



Financial Literacy and P/C Insurance

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Financial Literacy is the Skills Necessary to...

- Assess financial risks and opportunities
- Make informed choices, and
- Take effective action to improve one's financial well-being

Financial Literacy: A 3-Question Test

This test has been administered world-wide to provide a rough indicator of financial literacy among many populations.

The First Financial Literacy Question

- If you had \$100 in a savings account with an interest rate of 2 percent per year, after 5 years, how much do you think you would have in the account if you left the money to grow?
 - ◆ More than \$102
 - ◆ Exactly \$102
 - ◆ Less than \$102
 - ◆ Don't know
 - ◆ Refuse to answer

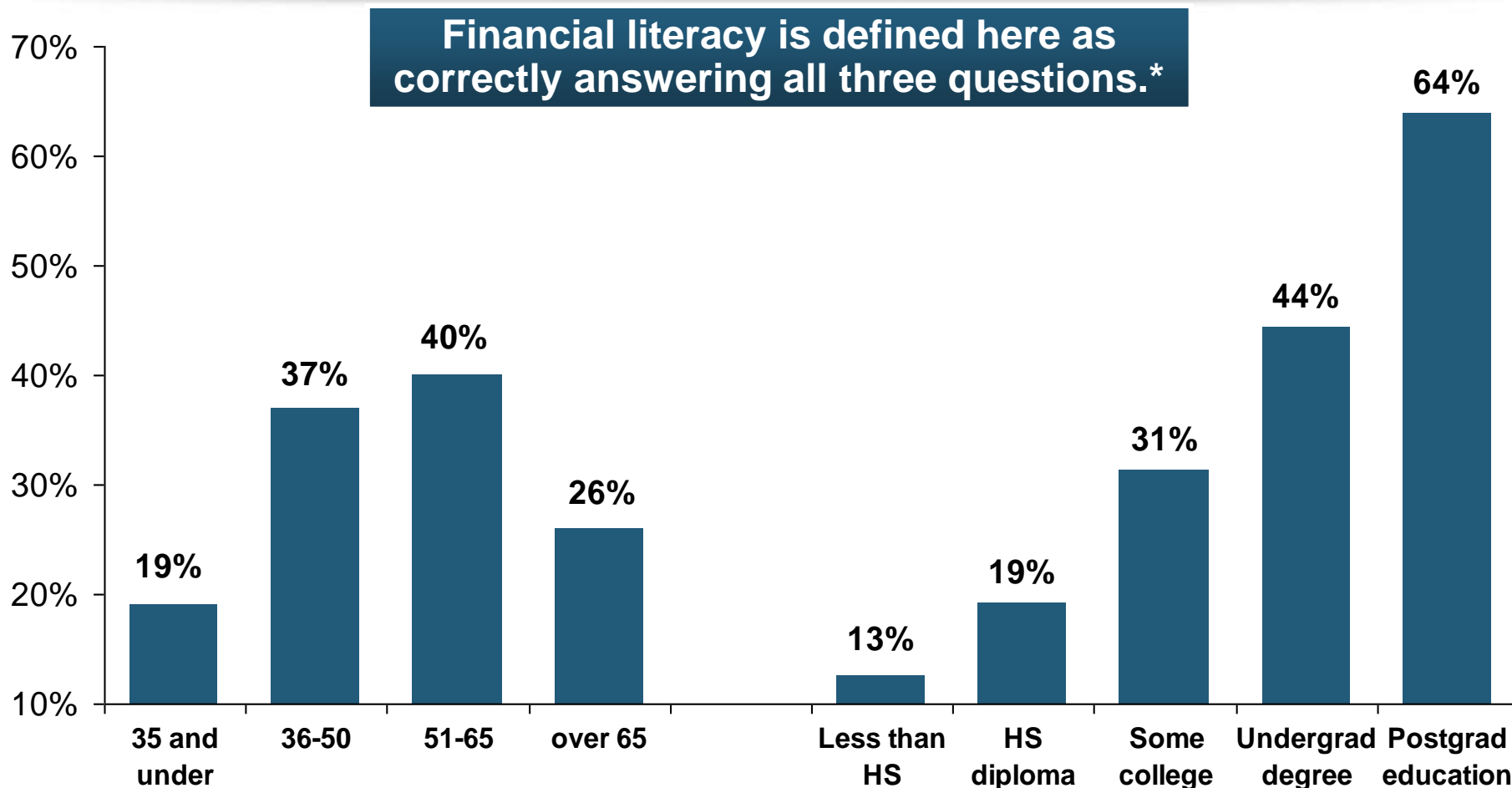
The Second Financial Literacy Question

