Minimum levels of insurance protection

Summary of roundtable: 6 December 2023

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15/02/2024

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Introduction

In the report, the Great Risk Transfer, the IFoA recommended that:

> *"government, in consultation with the IFoA and others with technical and industry expertise, determines the appropriate minimum level of insurance protection needed by all – including low-income families – to be financially resilient to specific risks and unexpected shocks."*

The purpose of this roundtable was to address this recommendation in more detail, and consider how a minimum level of insurance protection could be realised.

Questions that the roundtable considered included:

- Which types of insurance cover should be seen as essential for financial resilience?
- To what extent is low take up a supply side or a demand side issue?
- What 'levers' can Government and regulators pull to increase take up of insurance to a defined level?
- What is the role of mandation? How has this worked in other spaces?
- How can insurers be supported to take on risks that they would not currently?

The following people participated in this roundtable, which was held under Chatham House rules.

Attendees

Frankie Galvin	Fair by Design
Duncan Minty	Independent insurance ethics consultant
Matt Brewis	Financial Conduct Authority (FCA)
Jake Attfield	Fair4All Finance
Jacqui Draper	Government Actuaries Department
Chris Lees	Money and Mental Health Policy Institute
Richard Purcell	Pacific Life Re
Zoe Woodroffe	Gen Re
Peter Hamilton	Zurich
Leonora Miles	Macmillan
Dr Konstantinos Chalkias	Academic

Joe Ahern and Laura Osborne from WPI Economics presented at and facilitated the discussion.

What are the insurance gaps people face?

Insurance is used by most households to manage the financial impact associated with a range of risks. According to the FCA Financial Lives Survey, in 2022:[i]

- 84% of all adults held at least one general insurance product.
- About 61% of adults have contents insurance.
- Only 29% have life insurance, 13% have critical illness cover, and around 6% say they have income protection.

The data also shows **that just over half (53%) of all adults did not hold any protection (or health) products.** We know from other research that low take up of contents insurance is a particular problem for certain groups, for example **around 37% of low-income renters have contents insurance**.[ii]

Participants in the roundtable highlighted evidence that **many people have cancelled policies during the cost-of-living crisis**, where these products are optional purchases (such as contents or life insurance). This means that the current situation is likely to be worse than the 2022 Financial Lives Survey data.

Furthermore, it was noted that **an insurance gap can also be about the quality and level of cover, rather than just whether a policy is in place.** For instance, there has been a rise in motor insurance policies which, while ticking a legal box of providing third party liability cover, don't provide for standard cover items such as windscreen damage. These products can leave policyholders exposed to short term financial shocks, but they have risen in popularity during the cost-of-living crisis due to being cheaper. Price Comparison Websites help to drive this dynamic, with their focus on cost above criteria related to product quality.

How can we define minimum levels of cover?

Insurance can be a useful way for households to protect themselves against short term financial shocks. But a decision not to purchase insurance is not a problem per se. The question is **whether current levels of take up meet societal expectations** of the cover society thinks people should have in place. *Defining* minimum levels of cover was a key question for the roundtable.

Firstly, there was broad acknowledgement that the type and level of cover that an individual needs varies significantly based on their personal circumstances. This includes:

- **Assets** – whether they own a home or possessions that need to be insured.
- **Dependants** – would there be people who would rely on them if they were ill, unable to work, or passed away.
- **Legal requirements** – e.g. someone who drives to work will need compulsory third-party motor cover.

In addition, people may have other means of protecting themselves against short-term financial risks, such as savings buffers, and/or state benefits. Furthermore, people may have access to cover through their employer that means they don't need to buy a personal insurance product. Given the proportion of the population with very small savings buffers (over a quarter of adults have less than £100 in savings) it was agreed that many more could benefit from insurance coverage.[iii]

Finally, **concepts such as *essential* are values-based questions**, which require judgments about personal responsibility and depend on the degree of social solidarity between members of society. As a result, there is a need for a societal dialogue on these questions, particularly in cases where increasing insurance take up requires cross subsidy between policyholders.

One practical example raised was **the Pensions and Lifetime Savings Association (PLSA) Retirement Living Standards**, which set out people's required income in retirement, based on a set of assumptions. There are Minimum, Moderate, and Comfortable standards for couples and single people. These are based on certain assumptions, including that retirees do not have any housing costs. Something similar could be developed looking at insurance.

Figure 1: PLSA Retirement Living Standards

Source: PLSA Retirement Living Standards[iv]

What are the barriers to increasing insurance coverage?

Barriers to insurance take up can broadly be divided into ***supply*** **and** ***demand*** **side barriers**. Some of the key barriers that occur across different product types are described in the diagram below.

