Actuaries Institute Podcast – Aged Care Funding: Assessing the Options and Implications

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Guest: Gillian Harrex, Andrew Matthews
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Vanessa Beenders: **Hello, and welcome to the Actuaries Institute Podcast. My name is Vanessa Beenders, and I am the Executive General Manager of Public Policy and Professionalism at the Actuaries Institute. The Institute has recently launched a Green Paper titled Aged Care Funding - Assessing the Options and Implications. The paper has been written by several authors from Finity, including Gillian Harrex and Andrew Matthews, who are joining me on this podcast today. Welcome.**

Andrew Matthews: Thanks, Vanessa. All of us are touched by healthcare and aged care, so this is an exciting paper for us to do. We all have a loved one or a relative in aged care, and we might even need it ourselves one day. So, I see it as a grand challenge, that we as an actuarial profession can contribute something to the aged care environment.

Gillian Harrex: Yeah, thank you Vanessa for having us today. It's a pleasure to be here, to discuss the paper and the work that we've done, and how actuaries can add to the conversation about aged care, particularly the costs of aged care.

Vanessa Beenders: **So, that's where actually I want to begin this conversation today, because aged care and actuaries ... They're not two words that I would ordinarily hear in the same sentence. Why is it that this paper has been done? I might begin with you, Gillian.**

Gillian Harrex: It's certainly true that actuaries haven't always been associated with aged care funding. However, the financial challenges that are created by aged care costings are well suited to the work of an actuary, and thinking about it from an actuarial perspective. These questions are big, long-term questions our whole of society issues, and so they are big issues for the government, and for individuals. And, we're going to have more and more costs as the population ages, and that's one thing that actuaries are good at, is thinking about demographics and how populations age.

Gillian Harrex: There's uncertainty. That's something that actuaries are well used to, in dealing with all their work. There are a number of dimensions to the problem, and behavioral economics definitely plays a part.

Gillian Harrex: In lots of the work of an actuary, it's not just dealing with the numbers themselves, but thinking about the impact of decisions and rules on human behavior, and how that might impact costs going forward.

Interestingly actually, a number of actuaries have for many years provided advice to areas like retirement villages, and increasingly in recent years, to a number of aged care service providers, as they've considered their longer-term capital and cash needs. So, whilst actuaries and aged care haven't always been used in the same sentences, for a few people they certainly have been.

Vanessa Beenders: Thank you and Andrew?

Andrew Matthews: The thing that struck me, Vanessa, is when you said aged care and actuaries are not words usually used together I also teach actuarial control cycle at Monash University, and I think a few of my students would say aged care is what you need, so they do associate it.

Vanessa Beenders: **You've just set the context for the paper, for why it's been done. What then are the key findings of the paper?**

Andrew Matthews: I think the key findings ... There are three, and they're the sort of questions that you would ask yourselves if you were buying anything, let alone entering aged care. And, those three questions firstly are, "What does it cost?" and, we're projecting out using actuarial science if you like, "What's the demand? What's the demography? What might the demand be in the future?" But then saying, "Well, how can you fund that? How do I fund that cost?" And thirdly, "Why should I trust it?" and, that's when we get into the regulation environment.

So, I think what we're going to take you through today, is it's a diagnostic, not just an opinion. Everyone can have an opinion on things, but what we've tried to do in this paper is put some diagnostics and some analysis on the table as well.

Vanessa Beenders: **I would say, a really important point, is that this is like a system level diagnostic, isn't it? It's not specifically about any individual's specific circumstances?**

Andrew Matthews: And, our paper I think addresses those three questions, right? "What does it cost, how do we fund it, and why should you trust it?" And, we're focusing there on regulation.

Vanessa Beenders: **Precisely, because this is a major societal challenge that we're now facing. So, let's explore those then, one by one, and let's begin with those projected system costs, then. Can you talk us through what you did there, and a bit more about what you found?**

Gillian Harrex: Firstly, we took as a starting point, obviously, the Commonwealth budget, where there's some big, projected increases in costs over the next few years and, we didn't assume any material changes to who funds what piece, and we'll talk a bit more about that later on. What we've done is we've developed a 40-year projection of the expected costs of the various components of aged care spending. Often, when we think about aged care, we think about residential aged care as individuals, and it is a huge part of total spending, but there are really important other areas that touch so many lives.

