Insurance and the poverty premium

Summary

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This summary report is about the poverty premium in insurance. Its presence is a key indicator of the fact that the insurance market is failing people in poverty. Not necessarily in the technical economic sense, but because it is not delivering on the outcomes that, as a society, we would want it to.

The reasons are clear. Research with people in poverty (representative polling and in-depth focus groups) and existing evidence, as well as new modelling for this report show that:

- Where people on lower incomes take on insurance, the poverty premium results in them paying more for a product which they are required to have to live their day-to-day lives (motor insurance) or need to have in order to provide themselves an adequate level of financial security (e.g. contents insurance).
- People also argued that factors outside of someone's immediate control, should not be used to set insurance premiums. This means that the increased costs and the perceived unfairness of the poverty premium also contributes to poor take up of insurance products amongst lower-income people. The resulting lack of financial resilience has significant impacts for the families involved (both in terms of their ability to make ends meet and weather income shocks and their mental and physical health) as well as having knock-on costs for the economy, society, and the Government.

In normal times these issues hit low-income families hard. In the context of the post-pandemic economic shock and cost-of-living crisis, the poverty premium stands to have an even greater impact. The sections below summarise the key conclusions from the research underpinning this project and longer research report, kindly supported by Fair By Design. Our work has been informed and led by in-depth research with people in poverty. An online survey of 1,537 UK adults living in households with equivalised low income below 60% of median was conducted by Public First, on behalf of the Social Market Foundation between 24th and 29th June 2022. Two in-depth focus groups with people with lived experience of the poverty premium were run by Toynbee Hall and Poverty Alliance.

60%

Six in ten of those in poverty think that buildings insurance and contents insurance should be classed as an essential

Insurance should be seen as essential

Given these potentially significant costs, a key argument in this report is that insurance should be seen as an essential and its take up and cost for low-income families considered in a similar way to that of energy, fuel and food.

It can provide a vital form of resilience in times of financial strain. Through the necessity of motor insurance, it allows people to drive to work, see family and friends and access leisure activities. More broadly, people without insurance experience higher levels of anxiety and a range of other emotional and financial problems.

Insurance is peace of mind you know – life is uncertain and there are lots of commodities in our life that we need like mobile, like car, like washing machine… So we need actually the insurance to cover up uncertain situations.”

Low-income focus group participant

£300 per year

The poverty premium is estimated at around £300 per year for motor insurance. Combined with extra charges for paying monthly (£160), **this could rise to nearly £500 per year.**

An ‘ethnic penalty’ in motor insurance impacts all those who live in multi-ethnic areas – over 1 in 5 people.

But take up of insurance amongst those in poverty is low and they pay more for it

Take up rates of insurance cover amongst lower-income families is already low. For example, only half (50%) of all people in poverty have contents insurance and this figure falls to less than a quarter (23%) of people in poverty who live in private rented accommodation.

In other markets, insurance is mandatory (e.g. motor insurance), meaning that the poverty premium (estimated at around £300 per year for motor insurance[i]) is contributing to a significant cost of living issue. Additional charges for paying monthly instead of annually could mean an extra £160, adding up to a total poverty premium of nearly £500.

“[I need insurance]…my car is my life, I can’t live without it as I have mobility problems.”

“…sometimes we can't afford [insurance] because of the costs”

Low-income focus group participants

We know that people in poverty can also pay more for their insurance cover because they need to pay in instalments. We also estimate that around 1.2 million people in poverty are purchasing single-item insurance cover (e.g. for tech, white goods), which might be more cheaply obtained through a standard contents insurance policy.

[i] University of Bristol (2020), *The Poverty Premium: A Customer Perspective A Report From The Personal Finance Research Centre*

These issues make people in poverty even less able to make ends meet. It is also clear that the pandemic and subsequent cost-of-living crisis is making all of this worse. Of those in poverty who have motor insurance:

- 55% say that they are finding paying their premiums difficult.
- This rises to nearly three in four (74%) people in poverty aged 18-34.

