INSURANCE LITERACY IN AUSTRALIA: NOT KNOWING THE VALUE OF PERSONAL INSURANCE

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ABSTRACT

Underinsurance and low financial literacy have been shown to be key issues impacting the effectiveness of personal financial management. Both issues are made more important by the complex financial system, an ever moving array of financial products and services, and the progressive move towards self-reliance in retirement. These factors suggest a greater degree of financial independence and more effective financial decision-making is required over the long-term, both of which may be undermined by low financial literacy and underinsurance. Little is known, however, about the impact of financial illiteracy on the propensity to seek and retain insurance.

Using an interview methodology, we obtained the views of informed and non-informed participants to examine insurance literacy in Australia. We find evidence that insurance literacy of consumers is generally low and exacerbated by factors such as low product knowledge, low trust of providers, low awareness of risk mitigation strategies, and behavioural decision-making biases. These factors can culminate in a perception of low value and subsequent underinsurance. Furthermore, this appears to be more acute for personal insurances as opposed to general insurances.

Introduction

Financial literacy has attracted the attention of government, academia and industry as it is increasingly perceived as playing a vital role in consumers' financial decision-making in relation to retirement saving, investment, borrowing and the management of debt and insurance (ASIC, 2011). Financial literacy is seen as having a significant impact on long-term financial outcomes at the individual and community level. A key component of this is the variety of financial products available to consumers, and the growing superannuation savings for which more power has been given to consumers in terms of decision-making in relation to these funds (Bambrick, 2014). As the number of different financial products increases, so does the need for the general public to be knowledgeable about those products. However, it is often the case that not all groups in society have the necessary literacy to understand information about different financial products, which may be vital for their financial wellbeing (Gerrans, Clark-Murphy and Truscott, 2009). One such financial product is personal insurance. The types of personal insurance include life insurance, total and permanent disability cover (TPD), income protection (IP) and trauma cover.[1]

The insurance industry in Australia has grown, and covers many types of insurances. The primary role of insurance is to help alleviate the financial burden caused by adverse events[2] by transferring losses of the individual to the insurance company (Scriven, 2008). The importance of this can also be seen when taking into account the economic cost of inadequate amounts of personal insurance. Kelly and Vu (2010) stated that in 2008, there were 6,540 deaths of married parents of working age (20 to 64 years) in Australia. This equates to 18 families per day losing an income-earning parent. In addition, the 2008 Household, Income and Labour Dynamics in Australia (HILDA) survey data suggests that 17,040 employed people aged 20 to 64 years (who were living as a member of a couple with children) had been unable to continue working due to illness, disability or injury over the previous year. This means an additional 47 families with children per day face both a health crisis, and the possibility of financial hardship. Such events can cause financial distress to those involved, and those who depend on them. Many of these people will rely on government disability payments, yet the extent to which publicly provided payments are sufficient or tailored to individual needs is questionable (Guest and Wilke, 2012). Personal insurance would potentially provide financial resources to support the claimant and/or their dependants. While this would not allay the physical or emotional impact of the event, at least the economic aspects of the situation may be mitigated.

1 For the purposes of this paper, personal insurance covers life insurances (except business expenses insurance) for individuals as opposed to general insurance which largely covers physical assets. Types of general insurance include house and contents insurance, motor vehicle insurance, business insurance. Life insurance – provides a payment to a beneficiary when the insured individual dies. TPD – a lump sum payment to the insured when he/she is totally or permanently disabled or has cognitive inadequacies. Trauma cover is paid to the insured when he/she is diagnosed with a traumatic medical condition, such as cancer, stroke, heart attack, etc. Income protection is paid to the insured when he/she is unable to work due to illness or disability.

2 Events include: premature death, terminal illness, inability to work due to injury or disability and total incapacity where policies provide income and capital replacement in the event of death, illness or injury to assist either the insured or the insureds dependants to avoid the circumstance where the family of the deceased person may find it difficult to meet those obligations and continue to enjoy familiar lifestyle.

Given the importance of insurance to so many Australians, it is of concern that there is persistent evidence of underinsurance. 'Underinsurance' refers to situations when there is a gap between the insurance level that is needed to provide a comfortable living after a loss event takes place, and the level that is actually available through insurance policies (Kelly and Vu, 2010)[3]. Even when examining the multiplier approach to insurance needs analysis – a very rudimentary form of needs analysis – such as that outlined by Scriven (2008), the insurance needs of average full-time working couples in their mid-thirties with young children should range from around 10 times to 13 times their taxable income; and then for full-time workers in their mid-forties with older children the range should be between six and nine times taxable income. This is, however, often not reflected in insurance rates with the TPD underinsurance level in Australia in 2015 estimated to be $10,870 billion. Australians are also estimated to be underinsured by $471 billion for basic life cover and $3,435 billion for income protection (Rice Warner, 2015).

In terms of reasons for underinsurance, the Investment and Financial Services Association (IFSA) (2005) concluded that most people believed life insurance is too expensive, too complicated and a hassle to obtain, and preferred general insurance over personal. The IFSA note that many Australians insure their motor vehicles but fail to protect themselves or their families from accident, injury, disability or death. This preference for general insurance over personal insurance may reflect a greater value for physical capital rather than personal capital.

