

# The Behavioral Economics of the Annuity Puzzle: Framing Effect and Mental Accounting

Kan Takeuchi

## Abstract

This paper reports the behavioral biases that account for the annuity puzzle, by using the controlled Internet survey. I replicate Brown et al. (2008, AER P&P 98, 304-309) in Japanese context and confirm that the framing effect keeps responders away from the annuity pension plan as well. While the annuity serves as a protection or insurance, the responders in the controlled investment framing tend to perceive an annuity as an independent financial instrument. Then, they heavily averse to the risk of the annuity, which is the risk of not fully receiving the financial benefit from the pension account if died too early. This framing effect is significantly large; much of the responders in the investment framing prefer a fixed term pension plan to the annuity, while the expected discounted present value of those pension plans are all equivalent. This paper illustrates the important role of cognitive biases in the annuity puzzle and in any reform of pension systems.