

The Life Care Annuity: A New Empirical Examination of an Insurance Innovation Repairing Failures in the Markets for Life Annuities and Long-Term Care Insurance

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Abstract

The life care annuity – the integration of the life annuity with long-term care insurance coverage – is intended to deal with major problems in the currently separate markets for life annuities and long-term care insurance. The integration would allow the inclusion of most of the population currently rejected by underwriting – those in poor health or lifestyles but who would not go immediately into long-term care claim – who also have lower life expectancies.

We make use of the Health and Retirement Study, on individuals in retirement and their disability incidence, exploiting the panel nature of the survey to estimate transition probabilities in and out of disability states according to numerous demographic and health characteristics, allowing for analysis of disability and mortality risk across a number of dimensions. We find that different risk groups at age 65 have similar projected long-term care expenses, but that the level periodic premium structure of most long-term care insurance policies creates incentives for individuals to separate into different risk pools according to observable characteristics, justifying the underwriting observed on the market. Yet we also find that gender-rated life care annuities could succeed in pooling risks currently segmented in the market for long-term care insurance, thus qualifying individuals at or near retirement for permanent long-term care insurance coverage who do not currently qualify, and allowing for life annuities to be purchased more cheaply than in the standalone annuity market.