- If the interest rate on your savings account was 1 percent per year and inflation was 2 percent per year, after 1 year with the money in this account would you be able to buy
 - ◆ More than today
 - ◆ Exactly the same as today
 - ◆ Less than today
 - ◆ Don't know
 - ◆ Refuse to answer

The Third Financial Literacy Question

- “Buying a single company stock usually provides a safer return than a stock mutual fund.” This statement is
 - ◆ True
 - ◆ False
 - ◆ Don’t know
 - ◆ Refuse to answer

Financial Literacy by Age Group and Education



*The questions ask about interest rates, inflation, and risk diversification (by comparing individual stocks and stock mutual funds). The details are on page 10 of the cited article and in other articles cited by the authors.

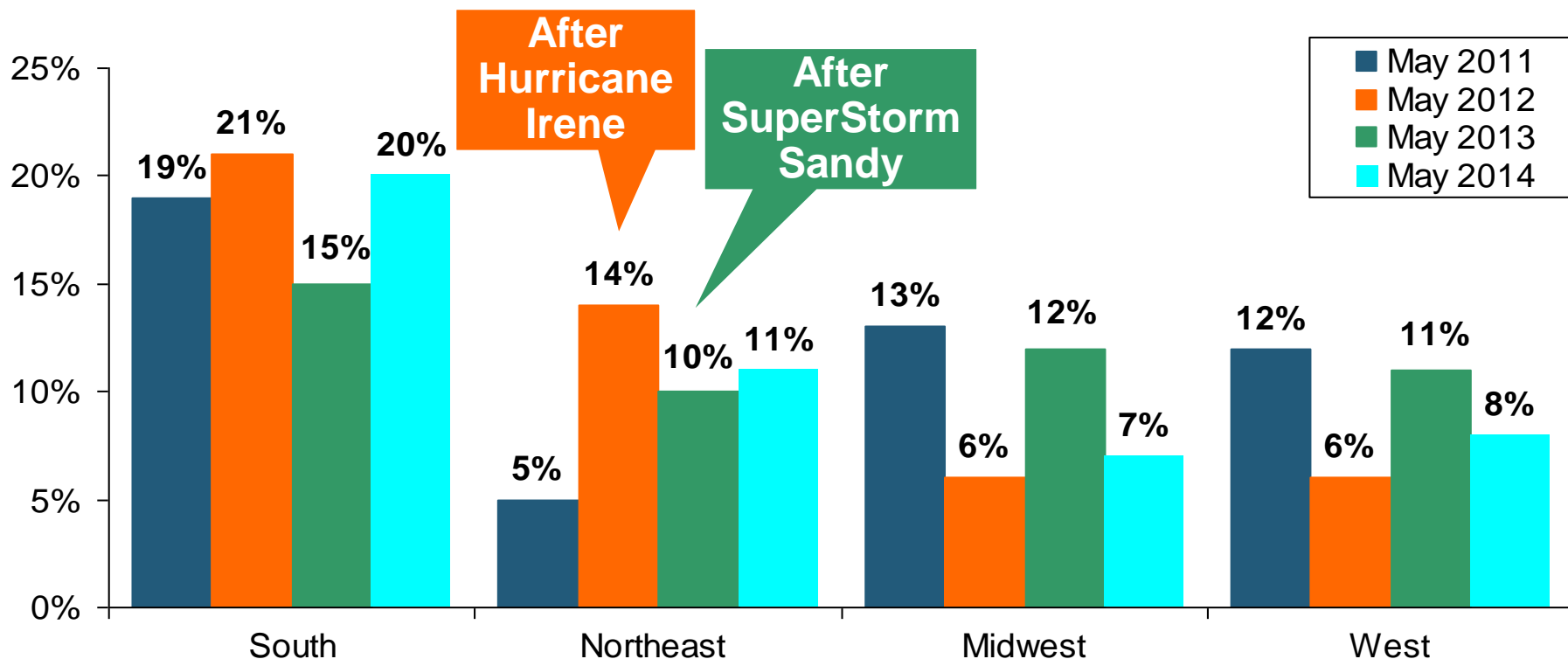
Source: Lusardi and Mitchell, "The Economic Importance of Financial Literacy: Theory and Evidence," *Journal of Economic Literature*, 2014 (pp. 5-44).

