

# 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

## Minor comments - 18 choice sets

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 ..

# Minor comments - testing understanding of annuities

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