Insurance and the poverty premium

Matthew Oakley
James Kirkup

SMF Social Market Foundation

Insurance and the poverty premium

March 2023

Matthew Oakley
James Kirkup

FIRST PUBLISHED BY

The Social Market Foundation, March 2023
5-6 St Matthew Street, London, SW1P 2JT

THE SOCIAL MARKET FOUNDATION

The Foundation's main activity is to commission and publish original papers by independent academics and other experts on key topics in the economic and social fields, with a view to stimulating public discussion on the performance of markets and the social framework within which they operate. The Foundation is a registered charity (1000971) and a company limited by guarantee. It is independent of any political party or group and is funded predominantly through sponsorship of research and public policy debates. The views expressed in this publication are those of the authors, and these do not necessarily reflect the views of the Social Market Foundation.

CONTENTS

ACKNOWLEDGEMENTS

We are grateful to Fair By Design for supporting this work. Our thanks also go to Poverty Alliance and Toynbee Hall, who supported our participatory research with people with lived experience of poverty. Of course, thanks also go to the people who gave up time to contribute to interviews, roundtables and workshops that contributed to this work. All views and conclusions remain the authors'.

ABOUT THE AUTHORS

Matthew Oakley

Matthew Oakley joined the SMF as Senior Researcher in July 2015, he is also Director of WPI Economics. Before joining the SMF, Matthew had been Chief Economist and Head of Financial Services Policy at Which?, Head of Economics and Social Policy at Policy Exchange and an Economic Advisor at the Treasury. He has an MSc in Economics from University College London, where he specialised in labour economics and econometrics. He also led the Independent Review of Jobseeker's Allowance sanctions that reported to Parliament in 2014.

James Kirkup

James Kirkup is the Director of the Social Market Foundation, responsible for the overall management and work of the think-tank. He joined the SMF in 2017 after a 20-year career in journalism, most of it spent at Westminster covering government and politics. He was Political Editor and Executive Editor at the Daily Telegraph and a correspondent for The Scotsman and Bloomberg News. He is a regular columnist for publications including the Spectator and the Times, writing about politics and public policy.

ABOUT THIS REPORT

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

The findings have been informed and led by in-depth research with people in poverty. An online survey of 1,537 UK adults living in households with equivalised low income below 60% of median was conducted by Public First, on behalf of the Social Market Foundation between 24th and 29th June 2022. Two in-depth focus groups with people with lived experience of the poverty premium were run by Toynbee Hall and Poverty Alliance. We would like to thank all those who took part in the survey and focus groups for their time and the insights they have provided.

EXECUTIVE SUMMARY

The insurance market is failing. Not necessarily in the technical economic sense, but because it is not delivering on the outcomes that as a society we would want it to. The reasons are clear. Insurance can provide a vital form of resilience in times of financial strain. Through the necessity of motor insurance, it allows people to drive to work, see family and friends, and access leisure activities. It is no surprise, therefore, that people without insurance experience higher levels of anxiety and a range of other emotional and financial problems.

The poverty premium and insurance

Seen in this way, insurance should be (and already is) seen as having the potential to play a key role in tackling poverty in the UK and helping lower-income families manage their finances and boost living standards. But people in poverty regularly face a poverty premium in the insurance market. This report shows that this comes from two distinct routes:

- **People in poverty pay more for the same cover.** A range of factors drive this issue including how insurers price risk, the premium paid to meet insurance costs monthly, rather than in a lump sum and the fact that many people in poverty have single item insurance policies, which would be more cheaply provided through a household contents policy. It means that people in poverty are offered worse value for money in the insurance market.
- **People in poverty pay more because they experience different risks.** Ultimately, some lower-income individuals face higher or more costly risks than others. The market charges insurance premiums that are higher to reflect these increased risks.

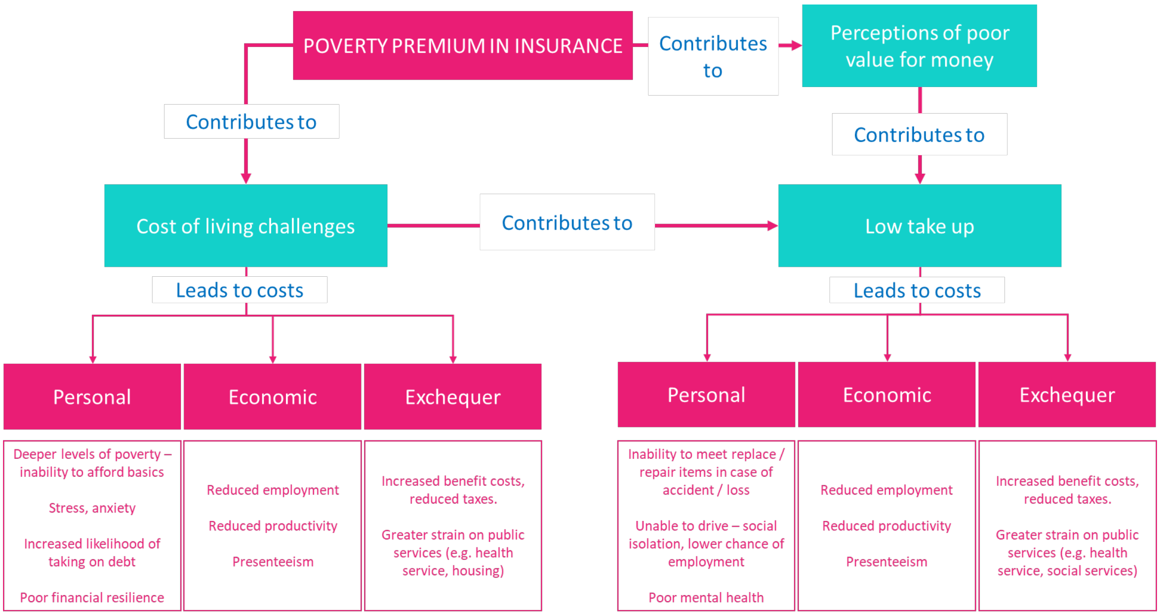
Whilst the drivers differ, neither of these things meets society's standards of fairness. For motor insurance, it contributes to a situation where those living in deprived areas pay around £300 more a year in premiums. Additional charges for paying monthly instead of annually could mean an extra £160, adding up to a total poverty premium of nearly £500.[1]

Research with people in poverty for this report shows that:

- Very few people subscribe to the idea that those in more deprived areas should pay more because they are more likely to make claims.
- Most people believe that this is unfair, because it makes insurance less affordable.
- **Just 7% of people believe that it is fair that those on lower incomes may pay more for their insurance, and 66% believe that it is unfair.**
- Only 1 in 10 (11%) say that premiums should be based on things like income and where people live. 57% of people in poverty say that premiums should not be based on these things.

Not only is it unfair, it also leads to worse outcomes for people, families and society (Figure 1). The poverty premium means that poorer people pay more – making it harder to make ends meet with already squeezed budgets. It also reduces take-up of insurance directly by making insurance unaffordable for some and indirectly by undermining trust and perceptions of fairness and value for money in the market.

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



In ordinary times, these are serious issues. In the context of the current cost of living crisis these problems are becoming even more severe. For some families it could lead to hard decisions to stop buying cover and further increase issues around lack of take up. More than half of people with motor insurance in poverty (55%) are finding it difficult to pay their premiums.

> **"A lot of times I want to do insurance, but when you see the, you know, what you're paying for, sometimes your budget is so, so tight, you can't afford to get insurance."**
>
> **"I had to cancel my contents insurance to be able to pay for my fuel. I hope nothing goes wrong."**
>
> *Low-income focus group participant*

Insurance as an essential

The evidence gathered for this report strongly suggests that there is a case for insurance products to be regarded as an essential, with their take up and cost for low-income families considered in a similar way to that of energy, fuel and food. The balance of the findings also suggests that many people feel that it is unfair that insurance premiums are currently higher for those in poverty. This is particularly true where premiums are raised by factors that are outside of the control of the individual.

Seen in this wider context of social expectations around markets and fairness, the findings in this report are a challenge to policymakers concerned with markets. That challenge goes beyond identifying a policy problem to address or mitigate. The challenge is bigger and concerns the very purpose of markets and their regulation, and how government can interact with markets to ensure outcomes do not fail those who need the goods and services most.

With regard to regulation, the Social Market Foundation has previously argued that the UK's market regulators should be given (or take) a more expansive view of their responsibilities to ensure the sustainable functioning of markets. Such an approach goes with the grain of much thinking and practice inspired by the climate crisis and its mitigation. When regulators (rightly, in our view) take responsibility for encouraging market participants to support the decarbonisation of UK economic activity, they enter territory that might once have been regarded as the sole preserve of politicians. If regulators can regulate with the overt intention of promoting climate policy, they can – and should – take a more ambitious approach to issues of financial inclusion and poverty premiums.

But regulators cannot act alone. Their actions need to be directed and supported by Government. Just as Government has set out its intentions on net zero, it can also provide clarity over the view that the insurance market should work better for people in poverty. This could spur action from regulators, and also set up targeted interventions from Government to support take-up and affordability amongst those most in need. Examples of such behaviour are already extant; many households at high risk of flooding already have access to household insurance that is made available and affordable by Flood Re, a scheme designed by Government and industry and supported by regulators to ensure those most in need of cover can get it. Whilst we argue that this would not be a good model for all other forms of insurance, the model of action is a helpful blueprint for how joint public-private action can deliver good outcomes when a market fails to provide adequate outcomes for all.

So what can be done?

No one pretends that tackling these issues in insurance will be easy or simple to do. This report offers significant new evidence on experiences in the insurance market, but our work here has limits. One of the most important points here is not about what we know or have learned. It is about what we do not know.

We still do not know how much of the higher price for insurance asked of lower-income consumers is based on their personal risk factors, and how much is driven by other causes. The market is opaque, and not just to consumers and researchers. Regulators themselves seem less than clear on quite how pricing decisions are made. That is unsatisfactory, to say the least. It suggests the possibility that groups of consumers, some of whom have characteristics protected under equalities law, are facing different and potentially discriminatory treatment. Such treatment would surely not meet society's expectations of a fair and functional market, not to mention the law's requirements. It has also led to a situation of "policy ping pong", where the regulator suggests the poverty premium is a social policy problem for Government to fix, while Government says there is little evidence of a social problem.

Ultimately, this has led to inaction and caused detriment to people in poverty.

That is why the first step to tackling this issue is to ensure that we truly understand it. In particular, clarity is needed over where responsibility for tackling the poverty premium in insurance lies between the regulator and Government. This means understanding the extent to which the poverty premium is driven by people in poverty paying more to reflect their higher risks, and the extent to which they are paying more and receiving worse value for money. The regulator is already doing good work in this area, and now needs to ensure that this can be focused on and make an impact on our understanding of the poverty premium. This should include consideration of issues like the additional costs faced by consumers opting to pay monthly (or in other instalments) and the extent to which these extra charges are cost-reflective.

Recommendation one – FCA should investigate the poverty premium in insurance

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

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

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

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

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

As other reports have highlighted, consideration should also be given to the extent to which the non-risk-reflective poverty premium is driven by poorer consumers accessing more expensive products. Stakeholders highlighted that the market for single-item insurance policies was likely to be one particular example of where this was the case and, based on our polling, around 1.2 million people in poverty have this sort of cover. Here, it was argued that people taking on single-item insurance policies would be better (and more cheaply) provided for through a broader contents insurance policy. If this were found to be true, there is a strong case for action by the regulator.

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

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

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

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

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

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

Building resilience, trust and confidence

Taking these proposals forward would go some way to ensuring that people in poverty can build the financial, economic and social resilience they need to boost living standards and manage the cost of living crisis. But, what is at stake here is not just the wellbeing and protection of people who currently miss out in the insurance market.

