Institute and Faculty of Actuaries

FAIR BY DESIGN
Ending the extra costs of being poor

The hidden risks of being poor: the poverty premium in insurance

A report by the Institute and Faculty of Actuaries and Fair By Design

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About the Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers. We act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public and social policy issues. Actuaries working in insurance can be involved at all stages of product development and in the pricing, risk assessment and marketing of the products. Actuaries' unique insight can facilitate a greater understanding of the causes of the poverty premium within the insurance sector and support the identification of solutions to address it.

About Fair By Design

Fair By Design (FBD) is dedicated to reshaping essential services, such as energy, credit and insurance, so that they don't cost more if you're poor. People in poverty pay more for a range of products, including energy, through standard variable tariffs; credit, through high interest loans and credit cards; insurance, through postcodes considered higher risk; and payments, through not being able to benefit from direct debits as they are presently structured. This is known as the poverty premium.

We collaborate with regulators, government, and industry to design out the poverty premium. Our Venture Fund provides capital/funding to grow new and scalable ventures to innovate the market and design out the poverty premium. Ascension manages the Fair By Design Fund.

Fair By Design is run by the Barrow Cadbury Trust on behalf of a group of foundations.

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Executive Summary

This research from the Institute and Faculty of Actuaries and Fair By Design examines the poverty premium in insurance.[1] It explores the prevalence, key drivers and impact of the premium on the low-income consumers who experience it. We have sought to understand and reflect the wide range of perspectives about this important topic. This has included discussions with regulators, civil servants, insurance practitioners and consumer advocates. Through engagement with consumers with 'lived experience' of poverty, we have ensured that the inter-relationship between the poverty premium and insurance is reflected. We have made a number of recommendations to mitigate the poverty premium as it relates to insurance. The key objective of this collaborative research is to shine a light on a complex issue and suggest ways to address it constructively.

The prevalence of the poverty premium

The average household in poverty pays almost £500 a year extra for essential services such as credit, energy and insurance.[i] In recent years, insurance has evolved to become the biggest contributor to the poverty premium in the UK.[ii] Given current trends in insurance pricing, especially the individualisation of risk, this is set to increase.

Vulnerable and low-income consumers can present a higher risk to insurers, due to a range of factors often outside the consumers' control. These individuals are quoted higher premiums for insurance, which they are less likely to be able to afford, or they are refused cover altogether.

As a result, those who need insurance the most are often the ones who are least able to access it and the protection that it affords. Insurance is designed to provide financial resilience and peace of mind in the face of an unexpected financial shock. Income shocks, such as illness, bereavement or unemployment, are among the main reasons people fall into problem debt.[iii]

Recent research by the University of Bristol's Personal Finance Research Centre found that some protected characteristics are associated with increased exposure to certain poverty premiums.[iv] For example, Bangladeshi, Pakistani and Black people are disproportionately likely to live in deprived areas – which can impact on the cost of insurance premiums. The research also found that people from Black, Asian and other ethnic minority[2] households, lone parents, and disabled people were less likely to hold any insurance. This 'going without' is often the alternative to paying the poverty premium and can signify a level of poverty or exclusion from the market.[v]

1 The poverty premium refers to the extra costs incurred by low-income households when purchasing the same or similar essential goods and services as households on higher incomes.

2 The University of Bristol's research was published in February 2021. This was prior to the publication of the report from the **Commission on Race and Ethnic Disparities** which found aggregated terms such as 'BAME' to be unhelpful and made a recommendation for ending their use.

Lived experience of poverty

To understand the lived experience, charitable organisation Toynbee Hall facilitated a workshop with a panel of consumers with lived experience of poverty. Discussions at the workshop enabled us to learn about panel members' experiences with, and perceptions of, a range of insurance products, including car insurance, home and contents insurance, individual appliance insurance, life insurance, travel insurance and income protection products.

Many panel members reported barriers to insurance which had prevented them from gaining the peace of mind that insurance is designed to provide. These barriers included complex or opaque products, penalties for paying monthly rather than annually for certain types of insurance, loyalty penalties, and being offered unaffordable premiums or refused insurance altogether based on factors that were outside of their control.

Panel members felt they had been treated unfairly when they were charged more or refused insurance. This was particularly the case for motor insurance, given that holding this type of insurance is a legal requirement.

There was a sense among panellists that overcoming the barriers to affordable insurance is hopeless and that their options were limited to:

- Purchasing a very expensive product
- Purchasing a product that was unsuitable for them
- Both of the above
- Having to forego that type of insurance altogether.

This negative view of insurance impacted panellists future behaviour, with some going so far as to say they were hesitant to get any type of insurance in the future, leaving them without any protection.

Increasingly individualised risk pricing

The concept of risk pooling is fundamental to insurance. By combining the risks of all policyholders into a risk pool, the premiums of lower-risk policyholders cross-subsidise higher-risk policyholders who are more likely to make a claim. Advances in technology, and a growing sophistication in data science techniques, have enabled insurers to set premiums that are more reflective of a consumer's individual risk profile.

Across a range of insurance products, there has been a trend away from broad risk pools and toward more granular pricing based on an individual's specific rating factors (ie their risk characteristics). Risk-based pricing offers a range of benefits for consumers, including the potential for consumers with a lower risk profile to be offered a lower premium. It can also have the additional benefit of incentivising positive behaviours that reduce risk and benefit society as a whole, for example discounts on motor insurance for safer drivers. Insurers also reported that risk-based pricing has enabled them to innovate to provide insurance to certain consumer segments that may have previously been excluded from the market.

While there are a range of identifiable benefits, a move toward individualised risk-based pricing and away from risk pooling also creates a range of negative outcomes for low-income and other vulnerable consumers. Low-income consumers are more likely to be offered a higher premium, or be refused insurance altogether, as a result of the higher risk they present. For example, consumers living in an area with a high crime rate are likely to be charged higher premiums for household and motor insurance, because they are assessed to be at greater risk of their house being burgled or their car being stolen. These consumers are also less likely to have the means to be able to reduce their risk. As a result, those arguably most in need of insurance are forced to opt out of cover, reduce cover, or 'self-insure'.

‘Fairness in insurance’

Insurers, consumer advocates and consumers have differing opinions about what is meant by ‘fairness in insurance’. Some within the insurance sector view individualisation of risk to be fairer, as a consumer’s premium reflects their level of risk. In contrast, consumer advocates and consumers often viewed fairness to mean that all consumers can access an affordable level of cover that ensures they are protected from unexpected shocks. The prevalence of the poverty premium identifies the need for a broader discussion about what fair and acceptable outcomes look like for consumers. We hope that this debate helps to develop discussions further and engages those with different views and experiences to focus on possible solutions.

Many raised the point that further consideration is needed about the role insurance should play in protecting those most at risk of experiencing financial hardship. It was a commonly held view that the government, alongside the Financial Conduct Authority (FCA), was responsible for facilitating ‘fair’ and acceptable outcomes and ensuring an insurance safety net is available to all households.