For some, this has led to the situation where people have been forced to cancel policies in order to make ends meet.

> **"I had to cancel my contents insurance to be able to pay for my fuel.**
>
> **I hope nothing goes wrong."**
>
> *Low-income focus group participant*

Deepening problems with take up

To the extent that it leads to people cancelling policies in order to prioritise immediate needs like food and energy, the poverty premium further undermines the take up of insurance. Our research showed the potential extent of this challenge, with 42% of people in poverty saying that cost is one of the biggest barriers to take up.

More generally, the issue with the poverty premium is not just about affordability. Our work with people in poverty demonstrated a lack of trust in insurers and a feeling that insurance was not a product that would provide them with what they need. A quarter (24%) of people in poverty said that they do not see the value in insurance. The poverty premium makes this issue with trust more significant. Just 7% of people in poverty believe that it is fair that those on lower incomes pay more for their insurance, and 66% believe that it is unfair. People also argued that factors outside of someone's immediate control, should not be used to set insurance premiums.

> **"When I do my car insurance, they ask:**
>
> **Are you disabled?**
>
> **Are you a single parent?**
>
> **Are you married?**
>
> **Are you divorced?**
>
> **What is your job title?**
>
> **What does it matter that I am a single parent at home because I am looking after my kids or in ill health, I'm a careful driver!**

But I have a disability, but I feel that I am penalised for my circumstances. Because we are already suffering and living in poverty, we should not be charged more.

Low-income focus group participant

Our research suggests that unaffordable premiums, lack of trust and perceptions of poor value for money, are key drivers of the low take up of insurance seen amongst low-income families. In turn, this is clearly detrimental to financial resilience of people in poverty and could lead to significant personal, economic and societal costs, which will be felt by us all.

An indication of the challenges here were revealed by our surveying of people in poverty. We found that five million people in poverty would find it impossible to pay for an unexpected cost of £500 without outside assistance.

Over the next five years, we estimate that some 2 million people in poverty could have to cope with an insurable loss, without any insurance cover to meet the costs.

Summary of the problems with the poverty premium

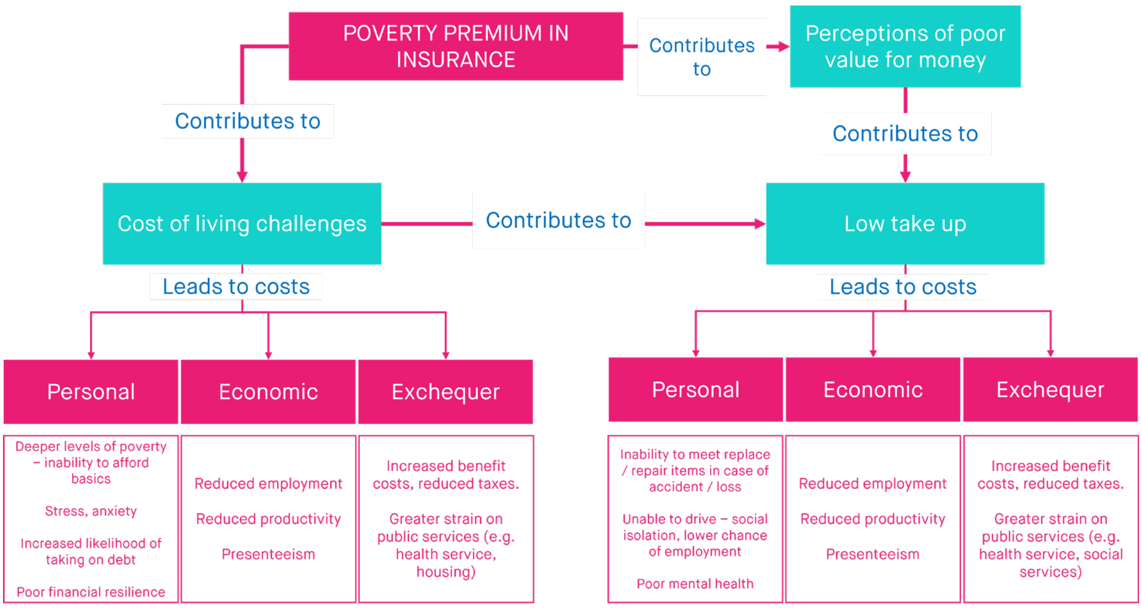
Overall, there are two clear routes through which the poverty premium causes significant issues:

- First, where insurance is taken up, the additional costs faced by people in poverty can drive cost of living issues, which exacerbate the already precarious financial situation that families in poverty are in.

