Insurance and the poverty premium

What's known and the policy implications

A WPI Economics Briefing Paper for Barrow Cadbury Trust

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Executive summary

A car accident, a burglary, a washing machine breaking down. No-one is immune from these sorts of incidents - and insurance provides us with a way to mitigate that risk.

Low-income households can face these issues like anyone else. But they are significantly less likely to have insurance to cover them.

Figure 1: Insurance rates by income, selected products

50% of households with car insurance and income of under £15,000 have breakdown insurance – compared to 59% earning between £15-30,000

39% of households with income of under £15,000 have contents insurance – compared to 59% earning between £15-30,000

5% of households with income of under £15,000 have mobile phone insurance – compared to 12% earning between £15-30,000

Source: WPI Economics analysis of FCA Financial Lives Survey

Some of this disparity can be explained by lower insurable needs. But a lack of insurance where there is an insurable need can raise people's anxiety, and effectively establishes a 'latent poverty premium' where, if something goes wrong, low-income households face an unenviable choice of using credit or drawing down savings (where available), or either going without or adapting in ways that might ultimately be more expensive.

And where low-income households do have insurance, it is often more expensive for a variety of reasons. These include low-income households being seen as higher risks, having to pay by more expensive methods, or being less likely to switch and end up paying a 'loyalty penalty'.[1]

It's important to understand the nature of these issues, and the extent to which they are market failures in an economic sense, and the extent to which they are issues of social policy. To the extent that higher costs for insurance are driven by low-income households being higher risks, for example, this is not a market failure but the market efficiently allocating risk and pricing accordingly. This higher cost, combined with macroeconomic factors like wages and levels of benefits, then combine to make insurance either entirely unaffordable or something that is worth going without, when the alternative is to go without something that is truly essential.

This does not, however, mean that no action is required. This principle can be seen in a range of other markets where an efficient private sector provision does not provide everyone with access to cover –

[1] https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/the-cost-of-loyalty-exploring-how-long-standing-customers-pay-more-for-essential-services/

such as unemployment insurance (through benefits) and longevity insurance (through the state pension).

In these examples, the state has stepped in to a greater or lesser degree through the welfare system, rather than force a reduction in cost. When it comes to contents, motor, or breakdown insurance, however, there are a range of market-specific measures that could work to reduce the cost of insurance and / or to increase low-income households' likelihood of taking out a product without requiring significant state involvement in direct provision. We have not, in this short note, undertaken a detailed examination of policy options, but some of the more promising areas to consider further are as follows:

- **A basic insurance product:** This could reduce costs, as well as overcoming issues around trust in financial services.
- **Regulation to eliminate the monthly payment premium:** This would prevent low-income households with little immediate access to funds from being charged more for needing to spread their payments.
- **Auto-enrolment through home rental contracts:** Particularly for local authority or housing association tenants, this could 'nudge' more low-income households to take out contents insurance.
- **Auto-enrolment through Universal Credit:** A single provider of insurance for Universal Credit claimants could benefit from economies of scale and reach large numbers of low-income households.
- **Incentives to business to offer insurance as a staff benefit:** Businesses already provide employees with pensions (through auto-enrolment), but many also provide additional benefits as part of an employment package (such as occupational sick pay). Larger employers in particular could also provide access to insurance, pooled among employees.

The outcome of the recent Citizens Advice super-complaint on charging higher prices to longstanding customers is not known at this point - so in this note we haven't looked at options to reduce the 'loyalty penalty', although this is another area with merit.

To take this agenda forward, we recommend work in the following areas:

- Further analysis of the Financial Lives Survey;
- Understand the existence and extent of different barriers among low-income consumers;
- Work with industry to better understand the reasons for the higher cost of insurance for low-income households, and the potential impact of different reforms; and
- Develop more detailed policy options to reduce the poverty premium arising from insurance.

Introduction

Insurance plays an important role in our financial lives. It protects us from the harmful impacts of a sudden economic shock – whether a loss of income, or an unexpected expense. In this way it plays a similar role as savings, except the benefit is only realisable in specific circumstances (unlike savings, which risk being used for other purposes), and the cover is available from an earlier period (whereas a savings pot takes time to build to the level of cover insurance offers). This is because the risk in an insurance market is pooled among the policyholders, meaning there are economies of scale and individual costs are lower – whereas savings are directly made by and linked to an individual. In some cases, holding insurance is also a legal requirement – drivers, for example, are required to have motor insurance as a condition of owning a vehicle.

We also know, however, that for a range of reasons lower-income households can often pay more for insurance in cash terms as well as (more obviously) as a proportion of income. Combined with the optional nature of most types of insurance, this also means that consumers may simply go without it. This would be less of a problem if low-income consumers could draw on savings in the event of an economic shock – but perhaps unsurprisingly, lower-income households also report lower savings. Half of households with total income of under £300 a week (approximately £15,000 a year) have no savings, compared to a little over a third of all households.[2]

Access to affordable insurance, then, is an important issue for low-income households. In this short briefing paper for Barrow Cadbury Trust, we have focused on the ownership of insurance, not the quality of the insurance. This would be an important area to research in the future to understand whether in addition to the problem of uninsured households there is also a problem of underinsurance, as would whether lower-income households are deterred from claiming in the event of an insurable incident (for example due to a lack of trust in the industry, or a fear that their premiums will increase).

These would be valuable areas for future research. Here, however, we focus on what we know about access to insurance, the reasons behind this, and the implications for low-income households - as well as where the existing gaps in evidence are.

From this we set out an indicative agenda for policymakers to better understand the nature of the problem and provide some initial thoughts on promising policy responses to this important issue.

