

# Beyond a binocular view: the interface between behavioural economics and income protection packages

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## Introduction

Behavioural economics has become the platitude in commercial realms, with the growing attention on consumer psychology. Briefly, the concept refers to a discipline of studies which highlights the interplay of economic and psychological factors on individual decision-making.<sup>1</sup> In the life insurance sector, a body of marketing research has leveraged this concept for designing some successful advertisements.<sup>2</sup> The essay leverages the concept to explore solutions to improving claimant's work outcomes and address claim dependency prevalent in MLC and the industry in general, with more than 68% of the income protection claims lasting more than 2 years (see Figure 1). The essay first defines behaviour economics as a departure from neoclassical economics, followed by an analysis of claims dependency under the lens of cognitive bias. Then, it introduces a practice continuum that outlines the interventions available in each stage of a claim in order to avoid the development of claim dependency. This essay hopes to inform existing claim policies and procedures and opens a space for integrating psychology into practice.

Duration of open retail Income Protection claims in MLC (n = 2650)

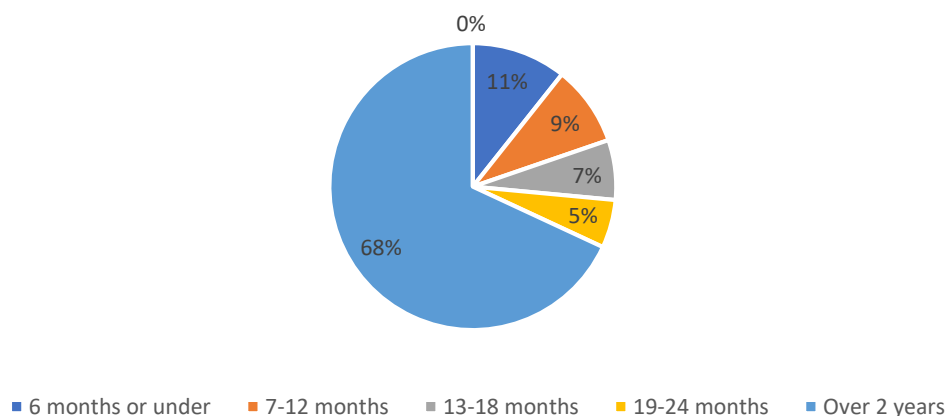


Figure 1: MLC's Income Protection Claims' duration

## Behavioural economics: the departure from 'homo economicus' to 'the flawed man'

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<sup>1</sup> Peter Earl, *Behavioural Economics* (Edward Elgar Publishing, 1990).

<sup>2</sup> Nick Chater, Steffen Huck, and Roman Inderst, "Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective," *Report to the European Commission/SANCO* (2010).

Behavioural economics provides an interface between economics and psychology. In neoclassical economic studies, a human is usually regarded as ‘homo economicus’ whose behaviours are dependent on a carefully calculated cost-benefit analysis, as if a person is economically rational in nature and will only opt for the decision that embodies a maximised value.<sup>3</sup> Therefore, irrational decisions exist because of information deficiency or a lack of economic incentives. However, the emphasis on externality does not address the fact that irrational decisions remain prevalent in the epoch of information explosion. In response, behaviour economists argue that a decision-making process reflects the interplay between external and internal factors, highlighting the significance of human perception to economic incentives and its implication on their behaviours.<sup>4</sup> This perspective has been implemented in development studies, chronic illness studies, advertisements, and social policies, demonstrating its wide applicability.<sup>5678</sup> These studies often show that changing the quantity of incentives alone might not successfully alter behaviours on an individual level; instead, addressing cognitive biases can be an effective catalyst for facilitating behavioural changes.

Under the lens of behavioural economics, *cognitive bias* acts as a binocular that undermines the ability to source and process information and make economically productive decisions accordingly. Imagine this, when an object is observed through binoculars, the central view is magnified but the rear-view is obstructed due to a biological limitation. Similarly, cognitive bias refers to a series of psychological barriers for gauging a comprehensive view in a decision-making process.<sup>9</sup> These barriers are also contextually contingent to the perception of the decision-making environment; challenging the neoclassical preoccupation that value-maximisation is a consistent principle that guides human behaviours. For example, in the realm of development studies, one-off financial assistance is often more popular than business subsidies among people in developing countries.<sup>10</sup> It is because the value in present is considered more significant than that in future, even though the latter might bring a more sustainable change. By recognising cognitive bias as inherent to decision-

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<sup>3</sup> Richard H Thaler, "From Homo Economicus to Homo Sapiens," *Journal of economic perspectives* 14, no. 1 (2000).

<sup>4</sup> Y. Hanoch, A. Barnes, and T. Rice, "A Brief Overview of Behavioral Economics," in *Behavioral Economics and Healthy Behaviors: Key Concepts and Current Research*, ed. Yaniv Hanoch Thomas Rice, and Andrew J. Barnes (Taylor & Francis, 2017).

