IFoA Call for Evidence: the Great Risk Transfer
Response from the Financial Inclusion Commission

About the Financial Inclusion Commission
The Financial Inclusion Commission (FIC) is an independent body of 14 experts drawn from UK politics, financial services, businesses, the charity sector and academia.
https://www.financialinclusioncommission.org.uk/

Our mission is to champion financial inclusion as a public policy priority. We work with policy makers and a wide range of stakeholders, to come up with practical policy proposals for government, business and civil society.

Financial inclusion remains a significant challenge for 21st century Britain, a nation which prides itself on being a global leader in financial services. But more needs to be done: 1.3 million people do not have a bank account, 16 million adults lack home insurance cover and 10.5 million UK adults would be unable to cover one month of living expenses if they lost their source of income.

Response to call for evidence
The FIC welcomes the Institute and Faculty of Actuaries' (IFOA) call for evidence for 'The Great Risk Transfer' campaign.

Please note that we consent to public disclosure of this response. Please note that the FIC has worked with Fair By Design on this submission so there will be some duplication of messages between responses.

For more information about this response please contact Commissioners Laurie Edmans or Martin Coppack via Commission@ukfinclusion.org.uk

Financial Inclusion Commission

Q 1. Where and how do you see risks being transferred from institutions to individuals in the area(s) you work in, or in wider industry and society?

Due to the link between low income, financial exclusion and wider consumer vulnerability characteristics (see below) our response covers each of these areas. This is because consumer vulnerabilities are central elements when discussing the topic of transferring risk to individuals/consumers.

Insurance

We have witnessed a large transfer of risk from businesses and government to individuals in the insurance market (as well as other markets such as pensions and savings). With reductions in welfare state provision, individuals are increasingly expected to look to the market to protect themselves and their families. This is a shift of problems from a structural/system level, to an individual/behavioural level.

Examples of this transfer might include structuring the welfare state in such a way that a person is expected to work 'harder' to ensure self-sufficiency and the ability to save (including pensions), along with self protection against income shocks via comprehensive private insurance products. However, what happens when a person is not able to work 'harder' due to health or caring responsibilities? What happens if a person cannot afford to move to a different neighbourhood which is deemed less risky? What happens if a person is not able to gain employment that provides a sufficient income? What happens when individuals are considered 'non-standard' or 'less desirable' by the market? This brings major problems when there is a move from a pooled risk approach to one of individualised risk.

As well as access to welfare benefits which meet minimum income standards, people also need access to insurance products that meet their needs at an affordable price. For this to happen the market needs to be able to accommodate the needs of people on low incomes and the characteristics that are often associated with low income – often referred to as consumer vulnerabilities.[1] However, a catch 22 situation has emerged where those who most often have the greatest need for protection are locked out due to:

- not being able to afford appropriate insurance because they are deemed to be a higher risk;
- not being able to access insurance that meets their needs because they are 'non-standard';
- being locked out of insurance altogether.[2]

There is a strong correlation between the detriment individuals face today and the shift away from pooled risk – from both the state (reduction of state safety nets) and the market.

Income shocks are the leading reason people get into problem debt. According to StepChange debt charity, 14 million people in Britain have experienced at least one income

[1] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-8.pdf
[2] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk

shock within a 12 month period; with 4.5 million people experiencing two or more.[3] Examples of income shock include losing a job, becoming seriously ill, getting divorced and bereavement. Millions of pounds are spent on debt advice, bankruptcy and debt write-off as a result of income shocks. It would be better to tackle such issues upstream with affordable, appropriate protection available for all.

As a result of consumer segmentation in the insurance market, and insurance premiums reflecting (or attempting to reflect) the risk profile of individuals, the cost of insurance for low income and vulnerable consumers has gone up. As more risk is carried by the consumer rather than the insurer, or not pooled via cross-subsidisation, this has increased low income individuals' exposure to the poverty premium along with associated access issues.

Research carried out by NatCen Social Research found that one of the four main drivers of the poverty premium in insurance was cost-reflective pricing: insurance premiums can be higher for individuals living in low-income areas, as these areas are considered riskier and are subject to a higher premium from the insurer[4].