We consider it timely for the government to consider its role in addressing the poverty premium in insurance and to take forward our findings with the FCA and industry. We note that since our research was conducted, the FCA has launched an important consultation process on a proposal for a Customer Duty principle which will be relevant to this report’s findings.

Insurance pricing and the Equality Act 2010

In addition to concerns about the fairness of individualised risk pricing, consumer advocates expressed concerns about the interaction between the Equality Act 2010 and insurance pricing. The Act exists to protect people against discrimination, harassment or victimisation in employment, and as users of private and public services.[vi]

Consumer advocates were concerned that the negative outcomes of risk-based pricing, including low-income and vulnerable consumers being quoted a higher premium, or refused insurance altogether, may be in breach of the Act, either directly or indirectly. Consumer advocates stated that they and consumers are not able to obtain enough information from insurers about how assessments are made, or what data sources have been used, to satisfy themselves that a breach of the Act has not occurred.

Through a 2019 Treasury Select Committee inquiry the FCA found that when asked to explain how their pricing systems and practices complied with their obligations under the Act, several firms were not able to provide an immediate answer about:

- The algorithms that sit under the firm’s pricing
- How the firm compiled that data
- Whether the firm had tested if each piece of data was compliant with the requirements set out under the Act.[vii]

In response to this, many consumer advocates have called for the FCA to ensure that insurers are using risk-based pricing in a way that does not breach the Act. This aligns with the FCA's responsibilities under the Public Sector Equality Duty and with the FCA's wider work on fairness in insurance pricing. In contrast, when concerns were raised with some practitioners in the insurance sector, they responded that protected characteristics are not included in underwriting decisions and that they were satisfied that pricing practices comply with the Act's stipulations.

Products to address the poverty premium

As part of this research, a number of alternative approaches and products were suggested by stakeholders to address the poverty premium. These include:

- Ending the monthly payment premium paid by people who cannot afford to purchase an insurance product in one payment
- Creation of government agreed reinsurance schemes[3] similar to Flood Re, such as a Postcode Re or Health Re
- Creating a range of clear and simple products, as recommended by the Sergeant Review in 2013 but not adopted by the insurance industry
- Auto-enrolment through employers, enabling people to access group insurance
- The introduction of microinsurance for some of the most common risks people face.

3 Reinsurance can be described as insurance for insurance companies. Reinsurance is the practice whereby insurers transfer portions of their risk portfolios to other parties to reduce the likelihood of paying a large obligation resulting from an insurance claim.

Recommendations

The poverty premium in insurance means that low-income households pay more for insurance or are prevented from accessing the protection that insurance can provide. This negatively impacts on their overall levels of financial resilience and their ability to protect themselves from financial shocks which has economic implications for the whole of society; where low-income households are unable to be financially resilient they are more likely to become reliant on state benefits.

We recommend the following:

1\. The government determines a minimum level of protection needed by all, including low-income families, in order for them to remain financially resilient to specific risks and unexpected shocks.

2\. In line with the recommendation of the Treasury Select Committee, the FCA should support government in this work by undertaking a study into the regulatory outcomes the market is currently delivering for low-income consumers. This study should also consider the interaction between the Equality Act and insurance pricing.

3\. The government should look at its role in facilitating the delivery of a minimum level of protection through the use of social policy interventions, such as extending the Flood Re model of insurance for different insurance product lines, to cover low-income and vulnerable consumers who are priced out or excluded from the market.

4\. The government should work with the FCA and industry to determine what changes are needed within the public policy and regulatory environment to support and incentivise the insurance sector to develop and deliver innovative solutions to address the poverty premium.

Stakeholder engagement

To inform this report, we engaged with a wide range of stakeholders to ascertain how they understand the poverty premium as it relates to insurance and its impact, what the key trends and developments are that have contributed to it, and what their views are on how it should best be addressed.

We held a stakeholder roundtable which was attended by representatives from the following organisations:

- Citizens Advice
- Social Market Foundation
- Cura Insurance
- Alea Risk
- Swiss Re
- Access to Insurance Initiative (International Association of Insurance Supervisors)
- Money and Mental Health Policy Institute
- Competition and Markets Authority
- Chartered Insurance Institute
- All-Party Parliamentary Group for Insurance and Financial Services
- Financial Conduct Authority (FCA)
- Government Actuary's Department
- Financial Services Consumer Panel
- New City Agenda

We held discussions with the following individuals/organisations:

- HM Treasury
- Craig Tracey MP, Chair of the APPG on Insurance and Financial Services
- Financial Conduct Authority
- Nick Reilly, Government's Access to Insurance Working Group
- Shân Millie, Bright Blue Hare
- Nick Hurman, Pension Quality Mark and Hurman Consulting
- Johnny Timpson, Scottish Widows, Cabinet Office Disability Champion for the Insurance Industry and Profession, Chair of Government's Access to Insurance Working Group
- John Godfrey, Legal and General
- Raluca Boroianu-Omuru, Association of British Insurers
- Jackie Wells, Financial Services Consultant
- Rosalie Hayes, National Aids Trust
- Fiona Macrae, Travel Insurance Facilities Group
- Laurie Edmans, Financial Inclusion Commission
- Andrew Wilkinson, Moneysworth
- Leonora Miles, Macmillan Cancer Support
- Shayne Halfpenny Ray, Secretariat to the APPG on Financial Services and Inclusion

Views and feedback were also sought from the following IFoA member groups throughout various stages of the report's development:

- General Insurance Board
- Life Board
- Health and Care Board
- Inclusive Insurance Members Interest Group

Foreword by Liz Barclay, Chair, Fair By Design Steering Group

We are all encouraged to take responsibility for our own financial health, be that saving for a rainy day or making sure we have enough to live on when we retire. Increasingly, we are also encouraged to protect ourselves and our families from future risks, not to rely on the state, and to look to the market for our needs.

However, the market may not want us as customers because we pose too high a risk, due to past ill health for example. What happens if you can't afford to move to a different postcode deemed less risky by your car or household insurer? What happens if you can't find employment that gives you enough money to pay for insurance, or to pay up front so as to avoid the additional charges that come with paying by instalments? These are major problems that will only get worse as we move from a pooled risk approach in insurance to one of individualised risk.

People in poverty already pay a premium. The average household in poverty pays almost £500 a year extra for life's essentials, such as credit, energy and insurance.[viii] A recent Fair By Design study of 1,000 low income households found that they are spending the equivalent of 14 weeks of food bills just to access the same essential services as people who are better off.[ix] This study also showed that the elements making up the poverty premium have evolved over the last five years. Insurance has overtaken energy as the biggest contributor to the poverty premium in the UK, and it is set to increase, because of greater personalisation of pricing and reduced risk-sharing.

Despite being encouraged by successive governments to take responsibility for our own financial futures, many of us fall into one of three camps:

1. Struggling to be able to afford appropriate insurance as we're deemed to be a higher risk
2. Not being able to access insurance that meets our needs properly due to policy exclusions or being unable to afford to pay for a comprehensive product
3. Being locked out of insurance altogether.

