The Role of Annuitized Wealth in Post-Retirement Behavior

By Laitner, Silverman, and Stolyarov

Comments by Kathleen McGarry
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“PUZZLES”

- Why don’t the elderly dissave after retirement?
  - Bequest motive
  - Risk out outliving assets
  - Medical Care costs
- Why don’t the elderly fully insure?
  - Why don’t they annuitize their wealth?
    - Delayed Social Security, cash out DB plans, reverse annuity mortgages
  - Why don’t they purchase long-term care insurance? (non-elderly as well)
“PUZZLES”

- Why don’t they annuitize their wealth?
  - Loads, life expectancy
  - Lack of indexation
  - Bequests / “Family as incomplete annuities market”
  - Psychological – fairness, insuring against a “good” outcome

- Why don’t they purchase long-term care insurance?
  - Misunderstanding of Medicare
  - Counter party risk
  - Remain at home, ltc insurance lowers the price of nursing homes
  - State dependent utility
“PUZZLES”

- Authors demonstrates that puzzling behavior can be consistent with utility maximization.
  - Presence of Medicaid, lack of other long-term care insurance is enough
- Model appeals to common sense.
  - High annuity individuals will self-insure for long-term care, save to finance additional consumption
  - Low annuity individuals rely on Medicaid for long-term care
    - Additional savings is lost in that it serves to reduce Medicaid payments
- Results suggest “cost” of additional annuitization for those eligible for Medicaid
EXTENSIONS

▪ Low health status is not an absorbing state
  ▪ Annuities can play an important role with the possibility of a return to good health state
  ▪ Use income/assets to pay for long-term care, Medicaid covers the remainder.
  ▪ Return to the community still have annuity income
▪ Housing comprises majority of wealth for many, can’t spend down smoothly
▪ Very few have annuity income sufficient to cover full cost of private long term care
▪ Family
  ▪ Bequest motives
  ▪ Care from children / transfers to children
  ▪ Heterogeneity in these dimensions
LTC INSURANCE

- Medicaid can be used to pay for family caregivers which may make it more attractive
  - “Disamenities of Medicaid”
- LTC insurance policies also offer cash option allowing payments to others
- Partnership plans that protect some assets for those with LTC insurance
- Coupled products
  - Annuities coupled with long term care insurance, bump up in benefits onset of ADLs
  - Life insurance that pays long term care benefits
EXTENSIONS

▪ State dependent utility

▪ Finkelstein et al. MU of consumption declines with worsening health ➔ don’t transfer wealth to low health state, spend down assets
EXTENSIONS

- Brown et al. find heterogeneity in MU of consumption and relationship to purchase of long-term care insurance
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HETEROGENEITY BY IMPAIRMENT

- Consider what your life may be like at age 80. Suppose there is a 50 percent chance that you will be healthy and able to live independently in your own home for the rest of your life and a 50 percent chance that your:

  **physical health** will have deteriorated to the point where you have to live in a nursing home (e.g., you have difficulties performing everyday tasks unassisted, such as eating, bathing, or walking).
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  **mental or cognitive** health will have deteriorated to the point where you have to live in a nursing home (e.g., Alzheimer's disease, severe short term memory loss, or dementia).
HETEROGENEITY BY IMPAIRMENT

Now suppose you have… $10,000 provided to you either if you are healthy and in your own home or if you are in a nursing home. Or, you can choose to divide up the money across these two possibilities… Please allocate the $10,000 across these two options, physically disabled and in a nursing home… healthy and living at home
HETEROGENEITY BY IMPAIRMENT

- Find differences across types of disability
  - Whether disability is during working years or old age
    - At older ages, individuals prefer consumption when in good health vs. disability
  - Whether physical or cognitive disabilities
    - Individuals more willing to transfer resources to low health state with physical rather than mental disabilities
- By level of resources
  - Higher income / wealth less willing to transfer to low health states ➔ differences in types of consumption
CONCLUSION

▪ Paper provides an appealing and tractable model for understanding “puzzling” behavior at older ages

▪ Provides a framework for expanding to include other aspects of decision making
  ▪ Heterogeneity in state dependent utility
  ▪ Heterogeneity in life expectancy
  ▪ Variation in types of long-term care insurance
  ▪ Bequest motives and familial behavior.