Improving Financial Literacy and Capability: What Works?

The George Washington University School of Business, June 21, 2012

UNDERSTANDING AND IMPROVING FINANCIAL LITERACY:
HEALTHCARE EXPENDITURES IN RETIREMENT

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Overview

- Financial Literacy Regarding a Complex Problem
  - “How much will you need to spend on out-of-pocket costs for health care during your retirement years.”
  - “Out-of-pocket costs are any expenses that you pay yourself. In addition to any direct payments, these costs include insurance premiums for government programs and other health insurance plans. Out-of-pocket costs also cover deductibles and co-pays. Out-of-pocket costs do not include payments made on your behalf or reimbursed by government programs or other insurance plans. In all cases, we are asking about your own personal health care costs in retirement. Do not include health care costs of other members of your household. Unless otherwise indicated, please do not include in your estimates the cost of long-term residential health-care services (such as extended stays in nursing homes) or premiums for long-term health care insurance. Some questions ask for estimates about costs in the future. Please do not attempt to adjust your estimates to reflect price increases from overall inflation. Just make your estimates using the value of money today.
Estimating Retiree Health Care Costs

- Key Sources of Additional Uncertainty
  - Personal Health Experience and Medical Needs
  - Unanticipated Inflation in Medical Costs
  - Policy Changes with Respect to Medicare and other Programs
Structure of Paper

- **Literature Review of Expert Views**
- **Survey from American Life Panel**
  - 1700+ responses from Eight 5-year Age Cohorts: 40 to 80
  - Background Questions on Health, Financial Sophistication and Life Expectancies
  - Three Treatments
    - A. Three Simple Questions on Health Care Costs
    - C + Anchoring from Expert Views on Life Expectancies, Premiums, Ratios of Total Costs to Premiums
- **Modules on Risk Assessments/Long Term Care**
Summary of Findings

- Expectations About Insurance Coverage Vary
### Table 2: Retiree Health Insurance Coverage Expectations by Cohort and Source

<table>
<thead>
<tr>
<th>Age Range</th>
<th>N</th>
<th>Medicare</th>
<th>Medicaid</th>
<th>Employer Sponsored</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Mean</td>
<td>SD</td>
<td>Mean</td>
</tr>
<tr>
<td>40-44</td>
<td>128</td>
<td>55.29</td>
<td>28.53</td>
<td>39.98</td>
</tr>
<tr>
<td>45-49</td>
<td>157</td>
<td>61.14</td>
<td>29.96</td>
<td>43.84</td>
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<tr>
<td>50-54</td>
<td>156</td>
<td>67.73</td>
<td>29.13</td>
<td>45.01</td>
</tr>
<tr>
<td>55-59</td>
<td>173</td>
<td>74.21</td>
<td>22.17</td>
<td>46.80</td>
</tr>
<tr>
<td>60-64</td>
<td>158</td>
<td>81.93</td>
<td>25.97</td>
<td>30.50</td>
</tr>
<tr>
<td>65-69</td>
<td>176</td>
<td>88.75</td>
<td>22.03</td>
<td>25.98</td>
</tr>
<tr>
<td>70-74</td>
<td>106</td>
<td>88.38</td>
<td>24.42</td>
<td>25.30</td>
</tr>
<tr>
<td>75-80</td>
<td>75</td>
<td>91.89</td>
<td>22.25</td>
<td>27.82</td>
</tr>
<tr>
<td>All</td>
<td>1154</td>
<td>72.86</td>
<td>29.10</td>
<td>37.84</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Source from Literature Review</th>
<th>95 percent</th>
<th>15 percent*</th>
<th>33 percent*</th>
</tr>
</thead>
</table>

* Reflects Percentage of Coverage of Medicare Beneficiaries.
Summary of Findings

- Expectations About Insurance Coverage Vary
- Expectations on Premiums Affected by Treatments and Narrows with Age
### Table Three: Expectations as to Insurance Premiums for Respondents in Treatments B and Treatment C*

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>p10</th>
<th>p25</th>
<th>Median</th>
<th>p75</th>
<th>p90</th>
<th>Mean</th>
<th>SD</th>
<th>Ranges Suggested in Anchoring for Treatment C**</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Treatment B</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Medicare Premiums</td>
<td>573</td>
<td>30</td>
<td>98</td>
<td>120</td>
<td>250</td>
<td>500</td>
<td>210.8</td>
<td>252.6</td>
<td>n.a.</td>
</tr>
<tr>
<td>Medigap Premiums</td>
<td>568</td>
<td>0</td>
<td>0</td>
<td>50</td>
<td>150</td>
<td>206</td>
<td>105.7</td>
<td>173.3</td>
<td>n.a.</td>
</tr>
<tr>
<td>Employer Sponsored Premiums</td>
<td>566</td>
<td>0</td>
<td>0</td>
<td>55</td>
<td>200</td>
<td>450</td>
<td>149.1</td>
<td>254.8</td>
<td>n.a.</td>
</tr>
<tr>
<td><strong>Treatment C</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$96 to $115 for typical basic Medicare Premium plus an average of $40 for typical Part D Prescription Drug Coverage</td>
</tr>
<tr>
<td>Total Medicare Premiums</td>
<td>562</td>
<td>50</td>
<td>100</td>
<td>135</td>
<td>200</td>
<td>350</td>
<td>259.2</td>
<td>1018.7</td>
<td>Considerable variation in policy types, but majority of monthly medigap premiums range between $50 and $200</td>
</tr>
<tr>
<td>Medigap Premiums</td>
<td>229</td>
<td>25</td>
<td>50</td>
<td>100</td>
<td>185</td>
<td>250</td>
<td>134.6</td>
<td>141.3</td>
<td>Average Participant Costs for Those Over 65 roughly $167</td>
</tr>
<tr>
<td>Employer Sponsored Premiums</td>
<td>342</td>
<td>0</td>
<td>80</td>
<td>165</td>
<td>200</td>
<td>330</td>
<td>300.1</td>
<td>1579.0</td>
<td></td>
</tr>
</tbody>
</table>

