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 – Summary

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

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The poverty premium

Insurance provides households with protection against financial hardship, yet is the least well-documented and discussed element of what it means to be financially included in the UK today.

We are all encouraged to look to the market to protect ourselves from future risks, such as income shocks. Income shocks like illness, bereavement or unemployment are among the main reasons people fall into problem debt.[1] But the poverty premium means that households may often go without insurance due to factors outside their control, including health conditions and disabilities, or because of where they live. They often have no choice but to use solutions such as credit that are more costly in the long run.

People on low incomes pay more than better-off consumers for many essential products and services. Examples include energy, through prepayment meters or expensive default tariffs, and credit, through high-interest loans and credit cards. It also includes insurance, for example through expensive premiums for living in postcode areas considered higher risk, or being charged extra due to a past health condition.

These excess costs are collectively known as the poverty premium. The poverty premium is paid by almost every single low-income household. It costs an average of £490 a year, and at least £780 for more than one in ten.[2]

A study commissioned by Fair By Design (FBD) of 1,000 low-income households who accessed the services of a debt charity found 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. For people living in a deprived area, car insurance can cost nearly £300 more a year than households in areas considered lower risk by an insurer.[3]

The poverty premium in insurance is a major problem that will only get worse as we move from a pooled risk approach in insurance to one of individualised risk.

Protected characteristics and the poverty premium

A second study commissioned by FBD found that certain protected characteristics are not only associated with an increased risk of poverty but also provide increased exposure to some poverty premiums, even when compared to low-income households as a whole. Intersectionality plays a large role. This means that the more protected characteristics a person has, the more likely they are to be in poverty – and paying a poverty premium.

These characteristics 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.

For example, Bangladeshi, Pakistani and Black people are disproportionately more likely to live in deprived areas, which can affect the cost of insurance premiums. The research also found that people from Black, Asian and other minoritised community households, lone parents, and people with disabilities were less likely to hold any insurance.

1 **StepChange, Life Happens (2019)**
2 University of Bristol, **Paying to be poor (2016)**
3 University of Bristol, **The poverty premium: a customer perspective (2020)**

This 'going without' is often the alternative to paying the poverty premium and can signify a level of poverty or exclusion from the market. It 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. [4, 5]

4 Financial Inclusion Commission, Improving access to household insurance (2017)

5 60% of households earning £15,000 or less per annum, have no contents cover. **WPI Economics for Barrow Cadbury Trust, Insurance and the Poverty Premium: What's known and the policy implications (2019)**.

Living with the poverty premium: a customer perspective

To capture the consumer perspective, we worked with the charity Toynbee Hall to facilitate a workshop with a panel of 'experts by lived experience' (of poverty) – 'the panel'.[6] At the workshop, discussion 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.

The reasons for low-income households not holding insurance are numerous. These include:

Unaffordable premiums and refusal

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 unfair. This was especially the case when there was nothing panel members could do about their situation, for example if they lived in a particular postcode or had had a previous or ongoing health condition.

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

Panel members also felt they had been treated unfairly when they were refused insurance. Some shared their experience of insurers refusing to sell them car insurance. In some instances, they stated they had been refused insurance because they lived in certain postcodes that were deemed a higher risk.[7] This was particularly concerning given that holding motor insurance is a legal requirement.

6 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.

7 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.

Loyalty penalties

Low-income households are less likely to switch so end up paying a loyalty penalty. Shopping around requires time, access to the internet and the ability to compare many different products that are often complex to understand. The panel gave car insurance premiums being raised at renewal as an example of unfair pricing and being penalised for staying with an insurer.[8]

Penalties for paying monthly

For certain types of insurance, panel members reported being charged more when they paid monthly, rather than the full lump sum upfront. This practice was considered unfair, as for many consumers there is little choice but to pay monthly because they cannot afford the total upfront payment. This is often due to being on a low or irregular income, such as a zero-hours contract, that means they are less able to put aside savings.

Complex or opaque products

Products were considered to be too complicated, with a lack of clarity about what was covered. In some instances, this led to participants feeling as though the seller deliberately misled or mis-sold to them. This resulted in negative experiences, such as fighting for payouts or viewing insurers as untrustworthy.

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, or
- Having to forego that type of insurance altogether.

This negative view of insurance affected 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.

8 The FCA has announced **new rules** coming into force in 2022 that will ensure renewal quotes for home and motor insurance consumers are not more expensive than the prices paid by new customers. This will go some way to addressing issues in the insurance market but fall far short of addressing the poverty premium.

The Great Risk Transfer

Traditionally, insurance products were created using the concept of risk pooling – combining the risks of all relevant policyholders into a risk pool. This meant that the premiums of lower-risk policyholders cross-subsidised higher-risk policyholders who were assessed by an insurer to be more likely to make a claim.

Advances in technology, such as telematics devices for cars and new forms of data, have led to a shift away from broad risk pools and towards more granular pricing based on an individual's specific rating factors (ie their risk characteristics).

