Should the Community Reinvestment Act Apply to Insurance Companies?

A Public Policy View

NAMIC®

Acknowledgments

NAMIC expresses its appreciation to members of the Public Policy Working Group for their generous contributions to this project. Members of the Working Group were selected from NAMIC's Public Affairs Committee, Legislative Steering Committee and Regulatory Affairs Steering Committee to work on this public policy paper. Their participation made this paper possible.

Stuart R. Birn
Auto-Owners Insurance Company

Brent R. Larsen
Grinnell Mutual Reinsurance Company

Elizabeth L. Osha
South Carolina Farm Bureau Mutual Insurance Company

Jeffrey D. Rouch
Nationwide Insurance Enterprise

Sherman Sitrin
American International Group

James Stahly
State Farm Insurance Companies

NAMIC Staff
Charles M. Chamness, APR
Richard H. Nelson, APR
Pamela J. Allen

NAMIC®

Table of Contents

I. The Purpose of this Paper 5

II. Executive Summary 6

III. The Community Reinvestment Act (CRA) 7

IV. Introduction to Insurance 8
- Insurance and its Benefit to Society
- A Profile of the U.S. Insurance Industry
- How Insurance Companies Work
- How Insurance is Regulated

V. The Social, Political and Economic Environment of the CRA issue 13
- The Social Environment
- The Political Environment
- The Economic Environment

VI. Extending CRA to Insurance 17
- Insurance Companies are Chartered to Provide Insurance, not Credit
- Banks Enjoy Federal Benefits not Available to Insurance Companies
- Insurance Companies do not Unfairly Discriminate

VII. The Insurance Industry's Investments in Our Communities 20
- Six Areas of Investment in Communities
- Model Programs and Good Corporate Citizens

VIII. Conclusion 23

I. The Purpose of this Paper

The National Association of Mutual Insurance Companies (NAMIC) is a national trade organization representing more than 1,200 member companies that make up over 34 percent of all property/casualty insurance premiums in the United States. NAMIC benefits member companies through government relations, public affairs, education and arbitration services, and insurance and employee benefit programs. Information about the association, its member companies and the property/casualty insurance industry can be found at *NAMIC Online, www.namic.org.*

NAMIC believes that public policy does not exist in a vacuum nor should it be created in one. During public policy's formulation, consideration ought to be given to the social, political and economic environment in which that policy will operate. Good public policy — or public policy that is in the public good — must consider these environmental factors.

The debate over the Community Reinvestment Act's (CRA) application to financial services sectors beyond banking — particularly in the context of federal financial modernization legislation — has often been conducted without regard to the broad public policy issues involved and to the differences between banks and other institutions in the financial services industry. This paper will examine the issue of imposing social investment obligations on the property/casualty insurance industry in the context of good public policy. It will conclude with recommendations that represent this association's view, and, we believe, good public policy for all Americans.

The paper focuses primarily on property/casualty insurance companies, since they comprise the membership of NAMIC. Life insurance companies are discussed to a lesser extent as they are part of the debate on legislating social investment obligations. A third segment — health insurance companies — is not generally included in the debate and therefore not included in the paper.

- The history, purpose and function of CRA are often misunderstood. Therefore, Section III begins with a summary of CRA as it applies to the banking industry.
- Since understanding how insurance works and how insurance is regulated is necessary to properly assess the industry's role with respect to social investment obligations, Section IV is an introduction to insurance.
- Since good public policy must consider the social, political and economic environment in which we operate, Section V examines these factors as they influence CRA policy.
- The theory of expanding CRA to insurance companies includes several assumptions that must be examined in the context of the purpose and regulation of the insurance industry versus the purpose and regulation of the banking industry. Section VI addresses these differences.
- Insurance companies already invest heavily in urban and minority communities throughout our nation. Section VII provides a glimpse of the myriad of programs supported by insurance companies and agents.
- Finally, the paper outlines conclusions reached by NAMIC's public policy process. These conclusions build on the information and analysis outlined in the paper.