- Second, the poverty premium can add to perceptions that insurance provides poor value for money for people living in poverty. Combined with higher costs, this can act as one of a range of barriers that reduce take up of insurance amongst those in poverty.

Together, these issues around costs and take up can lead to significant personal and economic harms as well as costs to the Exchequer, demonstrated in Figure 1.

Figure 1: The impacts and costs of the poverty premium in insurance



Source: SMF

The social market case for action

So why take action? The case is well-rehearsed in other markets. In fact, when society deems something essential, measures are typically put in place to ensure its universal provision – even when that thing is largely provided through a market. Where a person does not have housing, the State (generally) provides it. Some people do go hungry, but our expectation again is that no one is left to starve. In reality, coverage in these markets is incomplete. Some people are homeless and some people go short of food. But these outcomes are not shrugged off as the inevitable result of market provision. Society accepts that arrangements relying on market mechanisms to provide housing and food can fail some people and leave them without essentials, even if the market is, in the narrow technical sense, functioning well and efficiently.

Market provision can fail people even when there is no "market failure." No one would make evidence of technical "market failure" in the market for food a requirement of social welfare policies or the provision of food banks. We do not demand a market study on the performance of the housing market before trying to put a roof over the heads of the homeless. Nor does anyone seriously argue that the creation and implementation of policies meant to remedy hunger and homelessness means doing away with market mechanisms in food or housing.

To put it mildly, it is inconsistent to stand idle when the insurance market leaves significant numbers of people unprotected from harm. The development of new, more ambitious policies to mitigate that harm is required but not radical – it is of a piece with other interventions made to put a safety net under people who might fall out of other markets and come to harm. The recommendations made here are a starting point in this conversation about policies, but what is more important even than new policy is new ways of thinking. We need to change the way we think about insurance and the market that provides it, to take more account of the nature of the product and society's expectations around it.

Whilst we may all sometimes struggle to define in precise terms what we consider fair and unfair, we tend to recognise unfairness when we see it. To take a recent example, if a situation where some people face excessively high energy bills – through no fault or choice of their own – offend our sense of fairness and require intervention, how can we not demand a similar approach when they face premium prices for insurance not because of anything they have done but simply because of who they are?

Who should act?

