

Annuities and Out-of-Pocket Medical Expenditures

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I shall address three major issues related to the '*annuity puzzle*'. First, the illiquidity of annuities due to the absence of '*residual markets*'. Overwhelming evidence suggests that there is a need for flexibility by early-life purchasers of annuities who wish to sell (or purchase additional annuities). A market for short-sales (as the '*viatical market*' in life insurance), in spite of the inevitable adverse selection, would be welfare enhancing.

Second, out-of-pocket (OOP) medical expenses is an increasing burden on retirees in the US and elsewhere, particularly in the middle and upper income groups. We propose a new type of annuities (termed *Life-Care Annuities*), which enable measured coverage of OOPs, partially substituting for regular retirement benefits.

To accommodate flexibility in annuity markets, we propose to create '*Refundable Annuities*' (equivalent to '*annuity options*'), whose resale price is pre-fixed for different ages.

Third, for a '*pooling-equilibrium*' (uniform price independent of personal characteristics) which characterizes annuity markets, we propose the creation of *insurance bundles*, combining products whose underlying attributes are *negatively correlated* (e.g. annuities and life insurance or long-term care). This will mitigate adverse selection and enable more attractive pricing (of the bundles).