EBRI

T-59

Statement on

Employer-Sponsored Long-Term Care Insurance

by

Robert B. Friedland, Ph.D.
Research Associate

before the

Task Force on Long-Term Care
Health Policies

16 July 1987

EMPLOYEE BENEFIT RESEARCH INSTITUTE
2121 K Street, NW/Suite 860/Washington, DC 20037-2121/Telephone (202) 659-0670

Comments of
Robert B. Friedland, Ph.D.
Research Associate
Employee Benefit Research Institute
before the
Task Force on Long-Term Care Health Policies

I. Introduction

Thank you for the opportunity to review the June 17th draft of Chapter VI, "Tax Incentives and Employment Programs." I would like to direct my remarks to your proposal under section C, Employer-Sponsored Long-Term Care Insurance. I have approached this task as a researcher and represent no particular special interest. EBRI does not take policy positions and has no position on this proposal.

II. The Economic Status of the Elderly in the Future

The elderly's relative economic status has improved dramatically over the past two decades. By all indications, the next cohort of retirees will on average have greater income than retirees of today. Projections from the EBRI version of the Pension and Retirement Income Microsimulation model (PRISM), developed by ICF Inc. suggest that the first half of the baby-boom, those born between 1945 and 1954, and who will be retiring between 2012 and 2021 will have larger real retirement income then those persons now retiring. Pension recipiency is projected to increase, and among those with pensions, average pensions will be greater.

The projected growth in real pension income recipiency among future retirees is promising; suggesting that some employees may be able to restructure retirement saving without jeopardizing adequate wage replacement in their retirement years. Which employees and how many is an important empirical question.

Poverty is projected to decline, however, some elderly will remain poor or near poor. Although we can model who these people are likely to be *ex post* , that is very different from knowing who they are *ex ante* — that is, early or mid way through their working careers. The inability to know *ex* *ante* who will or will not have adequate retirement income makes knowing the advisability of reallocating retirement savings to insurance difficult.

Employer-provided pensions for future retirees are going to become increasingly more important sources of retirement income. This is due in part because of the projected growth in real pension income, scheduled reductions in Social Security payments and Social Security's generally lower wage replacement for retirees with relatively high pre-retirement earnings. Although total real retirement income is projected to rise, earnings replacement rates from pensions and Social Security, are projected to be slightly lower for the first half of the baby-boom than for workers retiring today.

RETIREMENT SECURITY NEEDS

The risk of needing assistance with activities of daily living increases with age and is likely to be greatest many years after leaving the workforce. Estimates of the lifetime risk of entering a nursing home suggest that the risk is close to negligible until after age 45; at least one study suggests that the risk peaks at 31 percent for men age 75 years old and 57 percent for women age 79 years old; another study suggests that the risk peaks at 46 percent for persons age 90.

For those who need nursing home care or extensive assistance at home, we know with certainty that the cost of care can easily exceed the means of most middle income persons. Preliminary data from the 1985 National Nursing Home Survey suggest that average nursing home costs for intermediate care range from $1,315 to 1,900 a month. Assistance at home for a victim of Senile Dementia, for example, can exceed $14,000 a year.

Preparing to meet the contingency of costly dependence on others for care requires planning long before retiring. Sufficient financing of long-term care requires both adequate saving for probable events and insurance for relatively unlikely events.

III. Some Considerations of the Task Force Proposal in Chapter VI

The Task Force has proposed group long-term care insurance provided or sponsored by the employer as the best way to encourage significant private financing of long-term care. The proposal outlined in Section C of Chapter VI, would encourage this development by enabling workers to purchase qualifying long-term care insurance with their vested retirement assets during their working years. Workers can trade-off future retirement income for long-term care insurance and would be encouraged to do so by the tax code.

This proposal brings long-term care into the realm of retirement income security. The Task Force's recognition that financing long-term care is a part of financing economic security during retirement will have a tremendous impact on advancing public debate on private financing of long–term care.

The feasibility and advisability of the proposal, however, will depend on how it is specified. I propose the following criteria to evaluate this or any proposal to exchange general retirement saving for insurance against the relatively unlikely, but financially catastrophic event of long-term care need:

1. The value of the long-term care insurance plan plus the asset value of the reduced pension benefit must be at least equivalent to the value of the pension benefit that would have resulted if long-term care insurance had not been purchased. That is, the purchase of the long-term care insurance must not result in reduced total asset value at retirement. This may be difficult to achieve if (1) the benefits paid by the insurance plan are unindexed; and if the long-term care insurance plan provides current coverage as well as an accumulation to finance future coverage. Whether the reduction in future retirement well being is significant will depend on the amount of the premium associated with current coverage.

2. Retirement income adequacy must not be impaired for retirees that never need long-term care. While all retirees need

adequate income, not all will be functionally dependent. Income adequacy, however, is normative over a broad range of income levels. Any proposal to reduce disposable retirement income must recognize some standard for income adequacy.

3. Workers who reduce their pensions in exchange for long-term care insurance must not lose asset value because they fail to make annual contributions to the plan. That is, either the insurance must be portable or the prefunded portion of the long-term care insurance must be returned to the employee. An important strength of the pension system -- and particularly defined contribution pensions -- is that a change in employment does not diminish the value of the accumulated asset even though no contributions are made.

4. The long-term care insurance and the reduced pension must be adequate to ensure access to the delivery of long-term care.

OTHER CONSIDERATIONS

By investing in a long-term care insurance plan, workers may be assuming more risk than they would if they made equal contributions to a pension plan. Insurance is an illiquid asset and unlike defined benefit plans the insurance is not guaranteed.

This proposal may not be feasible for defined benefit plans because the present value of the defined benefit is based on current, not projected, salary. This value may be too small over most worker's careers to pay long-term care insurance premiums. Another difficulty would be how to handle long-term care insurance in conjunction with joint-survivor annuity elections. Furthermore, what would happen in the case of divorce settlements that include this pension.

The proposal assumes that individuals will be motivated by relative advantages provided long-term care coverage. Namely, withdrawn funds used to purchase long-term care insurance and any benefits paid by the plan are tax exempt. The relative tax advantage however, may not be a compelling argument for workers to invest in long-term care insurance given the illiquidity and risk of the investment and reduced marginal tax rates.

The market for long-term care insurance is tentative, but growing. In general, education about current coverage and understanding about long-term care, clarification in the tax code, and public policy discussions, such as this one, are likely to expand the importance of private financing. The changing composition of the labor force due in large part to the rise in the average age of workers may encourage the growth in the private long-term care market.

In closing, I would like to congratulate the Task Force for the tremendous undertaking you have done to bring together the best thinking on these issues and for advancing discussion on options to facilitate private financing of long-term care. I know that all of this effort will be very productive.