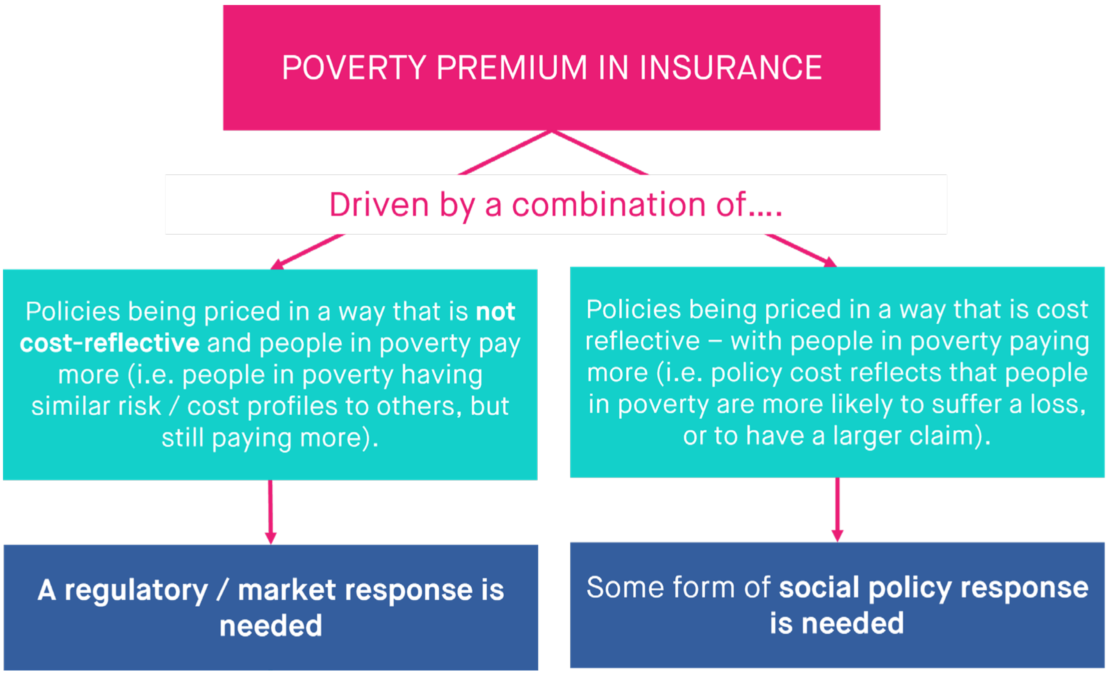
With the impacts and costs of the poverty premium identified, and the economic, social and moral case for action made, the question is then who should act and what should they do?

On the question of who should act, the answer lies in understanding what the causes of the poverty premium are. Our research and engagement with stakeholders shows that the poverty premium is be driven by two different factors. First, an increase in premiums because people in poverty present higher risks or greater costs to insure (cost-reflective poverty premium). Second, an increase in premiums, despite people in poverty having similar or lower risk levels and costs to insure (non-cost reflective poverty premium) .

The important point here is that the different drivers would need a very different policy response.

- **Addressing a cost reflective poverty premium** would involve resolving a series of social policy questions around how risk is managed across society. Solutions here could include determining an appropriate cross subsidy between the premiums of low- and high-income people (if one is justified at all). There are already a range of ways in which we choose to socialise risk as a society in order to protect relatively high risk (and often lower-income) individuals (e.g. risk of unemployment and disability, flood risk, health risks).
- **Addressing a non-cost reflective poverty premium** would suggest that the market for those on lower incomes is not functioning efficiently and in an equitable manner, meaning that regulatory interventions may need to be considered to ensure that insurers are delivering value for money for lower income consumers.

Figure 2: Sources of the poverty premium



Source: SMF

The challenge is a lack of evidence on the drivers of the poverty premium

Given the importance of understanding the balance between these two drivers of the poverty premium, it is no surprise that our discussions with expert stakeholders arrived at this topic. However, there was no agreement over the balance between the two issues. The root cause of this debate is the opacity of insurers' pricing models. While a key part of the competitive nature of the insurance market, this opacity means that evidence on the split between these two drivers of the poverty premium is largely non-existent.

The results of this lack of understanding has been a "ping-pong" of policy responsibility, with the regulator arguing that this is a social policy issue, which should be tackled by Government, and the Government arguing that it is a regulatory issue and there is no evidence that Government intervention is required.

This means that if we are to tackle the poverty premium in insurance, and drive detriment down and increase take-up, a better understanding of the basis of the poverty premium needs to be established. From this position, policymakers will then be able to determine the appropriate balance between regulation and social policy.

A lack of understanding of the drivers of the poverty premium in insurance has led to a policy ping-pong between the regulator and Government, and ultimately inaction.

Key finding from expert roundtables

Recommendations

Below are recommendations which we believe will support the industry, regulator and Government to work together to tackle the poverty premium and ensure more people in poverty get the cover they need, at prices that are fair.