There are some protection products that are mandatory, such as car insurance. Recent research carried out for Fair By Design by the University of Bristol (yet to be published) found that in 2019 area-based premiums, particularly car insurance, were the largest contributor to the overall poverty premium faced by low-income consumers. Customers who live in a higher-risk area (20th percentile Indices of Multiple Deprivation (IMD) area) paid nearly £300 per year more on average, if they had insurance, than those who lived in a lower-risk area (50th percentile IMD). In 2016, this figure was only £74, which shows a striking increase.

The risk transfer, to individuals from institutions, in reality means that low-income consumers' "insurable needs" will either be limited to more expensive coverage (which may impact that consumer's financial health and/or ability to pay) or become so unaffordable that insurance becomes a lower priority. For example, research from the Joseph Rowntree Foundation found that low-income households were less likely to have contents insurance, and that many of these households had previously had a policy but let it lapse due to financial constraints."[5] This may in turn lead to what WPI Economics has called the "latent poverty premium": where an uninsured item becomes lost or faulty, and needs replacing – which overall will cost the individual more than if they could afford to insure it.[6]

Data from the Association of British Insurers (ABI)[7] show how low-income households are often exposed to greater risks. For example:

- Social-rented households are almost twice as likely to be burgled as owner–occupied

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[3] https://www.stepchange.org/Portals/0/documents/media/reports/StepChange%20Debt%20Charity%20New%20Normal%20report.pdf

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/782513/natcen_report.pdf

[5] https://www.jrf.org.uk/sites/default/files/jrf/migrated/files/spr348.pdf

[6] https://www.barrowcadbury.org.uk/wp-content/uploads/2019/04/Insurance-and-the-poverty-premium-WPI-Economics-final.pdf

[7] Helping Tenants Protect Their Possessions, Association of British Insurers (2010)

households;
- Arson rates are 30 times higher in lower-income communities than affluent ones;
- Low-income households are 8 times more likely to be living in tidal floodplains than people in more affluent households.

In the coverage of risks from flood, fire or burglary, especially amongst people who rent, rather than own, houses we have seen the following:
- The demise of 'home service' insurance companies who previously sold home cover to (generally) less wealthy households, particularly renters.
- The failure of the insurance industry to find substitute distribution methods to those households. What efforts there are have been concentrated on easier to access, better off householders, generally homeowners.
- Competition amongst providers is focussed on competing for those people who have cover, not on getting more people into cover.
- The scale of the issue is huge. 10.5 million households which rent have no cover.
- The detail of the issue and possible solutions were set out in FIC's report in 2017. An 'infographic' showing the key findings is contained within Annex 1. The industry has not, with one or two notable exceptions, made any progress in dealing with it, despite the increasing incidence and severity of flooding.

Furthermore, changes in employment patterns have[8] seen the number of people working for larger organisations - which tend to have stronger HR policies, better provision for employee wellbeing and more resources to be able to absorb risks - diminish. The number of women in employment has risen sharply, increasing the prevalence of the 'gender gap' in earnings and pensions. The proportion of people employed in small and micro enterprises has increased significantly, as have the numbers who are self-employed, either in the traditional sense or as contract labour or zero hours employees in the 'gig economy'. There is very little ability (or inclination) for employers in these to absorb risks for employees.

Pensions

In pensions provision there has been a move away from defined benefit (DB) pension schemes to defined contribution. This has resulted in the following:
- The level of contributions being made for people accruing pensions has sharply reduced. According to the ONS the average rate in 2018 for private sector DC schemes was 5.0% of pay as a total of employer and employee contributions[9]. The increase in auto enrolment rates from April 2019 is welcome, but given that it only applies to 'band earnings', will still be well below the circa 20% of total earnings that DB schemes typically required[10].
- The risks from longevity and investment return variation has passed from the employer to the scheme member.

