

Underinsurance in Mature Economies

Reasons and remedies

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A THEORETICAL FRAMEWORK

Based on an extensive review of available academic and non-academic references, this research paper proposes a 'pentagon' of factors which underlie underinsurance, namely behaviour and perceptions, economics, institutions, sociodemographics and culture.

Behavioural factors relate to irrational and inconsistent patterns of human behaviour which can be explained either through biases that affect the perception of the value of insurance or through more general information processing problems that consumers face in making decisions. Applying behavioural economics to insurance suggests that only in a 'model world' of complete information and no transactions costs, actuarially priced insurance is always a beneficial product for rational, risk-averse consumers. In this behavioural context, the perceived appeal of the insurance offering is an important determinant of purchasing decisions. It also includes soft notions such as trust in insurers' ability and willingness to honour their obligations as well as their commitment to data protection.

Economic determinants include affordability, the distribution of wealth and the (perceived) cost-benefit characteristics of insurance. Price-driven buying behaviour is particularly common in residential property and motor insurance. However, a number of recent studies show that price sensitivity is

declining with the rise of new dimensions of customer engagement and value-added, real-time interactions related to policyholders' health and security, for example.

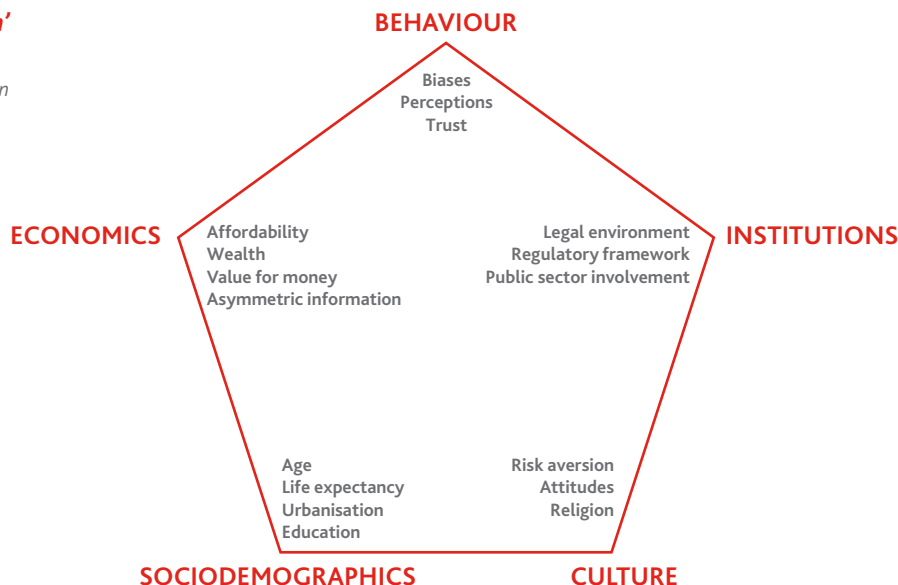
Institutional factors such as the rule of law, the quality of insurance supervision and the role of governments as ultimate absorbers of risk can have major effects on how individuals and organisations view the value of insurance which, in turn, shapes insurance demand.

Sociodemographic determinants include age, life expectancy, financial literacy and urbanisation. Various papers discuss their implications for the overall demand for insurance and its composition.

Last but not least, **cultural aspects**, including religious affiliations, have been the subject of a number of insurance research efforts, with an emphasis on their relevance for risk aversion.

Figure 1: The 'pentagon' of insurance demand

Source: The Geneva Association



THE GENEVA ASSOCIATION GLOBAL CUSTOMER SURVEY

In order to validate and further advance the theoretical understanding of underinsurance, The Geneva Association recently commissioned a global customer survey designed to identify the main obstacles to insurance purchases. The geographical scope included the mature insurance markets of France, Germany, Italy, Japan, the U.K., the U.S. and Switzerland, with a particular product focus on residential property insurance, voluntary private health insurance, term life insurance and retirement annuities.

The survey revealed a remarkable discrepancy in terms of customer knowledge and perceptions. On one hand, the basic function and potential utility of insurance for the economy and society at large are well understood by the 7,000 survey participants (see Figure 2). On the other hand, there is little knowledge about the insurance industry and its inner workings. Owing to a perceived lack of transparency, negative opinions of the industry abound (see Figure 3), adversely impacting insurance demand. Globally, less than a quarter of respondents report a good knowledge and a positive opinion of the industry. U.S.-based survey participants express the most favourable opinion (with a 'positive' share of 29%) whereas Japan ranks last (20%). From a demographic point of view, it is interesting and maybe surprising to note that the millennials are least negative about the insurance industry.