II. Executive Summary

In recent months, consumer lobbyists, community organizers, certain members of Congress and state legislatures have raised the issue of applying the Community Reinvestment Act (CRA) to the insurance industry. The CRA was passed by Congress 22 years ago to encourage banks and thrifts to lend in certain communities — particularly low-income, minority neighborhoods — in which they accept deposits.

Insurance companies, which are not depository institutions, have not been subject to CRA requirements. Proponents of applying CRA to insurance companies believe that consolidation is erasing the boundaries between financial services companies, such that CRA should apply to all financial services companies. However, important differences remain between banks and insurance companies:

Insurance companies are chartered to provide insurance, not credit
Insurance companies would violate their fiduciary duty to policyholders as well as safety and soundness requirements of state insurance investment laws if they were to extend credit in the manner and to the degree contemplated by the CRA.

Banks enjoy federal benefits not available to insurance companies
The federal government insures bank deposits and grants other financial advantages to depository institutions, providing a quid pro quo for banks' social obligations under CRA. Insurance companies do not enjoy the same federal benefits.

Insurance companies do not unfairly discriminate
It is unnecessary to extend CRA to insurance companies because the industry does not unfairly discriminate against low-income and minority communities — the assertion made against the banking industry that led to the creation of CRA. To the contrary, insurance companies participate in many voluntary programs in disadvantaged and minority areas and are seeking to expand their business in urban areas. In addition, existing laws prohibit unfair discrimination, insurance regulators enforce anti-discrimination laws and residual markets exist to cover high-risk properties.

Further, most insurance companies do not have a geographic community. The Community Reinvestment Act is by definition oriented to a specific geographic "community." Many insurers have no similar geographic orientation.

The idea of extending CRA to insurance companies is not only fundamentally flawed, it is impractical from a policy standpoint. Subjecting the industry to an unnecessary government mandate would:

- raise policyholders' premiums,
- weaken the insurance industry financially,
- undermine its competitive position, and
- jeopardize its ability to pay customers' claims, especially in a catastrophic situations.

III. The Community Reinvestment Act (CRA)

In 1977, Congress passed The Community Reinvestment Act, 12 U.S.C. 2901, commonly known as "CRA," to encourage federally insured depository institutions to help meet the credit needs of their entire community, including low- and moderate-income neighborhoods. Policymakers believed that as the beneficiaries of federal deposit insurance and other federal benefits, banks have an obligation to address the social needs of taxpayers and the communities they serve.

Congress adopted CRA in response to evidence that depository institutions drew deposits from their local communities, but refused to lend those deposits back into those communities, or at least into certain areas. Evidence further indicated that low- and moderate-income areas as well as areas with a high percentage of racial minorities and ethnic residents were most often denied loans and/or excluded from an institution's lending services.

CRA requires that federal banking regulators prepare a written evaluation of an institution's record of meeting the credit needs of its community, including an analysis of CRA assessment factors and a rating. A depository institution that fails to meet its CRA requirements can be denied permission by federal regulators to buy or merge with other depository institutions, to engage in interstate banking, or to open or close branches.

Federal regulation, 12 C.F.R. 25, establishes three tests to be used by federal banking regulators when assessing CRA performance: lending, investment, and services. These tests are applied to a depository institution's "assessment" area, defined as one or more metropolitan statistical areas in which the bank has its main office, branches and deposit-taking automatic teller machines, and the surrounding areas in which the bank has originated or purchased a substantial portion of its loans. Assessment areas may not reflect illegal discrimination or arbitrarily exclude low- or moderate-income geographies. An assessment area cannot extend beyond one state; banks with multistate operations have multiple assessment areas.

The **lending test** evaluates a bank's home mortgage, small business, small farm, and community development lending in its assessment area. Automobile, credit card, and home equity lending are also evaluated, if consumer lending constitutes a substantial majority of the bank's business. Regulators look at the number and amount of loans, their geographic distribution among low-, moderate-, middle-, and upper-income areas, and borrower characteristics, including income and size.

The **investment test** evaluates a bank's qualified investments that benefit its community or a broader geographical area that includes the bank's community. A qualified investment is any investment or grant that has community development as its primary purpose.