Figure 2: Supply and demand side barriers

Barriers to insurance take up

Supply

- Price of cover
- Exclusions for certain types of claim
- Restrictions on cover for certain groups
- Cost of cover for certain groups
- Complexity of cover

Demand

- Consumers not valuing insurance
- Lack of understanding/awareness of insurance products
- Poor perception from previous experience or social norms

Source: WPI Economics analysis

In order to boost insurance coverage, it is first important to **identify whether further take up is hampered by supply or demand side barriers,** as different policy solutions are required depending on the barriers faced.

A number of barriers were identified by roundtable participants. It was noted that as well as segmenting the population based on their insurance *need*, it is also **critical to segment people based on the *barriers* that they face.** For example, price is likely to be a greater barrier to lower income households, particularly where these groups may face higher premiums. In addition, certain groups will have clearer distribution routes or nudges towards getting cover, such as being offered life or buildings insurance alongside a mortgage.

Attendees highlighted **the effect of granularised risk pricing on distribution**, causing insurers to prioritise channels which lead them to higher income and / or lower risk consumers. As a result, while there may be insurance demand from low-income households, and products available, distribution routes which service them may be less well developed.

Trust was seen as a significant barrier to take up among certain groups. There is a widespread public view that insurers are very hesitant to pay claims, despite insurance payout rates being consistently higher than public perception.[v] Furthermore, many people feel they don't sufficiently understand the cover they are buying, and so disengage from buying insurance because they don't feel it will protect them.

As well as considering how to increase insurance take up from current levels, it is also **important to encourage current** policyholders **to retain their cover.** This is particularly the case during times of rising costs, such as the present cost of living crisis, where people might choose to cancel an optional purchase but in doing so risk a greater financial impact further down the line.

Ultimately, insurers can't be forced to provide products they do not view as commercially viable. Nevertheless, **it was noted that the industry as a whole has a responsibility to act in the long-term interests of its customers**, rather than only pursue profit in the short term.

In the coming decades, climate change will cause overall insurability issues for products which cover natural catastrophe related risks. Roundtable participants made the case that this requires us to **think about resilience and adaptability to climate change** as being at the core of ensuring there are adequate levels of insurance protection, taking a systems-focused view of the whole picture.

Policies to increase insurance coverage

There are a range of public policy options to increase insurance take up. For example, **insurance to protect third parties is mandatory in the UK in many instances**, such as motor and employers' liability insurance. Mandation addresses demand side barriers to insurance take up.

Sometimes, low insurance take up occurs because it is either impossible or excessively costly to supply that insurance product to people who face a certain level of risk. **Flood Re (see below) is an example of a successful policy intervention to socialise risk** in a way that ensures households at high flood risk can access cover. Flood Re is an example of a 'Protection Gap Entity'[vi] or state backed reinsurer.[vii]

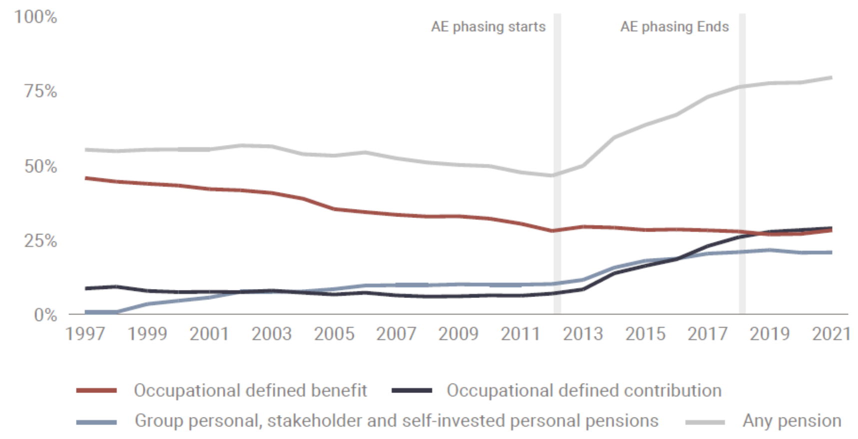
Case study: Flood Re

Flood Re is a collaboration between insurers and the government by which the properties most at risk of flooding in the country have their premiums cross subsidised through a levy on all home insurance policies. This cross subsidy is administered by a reinsurer – Flood Re - underpinned by the Water Act 2014. The legislation stipulates that Flood Re will exit the market in 2039.

Before Flood Re existed, 9% of households who had made flood claims previously could get quotes from two or more insurers. Flood Re means this is now 100% of households. In addition, four out of five eligible households saw a greater than 50% premium reduction in their home insurance as a result of Flood Re.