[2] WPI Economics analysis of the 2016/17 Family Resources Survey

Low-income households and insurance

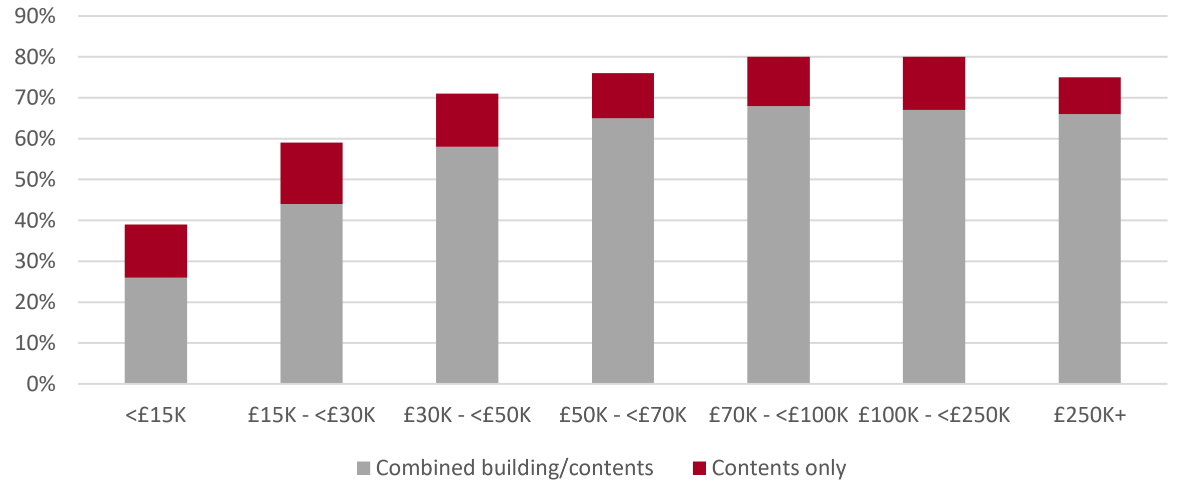
Take up of insurance

Rates of insurance by household income

Contents insurance

Contents insurance can be purchased as a standalone product, or alongside building insurance. Looking at contents insurance ownership rates (of either type) by household income reveals a clear pattern: lower-income households have much lower rates of contents insurance ownership.

Figure 2: Contents insurance rates by household income



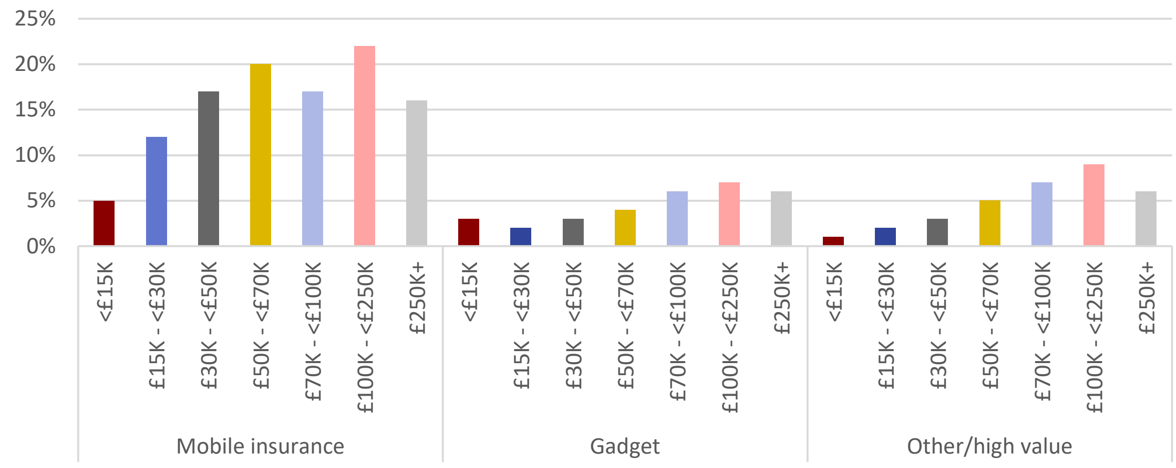
Source: WPI Economics analysis of **the** FCA Financial Lives Survey[3]

This may in part be because lower-income households have a lower insurable need if they have fewer or lower-value assets in their home to insure – for example some items may be bought under rent-to-own agreements rather than owned outright, or owned by their landlord. In order to explore this more we would ideally be able to compare renters and homeowners with similar incomes, which is likely to explain at least some of the variation between contents insurance and income; just 28% of renters have standalone or combined contents insurance, compared to 83% for mortgagors and owner-occupiers.

Lower-income households also have lower rates of insurance for specific items, although there is a marginally higher rate of gadget insurance for low-income households than the next-highest income bracket. The difference in proportion holding these types of cover is also less than for general contents cover.

[3] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults

Figure 3: Insurance rates for specific items by household income



Source: WPI Economics analysis of the FCA Financial Lives Survey[4]

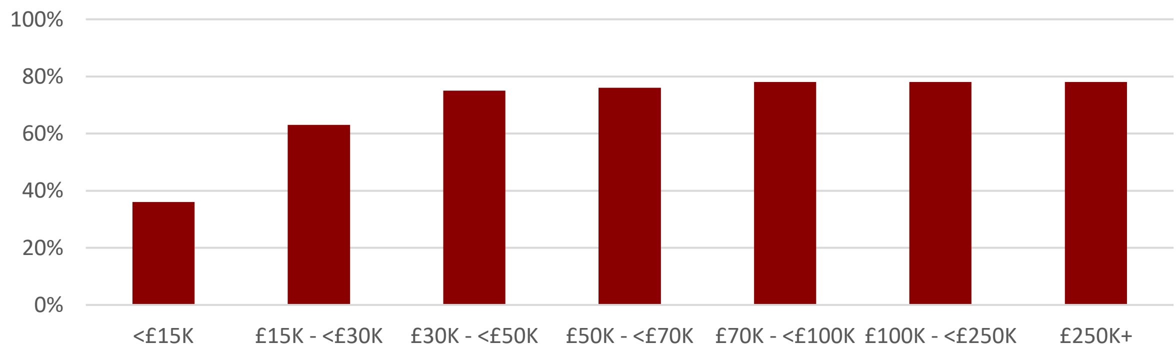
Part of the reason for the disparity in general contents insurance rates, therefore, could be that low-income households have a greater propensity to insure items one-by-one (perhaps because if a low-income household only has a few items worth insuring, it makes sense to insure each relevant item individually, rather than purchase a general cover - alternatively they could be over-insured and have both a general contents insurance product and a specific item coverage[5]).

