

Discussion paper: the future interaction of superannuation with aged care and health care

November 2015

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of Australia (ASFA)

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About ASFA

ASFA is a non-profit, non-politically aligned national organisation that is the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate for policy in the best long-term interest of fund members. Our members – which include corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider members – represent more than 90 per cent of the 12 million Australians with superannuation.

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November 2015

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As Australia's population ages, it is evident that that dealing with the associated costs will require measures that go well beyond the provision of the Age Pension alone. In this regard, ASFA has undertaken considerable work on what is required to remove impediments to the development of new post-retirement products that could deliver better retirement incomes for retirees. However, quality of life in retirement is influenced by more than a retiree's income. For instance, the cost of future health and aged care need to be considered.

The purpose of this discussion paper is to raise questions about how dealing with increasing health and aged-care costs might interact with the superannuation system. ASFA is seeking a broad range of views from stakeholders in order to inform future policy development in this area.

In order to address questions raised, the paper outlines trends in health and aged-care costs. It also provides the results of a survey recently undertaken by CoreData, on behalf of ASFA, that assesses Australians' perceptions regarding costs and other issues surrounding the provision of health and aged care, as well as the role of superannuation.

Finally, it canvasses a range of options for further discussion.

Emerging costs and the impact on retirees

The costs of health and aged care are increasing due to the ageing population, which will result in greater pressure for individuals to fund their own expenses, as the costs of provision of these services by government rise. In particular:

- health care costs funded by the Commonwealth Government are projected to more than double in real terms, per person, over the next 40 years
- the total cost of aged care is projected to reach almost \$290 billion in 2055, primarily driven by an ageing population and an increase in the prevalence of dementia
- Australian Government aged-care expenditure is projected to rise from 0.9 per cent of gross domestic product (GDP) in 2014/2015 to 1.7 per cent of GDP in 2054/2055 (\$220.2bn, or \$80bn in today's dollars)
- among other things, governments can be expected to seek higher contributions from individuals to help meet these increased costs
- even without policy changes, individuals face having to make substantial contributions for health and aged-care expenses as they reach old age
- the likelihood that a female aged 65 will enter permanent residential aged care in her lifetime is 54 per cent, and for a male, this risk is 37 per cent.

Consumer attitudes to age care provision and financing

At the same time as the costs of aged care are rising, large numbers of Australians over the age of 45 are dealing with the aged-care system. They are uncertain about the system and find dealing with it difficult.

More than half of those over the age of 45 are currently dealing with aged-care management issues for themselves, or for family members, or have dealt with it in the past. The majority of those dealing with the system find it difficult or somewhat difficult.

There is clearly a gap in the provision of advice in aged-care issues and the survey undertaken by CoreData shows an expectation that a superannuation fund provider should give such advice. Survey results included:

- close to half of survey respondents thought their superannuation fund could play a greater role in helping organise and pay for aged care
- there is considerable demand for financial advice and educational tools, and materials on aged care offered by superannuation funds, with three in five likely, or very likely, to take these up—around 60 per cent
- close to half of respondents support a rise in the Superannuation Guarantee (SG) rate beyond 12 per cent to help address the growing cost of aged care
- more than two in five of those whose main superannuation fund is not a self-managed superannuation fund would like to receive some support in dealing with aged care from their main superannuation fund.

Integrating health and aged care and superannuation

With the combination of increasing costs of health and aged care, the growing community interaction with these systems and consumers' uncertainty around them, it is evident that these are issues faced by superannuation fund members in the lead up to, and during retirement. Given that those surveyed consider that superannuation should, and could, play a role in meeting the future of aged-care costs, the role of superannuation needs to be considered by the government and the industry.

There are a number of broad options that could be used to assist individuals with the cost and complexity of health and aged care:

- increase dedicated private savings
- increase the Superannuation Guarantee to above 15 per cent of wages
- draw on housing equity through mechanisms such as equity release products, downsizing or income contingent loans
- take out voluntary or compulsory insurance.

These broader policy options require more detailed work from the government and the industry. Some specific questions that need to be considered are:

- Should the objectives of the superannuation system incorporate consideration of aged care and health costs in retirement? Why or why not?
- What is the role of the other retirement system pillars, government support and discretionary private savings, in ensuring adequate aged and health care provision in retirement?
- Should the level of compulsory superannuation contributions be increased to 15 per cent and beyond to finance individuals' future health and aged-care needs?
- What other mechanisms are worth considering to support adequate funding of health and aged-care needs? What role should superannuation funds play?
- What are the key features and issues that should be considered in designing options to meet future health and aged-care needs?

For the superannuation industry specifically, there is an increasing expectation that financial advisers should be able to provide advice about all aspects of retirement, including funding of health and aged care. For the industry and government—but more so the industry—two questions that need to be considered are:

- How can the program of increasing adviser standards incorporate aged-care advice? What else needs to be done to drive trusted advice in this space and increase levels of understanding in the community?
- How can access to aged-care advice be improved? What is the role of superannuation funds in this equation?

In this context ASFA is seeking feedback in order to help shape its future work on the issues canvassed in this paper and on possible policy options.

