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Consumer Protection for Insurance: Existing Evidence and Research Gaps

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Outline

- 1. Introduction**
- 2. Demand Side Issues**
- 3. Supply Side Issues**
- 4. Disclosure/Transparency**
- 5. Effective Recourse**
- 6. Fair Treatment**

1. Introduction: Insurance and Consumer Protection

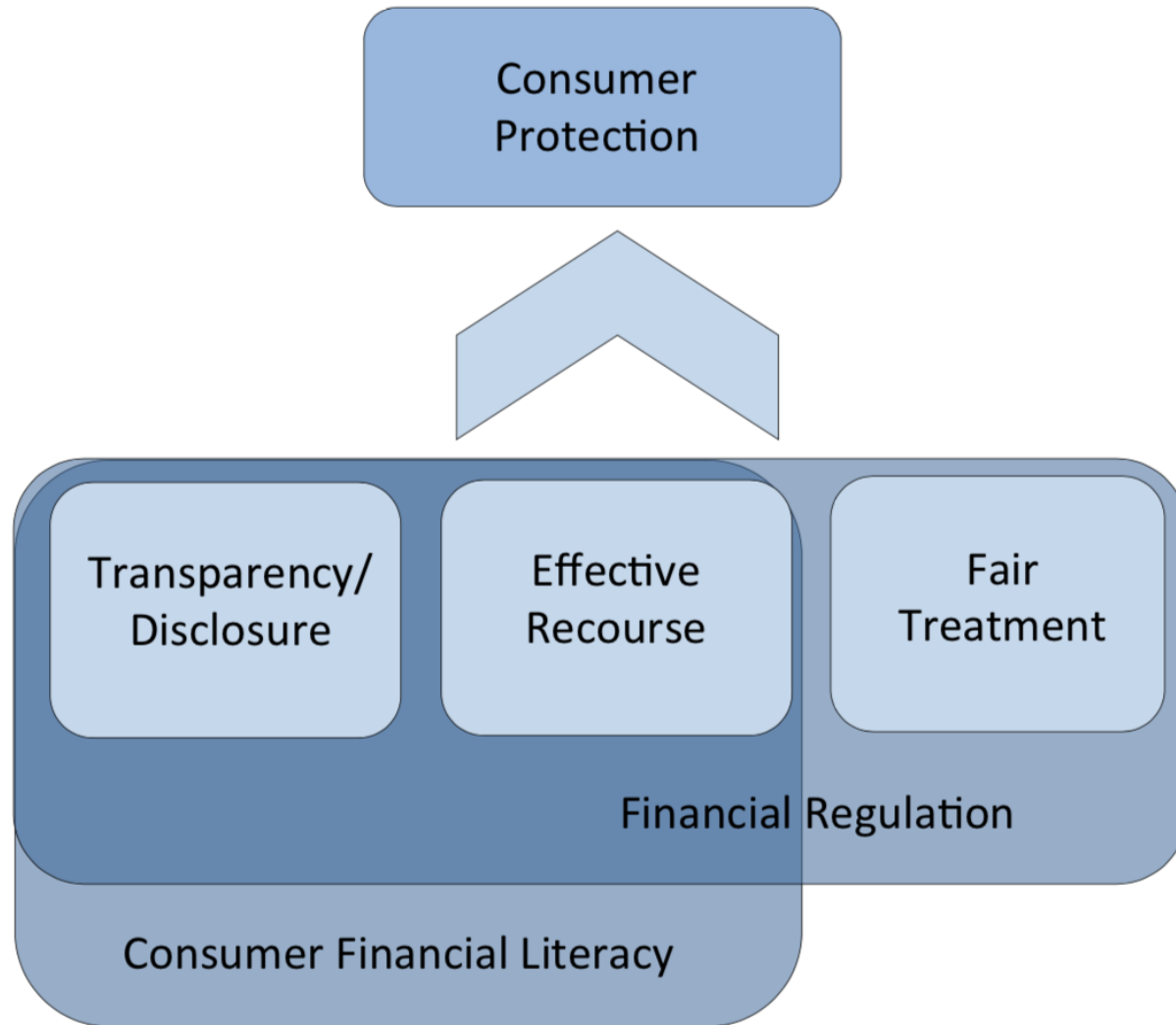
- ❑ **Most intangible of all financial services.**
- ❑ **Involves promise to mitigate losses (may occur, difficult to quantify).**
- ❑ **Complicated by intermediaries, acting for both parties.**

