Institute and Faculty of Actuaries

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Comprehensive Spending Review 2020

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

COVID-19 has caused unprecedented disruption to the UK's economy. As the Government looks to stimulate the economy the IFoA has highlighted three key topics where allocation of spending, or a change in fiscal policy, could boost the UK's economic recovery, not just in the short but in the long term.

Social Care: With a growing ageing population, and COVID-19 only furthering the strains put on the UK's social care system, the time for long-term, sustainable reform is now. The UK remains one of the few developed countries not to have implemented an insurance or cost sharing initiative to address the issue of social care. The Government must therefore look reasonably at what it can provide for individuals, now and in the future.

Infrastructure: If the Government is to meet the UK's infrastructure needs over the coming years, in a financial context, there is a need to address longer term under-investment in infrastructure. The Government should look to provide a policy framework to encourage private investment, including issuing new UK sovereign sukuk in 2020.

Green Finance: As the Government looks to stimulate the economy as it recovers from COVID-19, it is essential that the Government's spending priorities align with its net zero goals in order to accelerate the transition to a low carbon economy.

Financial Resilience in the Private Rented Sector: COVID-19 has highlighted the limited ability of many households to cope with an interruption in regular income. The Government should consider revising the rules of Universal Credit (UC) to allow for renters to put income received from insurance policies (IP) towards housing costs.

Beijing	14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004 · **Tel**: +86 (10) 6535 0248
Edinburgh	Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel**: +44 (0) 131 240 1300
Hong Kong	1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +852 2147 9418
London (registered office)	7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel**: +44 (0) 20 7632 2100
Oxford	1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel**: +44 (0) 1865 268 200
Singapore	163 Tras Street · #07-05 Lian Huat Building · Singapore 079024 · **Tel**: +65 6906 0889

Social Care

1. The pressures facing the health and social care system are well-documented, and are largely driven by the UK's changing demographics. The population is growing, individuals are living longer, and there is a growing proportion of older people. In mid-2016 there were 1.6 million people aged 85 and over; by mid-2041 this is projected to double to 3.2 million.[1]

2. The UK's ageing population will continue to increase pressure on public services, as the number of people using these services exceeds those paying into the system through general taxation. Social care is facing high growth in demand, the cost of which is projected to rise by around £12bn by 2031, growing at an average rate of 3.7% a year. At the same time, projected growth in spending on social care is just 2.1% a year. This has left a funding gap of £1.5bn in 2020/21 and £6bn by 2030/31.[2] The recently announced injection of £546m for care homes to weather the coming winter period will be welcomed by the sector but it longer-term financial reform is urgently needed.

3. The Care Act 2014 embodies the most recent attempt to reform the social care system in England. But despite making its way onto the statute book, the reforms were subsequently delayed in 2016 and have since been shelved in favour of new legislative proposals. The delay in tackling social care reform is both putting a strain on the Treasury's purse strings and leaving those who need to pay for care at risk. With COVID-19 exacerbating the pressures already placed on the social care system and the NHS under increasing budgetary strain, it is essential that Government tackles the topic of social care reform as soon as possible to clarify what individuals and Government will be expected to pay so that they can prepare accordingly.

4. COVID-19 has introduced significant additional costs in the provision of care. These costs include provision of Personal Protective Equipment (PPE), testing, increased cleaning and less flexibility in workforce deployment through the creation of smaller care bubbles. Although short term funding is now available from the Government to offset some of the additional costs, many care providers remain under financial pressure which is compounded by falling occupancy levels in care homes from excess deaths, practical restrictions on new admissions and reduced demand for residential care.

5. An Institute for Public Policy Research (IPPR) survey suggested that people are less likely to seek residential care than they were prior to the pandemic and there is anecdotal evidence that Domiciliary Care Agencies (DCA) have received a greater number of enquiries and demand for their services.

6. COVID-19 has triggered a reduction in care services available, increased care costs and closures of day care centres. More people are now providing unpaid care for their family members, friends and neighbours. Figures released during Carers Week in June 2020 revealed that the COVID-19 pandemic resulted in an additional 4.5 million people starting to provide care for older or disabled people or those with physical or mental illness. Among these unpaid carers, 2.8 million have taken on care responsibilities whilst juggling paid work. The sustainability and long-term consequences of this on the health of those providing care and those receiving care is not yet known but will need to be tracked and monitored.

7. The increased funding challenges in social care now run concurrently with increased pressures in the wider economy. The delayed Green Paper on the future funding of social care is needed now more than ever to bring about a sustainable for funding solution for both government and individuals.