The **service test** evaluates a depository institution's record of helping to meet the credit needs of its assessment area by analyzing the availability and effectiveness of its systems for delivering retail banking services and the extent and innovativeness of its community development services.

A small bank's CRA performance is assessed by evaluating the bank's loan-to-deposit ratio and other lending related activities, the geographic distribution of loans, and borrower characteristics.

Since its inception, CRA has influenced hundreds of billions of reinvestment dollars for low- and moderate income lending.

IV. Introduction to Insurance

Insurance is fundamental to every aspect of modern life and commerce. In addition to providing an overview of insurance, this section will cover several key points that are important to gain an understanding of how the aims of CRA and insurance law are often at cross-purposes. They include:

- State insurance departments regulate the type of investments companies are permitted to make;
- Investment profiles of companies differ depending on what type of insurance they underwrite;
- Each state enforces laws to protect consumers against unfair discrimination in the provision of insurance;
- Consumers who do not qualify for property insurance in the private market may obtain it through insurance industry operated FAIR plans;
- The insurance industry does not benefit from federal deposit insurance. Insurance companies pay for insolvencies in the industry through a system of state Guaranty Funds.

Insurance and its Benefit to Society [1]

Insurance is a system by which a risk is transferred by a person, business or organization to an insurance company, which reimburses the insured for covered losses and provides for sharing the costs of losses among all insureds.

Insurance helps society by reimbursing people and businesses for covered losses, encouraging accident prevention, investing in America's capital markets and bond markets, enabling people to borrow money and reducing anxiety.

The major benefit of insurance is the indemnification of insureds for covered losses. To indemnify is to restore the party that has had a loss to the same financial position as before the loss occurred. Through indemnification, insurance allows individuals, businesses and organizations to maintain their economic position and not suffer financial setbacks causing a burden to society or to other individuals. In addition, insurance indemnifies the injured persons.

When a family's house is destroyed by fire and the loss is covered by insurance, the family is less likely to be dependent on relatives or public assistance for lodging. Likewise, when a business is covered for a large liability loss that would have otherwise driven the firm into bankruptcy, insurance contributes to society because the firm continues to provide jobs for its workers, products for its customers and business for its suppliers.

Concerned with safety

While insurance exists to pay the losses that result from accidents, insurance companies are naturally interested in lowering the number of accidents and associated costs. Insurers also engage in a variety of accident prevention and reduction activities that reduce costs to policyholders. Society benefits when losses are controlled – lives are saved, injuries are prevented and property is preserved. Insurers and related organizations employ thousands of safety engineers, loss control representatives, and other specialists to help prevent auto accidents, fires, job injuries, injuries caused by defective products, explosions, and other accidental losses.

Invest in America

Insurance invests in the economy. Insurance provides funds to help businesses grow and create jobs. Premium funds that are not immediately needed are lent to government and businesses. Lending to

[1] Smith and Wiening, *How Insurance Works*, 2d ed., Insurance Institute of America, 1994, pages 2-8.

municipalities, in the form of bonds, provides local governments across the United States with the means to build, maintain and repair municipal infrastructure — schools, roads, bridges, sewers, airports. Insurers hold more than $255 billion in municipal bonds. Funds are also lent to businesses, providing them with the means to purchase buildings, equipment and supplies. Along with housing interests, the insurance industry is probably the most active voluntary investor in low- and moderate-income communities, particularly those located in urban areas. Compared to less-developed countries, the United States enjoys a higher standard of living, partly because these funds are available from insurance companies.

Support the provision of credit

Insurance provides support for credit. Even though mortgage lenders approve an applicant for a home loan based on the applicant's credit worthiness, most lenders also require that the dwelling be covered by homeowner's insurance. Likewise, a business applying for a loan to purchase inventory might be required to show that the inventory is insured before the loan is granted.

Reduces anxiety

Insurance also reduces anxiety because the insured knows insurance will provide indemnification if a covered loss occurs. By shouldering the burden of unexpected or catastrophic losses, insurance helps businesses avoid bankruptcy and keeps workers employed and local economies healthy. It also contributes to a stable society where people can plan for the future without an undue fear of catastrophic loss.

