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10 August 2010

Caring for Older Australians
Productivity Commission
PO Box 1428
Canberra City ACT 2601

Dear Sir / Madam

The Financial Planning Association of Australia (FPA)[1] welcomes the opportunity to contribute to the Productivity Commission's comprehensive review of Australia's aged care system, *Caring for Older Australians*.

The FPA's submission is limited to the issues of:

- Funding of aged care facilities - the transparency and equity of the funding arrangements and how this impacts on the accessibility to (residential) services and limits choice of those needing the services.
- Product availability - to encourage Australians to save for potential aged care needs.
- Prudential regulation – to strengthen the accountability and security of the aged care industry.
- Complexity of the aged care regulatory environment – to improve understanding of the system and enhance preparedness for aged care needs.

At 30 June 2006, there were 151,737 permanent residents and 3,135 respite residents in residential aged care. The majority of permanent residents were aged 75 years and over (87 percent); 53 percent were aged 85 years and over, and 7 percent were 95 years and over. The Intergenerational Report forecasts that by 2050 nearly one-quarter of Australians will be over 65, compared with 13 per cent today. While not all retirees will need to move into aged care accommodation, most retirees will require progressively greater levels of support as they age.

Increasing health and aged care costs as a person progresses through retirement may lead to an increase in retirement expenditure in later years and significantly impacts on the adequacy and longevity of retirement income. The expenses and impact on their retirement income will depend on the level of support from a spouse, family and friends, ongoing suitability of their family home to meet their needs, location and associated property expenses or care availability, personal health and mobility, and level of savings.

In fact, it could be argued that later in life, the need is higher for capital than income to access and pay for health and aged care. Yet the decision to spend capital in early years of retirement and rely on income from the aged pension later in life runs counter to this need. Such spending behaviours in retirement impacts on the level of government assistance needed to fund aged care needs. *Australia to 2050: Future Challenges* projects spending on aged care to increase as a proportion of the Gross Domestic Product from 0.8 per cent in 2009-10 to around 1.8 percent in 2049-50.

[1] The FPA is the peak professional organisation for the financial planning sector in Australia. With approximately 12,000 members, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than $630 billion.

The current aged care system demands consumers to have some financial independence to access choice in the care they need at a time of life when the majority of Australians rely on Government or family support financially, in part or whole.

1. Funding of aged care facilities

Aged care facilities are funded through a combination of government subsidies and resident fees. As described in Box 4 of the Productivity Commission's Issues Paper, a resident at an aged care facility may incur a basic daily fee, an income tested fee and an accommodation charge or an accommodation bond.

a) Equity in access to aged care facilities

The FPA supports the key theme of 'facilitating access to care regardless of economic and other circumstances' which runs through the legislation relating to the aged care system, as noted in the Issues Paper[2].

However, the current funding system incentivises facilities to offer places to people who can afford higher levels of accommodation bonds, or to those with very low levels of assets who qualify as "supported residents"

The (well documented) shortage in availability of aged care accommodation has resulted in aged care facilities giving preference to people who have the ability to pay larger bonds. It is therefore likely that having adequate funds for a large accommodation bond may assist in gaining entry to a particular aged care facility.

The favouritism toward those with either high or low levels of assets has created a gap which disadvantages people with mid-ranges of assets (for example, between $100,000 and $350,000). Feedback from FPA members indicates that those individuals who fall in the mid-ranges of assets gap have more limited opportunities to access places in low care and high care extra service facilities as a direct result of their financial position. Meeting the eligibility criteria for a service type does not ensure access. Gaining access to a facility appears to be ultimately determined by an individual's financial position rather than their need for care.

The FPA recommends the Government address the access to aged care issues for Australians with mid-range assets who fall in the gap between people who can afford higher levels of bonds and those who qualify as "supported residents".

b) Transparency and accountability

A further key theme of the legislation is that of 'accountability and transparency'[3].

Currently aged care facilities require potential residents to provide their detailed financial position which is then used to determine the level of bond they must provide to be accepted into the facility.

There is a need for greater accountability on aged care facilities to provide an estimate on the amount of the bond (within a reasonable range) before gaining details of the applicant's finances. This would significantly improve the transparency of the system and enable planners to help their clients better prepare for future aged care needs.