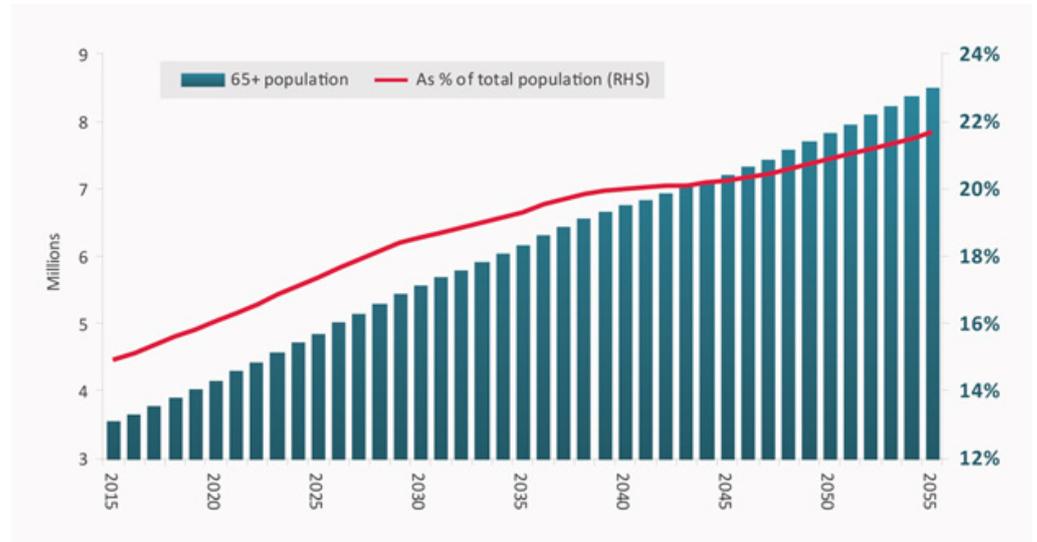
ASFA requests that feedback be provided by 1 March 2016. Responses can be emailed to Ross Clare: rclare@superannuation.asn.au or Glen McCrea: gmccrea@superannuation.asn.au.

Section 1

The impact of ageing on personal and government budgets

In the coming decades, all levels of government will face growing fiscal pressures as the population ages and expectations for greater government support of ageing-related programs increase. This is both a function of the increase in the real cost of many age-related services and the projected massive increase in the absolute number of older Australians and their percentage share of the overall population (Chart 1).

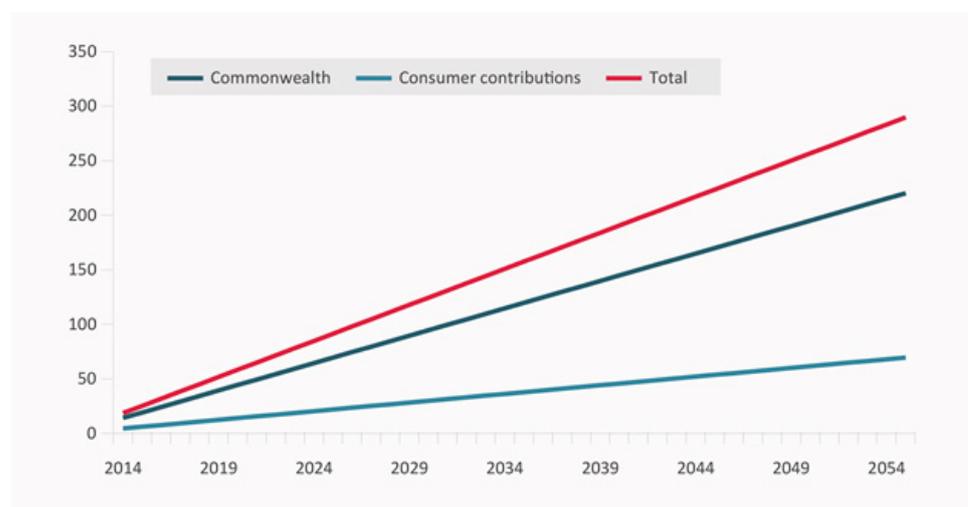
Chart 1: Proportion and number of the Australians aged 65 and over



Source: ABS Demographic Projections, cat. 3222.0.

This is likely to lead to pressure for individuals to make greater contributions to the cost of provision of health and aged-care services (Chart 2). As shown by the Chart, the amount of Commonwealth expenditure is forecast to increase markedly. In the absence of further policy changes, the gap between Commonwealth expenditure and consumer contributions is also projected to grow markedly. Both of these factors are likely to lead to pressures for greater financial contributions from users of aged-care services.

Chart 2: Forecast expenditure on aged care by the Australian Government and by consumers



Source: 2015 Intergenerational Report.

