Institute and Faculty of Actuaries

1 June 2023

THE FINANCIAL RESILIENCE ALL PARTY PARLIAMENTARY GROUP CALL FOR EVIDENCE 2023

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.

Opening Remarks

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Financial Resilience All Party Parliamentary Group's (APPG) 2023 call for evidence as part of its second inquiry.

British and global society has been existing in a state of 'permacrisis' since the onset of the Covid-19 in early 2020. Despite the global pandemic coming to an official end in May 2023, many of its non-epidemiological impacts remain, with the global economy now engulfed in extensive inflationary and thus economic pressure. This has been worsened by the economic impact caused by Russia's invasion of the Ukraine.

This long-lasting societal predicament has resulted in repeated income shocks to many individuals and households and as a result, there has been, broadly, a decreasing level of financial resilience among the population since 2020. As such, we believe the launch of this call to evidence is a timely one and will give the opportunity to the appropriate stakeholders to engage with policymakers on this vital issue.

It is the view of the IFoA that greater financial resilience will help the public, reduce the burden on the State who often have to intervene when individuals and households find themselves in financial crisis, as well helping tackle existing levels of financial and wider exclusion.

We have responded topically to the call to evidence rather than to individual questions. We believe this approach is more appropriate for our contributions, although we do answer many of the questions indirectly. In doing so, we have we referred back to a number of our recent reports that include: **The Great Risk Transfer**; **the Poverty Premium in conjunction with Fair By Design** as **well 'Building Financial Resilience for Households in the Private Rented Sector' – a joint report with the Building Resilient Households Group**. We also make reference to the work of the **IFoA Mental Health Working Party**.

In our response, we seek to explain where the main obstacles lie for individuals and households in maintaining and obtaining insurance – the primary provider of financial resilience. More importantly, we also make detailed recommendations on how to alleviate such difficulties.

We look forward to your reply to our submission. The IFoA stands ready to engage with the APPG on this important matter.

Beijing	14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004 · **Tel**: +86 (10) 6535 0248
Edinburgh	Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel**: +44 (0) 131 240 1300
Hong Kong	1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +852 2147 9418
London (registered office)	7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel**: +44 (0) 20 7632 2100
Oxford	1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel**: +44 (0) 1865 268 200
Singapore	163 Tras Street · #07-05 Lian Huat Building · Singapore 079024 · **Tel**: +65 6906 0889

www.actuaries.org.uk

1. ‘The Great Risk Transfer’ and financial resilience

Financial resilience is increasingly under threat by a phenomenon we have termed ‘The Great Risk Transfer’ (GRT); the trend of transfer of financial risks from institutions – such as employers, the state and financial services providers – to individuals.

As laid out in out in the publication of our final Great Risk Transfer report, risk transfer is particularly evident in insurance and pensions, where we have identified a broad range of examples. One striking trend here is that a combination of market forces and technological developments is encouraging more granular insurance risk pricing.

Premiums are being set for smaller and smaller subgroups of the population, and ultimately for individuals. This is resulting in winners as well as losers. Since smaller risk pools are more reflective of precise risk profiles, those with lower risk enjoy lower premiums while those at higher risk pay more.

Pricing may be dictated by factors outside people’s control, such as living in a high crime area and being unable to afford to move. In motor insurance younger and/or poorer drivers may be priced out of cover. Those with multiple health issues are among the most vulnerable. In many cases it is those who need insurance cover the most who may be unable to access it, and there is evidence that low-income households are more likely to be without cover. The ability to price individual risk in such a way that significant subgroups of the population are excluded from affordable insurance is a long-term systemic issue demanding systemic solutions.

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

Putting this recommendation in context, as actuaries involved in the design of insurance products, we appreciate that insurers are commercial organisations with a legitimate need to manage their business, and that pricing should reflect risks. We therefore believe that the government and regulators have the key role in identifying and protecting vulnerable groups.

The recommendations in our report reflect the diversity of the stakeholders that the IFoA has consulted with on the Great Risk Transfer since the campaign’s inception in 2020, the wide-ranging nature of the discussions we have convened, and the breadth of areas relevant to the subject of risk transfer. While it is not possible to capture every nuance of those conversations, we have identified two broad themes that capture our key policy recommendations.

These are:

- Rebalancing risks – We think there are opportunities to ease the burden for consumers in trying to manage complex risks by shifting the prime responsibility for certain risks back towards institutions. The mechanism for achieving this is structural changes to markets, products/services, and the legal/regulatory frameworks that shape them.

- Helping consumers manage financial risk through good decision-making – We believe a key driver for new products and services should be to help consumers with the complex decisions involved in managing financial risks effectively and affordably. This could dramatically improve outcomes.

2. Later life and financial resilience

In much of our work, particularly our 'Saving Goals in Retirement' series, we have called for the Government to reinvigorate its public messaging around minimum pension saving levels – particularly through workplace auto-enrolment pension schemes – to ensure that consumers are not lulled into a false sense of security that their pension savings will be adequate to achieve their retirement income goals. This is essential to ensure people have **financial resilience** in later life.