The aim of this research is to gain a greater understanding of the impact of financial literacy when it comes to personal insurance decision-making. It is argued that the more insurance literate a person is, the more likely he or she is to take an active and responsible role in considering the appropriate levels of personal insurance coverage (or seek professional advice to this affect). Using an interview methodology we investigate the drivers of insurance decision-making with a focus on insurance literacy. We find that the majority of people have poor knowledge of personal insurance with many not seeing the value and importance of those policies. We confirm the preference for general insurance, but highlight the resultant lack of trust and impact of behavioural decision-making biases. Therefore, this article contributes to both the insurance and financial literacy literature, and introduces the concepts of insurance literacy. We provide evidence of the drivers of insurance decision-making which is relevant to financial advisors, insurance product developers and regulators. The article also provides the foundation for further research into insurance literacy.

The remainder of the article is organised as follows. The next section provides an overview of the literature regarding financial and insurance literacy. We then outline the data and method used in this study, followed by the findings of the study in section four. The final sections provide suggestions for future research before the article concludes. It is argued that improved insurance literacy in relation to personal insurance could be part of the solution to the underinsurance problem.

3 The Insurance Council of Australia (2013) defines underinsurance as when a policyholder that does not have sufficient insurance to cover potential loss and thus cannot resume their same standard of living in the event of a crisis. For example, estimated coverage the average full-time workers in their mid-30's with young children require life insurance coverage equal to 10 to 13 times their annual pre-tax income, implying policy cover approaching three-quarter of a million dollars. Actual coverage of this group of citizens is around $70,000 (Pulis, 2010).

Background Literature

To understand the context of the current study, below is a discussion about financial and insurance literacy, as well as the data available about underinsurance.

Financial and Insurance Literacy

Financial literacy is broadly defined by Australian Securities and Investment Commission (ASIC) as 'knowing how to make sound money decisions', and states that making good financial decisions is a core skill in today's world, because it affects quality of life, opportunities people can pursue, their sense of security and the overall economic health of society (ASIC, 2011). Furthermore, Worthington (2008) argues that financial literacy means different things for different people. For some people it is a broader concept, involving understanding of economics and how household decisions are affected by economic conditions and circumstances. For others, the concept solely focuses on budgeting, saving, investment and insurance (Hogarth, 2002). Furthermore, any definition of 'personal' financial literacy differs from the 'professional' financial literacy levels expected of directors and audit committee members (McDaniel, Martin and Maines, 2002; Worthington, 2006).

In the United States of America (USA) the Jumpstart Coalition for Personal Financial Literacies conducted a study on high school seniors (Hogarth, 2002). The study concluded that the level of financial literacy was low, and financial literacy varies across socioeconomic and demographic groups each year. Mandell carried out two surveys in 1999 and in 2008 and found that by 2008 financial literacy had declined since the 1999 survey (Mandell, 1999 and 2008).

Large scale surveys in the United Kingdom (UK) were conducted by Schagen and Lines (1996) and Schagen (1997), and concluded that that most people were confident with their financial affairs, though this was lower for some groups, especially single parents and to a lesser extent, students. Although financial confidence differs to financial literacy, they are often correlated.

Australia's first national survey of financial literacy was conducted in 2002, and found that 75 per cent of respondents had home and contents insurance, 57 per cent held private health insurance and 33 per cent held life insurance (ANZ, 2003). In 2005, another report found that 82 per cent of respondents held home and contents insurance, 79 per cent held comprehensive vehicle insurance, 60 per cent held private health insurance, 35 per cent held life insurance and 12 per cent held income protection insurance (ANZ, 2005). Only 51 per cent of respondents who held insurance stated that they were aware that they needed to disclose information accurately and if they failed to do so the insurance company has the right to decline their claim. Overall, it is suggested that even though levels of insurance were increasing slightly, that on average people have very poor understanding of their obligations about accurate and truthful disclosure with regard to insurance.

The findings of the third ANZ survey were similar to the 2005 report, with only 54 per cent aware that a claim could be refused if the policyholder did not meet their duty of accurate disclosure (ANZ, 2008). Similar results were also reported in the fourth ANZ survey with small increases in policy uptake and a further deterioration (to 47%) of respondents who were aware that a claim could be refused if they did not disclose all relevant information (ANZ, 2011). The fifth and most recent ANZ survey was conducted in 2014 and published in 2015, and found that 76 per cent of respondents held home insurance, 81 per cent held contents insurances, 88 per cent held comprehensive motor vehicle insurance, 58 per cent held private health insurance, 33 per cent held life insurance and 35 per cent held income protection insurance (ANZ, 2015). Only 42 per cent of respondents were aware that a claim could be refused if they did not disclose all relevant information, continuing the deteriorating trend in this item and indicating that people are becoming less aware of their responsibilities to disclose information accurately. Complicating this further, it was found that 79 per cent of respondents used a ‘trial and error’ approach to managing their finance and relying primarily on personal experience rather than quality information.

This previous research illustrates that while most people are familiar with simple financial terms and concepts, they are not always able to understand more difficult issues involving investments, superannuation, retirement and insurance. In the past the focus has been on superannuation, investments and general concepts of financial literacy, with comparatively little detailed consideration of insurance. It can also be seen throughout the surveys that insurance coverage was high for general insurance, with little attention paid to life insurance and income protection, while trauma and total and permanent disability insurance was rarely investigated. This could suggest that awareness and understanding of personal insurance is low, leading to low take up of it.