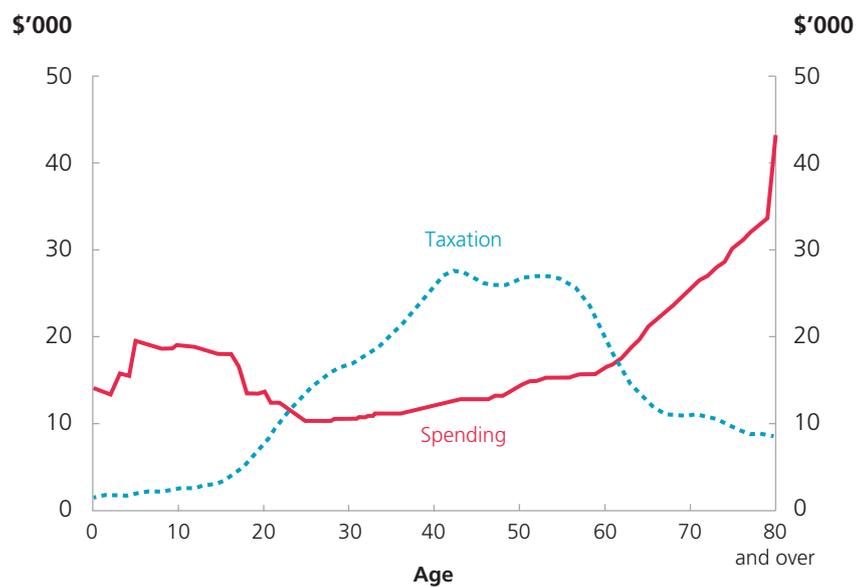
This raises a number of financing challenges.

Between ages 25 and 58, the value of total consumption of goods and services can usually be funded by individuals through income from employment. Beyond those years, because individual income is not sufficient to finance necessary expenditure on goods and services, some other source is needed. This can include own savings, transfers within households, or the government.

In retirement years, government payments and services (in the form of the Age Pension and provision of health and aged-care services), superannuation assets and income streams have important roles to play.

This financing challenge is compounded due to government expenditure per person rising sharply after age 60. This is because income from employment falls at the same time as the need for health and aged care rise (see Chart 3).

Chart 3: Total government spending and taxes per person per year by age (2009/2010)



Note: Total government refers to Australian Government and State and Territory governments.
Source: 2015 Intergenerational Report.

Health costs

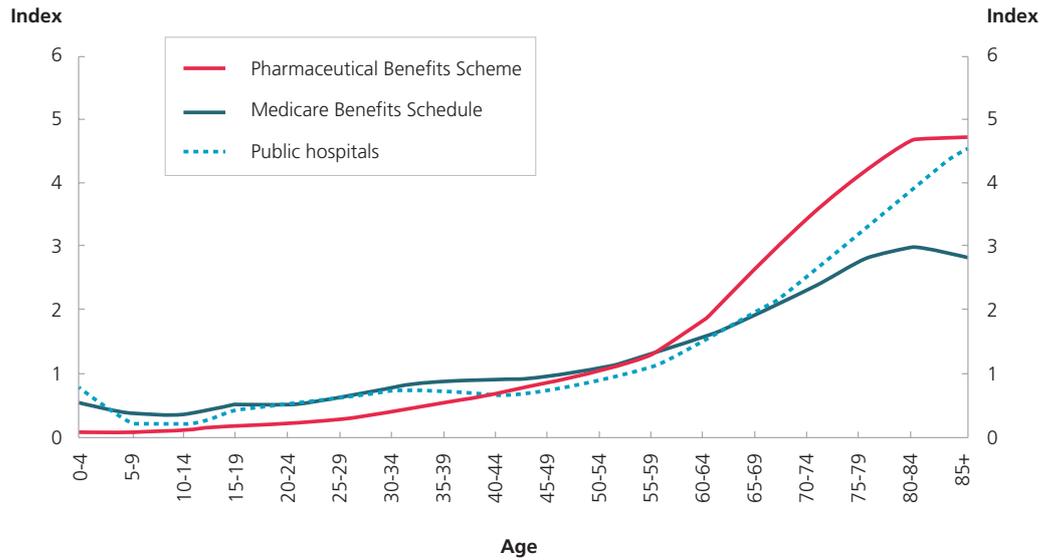
In the important area of health services, population ageing is a large component of the trend for higher consumption, though non-demographic factors are also major drivers.

According to the 2015 Intergenerational Report, non-demographic factors are expected to be the largest contributor to growth in real per person health spending. Non-demographic factors on their own (in the absence of the effects of an ageing population) are estimated to account for around 80 per cent of the projected increase in real expenditure per person.

While non-demographic factors are the biggest driver of growth in health spending, an ageing population will also contribute to increases. The impact of ageing on its own is expected to contribute around 10 per cent of the projected increase in real expenditure per person.

Elderly health care costs are substantially more than the average person across major health programs (Chart 4). For instance, for both pharmaceutical benefits and public hospitals expenditure, spending on the average person aged 85 years and older is more than four times the spending on the average person across all ages.

