Has COVID-19 increased awareness of risk for potential customers?

March 2022

Life & Health

SCOR
The Art & Science of Risk

The adage that life insurance is sold not bought doesn't appear to be becoming any less true. While insurers are more innovative and are adopting a more customer-centric, holistic approach to the products and services that they produce, trying to encourage an increase in demand for life insurance products remains a challenge. Sometimes however, events beyond the control of the industry can have an impact on the demand for insurance.

In this article, written by Niamh Uí Cheallacháin, Behavioural Science Associate and Octavian Rosca, Actuarial Analyst, we explore whether the COVID-19 pandemic has made potential customers more aware of the risks to health and life that life insurance products protect against the financial consequences of. Has an increased awareness of this risk impacted insurance demand? We explore this question through a behavioral lens. First, we investigate some of the behavioral biases that might help explain insurance purchasing decisions and then focus on the availability bias and how the pandemic may be bringing this bias forward. Lastly, we look at the evidence of increased awareness of the risks and the consequential impact on demand for life insurance products.

Biases that affect insurance demand

A number of behavioral patterns can help us understand and predict insurance purchase decisions. Understanding and assessing risk and selecting insurance products involve complex decision-making processes, often divorced from the rational processes that traditional economic theory would suggest. Behavioral biases help explain, for example, why customers are willing to cover a mobile phone against theft or damage or buy an extended warranty for a new laptop – which costs a few hundred dollars to replace if stolen or damaged – yet they won't purchase health or home insurance, the loss of which could completely wipe out life savings..

Risk is at the center of insurance, and we need to study the behavior of humans to understand better how we actually measure risk. This will enable the industry to better construct products and direct messaging at customers to make the insurance purchasing decision a more obvious and easy choice.

These biases are often at play in our assessment of risk and consequently in the insurance purchase decision making process[1]:

1) Availability bias

The availability bias is a distortion that arises from the use of information which most easily comes to mind, rather than that which is necessarily most representative. When assessing risk, we access our memories about the risk and pay attention to stronger memories. While measuring the probability of a risk, we check our memories based on:

- Recent events
- Frequent events
- Tragic events
- Unexpected events

Negative events are easier to remember and sometimes we exaggerate risks in such cases.

2) Optimism

Being optimistic about the future can be beneficial. However, when it comes to risk, being optimistic can be misleading.

While thinking about the future we generally give more weight to good things. This optimism might prevent us from seeing possible risks. This optimism bias can result in miscalculating the risk of certain events such as illness and disability. With this underestimation, any related insurance products may appear unnecessary or overpriced[2].

3) Overconfidence

Having too much self-confidence can result in misjudgments and the underestimation of risk. In the context of insurance, over-confidence may present itself in two forms. First, customers may overestimate their own abilities and underestimate their need for advice. Second, customers may overestimate their own health, leading them not to opt for products such as disability insurance or critical illness cover.

4) Present bias

Our preference for the present has been very well tested and documented and been the subject of many experiments in the past. Hyperbolic discounting describes how people favor a certain amount of money now over a larger amount in the future, far beyond what can be explained by usual discounting[3]. This present bias helps explain why people don't save enough for retirement but do not expect to have income problems when they retire. It can also help explain why many people opt to take their savings as a lump sum rather than annuitize it over a longer period[4].

5) Default effect

The default effect is a bias that leads to a tendency to maintain the status quo. This bias may lead people to make essential decisions, such as insurance purchasing decisions, too late. The Geneva Association Customer Survey[5] found that about 20% people mentioned procrastination as a reason for not purchasing insurance cover.

Conversely, awareness of the default effect can be, and has been, used for positive effect in the insurance world. Auto-enrollment in occupational pension schemes is an excellent example where awareness of the default effect has been used for the benefit of employees and for society at large. Auto-enrollment, rather than an opt-in process, has been shown to significantly increase the number of employees (in particular those of younger age and lower wages) registered in a retirement savings plan[6].

6) Loss aversion

Loss aversion describes how we humans are more motivated to avoid losses than to seek gains.

This bias helps explain why some people might be resistant to buying insurance. The purchase of life insurance can sometimes appear like a trade-off between a certain loss (the premium payment) versus an unknown and uncertain gain (the potential benefit payment). Term insurance policies that return a proportion of premiums to customers should they survive the term of the policy attempt to counter loss aversion.

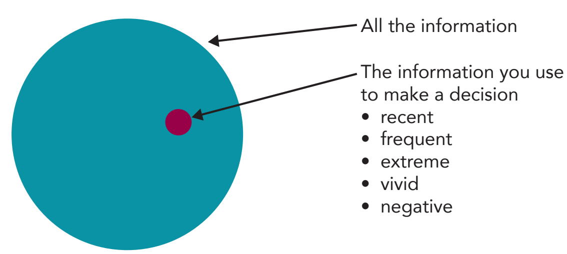
7) Illusion of control

The thought that we are fully in control of our own lives can lead to underestimating risks. For example, there are people who may be afraid to fly because they consider it risky but are perfectly happy to ride a motorcycle. The risk of being injured or dying while riding a motorcycle is much higher than the risk of being in an airplane crash, but people might be more likely to take the risk of riding a motorcycle because of the illusion of being in control.

