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Editorial: The Intersection of Behavioural Economics and Life Insurance: How might Don Draper have sold Life Insurance

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Question: If someone from the 1960s suddenly appeared now, what would be the most difficult thing to explain to them about life today? Answer: a pocket-sized device exists that is capable of accessing the entirety of information known to man. Most use it to look at pictures of cats and get into arguments with strangers.

Not even the visionary Don Draper of “Mad Men” could have seen that answer coming.

Looking back to Mad Men’s Swinging ‘60s (which really was not so very long ago), high-risk behaviors were the norm: pregnant

women smoked, three-martini lunches were *de rigueur*, drunk driving was common, most cars did not come with seat belts, and few used their seat belts even when standard equipment.

Jumping forward to 2016, many think it’s the Internet that made such a tremendous impact on our present lives and behaviors. But really, none of the social oddities cited above were changed by a smartphone app. And how about those ubiquitous little bottles of water? When did it suddenly become a bright idea that without constant hydration people would die of thirst?

The science of behavioral economics could help explain these shifts in social actions and behaviors. Behavioral economics studies how people actually behave in given circumstances—not what they did in the past or say they might do in the future, but how they are likely to behave now. It examines rational and irrational thought as well as unconscious motivations to arrive at a more nuanced understanding of consumer behavior.

Therefore, could the insurance industry utilize behavioral economics as a way to potentially increase consumer desire to buy life insurance?

IRRATIONAL EXUBERANCE

Life insurers generally assume clients will purchase protection because it is the logical thing to do.



Developers of such products are generally actuaries—rare individuals who think logically, are comfortable with large amounts of money, understand the time value of money, think about the future, practice deferred gratification, and have an unshakeable belief in the existence of the rational consumer.

Unfortunately, people are not always logical, rational, objective, self-interested, and/or cost-benefit-calculating. People are emotional; they like to live in the moment and make irrational decisions. They smoke, drink excessively, overeat mindlessly, under-exercise, max out their credit cards and then pay only the minimum, engage in unprotected sex, and more. People are also regrettably quick to form new irrational habits, such as texting while driving. All of these actions have no real up side and only serve to reduce life expectancy and quality of life.

Even when consumers are presented with hard data confirming the irrationality of their actions, such as calorie counts of favorite indulgences, accident statistics for texting drivers, or depressing information about the ills of smoking displayed prominently on a cigarette pack, bad habits still persist. However, it does appear that forcing smokers to stand outside a bar in order to have a cigarette might be a more persuasive smoking deterrent.

Traditional economic theory says consumers should relish choice. However, recent economic research has produced an alternative school of thought about the economics of decision-making, summarized by an excellent article in *The Atlantic* that says the complete opposite.¹ First, it said, making choices can be physically exhausting (decision fatigue). Second, it suggested that having too many choices can make consumers less likely to reach a conclusion due to fear of making a wrong decision so frequently no decision is made (choice overload). Third, it reminds us that humans are social animals, likely to let their friends, families and tribes do their thinking for them (confirmation bias). Clearly, all of these elements can work against the rational decision to buy life insurance.

RESPONSIBLE PARENTING AND INSURANCE

Social norms today for responsible parenting are numerous. They include: having a seven-seat mini-van with umpteen airbags; making sure one's child wears protective gear when cycling, rollerblading or skateboarding; mandatory seat belt use; making sure a child's cell phone has their parents' phone numbers on speed dial as well as a GPS tracker; a constant supply of BPA-free water bottles ... the list goes on and on.

Is it possible to envision life insurance protection as part of a “responsible parenting” list? Spending US\$100 a month on family life insurance protection might seem an obvious way to ensure loved ones can continue to live without financial hardship. How can our industry be convinced to go about this? How about appealing to a parent's natural protective instinct? Parents can be

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encouraged to take financially protective responsibility for their families. With each policy sale, an appealing giveaway, such as an umbrella, an oversized coffee mug or back-window car sticker that announces, “World's Best Parent—my family is protected with ABC Insurance,” can enhance a transaction's feel-good quotient. Additionally, people have been shown to be more likely to keep a commitment to maintain a positive self-image if such a commitment is made publicly.

One example of a fun and successful giveaway already associated with insurance companies is the stuffed meerkats (a very in-demand toy) being given away currently by the U.K.-based Comparethemarket.com to anyone over age 16 who buys insurance. Another, the plush toy AFLAC duck, has become a collector's item, and was even specifically requested from the company by President George W. Bush as these were his dog's favorite chew toy.

TEMPTATIONS

Behavioral economics taps into the business of understanding what tempts consumers to make purchases. Will the next smartphone, for example, prompt consumers to ditch their current smartphones more quickly as well as check them more (or less) often during the day? Will the next version of Facebook elicit more views and more clicks for advertisers? Will Mercedes Benz's luxurious 2017 cars tempt drivers to trade in their perfectly good 2012 models? The economic value of luxury objects is totally emotional, and based on how a consumer might feel when owning and using these objects (don't even get us started on the irrational temptation of new running shoe models).

The history of insurance suggests that risk transfer probably started around the third millennium B.C., making insurance one of the world's oldest professions. Still, I would be surprised if anyone ever lined up at midnight in the freezing cold to buy a new insurance policy when it first became available, or if anyone not in the business was ever tempted to toggle between the live video streams at the Worldwide Developers Conference (when Apple usually announces its new products) and Monte Carlo's Global Reinsurance Conference to hear about new risk coverages or updates to present policy benefits. In contrast, for many it can be almost irresistibly tempting to buy a lottery ticket—and even queue in the cold for the pleasure of it.

CONCLUSION

Life insurers are presently looking at how they can increase sales by leveraging Big Data and predictive modeling in order to identify customers with both a higher-than-average “propensity to buy” and a lower “probability to claim” risk profile. They are also investing in automated underwriting systems that use sophisticated decision-tree logic and looking at how social media can be leveraged as a distribution channel. However, we would argue that these new initiatives are based on the traditional theory of the consumer and don’t necessarily consider how insurers can improve how we engage and interact with the customer.

We are certainly not suggesting life insurers abandon these new sales initiatives. Rather, we are asking if behavioral economics could help attract a heretofore untapped base of new clients who might not fit into the decision-making mold of the presumed rational consumer. Logically, life insurance is a good thing, but even scientifically targeted clients might have a raft of rational-sounding reasons not to buy, such as: they don’t trust advisers and insurers; insurance agents are intrusive; the process takes too long; life insurance is expensive; and the benefits are confusing. These issues need to be addressed. Might it not be more effective to shift a sales conversation from offering a US\$1 million death benefit (a big confusing number) upon death, to offering a payout of half the customer’s current salary until a child’s 18th birthday?

If we think our potential customers never allow emotions to interfere with their decisions, then our present portfolio may be the best that we can achieve. However, if we think emotions do

play a role, then there is definitely room for improvement. Going forward, it would be great to see Behavioral Economics 101 included in the Society of Actuaries’ syllabus under Product Development. Maybe this might lead to seeing responsible families strolling around clutching their life insurance policies right next to their water bottles.

The views expressed regarding recognizing irrational behaviour and the revised SOA syllabus are solely their own and do not reflect the views of either their employers or the Society of Actuaries. ■

REFERENCES

- ¹ <http://www.behavioraleconomics.com/BEGuide2015.pdf>
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