A Profile of the U.S. Insurance Industry [2]

The United States is the world leader in insurance with 31 percent of the premium volume in 1996. Japan is second with just under a quarter of the world's volume. Germany, the UK, France, South Korea and Italy combined, hold another quarter of the premium volume.

The insurance industry is a major contributor to the U.S. economy. Government authorities in the various states regulate the operations of 7,900 domestic insurance companies. About 3,300 companies sell some form of property/casualty insurance. Altogether, the insurance industry provides 2.3 million jobs.

At the end of 1997, the insurance industry had responsibility for assets totaling $3.4 trillion. The property/casualty segment of the business was responsible for assets totaling just over $870 billion. The insurance industry accounts for at least 2% of all economic activity in 26 states, according to the U.S. Bureau of Economic Analysis.

Insurance companies also are major contributors to state revenue coffers. The industry paid $9 billion in premium taxes to the 50 states in 1997. These taxes are an additional form of taxation on policyholders. Premium taxes accounted for 2 percent of all taxes collected by the states in 1997. On a per capita basis, this works out to $34 for every person in the United States. Other payments are made to states and municipalities for licenses and fees, property taxes, sales and use taxes, unemployment compensation taxes, and in a few states, income and franchise taxes.

[2] *The Fact Book 1999, Property/Casualty Insurance Facts,* Insurance Information Institute, pages 5, 14, 40.

IV. Introduction to Insurance

How Insurance Companies Work

This section will focus on how property/casualty and life insurance companies work since both are part of the debate over legislation on social investment obligations. The third category – health insurance companies – is not generally included in the debate over CRA legislation so this paper will not provide an overview of this segment of the industry.

Property/casualty insurance companies underwrite most insurance that is not life or health, including homeowners, automobile, worker's compensation, general and professional liability, surety bonds, farm owners' multiperil, and medical malpractice insurance. Unlike banks, insurance companies are chartered to provide insurance. They generally do not extend credit and are often precluded from doing so by law and regulation. Because property/casualty policies are short-term – usually one-year – state insurance laws require most property/casualty investments to be short-term and highly liquid.

Legally permissible investments include cash, mutual funds, Treasury bills and notes, mortgage-backed securities, specified types of debt securities, and preferred stock. Generally, property and casualty insurers cannot invest in real estate, other than their own buildings and property.

To illustrate the short-term nature of property/casualty investments, consider that in an average year, out of $100 paid in homeowners' premiums, the industry pays out $74 in claims.[3] The remainder goes to agent commissions, administrative expenses, operating costs, and, in good years, policyholder protection funds[4] which protect against future catastrophic loss. When catastrophes strike, such as fires in Florida, hurricanes in Louisiana, or earthquakes in California, a greater percentage of premiums will be paid out in claims. Over time, customers receive back the vast majority of premiums in claims payments.

A look at Hurricane Andrew is instructive to grasp the impact of catastrophes on the economic ebb and flow of insurance investments on the property/casualty insurance industry. The insurance industry was already operating at a deficit in Florida when Hurricane Andrew struck the Atlantic coast in August of 1992. The property/casualty insurance industry had collected approximately $1 billion in premiums and paid out over $1.1 billion in claims. So when Andrew inflicted another $20 billion in additional damages on Florida property owners, these claims were paid using policyholder protection funds (surplus) and reinsurance.[5]

The billions of dollars paid by the industry in claims is itself "reinvestment" in the local community when disaster strikes. This reinvestment not only benefits policyholders, it benefits the people who rebuild the structure after the tornado, fix the car damaged by hail or sell the appliances and cabinets needed to repair the kitchen damaged by fire.

Life insurance companies primarily issue life insurance policies and annuities. Policyholder premiums are invested in compliance with state insurance laws for the benefit of policyholders to ensure that the company can meet its obligations under the terms of the policies. As they do for property/casualty companies, state insurance laws establish the types and amounts of permissible investments for life companies.

[3] As a 10-year average (1987-1997), according to Sean F. Mooney, CPCU, Senior Vice President, Research Director, and Economist at Guy Carpenter & Company, New York. When expenses for claims handling by insurers are added, the amount increases to $83.