Those who need insurance the most are the ones least able to get it. This is concerning given that we know that income shocks such as illness, bereavement or unemployment are among the main reasons people fall into problem debt.[x]

According to StepChange Debt Charity, 14 million people in Britain experience at least one income shock within a 12-month period, with 4.5 million people experiencing two or more. Millions of pounds have to be spent on debt advice, bankruptcy and debt write-offs, as well as government benefits and added pressure on the health services. Wouldn't it be better to tackle these issues upstream with affordable, appropriate protection for all?

For these reasons I welcome this report. It is the result of a real partnership between two organisations determined to shed light on the issues faced by people on low incomes and in vulnerable circumstances. I want to say a special thank you to those with lived experience of poverty who gave their time to ensure this report is based on the reality of what it means to be poor in the UK today, and trying to access insurance that meets their needs, at a price they can afford.

Many of us who operate in policy-making and regulation can rationalise why the world is as it is today and why markets have developed the way they have. However, many people on low incomes and in vulnerable circumstances have only their own experiences of trying to engage in the insurance market to go on, and that experience is often one of high prices, and products and services not designed for them, as the insurance market continues to chase the 'healthy and wealthy' – the 'best risk'.

The issues that this report brings to light are difficult and span the remits of government, regulator and industry. But people's lives are messy and don't fit neatly into institutional remits. We need solutions that fit people rather than institutions. We need collaboration and leadership. I hope this report, and the collaborative approach that went into it, are just the start of the dialogue and action.

Liz Barclay, Chair, Fair By Design Steering Group

Foreword by David Heath, Chair of the IFoA Policy Advisory Group

I welcome this report into a complex but important topic of public concern.

Advances in technology and a growing sophistication of data techniques have enabled insurers to more accurately price for risk. Increased personalisation, or pricing for a consumer's individual risk, has provided benefits for consumers and society alike, including lower premiums for lower-risk consumers and innovation on the part of insurers that has enabled them to insure people and risks for which they were previously unable to provide. However, increased personalisation has also led to negative outcomes for some groups of consumers, particularly vulnerable and low-income households who, often due to a range of factors outside their control, can present a higher risk to insurers. As a result, these householders are quoted higher premiums for insurance which they may not be able to afford, or they are refused cover altogether.

From my independent perspective, I am pleased that the IFoA, as a professional body with a public interest mandate, can offer insights and a platform to debate these key issues that are increasingly creating societal change. The IFoA is rightly at the heart of engaging and debating an issue of public importance.

This report provides a powerful overview, offering a number of valuable and different perspectives. Not all the viewpoints set out in this report are shared, but it is essential they are aired and debated. We intend this report to act as a launch pad for a broader debate about the poverty premium and to set out some thoughts and suggestions on possible solutions.

The higher costs, which we term 'the poverty premium', create a barrier for low-income households to access the protection that insurance provides against financial hardship, and prevents them building resilience in the face of financial shocks such as severe ill health or injury, a car accident, a home burglary, or the breakdown of a major household appliance, such as a boiler.
The advent of coronavirus has brought into sharp relief the limited financial resilience of low-income families. While the poverty premium existed in insurance prior to the Covid-19 pandemic, the job losses and other negative economic impacts precipitated by the pandemic are likely to have exacerbated its incidence and impact across our society, and will continue to do so in the future.

As the government commits to the 'build back better' agenda, it should consider how it can help to create a more sustainable social and economic system that provides all households with easily accessible and affordable solutions to achieve resilience against financial shocks. Improving outcomes and financial resilience for low-income households has the potential to reduce the costs of state welfare, and enable these consumers to continue to pay their bills and purchase goods and services, benefiting our economy, their well-being, and society as a whole.

Building back better to ensure a more sustainable social and economic model in the wake of Covid-19 will require input from a broad array of experts and stakeholders. We welcome the opportunity to partner with Fair By Design in our efforts to further inform discussion on this topic. We are also

grateful to all the individuals and organisations that contributed to the report at various stages of development, particularly the Toynbee Hall panellists who shared their lived experience of the poverty premium. We spoke to a range of different stakeholders, including consumers and their advocates, regulators and insurers. Through these discussions, many different perspectives, particularly around ‘fairness in insurance’, were raised.

We consider this report to be an important step for the actuarial profession in its efforts to understand and draw attention to the poverty premium in insurance and the broader issues surrounding it, including how risks can be spread more evenly across society. We will engage with government, regulators and other stakeholders to identify where actuarial expertise can assist further consideration of this issue and support the development of appropriate solutions.

David Heath,
Chair of the IFoA Policy Advisory Group

The poverty premium in the insurance sector

In the UK, approximately 14 million people are in poverty. This equates to more than one in five of the population, including 4.6 million children and 1.3 million adults of pensionable age.[xi] These figures have been on the rise in the past five years and are expected to increase in light of job losses due to coronavirus. In April 2021, there were 6 million people receiving Universal Credit, a 98% increase – or near doubling – since March 2020.[xii] The economic impacts of Covid-19 are likely to be felt for some time.

Insurance provides households with protection against financial hardship. It helps build resilience in the face of financial shocks, such as an illness, car accident, home burglary or the breakdown of an essential household appliance (such as a fridge). However, low-income households are less likely to have insurance to protect them from such risks — 60% of households earning £15,000 or less per annum have no contents cover.[xiii]

Yet, arguably, insurance is the least well-documented and discussed element of what it means to be financially included in the UK today.

When discussing financial inclusion, Sir Sherard Cowper-Coles, past Chair of the Financial Inclusion Commission, stated, 'banking and payment services, savings, and affordable credit have come under the financial inclusion microscope, but insurance has been forgotten'.[xiv]

On average, low-income households in the UK pay an additional £490 a year across the full spectrum of essential goods and services, including insurance.[xv] This is known as the 'poverty premium' — the extra costs incurred by low-income households when purchasing the same or similar essential goods and services as households on higher incomes.

For low-income households, the cost of the poverty premium often acts as a barrier to purchasing insurance and prevents the product from acting as a safety net. Insurance is often more expensive for low-income households since these consumers:

- Are assessed by insurance companies to present a higher risk to insurers, often due to factors that are not fully within the consumer's control (eg their postcode or medical history)[4]
- Are less likely to switch provider, which results in paying a loyalty penalty[5]
- Are more likely to only be able to pay on a monthly rather than annual basis for certain types of insurance, which is often more expensive.[xvi]

When faced with one or several financial shocks, low-income households are likely to have a reduced capacity to replace or repair uninsured goods or belongings. Over 10 million households in the UK have less than £1,500 in savings.[xvii] This effectively establishes a latent poverty premium, where many have no choice other than to go without or to use solutions that are costlier in the long run, such as credit, or expensive alternatives, for example going to a launderette because they cannot afford to replace a washing machine.

A report from the University of Bristol's Personal Finance Research Centre found that, in 2019, area-based premiums, particularly car insurance, were the largest contributor to the overall premium.

Of those surveyed as part of the research, those who lived in a high-risk area paid nearly £300 per year more on average, if they had insurance, than those who lived in a lower-risk area.[xviii] As discussed further on, this is more likely to affect people with certain 'protected characteristics'.

