

thinkpiece

Promoting debate and fresh thinking in the financial services industry

Too Big to Ignore: The protection and perception gaps for life and health insurance

Ron Wheatcroft and Stephen Bale

Summary

- The latest Swiss Re research shows that consumer thinking towards spending and debt has changed. Consumers do regard life and protection policies as important but lack the knowledge to acquire what they need. This problem is compounded by the fact that many consumers think they have more cover than they actually do.
- Despite attempts to improve protection products labelling consumers still find products and propositions complex and bewildering. Income Protection remains a confusing product, with many consumers thinking that it refers to redundancy or unemployment.
- Consumers see financial advice having a key role to play in distribution despite the prevalence of the internet. This has to be of an accessible nature, underscoring the need for a basic or simplified advice model, however research suggests a big gap between amounts consumers are prepared to pay for that advice, and possible adviser fees.
- The industry, government, regulators and distributors must create transparent, consistent and unequivocal messages in their efforts to engage consumers to recognise their responsibility.

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CII Introduction: The Insurance Report, published by Swiss Re in its twelfth edition in December 2009, takes a consumer-focused view of the long-term insurance market with a particular emphasis on long-term protection business. In this latest CII Thinkpiece, Swiss Re's Ron Wheatcroft, Technical Manager, and Stephen Bale, Disability Product Actuary, explain why the time is ripe for the life insurance industry to engage with all stakeholders in a concerted effort to close the protection and perception gaps.

The report was quite deliberately entitled "The cost of doing nothing". Doing nothing and failing to adapt to the new environment will result in a high price for the financial services industry, consumers and the population as a whole. Doing nothing might mean that those consumers who are making some provision for the future simply carry on doing what they are doing now – and that is not enough.

The authors of this article explore how the industry can make the step towards greater engagement and propositions which are relevant to consumers today and into the future.

The thoughts and recommendations of the authors are their own but draw heavily on the findings from qualitative and quantitative research conducted by Swiss Re among more than 1,000 UK consumers aged between 21 and 70.¹

The technology revolution

The consumer today is very different to the consumer from a generation ago. Technology has revolutionised the way we live our lives in a way few would have considered possible.

Technology has enabled us to compare products in a way in which the traditional high street could never have done, both comparison sites and informal websites allow us to compare experiences, both good and bad, often with complete strangers.

More choice – and increased confusion

We have a choice to select the products we want. In today's competitive environment, there is a greater choice in financial services products as providers attempt to differentiate themselves from another. But as we have done so, many of the propositions brought forward have been complex. We have designed products more to appeal to the intermediary sector rather than to the end customer. Often, what we considered innovative

¹ Swiss Re quantitative research: 1,003 of UK public aged 21-70, in June/July 2009, data weighted by age, socio-economic group and working status. Qualitative research: six moderated focus groups in London, Reading, Leeds and Birmingham. Full details of research available from Swiss Re via CII.

was in reality perceived very complex by the end consumer.

"What you want is straightforward English ... you are covered for XYZ and you are not covered for ABC."

Consumer, aged 45+

Long-standing relationships between families and firms, often stretching over several generations, have vanished. This has largely impacted lower earners where the advice sources have largely disappeared.

In the meantime, relationships between consumers and the industry, such as "the Man from the Pru", have changed. Long-standing relationships between families and firms, often stretching over several generations, have disappeared. This has largely impacted lower earners where advice sources have largely vanished.

There can be no doubt that the market needed to modernise, and the industry has made some real progress compared to the days when product charges were largely concealed from consumers through devices like capital units.

We have moved from a face-to-face model built on relationships to a more efficient market - but at what cost? There has been too little thought for those excluded from obtaining advice, surely an unintended consequence, and the result has been a regulatory structure which, increasingly, is there to protect the better off. As we move to the implementation phase of the Retail Distribution Review (RDR), the risk is that the eventual outcome excludes even more people. There has been too little debate about re-engagement with a market which has become disengaged. Well-intended attempts to improve consumer understanding of our products and services have resulted in consumers being swamped with more and more information. As a result, consumers still see many of the propositions that we regard as simple as being quite complex and find the terminology bewildering, a finding confirmed by our research.