More than half of the population over 80 will receive some form of aged care support. That's often things like home support, carer support, home care and Flexi Care, all things that enable people to stay in their homes. And then obviously residential aged care, which actually is a relatively small proportion of people who enter it, but a big proportion of the total spend. Over time, we have seen a drift away from residential aged care, and our modeling assumes that that continues into the future, so more people accessing more services at home.

We've also obviously allowed for different rates of inflation. Different kinds of care will grow at different rates, and will require different levels of inflation, so we've thought about that in these projections. What we've done then, is obviously overlaid the current age profile of the population, and allowed for that to age over the next 40 years using a cohort-based approach, and we've allowed for changes in morbidity. What we have assumed there is that people will actually stay in good health for a little longer, as the population life expectancy continues to increase, but that they will still have those periods at the end of their lives where they will require some form of care, or a lot of care.

What we found, was that we actually expect costs to increase more rapidly than the current findings of the intergenerational report. We think that the peak increase will occur over the next 20 years or so, as the Baby Boomer generation heads towards extreme old age, and into those periods where they do require significant support. After that peak around 2040, we do expect costs to continue to increase, but at a slower pace.

Overall, we are anticipating the costs of care are going to increase from around 1.6 percent of GDP a year or two ago, to 2.9 per cent of GDP by 2041, which is roughly an increase of around seven percent per annum. Thereafter, we actually think costs will stabilise at that 2.9 per cent of GDP, and that actually assumes a longer-term growth of around five per cent per annum. Costs are expected to more than or almost double, over the next 40 years, as a proportion of GDP, so [it's] a very important part of total spending in the economy.

Vanessa Beenders: **I guess to make it crystal clear for listeners, it's the shape of the curve if you like of the projected system costs that this Institute paper highlights, is much stronger growth earlier on, than compared with the Intergenerational equity report, which is what is I guess guiding current government funding of the sector.**

Gillian Harrex: That's right, Vanessa. what we see is the peak coming earlier, and towards the end of that 40-year projection, the Intergenerational Report actually has slightly higher costs. We see that peak coming earlier, particularly with the Baby Boomer generation, as it heads into that extreme old age. We think that that will result in a faster uptake, or a faster increase in the costs, of care over the next 20 to 30 years.

Vanessa Beenders: **So, that makes it all the more important to be having these conversations now, so that Australian society is well placed to manage that. So, the second finding then, or key area, is about funding this and the need to reconsider that. So, this is such as the government contribution and the consumer contribution. Andrew, I think you're going to take us through this one if you could, please.**

Andrew Matthews: Yeah, I can start and then Gill will pick up. But it's logical you first think about, "What's the cost?" And the next question that you would logically ask is, "How will I fund that cost?" So, that's what a lot of the paper spent time on, is how would we project that cost? Gill do you want to say what we saw as important in that?

Gillian Harrex: It's fair to say that this is a hugely complex area, and one that arouses some pretty strong passions, there are lots of different competing interests and you could write an entire paper about who funds aged care. What we have not done, is go down any specific rabbit holes in relation to who should fund what, but to draw out some conclusions about who pays for what at different stages of their lives now, and whether the current system of funding is logical, and whether there are some areas that could be reconsidered.

I'll just give you a specific example, Vanessa. Support for everyday living, be it gardening, or cooking, or those kinds of assistance. During people's working lives or active lives, people pay for this themselves, through their own income or their savings. When they enter residential aged care, they pay for it as well, either through the daily payment, or through payment of a RAD. But, at the point where they need those supports at home, the government largely steps in and pays for those. So it's an interesting conundrum that we move through this us paying, government paying, and then individuals paying again.

Gillian Harrex: Our observation is, that as the costs of care increase, will it be appropriate as society that we continue to reconsider what should government pay, and what should individuals pay?

Gillian Harrex: Whilst we haven't gone into it in any detail, there are obviously large pools of savings that are continuing to increase, particularly with the growth in superannuation that's occurred over the last 20 years and will continue to grow over the next 20 to 40 years. Governments are critically always going to have a very important role to play in providing a safety net, however we do think there is an open question as to how much government should be paying for all people at all stages.

