



STUDY ON CONSUMERS' DECISION-MAKING IN INSURANCE SERVICES:

A BEHAVIOURAL ECONOMICS PERSPECTIVE

Executive Summary

May 2017

Objectives of the study

The study sought to explore and understand consumers' decision-making in the non-life insurance market when purchasing domestically and cross-border, to test remedies aimed at helping consumers make better decisions, and to collect complementary data on the supply side of the market.

Context of the study

The non-life insurance market is a key sector for European businesses and consumers alike. This is due to both the size of the industry (in 2015 total non-life premiums grew to €343 bn, and non-life insurers paid €222 bn in claims¹) and the nature of insurance products, which provide consumers with important protection against the adversities of life.

The latest available consumption expenditure data² report that vehicle and home insurance represent 2% of the household budget. Only one in twenty (5%) of the respondents to the European Commission's 2016 Consumer Market Scoreboard³ have experienced problems with motor insurance or home insurance, but problems with insurance tend to result in higher detriment compared to other service markets.

Insurance is a market characterised by often complex products, where a number of information problems and behavioural biases may be at play, limiting the usefulness of insurance contracts and the benefits of competition for consumers. Insurance products are 'credence goods' (the quality of which cannot be fully established at the time of purchase) and because of the way that insurance is supplied, consumers often struggle to purchase the correct coverage.

Numerous behavioural biases apply, for example systematic misjudgement of probabilities, which can cause consumers to prefer products that cover small losses with high probabilities, rather than low-probability but high-impact losses, and 'availability bias' which may draw attention to coverage that is commonly advertised in a specific market, while leading to neglect of other risks that are not as salient, but present nonetheless. The accumulation of different behavioural biases may result in costly over-

¹ Insurance Europe, 'European Insurance — Key Facts', August 2016.

² Eurostat Household Budget Survey HBS 2010 (hbs_str_t211: CP1252 - Insurance connected with the dwelling and CP1254 - Insurance connected with transport).

³ European Commission, 2016 Edition Consumer Markets Scoreboard Making markets work for consumers http://ec.europa.eu/consumers/consumer_evidence/consumer_scoreboards/12_edition/docs/consumer_markets_scoreboard_2016_en.pdf

insurance in some areas while leaving consumers exposed to substantial financial risks due to under-insurance in others. Nevertheless, not each and every apparently sub-optimal choice can be dismissed as a decision-making error, because it may be the result of sophisticated and informed choice (e.g. mobile phone insurance may be unnecessary and overpriced for some, but can be a useful cover for others).

Methodology of the study

In 10 countries⁴ the team carried out a systematic literature review, market data collection, and stakeholder interviews with national supervisory authorities, trade and consumer associations, European Consumer Centres, and consumer complaints handling organisations. These activities, as well as consumer focus groups in six of these countries⁵, both informed the overall analysis and supported the design of online and laboratory behavioural experiments.

In the next phase, an online consumer survey with an embedded behavioural experiment was conducted in the six countries with 5,404 respondents in total.⁶ The experiment tested the effectiveness of remedies aimed at improving consumer decision-making and consumers' willingness to buy insurance cross-border. The survey furthermore included sections on cognitive ability, behavioural characteristics, comprehension of contract information, experience with insurance, and interest in and obstacles to cross-border purchasing of insurance. A laboratory experiment gathered data from 100 cross-border-oriented consumers each in Slovakia and Italy. The laboratory experiment focussed in particular on the cross-border aspects.

The data and evidence collected was used to estimate the range of potential savings that better choices may allow for consumers of the insurance products studied.

The types of insurance products covered by the study were home insurance (including buildings and contents insurance), motor insurance, car rental insurance, and insurance products sold as an add-on.

Conclusions of the study

The main conclusions of the study can be grouped into the three broad categories: (i) information, advice and the purchasing process, (ii) behavioural and consumer-related factors, and (iii) data availability:

Information, advice and the purchasing process:

- Information should be provided in a **concise, salient and user-friendly** way, since the experiments showed that this is likely to encourage consumers to engage with the information.
- Consumers make better decisions when they are allowed to **pause and reflect** and to **modify their choices**, such as their chosen insurer/contract and contract features, throughout the purchasing process.
- Consumers believe that **personal advice and comparison tools** are effective remedies, but that advice needs to be objective and unbiased, and that tools should be independent and comprehensive, allow for complex comparisons via standardised methods and terminology, and show costs clearly. Similarly,

⁴ France, Germany, Italy, Latvia, Luxemburg, Romania, Slovakia, Spain, Sweden, and the UK.