Looking at decision-making from a theoretical perspective, the classical model assumes that human beings are rational and will make decisions which will maximise their long-term worth and financial wellbeing (Tversky and Kahnemann, 1986; Simon, 1955). The person deciding whether or not to buy insurance analyses the options in terms of the expected utility and chooses the option with the largest utility (Mitchel and Holzworth, 2005). Maximisation of expected utility is an essential tool in decision-making (Lindley, 1985). As stated, classical theory assumes that all decision-makers are rational, but in reality people are not always rational and as a result do not always make rational decisions (Kahneman, 2003). Therefore, it was suggested by behavioural finance that the insurance decision-making process has not been explained adequately in traditional neoclassical economic theories. It is behavioural economics which provide some insight about the decisions regarding whether to buy or not to buy insurance products (Laury and McInnes 2003; Tversky and Kahneman, 1991). Behavioural economics helps explain the decision-making processes of those individuals who can act non-rationally in terms of neoclassical economics. One theory in behavioural economics is prospect theory, which was developed by Tversky and Kahneman (1992). It is an alternative to classic utility theory. In formulating cumulative prospect theory, Tversky and Kahneman (1992) note that the probability weighting function is not well-behaved near zero. While probability weighting allows for overweighting of small probabilities, very small probabilities appear to be either “rounded down” to zero or greatly overweighted (Kahneman and Tversky, 1979; Tversky and Kahneman, 1992; Laury, McInnes and Swarthout, 2009).

Behavioural finance literature also identifies that decision-making processes can be subject to biases and non-rational outcomes (Kahneman and Tversky, 1984). Insurance purchase decisions are no different, with overconfidence bias evident[4]. When individuals are overconfident and too optimistic, they are less likely to assess the risks fully and as a result will leave themselves exposed to risks. They are also unlikely to take out any preventative strategies, such as insurance, to protect from risks, especially low-probability, high-impact ones (Trevelyan, 2008).

A key tenet of behavioural finance is that individuals lack an adequate understanding of probability and risk concepts (Kahneman and Tversky, 1984). As a result, people can be scared of an event more than of the potential financial and emotional impact of the event (Shanteau, 1992). In the case of insurance, the decision to purchase may not be driven by the impact of the potential loss, but the frequency with which the loss is likely to take place (Kunreuther, 1978). As a result, people have a tendency to pay much for insuring themselves against high-frequency risks even if financial impacts are low (eg. general insurance events), whereas they fail to insure against low-frequency risks, but with high financial impacts (eg. personal insurance events).

Underinsurance

Underinsurance is a very real issue in Australia. For example, while many Australians may have some level of life insurance cover in their superannuation fund (ANZ, 2015), default levels are often considered inadequate, potentially leading to greater reliance on government support (ANZ, 2015). A Rice Warner report also states that the median level of life cover held in superannuation meets about 61 per cent of basic needs for average households and 37 per cent for families with children (Rice Warner, 2015). These numbers indicate that insurance within superannuation funds is not adequate.

Underinsurance can lead to greater pressure on government finances in terms of the ‘safety net’ for those who are vulnerable in our society. Underinsurance has also been shown to impact government through less tax revenue, and increased reliance on government payments where insufficient insurance is held to maintain an income after tax, mortgage repayments and childcare (Kelly and Vu, 2010). The cost to the government of social security expenses as a result of underinsurance is estimated to exceed $1 billion per annum, which consists of; $840 million for TPD, $140 million for income protection and $60 million for death cover (Rice Warner, 2015). Given that three in four Australians are likely to be diagnosed with a serious illness in their working life, Lifewise (2012) argues that underinsurance would result in people being forced to rely on their savings, government welfare, or selling their assets. IFSA (20010) concurs, suggesting that 53 per cent of Australians over 30 suffered from at least one of the government’s seven priority conditions identified under its National Health Priority Areas. These conditions can lead to long-term disability and consequently, a long-term loss of income. IFSA (2010) argues that without appropriate insurance, families could suffer severe financial hardship during chronic illness, injury or the death of an income earner or stay-at-home parent.

4 Where people demonstrate unwarranted faith in their own intuitive reasoning, judgments and/or cognitive abilities.

It has been argued that factors impacting insurance take up include the high price of premiums (Deposit Power/Real Estate Institute of Australia, 2007; IFSA, 2005; Pulis, 2010); lack of trust in the insurance sector (Feinman, 2010); not seeing the need for the insurance (IFSA, 2005; Pulis, 2010), and availability of life insurance within superannuation funds (Pulis, 2010). Factors related to literacy also appear to influence insurance take-up, including insurance policies being difficult to understand such as the difference between product types (IFSA, 2005; Pulis, 2010); and the lack of skills in evaluating risk (Capuano and Ramsay, 2011). While the literature about this may appear comprehensive, the majority of this work appears in publications that are not peer-reviewed and thus, the reasons for underinsurance appear to be under-researched. Insurance literacy has also received little attention in the literature, particularly in terms of a comprehensive examination of the different types of personal insurance compared to general insurance.