From the published data on the Financial Lives Survey it is not possible to calculate the proportion of households in each income bracket that have *some* sort of contents insurance, whether general or for specific items.

Motor insurance

Unlike contents insurance, motor insurance is mandatory for a subset of the population, and so in principle the number of households with motor insurance should equal the number of households with a vehicle, although some proportion of drivers are uninsured (we don't know the proportion of uninsured drivers who are in low-income households).

Figure 4: Motor insurance rates by income

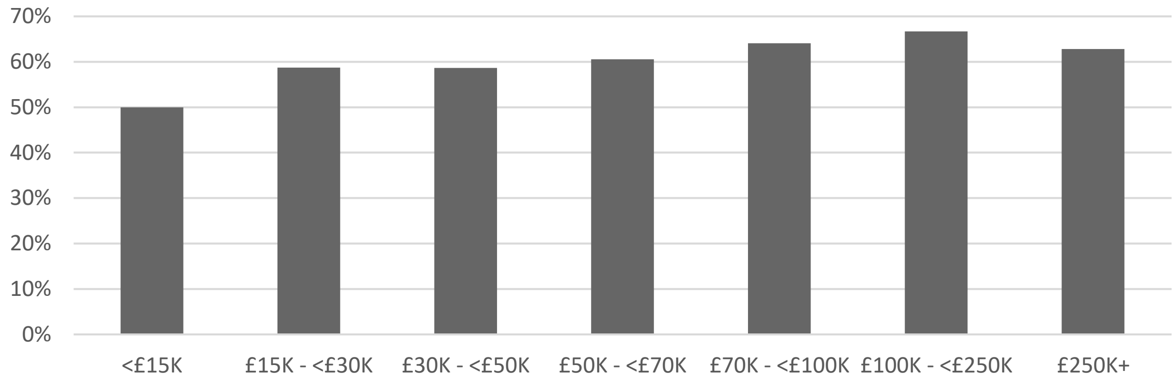


Source: WPI Economics analysis of the FCA Financial Lives Survey[6]

[4] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults
[5] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1615-poverty-premium-report.pdf
[6] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults

If we assume that all car owners hold motor insurance, we can also look at the proportion of this group who also hold breakdown cover. These are people who inherently have an insurable need (because any car can break down), but it is optional. When we do this, we again see that lower-income households are less likely to have insurance.

Figure 5: Breakdown cover as a % of motor insurance holders by household income



Source: WPI Economics analysis of the FCA Financial Lives Survey[7]

Breakdown cover can be a part of packaged bank accounts, and so the responses to the FCA survey may not perfectly reflect actual ownership of breakdown cover among motorists – for example, some people may not realise they have breakdown cover, or conversely they may have it but have no need for it (if other features of the account were nonetheless attractive enough).

Reasons for lower uptake among low-income households

A brief review of academic and grey literature identifies a range of reasons why people may not take out insurance. While much of this relates to types of insurance outside the scope of this note, or is from countries other than the UK, and does not focus on low-income households, similar factors are likely to be in play (albeit to different extents).

Misperception of the risk

There are a range of ways in which people may misperceive the risk of a need for a claim arising, which affects the value they place on insurance.

In a general sense, people have difficulty evaluating probabilities.[8] When it comes to potential negative events, People tend to estimate the likelihood and consequences of future disasters by focusing on recent past experience.[9] Even when people do think more about future negative events, their focus differs; some people pay more attention to the severity of an event, others the probability – meaning for low probability-high severity events, the latter may resist buying insurance.[10]

Myopia – and income constraints

Insurance does give some short-term gain in terms of peace of mind that protection is available if something bad happens, but its main benefit is long-term - whereas the financial cost is upfront.[11] A

[7] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults
[8] https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3385021/
[9] http://opim.wharton.upenn.edu/risk/library/WRCib2013a_Insurance+BehavioralEconomics.pdf
[10] https://www.le.ac.uk/economics/research/RePEc/lec/leecon/dp10-12.pdf
[11] http://opim.wharton.upenn.edu/risk/library/WRCib2013a_Insurance+BehavioralEconomics.pdf

focus on short time horizons could therefore lead to consumers systematically undervaluing the protection against future events that insurance offers.

This may be particularly acute among low-income households. This is less about a *perception* that the short-term matters more than a *reality*; for someone on a low income, the impact of spending money immediately is. It does not mean going without luxury items or cutting back a little; for people with no flexibility in their finances, it means cutting back on *essentials* like food and energy. While insurance is important, it is not an essential, and so it is understandably relegated to the status of 'nice to have'.

Some evidence for this is provided by a survey from the housing charity Shelter, in which the most common reason for not having insurance, cited by 42% of respondents without home insurance, was that they couldn't afford coverage.[12] Research from the Joseph Rowntree Foundation also found that low-income households were less likely to have contents insurance, and that many of these had previously had a policy but had let it lapse due to financial constraints.[13]

Belief that insurance is unnecessary

There is some evidence from the UK that renters in particular may not consider home insurance to be necessary. A 2010 poll for the charity Shelter found that 18% of renting households without home insurance didn't think they had anything worth insuring, while 22% didn't think home insurance was important.[14] This has been echoed in recent research by YouGov.[15]

Lack of trust that insurance would pay out

Another factor is lacking trust that insurance will pay out – i.e. a belief that the insurance will not *in practice* provide a benefit. There is some evidence that consumers underestimate the likelihood of claims being accepted, which could translate into lower uptake of insurance.[16, 17]

Transaction costs

Applying for insurance can be time-consuming and require detailed knowledge of features of a property or vehicle, and of the value of items to be insured. Complexity or perceived complexity can therefore be another barrier (even when the insurance is extremely important, such as health insurance in the US).[18]