Importance of Consumer Protection

- Client wellbeing (misunderstanding, mistakes, or abuse)
- Development of microinsurance markets (renewal, new products)

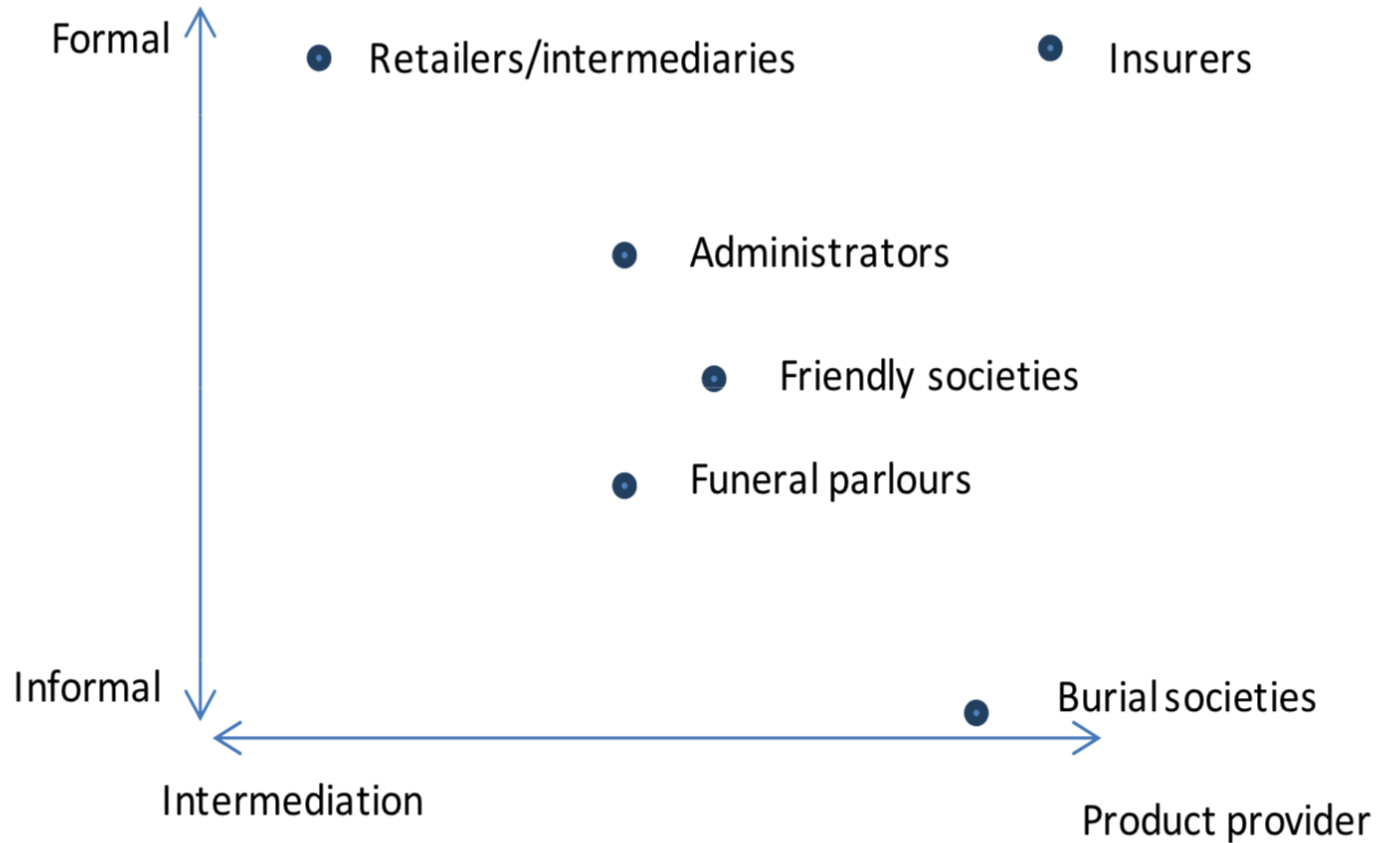
Introduction: Consumer Protection

Three components



Insurance: Formality vs. Consumer Contact

Gibson (2012) Illustration for South Africa



Dissecting Consumer Interactions

Seven Steps of the Customer Process (GIZ, 2016)



2. Demand Side Issues: Psychology

Cognitive limitations/psychological biases in consumers' risk decisions.