[4] Statutorily called "surplus."

[5] Bailey, William E., *Andrew's Legacy: The Winds of Change*, 1999, page 88.

Legally permissible investments include cash, mutual funds, Treasury bills and notes, mortgage-backed securities, corporate stock and other types of equity and debt securities, loans, and real estate. Reflecting the long-term nature of a life insurance policy, life insurance companies generally are permitted longer-term investments than those permitted for property/casualty companies.

How Insurance is Regulated

"No act of Congress shall be construed to invalidate, impair or supersede any law enacted by any state for the purpose of regulating the business of insurance ... unless such Act specifically relates to the business of insurance." These are the relevant words of the McCarran Ferguson Act, 15 U.S.C. 1012(b), which carve out insurance regulation by the states.

Insurance regulation is conducted by each state through its department of insurance, run by a commissioner or director who may be elected, or appointed by the governor. Insurance departments are charged with regulating the safety and soundness of insurance companies and consumer protection. Safety and soundness regulation is conducted primarily by the home state regulator, who leads safety and soundness examinations and reviews investments and the adequacy of policy reserves. Each state regulator must license any company that wants to do business in his or her state, and review and approve rates and policy forms to be used by any licensed company.

Unlike banks and thrifts, most insurance companies have no geographic community. Insurance companies must be "domiciled" in a single state and are primarily regulated by the home state regulator. They must be licensed in every state in which they do business. However, there may be no connection between a company's physical location and its home state or other states in which it is licensed. For example, an insurance company may be domiciled in Illinois, have its headquarters in California, and be licensed for business in 40 states. In the case of automobile insurance, the company likely would have claims offices and perhaps agents in each of the states in which it is licensed. In the case of more specialized coverages such as director's and officer's liability insurance, a company may not have a physical presence in any of its licensed states.

The regulator in each state in which the company writes insurance undertakes consumer protection regulation. Consumer protection regulation includes:

- Unfair Trade Practices and Competition Acts. These acts prohibit deceptive acts and practices by insurance agents and companies. Regulated practices include redlining, tying, rebating, advertising, manner of sale, privacy protection, and any other practice a state insurance regulator deems to be unfair or anti-competitive.
- Company Service. Each state has a process to address consumer complaints and to monitor policy rate and form filings for compliance with the law.
- Unfair Claims Settlement Practices Acts. These acts require claims to be handled fairly, timely, and in compliance with the policy.

Most states also have insurance industry shared-market mechanisms called Fair Access to Insurance Requirement (FAIR) plans. These plans make property insurance available to those who have difficulty obtaining property insurance because of abnormal exposure to risks over which they have no control. Through the FAIR plan, insurance companies collectively take on these substandard risks. The plans are funded by insurance companies, which contribute according to their market share in each state. Thus,

IV. Introduction to Insurance

FAIR plans represent a form of social investment by insurers and policyholders. No similar mechanism exists in the banking industry.

In a competitive environment, some insurance company failures will inevitably occur. However, unlike banks, thrifts and credit unions, the insurance industry does not have a government-backed fund to handle insolvencies. Instead, each state has a life insurance guaranty fund and a property/casualty insurance company guaranty fund. The guaranty funds ensure that the insolvent company is retired from the market in an orderly manner that gives maximum protection to the public.

Most insurance companies licensed in the state are required to participate in the guaranty fund by paying assessments based on premium volume. This is not comparable to the FDIC benefit enjoyed by banks. Guaranty funds pay claims of policyholders up to a specified amount if an insurance carrier becomes insolvent or is otherwise unable to pay claims.

The insurance industry, not the federal government and taxpayer, stands behind the guaranty funds. This is a major difference between insurance and deposit-taking institutions.

V. The Social, Political and Economic Environment of the CRA Issue

This section will provide an overview of the social, political and economic environment as it relates to proposed investment obligations being imposed on the property/casualty insurance industry.