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* Estimated Requested Only for Respondents Who Indicate Some Possibility of Maintaining Insurance Coverage at Some Point in Retirement.

** See Appendix C for Additional Detail on Anchoring.
Summary of Findings

- Expectations About Insurance Coverage Vary
- Expectations on Premiums Affected by Treatments and Narrows with Age
- Expectations on Total Costs Less Affected by Treatments but Also Narrow with Age, Rise in time
Estimates Are Similar Across Treatments
Less Variation Across Age Groups
### Sensitivity to Cost Growth with Aging

#### Table Five: Estimates of Changes in Monthly Costs During Retirement

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>p10</th>
<th>p25</th>
<th>Median</th>
<th>p75</th>
<th>p90</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final Year Monthly Costs</td>
<td>1671</td>
<td>25</td>
<td>120</td>
<td>350</td>
<td>800</td>
<td>2000</td>
<td>1797.7</td>
</tr>
<tr>
<td>Ratio of Final Year Monthly Costs to Average Monthly Costs</td>
<td>1599</td>
<td>0.83</td>
<td>1.00</td>
<td>1.46</td>
<td>2.40</td>
<td>5.71</td>
<td>5.34</td>
</tr>
<tr>
<td>Ratio of Estimates Monthly Costs at 85 to Estimatively Monthly Costs at 65</td>
<td>782</td>
<td>0.46</td>
<td>1.00</td>
<td>1.33</td>
<td>2.00</td>
<td>2.60</td>
<td>1.72</td>
</tr>
</tbody>
</table>
Summary of Findings

- Expectations About Insurance Coverage Vary
- Expectations on Premiums Affected by Treatments and Narrows with Age
- Expectations on Total Costs Less Affected by Treatments but Also Narrow with Age, Rise in time
- Similar Results for Lump Sum Estimates
Lump Sum Estimates by Treatment

Figure Nine: Lump Sum Estimates by Treatment
Figure Ten: Lump Sum Estimates by Age Cohort
Summary of Findings

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- Lump Sum Estimates Not Hyperbolically Discounted
Actual Lump Sum Versus “Implied Lump Sum”
Lump Sum Estimates by Age Cohort
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- Lump Sum Estimates Not Hyperbolically Discounted
- Variation in Estimates Not Consistently Associated With Most Common Correlations
Lump Sum by Gender: M > F !

Figure Thirteen A: Lump Sum Estimates by Gender
Lump Sum by Income: Wealth > Poor

![Graph showing Lump Sum Estimates by Income Quintile](image-url)
Lump Sum by Health: Excellent > Poor
Lump Sum by Financial Sophistication: +/-
Self-Reported Financial Sophistication
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- Variation in Estimates Not Consistently Associated With Most Common Correlations
- Responses on Risk Assessments Mixed, Understated
Ambiguous Results on Risk

- Summary Results on Module One: Willingness to Pay

<table>
<thead>
<tr>
<th>Table Nine: Willingness to Pay for Protection Against Three Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>N</td>
</tr>
<tr>
<td>Protection Against High Costs from Personal Health Experience</td>
</tr>
<tr>
<td>Protection Against High Costs Unanticipate Inflation in Medical Costs</td>
</tr>
<tr>
<td>Protection Against High Costs form Adverse Policy Changes</td>
</tr>
</tbody>
</table>
Module Two: Concern About Risks
Module Two: Assessment of Severity

Figure Twenty Three – Budget Increase to be Highly Confident for Adverse Personal Health
Further Research and Extensions

- Considerably More Work Can be Done in this Dataset
  - Controlling for different characteristics
  - Analyzing Long Term Care Estimates
  - Assessing Interactions with Insurance Coverage Expectations
- Better Coordination with Medical Cost Researchers
- Additional Work on Accuracy of Estimates on an Individual Basis; Mapping to Actual Savings Behavior
- Policy Implications from Apparent Misperceptions
  - Gender Differences
  - Implicit Negative Discount Rates on Many Lump Sum Estimates
  - Educational Efforts with Respect to Health, Policy Risks
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