The consumer decision journey for insurance

Informed by this literature, we have created a stylised consumer journey. At each stage of a journey, there is a question that a consumer must implicitly or explicitly answer. The journey for motor insurance

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12 http://media.shelter.org.uk/home/press_releases/over_five_million_households_in_the_uk_have_no_home_insurance

13 http://www.jrf.org.uk/sites/default/files/jrf/migrated/files/spr348.pdf

14 http://media.shelter.org.uk/home/press_releases/over_five_million_households_in_the_uk_have_no_home_insurance

15 https://yougov.co.uk/topics/finance/articles-reports/2014/01/20/only-39-private-tenants-have-contents-insurance

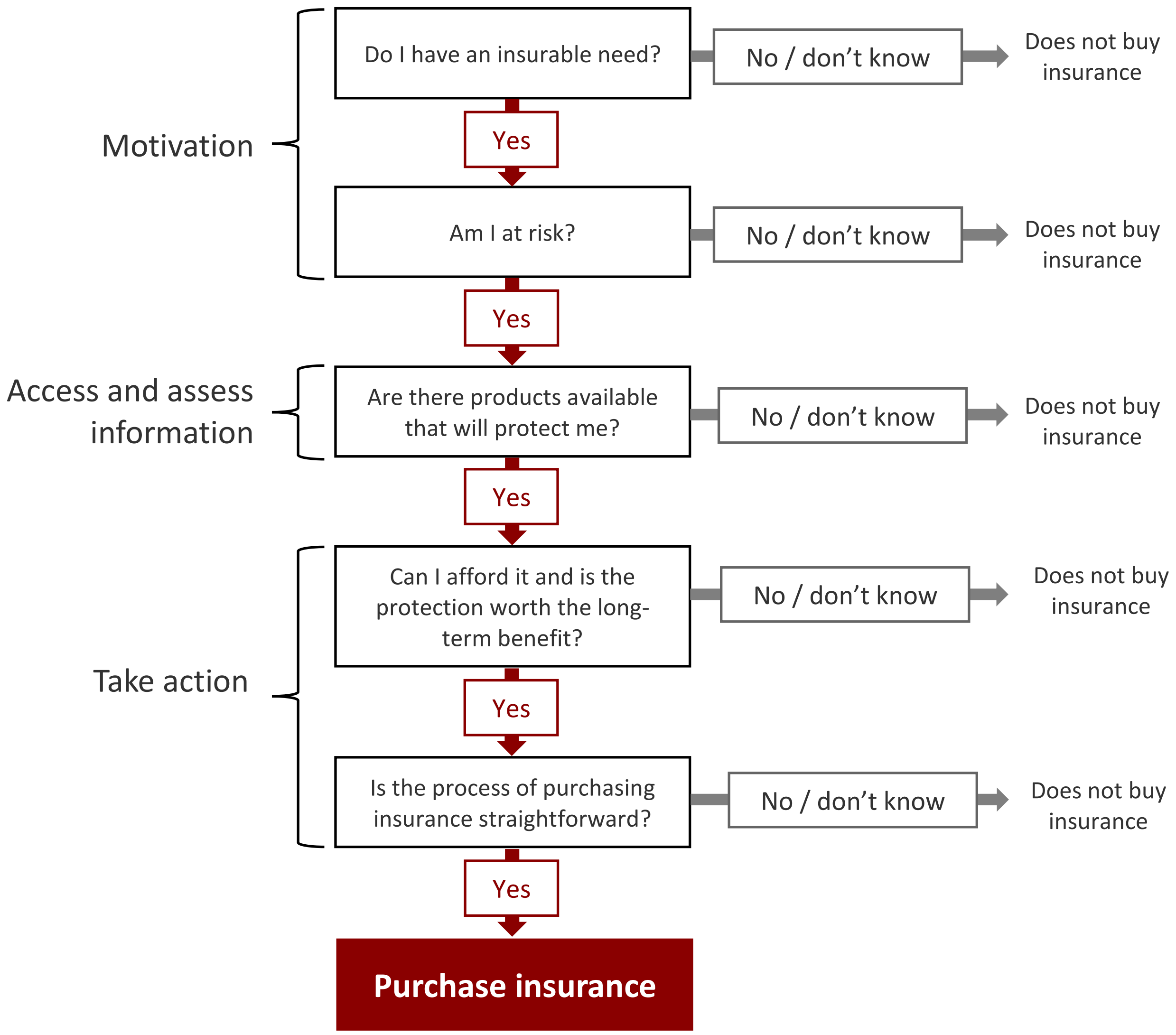
16 https://www.drewberryinsurance.co.uk/knowledge/research/2015-protection-survey

17 https://www.insurancetimes.co.uk/only-half-of-british-consumers-trust-insurance-companies-to-pay-claims/1425151.article

18 https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3385021/

is simpler, because if there is an insurable need there is a requirement to have cover, so this journey applies to optional insurance only.

Figure 6: Consumer decision journey for optional insurance



Source: WPI Economics analysis, adapted from SMF[19]

If the answer to any of these questions is not 'yes', the consumer may end the journey and not purchase cover. Understanding low-income households' responses to questions at each stage will therefore be important in fully understanding reasons behind this. It is also important to note that for all of these, *perception* matters as much as the reality; a consumer who sees the process of purchasing insurance as complex or time-consuming may well not go on to take out a product – however simple the process is in reality.

We explore what is known about cost of insurance premiums below, but there is also some evidence from the Financial Lives Survey that sheds some light on some of the relevant barriers. Lower-income households reported less confidence in UK financial services generally – which could translate into a lack of trust that an insurance claim will be handled fairly or will pay out when needed.