This is also about trust and confidence in that wider arrangement of using market mechanisms to provide important and even essential things. The SMF has always been dedicated to the proposition that markets can deliver not just economic wealth but also social justice. In some cases, policymakers have a vital role to play in ensuring the delivery of those benefits. This is because delivering them is the proof that markets work, both economically and politically. Where markets fail to deliver either economic benefits (more wealth and innovation) or political goods (more fairness and freedom), the public will reasonably ask why we use those markets. Maintaining trust and confidence in the market and its ability to meet society's expectations is vital work. Answering the challenge set out in this report is part of that work.

CHAPTER ONE – THE SOCIAL MARKET CASE FOR ACTION

Unsurprisingly for the Social Market Foundation, this report is about markets and their place in society. It is about aims and purposes: what are markets for? And it's about priorities and expectations: how does society answer that first question?

The market in question is that for insurance, and the starting point is the fact that people in poverty have low rates of cover and can pay more for cover than others ("the poverty premium"). So why is this the case?

The insurance market has unusual characteristics. They largely arise from the nature of the good being bought and sold. Insurance is not lunch at the Ritz: it is a not a luxury. In fact, this report suggests that insurance should not even be regarded as a discretionary purchase. We argue that it is an essential good. In motor insurance, this essential nature is clear. In order to drive, whether that be to pick up children from school, to get to work or to visit friends and relatives, motor insurance is a legal requirement. In other areas, like home contents insurance, the resilience and security that insurance brings provides a strong argument that many forms of insurance should be regarded as an essential. There is a clear social expectation that people should insure their homes and property, a view perhaps rooted in the idea that people should take some responsibility for their own wellbeing and security. And where society expects people to do this, there follows a duty on policymakers to ensure that people can live up to that expectation.

The majority (80%) of people in poverty believe that motor insurance should be classed as an essential. Six in ten (60%) of the same group think that home contents insurance should be classed as an essential.

Instances where the allocation and delivery of essential resources is carried out using a market mechanism are relatively scarce, and almost all are accompanied by significant public policies that ensure widespread, and often universal, uptake of the products concerned. Yet the insurance market typically lacks such policies, giving rise to the situations described in this report, where significant numbers of people do not have adequate (or any) insurance and those that do face a squeeze on their living standards because of the price they have to pay. The market is leaving some people without the product that it exists to supply. Others face a choice between having no insurance and paying unjustifiably high prices.

The impacts of this are felt by families themselves, as they face choices over how to balance already stretched budgets. And they are felt by society more generally. Previous research has shown that lack of insurance can lead to feelings of stress and anxiety, and with mental ill health costing the UK economy some £118 billion a year,[2] the potential scale of these costs should not be underestimated. The Exchequer and public services also feel the strain; with fewer people in work, more people on benefits and lower taxes coming in, the impacts of the poverty premium in insurance can be significant and wide ranging.

This report makes the case for change. Arguing that there is a clear need for action to address the poverty premium to ease financial pressures on people in poverty, and increase access to and take up of insurance. We put forward recommendations for how that can be delivered and a social market created.

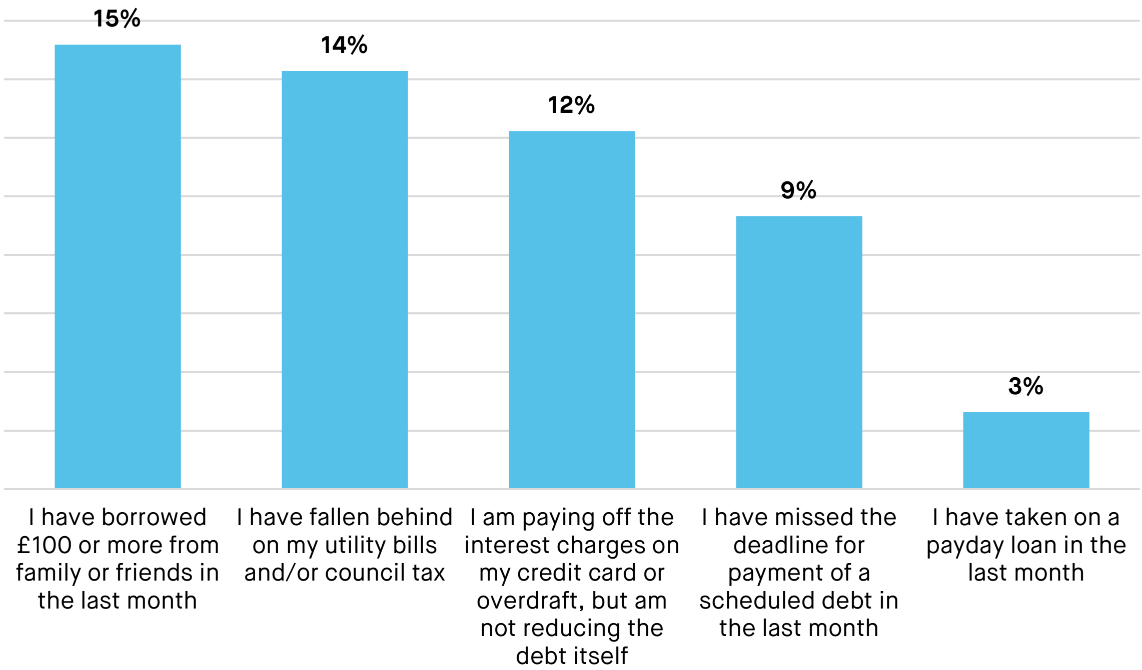
CHAPTER TWO – POVERTY, INSURANCE AND THE POVERTY PREMIUM

Context

The UK is in the middle of a cost of living crisis. For many, a combination of rapidly rising energy and fuel prices and pandemic-fuelled economic insecurity mean that they are facing pressures around making ends meet like never before. For others, this is simply a continuation of the economic and financial struggles that they have experienced over years and decades.

Before the pandemic, around 13.9 million people in the UK were in families that lived in poverty.[3] For these families, many of the things that the majority in the UK can afford are simply out of reach. And these struggles are not constrained to day-to-day affordability. Figure 2 demonstrates that a significant minority of those in poverty are already being forced into financial decisions that could lead to long-term issues around debt and financial insecurity.

Figure 2: Which of these (if any) apply to you?



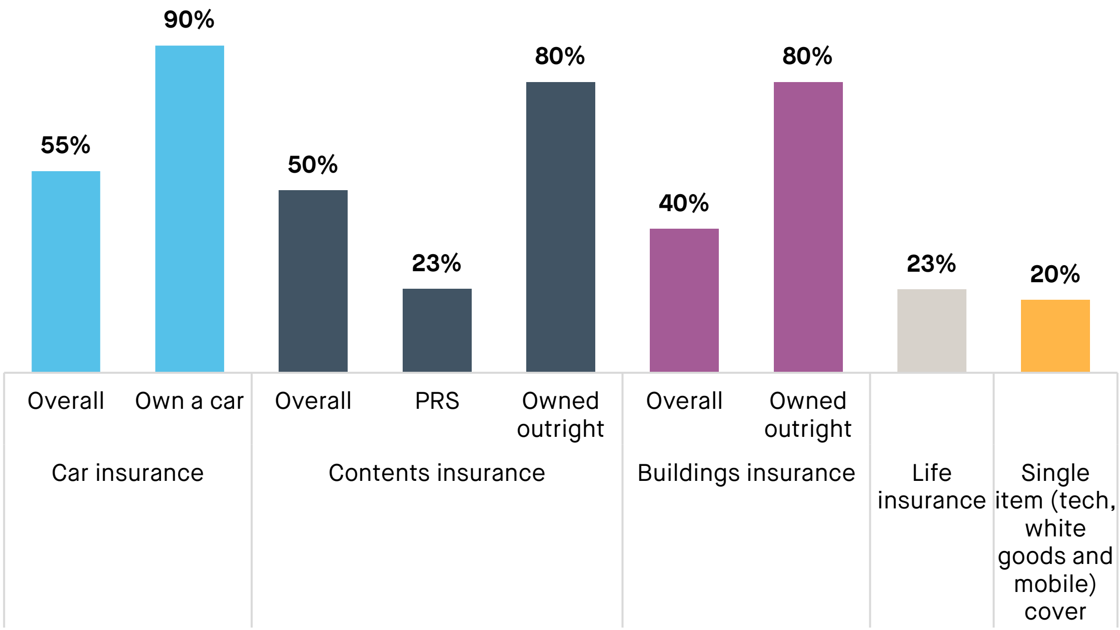
Source: Public First for SMF. Note: Sample is those in poverty

Here, a real challenge is that poverty also makes products and services that could help bring stability and security unaffordable. Just 50% of people in poverty have household contents insurance. For those in poverty and in social housing, this falls further still to 30%, and to 17% for those in poverty aged between 18 and 24. For these individuals and families, unexpected expenses – broken white goods, a car needing repair, or lost personal possessions – will mean a choice between making do without or turning to (potentially further) debt.

Take up of insurance and poverty

Overall, take up of insurance products amongst people in poverty is far lower than those families not in poverty. For example, less than one in four (23%) families in poverty who live in the private rented sector (PRS) have contents insurance. This compares to 44%[4] of those in the PRS overall, and 52% of those in the PRS who have relatively high incomes.

Figure 3: Which of these (if any) do you have?



Source: Public First for SMF

Notes: Sample is those in poverty

However, take up of some types of insurance for some groups in poverty is far higher. For example, 90% of those who own a car have insurance. Given that insurance is a legal requirement for those driving cars, this is not surprising. However, it demonstrates the range of problems that those in poverty can face with regards to the insurance market. For some, a lack of take up (e.g. contents insurance) leaves them exposed to financial risks. For others, legal requirements to purchase insurance means that they have to purchase cover, potentially at prices that mean them sacrificing on essentials like food and heating.

It is also of note that, overall, one in five (20%) of those in poverty report to have some form of single item cover, for either tech/gadgets/mobile phone or white goods. This figure falls to 17% of those who do not have contents insurance, but means that some 1.2 million people in poverty are purchasing single-item cover, which may be more cheaply provided through a contents insurance policy that would also cover their other possessions.

The poverty premium in insurance

Incomes, earnings and the social security system are all important factors in considering how to support these families to improve their situation and to take on insurance where it could be beneficial to their financial and general wellbeing. But too often it is forgotten that unaffordability of goods and services for people in poverty is also driven by them having to pay more for these items than those not in poverty; this is known as the poverty premium.

This report considers this poverty premium, with a particular focus on motor and home insurance. It provides new in-depth analysis of the issue, based on original quantitative and qualitative research with people in poverty and puts forward new ideas for how the poverty premium could be tackled.

The basics of the poverty premium in insurance have been well identified in previous research on this topic. Those on lower incomes undoubtedly pay more for insurance. This premium is largest in motor insurance.

