Urban Insurance Issues

THE TOPIC

2011

Underwriting, the task of deciding what risks to insure, allows insurers to discriminate between good and bad risks. Differences in prices for insurance must reflect expected differences in losses and expenses. When the risk of future losses increases or when rates are inadequate, insurers become more selective about the degree of risk they will assume in an effort to preserve their profit margin. However, redlining, defined as refusal to issue or renew, or to cancel an insurance policy based not on risk but on the geographic location of the structure or individual to be insured, is illegal in every state. Because losses tend to be higher in urban areas, rates for auto and home insurance are often higher than average in inner cities.

RECENT DEVELOPMENTS

- **Low-Cost Auto Insurance:** A number of states, including Michigan and Nevada, recently considered developing a low-cost auto insurance program in an effort to reduce the number of drivers who are uninsured but proposals failed to gain support.
- California has steadily expanded its low-cost program to become available statewide and in 2010 reauthorized it for another five years.At the end of 2010 there were more than 11, 600 policies in force, compared with close to 11, 440 a year earlier. However, despite efforts to enroll drivers in the plan, a study by the Insurance Research Council puts the number of uninsured drivers in the state at about 18 percent. California ranks among the states with the highest number of uninsured motorists, according to the study, whereas New Jersey, which also has a low-cost auto insurance program, ranks among the states with the lowest, at 8 percent.
- **Usage-based Auto Insurance Programs:** California?s Pay-As-You-Drive (PAYD) auto insurance program may benefit urban drivers since they can now purchase coverage in line with the number of miles they drive, which is often considerably less than non-urban drivers. Urban drivers may also benefit from broader usage-based auto insurance programs that take into account a driver?s behind-the-wheel performance as well as mileage. See Pay-As-You-Drive Auto Insurance for more details.
- **Investments in Low Income Areas:** In California the department of insurance allocates $2 million in tax credits each year to support more than $10 million in community development investments though a program known as the California Organized Investment Network (COIN). In May 2011 the department announced that three major insurance companies were providing a total of $11 million in new investments to benefit low-income communities. The loans are for five years and are interest-free. In return, the companies will receive a 20 percent state tax credit valued at $2.2 million. The funds received from the insurers will be used to make federally insured deposits with 20 or more community banks and credit unions so they can expand their lending activities in the community, COIN officials said. Since its inception COIN has invested more than $100 million in some of California?s most underserved communities.
- The California Department of Insurance has amended regulations to the community service statement requirement that will provide essentially the same information showing the extent of

insurers? marketing efforts to minorities but require the data to be collected less frequently. The statement, which includes information on written premiums, office locations, solicitations by zip code, languages spoken by agents and the race, and national origin and gender of policyholders, must be filed every odd-numbered year rather than every year and information about race, gender and national origin needs only to be submitted on new policyholders. The Report on Underserved Communities will be issued every two years, rather than every year, starting in September 2010.

- **Credit Scores:** Critics of insurers? use of credit scores often claim that insurance scoring unfairly discriminates against urban drivers. After several years of extensive research, the Federal Trade Commission (FTC) has found that auto insurers? use of insurance credit scores leads to more accurate underwriting of auto insurance policies in that there is a correlation between insurance scores and the likelihood of filing an insurance claim. The FTC report, Credit Based Insurance Scores: Impacts on Consumers of Automobile Insurance, published in July 2007, also states that credit scores cannot easily be used as a proxy for race and ethnic origin. In other words, credit scoring predicted risk for members of minority groups in much the same way that it predicted risk for members of nonminority groups. The Fair and Accurate Credit Transaction Act of 2003 directed the FTC to address the issue of whether the use of credit had a disparate impact on the availability and affordability of insurance for minorities. The FTC is conducting a study of homeowners insurance companies? use of credit-related information, analyzing data from nine insurance companies that represent about 60 percent of the homeowners insurance market. A report on the results of the study is expected some time in 2011.

BACKGROUND

Property Insurance

Studies by many different groups have shown that residents in urban communities have insurance (banks generally will not issue a mortgage without proof of insurance) and that the rates charged are in line with losses. However, because of the higher risk of loss (fire, vandalism and theft) more inner city homeowners are often insured outside the regular market, just like people who live in coastal areas exposed to hurricanes, see report on the Residual Market.