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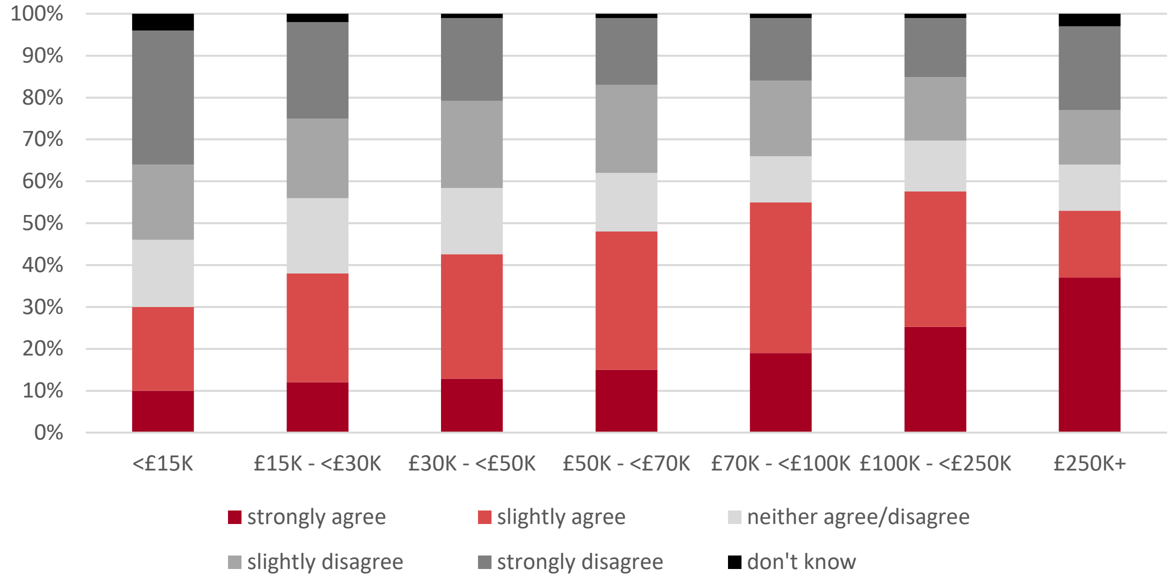
[19] http://www.smf.co.uk/publications/household-action-flooding/

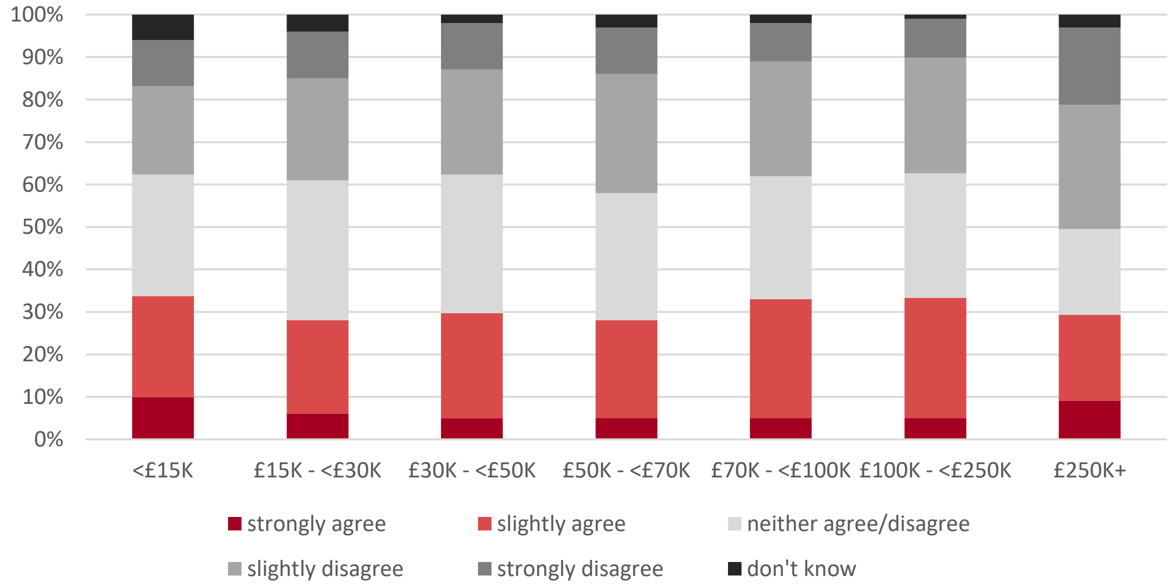
Figure 7: Agreement with the statement "I have confidence in the UK financial services industry" by income



Source: WPI Economics analysis of the FCA Financial Lives Survey[20]

However, when it came to how financial services firms had *actually* treated them, low-income households agreed to same extent as other income brackets that firms had been honest and transparent. This suggests that the lack of wider trust for low-income households is related to a mistrust in financial services firms they have not ever used.

Figure 8: Agreement with the statement "Most financial firms are honest/transparent in the way they treat me" by income