[2] Productivity Commission Issues Paper, Caring for Older Australian, p.15
[3] Productivity Commission Issues Paper, Caring for Older Australian, p.15

The FPA recommends a requirement on aged care facilities to provide an estimate on the amount of the bond (within a reasonable range) before gaining details of the applicant's finances.

c) Charging models and payment options of aged care facilities

The aged care regulations set the maximum limits on the fees facilities are permitted to charge, except in the case of extra service places. The fees charged for extra service places are a commercial decision of the each provider. More importantly, the method of payment for aged care facility entry fees and services is also a commercial decision of each provider. This has resulted in a variety of different payment arrangements in the aged care facilities market - some facilities require a lump sum payment, some allow other payment option such as periodic payments.

If entry fees are required to be paid as a lump sum, an individual must find the money from the sale of the family home, savings, or other assets (for example) or they will be forced to pay annual interest compounded at a very high rate, currently approximately 9 percent. Sourcing monies for a lump sum can significantly impact an individual's cash flow and pension drawdown's, which affect their ability to afford access to care. Given the nature of the regulatory environment (see 4. Complexity of the aged care regulatory environment, below) it may also place the individual at risk of incurring penalties related to superannuation legislation and social security benefits.

Moving into aged care is commonly a very emotional experience for an individual and their family and friends. Affording access to a facility and negotiating the financial arrangements can exemplify this issue. Having the option of periodic payments (as an example of one payment option) simplifies the process and significantly decreases the impact on cash flow for the resident.

However, many facilities will not negotiate payment arrangements creating an environment where the provider has all the power and control over the consumer's ability to access the facility. The lack of ability to negotiate payment options can have detrimental effects on an individual's ability to afford and access the residential care they need. It can often result in the provider denying access to the facility. For example, FPA member feedback indicates that no aged care provider in Ballarat will negotiate payment option or allow periodic payments.

The inability to negotiate payment arrangements makes it difficult to compare facilities services and price, significantly impacts on an individual's ability to afford residential care, makes it hard to develop effective strategies to plan and prepare for aged care funding, and demands consumers' have strong cash flows at a time of life when cash flows are often minimal or difficult.

The FPA recommends the Government mandate the use of consistent charging models across the aged care industry and a requirement on aged care facilities to allow payment options, such as periodic payment opportunities, for Australians to access the care they need. This would also provide Australians with the certainty to plan for such expense, potentially reducing reliance on Government assistance.

2. **Product availability**

Health and aged care costs can significantly impact on the adequacy and longevity of a person's retirement income. There is a need for products and Government incentives to assist individuals to set money aside for potential aged care costs.

a) Regulatory constraints to product development

There are currently a number of regulatory impediments which impact on the development and use of products designed to assist with aged care costs.

Lifetime income streams can assist with ongoing aged care fees but are unpopular options and represent a very small percentage of the income stream market. The treatment of income streams for aged care purposes can create a further disincentive for these options, as lifetime income streams purchased after 19 September 2007 are fully assessable as assets for determining the maximum bond payable in an aged care facility but do not allow access to capital to pay the bonds.

When a person moves into a low level or high level extra service aged care facility the maximum bond payable is based on the level of assessable assets. This calculation includes lifetime income streams purchased after 19 September 2007 even though they cannot be converted to cash to pay the lump sum bond. The person can negotiate to pay the bond as a periodic payment but this is at the discretion of the aged care facility and incurs high rates of interest (currently 8.76 per cent per annum).

The development of products to assist Australians fund retirement needs, including health and aged care needs, such as long term care insurance and longevity insurance, have been considered in recent Government reviews including the Retirement Incomes Review and the Future of Australia's Tax System (Henry Review).

The FPA notes and supports the Government's rejection of the recommendation of the Tax Review Panel of the establishment of a Government Insurance Pool to address the issue of longevity and adequacy in retirement incomes, which incorporates aged care costs.

The FPA believes a creative approach needs to be taken to encourage Australians to set aside money in products that work for aged care. For example, the superannuation system was developed to encourage saving for retirement and the First Home Owners Scheme to encourage saving for a home. A similar concept could be used for products designed for aged care, with tax incentives offered to encourage Australians to save and prepare for potential aged care costs. This may, or may not, be linked to the superannuation system.