Older homes in central cities have presented problems in the past in that the decorative and uniquely crafted features can push repair or replacement costs significantly above a home's market value and raise premiums to the point where insurance could become unaffordable. As a result, in the past, some insurers would not offer owners of older homes a full replacement cost policy, the most comprehensive homeowners policy that pays to rebuild the structure as it currently exists, regardless of whether they lived in an expensive Victorian mansion in suburbia or a more modest home in the inner city. Instead of a full replacement cost policy, owners of older homes purchased a policy based on the fair market value of the home with rebuilding costs based on standard building materials and techniques.

However, in response to the perception that homeowners insurance is not available in inner cities, most major insurers have changed their business practices regarding older homes, including eliminating age restrictions and minimum market value. Instead, they inspect the heating, plumbing and electrical systems and roofs more rigorously for hazards that could lead to losses and suggest repairs or replacement where necessary.

History: After the urban riots in the mid-1960s, insurers were reluctant to write policies in inner city areas because of the devastating losses they sustained. To improve economic conditions in these communities, Congress passed the Housing and Urban Development Act in 1968. This made federal riot reinsurance available to states that set up FAIR (Fair Access to Insurance Requirements) Plans, property insurance pooling mechanisms that made basic property insurance coverages available to homeowners living in urban areas where it was difficult to obtain insurance. Insurers needed federal riot reinsurance to protect them from fire and vandalism losses should riots erupt again. The private reinsurance market soon replaced the federal program but FAIR Plans and other residual market programs still exist to provide insurance where the voluntary market will not, see report on the residual markets.

The availability of insurance again became an issue in the aftermath of the Los Angeles riots in 1992. Some small businesses located in the areas destroyed by fire and looting failed to reopen, in part because they lacked the proper business insurance coverages. At the same time, community activists began to accuse the insurance industry of deliberately discriminating against inner city neighborhoods. As proof of redlining, they cited the difficulty of obtaining insurance in urban communities where the housing stock is often old and the fact that owners of older homes were offered policies that provided "actual cash value"?the depreciated value of damaged items?rather than replacement cost coverage.

Surveys by independent research groups for the insurance industry showed that most homeowners (96 percent) living in major cities had home insurance and only 3 percent of those surveyed said that they were aware of anyone in their neighborhood having difficulty obtaining homeowners insurance. Nevertheless, the charges of redlining prompted regulators and lawmakers to consider imposing expensive data collection requirements on insurers to monitor property insurance sales, marketing and cancellations. While data collection proposals failed to muster support in Congress, a program designed to encourage increased competition among large insurers in "underserved communities" was put in place in California. Insurers must report marketing and sales data, such as the number of insurance agents or agencies where representatives are conversant in languages other than English, to the insurance department every two years.

Underwriting and Other Business Practices: By laws or regulation, redlining is illegal in every state and there is no evidence to suggest that insurers unfairly discriminate based on racial or ethnic differences. However, insurers do discriminate based on risk and a company's profitability is determined in large part by its ability to evaluate risk and charge a premium commensurate with the potential for loss.

To help underwriters distinguish between what the company considers good and bad risks within the confines of its marketing strategy, insurers develop underwriting guidelines. These guidelines provide a framework for underwriting decisions by identifying what factors should be considered in accepting applications for coverage. They also help ensure underwriters' selection decisions are uniform and consistent throughout the company. For example, an insurer that wants to limit its exposure to hurricane damage may decide to decline all applications for property insurance on buildings within a certain distance from the ocean. That distance may be measured in yards or by surrogates for distance such as zip codes or counties. In regions prone to hailstorms or brush fires, insurers may refuse to insure homes with certain types of roofs.

Programs to Expand Urban Property Insurance Options: The insurance industry has been working with community groups, such as the Neighborhood Housing Services, in New York, St. Louis, Philadelphia, Seattle and other major cities across the nation to increase understanding of insurance, make homes more insurable and help insurance companies better market products and services in these communities. In addition, outreach programs have been established to increase the number of insurance agents in predominately low-income areas and to make it easier for them to be financially successful.

In some states, Market Assistance Programs (MAPs) have been set up to help insurance buyers and agents find insurance. Texas, for example, adopted new rules in 1997 that bar the use of age and value as the sole criteria for declining to insure a home and put into effect two programs to address urban (and rural) markets. One is a traditional market assistance program. The second offers financial incentives for insurers to offer a basic residential insurance property policy.

In Massachusetts, insurers receive credit against Massachusetts FAIR Plan assessments for voluntary market policies written in certain areas of the city. In addition, the state's 25 largest insurers are required to disclose their record of homeowners policy sales in these neighborhoods. Insurers are now allowed to write policies that cover the fair market value of properties rather than their replacement cost. (Formerly, insurers were required to provide replacement cost coverage which, on a large, older house with a low market value, made the cost of insurance prohibitive.)