This study aims to further our understanding of insurance decision-making and insurance literacy, and their impact on underinsurance. The primary research question we seek to address is: What are the reasons for Australians purchasing or not purchasing personal insurance products? In particular, this study examines if insurance literacy undermines insurance purchase decisions. We posit that having a better understanding of consumer purchase decisions, and the impact of insurance literacy on these will assist practitioners, product providers and regulatory authorities respond to underinsurance concerns.

Data and Method

We adopt a qualitative approach, interviewing financial planners (informed participants) and consumers (uninformed participants), in order to obtain a preliminary understanding about the reasons why people take out personal insurance products and what psychological aspects drive their decision-making. Obtaining the views of both professionals and consumers provides a more comprehensive view of consumer behaviour and provides insights that may be of use to the advice and insurance product communities.

The interviews adopted a semi-structured approach in order to facilitate investigation while still maintaining a degree of consistency (Walliman, 2011). The literature review informed the construction of both discussion guide questions which contained two parts: client perceptions of insurance and drivers of client decision-making. Both closed and open-ended questions were included; closed questions enable shorter responses, thus allowing more to be covered during the allotted time frame, while open-ended questions add breadth and allow for clarification, overcoming the interpretation threat to validity (Maxwell, 1996). A standard briefing on the topic and purpose of the research was also provided to all participants.

Informed participants were sourced through industry contacts in financial advice practices (43%) and Australian banks (57%), resulting in 30 financial planners being interviewed. Respondents consisted of 18 males and 12 females and the age range was between 25 and 50.

Consumer participants were sourced using convenience sampling[5] from the workplace and personal networks of the research team with 40 consumers being interviewed from a range of different industries, employment types and categories including the self-employed. Respondents were 52.5 per cent male, 52.5 per cent had a higher education qualification (Bachelor level and above), with 30 per cent in the 35-44 age bracket, and 8 per cent in the over 60 age bracket. The sample was also diverse in terms of marital status, those with and without children, recent immigrants to Australia, gender, age groups and educational backgrounds. In terms of policy ownership, 57.5 per cent of consumers reported holding life insurance, 45 per cent TPD and 35 per cent IP, the vast majority of which (75%) was within superannuation[6]. In terms of general insurance, 90 per cent had car insurance, 77.5 per cent contents insurance and 58 per cent home insurance (100% of those who reported owing a home reported owning home insurance). The sample was seen to be generally representative and able to provide an initial understanding of consumer attitudes toward personal insurance. Thus, overall for an interview protocol, we suggest the sample is generally representative.

Interview questions were similar for both groups of participants, being designed to gauge understanding, importance and perceptions of personal insurance, both focusing on the consumer perspective. The first group of questions (see Table 1) examined consumer perceptions of insurance with questions exploring value and importance, knowledge, and general versus personal insurance. The second group of questions examined the drivers of consumer decision-making with questions examining consumer motivations to purchase/cancel insurance, and the external drivers/inhibitors of these decisions[7].

Table 1: Discussion Guide Questions

Informed Participant	**Consumer**
Consumer perceptions of insurance	
In your opinion, do Australians think that personal insurance is valuable and important?	Do you think that personal insurance is valuable and important?
Do you think Australians have adequate knowledge of personal insurance products?	How much do you know about personal insurance products?

5 Convenience sampling involves drawing samples that are both easily accessible and willing to participate in a study (Teddlie and Yu, 2007). One of the strongest rationales for this method is when the group or phenomenon under study is generally difficult to access but the researcher is able to establish a sufficient degree of contact or trust with particular participants to conduct a viable project (Lynch, not dated).
6 This is also broadly in line with the ANZ (2015).
7 Research ethics clearance was obtained for the research protocol and the instruments including the briefing, the two discussion guides, and information sheet (regarding informed consent) and permission sheet regarding the interview being recorded. Interviews were recorded, transcribed, validated and then thematically analysed.

Table 1 continued

Informed Participant	Consumer
Do you think that people perceive personal insurance products differently to general insurance products, such as house and contents insurance?	When considering personal insurance products and general insurance products, such as house and contents insurance, how do you perceive them both? Are they similar or different and which type would you be willing to purchase first?
Drivers of consumer decision-making	
What factors do you think make a person to be self-driven to purchase personal insurance products?	What would make you self-driven to purchase personal insurance products?
In your opinion what drives or influences people to purchase personal insurance products?	Please tell me what drives or influences you to purchase personal insurance products?
What factors do you think make a person cancel their existing personal insurance products?	If you have personal insurance, what factors would influence you to cancel your existing personal insurance products?

Results

Perceptions

In relation to consumer perceptions of insurance, there was a general consensus by informed participants on the importance of insurance by our participants, and two key factors emerged from the data being: perceptions of value (lack of), and knowledge (lack of). In the sections below, direct quotes from interviews with consumers and informed participants is provided as a supporting tool.