The non-life market has changed and people have become used to shopping around each year for cover. In the life assurance market, however, contact and market access are less frequent. While some changes have occurred to the way that consumers access the market, for example more people purchasing simple products direct, the market is still largely one where cover is sold.

Need for greater self-provision

Consumers do recognise that they can no longer close their eyes to the need for greater self-provision and that the state will not provide other than for the most needy of cases. They have yet

to recognise, however, the gaps between the cover in terms of what they have and need. Even worse, they are ill-equipped to take the action necessary to do something about it.

Social change is making life more complex. Data published by the Office for National Statistics (ONS) show that the number of private households is projected to grow from 21.5 million in 2006 to 27.8 million by 2031, an increase of 29%. The main shift will be driven by people living alone, expected to go up from 32% to 39% over the same period.

Between 2002 and 2009, Swiss Re's Income Protection Gap, a conservative measure of the shortfall between the cover consumers have and need, increased from £130 billion to £190 billion.

Among the changes is the fact that mothers are delaying starting a family, with the age of motherhood having increased by almost 10% since 1991. LV= estimates that the cost of raising a child has increased by 38% since 2003 and now stands just under £200,000.

We have also seen the end of the "job for life" syndrome. CII-Reform research has reported that young people can expect to change jobs up to 11 times during their working lives.²

Too big to ignore

Since 2002, Swiss Re has published information about the UK Life Assurance Protection Gap, the difference between the amount of life cover people hold and the amount they realistically need. This now stands at £2.3 trillion sum assured, a figure in itself too big to be meaningful to the average UK consumer. Putting it into context, we estimate that around one half of the adult population in the UK has a personal protection gap amounting to approximately £100,000 on average, around four times national average earnings.

Although the number of single households includes people in retirement, much of the growth will be a result of people co-habiting or marrying later, or those who have been divorced. In these circumstances, they are likely to be reliant upon a single

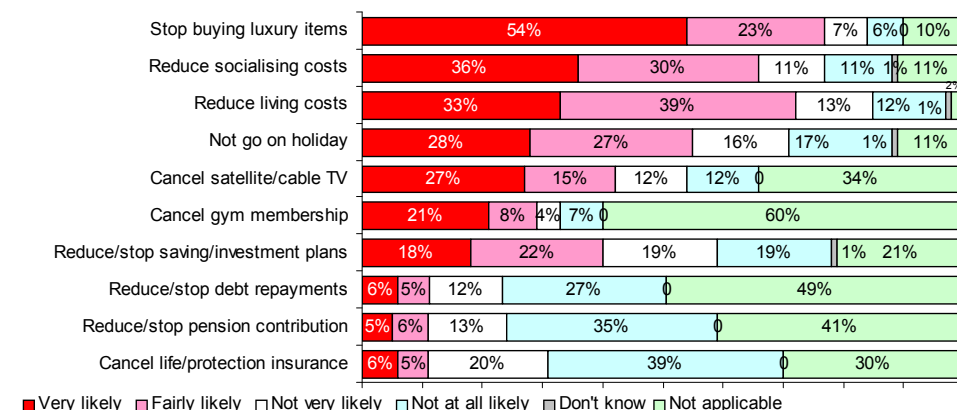
income to support themselves and their commitments which may include providing for an ex-spouse or for children who no longer live with them. They will also not enjoy the "economies of scale" which arise where more than one person lives in the same household. This will create a massive need for long-term cover to protect their income against the risk of prolonged disability.

Against these numbers, it is a sobering thought that the number of people insured, either through their own policy or an employer-sponsored scheme, remains between 3.5m and 4m and that between 2002 and 2009 Swiss Re's Income Protection Gap, a conservative measure of the shortfall between the cover consumers have and need, increased from £130 billion annual benefit to £190 billion. The debate about the "pensions time bomb" and the issues around providing adequate income in retirement are, of course, well known. Potentially, though, we have an emerging income protection time bomb which might be one of the costs of doing nothing.

