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Insurance is Sold, not Bought—But Why? Some Lessons Learned From *Nudge* by Thaler And Sunstein

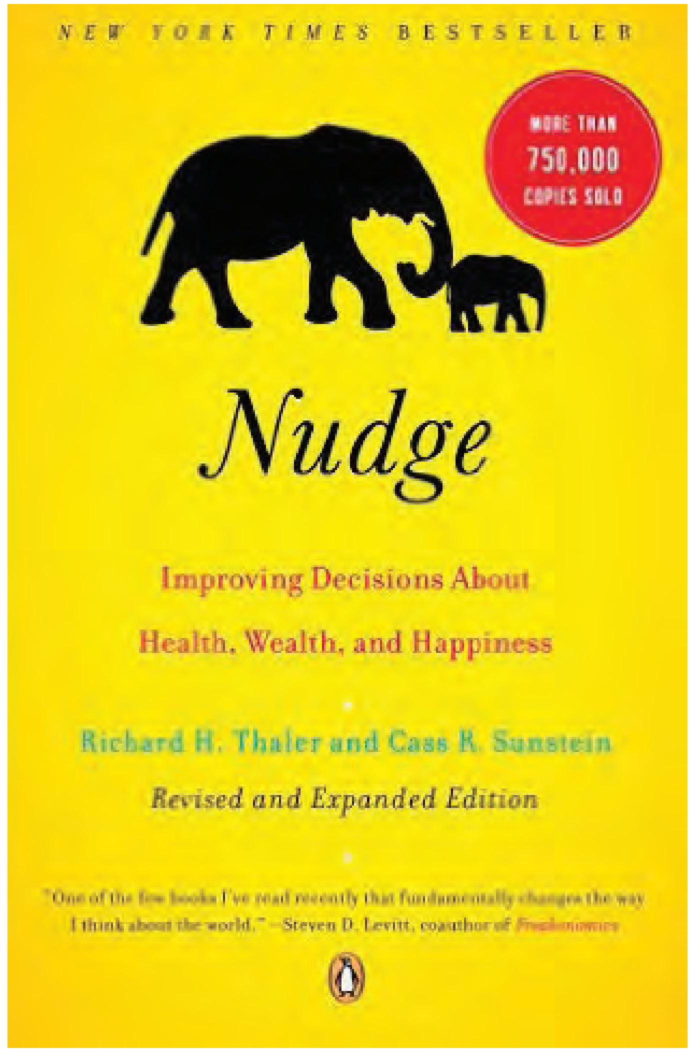
By Ailen Okharedia

Those familiar with the field of Behavioral Economics will have no doubt come across some of Richard Thaler's work and other interesting books written by him. He is arguably the most prominent mind in the field of Behavioral Economics today. *Nudge (Improving Decisions About Health, Wealth, and Happiness)* by Richard H. Thaler and Cass R. Sunstein is a book about the direct application of Behavioral Economics to tackle real world problems. Proponents of Behavioral Economics support the notion that it is possible to help humans make better decisions for themselves and their loved ones through seemingly small interventions—nudges.

Nudge starts off by identifying human tendencies and biases that make us susceptible to making decisions that are not always in our best interest. It then explores the world of nudges and provides examples of successful interventions that have been used in the world of Finance, Health and other social issues.

Here are a few notable examples of seemingly small but impactful interventions (nudges) from the book:

- **The power of continuous feedback (Thaler & Sunstein (2008, p. 196)):** "Thompson (2007) has explored the efforts of Southern California Edison to encourage its consumers to conserve energy—and its creative, nudge like solution. Past attempts to notify people of their energy use with emails or text messages did no good, but what worked was to give people an Ambient Orb, a little ball that glows red when a customer is using lots of energy but green when energy use is modest. In a period of weeks, users of the Orb reduced their use of energy, in peak periods, by 40 percent. That flashing red ball really gets people's attention and makes them want to use less energy."



- **The power of social norms (Thaler & Sunstein (2008, p. 69))**: "... consider a study of the power of social norms, involving nearly three hundred households in San Marcos, Calif. All of the households were informed about how much energy they had used in previous weeks; they were also given (accurate) information about the average consumption of energy by households in their neighborhood. The effects on behavior were both clear and striking. In the following weeks, the above-average energy users significantly decreased their energy use; ... But here is an even more interesting finding. About half of the households were given not merely descriptive information but also a small, non-verbal signal that their energy consumption was socially approved or socially disapproved. More specifically those households that consumed more than the norm received an unhappy emoticon, whereas those that consumed less than the norm received a happy emoticon. Unsurprisingly, but significantly, the big energy users showed an even larger decrease when they received the unhappy emoticon. ..."

