



**A one in ten chance:
As risk experts do insurers really communicate risk effectively?**
Exploring how the perception of risk affects customer responses to climate risk

Ian Foy, Former Chief Executive Officer, Equity Red Star

Introduction

How risk is perceived is key to whether people take action to manage risk.

Advertisers use insights from behavioural science all the time but it is not often considered when looking at responses to unexpected events. Insurers who are able to effectively communicate risk will be better able to promote desirable risk behaviours.

This ClimateWise Thought Leadership article is the fourth in a series which began in 2012.

Each article is authored by a senior executive from a ClimateWise member organisation and aims to inspire debate around a new issue related to managing climate change risk which the author believes could yield value for the insurance industry if adopted more widely.

The ClimateWise Thought Leadership Series is intended to provoke debate. Join the discussion on the ideas contained within this article on LinkedIn (Search 'ClimateWise' to find the Discussion Group), or connect with us on Twitter (@ClimateWise) or email (info@climatewise.org).

A one in ten chance

Growing attention has been given to questions around climate risk:

- Is the climate changing?
- What has caused this change?
- What will the impact be on society and insurance, as a barometer of society?

The evidence is compelling that action is needed to reduce and manage this risk but as societies we are still struggling to incentivise this.

For insurers to effectively engage with customers on this issue it's time attention is given to the equally critical questions:

- What change of behaviours do we need from customers?
- What barriers might be preventing this change?
- How do we communicate more effectively?

An initiative facilitated by

Our Unconscious Bias

“Everything depends on upbringing”
Leo Tolstoy, *War and Peace*

Insurers and reinsurers are typically populated by highly analytical, data rational individuals. This brings many wonderful advantages, including an ability to model risk, understand complexity and develop elegant solutions.

However, it also brings an inevitable bias that knowledge has always been the best basis for decision making. Knowledge is sometimes used for decision making and moderating behaviour, but less precisely than you might imagine.

Decision making is complex, often irrational and subject to a range of biases. I will briefly touch on 3 biases and indicate how insurers can address these to influence customer behaviour with a new approach.

Risk Frequency Bias

I still remember one of my first days in an underwriting team as a graduate trainee. Most of my time was spent admiring people manipulating rates of 0.1% or 0.2% or even 0.01% as an indication of the right price to charge for uncertain events. Years of training had habituated the skill of working out how frequently a factory burns down or a building floods.

This is an unusual skill. Try asking your friends how often they could expect their house to burn down or write off their car to discover the truth.

People are terrible at predicting low frequency events. It's much easier to predict things that happen (or don't) more frequently such as the likelihood of a train being late; Swansea beating Manchester United or the chance of career promotion.

While most of the predictions of global warming centre on an increased frequency (of high impact events) occurrence now is still low frequency. The human mind just isn't trained to respond accurately to this information.

The Availability Bias

This bias hinges not on whether information is available, but if information is actively and vividly available to the thinking mind. Consider the following example:

Australia has had the worst summer for many years for fatal shark attacks. A concerned mother asks you if it is safe for her children to swim at the beach or should they head to the zoo.

Availability bias is when your mind is flooded with images of dismembered bodies, maybe a few bars from Jaws theme music and perhaps even a sobbing mother. Images of a fatal road traffic accident, which has a much higher probability of occurring probably didn't rush into your mind.

The data rational answer is that in terms of being attacked by a shark, swimming remains an extremely safe pastime, but availability bias plays strange tricks.

Why should customers change behaviour when they lack personal and emotional connection to major loss events? It's easy to see major losses, as a result of weather events, as something that happens to other people in other countries.

Anchoring Bias

- How many tornados does the US experience each year (to the nearest hundred)?
- How many tornados does the US experience each year (to the nearest thousand)?

The question is the same, but the second variant will always produce a higher answer. In a similar way, most people get trapped by the range of their historic information. Take time to guess the price of milk in the supermarket and see whether your estimate is effected or anchored by the price it was during your childhood.

Even when the frequency and severity of loss events noticeably increase, it is likely perception will still be distorted by anchoring to the past

What to do?

We already have the tools to address these biases, but implementation will require careful thought.

- When considering customers, throw away the risk models and the analytical proof points. Embrace colour and emotion and use opinion leaders in the public eye to engage with the public on global warming and loss.
- Find methods of describing low frequency events in ways that people can understand and gain real perspective.
- Help people to disconnect from what they remember as normal to a more volatile, globally connected world.

If I were to recommend three compelling books to any aspiring insurance CEO, it would be:

- *The Tipping Point: How Little Things Can Make a Big Difference* by Malcolm Gladwell
- *Nudge: Improving Decisions About Health, Wealth and Happiness* by Richard H. Thaler, Cass R. Sunstein
- *Made To Stick: Why Some Ideas Survive and Others Die* by Dan Heath

These books describe how behavioural change really occurs; trigger points to initiate change and lastly how to bring memorability to even the driest topic.

Conclusion

In conclusion, when the insurance industry really understands not just the data but also combines that knowledge with insight into how people really think, genuine progress on responding to climate risk will be made.

**Ian Foy, Former Chief Executive Officer,
Equity Red Star, June 2013**

ClimateWise is the global insurance industry's leadership group to drive action on climate change risk. To contribute your views join us on www.linkedin.com (search 'ClimateWise').

For further information please contact the ClimateWise Secretariat:

E: info@climatewise.org.uk

T: +44 1223 768841

W: www.climatewise.org.uk