Becoming cautious

The credit crunch has influenced and changed consumer thinking since 2007, leaving consumers feeling much more cautious about their spending patterns and their attitudes to debt. This is in marked contrast to earlier Swiss Re research. Responding to how they would react to having to reduce monthly outgoings by £100 a month, only 6% of people said that they would be very likely to cancel their life or protection insurance, with 5% being very likely to cancel their contribution to a pension arrangement (see Figure 1 below). By comparison, 54% said they would be very likely to stop buying luxury items and 27% said they would be very likely to cancel their satellite TV

Figure 1: If you had to reduce your monthly outgoings by £100 a month, how likely would you be to...



Source: The Insurance Report 2009, *The Cost of Doing Nothing*, Swiss Re Europe S.A., UK branch

² [Money's too tight to mention: will the IPOD generation ever trust financial services?](#) A report by Reform and the Chartered Insurance Institute, October 2008

subscription. While this clearly shows that consumers do regard their life and protection policies as important, the evidence is that they

largely lack the knowledge and skills to acquire or update the cover they need.

Cope: some hope!

In view of the difference between the amount of insured life and long-term disability in the UK and the amounts which are realistically needed, the research tested consumer confidence in how well their household would cope if they were to suffer an illness, disability or death. Rather surprisingly, 71% of those researched thought that their household was very or fairly well placed to cope. Taking consumers aged between 35 and 54, 58% thought that they had adequate insurance and 22% thought they had adequate savings to see them through. Interestingly, 32% of those aged 21 to 34 said that they would rely on family and friends to help.

When asked what products they have, 52% said they had life insurance. Between 35 and 54, 74% claimed to have life cover in place. 22% said that they have their own long-term income protection policy. Between 35 and 54, the figure was 31%.

Gaps in perception

Comparing this against income protection market data, though, reveals a very different picture. Market in-force data, measured by policy count, stands at only around one-third of the holdings the research indicates. While 3.5m to 4m people have cover, between 10m and 11m people think they have it. Perhaps we should not be so surprised that people don't buy the cover if they believe they already have it?

A website search for "income protection" in the UK leads very quickly to many products which provide combinations of accident, sickness, redundancy and unemployment cover with varying durations of benefit.

Earlier, we described the complex nature of many of our products. The consumer understanding of products gave some revealing insights as to how our products and services are interpreted. When asked what income protection meant to them, consumers often spoke about the risk of being made redundant or unemployed. Relatively few related the term "income protection" to the risk of loss of income as a result of long-term incapacity.

Improving the labels

This is not surprising given that the product name we commonly use makes no reference to a long-term benefit payment duration or incapacity. A website search for "income protection" in the UK leads very quickly to many products which provide combinations of accident, sickness, redundancy

and unemployment cover with varying durations of benefit. Once the concept of protecting income against the risk of incapacity on a long-term basis was explained to consumers, it was considered a valuable and useful product. But, if there is nobody to explain what the product does, what will make the consumer seek it out? The evidence is that they struggle to work through much of the material we produce and fail to differentiate what is less or more important.

Describing the ideal relationship, consumers said they want somebody they can call, often to discuss a quite simple point and to seek the reassurance that they were doing the best thing.

This is one specific example of where our product labelling can be improved. While we acknowledge that much has been done already, we still need to make products and propositions clear and comprehensible. Every industry has its jargon but what chance do consumers have with product names such as variable annuities – a product which is neither variable nor an annuity! We suspect that many people working in the life industry would struggle to explain what the product actually is and does.

The role for advice

Many consumers see buying long-term protection on-line as different from buying products like motor or travel insurance. The perceived complexity of long-term products and the risk of the consequences if they made a mistake left people more cautious. Despite all we hear about the internet replacing advisers, in the same way that consumers have gone direct for many non-life insurances, financial advisers have a key role to play.

67% of consumers are prepared to buy protection cover through a financial adviser at a bank or building society and 60% from an independent financial adviser. Many consumers said that they would look for advisers and other sources to complement their own research. By comparison, 25% said that they would be prepared to buy cover through the internet. However, many people will do their own research to gain a better understanding of a product before seeing any adviser.