Lack of value

While there was strong consensus on the importance of insurance, all informed participants stated that in their opinion many Australians do not perceive 'value' in personal insurance products, and as a result choose not to purchase such policies. They argued, however, that there is value in insurance, and consumers should see appropriate insurance policies as money well spent. Informed participants also thought that once consumers understand the importance of personal insurance, they would see the value in it, with value explained in the context of the consequences consumers could face if something unfortunate would take place and they did not have appropriate cover. All informed participants stated that they thought the general public does not see value in personal insurance. Below are some of the examples of responses:

I think the perception of a lot of people is that insurance is just another thing to pay for and they don't see the value in having the insurance unless they have had a personal experience with a family member or even themselves where they had a serious illness and they can't get insurance and they wanted it. And unless they had decent fright, they don't see value in having insurance (Informed participant 7, female).

I see people who take more persuasion; or they need to be disturbed a little bit more to see to realise the value…… People don't see the value, maybe they are not disturbed enough (Informed participant 10, female).

People need to be disturbed enough for them to see the value in personal insurance, otherwise they don't realise how important it is (Informed participant 21, male).

Informed participants raised the idea that sometimes consumers need a 'disturbing' event to occur to highlight the value of personal insurance. To this end, it appears that informed participants informally engage their clients through telling impactful stories of previous claims made by other clients. On the other hand, the consumer participants were generally of the opinion that personal insurance was not very important, and as a result they did not see the value in it. This view appears to be driven by a belief that government support would replace the need for insurance, including that the government would provide support after a major trauma. Other reasons raised for not needing personal insurance included the ability of family and friends to assist, and perceived quick recovery time from serious illness. Most interviewed consumers thought that personal insurance was not important for them due to the above discussed reasons and some of the examples of responses are provided below:

I don't see much value in personal insurance, because the chances that I will be sick with cancer or heart attack are not that great (Consumer 21, male).

Centrelink is always there and pays disability pension, which combined with some savings we have, should be enough for us to survive on if something bad happened (Consumer 30, female).

I have a lot of family members, if something bad happens, they will be able to help out. (Consumer 39, female).

These reasons were supported by comments made by the informed participants. All informed participants were of the opinion that people relied too heavily on the government support:

People also think they will be covered by government (Informed participant 8, male).

Many people still have this idea that Centrelink will pay them a sufficient amount of money in case they were to get sick or disabled (Informed participant 22, female).

For the majority of consumers, 'value' was positively connected with preparedness to pay premiums, while some related it to life stages, suggesting it was only relevant when they had dependents:

> *With that insurance, even though it is hard to pay for the insurance, it's better to have it than not. I am definitely covered for anything we can now [have]. I believe it's very important (Consumer 7, female).*
>
> *We have adequate personal insurance covers pretty much for everything, trauma, TPD, income protection, life, private health insurance, so our premiums are high, but we believe it is very important and valuable for us (Consumer 32, male).*
>
> *I am young and healthy, so I don't think insurance is important for me at this stage, if I had children, then I would probably consider getting something (Consumer 11, female).*
>
> *It is just me and my partner, we both work, so we don't think personal insurance is important for us at this stage. If we have children, then I think it would be more valuable (Consumer 15, female).*

Personal insurance was also perceived by most respondents as secondary in importance to general insurance. The tangibility of an insured physical asset (house, car), and the value at stake was clear to consumer participants, while personal insurance was seen as more of an investment, and optional or luxury item. Furthermore, there was a cultural or familial norm with general insurance which appears to support its up-take. Here are some of the examples of what participants said:

> *People would be more inclined to insure a $5,000 car than they would to insure their income and that [has] been the case forever… very few people will have their income or lives insured (Informed participant 9, male).*
>
> *I think they see general insurance as more important. I think it is because they see their car and house as tangible assets and see more value in them, whereas they don't see the same value in themselves (Informed participant 15, male).*
>
> *I see them as the same thing…I think I would be choosing general insurance first… Personal insurance seems like added extras, whereas general seems like I really actually need, whereas personal seems to be like ordering fries with your burger, it is just an extra add-on you don't necessary need (Consumer 11, female).*
>
> *I see them as different. House and contents and car insurance you absolutely have to have…Personal insurance is optional (Consumer 15, female).*
>
> *Their parents always said, get car, get house and contents insurance, but never said when you get a job go and get income protection, which is again part of our culture (Informed participant 9, male).*
>
> *I purchase general insurance, because that's what my parents always did. (Consumer 34, male).*

Insurance Literacy

All interviewed informed participants unanimously agreed that most consumers have poor knowledge about personal insurance products with a particular lack of knowledge (if any) about trauma cover. While income protection insurance was noted as having a higher awareness level, informed participants argued that there was still confusion and misunderstandings about it, including the circumstances under which such policies are claimable. When it comes to total and permanent disability insurance, many people have this cover within their superannuation; however, this does not mean that they have a very good understanding of it. Below are some examples of what informed participants said:

> *I think most people don't have a good understanding of insurance (Informed participant 7, female).*

> *I think a lot of people know about life insurance…it's fairly easy to understand, you are either dead or alive. Income protection … some people will have a bit of an idea about it, but it's more around when they can claim that I find they don't have any idea about it. A lot of people seem to think that income protection will just pay out if they lose their job, but it is not there for that….I think they have some idea about TPD, with trauma it is very rare for people to know it actually existed (Informed participant 8, male).*

Consumers largely concurred with this view and appeared to have limited knowledge in relation to personal insurance. It seems evident that for some consumers they have a degree of awareness, but most of these admit they have little understanding of personal insurance. Here are some of the examples of what consumers said:

> *I generally know what they are about, but not completely informed….Life insurance is in case of death…until today I was not familiar about TPD…..I know about income protection, it's a cover just in case a person would lose work due to sickness or injury, but don't know more details…. I have never heard of trauma cover (Consumer 1, male).*

> *I have very limited knowledge about personal insurance, to be completely honest, I have not heard of trauma and TPD before (Consumer 2, female).*

In terms of trauma insurance, 63 per cent of consumers were not familiar with it, some stating that this kind of insurance could not possibly exist, while others confused it with private health insurance. Of the few consumers that were aware of it, all believed they should hold it, but few (15%) actually did as per the indicative respondent quotes above.