[8]https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employmentintheuk/august2019
[9]https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/2018
[10] https://www.pensionspolicyinstitute.org.uk/research/pension-facts/table-20/

- There is now the risk, created by the 'freedom and choice' changes, and identified by the Financial Conduct Authority[11] that up to 100,000 consumers a year might access those freedoms in a way in which they lose out. This arises as a result of consumers being defaulted into, or choosing to move pension pots into, cash savings, against a background in which many people worry more about the risk of the capital value of their savings dropping than they do about the risk of their real value falling. Likely longevity often being underestimated also contributes to the risk.

There has been a gradual wind down of the potential value of state pensions. This has followed from the initial promise of a state earnings related earnings pension of ¼ of relevant earnings being eroded and now eliminated. The Basic State Pension had also been eroding – relative to average earning - leaving many more people requiring means tested top ups, until the introduction of the 'triple lock'. The latter is frequently attacked, and whilst the relative value of the Basic State Pension has increased, the absence of any link to earnings leaves the considerable majority of private sector employees not accruing any certain earnings-related provision for their retirement.

A particular consequence of the changes in working patterns, which have seen more women in employment, is that the pensions provision for women is much lower than men[12]– exposing women, particularly as the incidence of divorce rises, to greater levels of risk. The average woman's pension pot at age 65 is currently one fifth of the average man's[13].

Q 2. Are these transfers working in or against consumers' best interests, and why?

Insurance

As stated above, because of the transfer of risk to individuals, and the impact that this has on the costs to insure, many lower income and vulnerable consumers (sometimes called non-standard consumers) are:

- Not able to afford appropriate insurance as they are deemed to be a higher risk;
- Not able to access insurance that meets their needs properly;
- Locked out of insurance altogether.[14]

Those who may find themselves in such non-standard categories include:

- 9.4 million people aged 65 and over who may want to travel.
- Three million people with disabilities who have been turned down for insurance or charged extra.

[11] https://www.fca.org.uk/news/press-releases/fca-proposes-rules-investment-pathways-and-other-measures-improve-retirement-outcomes-consumers
[12] https://www.pensionspolicyinstitute.org.uk/research/research-reports/2019/2019-07-11-understanding-the-gender-pensions-gap/
[13] https://www.insuringwomensfutures.co.uk/wp-content/uploads/2017/03/COH_J012646-IWF-Pension-Life-Journey-Report-Update-P2.pdf
[14] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk

- The 2.5 million people living with or after cancer, which is forecast to rise to four million by 2030, and their travel companions.
- Around 750,000 of the more than nine million people in the UK with a criminal record whose convictions are unspent. People associated with others with unspent convictions can also be affected, for example, a parent being denied buildings insurance if their child with an unspent conviction moves into their house[15].
- Customers who have made multiple claims within the last few years.
- Many low-income households may also perceive themselves as non-standard when, for example, they reject mainstream home contents insurance policies as a poor match for their particular needs. [16]

Furthermore, the Financial Lives Survey, carried out by the Financial Conduct Authority, found that 39% of those with earnings up to £15,000 per year had contents insurance, compared with 75% of those with earnings between £50-70,000, and 71% of those with earnings between £30-50,000[17].

A further analysis of the Financial Lives Survey, this time carried out by WPI Economics[18], found the following:

- 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.

While not directly related to risk pricing, it is worth mentioning some other factors that relate to higher overall costs for low-income consumers:

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. While this won't solely affect low-income consumers, it does explain part of the difference in cost as low-income customers are less likely to switch (as was found to be the case across markets by Citizens Advice[19]).

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15 https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk
16 All figures gained from: https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk
17 Analysis based on the 2017 FCA survey (https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults), detailed here: https://www.barrowcadbury.org.uk/wp-content/uploads/2019/04/Insurance-and-the-poverty-premium-WPI-Economics-final.pdf
18 https://www.barrowcadbury.org.uk/wp-content/uploads/2019/04/Insurance-and-the-poverty-premium-WPI-Economics-final.pdf
19 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20(1).pdf) (p.24)

The FCA also found that elderly and low-income people were among the worst hit groups in terms of experiencing a loyalty penalty for not shopping around[20]. Combined, they are overpaying by £1.2bn in annual premiums because insurance firms are not providing the same deals to loyal customers. The FCA accused insurers of specifically targeting such loyal customers with big premium hikes in the knowledge they were less likely to switch.

