

Chapter 2

Evaluation of Individuals' Risks and Insurance Awareness, Education and Capability

National evaluation surveys to assess consumer level of literacy about insurance products or financial products at large have been carried out in a limited number of OECD countries. In this respect, results of the few studies that have been conducted reveal that even though households increasingly need and are responsible for their own protection against a wide range of risks, at the same time, they are relatively unaware of their most significant risk-exposure and the way to address these needs through insurance solutions.

When assessment processes exist, they generally encompass three main types of evaluation: first, the appraisal of individuals' level of awareness of risks, specific exposure and need for appropriate coverage; second, the assessment of individuals level of knowledge and responsibility on insurance issues; and third, the analysis of the level of transparency and selling practices of insurance market players.

1. Risk awareness and inappropriate coverage/insurance

Assessment is important to estimate any shortcomings or flaws that might lead to under-coverage or inappropriate coverage in all or part of the population for potential risks. When they have carried out such assessments, depending on country circumstances, they often focus on natural and man-made large-scale disasters, long-term risks or risk involving important resources in the long run (this may typically be the case for longevity and severe health risks such as dependency), of which people are relatively unaware or for which they may be ill-covered.

Until 2002, the General Insurance Association of Japan prepared a study designed to evaluate consumer awareness of homeowners insurance, including coverage of earthquake risk. In Finland, the ombudsman monitors all types of risk that may affect the population and is responsible for informing consumers about them. For various reasons (highlighted in Box 2.1), results show a lack of awareness of the need to seek protection against risks, when insurance coverage is not compulsorily or otherwise provided automatically by public schemes. Households often seem to underestimate damages caused or needs for resources stemming from potential disasters and thus their coverage needs, in particular, those related to large-scale catastrophes or ageing risks. In Australia, for example, 40% of homes are poorly insured or not insured at all.¹ More recent surveys² also suggest that

Box 2.1. **Reasons for low risk awareness and inappropriate coverage**

Several reasons may explain inappropriate coverage and/or under-coverage for potentially seriously damaging risks. First, consumers' short-term mindset does not encourage them to consider long-term risks (such as old age and dependency risks¹) against which they often believe themselves to be covered. Households can also be reluctant to seek coverage for a risk they consider unlikely or are unaware of. This is typically the case for risks that have serious financial and economic consequences but are characterized by low likelihood of occurrence. Similarly, risks affecting third parties are difficult for individuals to perceive, since by definition they are not directly concerned.

Unfortunately, it is often the adverse experience of catastrophic events and their resulting damages that makes people aware of the risk. For example, the floods that occurred in Eastern Europe in 1997 and 2002, as well as the 2005 series of Hurricanes in the US and the resulting catastrophic floods raised public awareness of this risk and of the magnitude of damages such event could cause. Likewise, the 9/11 attacks have increased awareness of the risk of terrorism in OECD countries and of the need to develop adequate coverage. Research shows that sales of all types of protection insurance increased in the two years after 9/11, including life or dependency insurance that do not necessarily have any direct connection with terrorism risk and its coverage.²

This lack of awareness and knowledge about the scale of possible damage is often compounded by a conviction that the State already covers the risk (even if that is not or no longer the case), or will eventually cover damages (for example, in the event of natural disasters or terrorist attacks) – the so-called “Samaritan dilemma”.

Moreover, within mature and regulated OECD insurance markets, recent scandals that hit insurance providers and their intermediaries, coupled with cases of mis-selling of insurance products, has made consumers mistrustful of providers with respect to agreements based on long-term solidity and reliability. In countries where the insurance market is in the initial stages of development, households do not necessarily have the inclination or the desire to take out insurance against potentially damaging risks. In former Communist countries³ and in emerging economies, the lack of an insurance culture and financial education coupled with general mistrust of financial institutions is often mentioned as one of the main reasons, together with low incomes, for the absence or lack of insurance protection even for most needed coverage (e.g. against large-scale disasters and health-related risks).

Box 2.1. **Reasons for low risk awareness and inappropriate coverage (cont.)**

Finally, research⁴ and surveys – see hereinafter – have found that individuals often remain passive about decisions to be made to best handle their risk exposure. To that effect, it may not be enough to provide education to individuals to increase their awareness of risks and ways to prevent and cover them. The challenge rests in seeking solutions to incite them to change their behaviour, to enforce proper mitigation measures and to actively seek and get coverage in accordance with their risk exposure and vulnerability.

