

Behavioral Economics & Insurance

Introduction

Historically the insurance industry has been slow to respond to changing tides not just in technology but especially regarding customer needs and internal administrative hurdles that block efficiency and innovation. Currently, the global insurance market is making progress in accepting new technologies such as wearables, data analytics and digital features into their microcosm of underwriting & claims as well as altering corporate structure so as to meet the changing needs of its evolving customers. Leading re-insurer *Swiss Re* for example hosts symposiums all over the world in an attempt to bring forth new ideas and apply them to their business.

However, there has been little effort in conducting empirical research in, and applying behavioral methods throughout the global insurance industry. This is unfortunate bearing in mind the *behavioral* nature of insurance. Put simply, insurance is a promise of risk mitigation – pay now a small sum to safeguard from future (potential) ruin. This sentence alone is packed with behavioral attributes. *Promise* means trust in others and in institution; that the money I give today will be returned to me with interest in the future. *Risk* implies calculating probabilities of events and weighing them against utility. *Pay now for future return* means thinking about oneself in the future – we all procrastinate. Within these attributes lie cognitive biases like loss aversion, bounded rationality, mental accounting, and present bias all of which influence the way we make our decisions when purchasing insurance but also in every walk of life.

Behavioral economics can provide insights into the mechanisms of the mind that deal with and influence trust, risk, uncertainty and general decision making when buying insurance policies. These factors can support cluster analyses so as to provide enhanced profiling and customer segmentation. The idea here being that behavioral biases are important pieces of data that can illuminate the real needs of the consumer.

There is another age-old problem with insurance – put simply, insurance is boring. As the Behavioral Insights Unit has shown in its attempt to decrease tax evasion, social norms play a prominent role in changing behavior and engaging people. For insurance, these tactics of A/B testing, taking advantage of defaults, messengers, social pressures and the like, as well as designing products based on behavioral insights can open up new ways of nudging the customer to interact with insurance, maybe even change the way that they perceive of it!

In any case, thorough research in the use of behavioral methods can offer the insurance industry a clearer picture into their customer's behavior and their thought processes. Certainly then, insights on customer behavior, filling in their behavioral profiles, communicating better and designing efficient products can pave the way for a shift in how insurance is done, from the proprietor to the consumer and vice a versa.

A Three-Pronged Approach

Without question, every crevasse of insurance can be enhanced through the application of BE. However, there are three clear directions that we are interested in developing:

- Enhancing profiling data through the collection of behavioral variables on consumers
 - Report on potential behavioral data
- Behaviorally Modified Communication
 - A/B Testing Approach
- Better Product Design
 - Tweaking new products using human behavior as a guide

Behavioral Profiling

Currently, data analytics is taken only so far as the data permit it and unfortunately, the industry is behind on taking advantage of not only new techniques in analysis but the existing data itself, to better understand the consumer. Acquiring a comprehensive understanding of the European consumer's behavior, habits, needs and intentions is a strategy for our organization to predict future behaviors, offer relevant products, identify customer segmentations efficiently, enhance underwriting and operations and many more.

Considering the nature of the task, variables of interest could indicatively include but are not limited to:

- Risk aversion,
- loss aversion,
- mental accounting,
- intertemporal choice (present bias and others),
- Generalized trust levels
- bounded rationality
- herd-mentality (this indicator relates to the effects of *expectations* in economics e.g., Keynes's p-beauty contests etc.)

New behavioral data like this will add great value as supplementary variables to be measured against existing customer data, including but not limited to demographics, purchase behavior, health choices, and online behavior among others. Suffice it to say, if these indicators are to have real value we will need to associate them with others not mentioned here.

Deliverables: Report on Behavioral Variables for Cluster Analysis

- Identification of behavior that offers robust clustering (additional data to demographics and purchase behavior)
 - Identify and offer techniques to collect data
- Identification of behavioral heuristics/mechanisms that trigger the desired behavior (in this case: the consideration of risk mitigation or purchase of insurance policy).

Behaviorally Modified Communication

Just as the Behavioral Insights Team spearheaded field research showing practically that making small changes to letters can have large effects on when and whether people pay their taxes, so too should insurance encourage consumers to claim redress, especially when it is in the interest of the customer. As in other field research¹ that have validated these findings, behaviorally informed communication can show firms how to help consumers pay suitable attention to relevant information regarding their insurance policy.

Deliverables: A/B testing proposal using actual communication from European insurance firms (preferably Company K's)

- Case study review on current practices in behavioral interventions in insurance communication (Swiss-Re is the leading company working on this right now)
- Build a case for intervention in insurance communication for the European market using existing research conducted.
- Leverage behavioral insight on communication to design treatments to existing pieces of communication (likely letters)
- Develop a communication strategy based on A/B testing trials with at least 5 treatments
- Suggest the process through which a company such as Company K can implement said strategy

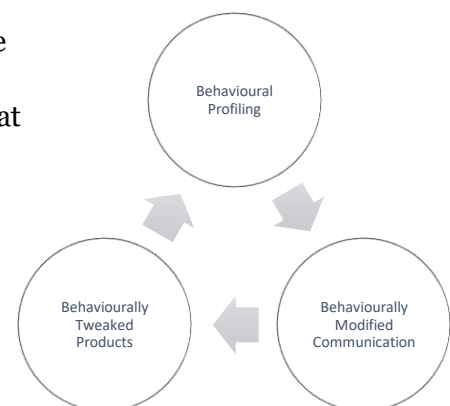
Behaviorally Tweaked Products

Insurance companies have an innate reason for existing - sharing net risk increases utility. However due to the nature of the product, the fact that it's not tangible or clear, many barriers stop it from being ubiquitous in society. When developing insurance products such barriers should be taken into account, that is, creating products in line with human behavior should be the baseline for any firm attempting to become pervasive. The bottom line is that products must be modified in order to offer higher utility to the consumer as well as help improve insurance literacy rates.

Deliverables: Product Development Plan using behavioral insights

- Identify biases & heuristics relevant to insurance products
- Design an approach for product development that includes behavioral tweaks

Ultimately, the three-pronged approach should be interconnected as one project, where enhanced profiling feeds into better communication that in turn creates the foundation for behaviorally tweaked products. This encapsulates in a sense, a behaviorally informed business strategy for the European insurance market, and preferably one that is fine-tuned for Company K.



¹ Adams & Hunt, 2013: Financial Conduct Authority
<https://www.fca.org.uk/publication/occasional-papers/occasional-paper-2.pdf>