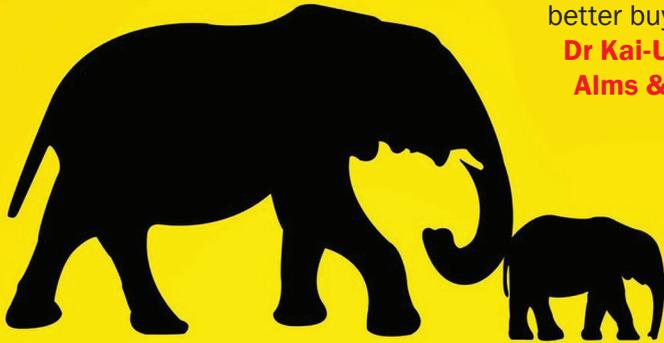


# Insurance view of Nobel Economics Prize



Behavioural economics can be harnessed by regulators and insurers to “nudge” customers towards making better buying decisions, argues

**Dr Kai-Uwe Schanz of Dr. Schanz, Alms & Company.**



Picture from cover of *Nudge* by Richard H Thaler and Cass R Sunstein

On 9 October 2017, Prof Richard H Thaler was awarded the Nobel Prize in Economics, honouring his work in behavioural economics. The 2017 laureate demonstrated how human action generally diverges from the paradigm of perfect rationality which underlies most economic modelling and thinking.

“Nudge”, a book co-authored with Mr Cass Sunstein, is Prof Thaler’s most influential publication. Its recommendations have been adopted by governments across the world; some have established “nudge units” which, for instance, aim at boosting savings or encouraging the take-up of certain forms of insurance coverage. At the core of this approach is the fact that the way choices are (subtly) framed – by firms or governments – can influence how citizens and customers decide.

For example, Thaler was instrumental in making enrolment in US pension plans the default for new employees which means that they must decide to opt out rather than opt in. This form of “nudging” led to a massive increase in the share of employees saving through such schemes.

## Out of economic models

In insurance, too, for those policies purchased voluntarily, decisions as to whether to buy coverage usually do not fit the standard economic models. Some types of insurance

could be considered “over-purchased” such as low-deductible coverage on homes or cars. On the other hand, many consumers and firms buy much less protection than economically beneficial against catastrophic losses to property or against very expensive medical treatments.

People often choose coverage that only partially protects them in order to keep premium payments low. When they suffer a loss, they have to realise that not all the damage is covered. At the same time, they are unhappy when a loss does not occur, perceiving insurance as a poor investment with no “return”.

Therefore, it is almost natural that consumers are much less satisfied with insurance than with products that give them tangible benefits immediately after purchase.

Another source of confusion and disappointment is the often complex and ambiguous wording of insurance contracts.

## On emotional plane

Behavioural economics takes into account emotions such as anxiety and fear, as well as phenomenon like the endowment effect, ie, people’s tendency to value losses more than gains.

It helps our understanding of fuzzy thinking, limited information processing abilities, and imperfect foresight which classical economics

tend to “assume away”.

These features are especially likely with insurance because decision makers deal with a considerable uncertainty regarding the likelihood and consequences of loss-producing events. Prospective policyholders frequently do not understand even the most basic product characteristics and often simply do not trust insurance providers.

Their decisions rarely reflect purely economic considerations and often serve the simple purpose of gaining peace of mind. If they do not collect on the policy, insurance customers tend to regret having bought coverage.

In summary, behavioural economics can assist insurance buyers in improving their purchasing decisions, especially when they do not merely respond to legal requirements or financial incentives such as compulsory schemes and tax benefits. At the same time, insurance companies can draw on behavioural economics to develop a better understanding about their customers’ motivations and biases, enabling them to build more attractive products. And last but not least, legislators and regulators can harness behavioural economics to make better decisions about how and when to intervene in private insurance markets. ▣

Dr Kai-Uwe Schanz is Chairman, Dr. Schanz, Alms & Company AG, Zurich. He can be contacted at kai-uwe.schanz@schanz-alm.com