Vanessa Beenders: **Great point, because that comes back to then this steeper shape of the curve, than what is in the Intergenerational Report. And I love that example, where you take us through the different stages of life. And, there's also another area that is called out in the report, and that's about care costs, and how those are shared. Can you elaborate on that please, Gillian?**

Gillian Harrex: Yeah, Vanessa, thank you. The vast majority of care costs are paid for by the Commonwealth, over 95 per cent and in other forms of care or support that is provided by the Commonwealth, for example Medicare, that proportion is more like 75 per cent is paid for by the Commonwealth, and 25 per cent by the private sector.

It's very appropriate that the Commonwealth ensures that there is a safety net, that provides for people who need that. But as we have this growing pool of wealth for individuals, it is appropriate that we have a question around the intergenerational equity of the Commonwealth continuing to fund such a large proportion of residential aged care and, I think that that's an important area. It's a brave conversation to have, it's not an easy one to be had. But, it is one that we need to have for this generation, and for our children's generation, and for our children's children. As we face these bigger issues, these are important issues to address.

Vanessa Beenders: **Finally, there are recommendations then around prudential regulation, because there's a lot of costs. As Gillian mentioned Refundable Accommodation Deposits, which are as the name says, what that consumer has, if you like, provided as an interest free loan to the aged care provider. There's lots of money potentially at risk in the system here, and we're dealing with an essential service. Andrew, I think you're going to explain what the findings in the paper are about prudential regulation. What's there now, and what do you recommend?**

Andrew Matthews: I think, Vanessa, this is, believe it or not, a really important area. People can switch off when you talk about regulation, but we're talking about a sector here that is 30, 32 billion dollars a year, so this is not small.

Andrew Matthews: So first of all, I'm going to cover what is regulation? So, what regulations would help? And then, now what's happening? How can we add to the current?

Andrew Matthews: So first of all, we're talking about what is financial regulation. We're not talking about actuaries regulating care and the number of shareholders, right? We're talking about how could financial regulation make a positive contribution. It's not a bureaucracy, it's a set of rules. Those rules provide some freedom within boundaries, and ultimately those rules are about providing some trust in the system. There's a lot of cost, we've talked about funding. And then, you've got this question of, "Well, why should I trust the system?" So, we want some regulations to build that trust.

So then, what financial regulations would help? Well, we suggest a minimum spec. By that, I mean let's not have too many rules. Let's make sure we have rules that really matter. The smallest number of rules that are important, the players in the system can see they're important, and you as consumers, and actuaries can see they're important. Because too many rules, and we'll just get overwhelmed by what becomes a bureaucracy, and is not enforced.

So, what are the risks? Let's come back to that. So, we talked about if there's money deposited, there is a risk that there's insufficient money. In actuary speak, it'd be, "You're insolvent," or, "There's insufficient capital." So, the risk is that aged care providers might not be able to pay back those deposits. There's a second risk, and that's about the quality and continuity of care. So, money doesn't provide the care, but without money or not enough money, there's a risk care is either interrupted, or the quality diminishes, and that's devastating for people in the system.

So now what? What regulations do we think can add to the current? So, I break that into three areas, adequacy, viability, and visibility. I might first of all add, we're really lucky that our Commonwealth Department of Health and Ageing is focused on this. The Royal Commission focused on that, and there's a lot of good work happening. So, let's just unpack a little bit of those.

So, adequacy would be, is there enough money in the system? Is there enough liquidity? And what are the rules to ensure that your deposit is safe, or the community's deposit is safe? So, the current arrangements are being strengthened to add a capital strength, and I think actuaries can help calibrate some of what's a good capital measure. The second area is viability. So, this is looking at capital and liquidity strength, to looking forward. Will you have enough money in the future to meet obligations?

And the third thing, we've called visibility, which is about, let's not overregulate the system. If you want to build trust, players in the system have an opportunity to put some information out there. It's visible, but not just transparent and dumped a lot of information on the table, but there's some form of rating it, that enables consumers to use it.