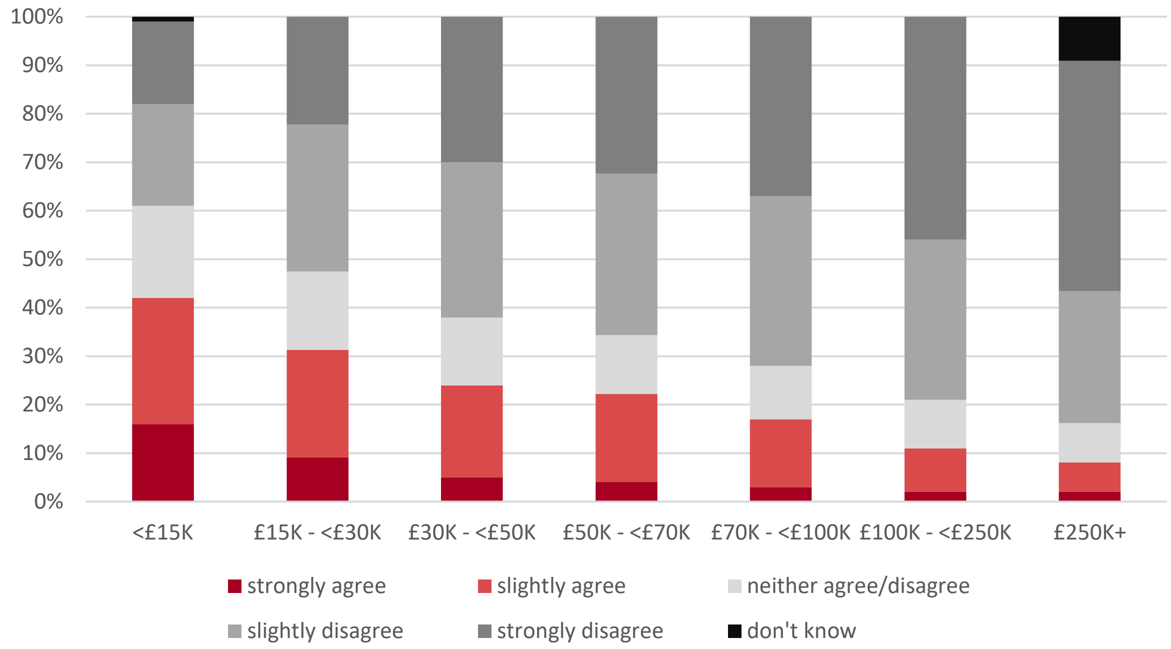


Source: WPI Economics analysis of the FCA Financial Lives Survey[21]

[20] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults
[21] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults

Trust in financial services is not the only relevant factor in purchasing insurance. Taking decisions such as whether to insure against potential future risks requires someone to look to the future and see that risk as worth mitigating. The Financial Lives Survey shows that 42% of low-income households agree with the statement 'I'd rather think about today than plan for tomorrow', a higher proportion than any other income bracket and a full 50% higher than the average.

Figure 9: Agreement with the statement "I'd rather think about today than tomorrow" by income



Source: WPI Economics analysis of the FCA Financial Lives Survey[22]

This could well be related to the concept of cognitive bandwidth and the psychology of scarcity, whereby low-income consumers are more focused on the day-to-day rather than having the 'breathing space' to think about the future.[23]

Implications of lower uptake of insurance

This lower uptake of various types of insurance among lower-income households has several implications, depending on whether there is an insurable need, whether the cover is mandatory, and whether a claim needs to be made.

If there is no insurable need, there is no harm from a household not being insured. While the desire to *avoid* a mandatory insurable need due to costs may affect behaviour, such as a decision about whether to purchase a car, and therefore may limit someone's opportunities or quality of life, it is not per se an implication of not being insured.

If there is an insurable need, then not having insurance is either illegal (motor insurance) or means the consumer can have no peace of mind that, if something goes wrong, they will not be left out of pocket – potentially a significant concern for low-income households with little recourse to savings or credit.

[22] https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults
[23] https://www.apa.org/monitor/2014/02/scarcity.aspx

Table 1: Implications of not having insurance for an insurable need

	Claim is not needed	Claim is needed
Mandatory insurance (motor insurance)	Risks prosecution No peace of mind	Risks prosecution No payout Cost covered by Motor Insurers' Bureau
Non-mandatory insurance (breakdown cover, contents insurance, item insurance)	No peace of mind *or* Unwarranted peace of mind	Must cover cost No payout

Source: WPI Economics analysis

Options if no payout

If something goes wrong but the household does not have insurance, there are a number of options. Broadly these are to go without, to use savings, or to use credit. An uninsured household, therefore, faces a *latent* poverty premium even if no incident ever arises, because the prospect of an event that leads to them needing to take out high-cost credit, or to use up savings (which may simply push the latent premium a little down the line), is always looming in the background.

Low-income households are less likely to have built up savings to cover an emergency, and may lack access to (affordable) credit, meaning they may simply have to go without the relevant item, lowering their quality of life (and potentially leading to additional costs and inconveniences, e.g. going to a launderette rather than using a washing machine). As with needing to take out potentially high-cost credit, in this way, parts of the poverty premium interact.

Cost of insurance

One key factor that is necessary, if not sufficient, for a household to purchase insurance is the affordability of the premiums. Low-income households are, by definition, constrained in their ability to pay – but this can be compounded by higher costs of insuring themselves, which exacerbates this constraint.

What is known about costs of insurance for low-income families?

Research from Bristol University's Personal Finance Research Centre found that the cost of insuring specific items added £27 to the annual poverty premium for low-income households, 5.5% of its total.[24] This is, however, an average across low-income households, rather than the additional amount that an individual low-income household might expect to pay extra.

There are a number of reasons why low-income households may face higher insurance costs:

- **Higher risks:** For some types of insurance, factors that affect risk profiles (the basis of pricing in insurance) may correlated with low income. For example, postcodes that are high-crime areas may be disproportionately likely to have low-income residents, or younger drivers, who are more accident-prone, may be more likely to be low-income. Low-income residents may also be

[24] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1615-poverty-premium-report.pdf

less likely to have protective features that could reduce premiums such as a burglar alarm, or a strong lock, particularly if they are renting and the landlord has no incentive to install such measures.

It's important to note that pricing by risk, even if that leads to low-income households paying more, is not itself a market failure (in the technical economic sense); it is an outcome from the market operating efficiently and allocating risk well. This does not mean that it is an outcome we should not try to change, but we should diagnose the issue carefully before identifying solutions.

- **Lack of switching:** In some parts of the insurance industry, it is common to charge existing customers more for their insurance when they renew than new customers. This won't solely be found across low-income consumers, and the Financial Lives Survey does not have large enough sub-samples for us to estimate the proportion of low-income insurance-holders who have had their product for a long time, but this could explain part of the difference in cost if low-income customers are less likely to switch (which may be related to the lower levels of trust exhibited by low-income consumers in financial services in general). These practices (across sectors including insurance) have also recently been subject of a super-complaint from Citizens Advice.[25]
- **Payment up front:** Paying monthly rather than annually often comes with a premium, to reflect the uncertainty the insurer has about whether they will receive the full annual premiums and the cost of processing multiple payments. Low-income households may not have ready access to money to pay the full cost, and so need to spread their payments – and pay more.

If access to better risk-profiling tools that reduced premiums, such as black box telematics for motor insurance, required an up-front fee, low-income consumers who would struggle to afford this may be paradoxically priced out of better deals by pricing structures. Our understanding is that an insurer will usually pay for the installation[26], but in future there may be further technological developments, or developments for different products, that could make this a further reason for low-income households paying more for insurance.

