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Insurance Redlining: Fact Not Fiction

—A report prepared by the Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin Advisory Committees to the United States Commission on Civil Rights

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The findings and recommendations contained in this report are those of the Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin Advisory Committees to the United States Commission on Civil Rights and, as such, are not attributable to the Commission. This report has been prepared by the State Advisory Committees for submission to the Commission, and will be considered by the Commission in formulating its recommendations to the President and the Congress.

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LETTER OF TRANSMITTAL

Illinois, Indiana, Michigan, Minnesota,
Ohio, and Wisconsin Advisory Committees
to the U.S. Commission on Civil Rights
February 1979

MEMBERS OF THE COMMISSION
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Murray Saltzman

Louis Nuñez, *Acting Staff Director*

Sirs and Madam:

The Midwestern Region Advisory Committees submit this report on insurance redlining (refusing to insure or varying the terms of insurance because of geographic location) as part of their responsibility to advise the Commission about civil rights problems within the region.

This report examines the structure of the property-casualty insurance industry, the controversies surrounding the issue of insurance redlining, and current practices of insurers within the city of Chicago. In the course of this examination, Committee members and Commission staff interviewed representatives of the insurance industry; local, State, and Federal officials with regulatory responsibility in the area of insurance; and leaders of community groups which have raised the issue of insurance redlining in their respective cities.

Insurance redlining is a national issue and related events in communities throughout the country have been surveyed. Particular attention has been given to proposed solutions that have emerged in various locations both inside and outside the Midwest region. The major findings of this investigation are that property insurance is more difficult to obtain in neighborhoods with a concentration of minority or lower income residents or older homes than in other communities, and that these insurance availability problems contribute to the decline of many older urban communities—with racial minorities again suffering an undue share of the burden. A number of recommendations are offered for actions by the insurance industry and government officials to eliminate this form of disinvestment.

Specifically, the Midwestern Region Advisory Committees find that, although property insurance is essential for individuals to own homes or operate businesses in today's society, it is frequently unavailable at affordable rates for many residents of older urban neighborhoods. Despite industry claims that its underwriting practices are based on loss experience and other objective, empirical data, the Committees find that marketing decisions are frequently made on the basis of subjective and unfairly discriminatory factors. In its examination of underwriting practices within the city of Chicago, the Committees find that communities containing a concentration of minority or low-income residents or older homes face insurance availability problems that cannot be explained by the two major causes of

compensable loss: fire and theft. (These two factors account for almost 75 percent of the dollars paid out in losses by homeowners insurers in Chicago.) Government efforts to solve availability problems, particularly FAIR Plans, have not adequately met the insurance needs of urban residents. In recent years, however, several States have enacted insurance redlining legislation, many Federal agencies have begun examining the issue of insurance redlining, some insurance companies have launched voluntary efforts to increase insurance availability in urban areas, and public policy researchers have developed innovative models for the delivery of insurance services.

A variety of recommendations are offered to resolve insurance availability problems and to eliminate redlining. The Committees advise insurance companies to disclose to the public current marketing practices (i.e., geographic location of policies written, renewed, cancelled, nonrenewed, and in force) and the empirical basis for underwriting decisions; and to work voluntarily with other segments of urban communities (e.g., neighborhood organizations, public officials, banks) to develop strategies for maintaining and revitalizing those areas, thus enhancing their insurability and increasing insurance availability. Recommendations for State legislation are offered along with model amendments to State unfair trade practices acts. The Committees also recommend that the Illinois Department of Insurance and the U.S. Department of Justice investigate to determine which companies are responsible for the discriminatory marketing patterns found and whether such practices violate State and Federal law. Among the recommendations directed to the Federal Insurance Administration is a recommendation to provide support for demonstration projects to explore the feasibility of some of the innovative insurance models which have been proposed. The Committees also advise Congress to amend the Fair Housing Act of 1968 to reach practices of the property-casualty insurance industry.

The findings of this investigation answer many of the controversial questions that have been raised by the insurance redlining debate. With the support of the Commission, the above recommendations can be implemented and, if implemented, would contribute substantially to ending this one critical form of urban disinvestment.

Respectfully,

Theresa F. Cummings, Chairperson
Illinois Advisory Committee

Harriette B. Conn, Chairperson
Indiana Advisory Committee

Jo-Ann W. Terry, Chairperson
Michigan Advisory Committee

Lupe Lopez, Chairperson
Minnesota Advisory Committee

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The United States Commission on Civil Rights, created by the Civil Rights Act of 1957, is an independent, bipartisan agency of the executive branch of the Federal Government. By the terms of the act, as amended, the Commission is charged with the following duties pertaining to discrimination or denials of the equal protection of the laws based on race, color, religion, sex, age, handicap, or national origin, or in the administration of justice: investigation of individual discriminatory denials of the right to vote; study of legal developments with respect to discrimination or denials of the equal protection of the law; appraisal of the laws and policies of the United States with respect to discrimination or denials of equal protection of the law; maintenance of a national clearinghouse for information respecting discrimination or denials of equal protection of the law; and investigation of patterns or practices of fraud or discrimination in the conduct of Federal elections. The Commission is also required to submit reports to the President and the Congress at such times as the Commission, the Congress, or the President shall deem desirable.

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An Advisory Committee to the United States Commission on Civil Rights has been established in each of the 50 States and the District of Columbia pursuant to section 105(c) of the Civil Rights Act of 1957 as amended. The Advisory Committees are made up of responsible persons who serve without compensation. Their functions under their mandate from the Commission are to: advise the Commission of all relevant information concerning their respective States on matters within the jurisdiction of the Commission; advise the Commission on matters of mutual concern in the preparation of reports of the Commission to the President and the Congress; receive reports, suggestions, and recommendations from individuals, public and private organizations, and public officials upon matters pertinent to inquiries conducted by the State Advisory Committee; initiate and forward advice and recommendations to the Commission upon matters in which the Commission shall request the assistance of the State Advisory Committee; and attend, as observers, any open hearing or conference which the Commission may hold within the State.

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This project was carried out under the supervision of Clark G. Roberts, Regional Director.

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Introduction

A Lake Shore Drive area resident in Chicago was informed by his insurance company that his homeowners insurance policy would cost him 140 percent more in 1977 than it did in 1976. The company had made no inspection of the property which the resident had maintained. Another homeowner in an older north side community was informed by his company that after paying premiums for 30 years, his policy would not be renewed even though the only claim he ever filed was for a $25 roof repair in 1958. A 21-year-old Boston area machinist received a $2,800 automobile insurance bill for 1977, up from $1,400 in 1976, although he had experienced no accidents. WBBM–TV (CBS) recently surveyed Chicago area residents and found: three-fourths of the people claim property insurance is too costly; more than half the people said they think auto insurance is unreasonably expensive; one-fifth said they had been cancelled by their insurance company or could not obtain coverage; almost half answered the following true or false questions incorrectly: A "premium" is the money you get if you have an accident. "Deductible" is a discount on the cost of your insurance for not having any accidents; and, 90 percent did not know there is a State office they can go to for help in resolving insurance problems.

An increasing number of people are angry about the way they are being treated by their insurance companies. At the same time, consumers reveal a disturbing lack of knowledge about the insurance industry. What many people do know is that they are facing increasing difficulty in obtaining protection for the largest investments most make: their homes and their automobiles.

The problem of insurance unavailability is not one which randomly affects isolated individuals but rather strikes at residents of older urban communities. Insurance unavailability threatens the viability of entire communities. Mounting concern has been expressed in recent years in all levels of private and public life. Community organizations have protested the practices of insurance companies, petitioned government officials to take action, and in some cases attempted to negotiate directly with the industry. Representatives of the industry have participated in joint efforts with citizens and public officials and have unilaterally initiated various programs in attempts to resolve availability problems. In Chicago, the city council is debating an ordinance that would prohibit the city from purchasing insurance from companies found guilty of redlining under Illinois State law. Several laws have been passed and others are currently being debated in State legislatures across the country. Some call for substantial restructuring of the insurance industry and, not surprisingly, have met sharp criticism from industry representatives.

A variety of Federal agencies and officials have begun examining various aspects of the insurance industry. The Federal Insurance Administration of the U.S. Department of Housing and Urban Development recently completed an analysis of availability problems. In 1977 the U.S. Department of Justice conducted an examination of the pricing and marketing of insurance and offered a series of recommendations for changing the regulatory mechanism under which the industry operates. In 1978 three congressional subcommittees held hearings on the propriety of industry classification and underwriting practices. Congresswoman Elizabeth Holtzman, Senator Edward Brooke, and others have introduced proposals to resolve availability problems. In its July 1977 report the White House Privacy Protection Study Commission offered a series of recommendations to improve the accuracy of information the insurance industry uses in making underwriting decisions and to protect the rights of individuals on whom information is collected and shared. The Federal Trade Commission has begun a study of loss experience and underwriting classifications to determine the extent of unjust discrimination involved in underwriting procedures. The General

Accounting Office is currently reviewing the effectiveness of State insurance commissioners. Clearly, the insurance industry has been and will continue to be the subject of close scrutiny from a variety of perspectives.

This study examines the problem of insurance availability in older urban communities, focusing on the underwriting practices for homeowners property insurance in the city of Chicago. The following three chapters review the structure and function of the insurance industry, the regulatory mechanism that currently governs the industry, and the various perspectives surrounding the "redlining" debate. In chapter 4 a variety of data pertaining to crime, fire, race, age of housing, and other demographic variables are examined to determine which factors explain the variation from neighborhood to neighborhood in insurance underwriting practices in Chicago. Chapter 5 reviews some of the approaches which have been taken or are proposed for resolving availability problems. The final chapter contains the major findings and recommendations of the Midwestern Regional Office.

Many consumers are uninformed about the complexities of the insurance industry. Efforts are being made by the industry and by others to open up communication between the industry and consumers. Such communication and subsequent education no doubt will contribute towards the resolution of some of the problems facing older urban communities. But the problems of insurance unavailability and the decline of urban neighborhoods are not simply public relations matters. As both industry and nonindustry representatives have argued, there is a need for structural changes in the industry itself and for greater cooperation among the industry, public officials, and consumers. Hopefully, this report will contribute towards these ends.

Chapter 1

The Problem: Essentiality but Unavailability of Insurance

Insurance is an essential commodity in today's world. The President's 1968 National Advisory Panel on Insurance in Riot Affected Areas stressed this basic fact when it stated:

> Insurance is essential to revitalize our cities. It is a cornerstone of credit. Without insurance, banks and other financial institutions will not—and cannot—make loans. New housing cannot be constructed, and existing housing cannot be repaired. New businesses cannot expand, or even survive.
>
> Without insurance, buildings are left to deteriorate; services, goods and jobs diminish. Efforts to rebuild our nation's inner cities cannot move forward. Communities without insurance are communities without hope.[1]

The essential nature of insurance, at least homeowners and automobile coverage, is one point on which politicians, the insurance industry, and regulators all agree. Senator Howard M. Metzenbaum (D–Ohio) stated, "Insurance has become a necessity of our daily lives."[2] The president of INA Corporation, Charles K. Cox, referred to insurance as "one of the cornerstones of our society, an essential and irreplaceable service."[3] And the Commissioner of Insurance in Michigan, Thomas C. Jones, wrote:

> In short, for both society and the individual, automobile and homeowners insurance is essential. Society's stability and growth depend upon it and the financial equilibrium and sense of well-being of individual citizens demand it.[4]

The heightened awareness of the importance of property insurance has caused many observers to question whether insurance should continue to be marketed as a consumer good by private industry on a profitmaking basis, or whether government should take steps to guarantee insurance to all members of society without regard to profit or loss. The Federal Insurance Administration, for example, has argued:

> The keystone in the arch of deficiencies. . .within the total property and liability insurance market—is continuation of the absolute right of insurer underwriters to deny essential insurance to applicants without reason or for arbitrary and capricious reasons which are entirely subjective in nature and which may have much more to do with the insurers' competitive moods, modes and postures than with the objectively determined loss-potential characteristics of the risks. So long as the exercise of untrammeled underwriting selection remains the right of insurers, the insurance regulator has little, if any, means of assisting the disadvantaged insurance consumer.[5]

That the insurance industry is aware of these concerns was indicated when Cox posed the question, "Is insurance a product of interstate commerce, as the courts finally ruled, or is it a birthright which

[1] President's National Advisory Panel on Insurance in Riot Affected Areas, *Meeting the Insurance Crisis of Our Cities*, (1968), p. 1 (hereafter cited as *Insurance Crisis*).

[2] Senator Howard M. Metzenbaum (statement at hearings before the Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 17, 1978).

[3] Charles K. Cox, "The Insurance Industry," *Vital Speeches*, Jan. 15, 1975, pp. 208, 211 (hereafter cited as "The Insurance Industry").

[4] Thomas C. Jones, *Essential Insurance in Michigan: An Avoidable Crisis* (Lansing: Insurance Bureau, Michigan Department of Commerce, 1977), p. 4 (hereafter cited as *An Avoidable Crisis*).

[5] Federal Insurance Administration, *Full-Insurance Availability* (1974), p. 29 (hereafter cited as *Full Insurance Availability*).

society owes to all its members whether they can afford it or not?"[6]

While property insurance is generally recognized as essential, recent studies have documented the fact that residents and those in business within the urban centers of major metropolitan areas have been experiencing increasing difficulty in obtaining adequate insurance since the urban unrest of the 1960s. When insurance is available to inner-city residents at all, it frequently provides only limited protection at unfairly discriminatory rates.[7] The withdrawal of insurance companies from inner cities subsequent to the urban upheavals of the 1960s has given rise to the charge that the insurance industry discriminates on the basis of geographical location. Such geographic discrimination is called "redlining."

Insurance unavailability, however, plagued several cities for many years, even before the 1960s.[8] While no precise quantitative data are available on how widespread the availability problem has been, some suggestive data were reported by the National Advisory Panel on Insurance. A study of 3,000 residents and businessmen in the poverty areas of six cities revealed that in 1967 almost 30 percent of the residents and over 40 percent of the businessmen had serious property insurance problems. Six percent of the homeowners and 20 percent of the businessmen did not have basic fire insurance coverage. Among those who were uninsured, over 50 percent of the homeowners and 35 percent of the businessmen said insurance was unavailable. Thirty percent of each group said available insurance cost too much. In addition, 15 percent of the homeowners and 14 percent of the businessmen said they had less insurance than they desired.[9]

State Farm Insurance recently reported that, in the State of Michigan, less than 5 percent of the people have had difficulty obtaining insurance in the normal markets. The company concluded, therefore, that there was no crisis in insurance marketing in Michigan.[10] However, when those who cannot obtain insurance are concentrated in specific sections of the cities, as indicated by the data on poverty areas reported by the National Advisory Panel, entire neighborhoods suffer. Indeed, insurance availability is a serious and growing problem, particularly in the inner cities of this Nation. Racial minorities, because of their concentration in central cities, once again are forced to endure a disproportionate share of the burden.[11]

Availability or Redlining?

Clearly, insurance unavailability is a function of several factors. For example, some risks simply represent such a high loss potential that they are uninsurable. In addition, the industry's capacity to write new insurance policies is affected by surplus requirements (assets over and above loss reserves) which, in turn, are affected by the general health of the economy since a substantial portion of the industry's profits are derived from investments. Another factor contributing to insurance unavailability, and the one on which this study focuses, is redlining.

For the purpose of this study, insurance redlining is defined as cancelling, refusing to insure or to renew, or varying the terms under which insurance is available to individuals because of the geographic location of a risk. "Varying the terms" includes but is not limited to differentials in the price, type of coverages, application procedures, inspections, and rules governing payments.

Among the redlining practices which have been documented are the following:

1. Placing agents selectively in order to reduce the opportunity to secure business in certain areas;
2. Terminating "unprofitable" agents and nonrenewing terminated agents' books of business;
3. Requiring insurance to replacement cost value and refusing to insure dwellings with a substantial disparity between replacement cost and market value (if such property were insured it would

[6] "The Insurance Industry," p. 210.

[7] Washington State Commission on the Causes and Prevention of Civil Disorders, *Race and Violence in Washington State* (1969). Carl Levin, *Homeowners' Insurance in Detroit: A Study of Redlining Practices and Discriminatory Rates* (1976) (hereafter cited as *Homeowners' Insurance in Detroit*). Alice Paul and Ken Baker, *Economic Investment and the Future of Neighborhoods* (New York: New York City Commission on Human Rights, 1977) (hereafter cited as *Economic Investment*). Sheilah Thorn, *Property Insurance Availability in New Haven: Preliminary Findings* (1978). Robert Abrams, *The Insurance Industry: It Redlines Too* (1978). *Insurance Crisis in Urban America*, a report prepared by the office of the Federal Insurance Administrator, U.S. Department of Housing and Urban Development (May 1978) (hereafter cited as *Insurance in Urban America*).

[8] Report of the National Advisory Commission on Civil Disorders (1968), p. 198–99. *Insurance Crisis*, p. 1. *Report of the Chicago Riot Study Committee to the Hon. Richard J. Daley* (Aug. 1, 1968), p. 79.

[9] *Insurance Crisis*, as cited in Gelvin Stevenson, *Fire Insurance: Its Nature and Dynamics* (Fire Research Group, School of Architecture and Planning, Princeton University, 1977), p. 36 (hereafter cited as *Fire Insurance*).

[10] State Farm Insurance Companies, *A Report to the People: A Response to the Insurance Bureau's Proposal to Disrupt the Regular Insurance Market in Michigan* (Nov. 28, 1978), p. 4.

[11] John F. Kain and John M. Quigley, *Housing Markets and Racial Discrimination: A Microeconomic Analysis* (New York: National Bureau of Economic Research and Harvard University, 1975) (hereafter cited as *Housing Markets*).

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[14] Karen Kollias, n

create what is referred to as a "moral hazard" since the insured would presumably have an incentive to burn his or her own house down or commit "arson for profit");

4. Refusing, limiting, or varying insurance availability solely because of age of structure;

5. Refusing, limiting, or varying insurance availability due to subjective evaluations by agents or by inspectors that certain areas are "deteriorating" or "changing";

6. Refusing, limiting, or varying insurance availability due to subjective perceptions of "adverse factors" such as the race or sex of an applicant or the racial composition of the geographic area in which the risk is located;

7. Requiring inspections in certain locations within a State but not within other locations;

8. Applying territorial classifications in certain locations of a State but not in others;

9. Pricing insurance at such high levels that for all practical purposes it is unavailable;

10. Informally instructing or formally requiring agents to avoid certain areas;

11. Varying underwriting practices solely by ZIP code;

12. Refusing to accept an application because it was previously rejected by another company or because the risk was previously insured under a FAIR Plan.[12]

The use of geographic classifications by insurers is not new. When the President's National Advisory Panel investigated the insurance industry in the late 1960s, it found geographic location to be a crucial factor in underwriting decisions. One insurer's manual reviewed by the panel contained the following advice on how to collect and catalogue information on neighborhoods:

> This knowledge can be gathered by drives through the areas, by talking to and visiting agents, and by following local newspapers as to incidents of crimes and fires. A good way to keep information available and up to date is by the use of a red line around the questionable areas on territorial maps centrally located in the Underwriting Division for ease of reference by all Underwriting personnel.[13]

Redlining practices have been documented in the following cities: St. Louis, Kansas City (Missouri), Philadelphia, Providence, Boston, Dorchester (Massachusetts), Chicago, Detroit, New York, Buffalo, Syracuse, Hartford, Milwaukee, and Seattle.[14] Consumers from various regions of the country have testified before local, State, and Federal authorities that they were victims of redlining,[15] insurance regulators acknowledge that redlining occurs,[16] and representatives of the industry admit redlining is practiced.[17] The underwriting manager of one of Michigan's leading homeowners insurers recently stated, "Anyone who thinks this industry isn't redlining has his head in the sand."[18]

Below are some examples of specific practices that have resulted in a reduction of insurance availability, or restrictions on the terms under which insurance is available, in certain geographic areas. Some of these practices may arguably be based on loss experience but some clearly constitute redlining. What follows is a sampling of the practices which have been uncovered in some of the available studies.

Barbara Pertz, a resident of the Buckeye-Woodland community in Cleveland, Ohio, asked an insurance agent why companies were refusing to

[12] Anton R. Valukas, *An Investigation of Discrimination in the Sale of Homeowners Insurance in Illinois* (Illinois Department of Insurance, 1977), pp. 4–5 (hereafter cited as *Homeowners Insurance in Illinois*). *Homeowners' Insurance in Detroit*, pp. 1, 9–11, 17. *An Avoidable Crisis*, p. 6. Karen Kollias, U.S. Department of Housing and Urban Development, memorandum to Insurance Redlining Sub-Group, Oct. 4, 1977, pp. 4–5. Kollias, memorandum to Insurance Redlining Sub-Group, Jan. 27, 1978, p. 2. Richard D. Rogers and Kim Brunner, *Redlining: The Illinois Experience* (Illinois Department of Insurance, 1977), pp. 4–5. Bernard Malewski and Mollie Lamp, *Where Do You Draw The Line?* (New York Public Interest Research Group, 1978). Public Technology, Inc., "Presentation to the D–2 Subcommittee Task Force on Redlining," Oct. 11, 1977. *Selective Placement of Homeowner's Insurance Agents in Chicago—1967–1978* (The Lake View Citizens' Council, 1978). *Insurance in Urban America*, pp. 43–44. Gerald M. Keenan, *Insurance Redlining: Profits vs. Policyholders* (Chicago: National Training and Information Center, 1978). John Bushemi, Indiana State Senator, "Impact of the Dual Housing Market on Taxes and Insurance," *Proceedings of Northwest Indiana Open Housing Conference*, Sept. 30, 1977–Oct. 7, 1977, pp. 37–39.

[13] *An Avoidable Crisis*, p. 6.

[14] Karen Kollias, memorandum to Insurance Redlining Sub-Group, Sept. 30, 1977, p. 2. "Senate Committee Told of Redlining Abuses," *St. Louis Globe-Democrat*, Feb. 15, 1977. *Homeowners' Insurance in Detroit*. *Homeowners Insurance in Illinois*. *Report of Examination: Assignments to the Motor Vehicle Insurance Facility* (Boston: Division of Insurance, The Commonwealth of Massachusetts, 1977), pp. 4–5 (see references in footnote 12).

[15] *An Avoidable Crisis*, p. 6. *Economic Investment*, p. 52. Minutes, House Insurance Subcommittee on Insurance Availability, State of Washington, Aug. 31, 1977. Bill Soldwisch, testimony presented before the finance committee, city council of Chicago, Jan. 12, 1978. Grace Evans (St. Louis), Barbara Pertz (Cleveland), Joseph Ciampa (Boston), James McBride (Chicago), testimonies presented before U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 17, 1978.

[16] James M. Stone, Massachusetts Insurance Commissioner, testimony presented before U.S. Senate Subcommittee on Citizens and Shareholders Rights, Jan. 17, 1978. "NAIC Statement of Principles and Objectives on Insurance Redlining" (adopted in Miami at the December 1977 meeting of the National Association of Insurance Commissioners).

[17] Arthur Wang, research analyst, memorandum to members, House Committee on Insurance, State of Washington, Aug. 10, 1977.

[18] *An Avoidable Crisis*, p. 6.

write new policies, were nonrenewing old policies, and were raising the rates at an alarming rate in her community. The answer was "It's the neighborhood you live in."[19] A New York real estate broker was unable to obtain a renewal on an insurance policy for a building he intended to rehabilitate. When he asked why, the insurance agent responded, "Quite frankly, we are getting out of Washington Heights."[20] Insurance company files that were examined in the process of conducting the Detroit and Chicago studies cited above included dozens of nonrenewal notices and intraoffice memos which indicated geographic area as the reason for the adverse decision. The following response from Fireman's Fund to an applicant is all too common: "Thank you for the submission. However, at this time coverage is declined due to area."[21]

Several agents in Baltimore, Maryland, whose agency contracts had been terminated by the American Mutual Insurance Company, filed a complaint with the insurance commissioner claiming that their termination constituted a violation of Maryland laws. The agents claimed the company had given them a map of Baltimore with certain ZIP codes outlined in red where more stringent underwriting standards were to be applied to automobile and homeowners insurance than in other ZIP codes. For example, no risks within the outlined areas could be bound by the agent. Other restrictions were also placed on risks in some areas of the city that were not applied in others. One agent claimed the company instructed him to "get out of the city."

Following an evidentiary hearing, the insurance commissioner ruled that the company had in fact established stricter underwriting standards for certain Baltimore neighborhoods than it applied elsewhere in the State, that the company had effectively denied residents of these areas insurance products because of geographic location, and therefore, that the company had violated three sections of article 48A of the Annotated Code of Maryland.

First, the commissioner found the company had violated section 61A which states:

> No insurer shall decline to issue or renew contracts of motor vehicle, property or casualty insurance solely on account of the geographic area within this State wherein is located the subject of the risk or the applicant's or insured's address, unless such insurer not less than sixty (60) days previously shall have filed with the Commissioner a written statement designating such geographic area, which statement shall be an open filing with the Commissioner as a matter of public record; provided, that the designated geographic area shall have an objective basis and shall not be arbitrary or unreasonable.

The commissioner also found that the company had violated section 234A(b):

> No insurer shall require the existence of special conditions, facts, or situations as a condition to its acceptance or renewal of, a particular insurance risk or class of risks in an arbitrary, capricious, unfair, or discriminatory manner based in whole or part upon the race, creed, color, sex, religion, national origin, or place of residency. Actuarial justification may be considered with respect to sex.

In addition, the commissioner found the company had violated section 234B(d) which states:

> Notwithstanding any other provision of this section, no insurer may cancel or amend a written agreement with an agent, or broker, or refuse to accept business from such agent or broker if the cancellation or amendment is arbitrary, capricious, unfair, discriminatory, or based in whole or in part upon the race, creed, color, religion, national origin, place of residency of the agent or broker, his applicants or policyholders.

The commissioner proceeded to fine the company $150,000 for these violations.[22] The decision has been appealed and oral argument before the Baltimore City Court was scheduled for December 18, 1978.[23]

According to two former employees of Home Federal Savings and Loan in Chicago, the W.W. Vincent & Co. insurance agency provided Home Federal with a list of "acceptable" and "unacceptable" ZIP codes where that agency would and where it would not write insurance. One of the former employees stated that the agency refused to write 95

[19] Pertz testimony, p. 2.
[20] *Economic Investment*, p. 53.
[21] *Homeowners Insurance in Illinois*, p. 35.
[22] In re American Mutual Insurance Co. of Boston and American Mutual Liability Insurance Co., order of the Maryland Insurance Commissioner (July 27, 1978).
[23] Richard Brooks, assistant attorney general, insurance division, State of Maryland, telephone interview, Oct. 12, 1978.

percent of the applications for insurance on properties in the "unacceptable" ZIP codes.[24]

While some industry spokesmen are quite frank about their use of geographic location, others deny the practice, even though they utilize it. A representative of Travelers denied that the company refused to write on a ZIP code basis or imposed restrictions on that basis. Yet an unsigned interoffice memorandum written to one of the Travelers agents listed five Detroit area ZIP codes in which homeowners policies should include a $250 deductible.[25]

Age of structure is another factor which is used, often arbitrarily, as a reason for rejection. The following rejection notice from Fireman's bluntly states: "The application indicates the dwelling was built in 1935 and as we do not accept any submissions for dwellings built prior to 1940, I cannot issue a policy.[26]

Frequently, insurance companies acknowledge that individual buildings are structurally sound, but cannot be insured simply because of the neighborhood in which they are located. A letter from Lumbermens Mutual Insurance Company to one of its agents illustrates the point:

> We are in receipt of information which indicates that this is an older dwelling in very favorable condition. However, our information indicates the location of the risk itself is in a deteriorating area, and therefore, unacceptable to us.[27]

In other words, individuals who maintain their property are unable to obtain insurance for reasons that are beyond their ability to control.

Sometimes a company refuses an application following its determination that an area is deteriorating, and refuses applications as a result even though the company's own agent may have a totally different evaluation. After United States Fidelity & Guaranty Company (USF&G) rejected an application because of "deteriorating neighborhood," the agent wrote the company back stating:

> I drove to the site this morning. I found this house, along with the other houses on either side of the street showing signs of good maintenance and good housekeeping. I discovered no signs of trash on the streets particularly found in fair planned business areas. As a past fire underwriter and field man serving the companies for some 30 years, I think I was in a position to objectively judge this particular risk from all other aspects. In no stretch of the imagination would I place this risk in either a deteriorating neighborhood or in an area eligible for fair plan treatment.[28]

That arbitrary underwriting decisions (i.e., decisions not based on objective, statistically valid criteria), such as rejecting a policy because it had been rejected by another company, are often made is indicated by the following statement included in an Allstate underwriting account:

> $30,000 HO in DPZ. Aetna—nonrenewing pol—because of location. We will not write business in DPZ which has been non-renewed by another company.[29]

Aetna has a similar policy. The general manager of the Chicago branch office and vice president of the Aetna Casualty & Surety Company of Illinois acknowledged that underwriters are instructed to decline a risk which has been nonrenewed by another company due to termination of an agent. When asked if the company would automatically decline every individual piece of business from an agent who had been terminated, the branch manager responded, "Yes. The individual underwriter would decline until he had been told otherwise by the personal accounts manager."[30]

James R. Faulstich, vice president-industry relations, and C. Robert Hall, vice president, National Association of Independent Insurers, recently testified that:

> the insurance industry refrain[s] from moral pronouncements about its customers. We measure risk as accurately as we can, applying experience and objective criteria refined for more than two centuries. We leave it to others to speak of discrimination and other such moral terms.[31]

Yet when one reads the following statements from underwriting manuals, it becomes clear that the industry has not always been as objective or morally neutral as the above statement implies. A recent

[24] "Insurance Firm Accused of Redlining by Zip Codes," *Chicago Tribune*, Oct. 6, 1978.
[25] *Homeowners' Insurance in Detroit*, p. 21.
[26] *Homeowners Insurance in Illinois*, p. 33.
[27] *Homeowners' Insurance in Detroit*, appendix 12.
[28] *Homeowners Insurance in Illinois*, p. 53.
[29] Ibid., p. 65.
[30] Ibid., p. 105.
[31] James R. Faulstich and C. Robert Hall, "Statement Before the Subcommittee on Citizens and Shareholders Rights and Remedies," Jan. 18, 1978.