Financial Literacy and P/C Insurance

**A Low Level of Financial Literacy is Probably
At Least Partly Responsible
for Low Ownership of Flood Insurance**

Even Frequent & Severe Floods Haven't Changed Flood Insurance Ownership Much

Q. Do you have a separate flood insurance policy?¹



Despite extensive flooding (and wide publicity), few U.S. homeowners say they have a flood insurance policy; moreover, there is no upward trend.

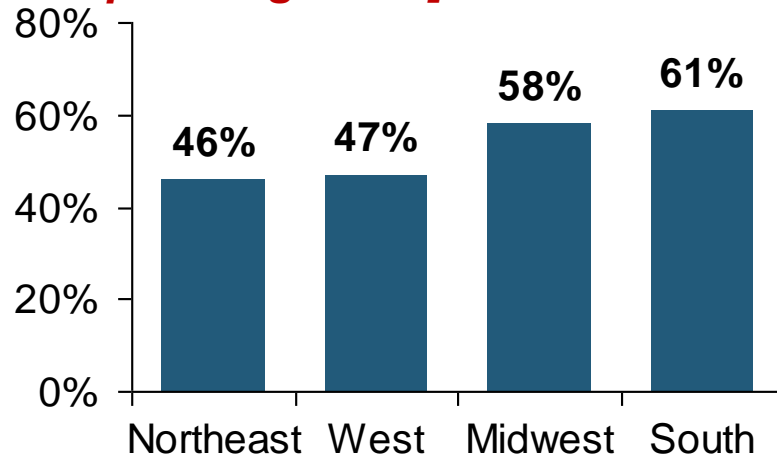
¹Asked of those who have homeowners insurance and who responded "yes".

Source: Insurance Information Institute Annual *Pulse* Survey.

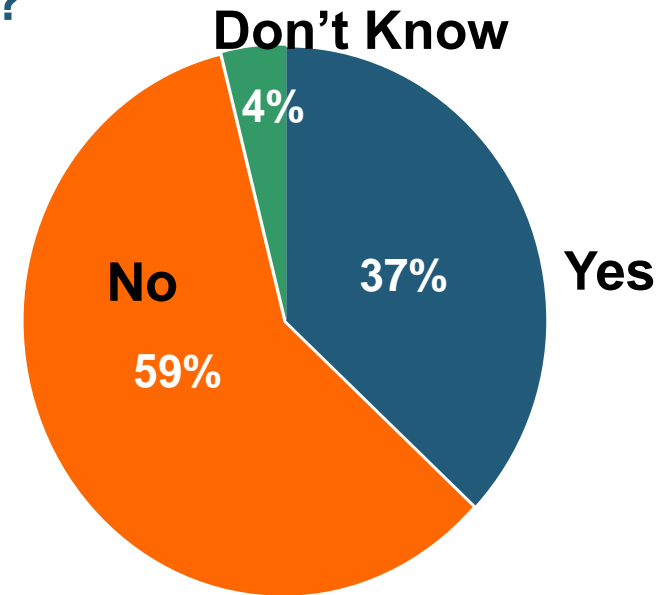
Flood Insurance: It's Not "Fair" for Premiums to Reflect Expected Claims

Q. The federal government plans to raise the price of flood insurance so it reflects the costs of paying claims. Do you believe this is fair?