Another option could be the development of insurance policy type products that provide a payment for an aged care bond, for example, similar to providing a payment on the death of the policy holder. However, legislative changes may be needed to facilitate the development of such products.

The FPA recommends:

- An exemption for all lifetime annuities when calculating the level of assessable assets and the maximum bond payable. This exemption is unlikely to be abused by people buying lifetime annuities before moving to aged care due to the pricing and the potential for a large capital loss if the person has a less than average life expectancy.
- A creative approach to providing the regulatory environment that encourages the development of products and incentives, by Government and/or the private sector, that encourage Australians to save for potential aged care needs.

b) Use of reverse mortgages for aged care funding

The Productivity Commission's Issues Paper suggests the use of reverse mortgages to increase the reliance on private savings to fund aged care needs[4]. While the FPA supports the need to encourage individuals to be financially prepared for their potential aged care needs, the Association and its members strongly suggest a cautious approach be employed in relation to the use of reverse mortgages in their current form.

The FPA notes the inclusion of reverse mortgages in the current consultation process being undertaken by The Treasury as part of the National Consumer Credit Protection Reform. However, due to the increasing interest in reverse mortgages and similar products in relation to retirement income adequacy and longevity issues, concerns related to such product must be considered within the context of the aged care system and consumer protection reforms should be considered.

While, reverse mortgages or equity release products have the potential to significantly improve the quality of life of older people with few assets other than the family home, they have significant risks and are not suitable in all cases. Such loan products are very complex, are commonly very expensive, and the FPA is concerned that existing laws do not adequately protect consumers.

One of the major risks with all reverse mortgages is the compounding effect of interest charges which means the accruing debt will usually double every 10 years, rapidly reducing the remaining equity in the home[5]. Whilst some of the earlier products developed a bad reputation, the current models have generally overcome these issues particularly those from product issuers who are members of the Senior Australians Equity Release Association of Lenders ("SEQUAL"), the industry body representing reverse mortgage lenders. Many new products include features such as interest rate protection and "no negative equity" guarantees. The FPA recognises that all members of SEQUAL abide by a voluntary industry code of conduct designed to increase awareness of the risks of equity release products and minimise consumer risk.

Notwithstanding these developments, a loan for a fairly modest sum could increase significantly and rapidly reducing equity remains a risk.

A recent FPA member survey showed that financial planners consider the suitability (57%) and complexity (46%) of reverse mortgage products pose the most risk to consumers. Some FPA members have indicated that the existing products are too complex to facilitate the giving of advice.

Concerns about reverse mortgage products highlighted by FPA members include:

- clients' ability to fully comprehend how the critical features and risks may impact on them in the future, particularly when conditions and circumstances change.
- future uncertainties (interest rates, property values and longevity) impacting on the suitability of the product.
- beneficiary discontent - planners felt the need to ensure that potential beneficiaries of the borrower's estate fully understood the nature of the product and the effect that it would have on their inheritance.
- high implementation costs for the product.
- the provision of funds through a reverse mortgage in a lump sum

[4] Productivity Commission Issues Paper, Caring for Older Australians, p. 20
[5] ASIC Fido page on reverse mortgages **www.fido.gov.au/fido/fido.nsf/byheadline/Reverse+mortgages?openDocument**

- the long-term, irreversible nature of the contract
- determining suitability of the product for the client when external conditions and personal circumstances can change.

The FPA recommends reverse mortgages and other equity release products not be relied upon for funding of aged care costs.

3. Prudential regulation

The FPA notes the issue raised by aged care providers of the "high compliance costs incurred in relation to financial reporting", as stated in the Issues Paper[6].

Aged care facilities rely heavily on the income derived from the investments they make using residents' accommodation bonds. The balances of these bonds (less retention amounts) are refunded to the person or their estate on leaving. The FPA believe aged care facilities have a duty to manage their investment responsibilities with a high level of accountability and transparency. Therefore, prudential regulation is key to the accountability of the aged care industry.

The FPA would urge the Productivity Commission to maintain strong prudential regulation with transparent reporting requirements for aged care facilities.