Impact of cost of insurance

As we have explored above, if insurance costs are high, they could deter people from taking out insurance for some or all of their insurable needs. It could also affect product choices – for example, the cost of insurance could be a factor in deciding not to buy a car, even if the other running costs and the upfront cost is affordable. In principle it could also be a factor in choosing to rent rather than own a product, although work from the FCA suggests that a high proportion of rent-to-own products are purchased alongside relatively high-cost insurance policies.[27] And if insurance *is* purchased, these higher costs could add to already squeezed household budgets.

[25] https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/excessive-prices-for-disengaged-consumers-a-super-complaint-to-the-competition-and-markets-authority/
[26] https://www.confused.com/car-insurance/black-box/telematics-faqs
[27] https://www.fca.org.uk/publication/consultation/cp18-35.pdf

Potential policy options

The evidence and analysis gathered for this note strongly suggests that there is no one reason for the lower rates of cover among low-income households. Some proportion of this will be due to lower insurable needs, some to do with cost, and some to do with a wide range of perception issues.

Understanding the proportion of uninsured low-income households that face different barriers (or different combinations of barriers) to taking out insurance will be important in identifying the most promising interventions. In this short note we have not been able to explore this further, nor have we assessed potential options in depth. However, we have set out some potential avenues for further exploration below. These are not mutually exclusive avenues, and so could be taken forward in tandem to tackle different barriers to uptake. We have also set out some further questions and issues that would need to be explored before any of these were taken forward, although the existence of these issues does not in itself mean the solution is a poor one.

Options to reduce costs

To the extent that cost of insurance is a barrier to low-income households, there are a number of measures that could help. We have focused here on demand-side options, rather than supply-side options such as increases to disposable income of low-income households. However, to the extent that cost is a barrier to taking up insurance, there is a limited amount that can be achieved through market-specific interventions. For households whose income from earnings or benefits already barely (if at all) cover their housing, food, fuel, and transport costs, no amount of reducing the cost of insurance or easing the process of purchasing an insurance product will make it affordable. We have therefore identified measures that could help – but without macroeconomic changes, there will continue to be uninsured low-income households.

The scope for a 'basic insurance product'

'Basic' or 'simple' financial products have been raised as a potential solution to a lack of access to financial services regarding a range of products. Anyone with basic ID in the UK can open a basic bank account, which has no fees or charges and is available regardless of credit rating. More widely, the Simple Financial Products agenda following the Sergeant Review proposed such products should be available in relation to savings and fixed-term life insurance.[28]

This was ultimately dropped in 2017 on the grounds that other work on the priority products was ongoing. However, a basic financial insurance product could have merit in reducing the costs of insurance. There would of course be questions of design to resolve, including:

- **Eligibility:** Which households would be eligible is a key question for any such product. The effects of this on competition in the wider market would need to be considered.
- **Awareness:** Eligible consumers would also need to be aware that the basic insurance product was available. This has been a challenge with basic bank accounts.[29]

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28 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191721/sergeant_review_simple_products_final_report.pdf

29 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/Getting%20the%20basics%20right.pdf

- **Cost of premiums and how they might vary:** If a basic insurance product is intended, the cost of premium will be a key factor, as will the extent to which that can vary if someone who is a higher risk applies for the scheme.
- **Features of the policy:** Insurance contracts include a combination of an excess (that must be paid before the insurance pays out), clauses (that restrict the insurer's liability in certain cases), and maximum payouts.
- **Who would offer it:** Whether all, or a specific set of, insurers would be required to offer it, or whether it would be a standalone scheme.
- **How would it be paid for:** The primary rationale for a basic financial product is that it is not economically viable for companies to offer them to certain groups of consumers. This suggests that there would need to be some form of subsidy for the products and related marketing – which could be from a levy on insurance providers, in a similar way as Flood Re.

There could also be an issue of adverse selection, whereby only higher-risk customers entered the scheme. This could increase the costs of the scheme to unanticipated levels, which could make it unsustainable over the longer term.

However, if these could be resolved, a basic insurance product could bring wider benefits than just its lower price. It could be seen as more trustworthy, and could also be, or be seen as, simple to apply for.

Reducing the distinction between low-income and high-income households

To the extent that insurance costs are higher for low-income households because of their greater perceived risk, one option could be to reduce the distinction between low- and high-income households. This could be done by restricting the criteria insurers can use in setting premiums, such as postcode (or income itself) in a similar way as has been done in motor insurance, where insurers are not able to use sex as a factor.

This effectively mandates greater pooling of risk, and spreads costs more evenly. However, there are a number of potential drawbacks. Most significantly, it may only prevent one *route* to a price distinction between low- and high-income households, rather than ending the distinction itself. Since the ban on varying premiums by sex was introduced, the difference between premiums paid by men and women has grown, which has been put down to other factors that correlate with sex (including professions).[30]

We have also not assessed whether the industry would adapt in other ways, for example by *excluding* whole postcodes from coverage, rather than varying premiums. While this has not happened in motor insurance, this is likely to be because sex-based discrimination is covered in the Equality Act, whereas income-based discrimination is not.

Another more promising option could be to prevent the current additional cost low-income households face from being unable to pay a year's premiums in one go. While this would slightly increase the costs of single premium payments, in a competitive market it should also reduce the costs of monthly payments. This might also lead to more consumers who currently pay annually to pay monthly (as they would receive no financial benefit from doing so), so more work would be needed to understand the impact this would have on the insurance market more widely, and any unintended consequences.

A further contributor to the higher costs faced by low-income households is likely to be engagement in the market and rates of switching. We have not assessed how this aspect of higher costs could be

[30] https://www.theguardian.com/money/blog/2017/jan/14/eu-gender-ruling-car-insurance-inequality-worse

reduced, given the work we expect the CMA will be undertaking in this area across markets following Citizens Advice's super-complaint, but reducing this penalty would be likely to disproportionately benefit low-income households.

