Why Do People Drop Long-Term Care Insurance?

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New study suggests a key reason is cognitive impairment.

Long-term care is a substantial financial risk for most retired households. Yet few buy long-term care insurance. And, among those who do, more than one third with policies at age 65 will let their policies lapse before death, forfeiting all benefits.

A new study by my colleagues at the Center for Retirement Research explains why people lapse and how it affects their welfare. The study tests three alternative explanations for lapsing.

First, over time some purchasers may come to view the premium as a financial burden, even though they may have learned nothing new about their risk of requiring care. If so, low-wealth and low-income individuals would be more likely to lapse. The analysis refers to these individuals as "Financial Lapsers."

A second explanation is that individuals lapse strategically. For example, policyholders who remain in good health may believe that their risk of requiring care is lower than originally expected. Seeing less need for insurance, they decide to drop their policies. These individuals are "Strategic Lapsers."

A third explanation is that lapses are unplanned and are due to poor financial decision-making, resulting from cognitive impairment. For example, individuals could forget to pay their premiums or no longer understand the potential value of their policies. In this case, individuals would be more likely to lapse even though their impairment makes them more likely to need care. These individuals are "Forgetful Lapsers."

The analysis uses data from the *Health and Retirement Study* (HRS), a nationally representative survey of older Americans. The sample is limited to individuals who were age 65 or over in 2002 and who held long-term care insurance at that time. To test for Financial Lapsers, it includes financial wealth and household income. To identify Strategic Lapsers, it includes the individual's self-assessed probably of using long-term care in the future. And to identify Forgetful Lapsers, the analysis includes survey respondents' cognitive scores, whether they had another person respond to the questions for them, and whether they have a spouse or daughters (who may provide and coordinate care and potentially prevent mistakes such as forgetting to pay insurance premiums).

The results are illuminating. First, low-wealth and low-income individuals are more likely to lapse their long-term care policies. Second, the study finds no evidence that individuals are lapsing strategically. Third, and importantly, the study finds that lapses are common among the cognitively impaired, perhaps reflecting poor decision-making.

The analysis next looked at the implications of lapsing by examining the factors that determine who uses long-term care. It turns out that those who lapse are also more likely to subsequently use care. Perhaps not surprisingly, this need for care is also linked to cognitive impairment. So cognitive impairment helps explain both why people lapse and why those who lapse are more likely to need care.

The bottom line is that, for some lapsers, having insurance could be counterproductive as they buy it to protect against risk but drop it just when the risk becomes more likely.