Response from Dr. Ros Altmann – June 2014
Budget Consultation response – using pension freedoms to kick-start social care funding
Integrating long-term care into pensions and financial planning:

Official estimates suggest that over 80% of the population over age 65 will need some care and support. Half are likely to need to spend around £20,000 and one in ten will spend over £100,000.

But there is no money set aside for care

Even though the demographics and medical advances obviously point to a dramatic rise in the numbers of older people needing long-term care, as the millions of baby boomers currently reaching their 60s will be likely to need care in the coming twenty years or so, there is almost no money set aside to pay for the care they will require. The Government has not set aside any money for this huge looming cost, so no one has actually prepared for the potential costs.

Summary of ideas to kick-start some pre-funding for social care

Using pensions for care – now possible following Budget reforms

Tax free pension withdrawal would be further incentive to keep money aside

Care ISAs – allow to be passed on free of inheritance tax for next generation's care

Family Care Saving Plans – IHT free for next generation's care

Workplace care savings plans – flexible benefits or embedded alongside auto-enrolment

Current system poorly understood and only covers 'substantial' care needs – NHS will not pay, social care is left to cash-strapped councils

Many members of the public mistakenly believe that taxpayers will pay. This is not normally the case. Long-term care funding is one of the least understood parts of the health and care system in the UK and is not free at the point of use like medical care would be in the National Health Service. Social Care is the responsibility of local authorities, while healthcare is funded nationally by the NHS. Most people do not really understand the difference between social care and healthcare, and indeed, there are often disputes about what is classed in each category.

Someone with cancer is likely to qualify for healthcare funding while someone with dementia may not be considered to have a health need.

State will only fund the worst cases and at a very basic level, subject to strict means-tests

If someone is considered to have a healthcare need, they could qualify for free care, with the state covering the costs. In Scotland, however, social care is provided free by the state. Elsewhere in the UK, someone needing social care must apply to their local authority for funding and this will only be given if strict criteria are met. Only those considered to have 'substantial' care needs will normally be covered by public funding. If their care needs are only considered 'moderate' – and the qualification criteria for this will vary from council to council – they will have to pay their own costs. In addition, local authority care funding is subject to one of the strictest means-tests. Those needing residential care must prove that they have assets worth less than around £23,000 in order to qualify for help. This sum includes the value of any property, even the family home, unless a partner is still living in it. Most people with some savings will receive no help from the state until they have used up the bulk of their assets.

It is also important to note that even care that is funded by the state is only of a basic standard. People wishing to live in a higher quality care home, or receive more homecare than councils are willing to fund, must find the money. If they want to be in a particular care home, perhaps where a friend is, or nearer to relatives, they may also find their local authority refuses to cover all the cost and they will need extra money. Cash-strapped councils have been cutting the duration of home care visits back dramatically, sometimes as short as just 15 minutes, which is an absolutely basic level. If people want longer care sessions, they will have to fund this themselves.

Pension savings not designed to pay for care – new freedoms could encourage pensions to be used for care if needed

As many more people will be living to older ages in future, the need for social care will increase. Pension savings are not currently designed to cover care costs. Income from an annuity or capped income drawdown policy is likely to be far lower than the amount required to pay for care. The new freedoms for pension saving could help with care funding as they may allow people to allocate some of their pension fund to pay for care. This could be an important advance in addressing the looming care crisis.

Hasn't the Government sorted this out following the Dilnot Commission reforms?

Successive Governments have recognised the need to deal with this issue and the current Government is introducing reforms to care funding which aim to address the crisis in social care funding. The reforms so far announced, however, will not be sufficient. The proposals follow the excellent work carried out by the Commission on the Funding of Care and Support in England and Wales, chaired by Sir Andrew Dilnot in 2011, which recommended setting a maximum cap on the costs of care that individuals would need to pay, with the balance then being picked up by the state. The original aim was to help stimulate an insurance market that would enable people to insure themselves against the costs of care up to the cap. This would give them peace of mind and help them plan ahead to cover their care needs knowing the maximum amount they would have to spend. Dilnot recommended a cap of around £35,000 as the maximum payable for social care in old age. This sounded promising, since setting aside a sum of £35,000, or buying insurance to cover against the risk of having to pay that amount initially sounded feasible.

£35,000 care cap excluded board and lodging

Unfortunately, the cap is not as straightforward as this. Dilnot's £35,000 excluded the cost of 'board and lodging' in residential care, which was supposed to add between £7,000 and £10,000 a year to the costs that would have to be paid by someone needing residential care. However, Dilnot assumed that such costs could, in most cases, be paid by a person's state pension, therefore not posing a major problem.

