

Why Do Life Insurance Policyholders Lapse? Liquidity Shock vs. Loss of Bequest Motive

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Abstract

Theoretical studies on the effect of life settlement market on consumer welfare show that it crucially depend on the reasons for the lapsation of life insurance policies: if lapsation is purely due to the loss of bequest motives by the policyholders, then life settlement is shown to be detrimental to consumer welfare in equilibrium; on the other hand, if lapsation results from liquidity shocks, then life settlement may be welfare enhancing. In this paper, we undertake the empirical investigation for the reasons for life insurance lapsation using the Health and Retirement Study (HRS) data. We use Sequential Monte Carlo (SMC) methods to deal with the serially correlated unobservable state variables in our estimation of the dynamic discrete choice model.

Keywords: Life insurance, dynamic insurance, secondary market

JEL Classification Codes: G22, L11

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