



Why is the Market for Long-Term Care Insurance so Small?

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Big Picture: Supply versus Demand

- Supply side market imperfections imply:
 - Large pricing loads
 - Quantity restrictions
- Yet evidence shows that:
 - “Actuarially fair” policies are available for some sub-groups (e.g., women)
 - Very comprehensive policies are available at comparable loads to less comprehensive policies
 - Yet demand for these products is no higher ...

Possible Demand Side Limitations

- Availability of substitutes
 - Medicaid
 - Family (financial vs. in-kind)
- Counter-party risk
- Value of consumption when sick
- Mistaken beliefs
 - About probabilities of needing care
 - About other coverage (e.g., Medicare)
- Optimization errors

Medicaid's "Implicit Tax"

1. Means testing: People with private insurance are less likely to qualify for Medicaid
2. Secondary payer status: Conditional on qualifying for Medicaid, the private policy must pay first
 - A substantial part of private policy benefits pay for expenditures that Medicaid would otherwise have covered (Medicaid "cannibalizes" private policy benefits)
 - **Crowd-Out Result: 65 – 90% of the wealth distribution is "rational" not to buy private LTCI**

How Big is Implicit Tax?

| Wealth Percentile | Men | Women |
|---------------------------|-----|-------|
| 10 th | 99% | 99% |
| 30 th | 84% | 95% |
| 50 th (Median) | 59% | 77% |
| 70 th | 27% | 47% |
| 90 th | 4% | 5% |

Interpretation: The implicit tax is the fraction of the expected present value of payments from private LTCI policy that provides no net benefit for policyholders because the costs would have otherwise been provided by Medicaid

How Fix This?

- Sadly, there is no easy solution!
- The key:
 - Make eligibility independent of the protective effects of LTCI
 - AND – make Medicaid the primary, not secondary, payer
- Two “extreme” (unrealistic) solutions:
 - Eliminate Medicaid, or
 - Provide universal LTC coverage

“Thought Experiment”

To eliminate implicit tax, Medicaid payments *must be independent of private insurance coverage*

Example: Offer individuals who buy a fully comprehensive policy a refundable tax credit equal to the EPDV of what Medicaid would have paid if there were no LTCI

- Requires much higher credit for lower income individuals
- Maybe impractical due to concerns about asymmetric information

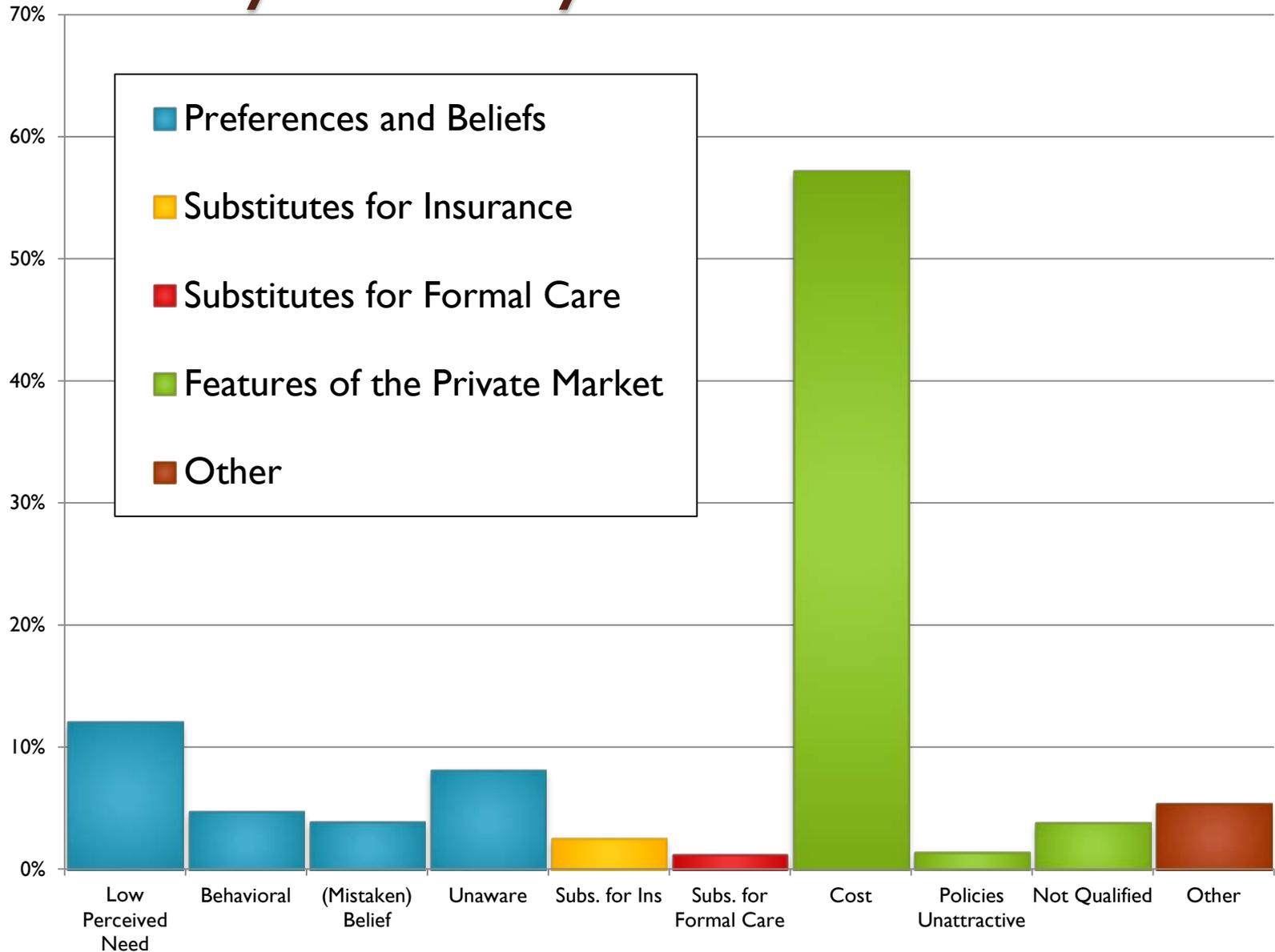
Recent Policy Interventions Ill-Suited to Reducing Implicit Tax