With regard to life insurance, all consumers reported they have heard of life insurance and knew that it pays a certain amount of money upon the insured's death. However, most consumers admitted their knowledge of life insurance was limited, and they could not provide further details about this cover. For those with superannuation accounts, they would have some level of cover, but few could detail why this cover was held within superannuation. Furthermore, of the respondents who did understand the importance of life insurance, and the limitations within superannuation, few had detailed knowledge of the policies held.

TPD cover also had a low level of awareness of 37.5 per cent, with the group who had not heard of trauma cover also very confused about TPD and what conditions it covers. In particular, 40 per cent of consumers thought that TPD was an addition to life insurance, and did not see this cover as a necessary one, explaining that there is very little chance they would be totally or permanently disabled. Consumers who had TPD insurance also believed that they did not have an intricate knowledge about it, which appeared to be because it was provided within their superannuation fund.

In regards to income protection insurance (IP), most consumers (65%) had heard of this cover. Once again, however, knowledge about this type of insurance was generally very limited with the main misconception being that they thought such policies would pay when they are unable to work for any reason, including dismissal and redundancy. Of the 35 per cent of consumers who held IP insurance, only about half were able to explain the circumstances under which they would be paid funds if they made a claim (waiting and benefit periods).

Thus, it appears insurance literacy is generally low, with many consumers not being aware of all forms of policies, and even those who hold policies having a low understanding (and in some case a misunderstanding) of the benefits provided by the policies. There also seems to be a suggestion that insurance within superannuation is somewhat opaque to consumers, and not well understood. Interestingly, the highest level of understanding seemed to be from those who held insurance outside superannuation (income protection (IP) in these cases), and five of the seven of these consumers had it organised through a financial planner. This higher level of literacy could be due to these consumers being more proactive or involved in the decision to take out IP insurance. Despite this, there also appears to be low recognition of the role of a financial planner in relation to risk advice. Coupled with the suggestion of low value, and being seen as a luxury/optional item in comparison to general insurance, tackling underinsurance in terms of personal insurance has its challenges.

It seems clear that insurance literacy needs to be addressed but how this can be achieved effectually is questionable. When asked how to improve consumer insurance literacy, informed participants pointed to mass media campaigns to raise awareness, independent sources (government, educational institutions) to provide more detailed information, and financial planners to educate clients as part of their role in giving financial advice. Consumers also referred to media campaigns, and ‘independent’ information; however, most did not refer to the role of the financial planner in improving insurance literacy. This is disturbing because financial planners should in theory be the first point of call for people to increase their financial literacy. The fact that financial planners were not recognised as an education source is somewhat telling and could relate to lack of trust and/or lack of knowledge/understanding regarding the information financial planners can provide. It could also relate to not seeing financial planners as independent and unbiased service providers and educators, but as ‘pushy sales people’ who receive commissions. This notion will be explored in a future study to get a better understanding of why ordinary people do not see financial planners as educators. Consumers expressed concerns about advertisements from insurance companies that sought to 'sell' insurance to them. Both informed and consumer groups commented on the importance of financial literacy education in high school that could incorporate insurance, as well as the potential role of employers in relation to free seminars in workplaces.

Motivations and deterrents

Informed participants and consumers put forward a range of issues that influence insurance purchase decisions including a lack of trust, life events, character traits, complexity and behavioural factors. In addition to these factors, both perceptions of lack of value and knowledge (as discussed above) are factors that appear to deter the personal insurance purchase decision.

Lack of trust

The Majority of informed participants and consumers commented that there is a pervasive lack of trust in insurance companies, which is reinforced by negative stories in the media in relation to policy outcomes, and in particular denial of claims:

> *I think really that insurance as a whole has a bad reputation in my opinion. People often think that life insurance will never pay out, they take your money for a long period of time and you get nothing back (Informed participant 8, male).*

In a number of cases, consumer respondents provided personal accounts of being made to feel like 'fraudulent claimants' when going through the claim process. This feeds the consumer view that insurance companies will always try to avoid paying claims:

> *I think insurance companies are not honest in general and when it comes to personal insurance it becomes easier for them to deny claims (Consumer 25, male).*
>
> *It was the whole thing; I could just feel like I was under suspicion of making a dodgy claim (Consumer 9, female).*

Insurance contracts require both the insurer and the insured to act with 'utmost good faith', which includes the need for full disclosure. Informed participants noted that when insurance companies deny a claim it is often the insured individuals who are at fault. They explained that when people apply for personal insurance products and they fill out their medical history, they may sometimes fail to disclose accurately their previous medical conditions. If this inaccuracy was an intentional misrepresentation or omission (which breaches their disclosure obligations) then it potentially has a consequence when consumers come to make a claim, there can be a refusal to pay out the claim or a reduced claim. This highlights that insurance literacy needs to include the importance of full and frank disclosure, as this can undermine the personal insurance contract itself.