Continental Insurance Homeowners Underwriting manual asserted, for example:

> There is also the type who has never lived anywhere but in a rural area. He commutes to an industrial plant, does odd jobs, lives on relief or lets his wife make the living. You can usually spot his place. Sometimes in the summer he can be seen sitting on his front porch without his shirt. He is not a good risk.

According to American States Underwriting Rules, "physically or morally objectionable neighborhoods should not be written." A Citizens Insurance Underwriting Manual states, "divorced persons may feel the effect of strained finances and consequent failure to maintain property. Occasionally the new-found freedom from family responsibility produces a change in life-style which may be productive of poor experience." And, according to Reliance Insurance Underwriting Guidelines, "persons who are not married should be closely underwritten."[32]

Former Detroit City Council President Carl Levin stated, "it is becoming increasingly difficult to purchase homeowners insurance in the private market in Detroit."[33] Unfortunately, Detroit is not unique. Geographic area, age of structure, previous underwriters' decisions, and other criteria are frequently used in an arbitrary manner. This does not mean that such factors should never be employed in developing classifications of risk. However, this cannot justify the arbitrary practices that do occur. The increasing difficulty in obtaining adequate property insurance, caused at least in part by redlining, portends serious consequences for the future of American cities.

Insurance Redlining and Urban Disinvestment

Insurance redlining constitutes one form of urban disinvestment (the practice of withdrawing financial resources from a community) which has contributed towards the decline of many central city neighborhoods, often for the benefit of suburban neighborhoods.[34] Once an area starts to deteriorate, or is perceived as deteriorating, a self-fulfilling prophecy occurs. A healthy community begins to deteriorate and one which may have had only marginal problems soon finds it has major ones. Whether the initial withdrawal or limitation of insurance is based on "sound business practices" or amounts to blatant arbitrary discrimination and redlining matters little after a trend is established. As the Federal Insurance Administration (FIA) stated:

> With the flight of insurance to suburbia in pursuit of the better risks which had first fled there, the deterioration of the inner city fed upon itself. As insurance became increasingly difficult to obtain or became more difficult to afford through the high-risk or surplus lines market where, alone, coverage, such as it was, could be found, vacated properties remained vacant since willing buyers could not obtain loans for want of insurance to secure such loans; properties urgently in need of repair or restoration declined further as credit for such purposes could not be obtained in the absence of insurance availability.[35]

More recently FIA concluded:

> Without question, insurance availability and insurance affordability in urban areas are crises of monstrous proportions. The tentacles of these crises reach into diverse areas of mortgage financing and property appraisals thereby denying credit and sealing the doom of today's vital urban neighborhoods.[36]

The insurance industry, of course, is not solely responsible for the development of urban ghettos within metropolitan areas throughout the United States. The decline of municipal services including education, the movement of upper- and middle-income families from cities to suburbs, increasing crimes rates, and many other factors are also both causes and effects of urban decline. But the increasing difficulty in obtaining insurance through the voluntary market in certain areas and the overt redlining which does occur do serve as catalysts for neighborhood deterioration. At least some representatives of the industry agree on this point. Leo J. Jordan, associate general counsel for State Farm Insurance Companies, recently stated:

> . . .(1) there is an urban insurance availability problem which is contributing to and aggravating the overall urban problem; and (2) regar-

[32] Carl Levin, testimony before U.S. Senate Subcommittee on Citizens and Shareholders Rights, Jan. 18, 1978, p. 8-9.

[33] *Homeowners' Insurance in Detroit*, p. 9.

[34] *Fire Insurance*, p. 2. David C. Spencer, Redlining Report, Cincinnati Human Relations Commission, 1976, Appendix F-4. Erma Henderson, chairwoman, Statewide (Michigan) Coalition on Redlining, "A Summary of Recommendations on Redlining, Disinvestment, Reinvestment" (undated).

[35] *Full Insurance Availability*, p. 24.

[36] *Insurance in Urban America*, p. 44.

. . . dless of whether out of social or moral obligation or enlightened self-interest, insurers must develop an efficient response.[37]

And individual victims can do nothing to reverse the trend. As Michigan Insurance Commissioner Thomas C. Jones pointed out:

> No amount of home repair or improvement will make the resident of a redlined neighborhood eligible for homeowners insurance. Even in the absence of clear-cut redlining, consumers have encountered additional underwriting barriers which have the effect of excluding an increasing proportion of urban residents. In addition, these same difficult barriers are imposed upon consumers who seek renewal of existing policies. Whether subtle or explicit, redlining not only exposes individuals to financial ruin, it also inflicts severe damage upon the entire neighborhood or city involved.[38]

The involvement of major insurance institutions regarding the phenomenon of neighborhood deterioration is a six-step process in which many residents suffer and major financial institutions profit.

The first stage is defined as that of a healthy community. The housing stock is in excellent condition, property values are stable or rising, there is a strong demand for housing, and conventional mortgages and home improvement loans are readily available. Homeowners property insurance is also available through the voluntary market.

During the second stage lending institutions and insuring companies perceive some risk in the neighborhood and indicate a preference for investing in newer suburban communities. Although mortgage loans are still granted, stricter terms are required such as higher downpayments or interest rates.

In the third stage, explicit disinvestment becomes more widespread. Insurance and lending institutions act more aggressively to channel money to other areas or refuse to invest in the neighborhood. Home improvement loans become more difficult to obtain, needed repairs and improvements are not made, and property begins to deteriorate. Potential buyers are steered to other communities and some businesses and residents begin to relocate.

The fourth stage is characterized by a preponderance of FHA-insured mortgages and FAIR Plan insurance policies (see chapter 3 for description of FAIR Plans). Since FHA mortgages are guaranteed, investors hold virtually no risk. With substantial "up-front" profits made through service charges, commissions, and other fees, early foreclosure can be a lucrative source of income for real estate and financial interests as property is turned over several times in a relatively short period. Homeowners are left with deteriorated housing at inflated prices, and they are unable to finance both mortgages and home improvement loans (if any are available). As borrowers default on loans, more and more property is abandoned.

In the fifth stage the growing number of FHA mortgages and absentee landlords further reduces the incentive to maintain property. Unable to refinance and improve property, landlords resort to overcrowding and higher rents to maximize short-term profits. As maintenance declines, deterioration increases. Business and property owners leave what has become a "blighted" area. City services decline, building code enforcement becomes virtually nonexistent, real estate taxes are unpaid, and crime accelerates. And no conventional insurance policies are available.

The sixth stage, urban renewal, results in a tearing down of blighted areas and the relocation of remaining residents. The same financial institutions that denied financing to what was previously a redlined neighborhood now profit from the financing of housing projects for higher income families and new commercial ventures.[39]

Disinvestment and Racial Minorities

Owing to their concentration within the urban centers of major metropolitan areas, racial minorities suffer a disproportionate share of the disinvestment burden.[40] In recent years that concentration has increased. Between 1960 and 1970 the number of black Americans living in central cities increased by 33.2 percent compared to just 0.1 percent for whites. Central cities were 16.4 percent black in 1960

[37] Leo J. Jordan (speech delivered to American Insurance Association, New York, May 23, 1978), p. 6.
[38] *An Avoidable Crisis*, pp. 5, 6.
[39] Frances E. Werner, William F. Frej, and David M. Madway, "Redlining and Disinvestment Causes, Consequences, and Proposed Remedies," *Clearinghouse Review*, October 1976, pp. 502, 503. Deborah Washington, *Existing Housing and Neighborhoods: Conservation or Decline?* Northeastern Illinois Planning Commission (Preliminary Draft, 1976), pp. 7–10.
[40] *Housing Markets.*

compared to 20.5 percent in 1970 and 22.3 percent in 1974.[41] Therefore, even assuming a total absence of intentional racial discrimination, the location of the minority population alone indicates that urban disinvestment has had a discriminatory effect.

But intentional discrimination has long permeated the real estate industry. Until 1950, for example, the official Code of Ethics of the National Association of Real Estate Boards included the following statement:

> A realtor should never be instrumental in introducing into a neighborhood a character of property or occupancy, members of any race, nationality or any individuals whose presence will clearly be detrimental to property values in that neighborhood.[42]

This position was taken subsequent to the adoption by the Chicago Real Estate Board of a committee report recommending residential segregation, reading in part:

> The Committee recognizes that a great immigration of negroes have [sic] arrived and are arriving in Chicago, and that some feasible, practicable and humane method must be devised to house and school them. . . .
>
> The Committee is dealing with a financial business proposition and not with racial prejudice, and asks the cooperation of the influential colored citizens. Inasmuch as more territory must be provided, it is desired in the interest of all, that each block shall be filled solidly and that further expansion shall be confined to continuous blocks, and that the present method of obtaining a single building in scattered blocks, be discontinued. . . .
>
> In the face of existing conditions the Committee has in an unprejudiced spirit reached the above conclusions, and hope [sic] for active cooperation from all civic bodies, and the Committee further desires to meet a representative Committee of colored citizens for the purpose of solving the problem.[43]

The private sector was not alone in the conduct of such overt discriminatory policies. In the 1940s the Federal Housing Authority's (FHA) underwriting manual warned of the infiltration of "inharmonious racial groups" and stated, "If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same racial classes."[44]

While such overt official sanction for racial discrimination may no longer exist, prevailing insurance redlining and urban disinvestment practices still have the effect, if not the intent, of racial discrimination. What the U.S. Department of Justice said regarding automobile insurance holds equally for homeowner insurance:

> racial discrimination is most often encountered as a product of a more subtle classification, that of geographic location. Frequently major American cities are divided into a number of territories, with the inner city, an area most often populated by minorities, classified as a high risk area and thus subject to significantly higher rates. Although the insurer is using the facially neutral geographic classification, the effect is that minorities citizens [sic] (and most often those with the lowest incomes) are paying a great deal more for auto insurance than white citizens.[45]

The major financial industries (banking and insurance) exercise a powerful influence on cities in particular and American society in general. That influence reaches beyond the immediate business concerns of the industries themselves, frequently to the detriment of urban communities. As Ron Shiffman, director of the Pratt Center for Community and Environmental Development in New York City, stated:

> banks have determined that some areas shall succeed and others shall not. Banks have determined that racial change portends decline, that integration cannot succeed, that women heads-of-households are risks, that certain geographic areas of the city are undesirable. They have set in motion and reinforced by their actions a self-fulfilling prophecy which, because of the withdrawal of mortgage money, actually causes decline.[46]

[41] U.S., Bureau of the Census, Current Population Reports, Special Studies, Series P–23, No. 54, *The Social and Economic Status of the Black Population in the United States*, pp. 14, 15.
[42] *Economic Investment*, p. 34.
[43] *The Chicago Real Estate Board Bulletin*, vol. XXV, no. 4 (April 1977) cited in Rose Helper, "The Racial Practices of Real Estate Institutions in Selected Areas of Chicago"(doctoral dissertation, University of Chicago, 1958), pp. 587–88.
[44] U.S., Commission on Civil Rights, *Understanding Fair Housing* (February 1973), p. 5.
[45] U.S., Department of Justice, *The Pricing and Marketing of Insurance* (January 1977), pp. 352, 353.
[46] *Economic Investment*, p. 44.

Similarly, the insurance industry has been described by the U.S. Department of Housing and Urban Development as:

> a quasi-public good which is essential in today's urban environment; and yet with a few exceptions, it is in total control of an industry whose goals may differ substantially from those of central city officials and residents and whose actions may negatively impact on central cities.[47]

Automobile and homeowners property insurance is generally recognized as essential in today's world. At the same time such protection is increasingly more difficult to obtain within many urban communities. Problems of insurance availability and insurance redlining contribute towards urban disinvestment, thus furthering the deterioration of central city neighborhoods. While local residents and businesses frequently suffer, the financial industry often profits. But the insurance industry is by no means a totally unregulated industry. The following chapters explore the structure of the insurance industry, the regulatory mechanism which it operates under, and the legal tools that currently exist for dealing with insurance redlining and discrimination.

[47] U.S., Department of Housing and Urban Development, Community and Economic Development Task Force, *Impact of Insurance Program Policies on Central Cities*, Information Bulletin (Draft), September 1977, p. 4.

Chapter 2

The Insurance Industry: Its Function and Structure

What Is Insurance?

Insurance is a social mechanism through which people obtain financial security, peace of mind, and freedom. Technically, insurance is a contract governed by general principles of contract law in which one party (the insurer) promises to compensate another party (the insured) for specific losses in return for a certain payment. Michigan Insurance Commissioner Thomas C. Jones defined insurance in the following terms:

> Insurance is a device through which individuals and businesses join together to protect themselves against potential serious losses. By paying a comparatively small amount regularly, an individual can avoid the cost of occasional catastrophes. In effect, an insurance company administers a large pool of money, into which many people pay and from which each person is entitled to draw when he or she has been damaged. Insurance enables people to plan their economic lives. People know that by periodically paying a predictable amount, they will not be subjected to unpredictable demands on their funds. This kind of planning capability and protection is in society's best interest as well as the best interest of individuals.[1]

State Farm Insurance acknowledged that, "This is a reasonably succinct statement of one of those truths which we would hold to be self evident, that insurance is the pooling of the risk of loss."[2]

The concept of property insurance has been traced as far back as 3000 B.C. In Babylon merchants and shipowners were charged interest on loans for which the sailing vessel was pledged as security. The interest on the loan covered the "insurance risk." If the ship did not reach its destination, the debt would be cancelled.[3] Chinese shipowners in the fourth century B.C. recognized the value of risk spreading when they divided their cargo among several ships so that if one were lost, only a partial loss would be suffered.[4] More than 600 years ago one English guild rule stated, "If the house of any brother or sister is burnt by mishap, every brother and sister shall give a half-penny towards a new house."[5]

The first fire insurance company in the United States was started in Charleston, South Carolina, in 1932 but operated only until 1741. A most successful company, The Philadelphia Contributorship for the Insurance of Houses from Losses by Fire, was started in 1752 by several businessmen including Benjamin Franklin.[6] Since that time the industry has grown to the point where in 1976 over $5 billion in premiums for homeowners insurance were generated.[7]

When an insurer issues a policy to an insured, the insurer is making an agreement to indemnify the insured for subsequent specific actual losses which may occur in return for a present ascertained premium or fee. To indemnify means to provide compensation for an actual loss. The insurance mechanism is designed to protect the insured only

[1] Thomas C. Jones, *Essential Insurance in Michigan: An Avoidable Crisis* (Lansing: Insurance Bureau, Michigan Department of Commerce, 1977), p. 3 (hereafter cited as *An Avoidable Crisis).*

[2] State Farm Insurance Companies, *A Report to the People: A Response to the Insurance Bureau's Proposal to Disrupt the Regular Insurance Market in Michigan* (1977), p. 19 (hereafter cited as *A Report to the People).*

[3] *Municipal Fire Insurance: An Alternative to Private Fire Indemnity at Public Expense in Fire Prevention and Suppression* (Berkeley: Institute for Local Self Government, 1977), p. 4 (hereafter cited as *Municipal Fire Insurance).*

[4] "What the Insurance Dollar Buys For You," *Journal of American Insurance*, Spring 1977, p. 7.

[5] Gelvin Stevenson, *Fire Insurance: Its Nature and Dynamics* (Fire Research Group, School of Architecture and Planning, Princeton University), 1977, p. 59 (hereafter cited as *Fire Insurance).*

[6] *Municipal Fire Insurance*, p. 7.

[7] *NAIC Report on Profitability By Line and By State For The Year 1976* (Milwaukee: National Association of Insurance Commissioners, 1977) (hereafter cited as *Profitability Results).*

against an actual personal loss. Therefore, to obtain insurance the insured must have an insurable interest in the property at risk.

Property insurance premiums are based on the amount of insurance purchased which, in turn, is generally determined by the replacement value of the home. Few homes, however, are totally destroyed by fire or other insurable perils. Most losses are partial. A kitchen may be seriously damaged by a fire or a wall may collapse destroying one or two rooms. The amount of damage resulting from a partial loss is the same no matter how much insurance has been purchased by the homeowner. Therefore, in order to generate adequate premium dollars to enable insurers to fully indemnify insureds for partial and total losses, insurers generally require homeowners to purchase insurance at least to 80 percent of replacement value. In those instances where a home is underinsured (insured to less than 80 percent of replacement value) the homeowner is generally not fully indemnified (on a complete replacement cost basis) for partial losses. However, compensation for partial losses in such cases is not reduced proportionate to the reduction in premium dollars received by an insurer on underinsured property. To protect itself from excess liability for partial losses, it is a general industry practice to require homeowners to purchase property insurance to 80 percent of replacement value.

Overinsuring property also creates potential problems. Traditionally, such overinsurance has been assumed to represent a "moral hazard." A "moral hazard" is any condition that increases the likelihood that the insured will cause a compensable loss. When the replacement value is substantially greater than the current market value, which is frequently the case in older urban communities, it is sometimes assumed that the insured will deliberately destroy his property for profit. If the building is insured for its replacement value, it is assumed the owner has less incentive for maintaining the property, or may even be motivated to burn the building down ("arson for profit") since the insurance payment would be greater than the price the owner could obtain by selling the property. In such situations, insurance is frequently unavailable through the conventional market.[8]

The insurance industry has been accused of contributing to the "arson for profit" problem by being too lax in its underwriting. Various State and Federal authorities have recommended that insurance companies obtain more complete information about property and applicants prior to issuing policies, that companies develop more cooperative working relations with arson investigators and other public officials, that companies not pay claims in cases of suspected arson until the investigation has been completed, and that companies in general be more selective in their underwriting activities.[9]

There are six basic types of homeowners policies (numbered HO-1 through HO-6) and one basic fire insurance policy available in the conventional market. Table 2.1 indicates the specific coverage available under these policies.

Rating Classifications—How Risks Are Spread

While the spread of risk is a central concept in insurance, this does not mean that all individuals who purchase a given type of insurance will pay the same premium or receive the exact same coverage. Rather, each policyholder is expected to pay a premium commensurate with the level of risk exposure he or she represents. The particular premium charged to an individual, if the insurance mechanism is functioning properly, is based on an objective evaluation of his or her risk exposure.[10] The term underwriting refers to the decisionmaking procedure used by the industry to determine whether an individual is eligible for a certain type of insurance policy and, if so, the conditions under which it will be made available.

It is virtually impossible, however, to predict what losses will occur, how large those losses will be, and who will suffer them. To some extent losses are simply random occurrences. Some predictability can be achieved if groups of people, rather than just individuals, are evaluated in terms of loss history. In its attempt to charge premiums that are related to risk exposure, the industry groups large numbers of similar risks within groups or classifications and utilizes the group characteristics in determining the coverage and the price that will be offered to

[8] *Fire Insurance*, pp. 7–21; Dempsey J. Travis, "Assure Your Insurables," *Dollars & Sense*, 4th Quarter, 1977, p. 37.

[9] Illinois Legislative Investigating Commission, *Arsons* (May 1978). General Accounting Office, *Arson for Profit: More Could Be Done To Reduce It* (May 1978). U.S., Department of Justice, Law Enforcement Assistance Administration, *Arson and Arson Investigation* (June 1978).

[10] "How Your Insurance Premium is Determined," *Journal of American Insurance*, Fall 1976, pp. 10–14. James R. Faulstich and C. Robert Hall, "Statement Before the Subcommittee on Citizens and Shareholders' Rights and Remedies," Jan. 18, 1978, p. 3.

Table 2.1
Insurance Policy

HO–5	HO–3	HO–4 & HO–6	HO–2	HO–1	Fire	Perils
contents & building	contents (1–18) building—	contents only (1–18)	contents & building (1–18)	contents & building (1–11)	contents & building (1–8)	1. fire or lightning 2. loss of property removed from premises endangered by fire or other perils
all perils except: flood earthquake war nuclear attack others specified in individual policies	all perils except: flood earthquake war nuclear attack others specified in individual policies	(HO–4: renters) (HO–6: condominium owners)				3. windstorm or hail 4. explosion 5. riot or civil commotion 6. aircraft 7. vehicles 8. smoke 9. vandalism and malicious mischief 10. theft 11. breakage of glass constituting a part of the building 12. falling objects 13. weight of ice, snow, sleet 14. collapse of building(s) or any part thereof 15. sudden and accidental tearing asunder, cracking, burning, or bulging of a steam or hot water heating system or of appliances for heating water 16. accidental discharge, leakage or overflow of water or steam from within a plumbing, heating or air-conditioning system or domestic appliance 17. freezing of plumbing, heating and air-conditioning systems and domestic appliances 18. sudden and accidental injury from artificially generated currents to electrical appliances, devices, fixtures and wiring (TV and radio tubes not included)

With some minor exceptions in selected States, this chart describes the coverages available in these policies throughout the United States.

Sources: Gelvin Stevenson, *Fire Insurance: Its Nature and Dynamics* (Fire Research Group, School of Architecture and Planning, Princeton University, 1977); Robert W. Gossrow, Property and Casualty Actuary, Illinois Department of Insurance, telephone interview, July 18, 1978.

individuals. One consequence of this approach is that the availability of insurance and the conditions under which it is available for an individual is determined in part by factors over which he or she has direct control and by others over which he or she may have little control. For example, while an individual's personal driving record can affect insurance premiums, the average loss experience for individuals of the same sex and age group in most States also has an effect. Or an individual may properly maintain his or her house, and such care can reduce insurance costs. But if the home happens to stand on a flood plain, flood insurance may be difficult to obtain. Risk exposures that are beyond the control of an individual are referred to as environmental hazards. For underwriting purposes, the insurance industry is primarily concerned with determining risk exposure and loss potential and not with the particular reason for that exposure or who is responsible. As a Stanford Research Institute study stated, "The purpose of classification systems is to assess risk; that is, to estimate the uncertain costs to an insurer arising from an insurance policy."[11]

In developing classification systems, the industry attempts to pool risks having similar characteristics in such a way that the pool is large enough to be credible, yet small enough to be homogeneous.[12] The objective is to separate out or discriminate among various types of risks so that each risk pays his or her fair share of anticipated losses.[13] As the Illinois Department of Insurance pointed out, "The business of insurance is, in fact, predicated on the process of differentiating between risks—in other words discrimination."[14] And, according to one industry spokesman:

> Equality is achieved, not when everyone pays the same amount, but when each pays for the cost of his or her fair share of the risk. It is as unfair to charge people with differing risks the same price as it is to charge different prices to people with the same risk. Essential equality is not in the price, which is only the end result of something else, but the equality which results from equal distribution of cost in relation to risk.[15]

The Alliance of American Insurers stated that a properly organized and effectively operated classification system would accomplish the following objectives:

1. Determine those risk characteristics which can be used as a valid predicate for estimating exposure to loss.
2. Promote effective risk assessment to enable the pricing of insurance to correlate closely to expected costs.
3. Establish a degree of class refinement that is readily comprehensible and can be practically applied without ambiguity.
4. Be actuarily and statistically sound with respect to the homogeneity of each major class, the distribution of expected losses and the class relativities established.
5. Provide useful incentives for loss prevention to the extent practicable.
6. Be equitable and not unfairly discriminatory.[16]

While fair discrimination (i.e., differentiating dissimilar risks according to objective evaluation of loss potential) constitutes sound insurance business practice, unfair discrimination does not. The distinction between fair and unfair discrimination was clearly expressed in recent testimony of three insurance commissioners:

> The insurance business, naturally, concerns itself with actuarial fairness—that is, conforming the rate structure and its classifications to statistically fair discrimination. A rate structure providing for actuarial fairness would require the various insured risks to pay their share of anticipated losses and expenses. Actuarial fairness among insureds should, ideally, call for a separately determined rate for each individual insured since no two insureds present the identical hazard or expense characteristics. There is, however, little practical utility in rating separately most individual insureds. The expense of such individual determinations would far outweigh the advantages of fairness thereby

[11] Barbara Casey, Jacques Pezzier, and Carl Spetzler, "The Role of Risk Classifications in Property and Casualty Insurance: A Study of the Risk Assessment Process," Executive Summary Report (Menlo Park: Stanford Research Institute, 1976), p. 3 (hereafter cited as "Risk Classification").

[12] *Report to the People*, p. 20.

[13] Harold B. McGuffey, H.P. Hudson, and Harold R. Wilde, Jr., "Statement on Behalf of the National Association of Insurance Commissioners," testimony presented before U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 17, 1978 (hereafter cited as "Commissioners Statement").

[14] Richard D. Rogers and Kim Brunner, ***Redlining: The Illinois Experience*** (Illinois Department of Insurance, 1977) p. 7. (hereafter cited as ***The Illinois Experience***).

[15] William B. Pugh, Jr., assistant general counsel, INA Corporation, testimony presented at Unfair Discrimination Hearing, Pennsylvania Insurance Department, Feb. 20, 1975, pp. 3–4.

[16] "Classification and Underwriting in the Property and Casualty Insurance Business," testimony of the Alliance of American Insurers before U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 18, 1978, p. 19.

realized. Rather, insureds are grouped into classes to reflect essential differences in their actual or probable losses and expenses. An actuarially fair share is determined by reference to loss and expense experience of different classes (or individuals) and by the expected effect of the insured's risk characteristics and underwriting factors upon the insurer's cost. It would be unfair discrimination from a statistical standpoint if the classes thus identified were not rated accordingly.[17]

These three commissioners went on to note that even if the classification structure is statistically valid and actuarially sound, the different treatment various groups receive is often perceived as socially unfair. To the extent that actuarial fairness and social fairness conflict, the general posture of the industry is that it must follow the dictates of sound business practices by basing its underwriting decisions primarily on risk exposure and loss potential. In fact, it is argued, to do otherwise would result in low risks (e.g., good drivers, suburban residents) unfairly subsidizing high risks (e.g., bad drivers, central city residents). If insurance unavailability is caused by social unfairness, then society in general and State legislatures in particular must develop and pay for solutions.[18] As the Stanford Research Institute study stated, "Determination of public policy is not the responsibility of the insurance industry."[19]

The validity of this general industry posture depends in part on the accuracy with which existing classifications measure actual loss experience. In other words, is there a credible empirical base on which distinctions made between individuals and groups can be justified? In reference to automobile insurance, the Stanford Research Institute study maintained:

> Insurers should be free to make full use of classification information. . . .The present effectiveness of the risk assessment process is still far from the theoretical limit, although it may be close to a practical limit. . . .The addition of new variables or classification refinements lead to diminishing returns, i.e., little incremental improvement in risk assessment.[20]

And in reference to the use of geographical classifications in particular, an American Insurance Association spokesman concluded, "In sum, territorial rating is supported by a body of credible statistical data and is an equitable and sound principle for predicting future losses."[21]

Some experts have seriously questioned industry classification and underwriting policies and practices. Michigan Insurance Commissioner Thomas C. Jones maintains:

> First, many of the underwriting "rules" are not rules at all, but are a conglomeration of myths, notions, perceptions, and beliefs. They are often subjective, not based upon scientific, empirical fact. Second, many of the "rules" are not put into writing and are therefore subject to inconsistent application. Third, an underwriting rule may be unduly simplistic. It is more difficult, though more equitable, to find the true reasons for variations in loss characteristics, and to make individualized judgments based upon those factors.[22]

Senator Howard M. Metzenbaum, who chaired the hearings of the U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies on insurance redlining, concluded:

> The evidence produced at those hearings revealed that such companies use a variety of categories—such as age, sex, race, marital status, occupation and territory—for making underwriting and rate decisions that disadvantage consumers with those characteristics. These categories are based on personal characteristics that consumers cannot control, that are not causally related to losses, and that cannot be statistically justified in many cases. . . .
>
> Further, occupational categories—both for underwriting and rating purposes—often operate to the particular disadvantage of minority groups. For example, some insurance companies consider unskilled manual laborers high risks for auto insurance, despite the lack of objective data showing that consumers practicing occupations in these categories have greater losses.
>
> Female insureds who are either widowed or divorced are specially scrutinized by property and casualty insurance companies. As a result, they may be subjected to higher rates than males with similar driving records and the same

[17] "Commissioners Statement," pp. 4–5.
[18] *A Report to the People*, p. 26.
[19] "Risk Classification," p. 4.
[20] Ibid., p. 3.
[21] Statement of American Insurance Association before U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 18, 1978, p. 3.
[22] *An Avoidable Crisis*, p. 10.

marital status or they may be denied insurance coverage altogether.[23]

Finding that insurance companies frequently refuse certain risks arbitrarily because of their geographic location (i.e., redlining), the Federal Insurance Administration of the U.S. Department of Housing and Urban Development found that this underwriting practice:

> is not based on any sound underwriting standards but rather on highly subjective criteria that would appear to result from unfounded generalizations or perceptions about urban property risks.[24]

More specifically, it is argued that the profit interests of the insurance industry conflict with the basic tenet of risk spreading; that is, companies seek to gain a competitive advantage by identifying and insuring smaller subgroups of the population who represent the better risks, while shunning other risks. The proliferation of classifications, particularly in automobile insurance and also in homeowners property insurance, has created smaller and smaller classifications which has not increased the accuracy of loss prediction. As the classifications are refined, and the population of each classification is reduced, it becomes difficult to apportion the risk of loss each member represents in a sound manner. Large numbers of insureds are necessary to achieve accurate predictability of losses. Ultimately, refinement of classifications becomes self-insurance: instead of spreading risk, everyone would pay the cost of his or her loss. As classification refinement moved toward this end, some individuals would be at a greater disadvantage than if they insured themselves. All insureds pay for administrative costs in addition to their share of predicted losses while self-insured individuals pay only for their losses.[25]

The use of geographic location has been singled out as a particularly arbitrary and unfair underwriting classification, one that fails to predict loss in a statistically meaningful way. In Michigan, for example, several companies rate Detroit and/or Wayne County in which Detroit is located differently from the rest of the State. Thus, a resident in Detroit may pay a higher premium for the same coverage than a resident in Flint since Flint is rated with the rest of the State and Detroit is not.[26] Carl Levin, former Detroit City Council President, testified that available data demonstrate: 1) residential burglary rates for principal cities in countries other than Wayne are different from the remainder of the county in which they are located, although Detroit is the only one in the State which is treated separately from its county; and 2) there are similarities in burglary and fire rates between parts of Detroit and several suburbs although the city is treated as a separate entity from the suburbs which are grouped together.[27]

The existing insurance mechanism has also been severely criticized for failing to provide an adequate incentive to reduce losses. Determining premiums strictly on the basis of group averages of characteristics beyond an individual policyholder's control creates little incentive to reduce losses, and encourages resentment and fraud. This is particularly true when policyholders perceive no causal relationship between a particular group characteristic, like age or sex, and losses.[28]

When geographical location is utilized as the basis for underwriting classifications, not only does this reduce the incentive for individuals in that geographic area to reduce loss, but the practice also leads to the deterioration of entire neighborhoods. As the Massachusetts Division of Insurance stated:

> To the extent that environmental theft or vandalism hazards cannot fairly be traced to the control and responsibility of a particular policyholder, it is a form of unfair discrimination to set premiums by allocating environmental costs to those who happen to be closest at hand. Such practices simply accelerate the current trend

[23] Senator Howard M. Metzenbaum, letter to Arthur S. Flemming, Chairman, U.S. Commission on Civil Rights, Feb. 23, 1978.