During the last four decades, urban problems have been among the nation's most difficult policy issues. A timeline tracing various policy proposals might include:

1960s — The Great Society programs.
1970s — The Community Reinvestment Act and Home Mortgage Disclosure Act.
1980s — Enterprise Zones and HUD's HOPE program (Homeownership Opportunities for People Everywhere).
1990s — Community development banks and welfare reform.

With each program, policymakers have struggled to find solutions to problems related to poverty, discrimination, joblessness and the breakdown of the family. Some programs have worked better than others, but there is no universal remedy and there are no quick fixes.

As already discussed, CRA has applied to the banking industry for 22 years. The following section evaluates the environment in which the current debate over CRA and insurance takes place.

The Social Environment

The notion of CRA is intertwined with issues of unfair discrimination and money. As noted earlier, the law was a targeted response to specific issues related to access to credit in neglected urban areas in the 1960s and 1970s.

Property/casualty insurance exists to meet an important socioeconomic need. It provides protection against risks that no single individual or business can bear. Property insurance is universally available to qualified applicants. It is usually obtained through insurance companies, which have made great strides to tap into the growth market of urban areas in recent years. However, it may also be obtained through state FAIR plans for the declining number of applicants who do not qualify for the private market.

As with any highly regulated industry, the property/casualty insurance industry has faced challenges from activist groups using the legal system to examine its business practices. In recent years, some insurance companies have entered into settlement agreements designed to enhance the marketing of insurance in urban areas. In general, these agreements are designed to promote the availability of property insurance in urban markets.

Unlike the situation with banks in the 1960s and 1970s, there are no data showing that the insurance industry practices unfair discrimination. This was recently demonstrated in a HUD-funded Urban Institute study of urban property insurance markets.[6] In examining two markets, the Urban Institute's testing and subsequent analysis found that no unfair discrimination existed in the provision of property insurance. Furthermore, officials at the U.S. Department of Housing and Urban Development have acknowledged (1996) that they have no record of individuals being denied homeownership as a result of not having access to homeowners insurance.[7]

A 1996 study by the Insurance Research Council found that the perception of unfair discrimination by property/casualty insurance companies is often caused by a general mistrust of large institutions,

[6] Wissoker, Zimmermann, Galster et al., *Testing for Discrimination in Home Insurance*, The Urban Institute, 1998.

[7] "HUD and Washington Legal Foundation Square Off Over Regulation of Insurance," *Property/Casualty Insurance*, 83, 6, November/December 1996, pages 31-33, 46-47.

V. The Social, Political and Economic Environment of the CRA Issue

as well as a lack of public understanding of the business of insurance.[8] The study, *Fairness and Balance in Residential Property Insurance: A National Survey of Homeowners' Attitudes*, found that more than 9 out of 10 white and minority homeowners report having insurance coverage on their residences. Regardless of race, respondents in the study did not report that access to insurance coverage is restricted or denied to them. The reason most often cited on why people do not have insurance is that they simply do not feel they need it, do not want it, or just have not bothered to obtain coverage.

To address the perception of discrimination, the industry has supported programs to educate consumers about the value of property insurance. Two programs, in particular, deserve mention:

- The **Urban Insurance Partners Foundation** was founded by the insurance industry in 1996 to maximize the availability of property insurance in urban areas. It does this by partnering with companies and community based organizations to teach the basics of homeowners insurance to low-and moderate-income prospective homeowners. It also contributes money, goods, and services to make particular neighborhoods better insurance risks by, among other things, distributing smoke detectors, installing security lights and rehabilitating housing using insurance company volunteers.
- The **National Insurance Task Force** was formed by several large insurance companies and the congressionally chartered Neighborhood Reinvestment Corporation in 1994. Its mission is to develop partnerships between the insurance industry and community-based organizations to better market the products and services of both, for the benefit of customers and communities they serve.

The insurance industry has founded other organizations to address issues related to the public good. Organizations founded by the property/casualty insurance industry include:

- **Underwriters Laboratory**, to make electrical appliances safer;
- **The Institute for Business & Home Safety**, to reduce deaths, injuries, property damage, economic losses and human suffering caused by natural disasters; and
- **The Insurance Institute for Highway Safety**, which has saved countless lives through its research on automobile safety.

