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Research Article

Explaining lapse in long-term care insurance markets

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Abstract

Expansion of private long-term care insurance (LTCI) is often posited as a potential mechanism to finance long-term care (LTC) for a growing elderly population in the US. One largely ignored issue is lapse or cancellation of policies. Individuals who let a LTCI policy lapse face resumed risk of LTC expenditures while suffering the financial loss of premiums paid. The motivation for lapse has been poorly understood, though some have hypothesized that improvements in health risk may be responsible. We use 1996–2006 Health and Retirement Study data from 3974 respondents who report having private LTCI to estimate baseline and dynamic predictors of lapse and test for *ex post* adverse selection. Individuals who lapse are generally poorer, less educated, less healthy, and more likely to be racial and ethnic minorities than those who retain their policies. Changes in health status play a relatively small role in lapse, and we find little evidence for adverse selection associated with lapse. We conclude that lapse of LTCI is more an issue of finances and alternatives than a reassessment of health risk. Because lapse rates are highest among the least healthy individuals, lapse should be considered explicitly in efforts to expand the LTCI market.

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