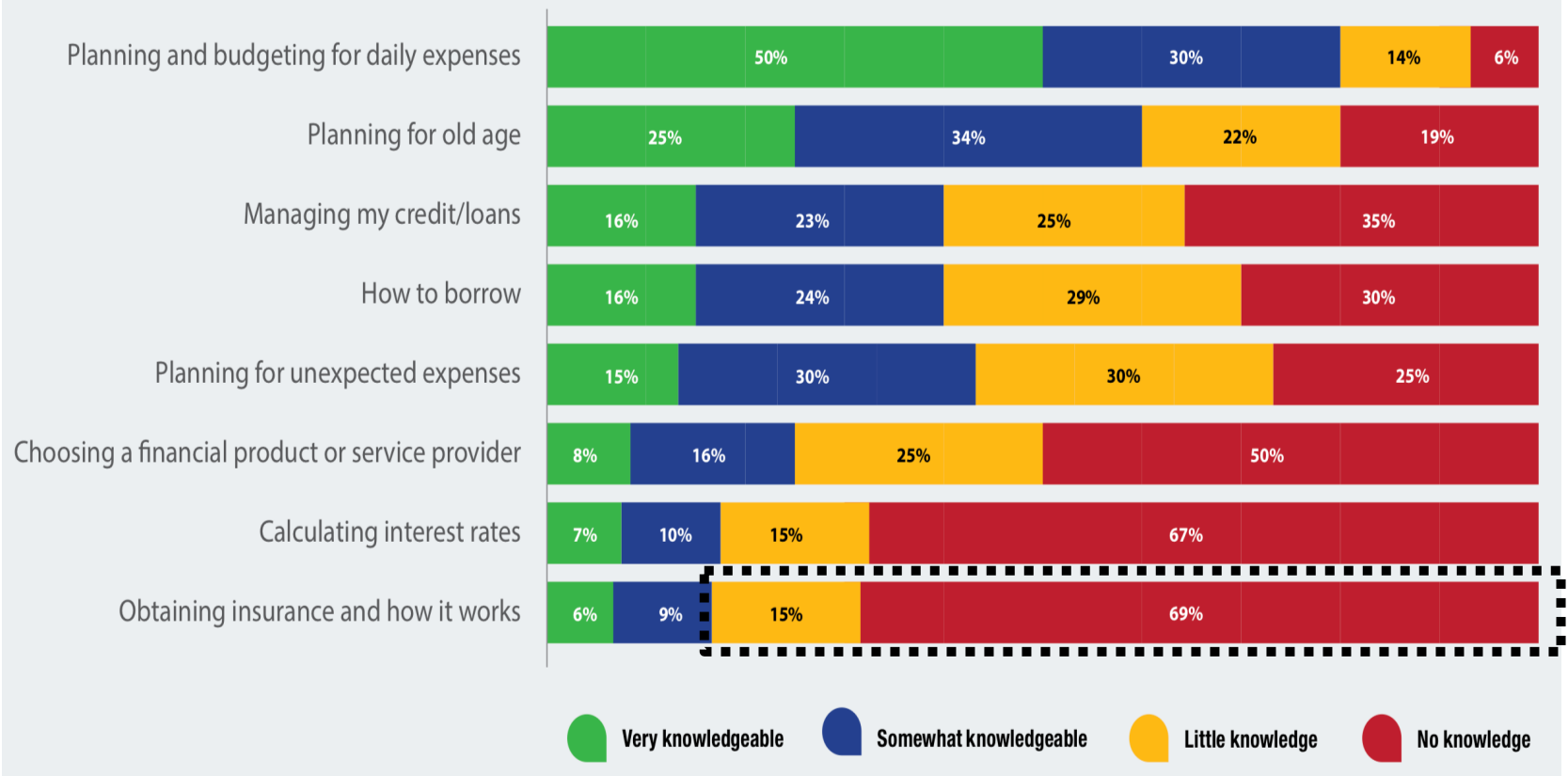
- ❑ **Evidence from experimental and empirical studies suggests that consumers:**
 - Do not have a good feel for probabilities.
 - Do not treat losses and gains symmetrically.
 - Tend to overestimate emotionally-laden loss events while underestimating low- probability loss events (Tennyson, 2011).