Payment up front
Paying monthly rather than annually comes with a premium (because monthly payment typically entails a credit agreement). Low-income households are more likely not to have ready access to money to pay the full cost up front, and so need to spread their payments – and thus pay more.

<u>Pensions</u>
Risk transfers are generally working against the interests of consumers. This is because of the following:

- Risk transfer has primarily been driven by the financial interests of either employers or government.
- Consumers by and large have not been given the support and encouragement they need to be able to properly understand the impact of the changes:
    - For example, the reduction in the value of future pension benefits has largely happened without any significant push back from employees. If the scale of the reduction in the benefits being promised, from average DB to average direct contribution (DC) levels is in excess of 10% of pay[21], this amounts to a reduction in the overall value of remuneration of 10%. Contrast the ease with which such reductions have been put through, compared to what would have been seen if a straight cut in pay of that amount had been made.
    - The reduction in the proportion of the workforce which is represented by collective bargaining is a significant factor in this.
- There is not a recognition amongst policymakers of the value of the effort it takes (and therefore the time and cost of doing) to overcome understandable consumer inertia in the areas mentioned above. This inertia is now widely recognised and acknowledged in the studies of behavioural economics.
- There is, now, almost no commercial effort to encourage people to save for the longer term, or to insure, because the margins of the products needed cannot support even a reasonable rate of return on the effort required to (to quote a former Treasury Minister) '*take people who should, and could, be making provision, but aren't, and see them become people who could, and should, and are*'. [22]
- The industry has made little or no attempt to defend such effort as a valid part of their costs.

[20] https://www.theguardian.com/business/2019/oct/04/six-million-insurance-customers-hit-by-loyalty-penalty
[21] https://www.pensionspolicyinstitute.org.uk/research/pension-facts/table-20/
[22] Chatham House event attended by one of the Financial Commissioners.

- The introduction of price capping (pensions) and comparison websites focussed primarily on price (general insurance) has exacerbated this.
- The interests of senior management and employees are now much less frequently aligned, when it comes to making provision for pensions above the minima:
  - Senior management are now rarely in the same retirement provision vehicles as their employees, largely because of the lifetime allowance. Therefore, a decision to cut benefits does not affect them personally.
  - The closure of most private sector DB schemes means that:
    1. their members are mainly deferred, and in a high and increasing percentage of cases, no longer work for the business
    2. the deficits in meeting the benefit promises are seen simply as a cost – the old arguments that employers saw a benefit from having more secure and thus more productive employees cannot apply, so there is no counterbalancing benefit. There is just a burden on the balance sheet and profit and loss account, especially against foreign competitors. This is clearly not a good climate for employers to feel inclined to take up pensions obligations beyond the minimum.

Q 3. What do you think are the main drivers of this phenomenon?

Insurance
As stated above, we have witnessed a transfer of risk from businesses and government to individuals in the insurance (along with many others) market. With withdrawals in welfare state provision individuals are increasingly expected to look to the market to protect themselves and their families. Customer segmentation and the movement away from collective pooling towards individualised risk pricing have driven up costs, as well as exacerbated access issues for low-income, excluded and vulnerable consumers.

While this group of consumers has a real need for insurance (arguably more so than wealthier and less vulnerable consumers), many are:

- Not able to afford appropriate insurance as they are deemed to be a higher risk;
- Not able to access insurance that meets their needs properly;
- Locked out of insurance altogether.[23]

We believe the main driver of this phenomenon is individualised pricing and a lack of a joined-up approach between government and regulator to intervene. As observed by the authors of an FCA Occasional Paper on access to financial services, "as insurance moves further towards individualised risk-pricing, some people will pay lower premiums than they did as part of a larger pool. Others may see their premiums rise, be priced out of the market completely or even deemed uninsurable. In the face of increased segmentation, whether to protect consumers from high personalised insurance premiums and refusal of cover is often

[23] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk

characterised as a social policy rather than a commercial decision". [24] This issue is compounded by a withdrawal of the welfare state and a lack of a joined-up approach between government and the regulator to address the needs of those that struggle to gain access to affordable products that meet their needs.