<sup>5</sup> Dimitar Kanev and Venelin Terziev, "Behavioural Economics: Development, Condition and Perspectives," *Business Economics* 4, no. 52 (2017).

<sup>6</sup> Braden K Mogler et al., "Using Insights from Behavioral Economics and Social Psychology to Help Patients Manage Chronic Diseases," *Journal of general internal medicine* 28, no. 5 (2013).

<sup>7</sup> Ernst Fehr, "Behavioural Science: The Economics of Impatience," *Nature* 415, no. 6869 (2002).

<sup>8</sup> Adam Oliver, "From Nudging to Budgeting: Using Behavioural Economics to Inform Public Sector Policy," *Journal of Social Policy* 42, no. 4 (2013).

<sup>9</sup> Hanoch, Barnes, and Rice, "A Brief Overview of Behavioral Economics."

<sup>10</sup> Julie Schaffner, *Development Economics: Theory, Empirical Research, and Policy Analysis* (Wiley, 2013).

making, behavioural economists develop an amalgamation of economic and psychological lens to investigate economic behaviours.

### **Behavioural economics and claim dependent behaviours**

In the realm of income protection insurance, *present bias* and *status quo bias* might contribute to claim dependency. Income protection products across the industry are often designed to provide financial assistance for claimants whose work capacity has been lost or diminished due to injury or illness.<sup>11</sup> With the expectation that in most cases, this work capacity could be recovered, the claim team helps to transition claimants back into employment. While studies have shown that working can be beneficial for a person as it renders professional identity and financial security, some claimants who are the beneficiary of income protection payments might not engage in employment actively.<sup>12</sup> Without framing claim dependent behaviours as ‘irrational’, a behaviour economist perspective is to decipher the cognitive bias possessed by claimants.

First and foremost, the drastic shift of lifestyle after an injury or a traumatic event develops a new behavioural pattern for claimants. Working regularly routinises economic productive behaviours and normalise employment as a ‘default’ of a claimant’s life. However, recovering from an accident, illness or a mental health condition transforms that pattern into an economically unproductive one due to recovery needs. The formation of a routine constructs a ‘status quo’ in a claimant’s cognition, contributing to a bias against changes. Informed by the prospect theory, this status quo bias stems from the human intrinsic inclination towards the domain of loss rather than gain.<sup>13</sup> In the realm of income protection insurance, the gap between a claimant’s claim payment and employment wage may not be significantly different, prompting fears of loss and regret when the claim payments cease. Cognitively, this magnifies the loss of switching while downplaying the positive impacts of employment.

Secondly, a present bias undermines the claimant’s ability to plan for their future in a structured manner as current gains are perceived as salient. Saliency refers to a cognitive reaction to choices in which certain benefits or costs are apparent to claimants in time of decision-making.<sup>14</sup> A person often prefers the choice whose payoffs are closer to the present time than in the future, illustrating a

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<sup>11</sup> T.S. Ltd and T. Sorell, *Health Care, Ethics and Insurance* (Taylor & Francis, 2002).

<sup>12</sup> Kate Walsh and Judith R Gordon, "Creating an Individual Work Identity," *Human resource management review* 18, no. 1 (2008).

<sup>13</sup> DANIEL KAI-INEMAN and Amos Tversky, "Prospect Theory: An Analysis of Decision under Risk," *Econometrica* 47, no. 2 (1979).

<sup>14</sup> Hanoch, Barnes, and Rice, "A Brief Overview of Behavioral Economics."

present bias.<sup>15</sup> Under this lens, a claimant who is the beneficiary of income protection payments tends to receive these payments (instant payoffs), instead of returning to work (future payoffs), gradually developing a chronic cycle of claim dependency. Therefore, behavioural economics probes into these cognitive nuances behind claimants' behaviours, contributing to a new practice framework to manage recovery claims.

### A proposed practice continuum as a structured intervention

The proposal of a return-to-work intervention will consider psychological nuances in decision-making. An intervention refers to a structured and evidence-based approach to behavioural changes, highlighting its prescriptive nature.<sup>16</sup> Moglor suggests that a patient will often encounter four psychological stages in the journey to recovery, starting from the change in physical and/or mental health, the initiation of efforts to positive changes, the proper management of health, to the development of sustained efforts to life changes.<sup>17</sup> Based on this framework, the proposed continuum provides strategies to improve the employment outcome of a claimant (see figure 2).