⁵ Germany, Italy, Romania, Slovakia, Sweden, and the UK.

⁶ Around 850 respondents in RO, SE and SK, and around 950 respondents in DE, IT and the UK.

according to stakeholders, there is a need for more impartial and independent price comparison websites.

- Regarding car rental and add-on insurance, the experiments showed that decision-making **problems may be caused by pressure** from having limited time to go through pre-contractual information or pressure from sales staff, and the availability of **alternative offers should be more salient** at the point of sale.

Behavioural and consumer-related factors:

- The focus groups and survey revealed that **behavioural biases**, including passiveness, inertia and preference for the familiar, as well as the time and effort needed to compare the alternatives, may be preventing consumers from getting the best deals.
- Certain decision-making patterns in the experiment – a tendency to select **too low an excess, not cover high impact risks**, and **not buy insurance** – highlight the lack of awareness among consumers about the benefit of selecting a higher excess (i.e. a lower premium), and the risks of under-insurance.
- There is evidence from the focus groups, stakeholder interviews, desk research and survey that there is **low awareness and understanding** among consumers of their contract terms and conditions, and there appears to be a significant share that do not read documents but instead rely on their intuition. This low awareness is due, at least to some extent, to the length and complexity of documents, and the experiment results suggest it may also be linked to the way information is disclosed (since whether respondents looked at information in the experiment depended on how it was made available).

Data availability:

- In some countries there is **limited availability of information and data relevant to consumers**. National statistics agencies and stakeholders usually do not distinguish between business-to-business and business-to-consumer data, which prevents a clear overview of consumer trends and problems, and hampers the elaboration of consumer-targeted measures to improve decision-making.

Factors that limit cross-border insurance purchases

According to the survey there is a non-negligible amount of latent cross-border demand. Almost one-fifth of respondents were interested in purchasing insurance cross-border but had never even tried to do so. Evidence collected via the consumer survey, focus groups, stakeholder interviews and the literature review points to a number of important factors that limit cross-border insurance purchases, which can be categorised into: (i) objective obstacles, (ii) subjective perceptions and (iii) supply side factors:

Objective obstacles:

- **Low awareness** among consumers of the possibility to purchase insurance cross-border limits cross-border demand, irrespective of the presence or absence of language, cultural or distance barriers.
- **Language barriers** are an important factor limiting cross-border purchases.
- **Regulatory differences** between countries increase providers' costs and create uncertainty and insecurity for consumers.

Subjective perceptions:

- The **perceived complexity** of completing a cross-border purchase, combined with language difficulties, appears to limit consumers' confidence in the cross-border market.
- Concern about the potential **difficulty of solving problems** that may occur with the insurance provider is an important factor reducing cross-border purchasing of insurance.

Supply side factors:

- Firms face various important **barriers to supplying insurance cross-border**, such as the need to adapt marketing strategies and the difficulty of assessing risks in foreign markets.

Recommendations

The study makes policy recommendations to improve consumers' decision-making, as well as to encourage cross-border purchasing of insurance. These are outlined below. These recommendations should be seen as generally addressed to the European Commission if not stated otherwise.

Improve information provision

- Regularly assessing whether standards for the provision of information in their countries ensure that information is clear, user-friendly and salient would allow national regulators and industry associations to drive improvements in this area. Such monitoring should look both at what information is provided to consumers, as well as how it is provided.
- The introduction of the insurance product information document (IPID) under the Insurance Distribution Directive is a positive step in this regard, and it will be important to monitor the effectiveness of the IPID in the Member States and to review whether improvements are necessary. When the IPID is provided digitally, the use of tools that allow easy access to additional information should be encouraged.
- The industry offering insurance products to consumers could consider establishing voluntary codes of conduct that promote good information practices.
- In the car rental sector, competent authorities should monitor whether leading car rental firms are implementing their recent commitments on information practices⁷ and encourage industry-wide take-up of the improved information provision.