Figure 2: The insurance industry's fundamental role is understood and recognized (all respondents, percentage of those agreeing)

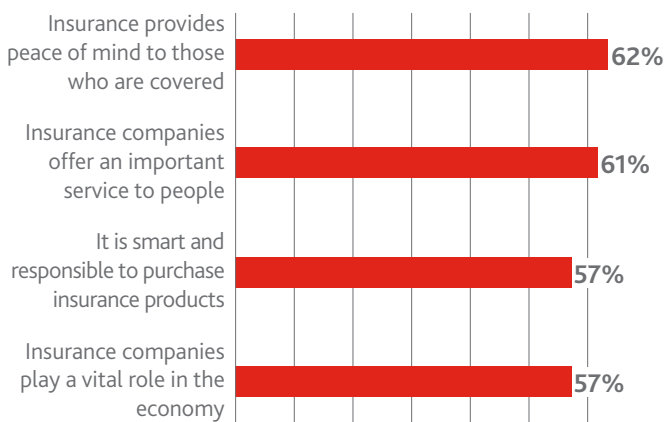


Figure 3: Poor overall image, knowledge and customer experience ratings (all respondents, percentage of those agreeing)

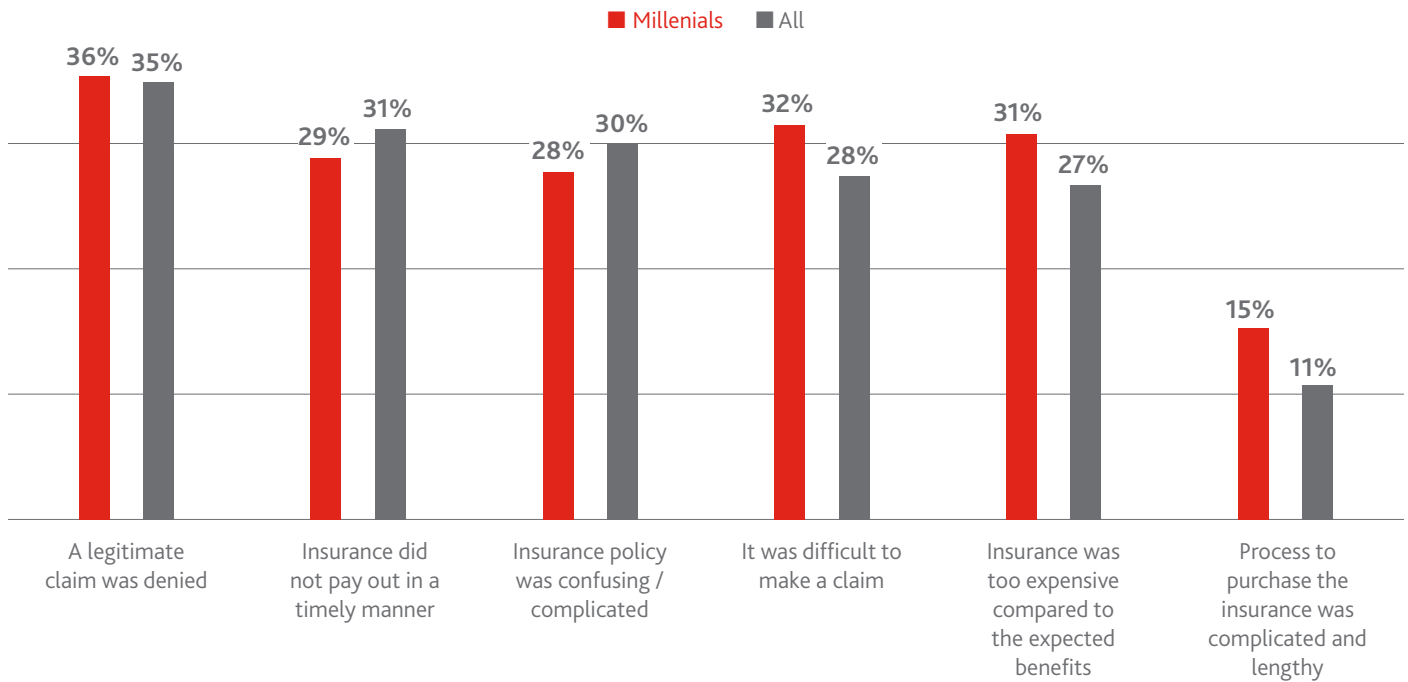


*Based on those who have bought at least one insurance product

53% of all respondents report a 'bad experience with insurance'. The top 3 customer 'pain points' include onerous claims filing and settlement, product complexity and unsatisfactory value for money, i.e. the economics of cover (see Figure 4).



