BRIEFING NOTE 4

Microinsurance Innovation Facility

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International Labour Organization

THE PSYCHOLOGY OF MICROINSURANCE: SMALL CHANGES CAN MAKE A SURPRISING DIFFERENCE

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Everyone who has struggled to meet a deadline, stay on a diet, or save for a large purchase knows how difficult it can be to translate intentions into actions. Many of us struggle when temptation is near: tomorrow's problems may seem distant and choices are complex. These realities drive the field of behavioral economics, the branch of research that combines lessons from psychology and economics to enrich understandings of how people make decisions. One important lesson from behavioral economics is the understanding that small changes in the design of products and marketing can sometimes make a surprising difference in how and whether financial products are used. This paper draws from laboratory and field research examples to present eight recommendations for microinsurance providers. The authors describe new insights into how households think about losses and gains, weigh present and future tradeoffs, struggle with self-control, and are influenced by the way choices are framed. These insights can help insurers navigate how to improve product design, marketing, insurance education, pricing, and take-up.

EIGHT STRATEGIES

Below are the behavioral tensions that can arise when designing insurance marketing campaigns and products, and eight "small change" strategies for overcoming or getting around these challenges.

1- Keep it Simple:

More is not always better. Each additional option changes the decision-making context and can shift the focus away from meaningful options. Having too many alternatives from which to choose can be overwhelming and lead to procrastination or inaction. Differences in presentation can be subtle, but they matter.

↗ Strategy: The solution is not to eliminate all choices but to recognize that too many choices can undermine microinsurance take-up. Recognizing that different combinations of options can shift the focus of customers, insurers can test menus of options to keep customers focused on the most meaningful options. In the United States for example, researchers found that implementing a Quick Enrollment™ mechanism that allowed employees to sign up for retirement accounts with pre-set contributions tripled participation rates versus the rates observed when employees had to pick and choose from an array of savings account options.

2 - Frame the Loss:

Options can be presented with a positive or a negative message. Evidence suggests that loss-framed messages generate greater demand than gain-framed messages: the perceived risk of losing something is more likely to stimulate demand than the possibility of gaining something.

↗ Strategy: Insurance marketing can take advantage of this behavioral pattern through campaigns that appeal to individuals' fear of loss (possessions, good health, etc.) rather than promoting the benefits of coverage.

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[1] This brief is excerpted from the Microinsurance Paper N° 5 available at www.ilo.org/microinsurance, which also includes all the acknowledgements and relevant citations. The research was conducted by the Financial Access Initiative.

3 - Facilitate Self-Control:

The concept of "time inconsistency" explains situations in which people hold preferences at different points in time that conflict with each other. For example, experimental data show that some people are particularly impatient about meeting their present needs. So even if these people genuinely value saving for the future, that plan will be hard to sustain and the preference to consume will predominate. The tension is sometimes called "present bias" and it can similarly reduce the demand for insurance.

↗ Strategy: One way to accommodate self-control problems is to make it easier to pay insurance premiums by allowing customers to pay in small installments rather than insisting on one large payment. Another way to address self-control problems is by requiring series of regular installments for paying premiums.

4 - Make it Salient:

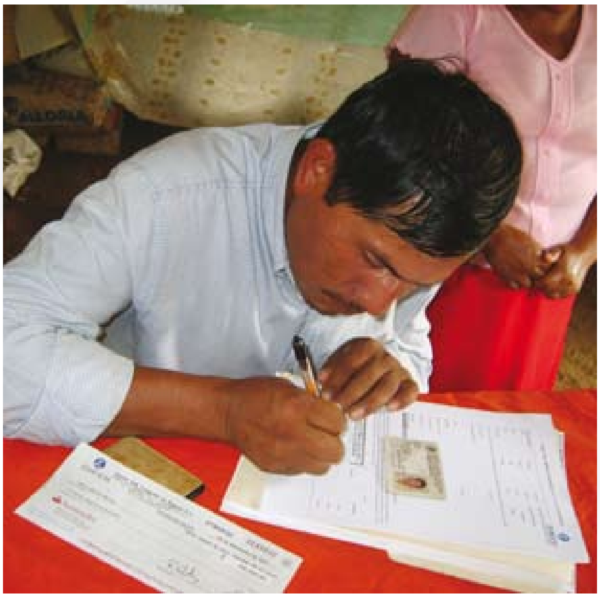
Like comparisons and framing, timing can influence decisions. One of the main reasons poor households struggle to invest in the future is that future needs are not "salient"— i.e., they are not at the forefront of our minds. As a result, some future needs might end up being ignored and not factored into decisions. In microinsurance, the problem of salience is particularly important for people with irregular or seasonal incomes. People buy insurance for unexpected events. If people make their expense allocations based on what they consider to be most salient, these unexpected events are lowest on their list of priorities, even though they might have the largest impact on their wellbeing.

