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Whole-life insurance lapse rates and the emergency fund hypothesis ☆

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Abstract

There has been a long-term interest in the subject of lapse rates and the basic question of what causes lapses has been under study for many decades by the insurance industry. The interest rate hypothesis has received the most attention and empirical support in recent years. An older hypothesis is that cash values are utilized by policyholders as an emergency fund. This hypothesis deserves attention here because it has not been extensively tested.

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Explaining the risk premiums of life settlements
2021, Pacific Basin Finance Journal

> *Citation Excerpt :*
> …The third rationale for the negative beta is related to the emergency fund hypothesis in the insurance literature. The empirical evidences (e.g., Outreville, 1990; Kuo et al., 2003; Kim, 2005; Jiang, 2010; Fier and Liebenberg, 2013) show that policyholders are more prone to surrendering their policies when the economy is bad. This implies that policyholders who have demands for money in economic downturns will be willing to sell their policies at a discount and render life settlement investors higher returns in such times.…

Don't lapse into temptation: a behavioral explanation for policy surrender
2017, Journal of Banking and Finance

> *Citation Excerpt :*
> …Such an income shock often implies a need for liquidity but can also be interpreted as a trigger to reconsider financial decisions. There are clear predictions in the literature as to how a rational decision maker would behave after such an income shock, most prominently represented by the emergency fund hypothesis (Outreville, 1990; Kuo et al., 2003).2

The emergency fund hypothesis states that the insured lapses if she lacks sufficient funds to finance her expenses due to micro factors, like individual income shocks, or macro factors, like financial market turmoil.…

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☆ Due to unforeseen circumstances, publication of this article has been delayed considerably.

** The author is a professor of Finance and Insurance and presently a member of the UNCTAD secretariat. The views expressed in this paper do not necessarily reflect those of UNCTAD or its staff.

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