Table 1: Poverty Premium in insurance

Premium	Households incurring premium 2019	Cost of poverty premium 2019	Average poverty premium 2019	*Cost of poverty premium (2016)*
	%	£ / year	£ / year	*£ / year*
Area-based premiums		-	**£133**	-
Home contents insurance - deprived area	44	£5	£2	*£14*
Car insurance - deprived area	44	£298	£131	*£74*
Insurance for individual items			**£23**	-
Household appliance insurance	8	£176	£14	*£132*
Mobile phone insurance	11	£81	£9	*£60*

Source: University of Bristol[5]

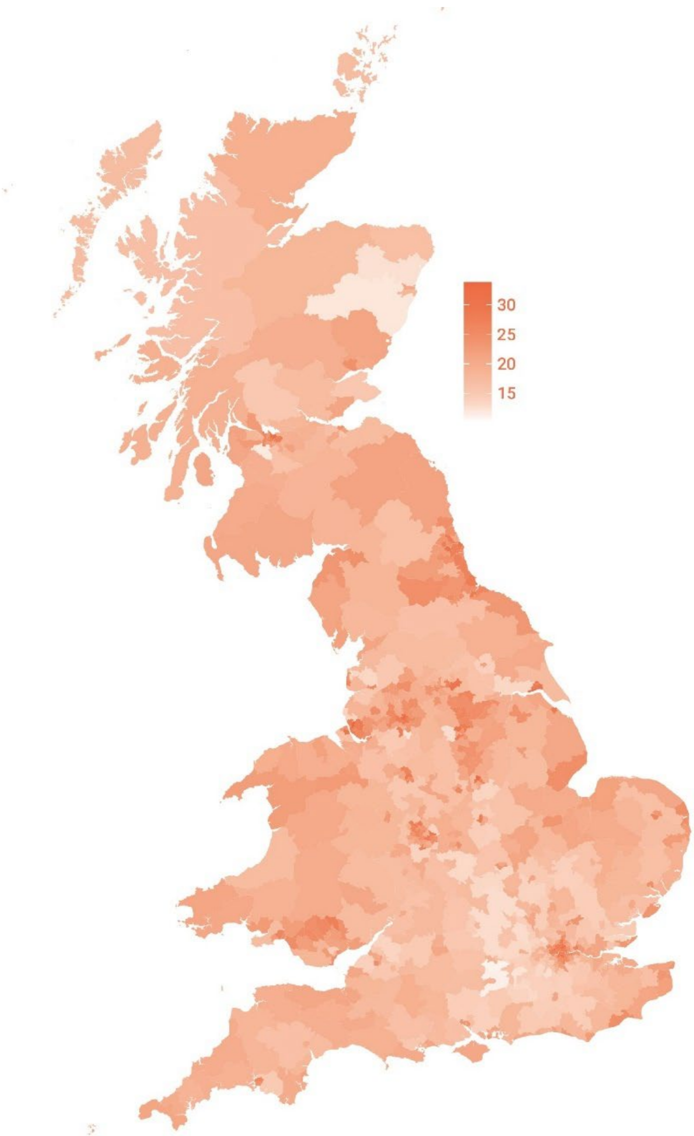
This premium is experienced unequally by those in poverty. In particular, those with protected characteristics tend to face a high premium. For example, evidence has found:

- An ‘ethnicity premium’ in motor insurance incurred by all those who live in multi-ethnic areas – over 1 in 5 people.[6]
- Area-based premiums in relation to motor insurance and buildings or contents insurance are likely to most heavily impact those from an ethnic minority background, as they are more likely to live in deprived areas. This penalty is also increasing over time.[7]
- Over a quarter of disabled people feel they have been charged more for insurance, or turned down, as a result of their disability.[8]

- Choosing services can incur high costs for people with poor mental health – Citizen's Advice estimates this to be £360-540 a year, due to problems getting the right deals on a range of financial products including insurance, and signing up to poor-value credit.[9]

Furthermore, recent work by Fair By Design has highlighted how the poverty premium is experienced differently depending on where in the country you live. Poorer areas in urban centres tend to be most affected by the poverty premium.

Figure 4: % of households experiencing at least one component of the poverty premium, by constituency



Source: Fair by Design

As well increasing the cost of living for those on low incomes, by reducing the take up of insurance, the poverty premium also harms the overall levels of protection and resilience of these families. The cost of this has been identified in previous work. For example, a lack of insurance:[10]

- Causes those on low incomes to rely on credit, when they experience a loss that would otherwise have been covered by insurance.
- Leads to negative emotional impacts, including feelings of stress, insecurity and vulnerability. Over 80% of those who were previously surveyed by Britain Thinks for the ABI said that they would feel vulnerable without insurance.[11]

Of course, the poverty premium is only one of a range of barriers that have been identified as reducing the take up of insurance by low-income families. Other factors include a lack of trust, complex and opaque products, and perceptions that insurance provides poor value for money. However, other reports, and evidence presented below, show that not only does the cost of insurance and the poverty premium faced by low-income families limit uptake, it is also seen as unfair and causes significant detriment to the families affected.

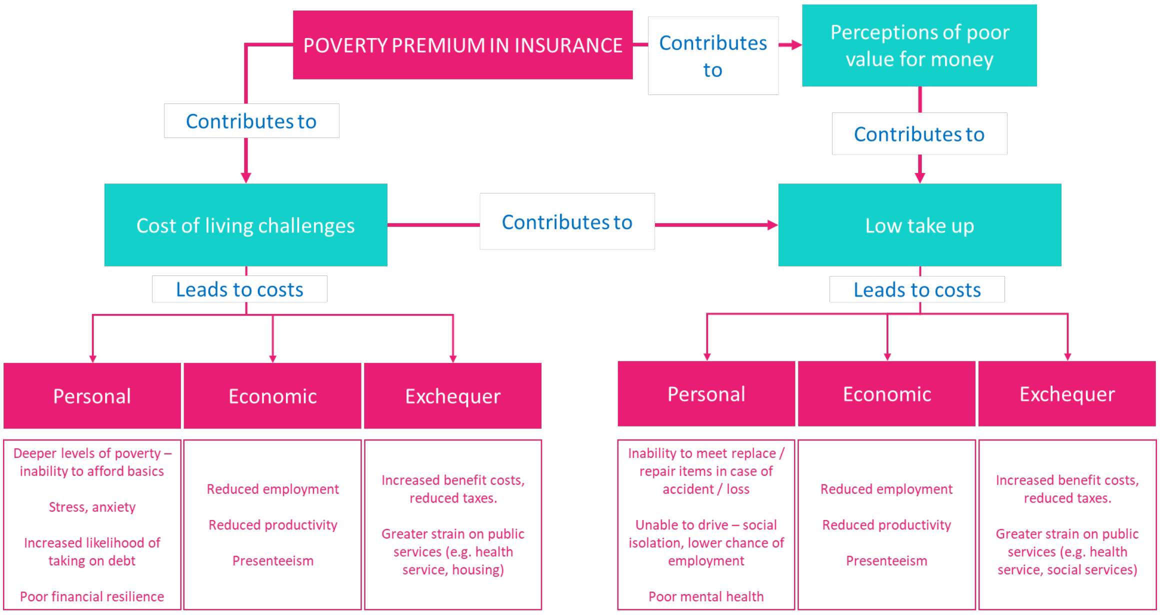
In response, many previous reports have laid the blame at the door of insurers and argued for regulatory interventions to change their approach. This report goes beyond this basic analysis in order to create a comprehensive picture of the multiple drivers of the poverty premium and how it can be tackled. In doing so, it shows that the industry must change, but also that the only way to ensure that the personal, familial and societal benefits of insurance for low-income families are realised is through a social market approach; with Government working in partnership with the industry and others to create a market that is both competitive and effective, but also delivers the social goals that we would like.

So what's the problem?

Overall, this suggests two current problems which the poverty premium in insurance contributes to (Figure 5). First, where insurance is taken up, the additional costs faced by people in poverty can drive cost of living issues, which exacerbate the already precarious financial situation that families in poverty are in. Second, the poverty premium can add to perceptions that insurance provides poor value for money for people living in poverty. Combined with higher costs, this can act as one of a range of barriers that reduce take up of insurance amongst those in poverty.

Together, as highlighted above, these issues around costs and take up can lead to significant personal and economic harms as well as costs to the Exchequer, again demonstrated in Figure 5.

Figure 5: The impacts and costs of the poverty premium in insurance



As Table 2 demonstrates, these issues are experienced differently for different types of insurance policies. For mandatory policies (like motor insurance), the poverty premium causes issues around the cost of living, which in some cases may make cover completely unaffordable and lead to people not being able to legally drive. In these instances, the poverty premium could lead to significant economic (not being able to get to work) and social (not being able to meet friends and/or family) consequences.

For optional cover, like contents insurance, the issues are predominantly around take up. These issues are explored in the following chapters.

Table 2: Issues in insurance that are related to the poverty premium

	Cost of living issues	Take up issues
Mandatory cover (motor insurance, buildings insurance for homeowners)	Yes – most significant for motor insurance	Yes – but more marginal issue as families are required to have the insurance
Optional cover (e.g. contents insurance)	Yes – but more marginal than the issues around take-up	Yes – the poverty premium is a contributor to low take up amongst people in poverty

CHAPTER THREE – TAKE UP OF INSURANCE AND THE POVERTY PREMIUM

The previous chapter demonstrated that, for some types of insurance, particularly optional policies like contents insurance, take up amongst those in poverty can be very low. This chapter begins to explore the drivers of this and the extent to which it is driven by the poverty premium.

Do people in poverty, without insurance, want and value insurance?

The first question to explore is whether people in poverty want and need insurance. Here, as previous research has found, there is a clear need for insurance amongst the group:

- For those who own a car, insurance is mandatory (and take up is high).
- For those who own a property and have a mortgage, buildings insurance is typically a requirement of the mortgage contract (and take up is high).
- For everyone in poverty, contents insurance can provide peace of mind, and financial resilience that could prove vital in helping them manage their already strained finances (and take up is very low).

This suggests that the problem with take up is largely confined to optional insurance policies, that could provide improved financial resilience. The need for such policies amongst the population in poverty is easy to demonstrate from the results of our surveying and in-depth focus groups with people in poverty. From the focus-groups, words such as comfort and safety, and the phrase ‘peace of mind’, were commonplace in participants’ perceptions of insurance.

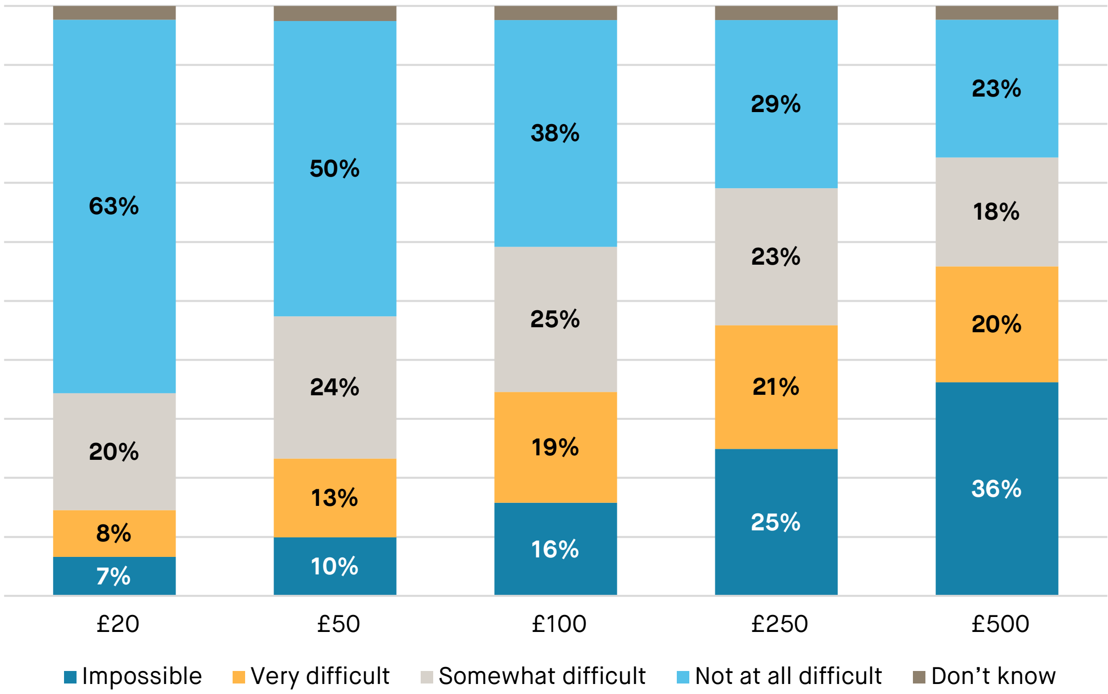
Surveying of people in poverty demonstrates the value that can be derived from insurance for people in poverty. This stems from the fact that financial resilience amongst families in poverty is very low, meaning that unexpected costs are very hard (or impossible) to manage and that existing evidence shows that such unexpected costs (e.g. damage to goods, or loss/theft) are reasonably commonplace.

