



CPB Netherlands Bureau for Economic
Policy Analysis

Demand for annuities and LTC insurance with recursive utility: the impact of housing

Discussion

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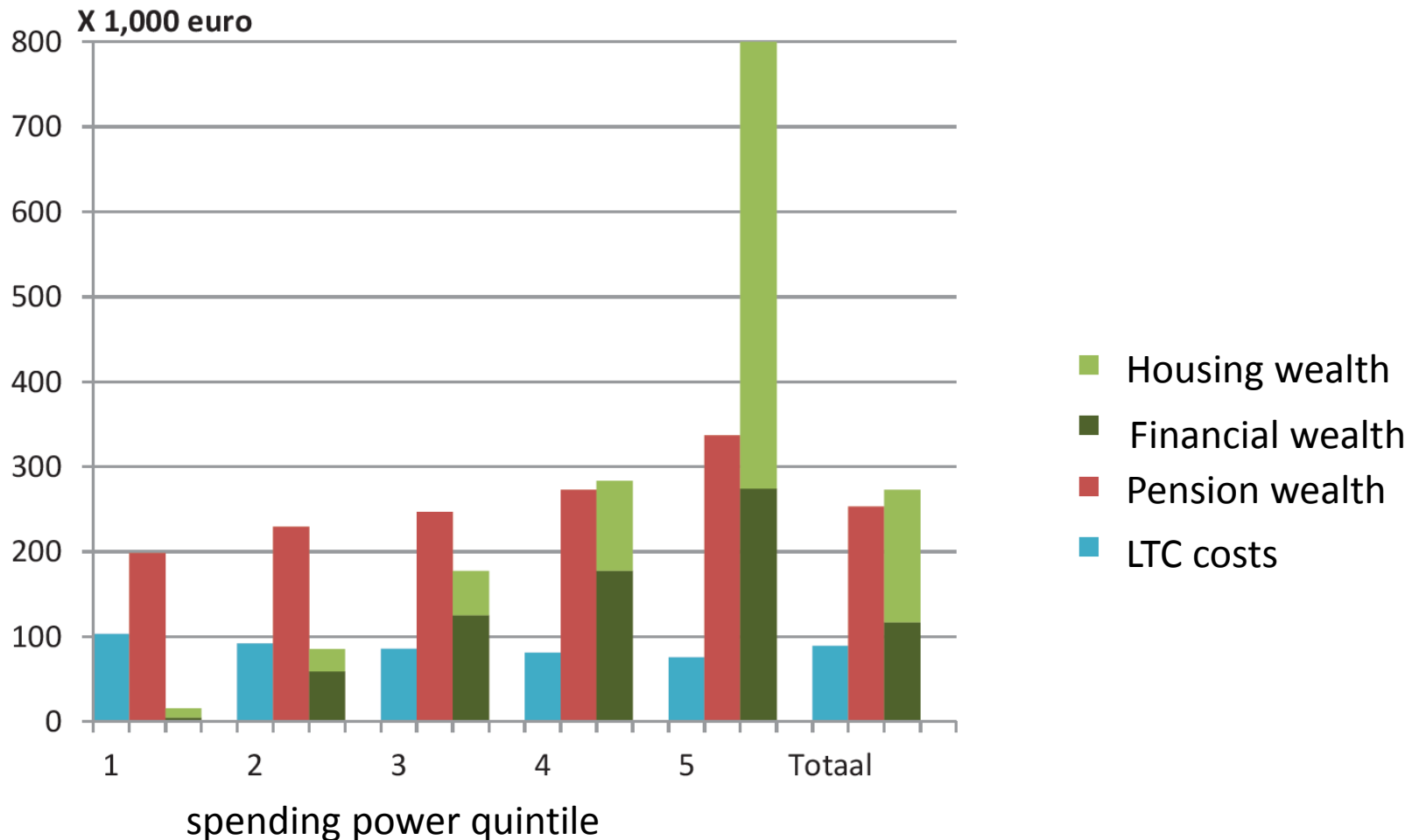
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Erasmus School of Health
Policy & Management





Relevance: household wealth at 70 in NL





Intuition behind results?