4. Complexity of the aged care regulatory environment

The FPA suggests consumer understanding of financial matters and the ability and desire to plan ahead for a financially secure future, especially aged care needs, are at the core of addressing the issue of funding the aged care system.

Currently, approximately 8 million Australians or 53 per cent of the adult population have been assessed as having low levels of the knowledge and skills required to effectively manage and respond to situations requiring financial decisions[7]; and 44 per cent of households on incomes of less than $50,000 per annum do not have the skills to make sound financial decisions[8].

There is a need for access to quality financial planning advice well before retirement to ensure people plan early so they can afford to access the care they require in later years and are able to structure finances appropriately when they move into aged care. Anecdotal evidence shows that those who seek advice are more likely to have assets in place to give them the means to fund aged care needs.

However, the current aged care system creates the significant barriers to the provision of advice on aged care limiting planners' ability to help people plan financially for future needs.

Financial planners are at the "front line", helping Australians' prepare for their future financial needs. However, the complexity of the current aged care regulatory environment significantly impacts on planners' ability to provide advice on the vital issue of aged care. The complexity and multifaceted regulations of aged care makes it extremely difficult to advise on. There are too many choices and options all with complex rules that could have detrimental effects on an individual if they make the wrong choice. This issue would be significantly amplified for individuals who do not seek advice.

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[6] Productivity Commission Issues Paper, Caring for Older Australians, p. 22
[7] Organisation for Economic Cooperation and Development (OECD), published by the Australian Bureau of Statistics
[8] The Smith Family

Often there is a disconnect between the plethora of laws and regulations relevant to people at the stage of life when they need to access aged care facilities and Australians planning for potential aged care needs. Aged care facilities enter into individual contracts with each resident. These contracts are governed under contract law and common law. There are also specific requirements in the Aged Care Act about how facilities can behave. Residents are often told one thing by an aged care facility without consideration or knowledge of how this effects other issues such as social security regulations and Centrelink, the Superannuation Industry (Supervision) Act and pension arrangements, tax law and assets, for example, all of which can have significant impacts on an individual's financial situation and their ability to afford and pay for aged care services. This in turn affects an individual's access to aged care facilities.

As the relationship between aged care facilities and residents is based on a contract, a new contract can be entered into at any time under Contracts Law. However, this can have significant implications for the individual's arrangements with Centrelink and social security of legislation.

On top of this is the multi-tiered nature of aged care regulations involving all three levels of Government, as noted in the Issues Paper.

Removing the complexity of the system would enable planners to embed aged care advice in the financial planning process, which would lead to more Australians being financially prepared for future care needs.

Recognising the recent changes to funding arrangements announced at the Council of Australian Governments (COAG) meeting in April 2010, the FPA would support the move to a simplified, nationalised regulatory system for aged care.

Summary of FPA recommendations and Government action required

The FPA recommends that Government action is required to:

- Address the access to aged care issues for Australians with mid-range assets who fall in the gap between people who can afford higher levels of bonds and those who qualify as "supported residents".
- Introduce a requirement on aged care facilities to provide an estimate on the amount of the bond (within a reasonable range) before gaining details of the applicant's finances.
- Mandate the use of consistent charging models across the aged care industry and a requirement on aged care facilities to allow payment options, such as periodic payment opportunities, for Australians to access the care they need.
- Provide an exemption for all lifetime annuities when calculating the level of assessable assets and the maximum bond payable. This exemption is unlikely to be abused by people buying lifetime annuities before moving to aged care due to the pricing and the potential for a large capital loss if the person has a less than average life expectancy.
- Develop a creative approach to providing the regulatory environment that encourages the development of products and incentives, by Government and/or the private sector, that encourage Australians to save for potential aged care needs.

- Ensure reverse mortgages and other equity release products are not to be relied upon for funding of aged care costs, in their current form.

- Maintain strong prudential regulation with transparent reporting requirements for aged care facilities.

- Simplify and nationalise the regulatory system for aged care

If you would like to discuss any of the issues raised in this submission, please contact me, Dante De Gori, General Manager, Policy and Government Relations (Tel. 02 9220 4505 or email **dante.degori@fpa.asn.au**.

Yours faithfully

Dante De Gori
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