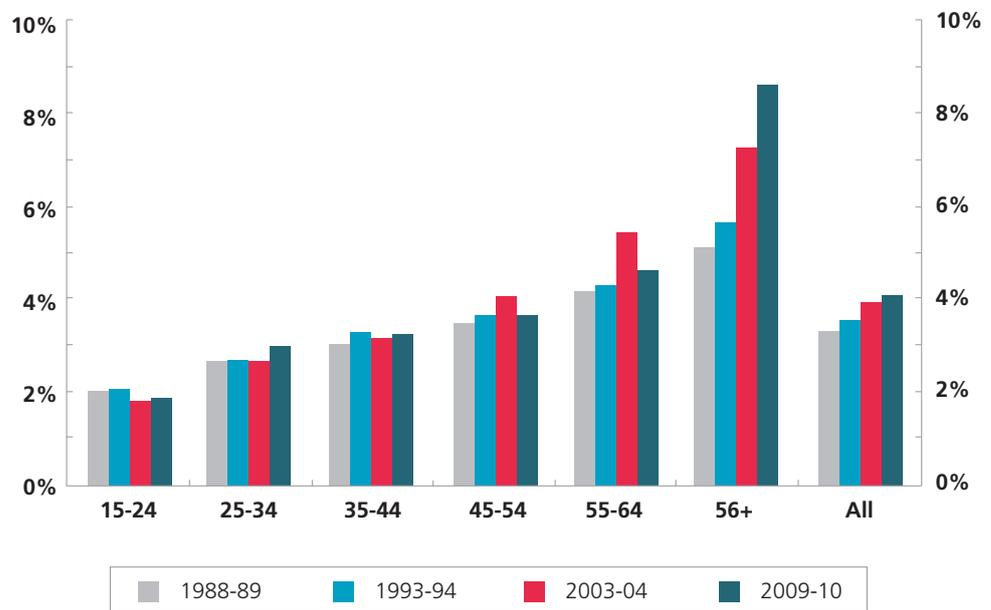
Chart 4: Australian Government health spending by program based on age



Note: Index of average cost per person in 2012 13 = 1.
Source: Department of Health.

As the population ages, overall consumption patterns will change. For example, older people spend a greater proportion of their income on health services than younger people and this proportion has been rising over time (Chart 5).

Chart 5: Expenditure on medical care and health expenses as a percentage of total household expenditure by age of reference person



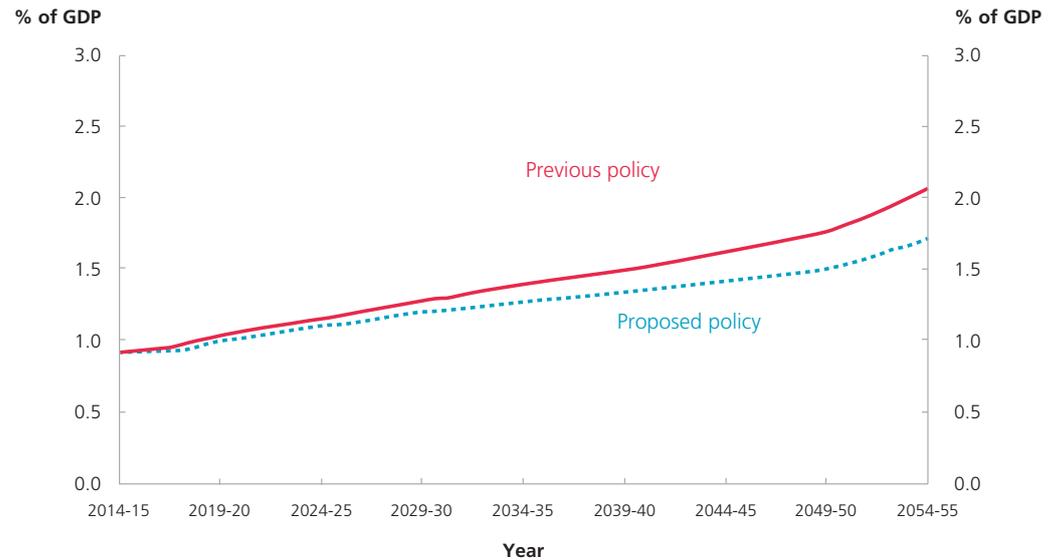
Source: ABS, cat. 6530.0.

Aged-care costs and usage

The Australian Government provides aged-care funding for residential aged care and a range of community care services, including care in the home. In 2014/2015, the Australian Government provided around 0.9 per cent of GDP for total government aged-care expenditure. The States and Territories contributed a small proportion of less than 0.1 per cent (see Chart 6).

As indicated in the Chart, Australian Government aged-care spending is forecast to substantially increase as a percentage of GDP, although recent policy changes will limit future growth.

Chart 6: Australian Government aged-care spending



Source: Treasury projections. Projections assume trend economic growth from 2021–22 to 2054–55.

Having to deal with residential aged-care costs is something that a large proportion of retirees already have to deal with at some stage during their retirement years. As life expectancy increases and more individuals reach age 85 and beyond, the likelihood of having to deal with residential aged-care access and financing will further increase.