For example:

- 68% of those surveyed were worried about their household finances. This is higher among those with mortgages (77%) and renters (80%).
- 4 in 10 (38%) have no savings. Another 10% have less than £250 in savings.

Given these findings, it is no surprise that a majority (56%) of those surveyed would find it very difficult or impossible to pay for an unexpected cost of £500 without outside assistance. This rises to 73% among those of working age who are not in work and drops to just 29% among those who are retired.

Figure 6: Ability of people in poverty to meet financial shocks
Without assistance from an external source (e.g. friends, family, a financial institution), how difficult, if at all, would you find it to pay immediately for an unexpected bill (e.g. to replace a broken household appliance or repair a car) for the following amount?



Source: Public First for SMF

Notes: Sample is those in poverty

We also know that those in poverty are more likely to face an insurable loss.[12] For example:

- Those in social housing are nearly twice as likely to be burgled as owner-occupiers;
- Arson rates in low-income communities are 30 times higher than in higher-income communities;
- Low-income households are eight times more likely to be in tidal floodplains than more affluent households; and
- Data from London suggests that collisions are higher in low income neighbourhoods. The 10% of areas with the highest deprivation saw almost 2,500 collisions in 2020, which was more than double the 1,100 in the 10% of areas with the lowest deprivation.[13]

Overall, nearly one in four (23%) people in poverty say that they have experienced a loss (damage to or lost/stolen possessions) that would likely be insurable under a contents policy in the last five years. The same proportion say that they have been involved in a potentially insurable car incident. While 86% of those with a potential car claim are already covered by an insurance policy, less than half (42%) of those with a potential home/contents claim are covered by insurance. If these trends continued, it would suggest that, over the next five years, some 2 million people in poverty will have to cope with an insurable loss, without any insurance cover to meet the costs.

This shows that many of those who are in poverty and are not covered by insurance may face an insurable loss that they are not able to cover, without external assistance. As highlighted above, those who are covered by insurance face paying over the odds for the cover they do have.

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

Low-income focus group participant

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

Low-income focus group participant

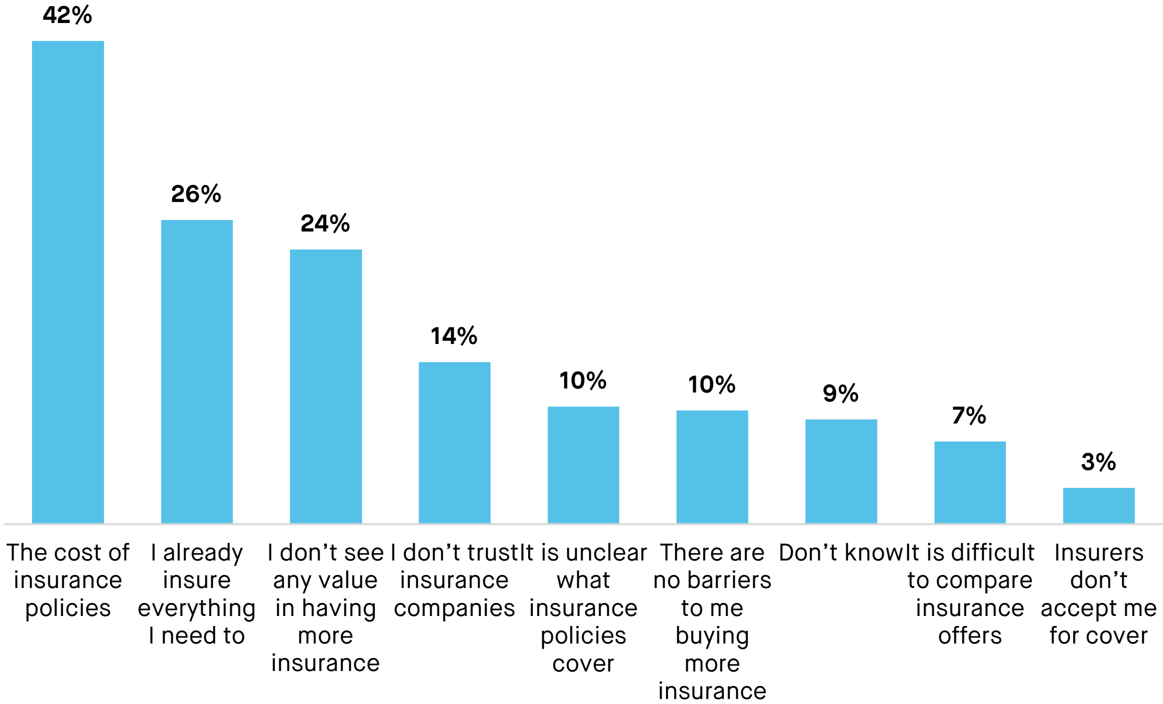
So what’s driving a problem with take up?

The last sections have shown that there are clear benefits to optional insurance policies (e.g. contents insurance) for families in poverty, but that take-up is low. The question is then what is driving that low take-up. From surveying of people in poverty, it is clear that there is not an issue with lack of access to the market. Just 3% of people in poverty say that an inability to get cover is an issue, and one in four say that they have already insured everything that they need to.

Figure 7 demonstrates that cost and the value of insurance are the two biggest barriers to purchasing more insurance cover for people in poverty:

- 4 in 10 (42%) say cost is one of the biggest barriers.
- 1 in 4 (24%) do not see the value in insurance.

Figure 7: Views of people in poverty about the barriers to take up of insurance products
What are the biggest barriers to you personally buying more insurance?



Source: Public First for SMF

Notes: Sample is those in poverty

Cost (and value) and the poverty premium

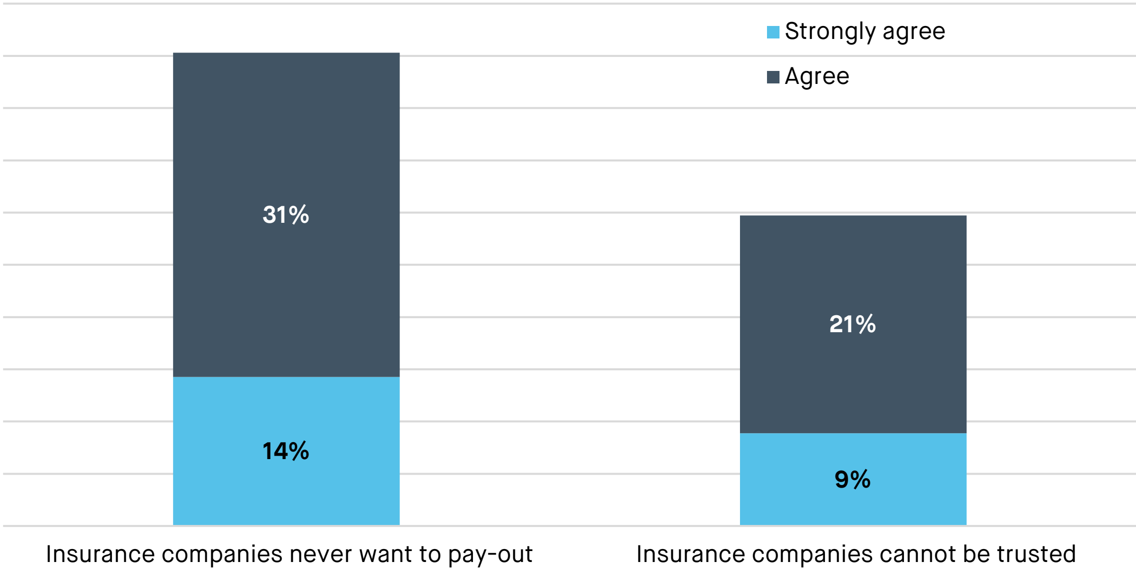
Whilst 42% of those in poverty say that cost is one of the biggest barriers to purchasing insurance, the earlier part of this report demonstrated evidence which suggested that, for optional insurance policies like contents insurance, the size of the poverty premium is relatively small (less than £5 a year on average). This suggests that the poverty premium is not likely to be a major driver of low take up amongst these families. Instead, it is simply the overall cost of insurance and how this compares to the perceived value of cover, which is driving low take up.

A wide range of factors contribute to this perceived lack of value for money, many of which were highlighted in the in-depth focus groups.

- **Insurance is not for me:** Many participants don't see insurance as for them and feel that they do not have possessions that are valuable enough to be worth them taking out insurance.
- **Dislike of excesses:** Excesses were frequently raised as being effectively 'double charging' and something that put off those who were cash strapped.
- **Confusion about products and coverage:** A feeling that insurance deliberately tries to confuse at application stage and declined claims later were commonplace.

- **Lack of trust:** Where views of poor behaviour from financial services firms and unfair product features contributed to the view that insurance was just not worthwhile for people in poverty (See Figure 8).

Figure 8: Views of people in poverty about insurance companies and their services



Source: Public First for SMF

Notes: Sample is those in poverty

"I go through each site when I look for my insurance. You need to understand how to navigate through all of this and the terminology that insurance companies use. If you are a newbie, you are going to have to phone up someone and you might get higher prices. You might have to pay double"

"Insurance policy documents should be shorter and easy to read. They should include what is covered and what is not."

"The other main thing that I was thinking of is trust. Because I feel that insurance companies generally, in broad terms, they generally profit off of people's fears and anxieties."

Low-income focus group participants

So does this matter?

The simple answer is yes. There could be significant benefits to improved take up of optional insurance products amongst families in poverty. These benefits would accrue to the families themselves, as well as wider society, as stronger financial resilience has been shown to support economic growth, reduced welfare spending and improved living standards overall.[14]

It is also apparent that, even where the poverty premium is relatively small and a potentially minor direct driver of low take up amongst people in poverty, it can relate to and exacerbate many of the other drivers (e.g. feelings of unfairness and that insurance products are not designed to support those in poverty). This means that, alongside other measures to support take up, tackling the poverty premium in insurance could support increased take up of insurance and bring significant economic and social benefits.

CHAPTER FOUR – COST OF LIVING AND THE POVERTY PREMIUM IN INSURANCE

Where insurance is mandatory, or where people in poverty are already taking up optional insurance policies, increased costs associated with the poverty premium can drive cost of living issues. Even in ordinary times, this chapter shows that these can be significant. However, in the context of the current cost of living crisis these issues are becoming even more severe. This is a problem now, as it is pushing families already in poverty to struggle more with finances, and for some families it could lead to hard decisions to stop buying cover and further increase issues around lack of take up. This could be true of both mandatory and optional insurance policies.

"...sometimes we can't afford [insurance] because of the costs"

"A lot of times I want to do insurance, but when you see the, you know, what you're paying for, sometimes your budget is so, so tight, you can't afford to get insurance."

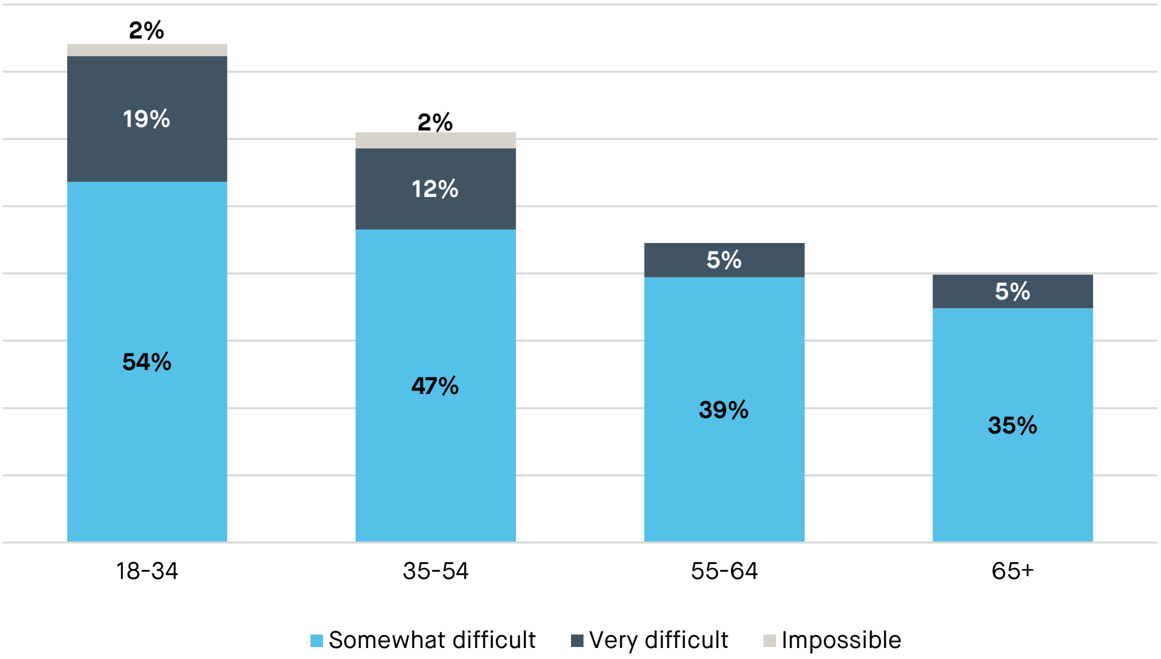
"Why should people who can afford to pay one lump sum pay less than those on low income who can only afford to pay monthly?"