[24] U.S., Department of Housing and Urban Development, *Insurance Crisis in Urban America*, a report prepared by the Office of the Federal Insurance Administrator (May 1978), pp. 27 and 44.

[25] "Insurance Redlining," Neighborhood Revitalization Project, Center for Community Change, p. 5. Massachusetts Insurance Commissioner James M. Stone, testimony before U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 17, 1978, p. 2. Federal Insurance Administration, *Full Insurance Availability* (1974), p. 54 (hereafter cited as *Full Insurance Availability*).

[26] Howard B. Clark, Special Assistant to the Administrator of the Federal Insurance Administration, "Statement in connection with certain rating matters pertaining to homeowners insurance," July 15, 1977, p. 2.

[27] Carl Levin, testimony before the U.S. Senate Subcommittee on Citizens and Shareholders Rights and Remedies, Jan. 18, 1978, pp. 3–4.

[28] James M. Stone, *Opinion, Findings and Decision on 1978 Automobile Insurance Rates* (Massachusetts Division of Insurance, 1977) (hereafter cited as *Decision on Insurance Rates).* Tom C. Allen and Richard M. Duvall, *Property Insurance Rating: A Plea for Change* (New York: The Journal of Commerce, 1973) (hereafter cited as *A Plea for Change).*

toward the deterioration of urban neighborhoods.[29]

Similarly, the Advisory Committee to the Redlining Task Force of the NAIC maintained:

> to the extent that exposure to risk is a function of factors beyond the control of an individual, consideration should be given to developing more equitable, in a social sense, and fair, in an actuarial sense, ways for sharing risk. . .the Committee believes that at all times the industry should attempt to improve the social equity and actuarial fairness of rating plans.[30]

A more appropriate mechanism in terms of both social justice and loss reduction, it is argued, would be a merit system based on those characteristics which an individual insured can control. As Massachusetts Insurance Commissioner James Stone testified:

> Until insurers abandon the notion that rating must be based on immutable group statistics, beyond any individual's control, the insurance mechanism cannot perform its proper role in modern society. Insurance must be used to spread the risks of natural and environmental hazards, not to narrow them. Insurance must be used to encourage responsible behavior, not to generate profits from the cost-plus servicing of an ever-increasing claims load.[31]

While the insurance industry generally explains its underwriting practices in terms of loss experience based on statistically valid empirical data, critics dispute this claim. First, the critics claim that the data on which classification and rating decisions are based are difficult to obtain and are often unavailable to appropriate regulators and the general public.[32] A more fundamental challenge to industry practices is that decisions are made on subjective rather than objective criteria. In his study of insurance availablity in Chicago, Anton Valukas found that:

> None of the agents interviewed were able to pinpoint any statistical basis by which they or their companies made the determination that a particular area was "bad" or "undesirable. . . ."
>
> The subjective evaluation of neighborhoods by inspection companies or agents as "changing" or "deteriorating" frequently results in a blanket refusal to write insurance in those neighborhoods. No company or agent who was interviewed was able to provide an objective standard used to determine that a neighborhood was "deteriorating." One agent described it as a "gut feeling." None of the companies provided any statistical information or studies that showed which particular factors identified with "deteriorating" neighborhoods contributed to increased risks.[33]

And another report by the Illinois Department of Insurance concluded:

> In the absence of significant unavailability problems, the insurance industry has not justified, nor has it been asked to justify, its marketplace practices. In general, it has not provided adequate statistics on which to base an evaluation of its premise that the practice of establishing geographical differentials has its foundation in economics: e.g., that the loss experience on the Chicago north side differs from the loss experience in Peoria. Without such statistics the industry can argue that the practices are legitimate; it cannot, however, illustrate to the satisfaction of the public that the practices are legitimate.[34]

When asked by the Metropolitan Area Housing Alliance (a coalition of community organizations in Chicago) to explain its policy of selling only basic fire policies to residents of homes where the replacement value exceeds market value by 150 percent or more, Allstate responded:

> Allstate will not change its underwriting guidelines on the "150 percent rule." That figure is our best judgment of the break between those properties that have an average number of losses and those that have a higher-than-average number of losses. Our experience and statistics back this up, though we have made a business

[29] Massachusetts Division of Insurance, "Automobile Insurance Rates and Social Policy," *Research Papers Prepared by the Division of Insurance on Classification Systems in Automobile Insurance* (1977), p. 17 (hereafter cited as *Research Papers*).

[30] *Ninety Day Report of the Advisory Committee to the NAIC Redlining Task Force* (Mar. 31, 1978), p. 4.

[31] Stone testimony, p. 5.

[32] U.S., Department of Housing and Urban Development, Community and Economic Development Task Force, *Impact of Insurance Program Policies on Central Cities*, Information Bulletin (Draft) (September 1977), p. 12.

[33] Anton R. Valukas, *An Investigation of Discrimination in the Sale of Homeowners Insurance in Illinois* (Illinois Department of Insurance, 1977), pp. 16, 22.

[34] *The Illinois Experience*, p. 19.

judgment and cannot offer statistics that point to 150 precent as the precise number.[35]

The data which have been made available and the empirical studies which have examined the relationship between existing classification systems and actual losses have raised further questions. In its study of risk assessment in automobile insurance, the Stanford Research Institute found that 30 percent of the variance in the expected loss distribution among drivers could be explained by current risk assessment methods.[36] In other words, 70 percent of the variance is either a result of random occurrences, variables which were not studied, or more likely, a combination of these two factors. Commissioner Stone concluded that this "is not an accurate system," which in the State of Massachusetts means that approximately half the population is overcharged and half is undercharged.[37]

A further challenge to the validity of the statistical base of underwriting practices was presented by a study of automobile insurance in the State of New York.

> If no underwriting selectivity had been exercised by any insurer, the entire industry in New York would have had, during the 1968–1970 period, 95.9 risks without loss for every 100 risks insured for private passenger automobile bodily injury liability insurance. In fact, for that period, after fully utilizing all of its selectivity tools, the industry was able to produce in the voluntary business written in that State only 96.6 clean risks for every 100 risks. As regards auto property damage liability risks, complete elimination of selection would have produced 91.0 clean risks for every 100 insured, whereas the selection process actually produced only 91.6 clean risks for every 100 insured.[38]

Although the Stanford Research Institute study basically defended existing risk assessment methods as being close to the practical limit for effectiveness and concluded that determination of public policy is not the responsibility of the insurance industry, it also concluded:

> The actuarial models should be improved to become more "causal" and to be more thoroughly verified. . . . The social acceptability of classification variables should be considered in revising the risk assessment process. It is likely that this can be achieved without loss of accuracy.[39]

No similar analysis of homeowners property insurance has been conducted. But a study of loss experience in retail establishments found that existing classification systems could only explain 12.5 percent of actual losses.[40] The variables examined in this study were geographic location, fire protection, exposure, and type of construction. If one replaces geographic location with occupancy, then this list would include the principal variables used to determine homeowners property insurance. "Construction" refers primarily to whether a home is of brick or frame construction. "Occupancy" refers to common hazards such as heating and electrical equipment or any special hazard involving combustible material. "Fire protection" refers to both public and private firefighting services which are available. "Exposure" refers to the location of other buildings in the area which affect potential loss.[41] In reference to the small amount of the variance in losses that could be explained in the study of retail stores, Gelvin Stevenson concluded, "This implies that the rate setting system is based on hypotheses that are not substantiated by empirical testing."[42]

While most critics acknowledge that loss experience does enter into the rating and underwriting processes, they claim that noneconomic, unfairly discriminatory factors operate as well. Certain areas may contain a disproportionate number of high risks but, it is argued, insurance companies frequently draw rough generalizations about communities and proceed to write off entire areas, thus penalizing individuals within those areas who in fact represent good risks. As Robert Jaspan argued:

> While the industry-wide refusal to insure ghetto residents on equal terms is asserted to be economically justifiable. . .racially oriented discrimination plays a significant role. . . .
>
> It therefore seems clear that more than economics motivates the scarce insurance coverage available to the ghetto resident. This conclusion is supported by the Hughes Panel findings:

[35] L.H. Williford, vice-president, Allstate Insurance Company, letter to Joseph Simmons, Metropolitan Area Housing Alliance, Aug. 9, 1978.
[36] "Risk Classification," pp. 14–15.
[37] *Decision on Insurance Rates*, pp. 137–39.
[38] *Full Insurance Availability*, p. 41.

[39] "Risk Assessment," p. 25.
[40] *A Plea for Change*, p. 160.
[41] *The Pricing of Insurance*, p. 189.
[42] *Fire Insurance*, p. 111.

> "The underwriting function has taken place in general without careful verification of the actual extent of particular inner city hazards."
>
> In effect, the industry had made vague generalizations on the condition of decrepitude in the area and has refused to underwrite any risk there regardless of specific condition.[43]

Much controversy has been generated regarding the role of the insurance industry and insurance regulators in public policy matters. The basic industry posture has been that to make a classification, underwriting, or pricing decision on other than actuarial grounds constitutes entering the realm of public policy, a responsibility of legislators, not the insurance industry nor State insurance commissioners. In the words of Ohio Insurance Commissioner Harry Jump, "Insurance companies should not be expected to make social policy"[44] Massachusetts Insurance Commissioner James Stone disagrees and argues that this position implies "that present classification techniques are socially neutral and objectively based. . . .The classification system for automobile insurance is not socially netural in its choice of variables. It is not socially neutral in its economic impact. To pretend that it is such is blindness."[45]

The apparent conflict between the insurance industry's fiscal responsibilities and public policy is sparked primarily by the notion that any disregard for actuarial soundness in the marketing of insurance constitutes a subsidy of bad risks by good risks. The Massachusetts Division of Insurance maintains, however, that at least in the case of automobile insurance the existing classification mechanism results in an unfair subsidization of commuting suburban drivers by city drivers which the regulatory body has an obligation to rectify. In response to the industry's position that since accidents are charged to the location of where cars are parked rather than where accidents occur, costs are fairly spread over both urban and suburban drivers, the division stated:

> The obvious fallacy in this explanation is that. . .any car that enters the central city contributes to the city's congestion and increases the probability of an accident to any car operating there.[46]

Quoting Dr. Michael Etgar, professor of operations management at the State University of New York at Buffalo, the division went on:

> City residents. . .consequently face higher costs of insurance, while suburban residents do not pay the full price for their commuting habits. . . .Such a result directly negates the statutory requirements that insurance rates will not be unfairly discriminatory.[47]

Commissioner Stone also asserted:

> Our social consciences certainly tell us that, other considerations being equal, a program which takes a disproportionate share of its costs from the economically deprived is less tolerable than one which exhibits the reverse effect. Our tolerance should be further reduced if the program is one which, in many instances, is mistakenly taking from the economically poor because of inherent inaccuracies in its assessment of costs.[48]

Recognizing that the existing automobile insurance risk assessment process has precisely this effect, and the widespread public policy implications of the insurance industry in general, Commissioner Stone does not agree that insurance regulators can avoid issues of public policy.

The key word in this debate is "fair." To the industry, a fair rating structure is one in which those who represent greater risk exposure and loss potential are charged higher premiums, even though certain factors which contribute to risk exposure and loss potential are beyond the control of individuals. The industry also maintains that it currently operates according to such a structure and that it should be permitted to continue doing so. Its critics argue that the existing rating structure in fact does not accurately match premiums with risk exposure, and therefore is not fair even according to the industry's definition. In addition, it is argued, the rating structure must be socially as well as actuarially fair; that is, even if certain characteristics like age, sex, and geographic location are statistically useful in predicting loss, the use of such factors constitutes unjust discrimination and should not be permitted.

Clearly, there is widespread disagreement on basic insurance industry policy and practice among industry representatives, regulators, public officials, and

[43] Robert Yaspan, "Property Insurance and the American Ghetto: A Study in Social Irresponsibility," *Southern California Law Review*, vol. 44 (1970), pp. 219, 252.
[44] Harry Jump, interview in Columbus, Ohio, May 17, 1978.
[45] *Decision on Insurance Rates*, p. 153–54.
[46] *Research Papers*, p. 19.
[47] Ibid., p. 20.
[48] *Decision on Insurance Rates*, p. 164.

citizens in general. An understanding of how the industry is structured and regulated may provide some insight as to how these issues will be resolved.

The Structure of the Insurance Industry

Along with banks and savings and loans institutions, the insurance industry is one of the largest and most powerful financial industries in the United States. In 1976 the industry generated approximately $130 billion in premium volume and administered about $434 billion in assets.[49] In the area of property and liability insurance, more than 2,800 companies collected almost $60 billion in premiums in 1976 alone, earning approximately $1.3 billion (2.4 percent of premiums earned) in profits (these figures are after taxes).[50] The industry did experience losses on its underwriting operations for 3 consecutive years beginning in 1974, reaching a total of $780 million in losses in 1976. It is important to note, however, that only $66 were paid out in losses for every $100 of premiums earned in 1976. The net underwriting loss also includes commissions, administrative expenses, and other costs incurred by the industry as part of its underwriting operations. Despite these underwriting losses, the industry still showed a net profit, resulting primarily from a $2.8 billion return on its investments.[51] And in 1977 the industry reported a record profit of 21 percent on its underwriting activities, which *Business Week* described as "windfall profits. . .reminiscent of the embarrassment of riches that faced the giants of the oil industry four years ago when the Arabs quadrupled the world price of oil."[52]

The traditional measure of underwriting profitability is the "combined ratio," which is the sum of the ratios between losses to premiums earned and expenses incurred to premiums written. "Losses" equals payments on claims filed by policyholders. This came to 66.0 percent of premiums earned in 1976. "Expenses" equals costs involved in settling claims (9.5 percent in 1976), sales commissions (20.3 percent in 1976), and other general administrative expenses (5.8 percent for 1976).[53] If the combined ratio is 100, the company breaks even on its underwriting operations. If the combined ratio is less than 100, the company has earned a profit on its underwriting operations. If the combined ratio is some number higher than 100, a loss has occurred.[54] During the years 1974–76 in which the insurance industry showed losses on its underwriting operations, the combined ratios were 105.0, 107.5 and 102.0.[55]

Two types of property-liability insurance companies dominate the market. Stock companies are those owned by stockholders who have invested capital in the companies. These companies own more than 70 percent of industry assets and write almost 70 percent of total industry premiums. Mutual companies, on the other hand, are owned by their current policyholders. Dividends are paid to policyholders which, in effect, lower their premiums. Though greater in number than stock companies, mutuals control less than 25 percent of industry assets and write just over 25 percent of total premiums.[56]

Insurance is marketed in several different ways. The four principal types of retailers are brokers, independent agents, exclusive agents, and direct writers. Brokers do not represent particular companies but rather serve their clients through a variety of companies. Independent agents have a contractual relationship with two or more companies. Services and commissions are limited by the terms of the contracts. Exclusive agents are employees of a specific company and place all insurance with their employer. Other insurers employ mass merchandising techniques and do not utilize sales representatives or local agencies.[57]

Before an insurance company can issue a new insurance policy, it must have adequate reserves to cover losses it may be required to pay under that insurance contract. The term "surplus" refers to company funds available to meet such obligations. When new policies are sold, surplus must be increased to meet the potential liability. An insurance company is considered to be operating at an acceptable level if the written premium dollars to surplus ratio is three to one. To write more insurance, a company must increase surplus either from its underwriting activities or its investments. During the late 1960s and early 1970s, underwriting losses and a declining equities market resulted in some companies' dollar-at-risk to surplus ratios reaching four to

[49] *Insurance Facts 1977 Edition* (New York: Insurance Information Institute, 1977), pp. 3, 11.
[50] INA Corporation, *1976 Annual Report*, p. 5. *Profitablity Results.*
[51] *Profitability Results.*
[52] "Sudden Riches for the Casualty Insurers," *Business Week*, May 1, 1978, p. 66–67.
[53] *Profitability Results.*
[54] *Fire Insurance*, p. 131.
[55] "Insurance: Current Analysis," *Standard & Poor's Survey* (Jan. 19, 1978), p. I.
[56] *Fire Insurance*, pp. 64–65.
[57] Ibid., pp. 70–75.

one, and others going even higher. The resulting "capacity crunch" forced the industry in general to limit underwriting activity at a time when consumer demand continued to grow.[58] One important implication of the current structure of the insurance industry, therefore, is that insurance availability has recently been determined as much by the health of the stock market as by consumer demand or the quality of risks represented by that demand.

The increasing tendency of insurance companies to merge with companies in other industries is another factor that has served to limit the extent to which consumer demand and the qualifications of potential consumers determine whether or not insurance is available. In other words, "the insurance part of the insurance business" (as *Fortune* recently referred to insurance underwriting and marketing practices)[59] may be assuming less and less importance within the industry to the detriment of insurance consumers, particularly those in older urban communities.

Mergers have occurred in which insurance companies became the parent corporation of other companies and also when insurance companies have been absorbed by other companies. The only clear trend from recent mergers is the further integration of the property-liability insurance industry with industry in general. What frequently happens when an insurance company becomes a subsidiary of a larger concern is that some of the surplus of the insurance company is used to pay a dividend to stockholders and for other purposes. For example, when National General acquired the Great American Insurance Company in 1969, it paid a $174 million dividend from the insurance company's surplus. Soon after INA formed its own holding company, INA Corporation, it used $175 million in surplus to acquire a bank, three manufacturers of fire prevention equipment, an interest in a nursing home development, real estate, and other assets. Between 1969 and 1973, $2.25 billion moved upstream from insurance companies to their parent organizations. When larger profits can be made elsewhere, companies can and have taken insurance company capital and invested it in a variety of places ranging from the Eurodollar market to a new manufacturing plant in Brazil or Taiwan.[60]

One obvious effect of this capital outflow and the drain on insurance company surplus is that underwriting capacity is diminished and the problem of insurance unavailability is exacerbated. If the rate of return on other investments declines, money could, of course, flow into the property-casualty stock companies potentially expanding capacity. The key issue, however, is whether it is in the overall best interests of society for the availability of an essential product like homeowners insurance to be a function of the varying moods of the Nation's major investors.

The insurance industry, however, is not an unregulated industry. The following chapter provides a brief overview of existing regulatory mechanisms, with particular attention paid to current civil rights protections.

58. Charles K. Cox, "The Insurance Industry," *Vital Speeches*, Jan. 15, 1975, p. 210. "The Insurance Industry's 'Capital Crunch'," *Journal of American Insurance*, Fall 1977, p. 20.

59 Carol J. Loomis, "An Accident Report on Geico," *Fortune*, June 1976, p. 128.

60 *Fire Insurance*, pp. 166–74. Gelvin Stevenson, testimony before the House Subcommittee on Housing and Community Development, Nov. 2, 1977, p. 166.

Chapter 3

The Role of Government

State and Federal Government agencies are involved in insurance activities both as providers of insurance services and as regulators of the private insurance industry. Federal activity has increased in recent years, in part as a result of growing availability problems in urban areas. Regulation of the insurance industry, however, is vested primarily at the State level. Prohibitions against overt racial discrimination have long been incorporated into the regulatory mechanism. More subtle racial implications of various trade practices, however, have raised new challenges in recent years and created important changes in the activities of at least some regulatory authorities. The following pages provide a brief summary of current and potential government activity in the areas of insurance, focusing primarily on the regulatory functions.

State Statutory Regulation and the McCarran-Ferguson Act

Until 1944 the business of insurance had been considered a matter of intrastate commerce exclusively.[1] Regulation of the insurance industry rested solely with the States. Federal antitrust laws applicable to interstate commerce did not extend to insurance transactions. Price-fixing of premium rates was common despite the Supreme Court's recognition in 1914 of the power of State insurance regulatory officers to control insurance rates.[2] In that year, the Court determined that because insurance companies are uniquely important as depositories of vast sums of money and as vehicles of risk distribution protecting a large part of the country's wealth, public interest required public control of the industry for the common good.[3] For the next 30 years, regulation of insurance industry practices, including premium rate schedules, existed at the State but not at the Federal level.

In the 1944 case of *United States v. South-Eastern Underwriters*, the Supreme Court reversed its traditional position that insurance is not interstate commerce.[4] Because the chain of events leading to the ultimate contract of insurance represents an interrelated, interdependent, and integrated transaction, insurance companies that conducted their activities across State lines were held to be engaged in interstate commerce. Therefore, such insurance companies would be subject to Federal regulation including Federal antitrust statutes.[5] However, the Court in *South-Eastern Underwriters* invited the Congress to create an exemption for the insurance industry from the existing antitrust regulations.[6] Congress responded in 1945 with the McCarran-Ferguson Act.[7] The act does not provide total exemption from the Federal antitrust statutes but does provide exemption "to the extent that such business is. ... regulated by State law."[8] While retaining Federal control over abuses uncovered in the *South-Eastern Underwriters* case, Congress was clearly relegating routine regulation of the "business of" insurance to the States.[9] However, whether regulated by the States or not, the McCarran-Ferguson exemption specifically prohibits acts or agreements by insurance companies to boycott, coerce, or intimidate in accordance with the Sherman Act.[10] Traditionally, the proscriptions against boycotts, coercion, and intimidation have been interpreted to protect insurance companies from the concerted action of competitors. Recently, however, in the case of *St. Paul Fire and Marine Ins. Co. v. Barry* the Supreme Court determined that Federal protection against boycotts protects policyholders as well as insurers.[11] While the consequences of the express inclusion of insureds within the ambit of this Federal protection are as yet undetermined, it is reasonable to suggest that agreements among insurance compa-

[1] Paul v. Virginia, 75 U.S. (8 Wall.) 168, 183 (1869).
[2] German Alliance Ins. Co. v. Kansas, 233 U.S. 389 (1914).
[3] Ibid., pp. 414–15.
[4] United States v. South-Eastern Underwriters Ass'n. 322 U.S. 533, 553 (1944).
[5] United States v. South-Eastern Underwriters Ass'n. 322 U.S. 533, 541, 457 (1944).
[6] United States v. South-Eastern Underwriters Ass'n. 322 U.S. 533, 561 (1944).
[7] 15 U.S.C. §§1011–1015 (1976).
[8] 15 U.S.C. §1012 (1976).
[9] 15 U.S.C. §1012(a) 1976).
[10] 15 U.S.C. §1013(b) (1976).
[11] St. Paul Fire and Marine Ins. Co. v. Barry, 46 U.S.L.W. 4971 (June 27, 1978).

nies and with others to "redline" geographic areas by refusing to write insurance or unreasonably restricting coverage represent boycotts forbidden by the Sherman Act, which is enforced by the Department of Justice.[12]

In response to the limited exemption of the industry from Federal antitrust legislation, the States enacted regulatory legislation. The focus of most regulatory action, at least until recently, has been on rate structures. Most States, including Minnesota, Wisconsin, Michigan, Illinois, Indiana, and Ohio, followed the recommendations of the National Association of Insurance Commissioners (NAIC) and adopted "regulatory approval" regulations.[13] Under a "regulatory approval" system, an insurer or a private rate bureau to which an insurer subscribes files rates with the chief insurance regulatory officer which are generally subject to his or her prior approval but which may become automatically effective unless expressly disapproved within a fixed period. The NAIC intended that rates filed with the State insurance commissioners by private rating organizations would be mandatory although subscription to the organization itself would be voluntary. Insurers and rating organizations were encouraged to cooperate unless such cooperation created unfair or unreasonable rates. A few States chose "open competition" laws which precluded an insurer from being required to adhere to the rates set by the rate service bureau and permitted it to develop its own rate structure without the prior approval of the chief insurance regulatory officer.[14] Other States developed a system of State-mandated rates.[15]

Both the "regulatory approval" and the "open competition" laws expressly prohibited excessive, inadequate, or unfairly discriminatory rates and permitted joint rate making.[16] Some States either retained the system of State-made rates or required rating bureau membership as a condition of writing insurance within the State.[17] Courts have upheld each of the three patterns of rate regulation as satisfying the requirements of the McCarran-Ferguson exemption.[18] Nonetheless, the last decade has seen a significant shift within the industry from reliance on rigid "regulatory approval" laws to a system of "open competition."[19] At the present time, Minnesota, Wisconsin, and Illinois have shifted to some type of "open competition" rating system. Ohio, Michigan, and, with significant modification, Indiana continue to rely on "regulatory approval" systems.[20] Illinois is the only State which, since 1971, has had no rating law.[21] By regulation, insurers file rates with the insurance commissioner for informational purposes only.[22]

Business practices of the insurance industry in addition to those strictly related to rate structures are heavily regulated by the States through statute and insurance department regulation. States have adopted unfair trade practices acts to deal with a variety of unfairly discriminatory industry practices. The States' initial unfair trade practices legislation was based on a 1947 NAIC Model Regulation (An Act Relating to Unfair Methods of Competition and Unfair and Deceptive Acts and Practices in the Business of Insurance) and represented industry response to the McCarran-Ferguson exemption requirements.[23] Subsequently, many States amended their unfair trade practices sections to include "unfair discrimination" based on one or another specific classification of individuals. For example, Wisconsin treats unfair discrimination based on sex as an unfair trade practice. By "unfair," Wisconsin means discrimination not based on "sound actuarial

[12] 15 U.S.C. §4(1976).

[13] *Proceedings of the NAIC* (1946) pp. 410–22. Model regulations promulgated by the NAIC have been adopted by many States on a variety of subjects. The stated objectives of the NAIC include promoting uniformity in insurance legislation and regulation and preserving to the several States the regulation of the business of insurance. NAIC constitution, art. 2 (1978). Now composed of the chief regulatory officers of the 50 States, the District of Columbia, Puerto Rico, and the Virgin Islands, the NAIC was organized in 1871 to strengthen the ability of regulators to protect the interests of policyholders through unified solutions to common problems.

[14] California, Missouri, Idaho. John G. Day, *Economic Regulation of Insurance, in the United States*, a report of the U.S. Department of Transportation (1970), p. 28 (hereafter cited as *Economic Regulation).*

[15] E.g., Texas, *Economic Regulation*, p. 28.

[16] National Association of Insurance Commissioners, *Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business* (NAIC Staff Study, 1974), pp. 396, 409, 425 (hereafter cited as *Monitoring).*

[17] Louisiana, Mississippi, North Carolina, Virginia, Texas, District of Columbia. *Economic Regulation*, p. 28.

[18] Regulatory approval laws; North Little Rock Trans. Co. v. Casualty Reciprocal Exchange, 181 F.2d 174 (8th Cir.), *cert denied*, 340 U.S. 823 (1950): Mandatory adherence to rating bureau rates; Allstate Ins. Co. v Lanier, 361 F.2d 870 (4th Cir.), *cert. denied*, 385 U.S. 930 (1966): Open competition laws; California League of Indep. Ins. Producers v. Aetna Casualty and Surety Co., 175 F. Supp. 857 (N.D. Calif. 1959), as reported in U.S., Department of Justice, *The Pricing and Marketing of Insurance* (1977), p. 25 (hereafter cited as *Pricing and Marketing).*

[19] *Pricing and Marketing*, pp. 27, 372.

[20] *Monitoring*, p. 58. Michigan Insurance Bureau of the Department of Commerce, *Essential Insurance in Michigan* (1977), pp. 7, 48; Ill. Ins. Regs. 7A.04 (1972); Ind. Code §27–1–22–4(d)–5(a),–7(b) (1976); Mich. Comp. Laws §500.2430, .2628, .2608 (Mich. Stat. Ann. §§24.12430, .12628, .12408, .12608 (Callahan 1974)); Minn. Stat. §§70A.06(1), .08(1) (1976); Ohio Rev. Code Ann. §§3935.04(D), 3937.03(C) (Page 1975); Wis. Stat. §625.21 (1975).

[21] Ill. Rev. Stat. ch. 73, §1065.18–34 (1971).