Wealth (\$000)		Single product			Both products		
		Annuity only		LTCI	Annuity		LTCI
Liquid	House	% Liquid	% Total	only	% Liquid	% Total	LTCI
500	0	0.30	0.30	0.93	0.71	0.71	0.92
220	280	0.94	0.41	0.89	0.65	0.29	0.81



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Full annuitization of
remaining wealth
 $(220 - 0.81 * 95) / 220 = 0.65$

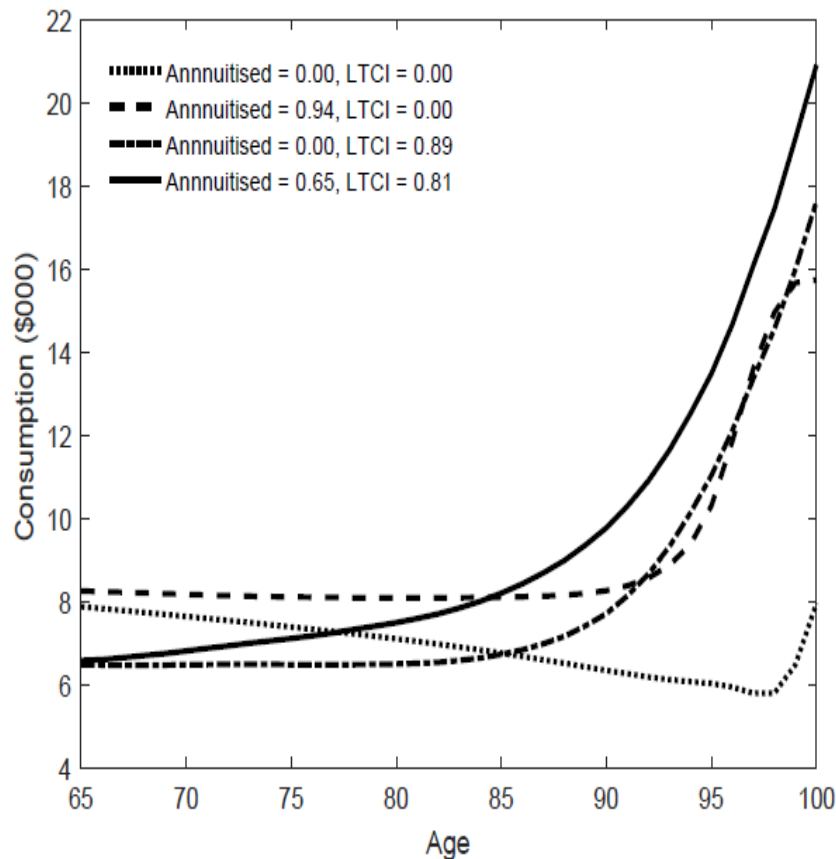


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Optimal policy?



- Straight line is optimal, but doesn't really look optimal:
 - highest consumption at oldest ages
- Most successful in utilizing housing wealth for consumption?
- Housing is really just a strange asset you can only use when you get ill or die



Some remarks

- Reduce complexity
 - improve intuitive explanation
 - stochastics in housing prices, bequest motive, price increases in LTC, low uninsurable costs in mild disability
- Increase complexity
 - macro risk in LTC costs
 - health dynamics
- Base case has relatively little liquid (pension) wealth



Policy implications

- Relationship housing, pensions, LTC more complicated than we think
 - LTCI coverage remains high even with house
 - optimal mix depends on many factors
- Different insurance product
 - only insure LTC costs $>$ housing wealth



Pensions and LTCI

- *Abstracting from house prices and bequests*
- No LTC costs
 - fully annuitize
- LTC costs, no insurance
 - need liquid wealth to pay LTC costs -> not fully annuitize
- LTC costs, insurance
 - smooth evenly across all states:
 - fully insure
 - fully annuitize remaining wealth



Pensions and housing wealth I

- Housing wealth in the model
 - wealth you cannot touch unless you become very sick or die
- No (private) LTC costs
 - poor health releases additional wealth to be fully used for consumption
 - smoothing: increase consumption in healthy state by consuming more in beginning of life: no full annuitization



Pensions and housing wealth II

- LTC costs
 - housing wealth is partly insurance against LTC costs
 - instead of shock in LTC costs we have shock (LTC costs - housing wealth)
 - > can be positive or negative
- Comparison to no housing
 - protection against LTC costs is more important than positive wealth shock
 - annuitization share will be higher



Pensions, LTCI, and housing

- Complicated (at least for me..)
- My guess would be that
 - optimal LTC coverage will depend on housing/LTC costs
 - full annuitization of remaining wealth (because else lower or higher LTCI coverage)



Some intuition

- Housing wealth in the model
 - wealth you cannot touch unless you become very sick or die
 - instead of negative wealth shock when ill, you can have either a positive or negative shock
- Pensions & LTCI
 - full insurance against both risks
- Pensions & housing
 - housing insures against LTC risk, so higher annuitization
- LTCI & housing
 - lower LTCI coverage
- Pensions, housing & LTCI
 - ??
 - guess: LTCI coverage depends on house, annuitize remaining wealth



The role of housing wealth

- Housing in the model is just some strange form of wealth
 - leads to some peculiar results
- Housing and LTC use are interrelated
 - house owners are more likely to use home care
 - house owners are more likely to use informal care?