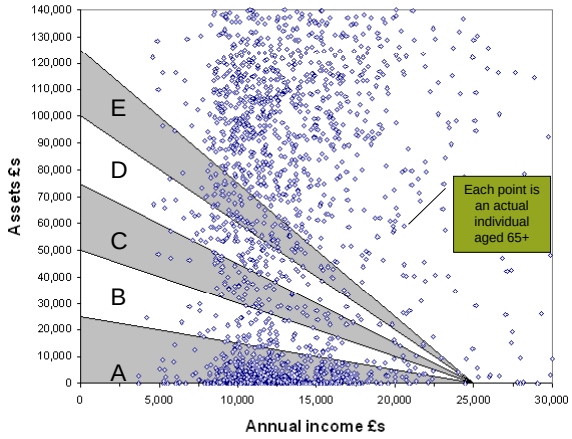


Income and asset distribution



% people 65+ by band

A – 19.8%

B - 2.1%

C - 2.2%

D – 2.8%

E – 3.1%

Self funding 69.9%

Under present system

~22% could be under the threshold

Under new system

~ 30.1% would get something

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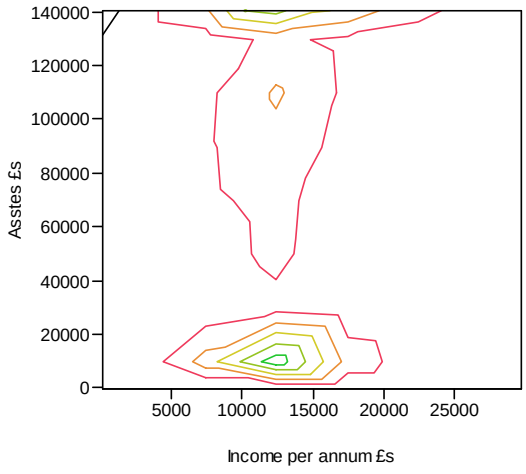

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Cohort effects

% of individuals by band reaching age 85 in given years

Band	2010	2015	2020	2025	All
A	29.9	26.3	21.1	15.9	19.8
B	2.4	3.5	1.6	2.1	2.2
C	2.8	3.0	2.4	1.8	2.2
D	2.6	3.6	2.7	2.7	2.8
E	2.6	2.6	2.6	3.5	3.1
>E	59.7	61.0	69.6	74.0	69.9

Note that the proportion that cannot self fund for more than 1 year goes down over time

Annual insurance premiums based on top up mechanism

Policy triggered by failing 3 ADLs (Activities of Daily Living)

amount of weekly state support £s	male	female	male or female
<100	778	898	838
100-200	597	689	643
200-300	416	480	448
300-400	235	272	253
400-500	54	63	59

People getting more state support pay lower premiums

Summary of key proposals

1. *Control of public expenditure is maintained:*
   - through the personal cap (e.g. £25k)
   - the banding structure and top up rates
   - through the unified assessment system
2. *Equity* through universality and equal treatment of people with different means
3. *Flexibility and choice* through the range of products and ways of meeting costs
4. *Avoidance of gaming: '7-year rule'*

Suggested role of the state

To:

- Clarify state entitlement based on a unified assessment system
- Provide regulation of products and policy stability
- Make it easier to get financial advice and direction at points of need or contact
- Provide incentives for people to take up private finance products e.g. through the tax system
- Improve the quality and efficiency of care services
- Create conditions for private sector to invest

Timing issues

- New products will take time to mature e.g. LTC bonds may take 10 years or so to reach a steady state
- Implies that private finance funding mix will gradually evolve with equity release likely to be most popular initially
- Investment in computer systems would be borne largely by private sector providers
- Some public investment in IT might be needed for monitoring and regulation purposes

References

- lesmayhew@googlemail.com

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