Risky Insurance: Life-cycle Insurance Portfolio Choice with Incomplete Markets

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Discussion by Sasha Indarte

Motivation

- A large literature argues households sub-optimally hold life insurance, LTCI, and annuities

- These products target important risks:
  - **Life insurance:** death of a family can be an important source of financial distress (Corden et al., 2010)
  - **LTCI:** wellbeing in old age (standard US insurance, outside of Medicaid, does not cover LTC)
  - **Annuities:** provide insurance against outliving your other wealth

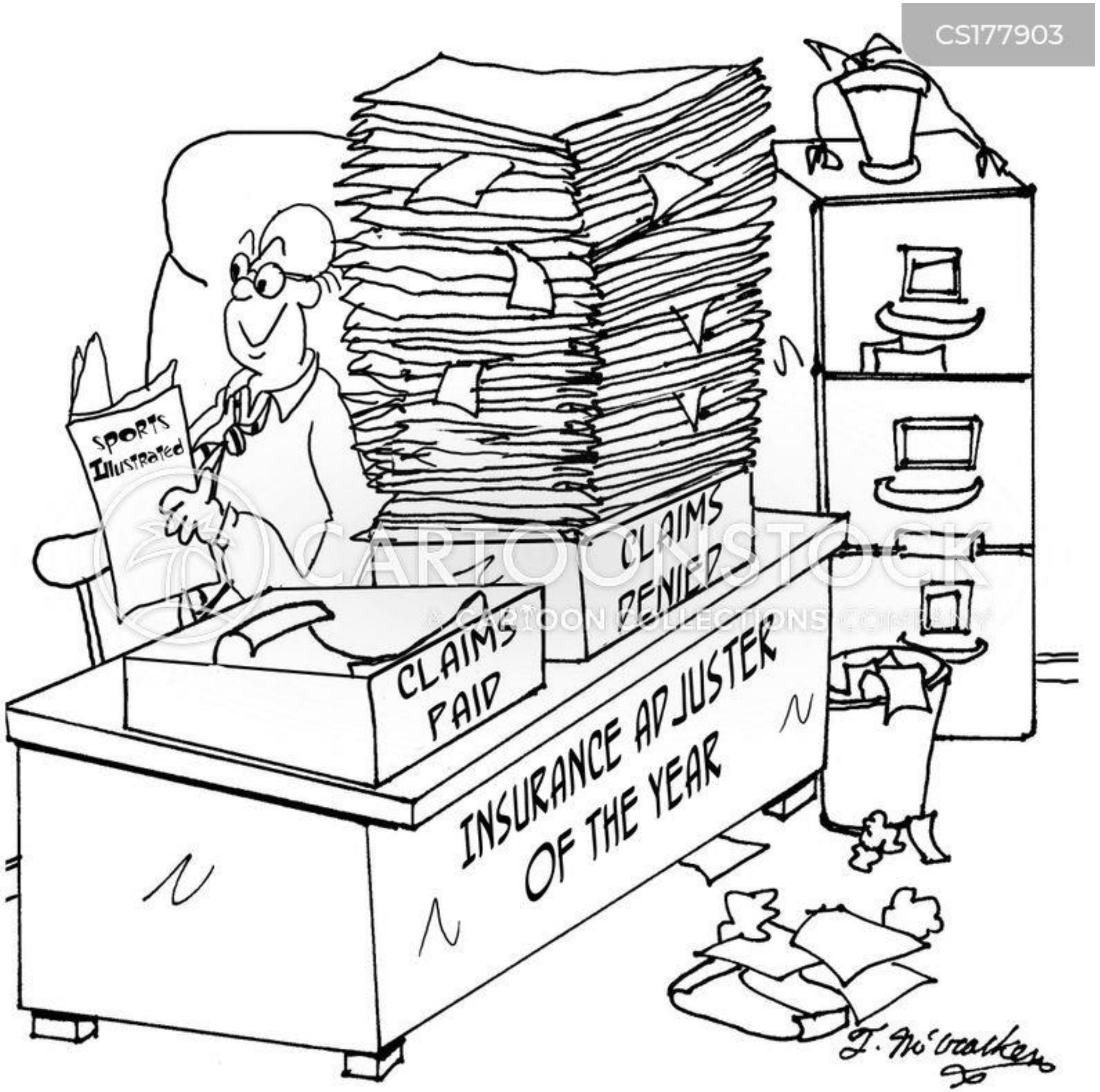
- **This paper:** can biased (subjective) expectations about nonpayment risk explain the low holdings of these products?

Paper Overview

- **Survey:** solicit perceived nonpayment risk (expect 76-87% payout!)
  - Link to rich set of economic and demographic variables
  - Past experiences of fraud and financial literacy are strong predictors of beliefs
  - ➔ Insurance pessimism predicts ownership of insurance

- Build a **model** w/ life insurance, LTCI, annuities, and risk-free bond
  - Allow pricing above actuarially fair prices & perceived nonpayment risk
  - Removing nonpayment risk **significantly** increases ownership
    - 55% ➔ 73% (life), 13% ➔ 43% (LTCI), 2% ➔ 8% (annuities)
  - Find large welfare gains from presence of insurance, esp. with no payment risk
    - 0.6% consumption equivalent vs 2.2%

Denial of claims is a major reason people dislike insurers



What do consumers say about a defaulting LTC insurer?