- Federal and state tax subsidies for LTCI
 - We estimate median still won't buy (net load still high)
 - Implicit tax decreasing in wealth, subsidy increasing in wealth
- Medicaid reforms
 - Eliminate Medicaid asset test if buy minimum private insurance
 - We find median still won't buy (implicit tax remains large due to secondary payer status)
- What about making Medicaid a primary payer?
 - Median still won't buy
 - Implicit tax reduced but not eliminated (means testing)

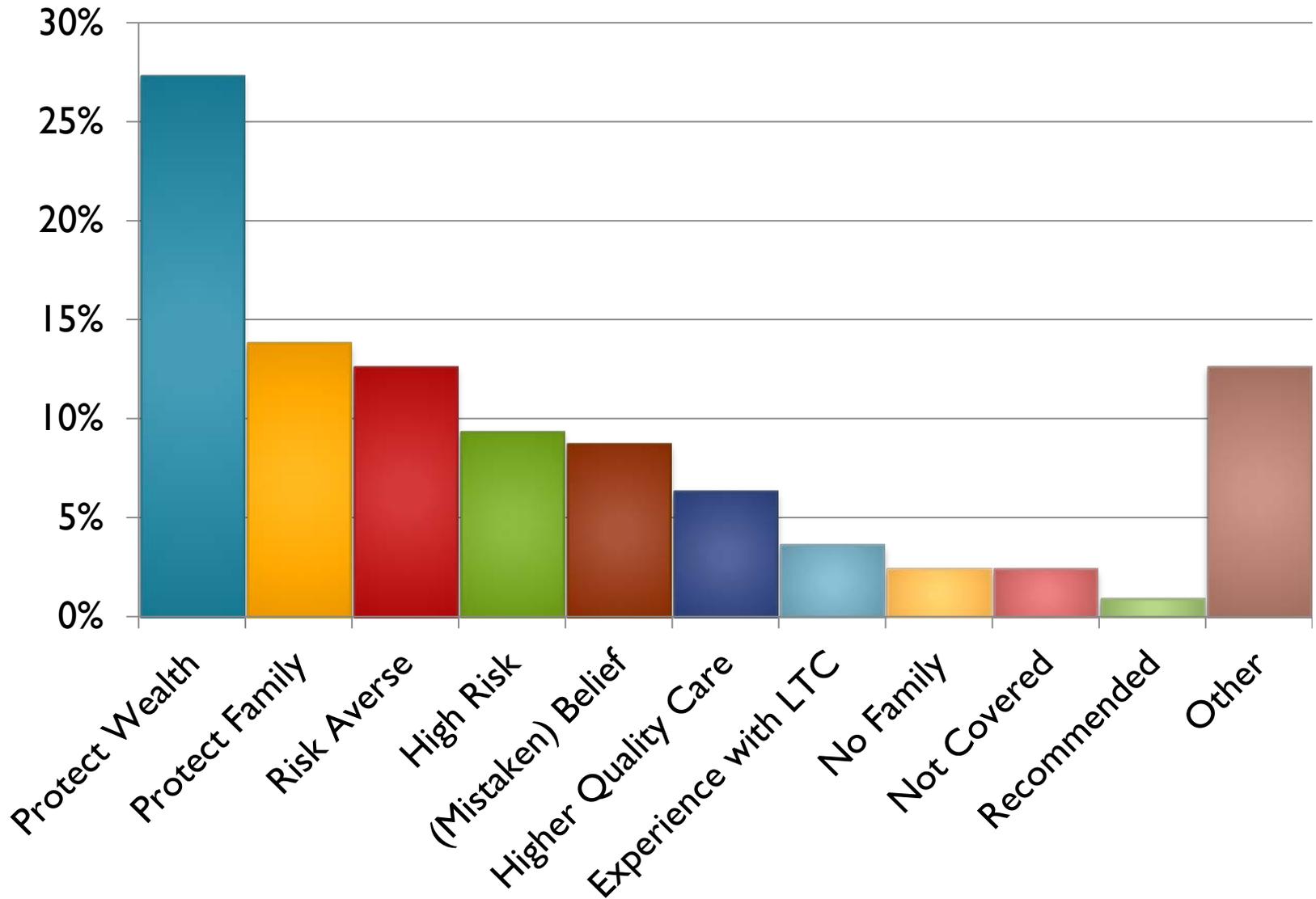
Survey Evidence

- American Life Panel (ALP) Survey
 - 1,974 respondents age 50 and older
 - Questions specifically related to long-term care insurance + demographics
- Caveat: *Correlation \neq Causation*

Open-Ended Responses: Why Not Buy Private Insurance



Open-Ended Responses: Why Do Buy Private Insurance



Beliefs About Need for Care

| Statement | Rate of Ownership if Disagree / Strongly Disagree | Regression Adjusted Difference if Agree / Strongly Agree |
|---|---|--|
| At some point in the future it is likely that I will no longer be able to live independently because of my health | 14.2% | +12.0*** |
| Even without long-term care insurance, I would have the means to pay for long-term care if I were to need it | 23.1% | -9.8*** |

Beliefs about Government

| Statement | Rate of Ownership if Disagree / Strongly Disagree | Regression Adjusted Difference if Agree / Strongly Agree |
|--|---|--|
| Medicare covers extended use of LTC-term care for those over 65 | 22.3% | +2.5 |
| Medicaid covers the extended use of long-term care for those who qualify | 18.6% | +4.4* |

Family Issues

| Statement | Rate of Ownership if Disagree / Strongly Disagree | Regression Adjusted Difference if Agree / Strongly Agree |
|---|---|--|