Increased automation also plays a considerable role. As the FCA's Occasional Paper on access to financial services pointed out: "Insurers achieve economies of scale if they can funnel large numbers of customers through a standardised underwriting process, especially if it can be automated and delivered online. The mainstream insurance market conforms to this low-cost model which rules out the level of detail needed to cater for 'non-standard' risks. As a result, consumers with less common risk factors may find they are refused cover or quoted unusually high premiums when they search on comparison websites, because their non-standard circumstances are outside the parameters of the automated algorithm."[25]

The availability of Big Data has made the transfer to individualised risk pricing easier for insurers. But, as evidenced above, this has shifted pressure onto particular groups of consumers, in particular those on low incomes and in vulnerable circumstances.

The FCA has previously stated its concerns over the potential of big data to increase risk segmentation and consequently lead to consumers with higher risks being unable to obtain affordable insurance. The Financial Services Consumer Panel has also described this process as an "increasing demutualisation of risk" and has called on the FCA to assess the risk models used by firms, to ensure they are treating customers fairly.[26]

When the Financial Inclusion Commission looked at the consequences of increased segmentation it found[27]:

- Firms, operating low cost bases, are able to offer low premiums only to 'standard risk' consumers.
- This leads to reduced prices for those who fit within the product parameters, and increased prices for those consumers that don't fit.
- More differential pricing means fewer cross–subsidies/less pooling of risk.
- Some consumers are therefore priced out of the market and living with no cover.
- Others are having to restart the process offline i.e. by telephone or email, because the online application has not given an explanation for the quote, or lack thereof.
- An increased focus on price as the point of comparison for consumers, at the expense of other factors such as coverage – increasing the likelihood of purchasing an inappropriate product that does not meet or reflect their needs.
- Pressure on insurance providers to focus on cost at the expense of other factors, in order to win business.

[24] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk
[25] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk
[26] https://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf
[27] https://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf

As a result, consumers who are deemed by insurance companies to be high risk or 'non-standard' may find few options open to them. As the Financial Inclusion Commission points out, this may become apparent "only after a lengthy, sometimes distressing, search." The Commission continues: "If they can find products, these consumers may end up paying a high price for a product that doesn't fully meet their needs, choose to go without cover or even fail to disclose their circumstances fully with the risk that any subsequent claims may not be paid. What is clear is that there is a supply gap for consumers who want to purchase cover and find they are categorised as 'non-standard' risk. This leads to a coverage gap for those who should have cover but don't."[28]

Pensions

The main drivers of the phenomenon are implicit in the descriptions above, but common characteristics include:

- In government and regulators (some notable exceptions aside): too little comprehension amongst policymakers of the issues; of the underlying drivers of financial services industry financials; of what really constitutes 'value for money' in the eyes of consumers; and of what can make a difference.
  - There are, for example, opinions expressed that the advent of automatic enrolment, which has brought many new savers into pensions, has led to change in the dynamics of consumer behaviour – that it has made more consumers conscious of the need to save and act accordingly. That this is not the case is demonstrated by:
    i. The fact that virtually all members joining new schemes set up for automatic enrolment contribute only at the minimum level, and
    ii. New employees who are offered a workplace pension at higher levels of contribution than the minimum are as likely to turn it down as to take advantage of it (despite the fact that it constitutes higher remuneration and the 'deal' given tax and NI contribution relief makes it extremely good value). This shows the same issue as led to the 'non-joiner' problem – 50% of people offered pension scheme membership did not take it up – prior to the automatic enrolment.
- In the financial services industry: 'group think', often driven by investment analysts of what constitutes a sound strategy for a long-term savings or general insurance business means:
  - Senior management remuneration is frequently linked to share price.
  - Share price is driven by investment analyst views.
  - The analyst's views are driven by short term performance comparisons against peers.
  - It is very difficult to avoid being driven towards the industry norms in terms of behaviour, products or services.
  - Long-term financial services businesses now, contrasted with 20 years ago:
    i. Comprise, almost invariably, shareholder-driven businesses, rather than mutuals. This contributes to shorter term thinking.

