Long Term Care Funding and Insurance Opportunities

January 2013

The potential reform of adult social care funding presents opportunities for the insurance sector, but the devil is in the (yet to be revealed) detail

INTRODUCTION

In 2010, the government created the Commission on Funding of Care and Support "Dilnot Commission" to investigate options for a better, fairer way to pay for adult social care. The Dilnot Commission reported in July 2011 with a set of proposals, which are explained in more detail below. In January 2013, the coalition government's mid-term review indicated that it agreed with the Dilnot Commission proposals "in principle", but at the time of writing, has yet to release its own detailed plan for adult social care.

This Client Briefing presents an overview of the Dilnot Commissions proposals, the likely government response and some commentary on the opportunities for insurers.

DILNOT COMMISSION PROPOSALS

The Dilnot Commission indicated that the current adult social care funding mechanism in England needs urgent reform to make it fairer and allow people to plan. It also commented that the current availability and choice of financial products to meet care costs is limited and therefore people have few opportunities to protect themselves against catastrophic care expenses.

Dilnot therefore proposed:

- A lifetime cap on an individual's contribution it his/her own social care costs of £35,000.
- Increasing the means-test threshold to £100,000 from the current £23,250.
- Those who reach 18 and already require care/support, should be receive full state funding for the remainder of their lives.
- Individuals should contribute between £7,000 and £10,000 to cover food and accommodation in residential care. This amount would be excluded from the cap of £35,000.
- The eligibitlity criteria for accessing social care support should be national, rather than the current system of each local council setting its own criteria.

Modelling from the PSSRU for the Dilnot Commission shows that 25% of the over 65s will need no social care (both domiciliary and residential) for the remainder of their lives while 10% will have social care costs exceeding £100,000 (in 2009/10 prices). However the Dilnot Commission report comments that data on social care costs is poor and we would view these estimates with considerable caution. They do not include general costs of living, such as accommodation and food while in a residential long term care facility.*

It should also be noted that the numbers of people receiving social care has fallen in recent years as local authorities have tightened eligibility criteria to control budgets. Therefore it is possible that the statistics quoted by the PSSRU are a considerable underestimate of the money that would be spent on social care under a more generous funding arrangement

**Personal Social Services Research Unit*

The recommended cap at £35,000 has been pitched at a level which the Commission believes would be low enough to offer sufficient protection for the assets of lower income groups, but high enough to avoid creating undue long term burdens for government finances. Above all, it was deemed by Dilnot to meet the (somewhat subjective) "fair" criteria. Dilnot proposed that younger adults would have a lower cap imposed (zero below age 40) on the basis that they would have had insufficient time to build up assets. All episodes of care received, at whatever age, would count towards the cap.

Individuals in expensive parts of the country would reach the cap significantly more quickly, whether they are receiving domiciliary or residential care. They are also likely to have to find much more than the £7,000 to £10,000 per annum suggested by Dilnot as necessary for accommodation and food. This suggests that any insurance products to cover the cap would have differential premiums by area, or that "network" pricing, analogous to that used in medical insurance, may be used.

On reaching the cap, only costs based on local authority funded rates in residential homes would be covered, However, unlike the current system, where if you have assets or income that disqualify you from state assistance you are liable for the full costs of a private care home, under the proposed Dilnot model, you would be able to "top up" local authority payments to stay in your expensive care home.

GOVERNMENT RESPONSE

Initial responses from the government seemed to indicate that Dilnot's proposals would be disregarded, because of the estimated £2bn annual cost to the Treasury. However, it recent months, it has been revived and the coalition's mid-term review indicated that "it supports the proposals in principle". As part of a separate briefing to journalists (not contained in the mid-term review), a potential cap of £75,000 was proposed. No mention of the level at which the means-test would be set were announced. More details are expected to be released in the next month.

By capping costs and bringing certainty over an individual's lifetime liability via a government operated risk pool, Dilnot hoped that consumers would be encouraged to plan financially for care costs, while insurers would be encouraged to develop products which would appeal to those of modest wealth. At £35,000, approximately 40% to 50% of people would expect to exceed the cap, and therefore there would be sufficient incentive to buy insurance to fill the self-funded gap - although equally it could be argued that many will simply decide to self-fund.

However, the proposed government response of a cap around £75,000, would mean that, according to the PSSRU modelling, fewer than 1 in 5 would expect to exceed the cap. Insurance products would be significantly more expensive, which may limit the market penetration. While any cap is better than nothing from an individual's point of view, an overly high cap does little for the vast majority of those requiring care and therefore does not encourage either the supply or the demand side of the insurance market in Long Term Care products.

INSURANCE PRODUCTS

Pre-funded products for long term social care have all but disappeared in recent years and the remaining products are simply immediate or deferred needs annuities, which boast a tax advantage if the payments are directly to residential care homes, rather than to the individual.

Several barriers have prevented the historic development of a sustainable long term care insurance market in the UK. The Dilnot proposals address some of these, by clarifying the extent of the potential liability and introducing a national standardised assessment, but several still remain:

- lack of public awareness over the likely future costs of care and the government contribution to these costs;
- low volumes of data to predict risk costs;
- uncertainty over the future movement of the cap and how this might be indexed or affected by changes in government finances;
- uncertainty over how the social care costs which may count towards the cap would be calculated over a lifetime and defined relative to health needs or residential accommodation costs;
- changes to funded utilisation rates for care services that may result if the current large volume of informal unpaid care provided by family members and friends for the elderly shifts into the formal, paid, sector; and
- uncertainty over how the means test might operate, or may change over time.

The high level of uncertainty over the expected costs because of the paucity of data is a concern for those seeking to develop new products. While ample data is available from other countries on the utilisation and distribution of costs of long term social care, it requires careful calibration to allow for different eligibility criteria, varying distributions of underlying heath/disease status and cost differences.

The current long term care insurance market in the UK is very small with fewer than 1,000 policies sold per year. These policies typically provide a level of income for an individual who needs to fund care costs rather than insuring them against their total care costs.

Under a new funding model based on Dilnot, even when the level of the cap is known, uncertainty about the permanence of the level of the cap and the risks that a future government may change it in an unpredictable way makes the development of such products challenging. Such a movement in the level of the cap could expose the insurer, distributor or customer to unexpected risks or devalue the worth of any insurance product.

One area of potential development might be top-up indemnity products to meet the excess cost of a private nursing home over and above the agreed state-funded contributions once the cap has been exhausted.

SUMMARY

Any clarification the current funding model and each individual's expected contribution should bring significant benefits to consumers and a material potential opportunity the insurance industry. However, the level of the cap, the definitions of eligible social care and the interaction with the means-testing level is critical to whether or not the insurance industry can respond with well-designed robust and affordable products for even a minority of consumers.

The Dilnot Commission proposed a widespread awareness campaign to inform people of the new system and encourage financial planning, as well as a major information and advice strategy to assist people at the point of their care needs arising. It remains to be seen whether the government will seize that challenge, or whether it will be left to the financial services industry to take over that role.

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