1. On this subject, see for example, S. Parente, D. Salkever and J. Da Vanzo (2003).
2. Source: Verzone, Ronald D. (2002).
3. See for example OECD (2004b) and OECD (2005d).
4. For further information on behaviour as regards risks, see for instance: Grenn, CH, (1990) and Lane S.N., Berger A. and Sandercok A.J., (2002).

between 27% and 81% of consumers are underinsured by 10% or more against current rebuilding costs.

More precise assessments of the appropriateness of flood coverage undertaken in several countries³ reveal similar results. In the United States, only 25% of homes in areas liable to flooding have flood insurance cover (which is not included in standard householder insurance policies).⁴

Surveys are also conducted into the appropriateness and adequacy of coverage of long-term risks such as ageing through life insurance policies. For instance the European Commission carried out a study⁵ in 2006-2007 on the market for long-term savings. One of the purposes of the study is to appraise whether these products and recent evolutions best meet consumers increasing needs.

Assessment may also imply monitoring general public awareness and knowledge on the possibilities available to cover these risks including insurance vehicles. This analysis is rarely undertaken. In addition, the criteria for measuring such awareness are rather difficult to define. One interesting initiative in this area is an annual survey carried out by the Korean Insurance Development Institute. The survey is designed to assess the extent of awareness and the existence of an insurance culture among potential consumers according to criteria such as life and non-life coverage rates, policyholder satisfaction and consumers' propensity to take out insurance.⁶

In Australia, the Government is currently conducting benchmark research into financial literacy levels at large. Surveys conducted on the Australian population will also include data on attitudes, awareness and competency in relation to insurance and risks. In this area, a survey of US consumers

conducted by the National Association of Insurance Commissioners (NAIC) in 2006 targeting specific age-groups reveals a relatively low awareness of the needs to seek coverage. The survey finds that 20% of young adults would rather let their auto insurance policies lapse to save money. Similarly, 18% would decline employer health insurance to save money. At the other range of age groups, only 12% of empty nesters/seniors think they are very likely to need long-term care and they significantly underestimate the cost of such care (annual estimate is USD 35 000 whereas the actual annual cost is USD 70 000).

In Poland in 2002, the Insurance Chamber carried out a survey on representatives of public opinion (e.g. politicians, journalists, civil servants), which revealed a very low degree of familiarity with risk and insurance products.

2. Measuring level of insurance knowledge, understanding and capability

Another stage in assessing the specific education needs of consumers includes measuring real (as compared to alleged) understanding of policies and how insurance works. The NAIC consumer study in the USA shows that although two-thirds of American consumers considered that they had adequate coverage, only one-third thought that they properly understood their policies. Moreover, the same study reveals a need for greater awareness about fake insurance and understanding of insurance policies. In this respect, only 45% of US consumers overall get suspicious about a policy that costs significantly less than comparable ones. In Germany in 2003, NFO Infratest Finanzforschung and the Bertelsmann Foundation carried out studies to identify the level of financial education among adults, the reasons why it was so low and the factors behind individual decisions about retirement saving and investment (including life assurance products). In Japan, the Central Council for Financial Services Information prepared a consumer questionnaire, which investigated the level of consumer knowledge and understanding of financial matters in general (including insurance). The results of the survey demonstrated that consumers' needs for enhanced education and understanding were considerable and urgent. These outcomes have been reflected in the design of future education programmes by the government. As mentioned, with a view to support the project "building financial capability", the FSA in the UK also conducted an extensive analysis of consumers' understanding of financial products. The results of this survey were published in 2003, showing a general weakness of financial planning and comprehension.⁷

To assess inappropriate coverage or mis-selling that may result from a lack of a good understanding of insurance policies, a relatively useful and

widely used tool is the number and types of complaints recorded⁸ by the authorities (generally the insurance supervisory authorities or ombudsman when relevant). In this respect, in Spain, the Annual Report of Inquiries and Complaints compiled by the Directorate General of Insurance and Pension Funds (DGSFP) tables and classifies the number and nature of consumers' inquiries and complaints received, resolved or withdrawn and the insurers that are the object of complaints. In addition, the DGSFP analyses the outcome of such data collection along with its records on calls to its hotline and the face-to-face support provided. The DGSFP is then able to take remedial measures if deemed relevant.

Other types of assessment relate to consumers (pro)active stance regarding risk and insurance issues: and in particular whether they accurately appraise their risk-exposure and the appropriateness and competitiveness of their insurance (or public) coverage, take remedial action when relevant, shop around before choosing products and policies, collect information (and from which sources), are knowledgeable about what important questions to ask insurance distributors depending on the type of products and know where to find information, advice and help in case of disagreement with insurers. Surveys conducted in OECD countries⁹ revealed that, on average, consumers remain passive with respect to risk and insurance issues and related decisions to be made. For example, a UK study¹⁰ based on a representative sample of consumers having yet to subscribe to a life insurance contract showed that only 10% of them had personally considered more than one policy and that 59% had followed the advice of a distributor.

