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Household Life Cycle Protection: Life Insurance Holdings, Financial Vulnerability, and Portfolio Implications

Yijia Lin, Martin F. Grace

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Abstract

Using the Survey of Consumer Finances, we examine the life cycle demand for different types of life insurance. Specifically, we test for the consumer's aversion to income volatility resulting from the death of a household's wage-earner through the purchase of life insurance. We first develop a financial vulnerability index to control for the risk to the household. We then examine the life cycle demand for life insurance using several definitions of life insurance. We find, in contrast to previous research, that there is a relationship between financial vulnerability and the amount of term life or total life insurance purchased. In addition, we find older consumers use less life insurance to protect a certain level of financial vulnerability than younger consumers. Secondly, our study provides evidence that life insurance demand is jointly determined as part of a household's portfolio. Finally, we consider the impact of family members' nonmonetary contribution on the household's life cycle protection decision. Our results provide some evidence that households take into account the value of nonmonetary contribution in their insurance purchase.

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