RESEARCH BRIEF

Addressing Obstacles to Life Insurance Demand

THE GENEVA ASSOCIATION

INSURANCE FOR A BETTER WORLD

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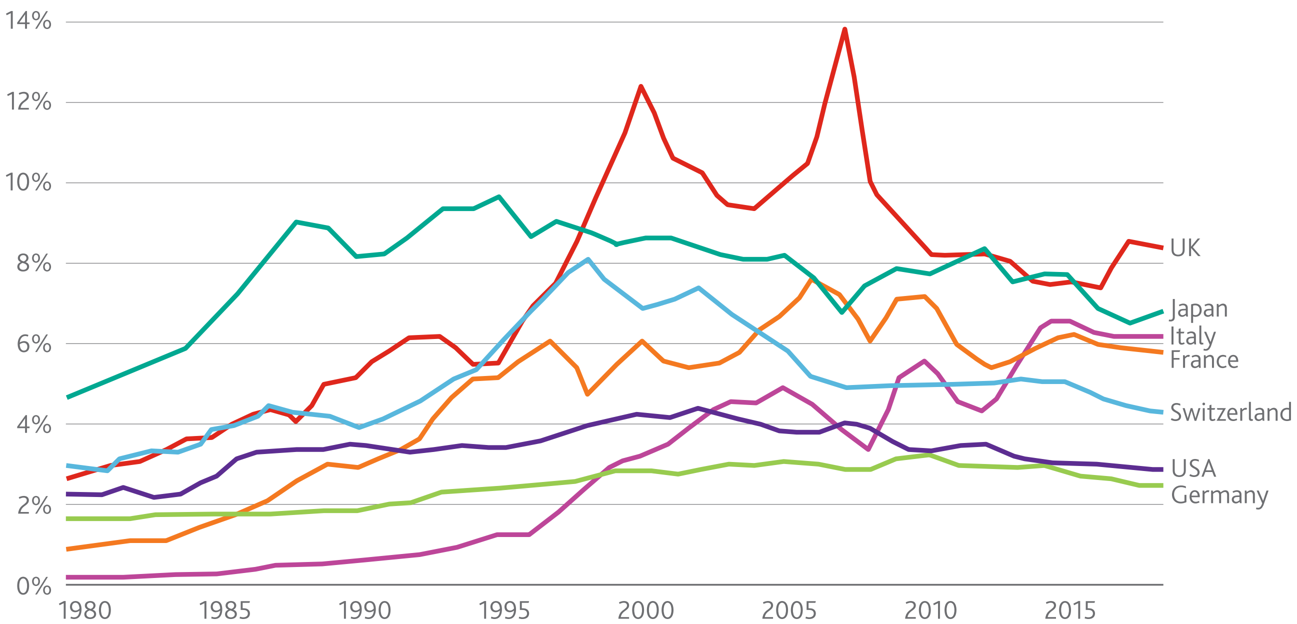
Eroding relevance of life insurance in rich countries

In a number of mature economies, life insurance penetration, defined as the share of premiums in GDP, has been declining since the beginning of this century, a trend that has accelerated in the wake of the global financial crisis. For all OECD countries combined, life insurance penetration has fallen from 5.4% to 3.8%. Yet, populations in many advanced economies are ageing rapidly. We have already seen the opioid crisis in the U.S. reverse mortality improvements there, while threats like antimicrobial resistance and pandemics threaten to do so on a global scale. Life-style related ailments such as diabetes and obesity are causing structural shifts in disease patterns. The list of societal challenges goes on.

Against this backdrop, the decreasing relevance of the life insurance industry is a worrying trend for society at large, given the sector's historical contributions to funding for retirement and mitigating biometric risks. The devastating COVID-19 pandemic only adds to this concern.

Figure 1 shows that in the U.S. and Japan, life insurance uptake, measured by penetration, has fallen back to levels last seen almost 35 years ago. In the U.K., Germany and Switzerland, they are at levels last seen 20–25 years ago. The bursting of the dotcom bubble in 2001 can be viewed as a turning point, with stock markets plunging, monetary policies loosening and interest rates continuing a downward trend, further accelerated by the global financial crisis and – more recently – the bazooka-style response to COVID-19.

Figure 1: Life insurance penetration (premiums as a share of GDP, 1980-2018)



Source: Compiled from the Swiss Re sigma database

Customer views

In order to better understand these developments, The Geneva Association commissioned a survey of 7,000 customers in seven mature insurance markets to identify the main barriers to purchasing (life) insurance. An in-depth analysis of the drivers of customers' life insurance buying decisions suggests three major determinants: behavioural biases, economic constraints or considerations and a lack of knowledge.