There are also strong links between being on a low income and wider 'consumer vulnerabilities'[xix] that place consumers in a higher-risk category, or into a 'non-standard' grouping for risk assessments made by insurers.

The poverty premium and protected characteristics

Recent research commissioned by Fair By Design and carried out by the University of Bristol's Personal Finance Research Centre found that some protected characteristics are associated with increased risk of poverty in the UK and more likely to be exposed to certain poverty premiums.[xx] These include:

- Race
- Sex, in the case of single mothers
- Disability
- Age, where young workers are much more likely to be in poverty than other age groups.

Intersectionality plays a large role. This means that the more protected characteristics a person has, the more likely they are to be in poverty.

The evidence also points to certain groups with protected characteristics being more vulnerable to experiencing the poverty premium, even when compared to low-income households as a whole.

4 Links between low-income and wider vulnerabilities such as disability and illness are well documented. For example see: **https://www.bma.org.uk/media/2084/health-at-a-price-2017.pdf**

5 Following consultation by the FCA, new rules will come into force in 2022 to ensure renewal quotes for home and motor insurance consumers are not more expensive than they would be for new customers. This measure goes some way to addressing issues in the insurance market but falls far short of fully addressing the poverty premium issue.

For example, Bangladeshi, Pakistani and Black people are disproportionately likely to live in deprived areas – which can impact on the cost of insurance premiums. The research also found that people from Black, Asian and other ethnic minority[6] households, lone parents, and disabled people were less likely to hold any insurance. This 'going without' is often the alternative to paying the poverty premium and can signify a level of poverty or exclusion from the market.[xxi] As discussed below, the interaction between the Equality Act 2010 and insurance pricing has raised concerns from some stakeholders, including consumer advocates.

The coronavirus crisis has demonstrated that now, more than ever, is the time to address the poverty premium in insurance. Increasing the number of low-income households that can protect themselves from the inevitable ups and downs of life is instrumental to improving financial resilience among UK households.

Lived experience of the poverty premium

As part of our research, charitable organisation Toynbee Hall facilitated a workshop with a panel of "experts by lived experience (of poverty)".[7] Discussion at the workshop focused on panel members' experiences and their perceptions of a range of insurance products, including car insurance, home and contents insurance, individual appliance insurance, life insurance, travel insurance and income protection products.

Insurance is designed to provide financial resilience and peace of mind in the face of an unexpected financial shock, and for some panel members it had served this purpose. For many panel members, though, several barriers had prevented this sense of security. They reported these as including:

Complex or opaque products

A lack of clarity about what was covered by insurance was a common barrier, often because the product was considered to be too complicated. In some instances, participants even felt as though the seller deliberately misled or mis-sold to them. This led to negative experiences, such as fighting for pay-outs or viewing insurers as untrustworthy.

Penalties for paying monthly

Panel members reported the high cost of insurance to be a barrier. This was exacerbated by consumers being charged more for paying monthly for some types of insurance, rather than paying the full annual premium upfront. This practice was seen as unfair, as for many consumers there is little choice but to pay monthly because they cannot afford the upfront payment.

Loyalty penalties

Shopping around requires time, access to the internet and the ability to compare lots of different products that are often complex to understand. Being penalised for staying with an insurer was raised as an example of unfair pricing, with panel members raising the example of car insurance premiums being raised at renewal every year.

6 The University of Bristol's research was published in February 2021. This was prior to the publication of the report from the **Commission on Race and Ethnic Disparities** which found aggregated terms such as 'BAME' to be unhelpful and made a recommendation for ending their use.

7 Of the panel members:

- the majority of the panel were renting through the council or a housing association;
- roughly half of the panel had a car;
- roughly half of the panel had a medical issue such as thyroid problems, asthma, autoimmune problems, diabetes, depression and hearing problems.

Unaffordable premiums or refusal and perceived disadvantage

Panel members said they were quoted prices that either prevented them from taking out an insurance product or severely stretched them beyond their means. They felt that better off consumers had access to cheaper products, which they considered to be unfair. This was especially the case when there was nothing panel members could do about their situation, such as move to a different area, or the fact they had previously experienced a health condition.

> 'It's a bit like the hunger games. If you have money you survive.' Panel member

Panel members felt they had been treated unfairly when they were refused insurance. Some panel members also shared their experience of insurers refusing to sell them car insurance. In some instances, they stated they had been refused on the grounds hat they lived in a particular postcode in London.[8] Panel members found being turned down for car insurance particularly concerning given that holding motor insurance is a legal requirement.

There was a sense across the panel that overcoming these barriers to affordable insurance is hopeless and there is little that ordinary people can do to tackle them. Panel members reported feeling that their choices were limited to:

- Purchasing a very expensive product
- Purchasing a product that was unsuitable for them
- Both of the above
- Having to forego that type of insurance altogether.

This negative view of insurance impacted on their future behaviour, with some going so far as to say they were hesitant to get any type of insurance in the future, leaving them without any protection.

8 Panel members reported refusal based on their postcode, but it should be noted that the cost and provision of motor insurance is determined by a wide range of factors in addition to postcode, such as driving history and age.

Increasingly individualised risk

The great risk transfer

While the poverty premium exists across several essential goods and services, it is particularly difficult to address in insurance due to the complex pricing mechanisms used. Across a range of insurance products, there has been a trend towards increasingly individualised risk-pricing. This trend is part of a larger risk shift that has been occurring in recent years.

Many risks that were previously managed by institutions, such as the state, financial services providers and employers, have increasingly become the responsibility of individuals.

There has been a steadily evolving trend towards institutions providing consumers with more choice. However, this choice comes with more responsibility and individuals now have to understand and manage a range of risks that they did not need to worry about previously.[xxii] The IFoA is exploring this trend through its Great Risk Transfer campaign and is considering four distinct areas: pensions, employment, health and insurance.

The concept of risk pooling is fundamental to insurance. It involves combining the risks of all relevant policyholders into a risk pool. Traditionally, this means the premiums of lower-risk policyholders cross-subsidise higher-risk policyholders who may be more likely to make a claim.

Advances in technology, and a growing sophistication in data science techniques, have enabled insurers to set premiums more reflective of a consumer's individual risk profile. Across insurance, there has been a move away from broad risk pools and towards more granular pricing based on an individual's specific rating factors (ie their risk characteristics). Consumers who represent a higher risk to an insurer will be offered a higher premium, reflecting this risk, than consumers who represent a lower risk.

Positives and negatives of individualised risk pricing

A number of factors have contributed to increased individualisation of pricing. Firstly, by including a greater range of risk factors in the underwriting process, insurers can more accurately price for risk. Consumers with lower risk profiles can potentially be offered lower premiums. This has been made possible through increased availability of data, such as that collected through a telematics device or wearable healthcare technology.[9, 10] In some cases, this can have the additional benefit of incentivising positive behaviours that reduce risk and benefit society as a whole, for example safer driver discounts for motor insurance via telematics devices or specialist health insurance policies which allow consumers with diabetes to demonstrate how they are managing their illness so that premiums can remain lower.

