Why Don't Retirees Insure Against Long-Term Care Expenses?

Evidence from Survey Responses

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Motivation

- Adequacy of Social Security depends on extent to which health shocks are insured
- Long-term care is one of the largest out-of-pocket expenditure risks facing the elderly
  - 12 percent of men and 22 percent of women stay in nursing homes for 3 years or more
  - Annual cost of nursing home care: $75,000+
- However, long-term care insurance is not prevalent
  - 10-12 percent of the elderly has coverage

Why not?

1. Preferences and Beliefs
   - Time preference, risk aversion, bequest motives, state-dependent utility, beliefs about need for care
2. Substitutes for Insurance
   - Savings, home equity, family financial resources
   - Medicare/Medicaid
3. Substitutes for Formal Care
   - Informal (unpaid) care from family members
4. Features of the Private Market
   - Cost/affordability, counter-party risk, distrust of insurers

Understanding why is important for individual welfare and public policy

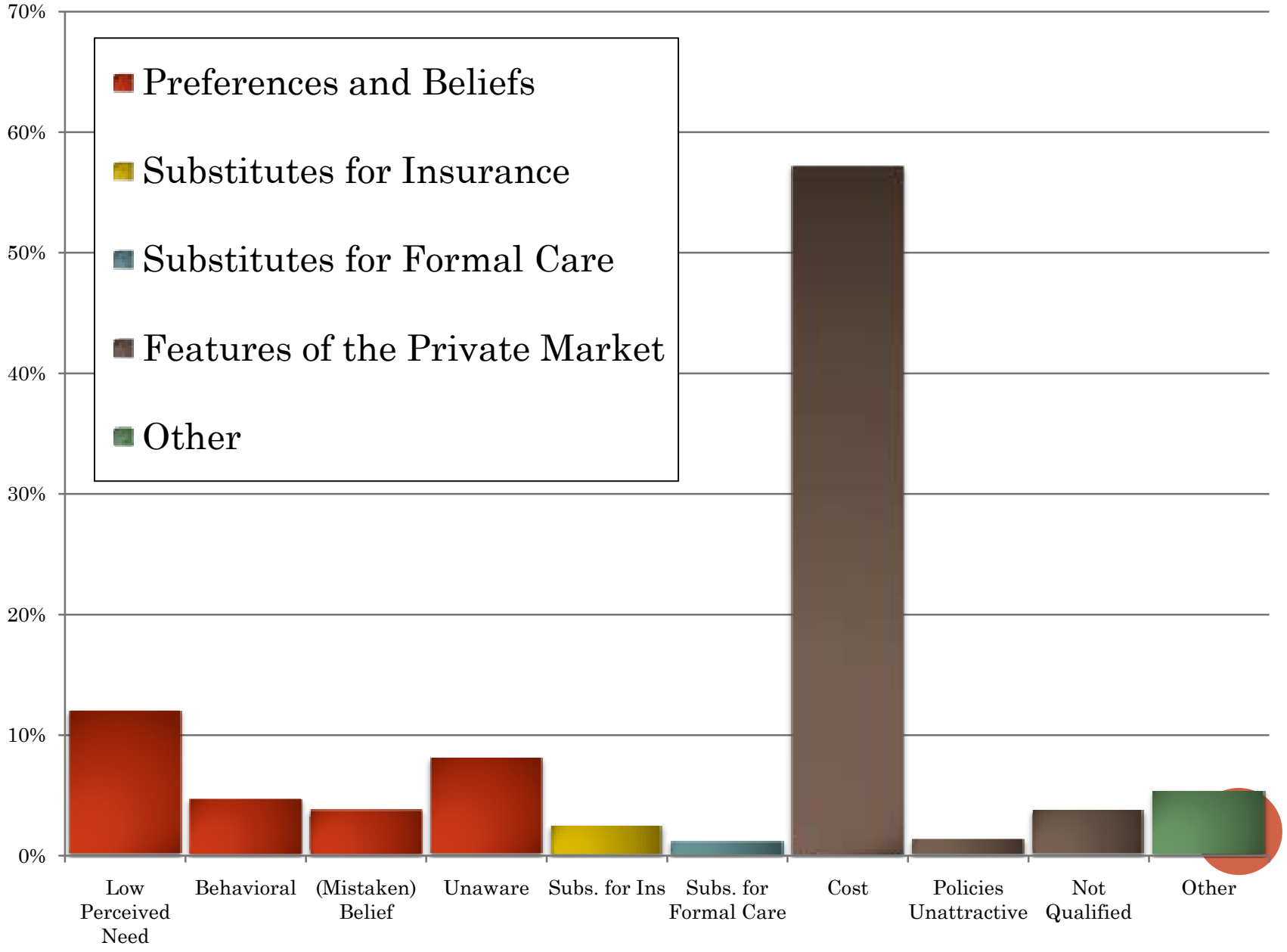
What do we know?

