Discussion of the Paper
“Demand for Catastrophe Insurance and the Representative Heuristic”

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Summary

• The representative heuristic (Kahneman and Tversky, 1972)
  - Individuals estimate probabilities from an information subset that they believe to be “representative”

• Due to the representative heuristic individuals tend to
  - ...underweight the probability of a catastrophe prior to its occurrence
  - ...overweight the probability of catastrophe when one has struck recently

• Impact on the demand for insurance
  - Individuals tend to underinsure for catastrophic risks if the last disaster dates further back
  - Demand rises sharply after the occurrence of a catastrophe and people buy over-priced policies

• Main results of the empirical analysis
  - Consistent with the theory, demand seems to rise with losses in prior years
  - Demand effect dissipates when losses recede into the past

The paper empirically examines the effect of the representative heuristic on the demand for homeowner’s insurance in Florida.
Discussion I

Strengths

• Interesting contribution to the literature on catastrophe insurance demand

• Comprehensive data set from the residual insurance market in Florida

• Empirical findings are consistent with the representative heuristic theory

• Important practical implications with regard to the catastrophe insurance cover

• Paper is written in a concise and understandable way
Comments and Suggestions

• The derivations in section 2 are quite brief and rather difficult to follow: Could show in greater detail how you get from Bayes’ Rule to the estimations for the disaster probabilities under the representative heuristic.

• The current model set-up directly describes the impact of past losses on the demand for homeowners’ insurance in Florida. Potential extensions:
  ▪ Calculation of implicit disaster probabilities under the representative heuristic
  ▪ Comparison of implicit with true disaster probabilities (from historical experience)
  ▪ Determine the weighting parameters placed on prior and posterior distributions
Discussion III

• Motivation for the estimation of a pooled OLS and a fixed effects model?

• Why does the model contain year dummies for 2006 and 2007?

• Are the standard errors robust with regard to heteroskedasticity/autocorrelation?

• Data is from the residual insurance market: Might look at main market, too.

• Section 4 appears to be slightly out of place. Could be integrated in Section 3

• Could aim to confirm the results with data from another state (e.g., California)