Pensions Policy Institute

PPI

Care in later life: incentives to use assets to pay for care

Executive Summary

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John has been the PPI's Senior Policy Analyst since 2008. In his time at the PPI John has worked in a lead role in the modelling of a wide range of projects including looking at public sector pensions and pension related tax-relief.

At the PPI, John is responsible for the PPI's Pension Facts and has authored briefing notes and reports on subjects such as how housing wealth can support retirement, tax policy on pension schemes, harnessing pension savings for debt alleviation, public sector pension reforms.

John joined the PPI in 2008 from Hewitt Associates. At Hewitt he worked primarily on modelling of standard and non-standard Defined Benefit pension scheme calculations for the consultants to present to the clients.

John has a BSc in Actuarial Mathematics and Statistics from Heriot Watt and a Post Graduate Diploma in Actuarial Management from Cass Business School.

The Pensions Policy Institute (PPI)

The PPI is an educational, independent research organisation with a charitable objective to inform the policy debate on pensions and retirement income provision. The PPI's aim is to improve information and understanding about pensions and retirement provision through research and analysis, discussion and publication. It does not lobby for any particular issue or reform solution but works to make the pensions and retirement policy debate better informed.

Pensions affect everyone. But too few people understand them and what is needed for the provision of an adequate retirement income. The PPI wants to change that. We believe that better information and understanding will lead to a better policy framework and a better provision of retirement income for all. The PPI aims to be an authoritative voice on policy on pensions and the provision of retirement income in the UK.

The PPI has specific objectives to:

- Provide relevant and accessible information on the extent and nature of retirement provision
- Contribute fact-based analysis and commentary to the policy-making process
- Extend and encourage research and debate on policy on pensions and retirement provision
- Be a helpful sounding board for providers, policy makers and opinion formers
- Inform the public debate on policy on pensions and retirement provision.

We believe that the PPI is unique in the study of pensions and retirement provision, as it is:

- Independent, with no political bias or vested interest
- Led by experts focused on pensions and retirement provision
- Considering the whole pension framework: state, private, and the interaction between them
- Pursuing both academically rigorous analysis and practical policy commentary
- Taking a long-term perspective on policy outcomes on pensions and retirement income
- Encouraging dialogue and debate with multiple constituencies

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A Pensions Policy Institute report

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ABI

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Executive Summary

The care funding system in England is widely perceived to be in need of an overhaul. The ageing population means there are more people than ever reaching older ages and increasing the need for care. The Association of British Insurers (ABI) asked the PPI to investigate a selection of incentivised proposals that could encourage and assist people to use their existing savings and assets to fund their care in an efficient manner.

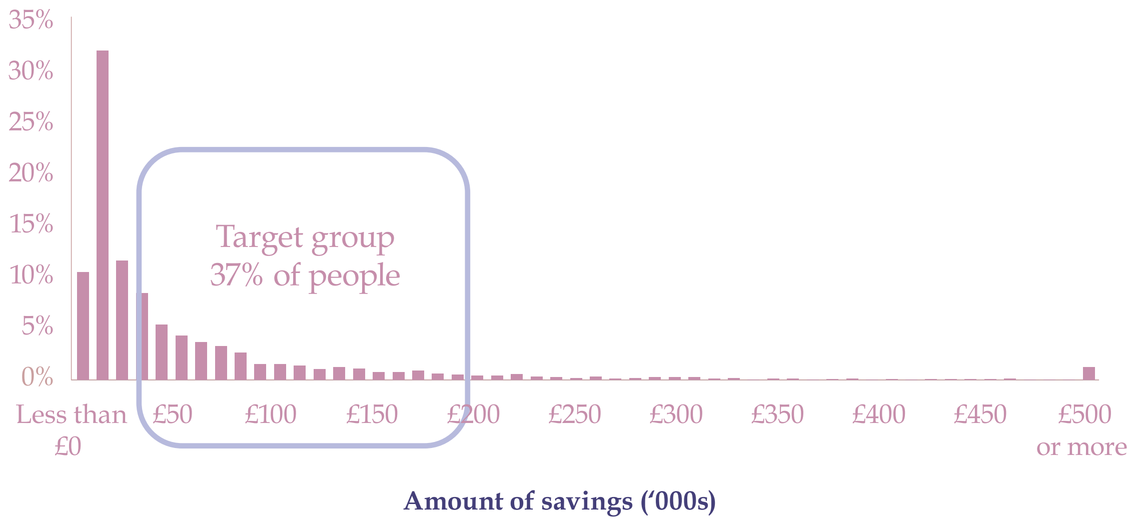
The state provides care services for people with assets below a threshold level, others with very high levels of assets may be able to pay for care without specifically needing to put money aside. But there is a middle group, who are unable to claim support from the state, yet do not have adequate finances that the cost of care would not impact their financial well-being. This group may benefit from some way of preparing, or being able to efficiently use currently owned assets to meet care costs if, following reform, they are required to self-fund.