In this context, in 2007/2008, the likelihood that a female, aged 65 years old, would enter permanent residential aged care in her lifetime was 54 per cent, and for a male this risk was 37 per cent. The likelihood that someone will enter into residential aged care in their lifetime increases with age, although this risk declines again for the very old. In 2007/2008, for females, the likelihood of entering residential aged care, for those who have not been previously admitted, was at its highest during their early to mid-80s where the likelihood of entry was around 60 per cent. For males, the peak likelihood of entering into residential aged care was during their mid to late-80s, where the likelihood of entry is around 48 per cent.

In 1997/1998 the average age of entry into residential aged care for females was 82.8 years; by 2008/2009 this had increased to 84.3 years. For males, over the same period, the average age of entry into residential aged care increased from 79.5 years to 81.6 years. This suggests that better health outcomes and use of home and community care have led to individuals delaying accessing residential aged care. However, more Australians are reaching the age of 80 or more, increasing the demand for residential aged care.

Section 2

Consumer attitudes to aged-care provision and financing

Due to rising health and aged-care costs and the high probability of older Australians requiring access to formal aged care at some stage (as described above), ASFA commissioned CoreData to explore the current level of knowledge and views about aged care of superannuation fund members aged over 45.

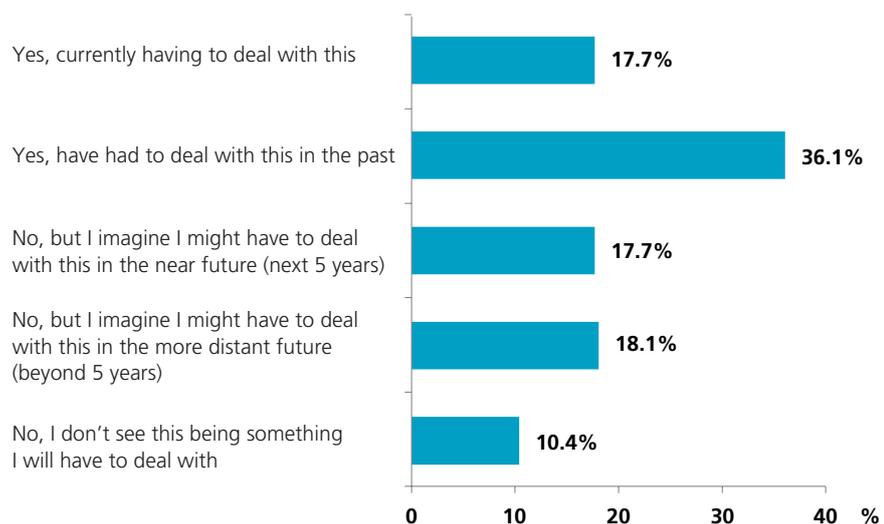
This age group was chosen because those aged over 45 are more likely to have had some contact with aged care, either personally or because of the needs of a relative. Those Australians over 45 are also more likely to have started thinking about their future aged care requirements. There were 1,028 respondents to the survey, randomly drawn from CoreData's panel of more than 132,000 consumers.

Following is a summary of the findings of the survey.

Consumer involvement with and concerns about aged-care provision

It is relatively common for those aged over 45 to have dealt with aged-care issues or expect to do so in the next five years (Chart 7).

Chart 7: Incidence of dealing with aged care issues in regard to family or self

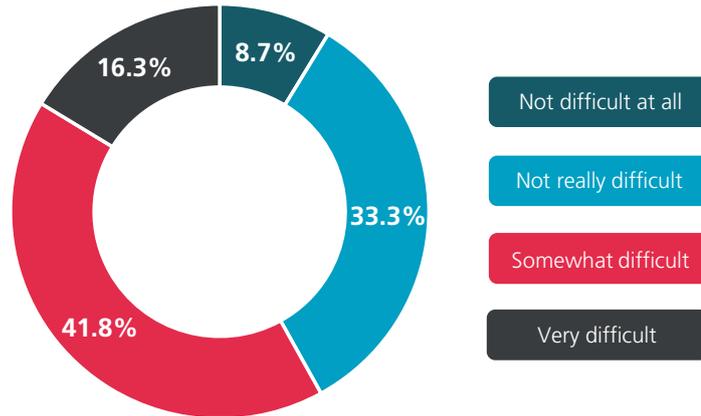


Source: CoreData survey, October 2015.

As shown by Chart 7 above, more than half of respondents were currently having to, or have had to deal with aged-care management issues for themselves or family members, most commonly parents and in-laws.

More than a third anticipated dealing with these issues at some point in the future. Only one in 10 thought they will never have to deal with aged-care issues. The survey results also indicate that the majority of those who have dealt with, or are dealing with aged-care management issues, find them somewhat, or very difficult (Chart 8). Females are more likely to see these issues as difficult.

Chart 8: Degree of difficulty in dealing with aged-care management



Source: CoreData survey, October 2015.

The most common aged-care management issues revolve around difficulties in finding suitable care, health issues, financial issues and what is perceived to be poor service provided by paid carers or aged-care facilities. Anticipated aged-care management issues revolve around difficulties in finding suitable care, financial issues and emotional issues.

One of the reasons that respondents find dealing with aged care difficult is that aged-care options are poorly understood. Half of the respondents felt that they have some understanding of the options available in choosing and paying for aged-care services, but feel it is insufficient. Furthermore, close to one in five felt they have no understanding at all.