Defaults were highlighted by participants as a potential route to boosting insurance take up through addressing demand side barriers. For example, auto enrolment mandates employers to provide a workplace pension to their employees, and defaults employees into contributing part of their salary too. This has had a significant impact on pensions saving participation.

Figure 3: Proportion of employees with a workplace pension by type of pension



Source: ONS[2]

It was noted by some participants that **auto enrolling people into a protection product through their employer** could act as a route to improving take up. However, this would carry far greater complexity than pensions auto enrolment given different claims risk profiles across each sector.

Defaulting tenants into **having contents insurance by including a small premium as part of rent payments** was also mentioned in the discussion, and something being actively explored by social landlords. While this has potential, there are a whole range of legal and regulatory implications that would need to be addressed.

Regulators play an important role in protecting consumers from detriment in their interactions with financial services companies. It has been suggested by a range of consumer and civil society groups, that the FCA should also be required to **have regard to financial inclusion** as part of its remit, that is to support wider access to certain products. This was rejected as part of the recent review into the regulatory objectives, but should be explored again in the future according to some roundtable attendees.

Although previous attempts to design **simple insurance products** were not successful, arguably due to the stringent rules imposed by the Sergeant review,[viii] looking again at introducing a similar system could provide a route to insurance take up for certain groups. Some attendees noted this could help to overcome concerns from some consumers about trust in providers and product complexity.

In order to address barriers around granular underwriting excluding certain groups, **bundling customers into a single pool from an underwriting perspective** was seen as a potential route to improving access in certain instances. The insurance secured for customers of the Motability scheme was seen as a positive example here.

Interventions such as Flood Re could have potential to boost take up in certain areas, although care needs to be taken around how and with which product lines these are implemented. Previous work by WPI Economics looked to design a framework to be able to determine where these interventions are appropriate.

Figure 4: 'Re' scheme decision making framework

Criteria	Key question
Public policy Imperative	Is there a well-articulated public policy imperative for this scheme?
Proportionality	Is the operational and opportunity cost proportionate to the intervention?
Feasibility	Is it a feasible and well targeted intervention?
Moral hazard	Does it create a risk of moral hazard?
Adverse selection	Does it create a risk of adverse selection?
Fairness	What are the distributional impacts of the intervention?
Exit approach	Is there a viable exit strategy, and what strategic role can the 'Re' scheme play?
Potential alternatives	Can better alternative policies achieve the intervention's objectives?

Source: WPI Economics[ix]

It was agreed that often these schemes work effectively when they operate in tandem with two things. Firstly, measures which help to boost demand such as defaults or mandation, as this helps to bring a broad range of people into the risk pool, mitigating the potential for adverse selection. Secondly, actions to improve overall levels of resilience to claim events.

Conclusion and IFoA proposed next steps

This discussion helped to shine a light on some of the key issues around establishing a minimum level of insurance protection, as well as a series of potential areas for further exploration. The IFoA plans to take forward and further explore a number of these, including:

- **The interaction between aggregating demand and risk sharing –** how can 'Re' schemes and mandation or defaults complement each other to address issues around low take up. By creating a bigger pool of risks, boosting demand for insurance products through mandation or defaults can help address concerns about adverse selection. The combination of these two interventions may be a particularly strong route for improving access to protection insurance, where there are concerns about both low take up and adverse selection.
- **How can we take a product-based approach to defining minimum standards -** product by product, how can we determine the minimum level of protection required by different groups of people? Establishing the minimum level of protection society aims to achieve is required before introducing strategies to address take up (one of which *could* be mandation). The Retirement Living Standards developed by the PLSA could be an important example to build on.
- **Strategic risk management and insurance take up** – more broadly, there is a need ensure that we integrate the management of the underlying risks that society faces into our thinking about insurance take up. This could include considering how we do this across climate change, cyber risk and other risks. Flood Re already looks to do this as part of its various Transition activities, such as Build Back Better.[x]
- **Social dialogue, essential products, and risk pooling** – many of the questions addressed as part of this roundtable are values-based decisions for society as a whole, rather than commercial or technical ones. As a result, ways to engage the public in these questions should be considered, such as through citizen assemblies.

[i] https://www.fca.org.uk/publications/financial-lives/financial-lives-2023
[ii] https://wpieconomics.com/site/wp-content/uploads/2019/07/WPI-Economics-Aviva-Contents-Covered-JULY-2019-FINAL.pdf
[iii] https://maps.org.uk/en/media-centre/press-releases/2022/one-in-six-uk-adults-have-no-savings#
[iv] https://www.retirementlivingstandards.org.uk/
[v] https://www.drewberryinsurance.co.uk/knowledge/research/2015-protection-survey
[vi] https://www.bayes.city.ac.uk/__data/assets/pdf_file/0020/420257/PGE-Report-FINAL.pdf
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