Auto Insurance

Auto insurance rates are generally higher in central cities. There are several reasons for this including the greater traffic density and pre-automobile-era design of streets in the older cities of the Northeast that increase the risk of accidents and the higher incidence of theft and vandalism.

In low-income urban communities, where the cost of insurance may force drivers to choose between insuring their vehicle and purchasing other basic necessities, many cars are uninsured. Insurers have long advocated auto insurance policies that provide basic insurance coverage as a cheaper option for low-income drivers, who have less need for liability insurance because they have no assets to protect if they are sued.

In some states with large urban populations, regulators have placed restrictions on auto insurance rates for central city drivers. These caps force non-urban residents to pay a subsidy to keep urban insurance prices more affordable, the reasoning being that the influx into central cities of drivers who work and shop there but live elsewhere is responsible in part for the greater number of traffic accidents.

Over the past decade, insurers and lawmakers have tried to enact no-fault auto insurance programs of various kinds in an effort to lower premiums. But, with the exception of Pennsylvania where a choice no-fault system has offered urban drivers a means of reducing the price they pay for auto insurance, efforts to introduce no-fault have been unsuccessful, largely due to opposition among trial lawyers and others whose income would be reduced if more claims were settled outside the court system. In addition, the high incidence of fraudulent personal injury protection claims in some urban areas of states with no-fault auto insurance law has led some states to dismantle their no-fault systems.

California and New Jersey have created programs that offer lower priced coverage in the hope that more drivers would purchase insurance. In California, where the low cost program provides liability coverage which drivers in the state must have by law, the program has been expanded from the cities of Los Angeles and San Francisco, which were the first to participate in the program, to all counties in the state, allowing those drivers that meet eligibility requirements to comply with the law. Most drivers are uninsured when they apply.

To be insured under the plan, the driver must meet income requirements and have a good driving record, defined as no more than one at fault property damage only accident or more than one point for a moving violation in the past three years and no felony or misdemeanor conviction or violation of the Vehicle Code. Insurance department officials say that the program draws drivers who would not ordinarily look for insurance into the system.

Enrollment in the California program has been rising slowly. As in all states, except New Hampshire, to protect the public and encourage people to buy auto insurance, proof of insurance is needed to register a car. Some people therefore apply for a policy through the low cost auto insurance program then drop their coverage as soon as their vehicle is registered. In addition, experience shows that even among those who meet the qualifications, for many drivers with incomes close to the poverty line, the cost of insurance is still too high to enable them to comply with the state?s compulsory auto liability insurance law. And for those who qualify but have bought insurance through the regular market or the assigned-risk plan, the cost of the bare-bones package is not so low that drivers with a policy providing broader coverage are likely to switch.

In New Jersey, many previously uninsured drivers have purchased low cost policies, in large part because they offer medical coverage which the California policy does not. The Dollar-A-Day and Basic insurance policies were both created as alternatives to the standard policy in an effort to reduce the number of uninsured drivers and make auto insurance more affordable for the state?s low-income drivers. The Dollar-A-Day policy pays up to $15,000 of most medical expenses after an accident and $10,000 in death benefits and, like the standard auto insurance policy, provides coverage for catastrophic injuries, such as severe brain damage, up to $250,000. The program is administered by the Personal Automobile Insurance Plan, the state?s assigned risk program, and covers relatives as well as the driver. Eligibility is based on standards for Medicaid.

In the past, there was also hope that no-fault auto insurance would help solve the problem of affordability by putting more of the insurance premium in the hands of accident victims. But no-fault systems have encouraged fraud in some communities, pushing up the cost of coverage in the very areas where people can least afford it. However, in some states with a large urban population, urban rates are subsidized to some degree by those living in other areas of the state.

Credit-Related Insurance Scoring: Most insurance companies now use credit-related insurance scores to help them decide whether to accept an applicant for insurance and sometimes to set a price for coverage. Insurance scores predict the average claim behavior of a group of people?applicants for insurance with basically the same score. Studies show that as a group, people with low insurance scores tend to file more claims and people with high scores file fewer claims. Essentially, people who manage their finances well tend to manage other important aspects of their lives responsibly. The extent to which credit is used varies by state regulation and by company. It is generally used in conjunction with other underwriting criteria. In many states, insurers must file their credit scoring plan with the insurance department. See report on credit scoring for more information.

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