The survey reveals a striking lack of insurance awareness among respondents, as shown in Figure 2. Key industry products such as wealth accumulation (endowment and unit-linked) and longevity protection (retirement annuities) are unknown to more than 50% of those polled. Further, the level of preparedness among insurance customers appears to be perilously low, with only 7% owning critical illness or retirement annuity insurance (Figure 3).

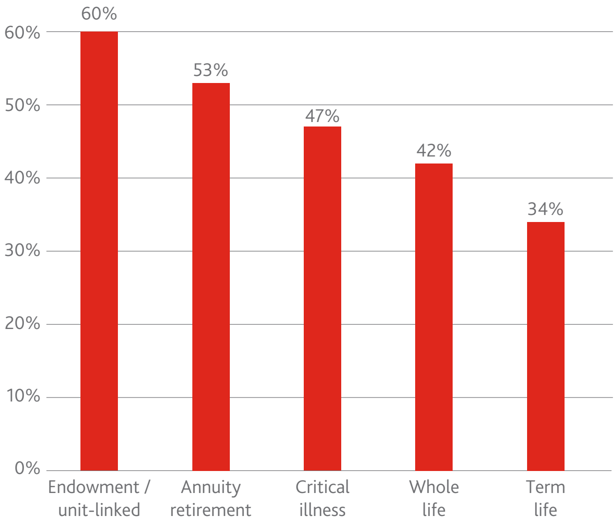
Survey participants who decided to delay insurance purchases cite 'other priorities', affordability and a perceived lack of knowledge, for both annuity and term life products, as their main reasons. Those who rule out buying insurance at any point in the future perceive insurance as unaffordable and insufficiently understood.

Harnessing behavioural economics

Until recently, our understanding of life insurance purchasing behavior was based on the so-called 'homo oeconomicus', or economic human, whereby the figurative human being is characterised by the infinite ability to make rational decisions. However, the 'homo oeconomicus' model increasingly contradicts people's actual behavioral patterns. In order to explain these anomalies, the field of behavioral economics incorporates insights from psychology.

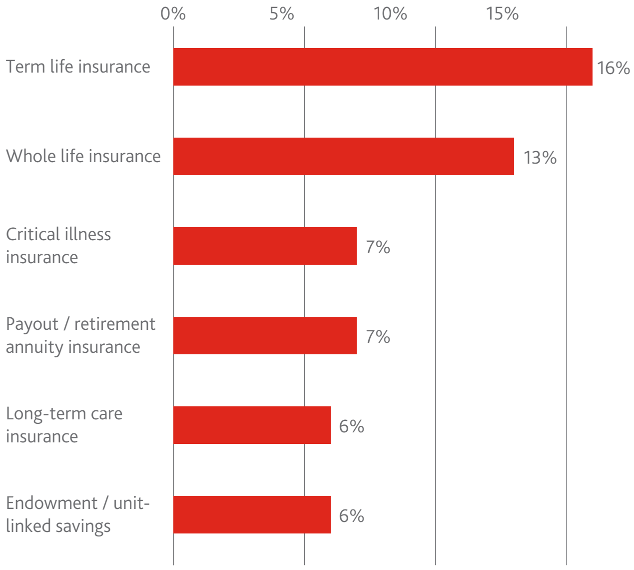
Figure 4 summarises a number of observed behavioural patterns and their relevance for understanding and predicting insurance purchasing decisions. Analyses suggest that dealing with risk and insurance products comes with complex decision-making processes that can only be thoroughly understood on the basis of behavioural science. For example, people decide on life insurance offers based on how these are framed (investments or protection of life style, for example), an engrained preference for the status quo, an aversion to perceived financial losses as a result of premium payments or a clear preference for a certain amount of money today over a larger amount tomorrow.