Means-test level increased to £100,000

In addition, the Commission recommended that the level of the means-test should be increased from the very low £23,250 level, to around £100,000, therefore allowing more people who need care to at least retain some of their assets, rather than losing virtually everything if they were unlucky enough to need care. The particular unfairness being addressed was that some older people paid nothing for care that qualified for NHS funding, while others had to pay huge sums if they happened to become unwell in a different way.

Dilnot package watered down, with much higher cap and annual charges

This package of measures commanded initial widespread support. The Government's White Paper 'Caring for our Future' accepted Dilnot's principles, but it has set a much higher level for the cap, at around £72,000. This means the reforms are unlikely to meet the desired objectives – and further measures will be required. The most positive aspect of the Government's care funding reforms is that they have adopted the recommended increased means-test threshold of around £100,000. Nevertheless, those with a home worth well over this level could still face significant costs if they or their loved ones need care. It is important to recognise that people will still need to pay for care even when their assets fall below £100,000.

What's wrong with the reforms introduced to address the care crisis? £72,000 cap is not a strict maximum and represents only a part of the amount people may need to actually spend on their care.

- £72,000 cap excludes £12,000 a year board and lodging costs which must still be paid
- Cap only covers spending when care needs assessed as 'substantial', ignores moderate need care spend
- Cap only covers spending up to local authority basic rate
- Only starts from 2016, any spending before that won't count towards the cap
- Even after cap is reached, people must still pay £12,000pa for care home accommodation

The care cap due to be introduced from April 2016 will be £72,000, not £35,000. But there are so many restrictions on the amount of care spending that will count towards the cap that many people will spend far more than this, possibly even double, without help from the State. In particular, the cap excludes the costs of

accommodation in a care home, which Ministers have set at around £12,000 a year (not £7,000-£10,000 as suggested by Dilnot). Most people's state pension will be insufficient to meet this extra cost. Everyone who needs care will have to have an assessment of their care needs. The national criterion to start the care 'meter' running will only begin once someone is assessed as having substantial care needs. If their needs are moderate (which could mean they still need help with basic daily activities but are not as severely handicapped to be considered to qualify as having substantial needs) then any care they pay for will not count towards their official £72,000 cap. On top of this, the care 'meter' will only cover an amount that reflects the local authority's estimate of reasonable basic costs. Someone who wants to use a care home that charges more than the standard local rate will only have the official rate credited towards their care cap. Not only will they have to pay for extra themselves, they will also have to pay the additional £12,000 a year 'hotel' costs and none of this will count towards their official care cost cap.

The same applies to homecare. The local authority will only credit people for the amount they deem to be the appropriate rate, and for the time they assess that would be covered by the council. Often this will be less than the care people would choose for themselves, either because they employ a care worker who charges more than the minimum local rates, or because they feel they need more than the basic minimum amount of time.

How can people plan to meet such costs?

It will be important to ensure that guidance or advice on retirement planning includes consideration of having to pay for care. Materials that help people understand the risks of facing very high costs if they or a loved one needs care, can help educate people who are currently totally unaware of this issue and encourage them to set aside money just in case. Currently, people are not saving for care and often have to just buy products at the point of need, when they have a limited range of options and may find the costs seem substantial.

Current products to help people cover care costs

There are various products on offer to help people pay for care, each of which has advantages and disadvantages.

1. Immediate needs annuities

Those who do not have any provision set aside can purchase protection against unlimited costs at the point of need by buying what is known as an 'immediate needs annuity'. This product requires payment of a lump sum to an insurance company, in exchange for which the insurer promises to cover the costs of care for the rest of the person's life. The average length of time spent in a care home is between 2 and 3 years, but some people could be in care for ten years or more. With fees of around £30,000 - £50,000 a year, the costs can be crippling. It is possible to cap the maximum costs with these immediate needs annuities which effectively offer insurance against living much longer than expected in a care home. As with any annuity, the insurance company is likely to price relatively conservatively, probably assuming the person will be in a care home for, say, 4 years. Those who die before that time will not receive any money back, the extra funds will either be used to subsidise the extra payments for people who live longer than expected, or to provide profit to the insurer. The advantage of the immediate needs annuity, however, is that the family can have peace of mind that their loved one's care will be paid for. They may have to pay perhaps £150,000-£200,000, depending on the health, age, medical status and care home, but that would be the upper limit of the costs.

2. Equity Release

Some people will not have a lump sum readily available to fund the cost of an immediate needs annuity. If they still own their own home they may have to use the value of their house to fund later life care. If they do not wish to sell the home or the process of a sale would take too long and money is required urgently, then they can take out an 'equity release' loan against the value of the property. There are different types of equity release product. Essentially it is a loan made against the value of the property. The loan can come in different forms, sometimes as a lump sum, on which interest has to be paid, or based on a percentage of the value of the property, or could be in the form of a 'drawdown' type loan. The house can then be sold later to repay the loan.