- Some theories have been tested in existing literature, for example:
  - Medicaid (Pauly 1990, Brown and Finkelstein 2008, Brown, Coe and Finkelstein 2007)
  - Home equity (Davidoff 2008)
- However, generally tested in isolation
  - How do they compare in size?
  - How do they interact?
- Some hypotheses theoretically ambiguous, e.g. bequests (Lockwood 2010)
- Several untested
  - State-dependent utility, beliefs about need for care, trust in insurers, role of family in purchase decisions…

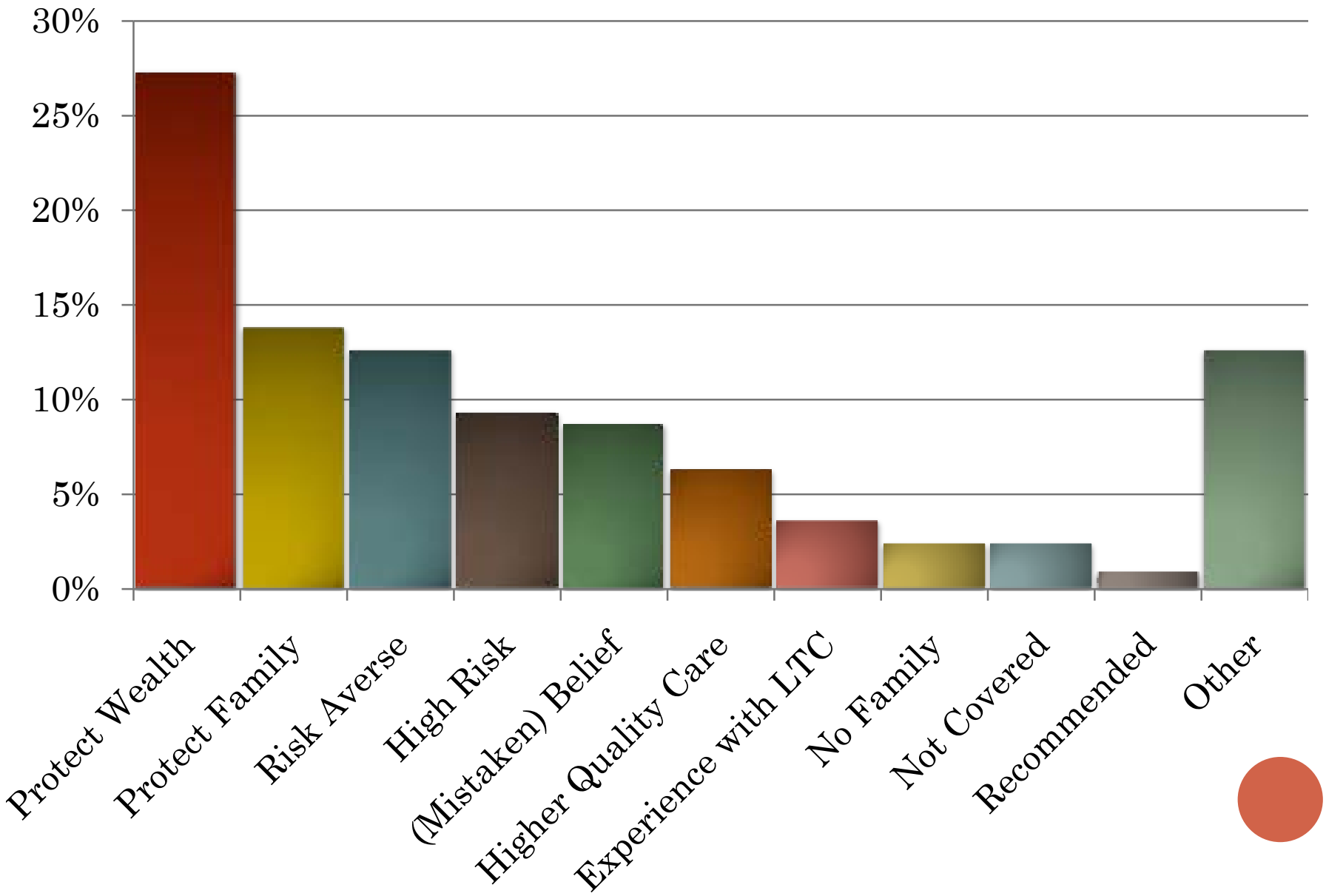
Our approach

- Design a survey for the American Life Panel (ALP)
  - 1,974 respondents age 50 and older
  - Questions specifically related to long-term care insurance + ALP demographics
