Assessing the Demand for Annuities in an Undeveloped Market: Evidence from Hong Kong

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The annuitization puzzle

Households are reluctant to voluntarily purchase annuities in developed countries

- **Characteristics of the annuity product** (e.g. indexed payout, bonus payment, period-certain guarantee and, counter-party risk)

- **Household characteristics** (e.g. financial wealth, bequest motive, health care, family support, loss aversion and, financial literacy)

This paper assesses the demand for annuities in an undeveloped market using a two-step approach

1. Identify the preferred annuity (4 product characteristics)
2. Assess the demand for the preferred annuity
Main Results

Using a discrete choice experiment (DCE) in the first stage and a household survey in the second stage, the authors find:

- Participants prefer a nominal annuity with a 10-year period-certain guarantee provided by an insurance company with an A-rated credit rating.
- Confronted with the choice between the preferred annuity and no annuitization, 32.4% of the participants choose the preferred annuity.

Take away: the demand appears to be high compared to observed annuitization rates in developed markets (U.S. 10%, U.K. 6%).
Strengths

- Clear and detailed econometric approach (two-step analysis)
- The Hong Kong Mandatory Provident Fund is a useful setting for this analysis (second pillar, privately managed accounts)
- The main content is to the point and well-written
Major comments - sample selection

Respondents were only asked to participate in DCE if they claimed to understand the features of the annuity → sample selection

In total 20.76% of the respondents (131 out of 631) claims it does not understand the features of the annuity product

- less financial literate?
- lower household income?

Test for potential differences between the characteristics of respondents that do and do not understand the annuity product.
Major comments - framing

Set-up DCE

1. Definition of an annuity
2. Description of the advantage of annuitization; don’t face the risk of outliving your assets
3. Explain four main features of the annuity products

However, mentioning only the advantage of an annuity might lead to framing effects. Overestimating the demand for annuities?

Possible ways to limit the framing effect

- Phrase it as a characteristic of an annuity instead of ‘the main benefit’
- Broader explanation of the annuity; e.g. how it relates to survival probabilities
In total $3 \times 3 \times 3 \times 2 = 54$ choice sets are available and 18 choice sets are presented to each individual. This is done by implementing an "efficient design"

- Chooses the 18 most informative choice sets
- Avoid so-called dominants alternatives

Clearer explanation of the "efficient design" preferred. Moreover, not clear which annuity product dominates the other

- e.g. nominal annuity with no bonus, A counter-party risk and 0 years period-certain is dominated by nominal annuity with no bonus, A counter-party risk and 10 years period-certain because ..
The authors ask the respondents whether they understand the features of the annuity contract. However, is this reflecting the truth?

- Include a small test with questions regarding annuities
Suggestions - variable annuity

Financial literacy has a significant and negative impact on the demand for the preferred annuity product (a nominal annuity with a 10-year period-certain guarantee provided by an insurance company with an A-rated credit rating).

- Desire to maintain stock market exposure during retirement

Interesting to study whether the financially literate has a stronger preference for a variable annuity.
Conclusion

- Relevant and interesting topic
- Clear and to the point econometric approach
- However, sample selection could potentially bias the results