Low-income focus group participants

How important is the poverty premium for cost of living issues?

At the most basic level, Figure 9 shows the real struggles that having to pay for mandatory insurance products can have on people in poverty. Overall, 55% of people in poverty who have motor insurance say that they are finding paying their premiums difficult. This rises to nearly three in four (74%) people in poverty aged 18-34, who have motor insurance.

Figure 9: How difficult do you find it to pay for your car insurance (by age group)?



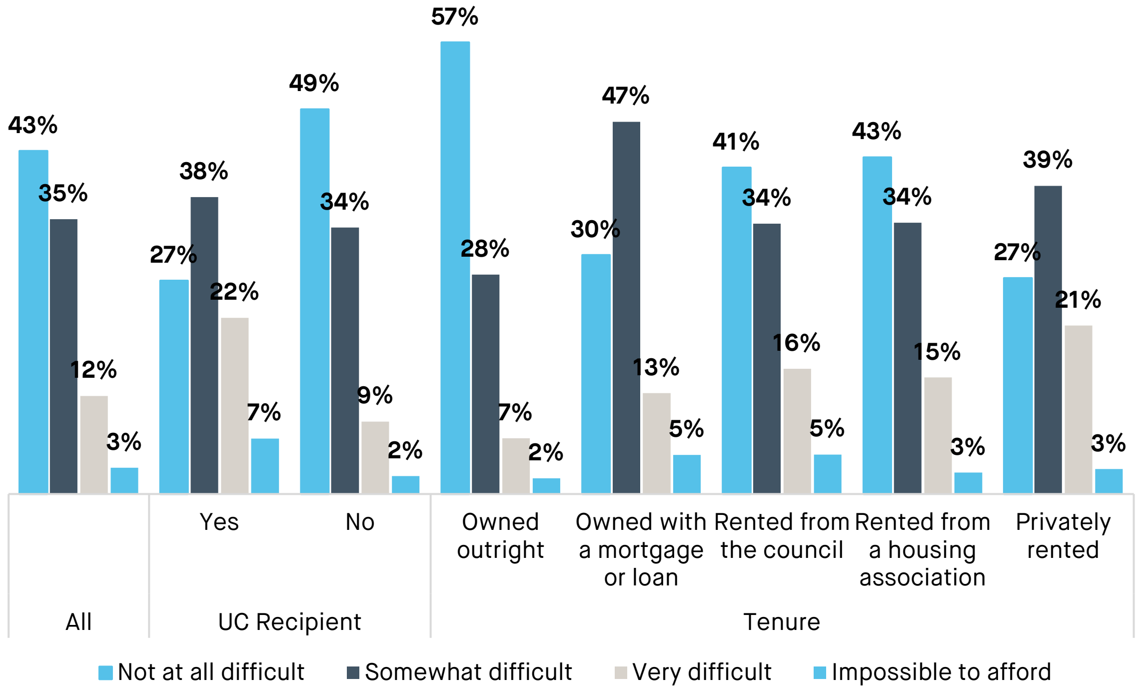
Source: Public First for SMF

Note: Sample is those in poverty

The poverty premium is estimated at around £300 per year for motor insurance[15] for those in deprived areas, with additional charges for paying monthly, instead of annually, adding an extra £160. With a total poverty premium of nearly £500, it is clear that it could be acting as a significant contributor to these issues.

Figure 10 shows the situation across all those with any insurance product. It shows that the issue of affordability is lower overall, with 50% of those with policies struggling to pay premiums. However, it also highlights that some groups are struggling more than others.

Figure 10: How difficult, if at all, have you found it to afford your insurance premiums in the last month? (only those with insurance)



Source: Public First for SMF

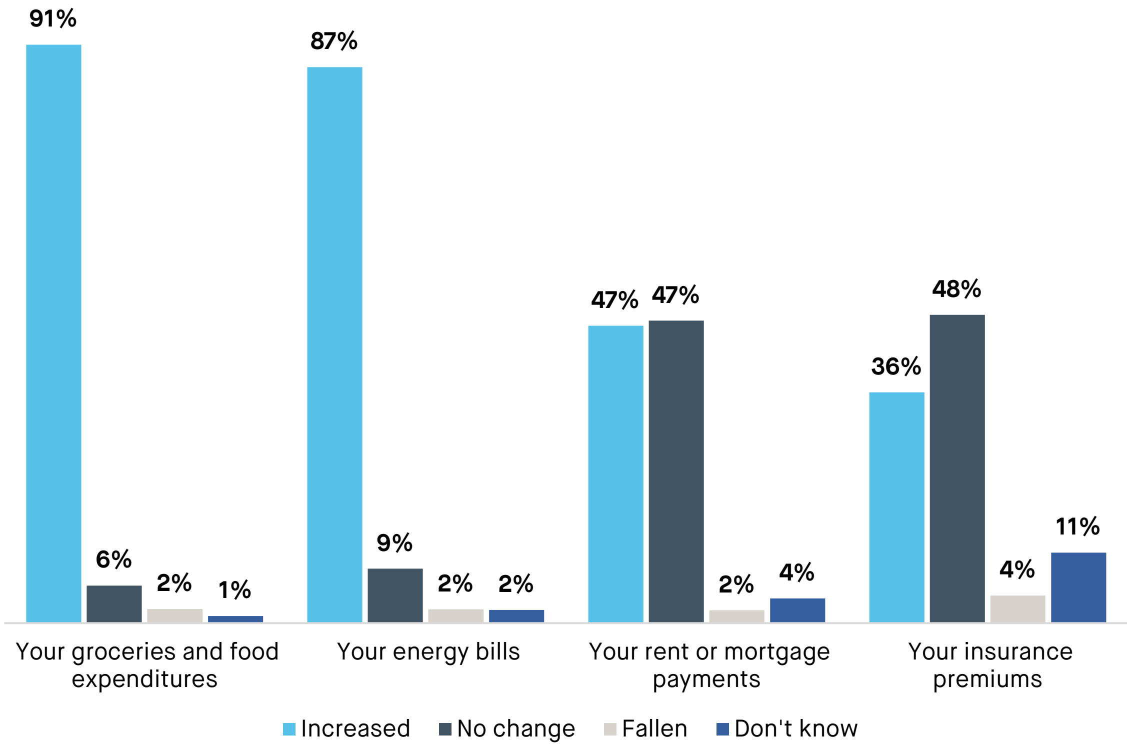
Notes: Sample is those in poverty, with some kind of insurance product

The current cost of living crisis is also impacting heavily on those in poverty. Figure 11 shows that the vast majority of people in poverty have noticed a rise in the costs of energy (87%) and grocery bills (91%) over the previous month. Whilst a lower proportion (36%) have noticed increases in insurance premiums, rising costs overall put further pressure on already stretched budgets and make it more likely for the poverty premium to impact on families' ability to make ends meet. And with 51% of those surveyed feeling that their personal financial situation would get worse over the next six months, this situation will only deteriorate over time.

"I had to cancel my contents insurance to be able to pay for my fuel. I hope nothing goes wrong."

Low-income focus group participant

Figure 11: Have you personally noticed any changes in the cost of the following in the last month (those with the products)



Source: Public First for SMF

Notes: Sample is those in poverty, who have purchased / used the goods / services

What this means

The poverty premium in insurance (particularly for mandatory items like motor insurance) is contributing to a significant cost of living issue. In the short term, this makes people in poverty even less able to make ends meet. In the longer term, to the extent that it leads to people cancelling policies in order to prioritise immediate needs like food and energy, it will undermine take up of insurance and be detrimental to financial resilience of people in poverty. As described above, this could lead to significant personal, economic and societal costs, which will be felt by us all.

CHAPTER FIVE – THE WAY FORWARD

The poverty premium in insurance makes people in poverty pay more for essential insurance cover, causing significant detriment to families already under serious financial strain. The poverty premium also contributes to low take up of policies amongst people in poverty. As the cost of living crisis deepens, challenges around take up are likely to increase, and families are likely to be forced to sacrifice optional policies, in order to meet the costs of energy and groceries. Some may even be forced to sacrifice mandatory cover like motor insurance, thereby being pushed into illegal activity or having to give up what might be their means to travel to work. Overall, this means that the poverty premium in insurance is only going to become a more serious issue for people in poverty over the coming months; pushing more families into financial distress and undermining financial resilience. The question then is whether we should try to do something about it and, if so, what can be done.

The poverty premium in insurance: should we do something?

The first point to note is the reason that nothing has been done already is partly caused by a misperception of the essential nature of insurance. Beyond vehicle insurance and some professional cover, there is mostly no legal requirement to have insurance. In the narrow legal sense, insurance is an optional good which people can choose to purchase or not purchase. But that narrow definition does not tell the whole story. Insurance is not just a product like any other good. Even if the law does not require it, we have shown that there is a clear social imperative for people to have it, because being insured is a good thing. Arguably, it is also a socially responsible thing too, since someone insured against loss is better able to sustain losses without requiring state assistance.

The point is that our society clearly deems insurance to be desirable and useful. Among those with the means to have insurance, uptake of buildings and contents cover is almost complete: people who can get insurance for their homes do so; they are also much more likely to insure their lives, their travel, their pets. Meanwhile as this report – sometimes movingly – shows, people who struggle to assemble the means to pay for insurance face harm. Harm to their financial resilience. Harm to their peace of mind and emotional wellbeing.

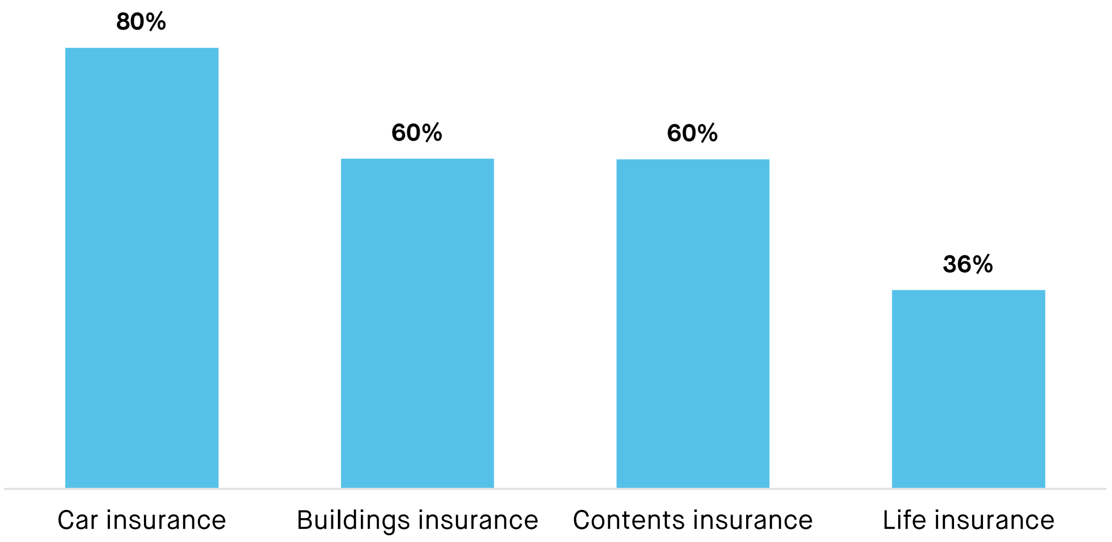
This calls to mind Immanuel Kant's categorical imperative. Kant says that we should "…act as though the maxim of your action were to become through your will a universal law of nature." In practical terms, if something is the right thing for one person to do or have, it is the right thing for all people to do or have. If it is right for those with sufficient means to be insured and thus protected from harm, we must accept that it is right for everyone to be insured – and at an affordable price.