[22] Ill. Ins. Regs. 7A.04 (1972).

[23] *Proceedings of the NAIC* (1947), pp. 392–400.

principles, a valid classification system and actual experience statistics."[24]

Michigan now treats unfair discrimination as an unfair trade practice.[25] Such discrimination includes refusing to insure, refusing to renew, or limiting the amount of coverage on the basis of a previous denial of insurance, or of race, creed, color, marital status, sex, or national origin. In addition, such discrimination based on handicap, lawful occupation, or age is prohibited unless there is a reasonable relationship between these factors and the extent of the risk involved. With property insurance, location of risk may be differentially considered in Michigan only if there exists a statistically significant relationship between the location of the risk and a risk due to fire within the area (ZIP code) in which the risk is located. It is also an unfair trade practice to charge a different rate based on sex, marital status, age, residence, location of risk, handicap, or lawful occupation unless the rate differential is based on sound actuarial principles, a reasonable classification system, and credible actual or anticipated loss experience.

In Illinois unfair discrimination between individuals in the sale of fire and casualty insurance based on the race, color, religion, or national origin of the applicant or risk is an unfair trade practice. Discrimination which merely reflects differences in loss and expense elements is apparently considered fair discrimination and is not prohibited even where such discrimination indirectly creates classifications coextensive with the prohibited categories. Illinois has recently amended its unfair trade practice section to include the refusal of an insurer to provide homeowners or renters insurance solely on the basis of the geographic location of the real or personal property risk.[26] In Ohio, it is an unfair trade practice to refuse to issue or renew or to cancel any insurance policy because of the insured's sex or martial status, or to discriminate between individuals of the same class and hazard in rates and underwriting standards and practices.[27]

States have statutorily prohibited discriminatory practices other than through their unfair trade practices acts. For example, Minnesota and Wisconsin prohibit classification of risks based on race (color), creed, or national origin.[28] Indiana prohibits unfair discrimination between persons of the same class and essentially the same hazard in insurance rates.[29] Ohio, along with most States, requires that rates shall not be unfairly discriminatory and, since 1965, has proscribed establishing criteria by area (postal zone) including "type of neighborhood" which will be used in a discriminatory manner against racial or ethnic groups.[30] Illinois now precludes the nonrenewal of fire and extended coverage policies for reasons of age or location of property or age, sex, race, color, ancestry, or occupation of occupants.[31]

When an unfairly discriminatory practice is legislatively prohibited by amendment of the unfair trade practices act, the preexisting enforcement mechanism specific to that act automatically extends to the amendment. The existing enforcement sections of the respective State unfair trade practices acts are quite specific in regard to procedures for determining and sanctioning violations. Where the State insurance code is amended generally to prohibit a practice, the general statutory enforcement powers of the chief insurance regulatory officer alone apply. Frequently these powers are vaguely defined. For example, the chief insurance regulator may have only the general mandate to "administer and enforce the insurance laws. He shall act as promptly as possible under the circumstance on all matters placed before him."[32] Under the unfair trade practices sections, the chief insurance regulatory officer is generally empowered to hold a hearing whenever he has reason to believe a violation has occurred and, after a fair hearing resulting in a finding of unlawful conduct, may impose sanctions, including a cease and desist order, seek judicial remedies (both civil and criminal), revoke or suspend an insurer's State license, order the suspension of a culpable employee or consultant, and impose fines and forfeitures.[33]

The importance of the distinction between the power of the chief regulatory officer to enforce the insurance laws generally and his specific powers

[24] Wis. Adm. Code Ins. §6.55 (1976).
[25] Mich. Comp. Laws §500.2027 (Mich. Stat. Ann. §24.12027 (Callahan Supp. 1978)).
[26] Ill. Rev. Stat. ch. 73, §1031(3) (1977); Ill. Rev Stat. ch. 73, §767.22 (1977); P.A. 80–1369, 80th Ill. Gen. Assembly, 1978 Reg. Sess. (Aug. 14, 1978).
[27] Ohio Rev. Code Ann. §3901.21 (L),(M) (Page Supp. 1977).
[28] Minn. Stat. §70A.05(2) (1976); Wis. Stat. §625.12 (1975).
[29] Ind. Code, §27–4–1–4(7)(c) (1976).
[30] Ohio Rev. Code. Ann. §3935.03 (Page 1975); Ohio Ins. Bull. No. 45 (May 14, 1965).
[31] Ill. Rev. Stat. ch. 73, §755.21a (1977).
[32] See e.g., Wis. Stat. §601.41 (1975).
[33] Ill. Rev. Stat. ch 73, §§1021–1041 (1977); Ind. Code §§27–1–3–8, 27–4–1–5—27–4–1–14 (1976); Mich. Comp. Laws §§500.2028–.2050 (Mich. Stat. Ann. §§24.12028–.12050 (Callahan Supp. 1978)); Minn. Stat. §§59A.05, 60A.031, 72A.23 (2976); Ohio Rev. Code Ann. §§3901.22–.25(Page Supp. 1977); Wis. Stat. §§601.61–601.73(1975).

under the unfair trade practices section varies by State according to the general powers delegated to the insurance commissioner by the State legislature. For example, under his general powers the chief insurance regulatory officer in Illinois began requiring major insurers to submit data by ZIP code in March of 1977 although the specific statutory authorization for such data collection was not effective until October 1, 1977.[34] Nonetheless, the respective State statutes appear to place on the chief regulatory officer an affirmative duty to inquire into the affairs of insurers to ascertain whether unfair trade practices are being committed.[35] With discriminatory practices not specifically defined as unfair trade practices, the legal burden would seem to be on an aggrieved insured to inform the chief insurance regulatory officer that he or she had been subjected to unfair discrimination. What the insurance regulatory officer should do under his or her general powers to investigate individual complaints of unfair discrimination—the procedures for determining whether a violation has occurred and the range of sanctions to be applied—remains largely undefined.

State Constitutional Limitations

The United States Constitution represents the supreme law of the land binding on the several States.[36] A State may afford more but not less protection to those within its jurisdiction than is required by the Federal Constitution. That State constitutional and statutory law must accord with the minimum standards of Federal constitutional law is well settled.[37] All judges, State and Federal, are constitutionally bound to accept the United States Constitution as supreme over State constitutions and statutes.[38] Where conflicts between State and Federal constitutional law arise at the State level, State judges must and do interpret matters of Federal constitutional law.[39]

With due regard to these fundamental principles of Federal constitutional law, States have adopted portions of the Federal Bill of Rights in their respective State constitutions.[40] For example, some State constitutions expressly guarantee equal protection and due process of the law, provisions that echo the 14th amendment.[41] A few States have moved even further in constitutionally protecting civil rights. The 1970 Constitution of Illinois, for example, prohibits discrimination on the basis of race, color, creed, national ancestry, and sex in employment and in the sale or rental of property.[42] Both private and public (State) action is prohibited.

An insurance contract creates a limited property right.[43] Thus, in States such as Illinois, where private discrimination in the sale of property is prohibited by State constitutional law, insurance industry practices which discriminate against members of expressly protected classifications, e.g., race, color, or national ancestry, may be fairly interpreted as violating State constitutional law.[44] The States vary considerably, however, in the extent to which they afford protections against unfair discrimination by the insurance industry as a matter of State constitutional law.

Federal Civil Rights Constraints

The Thirteenth Amendment

The 13th amendment states:

> Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.

The Civil Rights Acts of 1866 and 1870 and that part of the Act of 1871 sustained by the 13th amendment provide a number of fundamental protections of individual rights.[45] "All persons" are guaranteed equal rights to make and enforce con-

[34] Ill. Rev. Stat. ch. 73, §755.25 (1977); Ill. Ins. Adm. Order, Mar. 21, 1977.
[35] Insurers are required to file annual reports with the chief regulatory officer concerning their financial affairs. In addition, the chief regulatory officers are required to conduct triannual audits of each insurer licensed to do business in the State to determine if an unfair or deceptive act or practice has been committed. The regulatory officer may also conduct periodic market reviews of insurance company practices.
[36] U.S. Const. art. VI, §2.
[37] Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803).
[38] U.S. Const. art. VI, §2.
[39] Martin v. Hunter's Lessee, 14 U.S. (1 Wheat) 304 (1816).
[40] See e.g., Mich Const. art. I; Ill. Const. art. I, U.S. Const. amends. I—X.
[41] U.S. Const. amend. XIV, §1.
[42] Ill. Const. art. I, §17.
[43] See Sims v. Order of United Commercial Travelers of American, 343 F. Supp. 112, 115 (D. Mass. 1972); Margolis v. St. Paul Fire and Marine Ins. Co., 125 A.2d 768, 771 (N.H. 1956); Tonini v. Thurman, 136 P.2d 909, 912 (Okla. 1943). In addition, as discussed in chapter 2, policyholders insured by mutual insurance companies (e.g., State Farm Insurance) are also "owners" of the company, "insurers" as well as insureds, for the life of their insurance contracts.
[44] See R. Helman and W. Whalen, *Constitutional Commentary*, Ill. Rev. Stat Ann., Ill. Const. art. I, §17, p. 674 (1971) for a discussion of the clear legislative intent to include all forms of property, real, and personal, within the purview of Ill. Const. art. I, §17; Gertz, *The Unrealized Expectations of Article I, Section 17*, 11 J. Mar. J. Prac. & Proc. 283, 309–311 (1978).
[45] Act of Apr. 9, 1866, ch. 31, §1, 14 Stat. 27 (codified at 42 U.S.C. §1982 (1976)); Act of May 31, 1870, ch. 114, §16, 16 Stat. 144 (codified at 42 U.S.C. §1981 (1976)); Act of Apr. 20, 1871, ch. 22, §2, 17 Stat. 13 (codified at 42 U.S.C. §1985)); Griffin v. Breckenridge, 403 U.S. 88, 105 (1971).

tracts (42 US.C. §1981). Similarly, "all persons" possess equal rights to buy and sell real and personal property (42 U.S.C. §1982). Finally, "all persons" are protected by Federal law from conspiracies to interfere with their civil rights (42 U.S.C. § 1985). The conduct of private individuals as well as of public officers and employees falls within the scope of the foregoing laws.[46] For example, racial discrimination by private persons in the purchase and sale of property or in the making and enforcement of contracts is prohibited.[47] Furthermore, purely private conspiracies, i.e., agreements between private individuals to deprive a member of a racial minority of his or her civil rights, are proscribed.[48]

Insurance is both a contract within the scope of §1981 and a personal property right within the purview of §1982.[49] Thus, insurance practices which adversely affect property and contract rights of members of racial minorities lie within the scope of protections afforded by Federal civil rights laws. An insurance company's refusal to ensure the property of a person because of his or her race, for example, would be prohibited by these statutes. Furthermore, the use of nonracial insurance classifications for the purpose of discriminating against members of a racial minority would represent an unlawful practice.[50] Finally, collusive underwriting practices between insurers and others which discriminate against racial minorities would be similarly precluded by these laws.[51] It is important to note that the McCarran-Ferguson Act, which leaves regulation of the "business of insurance" to the States, does not prohibit "access to the Federal Courts for redress for violations of a person's civil rights guaranteed by the Federal Constitution" and protected by Federal civil rights statutes.[52]

The Fair Housing Act of 1968 mandates nondiscrimination in housing transactions.[53] Although promulgated under the authority of the 13th amendment, the Fair Housing Act prohibits discrimination not merely on the basis of race but also on the basis of color, religion, sex, or national origin in the sale, rental, or financing of housing.[54] Mortgage lenders customarily require property insurance as a condition for obtaining a mortgage.[55] A potential home purchaser who cannot obtain property insurance at least to the value of the mortgage lender's investment will not be able to obtain a mortgage loan. Without a mortgage loan, few persons can afford the cost of homeownership. Therefore, the refusal of an insurance company to issue property insurance to a mortgage applicant may effectively make housing unavailable, at least in States where the applicant cannot obtain insurance through an involuntary residual insurance program such as the FAIR Plan.[56] If the refusal to issue insurance is based on reasons of race, color, religion, sex, or national origin, and that refusal makes a particular dwelling unavailable to a willing purchaser, it is possible that the practice is prohibited under the existing Fair Housing Act.[57] However, the indirect and independent nature of property insurance as it affects housing availability and the availability of property insurance in many States through the involuntary residual insurance market suggest that the underwriting practices of the insurance industry may be outside the current scope of the Fair Housing Act.[58] At the present time a bill is pending before the Subcommittee on Civil and Constitutional Rights of the Judiciary Committee, House of Representatives, which would expand Title VIII to prohibit, among other things, an insurer from refusing to enter into an insurance contract because of the race, color, or national origin of persons living in or near the dwelling.[59]

The Fourteenth Amendment

The 14th amendment states in pertinent part of section 1:

[46] Jones v. Alfred H. Mayer Co., 392 U.S. 409, 413 (1968).
[47] Runyon v. McCrary, 427 U.S. 160, 168 (1976); Clark v. Universal Builders, 501 F.2d 324, 329 (7th Cir.), *cert denied* 419 U.S. 1070 (1974).
[48] Griffin v. Breckenridge, 403 U.S. 88, 105 (1971).
[49] Ben v. General Motors Acceptance Corp., 374 F. Supp. 1199 (D. Colo. 1974). (See also Sims v. Order of United Commercial Travelers of America, 343 F. Supp. 112, 114 (D. Mass. 1972).
[50] Clark v. Universal Builders, 501 F.2d 324, 329 (7th Cir.), *cert. denied*, 419 U.S. 1070 (1974). *See also* Arlington Heights v. Metropolitan Housing Development Corp., 429 U.S. 252, 264–66 (1977), a case arising under the 14th amendment which discusses the prohibition against creating apparently neutral classifications with the purpose and effect of discriminating against racial minorities.
[51] 42 U.S.C. §1985 (1970).
[52] Ben v. General Motors Acceptance Corp., 374 F. Supp. 1199, 1202 (D. Colo. 1974) and citations therein.
[53] Fair Housing Act, 42 U.S.C. §§3601–3631 (1970).
[54] 42 U.S.C. §§3604, 3605 (1976).
[55] See discussion in chapter 1.
[56] At the present time, 26 States, Puerto Rico, and the District of Columbia provide a residual insurance market under the FAIR Plan for insurable risks which have been rejected by the voluntary insurance market. See discussion in this chapter.
[57] 42 U.S.C. §3604 (a),(b)(1976).
[58] According to the Department of Justice, the present Fair Housing Act probably does not prohibit racially discriminatory insurance practices. Drew S. Days III, Assistant Attornery General, Civil Rights Division, Department of Justice, letter to Sen. Howard M. Metzenbaum, undated. Congress has the power to amend the Fair Housing Act to preclude insurance practices based on race, color, religion, sex, or national origin which effectively make housing unavailable. Such a recommendation was made by Mr. Days in his letter.
[59] H.R. 3504, 95th Cong., 2d sess. (1978).

nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person the equal protection of the law.

In 1871, 3 years after the 14th amendment became the law of the land, Congress enacted legislation principally to enforce the amendment in what is now 42 U.S.C. §1983. The equal protection clause through §1983 forbids action by a State or its subdivisions causing "invidious discrimination." Invidious discrimination is any classification of individuals which stigmatizes the group with the badge of inferiority or is so irrational, arbitrary, and capricious that it bears no reasonable relation to a legitimate purpose of the State.[60] If a member of a "suspect" classification—i.e., one based on race, religion, or ancestry—is adversly affected by State action, the State must demonstrate that the classification is essential to accomplish a an essential State purpose. Otherwise, such classification would represent prohibited invidious discrimination.[61] If other than a "suspect" category is involved—e.g., sex or economic level—or if the contested State action merely affects members of a suspect classification disproportionately, the action must bear only a reasonable relationship to any legitimate State purpose to accord with the requirements of the 14th amendment.[62]

Section §1983 permits individuals to sue (for redress of their rights to the equal protection of the laws) only those persons acting under "color of State law"; i.e., under the authority of the State. However, where discriminatory practices are committed, an action under §1983 is not appropriate.[63] Even where a private industry, such as a public utility, is heavily regulated and controlled by the State, the State's mere passive acquiesence to that industry's discriminatory practices has not been held to constitute State involvement or State action within the scope of §1983.[64] Under this section, "State action" requires a "sufficiently close nexus between the State and the *challenged action of the regulated entity* so that the action of the latter may be fairly treated as that of the State itself" (emphasis added).[65] State statutes generally prohibit "unfair discrimination" in rates and expressly preclude classifications based on race, color, or creed.[66] Therefore, if an insurance company practices discrimination against racial minorities, such practices occur without the express affirmative involvement of the State. Consequently, the requisite nexus for a finding of State action under §1983 between the conduct of the State and such discriminatory practices is absent.

Based upon the reasoning and decisions of the Supreme Court concerning the limits of "State action," it seems unlikely that §1983 is directly applicable to insurance industry practices, even when racially discriminatory practices are passively tolerated by State regulators. Despite heavy State involvement through regulation of the insurance industry by statute and administrative regulation, insurance company decisions probably remain beyond the scope of the 14th amendment as currently interpreted by the Supreme Court.[67]

Government Participation in the Insurance Market

The Federal Government participates in the property-casualty insurance market through a variety of programs. Most of these programs involve the cooperative efforts of the private insurance industry and the Federal Government.

Federal reinsurance of primary insurers against property losses resulting from riots and civil disorders and the federally-mandated FAIR (Fair Access to Insurance Requirements) Plan were established by Title XII of the 1968 Housing and Urban Development Act.[68] These programs complement each other. Riot reinsurance covering property losses resulting from riots or civil disorders is available only to those insurers who are directly participating in a State-authorized FAIR Plan meeting the minimum standard prescribed by Federal law.[69] The FAIR Plan was designed to ensure that property owners with insurable risks would be able to obtain essential property insurance against loss from fire and

[60] Reed v. Reed, 404 U.S. 71, 76 (1971); Brown v. Board of Education, 347 U.S. 483, 495 (1954); Skinner v. Oklahoma, 316 U.S. 535, 541 (1942); Strauder v. West Virginia, 100 U.S. 303, 310 (1879).

[61] Graham v. Richardson, 403 U.S. 365, 376 (1971); Oyama v. California, 332 U.S. 633, 646–47 (1948).

[62] Arlington Heights v. Metropolitan Housing Development Corp., 429 U.S. 252, 269 (1977); Washington v. Davis, 426 U.S. 229, 242 (1976). Kahn v. Shevin, 416 U.S. 351, 355(1974); San Antonio Indep. School District v. Rodriguez, 411 U.S. 1, 40 (1973);

[63] Civil Rights cases, 109 U.S. 3, 11 (1883).

[64] Jackson v. Metropolitan Edison, 419 U.S. 345 (1974).

[65] Id. at 350–51; See, Moore Lodge No. 107 v. Irvis, 407 U.S. 163, 177 (1972).

[66] E.g, Ill. Rev. Stat. ch 73, §1031 (1977); Mich. Comp. Laws §500.2403 (Mich. Stat. Ann. §24.12403(d) (Callahan 1974)); Wis. Stat. §625.12(2)(1975).

[67] See generally "State Action After Jackson v. Metropolitan Edison Co.: Analytical Framework for a Restrictive Doctrine," 81 Dick. L. Rev. 315 (1977).

[68] 12 U.S.C. §§1749bbb–bbb-10 (1976).

[69] 12 U.S.C. §1749bbb–7(c) (1976).

extended coverage without regard to "environmental hazards," those risks which are beyond the control of individuals.[70] The Secretary of Housing and Urban Development is empowered to prescribe additional coverage for vandalism, malicious mischief, burglary, or theft.[71] By rule, the Secretary has authorized vandalism and malicious mischief protection. Liability, theft, robbery, and burglary insurance are not available except separately and with deductibles.[72] A broad "homeowners" policy is available under the plan only in four States, including Illinois and Wisconsin.[73]

The FAIR Plan requires that a State create an insurance pool consisting of all insurers in the State who want reinsurance for riot and civil disorder damage. The pool operates through an industry placement facility which distributes the risks equitably among the participating insurers.[74] While the individual State FAIR Plans may vary from State to State, minimum requirements are prescribed for all States.[75] These requirements include the right of an applicant for insurance under the FAIR Plan to have his or her property individually inspected at no cost. Following the inspection, a report is sent to the placement facility or participating insurer. On the basis of the report, a determination is made as to whether the property meets reasonable underwriting standards and will be insured. If coverage is to be limited or the risk is to be surcharged or declined, the insurer must give specific reasons for its action, including what improvements are necessary to bring the property up to standard. Such a report is sent both to the individual property owner and to the State insurance authority. All policyholders in the voluntary insurance market must be given reasonable time before their policies are cancelled or nonrenewed to seek insurance under the plan.

Each insurer participating in the inspection facility must submit to the State insurance authority the number of risks accepted and conditionally accepted, reinspections made, risks declined, and other information requested by that authority. For effective monitoring and control, all policies written under the aegis of the FAIR Plan must be separately coded.

At the present time, only 26 States in addition to the District of Columbia and Puerto Rico have passed legislation creating FAIR Plans.[76] Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin have enacted a plan. In all States but Indiana the plan is mandatory and requires all insurers writing property insurance in the State to participate. Indiana relies on a voluntary FAIR Plan.[77]

Since 1970 the FAIR Plans have been periodically reviewed through the Office of Review and Compliance under the Federal Insurance Administration (FIA).[78] Serious criticisms have been made by FIA concerning the operation of the plans, including inequitable treatment of insureds, inferior management, excessive underwriting expenses, and upward rate revisions based on subjective factors rather than credible statistical data.[79] FIA also found that the FAIR Plan has contributed to the abandonment of central cities by insurers. Others who have monitored the operation of FAIR Plans have expressed concern about the cost of the limited coverage available and the creation of a dumping ground not only for objectively determined substandard risks but also for clean risks.[80] Of the approximately 1 million FAIR Plan policies in force, less than 5 percent of the owners have ever made claims, suggesting that most FAIR Plan insureds are indeed good risks.[81]

Several recent arson studies have also criticized FAIR plans for encouraging "arson for profit" through careless underwriting.[82] Critics of these arson studies have noted, however, that "arson for profit" is a manifestation of the insurance mechanism itself, not of FAIR Plans alone. As FIA Administrator Gloria M. Jimenez has stated, only

[70] "Environmental hazard" is defined as "any hazardous condition that might give rise to loss under an insurance contract, but which is beyond the control of the property owner." 12 U.S.C. 1749bbb–2(a)(4) 1976.

[71] 12 U.S.C. §1749 bbb–2(a)(5) (1976).

[72] 24 C.F.R. §1905.3(a) (1977).

[73] A "homeowners" policy typically includes such coverage as personal liability, burglary, robbery and theft, breakage of glass, sudden tearing asunder of heating systems, and other protections, in addition to fire and extended coverage. Wisconsin, Rhode Island, Massachusetts, and Illinois currently provide for homeowners policies in the FAIR plans. See, for example, P.A. 80–1365, 80th. Ill. Gen. Assembly, 1978 reg. sess. (Aug. 14, 1978).

[74] 12 U.S.C. §1749 bbb–4 (1976).

[75] 12 U.S.C. §1749 bbb-3 (1976).

[76] David J. Brummond, NAIC counsel, letter to Ruthanne DeWolfe, Midwestern Regional Office, U.S. Commission on Civil Rights, Jan. 23, 1978.

[77] The Indiana commissioner is empowered to require all insurers writing property insurance in the State to participate in the FAIR Plan. Sen. Conc. Res. No. 5 (Jan. 31, 1977).

[78] 12 U.S.C. §1749bbb-6a (1976) sets forth the responsibilities of the Office of Review and Compliance.

[79] U.S., Department of Housing and Urban Development, Federal Insurance Administration, *Full Insurance Availability* (1974), pp. 26–32 (hereafter cited as *Full Insurance Availability*).

[80] 124 Cong. Rec. H.7,124 (daily ed. July 21, 1978) (remarks of Rep. Frank Annunzio).

[81] Gloria M. Jimenez, Federal Insurance Administrator, letter to Elmer B. Staats, June 15, 1978 (hereafter cited as Jimenez letter).

[82] Illinois Legislative Investigation Commission, *Arsons* (May 1978); General Accounting Office, *Arson for Profit: More Could Be Done to Reduce It* (May 1978); Law Enforcement Assistance Administration, *Arson and Arson Investigation* (June 1978).

one-half of 1 percent of Illinois fire insurance claims under the FAIR plan have represented arson for profit. Jimenez concluded that, at least in Illinois, arson for profit is about 10 times more likely in the voluntary market than in the FAIR Plan.[83] The manager of the Metropolitan Chicago Loss Bureau has concluded that in Chicago the proportion of fires intentionally set by homeowners holding conventional policies is twice that of FAIR plan policyholders and the proportion of dollars lost through fires intentionally set by homeowners is five times as high among conventional policyholders. Thus, "the FAIR Plan has not contributed to the arson problem in any way, shape, or form."[84]

The National Flood Insurance Program, established by Title XIII of the 1968 Housing and Urban Development Act[85] provides protection against financial loss due to floods, mudslides, and wave-wash shoreline damage. The program involves the reinsurance of private insurers who, operating as a pool, write the actual flood insurance policies. The Secretary of the Department of Housing and Urban Development through the Federal Insurance Administration regulates rates, terms, and conditions.[86] The pool contracts with the Secretary to reinsure for losses in excess of the losses assumed and retained by the pool.[87] Part of the purpose of the program is to encourage appropriate land use by State and local governments by limiting the availability of the Flood Insurance Program to States that meet Federal requirements for adequate land development and flood control measures.[88]

The Crime Insurance Program was established through Title VI of the 1970 Housing and Urban Development Act which amended Title XII of the 1968 act.[89] The program offers direct insurance protection rather than serving as a reinsurance facility for the private voluntary insurance market. The Secretary of Housing and Urban Development reviews the States periodically to determine whether "crime insurance" is available in the voluntary market at affordable rates.[90] The Secretary determines whether Federal insurance should be offered in a particular State or subdivision. Twenty-two States, including Illinois, Minnesota, and Ohio, and the District of Columbia, Puerto Rico, and the Virgin Islands have been denominated as meeting the criteria.[91] Indiana, Michigan, and, Wisconsin are not currently eligible. Although the program is one of direct insurance, the Secretary may and usually does work through private insurers who are selected through competitive bidding to service the insureds. In both the FAIR Plan and the Crime Insurance Program, personal and commercial property is insurable although automobile and certain manufacturing risks are expressly excluded.[92] The Crime Insurance Program is operated by the Department of Housing and Urban Development through the FIA. Since its inception, modifications have been introduced by the FIA both in expansion of risks covered and in rates charged.[93] Continuing review of the program is the responsibility of the FIA.

Despite extensive regulatory and participatory involvement of government in the insurance industry (or perhaps because of it), individual consumers and community organizations have expressed increasing discontent over insurance practices in recent years. Nowhere has concern over insurance unavailability and redlining been expressed more intensively than in Chicago. Illinois is one of the few States which has recently enacted insurance redlining legislation and the city of Chicago is the only major metropolitan jurisdiction where a local insurance redlining ordinance has been formally introduced. The following chapter examines how underwriting practices vary within the city of Chicago and what factors appear to account for current practices.

[83] Jimenez letter.
[84] Chicago Metropolitan Loss Bureau, "Analysis of incendiary fires—Chicago Metropolitan area," June 9, 1978. Donald H. Mershon, manager, Chicago Metropolitan Loss Bureau, telephone interview, July 31, 1978.
[85] 42 U.S.C. §§4011–4127 (1970), *as amended* by 42 U.S.C. §§ 4011–4128 (1976).
[86] 42 U.S.C. §4015 (1976).
[87] 42 U.S.C. §4055 (1976).
[88] 42 U.S.C. §4012(c) (1976).
[89] 12 U.S.C. §§1749 bbb–10a,–21 (1976).
[90] 12 U.S.C. §§1749 bbb–2(a)(2), –10a(1976).
[91] 43 Fed. Reg. 50,428 (1978) *revising* 24 C.F.R. §1931.1(b)).
[92] 12 U.S.C. §§1749 bbb–2(a)(2),-2(a)(5) (1976).
[93] *Full Insurance Availability*, pp. 32–34.

Chapter 4

Redlining or Underwriting: The Marketing of Insurance in Chicago

In Chicago, problems with insurance availability have recently been receiving increased attention from diverse groups. Several community organizations have charged insurance companies with redlining their neighborhoods. A group of black State legislators from Chicago has filed a lawsuit charging 10 companies (and the department of insurance) with redlining and racial discrimination. The department of insurance claims to be actively investigating consumer complaints and working on further legislation to resolve redlining problems. On the other hand, segments of the industry have publicly recognized that unavailability problems do exist and are working to resolve those problems. (The activities of these groups are described in the following chapter.)

One fact upon which there is general agreement is that the availability and cost of homeowners insurance varies from community to community. What the parties to the debate do not agree on is why. The industry argues that it follows the dictates of sound actuarial principles in its underwriting activities. As the National Association of Insurance Commissioners (NAIC) recently stated, "Under fire insurance and homeowners insurance rating plans it is common to charge different rates for insurance coverage because of the different loss experiences associated with rating territories or zip code areas."[1] Others charge that the industry's underwriting criteria are subjective and arbitrary and result in discrimination against racial minorities and residents of older communities. Studies of Chicago and other cities across the country have concluded that homeowners property insurance is more difficult to obtain in older urban areas. These studies report many cases of individuals who have apparently been unfairly discriminated against as a result of subjective and arbitrary underwriting practices.[2] What remains unknown is the extent to which variations in insurance availability, cost, and services from neighborhood to neighborhood are functions of objective loss-related underwriting practices and the extent to which those variations result from subjective, unfairly discriminatory decisionmaking on the part of the industry. The following pages attempt to answer this question for the city of Chicago.