- ❑ **In the insurance context these tendencies can lead to:**
 1. Focus on short term costs (low premiums) while ignoring product benefits over longer-term.
 2. Poor choice of deductibles and contract limits.
 3. Purchase of insurance that has little value (Kirsch, 2002).

Demand Side Issues: Financial Literacy

Evidence from FinCap Tanzania (2014)

Figure 10: Knowledge of financial planning activities (self-assessment)



3. Supply Side Issues

Some evidence of serious relationship issues - high turnover, low trust a signal

❑ Mis-selling

- When purchasing a consumer durable on credit, consumer told credit insurance needed. Ancillary financial services profitable.

❑ Misaligned incentives

- Broker receives full risk information from client, only passes partially to insurer. Insurer pays commission to broker and insurer denies claim on basis full information was not forthcoming.

❑ Poor communication

- Insurers have so few interactions with their customers that each one becomes a critical moment of truth.

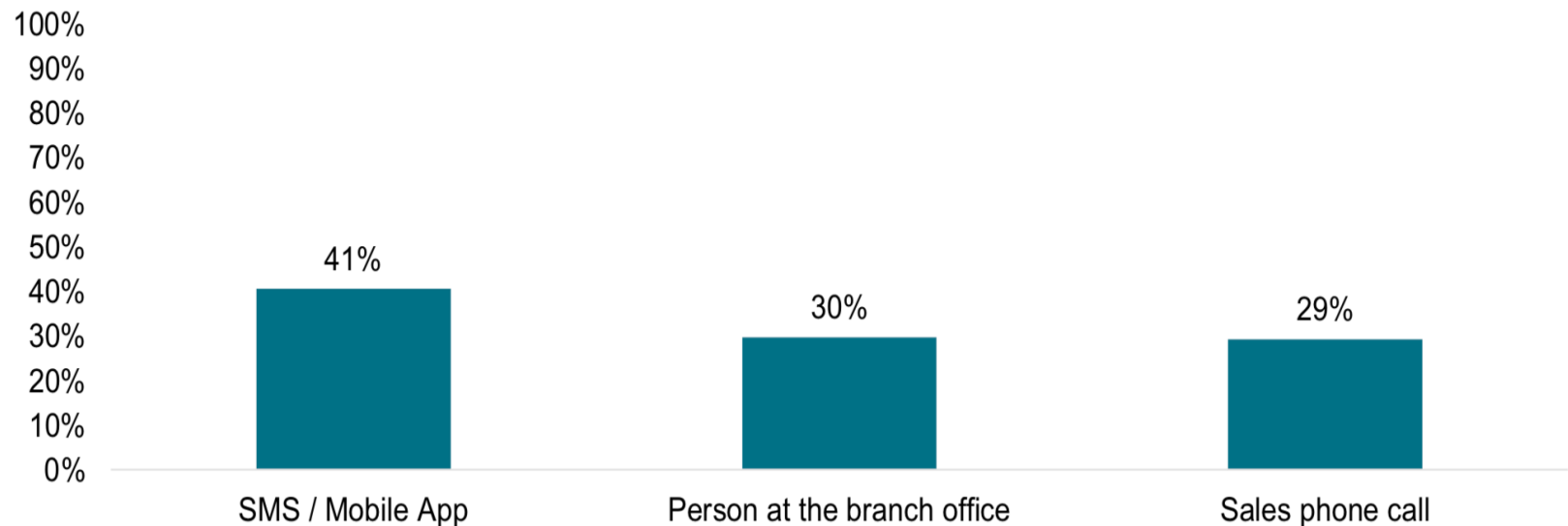
❑ Failure to pay

- Correlated risk may undermine financial sustainability of sector.