Focus on availability bias

As described above, the availability bias is a distortion that arises from the use of information which most easily comes to mind, rather than that which is necessarily most representative.

THE AVAILABILITY HEURISTIC[7]



We use many mental shortcuts or heuristics on a day-to-day basis because our brains cannot possibly process all of the information available to it at any one moment in time. The brain is forced to tradeoff between accuracy and speed, and it does this by taking mental shortcuts, which are accurate most of the time, but not all of the time.

The availability heuristic is one such mental shortcut. In a classic illustration of the availability heuristic at play, Kahneman and Tversky[8] found that, when asked to consider a typical piece of text, twice as many people thought the letter k would occur more frequently at the beginning of words rather than in the third position of words. In this experiment, people answered the question by comparing the availability of the two categories, i.e., by assessing the ease with which instances of the two categories come to mind. Because it is easier to think of words that start with a k than to think of words where k is in the third position, participants confused easy with true. This shortcut can lead to a bias in our thinking.

The availability bias relies on ease of recall. The factors that make something easier to recall are:

- Frequent is easier to recall than infrequent
- Extreme is easier to recall than ordinary
- Negative is easier to recall than positive
- Recent is easier to recall than the distant past
- Vivid is easier to recall than non-vivid

For example, studies have shown that negative events such as losing money or receiving criticism results in a greater physiological and cognitive reaction than making money or receiving praise.[9]

Perception and awareness of what poses most risk to us is therefore affected by how easy it is for us to imagine the risky event and the consequence of the risk. This then leads on to decision making regarding what to do about mitigating the risk.

The following sections will explore where we see the above factors affecting risk perception and consequential insurance purchasing decisions in non-life settings, and we question if the current pandemic presents an event that increases individual's perception and awareness of risk to their own health that will subsequently drive life insurance purchasing decisions.

Availability bias in other lines of insurance

As discussed above, the availability heuristic is a prevalent mental shortcut which relies on immediate examples that come to mind when evaluating a specific decision. The insurance industry has seen a number of different events which have caused consumers to buy insurance based on the perceived risk as opposed to the actual risk. One notable example of this heuristic in action can be seen when Hurricane Katrina hit New Orleans. Between 2001-2009[10] sales of flood insurance policies saw a steady increase of between 0% - 4% each year; however, there was a noticeable anomaly in this time period. In 2006, there was a 14.3% increase in insurance policies protecting against flood. Why? After Hurricane Katrina, the concept of flooding evoked very poignant images in people's minds. People saw the widespread media coverage of the flood. As a result, people perceived their risk to be greater than what it actually was, and this in turn increased their likelihood of insuring themselves against floods.

The provision of long-term care (LTC) in an aging population poses financial risks to the elderly and their family members. In many European countries, adult children are legally required to assist their parents when the older generation lacks the financial resources to provide for the LTC.

According to data from the German Federal Statistical office, more than 11% of people aged 65 and over were in need of LTC in 2005. Germany is one country where adult children are responsible for the cost of LTC should their parents be unable to finance it.[11] The study found that parents have an increased demand for LTC insurance products if their adult children are more aware of the risks that LTC products cover. The level of risk awareness for this type of product was measured using two proxies namely, whether the adult children have purchased or thought about purchasing LTC products themselves and whether the adult children discussed the possibility of LTC coverage with their parents. This finding echoes the availability heuristic that is prevalent in the purchase of flood insurance after a flood has occurred.

It is not surprising that vivid imagery and visualization may significantly impact perception of risk. A 2011 study[12] found that when people are asked how much they will pay for flight insurance for losses resulting from terrorism, they will pay more than if they are asked about how much they will pay for flight insurance for losses arising from all causes. This easy to understand because when an image of a bad outcome easily comes to mind, people become more concerned about the risk while holding the probability of the risk constant.

A survey[13] conducted in 1989 found that 63.1% of respondents estimated their probability of a major earthquake damage in their community to be 1 in 10. After the 1989 Loma Prieta earthquake in California, this percentage rose to 75.7%.

Interestingly, this availability heuristic can influence consumers decisions to purchase insurance for up to nine years after the event has occurred. One study found that a flood results in an increase of flood insurance policies being sold at 8% above normal levels in the year after the event. This percentage then goes up to 9% in the second year after the event, but by the time we get to the 10th year of the policy, the number of policies being sold reverts to normal levels[14].