  - Note: results are preliminary/responses not complete (1,512 responses, 76% of total)
- Two strategies:
  - Open-ended responses
  - Agree/disagree statements

Open-Ended Responses: No Insurance



Open-Ended Responses: With Insurance



Analysis of Agree/Disagree Statements

- We tabulate rates of long-term care insurance ownership across different answers

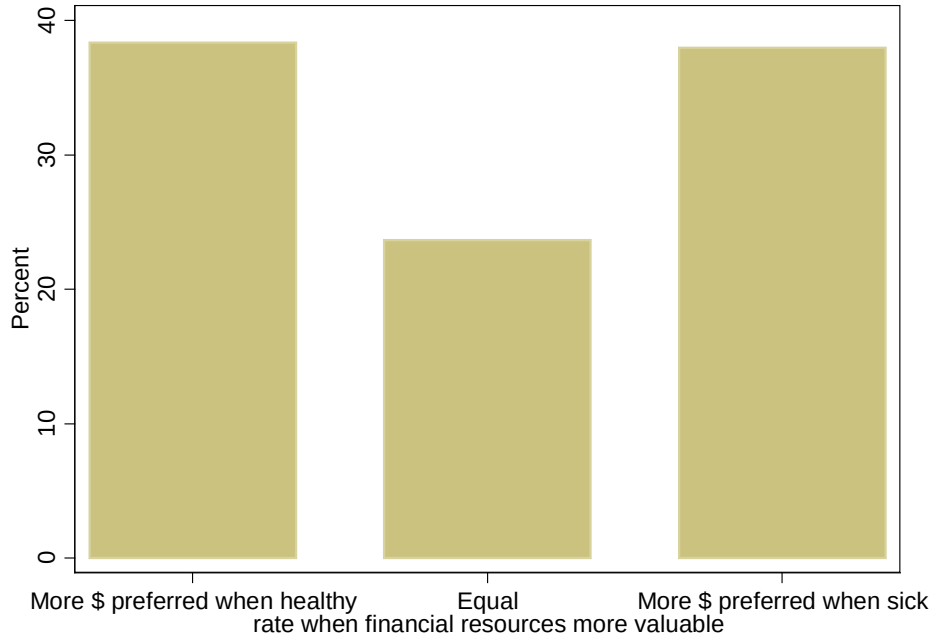
- Notes:
  - Results are very similar when we run formal regressions, controlling for age, gender, marital status, education, income and wealth
  - Interesting descriptives rather than causal analysis
    - Some instances where causality may run the other way
  - More comprehensive set of results in paper