Life events

Informed participants saw consumer life stage and events as key drivers of consumer decision-making, particularly starting a family, taking on personal debt (typically the first mortgage) and personal/family experiences. The latter refers to unfortunate life-changing personal experiences that highlight either the value of, or need for personal insurance, resulting in consumers becoming self-driven to purchase personal insurance. People who are not in these circumstances were generally seen to take the view that they will get personal insurance policies later in life, 'when they need it'. This was extended by some participants to an overconfidence bias where consumers took the view that bad or unfortunate events, such as cancer or severe accidents 'won't happen to me'.

Consumers largely confirm these views, with those who did not have dependants, children in particular, arguing they did not need personal insurance as they did not have anyone to leave money to. This notion could suggest that people would be more likely to take out other forms of personal insurance, for example TPD or trauma, because even if they do not have dependants, they would still need a payout in case they got diagnosed with medical conditions for which they would be covered.

Culture and personality types/character traits

It was suggested by some informed participants that purchase of personal insurance could be influenced by cultural backgrounds. For example, immigrants from the United Kingdom, the United States of America, South Africa and New Zealand were seen as more likely to seek insurance, due to familiarity with insurance given the use of these products in their country of origin. Others referred to personality types and intellectual traits such as those who are more 'intelligent', 'conservative', 'more responsible' are more likely to purchase insurance regardless of their family status, number of dependents and the presence of liability. This included discussion of the Australian culture of being very relaxed, with many Australians not believing that an unfortunate event could happen to them. Below is the example of what most informed participants said during the interviews:

> *It's just a culture in Australia really… [Australians] are very relaxed and they've got this attitude that it will not happen to them (Informed participant 8, male).*

Complexity of the process

Informed participants also argued that the general public thought that purchasing personal insurance was a lengthy and complex process which acts as a deterrent. Indeed the possibility of medical checks and voluminous paperwork would be a significant 'hassle'. Consumers affirmed this position and used this to further delay take-up of insurance, and/or to rationalise their decision not to purchase it. Of course, it is important to acknowledge that this 'paperwork' is a critical part of the personal insurance process, especially given the disclosure obligations involved.

Behavioural factors

Analysis of the consumer interview data suggests a range of other biases may be influencing consumer insurance decisions. For example, the reference to the influence of media stories and experiences from family and friends may suggest confirmation bias[8], particularly given the commentary by experienced investors that rejected claims are often due to policyholder errors or omissions.

8 When facts are gathered in such a way as to support our pre-conceived conclusions.

Furthermore, given comments by consumers in relation to the lack of trust in the insurance system (advisers and insurance companies), evidence that consumers often rely on family, friends and websites for information rather than professional advice, it is possible that both the bandwagon effect[9] and herding effect are present. The former suggests that one's view and beliefs are formed based on the number of people that hold that view. In the latter case, one follows the decisions of others because they believe they have better information. Given that the strong consensus among consumers was a lack of trust, the perception of low chance of a successful claim, low levels of insurance literacy and the contrary view of informed professionals, we conclude that these biases are also influencing insurance decisions.

With the strong focus on 'value' in terms of both the cost of premiums and perception of low payout rates, it is also possible that regret aversion bias[10] is present. Coupled with underinsurance, even within those that are aware of the policy types, and the attitude that 'this will never happen to me', this suggests there is tension over facing the reality of what could occur, and also struggling with understanding the efficacy of insurance policies in managing these risks. This could be one of the reasons why people procrastinate making important decisions. Extending on the point in relation to likelihood of 'loss', it is clear from our consumer group that insurance literacy is low, confounded by consumers not appreciating the possibility of illness, injury or premature death. Thus, it is appears from the commentary that availability heuristics[11] are being applied to support the no purchase decision.

In terms of people's lack of understanding of probability and risk concepts that was evident in relation to general insurance versus personal insurance take-up rates, consumers appeared to be motivated to purchase general insurance as a high frequency risk even if the financial impacts can be low. This highlights the behavioural challenges consumers face when making (or avoiding) insurance purchase decisions.

Policy Cancellations

The main factor informed participants believed influenced the cancellation of personal insurance was cost. Other reasons included a switch to another superior policy and/or because consumers no longer required the cover. Informed participants also noted that clients often fail to contact their financial planners when they make a decision to cancel their existing personal insurance policies, further undermining the utility of their insurance cover and contributing to underinsurance.

9 The probability of one person adopting a belief increases based on the number of people who hold that belief.
10 This is where one avoids making decisions for fear the decision will lead to a bad outcome.
11 People take a rule of thumb approach to estimating the probability of an outcome based on how easily the outcome comes to mind.