C-GAP Case Study: Mobile Insurance in Tanzania

Distribution Channels

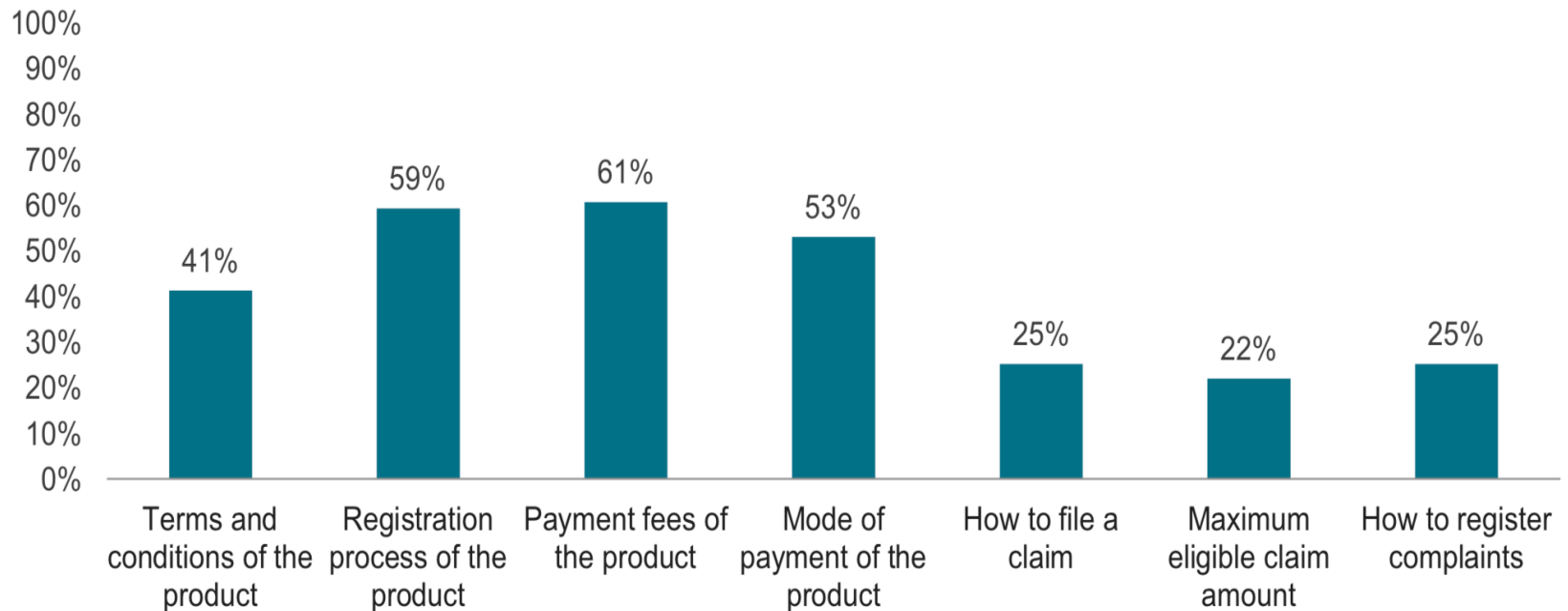
HOW DID THE MAJORITY OF CUSTOMERS SIGN UP?



C-GAP Case Study: Mobile Insurance in Tanzania

Extent of Disclosures

WHAT INFORMATION WAS DISCLOSED DURING SIGN UP?



C-GAP Case Study: Mobile Insurance in Tanzania

Issues Identified

Findings of Consumer Survey

- 75% of current/former mobile insurance customers did not receive information about the claims process during sign-up.
- 59% did not receive information about the terms and conditions of the product.
- 70% of respondents failed to answer modestly complicated question about claim entitlement.

Mystery Shopping Exercise

- 90% of mystery shoppers did not receive information on terms and conditions.
- 88% were not told about the claims process.