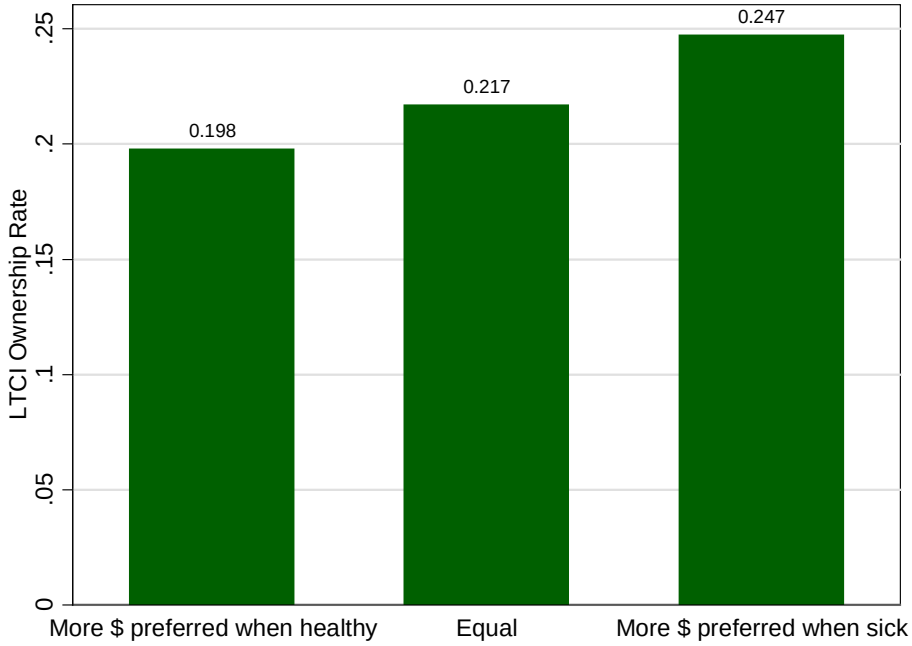
Hypothesis 1: Preferences & Beliefs

- Example: State-dependent utility
- Typically assumed that extra $$ is equally valuable regardless of health status; however, financial resources may be more valuable:
  - when sick, so higher quality care can be provided
  - when healthy, so leisure activities can be enjoyed
- If financial resources preferred when healthy, desire to transfer wealth to unhealthy states of the world (via insurance) may be limited

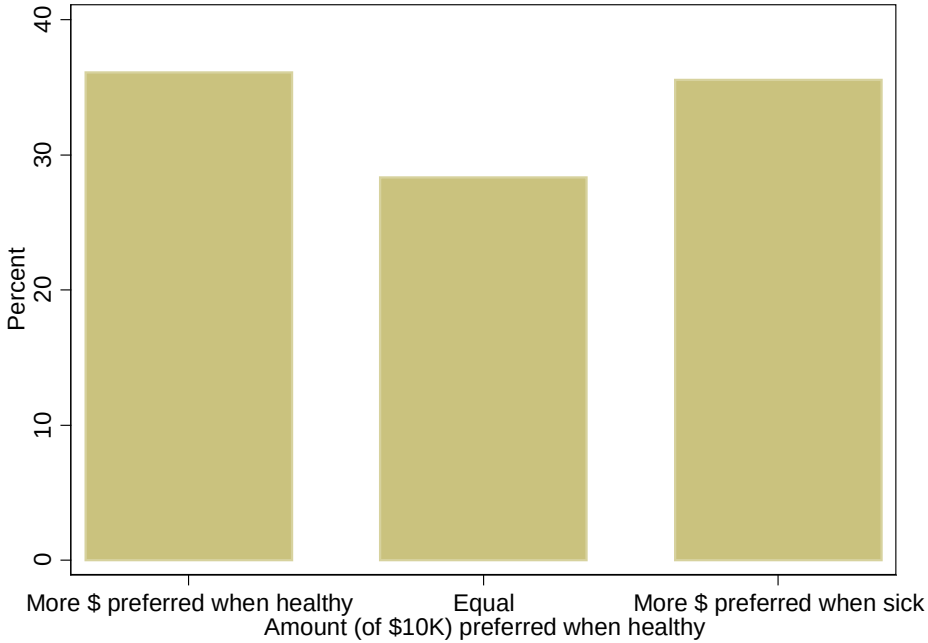
Hypothesis 1: Preferences & Beliefs (Cont.)