3. Deferred payment plans

Currently, councils are obliged to help people who cannot sell their family home. They are supposed to offer 'deferred payment plans' under which the Council pays for the care home, while taking a charge over the property and then recovers the monies spent when the house is sold after the person has passed away. It has become increasingly difficult to obtain these plans, especially as they have been interest-free and are therefore a very attractive way for people to borrow to pay the costs of care. They are also, however, expensive for

councils to provide. The Government may well extend the deferred payment plans to ensure far more people can use them, but in future interest will be charged on the money, so the advantages relative to private equity release products will need to be assessed.

4. Other savings

Some people will have savings apart from their pension and their house, which they could use for care, such as ISAs, insurance bonds, national savings or an inheritance, but most will not have enough put by to meet the extremely high costs of social care. It is perhaps surprising that so little has been done to help people plan to set money aside for care in case it is required. Ideally, the Government would incentivise care saving and I believe such incentives are urgently required. New products could also be designed – or existing products adapted – to prepare for such costs via savings or insurance.

5. Other insurance

There are other possible insurance products that can help with the costs of care. Convertible critical illness policies, flexible life policies and long term care bonds are available but are not generally widely used.

All the products currently available have drawbacks. Some are expensive, some do not provide for all the costs, some are very inflexible, so these cannot provide solutions for all those who will need to fund care. New products and approaches, together with new Government incentives, are likely to be required.

What might these new tax incentives and products look like?

Using pensions for care

Until the latest Budget changes, pension savings could not be easily accessed to help pay for care. Many people reaching retirement will have some tens of thousands of pounds in their pension funds but once they buy an annuity, this capital could not be directed to pay for care. Now that the annuity requirement is removed, pension funds could potentially be used for care. Those who do not require extra income from all of their pension savings, might be interested in a savings or investment product that would be specifically earmarked to pay for care – perhaps for themselves or for a member of the family. Each couple may have a one in two chance of needing long-term care, although they do not know which one of them or when, the Government could use the new pension reforms to kick-start a culture of saving for long-term care. Even without new incentives, people may benefit from the opportunity to use their pension savings to pay for care. However, if any money withdrawn is taxed, the amount available will be reduced by 20-45%.

Tax free pension withdrawal

Given the social importance of funding social care, it makes sense for the Government to consider tax-exempting pension withdrawals that are used to pay for care needs. A specified sum of money might be allowed to be taken out of a pension fund tax-free if spent on care. This might encourage people to leave money in their pension funds for later life, closer to the point when they might need it, in the knowledge that there are tax advantages if they do spend it on care. While the money stays in a pension wrapper, it does not incur tax on investment returns, and then allowing it to be withdrawn tax-free if paying for care, might encourage more people to leave it there unless they really have an important reason to spend it.

Care ISAs – IHT free

Another possibility is for the Government to allow ISAs to be used as a care saving plan. It could introduce a specific annual allowance for any ISAs that are earmarked to pay for care. This could be to pay for care for oneself, or for another family member, but as long as the money is used for care, people might be offered a special tax concession. Investment returns would be tax free and if the fund was not needed for care, a powerful incentive could be to exempt the money from inheritance tax as long as the funds passed on are themselves set aside for future care funding. These special 'Care ISAs' would help signal the need for people to save for care and the publicity surrounding the introduction of Care ISAs could help more people realise the need for this kind of saving, which is important because most are currently unaware of the issue. By passing a care saving plan down the generations tax free, a system of care saving could be built up for the future more effectively than might otherwise be possible.

Family Care Savings Plans – IHT free

Another possibility is for families to save collectively for the care needs of their loved ones. For example, parents, siblings or children might join together to put in money each year, to build up a fund in case one of

them needs care. The probability is that one in four people will need care, but nobody knows in advance which one. Again, the Government could offer tax breaks to incentivise this kind of saving. People could perhaps use the tax free lump sum from their pension, with these plans being free of all inheritance tax as long as they stay earmarked for care spending. These savings plans might also include some 'catastrophe insurance' that would pay out if more than the expected number in the group actually need care.

Workplace benefits for care saving

Alongside auto-enrolment, it might also be helpful to ensure that employers consider offering the option for people to save in a workplace savings plan that is set aside specifically for care. This could be set up by the employer, and perhaps offered as part of a flexible benefits package, or offered to older workers who have some pension savings, but have not yet saved for care. These could be tax advantaged savings products, offered as a workplace benefit, or ordinary savings accounts which receive an employer contribution.