The Great Risk Transfer: How can Government, employers and industry help individuals to negotiate risk barriers on the climb to financial security?

Wednesday 16 June 2021

The IFoA's Great Risk Transfer (GRT) campaign has been exploring a long-standing trend in which financial risk is increasingly being transferred from institutions to individuals, many of whom are ill-equipped to manage these risks. The overall goals of the campaign are to gather evidence about the GRT trend and its impacts; to bring stakeholders together to debate that evidence and potential responses; and to work with stakeholders, including government and regulators, to drive actions that will have a positive impact in the public interest.

The GRT final report, published in April 2021, calls for urgent action – by policymakers, employers and the financial services industry – to tackle risk transfer as a systemic failure. It also recommends some practical solutions, highlighting opportunities to rebalance risk away from consumers and back to institutions, as well as ways to support individuals with managing their risks, when such rebalancing is not possible.

The following note is a summary of the second of two roundtable discussions which were organised by the IFoA, in conjunction with the think tank Demos, to help identify practical insights into the recommendations in the GRT final report, with the benefit of participants' knowledge and expertise.

In attendance

- Rowena Crawford is Associate Director at the Institute for Fiscal Studies.
- Shane Halfpenny-Ray is Public Affairs Manager at the Chartered Insurance Institute.
- Mick McAteer is founder and co-Director of The Financial Inclusion Centre.
- John McGlade is Policy Research Officer for the Association of Personal Injury Lawyers (APIL).
- Sam Sims is Chief Executive Officer of National Numeracy.
- Gary Smith is Head of Product Management at Old Mutual Wealth.
- James Smith is Research Director of the Resolution Foundation.
- Ben Stafford is Head of Public Affairs at Just Retirement.
- John Taylor is Immediate Past President of the IFoA.

Unattributed summary of discussion

Context

- The Great Risk Transfer (GRT) describes a long term trend beginning in labour market and pension reforms in the 1980s, and including later developments like Freedom and Choice and more individualised insurance.
- The GRT recommendations include ways to help people manage the risk they bear, such as PensionWise and the Pensions Dashboard, as well as risk sharing mechanisms like CDCs.

Guidance and advice

- People need to engage more with financial decisions, including taking more advice.
- Only a fairly small group can afford advice.
- People are baffled by consumer disclosures, and the financial services industry needs major simplification
- Regulation can include requirements that are a barrier to simplification.
- The complexity of financial services means it is unwise to rely only on taking advice.
- It is important to stress the value of advice: positive features of good quality advice are that it is holistic, goal-based and changes over time.
- It would be a useful exercise to compare outcomes for three groups – one taking targeted advice, one using the Pension Wise service and one not receiving any guidance or advice.

Financial literacy and numeracy

- Consumers find it challenging to make judgements, so financial literacy is important.
- Many suffer anxiety and lack of confidence about financial decision-making.
- Innumeracy is a major issue - half the population is unable to work with percentages and younger people are particularly affected.
- Therefore there is a risk that guidance or advice will not reach many people.

Pensions

- Certain key pensions decisions are especially high risk, e.g. not saving enough, and decumulation choices with associated longevity risks.
- People undervalue having a guaranteed income and instead may naively embrace risk.
- Government and employers need to create more pathways. NEST's decumulation blueprint is a good example from a few years ago.
- AE has succeeded through exploiting inertia, with 10m more pension savers. This suggests a combination of paternalism and aligning with consumer behaviour can be effective.

Insurance

- General insurance often bases underwriting decisions on algorithms, with about 25% of people struggling to secure cover. (In life insurance decisions are more people-based.) By using cross-subsidies, Flood Re's model helps to pool the risks.
- Lack of access to insurance for poorer consumers is exacerbated by welfare cuts.
- There is interest, e.g. from the All Party Parliamentary Group on insurance and financial services, in reinsurance schemes (perhaps similar to FloodRe). Possible risks to address this way are high

crime, climate change and pandemics. A key issue is working out the respective roles of the State and the private sector in such schemes.

- By segmenting consumers Fintech is currently creating financial exclusion. However, it would be possible to design cheap, daily insurance cover. This would either be provided directly by the State, or the State could mandate insurers to do so.

Role of government

- There is evidence that countries with stronger social security systems encourage more entrepreneurialism.
- A new social contract is needed: this would involve a new paternalism and less individualism.
- More recognition of the GRT trend could encourage greater openness to a more paternalistic approach.
- Markets alone will not stop exclusion. For example, an agreement by insurers not to use the results of genetic tests may well collapse because the range of available tests has greatly increased. Only government / regulatory intervention would prevent this.

Policy environment

- Globally there is a low growth, low interest rate environment, with an imbalance between savings and investments. Encouraging more saving could make this worse.
- A riskier environment creates risk averse behaviour. For example, lack of business interruption cover during the pandemic led companies to hold more cash.
- The trend of risk transfer cannot be reversed, but positive change is possible.
- An encouraging pilot study of workplace payroll saving was mentioned. Employees benefit from economies of scale and see their employer as a trusted intermediary.
- Real earnings for the poorest in society have fallen, and they are forced to borrow (the inbuilt obsolescence of white goods is an example of risk transfer because breakdowns lead to debts).