↗ Strategy: Making future needs salient when people are making investment decisions can help with planning ahead. By making adverse effects more salient, reminders can help overcome the limited attention that people typically pay to unpleasant, future events. Recent research found that West African farmers were much more likely to purchase fertilizer at the time of harvest because of availability of liquid funds. Marketing insurance to people when they have money to spend seems intuitive, and harvest time is also when the benefits of insurance are most salient.

5 - Undermine Overconfidence:

People tend to have overly optimistic estimates about the likelihood of experiencing both positive and negative events. This could cause people to under-invest in proactive risk management compared to what they would invest if they were considering actual risk probabilities. When people do not have a good understanding of how likely they are to experience a hardship, they may undervalue protective measures like insurance.

↗ Strategy: Microinsurers can increase take-up by addressing the potential clients' unrealistic assumptions of how likely they are to experience a hardship.



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6 - Access Mental Accounts:

Traditional economic theory assumes that money is fungible — money has no labels and households' wealth can be collapsed into a single lump sum. Insights from behavioral economics, however, have shown that people often group their wealth into separate "mental accounts" tied to specific spending goals.

↗ Strategy: Mental accounting can be used to create an association between a spending goal and a future need: by linking microinsurance with a specific income stream, insurers can increase take-up. Achieving this association could also make a future need salient and, because mental accounts are not fungible, could prevent present need from prevailing over future need. In this context, mental accounts could have a powerful effect on how people view insurance products.

7 - Realize the Value of Zero:

Experiments show that items given away for free are strongly preferred to alternatives with a positive cost and higher net benefit. People's preferences change when zero enters the equation.

↗ Strategy: With respect to insurance, people generally prefer zero deductible/co-pay policies instead of those with cost-sharing mechanisms. The right approach is to take advantage of this preference without undermining the role of cost-sharing in mitigating moral hazard and adverse selection. One option may be to offer a health insurance policy with a limited number of free outpatient visits per year and a normal deductible or co-pay for all covered expenditures after that.

8 - Eliminate Obstacles to Action:

"Channel factors" can influence people's choices. When analyzing decision making, economists often emphasize the influence of internal, personal characteristics of the individual, and economists have focused less on the power of external, contextual factors. In practice, people's actions are influenced, sometimes disproportionately, by seemingly inconsequential channel factors.The idea is that certain behaviors can be facilitated with encouragement. Channel factors determine whether customers recognize the need for insurance and actually purchase a policy. Channel factors can also influence on whether people buy insurance and how they utilize it.

↗ Strategy: When designed properly, channel factors can be effective in translating intentions into actions, but if ignored, they can lead to inaction. The Quick Enrollment™ example described in Strategy I is relevant – by simplifying the required process, people were much more likely to carry out the desired action. This idea applies whether the choice is investing in a savings account or paying microinsurance premiums.

CONCLUSION

New evidence from research at the intersection of psychology and economics highlights how small details can have big effects. One important conclusion is that the context in which individuals make choices, including whether to purchase insurance, strongly influences their decisions.

Housed at the International Labour Organization's Social Finance Programme, the **Microinsurance Innovation Facility** seeks to increase the availability of quality insurance for the developing world's low-income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with the support of a grant from the Bill & Melinda Gates Foundation.
See more at www.ilo.org/microinsurance

The **Financial Access Initiative** (FAI) is a consortium of researchers at NYU, Yale, Harvard and IPA focused on finding answers to how financial sectors can better meet the needs of poor households. The Initiative aims to provide rigorous research on the impacts of financial access and on innovative ways to improve access.
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