Understanding of aged-care options was lowest among respondents aged 45-49.

Most respondents had taken few or no steps to prepare for their relatives who may need aged care, with a preference for staying at home, or delaying the preparation until the need arises.

Among the minority who had taken action, steps included saving more money and researching the options.

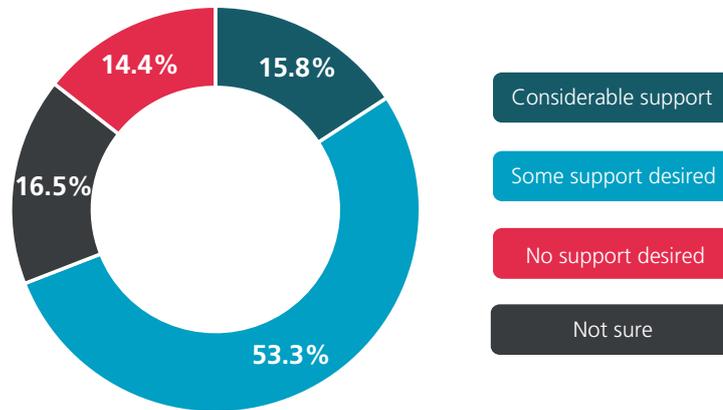
However, after CoreData made respondents aware of the aged-care reforms that came into effect on 1 July 2014, the vast majority (83.3 per cent) of respondents indicated that they are somewhat, or very concerned with the cost of aged care.

Providing support to Australians in regard to aged care

Given the various issues associated with aged care and a poor understanding of the options, it is unsurprising that the majority (69.1 per cent) of respondents desire some, or considerable support to organise aged care for themselves or family members (Chart 9).

In particular, Australians are looking for support in finding a suitable care option and organising finances.

Chart 9: Preferred level of support for organising aged care for self or family

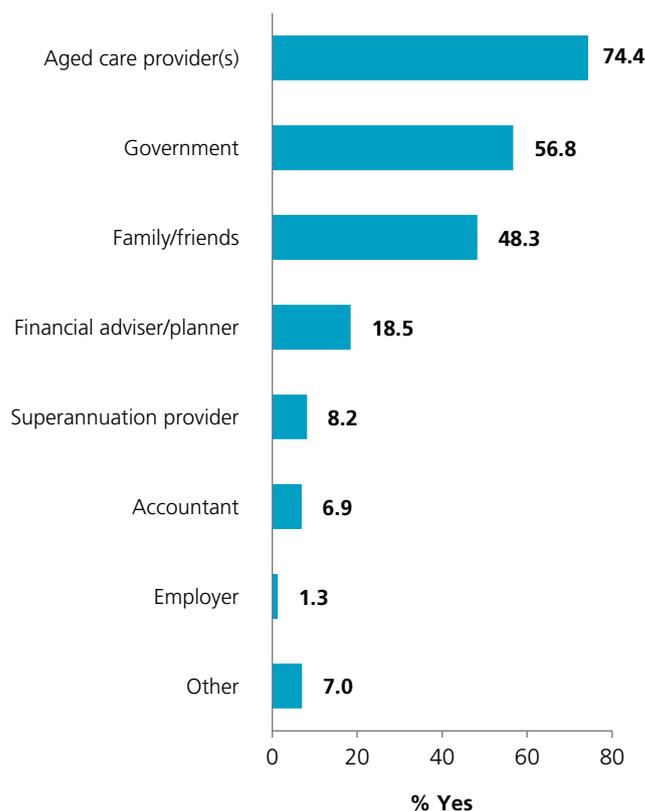


Source: CoreData survey, October 2015.

Currently, support was most commonly desired by respondents from aged-care providers (74.4 per cent) and the Government (56.8 per cent) (Chart 10).

At this stage, superannuation funds are not high on the list of organisations currently likely to be approached for assistance in aged-care management.

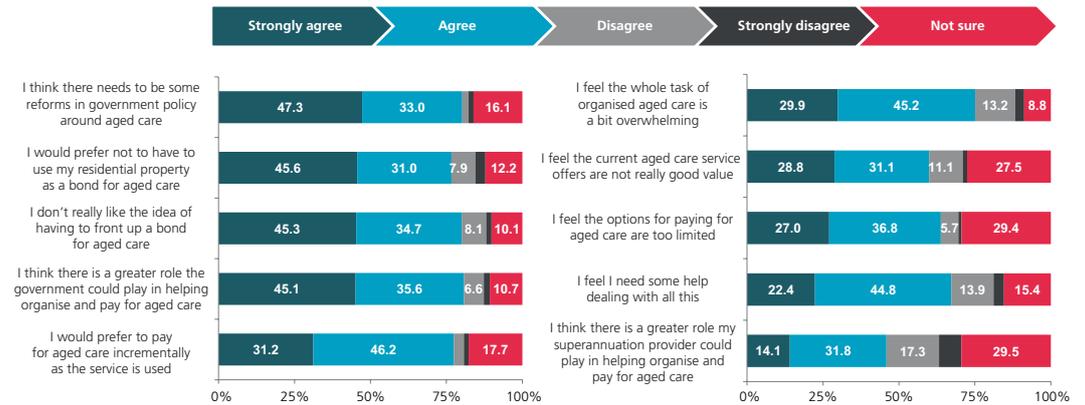
Chart 10: Organisations and individuals currently likely to be approached for support in regard to aged-care management



*Multiple answers allowed.
Source: CoreData survey, October 2015.

