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Session 3, Concurrent Session in General and Health Insurance
Behavioural Finance in Non-life Actuarial Work

Changing Risks, Expecting the Unexpected

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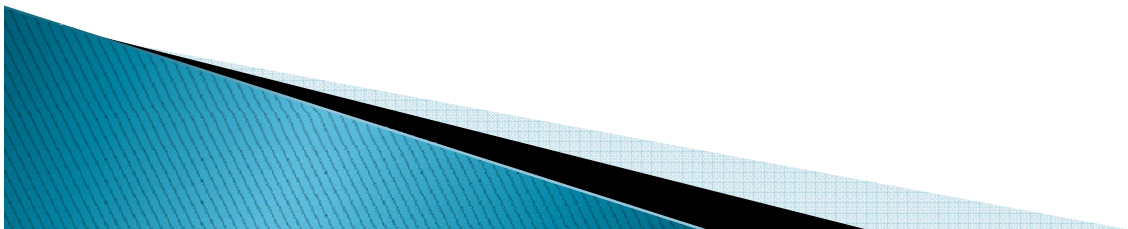
Motivation

Behavioral economics and the related field, **behavioral finance**, study the effects of social, cognitive, and emotional factors on the economic decisions of individuals and institutions.

Apart from data modeling, Reserving/ IBNR process is also guided by the actuary's judgment.

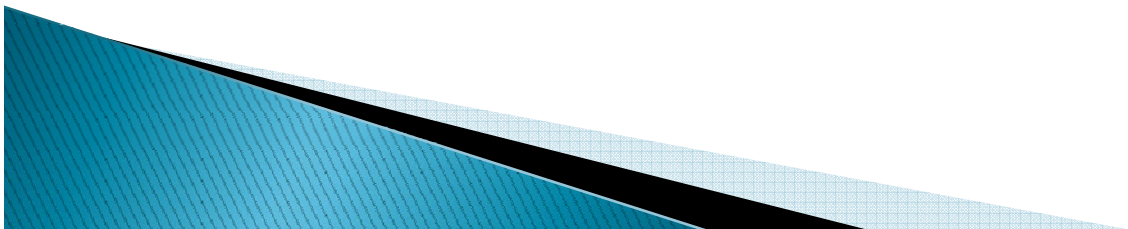
This short presentation discusses behavioural traits that can affect Reserving/ IBNR.

It sensitizes about behavioural tendencies in Reserving/ IBNR, and what to guard against.



Theories discussed

1. Anchoring
2. Money Illusion
3. Prospect Theory
4. Mental Accounting



Key Theories in Behavioural Economics

1. Anchoring

Decisions are often made by adjusting from an existing position

Q. Does the previous quarter's IBNR affect current estimate?

Q. Can objective estimates be made when anchored to an earlier one?

Key Behavioural Economics Theories .. Contd.

2. Money Illusion

Human beings tend to think about money in nominal, not real terms

Q. When professional and regulatory guidance places greater emphasis on pure IBNR over IBNER, is the inflation effect diluted in the IBNER?

Key Behavioural Economics Theories .. Contd.

3. Prospect Theory

People are risk-averse when facing gains, but become risk-seeking when facing losses

Problem 1: Which do you choose – i) or ii)?
i) Get Rs9,000 OR ii) 90% chance to get Rs10,000

Problem 2: Which do you choose – a) or b)?
a) Lose Rs9,000 OR b) 90% chance to lose Rs10,000

Q. Does a loss-making insurer take IBNR risks i.e., less rigorous IBNR process?

Key Behavioural Economics Theories .. Contd.

4. Mental Accounting

Use of separate mental accounts impacts financial decisions

Q. Are LOB IBNR estimates drawn from mental LOB revenue results?

QUESTIONS?

