Institute
and Faculty
of Actuaries

Pensions and the funding of long term care

Policy summary

Key findings

The consequences of the UK's ageing population for public spending will be significant. The issue of long term care and how it will be funded is one that the next government must prioritise.

We estimate that, for individuals aged 85, fewer than 8 per cent of males and 15 per cent of females will reach the cap.

On average (across England), those who do reach the £72,000 cap will have spent around £140,000 towards their long term care costs before doing so. We believe more must be done to raise awareness of the costs of care and to incentivise people to save.

Pension savings could play a part in meeting care costs alongside other personal savings including ISAs and products such as equity release, and various forms of insurance.

We suggest further research is required to explore whether pensions could provide a framework for people to save for the costs of long term care and whether the care and pension reforms might facilitate financial product innovation.

Ageing population

Background

The UK has an ageing population and this presents both opportunities and challenges for individuals and Government. One of the challenges is meeting long term care costs, which is a significant funding challenge for individuals, and both, current and future governments. The Select Committee on Public Service and Demographic Change estimates public expenditure on social care and continuing healthcare for older people may rise to £12.7 billion by 2022 – an increase of 37 per cent from £9.3 billion in 2010 – to keep pace with expected demographic changes.[i]

The IFoA's Long Term Care Working Party conducted a review of funding models for long term care in a number of countries and found that a range of policy options have been adopted. These include long term care insurance funds that are paid into via payroll and income related contributions, as in Germany and the Netherlands and municipalities in Japan.[ii] This paper outlines the potential for using pensions to fund long term care in the UK where the long term care market in the UK has been slow to develop. This has, in part, been due to a common misconception that the State will provide for all of an individuals care needs. The Care Act 2014 seeks to address this misconception whilst preventing individuals from facing unlimited costs and creating innovation in the long term care financial product market.

The consequences of the UK's ageing population for public spending will be significant. The issue of long term care and how it will be funded is one that the next government must prioritise.

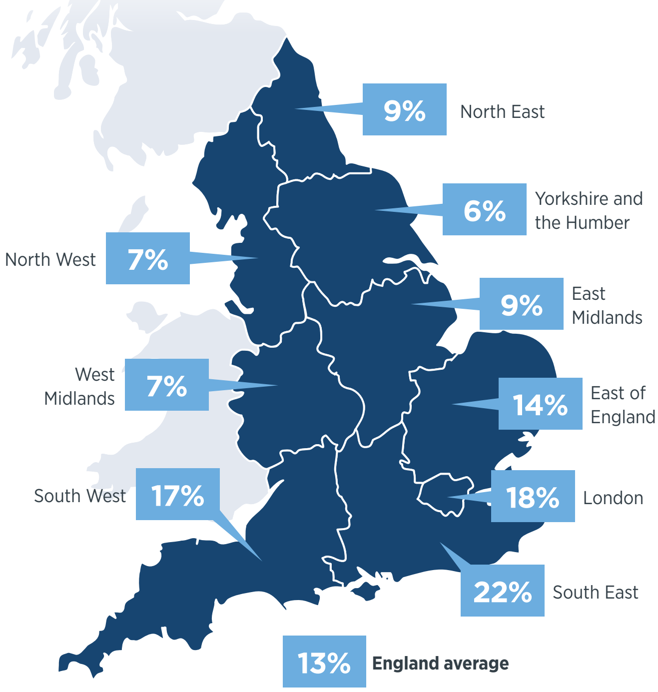
Social care reforms

The Care Act 2014 aims to mitigate individuals facing catastrophic care costs should they require long term care.[iii] This Act legislates for a £72,000 cap on the cost of social care for people of State Pension Age and beyond.[iv] The cap will apply to local authority set care costs. It does not include daily living costs and top-up care costs.

1 in 4 men and **1 in 3 women** aged 65 will have eligible care at some point in their lives.

A significant proportion of the population are likely to need to find the means to fund their care needs in later life. In England, there is, approximately, a 35 per cent chance of a 65 year old female, and 25 per cent chance of a 65 year old male, having substantial care needs at some point in their life.[v] Our research finds that, further to this, there is a wide variation in local authority care costs across the country. This has a significant impact on the time taken to reach the cap and the personal costs incurred by the time an individual reaches the cap.

The probability of reaching the cap for an 85 year old entering a care home with nursing from 2016



All costs are based on the Laing & Buisson survey of care homes 2012-13: the figures include daily living costs and allow for inflation at 3.5%.

The probabilities of reaching the cap allow for regional variation in costs, but do no allow for regional variation in mortality rates.