[% Responding "NO"]



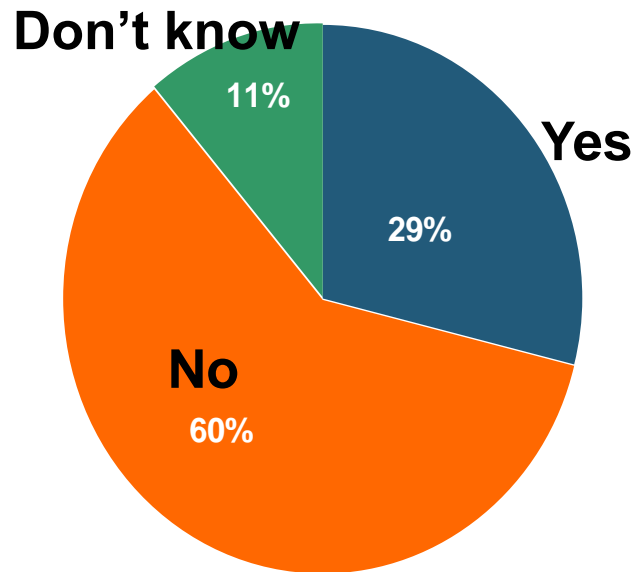
Q. Do you think that it is fair that people who live in areas affected by record storms in 2011 and 2012 should pay more for their homeowners insurance in the future?



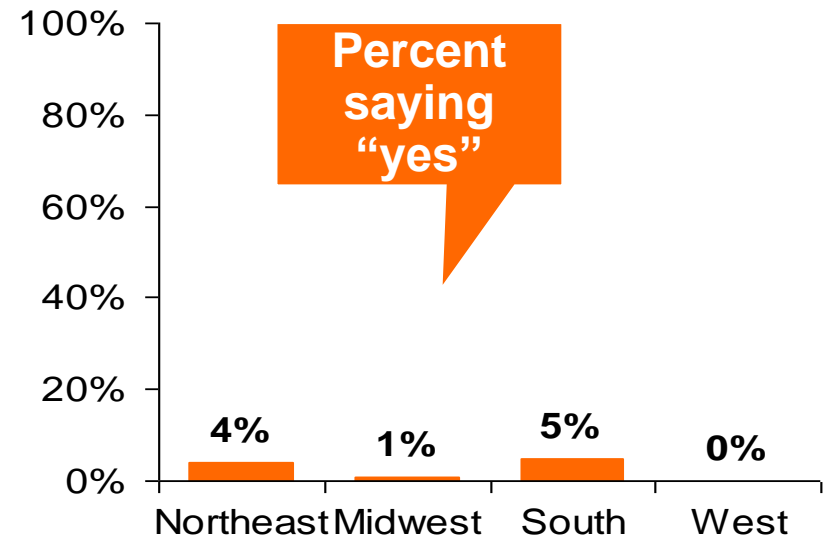
A majority of Americans do not think it is fair for the federal government to raise its flood insurance premiums to better reflect claims payouts or to charge people who live in high-risk areas actuarially-fair premiums.

Why Buy Flood Insurance?

Q. Will the government provide you with funds to pay some of the disaster costs to your property?



Q. Have recent flooding events such as Hurricane Sandy or Hurricane Irene motivated you to buy flood coverage?¹



30% of Americans believe the government will pay some of their disaster costs.

Can/Should Financial Literacy Be Taught?