[1] ONS projections https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/bulletins/nationalpopulationprojections/2016basedstatisticalbulletin

[2] Health Foundation/The King's Fund 2018. https://www.kingsfund.org.uk/sites/default/files/2018-05/A-fork-in-the-road-next-steps-forsocial-care-funding-reform-May-2018.pdf

8. In the short term and as an immediate step towards a sustainable funding solution, the Government may consider introducing a more generous means test to widen access to the state-funded system of care and support for pensioner households with modest assets and wealth. The Government should implement Phase 2 of the Care Act as soon as possible to reduce the disincentives to saving towards the cost of care. The additional introduction of a care cap would be a welcome safety net, but individuals would need to make financial plans so that they only need to pay for costs up to the cap. There will also be a role for Government in helping more individuals meet this level of provision. The Government should look to clarify which households in future can access deferred payment agreements and greater clarity also needs to be given on what costs are capped.

9. In the longer term, it is likely that a range of funding options will be needed in order to solve the crisis in a way that is intergenerationally fair. This might include one solution for those already in retirement, or with care needs, and one for the working population with potential future care needs. It is unlikely that there will be a universal "silver bullet" product solution. We note there are a range of both insurance and savings-based financial products that already exist on the market that government should consider to be suitable for certain parts of the working population, depending on their wealth, assets, risk appetite and health. These include, immediate needs annuities, lifestyle insurance care riders, retirement income options made available by the "Freedom and Choice" and Equity release or other property-based solutions.

10. Proposed reforms should also look to rectify the artificial divide between health and social care in line with the Government's ambitions to integrate health and social care procurement. At present, the inconsistency with the division of health and social care causes systemic problems for the care sector, particularly in the increasing cohort of those with dementias. NHS funding and performance is on the edge of a precipice, as are local authorities, and a sudden and substantial cash crisis in the public sector would in turn precipitate a collapse in private sector provision.

11. Furthermore, there is a hidden cross-subsidy in the care sector, in that privately funded provision subsidises under-payment from social service departments. In turn, it also drives down wage levels in the sector to unsustainable levels, meaning care homes are often unacceptably understaffed. The entire sector urgently needs more funding, and long-term sustainable cross-party political agreement is a necessary prerequisite in this area, however hard to achieve.

12. High levels of government spending will not guarantee affordable access to social care, and increased levels of spending are likely to become unaffordable for government over the longer term. The UK remains one of the only developed countries not to have implemented an insurance or cost sharing initiative to address the issue of social care. In the 2020 spending review the Government should look reasonably at what it can provide for individuals, now and in the future, to support the UK's ageing population.

Infrastructure

13. Well-designed infrastructure projects have long-term economic and environmental benefits, contributing to economic growth and productivity. The UK has a set a binding target to reduce greenhouse gas emissions to net zero by 2050. To meet this target, an enormous amount of new and resilient infrastructure will be needed, requiring significant capital investment. The upcoming launch of the National Infrastructure Strategy will present a chance for the Government to define the UK's infrastructure needs over the coming years.

14. Alongside major projects, small-scale, more diffuse infrastructure development is also important, together with any necessary changes to building regulations to support this. Examples could include home insulation, flood defence and enabling water retention on farmland. Given regional water

resource disparities, increased reservoir provision could allow for water transfer on an equitable basis between regions.

15. Climate change is a key factor behind the need for resilience in infrastructure projects. Achieving resilience requires identifying resilience options, devising alternative future scenarios and taking account of extreme events. The Government and the National Infrastructure Commission should issue guidance on analysing resilience options. In developing solutions, there should be a focus on balancing 'quality of life' impacts against costs. Comprehensive analysis of resilience options should not be limited to major projects, since infrastructure assets are increasingly interdependent. Where possible, resilience analyses should be released to potential investors.

16. In a financial context, there is also a need to address longer term under-investment in infrastructure and the Treasury should look at how it could close the institutional investment gap. Barriers to investment need to be removed if the UK is to meet the shortfall in infrastructure. By utilising the capital available in private finance the Government can relieve some of financial pressures placed on the Treasury whilst giving investors greater certainty at a time where COVID-19 has caused significant economic disruption.

17. It is important to recognise that infrastructure projects are complex, and how their financing is structured can have a big impact on whether there is sufficient momentum to get them off the ground, as well as on subsequent revenues. In recent years in the UK, money has been available for suitable projects, but projects that ought to attract support sometimes fail to do so. This is because they fail to offer investors an attractive balance of risk and reward due to inadequate planning, management and financial structures. UK institutional investors face challenges if they wish to invest in infrastructure. Pension funds often lack the resources to research projects in depth, and defined contribution funds must also meet requirements for daily liquidity. Insurance companies need to reassure regulators that investments meet stringent solvency requirements.

18. The Government should look to provide a framework to encourage private investment in several ways. This could include guarantees to limit investors' risk exposure, incentives to increase the level of institutional investment, publicising a project pipeline to clarify the Government's priorities, and streamlining administrative processes for investors. We encourage the government to revisit any regulatory constraints that may currently inhibit insurers and pension schemes from investing in infrastructure. In addition, the Government has a role in promoting sustainable investment, which in time should help to expand the infrastructure sector.