The reality is that current minimum contribution rates of 8% (3% from employers, and 5% from employees) are unlikely to be sufficient for many individuals to secure a standard of living that they may want or expect. The IFoA has called for the Government to review minimum AE contributions, and to consider carefully how overall saving could be increased, noting that there are various ways of achieving this other than simply increasing the employee and employer percentage.

The IFoA's Savings Goals indicate that people need to be saving well above the automatic enrolment minimum if they are to achieve a 'moderate' standard of living and remain **resilient** to inevitable income shocks in later life. We are concerned that people are not on track to achieve this and might not be aware of the problem or what they might need to do to address it.

Moreover, we are keen to encourage policy decisions which provide a stable environment for people to save for the long term through a pension and which remove unnecessary barriers or disincentives to saving adequately via a pension.

This is particularly relevant when assessing the state pension, where we recently welcomed confirmation that the Government will pause any decision until a proper examination of longevity impact can be undertaken. Increasing longevity has been the driving force behind previous rises in the state pension age and it is right that Government properly assesses longevity trends before accelerating any planned increase in state pension age.

The Neville-Rolfe report and evidence from the Government Actuary's Department showed that increases in life expectancy are slower than initially predicted. Raising the state pension age at a quicker rate in this context could have a detrimental impact on the financial resilience of younger generations.

3. The insurance 'Poverty Premium' and financial resilience

Insurance provides households with protection against financial hardship. It helps **build financial 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, vulnerable and low income consumers are sometimes quoted higher premiums for insurance, or are refused cover altogether due to a range of factors, many of which are often outside someone's control, such as where they can afford to live, or their medical history. This is known as the 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. This has been referred to as the poverty premium in insurance, and the IFoA has been working collaboratively with Fair By Design and other stakeholders across the industry to try and address the consequences of this phenomenon.

In our joint report on the poverty premium with Fair By Design, 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 (e.g. their postcode or medical history)
- Are less likely to switch provider, which results in paying a loyalty penalty

- 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.

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. 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. This is more likely to affect people with certain 'protected characteristics'.

Considering this, and as laid our in our report, we recommend that:

- 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.

- 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.

4. Health and financial resilience

The IFoA Mental Health working party aims to raise the level of understanding of mental health amongst actuaries, promote the consideration of mental health in the design of insurance products and processes and explore data and modelling for mental health risk factors.

In 2022, the party produced the output 'Mental Health in Life Insurance: Triggers to Purchasing Insurance'. It considered what the actuarial and insurance sectors could to support individuals when they incur a mental health issue and when seeking to access life insurance.

It identified that a key first step was understanding the main life stage and financial event triggers that have the potential to impact our mental health and wellbeing. Individuals and families face an array of potentially negative life events with associated financial shocks, including job loss/change and income fluctuation or debt.

It is the view of the IFoA and others that educational, vocational rehabilitation and support interventions designed to raise awareness and signpost to specialists that can help, may improve individuals' **financial resilience** and outcomes when addressing specific life events. Personal and occupational protection and health insurers, such as the ABI, are responding to this with the provision of specialist support service and employee assistance programme facilities.

The recent Mental Health and Insurance Standards from the ABI are already seeing many insurers making progress in addressing some of the steps above. Last year's Mental Health and Life Insurance Awareness week organised by the IFoA's Mental Health Working Party shone a further light on areas the industry can collaborate to improve the journey for those seeking to access life insurance.

5. Generation Rent and Financial Resilience

As a concluding remark, we wanted to comment on a part of the benefits system that is particularly behind in cultivating financial resilience and fairness – the disregard in the Universal Credit (UC) system, currently applied to Income Protection (IP) and Family Income Benefit (FIB) payments paid to homeowners – but not to private renters. This is both unfair to renters while reducing the incentive for **financial resilience** among homeowners.

The IFoA's and Building Resilient Household Group's (BRHG) joint report, which contains research commissioned by the BRHG and performed by Hymans Robertson, determines a lower-level **financial resilience** of individuals in private rented accommodation in comparison to homeowners - particularly in the event of unexpected drops in income due to ill health. The report calls for the extension of the insurance payment 'disregard' in the UC system, currently applied to IP and FIB payments paid to cover housing costs in the form of a mortgage payment, to all housing costs.

Under the current Universal Credit (UC) rules, many renters receive only partial help with their rents and may face a 'rent gap' of hundreds of pounds each month. Yet those who receive income from insurance policies, such as Income Protection (IP) and Family Income Benefit (FIB) payments, are unable to use this money to cover the gap. Instead it simply reduces the help they get from UC. This means that it is effectively impossible to insure against facing a rent gap while on UC. Due to this interaction, some renters, particularly those on low incomes, may find that IP does not enable them to ensure their housing costs are met following an unexpected illness or accident. This problematic interaction only exists for renters. For owner-occupiers, any insurance payment they receive to cover their mortgage is disregarded in UC.

Should you want to discuss any of the points raised in this response, please contact Charlie Wynne (charlie.wynne@actuaries.org.uk)