Insurers pay the property claims of their insureds when insured property is damaged (principally because of fire) and when property is lost or stolen (principally the result of theft). According to the Insurance Services Office, a rating service which serves 40 percent of the companies selling homeowners insurance in Illinois, losses due to fire and theft accounted for over 74 percent of the dollars paid out by insurance companies to Chicago policy-

[1] Statement on Behalf of the National Association of Insurance Commissioners on Title II of H.R. 3504, July 28, 1978, p. 4 (hereafter cited as NAIC Statement).

[2] Thomas C. Jones, *Essential Insurance in Michigan: An Avoidable Crisis* (Lansing: Insurance Bureau, Michigan Department of Commerce, 1977). Anton R. Valukas, *An Investigation of Discrimination in the Sale of Homeowners Insurance in Illinois* (Illinois Department of Insurance, 1977). Richard D. Rogers and Kim Brunner, *Redlining: The Illinois Experience* (Illinois Department of Insurance, 1977). U.S., Department of Housing and Urban Development, *Insurance Crisis in Urban America*, a report prepared by the Office of the Federal Insurance Administrator, U.S. Department of Housing and Urban Development (May 1978). Carl Levin, *Homeowner's Insurance in Detroit: A Study of Redlining Practices and Discriminatory Rates* (1976). Alice Paul and Ken Baker, *Economic Investment and the Future of Neighborhoods* (New York: New York City Commission on Human Rights, 1977). Washington State Commission on the Causes and Prevention of Civil Disorders, *Race and Violence in Washington State* (1969). Robert Abrams, *The Insurance Industry: It Redlines Too, Report of the Borough President of The Bronx* (1978). Sheilah Thorn, *Property Insurance Availability in New Haven: Preliminary Findings* (1978).

holders of homeowners insurance between July 1972 and June 1977.[3] It is reasonable to expect, therefore, that differences in underwriting activities from one community to another will reflect the underlying disparities in fire and theft. The minority composition, the economic level of a community, and the age of buildings, independent of loss experience, should not affect underwriting decisions unless those decisions are based on unfairly discriminatory considerations. The NAIC acknowledges that availability problems have racial implications but denies that the industry bases underwriting decisions on racial composition *per se*. Rather, such problems are "the product of a correlation between geographic location of risks and racial composition of neighborhoods."[4] In other words, according to the NAIC, minorities tend to be located in areas experiencing high losses and thus they have greater insurance availability and affordability problems. To the extent that racial composition, age of buildings, or economic level of a community, independent of loss experience, influence underwriting decisions, underwriting is based on subjective and unfairly discriminatory factors. In the following analysis several variables are examined to identify which factors best explain the variance in insurance marketing activities among neighborhoods in Chicago, to examine the extent to which redlining is a reality in that city, and finally, to determine whether or not industry practices violate State or Federal law.

Data and Methodology

Data were obtained from a variety of sources. First, the Illinois Department of Insurance provided the number of cancellations, nonrenewals, new policies, and renewals of homeowners and residential fire insurance policies by ZIP code for the months of December 1977 through February 1978. The companies that provided this information to the department account for more than 70 percent of the homeowners insurance written in the city of Chicago.[5] The department also supplied the number of FAIR Plan policies written and renewed in Chicago, by ZIP code, for the months of December 1977 through May 1978. Since most FAIR Plan policyholders secure such coverage only after they have been rejected by the voluntary market, rather than as a result of a preference for that type of insurance, the distribution of FAIR plan policies is another measure of insurance availability in the voluntary market.[6]

The loss data from which most insurance companies develop their rates are approximately 2 years old, with homeowners insurance loss data ordinarily collected over a 5-year span going back from 2 to 7 years.[7] Therefore, other data including incidence of fire, theft, and minority composition were analyzed for years within this period rather than for the year which the actual insurance underwriting practices being analyzed occurred. The Chicago Police Department provided data on all index and non-index crimes by police beat for the year of 1975.[8] The bomb and arson squad of the Chicago Police Department provided the specific street location of each arson incident occurring in 1975.[9] The Chicago Fire Department provided the address of each building fire which occurred in that year.[10] The U.S. Bureau of the Census supplied data on racial

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[3] Carole J. Banfield, vice-president, Insurance Services Office, letter to Gregory D. Squires, Midwestern Regional Office, U.S. Commission on Civil Rights, Aug. 7, 1978.

[4] NAIC Statement, p. 8.

[5] Robert Gossrow, Property and Casualty Actuary, Illinois Department of Insurance, letter to Gregory D. Squires, Midwestern Regional Office, U.S. Commission on Civil Rights, July 11, 1978.

[6] Robert Gossrow, telephone interview, Oct. 2, 1978. Philip R. O'Conner, Illinois Department of Insurance, telephone interview, Oct. 2, 1978. Gossrow stated that if any redlining has been going on, most of it probably occurred in the late 1960s and early 1970s. With the advent of the FAIR Plan, he suggested that several companies may have stopped writing insurance in Chicago. The current distribution of FAIR Plan policyholders, therefore, reflects the underwriting activity of the industry over the past few years. O'Conner stated that the department of insurance views the distribution of FAIR Plan policies as a measure of unavailability in the voluntary market.

[7] Carole Banfield, Insurance Services Office, telephone interview, June 5, 1978.

[8] The index and non-index crime data provided by the Chicago Police Department are those which the department reported to the FBI for its uniform crime statistics reports. The data reported are the number of arrests. It should be noted that if one incident represents several chargeable crimes, only the most serious crime is reported. If, for example, a person broke into a home, stole a string of pearls, and killed one of the residents (thus committing burglary, robbery, and homicide), this incident would be recorded as a homicide for the purposes of the uniform crime statistics, although the individual would be charged with more than the single offense.

[9] The arson data provide the number of incidents, not the number of arrests. Only those arson incidents occurring in a private residence or residential garage are included in this analysis. There is some overlap between arson incidents and arrests for non-index crimes, since arson is categorized by the FBI and the Chicago Police Department as a non-index crime. However, Deo Dantes of the Chicago Police Department informed Commission staff on July 21, 1978, that there were only 232 arson arrests in 1975 out of a total of 347,550 arrests for non-index crimes. The overlap, therefore, represents less than one-tenth of 1 percent of all non-index crimes, causing little, if any, distortion in the analysis.

[10] Whether or not a given fire occurred in a residential or commercial property is unknown. However, David Ciszik of the Chicago Fire Department informed Commission staff on June 7, 1978, that only 18 percent of structural fires in the city of Chicago in 1975 occurred in commercial buildings. Given that this analysis focuses on residential neighborhoods, and excludes several predominantly commercial ZIP codes, the proportion of commercial fires included in this analysis is undoubtedly smaller than 18 percent.

composition, income, and the age and value of residential units for each ZIP code in Chicago.[11] To eliminate the bias that would result from the differences in the population of different ZIP code areas, the insurance, fire, and arson variables are expressed in ratios as incidents per housing unit and the remaining crime variables are expressed in ratios as incidents per 1,000 population.

The basic objective of the analysis is to determine the extent to which such loss-related factors as fire and theft account for the variance in underwriting activity among Chicago neighborhoods, and the extent to which such factors as minority composition of neighborhoods, income, and age of housing account for that variance. All predominantly residential ZIP codes in the city of Chicago were included in the analysis.[12]

Of particular interest is the extent to which the racial composition, income, and age of housing of a community affect current underwriting practices after controlling for those factors which directly cause compensable losses (e.g., fire, theft). Second, underwriting activity is compared between neighborhoods containing a high proportion of minority residents and those which are predominantly white.[13] Third, communities with similar theft and fire rates but which differ in minority composition, age of housing, and income level are identified and insurance practices between these areas are compared.

Several qualifications must be kept in mind in reading the following analysis. First, the analysis does not indicate how many people are having availability or affordability problems. Rather, it focuses on the variance from ZIP code to ZIP code in current underwriting activity and those factors which are associated with that activity. Second, the insurance data come from companies that are writing at least some property insurance in the city of Chicago. Part of the unavailability problem results from the fact that some companies have stopped writing insurance altogether within the city. Frequently those companies that remain receive severe criticism for redlining while those who have stopped writing any insurance in the city go blameless. Third, this analysis does not take into consideration a number of factors identified earlier which contribute to the unavailability problem. These factors include limited capacity, upstreaming of company surplus, and the uninsurability of certain risks. Redlining and unfair discrimination, which this analysis focuses on, account for only a portion of the unavailability problem. Fourth, this study does not examine such subtle, though important, forms of redlining like variation in costs, coverage, or terms under which insurance is available in the voluntary market. Fifth, it is recognized that no company claims to base its underwriting decisions on the specific variables examined here. As indicated in chapter 2, the principal variables utilized in developing rating classifications for homeowners property insurance are construction (brick or frame), fire protection ratings of municipalities, occupancy (hazards involv-

[11] Racial composition is represented by the percentage of minorities in the ZIP code. The percentage of minorities living in each ZIP code is the sum of the percentage of nonwhites plus 0.94 times the percentage of the Spanish language population, as reported by the U.S. Bureau of the Census, 1970 Census of Housing and Population, Fifth Count, Selected Social and Economic Characteristics of Metropolitan Chicago ZIP Code Areas. The Census Bureau does not report the Spanish language population as a racial minority even though this particular group shares many of the problems facing racial minorities and the general community perceives this group more as a minority than as part of the majority white population. The Census Bureau does report the racial composition of the Spanish language population, some of whom are reported as members of racial minority groups. Therefore, adding the Spanish language and nonwhite population would result in some double counting and inflation of the actual minority population. Leaving out the Spanish language population from the minority group altogether would result in a serious undercount of minorities in several Chicago ZIP codes. Since 94 percent of the Spanish language population in urbanized areas in Illinois are reported as white, and since most of Illinois' Spanish language population resides in Chicago, the formula indicated above was utilized to determine the minority population. (The racial composition of the Spanish language population was taken from: PC(D)-C15 *General Social and Economic Characteristics*, 1970 Census of Population, Illinois, table 49.)

For purposes of this analysis, ZIP codes with a minority population of 10 percent or less are considered predominantly white; those with a minority population larger than 10 percent but less than 50 percent are considered mixed; while those with a minority population larger than 50 percent are considered predominantly minority. This configuration approximates the categorization scheme utilized by the Chicago Urban League in its 1978 report, "Where Blacks Live: Race and Residence in Chicago in the 1970's." In addition, limits of 10 percent and 50 percent divide Chicago ZIP codes out into three approximately equal groups: 18 predominantly white, 14 mixed, and 15 predominantly minority.

Income refers to the median family income in each ZIP code. The age variable is simply the percentage of housing units built in a ZIP code in 1939 or earlier. Housing value is the median value of all housing units in the ZIP code.

[12] The unit of analysis is individual ZIP codes for the city of Chicago. Downtown (Loop area 60601–60606) business ZIP codes were deleted since the total population of these six ZIP codes is less than 7,000. Those ZIP codes with 10,000 or more residents were included. Some manipulations of the ZIP code data were necessary because ZIP codes 59 and 60 did not exist in 1970, and the census data utilized in this study are for 1970. In 1970 ZIP code 26 contained the area now included in both 26 and 60; therefore, these two ZIP codes were combined into one for the purposes of this analysis. Similarly, in 1970 ZIP code 45 contained the area now included in both 45 and 59, so these two ZIP codes were combined.

[13] A similar analysis comparing ZIP codes containing predominantly new housing with those containing predominantly older homes proved unworkable since there are too few ZIP codes that could be considered "new" within the city to permit a statistically valid analysis. In all but 13 ZIP codes more than half the residential units were built before 1940. In all but six ZIP codes more than 60 percent of the residential units were built before 1940. If the sample of 47 ZIP codes had been dichotomized into "older" and "newer" categories, several ZIP codes in which over half the housing was built before 1940 would have been included in the "newer" category.

ing heating, electrical, or other combustible material), and exposure (location of other buildings which may affect losses). However, given the perils for which homeowners insurance provides protection and the functions that rating classifications and underwriting practices are supposed to perform, it is reasonable to expect that differences in insurance underwriting activity from one neighborhood to the next would reflect differences in fire and theft rates. Another reasonable assumption is that racial composition, income, and age of housing, independent of loss experience, should be irrelevant.

Finally, it is recognized that many companies do not use ZIP code classifications. Some do,[14] however, and many underwriting decisions are made on the basis of factors that are not included in company classification systems,[15] such as perceived neighborhood characteristics. Sometimes, the use of a combination of factors results in geographic variations in marketing practices. As the Illinois Legislative Investigating Commission stated:

> It is entirely possible that many insurance companies are no longer considering geographic location in their assignments to risk categories. Yet it is also entirely possible that these companies have found some other variable or combination of variables which are equally unjust and the use of which has the same or similar effect.[16]

The industry is charged with discrimination on the basis of geographic location, particularly against older urban communities within major metropolitan areas. To understand the extent to which these charges have merit, it is vital to examine, on a neighborhood level, how industry practices vary. The ZIP code data available through the Illinois Department of Insurance provide an opportunity to conduct this kind of examination.

Results

Insurance underwriting activity varies markedly among ZIP codes within the city of Chicago. The number of homeowners policies written and renewed between December 1977 and February 1978 by those companies included in the data provided by the Illinois Department of Insurance ranged from 170 (0.6 per 100 housing units) in ZIP code 60653 (a predominantly black community on Chicago's south side) to 3,713 (10.3 per 100 housing units) in ZIP code 60634 (a predominantly white community in the northwest side of Chicago). The number of FAIR Plan policies written and renewed ranged from 2 (virtually 0 per 100 housing units) in ZIP 60652 (a predominantly white community in the southwest side) to 735 (1.9 per 100 housing units) in ZIP code 60623 (a predominantly black community with a substantial Hispanic population in the west side).

Both the voluntary and involuntary markets are examined in order to analyze the variation from ZIP code to ZIP code in current underwriting activity. Voluntary market activity is represented by the following ratio: new and renewed homeowners policies minus cancellations and nonrenewals per 100 housing units. Involuntary market activity is represented by the following: new and renewed FAIR Plan policies per 100 housing units.

The variable which correlates most strongly with current voluntary market activity is minority composition of the ZIP code ($r = -.78$) (see table 4.1). The negative correlation indicates that as minority concentration increases, the amount of voluntary market insurance currently being written in the ZIP code decreases. More than 60 percent of the variance in current voluntary market activity can be explained by minority composition. (Variance is determined by squaring the simple correlation.) Median income (.75), fire ($r = -.69$), age of housing ($r = -.61$), and theft ($r = -.31$) are also associated with current voluntary market activity.

Similar relationships are found in current involuntary market activity (FAIR Plan). The strongest correlation with this variable, again, is minority composition. As the minority composition of a ZIP code increases, so does the concentration of involuntary market activity ($r = .72$). Fire ($r = .70$), median income (-.66), and age of housing ($r = .48$) are also significantly related to involuntary market activity.

Of particular interest are the correlations between minority composition, age of housing, and current underwriting activity after the effects of fire and the effects of theft have been eliminated. Even with fire and theft removed from the effect of minority composition, the correlation between minority com-

[14] For example, Allstate Insurance Company's *Homeowners Mannual* for 1977 lists six territorial zones for the city of Chicago, each consisting of from 5 to 17 specific ZIP codes. State Farm Mutual Automobile Insurance Company uses ZIP codes to define the boundaries of two of its four Chicago rating territories, according to 1976 rating sheets provided by the Illinois Department of Insurance.

[15] See footnote 2.

[16] Illinois Legislative Investigating Commission, *Redlining—Homeowners' Insurance (Interim Report)*, A Report to the Illinois General Assembly (June 1978), p. 8.

Table 4.1

Correlation Matrix

	1	2	3	4	5	6	7
1. Voluntary Market Activity (new and renewed homeowners policies minus cancellations and nonrenewals per 100 housing units)		—.75 (p<.001)	—.69 (p<.001)	—.31 (p<.05)	—.78 (p<.001)	—.61 (p<.001)	.75 (p<.001)
2. Involuntary Market Activity (new and renewed FAIR Plan policies per 100 housing units)			.70 (p<.001)	.15 (NS)	.72 (p<.001)	.48 (p<.001)	—.66 (p<.001)
3. Fire (fires per 100 housing units)				.56 (p<.001)	.60 (p<.001)	.41 (p<.01)	—.61 (p<.001)
4. Theft (thefts per 1,000 population)					.26 (NS)	.32 (p<.05)	—.17 (NS)
5. Minority Composition (percent minority in population)						.26 (NS)	—.70 (p<.001)
6. Age of Housing (percent of residential units built before 1940)							—.53 (p<.001)
7. Income (median family income)							

position and voluntary market activity remains statistically significant (r = -.36).[17] The correlation between age of housing and voluntary market activity also remains statistically significant (r = -.46). In other words, there is a statistically significant relationship between minority composition and current voluntary market activity, as well as between age of housing and current voluntary market activity which cannot be attributed to the two major causes of loss—fire and theft. The greater the minority concentration of an area and the older the housing, independent of fire and theft, the less voluntary insurance is currently being written.

Minority composition and age of buildings are also associated with involuntary market activity, again even after the effects of fire and theft have been removed. Whereas these variables are negatively associated with the voluntary market activity (i.e., as the minority composition or age of housing increases, the number of voluntary market policies decreases), these factors are positively associated with involuntary market activity (i.e., as the minority composition or age of housing increases, the number of FAIR Plan policies increases).

With fire and theft controlled, there is a statistically significant positive relationship between minority composition and involuntary market activity (r = .41) and between age of housing and involuntary market activity (r = .31). The greater the minority concentration and median age of housing, independent of the effects of fire and theft, the greater is current involuntary insurance market activity. Again, part of the variance in current involuntary market activity explained by minority composition and age of housing cannot be accounted for by fire or theft.

Given the relationship between minority composition and income (r = -.70), a question arises as to whether the relationship between minority composition and current market activity reflects the lower economic status of minorities rather than minority status per se. The relationship between income and current voluntary market activity (r = .44) is somewhat stronger than the relationship between minority composition and current voluntary market activity (r = -.36), after controlling for fire and theft in both cases. But the relationship between minority composition and current voluntary market activity is still statistically significant (r = -.39), even after the relationship between income and minority status is eliminated. The correlation between income and current voluntary market activity, controlling for minority composition, is also significant (r = .33). That is, both income and minority status are independently related to current underwriting activity in the voluntary market.

The significant relationship that exists between income and current voluntary market activity cannot be accounted for by the interrelatedness of income and fire and theft. And while income independent of the effect of fire and theft may be a slightly better predictor of current voluntary market activity than minority composition, the relationship between minority composition and current voluntary market activity is independent of the lower economic status of minorities.

The relationship between income and current involuntary market activity, after controlling for the relationship of fire and theft, proved to be not statistically significant. Similarly, the relationship between income and involuntary market activity, after controlling for the relationship of minority composition with income, is not statistically significant. The relationship between minority composition and current involuntary market activity, controlling

[17] Part correlations were calculated to measure the relationship between a predictor or independent variable (e.g., minority composition) and a criterion or dependent variable (e.g., voluntary market activity) after removing that part of the predictor variable associated with another predictor variable (e.g., fire).

Both first order part correlations (which remove the effects of one predictor variable) and second order part correlations (which remove the effects of two predictor variables) were calculated.

The formula used to calculate first order part correlations between a predictor variable (e.g., minority composition) and a criterion variable (e.g., voluntary market activity) after removing that part of another predictor variable (e.g., fire) which is associated with the first predictor variable (minority composition) is:

$$r_{1,2\cdot3} = \frac{r_{1,2} - (r_{1,3})(r_{2,3})}{\sqrt{1-(r_{2,3})^2}}$$

Where
variable 1 = minority composition
variable 2 = voluntary market activity
variable 3 = fire

The formula used to calculate second order part correlations in which the effects of two predictor variables (e.g., fire and theft) are removed is:

$$r_{1,2\cdot3,4} = \frac{r_{1,2\cdot4} - (r_{1,3\cdot4})(r_{2,3\cdot4})}{\sqrt{1-(r_{2,3\cdot4})^2}}$$

Where
variable 1 = minority composition
variable 2 = voluntary market activity
variable 3 = fire
variable 4 = theft

for income, is significant (r = .34). As indicated above, the relationship between minority composition and current involuntary market activity, after removing that part of the minority composition variable related to fire and theft rates, is significant (r = .41). Whereas income explained part of the variance among ZIP codes in current voluntary market activity, and even part of the relationship between minority composition and current voluntary market activity, income is not a statistically significant predictor of the variance among ZIP codes in current involuntary market activity independent of these other factors. The relatively high proportion of FAIR Plan policies in minority areas, therefore, cannot be explained in terms of fire, theft, or economic status of those areas.

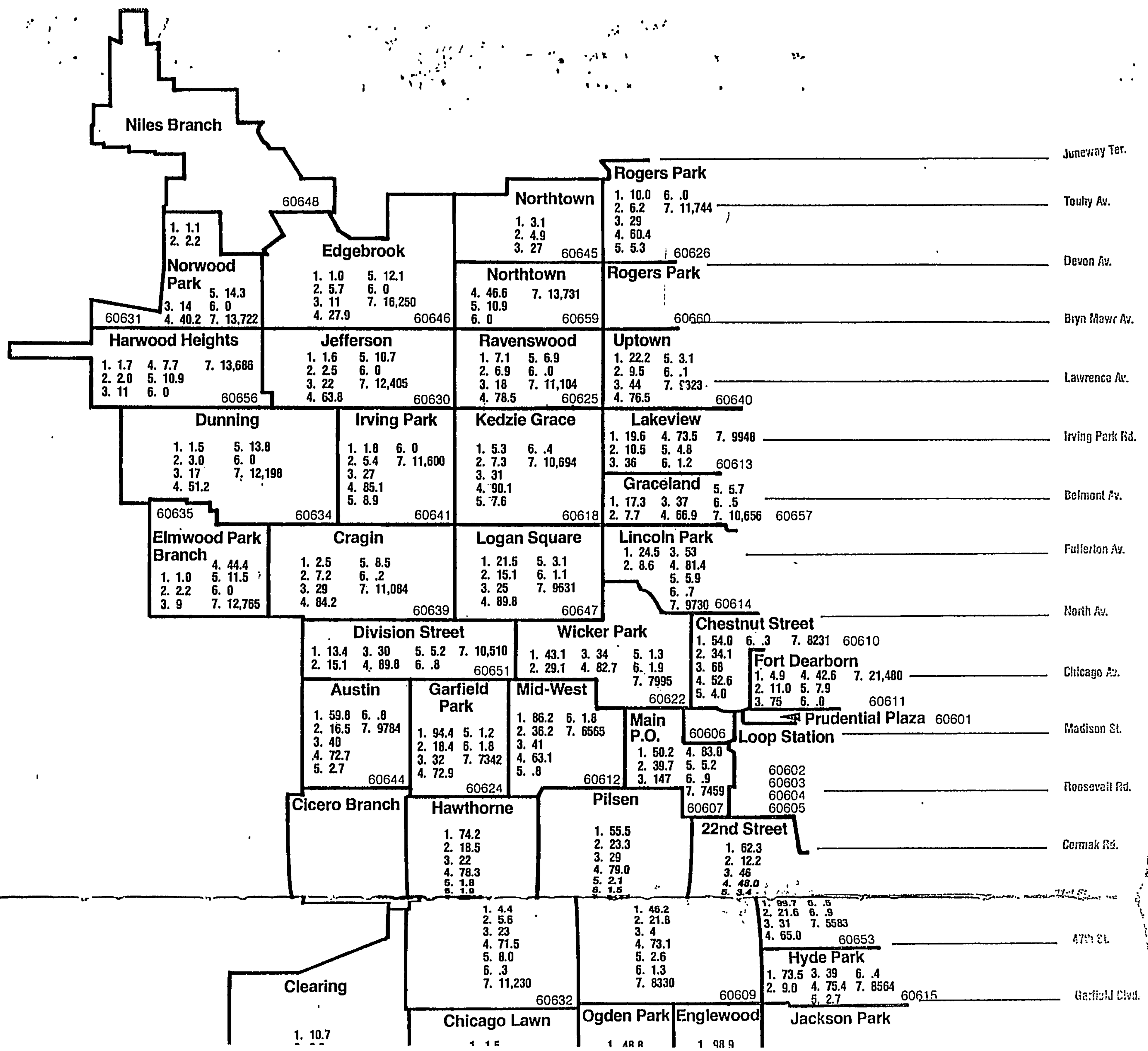
When the effects of fire and theft were examined in predominantly white and predominantly minority areas separately, no significant differences were found. In other words, fire and theft generally account for the same proportion of the variance in white and minority communities.

The fact that minority composition, age, and income explain a portion of the variance in current underwriting activity which cannot be accounted for by fire or theft is illustrated by the varying levels of underwriting activity which exist in ZIP codes having similar fire and theft rates, but differing in their minority composition, age of housing, or median family income. For example, ZIP code 60637 with a minority population of 90.6 percent and ZIP code 60651 with a minority population of 13.4 percent had similar fire rates (11.3 and 13.4 per 1,000 housing units, respectively) and similar theft rates (34 and 30 per 1,000 population, respectively), yet the current voluntary market activity differed widely. The voluntary market ratio in the mixed ZIP code (5.2) was more than two and one-half times the ratio in the predominantly minority area (1.9) despite the fact that fire and theft rates were approximately the same. The involuntary market ratios were the same in these two ZIP codes, both being .8 (see figure 4.1).

The fact that age is related to current market activity, independent of fire and theft, is illustrated in a comparison of two predominantly white ZIP codes, 60625 and 60655. These areas have similar fire rates (6.9 and 4.8 per 1,000 housing units, respectively), similar theft rates (18 and 19 per 1,000 population, respectively), but differ in terms of the age of housing. In 60625, 78.5 percent of the housing units were built before 1940 compared to 15.2 percent in 60655. The voluntary market ratios, however, were 6.9 in the older community and 13.0 in the newer one. Despite similar fire and theft rates, the voluntary market ratio was almost twice as high in the newer ZIP code than in the older area. Again, the involuntary market ratios were equal, both being 0.

The effect of income, independent of fire and theft, is illustrated by ZIP codes 60609 and 60636, two racially mixed areas southwest of the Loop. These two areas differ in median family income ($8,330 and $9,742, respectively). ZIP code 60609 had the smaller fire rate (21.8 compared to 28.6) and a substantially smaller theft rate (4 compared to 27), and would thus be expected to have a higher voluntary market ratio, yet the voluntary market ratio was only 2.6 in 60609 compared with 4.0 in 60636.

In the city of Chicago the variation from community to community in current insurance underwriting practices is related to the minority composition, age of housing units, and family income of residents in those communities. These relationships are statistically significant and they hold even when that portion of these variables associated with fire and theft rates is removed. While the relationship between minority composition and current voluntary market activity is accounted for in part by the lower economic status of minorities, such is not the case regarding current involuntary market activity. The current concentration of FAIR plan policies in minority areas reflects historical constriction of the voluntary market in these areas. These patterns cannot be explained in terms of fire, theft, or income. In Chicago, the disparate impact of industry practices on older, poorer, and minority communities exists independently of the two major causes of loss, fire and theft.


