



Royal Commission on Long Term Care for the Elderly

Continuing Care Conference Submission No 3:

Equity Release

Summary of CCC's Position

For most people, retirement income is not enough to pay for long-term care. Until sustainable solutions are found, the only asset which most people can access is their house. CCC therefore believes that, with necessary safeguards, every help or encouragement should be given for the use of equity release to fund long-term care.

Why Equity Release?

Announcing the establishment of the Royal Commission on 4 December 1997, the Secretary of State for Health drew attention to the need to find a way to fund long-term care which is fair and *affordable* for the individual and the taxpayer. The Royal Commission's terms of reference have regard to fair and *efficient* ways for individuals to make any contribution required of them.

Given that 60% of people aged over 65 own their own homes, and many of those people do not have access to the income required to fund care, the Continuing Care Conference (CCC) believes that responsible equity release schemes can play a significant part in making the cost of long-term care affordable. There are, however, certain constraints on the development of the evolving equity release market, including an unfavourable fiscal environment.

- CCC's submission demonstrates how certain adjustments to the tax treatment of equity release could greatly increase the efficiency by which individuals could then use equity release products to fund the care that they need.

We understand that the Association of British Insurers has provided the Royal Commission with detailed briefing on the workings of equity release products to fund long-term care. CCC does not propose to duplicate such information in this paper. Should more information be required, CCC has prepared a number of papers for the benefit of members, one of which considers equity release, the constraints on market development and what is likely to drive the development of the equity release market.

Potential for Equity Release: Market Development

- CCC acknowledges that currently-available equity release products, while welcome additions to the portfolio of choice, are unlikely to be sufficiently attractive to the majority of consumers who wish to finance the purchase of long-term care. We would support any initiatives that enable product providers to continue to develop innovative and attractive equity release products to fund long-term care.

Regulatory Issues

- CCC welcomes indications that the Financial Services Authority (FSA) will include the regulation of long-term care within its remit and the recent announcement by the Economic Secretary to the Treasury, on 7 April, that the activities regulated by the FSA will include mortgage business. CCC believes not only that consumers of long term care financial products require the full protection of statutory regulation, but that appropriate regulation will enhance the consumer confidence required for the development of the market.
- CCC strongly believes that where equity release is used to finance the purchase of a regulated product and arranged through the same sales channel, then the regulatory and compensatory processes should apply to both the equity release and the product. If long-term care insurance becomes regulated, then this would also apply.

Incentives for Self –Provision

- If long-term care provision continues to be vigorously means-tested, people will need major incentives to make self provision. One such incentive could be along the lines of the previous government's partnership proposals. However, any new proposals must be more attractive to the public and must include equity release within their scope. CCC would welcome such an approach but it must not become the primary focus of government assistance.

Consumer Education

- CCC believes that there is a need for greater consumer education about equity release mechanisms and how they can fund long-term care.

It is imperative that consumers are aware of the benefits *and also the limitations* of such complex products, whether in generic terms or relating to individual products. It is important, for instance, that consumers have easily understood information to enable them to establish the true cost not only of purchasing the equity release product itself but of applying those funds to purchase long-term care insurance.

- CCC is concerned that certain reversionary and mortgage-type products may incur double charging if the cash released is reapplied to buy an annuity, long-term care or other products, since the customers will have to bear two sets of commission expenses, profit and other margins.

Generally speaking, the benefit structure of equity release linked to an ordinary annuity means that the value for money is poorer the younger the customer. This

peculiarity therefore gives the potential for individuals to act, or to be advised to act, against their best interests. There is a real danger that customers could sign up to a combination of two financial products (ie a reversion or mortgage plus a long-term care annuity product) and not be aware of the significant profit margins taken by the product providers. If value for money is inversely related to the age at purchase, this also contradicts one central policy imperative for the present government, and for future governments, which is to develop mechanisms that encourage early, and therefore more cost effective, self-provision for care. The value for money aspect is in some cases obscure.

Equity Release and Taxation: Maximising Efficiency

Two key factors inhibit the potential for equity release to provide funding for care:

- the low limit of MIRAS, and
- limitations on how capital content can be calculated.

The maximum MIRAS limit is £30,000 and was fixed when property prices were relatively low. CCC recognises that the prevailing political orthodoxy is to reduce such tax reliefs. However, to raise and ring-fence the MIRAS limit for mortgages taken out specifically to fund care would greatly increase the efficiency of this funding mechanism and provide the security needed for rational planning.

At present, the capital content of a mortgage-based income plan can only be calculated based on the life expectancy of a healthy policyholder. Computations assume that the lives concerned are healthy and that a pooled average life expectancy is used. Thus if a person is in ill health (or one partner in a joint application is in poor health) then the taxable content is unrealistically high and is unfair. The capital content should be based on the life expectation determined by the insurer when the insurer gives special terms because the life is impaired or because one of the lives is impaired.¹

Such a change in regulation would increase significantly the attractiveness of using equity release to cover long-term care costs – with significant savings to the State.

CCC
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¹Using the example of an 80 year old male with impaired health, CCC has calculated the effect of increased MIRAS relief for long-term care provision, together with equitable tax treatment. The calculation assumes that life expectancy has been reduced from 7.5 years for a healthy life to 4 years owing to the assumed impairment and that the individual has a £60,000 mortgage. The result is that net income would increase by between 15% and 20% a month (£50 to £150 per month). Long term care or long-term care insurance premiums would therefore become significantly more affordable. (If required, more detailed numerical answers and examples can be provided.)