Facilitate consumers' decision-making in insurance purchases

- National regulators and industry associations, possibly with input from EIOPA, could consider measures to ensure that consumers are given the opportunity to reflect on and modify their choices throughout the purchasing process – for

⁷ These practices will ensure that information on additional insurance is clear. For details see: http://europa.eu/rapid/press-release_IP-17-86_en.htm

example, by introducing guidelines or standards that allow sufficient opportunities for consumers to pause and reconsider their choices.⁸

- Where possible, consumers should be made aware of the availability of alternative offers during the purchasing process, which could be ensured via the introduction of industry guidelines.
- Where still allowed, Member States could consider banning the practice of pre-selecting optional insurance services ('pre-ticking'),⁹ given its negative impact on consumer decisions.

Address pressure selling

- Regarding car rental and add-on insurance, to mitigate the negative effects of pressure at the point of sale a code of conduct could be established¹⁰ that sets standards on how insurance should be offered, including to:
 - provide information on the insurance early enough to allow sufficient time for the consumer to absorb the information;
 - provide a balanced description of the characteristics of the insurance; and
 - not rush consumers' decisions, and offer them the option to make a final decision later.
- Designing the purchasing process such that consumers can reflect on and alter their decisions throughout the process – as suggested above – would also help addressing point-of-sale pressure.

Harmonise definitions and contract formats

- The use of common terms, definitions and contract formats would facilitate consumer understanding of the insurance products on offer and comparison of different products on the market. Where possible and practical, given product and market differences, harmonisation of terms, definitions and contract formats should be encouraged.

Establish standards for price comparison websites (PCWs)

- In line with relevant EU legislation¹¹ national authorities should ensure that PCWs are transparent, comprehensive, show costs clearly, and enable complex comparisons.

⁸ The 14 day right of withdrawal period provided by Article 6 of the Distance Marketing of Financial Service Directive (DMFSD) for any type of financial product it covers (including insurance) is helpful in this respect. However, this right is only provided if the entire commercial relation is on-line.

⁹ France, the United Kingdom and Luxembourg have introduced such a ban on pre-ticked optional insurance services. The EU Consumer Rights Directive, which bans pre-checked boxes for additional options, does not apply to insurance contracts.

¹⁰ In addition to good enforcement of the applicable consumer protection rules, especially the EU Unfair Commercial Practices Directive.

¹¹ Including the Insurance Distribution Directive (IDD), Unfair Commercial Practices Directive (UCPD), Consumer Rights Directive and E-commerce Directive. For example, Article 19 of the IDD obliges PCWs to reveal their relationship with any insurance undertaking and the nature of their remuneration, and the UCPD provides a list of prohibited unfair business-to-consumer practices applying to PCWs including misleading and aggressive practices.

- The transparency and comprehensiveness of PCWs could be further investigated at EU and national level; based on this, a scheme to accredit PCWs and/or a quality labelling system could be considered.
- Standards or guidelines might also be introduced by national regulators and industry associations, including requirements to indicate commercial links, specify the coverage of the PCW, and enable consumers to compare not only prices but also other features of contracts (e.g. risks covered).

Make it easier to switch between insurance products

- Measures recommended above to improve information to consumers and better design the purchasing process should help consumers overcome inertia (i.e. the tendency not to compare and change insurance products, which was identified by the research as an issue in the non-life insurance market).
- In addition, streamlining the transfer of a consumer's coverage from one provider to the next¹² could make it easier for consumers to switch some types of insurance.

Collect more data on insurance markets

- Regular monitoring of insurance markets and systematic collection of more detailed data (including on consumers) across the EU would allow authorities to identify and address problems in the sector in a targeted manner.

Encourage cross-border insurance

- Raise consumers' awareness of the possibility to buy insurance cross-border and highlight the potential benefits of purchasing cross-border, for instance by encouraging pan-European comparison sites.
- Improve consumers' awareness about their rights and the consumer protection available to them¹³ when purchasing insurance cross-border.
- Industry associations could encourage insurance providers to reduce language barriers, e.g. where practical (and not prohibitively expensive), by providing contract information and customer service in more languages.
- Standardised claim forms could be promoted by EIOPA at EU-level for different types of insurance products.

¹² For example, by taking inspiration from the Hamon Law in France, which provides that for motor third party liability and household insurance the new insurer is responsible for the procedure of terminating the consumer's previous contract to ensure continuity of protection, with an agreement between insurance associations to facilitate the necessary formalities.

¹³ For example, consumers could be informed – in product documentation – about where and how they can get help if they need assistance with their cross-border insurance.

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