9 A telematics device is an instrument, usually provided by an insurance company that is installed in a car to record information about driving behavior. Metrics include driving speed, braking speed, and distance driven.

10 Wearable heathcare technology includes electronic devices that consumers can wear, like Fitbits and smartwatches, and are designed to collect data of users' personal health and exercise. Fitness trackers are the most popular form of wearable technology and are equipped with sensors to keep track of the user's physical activity and heart rate. More advanced devices have the capability to monitor detailed clinical metrics such as blood pressure, heart function, glucose and insulin levels, medicine intake and blood oxygenation levels. These wearables go beyond measuring health, and provide a tool to help manage conditions that wearers are already known to have.

The ability of insurers to price according to an individual's risk profile has also enabled insurers to innovate to provide insurance to consumer segments which may have previously been excluded from the market. For example, it used to be nearly impossible for an individual diagnosed with HIV to access life insurance. However, advances in medical science have led to a greater understanding of many diseases, their treatment and their prognosis. This has enabled insurers to identify rating factors which allow them to differentiate levels of risk among individuals living with HIV.

Similarly, in many cases travel insurers did not previously provide cover to people with cancer. As insurers learn more about advances in treatment and diagnosis, they are better able to consider factors, such as treatment received, in the underwriting process and assess each consumer's risk on an individual basis.

To further support consumers, the British Insurance Brokers' Association (BIBA) launched a travel insurance directory for people with serious pre-existing medical conditions (PEMCs) in 2021.[xxiii] By signposting to the directory, firms that offer retail travel insurance will be supporting consumers with more serious PEMCs to better navigate the travel insurance market. Signposting was introduced to reduce the number of uninsured consumers who currently face a choice of not travelling, or risk having to pay significant costs, including medical bills.[xxiv] It also aims to prevent consumers from significantly overpaying for travel insurance. Despite these improvements, some consumer advocates reported that individuals with/who have had cancer still face barriers when seeking to obtain insurance at an affordable price, or obtaining it at all.

While there are identifiable benefits, increased individualisation of pricing reduces the impact of risk pooling and can create a range of negative outcomes, including for low-income consumers. Low-income consumers are more likely to be offered a higher premium as a result of the higher risk they present and are less likely to be able to afford it, or are refused insurance altogether.

For example, consumers living in an area with a high crime rate are likely to be charged higher premiums for household and motor insurance,[xxv] because they are assessed to be at greater risk of their home being burgled or their car being stolen. These consumers are also less likely to be able to reduce their risk, either because certain risk factors are outside of a person's control, such as a disability, or because they do not have the financial means to do so. The impact is that those arguably most in need of insurance are forced to opt out of cover, or reduce cover and 'self-insure'.[xxvi]

Transparency for the consumer

Should a consumer think that an insurer's risk assessment of them has been based on an unreliable or out-of-date source of information, they are able to challenge the insurer's decision. In practice, however, consumer advocates have reported that consumers find this very difficult, as insurers typically provide little information about how the assessment has been made or what data sources have been used. Many consumer advocates called for greater transparency by insurers to make it easier for consumers to understand and challenge their individual risk assessments. However, this information is largely viewed as commercially sensitive and insurers are therefore not required to share it.

> Consumers and their advocates have reported that they cannot assess whether a high or unaffordable premium, or an insurer's decision not to offer cover at all, is reasonable or fair. They believe that this leaves them in a lose-lose situation – unable to sufficiently prove a market failure to the government and regulators, and unable to take any legal action.

Pooled versus individualised risk

To address these negative impacts, some stakeholders have called for a refocus towards risk-pooling and limits on the extent of individualisation in pricing. Specifically, adapting pricing models so that the weighting given to rating factors outside a consumer's control, such as their postcode or certain health conditions, is limited or restricted.

As a way of seeking to align consumer outcomes with public policy objectives, government could impose restrictions on information that insurers can use when determining a consumer's risk profile. For example, in 2011 the European Court of Justice ruled that the use of gender in the underwriting process represented gender discrimination. From December 2012, gender was banned as a risk factor in insurance pricing and insurers can no longer offer different premiums on the basis of gender. This had a notable impact on the pricing of term life insurance. Mortality risk is a key driver in the pricing of term life insurance, and at any given age women have lower average mortality rates than men. As women have a lower average risk of dying during their insured term, they paid less for these products prior to the ban. However, following implementation, the gender neutral premium for term life insurance is much closer to the previous male premium, since a larger proportion of the risk pool is male. The average price drop that has been offered to individual male consumers is smaller than the average price increase individual female consumers have experienced.

This example highlights that limits on risk-based pricing do not guarantee improved outcomes for all consumers and can have the unintended consequence of leaving some consumers worse off. Given this,

it is imperative that government, regulators and a broad range of stakeholders work together to find a practical way forward. This collaboration will reduce the risk of unexpected and unintended consequences.

For society as a whole, there are advantages and disadvantages to both broader risk pooling and increased individualisation when pricing insurance. It is important that government consider the trade-off between the two when determining what outcomes are acceptable for society. At one extreme, uniform pricing in insurance for all customers would create cross-subsidies which might be seen as unfair. At the other extreme, increasing personalisation of pricing, made possible by data science techniques, would reduce the benefits of risk-sharing and lead to higher prices for some customers, which would often include vulnerable and low-income customers, and lower prices for others. The viability of limiting or restricting certain rating factors, and the potential implications for insurers, would also need to be considered to ensure any change in pricing methodologies doesn't inadvertently result in reduced availability of products for the public.

Fairness in insurance

The response of the insurance sector to changing demographics and technological advancements provides both challenges and opportunities. In considering these responses, we should ask whether they promote ‘fairness’ and whether sufficient protections are in place to ensure insurance remains fit for purpose, or whether they unfairly penalise or exclude vulnerable consumers, including low-income consumers.

Our research found that insurers, consumer advocates and consumers have differing views about what is meant by ‘fairness in insurance’. Some within the insurance sector view individualisation of risk pricing to be fairer, as a consumer’s premium reflects their level of risk. This is in contrast to consumer advocates and consumers who often viewed fairness to mean that all consumers can access an affordable level of cover that ensures they are protected from the inevitable ups and downs of life. There was a general sense that consumers should not be penalised for factors or risks out of their control, which aligns with broader risk pooling, discussed earlier.

Different views on fairness in insurance impact how the poverty premium in insurance is understood and considered, as well as views on how to address it. This disparity highlights the need for continued conversations about fairness and what fair and acceptable outcomes look like for consumers, including low-income and vulnerable consumers.

Many consumer advocates believe the role of insurance in protecting those most at risk of experiencing financial hardship should be paramount. In their view, the market is not working for a large proportion of consumers. Concerns were raised that this group of consumers will grow as individualisation of risk increases.

> If the objective is greater financial inclusion, is a new approach needed?