Despite all we hear about the internet replacing advisers, the financial adviser has a key role to play.

Describing the ideal relationship, consumers said they want somebody they can call, often to discuss a quite simple point and to seek the reassurance that they were doing the best thing.

This is quite a way from a model based on detailed client fact finding and regular reviews which many advisers would wish to adopt in the lead up to and beyond the RDR but reflects the fact that people see their needs as essentially simple. Consumers told us that they were looking for a relationship but very much on their own terms. This suggests that we need to explore further how a basic or simplified advice model might work for consumers.

Who do you turn to?

The first port of call for research and information for consumers was banks (69%), closely followed by friends and family (68%). For people aged between 21 and 34, friends and family was the prime choice (84%), perhaps reflecting the relative lack of familiarity with financial institutions among younger people. Interestingly, when consumers were asked if they would purchase from specific brands, the 21-34 group was far less selective in terms of the organisations it would or would not wish to use. We attribute this to a willingness to shop around and to consider a wider range of potential sources, while older consumers may reject brands based on past experiences or because they do not consider a brand as relevant in the context of financial services.

Independent – what's in a name?

Consumers liked the concept of independent advice, but testing which firms they knew to offer independent advice showed that few are able to identify any specific independent financial advisers and find it difficult to distinguish between independent and other sources of advice – despite regulation drawing a distinction between independent and other advice for over 20 years.

The research suggested that many consumers do not care too much about adviser status provided they get the help they need and feel confident that the adviser has done a good job.

The most commonly named IFA firms were the major banks, with other firms thought to provide independent advice including past and present product providers such as Allied Dunbar, Scottish Equity (sic) and Scottish Widows. Other organisations believed to be independent included Baines & Ernst and the websites associated with Richard Branson and Martin Lewis.

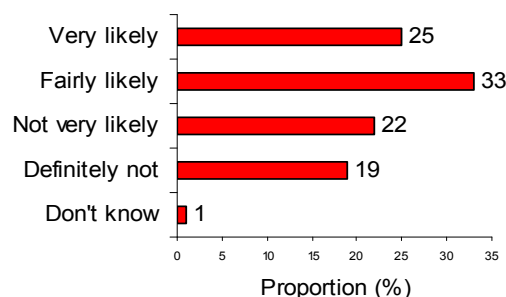
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This provides food for thought as the RDR is likely to move the definitions on to a distinction between independent and restricted advice which could be common across investment business, mortgages and protection. While we debate at length the scope and range of independence against other advisory descriptors, will consumer awareness really improve?

What price for advice?

The research provided further insights into the amounts that consumers would be prepared to pay for financial advice. 58% claimed that they would seek independent financial advice for life and protection insurance products (see Figure 2 below). Despite this, the amounts consumers are prepared to pay are limited.

Figure 2: How likely would you be to seek independent advice for life and protection insurance products?



Source: Insurance Report 2009, *The Cost of Doing Nothing*, Swiss Re Europe S.A., UK Branch

Of those prepared to pay a one-off fee, 20% were prepared to pay up to £100 and 26% between £100 and £199. 36% were unable to give a figure, perhaps reflecting a lack of familiarity with paying for advice. The figures for advice on savings and investment needs are broadly similar.

We conclude that there is a big gap between the amounts consumers would be prepared to pay, if anything, and typical adviser commissions. Consumers may be resistant to fee-based advice.

Time to put intentions into action

The challenge we now face is to move consumers on to action to meet their needs better, both in their working lifetime and in later years.

Our consumer research indicates a new-found sense of responsibility in the way people manage their money yet they remain very confused about the different products and services the industry offers. The biggest challenge we face is to build on this greater recognition of responsibility to the point where they act.

Improving financial capability in the UK is essential and this has been recognised with the Financial Services Authority-led initiative to develop better financial awareness and capability. It may be tempting to see this initiative as yet another cost on an over-burdened industry, yet better informed and confident consumers are essential. It is not a lack of trust in the life industry which is the biggest barrier to buying, more that consumers have not got round to doing anything, don't think they need our products or have not thought about it.

