We all act in ways that seem irrational.

Consumers don’t always switch to a better or cheaper product. Investors too often follow the herd causing them to buy high and sell low. Very few of us exercise or sleep enough, eat as well as we should or save enough for our futures.

We know this is true but so often we act as if it were not. We spend our time creating policies, products and houlda2esew oe . c’ml lcehit as is tod oiesp enghe44 m1 (e)(r k) 1 (e)1.()4 (i)(e o)5 (r s) (g t)(’)14.idapbehave rather th

Behavioral science can help us escape this trap. Sitting at the intersection of psychology, neuroscience, sociology and economicsno(es5 (no)5 (mi)1.5 (c)14 (s)7 15 (no)15 (no)15 (no)15 (no)15 (no)15 (no)15 (0.005 Tc 0 Tw

Our brains use mental shortcuts known as heuristics to make decisions among all this information. These shortcuts look for patterns, make associations and quick inferences based on the limited ing 7.17.(s)5 (g5o)5 17 (h)c.2 (s4(r)(n)1)(s4(r)(s4

Making insurance decisions

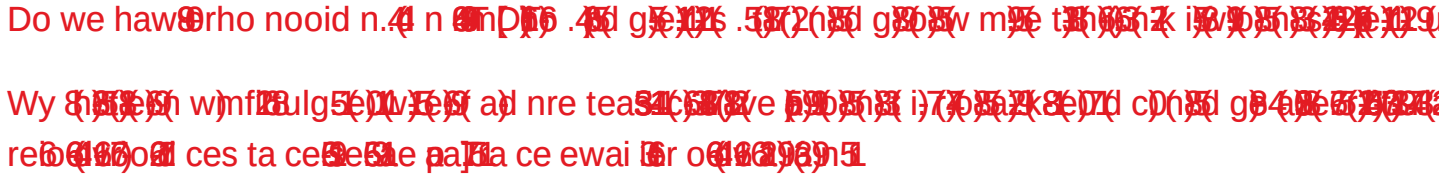
At the heart of most insurance behaviors are decisions about risk and probability. We might like to think that insurance consumers act like an economist would, considering all possible outcomes, researching and estimating the probability of these outcomes and attaching a value to each.

Unfortunately, this is not how people make most judgments about risk and probability; they use shortcuts. One common example is the availability heuristic.

The availability heuristic is a mental shortcut that relies on immediate examples that come to mind when evaluating a specific topic or decision. If something can be recalled, if it is easy to imagine happening or to remember happening, it must be important, or at least more important than alternative solutions not as readily recalled. Under the availability heuristic, people tend to heavily weigh judgments toward more recent information, making new opinions biased toward that latest news.

This explains why so many people take out insurance after an event. For example, sales of home insurance that covers flooding will increase after a major flood. After seeing people in neighboring areas suffer from flooding, the risk of a flood is now more available, even if the risk itself hasn't changed. Rates of insurance decline again as memory fades.

When we talk about heuristics and biases, we are not saying people are stupid. We would not have been as successful as a species if we were. What we are is constrained. We have limited cognitive power and therefore try to ration it and give priority where we think it is needed. The key point is that too often we forget this.



What's different is we now realize that many more decisions are like selecting tins of soup. You're not Homer Simpson in the supermarket and then Sherlock Holmes once you walk into the office.

Actuaries are humans too. In fact, my contention is that insurance professionals often exhibit our own bias. My question for you is: Do we too often assume our audience is like Sherlock Holmes? When we're creating products, communications, application forms, wellness programs, etc., do we assume people are willing to dedicate precious System 2 time to focus on an issue we think is important?

I think we do, and this is a big problem. If we design for the ideal person, then we design for no one. But if we instead use behavioral science to really understand how people think and make decisions, the results can be powerful.

Reference

1 Wansink, Brian and Jeffrey Sobal (2007), "Mindless Eating: The 200 Daily Food Decisions We Overlook," Environment and Behavior)