This has led to opportunities, such as providing safer drivers with lower premiums, or catering to previously excluded consumer segments. For example, advances in medical science have led to a greater understanding of many diseases, enabling insurers to differentiate levels of risk among individuals living with health conditions such as HIV or cancer. However, the shift away from broad risk pools has meant more risk being carried by the consumer rather than the insurer – and not pooled via cross-subsidisation. This has led to an increase in the costs for low-income and vulnerable consumers, increasing their exposure to the poverty premium along with associated access issues.

Low-income and vulnerable consumers are less able to reduce their risk, either because certain risk factors are outside their control, such as a disability, or because they do not have the financial means to do so, such as moving to a different area.

Fairness in insurance

Among consumers, consumer advocates and industry, there are differing perceptions of fairness. Some within the insurance sector consider individualisation of risk pricing to be fair, as a consumer's premium reflects their level of risk. Consumer advocates and consumers define fairness to mean that all consumers can access an affordable level of cover that protects them from life's ups and downs. Many believe that the role of insurance in protecting those most at risk of experiencing financial hardship should be paramount, with people not being penalised for factors or risks outside their control. This aligns more with how insurance used to work with wider risk-pooling.

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

Insurance pricing and the Equality Act 2010

The interaction between insurance pricing and the Equality Act 2010 has raised concerns from some stakeholders.

In its Inquiry into Consumers' Access to Financial Services,[9] the Treasury Select Committee (TSC, 'the Committee') acknowledged questions around the fairness of underwriting processes.

Several firms were unable to explain to the Committee how their pricing systems and practices complied with their obligations under the Act – but the FCA, as the organisation best placed to investigate this, did not request more information from firms in its call for input following the TSC's inquiry.[10] The TSC considered this a missed opportunity, as the FCA had the resources to look at individual firms' algorithms and assess compliance with the Act.[11]

The Equality and Human Rights Commission (EHRC) also publicly stated that it does not have the relevant resources to investigate.

A number of consumer advocates have called for the FCA to revisit its decision not to ask individual firms for their data.[12]

Although the TSC stated that responsibility for insurance companies' compliance with the Equality Act should be transferred to the Financial Conduct Authority (FCA), this has not happened.

Consumer advocates believe that addressing questions on compliance with the Equality Act aligns directly with the FCA's Public Sector Equality Duty – to promote inclusion through its policies and processes. In addition, there is a clear expectation that addressing this issue is key to the FCA's work on fairness in insurance pricing.

Consumers and consumer 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.

Many consumer advocates have called for insurers to be more transparent about how they assess risk, as this would make it easier for consumers to understand and challenge their individual risk assessments. However, this information is generally viewed as commercially sensitive and insurers are not required to share it.

9 https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/1642/164211.htm
10 Ibid
11 Ibid
12 Consumers' Access to Financial Services: Financial Conduct Authority response to the Committee's Report

Products to address the poverty premium

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

Ending the monthly payment premium paid by people who cannot afford to purchase an insurance product in one payment

Creation of reinsurance schemes similar to Flood Re, such as Health Re and Postcode Re

Creating a range of clear and simple products, as recommended by the Sergeant Review in 2013 but not adopted by industry

Auto-enrolment through employers, enabling people to access group insurance

The introduction of microinsurance[13] for some of the most common risks people face.

13 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. Products are tailored for protection against specific risks, such as illness, injury or death, and loss of lower valued assets or possessions.

Recommendations

The prevalence of the poverty premium highlights the need for a broader discussion about what fair and acceptable outcomes look like for consumers, including low-income consumers.

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. 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.

3. 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.

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.

To view the report in full, visit https://fairbydesign.com/insurance-poverty-premium/

In conducting this project, we engaged with a range of stakeholders, including:

- Access to Insurance Initiative (International Association of Insurance Supervisors)
- Alea Risk
- All-Party Parliamentary Group for Insurance and Financial Services
- Association of British Insurers
- Bright Blue Hare
- Craig Tracey MP, Chair of the APPG on Insurance and Financial Services
- Citizens Advice
- Cura Insurance
- Competition and Markets Authority
- Chartered Insurance Institute
- Financial Conduct Authority (FCA)
- Financial Inclusion Commission
- Financial Services Consumer Panel
- Government Actuary's Department
- HM Treasury
- Hurman Consulting
- Government's Access to Insurance Working Group
- Jackie Wells, Financial Services Consultant
- Johnny Timpson, Cabinet Office Disability Champion for the Insurance Industry and Profession, Chair of Government's Access to Insurance Working Group
- Legal and General
- Macmillan Cancer Support
- Moneysworth
- New City Agenda
- Shayne Halfpenny Ray, Secretariat to the APPG on Financial Services and Inclusion
- Social Market Foundation
- StepChange
- Swiss Re
- Travel Insurance Facilities Group

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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.

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Fair By Design is dedicated to reshaping essential services such as energy, credit and insurance, so they don't cost more if you're poor.

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 Venture Fund.

Barrow Cadbury Trust

The Barrow Cadbury Trust runs Fair By Design's advocacy work on behalf of a group of foundations.
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