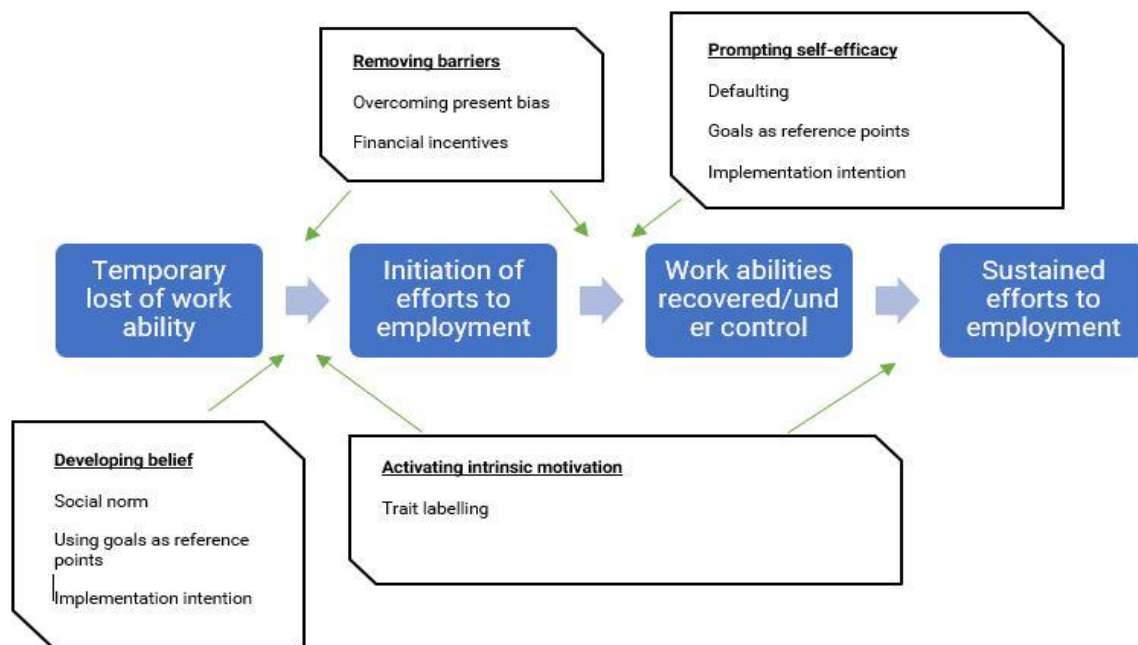


Figure 2: Recovery practice continuum

### Developing belief

<sup>15</sup> Ibid.

<sup>16</sup> Susan Michie and Charles Abraham, "Interventions to Change Health Behaviours: Evidence-Based or Evidence-Inspired?," *Psychology & Health* 19, no. 1 (2004).

<sup>17</sup> Mogler et al., "Using Insights from Behavioral Economics and Social Psychology to Help Patients Manage Chronic Diseases."

According to a health belief model, the perception of a health problem contributes to a person's intrinsic motivation to adopt behavioural changes.<sup>18</sup> Individuals interpret and estimate the severity of symptoms and the possibility to recover in their mind. From a life insurance perspective, this stage is an opportunity to provide a positive frame for claimants.

*Social norm, goal setting, and implementation intention* are strategies to develop a positive health belief. First, reiterating social norms provides a psychological clue for claimants to avoid social deviation.<sup>19</sup> In this regard, a claim consultant can provide a normative claim that working is an embedded part of life. For example, they could make an explicit statement about how most people would prefer working to staying at home. This contextualises unemployment as deviant to the norm, motivating a claimant to comply with the majority. In addition, *goal setting* and *implementation intention* complement each in order to outline a long-term vision for recovery. Inspired by the National Disability Insurance Scheme (NDIS), short-term and long-term return-to-work goals can be established with the consultation with claimants and their medical teams.<sup>20</sup> This is an effective way to navigate the recovery journey of a claimant with the intention to work towards employment. To implement the intention, setting multiple milestones of recovery reviews and facilitating review meetings can motivate claimants to work towards employment.<sup>21</sup> These strategies create a structured vision for a claimant to recover while developing the initial motivation to work.

### Removing barriers

While financial incentives are an external factor shaping decision-making, return-to-work and its payoff can be manifested as 'salient' by highlighting risks instead of long-term benefits. Cognitively, the presentation of risk exploits the natural inclination to negative thoughts because it promulgates the feeling of insecurity.<sup>22</sup> However, the promotion of risk might contradict the nature of insurance. Predicated upon studies in behavioural control, claim consultants can suggest a small cost and immediate action for redirecting claimants from satisfying with instant payoffs to a risk management mindset.<sup>23</sup> For example, positive reinforcement, which is a psychological strategy that motivates claimants via promoting long-term benefits, is often used to improve return-to-work

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<sup>18</sup> Martha Brownlee-Duffeck et al., "The Role of Health Beliefs in the Regimen Adherence and Metabolic Control of Adolescents and Adults with Diabetes Mellitus," *Journal of consulting and clinical psychology* 55, no. 2 (1987).