- We ask respondents to:
  - Rate on a 7-point scale whether financial resources are more valuable
    - When in poor health (so they can be used to provide for care), or
    - When in good health (so they can be used for other goods and services that they enjoy)
  - Decide how to allocate $10,000 across two different states of the world (multiple choice)
    - Healthy living at home
    - Living in a nursing home

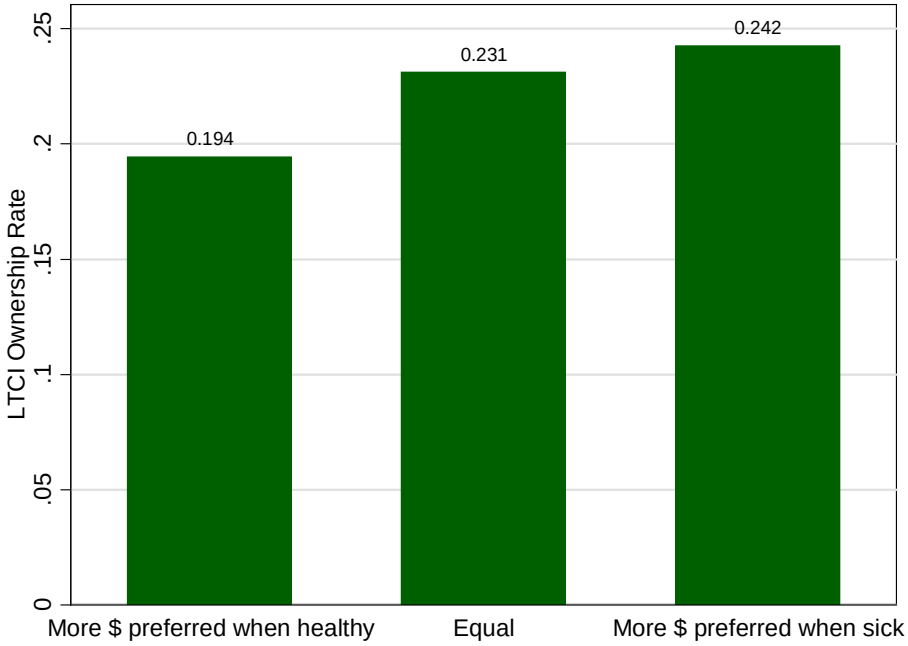




- Relatively even split between those who prefer financial resources when healthy and when sick
- Difference in long-term care insurance ownership:
  - 4.9 percentage points
  - 25 percent increase
  - p-value = 0.0437
- State-dependent utility likely influences purchase decision



- Results from second question are largely similar to first question
- Positive correlation in answers to both questions



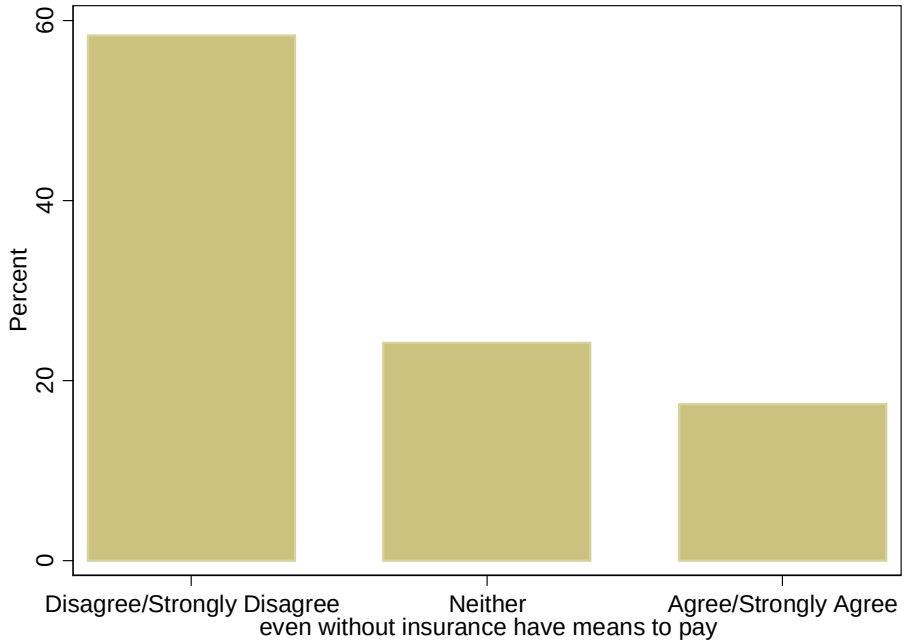
- Difference in long-term care insurance ownership:
  - 4.8 percentage points
  - 25 percent increase
  - p-value = 0.0581