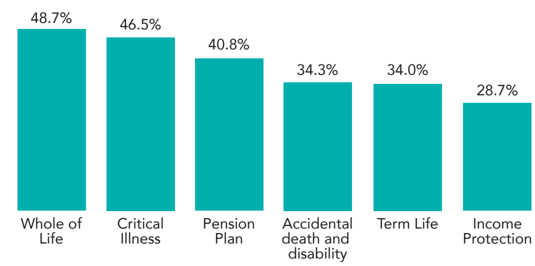
Evidence of customers changing attitudes to risk and insurance because of COVID-19

The ongoing pandemic appears to have brought the fragility of life to mind. A 2021 Global Consumer Study (GCS)[15] conducted by Remark Group found that COVID-19 has caused a shift in attitudes towards risk and the value of insurance, particularly for millennials. The study found that 35.5% of respondents had bought a life insurance policy for themselves or for a family member within the last two years. The results from this consumer study are reverberated in another consumer study published by the Geneva Association[16], which found that 40% of retail consumers consider health and life insurance more important post-pandemic.

Respondents in growth markets are much more likely to have made a purchase in the last two years than their counterparts in established markets (52% vs 28.2% respectively). This shift in attitudes is most salient with millennials who are a key target group for insurance sales, with 50% of millennials having made a purchase in the last two years. Moreover, millennials are also the group that were most likely to purchase multiple policies.

As can be seen in the graph below, this Remark study found that whole life insurance was the most common type of insurance policy purchased by respondents, bought by 48.7% of recent buyers.

WHAT PRODUCTS DID CONSUMERS BUY RECENTLY?



The survey asked the specific question to respondents about whether they believed COVID-19 had changed their attitude to risk and the value of insurance. Just over 40% of respondents confirmed that it had. The percentage was highest among those that had a family member or friend who died from COVID-19 (71.8%) and higher than average for those who had tested positive or knew someone who had tested positive (58.1%).

This change in attitude appears to have been converted into action with two-thirds of those whose attitudes changed claiming to have increased their cover levels of either life or health insurance during the pandemic. The heightened awareness of risk post-pandemic may represent a great opportunity for insurers to narrow protection gaps and to promote risk solutions which will rank higher in people's minds.

Evidence of actual changes in purchasing behavior because of COVID-19

In addition to survey responses regarding the impact of the pandemic on life insurance purchasing decisions, there is some evidence of an observed increase in sales. LIMRA's U.S. Individual Retail Sales Survey found that although new total life insurance annualized premiums fell by 3% in 2020, the number of policies actually increased by 2% for the year[17].

This increase was primarily driven by strong sales growth in whole life (WL) and term sales.

Interestingly in Q4 2020, new premiums coming from life insurance dropped by 8%, compared to levels that were seen in Q4 2019. Total policy sales were however up by 2% in the fourth quarter. Findings from the LIMRA sales survey were consistent with the findings in the GCS, as in the fourth quarter, whole life sales were strong. WL new premiums rose by 5% and experienced the largest growth in absolute dollars. This was fueled by consumer interest in life insurance and an expansion of accelerated underwriting programs. For 2021[18], LIMRA reported strong double-digit growth in sales of WL products throughout the year (including VUL and IUL), with this trend expected to continue into 2022, before an expected return to normal growth by 2023 (outlined in the table below).

U.S. INDIVIDUAL LIFE INSURANCE ANNUALIZED PREMIUM GROWTH FORECAST

	Total	Whole Life	Term	Fixed UL	VUL	IUL
2020	-4%	0	+5%	-27%	+4%	-8%
2021 (forecast)	+14% to 18%	+1.4% to +1.8%	+4% to +8%	+1% to +5%	+58% to +62%	+14% to +18%
2022 (forecast)	+5% to +9%	+6% to +10%	+2% to +6%	-4% to 0	+13% to +17%	+5% to +9%
2023 (forecast)	+2% to +6%	+3% to +7%	+1% to +5%	-8% to -4%	+8% to +12%	+2% to +6%

Elaine Tumicki, corporate vice president of LIMRA Insurance Product Research, believes that the pandemic has raised consumer awareness of the need for life insurance protection. The expansion of simplified underwriting and online sales during the pandemic has resulted in strong D2C growth of WL and term products[19].

The MIB Life Index found that U.S. life insurance application activity finished 2021 with annual growth of +3.4%, representing the second consecutive year of growth. The year-on-year growth by month is displayed in the below graph. Following record breaking growth in 2020 of +3.9%, 2021 achieved the second highest annual growth rate on record. When comparing 2021 results to 2019, the industry was up +7.4%[20].

COMPOSITE – 12 MONTHS TRAILING
YOY % gain/loss

Final Remarks

The life insurance decision-making process is a complex one. Chief among the main steps of the process is an assessment of the risk being insured against. We have seen that many behavioral biases can impact the way that we assess risk and consequentially have an impact of the insurance purchasing decision.

In particular, the availability bias explains how we use information which most easily comes to mind, rather than that which is necessarily most representative when assessing risk making decisions. Studies have shown how this bias might help explain, for example, increased purchasing of flood insurance after a flood or a greater propensity to buy LTC insurance when exposed to the care required for elderly parents. Has COVID-19 made the risk to health and life more available to potential customers and increased the demand for insurance?

Certainly some evidence suggests that it has heightened the awareness that people have and increased their intent to buy life insurance. There is also evidence to suggest that there has been an increase in number of policies purchased during the pandemic. Whether this increased awareness continues after the pandemic is behind us remains to be seen.

Footnotes

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