Going forward, as shown by Chart 11, there is interest in a variety of reforms being made to aged-care provision and financing.

Chart 11: Views on desirability of various possible reforms and assistance

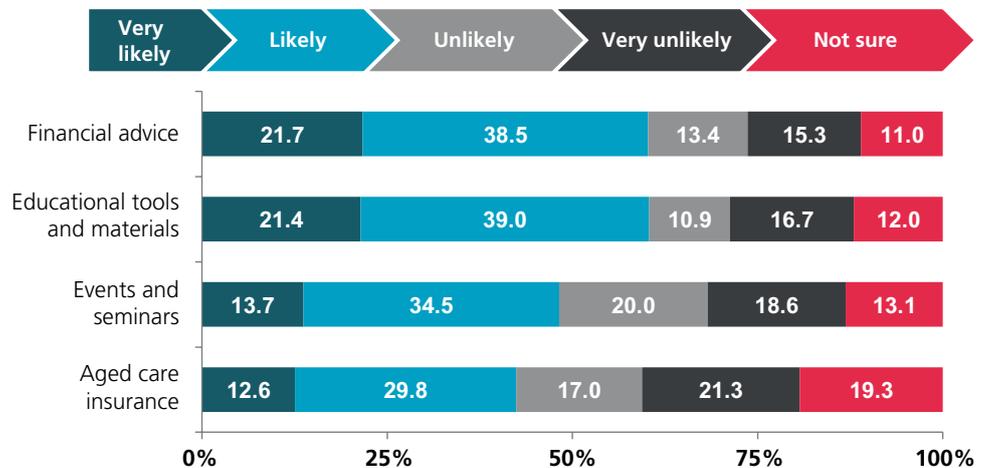


Source: CoreData survey, October 2015.

Close to half of respondents considered that their superannuation fund should play a greater role in helping organise and pay for aged care.

There is considerable interest in financial advice and educational tools and materials on aged care if offered by superannuation funds, with three in five likely or very likely to take these up (Chart 12).

Chart 12: Likelihood of taking up services if offered by respondent's super fund



Source: CoreData survey, October 2015.

Respondents also indicated support for a higher rate of compulsory superannuation contributions linked to aged care. Close to half (48.3 per cent) of respondents supported a rise in the Superannuation Guarantee (SG) rate beyond the planned increase to 12 per cent, to help address the growing cost of aged care. On average, these respondents think the SG rate should be increased to 16 per cent.

Section 3

Better integration of superannuation with aged care and health care provision?

Aged care and health care costs impact on both standard of living and financial requirements of those in retirement. The CoreData survey shows that respondents consider superannuation can, and should play a key role in meeting the future aged care and health care needs of older Australians.

It is timely to closely consider this possible role for superannuation given the public debate that the Financial System Inquiry (FSI) started on the objectives and purpose of superannuation.

If superannuation is to play a key role in meeting the future needs of aged and health care, should this be considered when determining the purpose of superannuation?

In this context, it is useful to remind ourselves about the purpose of the system as outlined in the FSI report. It indicated that the system is about “providing income in retirement to replace or supplement the Age Pension”.

ASFA interprets this definition in terms of it being focused on adequacy. ASFA considers that the system should aim for the majority of Australians to achieve a comfortable standard of living in retirement (currently expenditure of around \$42,861 per year for a single and \$58,784 per year for a couple). ASFA considers that there is no need for tax concessions for those that well exceed the comfortable standard (that is, those with balances over \$2.5 million).

A narrower definition that has also been raised in public debate is that “superannuation was set up as an alternative to the Age Pension so that people don’t have to rely on the Age Pension”. In other words, it is not about supplementing the pension, but replacing it. If this objective/purpose were adopted, it would have significant implications for the design of the retirement incomes system.

However, given the consumer feedback reported in this paper, the argument could be raised that the objective/purpose of superannuation should be broader than proposed in the FSI. That is, it should extend further than income and also include consideration of meeting aged care and health care expenses in retirement.

ASFA has previously indicated that at the core of any set of objectives must be the requirement that all Australians are financially confident about their retirement. It could be reasonably argued that just providing replacement income for the segment of retirees who are lucky enough to remain healthy and free from significant aged-care costs would fall short of achieving this objective.

Meeting the health care and aged care needs of the future

The current funding arrangements for aged care are supported by two pillars—a dominant taxpayer funded pay-as-you-go subsidy pillar and a user-pays pillar. Under these arrangements, taxpayers bear the full financial risk associated with the public subsidy, including rising unit costs and the effects of population ageing on overall care costs.¹

The Productivity Commission, in their 2011 Aged Care Inquiry considered a number of potential measures to broaden the funding base for aged care including:

- increasing dedicated private savings (aged-care savings accounts, quarantined higher superannuation contributions)
- drawing on housing equity (equity release products or income contingent loans)
- insurance — voluntary or compulsory.