19. The Government could use approaches based on sukuk finance to attract more private investment without increasing its own debt. Sukuk is an Islamic financial certificate that provides an investor with ownership in an underlying asset. In 2014 the Government cemented Britain's position as the western hub for Islamic finance by becoming the first country outside the Islamic world to issue sovereign Sukuk, the Islamic equivalent of a bond. The UK's first sovereign Sukuk received very strong demand, with orders totalling around £2.3 billion, and allocations have been made to a wide range of investors including sovereign wealth funds, central banks and domestic and international financial institutions. The UK Government has previously announced it intends to issue new UK sovereign sukuk in 2020, and the IFoA would support the Government's efforts to bring this into fruition – opening up the UK infrastructure financing to the world and cementing its position further as international beacon for economic investment.

Greening Finance

20. Following the COVID-19 crisis, stimulating the economy will be a priority for government. The Government must seek a just transition[3], with Green Finance and the environment at the heart of reshaping the UK's economy. A shift is required to align the objectives of the financial system with the UK's net zero commitments. This will require a collaborative effort from policy makers, regulators and industry to create incentives to organise and direct capital towards green products.

21. The Government's Industrial Strategy will be essential in shaping this transition, creating jobs, boosting productivity and encouraging investment across the UK. Green Finance will play an essential role in funding the transition to a net zero economy and to bring the ambition of the Industrial Strategy to life. There are a number of barriers that exist to growing Green Finance in the UK. Failure on the part of decision makers within firms to recognise responding to climate risk as a shared responsibility is perhaps one of the greatest barriers.

22. Effective and thoughtful disclosure is essential to understanding the financial risks of climate change and for the purpose of enabling investors to make adequately informed decisions. We welcomed the Strategy's expectation for all listed companies and large asset owners to disclose in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations by 2022. We recognize firms will refine their approach to disclosure over time and as accepted good practice evolves. However, it is most important that firms simply start.

23. As the Government looks to stimulate the economy as it recovers from COVID-19, it is essential that the Government's spending priorities align with its net zero goals in order to accelerate the transition to a low carbon economy.

Financial Resilience in the Private Rented Sector

24. COVID-19 has highlighted the limited ability of many households to cope with an interruption in regular income. Around a fifth of British households now live in privately rented housing and as we turn our thoughts to a post-COVID future, there is a clear and urgent case to develop policies which will help renters be more resilient to income shocks.

25. Under the current Universal Credit rules, many renters receive only partial help with their rents and may face a 'rent gap' of hundreds of pounds each month. Yet those who receive income from insurance policies, such as Income Protection (IP) and Family Income Benefit (FIB) payments, are unable to use this money to cover the gap. Instead it simply reduces the help they get from UC. This means that it is effectively impossible to insure against facing a rent gap while on UC.

26. Due to this interaction, some renters, particularly those on low incomes, may find that IP does not enable them to ensure their housing costs are met following an unexpected illness or accident. This problematic interaction only exists for renters. For owner-occupiers, any insurance payment they receive to cover their mortgage is disregarded in UC.

27. By revising the rules of UC to allow for renters who receive income from insurance policies to put those costs towards the rent gap, it would bring the treatment of rental households in line with the treatment of owner-occupied housing costs (mortgages), in turn providing more people with the opportunity to protect their basic human need for secure housing.

[3] A just transition follows a body of work which includes broader resource consideration and the support to reduce social inequalities, especially those created by climate changes.

28. By making these proposed changes, analysis carried out by the IFoA and the Building Resilient Households Group (BRHG) suggests that although there is likely to be a small short-term cost to Government, over time it is anticipated that the policy change will encourage more renters to take out cover for the gap between gross and net rent, giving them the ability to protect their basic human need for secure housing. This in turn is expected to lead to savings to Government spending in the medium term:
    - **Short term cost to Government:** If the proposed policy is implemented, and there is a resulting small short-term increase in take up of IP (by 0.5% from 2.0% to 2.5%), the net cost to the State would be around £8.9m per year.
    - **Future savings for Government:** It is anticipated that following a change in policy, there would be greater certainty over the interaction between IP and UC, encouraging more advisers to discuss IP with renters. Allowing for a small marginal rise in take up of IP to 3% in 5 years' time, and allowing for expected increases in renter numbers, it would take the State past break-even point to create savings of £8.3m per year. This would rise further to £43m if 4% held IP, and savings of £151m if 7.12% held IP in 5 years' time (7.12% is the approximate ownership level of individual IP amongst homeowners).
    - **The cost of no action**: However, if there is no policy change, the existing interaction between UC and IP could lead to more uncertainty in the market, and a decline in IP amongst renters (say from 2% to 1.5%). In this scenario, the failure to make the proposed policy change could lead to public spending increasing to £43.8m each year in the medium term.

Should you want to discuss any of the points raised please contact Katy Little, (katy.little@actuaries.org.uk) in the first instance.

Yours Sincerely,

Louise M Pryor

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President Elect, Institute and Faculty of Actuaries