In addition to research by public bodies in some OECD countries, surveys are often carried out by consumer associations (*e.g.* "Which?" in the UK) or research institutes on certain segments of the population (*e.g.* immigrants, young people and old people.) and on certain products (especially life and long-term care insurance). The Japan Institute of Life Insurance, for example, carried out a three-year study of what ordinary consumers know about the terms of life insurance contracts. The most recent study in 2003 showed that the diversification and complexity of life assurance products posed problems of comprehension for consumers.

A number of public and non-governmental websites¹¹ contain questionnaires that allow consumers (depending on their profile) to assess their own basic insurance needs (*e.g.* life, health, automobile and loss insurance) and their understanding of such policies. Although such self-assessment is helpful in making individuals more aware of, and responsible for, their need for education, such resources do not provide any information about the level of financial literacy and capability of the population as a whole or of more specific target groups.

3. Evaluating overall insurance market integrity, transparency and practices

Assessing the size, competitiveness and overall transparency of insurance products and markets – including products targeting low-income groups such as micro-insurance policies – and the performances and practices of insurance product providers is important in order to identify possible improvements. As mentioned, education needs may differ according to the maturity and competitive nature of the market. For example, scandals affecting major insurance industry players may require to improve both regulation of the sector and commercial practices, as well as education and capability of potential consumers in order to restore a climate of trust.

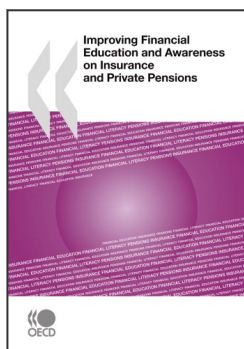
In Mexico, an official body called PROFECO (*Procuraduria Federal del Consumidor*) carries out occasional quality surveys of service providers' performance. In the UK, an assessment of both life and non-life insurers was carried out as part of the "Treating Consumers Fairly" programme. In Japan, non-life insurance providers organise conferences and round-tables to measure consumers and media opinion of the selling and management of policies. Feedback is then used by association members to improve their practices. In most jurisdictions, consumer associations also take part in such monitoring, conducting covert surveys of insurance providers, with the aim of sensitising public opinion to any problems encountered. In Poland, under the insurance code, the ombudsman is responsible for carrying out research into the insurance market and preparing reports on the general conditions for the provision of insurance policies. The ombudsman is also responsible for reporting any irregularity to the supervisory authority and informing the public of the results of its research.

Notes

1. Estimates by the Australian insurance industry, 2004.
2. Source: « Getting home insurance right » ASIC. www.fido.asic.gov.au
3. The Association of British Insurers (ABI) in the UK and the National Association of Insurance Commissioners (NAIC) in the US.
4. Source: Insurance Information Institute, 2004.
5. *The EU market for consumer long-term retail saving vehicles*, 15 November 2007.
6. The study is generally based on a sample of 1200 people aged over 20 and the results are published on the Institute's website at www.kidi.or.kr.
7. In particular, the financial capability survey highlights the following main challenges: individuals are not saving and/or protected enough for/against long-term risks (in particular to cope with the consequences of ageing), many people are subscribing inadequate policies or are taking inappropriate risks and more

worrisome the greatest demands are often placed on those least equipped to deal with them.

8. The result of such data collection should be interpreted with caution in so far as many factors can explain the amount and evolution of complaints, if not otherwise qualified. For instance, an increase in the number of complaints will not necessarily mean that the number of mis-selling or fraudulent selling is increasing in the market, but may show that consumers are more aware of their rights to sue or to seek advice.
9. For instance, see in the US, NAIC surveys, in the UK, FSA, Building capacity initiatives; and in France, see Delmas-Marselet (2005).
10. Source: *Leadership in Consumer Literacy*, Mitchell, J. (2003).
11. See "Check Your Financial Knowledge" on the FSA website (www.fsa.org) or "Get Smart About Insurance" on the NAIC website (www.naic.org).



From:
**Improving Financial Education and Awareness on
Insurance and Private Pensions**

Access the complete publication at:
<https://doi.org/10.1787/9789264046399-en>

Please cite this chapter as:

OECD (2008), "Evaluation of Individuals' Risks and Insurance Awareness, Education and Capability", in *Improving Financial Education and Awareness on Insurance and Private Pensions*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264046399-5-en>

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