The regulator and 'fairness'

We recognise that the question of fairness is complex and one that the Financial Conduct Authority (FCA) has been considering through its work on fair pricing in financial services. In October 2018, the FCA launched a discussion on the fairness of certain pricing practices in financial services. It focused on the practice of firms charging different prices to different consumers based on differences in their price sensitivity, (also known as price discrimination) and the practice of firms charging existing customers higher prices than new customers (the loyalty penalty). The FCA found that while these pricing practices are not always unfair, it had concerns that in some forms they have the potential to significantly disadvantage some consumers, particularly the most vulnerable and least resilient consumers.[xxvii] The FCA's work on fair pricing aligns with its operational objective of securing an appropriate degree of protection for consumers.[xxviii]

Following this, the FCA launched its general insurance prices practices market study. Through the market study, it sought to understand whether pricing practices in home and motor insurance support effective competition and lead to good consumer outcomes. It found that firms use complex techniques to identify consumers who are more likely to renew with them and then increase prices to these consumers at renewal each year, resulting in some consumers paying very high prices referred to as a loyalty penalty or premium. It also found some firms use practices that can discourage consumers from shopping around, including making it more difficult to cancel automatic renewal.[xxix]

Following consultation by the FCA, it has announced new rules that will come into force in 2022 which will ensure renewal quotes for home and motor insurance consumers are not more expensive than they would be for new customers. This measure will go some way to addressing issues in the insurance market but fall far short of addressing the poverty premium issue.[xxx]

The government is currently undertaking its Financial Services Future Regulatory Framework Review (FRF) which is considering how the regulatory framework needs to adapt to be fit for the future.[xxxi]

It is timely for the government to consider how it can deliver a regulatory framework which addresses this issue and delivers improved outcomes, as well as supporting improved financial resilience, for low-income or vulnerable consumers.

Relevant to its work on fair pricing is the FCA's consideration of whether the right balance is being struck between the responsibility of consumers and that of firms. It is exploring options which would increase consumer protections and deliver better outcomes for consumers via a possible Consumer Duty,[xxxii] owed to consumers by firms. These options include reviewing how the FCA applies the regulatory frameworks, with proposals to strengthen and clarify firms' duties to consumers.

Engagement from the regulator is essential to meaningfully address the poverty premium. We encourage the FCA to build on its body of work around fairness and vulnerable consumers by considering what future work it can deliver on this topic. In addition to protecting consumers, the FCA also has responsibilities under the Public Sector Equality Duty (PSED) to promote inclusion via their policies and decisions. This relates to people with protected characteristics as documented in the Equality Act 2010 (the Act).[11] [xxxiii]

11 The Act defines protected characteristics as age, disability, gender assignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, sexual orientation.

As consumers with protected characteristics are more likely to experience the poverty premium, consumer advocates have called for the FCA to research insurance outcomes and assess whether they promote inclusion.

Given the link between 'protected characteristics' and the poverty premium, the FCA may also consider providing greater detail about the Act within the Senior Managers and Certification Regime (SM&CR). The SM&CR is intended to reduce harm to consumers by making senior managers within insurance companies accountable for their conduct and competence. The FCA could have greater regard to its PSED by ensuring the SM&CR provides additional guidance and support regarding the Act, including articulating what good outcomes look like for consumers.

Through its work, the FCA identified there can be complex cases, where improving outcomes for one group may only be possible by making outcomes worse for another. As questions around the 'fairness' of such cases can often involve social policy, the FCA considers that it might be more appropriate for Parliament to clarify and determine certain policy areas and priorities. [xxxiv]

Insurance pricing and the Equality Act 2010

In response to increased individualisation of risk pricing, consumer advocates expressed their concerns about the interaction between the Equality Act and insurance pricing. The Act exists to protect people against discrimination, harassment or victimisation in employment, and as users of private and public services.[xxxv] In general, an insurance provider must not discriminate against a person because of a protected characteristic when it comes to providing them with insurance products or in terms of the products themselves, for example the cost of premiums.[xxxvi] However, in line with the legislation, it is sometimes lawful for an insurer to discriminate against a consumer because of their age or disability. For instance, where a greater insurance risk exists as a direct result of a consumer's disability, insurers can consider the disability as part of a risk assessment to decide whether, and on what terms, to offer insurance.[xxxvii]

Consumer advocates were concerned that the negative outcomes of risk-based pricing, including low-income and vulnerable consumers being quoted a higher premium, or being refused insurance altogether, were not only considered unfair, but may also be in breach of the Act, either directly or indirectly. Consumer advocates have stated that they are often not able to obtain enough information from insurers about how assessments are made or what data sources have been used. They have called for this lack of transparency to be looked into.

In 2019, the Treasury Select Committee (TSC) undertook an inquiry into consumers' access to financial services. In response to the inquiry, the FCA asserted that it did not review the pricing models of insurers, believing that firms could examine whether their approach was reasonable in the circumstance. The FCA also said that when firms were asked to explain how their pricing systems and practices complied with their obligations under the Act, several were not able to provide an immediate answer about:

- The algorithms that sit under the firm's pricing
- How the firm compiled that data
- Whether the firm had tested whether each piece of data was compliant with the requirements set out under the Act. [xxxviii]

In its conclusions, the TSC reported how despite the fact that a number of firms could not provide immediate assurance that their pricing data is compliant with the Act, the FCA had not asked for more information.[xxxix]

The TSC considered it a missed opportunity that despite having the resources to look at individual firms' algorithms to assess compliance with the Act, the FCA chose not to ask for individual firms' data when it held an initial call for input regarding the issue.[xl]

Many consumer advocates called for the FCA to revisit this decision and asked that the FCA ensures that insurers are using risk-based pricing in a way that does not breach the Act, either directly or indirectly. In addition to aligning with the FCA's responsibilities under the Public Sector Equality Duty – to promote inclusion through its policies and decisions – consumer advocates also consider it to align with the FCA's wider work on fairness in insurance pricing. Christopher Woolard, in his previous role as Executive Director of Strategy and Competition at the FCA, said the FCA has the 'resources and expertise to pick inside those insurance models'.[xli]

When these concerns were raised with some practitioners in the insurance sector, they responded that protected characteristics are not included in underwriting decisions and that they were satisfied that pricing practices comply with the Act's stipulations. However, they acknowledged that being unable to provide greater transparency about complex pricing mechanisms and how decisions are made, under the principle that this information is commercially sensitive, may be contributing to the negative perceptions held by consumers and their advocates.

As part of research for this publication, Johnny Timpson, Cabinet Office Disability Champion for the Insurance Industry and Profession, highlighted that improving inclusion and access to products and services, as well as removing barriers, are central themes of the government's planned National Disability Strategy. He suggested that to be able to provide consumers and their advocates with the clarity and confidence that the underwriting decisions and outcomes that they receive are both fair and reasonable, greater awareness and understanding of the Act within the insurance sector is likely to be necessary. The Chartered Insurance Institute and the Cabinet Office Ambassador's Access to Insurance Working Group are currently undertaking efforts to enhance awareness and understanding of the Act within the sector, which may help to address this.