Andrew Matthews: So, we can see that the Department of Health might be the regulator of that and set some sort of rating, but actuaries could play a role in how that rating is determined. Like, what level of capital, what level of financial strength, would get you a higher or lower rating. So, why is all this important? It's about building trust, and it's about building agility to respond. We just had a Royal Commission into aged care. If regulation works, we'll have little responses along the way, rather than waiting for the next big problem, and hold a Royal Commission. So, we'd be agile.

The second thing is, we can think of bureaucracy as having cost. Actually, I'd see it the other way. If you build trust through regulation, that building of trust creates lower costs, lower friction costs in the whole system. So that's really, Vanessa, where we're finding if you want to keep the specifications to a minimum, it needs to be run on adequacy, build on forward viability, and we think you can lighten the regulations if there's a focus on visibility, and what we would often call disclosure.

Vanessa Beenders: **Thank you, Andrew. So, I think we've had a lovely journey through the paper here, of the three key points. A much stronger predicted increase in costs than is factored into budget projections at this point in time. There are some areas worth investigating about cost sharing that we can call out, and certainly the regulatory framework, particularly around prudential settings, could be strengthened so that the whole of society has greater trust in the system then to deliver what we would expect of it. I think it's a fantastic report, and a great contribution from the actuaries, so thank you for being key authors in this.**

I'm going to come back full circle now to actuaries and aged care, and having completed this report, what then is your hope for what comes out of this? I'm going to begin with you, Andrew

Andrew Matthews: I think the key capability that we want to get is the capability to adapt. We want a system that looks at alternative future scenarios. We want a system that sees regulation as important, and why is it important, is so the system can adapt, rather than wait for the next Royal Commission into a failure.

Vanessa Beenders: **Thank you. Gillian, your hopes?**

Gillian Harrex: I just hope that the work that we have done does start a real conversation about the importance of continuing to invest in aged care, so that people can live lives of dignity. But equally, we need to have pretty open and honest and frank conversations about society's ability to pay, and individuals' ability to pay, for different kinds of care and support, and what the appropriate mixes are.

Vanessa Beenders: **Are there any final parting thoughts that you'd like to leave listeners with. Andrew?**

Andrew Matthews: Yeah, I think Vanessa, I'd like to leave listeners, particularly actuaries, with this is a really important part of society. It's big in dollars, 30, 32 billion dollars. But, I don't think any of us are untouched by it. We've got a relative in aged care, we're getting a care package at home, or we're trying to get that, or we're wrestling with the system. So, we have a responsibility to get involved. And, if you think of the three questions that this paper addresses, "What's it cost?" We're good at forecasting. "How do you fund that cost?" And finally, how do you build some trust, because that's ultimately the purpose of regulation. It's what actuaries do in a lot of other industries. So, you out there have a responsibility to get involved in what's a vital sector for our society.

Gillian Harrex: I'd just support and endorse those comments. I mean, these are really critical questions around what we do with aged care, and how we fund it, and how we enable people to live lives of dignity. But, the questions around how you fund it, or how much it might cost, are indeed questions that are well suited to the actuarial skillset of thinking about things from a bigger picture perspective. Knowing that there is lots of uncertainty, but not being afraid to put a shape or a boundary around what that uncertainty might look like.

Vanessa Beenders: **And to help design something then that's sustainable and preserves equity across all generations.**

Gillian Harrex: Absolutely.

Vanessa Beenders: **Once again, thank you for this fantastic report for the Actuaries Institute. Thank you listeners, that's all we've got time for today. I hope you've enjoyed the discussion. You can listen to more Actuaries Institute podcasts by visiting the podcasts section of Actuaries Digital, or via all mainstream podcast apps. If you'd like to continue the conversation with us on social media, please follow us on Facebook and LinkedIn, @ActuariesInstitute, or our Instagram and Twitter, @ActuariesInst.**

Vanessa Beenders: **Please write in with your questions and comments on the show, we'd love to hear from you. So once again, thank you Gillian and Andrew.**

Gillian Harrex: Thank you.

Andrew Matthews: Thank you.

Vanessa Beenders: **I'm Vanessa Beenders, bye for now.**

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