Figure 2: Share of respondents who are not aware of the product



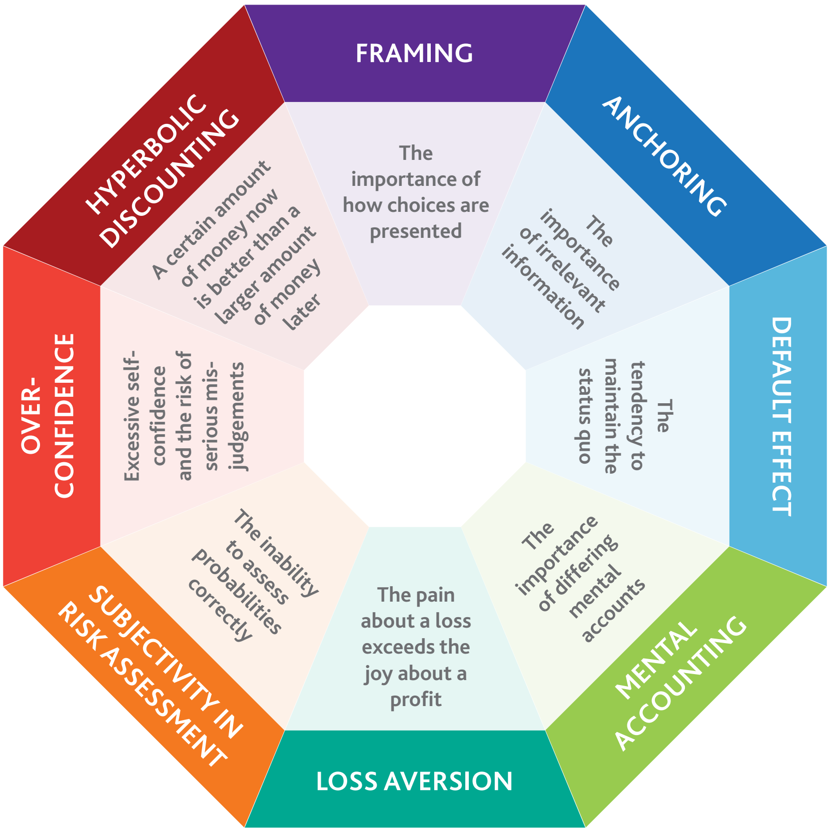
Source: Geneva Association Customer Survey

Figure 3: Share of respondents who currently hold an insurance policy



Source: Geneva Association Customer Survey

Figure 4: The octagon of behavioural insurance



Source: The Geneva Association

In addition to behavioural biases, there are economic barriers to life insurance demand. One of the most frequently quoted references in the discussion of price as an obstacle to life insurance buying is the annual LIMRA Insurance Barometer Study covering the U.S. Sixty-three percent of respondents say that they did not buy life insurance because it was too expensive. To some extent this claim seems to be based on misperceptions: the same survey respondents exhibited a lack of understanding and knowledge of life insurance products, with the vast majority believing that life insurance is three times more expensive (at an estimated annual premium of USD 500 for a USD 250,000 term life policy for a healthy 30 year old) than it actually is (as little as USD 160). This misperception also points to the relevance of behavioural factors and fundamental knowledge gaps.

Rising to the occasion

Based on the survey findings and an analysis of behavioural and economic barriers to life insurance demand, we can formulate a number of recommendations for insurers, designed to promote the role of life insurance and improve individual, family and societal preparedness for ageing, new disease patterns and mortality threats.

First, insurers should accelerate ongoing efforts to rethink existing products and develop new, more customer-friendly offerings. For life insurers to respond to the new realities it will be crucial to adapt traditional savings products and design attractive solutions that are less dependent on interest rates. In a number of markets, these enhancements are already well under way. European life insurers, for example, have expanded their portfolios with hybrids of unit-linked and traditional products and offer innovative investment-linked products that provide sub-100% paid premium protection while giving the policyholder access to riskier assets with a higher potential upside. In addition, the Geneva Association Customer Survey highlights scope for product innovation taking into account findings from behavioral economics. Examples include annuities framed as protection, rather than investment products, and addressing customers' loss aversion by offering guarantees that limit asset losses in the event of early death, for example.

Second, insurers can reduce price sensitivity through value enhancements, such as accelerated underwriting on the back of advanced analytics, that would bring down frictional costs for purchasing life insurance. Also, improved customer segmentation, marketing and transparency enabled by new technologies and data could address customers' tendency to overestimate the cost of life insurance. In general, more innovative and comprehensive product propositions, that promote loss prevention and enhance customer preparedness, would add to the perceived value of life insurance and reduce price sensitivity.

Third, life insurance has the potential to become more cost-competitive. Arguably, life insurers have yet to fully address operating costs at a structural level. Adding value to product offerings should, therefore, be accompanied by measures that address customer concerns about price and affordability.

Fourth, life insurers should address low levels of insurance awareness and education. The Geneva Association Customer Survey unearths major deficits in awareness, especially for endowment and annuity retirement products. In order to tackle this long-standing issue, insurers and their associations could team up with public authorities, agencies and consumer associations. Insurers could also advocate the integration of basic insurance and protection knowledge in schools.

For the life insurance industry, embracing these recommendations is not just a critical business challenge. With society facing a multitude of challenges, ranging from an ageing population to new disease patterns, life insurers worldwide must rise to the occasion.