The State of Oklahoma is Trying

Oklahoma's 14 Financial Literacy Standards Required for High School Graduation

| | | | | |
|--|--|---|--|---|
| Standard 1 Earning an Income | Standard 2 Taxes | Standard 3 Banking & Financial Services | Standard 4 Managing a Bank Account | Standard 5 Saving and Investing |
| Standard 6 Retirement Planning | Standard 7 Borrowing Money | Standard 8 Online Shopping & Credit Cards | Standard 9 Fraud & Identity Theft | Standard 10 Renting vs. Buying |
| Standard 11 Insurance | Standard 12 Gambling | Standard 13 Bankruptcy | Standard 14 Charitable Giving | Personal Financial Topics General |

STANDARD 11:
***THE STUDENT WILL DESCRIBE
AND EXPLAIN HOW VARIOUS
TYPES OF INSURANCE CAN BE
USED TO MANAGE RISK.***



But Instinct and Long-Held Habits Often Dominate Financial Decision-Making

THIEVES OF THEIR OWN WALLET

Few people will walk past a dollar lying on the sidewalk, but when opportunities present themselves more subtly, we often ignore them at immense cost to ourselves

Does Education for Financial Literacy Work? Research Is Mixed

A January 2014 report by the World Bank reviewed 188 studies of financial literacy education.

- Most showed some improvement in financial decision-making, but many studies were judged to be not rigorous.
- Nearly 1 in 4 studies showed little or no benefit from the education

“Financial education will not lead to improved financial behavior, Dan Ariely* believes.”

“The real improvement will come from designing or enforcing mechanisms that make it easy for us to make the right decision, or prevent us from making big mistakes.”

*Dan Ariely, James B. Duke Professor, Duke University, is a leading thinker and writer in the field of behavioral economics

Sources:

The World Bank Development Research Group, “Can You Help Someone Become Financially Capable?” Policy Research Working Paper #6745; The Ariely quotes are from Allianz, Project M, #18, pp. 22-24; Insurance Information Institute

In Conclusion

Why the Issue of Financial Literacy Is Important for P/C Insurance

- Increasingly severe weather increases the likelihood that policyowners will have a significant loss that could be insured.
- Research shows that financially literate people are more likely to act, while less-financially-literate people procrastinate and often don't act
 - ◆ This might help explain why so few people have flood insurance
- When new types of exposures arise, financially-literate people are more likely to buy insurance against them

Why the Issue of Financial Literacy Is Important for P/C Insurance

- People who don't understand their policies—or the events they insure against—are likely to blame, or be antagonistic to, insurers and agents
 - ◆ Legislatures might create organizations like the federal Consumer Financial Protection Bureau to “protect” unsophisticated policyowners
 - ◆ Growing numbers of policyholders will be age 80 and over. Many will have cognitive limitations and might become financially illiterate even if they were previously financially literate. Agents and insurers will have to develop strategies for dealing with these people.

P/C Insurance Implications of Financial Illiteracy

- It seems likely that financially illiterate people are...
 - ◆ Less likely to buy and renew P/C insurance when they are not required to do so
 - ◆ Less likely to buy and renew P/C insurance even when they are required to do so
 - Low financial literacy might help to explain high percentages of drivers who don't have auto insurance
 - ◆ Less likely to buy appropriate policy limits
 - ◆ Less likely to understand policy terms and features (e.g., hurricane deductibles)
 - ◆ More likely to focus on price (because they don't understand other aspects of the P/C insurance relationship)

Insurance Literacy: A Proposed 3-Question Test

This test has never been administered to anyone but if it were it might provide a rough indicator of property/casualty insurance literacy.

The First Insurance Literacy Question

- If you had \$500 deductible in your insurance policy and you had \$2,000 of damage covered by the policy, how much would the insurance company pay?
 - ◆ \$2,000
 - ◆ \$1,500
 - ◆ \$500
 - ◆ Don't know
 - ◆ Refuse to answer

The Second Insurance Literacy Question

- If your insurance policy had a policy limit of \$50,000 and you had \$80,000 of damage covered by the policy, how much would the insurance company pay?
 - ◆ \$80,000
 - ◆ \$50,000
 - ◆ \$30,000
 - ◆ Don't know
 - ◆ Refuse to answer

The Third Insurance Literacy Question

- “Insurance policies usually cover several different types of losses in a single policy.”
This statement is
 - ◆ True
 - ◆ False
 - ◆ Don’t know
 - ◆ Refuse to answer

Insurance Information Institute Online:

www.iii.org

***Thank you for your time
and your attention!***