

# Non-annuitization and the interplay between bequest motives and asymmetric information

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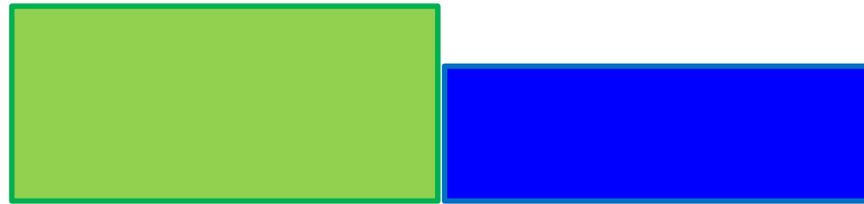
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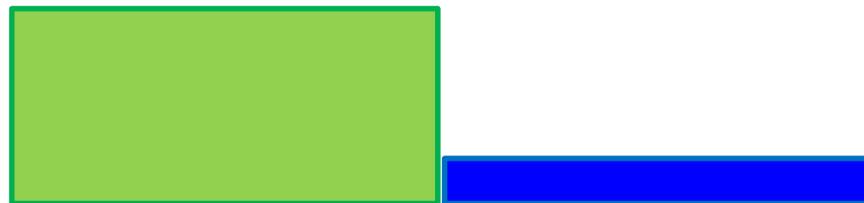
# Bequest motives & adverse selection

## Die too young – Die too old



«Healthy individual»

Need more money in old age, benefit from pooling  
=> annuity price affects bequest/annuity trade-off



«Un-healthy individual»

Need less money in old age, suffer from pooling  
=> annuity price affects bequest/annuity trade-off

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\* We thank participants at the 2016 Netspar Pension Workshop and Monika Bütler for helpful comments.

# The birth (and hopefully death) of a puzzle

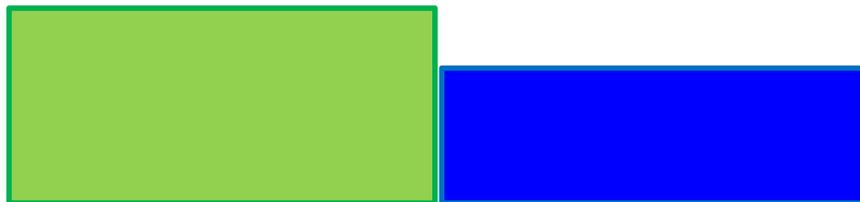
- Absolutely convincing economic reasoning that financial product is welfare improving (stock, annuity, RM)
- Small problem: Nobody wants it – well, almost nobody
- **Way out 1: no puzzle because some rational explanations have been overlooked**
- Way out 2: Still a puzzle, no rational explanations
  - The puzzle is worse than you think
  - The puzzle is not as bad as you think
- In case of 2: There must be something else
  - Informational barriers, product knowledge, misunderstandings
  - Behavioral factors: peers, framing, defaults (implicit, explicit)
  - Back to square 1: the product is not as convincing as we thought

# Non-Annuity: (Still) A Puzzle?

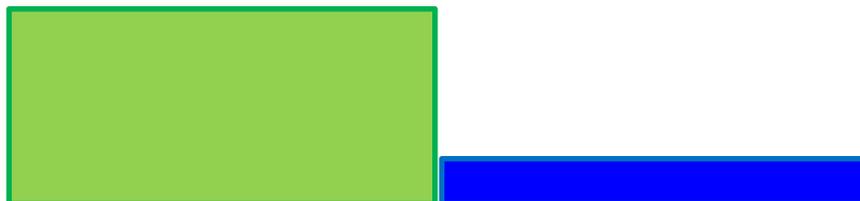
- Annuity rates are low:
  - (1) There are good reasons for low demand
  - (2) Individuals take the wrong decision
    - This paper: bequests & asymmetric information (plus social security and fees)
- Good reasons for low demand – besides bequests & AI
  - Means-tested benefits (Pashchenko; Bütler, Peijnenburg, and Staubli)
  - Health costs ... and many more
- Optimal annuity of 0 is easy to generate:
  - => Paper needs a more unique focus (non-linearities?)

# Is Abel (1986) the right model frame?

- I do not think so:
  - Abel (1986) is basically a micro-based macro model to study capital accumulation in GE
  - Very simplistic planning: 1 decision time, immediate resolution of uncertainty at “retirement”
  - No tail risk => very important for annuity demand
  - No correlation between “health” and wealth



«Healthy individual»



«Un-healthy individual»

# Are there still puzzles in the wild?

- Non-linearities in annuity demand:
  - The poor do not annuitize (means-tested benefits and pre-annuitization by social security)
  - The very rich do not annuitize (low marginal utility of insurance, bequest)
  - (Too) little partial annuitization (MTB helps)
- Not only risk-aversion, but also prudence  
Example: Life insurance is an inverse annuity (Cutler, Finkelstein & McGarry (2008))
  - The short-lived buy life insurance, but not annuities
  - The long-lived buy annuities – but also life insurance...

## Further remarks

- LITERATURE: really need to have a closer look at the vast existing literature
  - Some references badly misrepresented: Hosseini (2015), Pashchenko (2013), Lockwood (2012)
  - Important papers missing: Finkelstein & Poterba (2012), Brown (several); Benartzi, Privitero, Thaler (2011)
- Not sure the notation w.r.t. adverse selection is correct
  - Pooling  $\Rightarrow$  adverse selection (separating eq?)