For the majority of individuals entering care, there is a low chance of the cap being reached. We estimate that, for individuals aged 85 (the typical age when entering care), fewer than 8 per cent of males and 15 per cent of females will reach the cap in their lifetime. On average (across England), those who do reach the cap will have spent around £140,000 towards their long term care costs before doing so and this can increase to around £250,000 if an individual is in care for 10 years, although only around 1% of individuals are expected to live this long whilst needing long term care.[vi] Whilst we welcome this, the potential costs of care remain very high.[1]

The cap is **£72,000,** but the average amount spent before hitting the cap is **£140,000**

A significant proportion of the population will need to find the means to fund their long term care needs in later life; we believe more must be done to raise awareness of the costs of care and to incentivise people to save.

[1] These figures are based on a care home without nursing and include daily living costs and top-up care costs.

How pensions could be used to help fund long term care

Alongside care reforms, the government is radically reforming pensions. Auto enrolment has been introduced to encourage greater participation in workplace saving into defined contribution (DC) schemes and, so far, the evidence suggests that this has had a positive impact on saving for retirement overall.[vii] The pension freedoms introduced in the 2014 Budget mean individuals have greater flexibility when accessing their DC pension savings. It is difficult to predict how individual behaviour might change in response to the freedoms and how spending decisions and uncertainty around life expectancy might impact on the availability of funds to cover long term care costs. For example, some individuals may choose to use some of their pot to buy a long term care product, whereas others may underestimate their likelihood of needing long term care, and therefore, not save sufficient funds to cover their desired level of care, should they have long term care needs.

The IFoA has embarked on a series of research projects to explore opportunities where the pensions framework could incentivise individuals to make provision for prospective future long term care needs. Our research has found that, as a consequence of the care cap, whilst catastrophic care costs might be mitigated, many people will still face huge expenses. To protect individuals having to make critical financial decisions at the point of need, when perhaps they are at their most vulnerable, policy makers should explore ways to incentivise individuals to start planning for their potential long term care needs much earlier in life.[viii]

With sweeping reforms underway, in both pensions and social care, we would suggest that now is the right time to be considering the merits of incentivising people, perhaps through the pensions framework, to save for their future care needs.

We do not suggest that pension savings alone are likely to enable individuals to fund their long term care needs. However, pension savings could play a part in meeting care costs alongside other personal savings including ISAs and products such as equity release, and various forms of insurance.

Pension products could be created and adapted to provide extra income to cover the costs of care on a savings or an insurance basis. There are two types of pension-style products – those starting well in advance of needing long term care and those purchased near, or at, the point of, need. Both these avenues of funding should be explored by government and industry. The IFoA is undertaking some research to model how different products might work and will look to publish this in the second half of 2015.

Individuals' needs are diverse and funding of long term care is complex. The suitability of different products for individuals will depend on their level of income and assets and the life stage at which they are making provision for potential long term care needs. There is no unique product that is suitable for all consumer needs. We suggest that those individuals most likely to benefit from making additional provision for their long term care are those with assets above the means test upper limits, but with expected retirement income below the cost of long term care.

We suggest further research is required to explore whether pensions could provide a framework for people to save for the costs of long term care. The care and pension reforms could facilitate product innovation. Further analysis of how different products might work for different financial circumstances would be useful to demonstrate how the market could respond to the changed environment.

Since needs are diverse and cost structures complex, good information and advice is needed to help individuals make spending decisions to mitigate uncertainty around life expectancy and potential long term costs. The likely impact of the care cap on consumer finances needs to be made clear as part of a communications strategy, as does the suitability of different products. Industry and governmental bodies have a joint role in making information available and raising awareness of the funding need and the potential range of product solutions that exist.

Widespread public engagement is required to raising awareness around the impact of the care cap on consumer finances and the availability of potential product solutions for any non-State solution to long term care funding to be commercially viable.

i House of Lords Select Committee on Public Service and Demographic Change (2013) *Ready for Ageing? Report: Report of Session 2012-2013.* London: the Stationary Office Limited

ii Elliott, S., Golds, S. and Wilson, H. (2014) *Long-term care – A review of Global Funding Models.* The Institute and Faculty of Actuaries

iii Care Act 2014. Available at: *www.legislation.gov.uk/ukpga/2014/23/contents/enacted*

iv Care Act 2014. Available at: *www.legislation.gov.uk/ukpga/2014/23/contents/enacted*

v Rickayzen, B. (2007) *An analysis of disability-linked annuities'*, Actuarial Research Paper No. 180, Cass Business School, London.

vi Laing and Buisson (2013) *Care of Elderly People UK Market Survey 2012-13*

vii Department for Work and Pensions (2014) *Automatic Enrolment evaluation report 2014: November 2014*

Contact us

If you would like to know more about the IFoA's work on pensions and the funding of long term care please contact us at:
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The full report can be found on the IFoA's website:
www.actuaries.org.uk/research-and-resources/documents/how-pensions-can-meet-consumer-needs-under-new-social-care-regime-0

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