Options to increase motivation to take out insurance

Another area for intervention could be, where insurance *is* affordable, to encourage consumers to take it out. Below we have explored some of the types of interventions that could increase this.

Leveraging existing trust

As noted above, low-income consumers answer more positively in relation to financial firms they already use than to financial services firms in general. One option, therefore, could be to incentivise companies with existing relationships with low-income consumers to offer contents insurance products.

There are, however, risks to this approach. In particular this trust may be misplaced – or where it is justified in relation to a particular product that justification may not carry across to insurance. The FCA's recent findings in relation to the rent-to-own sector, in which trust in the retailer appears to lead to trust in expensive add-on products, demonstrate the potential drawbacks to this.[31]

Another option could be to understand the extent to which social financial institutions such as credit unions currently offer insurance to their members, and whether the barriers to this could be introduced.

Raising awareness of the consequences of being uninsured

Although low-income households have lower rates of insurance and are more likely to think about today rather than tomorrow, they were not significantly less likely than other income brackets to say that they preferred to be safe than sorry. An advertising campaign based around the concept of 'better safe than sorry' could increase uptake of insurance, although there would again be questions about who should pay for it.

Tackling both costs and availability

Finally, there are a set of potential solutions that could both increase motivation (or likelihood) of taking up insurance *and* reduce costs. Interventions to 'nudge' people towards particular choices, rather than mandating them, are a way to encourage certain choices, particularly when the choice is not necessarily appropriate for all people. The most high-profile example of this is pensions auto-enrolment, which has increased the number of employees saving for a pension in the UK.[32]

A similar 'opt-out' scheme could be introduced for insurance, if insurance could be tied to a common factor (in the same way auto-enrolment is tied to employment). We have set out below three ways this could be put into practice. Because these would be opt-out they would increase the likelihood of households taking out insurance (by making 'having insurance' the default option), while also reducing costs (by leveraging economies of scale and potentially through state subsidy on top of this).

[31] https://www.fca.org.uk/publication/consultation/cp18-35.pdf

[32] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions/articles/pensionparticipationatrecordhighbutcontributionsclusteratminimumlevels/2018-05-04

Nudging through rental contracts

This was proposed by the Financial Inclusion Commission in 2017, which suggested insurance could be bundled into rental contracts,[33] although in practice this would be likely to be passed on to renters in rental prices.

There are general potential issues in such a scheme around who chooses the provider and how well they are incentivised to choose an appropriate product that does not significantly under- or over-insure, and offers good value.

Issues of compliance have also been identified in relation to auto-enrolment, and may be more pronounced in the private rental sector, which is highly fragmented. Research from Shelter found poor knowledge of the law among private landlords (although this led some to over-comply), and given the fragmented nature of the market, monitoring and enforcement is difficult. This should be less of an issue in the social rented sector – and one option for the private sector could be to make some degree of 'tenant contents insurance' a mandatory add-on to landlord insurance and / or building insurance on a rental property's building insurance, which could achieve greater, if not universal, coverage.

A 'Universal Insurance'

The nature of Universal Credit means that most (if not all) low-income households will interact with it in some way, unlike with previous benefits. This makes it a potentially efficient way to reach these households who may have insurable needs but no insurance.

This could operate as an auto-enrolment scheme, with the DWP contracting a single provider to offer the product (and using the size of the potential customer base to drive down costs), or establishing a mutual insurance company that is owned by its policyholders.

Similarly to a basic insurance product or auto-enrolment through tenancies, there would be a number of important design features to consider if taking this forward.

Encouraging employers to include insurance in their benefits package

Employers are already required to provide their employees with access to a pension, and many choose to offer additional benefits (including, for example, occupational sick pay or life insurance). Working through employers could therefore either be another way to establish an 'automatic enrolment' scheme for some types of insurance, or could be incentivised voluntarily through engagement with employers and employer groups, or the tax system. These would not reach all low-income households – in particular those not in work, or who do not meet other qualifying criteria – but could make a difference to some.

[33] https://www.bbc.co.uk/news/business-41996352

Potential next steps

This short project has provided an overview of the available evidence on what could be responsible for the lower uptake of insurance among low-income households. It has also provided some initial thoughts on promising avenues for reducing the 'insurance poverty premium'.

To take this agenda forward, we recommend work in the following areas:

Further analysis of the Financial Lives Survey: So far we have only been able to analyse the publicly available tables from the Financial Lives Survey. However, with more time we would be able to apply for and use the underlying data, which would allow us to understand with greater granularity the relationship between product ownership and household characteristics. For example, we could look at differences in product ownership between 'low-income renters' and 'high-income renters', or 'low-income renters' and 'low-income homeowners' – whereas at present we can't combine income brackets with housing tenure to create these categories.

Understand the existence and extent of these barriers among low-income consumers: The interviews conducted by Barrow Cadbury Trust as part of this project will provide some initial and valuable insight into low-income households' engagement with insurance markets. However, there remains a lack of research into the specific barriers faced by low-income households, and the extent to which they interact. This limits our ability to say which factors or combination of factors need to be addressed to deliver the most benefit to low-income consumers when it comes to insurance.

Work with industry to better understand the reasons for the higher cost of insurance for low-income households, and the potential impact of different reforms: Similarly to the situation with research , this agenda would also benefit from a more detailed understanding of the reasons underlying the cost of premiums to low-income consumers, and the industry's appetite to serve this group, as well as the extent to which improved risk-profiling (through big data, or the use of additional factors in setting premiums) could lessen or exacerbate these. Any intervention in a market also needs to be undertaken with a clear understanding of the likely dynamic effects on that market itself, which engagement with the industry would also help with.

Develop more detailed policy options to reduce the poverty premium arising from insurance: In this note we have been able to set out some broad areas that have promise in reducing the poverty premium arising from insurance – both in terms of the cost of premiums, and the 'hidden' costs of risk of not being insured. These are, however, only broad areas rather than detailed policy designs, and each would need further work to test and refine with consumers and industry to understand their likely effectiveness in practice and any potential unintended consequences.