When consumers were asked this question, their responses were in line with those of the informed participants. The main reason was the inability to pay the cost of premiums due to adversely changed financial circumstances, and/or the increased cost of premiums over time. A few consumers admitted to switching funds mainly due to finding a better product or having problems with the insurance company. When asked if they were in a situation where they needed to cancel their policies what policy would they cancel first and why, the answers were the consistent for all respondents: the first insurance type to be cancelled would be personal insurance, because they could not imagine driving their car or living in their house without general insurance cover.

Discussion and future research

Insurance is important both at an individual level and also for the society as a whole. The more individuals with appropriate personal insurance coverage, the less the impact on publicly funded support schemes, and the better financial position the insureds are in due to receiving the benefits of the policies. This can also place consumers in a better position to deal with the physical and emotional impacts of the crisis they have suffered. Despite this, underinsurance is persistent and pervasive. Research to date suggests that financial literacy especially in relation to insurance is very low, with many Australians not comprehending the basic principles of insurance. This is driven by factors such as a lack of understanding of the importance of insurance, lack of knowledge about insurance products, lack of trust associated with insurance companies and not understanding the need to have appropriate cover. Of particular focus for this article, is literacy in terms of personal insurance in Australia.

We find that people are rarely self-driven to purchase personal insurance and thus can remain underinsured. Factors such as lack of trust in the insurance industry, a perceived lack of value in personal insurance and the impact of a range of behavioural biases undermine propensity to seek and maintain personal insurance. Furthermore, most consumers have very limited knowledge when it comes to personal insurance products. If there is a low level of literacy in terms of personal insurance, then it is hard to see how effective and adequate decisions can be made about it. Perhaps even worse, in terms of tackling the underinsurance problem, is that there also appears to be a reticence to explore and better understand insurance, or even seek advice from professionals in this regard. This is further confounded by negative media and negative consumer experiences that consumers report.

Interestingly, it appears that when consumers obtain a deeper understanding of personal insurance, they realise the value of it, and thus can make more informed decisions. This appears to be particularly the case when a professional advisor is involved in that process. Part of this process for advisors is to inform their consumers with stories of the consequences of underinsurance. Furthermore, it can be argued that lack of knowledge can also lead to a lack of trust, especially when the general public is exposed to other information/media that confirms their perceptions. The inability to see value also increases the chances of procrastination and decision paralysis (Mitchel and Holzworth, 2005).

In summary, we argue that insurance literacy is a key element of the underinsurance problem. Dealing with this, however, is not as simple as producing websites and flyers. Rather, we suggest, it requires a sustained program of information and advice that educates consumers about the value of insurance, their obligations in the process, and highlights cases (and broad statistics) of successful policy outcomes. Such improvements to insurance literacy should challenge behavioural biases, while also attempting to reposition the industry. Of course, the industry would be well served to do its utmost to eliminate any poor behaviour on its behalf also. Finally, it must be recognised that insurance literacy in and of itself will only go so far. Rather, a higher order outcome of 'insurance capability', most likely delivered in conjunction with an advice relationship, is the optimal outcome given the underlying complexities in the financial and insurance systems in line with Brimble and Blue (2010). This, in addition to providing knowledge, will influence behaviours and maintain support for consumers leading to more effective financial decision-making.

Finally, we note once again the exploratory nature of this work and the qualitative approach, with a relatively small sample size, which should be taken into account when considering the conclusions of this article. The study opens up various avenues for further research including a larger scale survey approach to further examine the findings, further examination of the behavioural issues identified, and an examination of differences within different demographic groups.

Conclusion

The move to greater self-reliance in retirement has made the issue of financial literacy and the related concept of underinsurance an acute issue for governments to address. However, it is not only self-reliance in retirement that needs to be considered. The issue of financial literacy and the related concept of underinsurance is also very important throughout the life cycle and related exposure to risk. If people have low levels of financial literacy, they could be less likely to purchase appropriate personal insurance products. Without adequate financial literacy the extent to which people will be able to adequately provide for themselves (in retirement and throughout the life), and hence lower their reliance on government benefits (pension and various government payouts) is inhibited.

A particular issue addressed in this article was Australians' personal insurance literacy and factors that influence their motivation to purchase personal insurance.

This article first outlined the available evidence of Australians' financial literacy levels and the limited empirical evidence there is in relation to personal insurance. This included a discussion of the knowledge and behavioural factors that could influence the purchase decision. Data and concerns about Australians' underinsurance were canvassed, which was largely from non-peer reviewed research sources.

This article then discussed the current method of the study that involved interviews with informed participants (advisors) and consumers, which was designed to address the research question regarding the reasons why (and why not) people take out personal insurance, as well as their insurance literacy levels. The results demonstrate that 'perceptions' appeared to be an important factor in the personal insurance decisions, including the perceptions of value and knowledge about it. Also the data appeared to demonstrate a low level of literacy by consumers in relation to the various types of personal insurance products available. In terms of motivations and deterrents, the notions of trust, life events and behavioural factors appeared to have a role in personal insurance decision-making.

Overall it is argued that if personal insurance literacy could be improved then this may in part address the underinsurance problem. This preliminary research lays the foundations for further research to build our knowledge about Australians' personal insurance decision-making processes and faults. Continued empirical research in this area will serve to further our understanding of insurance literacy and decision-making and inform better policy, product and advice approaches and outcomes. These outcomes will be of use to insurance companies, financial advisers, superannuation funds, policymakers and researchers.

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