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[28] https://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf

ii. Have seen many withdrawals from the UK market, as it has not been possible to make margins to satisfy shareholders (ultimately, of course, to a large extent the same people, as savers, as the customers of their products) which are available in overseas markets, particularly in emerging economies.

- Consequently, we have seen little innovation in products and even less in methods of getting products to any customers other than those most easy to reach. While there have been many claims that digital communications may change this, there is little evidence, in medium and long term savings, that effective measures have been found.

Q 4. Which consumer groups are benefitting and which are being negatively affected by this risk transfer? How are these groups being affected?

Vulnerable, excluded and low-income consumers are being negatively affected by the risk transfer.

<u>Insurance</u>
There are a number of factors that act as drivers to actual or potential vulnerability as described by the FCA in their consultation on consumer vulnerability guidance[29]:

- Health – health conditions or illnesses
- Life events – major life events such as bereavement, relationship breakdown, income shocks
- Resilience – low ability to withstand financial or emotional shocks
- Capability – low knowledge of financial matters or low confidence in managing money.

These categories are not meant to be definitive or exhaustive. However, they are a useful illustration of the permanent and transient nature of consumer vulnerability. See table below for further examples from the FCA[30].

[29] https://www.fca.org.uk/publications/guidance-consultations/gc19-3-guidance-firms-fair-treatment-vulnerable-customers
[30] https://www.fca.org.uk/publications/guidance-consultations/gc19-3-guidance-firms-fair-treatment-vulnerable-customers

Health	Life events	Resilience	Capability
Physical disability	Caring responsibilities	Low or erratic income	Low knowledge or confidence in managing financial matters
Severe or long-term illness	Bereavement	Over indebtedness	Poor literacy or numeracy skills
Hearing or visual impairments	Income shock	Low savings	Low English language skills
Poor mental health	Relationship breakdown	Low emotional resilience	Poor or non-existent digital skills
Low mental capacity or cognitive disabilities	Having non-standard requirements such as ex-offenders, care leavers, refugees	Lack of support structure	Learning impairments

In addition, vulnerable and lower-income consumers are disproportionately affected by underwriting methods. This could be due to the way insurers price risk, based on the area where people live (with more deprived areas incurring higher premiums); or because insurance underwriting models penalise certain characteristics such as those with 'non-standard' needs (e.g. higher costs due to adapted cars or high-value items to make homes accessible) or due to characteristics such as pre-existing health conditions.

The FCA, in its interim report on general insurance pricing practices, did acknowledge that underwriting methods have put certain customers, especially vulnerable consumers, at a disadvantage.[31] Additionally, the FCA, in its vulnerability guidance consultation[32], recognised low and erratic income, as well as general financial resilience, as key drivers of vulnerability.

Furthermore, we know that many consumers find information about financial products complex, too confusing, or are time-poor to such a degree that relying on information impedes their ability to make good decisions. This is especially the case for more vulnerable consumers, including those on low incomes. [33]

Instead of placing the onus on consumers to make the 'right' purchasing decisions, we believe there needs to be more focus on regulator and firms' actions, such as observing inclusive design principles – where regulators must design markets and firms must design products and services that consider and serve all consumers. Instead of making the consumer fit the product, businesses (via regulatory rules and guidance) should shape products to serve consumers in ways that reflect their lives. We believe that many of the problems faced by low income, excluded and vulnerable consumers could be addressed by inclusive product and service design. There is too much reliance on trying to fix problems later via customer service/support.[34]

[31] https://www.fca.org.uk/publication/market-studies/ms18-1-2-interim-report.pdf (paragraph 4.21)
[32] https://www.fca.org.uk/publications/guidance-consultations/gc19-3-guidance-firms-fair-treatment-vulnerable-customers
[33] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-8-consumer-vulnerability
[34] https://fairbydesign.com/news/inclusive-design-in-essential-services/

Pensions and wider products

Those benefitting are, generally, wealthier/higher income consumers, those with good skills and qualifications, and those with housing equity because they have much greater risk capacity:

- Wealthier/higher income consumers are less reliant on state provision and are more able to cope in the event that the increased risks which they are bearing, transpire. They are much less likely to have to resort to short term expedients – like high cost credit, which can create and accelerate a downward spiral into problem debt.
- People with higher skills, qualifications and social capital are more able to command better wages and benefits.
- Those with housing equity can borrow against their property on much better rates than are available for unsecured lending. Once the mortgage is paid off, they do not have the regular outgoings of renters and – especially in retirement – can downsize or release equity.