We have considered a target group to be people who have savings and assets, excluding their house value, of more than the threshold for losing state support (£23,250), but less than £200,000. The target group makes up approximately 37% of people in England aged over 50 (Chart Ex1).

Chart Ex1

The target group of people for care funding is around 37% of people

Distribution of savings levels among people in England aged over 50 (excluding pension and housing wealth). Target group is those with between £23,250 and £200,000 of savings.



There is unlikely to be a single solution that works for all people. Financial product providers may be able to offer products that can help people prepare for care as part of a range of solutions. Targeted government incentives, such as tax relief on care spending or preparation may help encourage people to use their money efficiently to pay for care. The report considers five possible proposals that have been raised within the financial industry:

- Income from a pension scheme is used to pay for care, exempt from income tax. Payments from pensions which are made to care providers would be exempt from income tax. Around two thirds of those in the target group who are currently aged over 65 have a pension in payment that may be a means to pay for care. For those with a care need, tax relief on their care spending could give them a significant increase in purchasing power.

  There is a cost to government in terms of the tax relief given on pension income used to pay for care. This tax cost is ongoing during the period that such pension payments are being used to pay for care.

- Use tax exempt pension withdrawals to secure an insurance product that covers care costs. Premiums for an insurance product to pay for care could be taken tax free from a pension, the insurance company then pays off future care needs if they should arise during the period of cover.

  The number of people within the target group who are between ages 55-59 and who have some un-accessed Defined Contribution pension is around 29%. The premium value for full cover may be more than that which most people with pension savings could afford from their pension scheme.

- The introduction of a Care ISA with no Inheritance Tax paid on residual amounts at death. This would use people's propensity to save in ISAs to fund care by introducing a Care ISA which would provide a fund earmarked to pay for care, with the funds invested tax free and any left-over money free of Inheritance Tax upon death. Saving in an ISA is very common among the target group, around 85% of whom have ISAs. The median savings level in ISAs for members of the target group is around £35,000.

  The popularity of ISAs may mean that the Care ISA is a product that people feel they understand and are therefore attracted to. However, Inheritance Tax relief may not be a large incentive to save in a Care ISA as only around 4% of deaths in the UK are subject to Inheritance Tax.

- Releasing equity from a property to secure an insurance product that covers care costs. In the case that an insurance market for care cover develops, the current older generation could pay for care insurance by releasing equity in their home. The policy would leverage the high incidence of home ownership amongst older people. Essentially the proposal is simply using equity release to pay for care insurance. With no government intervention required through tax incentives, it may be possible that this proposal could be offered by providers now.

  Home ownership is very high. Among the target group, over 90% of people aged between 65 and 79 own their own home with the median house value being around £300,000. The use of housing equity release does not tangibly affect day to day income, so may be more attractive than other forms of using assets to pay for care.

- Pledging equity from a property to cover care costs in return for a corresponding government pledge. A government incentivised scheme to encourage people to pledge that a proportion of the equity in their home would be made available to cover care costs if, following reform, they are required to self-fund. The government incentive would be to make a notional corresponding pledge of a proportion of the amount that the person pledged. Both pledges are notional until a care need arises.

  Like the proposal where insurance is purchased through releasing equity, the pledge aims to utilise the high levels of home ownership among the target group. The pledge may also be attractive because it is not an immediate financial transaction, so it may be seen to be even less tangible than using equity release to purchase insurance.

These proposals, provided by the ABI, are intended to represent a selection of the types of products and/or fiscal regime changes that could be adopted to create an environment that enables people to efficiently pay for, or prepare for, care costs. In analysing these proposals the Pensions Policy Institute is not endorsing them.

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