The alternative proposition is that we accept that some people – purely by reason of wealth – are denied a desirable, useful and essential good and face harm. Here, the nature of insurance matters. We may be content for wealth to bar some (most) people from eating lunch at the Ritz, because being unable to eat lunch at Ritz does not cause harm. But insurance is not lunch at the Ritz.

This is also something that chimes with those that experience the poverty premium. Previous work by Fair by Design and the Institute and Faculty of Actuaries (IFoA) set out a vision of access to certain insurance products being part of a minimum level of social protection.[16] At this principle level, that insurance products are essential, there is overall support from those in poverty:

- The vast majority (80%) of people believe that car insurance is an essential. More than half of those in poverty (54%) strongly agree with this.
- Support is particularly high amongst older groups in poverty, with 87% of those aged 65+ agreeing that car insurance is an essential.
- Even amongst those who do not own a car, 60% say that car insurance is an essential.
- Six in ten of those in poverty (60%) think that buildings insurance and contents insurance should be classed as an essential

Figure 12: Views on whether different forms of insurance should be regarded as an essential (proportion that agree/strongly agree)



Source: Public First for SMF

Notes: Sample is those in poverty. Full question: Some people have suggested that, like household energy and groceries, some types of insurance should be classed as an "essential". To what extent do you agree or disagree that the following should be regarded as "an essential"?

A failing market, even if there is no market failure

Another cause of inaction is the argument that the market is simply functioning as it should; pricing policies in way that reflects underlying risk. However, even if this were found to be the case, there is still a strong case for action and parallels can be drawn with other markets.

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

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

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

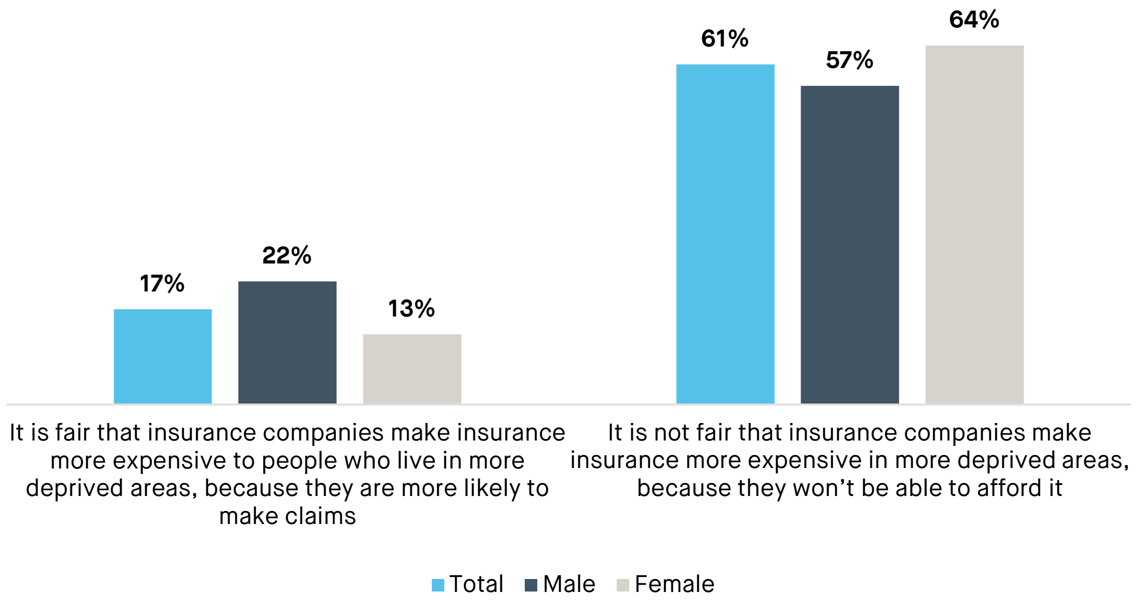
Recent events around energy are a helpful illustration of the way society's expectations of markets can shape policy. Energy prices have reached very high levels for many reasons, but many of them arise from the provision of energy via market mechanism. Rising demand (current and future) and flat or falling supply means prices rise. This is, broadly, a market functioning normally. Yet where prices are deemed to be too high, social expectation demands intervention. Hence successive policies limiting the prices paid by first some, and then all, consumers. The relevant principle here is that sometimes, our sense of fairness trumps the need to let markets operate unchecked, because otherwise some people are asked to pay too much for something important.

Applying that same sense of fairness to poverty premiums in insurance surely demands a more robust policy response. We may all sometimes struggle to define in precise terms what we consider fair and unfair, but we recognise unfairness when we see it. If a situation where some people face excessively high energy bills – through no fault or choice of their own – offends our sense of fairness and require intervention, how can we not demand a similar approach when people face premium prices for insurance not because of anything they have done but simply because of who they are?

Again, this is a point that echoes with those that experience the poverty premium. Here, there is strong opposition to the idea that those who are deprived should pay more for their insurance (see Figure 13).

- Very few people subscribe to the idea that those in more deprived areas should pay more because they are more likely to make claims.
- Most people believe that this is unfair, because it makes insurance less affordable.
- **Just 7% of people believe that it is fair that those on lower incomes may pay more for their insurance. 66% believe that it is unfair.**

Figure 13: Views of risk-reflective pricing



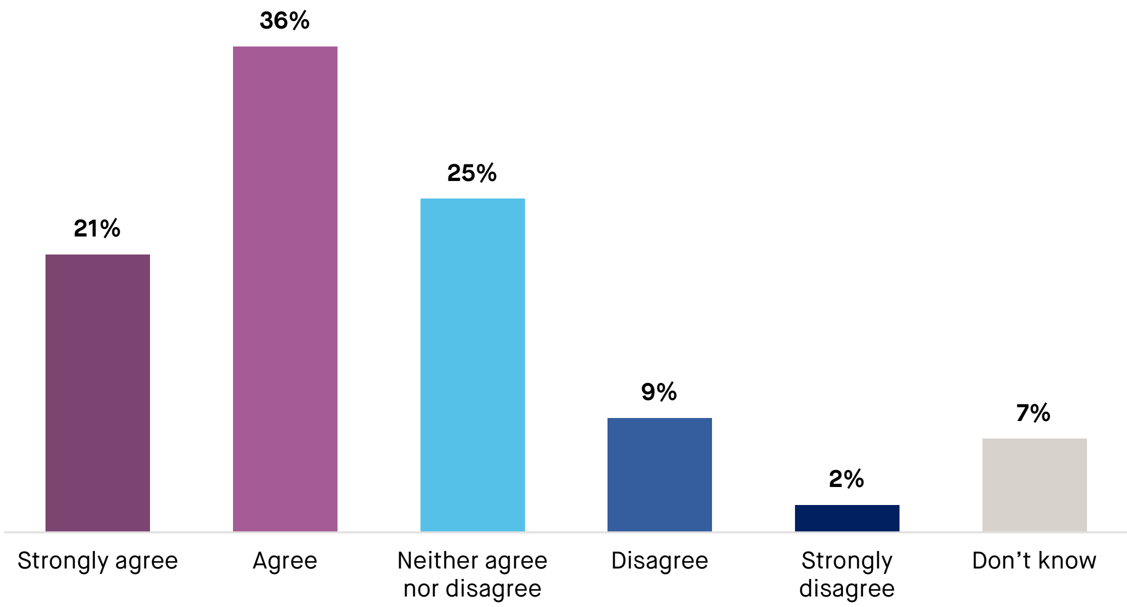
Source: Public First for SMF

Notes: Sample is those in poverty

In addition to this, those in poverty also tend to oppose the use of characteristics like income and location to calculate premiums (see Figure 14).

- 1 in 3 (34%) believe that people who live in higher-risk areas should pay more for their car/home insurance.
- However, just 1 in 10 (11%) say that premiums should be based on things like income and where people live.
- 57% of people in poverty say that premiums should not be based on these things.
- Just 16% of people in poverty believe that people on lower incomes are more likely to make insurance claims than those on higher incomes.

Figure 14: Views on whether insurance premiums should not be based on characteristics like income and where people live



Source: Public First for SMF

Notes: Sample is those in poverty

Some of the insights from the qualitative work suggests that these perspectives may be a result of a view that factors such as location or income are (a) not directly relevant to risk or (b) outside of someone's control, and so ought not be used by underwriters.

> **"When I do my car insurance, they ask, are you disabled? Are you a single parent? Are you married are you divorced? What is your job title?**
>
> **What does it matter that I am a single parent at home because I am looking after my kids or in ill health, I'm a careful driver! But I have a disability, but I feel that I am penalised for my circumstances. Because we are already suffering and living in poverty, we should not be charged more. What difference does it make? Whether you are an accountant or unemployed? I want to understand is how insurance works. How can you judge that?"**
>
> *Low-income focus group participant*

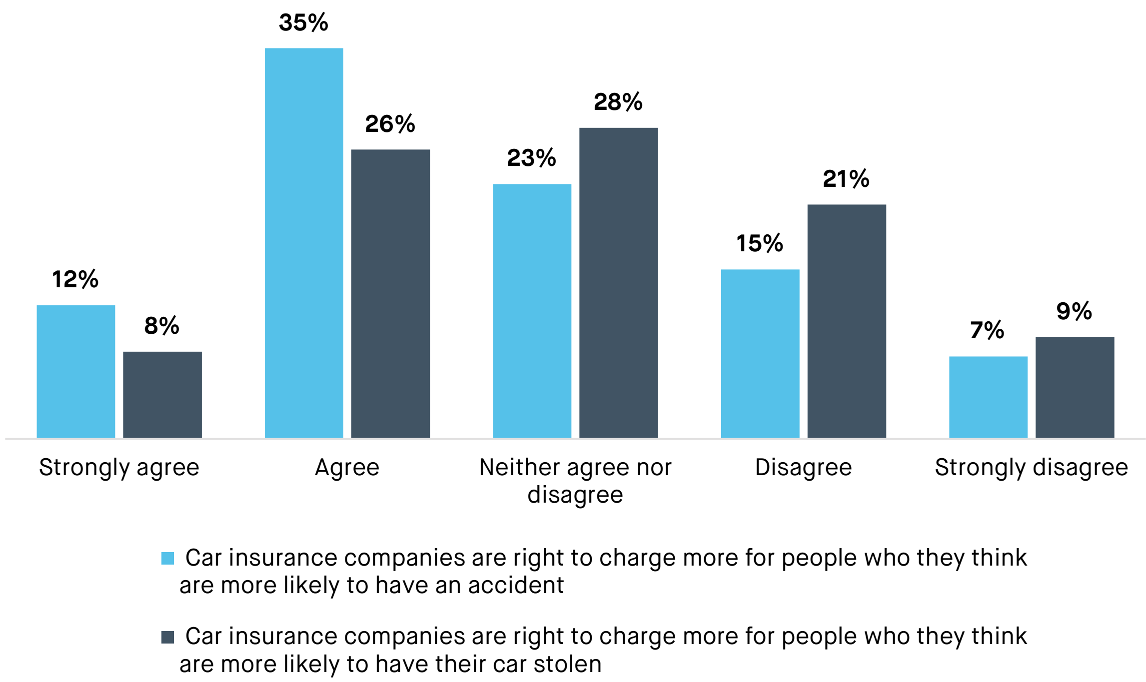
Other elements of the polling found more nuanced results around public attitudes to risk pricing. For instance:

- Nearly half (47%) agree that premiums should be higher for those judged to have a greater risk of having an accident; and
- A lower proportion (34%) believe the same for those at risk of having their car stolen.