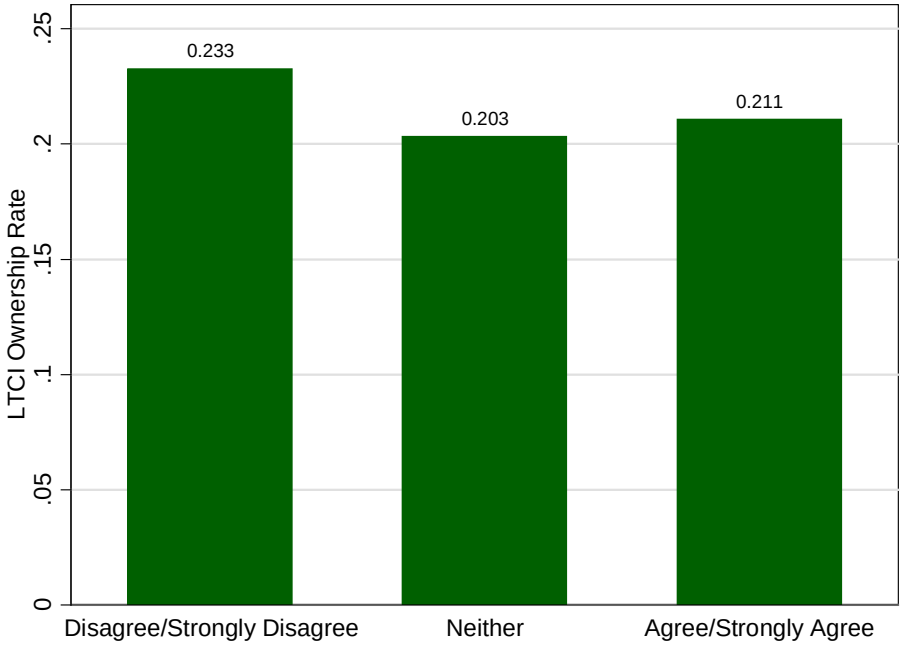
Hypothesis 2: Substitutes for Insurance

- Example: self-insurance

- Respondents are asked to rate their agreement with the following statement on a 5-point scale:

  "Even without long-term care insurance, I would have the means to pay for long-term care if I were to need it."





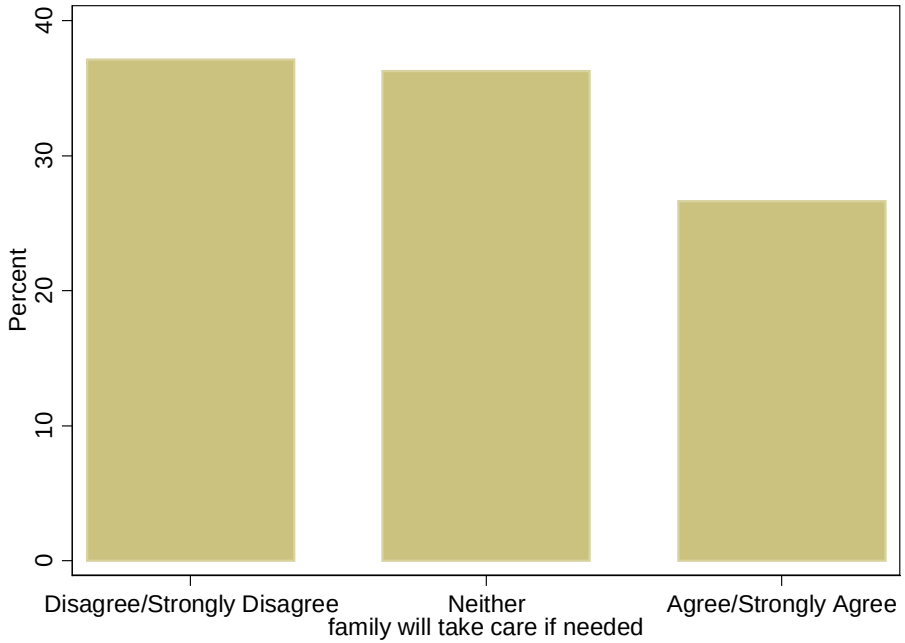
- Majority of respondents (58 percent) disagree or strongly disagree
- Difference in long-term care insurance ownership:
  - 2.2 percentage points
  - 9 percent decrease
  - p-value = 0.455
- Little evidence that self-insurance explains low rates of coverage