Trust is the Key

Without Trust Consumers Unwilling to Purchase

❑ Normally think the more risk averse purchase insurance

- But recent evidence shows that farmers who valued agricultural insurance highly were characterized by overconfidence in behavioural games (King and Singh, 2018).
- In many contexts consumers still need a leap of faith to trust insurance contracts/firms.

❑ Coercion wont build trust (e.g. potentially unfair 'lock-ins').

Agenda for Building Trust

Appropriate Products + Regular Communication
+ **High End Consumer Protection**

4. Disclosure/Transparency

Empirical Evidence from Banking and Other Financial Services

□ How information is presented affects consumer choice:

- Presenting fees or interest payments in currency terms instead of percentage rates facilitated choice of funds/loans with lower average fees (Hastings and Tejeda-Ashton 2008, Bertrand and Morse, 2009, Gine et al, 2014).
- How product attributes are presented changes consumer choice (Wonder et al, 2008, King and Singh, forthcoming).
- Too much information hinders good choice (De-Meza and Reyniers, 2008)
- With mandatory disclosure of commission, agents change product recommendations, unfortunately in this case to high commission products with no disclosure requirement (Anagol, Cole and Sarkar, 2015).

Disclosure/Transparency

Research Questions and Unknowns

❑ Presale

- What disclosure/communication strategies improve consumer understanding and usage of product?
- What strategies improve product decision making?
- How do we regulate intermediaries to reduce misaligned incentives?

❑ Post Sale

- What disclosure/communication strategies make valid claims more likely, affect renewal?

Disclosures can only go so far due to complexities of insurance contracts, considerable degree of financial education required, but much low hanging fruit.

5. Effective Recourse

Mechanism for handling inquiries/complaints and formal dispute resolution procedures

- ❑ **Short term business incentives for recourse to be slow and challenging for customers.**
- ❑ **High quality recourse systems can help insurers to:**
 - Improve trust and customer loyalty
 - Identification of recurring issues/risks within customer base
 - Avoiding regulatory censure
- ❑ **Need independent recourse system to allow for escalation.**
 - EU legislation mandates extension of consumer dispute resolution (CDR) mechanisms. Example: The UK Financial Ombudsman.
 - Despite the rise of E-commerce, a parallel system of online dispute resolution has not kept pace (Cortes and Lodder, 2014).

Recourse: Related Research

Not Much Evidence

❑ From other sectors we do know the following:

- Effective handling of complaints results in satisfaction, trust, spreading positive word of mouth and repurchase intention (Mensah, 2012).
- Conflict resolution which is fair leads to customer trust (Oxoby and Zapata, 2015; Kau and Loh, 2006).

❑ Short-term recourse: cooling-off periods popular and do little harm

- Cooling-off periods help deal with over zealous selling and misunderstandings.
- Human behaviour reduces effectiveness (endowment effect, status quo bias, consistency theory) show once a person “owns”, value it more, less likely to give it up, at least in the short term (Harrison, 2017).

❑ What forms of consumer recourse are effective?

6. Fair Treatment

UK's Definition of Fair Treatment – 'A firm must pay due regard to the interests of its customers and treat them fairly'.

1. Consumers can be confident they are dealing with firms where fair treatment is central to the corporate culture.
2. Products are designed to meet client needs and targeted accordingly.
3. Customers are provided with clear information before, during and after sale.
4. Advice is suitable and takes account of circumstances.
5. Products perform in accordance with how companies have led customers to believe.
6. Consumers do not face unreasonable post sale barriers to change product, submit a claim or make a complaint.

Research questions can flow from any one of these components.

Fair Treatment

Research Findings: Unfair Treatment Exists

❑ **Peruvian Life Insurance product**

- Offers low-income consumers a benefit of \$800 USD.
- To make claim consumers must provide autopsy and other reports that take several months and cost \$300 USD, often informally borrowing at high interest rates to cover the cost (GIZ, 2016).

❑ **Perceptions of insurance companies in Cameroon**

- Prompt to collect premiums but slow to settle claims made against them by the insured (Kwanga, 2017).

Final Question

Is consumer protection a compliance or regulatory issue?

➤ More a strategic issue for insurance providers and one that can be ultimately to drive business performance.

Thank you for listening.