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Indemnity of magical thinking

Garry Marr, Financial Post

Do you make financial decisions based on superstitions? Tell the truth. Were you fingers crossed? There is always that thought lurking in the back of your head: If you don't buy insurance for that trip, you know something is going to happen and you'll lose your money. If you do buy insurance, you'll never use it .

"That's magical thinking," according to Eric Dolansky, assistant professor of marketing at Brock University in St. Catharines. "Magical thinking is the idea that two rationally unrelated events are related."

It's both simple and illogical. You think to yourself, "If I don't bring an umbrella with me today, it's going to rain." Deep down, people know that makes no sense, but their actions speak differently.

The Ontario professor, with Robert Schindler and Grant Adams, both of Rutgers University in Camden, N. J, looked at the issue of magical thinking and how it applies to personal finance. One key issue they explored was whether insurance coverage "helps you avoid tempting fate."

According to their studies, 44% of Americans admit to one superstition, while 74% say they read their horoscope. There is no reason to believe Canadians behave differently.

"There was a study done 20 years ago that showed people were reluctant to exchange lottery tickets," Mr. Dolansky says. "We each have the same odds of winning the lottery, but we feel doing that will change the odds. You may be giving away the winning ticket, but you may also be receiving the winning ticket."

In the first part of the new study, the New Jersey professors interviewed participants after giving them a scenario where they had just moved to Florida but forgot their crystal punch bowl. A cousin from New Jersey offers to bring it to Florida. Some participants were told the bowl was insured for breakage, others were told it was not.

"What we found was amongst those people who rate their superstition as high, they found it less likely the bowl would break if they had insurance," Mr. Dolansky says. "We have this magical thinking that insurance protects an object and not just potential loss."

But it's not just people who admit to being superstitious who are susceptible to this train of thought. The St. Catharines professor took the study a step further. He gave two groups of people a set of words with missing letters and asked them to complete the words. One set of words contained superstitious phrases such as "good luck" and "knock wood." The other set did not.

"We gave them the punch bowl scenario and what we found is people who had the list of words with superstition meanings exhibited the same behaviour as people who actually [said they] were superstitious. Just thinking about it seems to make you behave superstitiously," Mr. Dolansky says.

He says this type of logic could potentially be used to drive a slew of other insurance-like services, such as warranties.

"I'll give you an example: I buy a $1,100 Sony TV and the two-year extended warranty is $190. Do the math; in order for this to be financially rational, one of 12 Sony TVs has to break in the first two years," Mr. Dolansky says. "These warranties are much more expensive than they are worth."

Can't the same argument be made for life insurance? Are we not insuring ourselves for way more risk than we actually face?

Mark Halpern, a certified financial planner who runs illnessprotection.com, doesn't make any apologies for his advertising campaigns that focus on worst-case scenarios, such as widows, widowers and children left with nothing because there was no insurance.

Mr. Halpern admits that a few years back he returned to an electronics retailer with a broken stereo only to find he had not purchased a warranty. He had to buy a new stereo, so this time he bought the warranty. Guess what? Eventually the car gave out, but not the stereo.

But he says you can't treat life insurance the same way. Only 2% of people who buy term life insurance -- the term is the length of time the policy is valid -- ever get paid out. "Everybody else lives a nice, long life," he says. "But you either love somebody or you don't, and if you do, you have to have insurance."

For $50 a month, Mr. Halpern says a 40-year-old healthy non-smoker can get a $500,000 life insurance for a 20-year term.

But according to Mr. Dolansky's study, most people believe that means they'll never collect that money once they buy the policy.

In case you're wondering, Mr. Dolansky has kids and life insurance. He didn't say whether superstition contributed to his purchase decision.

Dusty wallet If you work for an employer who offers group insurance plans, buy as much insurance as you can at group rates. That goes for disability insurance and life insurance. Most insurance brokers can't get you a better rate. Of course, brokers will advise you that you probably need more insurance.

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