| It is important to leave an inheritance to my loved ones | 17.2% | +9.4*** |
| It is important to me that I not create a financial burden for my family if I need long-term care | 17.5% | 5.1 |
| If I need long-term care, a family member will be able to take care of me | 27.3% | -8.2*** |
| I would prefer receiving care from a professional health aide or nurse rather than my spouse or another family member | 15.7% | +9.1*** |
| It is a child's obligation to help a parent with long-term care needs | 23.2% | -3.2 |

Pricing

| Statement | Rate of Ownership if Disagree / Strongly Disagree | Regression Adjusted Difference if Agree / Strongly Agree |
|--|---|--|
| I am concerned about my ability to afford the premiums for a long-term care insurance policy | 46.1% | -29.4*** |
| Long-term care insurance policies are appropriately priced given the cost of the care they cover | 14.0% | +24.0*** |

Counter-Party Risk

| Statement | Rate of Ownership if Disagree / Strongly Disagree | Regression Adjusted Difference if Agree / Strongly Agree |
|--|---|--|
| I am concerned that an insurance company may not remain in business long enough to pay for my care | 33.9% | -14.6*** |
| I am concerned that once I own a long-term care insurance policy, an insurance company might raise my premiums | 35.3% | -14.1*** |
| I am concerned that an insurance company might deny reasonable claims for long-term care | 30.0% | -8.0*** |

Summary Observations

1. Private LTC insurance market is more constrained by demand than supply
2. All by itself, the current structure of Medicaid is sufficient to crowd-out demand for private insurance
3. But there are almost surely many other factors that operate to reduce demand too: Thus, eliminating any one barrier may not “move the needle”

References

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