Niles Branch
60648
Norwood Park
1. 1.1
2. 2.2
3. 14
4. 40.2
5. 14.3
6. 0
7. 13,722
60631
Edgebrook
1. 1.0
2. 5.7
3. 11
4. 27.9
5. 12.1
6. 0
7. 16,250
60646
Northtown
1. 3.1
2. 4.9
3. 27
60645
Northtown
4. 46.6
5. 10.9
6. 0
7. 13,731
60659
Rogers Park
1. 10.0
2. 6.2
3. 29
4. 60.4
5. 5.3
6. .0
7. 11,744
60626
Rogers Park
60660
Harwood Heights
1. 1.7
2. 2.0
3. 11
4. 7.7
5. 10.9
6. 0
7. 13,686
60656
Jefferson
1. 1.6
2. 2.5
3. 22
4. 63.8
5. 10.7
6. 0
7. 12,405
60630
Ravenswood
1. 7.1
2. 6.9
3. 18
4. 78.5
5. 6.9
6. .0
7. 11,104
60625
Uptown
1. 22.2
2. 9.5
3. 44
4. 76.5
5. 3.1
6. .1
60640
Dunning
1. 1.5
2. 3.0
3. 17
4. 51.2
5. 13.8
6. 0
7. 12,198
60634
60635
Irving Park
1. 1.8
2. 5.4
3. 27
4. 85.1
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Kedzie Grace
1. 5.3
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Lakeview
1. 19.6
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Graceland
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4. 66.9
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Elmwood Park Branch
1. 1.0
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Logan Square
1. 21.5
2. 15.1
3. 25
4. 89.8
5. 3.1
6. 1.1
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60647
Lincoln Park
1. 24.5
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3. 53
4. 81.4
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7. 9730
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Division Street
1. 13.4
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7. 10,510
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Wicker Park
1. 43.1
2. 29.1
3. 34
4. 82.7
5. 1.3
6. 1.9
7. 7995
60622
Chestnut Street
1. 54.0
2. 34.1
3. 68
4. 52.6
5. 4.0
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7. 8231
60610
Fort Dearborn
1. 4.9
2. 11.0
3. 75
4. 42.6
5. 7.9
6. .0
7. 21,480
60611
Prudential Plaza
60601
Austin
1. 59.8
2. 16.5
3. 40
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Garfield Park
1. 94.4
2. 18.4
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5. 1.2
6. 1.8
7. 7342
60624
Mid-West
1. 86.2
2. 36.2
3. 41
4. 63.1
5. .8
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7. 6565
60612
Main P.O.
1. 50.2
2. 39.7
3. 147
4. 83.0
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6. .9
7. 7459
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60606
Loop Station
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Cicero Branch
Hawthorne
1. 74.2
2. 18.5
3. 22
4. 78.3
5. 1.8
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1. 55.5
2. 23.3
3. 29
4. 79.0
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22nd Street
1. 62.3
2. 12.2
3. 46
4. 48.0
1. 4.4
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4. 71.5
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1. 73.5
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Juneway Ter.
Touhy Av.
Devon Av.
Bryn Mawr Av.
Lawrence Av.
Irving Park Rd.
Belmont Av.
Fullerton Av.
North Av.
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Madison St.
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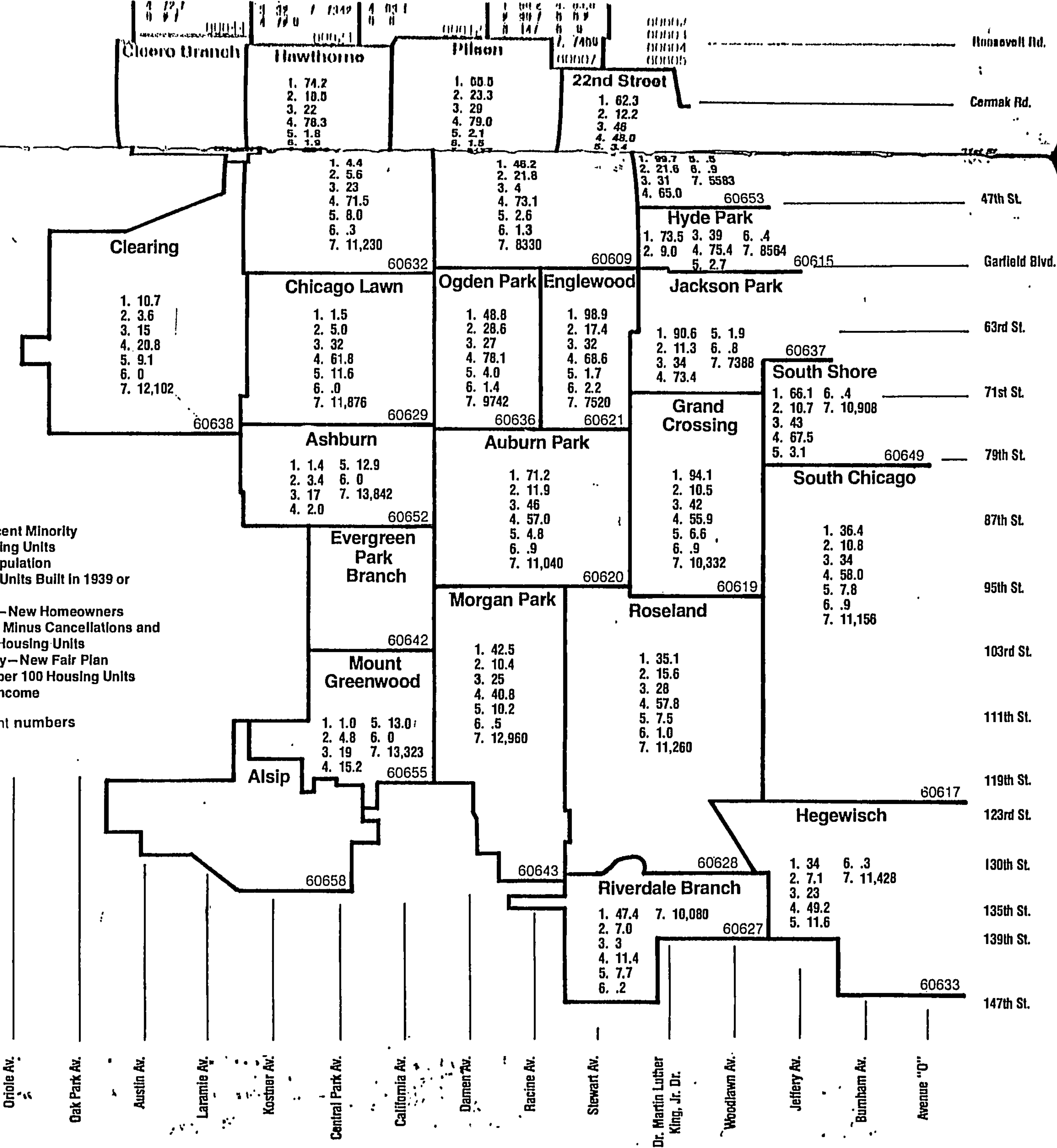

Key

1. Racial Composition—Percent Minority
2. Fire—Fires per 1000 Housing Units
3. Theft—Thefts per 1000 Population
4. Age—Percent of Housing Units Built in 1939 or Before
5. Voluntary Market Activity—New Homeowners Policies plus Renewals, Minus Cancellations and Non-Renewals per 100 Housing Units
6. Involuntary Market Activity—New Fair Plan Policies and Renewals per 100 Housing Units
7. Income—Median Family Income

Zip codes indicated in light numbers

The fact that age is related to current market activity, independent of fire and theft, is illustrated in a comparison of two predominantly white ZIP codes, 60625 and 60655. These areas have similar fire rates (6.9 and 4.8 per 1,000 housing units, respectively), similar theft rates (18 and 19 per 1,000 population, respectively), but differ in terms of the age of housing. In 60625, 78.5 percent of the housing units were built before 1940 compared to 15.2 percent in 60655. The voluntary market ratios, however, were 6.9 in the older community and 13.0 in the newer one. Despite similar fire and theft rates, the voluntary market ratio was almost twice as high in the newer ZIP code than in the older area. Again, the involuntary market ratios were equal, both being 0.

The effect of income, independent of fire and theft, is illustrated by ZIP codes 60609 and 60636, two racially mixed areas southwest of the Loop. These two areas differ in median family income ($8,330 and $9,742, respectively). ZIP code 60609 had the smaller fire rate (21.8 compared to 28.6) and a substantially smaller theft rate (4 compared to 27), and would thus be expected to have a higher voluntary market ratio, yet the voluntary market ratio was only 2.6 in 60609 compared with 4.0 in 60636.

In the city of Chicago the variation from community to community in current insurance underwriting practices is related to the minority composition, age of housing units, and family income of residents in those communities. These relationships are statistically significant and they hold even when that portion of these variables associated with fire and theft rates is removed. While the relationship between minority composition and current voluntary market activity is accounted for in part by the lower economic status of minorities, such is not the case regarding current involuntary market activity. The current concentration of FAIR plan policies in minority areas reflects historical constriction of the voluntary market in these areas. These patterns cannot be explained in terms of fire, theft, or income. In Chicago, the disparate impact of industry practices on older, poorer, and minority communities exists independently of the two major causes of loss, fire and theft.

Chapter 5

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[1] Ninety Day
Force, Mar. 31

Chapter 5

Proposed Solutions to the Problem of Insurance Unavailability

A number of proposals have been suggested, and in some cases implemented, to alleviate the problem of insurance unavailability. Several States have enacted antiredlining laws. In other States, antiredlining bills are currently being debated. The possibility of greater Federal regulation of the insurance industry is also being considered. Voluntary joint efforts on the part of insurance companies and consumers (often with the assistance of insurance departments) have been initiated. New insurance products have been developed and major structural changes in the insurance mechanism (e.g., reinsurance facilities, public insurance programs) have been advocated. More proposals, undoubtedly, will be offered in the near future. Following is a review of some of the programs that have been implemented or proposed.

Industry Response

Representatives of the insurance industry have offered a variety of responses to the problem of insurance unavailability. As indicated in chapter 2, one company has stated that, at least in the State of Michigan, there is no crisis and that the vast majority of policyholders have been well served. At the same time, an underwriting manager for a homeowners insurer in that State said, "Anyone who thinks this industry isn't redlining has his head in the sand." Some members of the industry claim that since insurance is a competitive business, the forces of the market will assure that all qualified risks will be able to obtain insurance. For those unable to obtain insurance in the voluntary market, it is argued, some kind of subsidy is required. If insurance is to be considered essential and available to all members of society, that is a public policy issue which must be settled by public officials. Any costs involved in providing such a subsidy should be paid for by the public sector, not by private industry. Industry representatives have also maintained that the key to increased insurance availability is adequate rates. Without profits a company cannot stay in business and serve the market. Therefore, it is argued, "profit is the necessary cornerstone upon which social responsibility can be built."[1]

Other insurers have acknowledged insurance unavailability is a problem and have taken concrete steps to alleviate the problem. Ralph J. Marlatt, vice president of government and industry affairs of the Professional Insurance Agents, has stated:

> we cannot continue to justify the current practice. The time has come for a basic restructuring of the insurance principles coupled with innovative marketing techniques.[2]

One approach has been the development of new property insurance policies which provide less coverage than standard homeowners policies but still provide essential coverage. Three new forms of insurance policies have been filed with insurance commissioners throughout the country and will be available to consumers in those States which approve them.

One form, referred to as an actual cash value (ACV) homeowners policy, provides coverage similar to that included in the traditional homeowners package (fire, extended coverage, vandalism and malicious mischief, personal theft, and liability). The

[1] *Ninety Day Report of the Advisory Committee to the NAIC Redlining Task Force,* Mar. 31, 1978, p. 5.

[2] Ibid., p. 60.

primary difference is that losses will be adjusted on an actual market value rather than replacement cost basis. That is, a policyholder will be compensated for loss equivalent to the replacement cost of his or her home minus depreciation. Further, insureds will not be required to insure to 80 percent of replacement cost as is required under the traditional homeowners policy for full recovery on partial losses, but will be able to purchase the amount of coverage they deem appropriate. The amount of recovery for loss is limited by the amount of insurance purchased.

A second form, "variable percentage replacement loss settlement endorsement," also permits consumers to insure at less than 80 percent of replacement cost and still receive loss adjustments equivalent to replacement cost for partial losses up to the limits of the policy. This type of coverage will appeal to those who want partial losses to be adjusted on a replacement cost basis, where the replacement cost is greater than the market value of property.

The third form is a "repair cost" program, designed primarily for owners of older homes which contain construction or decorative detail that would be extremely expensive to replace in case of loss. For example, a home may contain elaborate sculpturing on a wall or ceiling, or may be constructed with rare and expensive materials. Again, because the replacement cost of the home far exceeds the market value, conventional homeowners insurance may not be available. But under a "repair cost" policy, the homeowner can have the costs of conventional repairs covered. The elaborate sculpturing may not be replaced, but the insurance will cover the costs of repairing or rebuilding a functional wall or ceiling using contemporary materials and workmanship.

The effectiveness of these new products in alleviating the unavailability problem depends in part on how actively different companies market them. A company may resist becoming the only one offering an innovative product to avoid overexposure in that particular kind of risk. There may be some hesitancy, at least in the early stages, on the part of any particular company to market these new products vigorously until others are also marketing in those areas.

Other companies have stated publicly their opposition to redlining practices. The St. Paul Fire and Marine Insurance Company, for example, recently issued a statement reaffirming "its policy of not refusing to write insurance on the basis of geographic location."[3] According to Robert J. Haugh, "We have never intended to redline but we want to make sure that all of our people understand and properly interpret that policy."[4] The major principles set forth in that statement are:

> The St. Paul will *not* refuse to insure, refuse to renew or otherwise limit property or automobile insurance on the basis of location within a geogephic area (such as a section of a city). . . .
>
> Assuming property is adequately maintained, The St. Paul will not refuse to write property coverage because of the age of a building. The Company will not take underwriting shortcuts such as declining a risk because of similar action by another insurer. Nor will we decline a risk for poor maintenance or unsafe conditions without verification by a physical inspection.
>
> —We will not terminate or refuse to appoint agents on the basis of their office location or the location of their customers.
>
> The Company will provide to present and prospective insureds, upon their request, the reasons for adverse underwriting decisions. . . .
>
> We believe we have an obligation to inform insureds and the public about elements of insurance that affect them directly or indirectly. In the case of policyholders and prospective policyholders, we should tell them how they can prevent losses and control insurance costs. If they are uninsurable, there must be a reason they are uninsurable and we must provide this information. In turn, if they take steps to become insurable, we have an obligation to reconsider their application and provide the insurance. . . .[5]

In some metropolitan areas, members of the insurance industry have participated in voluntary joint efforts with consumers and regulators to resolve the unavailability problems in their communities. Examples of such programs are reviewed below.

Federal Proposals and Recommendations

The business of insurance has received considerable Federal attention over the last several years. Established policies such as the McCarran-Ferguson exemption of insurance companies from Federal

[3] The St. Paul Issues Formal Policy on Geographic Underwriting, News Release, May 26, 1978.

[4] Ibid.

[5] Ibid.

antitrust laws (1945), the FAIR Plan (1968), and rating classifications have been scrutinized with particular care by both the executive and legislative branches.[6] As a result of these appraisals, alternative programs and modifications of existing programs are being suggested.

HUD Assessment of FAIR Plan

In 1974 the Federal Insurance Administration (FIA) issued a report entitled "Full Insurance Availability," which was highly critical of the operation of the FAIR Plan. This plan represents an involuntary residual insurance program. Pointing out, at the time of the report, that only 4.8 percent of the 3 million policies written in the FAIR Plan had annually sustained losses and that 95 percent of those policies had been loss free, the FIA concluded that "the vast majority of insureds in the plans should have been written voluntarily."[7] These individuals, according to the report, have been unfairly relegated to the FAIR Plan. Consequently, they are paying premiums far in excess of what would be a reasonable reflection of the risks they represent as well as subsidizing other genuinely poor risks.

To alleviate the problems created by the residual involuntary insurance market which the FAIR Plan represents, FIA proposed instead a two-level program of full insurance availability through a single voluntary market. The basic premise of the proposal is that every person seeking coverage for an insurable risk will choose his or her own insurer and select the type and extent of coverage from that which the insurer currently offers for other similar risks.[8]

The FIA report points out that two conditions are necessary to meet the goal of full-insurance availability. First, every insurer must accept all risks which meet the objective qualifications of the insurer's risk classification plan. Second, sufficient insurer outlets must be developed to ensure that consumers will have ready access to a number of insurers. The insurance lines that insurers would be required to offer would include coverage for essential personal and business requirements.[9] Objectively determined uninsurable risks—i.e., risks that cannot meet "minimal safeguards against loss"—would not be able to obtain coverage at all.[10]

The second level of the FIA proposal concerns the ultimate disposition of those risks which insurers have accepted and for which policies have been written. To ensure that losses and expenses will be fairly distributed over the entire insurance industry, the FIA plan proposes that a reinsurance exchange be established.[11] Under the FIA plan, any insurer who determines that he has written an amount or type of insurance which impairs his business integrity will be able to cede a share to such a reinsurance exchange.[12] The exchange would consist of all insurers licensed to do business in a particular State. While the individual policy would be serviced exclusively by the primary insurer who would pay all losses on the ceded risk, that insurer would receive from the reinsurer reimbursement to the extent of the ceded risk. Part of the original premium obtained by the insurer from the insured would also be ceded to the exchange in proportion to the extent of the ceded risk. Use of the exchange by primary insurers would be carefully monitored to prohibit them from misusing the facility by retaining only preferred risks.

The full insurance availability proposal anticipates broadened State responsibility and diminished involvement of the Federal Government which would work actively to remove itself from insurance industry regulation and "intrusion."[13] Indeed, the report indicates that federally-controlled programs to solve insurance availability problems would be "inappropriate if not impossible."[14]

Justice Proposal for Regulatory Reform

The Department of Justice, in response to a request of the Task Force on Antitrust Immunities, completed an 18-month survey of the insurance industry in January 1977 in which it recommended substantial changes in the regulation of the business of insurance, including an expanded Federal role.[15]

[6] The McCarran-Ferguson exemption is set forth in 15 U.S.C. §§1011–1015 (1976). The FAIR Plan is set forth in 12 U.S.C. §§1749bbb–bbb-10. (1976) and 24 C.F.R. 1905 (1977).
[7] U.S., Department of Housing and Urban Development, Federal Insurance Administration, *Full Insurance Availability* (1974), p. 2 (hereafter cited as *Full Insurance Availability).*
[8] Ibid., p. 73.
[9] Ibid., p. 74.
[10] Ibid., p. 75.
[11] Ibid., p. 78ff.

[12] Reinsurance is an established medium through which insurers have traditionally ceded to other insurers part or all of a particular risk. The relationship between insurer and reinsurer has no effect upon the contractual relationship between the insured and his primary insurer. Appleman, *Insurance Law and Practice* (1976), §7694, vol. 13A, p. 528.
[13] *Full Insurance Availability,* p. 91.
[14] Ibid., p. 92.
[15] U.S., Department of Justice, *The Pricing and Marketing of Insurance* (1977)(hereafter cited as *The Pricing and Marketing of Insurance).*

The Justice study centered on the pricing and distribution of insurance under the State regulatory system authorized by the McCarran-Ferguson Act of 1945.[16] Justice concluded that rigid State rate regulation effectively stifled competition, created unreasonable insurance rates, and aggravated the present problem of insurance unavailability in the voluntary market.[17] Finally, Justice concluded that the insurance industry does not need the current McCarran-Ferguson antitrust exemption in order to conduct business profitably for itself and safely for the consumer.

In place of the current system of potentially exclusive State regulation of the business of insurance authorized by the McCarran-Ferguson antitrust exemption, Justice recommended an alternative system of Federal chartering analogous to federally-chartered financial institutions. Under this system, insurers would have the option of seeking a Federal charter and relinquishing their antitrust exemption or retaining that exemption under a State charter.

Those insurers electing to operate under a Federal charter would participate in a Federal guaranty system. The guaranty fund, like that of the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Corporation (FSLIC), would provide consumer protection against defaults by insolvent insurance companies whose financial problems had not been detected by a Federal solvency regulatory agency in advance of the default. These companies would be subject to various Federal controls, including Federal solvency and investment standards, Federal laws against invidious discrimination of risks based on race, age, and sex, and Federal standards on the disclosure of price and underwriting information.[18] Federal antitrust laws would be fully applicable to the insurers electing a Federal charter. Those insurance companies electing to retain their exemption from the antitrust laws under the McCarran-Ferguson exemption would remain State chartered and subject exclusively to State regulation.

Even under this dual system of regulation, however, State law would continue to control all insurers licensed to do business within a particular State to the extent that State law was not preempted by Federal law or in conflict with it.[19] In addition, State law would continue to govern the basic insurance contract itself as well as reinsurance facilities located in that State. States would continue to tax insurers doing business within their jurisdiction.

The Justice proposal recommends a considerably expanded Federal regulatory role over the insurance industry. Part of that regulatory role would involve specific Federal legislative prohibitions against invidious discrimination in the business of insurance. Classifications based on age, sex, and race would be closely scrutinized to ensure that such classifications have been objectively validated and do not reflect arbitrary and illogical criteria.[20]

In June 1977, Senator Edward W. Brooke (Massachusetts) submitted a bill to the Senate which embodied the basic ideas of the Justice proposal.[21] Hearings were held on that bill before the Banking, Housing, and Urban Affairs Committee in September 1977. At that time, Senator Brooke indicated that he would not proceed with the bill but would instead submit a revised version containing the same basic principles at a later date.[22] At the time of this report, no such action had been taken.

Legislative Amendment of the FAIR Plan

Concern about the cost of insurance under the FAIR Plan prompted Representative Elizabeth Holtzman (16th District, New York) to offer an amendment to the Housing and Community Development Amendments of 1977 which would have required that rates under a State FAIR Plan could be no higher than those applicable to property insured through that State's voluntary market.[23] At the time the amendment was offered (May 1977), the FAIR Plan rates in New York, for example, were four times those of the voluntary market.[24] However, the House amendment was deleted during the House-Senate conference.[25] As a result, the provision suggested by Representative Holtzman did not become part of the

[16] See discussion of the McCarran-Ferguson exemption in chapter 3.
[17] *The Pricing and Marketing of Insurance*, p. 340.
[18] Ibid., pp. 360–61.
[19] Ibid., p. 369.
[20] Ibid., p. 366.
[21] S. 1710, 95th Cong., 1st sess. (1977).
[22] *Hearings on S. 1710 Before the Committee on Banking, Housing, and Urban Affairs*, 95th Cong., 1st sess., p. 780 (1977).

[23] H.R. 6655, 95th Cong., 1st sess. (1977).
[24] 123 Cong. Rec. 4290 (daily ed. May 11, 1977) (remarks of Rep. Thomas Ashley). In July 1978, the cost of FAIR Plan insurance in New York was between four and five times higher than that of comparable insurance available through the voluntary market. 124 Cong. Rec. 7124 (daily ed. July 21, 1978) (remarks of Rep. Frank Annunzio).
[25] U.S. Code Cong. & Ad. News, 95th Cong. 1st sess., vol. 3, p. 2994 (1977).

Housing and Community Development Amendments of 1977.[26]

The Housing and Community Development Amendments of 1978, which were enacted into law on October 31, 1978, contain the basic proposal of the 1977 Holtzman amendment[27] Effective January 31, 1979, the cost of insurance under a State's FAIR Plan must be essentially the same as the cost of coverage available through that State's voluntary market.

Two additional amendments to the 1978 Housing and Community Development Amendments were also proposed by Representative Holtzman. The first of these amendments, which requires that one-third of the voting members of the State FAIR Plan boards be composed of members drawn from the public and without insurance industry ties, was enacted into law effective October 31, 1978.[28] The second amendment would have required that standard homeowners insurance coverage be made available to consumers through the FAIR Plan.[29] This amendment was defeated in committee in the House and was not included in the Senate version of the 1978 amendments.[30]

Executive Oversight of Current Antitrust Law

On December 1, 1977, President Carter established the National Commission for the Review of Antitrust Laws and Procedures.[31] Part of the commission mandate was to report to the President within 6 months upon the desirability of retaining Federal antitrust exemptions for State-regulated industries, such as insurance companies. The 15-member commission includes the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice and the Chairman of the Federal Trade Commission (FTC).

In a speech before the National Association of Insurance Commissioners, on April 3, 1978, Michael Pertschuk, Chairman of the FTC and a commission member, suggested that insurance company mergers require close monitoring of their impact on competition. Stressing that the FTC fully supports a system of free competition as being in the best interests of consumers, Mr. Pertschuk suggested that Federal antitrust laws must be utilized to prevent those insurance company mergers which effectively restrict competition.[32]

Privacy Commission Recommendations

The 1977 report of the White House Privacy Protection Study Commission[33] focused primarily on abuses in the collection of personal information. Its chapter on insurance, however, contained some recommendations relevant to the problem of insurance unavailability.

Recognizing the variety of sources used by the insurance industry to gather information (e.g., statistical research organizations, investigative agencies, insurance support services), the subjective nature of underwriting practices (e.g., concern for morality, lifestyle, values), and the abuse that does occur in the collection and utilization of personal information, the Commission offered a series of recommendations to resolve an uneasy tension between the industry's need for information and the privacy rights of individuals.

In its 17 recommendations directed to the insurance industry, the Commission maintained that the industry can obtain the information it needs to continue "providing needed insurance protection, properly pricing it, and in servicing insurance contracts,"[34] and at the same time individuals may obtain "the reasons for the adverse action (when such actions are taken) and the specific items of information that support the reasons."[35] The Commission proposed using existing regulatory and legislative mechanisms to keep administrative costs to a minimum, providing incentives for voluntary compliance, and providing protection against liability for unintentional failure to comply. The State insurance departments and the Federal Trade Commission under the Federal Fair Credit Reporting Act would be primarily responsible for implementing the recommendations. The key recommendations as they relate to the problems of insurance unavailability offered by the Commission are:

[26] Act of Oct. 12, 1977, P.L. No. 95–128, Title VII, 91 Stat. 1144.
[27] Act of Oct. 31, 1978, Pub. L. No. 95–557.
[28] Ibid.
[29] H.R. 11969, 95th Cong., 2d sess. (1978); S. 3084, 95th Cong., 2d sess. (1978).
[30] H.R. 12433 and S. 3084, 95th Cong., 2d sess. (1978).
[31] Exec. Order No. 12,022, 42 Fed. Reg. 61,441 (1977).
[32] Michael Pertschuk, Chairman, Federal Trade Commission (remarks before the National Association of Insurance Commissioner, Zone II Conference, Richmond, Va., Apr. 3, 1978), p. 8.
[33] *Personal Privacy in an Information Society, Report of the Privacy Protection Study Commission* (July 1977), chapter 5.
[34] Ibid., p. 220.
[35] Ibid., p. 178.

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[25] U.S. Code Cong. & Ad. News, 95th Cong. 1st sess., vol. 3, p. 2994 (1977).

- Before collecting any information about an applicant or a third party, an insurer must inform the person about the types of information that will be collected; how and from what sources it will be collected, who the information may be shared with, how the individual can receive a copy of any record made on him/her self with the information, and how the person can dispute or change any incorrect information;
- An insurer must provide any individual, upon request, with copies of any recorded information that the insurer has obtained regarding that person;
- Insurers must provide an individual the opportunity to request corrections, amendments, or deletions in any record of information obtained by that institution on the individual. Any organization with which the insurer has shared the information must be notified of any changes which are made. If the insurer refuses to make requested changes, the individual must be provided with the reason(s) for that refusal. The individual must also be provided the opportunity to add a concise statement to the record indicating his or her disagreement and that statement must be shared with those organizations with whom the insurer has shared the contested information.
- When an adverse underwriting decision is made, the insurer must provide the applicant with the specific reason(s) for the decision, the item(s) of information on which that decision was based, the name and address of the institution(s) which provided that information, and upon request a copy of all recorded information concerning the individual used to make the adverse decision. The individual must also be informed of the procedures he or she can initiate to change or dispute any of that information.
- No insurance company can make an adverse decision based in whole or in part on the mere fact that another insurer had made an adverse decision or that an individual had previously obtained insurance through the substandard (residual) market. Such decisions can be affected, however, by the reasons given for previous underwriting decisions.

State Actions

Several States have recently enacted antiredlining laws and others are currently considering a variety of proposals. Most proposals call for reforming the criteria used by insurance companies in their underwriting practices, disclosing the basis of industry decisions to consumers, and increasing "lead time" before a decision to nonrenew or cancel becomes effective. Some proposals, however, call for fundamental alterations in the structure of the insurance industry.

The State of Missouri enacted one of the earliest antiredlining laws.[36] In its act, Missouri prohibited insurance companies from cancelling, refusing to write, or refusing to renew insurance policies solely because of age or place of residence, race, sex, color, creed, national origin, ancestry, or lawful occupation of an individual, or because an applicant had been previously cancelled or nonrenewed by another company. These provisions do not apply where either place of residence or occupation is the sole cause of increased risk of loss. The law also provides that insurance policies may be cancelled only for the following reasons: nonpayment of premium; fraud or misrepresentation; criminal acts increasing the risks insured against; or physical damage to property which increases risk exposure. In addition, when a policy is cancelled the insured must be provided with the precise reason for the decision and the notice of cancellation must be delivered 30 days prior to cancellation.

The State of Illinois enacted a number of laws in 1977 which prohibit insurance companies from refusing to provide homeowners insurance solely on the basis of geographic location and discriminating against similar risks on the basis of race, color, religion, or national origin.[37] Other legislation provides that fire and extended coverage policies that have been in effect for 5 years cannot be nonrenewed except for nonpayment of premium, fraud, or increase in risk.[38] In addition, companies issuing automobile or fire and extended coverage are required to disclose, by ZIP code, the number of policies issued, cancelled, and nonrenewed.[39] Further legislation was enacted in the summer of 1978. Companies are prohibited from cancelling or refusing to write or renew automobile, homeowners, or renters insurance because no agent or broker is

[36] Mo. Rev. Stat., §§375.001 -.008 (Supp. 1977)
[37] Ill. Rev. Stat. ch 73, §767.22, 1031 (1977).
[38] Ill. Rev. Stat. ch 73, §755.13, 755.21a (1977), *amending* Ill. Rev. Stat. ch 73, §755 (1976).
[39] Ill. Rev. Stat., ch 73, §755.25 (Supp. 1977), *amending* Ill. Rev. Stat. ch. 73, §755 (1976).

located in geographic proximity to the residence of the applicant.[40] Companies are also prohibited from cancelling, terminating, or refusing to renew a policy on the ground that the company's contract with the agent who obtained the policy was cancelled, and from cancelling or refusing to write or renew a policy because that person had previously been denied coverage by another insurer. When an application for a fire and extended coverage policy is denied or a policy is cancelled or nonrenewed, the person can obtain the complete file the company has regarding the person's application or policy.[41] The FAIR Plan has also been revised to include availability of a homeowners policy, to provide for immediate "binding" upon application for insurance, to provide for installment payments, and to add four public members (not affiliated with the insurance industry) to the board of directors.[42]

A report prepared for the Illinois Department of Insurance by Anton Valukas included the following recommendations: 1) that the department determine the feasibility of requiring all companies writing homeowners business in Illinois to write a percentage of their business in areas found to be victimized by discriminatory action; 2) that any company found to have engaged in discriminatory activity in violation of Illinois law make insurance available to those areas victimized by such practices. (In California financial institutions found guilty of discrimination in their lending practices on the basis of race, color, religion, sex, marital status, national origin, or ancestry, or due to the racial, ethnic, religious, or national origin composition of the neighborhood or geographic area surrounding a housing accommodation, can be ordered by the State to make the disputed loan)[43]; 3) that an individual have the right to examine the complete file of an insurance company in those cases where a person believes he or she has been declined a policy, cancelled, or nonrenewed for improper reasons; and 4) that ZIP code reporting be expanded to include loss information.[44]

In July 1978, Illinois Insurance Director Richard Mathias appointed a Citizens Task Force on Homeowners Insurance Availability to:

- examine the extent to which fire and extended coverage and homeowners insurance are available to urban residents in Illinois and to determine the primary causes of availability problems which may be found;
- inquire into those factors which are related to increased risk for homeowners and to identify underwriting criteria which are demonstrably unrelated to risk and which result in reduced availability;
- explore alternatives to insurance coverage based solely on estimated home replacement costs;
- examine the Illinois FAIR Plan in light of recent legislation prohibiting geographic discrimination in the sale of fire and extended coverage and homeowners insurance;
- recommend specific legislative and regulatory measures which would alleviate the problem of insurance availability for urban residents.