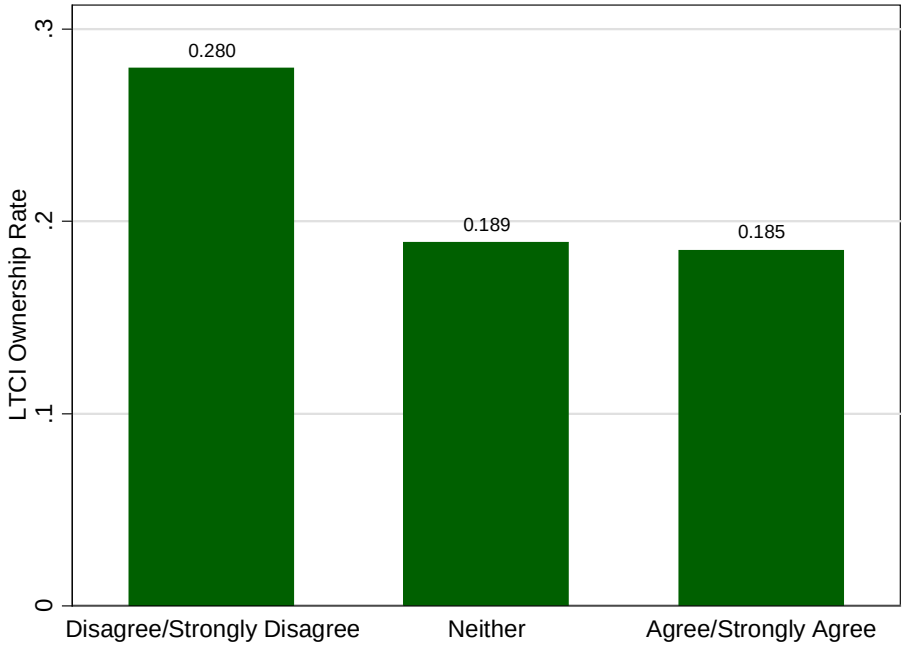
Hypothesis 3: Substitutes for Formal Care

- Example: availability of family

- Respondents are asked to rate their agreement with the following statement on a 5-point scale:

  "If I need long-term care, a family member will be able to take care of me."



