Subjective Life Expectancy and Private Pensions *

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March 1, 2013

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adult in the house and therefore we can directly link any annuity contract. In a second case when we look at couples that own more than one Riester contract we can assume that the person answering the questionnaire directly owns one of the contracts.[30] Apart from these two circumstances there is a third combination of answers from which we can directly link a Riester contract to the respondent. If there is only one Riester contract and no private old age provision contract in a non-single household we can exploit a question that asks for the expected old age income sources separately for both partners. One sub-item contains private old age provisions including Riester contracts. The reason we do not use this question directly is that it covers both, subsidized and unsubsidized, old age provisions. In our case we know that out of the broader category there is only one Riester contract in the household, therefore if the respondent answers that he or she will expect income out of that category but his or her partner will not we can link the Riester contract to the respondent.

Based on this approach, we compare our newly derived smaller group of directly linked contract holders with our initial group of Riester annuity savers. Table 8 shows the resulting subjective life expectancies of our two initial groups from table 4 plus the newly derived expectancies of Riester savers where a direct link was possible. Our initial results remain unchanged when using the reduced sample. For women, conditional on age, we find a significant positive effect of subjective life expectancy on the likelihood of owning a Riester pension, for men we still do not find a significant effect of subjective life expectancy on Riester ownership.

8   Conclusions

We have three central findings. First, men as well as women are pessimistic about their life expectancy. Women (men) underestimate their life span by about 7 (6.5) years compared to the official records by the German statistical office. Second in line with our hypothesis we find a small selection effect in the German market for Riester annuities based on women' subjective life expectancy. This selection effect is present not only when controlling solely for age, as the only variable that the provider can use to set the price for a Riester contract, but also when controlling for additional covariates that potentially influence annuity choice and subjective life expectancy at the same time. Women holding a Riester contract expect to live longer compared to women without an annuity contract. However, in contrast to our hypothesis we do not find a selection effect

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[30]In very rare cases there might be children eligible for Riester annuities that also live in the household. In these cases if the number of contracts is smaller than the amount of eligible household members we again have an assignment problem. For our analysis we will disregard these cases.

for men on the Riester market based on their subjective life expectancy. At first glance our findings appear counterintuitive considering the design of the Riester contracts. Women benefit from subsidies as well as unisex life tables which generally make the contracts attractive, even for women with lower life expectancies. Men only benefit from the subsidies but suffer from the unisex regulation. As a result the difference in subjective life expectancy between Riester savers and individuals without an annuity contract should be more pronounced for men.

The third important finding concerns the loading charge of the insurance industry compared to the selection effect based on subjective life expectancy. For women the subjective mark up ranges between 1 and 2 years and is approximately in line with the loading charge by the industry. However, due to the special unisex regulation on the Riester market mark ups are very high for men (up to 8 years) and do not correspond to the subjective mark ups for men. Men do not select themselves into Riester contracts based on SLE but rather due to other socio-demographic characteristics. The gender gap in mark ups gives us a possible explanation for the results regarding our hypotheses. The mark ups for men might simply be high enough to prevent a selection process according to subjective life expectancy. For men other factors seem to determine whether to invest into the Riester scheme.

The overall judgment of whether the mark up of the insurance industry is justified based on adverse selection remains complex because we can only compare the statistic adjustments by the DAV with subjective estimations of our sample. If the SAVE participants systematically make errors regarding their subjective life expectancy their real mortality risk could still match the assumptions by the insurance companies. However, because people base their decision making process on subjective assumptions the fact that they think the mark up is too high can already cause negative consequences, namely that a large share of the population will be underinvested in private annuity contracts. Informing individuals about their longevity risk might improve individual's risk assessment and ultimately lead to better coverage.