Recommendation one – FCA should investigate the poverty premium in insurance

The Financial Conduct Authority (FCA) should build on its existing work, and undertake new work where needed, to provide better information on the poverty premium in insurance. This should identify and publish annually:

- The overall level of the poverty premium for different policy types and different groups in society;
- The portion of this that can be attributed to problems in the market, and the portion that would need to be tackled through social policy interventions;
- The impact on the poverty premium of issues such as monthly payment arrangements and the extent to which current charges are cost reflective.

This information can also be used to hold firms to account and change behaviour.

Recommendation two – FCA investigation should publish results on firm-by-firm basis

To provide the data needed to hold firms to account, the FCA should publish the results of their assessment of the poverty premium in insurance on a firm-by-firm basis. This would highlight which insurers have the largest non-risk-reflective poverty premium (i.e. where poorer customers are being provided with the worst value for money). This data could be useful for a number of audiences including consumers, civil sociery groups and investors.

As other reports have highlighted, consideration should also be given to the extent to which the non-risk-reflective poverty premium is driven by poorer consumers accessing more expensive products. Stakeholders highlighted that the market for single-item insurance policies was likely to be one particular example of where this was not the case. Our research suggests that 1.2 million people in poverty have this sort of cover. Here, it was argued that people taking on single-item insurance policies would be better (and more cheaply) provided for through a broader contents insurance policy. If this were found to be true, there is a strong case for action by the regulator.

Recommendation three – FCA should conduct a Market Review of single-item insurance cover

The FCA should conduct a Market Review of single-item insurance cover (i.e. including insurance of rent-to-own, mobile phone, gadget and other white and technology goods, that could likely be covered through a broader contents insurance package). If the review finds significant detriment to consumers, and particular low-income consumers, it should consider strong action to tackle this – including strongly regulating all, or some forms of, single-item cover and/or their distribution routes.

Where the FCA's analysis reveals an issue with people in poverty paying more because they face greater risks, this is likely to then need a social policy response. This social policy response could come in the form of a state-backed intervention, or increased regulation, which was explicitly targeted at ensuring that insurance companies could not price policies based on factors that increase costs to low-income families. There are a wide range of potential options here, with significant pros and cons of each.

Recommendation four – Where required, Government should undertake a review of potential interventions

Where a social policy response is identified as being needed, the Government should undertake a review of potential interventions that could tackle it. This should include:

- State-backed insurance products for people on means-tested benefits or low incomes (in and out of work).
- Insurance Vouchers (like childcare vouchers) for people on means-tested benefits or low incomes (in and out of work).
- The introduction of stricter regulation on pricing, such as greater oversight by regulators and the banning of certain rating factors.
- A significant reduction in Insurance Premium Tax (IPT).

Building resilience, trust and confidence

Taking these proposals forward would go some way to ensuring that people in poverty can build the financial, economic and social resilience they need to boost living standards and manage the cost-of-living crisis. However, what is at stake here is not just the wellbeing and protection of people who currently miss out in the insurance market. This is also about trust and confidence in that wider arrangement of using market mechanisms to provide important and even essential things. The SMF has always been dedicated to the proposition that markets can deliver not just economic wealth but also social justice. In some cases, policymakers have a vital role to play in ensuring the delivery of those benefits. This is because delivering them is the proof that markets work, both economically and politically. Where markets fail to deliver either economic benefits (more wealth and innovation) or political goods (more fairness and freedom), the public will reasonably ask why we use those markets. Maintaining trust and confidence in the market and its ability to meet society's expectations is vital work. Answering the challenge set out in this report is part of that work.

About Social Market Foundation

The Social Market Foundation is Britain's leading cross-party think tank. A registered charity, our mission is to educate the public and their representatives about how better policies can deliver greater wealth, happiness and fairness.

About this report

This research project was supported by Fair By Design. Fair By Design is dedicated to reshaping essential services such as energy, credit, insurance and payments so that they don't cost more if you're poor – also known as the poverty premium. Fair By Design collaborates with regulators, government and industry to design out the poverty premium. Fair By Design is managed by the Barrow Cadbury Trust on behalf of a group of foundations. Charity number: 1115476. Registered in England No: 5836950

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