Touching upon similar themes in an address to the ASFA 2012 Conference, ex-Prime Minister Paul Keating called for the establishment of a government-administered longevity insurance fund to ensure the adequacy of retirement incomes in the later years of life.

¹ Productivity Commission Health and Aged Care Report, 2011 Volume 2.

Keating considered that privately managed superannuation currently provides a reasonable retirement lifestyle for the first half of retirement during age 60 to 80 (superannuation phase one) when it is all about retirement lifestyle. However, due to increasing life expectancy, he argued that the superannuation system is struggling to meet its promises during age 80 to 100 (phase 2), which is more about aged care than lifestyle.

To address this longevity issue, Keating recommended making it compulsory to convert part of a lump-sum retirement benefit to a deferred annuity as a pre-payment that would become available from age 80.

Alternatively, Keating called on the government to increase the SG from 12 per cent to 15 per cent, and use the additional 3 per cent to fund a government-administered longevity insurance fund to cover the longevity risk from age 80.

While covering the longevity risk for later in life is a classic insurance task, Keating considered that the government is in a superior position to pool risk, and operate a universal social insurance scheme with a fully funded, carefully constructed product.

In contrast to Keating, the Productivity Commission in their 2011 review recommended that compulsory social or private insurance was not the best approach. This was followed in 2015 by the FSI, which recommended that trustees should be required to pre-select a comprehensive income product for members which would commence at the member's instruction.

Design of a scheme to meet the health and aged care costs of the future

The work undertaken by the Productivity Commission and comments by Paul Keating indicate that there are a number of options to enable retirees to meet the increased costs of health and aged costs.

These options include various combinations of social insurance through government provision of certain health and aged-care services funded out of consolidated revenue, and private contributions funded out of insurance arrangements, quarantined components of superannuation account balances or home equity.

In designing the products that underpin these options, careful consideration would need to be given to managing intergenerational equity and risks such as moral hazard and adverse selection. In addition, such products would need to be designed to provide value to consumers through appropriate pricing, delivering benefits that match expenses when they occur and clear specification of their coverage (i.e. a test of appropriateness would be whether the product would meet future costs of private health care needs, or provide funds required for accommodation bonds associated with residential aged care).

From a system perspective, the tax and social security implications of such products would need to be considered. Adverse tax or social security outcomes might render such products unattractive or unviable.

As the CoreData survey results also identified, there is a clear role for the provision of advice, potentially by superannuation funds, in providing value to consumers.

Role of financial advice

Financial advice can play an important role in optimising health and aged-care related decisions. For example, the approach adopted in relation to financing accommodation bonds for aged care facilities can have a major impact on aged care and financial outcomes for retirees. Eligibility for government subsidies and support, as well as the impact of various options on pension entitlements, all need to be considered.

There are often a variety of fee structures available to purchase aged-care services and accommodation, for example paying a higher upfront bond may reduce ongoing fees, and these need to be considered carefully to achieve the best outcome for the individual.

A trusted financial adviser can assist families as they navigate complex, emotional decisions.

Further consideration needs to be given to the potential value of advice whether it is intra-fund, limited or full advice. This is particularly relevant as in its FSI response, the Government confirmed that it would raise the competency of financial advisers with new standards to be set by an independent, industry-funded body, which will be recognised in legislation. (The Government has indicated it will introduce legislation to this effect by mid-2016).

Questions for consideration

With the combination of growing costs of health and aged care, the very wide community interaction with these systems and consumers' uncertainty around them, it is clear that there are issues faced by superannuation fund members in the lead up to, and during, retirement. Given that those surveyed consider that superannuation should, and could play a role in meeting the future of aged-care costs, the role of superannuation from the perspective of the government and the industry needs to be considered.

There are a number of broad options that could be used to assist individuals with the cost and complexity of health and aged care. These include:

- increase dedicated private savings
- increase the SG to above 15 per cent of wages
- draw on housing equity through mechanisms such as equity release products or income contingent loans
- take out voluntary or compulsory insurance

These broader policy options require more detailed work from both the superannuation industry and the Government before they would be capable of being implemented.

In this context ASFA is seeking feedback in regard to the following questions in order to help shape its future work on the issues canvassed in this paper and on possible policy options.

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Question: Should the level of compulsory superannuation contributions be increased to 15 per cent and beyond to finance individual's future health and aged-care needs?

Question: What other mechanisms are worth considering in order to support adequate funding of health and aged-care needs? What role should superannuation funds play?

Question: What are the key features and issues that should be considered in designing options to meet future health and aged-care needs?

Question: How can the program increasing adviser standards incorporate aged-care advice? What else needs to be done to drive trusted advice in this space and increase levels of understanding in the community?

Question: How can access to aged-care advice be improved? What is the role of superannuation funds in this equation?



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