As stated in the previous section, this perhaps indicates a concern for agency; it appears to reflect a view that people shouldn't be penalised for things which are out of their control. Driving safely is possibly deemed to be more in someone's control than the risk of theft in the location that they park their car.

In summary, while there is a broad opposition to those on lower incomes paying more for insurance due to being higher risk, there is reasonably strong support for the principles of risk pricing – that risker individuals could pay more for insurance.

Figure 15: Views over pricing methods in motor insurance



Source: Public First for SMF

Notes: Sample is those in poverty

This finding replicates previous work in this space. Research by Britain Thinks for the ABI found a majority in favour of individuals paying premiums based on their risk of a claim – with a significant minority opposed.[17]

What does this mean?

These findings strongly suggest that there is a case for insurance products to be regarded as an essential and their take up and cost for low-income families considered in a similar way to that of energy, fuel and food. The balance of the findings also suggests that many people feel that it is unfair that insurance premiums are currently higher for those in poverty. This is particularly true where premiums are raised by factors that are outside of the control of the individual.

Overall, this points to the idea that something should be done to tackle the poverty premium in insurance. This would ensure that lower-income families have access to a product regarded as an essential, and that the current perceived unfairness is removed. As highlighted above, it would bring significant benefits to individuals, families, the economy and society overall.

So what should we do?

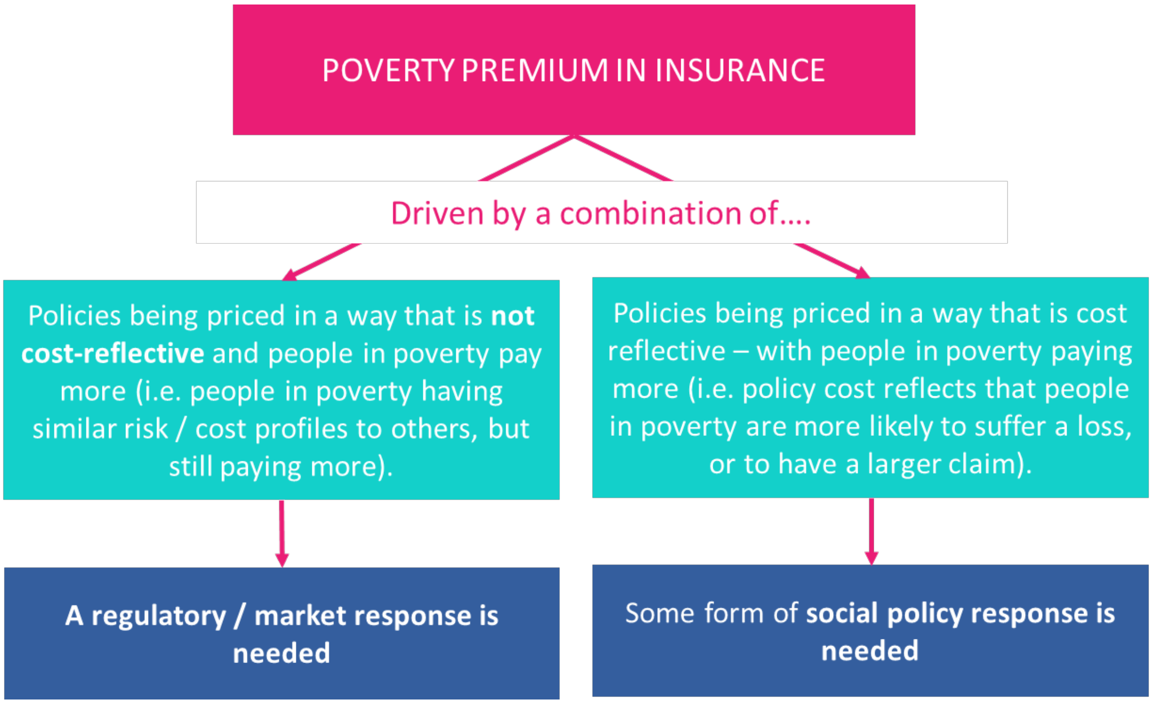
Understanding the poverty premium

To understand what can be done about the poverty premium in insurance, we first need to understand more about its conceptual basis. In simple terms, this comes down to a question of the extent to which the poverty premium can be explained by the higher risk of claim that is faced by certain groups:

- Is the poverty premium simply that those in poverty pay a **cash poverty premium (or "cost-reflective poverty premium")**, due to actually being higher risk of a claim, or having higher costs associated with any given claim (for example, as a result of higher crime rates, more vehicle collisions in poorer areas)? In essence, **are poorer policyholders paying more for more?**
- Or is there also a **value poverty premium (or "non-cost reflective poverty premium")**, where those in poverty pay a higher premium but not as a result of being higher risk. In essence, **are poorer policyholders paying more for less?**

Stakeholders interviewed as part of this research agreed that understanding the balance between these two routes of the poverty premium is very important. Figure 16 provides an indicative illustration of this concept.

Figure 16: Poverty premium components



Source: SMF indicative analysis

The importance of understanding this is clear, since the policy and regulatory responses would be different for each part of the poverty premium:

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

Given the importance of this question for determining an effective policy response, it is no surprise that our discussions with expert stakeholders arrived at this topic. However, there was not agreement over the balance between the two issues, with different stakeholders arguing the case for each of the routes of the poverty premium. The root cause of this debate is the opacity of insurers' pricing models. This opacity, while a key part of the competitive nature of the insurance market, means that evidence on the split between these two drivers of the poverty premium is largely non-existent.

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

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

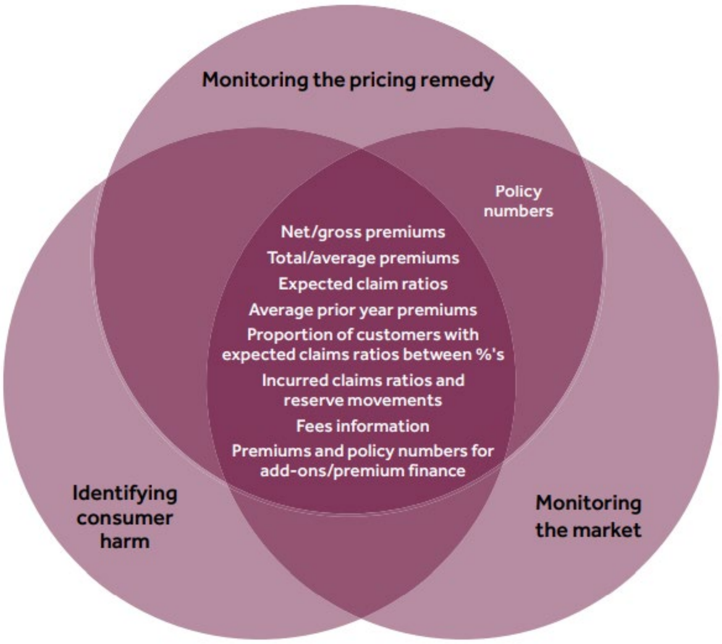
This means that if we are to tackle the poverty premium in insurance, and drive detriment down and increase take-up, a better understanding of the basis of the poverty premium needs to be established. This will allow policymakers to determine the appropriate balance between regulation and social policy.

Given the need for working with data and practice across the industry, and to provide a comprehensive view of this issue, the FCA is the appropriate organisation to do this. In its own words:

> **Financial markets must be honest, fair and effective so consumers get a fair deal. We work to ensure that these markets work well for individuals, for businesses and for the economy as a whole.**

This report has demonstrated that the insurance market does not "work well" for individuals in poverty. The FCA is also already doing good work in this area as part of its ongoing activity and has the tools to collect pricing information from insurers. This includes existing approaches to gathering data on the back of General Insurance (GI) pricing interventions, particularly around claims ratios, which could be instructive in determining the value of insurance products to different groups. We believe that much of this data could be repurposed with a focus on providing a comprehensive view of the poverty premium in insurance, building understanding and driving positive behaviours in the market.

Figure 17: Main reporting metrics for GI pricing remedy



Source: FCA GI pricing practices final rules[18]

Recommendation one – FCA should investigate the poverty premium in insurance

Clarity is needed over where responsibility for tackling the poverty premium in insurance lies between the regulator and Government. The FCA should build on its existing work, and undertake new work where needed, to provide better information on the poverty premium in insurance. This should identify and publish, annually:

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

The FCA should then publish a yearly review of its findings.

Once a clearer picture has been gained of how the insurance market is working for lower-income households, further regulartory and social policy interventions can be identified. The following sections provide examples of options that could be explored for both the risk-reflective and non-risk-reflective poverty premiums.

Addressing the non-risk-reflective poverty premium

Through their investigation of the composition of the poverty premium, the FCA will be able to determine the extent of the non-risk-reflective poverty premium. That is, the portion of the poverty premium that is not based on increased risks, and means that people in poverty are getting poor value for money. This could be determined by assessing whether certain customers pay more for their cover than is reflected by their risk. For instance, if lower income groups (which may need to be determine by proxies) had lower claims ratios than other groups, then this would suggest that they are getting poorer value products, as well as paying more.

Ultimately, providing poorer customers with worse value for money is not something that will align well with many firms' ethos or positioning in the market. As such, we believe that providing transparency and holding firms to account when this happens could be a key route through which such actions could be challenged and behaviour changed.

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

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

- **Consumers** – either those on low incomes who are keen to get better value from insurers, or any consumer who would prefer to buy from insurers who do not unfairly penalise those on low incomes.
- **Civil society groups** – who are keen to steer consumers whose interests they represent towards better value insurers for lower income individuals.
- **Investors** – who may have ESG related concerns to insurers unfairly overcharging low-income policyholders.

As other reports have highlighted, consideration should also be given to the extent to which the non-risk-reflective poverty premium is driven by poorer consumers accessing more expensive products. This may be driven by the assumption that all consumers have the time, resources and inclination to navigate the market effectively to find the best and value for money. In practice, this is clearly not true and it should be incumbent on the industry to ensure that their products and actions support low-income and other more vulnerable groups to get the products and services they need, at prices they can afford.

Stakeholders highlighted that the market for single-item insurance policies was likely to be one particular example of where this was not the case and we have already shown that some 1.2 million people in poverty have this sort of cover. Here, it was argued that people taking on single-item insurance policies would be better (and more cheaply) provided for through a broader contents insurance policy. If this were found to be true, there is a strong case for action by the regulator.

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

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

Addressing the risk-reflective poverty premium

The key to understanding how to tackle the risk-reflective poverty premium is to realise that this is not necessarily a problem with the insurance market. Insurers are simply following a market-wide trend of pricing policies to reflect their expected costs, and people in poverty are paying more because they are higher risk. In essence, policies offered to people in poverty could be seen as offering value for money as much as policies offered to people not in poverty.

This means that, if the benefits of increasing take-up, or reducing the costs, of insurance for people in poverty were deemed to be significant enough, it would require a social policy response. This social policy response could come in the form of a state-backed intervention, or increased regulation, which was explicitly targeted at ensuring that insurance companies could not price policies based on factors that increase costs to low-income families.

Unsurprisingly, given the scale and potential impacts of the interventions that would be considered, this was a controversial subject amongst the stakeholders we interviewed.

This was particularly true when options to restrict or influence pricing strategies were considered. Here, many highlighted the benefits of accurate risk pricing, noting that it:

- Promotes competition that brings down the average price for everyone;
- Incentivises individuals to reduce their risk in exchange for a lower premium (such as through innovations like telematics); and
- Allows for underwriting innovations which improve outcomes for underserved groups.