We need clear, consistent and unequivocal statements from the government that savings, investment and buying protection are a good thing and that it is the consumer's responsibility to do so.

We urgently need more stability and consistency in the messages given out by government and by regulators. The pensions tax simplification changes introduced from April 2006 removed some of the complexity which had bedeviled the system for too long. But we then saw pensions term assurances withdrawn within eight months (at a cost to an industry previously given the green light) and more recent attacks on perceived abuses by higher earners. More fundamentally, the development of personal accounts has been delayed. What is the cost of all of this in terms of consumer and employer confusion and apathy?

We need to build financial capability to the point where people are at least aware that they need to do something. We can debate endlessly whether it is the responsibility of the industry, the government or somebody else. The answer is that all of us need to work out how we best work together.

We need clear, consistent and unequivocal statements from the government that savings, investment and buying protection are a good thing and that it is the consumer's responsibility to do so. The messages need to be clear across all stakeholders, be they distributors, insurance companies or government.

Growing pressure

In the current economic climate, it is unrealistic to expect anything other than even greater responsibility to be placed upon the individual – but we cannot rely on tax incentives to encourage this, at least not in the short term as pressures on the public purse and the need to reduce debt take higher priority. The life insurance industry has a key role to play when working in partnership with the government to reduce the protection, retirement and care gaps. This is where we need

to step in and convert our good intentions into action.

Be transparent and consistent

We must be more transparent in what we do. Does it go too far to say that products which cannot be understood by a reasonable cross-selection of the target market should not be sold?

Does the answer to reducing the size of the Protection Gaps lie in more products being available? We think not - competition is good for consumers but competition built around product complexity can only have limited value. It is a sobering thought that the cause of many of the reviews of past sales led by regulators have stemmed from complex propositions, whether through poor marketing and product literature or poor advice.

Consistent and simple messages which explain the basics of our products instead of describing the nuances of distribution will be key to keeping consumers engaged. We must stress the need to take action so that they move on from being largely passive in their insurance buying habits to becoming engaged and informed retail buyers.

We need to give clear messages to employers since they are currently not obliged to provide pension or other benefits.

Many consumers see the workplace as a natural access point for financial information. Employers have therefore a key role to play and are important providers of financial products, with almost three-quarters of all long-term income protection and 40% of all life assurance cover provided and paid for by the employer.

We all need to give clear messages to employers since they are currently not obliged to provide pension or other benefits. While benefit provision is a common part of the remuneration package in some industries, particularly in financial services, employers could withdraw cover at any time if the cost and uncertainty of doing so is seen as disproportionate to the benefit of provision. Positively, the group risk market, through its trade body, GRiD, has already begun work to raise the profile of cover with employers with some success.

One of the challenges we face is that members who leave employment lose cover under the scheme. Is there more we could do to help?

If, as expected, the number of adviser firms falls, where will consumers get the help they need? We would not be too worried by the contraction if consumers were better capable of making

informed decisions. Unfortunately, the research shows that this is not the case.

The time is now

From the consumer research, we have detected a new-found sense of financial responsibility. Consumers are thinking much harder about their finances and choices but remain very confused about the different products we offer. They understand that they will have to provide for themselves with the state largely withdrawing. Yet, while they recognise this, the gap between the greater recognition of responsibility and taking action needs to be filled.

This is an opportunity for the life industry to re-engage with all stakeholders, be they consumers, distributors, insurance companies or government. The funding of health and care in the UK is a complex and often political issue. The costs of

care and retirement continue to grow, as increased longevity leads to an increasing proportion of the population being made up of elderly lives. The government faces significant pressures over the coming years to tackle the growing public debt and the impact on public finances. The life insurance industry has a key opportunity to work in partnership to reduce the protection, retirement and care gaps – an opportunity we need to seize.

This article is based on Swiss Re's 2010 annual Insurance Report entitled "The Cost of Doing Nothing," published on 3 Dec 2009. See Swiss Re's [press release](#).

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