Figure 4: Specific deficits in customer experience (based on all respondents, percentage of those agreeing)



For those interviewees who have never bought insurance before, unaffordability and a lack of knowledge are the two most relevant obstacles to purchases, with the latter believed to influence (the perception of) the former. One out of three says insurance is unaffordable and one out of five states not to know enough about insurance. Among all respondents, two-thirds consider insurance products as ‘complicated and difficult to understand’ and even three quarters as ‘expensive’, based on cost-benefit considerations.

As far as voluntary private health insurance and residential property insurance (the two non-life segments in focus) are concerned, the importance of being prepared and limits to self-financing losses rank highest among buying motives. In terms of the reasons why people have not yet purchased cover (but would consider doing so in the future), unaffordability and ‘other priorities’ were most frequently mentioned for health insurance, and a lack of necessity for residential property insurance. Among those who have no intention whatsoever to purchase any insurance products going forward, unaffordability is the most frequently mentioned deterrent for both private health and residential property insurance.

Looking ahead, building trust (primarily in insurers’ willingness and ability to pay) and communicating more clearly and transparently are the key identified requirements for the insurance industry to overcome the disconnect between customers’ fundamental appreciation of the role of insurance versus their unwillingness to purchase it. Also, as only 4 out of 10 respondents claim to be financially literate (something which they regret), there is further opportunity for insurers to educate customers and stimulate demand through enhancing product awareness and understanding.

Interestingly, and in contrast to some other polls, the sheer ease and simplicity of buying and transacting insurance (e.g. through smart phone apps) is not a relevant factor which, on its own, would encourage additional insurance demand. Just 15% of those interviewed on behalf of The Geneva Association would buy more insurance simply on the back of an improved ease of use. At a share of 20%, the millennials are no exception.

The survey suggests that the future of insurance distribution will remain omnichannel. Agency networks are here to stay as 55% of the interviewees name them as their preferred channel. Somewhat surprisingly, 50% of the millennials share this view.

RECOMMENDATIONS FOR INSURERS

Based on these findings our recommendations for insurers can be summarised as follows:

Revamp traditional approach to product and industry communication

People do understand the fundamental role and benefits of insurance, which can be considered the necessary condition for increasing insurance penetration. This basic understanding, however, does not translate into an economically beneficial level of insurance utilization. A major reason is the perceived lack of clarity and transparency as far as insurers' products and the inner workings of the industry are concerned. The survey results suggest that a less technical and more regular and pro-active approach to communication would effectively remedy this situation.

Enhance customer experience in the 'moment of truth'

Insurers' claims processes are the single most important customer pain point. About a third of all survey participants complain about the denial of legitimate claims, delays in receiving pay-outs and the complexity of filing a claim. Addressing these shortcomings would go a long way towards overcoming underinsurance.

Respond to customers' need for financial education

The survey clearly suggests that insurers should place more emphasis on promoting their customers' financial literacy. Customers are both very realistic and regretful about existing gaps. Against this backdrop, they are likely to welcome support from insurers in reducing knowledge deficits which, as corroborated by a number of previous studies, is set to translate into higher demand for insurance.

Build an omnichannel proposition for distribution

The survey reveals that the agency channel continues to be the most popular option for buying insurance. This holds true for all age groups, including the millennials. Therefore, the digitalisation of the agency force is arguably the core of any future-proof distribution strategy. Insurers need to build an omnichannel proposition to meet today's and tomorrow's customer buying preferences.

THE BOTTOM-LINE

Protection gaps are well documented. Contrary to general belief, they are not limited to developing and emerging countries but also common in advanced economies. Across various protection needs people use less insurance than economically beneficial—even after taking into account that insureds should retain some risks according to their personal risk appetite, risk bearing capability and cost-efficiency considerations. Societies are faced with significant protection gaps, and practitioners, academics and policymakers alike struggle to come up with plausible explanations which could inform corporate and public decision-making.

The Geneva Association global customer survey offers a resounding corroboration of the role of behavioural economics and finance in understanding obstacles and identifying potential stimulants to insurance demand. Importantly, the report also confirms that many of these behavioural factors are not immutable exogenous factors but can actually be influenced or even reshaped by the insurance industry's actions.

As far as the prospects of addressing underinsurance are concerned, 'the glass is half-full'. People do understand the fundamental role and benefits of insurance which can be considered the necessary condition for increasing insurance penetration.