<sup>19</sup> Morton Deutsch and Harold B Gerard, "A Study of Normative and Informational Social Influences Upon Individual Judgment," *The journal of abnormal and social psychology* 51, no. 3 (1955).

<sup>20</sup> Bruce Bonyhady, "Tides of Change: The Ndis and Its Journey to Transform Disability Support," *The Australian Journal on Psychosocial Rehabilitation* 7, no. 1 (2014).

<sup>21</sup> Deutsch and Gerard, "A Study of Normative and Informational Social Influences Upon Individual Judgment."

<sup>22</sup> Hanoch, Barnes, and Rice, "A Brief Overview of Behavioral Economics."

<sup>23</sup> Mogler et al., "Using Insights from Behavioral Economics and Social Psychology to Help Patients Manage Chronic Diseases."

outcome; yet, it overlooks the claimant's desire for an instant payoff.<sup>24</sup> Instead, claim consultants could inform the claimant that, 'the longer you are out of the workforce, the harder for you to adapt to a new environment. If you start doing some part-time tasks now, it will be easier for you to integrate into the workforce later.' This strategy labels risk as salient and motivates the claimant to adopt a small cost action to mitigate the risk, nudging claimants to action on risk reduction instead of value maximisation.

### Activating intrinsic motivation

Trait labelling can empower claimants to take ownership of their short-term achievement and enables their intrinsic motivation to return to work. While providing financial incentives alone positions claimants into a passive role in which they are 'lured' to decide (extrinsic motivation), intrinsic motivation attributes positive behaviour changes to personality traits, such as hard work and persistence.<sup>25</sup> Kamenica argues that emphasising financial incentives might undermine a person's motivation due to perceived negligence of their subjectivity.<sup>26</sup> To implement trait labelling in insurance practice, a claim consultant could tell the claimant, 'The fact that you have worked hard to connect with your colleagues shows that you care about their wellbeing.' This draws claimants' attention to their personal attributes instead of the economic benefits, creating a perception that they have the capacity to integrate into a work environment.

### Prompting self-efficacy

When the initial motivation to return to work has been established, creating a *new status quo* is a sustainable way to reproduce positive behaviours. As mentioned above, the transformation of lifestyle undermines a claimant's desire to return to work. *Intellectual defaulting* and the goal-setting strategies illustrated in the first stage can be employed to develop a new status quo. Intellectual defaulting exploits the people's inertia to conform to a previous decision, creating an environment which returning to work becomes a 'default' option.<sup>27</sup> For instance, a 'work assistance' program can be created after a claimant's work abilities are recovered or managed. This pathway might include behavioural supports, career counselling, and service referrals to redirect claimants from unemployment to working life. This renders an implicit clue that the insurance package is designed to integrate a claimant into the workforce, instead of a 'protection', creating a

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<sup>24</sup> Thomas J D'zurilla and Marvin R Goldfried, "Problem Solving and Behavior Modification," *Journal of abnormal psychology* 78, no. 1 (1971).

<sup>25</sup> Robert B Cialdini et al., "Undermining the Undermining Effect of Reward on Sustained Interest 1," *Journal of applied social psychology* 28, no. 3 (1998).

<sup>26</sup> Emir Kamenica, "Behavioral Economics and Psychology of Incentives," *Annu. Rev. Econ.* 4, no. 1 (2012).

<sup>27</sup> Lunn Pete, *Regulatory Policy and Behavioural Economics* (OECD publishing, 2014).

natural inertial for claimants to engage in work-related activities. To sustain this status quo, goal setting strategies can be utilised when a new default has been operationalised. For example, a claim consultant can use the short and long-term goals as *reference points* to plan the pathway to employment with attention to *deadlines*. This does not only remind the claimant of their initial intention, but the establishment of *deadlines* also nudges them into complying with the plan, ensuring their self-efficacy.<sup>28</sup> The success of these strategies is achieved when claimants eventually sustain their motivation to return to work.

## **Conclusion**

The essay leverages behaviour economics to analyse claimants' behavioural patterns and develop a practice continuum in the hope of addressing claim dependency. First, it recognises that such dependency is natural to human cognition due to the change of environment. By identifying the status quo and presence biases, as well as the four stages of recovery, the practice continuum provides a series of strategies to develop claimants' motivation. This research recognises the fact that while some features of the practice continuum may currently be used to assist claim management and return to work outcomes, the continuum has likely not been implemented in its entirety in an income protection package and therefore, further research can investigate its feasibility in an organisational context. In the meantime, the study also attempts to open a space for exploring alternative incentives for return-to-work.

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<sup>28</sup> David De Meza, Bernd Irlenbusch, and Diane Reyniers, "Financial Capability: A Behavioural Economics Perspective," *Consumer research* 69 (2008).

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