American Network Insurance Co

Write a revie

3440 Lehigh St, Allentown, PA 18103, United States

1.9 ★★☆☆☆ 8 reviews ⓘ

Sort by

✓ Most relevant | Newest | Highest rating | Lowest rating

j [redacted]

★☆☆☆☆ 2 years ago

Quite possibly the worst LTC insurance company in the world. They will do whatever is possible (lose your paperwork, lie to you over the phone, make things up, deny legitimate claims) to not have to pay your claim. DO NOT USE TRIPLUS (Now Davies, or American Network Insurance, or whatever else they try to "rebrand" as)

What do consumers say about a defaulting LTC insurer?

C [redacted]
6 reviews

★☆☆☆☆ 5 years ago

These people should be sued for causing emotional distress on my mother. They keep giving her the run around by asking for documents she has already sent multiple times. Then they ask for new documents. It's becoming clear to me they are stalling to avoid their financial responsibility. I hope there are lawyers that specialize in going after companies like this. It's time for me to start looking for one. Sorry to all those who have policies with this company. You would be better off just burning your premium money.

2

K [redacted]
6 reviews

★☆☆☆☆ 5 years ago

Worst case scenario, they twist everything you say and mislead the State Guarantee Associations to not pay on policy. Don't trust them in my opinion. 90 year old mother with Alzheimers certification by 2 doctors & would not pay. My opinion is less than 1 star. 0 out of 5.

What do consumers say about a random life insurer?

Atlanta Life Insurance Company

Overview | Reviews | About

[redacted]
Local Guide · 158 reviews · 25 photos

★ 8 years ago

Terrible phone service. Yesterday I called and they had a 3 hour hold time. Called back today. Still on hold. Yes this is what exactly people want to do when dealing with deceased loved ones affairs. Typical evil insurance company. I would never recommend them.

Atlanta Life Insurance Company

Overview | Reviews | About

M [redacted]
8 reviews

★ 7 years ago

They lost all my policies and cannot locate where my payments went

How important are *deviations* in beliefs from rational expectations?

Are biased beliefs contributing to suboptimal insurance coverage choices?

- *"Consumers perceive much higher risk in insurance markets than what would be inferred from historical observations of insurer default, possibly* ***suggesting high paperwork or contractual complications as the main barrier to full payment****."*

- How large are these barriers?

- Quantifying overall non-payment risk—including **denials**—would provide a rational benchmark against consumer beliefs

Evaluating the welfare effects of correcting biased beliefs

- Paper's comparison of rational and non-rational scenarios:
  - **Rational:** assumes actual risk = subjective expected risk
  - **Non-rational:** assume beliefs = subjective beliefs BUT actual risk = zero

- **Suggestion:** estimate nonpayment rates, including denials, then:
  - **Rational:** assume beliefs = actual risk
  - **Non-rational:** assume beliefs = subjective BUT actual risk = empirical risk
  - How much do holdings and welfare change *across* these scenarios?

- ↑ would speak more directly to the role of **biased** beliefs
  - I.e., are there large potential welfare benefits from information interventions?

Some (incomplete) stats on nonpayment

- The National Organization of Life and Health Insurance Guaranty Association (NOLHGA) has paid coverage benefits (due to insurer defaults) of **$25.6 billion** between 1983—2023, to 2.6 million policyholders (link)
    - Small relative to the face value of life insurance policies in force in 2023: **$22.2 trillion** (link)

- 10-20% of life insurance claims are denied (link)
    - There's large **heterogeneity**; some provides deny 50% of claims!
    - Note: heterogeneity in denial rates could complicate an info intervention…

Are risky assets an alternative to life insurance/LTCI/annuities?

When are risky assets (equity, housing, etc) a good alternative to insurance?

- You value liquidity (equity!)
- You're wealthy (low risk of outliving wealth)
- You face a high premium (due to age or health)
- ENPV of insurance is low (e.g., low subjective risk of death)
- Long investment horizon (young, plan to bequeath, etc)
- No dependents
- Have dependents (tax basis step-up)
- Have a spouse that's a joint owner or designated beneficiary
- You have a high risk tolerance

Should the model feature risky assets?

- **Welfare** measurement is based on comparing world with 3 insurance products against world with only non-contingent bond
  - If non-contingent bonds are the only way to self-insure, more insurance products are *very* valuable
  - But if there are alternatives (like equity), gains from adding them are smaller

- **Insurance holdings:** may be more sensitive to beliefs when alternatives are available

- **Model:** I recommend adding a risky asset

- **Data:** do people with more pessimistic beliefs about insurance products hold more equity? Participate more in equity markets?
  - Would be evidence of substitution

Wrap up

Misc. comments

- Why is perceived risk in annuities similarly large?
  - This was very surprising to me, since there's much less qualification/denial risk

- Could correlation between beliefs and liquidity/wealth lead the model to attribute too much influence to beliefs in coverage choices?

In conclusion...

- Well-designed survey
- Rigorous quantitative model
- New evidence on importance of subjective beliefs for explaining insurance choices
- Excellent example of an insightful combination of subjective beliefs data with theory!