The opposite applies for low-income, excluded and vulnerable consumers who have low earnings, low skills or qualifications and who rent, because they have less financial resilience and often have little option but to take up sub-optimal and costly means of coping.

Q 5. Are there any examples of regulatory or policy interventions which are either supporting consumers to maximise the opportunities afforded by choice, or helping to tackle the potential adverse impacts?

Insurance

Fair By Design has a venture fund that invests in new products designed to address the poverty premium faced by low-income consumers (see: https://fairbydesign.com/fair-by-design-fund/) At the time of writing this fund has not been able to find any insurance initiatives suitable for investment, which points to the need for social and regulatory policy intervention in the market.

As the FCA's role includes consideration of systemic risks, it should also consider requirements on industry to use data in a way that promotes better outcomes for consumers. We believe the FCA should work closely with government and insurance suppliers in a joined-up approach to ensure that consumer needs don't fall into the black hole between market and social policy.

Flood Re was created to address the insurance needs of people living on flood plains and provides a useful example of where social policy can override the commercial insurance principle. If low-income consumers present higher risk for insurers (e.g. living in areas susceptible to crime) a system akin to Flood Re could be developed. When the cost of the risk (burglary, etc.) climbs above a certain level, the insurer could place that part of the policy into a pooled fund where, in the event of a customer making a claim, the insurer will then be able to recover the costs associated with a pay out.

Finally, WPI Economics[35] proposed a range of options to increase low-income consumers' access to insurance, which we support. These are:

- **A basic/simple 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 (opt out) through home rental contracts**: particularly for local authority or housing association tenants, this could 'nudge' more low-income households to take out contents insurance (via low cost group schemes).
- **With present deficiencies in state safety nets, 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. This would need to be paid by the state rather than individuals.
- **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 provide access to affordable insurance, pooled among employees.

<u>Pensions and wider products</u>
Even though it is not a panacea (for reasons given above), the introduction of automatic enrolment into pension schemes means employers have to direct some level of overall remuneration towards longer term provision. Without the policy intervention, virtually no-one working for the million small and micro employers had any provision at all[36].

The risk to pensions outcomes described earlier, of consumers losing out as a result of the way in which they access their savings using the 'pensions freedoms', is being vigorously addressed by the Financial Conduct Authority in its 'Investment Pathways' initiative[37]. However, at present, this applies only to the 'contract based' pensions under the FCA's remit. Similar measures are not yet in train for 'trust based' pensions under the remit of DWP and the Pensions Regulator, but are anticipated.

In other sectors, positive consumer outcomes have been witnessed through the introduction of regulatory controls when the market failed to provide adequate protection; two examples include the introduction of controls on high cost lending, which were

[35] https://www.barrowcadbury.org.uk/wp-content/uploads/2019/04/Insurance-and-the-poverty-premium-WPI-Economics-final.pdf
[36] https://www.pensionspolicyinstitute.org.uk/media/1373/201802-bn105-the-impact-of-the-introduction-of-automatic-enrolment-on-future-generations.pdf
[37] https://www.fca.org.uk/news/press-releases/fca-proposes-rules-investment-pathways-and-other-measures-improve-retirement-outcomes-consumers

spiralling out of control, and reducing the maximum bet allowed to be placed with fixed odds gambling machines.

Q 6. What are the current barriers to interventions in this area and how might they be overcome?