The role for government

The prevalence of the poverty premium raises many questions and identifies the need for a broader discussion about what fair and acceptable outcomes look like for consumers, including low-income consumers. Following this discussion, efforts can be made to understand what the 'right level of pooling' is, and what changes are needed to meet the desired outcomes set out by government.

Many consumer advocates raised the argument that further consideration is needed about the role insurance should play in protecting those most at risk of experiencing financial hardship. As part of this process, consumer advocates and others held the view that the government, alongside the FCA, was responsible for facilitating fair and acceptable outcomes. In particular, many felt it was government's responsibility to ensure an insurance safety net is available to all households. This view was common among the Toynbee Hall workshop panel, who indicated a preference for a protection product to be offered by the government rather than the insurance industry. However, that may be as a result of a general mistrust of the insurance industry among panellists.

Many contributors to this paper expressed the view that government should have stepped in a long time ago, either to provide the safety net themselves or mandate the market to do so — for example, mirroring the Flood Re scheme which provides more affordable premiums to people living on flood plains. Given the possibility that there will always be some consumers who are uninsurable, or deemed less desirable to provide insurance for, particularly due to increased individualisation of pricing, the government should consider how it can ensure these individuals have appropriate protection.

The coronavirus crisis has highlighted the limited financial resilience of low-income families and their limited ability to protect themselves from a financial shock. In addition to the high number of job losses attributed to the pandemic, there is also some evidence that people on low incomes saw a higher than average drop in income at the beginning of the pandemic.[xlii] While the poverty premium in insurance existed long before the pandemic, Covid-19 is likely to increase the number of households that experience an insurance poverty premium and to exacerbate the impact of it. It is therefore timely that the government should consider its role in addressing the poverty premium and take forward these discussions with the FCA and industry.

Products to address the poverty premium

Throughout the stakeholder engagement undertaken to inform this report, alternative approaches and products were suggested for their potential to address the poverty premium and to produce more positive outcomes. These are discussed below.

Ending the monthly payment premium

Introducing measures to remove the monthly payment premium in general insurance for low-income consumers could be a quick win. Typically, general insurance products, such as car insurance, can be paid in monthly instalments or as a lump sum. Where consumers pay monthly, the monthly payment premium is the interest consumers pay on their credit agreement.

Most insurance companies will run a 'hard credit search' before they offer monthly car insurance, which can affect a consumer's credit score. If a consumer has a bad credit score or a patchy credit history, an insurer may choose to not offer insurance. If insurance is offered, it is likely the consumer will have to pay interest at a higher annual percentage rate (APR), increasing the overall amount paid for the policy.[xliii] Removing this premium would remove the additional strain placed on low-income or vulnerable consumers who often have reduced access to immediate funds.

A government-agreed reinsurance scheme – a Postcode Re or Health Re?

A government-agreed reinsurance scheme, such as Flood Re, was viewed by stakeholders as a fair way to address issues relating to individualised risk pricing and to balance risks outside consumers' control. The Flood Re scheme is outlined in greater detail in the box on the next page. Development of such schemes for the risks raised in this report would present an opportunity for government to step in, either directly or via the market, where it is not financially viable for insurers to do so. Such compulsory levy schemes would provide more affordable cover to those who may be deemed higher risk, in the same way that Flood Re provides more affordable flood insurance to those who live in high flood-risk areas.

A Postcode Re could be established to improve the availability and affordability of motor or household insurance for consumers who live in deprived areas with higher crime rates. The reinsurance scheme could subsidise the element of the policy which relates to area-based risk. Insurers could then set the price, excesses and terms for policies based on other relevant factors, such as driving behaviour. Alongside the scheme, the government should tackle the factors that make cover unaffordable and inaccessible to these consumers.

Through its Great Risk Transfer campaign, the IFoA is exploring what factors make a model like Flood Re successful. Could a similar approach work to provide a baseline level of protection across other insurable risks – such as where a policyholder lives or when they have a pre-existing medical condition? The findings from such research could help government and the industry to develop innovative solutions that lead

to better outcomes in terms of how risk is shared between consumers and institutions, and access to affordable insurance for all. The IFoA will seek to engage with other interested parties as it delivers this work.

The Flood Re Scheme is a joint initiative between the UK insurance industry and the UK government. The Scheme was established by the Water Act 2014 and started operation in 2016, to improve the availability and affordability of household insurance for consumers who live in high flood risk areas. It established Flood Re, a reinsurance company that enables insurers to insure themselves against losses because of flooding. It is a not-for-profit fund, owned and managed by the insurance industry.[xliv]

Flood Re works with insurers behind the scenes. When consumers purchase home insurance cover, insurers can pass the flood risk element of a policy to Flood Re for a fixed, below-market premium. This enables insurers to offer a lower premium to consumers. Consumers purchase their home insurance through insurers, who set the price, excesses and terms for policies. If a consumer makes a claim, the insurer will pay the claim and will later be reimbursed from the Flood Re fund.

Most of the costs to run Flood Re are covered by the home insurance industry. When Flood Re accepts a flood risk, it charges the insurer a fixed premium based on the council tax band of the consumer's home, and applies a standard excess of £250 for each policy. Flood Re also collects an annual levy from every insurer offering home insurance in the UK. This provides £180m annually for Flood Re to subsidise premiums and excesses to improve the availability of flood cover to households in high flood risk areas.[xlv]

The costs of setting up Flood Re were paid for by the insurance industry. Rather than provide funds for setting up the scheme, the government has committed to contributing to relief if the country is hit by an especially costly flood.[xlvi] It has also contributed to the improvement of flood defences in high-risk areas, in order to limit the overall risks of flooding and reducing the damage caused by, and costs associated with, flooding.

Flood Re has greatly improved outcomes for consumers who live in affected homes. In 2016, only 9% of households who had made previous flood claims were offered quotes from two or more insurers, with none able to receive quotes from five or more. Increases in premiums after a flood event could also be several hundred percent. By 2018, four out of five households with a prior flood claim reported price reductions of more than 50%, and 100% of these households received quotes from at least two insurers. Nearly three in four were able to choose from at least 10 insurers.[xlvii] It is expected that 350,000 households will meet the eligibility criteria and benefit from the scheme over time, although there is no cap.[xlviii]

Flood Re has been established for a specific 25 year period. It must, during its lifetime, manage the transition to risk-reflective pricing and ensure that an effective market for household insurance exists without the benefit of the levy. It is anticipated that tackling the factors that drive up the costs of flooding and flood cover through more effective flood risk management, growing expertise in flood risk modelling, and employing insights gained from cutting the cost of flooding, will support this.

Clearer and simple products

For many of the Toynbee Hall panellists, an important characteristic of any insurance product was simplicity. This includes both the communication around what the insurance covers and the products themselves. The idea of a **basic, simple insurance product which covers the necessities** was popular. For example, a simple life insurance product which would pay out a clearly defined sum on the death of the policyholder in exchange for a transparent monthly premium. This was recommended by the Sergeant Review of Simple Financial products in 2013 but was not adopted by the industry.[xlix]

We note that some insurance providers are already offering cheaper products with fewer benefits. For example, with regard to income protection, some insurers offer a budget policy for a lower premium than standard income protection plans.[l] Whereas the standard policy can potentially pay a claimant a benefit until retirement age if they are unable to work as a result of illness or accident, the budget policy will limit this to a maximum period eg two years. Similar budget offerings across the spectrum of insurance products may offer a way to cover the necessities. However, the reduced offering of these products still results in lower protection from income shocks for those deemed to be higher risk.