However, as highlighted above, (while by no means a universal view) many people in poverty feel that risk-based pricing practices are not fair. Along similar lines, other experts and some of those in the industry noted that risk pricing is controversial given that it runs counter to principles of social solidarity and risks leaving some people uninsurable for what many agree are essential products. This was particularly the case where pricing is based on factors beyond an individual's control. As a result, it runs in stark contrast to institutions which our society highly values, such as the National Health Service (NHS) and the social security system.

There was also disagreement about what interventions in this space would look like. Approaches analogous to other state-provided schemes to ensure affordability amongst those in poverty, would require a cross subsidy of some sort. This could be delivered in a number of ways, including via a subsidy provided by the state, and financed through (typically progressive) general taxation. It could also be delivered more explicitly through a cross subsidy from lower-risk (higher-income) policy holders.

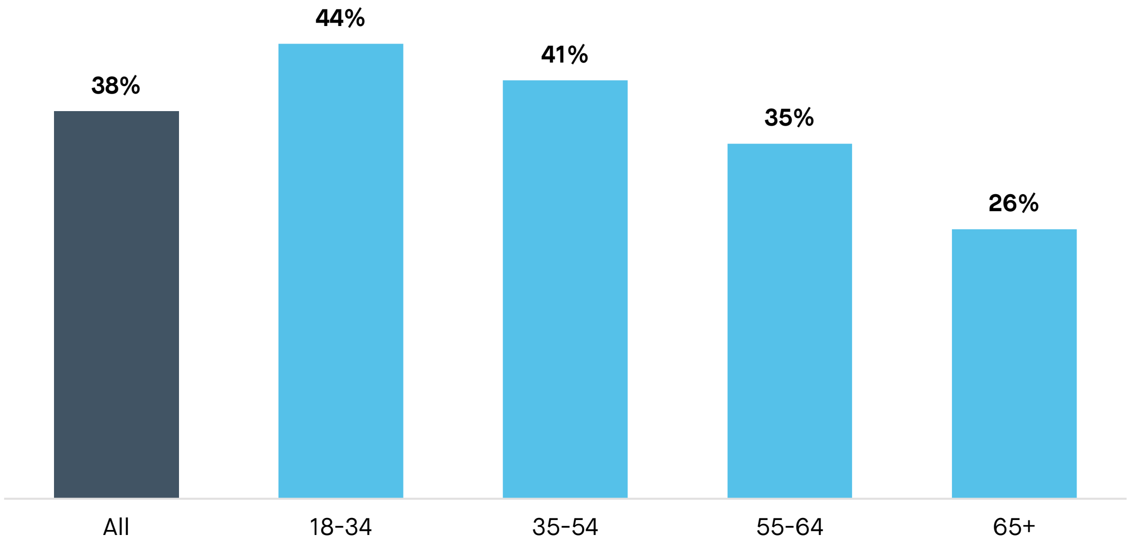
In this respect, some stakeholders raised the prospect of a similar approach to that of Flood Re (see Box 1).[19] It was argued that a "Postcode Re" might be set up to support the provision of more affordable motor or home insurance to people in deprived postcode areas. While an attractive idea in principle, others argued that, in practice, the approach was unlikely to be feasible as it would be hard to identify specific "risks" that could readily be re-insured.

Box 1: Flood Re as an intervention to tackle social policy objectives in an insurance market

Flood Re is a collaboration between insurers and government by which most-at-flood-risk properties in the country have their premiums cross subsidised through a levy on all home insurance policies. This cross subsidy is administered by a reinsurer underpinned by the Water Act 2014. The legislation stipulates that Flood Re will exit the market in 2039. Before Flood Re existed, 9% of households who had made flood claims previously could get quotes from two or more insurers. Flood Re means this is now 100% of households. In addition, four out of five eligible households saw a greater than 50% premium reduction in their home insurance as a result of Flood Re.

Views amongst those in poverty surveyed by Public First for the SMF, were also mixed on these issues. For example, four in ten people (38%) thought that the Government should subsidise insurance to make it affordable, even if that meant taxes going up, while 23% disagreed with this statement. Support was stronger amongst younger age groups.

Figure 18: Even if it meant that taxes needed to go up, the Government should subsidise insurance to make sure everyone can afford it



Source: Public First for SMF

Notes: Sample is those in poverty

A lower proportion (29%) thought that premiums for people on lower incomes should be subsidised by higher premiums paid by others, whose insurance is currently cheaper. A similar proportion (27%) opposed the idea.

Given this lack of consensus, care should be taken over designing interventions in this space. However, given the potential benefits to lower-income families of lower costs and higher take up, and the associated economic and societal benefits, there is a clear case for intervention. So we believe that there are a range of options that could be considered by the Government, in consultation with the industry and people in poverty.

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

The Treasury should lead a consultation on a series of proposals that could reduce the risk-reflective poverty premium. To ensure that the trade-offs between different groups and objectives are fully captured, this should ensure detailed engagement with the insurance industry and people in poverty, including:

- **The introduction of Workplace Insurance Vouchers**, targeted at low-income families. Like childcare vouchers, these would provide subsidised/tax free support for low-income families buying insurance products. The Government could also introduce a similar scheme with an equivalent level of subsidy for those who are out of work and on social security benefits. This would come with a cost to the Exchequer, either through foregone tax revenue or the cost of the subsidy for those out of work. This could be justified on the basis that:
    - Funding this through taxation is progressive, as well as more popular according to our polling.
    - This comes at a time when Government is intervening in a significant way to financially support those paying their energy bills – an intervention to provide workplace insurance vouchers could help limit the long-term impact of the cost-of-living crisis on levels of social protection.

The key consideration in terms of policy design here would be to ensure that this scheme could be well targeted on those in need.

- **The introduction of a state-backed insurer that provides affordable cover to people on means-tested benefits** (both in and out of work). Government could set up its own insurer, or insurance type vehicle, that would provide low-cost cover to low-income individuals.
    - A broad precedent for such as step is the introduction of NEST – a government-backed pension provider, which competes in the private pensions market, to help smaller employers fill their requirements with regard to auto-enrolment.
    - The vehicle could be initially capitalised by taxpayers, and they could also be responsible for any ongoing subsidy which might be required depending on the cost of the cover. If it was possible for risk to be held on the Government's balance sheet, this could ensure cover was provided at lower cost than through a private insurer, as Government would not need to be subject to Solvency II. However, this would be unlikely to be possible for motor insurance under current legislation.
    - A state-backed provider could work with mainstream insurers to support them with their data and insights of the low-income customer base so that the private insurance market can better compete with the state backed entity. This collaboration could take place on the basis that, over time, the state-backed insurers would be prepared to withdraw from the market if it felt that private insurers are able to step in.

  - Again, if this cover needed to be provided in a loss-making way, the cost of this would fall on taxpayers, which would be more progressive and popular than it falling on other people's insurance premiums.

- **The introduction of American-style file and use/or pre-approval regulatory systems and rating restrictions** – In the US, insurance is regulated on a state-by-state basis. Some states have systems where insurance ratings have to be pre-approved by a regulator, and others have 'File and Use' systems wherby ratings need to be shared with the state regulator who has the ability to prevent them from being used.[20] For example:
  - Some states, such as Mississippi and North Dakota, have prior approval systems where rates need to be approved by a regulator, before they can used. Others, such as Indiana and Georgia, have 'File and Use' systems whereby ratings need to be shared with the state regulator before being used. The regulator then has the opportunity to withdraw approval for the rates over a certain period of time.
  - Some states, such as California, have very strict restrictions on rating factors, including bans on the use of credit history and occupation.[21]A shift towards such a system would be a radical option, and a significant change to the current regulatory environment, which would reduce insurers' ability to compete on price. The risk is that this would lead to higher premiums overall for everyone. However, it would likely restore an element of solidarity and cross-subsidy to the market, which is something that was stressed as important by a number of stakeholders. As such, it may help to reduce the Poverty Premium.
- **A significant reduction in Insurance Premium Tax** – As previous work by the SMF has highlighted, Insurance Premium Tax (IPT) is a regressive tax which hurts the poorest and at its current level unfairly penalises take up of insurance. Research by the Institute for Fiscal Studies found that the appropriate level of IPT would be **20% of the difference between premiums and claims**. As result, a low single digit rate would be more appropriate than its current 12%. A significant cut to IPT could be considered to lower the cost of insurance for everyone. While this would not help to reduce the poverty premium, it would be a progressive tax cut overall supporting low earners.[22]

Conclusion

This report has shown that the poverty premium in insurance leads to significant detriment for people in poverty and has knock-on effects to the economy and society more generally. Higher costs, lower take up and associated lower levels of financial resilience are bad for all of us.

This means that something should be done. However, there is no simple solution. The poverty premium is driven by a mixture of market-based and individual-based factors. Even if the market were functioning perfectly, people in poverty would likely pay more for insurance. The first thing that needs to be done is to better understand the balance between these two factors. With this information in hand, policymakers could determine the appropriate balance between regulation to make the market work better, and social policy interventions that seek to provide direct support for the individuals affected. We have put forward a number of ideas for options that could be considered for both of these approaches. We believe that by working together, the Government, industry and stakeholders could develop a social-market approach that ensures affordable, value-for-money insurance for those in poverty who need it, and that this would bring significant benefits to us all.

ENDNOTES

[1] https://www.bristol.ac.uk/media-library/sites/geography/pfrc/The-poverty-premium-A-Customer-Perspective-Report.pdf

[2] https://www.mentalhealth.org.uk/about-us/news/mental-health-problems-cost-uk-economy-least-gbp-118-billion-year-new-research

[3] Social Metrics Commission – 2020 report.

[4] https://wpieconomics.com/site/wp-content/uploads/2019/07/WPI-Economics-Aviva-Contents-Covered-JULY-2019-FINAL.pdf

[5] https://www.bristol.ac.uk/media-library/sites/geography/pfrc/The-poverty-premium-A-Customer-Perspective-Report.pdf

[6] https://www.thompsons.law/media/1839/ethnic-penalties.pdf

[7] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/The-poverty-premium-A-Customer-Perspective-Report.pdf

[8] https://www.scope.org.uk/campaigns/extra-costs/disability-price-tag/

[9] https://www.citizensadvice.org.uk/about-us/our-work/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/the-mental-health-premium/

[10] Oakley, M., (2019), Contents covered: the role and importance of home contents insurance for low-income renters. Available here: WPI-Economics-Aviva-Contents-Covered-JULY-2019-FINAL.pdf (wpieconomics.com) Accessed 29/08/2022.

[11] https://www.abi.org.uk/globalassets/files/publications/public/data/britain_thinks_consumer_data_insurance_report.pdf

[12] ABI

[13] https://www.trustforlondon.org.uk/data/road-traffic-collisions/

[14] https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf_public/ga2012-the_social_and_economic_value_of_insurance.pdf

[15] https://www.bristol.ac.uk/media-library/sites/geography/pfrc/The-poverty-premium-A-Customer-Perspective-Report.pdf

[16] https://fairbydesign.com/wp-content/uploads/2021/09/IFoA_Hidden_Risks_of_Being_Poor_Aug_21_v09.pdf

[17] https://www.abi.org.uk/globalassets/files/publications/public/data/britain_thinks_consumer_data_insurance_report.pdf

[18] https://www.fca.org.uk/publication/policy/ps21-5.pdf

[19] Ahern, J., (2022), Time for a Re-think? Risk in insurance markets. WPI Economics. Available here: IFOA-Main-Report-220817.pdf (wpieconomics.com)

[20] https://www.rstreet.org/wp-content/uploads/2020/12/Final-Insurance-Report-card-2020.pdf

[21] https://www.thezebra.com/resources/research/car-insurance-rating-factors-by-state/

[22] https://www.smf.co.uk/wp-content/uploads/2020/02/The-impact-of-IPT-on-UK-households.pdf