Insurance

The main barriers include:

- **A lack of a joined-up approach between the regulator and government on who owns the UK's under-insurance problem and how it should be addressed.**
- **A lack of appetite to bridge social and regulatory policy by both the regulator and government so adequate interventions can be put in place.**
- The opacity of mainstream insurers' risk models is a significant barrier to intervention (more detail below).
- An emphasis by the FCA on signposting and consumer education rather than addressing the underlying systemic issues of fairness and access for low income and consumers in vulnerable consumers.[38]
- Lack of resource at the Equality and Human Rights Commission to investigate whether the insurance industry is treating people with protected characteristics, such as disability, fairly in line with the Equality Act. Plus, the lack of a statutory gateway to enable the FCA to share confidential information with the EHRC.[39]
- Lack of inclusive design approaches to policy making and necessary interventions at the FCA.[40]
- Measures designed to prevent inappropriate inertia selling (e.g. PPI) at the same time act as a constraint on the ability of landlords – especially social landlords – to 'bundle' protection for possessions with rent.

As the risk modelling of insurance firms is considered by some to be commercially sensitive and often private, the FCA should consider a new standard for how data, including non-financial data and Open Finance data, can be used in calculating insurance premiums. The standard should also provide guidance on explaining, wherever possible, to a consumer why they are charged the price they are for insurance, including justification of any price increase. This would also allow consumer advocates to better understand risk modelling so they can take action to address issues the current competitive market alone cannot deliver for low income, excluded and vulnerable consumers.

Increased transparency would be an important first step to reducing the barriers to effective intervention. The Financial Inclusion Commission found an apparent lack of transparency in

[38] https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2423/242302.htm
[39] https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2423/242302.htm
[40] https://fairbydesign.com/news/inclusive-design-in-essential-services/

the underwriting process[41]. The Commission notes a proposed solution: that industry is required to be as transparent in all areas of its underwriting as it is currently required when considering age and disability (because of exemptions under the Equality Act).

It is worth noting that a lack of transparency is also a major issue for consumer organisations. As the FCA's Occasional Paper on access to financial services states, given the opacity about the way insurers determine risk-based prices, "it is impossible for consumers or the bodies that represent them to know whether the pricing is fair. The ABI/BIBA non-statutory agreement with the Government … commits the industry to increased transparency by requiring the ABI to publish annually data on how age affects risk and premiums […] While there are no plans to extend this initiative, similar data for other areas of insurance (for example, the correlation between different types of disability, claims and premiums) would improve transparency and trust among consumers (and their representative organisations). They would also provide the opportunity for outside scrutiny to ensure that insurance decisions are based on the most relevant and accurate information."[42]

In household insurance, measures designed to prevent inappropriate inertia selling (e.g. PPI) also act as a constraint on the ability of landlords – especially social landlords – to 'bundle' protection for possessions with rent. If they were able to – perhaps with an opt out option designed to render it a very deliberate act rather than a reaction (as with pensions automatic enrolment) – the benefits of the 'right sort' of inertia would emerge in lower distribution costs, higher coverage rates, better risk spread and less risk of adverse selection. All of this should enable lower premiums.

Pensions and wider products

A key barrier is the absence of effective personal financial advice for people below 'High Net Worth' levels[43]. This is created by industry fear of giving 'advice' due to it being classed as a regulated activity, and finding that without a very substantial and expensive (but not valued by consumers) fact finding and report creation process, they incur substantial and unforeseeable costs and reputational damage. This is a particular problem in pensions with regard to:

- Transfer out of DB schemes to DC, with the ensuing risk transfer generally not fully comprehended.
- Until the planned measures are seen to be effective, people accessing their retirement funds early and transferring the proceeds (sometimes paying tax unnecessarily) into less suitable savings vehicles, because of a perception that their money is safer there.

[41] https://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf
[42] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf
[43] https://assets-global.website-files.com/5dcfc5ecafa6ed691b341c4b/5e0f67d32aef55698c39ca4f_OpenMoney%2C%20The%20Advice%20Gap%20Report%2C%202019.pdf

Finally, there is a need for accurate and complete data sources across the topic of pensions. We are supportive of a permanent Pensions Commission, to operate in a similar advisory capacity to the Low Pay Commission.

Above all, as with the insurance gap, we would like to see:

- **A joined up approach between the regulator and government on who owns the problems and how the problems should be addressed.**
- **Action to bridge social and regulatory policy by both the regulator and government so adequate interventions can be put in place.**

Financial Inclusion Commission

Annex 1