As the government looks to 'build back better' in the wake of Covid-19, it is timely for it to revisit how it can support or incentivise the introduction of simple insurance products. As well as increasing affordability of insurance for those who need it most, simplicity is likely to help improve consumer trust and engagement with the insurance sector. Actuaries working in insurance can be involved in all stages of product development and could support the pricing, risk assessment and marketing of simple insurance products.

Auto-enrolment through employment contracts

Toynbee Hall panellists said that ease of access was a key factor in choosing who to access insurance from. Given the regular interaction many consumers have with their employers, employers were considered to meet this criteria. As such, they were seen by panellists as a suitable provider or vehicle for insurance. This view was shared by other stakeholders we spoke with, a number of whom considered **auto-enrolment into a group income protection or life insurance policy through an employer to be a sensible approach.**

The government has successfully used auto-enrolment to support employees in saving for later life through a pension scheme at work. It was phased in from 2012 and, as of 2018, it is compulsory for all employers to automatically enrol all eligible workers into a pension scheme. Employers must also pay money into the scheme.[li] To facilitate auto-enrolment, the government established the low-cost workplace pension scheme, National Employment Savings Trust (NEST). NEST is free for employers to use and it has an obligation to accept any employer that wants to use it. It is run by the NEST Corporation on a not-for-profit basis.[lii]

Auto-enrolment and the establishment of NEST have been successful in increasing pension enrolment rates. In 2019, 77% of UK employees were members of a workplace pension scheme, up from 47% in 2012.[liii] NEST is now one of the biggest pension schemes by membership in the UK. It serves over 9 million members and 800,000 employers.[liv] While employees can choose to opt out of the scheme, opt out rates have remained under 10% since the introduction of auto-enrolment.[lv]

The success of auto-enrolment in pension saving suggests the introduction by the government of a similar model for insurance might also be popular and successful. This model may be suitable in providing employees with a basic level of income protection or life insurance that acts as a safety net and, due to the scale of provision, provided at a much more affordable rate. The ability

to continue with this product when changing employers would be critical to its success. For those not in employment and the self-employed, another government-agreed scheme would need to be created.

Microinsurance

Government should consider how it can employ microinsurance to provide low-income consumers with protection against the risks they most commonly face. Microinsurance is affordable insurance for the low-income population of developing economies, who generally have higher exposure to risks, often with limited access to social safety nets. Microinsurance products are tailored for protection against specific risks, such as illness, injury or death, and loss of lower-valued assets or possessions. Because the coverage amount is considerably lower than typical insurance plans, consumers pay much smaller premiums. Although more commonly considered as a solution in developing countries, several stakeholders considered microinsurance to have the potential to play a crucial role in providing protection to low-income consumers in the UK.

Microinsurance is a growing market. Since its founding in 2002, UK-based microinsurance specialist MicroEnsure, has expanded to provide insurance to over 40 million low- and middle-income consumers in 20 countries – 85% of them having never previously accessed insurance.[lvi] While not a traditional insurer, MicroEnsure partners with insurance and reinsurance companies that can underwrite risk, and mobilises distribution partners equipped to deliver its products. For example, it partnered with Indian telecom company Telenor to provide free life insurance to all existing and new mobile subscribers. Subscribers receive the life cover free when they make a regular payment for phone credit. When launched in 2015, the product was the fastest-growing insurance product in the world.

While the insurance sector is well-developed in the UK, many low-income consumers and their advocates said the market is not working well for them which means uptake of insurance remains low. RSA Insurance Group addresses this through its 'Insure with Rent' scheme which collects insurance premiums weekly, the same way social housing tenants pay their rent.[lvii] Low premiums, which could be paid in cash, made this type of cover accessible and financially viable. In 2008, RSA worked with 320 social housing schemes in Britain to protect around 180,000 consumers.[lviii] Further research should be undertaken to determine whether this model could be expanded to deliver different types of insurance, such as life insurance, to low-income consumers. Given the large number of low-income households that would be eligible, local authorities or housing associations could operate group schemes and provide more affordable premiums to tenants.

The Microinsurance Network identifies microinsurance as a tool to extend social protection to provide security and contribute towards poverty alleviation.[lix] The role of microinsurance should be viewed alongside the government provision of other social safety nets. Government should consider how it can motivate and support the insurance sector to deliver microinsurance products, alongside a range of other safety nets, to ensure all consumers have access to a minimum level of protection.

As with simple insurance products, actuaries could support the pricing, risk assessment and marketing of microinsurance products. There is scope for the IFoA to work with stakeholders to explore how microinsurance could be developed and delivered

Recommendations

The poverty premium in insurance means that low-income households pay more for insurance, or are prevented from accessing the protection that insurance can provide. This negatively impacts on their overall levels of financial resilience and their ability to protect themselves from financial shocks, which has economic implications for the whole of of society – where low-income households are unable to be financially resilient they are more likely to become reliant on state benefits.

In addition to any societal benefits, addressing the poverty premium could deliver savings to the state. The case for improving individuals' financial resilience, and the likely widespread societal and economic benefits that would follow, is set out in The UK Strategy for Financial Wellbeing 2020-2030, published by the Money and Pensions Service.[lx]

In addition to highlighting the pressing need to support many in our society to become more resilient to financial shocks, the coronavirus crisis has highlighted the lack of safety nets in our systems and institutions. There is a growing recognition among many contributors to this report that we need to 'build back better'. That is, as the economy recovers from the ongoing impact of coronavirus, a more sustainable social and economic model is needed, one that provides society and communities with greater resilience, allowing people to manage the financial impacts of life's ups and downs.

We therefore recommend that:

1

The government determines a minimum level of protection needed by all, including low-income families, in order for them to remain financially resilient to specific risks and unexpected shocks.

2

In line with the recommendation of the Treasury Select Committee, the FCA should support government in this work by undertaking a study into the regulatory outcomes the market is currently delivering for low-income consumers. This study should also consider the interaction between the Equality Act and insurance pricing.

3

The government should look at its role in facilitating the delivery of a minimum level of protection through the use of social policy interventions, such as extending the Flood Re model of insurance for different insurance product lines, to cover low-income and vulnerable consumers who are priced out or excluded from the market.

4

The government should work with the FCA and industry to determine what changes are needed within the public policy and regulatory environment to support and incentivise the insurance sector to develop and deliver innovative solutions to address the poverty premium.

The IFoA and FBD view this report as an important step in progressing the discussion around the poverty premium in insurance and in helping to develop practical and innovative solutions. FBD and the IFoA will continue to engage and work with government, regulators and industry to support them in acting on these recommendations.

Appendix

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