- **The power of ratings and disclosure (Thaler & Sunstein (2008, p. 192)):** "… A paper by Ginger Zhe Jin and Phillip Leslie (2003) documents a similar finding for restaurants. In 1998, Los Angeles County introduced hygiene quality grade cards that had to be displayed in restaurant windows. The researchers found that the grade cards caused the restaurant health inspection scores to improve, consumers' sensitivity to hygiene in restaurants to increase and hospitalizations for food-borne illnesses to decline." Thaler, Sunstein, Nudge.
- **The power of seemingly small financial incentives (Thaler & Sunstein (2008, p. 236)):** "Dollar a day: Teenage pregnancy is a serious problem for many girls and for those who have one child, at (say) eighteen, often become pregnant again within a year or two. Several cities, including Greensboro, N.C., have experimented with a "dollar a day" program, by which teenage girls with a baby receive a dollar for each day in which they are not pregnant. Thus far the results have been extremely promising. A dollar a day is a trivial cost to the city, even for a year or two, so the plan's total cost is extremely low, but the small recurring payment is salient enough to encourage teenage mothers to take steps to avoid getting pregnant again. And because taxpayers end up paying a significant amount for many children born to teenagers, the costs appear to be far less than the benefits."

The book makes it clear that nudges are most impactful where decisions are difficult and rare, where people do not get prompt feedback for their decisions and when they have trouble translating aspects of the situation into terms that they can easily understand (Page 74, Nudge by Thaler & Sunstein). There are many similarities between the situation described above and the products offered by the life insurance companies. Specifically, **"the benefits of holding the insurance are delayed, the probability of having a claim is hard to analyze, consumers do not get useful feedback on whether they are getting a good return on their insurance purchases, and the mapping from what they are buying to what they are getting can be ambiguous."** (Page 79, Nudge by Thaler & Sunstein).

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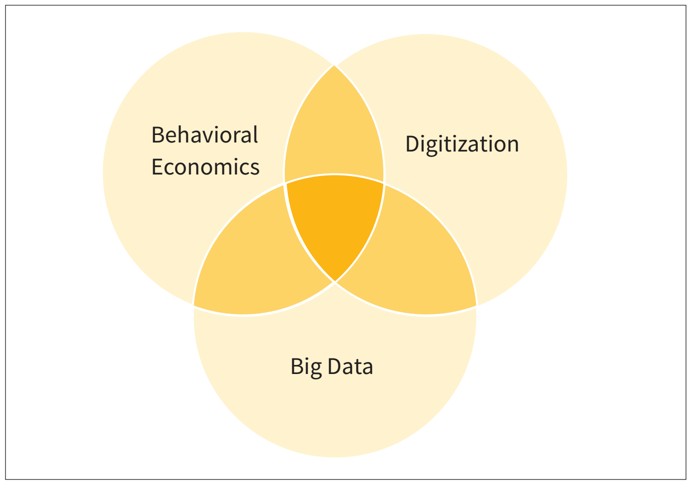
A well-defined problem is critical to finding an appropriate solution to the problem. The better we are at identifying the underlying traits that make the current paradigm of "insurance is sold, not bought" a reality, the closer we are to finding solutions to this age-old problem and the better positioned we are to explore innovative ideas that will help consumers appreciate the future benefits of their insurance products, help consumers to become better at mapping what they are buying to what they are getting. But it all begins with focusing on defining the problem. Are there nudges that can make the probability of a claim less difficult to analyze? Are there ways we can provide consumers with useful feedback on whether their insurance purchase is giving them a good return? Are there ways we can make the process of buying less ambiguous? Behavioral Economics digitization and big data are tools we can use to engage with consumers in ways that was previously not possible. We are able to engage with them in a way that can breakdown some of the barriers/challenges we described above. (See chart 1)

Chart 1



A holistic approach to tackling these well-defined problems is required which will ultimately impact all aspects of the life insurance value chain: marketing, distribution, sales, product design, pricing, underwriting. I recommend reading this book and allowing your creative juices to flow as you explore the many examples of other successful interventions in the book and think about appropriate applications to the life insurance industry. In future publications we will seek ways to explore ideas and opportunities that exists right across the life insurance value chain to breakdown some of the barriers described above, particularly through engaging the tools of digitization and big data. ■

Ailen Okharedia, FSA, MAAA, is an actuarial manager at PwC Actuarial Services. He can be reached at *ailen.a.okharedia@pwc.com.*