The Task Force consists of agents and brokers, representatives of insurance companies, members of community organizations and civic groups, and officials of savings and loan institutions. Mathias has instructed the group to report its findings by January 1, 1979.[45]

The State of Washington is currently considering a proposal that would prohibit insurers from refusing to issue or renew, or cancelling policies, or varying the price for similar coverage because of the age or location of property, occupation of applicant, or because another insurer refused to issue or renew a policy or cancelled a policy in which that person was the insured. These strictures would not apply where there is a statistically significant relationship between the hazard insured against and exposure to loss which is attributable solely to location of residence or occupation of applicant. The bill would also prohibit insurers from requiring applicants to divulge information on whether another insurer has previously cancelled or refused to issue or renew a policy. Insurers must notify the insured at least 20 days in advance of cancellation or nonrenewal and must give clear reasons for that action.[46]

[40] P.A. 80-1369, 80th Ill. Gen. Assembly, 1978 Reg. Sess. (Aug. 14, 1978), *amending* Ill. Rev. Stat. ch 73, §§755.26, 767.22 (1977).
[41] P.A. 80-1374, 80th Ill. Gen. Assembly, 1978 Reg. Sess. (Aug. 14, 1978), *amending* Ill. Rev. Stat. ch 73, §§753.01, 755.10, 755.23a (1977).
[42] P.A. 80-1363, 80th Ill. Gen. Assembly, 1978 Reg. Sess., (Aug. 14, 1978), *amending* Ill. Rev. Stat. ch 73, §§755.11, 1031, 1065.69, 1065.70, 1065.71, 1065.72, 1065.77 (1977).
[43] Cal. Health and Safety Code §35800–803. (West Supp. 1978).
[44] Anton Valukas, *An Investigation of Discrimination in the Sale of Homeowners Insurance in Illinois* (Illinois Department of Insurance, 1977), pp. 130–31.
[45] Order of Richard Mathias, director of insurance, July 24, 1978.
[46] Code Revisor draft H 2429/78 (fourth draft), State of Washington (1977).

A bill introduced in the Wisconsin Legislature in 1977[47] (but which eventually died in committee[48]) would have prohibited insurers from denying a policy or approving one on terms less favorable than are usually offered because of neighborhood factors other than those conditions affecting present or future property values in the area surrounding the property to be insured. In addition, the Wisconsin proposal would have required all insurance companies to disclose annually the number and dollar amount of all property insurance policies issued and the number of applications denied by census tract. The insurance commissioner would have been required to make a public report on the marketing practices of insurance companies and to identify those tracts which may be deficient in terms of property insurance. If the commissioner found that property insurance is not available in the voluntary market in any part of the State on terms as favorable as those usually offered, he would provide such insurance or require the industry to prepare plans to do so.

In August 1978 the Office of the Commissioner of Insurance launched a ZIP code disclosure program involving companies writing homeowners and residential fire insurance in selected cities within the State of Wisconsin. Companies which wrote more than $500,000 of homeowners insurance in 1977 will be required to report by ZIP code the number of cancellations and nonrenewals beginning with the fourth quarter of 1978. In 1979 this requirement will apply to residential fire policies as well. In addition, companies will be required to report new business and renewal business as well as cancellations and nonrenewals on a quarterly basis.[49]

Two bills introduced in the Minnesota Legislature in 1977 would have prohibited insurance companies from refusing to sell homeowners fire or liability insurance in any area of a town or city in which it sells such insurance. Companies would not be prohibited, however, from varying premiums from one area to another if geographic area is relevant to the assessment of risk.[50] Although neither bill was enacted into law, an amended version of the house bill will be introduced in the 71st legislative session, beginning in January 1979.[51] Under this proposal all companies offering homeowners insurance in metropolitan areas would be required to file annually the following information by census tract: number of policies written, total dollar amount of homeowners coverage written, total dollar amount of homeowners premiums written, number and total dollar amount of claims paid, and the number of claims incurred but not closed or paid. No homeowners policy could be cancelled for any reason except for the following: nonpayment of premiums, policy was obtained through a material misrepresentation, policyholder filed a fraudulent claim, or the premises were substantially changed. Insureds must be given 30 days notice prior to the effective date of the cancellation, 15 days notice if nonpayment of premium is the reason for cancellation. In the case of nonrenewals, insureds must be given 60 days notice, except in the case where nonpayment of premiums is the reason for nonrenewal. Any applicant who has an insurable interest shall be entitled, upon request, to a clearly written statement explaining precisely what type of coverage will be provided and under what terms or the reason why the application is denied. This proposal will also prohibit insurers offering homeowners coverage in any city from refusing to sell or renew or from charging different rates for similar coverage on other properties in that city solely because of geographic location.

The State of Indiana has debated insurance redlining legislation for several years but no antiredlining laws have yet been enacted.[52] A bill recently introduced in the house by Representative Jule G. Harris would have prohibited an insurer from refusing an application, nonrenewing a policy, or setting unfairly discriminatory rates primarily on the basis of the age or geographic location of the property or the age, sex, race, color, ancestry, or occupation of the occupants. In addition, companies offering a type of insurance in one part of the State would be required to offer that type in every geographic location.[53] This particular bill died in committee.

Another bill drafted for but never filed by Senator Katie Hall would have prohibited insurers from

[47] Assembly B 13, Wis. Gen. Assembly (introduced Jan. 6, 1977) (1977).
[48] Marsha Coggs, State Representative, testimony before the Wisconsin Advisory Committee, June 1, 1978, p. 37.
[49] Bulletin from Harold Wilde, commissioner of insurance, to all insurers writing homeowners and residential fire premiums in Wisconsin, Aug. 31, 1978.
[50] H.F. No. 189, 70th Minn. Leg. Sess. (1977). S.F. No. 588, 70th Minn. Leg. Sess. (1977).

[51] Marge Lane, administration assistant, Financial Institutions and Insurance Committee, Minnesota House of Representatives, telephone interview, July 8, 1978.
[52] Steve Rahn, Legislative Council of the General Assembly, telephone interview, June 8, 1978 (hereafter cited as Rahn Interview).
[53] H.B. 1285, 100th Ind. Leg. Sess. (1978).

refusing to provide or nonrenewing insurance because of the age, sex, race, ancestry, or occupation of the applicant, the age of the property, or the racial composition of the neighborhood in which the property or applicant is located. That bill also would have required insurers to file annually with the insurance commissioner the following information by neighborhood: number of policies applied for, number of policies issued or renewed, number of applications rejected, and number of policies cancelled.[54]

Michigan considers the refusal to insure or renew, or limiting the coverage on the basis of race, creed, color, handicap, occupation, sex, age, or marital status of an applicant, or on the basis of the location of the risk, or because of a previous cancellation, or nonrenewal by another insurer to be an unfair trade practice. With property insurance, location may be taken into consideration only if there is a statistically significant relationship between location and risk.[55]

State Senator Jack Faxon has introduced seven bills to accomplish the following: prohibit cancellation of homeowners policies in mid-term except for grounds of fraud; require companies to inform homeowners of specific reasons for nonrenewal of policies; allow homeowners to purchase insurance equal to the market value of their homes and to receive full cost of repairs in the event of partial loss and market value plus 15 percent in the event of total loss; prohibit discrimination on the basis of geographic location even if there is a statistically significant relationship between location and extent of risk; require companies to justify geographical rating territories; and establish a Joint Underwriting Association from which homeowners could obtain policies at rates comparable to those charged in the private market.[56]

The insurance commissioner in Michigan has proposed a major restructuring of the insurance industry in that State. Under the Essential Insurance Reform Act of 1977,[57] a reinsurance facility, the Michigan Indemnity Association, would be created in Michigan. The association would be similar to HUD's proposed full insurance availability system. Each insurer with more than one-half percent of the homeowners property and automobile insurance market would be required to sell automobile or property insurance to all qualified risks according to the insurance company's class and territory rating plan through normal marketing channels. A company could subsequently cede some of its book of business to the Michigan Indemnity Association. The profits or losses of the association would be shared among all participating companies according to the exposure units written by each company. The act also calls for open competitition to establish rates. The insurance bureau would have responsibility for monitoring the market to assure that rates are not inadequate, or excessive, or unfairly discriminatory. Where open competition does not provide for appropriate rates, the commissioner of insurance would require prior approval of rate filings. Companies would be required to submit documentation to justify their rating plans. Criteria for class and territory plans would have to be objectively defined, with a reasonable relationship between those criteria and the probability of loss. The act also calls for a mandatory merit rating plan which requires a surcharge upon the basic premium. This surcharge is based on criteria that are under the direct control of the individual insured. This plan is designed to eliminate unfair subsidies of bad risks by good risks, and to encourage insureds to contain losses.

State insurance regulators have taken actions in addition to writing, sponsoring, and encouraging new legislation and regulations within individual States. The National Association of Insurance Commissioners (NAIC) created a Redlining Task Force, chaired by Wisconsin Insurance Commissioner Harold Wilde. Recognizing that "some insurers are refusing to insure, refusing to renew, or limiting the amount or type of property and automobile coverage available to individuals because of the geographic location of a particular risk,"[58] the NAIC intends to define redlining and propose model legislation to solve redlining problems by the end of 1978. As a first step, the Redlining Task Force appointed an industry advisory committee. The advisory committee was asked to report to the task force by April 1, 1978, on the kinds of steps the industry should take to address the problems of insurance unavailability. The NAIC intends to hold public hearings and gather other relevant information throughout the year in order to develop its recommendations.[59]

[54] Rahn Interview.
[55] Mich. Stat. Ann. §24.12027 (1977).
[56] "Insurance Redlining," statement prepared by State Senator Jack Faxon.
[57] Originally H.B. §196, Mich. 79th Leg. Sess. (1977) now H.B. 6322, Mich. 80th Leg. Sess. (1978).

[58] "NAIC Statement of Principles and Objectives on Insurance Redlining," Appendix B of *Report to the NAIC Redlining Task Force*, Apr. 1, 1978.
[59] Three nonindustry representatives were appointed to the advisory

The Redlining Task Force is currently considering the following amendment to the NAIC Unfair Trade Practices Act which would declare the following to be unfair trade practices:

> Refusing to insure or refusing to continue to insure, or limiting the amount of coverage available to a risk because of the geographic location of the risk.

In proposed implementing regulations, the following practices are examples of those actions which would violate this amendment:

1. refusing to insure a risk solely because of the age of the property;
2. refusing to enter into a relationship with an agent solely because of the location of the agent's business;
3. refusing to insure a risk solely because the applicant was previously denied coverage or terminated by another insurer;
4. asking on an application whether the applicant was previously denied coverage or terminated by another insurer;
5. not making available the exact reason for insurer's rejection, cancellation, or nonrenewal of an insurance contract;
6. not stating, before issuing a notice of rejection, cancellation or nonrenewal, what corrective actions must be taken to obtain or continue coverage;
7. not having a system for verifying the accuracy of inspection reports;
8. ending a relationship with an agent because of the location of the agent's business or through the application of underwriting or loss ratio standards not generally applicable to all agents of the company.[60]

Recognizing the vast capital assets of the industry, Commissioner Wilde has suggested a "Marshall Plan for the cities—where the insurance industry would use its economic and human resources as part of a major effort by the private sector to revitalize declining neighborhoods (thereby making them better risks)."[61] Available research on industry investment practices indicates that precisely the opposite phenomenon is occuring; that is, companies have demonstrated a strong suburban bias that cannot be explained simply in economic terms.[62]

Local Initiatives

Efforts at the local level include both legal and voluntary activities. The city of Chicago has been extensively involved on both fronts.

Redlining Ordinance

The Chicago City Council is currently considering an antiredlining ordinance. Under this ordinance, any insurance company requesting to share in the $2.8 million of insurance annually purchased by the city must agree to write insurance without discriminating on the basis of location or age of property, or on the basis of the race, religion, color, national origin, sex, or marital status of applicant. The ordinance requires insurance companies seeking city business to submit by ZIP code and by type of insurance a list of all policies in force, all policies that were cancelled or nonrenewed in the previous fiscal year, and all applications that were rejected. Companies found to be in violation of State redlining laws would be ineligible for city business for 2 years. If a company is found guilty of redlining after a bid has been accepted, the city would be required to cancel that insurance policy and to advertise for new bids. When the city's purchasing agent reviews bids, he or she would be required to take into consideration the proportion of a company's Illinois business which is written in Chicago and to give preference to those companies writing a high percentage of their business in the city. Recommendations made to the city council by the purchasing agent must be based on an evaluation of those considerations.[63]

Petitioning the State

Several community organizations in Chicago have attempted to use the leverage of recent State legislation and the authority of the Illinois Department of Insurance to increase availability of conventional insurance within the city. Among the organizations involved are: United Neighbors in Action, Lake View Citizens Council, Southwest Community

committee, including Gregory D. Squires (Research/Writer, Midwestern Regional Office of the U.S. Commission on Civil Rights). Participation on that committee provided Commission staff with an excellent opportunity to learn about the insurance industry.

[60] Proposed Amendment to NAIC Unfair Trade Practices Act and Proposed Implementing Regulations, NAIC Redlining Task Force Meeting, June 11, 1978.

[61] Harold R. Wilde, memorandum to Laura Sullivan, chairperson of Advisory Committee to NAIC Redlining Task Force, Apr. 26, 1978.

[62] Karen Orren, *Corporate Power & Social Change: The Politics of the Life Insurance Industry* (Baltimore: The John Hopkins Univeristy Press, 1974), pp. 97–144.

[63] City of Chicago, "Code Amendment to Intensify Regulations for Insurance Companies Doing Business With City."

Congress, and Metropolitan Area Alliance (MAHA).[64] MAHA accused Allstate of redlining 12 neighborhoods in Chicago after the organization found that more than 2,600 homeowners policies in those communities had been cancelled by that company in a 9-month period in 1977. Allstate responded that the charges were false since it writes 15 percent of the homeowners business in Chicago, including a large proportion of those policies in the areas where it is accused of redlining.[65]

MAHA has continued its organizing drive utilizing a number of tactics, including sending 200 members to Sears, Roebuck and Company's annual stockholders meeting in Chicago in June 1978. (Allstate is a wholly-owned subsidiary of Sears). Allstate President Robert B. Shepard agreed to meet with representatives of MAHA to resolve their differences. At a June meeting the insurance company agreed to eliminate the higher advance premium payment and the requirement of a submission of a signed policy prior to coverage in 12 ZIP code territories where such marketing policies had previously been followed.[66] The company also agreed to provide MAHA with a quarterly listing of the number and types of homeowners policies it sells by ZIP code within the city of Chicago. The reporting will begin on October 1, 1978, and will continue for 1 year.[67]

The Organization of the Northwest

At least one community group on Chicago's northwest side, The Organization of the Northwest (TON), has chosen to negotiate directly with insurance companies. TON recently negotiated a joint urban homeowners plan with CNA which will be put into effect in February 1979.[68] Under this program homeowners insurance will be available to qualified risks on Chicago's northwest side who will participate in a safety group program. A safety and review committee staffed by TON representatives working with CNA will conduct a variety of safety measures including: annual fire prevention interviews with 20 percent of the insureds, an annual spring cleanup campaign to be conducted with the city of Chicago, safety training meetings for insureds with public agencies such as the Chicago Crime Prevention Bureau and the Fire Prevention Bureau, and quarterly meetings to review loss experience and prepare appropriate corrective action plans. After the first 18 months loss experience will be evaluated to determine whether premiums should be adjusted upward or downward.

TON representative Rev. Greg Olson said this program will make insurance available at affordable rates and should contribute to TON's overall strategy for neighborhood improvement. He also expressed hope that this program would be a model for other cooperative efforts involving community groups and insurance companies.

Cleveland Action Committee

The Cleveland Action Committee (CAC) was created by members of the insurance industry to respond to complaints of redlining in that Ohio city. Participants include the Insurance Board of Cleveland, Ohio Insurance Institute, Ohio FAIR Plan, and Allstate, State Farm, Hartford, Nationwide, and several other insurance companies. Between November 1977, when the committee was founded, and February 1978, 101 complaints were received. Each complaint was answered and in 23 cases coverage was reinstated or secured elsewhere. One participant concluded that, "Although every one of the 101 complaints was important, it is also important to emphasize that 101 complaints from several hundred thousand property owners in Cleveland is an indication that there is *not* [emphasis in original] a major redlining problem in Cleveland."[69] Ohio Insurance Commissioner Harry Jump maintains that most complaints are due to the fact that insurance premiums in general have been increasing and that many people believe they have been discriminated against unfairly when in fact no such discrimination has been practiced.[70] As a result of what these industry participants perceive as a successful program in Cleveland, similar committees have been established in Youngstown and Dayton.

[64] "Essential Insurance and the Public Interest," testimony presented to Finance Committee of Chicago City Council by Midwestern Regional Office, U.S. Commission on Civil Rights, Jan. 12, 1978.
[65] "Logan Square Unit Assured of Redlining Probe," *Chicago Sun Times*, Feb. 22, 1978; "MAHA Hits Allstate, Claims Redlining in City Neighborhoods," *Chicago Sun-Times*, Feb. 28, 1978; "Allstate Rips 'False' Charge of Redlining," *Chicago Sun-Times*, Apr. 7, 1978.
[66] "Allstate to Drop 'Zone' Practice," *Chicago Sun-Times*, June 17, 1978.
[67] "Allstate to Check on Redlining," *Chicago Tribune*, Aug. 11, 1978.
[68] TON news release, Mar. 8, 1978, Commission files.
[69] John C. Winchell, executive director, Ohio Insurance Institute, letter to James R. Faulstich, vice president, Industry Relations, National Association of Independent Insurers, Feb. 28, 1978. Also see *OI Newsletter*, Feb. 10, 1978.
[70] Harry Jump, interview in Columbus, Ohio, May 17, 1978.

Buckeye-Woodland Community Congress

According to George Barany, a member of the Buckeye-Woodland Community Congress (BWCC) in Cleveland, Ohio, the Cleveland Action Committee amounts to the proverbial finger which is used to plug up a broken dam.[71] At an April 21, 1978, hearing on insurance redlining conducted by BWCC, the organization released a 10-point legislative program to protect insurance consumers. The specific points were:

1. Requiring insurance companies and the Ohio FAIR plan to disclose the number of cancellations and nonrenewals by ZIP code on a quarterly basis and to file such information with the insurance commissioner;
2. Requiring insurance companies and the Ohio FAIR plan to disclose the number and dollar amount of new policies written and renewals and to file such information with the insurance commissioner;
3. Requiring the State insurance commissioner to compile a report on a quarterly basis and to make that report available to the public;
4. Prohibiting cancellation or nonrenewal of policies because of: geographic location, cancellation of an agent within a territory, previous cancellation, previous rejection by another company, age of dwelling, previous filing of a claim;
5. Prohibiting rate increases based on the fact that a claim had been filed;
6. Requiring that a written explanation and a notice of the right to appeal to the insurance commissioner be supplied with each cancellation and nonrenewal;
7. Requiring any insurance company licensed to sell within the State of Ohio to sell in all areas and prohibiting such companies from refusing to sell in certain areas;
8. Making homeowners insurance available on a market value basis and prohibiting companies from requiring insurance to replacement value;
9. Prohibiting discrimination on the basis of age and sex in the sale of automobile insurance;
10. Requiring the insurance commissioner to establish an office in Cleveland and to be in that office at least once each week.[72]

Voluntary Residential Insurance Placement Committee

In November 1977, Johnnie L. Caldwell, Georgia Insurance Commissioner, asked all companies selling residential property insurance in the State to develop voluntary plans to eliminate geographic discrimination in the marketing of insurance. If the industry failed to act, he said, he would create a Joint Underwriting Association (a risk pooling reinsurance facility similar to the mechanism proposed by the Michigan Insurance Commissioner), provide homeowners coverage in the FAIR plan, or "take other such drastic measures as are necessary to solve the problem."[73]

As a result, the Voluntary Residential Insurance Placement Committee was formed. Members include Allstate, State Farm, Safeco, and several other companies as well as two members of the Georgia Underwriting Association. The committee's responsibility is to study each case of allegedly unjust denial of coverage because of geographic location of the risk and to assist in securing coverage in the voluntary market for those individuals who were in fact unfairly denied coverage. As of January 9, 1978, several complaints were received, 20 of which related to the responsibilities of the committee. Only 13 required further action, 3 of which were found to be legitimate complaints upon committee investigation. Coverage was found for those three complaints.[74]

The Milwaukee Experience

Members of the insurance industry in Milwaukee launched a 3-year effort (1969–72) at the request of the Wisconsin Insurance Commissioner to resolve the unavailability problem in that city. A committee consisting of consumers, public officials, and industry representatives held weekly meetings in the central city to discuss insurance problems with residents. Local media were used to publicize the existence of the committee. Efforts were also made to recruit and train minority agents.

These efforts demonstrated the complexity of the problems and the difficulties in generating solutions. Few minorities were brought into the industry. Many of those who obtained jobs as agents soon left for government positions or other jobs outside the insurance industry. One insurance industry represen-

[71] George Barany, Buckeye-Woodland Community Congress, telephone interview, Mar. 22, 1978.

[72] BWCC Legislative Packet, Laws Needed to Protect Insurance Consumers, presented at Apr. 21, 1978, hearing on insurance redlining conducted by BWCC in Cleveland, Ohio.

[73] Johnnie L. Caldwell, Georgia Insurance Commissioner, memorandum to all insurers authorized to transact residential insurance in the State of Georgia, Nov. 7, 1977.

[74] J.R. Alexander, Voluntary Residential Insurance Placement Committee, letter to Johnnie L. Caldwell, Jan. 9, 1978.

tative, Bob Docuette of Milwaukee Insurance, who was centrally involved in the program, drew the following conclusions:

> Although excellent in concept, the entire program brought to the front the tremendous problem of education, communication, and orientation that could not be solved by any short range two or three-year program. What theoretically looked to be an answer to many of the concerns of the people of the inner city turned out to be the obvious recognition that for a program of this type to succeed, a much longer commitment to a stronger emphasis on education and communication would be necessary.
>
> Today in 1978, we are looking at the same problem. The problem must not seek short-range answers or it will be faced with the same disappointments that we experienced in the early 1970's. There are no easy answers and no easy programs and the insurance industry cannot solve some of the problems that were made obvious during the time of our inner-city program.[75]

Another program was launched in Milwaukee in June 1978 which Doucette believes will prove to be more successful.[76] The Community Insurance Information Center has been created by the insurance industry as a nonprofit service to aid insurance consumers. The center sells no insurance. It provides free information on purchasing automobile and home insurance and assistance to those who are having difficulty obtaining insurance. Consumers are referred to agents within the areas who are able to provide the type of insurance requested. Agency referrals will be made on a rotating basis although attempts will be made to refer individuals to agents who are conveniently located. In those cases where the individual still is unable to purchase the type of insurance he or she wants, staff members of the center will contact the agent for an explanation. If the adverse decision was legitimate, staff will attempt to explain it to the potential buyer. If the decision was not, the center will attempt to encourage the agent to reconsider.

According to Doucette, this program has the full support of more than 50 community groups in Milwaukee. As of November 1978, 12 insurance companies provided financial and staff support for the center.[77] The two principal reasons why Doucette is confident this program will work is that there will be a followup mechanism (which was not included in the previous program) and that the center will be open 5 days each week instead of 1 day as was the case before.

[75] Bob Doucette, Milwaukee Insurance, letter to Laura Sullivan, State Farm Insurance, Feb. 28, 1978.

[76] Bob Doucette, presentation to Advisory Committee to NAIC Redlining Task Force, June 29, 1978.

Neighborhood Housing Services

Neighborhood Housing Services of America, Inc. (NHS), was established in 1974 to stimulate reinvestment in urban neighborhoods. NHS programs are locally controlled, locally funded, nonprofit tax-exempt organizations which offer comprehensive housing rehabilitation and financial services to residents of urban communities. Initial support for these programs came from the Urban Reinvestment Task Force composed of the heads of the following Federal agencies: Federal Home Loan Bank Board, Federal Reserve System, Comptroller of the Currency, Federal Deposit Insurance Corporation, and Department of Housing and Urban Development.

While seed money is provided by the Urban Reinvestment Task Force, the key to these programs is the development of a working relationship among local financial institutions, public officials, and residents. Lenders are asked to make loans at market rates to all homeowners who meet normal underwriting criteria. Local government officials are expected to demonstrate their commitment by making necessary capital improvements and providing appropriate city services, including systematic inspections of housing to encourage maintenance of the housing stock and property value. Residents must want and be prepared to work for the improvement of their neighborhood. A revolving loan fund, operated by the NHS, is maintained for those homeowners who are unable to qualify for conventional loans but who want to make needed home repairs. Such partnerships are operating in 47 cities. In six of those cities more than one NHS program is in operation. Four Chicago neighborhoods are operating an NHS program.

A pilot program will soon be launched in Chicago to bring the insurance industry into the partnership. Recognizing the importance of the availability of adequate insurance, representatives of the insurance industry will work with the other partners to assist

[77] Terri McKinnon, program coordinator, community insurance information center, interview in Milwaukee, Wis., Nov. 29, 1978.

homeowners in obtaining coverage through the voluntary market.[78]

Municipal Insurance Programs

In virtually every discussion of insurance availability, the problem and potential remedies are discussed within the framework of balancing the social needs of the community with the profit needs of the industry. John R. Groves, an attorney for State Farm Insurance Companies, succinctly made this point when he wrote about "the need to maintain a balance between an insurer's business interest, i.e., his incentive to operate on a profitable basis, and the call for social responsibility."[79]

Public officials and consumer groups have also adopted a similar approach. As the New York City Commission on Human Rights maintained, "Effective strategies must be grounded in the realities of our economic system. Attempts to mandate business investment in socially desirable programs must be predicated on the factor of profit if they are to succeed."[80] And in the words of Public Technology Inc.:

> Insurance has become a good necessary for everyday life by most citizens. This is similar to a public good, such as electricity. As such, it must be available to anyone who wants it, and is able to pay for it, at a fair price.
>
> At the same time, the insurance industry must be allowed to make reasonable profits.[81]

While it may be true that the only remedies which the insurance industry and public officials will seriously entertain are those that are firmly rooted within this framework, it also places serious limitations on the entire debate. Generally, such limitations are not recognized: what frequently passes for open, objective problemsolving is in fact an ideological justification for the existing insurance mechanism.

The assumption that an industry's profit needs must be balanced against the services provided to the larger community implies that there are two competing needs, both of which have equal value and both of which must be protected by appropriate public policy. If a conflict arises between the needs of the community and the profit needs of industry, however, it should not be assumed, as is often the case, that the former must be compromised in the interest of the latter. For example, automobile and homeowners property insurance are generally recognized as essential needs of the community. Yet the short-range profit requirements of the insurance industry have sometimes dictated that the genuine insurance needs of the community would not be met. The statement that "profit is the necessary cornerstone upon which social responsibility can be built" only makes sense within the framework of a particular kind of economic system; this statement is by no means an absolute truth. If within the framework of a free enterprise system, the problem of insurance unavailability cannot be resolved, then perhaps a different framework should be explored.

The central problem discussed in this and in many other reports is the unavailability of insurance, not the correct balance between this social concern and the insurance industry's profit margin. When the problem of unavailability is confronted directly rather than as part of a socially constructed economic balancing act, a different set of questions are suggested and a different set of remedies can be considered. For example, rather than asking how two competing interests can be balanced, a more appropriate question might be: are there alternative ways that a group of people can pool their money, spread the financial burdens of loss, and provide more adequate protection and peace of mind for the individuals involved. Such alternatives have been proposed which, if implemented, might well meet these objectives more efficiently and effectively while reducing the number and dollar value of losses.

Municipal Fire Insurance

Public insurance programs have been considered by several State and local governments; many have been successfully implemented. One alternative to the conventional, private sector insurance delivery system is a municipal fire insurance program which

[78] Information packet distributed by Neighborhood Housing Services of America at the 1978 annual meeting of the National Association of Insurance Commissioners, Washington, D.C., June 11–16, 1978.

[79] John R. Groves, letter to Louis Hannes, Office of the Commissioner of Insurance, State of Wisconsin, Oct. 25, 1977.

[80] Alice Paul and Ken Baker, *Economic Investment and the Future of Neighborhoods* (New York: New York City Commission on Human Rights, 1977), pp. 98–99.

[81] Presentation to the D-2 Subcommittee Task Force on Redlining, National Association of Insurance Commissioners, Public Technology Inc., Oct. 11, 1977, p. 4.

has been proposed by the Institute for Local Self Government in Berkeley, California.[82] Basically, this proposal calls for combining fire prevention, suppression, and insurance activities into one integrated system for the purposes of reducing fire losses and all related costs. Currently, fire prevention and suppression functions are generally carried out by local municipalities while fire insurance is provided by private industry. The primary interest of the industry is to generate adequate premium dollars to cover costs and generate a profit. Loss reduction is not a crucial concern. What is crucial is that premiums exceed losses and other expenses. Since territorial rating classifications frequently consist of several cities, the loss experience and prevention activities of an individual municipality may not affect insurance rates in that municipality. Therefore, there is little incentive for individuals to take steps to reduce fires. If the prevention, suppression, and insurance functions were carried out as part of one integrated system, however, such an incentive would exist.