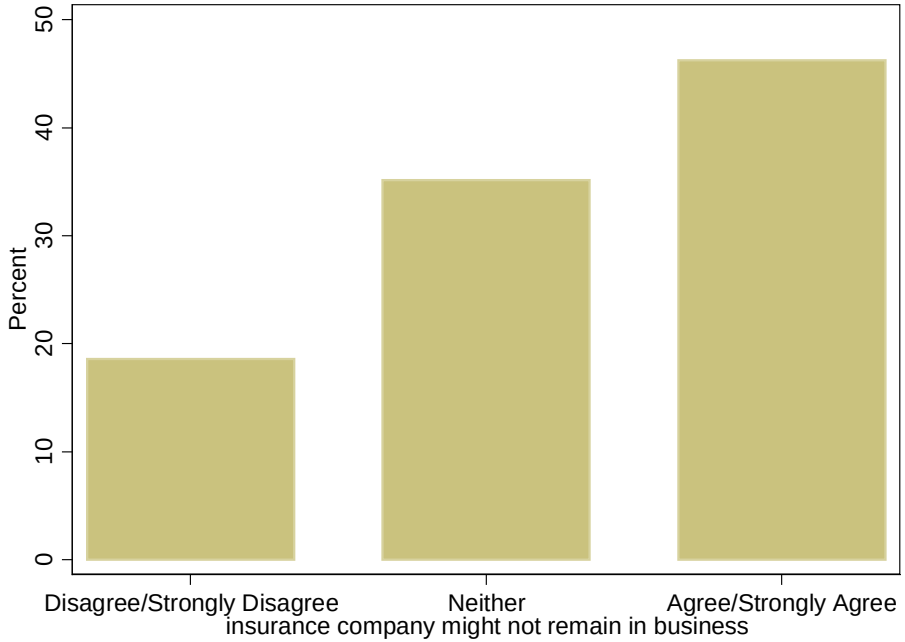


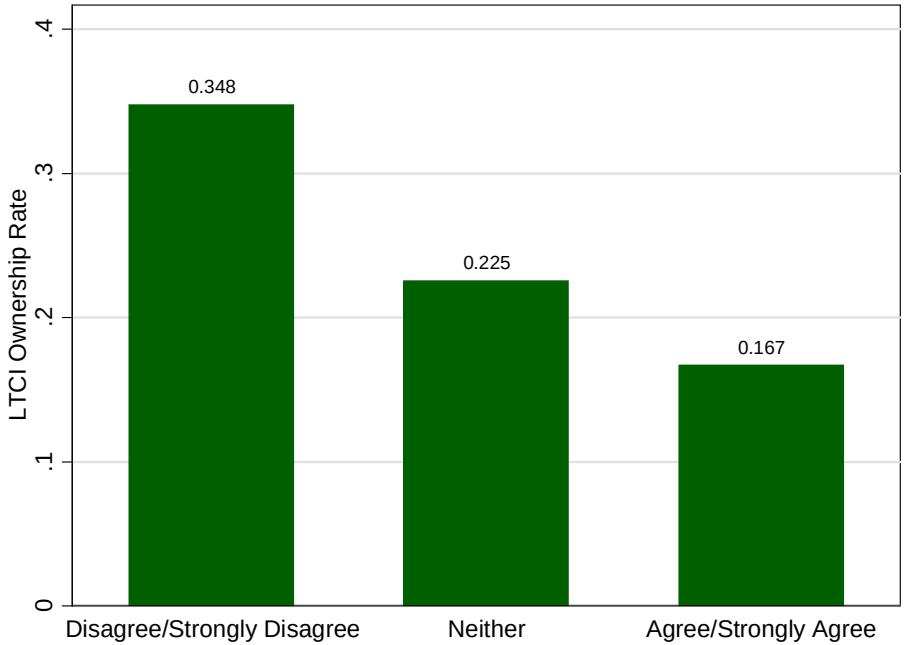
- Only 27 percent of respondents agree or strongly agree
- Difference in long-term care insurance ownership:
  - 9.5 percentage points
  - 34 percent decrease
  - p-value = 0.005
- Availability of family members appears important in decision to purchase insurance

Hypothesis 4: Features of the Private Market

- Example: Counter-party risk
- Risk that insurance company could go out of business before care is needed
- Respondents are asked to rate their agreement with the following statement on a 5-point scale:

  "I am concerned that an insurance company may not remain in business long enough to pay for my care."





- Only 19 percent of respondents disagree or strongly disagree
- Difference in long-term care insurance ownership:
  - 18.1 percentage points
  - 52 percent decrease
  - p-value < 0.001
- Counter-party risk appears very important in decision to purchase insurance

Conclusion

- We provide a high-level overview of the relative importance of various reasons why long-term care insurance coverage rates are low
- We find evidence that preferences and beliefs, substitutes for formal care, and features of the private market are important in explaining long-term care insurance ownership decisions
- More results in the paper, and more yet to learn!