One of the major fire protection costs is insurance. Among the factors which contribute to the cost of fire insurance is the percentage of the premium dollar that goes towards commissions, generally in excess of 20 percent. By eliminating those costs, devoting more resources to fire prevention, and creating appropriate incentives to reduce fire loss, a municipal fire insurance program represents a viable alternative.

By creating a mutually beneficial partnership between the insurer and the insured, the municipal insurance program provides the proper incentive. While insureds will continue to pay premiums, funds which are collected above and beyond those necessary to pay claims can be used for a variety of fire prevention and cost reduction activities. Instead of going to stockholders as dividends on invesments, "profits" can be used to purchase and install smoke detectors in buildings, to increase fire safety inspections, to purchase new equipment or to add personnel to the fire department, to reduce insurance premiums, or for whatever purpose deemed appropriate for the municipality. Eventually, enough surplus revenues could be generated to pay all fire service costs, thus eliminating a majo. line item from the general fund. The key, however, is that the insureds can tangibly benefit from efforts they make to reduce fire losses while the insurance dollar they do spend also contributes more directly to reduction and, ultimately, lower premiums.

There are problems that would have to be solved before a community could implement such a program. Since fire insurance is generally purchased as part of a package, the municipality would have to provide the other coverages or the fire insurance would have to be properly priced and an agreement with private insurers worked out so that remaining coverages could be purchased separately. To set reasonable premiums and to operate a program effectively, insurance experts might have to be consulted to assist the municipality. It might not be possible to maintain large enough reserves to cover random catastrophic losses, requiring creation of a reinsurance mechanism to which some risks could be ceded. In addition, market penetration must be large enough to establish an economically viable program, perhaps requiring mandatory participation of local citizens or a tax of some kind. Problems exist; however, they are not insurmountable. As the California proposal states, "utilizing what would ordinarily be insurance industry 'profits' to provide better local fire protection at reduced cost to citizens can hardly be a bad idea."

A theoretical case study of the costs and benefits involved in creating a municipal fire insurance program in Mountain View, California (a town of 60,000), illustrates the possible savings. After analyzing the actual fire department budget, estimated fire insurance premiums, and reported dollar value of fire losses over a 5-year period, and estimating future costs, assuming implementation of a municipal fire insurance program beginning in 1976, the Institute for Local Self Government estimated that the following would be accomplished by the end of 1982.

1. All single family (9,308) residences and apartment units (18,764) would have had products of combustion detectors installed at a cost of $2,680,000 provided out of the excess fire premiums;
2. All apartment houses would have detectors installed in stairways and over exits;
3. A major catastrophe fund of $2,680,800 would be established through excess premiums, earning at least $160,845 in annual interest;
4. 65 percent of the fire department budget would be covered by excess premiums.

[82] The discussion of the municipal fire insurance program is based on: *Alternatives to Traditional Public Safety Delivery Systems: Municipal Fire Insurance* (Berkeley: Instituttе for Local Self Government, 1977) (hereafter cited as *Municipal Insurance).*

In the spring of 1978 the National Fire Prevention and Control Administration provided the Institute for Local Self Government with a 2-year grant to explore the feasibility of this concept, with the ultimate objective to be demonstration projects in several cities.[83] The institute will determine the fiscal, legal, and political feasibility of five basic municipal insurance models. Utilizing the expertise of individuals from the insurance industry, public administration, fire prevention, law and related areas, the institute will develop a set of guidelines for implementation of a municipal insurance program. These guidelines will then be examined in conjunction with the fiscal, legal, and political characteristics of selected cities to determine whether or not they can be followed to implement a viable program. A number of cities have indicated an interest in the municipal fire insurance concept and 11, including Madison, Wisconsin, have been selected as resource cities to provide data bases for the feasibility analysis. Whether a program is implemented depends on the results of the feasibility study and the willingness of a municipality to launch such an experiment.

Publicly operated insurance programs which cover public property have been operated successfully in many States and in several foreign countries. Twenty-five States currently insure at least a portion of their own State property risks while also purchasing some commercial insurance protection. A State self-insurance program in Alabama, for example, provides fire and extended coverage for State and school buildings and contents at 40 percent of prevailing commercial rates. Operating expenses have been limited to less than 6 percent of earned premiums and as of 1967 the fund had a surplus of $8 million which, along with investment income, covered all operating costs. The State purchases reinsurance to cover losses over $500,000. In Wisconsin, all State and some municipal property is insured under a State program. Insurance premiums were 50 percent of commercial rates between 1934 and 1973 and no premiums on State property were collected between 1961 and 1971, yet the program accumulated a surplus that enabled the legislature to divert $11,500,000 to the general fund between 1955 and 1967.[84]

Historically, groups have responded to what they perceived as unfairly high commercial insurance rates by forming mutual companies to meet their own needs. The Municipal Mutual Insurance Ltd. was established in England in 1903 and currently 410 of 422 local governments insure at least part of their risks with the fund. In Germany there are approximately 20 mutual insurance companies composed of local governments. Seven Chicago surbubs (Midlothian, Crestwood, Robbins, Markham, Country Club Hills, Oak Forest, and Posen) are currently studying the feasibility of forming a mutual insurance program to cover a portion of their risks.[85] Apparently, the private commercial insurance market is not the only viable mechanism for meeting at least some insurance needs.

Nonprofit Automobile Insurance

In 1970 the Canadian Province of Manitoba passed the Automobile Insurance Act which provided that all automobile insurance be written by a nonprofit public corporation entitled the Manitoba Public Insurance Corporation.[86] This program has reduced insurance rates for 90 percent of all policyholders, increased the coverage for most policyholders, introduced no-fault auto insurance to the Province, and provided faster claims service. The program is based on the premise that whenever the private sector cannot or will not provide a service that is regarded as a necessity at an affordable price, the public sector must step in and provide that service.

The Canadian experience appears to be successful.[87] Expenses have been held down to 17 percent of all premium dollars, leaving 83 percent to cover

[83] "Proposed Feasibility Analysis and National Demonstration Project for Municipal Fire Insurance Protection," prepared for the National Fire Prevention and Control Administration by the Institute for Self Government (undated). Charles H. Boehe, National Fire Prevention and Control Administration, telephone interview, Aug. 18, 1978. William Hanna, Mission Research Corporation, telephone interview, Sept. 15, 1978.

[84] *Municipal Insurance*, p. 25. Werner Pfennigstorf, "Governmental Risk Management in Public Policy and Legislation: Problems and Options," *American Bar Foundation Research Journal*, Spring 1977, pp. 285–90, 306 (hereafter cited as "Governmental Risk").

[85] Arthur J. Watson, *The First Fifty Years: Municipal Mutual Insurance Limited* (London: Walter Pearce & Co., 1953). "Governmental Risk," pp. 308–15.

[86] Except where otherwise noted, the discussion of the Canadian experience is based on: *The Manitoba Auto Insurance Plan* (Washington, D.C.: Conference on Alternative State and Local Public Policies, 1976).

[87] The private insurance industry frequently points to government run programs which it perceives as having failed, thus concluding that government cannot do a better job. A popular target is the Maryland Automobile Insurance Fund established in 1972 to allow high risk drivers to obtain insurance at standard rates. That program has since lost millions of dollars. ("Could the Government Do a Better Job?" *Journal of American Insurance*, Fall 1976, p. 9.) The fallacy in this argument, however, is that the Maryland program was established specifically for high risk drivers which private industry would not insure, not as an alternative to compete with private industry. How well government might fare if it ran a program that included both the profitable good risks as well as those in residual markets cannot be evaluated on the basis of the Maryland experience.

Table 5.1

Automobile: 1971 Chevrolet Impala
No Chargeable Accidents—Comparable Coverage

Classification	Autopac 1973	Pre-Autopac 1971	Baton Rouge 1973
Husband and Wife–over 25 Pleasure Use Only	$ 78.00	$125.00	$193.00
Husband and Wife–over 25 Driving To and From Work	111.00	161.00	217.00
Husband and Wife with Underaged Son and Daughter	140.00	375.00	422.00
Single Male–20 Years Principal Operator	123.00	391.00	494.00

claims. This compares, for example, with 70 percent of premium dollars that went to cover losses incurred on private automobile policies (resulting in a 2.8 percent underwriting loss) in the United States in 1976.[88] Since in Canada there are no underwriting restrictions, other than the possession of a valid driver's license, and most billing procedures are automated, agents do not have to write policies and they do little more than receive payments from insureds and transmit them to the corporation. A major savings, therefore, is that since agents do considerably less work per policy, they receive a 5 percent commission, compared to approximately 20 percent in the United States.[89] Agents who fought introduction of this program are now reported to be satisfied with it.

Like private insurance companies, the Manitoba Public Insurance Corporation generates funds which are invested. Investment decisions are made by the director of finance and the government's Ministry of Finance. The corporation also pays regular insurance company taxes.

Table 5.1 illustrates the effect of this program on automobile insurance rates in Winnipeg and provides a comparison with a similar city in the United States. Baton Rouge, Louisiana, was selected because in 1970 per capita income, number of bodily injury and property damage claims per 100 insured cars, and cost per claim were similar in Manitoba and Louisiana. One difference is that cost per claim has been increasing faster in Louisiana than Manitoba.

Litigation

In recent years some groups have turned to the courts in attempts to resolve problems of insurance availability. Undoubtedly, more will seek judicial remedies in the near future.

In April 1978, 13 Illinois State legislators filed a class action suit in U.S. district court charging 10 insurance companies, the Illinois Department of Insurance, and the Director of Insurance for the State of Illinois with racial discrimination.[90] The plaintiffs claim that by "redlining" or by dividing "the area of the city of Chicago into differential geographical areas or territories based upon the racial composition of the inhabitants of those areas or territories," the defendants have discriminated against some black residents in Chicago by "denying them the opportunity to purchase insurance or by imposing upon them, higher financial rates or more

[88] *NAIC Report on Profitability by Line and by State for the Year 1976* (Milwaukee: National Association of Insurance Commissioners, 1977).
[89] Ibid.

[90] Civil Action No. 78C 1599, U.S. District Court, Northern District of Illinois, Apr. 25, 1978.

onerous conditions than those generally imposed upon similarly situated White residents living elsewhere in the City of Chicago." Among the specific redlining practices cited in the complaint are: charging different rates for insurance in different geographical areas, varying the price of insurance according to the age of structures, and placing fewer agents in selected areas, all of which serve to limit insurance availability to black residents. By acquiesçing in these practices, the director of insurance and the Illinois Department of Insurance were charged with having "advanced and furthered such 'redlining' practices."

The legislators who filed the suit claimed that such insurance redlining practices have contributed to the destruction of the economic viability of several neighborhoods.[91] In the suit they seek $2 million in damages for 100,000 black residents who constitute the class for whom the action was taken.

A number of individuals and groups at various levels of public and private life have offered a wide-ranging set of proposals for solving the problem of insurance availability. Some have already been implemented, with varying degrees of success. The following chapter contains a series of recommendations which, if implemented, would substantially alleviate availability problems.

[91] "Sue Insurance Firms," *Chicago Defender*, Apr. 25, 1978, p. 1. "13 Black Legislators Sue Over 'Redlining'," *Chicago Sun-Times*, Apr. 25, 1978, p. 4.

Chapter 6

Findings and Recommendations

Findings

I. The Role of Property Insurance in the United States

1. Property insurance is essential for individuals owning homes or operating businesses in today's society.
2. In older urbanized sections of many major metropolitan areas, essential insurance is difficult to obtain and is frequently unavailable through the voluntary insurance market. The unavailability of property insurance has had, and continues to have, serious consequences for the social and economic development of such neighborhoods.
3. Insurance company rating classifications and the marketing practices of brokers and agents are frequently arbitrary and unfairly discriminatory despite proclamations by industry representatives that such practices reflect loss experience based on empirical data available to the industry.
4. Availability of property insurance is frequently determined by personal characteristics (e.g., age, sex, occupation) and factors beyond the control of individuals—so-called environmental hazards (e.g., geographic location)—rather than by factors over which individuals have immediate control. To the extent that the insurance mechanism is not based on individually controllable factors, the incentive to reduce loss (and ultimately insurance premiums) is decreased.
5. Given the economic interdependence of residents within a metropolitan area and the diversity of neighborhoods within urban and suburban communities, territorial rating classifications which separate cities from their suburban rings penalize many city residents.
6. The utilization of underwriting criteria not related to actual or anticipated loss experience violates two basic industry principles: 1) developing homogeneous risk classifications, and 2) spreading risks over large classes.
7. Although the property-casualty insurance industry experienced 3 consecutive years of losses associated with underwriting activities between 1974 and 1976, the industry did enjoy healthy profits primarily as a result of its investment activity. In 1976, for example, the industry earned a $2.8 billion profit from investments. In 1977 underwriting-related activities produced a 21 percent industrywide profit.
8. A company's capacity to write insurance is limited in part by its surplus requirements (assets over and above loss reserves). The amount of insurance a company can make available, therefore, is partially dependent on its ability to generate an underwriting and/or investment profit. When profits decline, underwriting must be restricted.
9. In recent years the declining stock market has limited insurance industry investment profits, thus restricting the amount of property insurance available for reasons unrelated to the degree of risk represented by potential insureds or the demand for such insurance.
10. In recent years there have been several mergers involving insurance companies where available surplus has been utilized for a variety of investment purposes, thus constricting the company's capacity to write insurance. While such practices may be in the best interest of the corporations and their stockholders, they often have detrimental effects on many residents of urban communities.
11. Availability of essential insurance and insurance practices in general are inextricably intertwined with matters of public policy. The Supreme Court ruled in 1914 that because insurance companies are uniquely important as depositories of vast sums of money (the industry currently controls over $400

billion in assets) and as vehicles of risk distribution protecting a large part of the country's wealth, public interest requires public control of the industry for the common good.

12. While arson is a growing problem in the United States and the existence of an insurance mechanism allows some individuals to profit from this crime, there is much debate over whether or not access to property insurance in fact encourages owners of buildings to destroy the homes in which they reside. While the so-called moral hazard (i.e., a home insured to its replacement cost where replacement cost is far in excess of market value) is often cited as a reason for not insuring older homes in urban areas, no systematic objective data have been presented to demonstrate the extent to which this phenomenon occurs among owner occupants.

13. Congress established the FAIR Plan in 1968 in order to make essential property insurance available in urban areas. A number of problems have been identified in the administration of the FAIR Plan programs. In addition, FAIR Plan policies in several States provide less protection at greater cost than homeowners policies available in the voluntary market. Four States, however, now offer homeowners policies in the FAIR Plan.

14. Despite recent reports claiming that the FAIR Plan contributes to the "arson for profit" problem, available evidence indicates that, at least in Chicago, a much more serious problem exists in the voluntary insurance market. It is the insurance mechanism itself, not the FAIR Plan or any other particular type of insurance program, which provides the "arson for profit" incentive.

15. Because mortgage lenders require purchase of property insurance as a condition for qualifying for a home loan, insurance unavailability restricts homeownership opportunities for many urban residents. Racial minorities suffer a disproportionate share of this burden.

II. Insurance Availability in Chicago

1. Availability of homeowners insurance and the concentration of FAIR Plan policyholders varies markedly among communities within the city of Chicago.

2. Fire and theft account for almost three-quarters of the dollars paid out by insurance companies to indemnify Chicago residents insured under homeowners policies.

3. There is a statistically significant correlation between the minority composition of a ZIP code area and current underwriting practices, between the age of housing in a ZIP code area and current underwriting practices, and between the median income of a ZIP code area and current underwriting practices. These relationships hold even after the effects of differential fire and theft rates have been eliminated. In other words, the relationship between minority composition and current practices, between age of buildings and current practices, and between income and current practices cannot be explained by the differences in fire or theft among communities.

4. Minority groups, residents of older homes, and poor people have greater difficulty obtaining insurance in the voluntary market and are more likely to be insured by the FAIR Plan than are other segments of the Chicago population for reasons not related to the principal causes of loss; i.e., fire and theft.

III. Legal Findings

1. Discrimination in the sale of insurance based on race, color, creed, national ancestry, or sex violates the Illinois constitution.

2. Unfair discrimination in the sale of fire and theft insurance based on race, color, or national origin and the refusal to provide homeowners or renters insurance solely on the basis of the specific geographic location of the property violates the Illinois unfair trade practices act. Discrimination between individuals which represents differences in loss and expense elements is not prohibited even where such discrimination effectively creates classifications based on race, color, or national origin.

3. The Illinois Commissioner of Insurance is obligated by law to determine whether insurers are violating the unfair trade practices act. Whenever he has reason to believe that such violations are occurring, he is mandated to hold a hearing to determine the facts. Upon a finding that an insurer is violating the act, the commissioner is authorized to issue a cease and desist order. For violations of such a cease and desist order a civil penalty of $500 for each violation may be imposed. In addition, the director may revoke, refuse to renew, or suspend the certificate or license of a company or person for intentionally violating a cease and desist order or intentionally failing to comply with the unfair trade practices act.

4. Discrimination in the sale of insurance based on race and conspiracies between insurers and others to

discriminate in the sale of insurance based on race violate Federal civil rights law.

5. There is no express Federal statutory prohibition against discrimination in the sale of insurance based on geographic location.

6. Drew S. Days III, Assistant Attorney General, Civil Rights Division of the Justice Department, has stated that the Fair Housing Act of 1968 may reach insurance practices, but he has recommended that the act be amended to prohibit unequivocably discriminatory insurance practices based on minority status or sex.

7. Agreements between insurers and others to refuse to sell insurance in a particular geographic area or to limit the coverage available may represent boycotts which would be violations of the Sherman Act.

8. When a violation of the Sherman Act is suspected, the Department of Justice is empowered to investigate and to institute legal proceedings to restrain the violation.

9. There is reason to believe that certain practices of insurers transacting business in Illinois violate the Illinois constitution, the Illinois unfair trade practices act, Federal civil rights law, and the Sherman Act.

IV. Proposed Remedies

1. Several local, State, and Federal officials as well as private organizations and individuals (within and outside of the insurance industry) have examined the problem of insurance unavailablity and have proposed a variety of remedies. Such proposals range from better communication between the industry and the public, to legislative and regulatory restrictions, to major structural changes in the industry itself. Examples include the following:

   a. The city of Chicago is considering an ordinance that would prohibit that city from purchasing insurance from companies found to be in violation of State antiredlining laws;

   b. Illinois has enacted, and all Midwestern States have debated, legislation that would prohibit insurance companies from discriminating in the sale of property insurance on the basis of geographic location;

   c. In the Essential Insurance Reform Act of 1977, Michigan has proposed a program that would require most insurance companies to provide property insurance to all qualified risks who apply. A company could cede some risks to a reinsurance facility whose profits and losses would be shared by all companies writing property insurance in the State.

   d. Neighborhood Housing Services (NHS), partnerships involving financial institutions, city officials, and residents, have been developed in more than 40 cities to maintain and revitalize urban communities. Such partnerships may include representatives of the insurance industry in the near future.

   e. The Institute for Local Self Government has proposed a municipal insurance plan where surplus revenues which currently accrue as profits for insurance companies and their stockholders would be utilized instead for a variety of loss reduction (and ultimately premium reduction) activities. Under a grant from the National Fire Prevention and Control Administration, the feasibility of municipal insurance programs is currently under examination in selected communities.

2. Representatives of the insurance industry have acknowledged the need for basic restructuring of insurance practices. While better communication and more consumer education are positive steps, fundamental and creative actions beyond improved public relations are called for.

Recommendations

I. To the insurance industry

1. Each company writing homeowners insurance should disclose to the insurance commissioner in each State, and should make available to the public, its loss experience and all other data on which it develops classifications for eligibility and rating purposes. This information should be provided in a format that can be readily understood by most people.

2. To increase incentives to reduce losses, companies should develop rating systems that reward the individual for factors within his or her control and deemphasize those that are generally beyond the control of individuals.

3. Companies, agents, and brokers should recognize that the use of unfounded generalizations in underwriting procedures unfairly penalizes many homeowners and causes the industry to reject some profitable business. By acting on more rational bases, steps can and should be taken to increase market penetration in urban communities.

4. Companies should issue and act on a policy statement, similar to that released by the St. Paul

Fire and Marine Insurance Company, indicating that they will not limit coverage on the basis of geographic location, that they will inform applicants of the reasons for all adverse decisions, and that they will reconsider applicants when steps are taken by previously rejected applicants to become insurable.

5. Companies should join Neighborhood Housing Services partnerships and work with other voluntary organizations and activities whose objectives are to maintain or revitalize urban communities.

II. To the city of Chicago

1. The city should immediately adopt an antiredlining ordinance, similar to the one it has debated for more than 6 months, that would prohibit the city from purchasing insurance from companies found to be in violation of State antiredlining laws. The mayor should state publicly his full support for the ordinance and for vigorous enforcement and the city council should provide adequate resources for an effective enforcement program.

III. To State insurance commissioners and State legislators

1. Since there is reason to believe that insurers transacting business in Chicago have been and are violating Illinois insurance laws, the Illinois Department of Insurance should determine whether and which companies are responsible for these violations. An investigation and any necessary enforcement proceedings should begin immediately.

2. The State of Michigan should enact the Essential Insurance Reform Act of 1977, thus permitting any qualified risk to purchase essential insurance and creating a reinsurance mechanism to which companies can cede those risks they do not want to carry.

3. Commissioners in each Midwestern State should collect the following information on homeowners insurance policies by ZIP code for the major urbanized areas in their States: written applications, cancellations, nonrenewals, renewals, new policies written, and total policies in force. Such information should be analyzed in conjunction with loss experience, racial composition, age of housing units, and other demographic variables to determine what factors account for the variance in underwriting activity within metropolitan areas. Where such underwriting patterns cannot be justified by rational, loss-related factors, and where they result in discrimination against minorities or residents of older communities, appropriate sanctions should be imposed to increase market penetration in those areas not adequately served.

4. Each State should amend its unfair trade practices act to prohibit the following:

a. refusing to insure, refusing to renew, or cancelling insurance policies, limiting coverage, varying the terms under which coverage is available, or in any way varying insurance products and services because of the location of a risk within a metropolitan area.

b. varying availability of insurance products or services because of the age of the property;

c. asking on an application if an applicant was previously denied coverage by another insurer or if an applicant previously was insured under a residual market mechanism;

d. varying availability of insurance products or services because an applicant was denied coverage by another insurer or previously participated in a residual market mechanism;

e. refusing to enter into a contractual relationship with an agent because of the location of the agent's customers or the agent's business;

f. requiring inspections in certain locations of a State but not in other locations of that State;

g. classifications based directly on race, creed, color, and national origin, or a combination of other factors, the purpose of which is to create indirectly such classifications, whether or not such classifications can be supported by loss and expense experience.

Each State should amend its unfair trade practices act to require the following:

a. Before an application is denied or a policy is cancelled or nonrenewed, the applicant or policyholder must be informed of the precise reason for that adverse decision and must be informed what must be done for him or her to become insurable. If steps are taken to become insurable, the company must reconsider the application;

b. Whenever a company terminates a contractual relationship with an agent or broker, the company will continue servicing the policies the agent or broker placed with the company, and will locate another agent or broker to continue to provide insurance service;.

c. Upon request of an applicant or insured, a company must provide copies of any information the company received on that individual, the source of the information, the names of all organizations and individuals with whom the

company has shared that information, and an opportunity for the individual to correct or delete any incorrect information or to add a statement to the record indicating his or her disagreement with any information. (See appendix for recommended model amendments to unfair trade practices acts.)

5. Each State should enact legislation that would prohibit all geographic rating territories smaller than standard metropolitan statistical areas or cities where a city is not part of a standard metropolitan statistical area.

6. Insurance commissioners should determine the level of staff necessary to conduct adequate monitoring and enforcement programs and should request the money necessary to maintain such staff from the legislatures. State legislators should cooperate with insurance commissioners and support their efforts to conduct such a program.

IV. To the U.S. Department of Justice

1. The U.S. Department of Justice should immediately investigate insurers doing business in Illinois to determine the extent to which any insurer may be violating the Sherman Act.

V. To the Federal Insurance Administration (FIA)

1. FIA should launch or sponsor a major investigation of insurance industry investment practices. That investigation should examine where investment capital is derived and where it is invested, the effect of such multibillion dollar investments on cities (and in determining what are good and bad risks), and how investments and other financial concerns of insurance companies (and the companies with which they have merged) affect the availability of essential insurance.

2. FIA should work with the National Fire Prevention and Control Administration in exploring the feasibility of the municipal insurance concept (in which surplus revenues are utilized for loss prevention activities rather than as profits for private companies or investors) as a mechanism for increasing insurance availability, at affordable rates, to residents of urban communities.

If the study currently being conducted by the Institute for Local Self Government concludes that the program is feasible, these two Federal agencies should provide funding for a demonstration project in those municipalities that have expressed an interest in the concept and where the feasibility has been demonstrated.

3. FIA should conduct or sponsor a study of the "arson for profit" phenomenon to determine the extent to which owner occupants, compared to absentee landlords and owners of other commercial property, are burning down their property for money, and ultimately to determine whether or not providing insurance for homeowners residing in structures where replacement cost exceeds market value in fact creates a "moral hazard."

VI. To Congress

1. As the Assistant Attorney General of the Civil Rights Division of the Justice Department recommended, the Fair Housing Act of 1968 should be amended to reach practices of the property-casualty insurance industry. The amendment should include the protections provided in recommendation III-4 above.

2. Recognizing the economic interdependence of residents within a metropolitan area and the diversity of neighborhoods within urban and suburban communities, Congress should prohibit all geographic rating territories smaller than standard metropolitan statistical areas or cities where a city is not part of a standard metropolitan statistical area.

Recommended Model Unfair Trade Practices Amendments

Section 1

1. It is an unfair trade practice for an insurer of residential property (i.e., one to four family dwellings) and, unless otherwise stated, of personal lines auto to:

(a) vary the availability of insurance products or services because of the age of the residential property risk;

(b) refuse to insure a risk because an individual was previously denied insurance by another insurer;

(c) ask in an insurance application whether or not an applicant was previously insured in an involuntary market plan. This subsection shall not be interpreted to preclude an insurer from asking the name of the previous insurer in an insurance application;

(d) refuse to insure a risk because an individual was previously insured in an involuntary market plan;

(e) fail to state the precise reason for an insurer's decision to decline, nonrenew, or terminate an insurance policy;

(f) fail to state prior to issuing a notice of termination or nonrenewal or at the time of issuing a notice of declination what corrective action, if any, the applicant or insured must take in order to obtain insurance;

(g) fail to reinspect a risk, upon request of the applicant or insured, where an inspection report has been used in part or in whole to decline, nonrenew, or terminate a residential property insurance policy;

(h) refuse to renew policies placed by an agent or broker if the insurer terminates its contract with the agent or borker for 1 year from the date of termination of the insurer's contract with the agent or broker;

(i) fail to provide an applicant or insured, upon request, with any information the insurer has received on that individual, the source of the information, the names of all organizations and individuals with whom the insurer has shared the information, and the opportunity for the applicant or insured to correct or delete any incorrect information or to add a statement indicating his or her disagreement with any information;

(j) fail to correct or delete any incorrect information of which the insurer has knowledge and which the insurer is maintaining in the applicant's or insured's records or on which the insurer has in part or in whole based an adverse underwriting decision.

Section 2

2. It is an unfair trade practice for an insurer of residential property (i.e., one to four family dwellings) and of personal lines auto to refuse to insure or refuse to continue to insure, or to limit the amount or type of coverage available to a risk, or to require special facts as a condition to acceptance or renewal of such insurance because of the geographic location of the risk, unless

(a) such insurer not less than sixty (60) days previous to such refusal or limitations shall have filed with the Commissioner:

1) a written concentration of risk plan which the risk exceeds. Such a plan shall be applied by the insurer uniformly across all geographic areas in the State;

2) a written statement limiting its business to specific counties in which the risk is not located;

3) a written statement that, with respect to the geographic location, a natural hazard exists which would subject the insurer to an extraordinary loss exposure;

provided, that such filings shall be based on credible data and the standards and practices shall not be arbitrary or unreasonable: or

(b) the risk is located close to a particular and immediate hazard. The insurer's standards and practices in regard to such hazard shall be applied uniformly throughout the State;

provided, that such standards and practices shall not be arbitrary or unreasonable.

Regulations Under Section 2 of the Recommended Unfair Trade Practices Amendments

Conduct which constitutes unfair trade practices under Section 2 of the Unfair Trade Practices Amendments and is prohibited by these regulations*

1. Varying the application of any or all of the following standards and practices because of geographic location:
   a. Age of the risk;
   b. Previous denial of coverage or termination by another insurer;
   c. Use of insurance application questions concerning whether the applicant was previously denied coverage or was terminated by another insurer;
   d. Previous coverage under an involuntary insurance plan;
   e. Use of insurance application questions concerning whether the applicant was previously covered in an involuntary insurance plan;
   f. Statement to applicants and insureds of the reasons for insurer's declination, termination, or nonrenewal of an insurance contract;
   g. Statement to applicants and insureds before issuing notices of declination, termination, or nonrenewal what corrective action, if any, the applicant or insured must take to obtain or continue coverage;
   h. Requiring inspections or ascertaining the accuracy of inspection reports on which a decision to decline, terminate, or nonrenew an insurance contract is based;
   i. Services including but not limited to the speed with which claims are settled, access to information about insurance availability, inspections where required for obtaining or continuing insurance, terms of premium payment;
   j. The use of deductibles;
   k. Appointing or terminating a contractual relationship with an agent or broker.
2. Refusing to enter into or continue a relationship with an agent or broker because of the geographic location of the agent or broker or because of the geographic location of agent's or broker's business.

* These regulations are intended to supplement Section 2 of the Unfair Trade Practices Amendments. If Section 1 is also enacted into law, Regulations 1a through h, above, become redundant and should, therefore, not be promulgated.

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