Insurers also sponsor and coordinate safety and educational programs benefiting school children and adults across the nation on a wide variety of topics.

Insurance companies and their employees donate hundreds of millions of dollars each year to not-for-profit charitable community organizations such as the YMCA and the United Way. Insurance company employees understand the value of giving back by donating their time, energy and finances to these and other worthwhile charities.

The Political Environment

The Community Reinvestment Act provides policymakers with the ability to address social problems without expending public funds. In this era of legally mandated balanced budgets and "pay as you go" program funding, this is an attractive feature. However, it is important to recognize that addressing social problems is not the purpose of business, and *requiring* business to address these issues can produce unintended, undesirable results.

[8] The Tarrance Group was commissioned by IRC to conduct and analyze a national survey using telephone interviews of 2,011 respondents. The confidence interval for the survey was that 95% of the time the results are within +/- 2.2% of the "true values" where "true values" refer to results obtained if it were possible to interview every homeowner in the country.

At the national level, CRA is receiving increased attention because of financial services reform legislation. While Senate Banking Committee Chairman Phil Gramm, R-Texas, opposes what he believes are the “extortion” aspects of CRA, other legislators view extending CRA to other financial services industries as an important aspect of financial modernization.

Some policymakers who support CRA’s expansion to other financial services sectors characterize their support as responding to marketplace changes in the financial services industry. They speculate that bank assets may shrink as a share of the total financial services industry assets if new laws allowing financial modernization are approved. Therefore, these policymakers argue that expanding the share of financial services assets (insurance and securities) to which CRA applies, is necessary to keep CRA’s “investment” growing. Though the political motivation is understandable, it is irrational from a public policy perspective to add the assets of unrelated industries to banking industry assets simply to maintain the growth in CRA spending.

If property/casualty insurance companies were required to meet a new obligation to “reinvest” in communities, they would, in effect, serve as private tax collectors assessing policyholders for the revenue required to meet the industry obligation. This hidden tax would be burdensome to policyholders, inefficient to administer and destructive to the industry. Over time, it could lead markets to create new risk-sharing mechanisms that can offer the protection of insurance without the mandated obligation — or tax — imposed on the policyholders of the traditional insurance company.

A predominant issue in the political environment is that reinvestment is obligated due to benefits conferred by the government. As noted earlier, banks have special government-conferred benefits — primarily federal deposit insurance and access to the Federal Reserve payment system and discount window — and therefore have special obligations to meet government-imposed social mandates. Insurance companies have no comparable government benefits, and, as a result, have no greater responsibility to meet social obligations than other businesses operating in the private sector. This key issue is addressed comprehensively in Section VI.

At the state level, CRA has become an issue in the political give-and-take between the insurance industry and consumer activists. When the industry seeks legislation to address an issue affecting insurance, the professional consumer activists demand something in return, such as a social investment obligation similar to CRA.

The most important recent development on this front took place in Massachusetts in 1998. Massachusetts-based insurance companies sought a change in the excise tax structure because it forced them to pay a higher rate than insurers not located in the state. The resulting law provides domestic insurers (property/casualty and life) with a credit against the excise taxes then placed upon premiums in the state, if insurers contribute to a community and economic development limited partnership established by the law. The partnership provides capital for investment in low- and moderate-income communities.

Despite the course of action taken by the Commonwealth of Massachusetts, private programs are favored over government intervention.

V. The Social, Political and Economic Environment of the CRA Issue

Figure 1

Most Homeowners Think Insurance Problems Are Addressed Best By Private Rather Than Government Programs

The Insurance Research Council asked homeowners about various private market approaches and government programs for meeting challenges posed by urban insurance markets. Respondents overall voiced strong approval of private sector solutions and rejected government interventions (Figure 1). "Private actions, such as those sponsored voluntarily by insurers and community groups to promote neighborhood betterment and safety, are almost uniformly favored. None of the government interventions receive majority support." [9]

The Economic Environment

The convergence of banking, insurance, securities and other financial services is an economic factor that threatens the status quo. Attempts by Congress to rationalize the financial services system through legislation are essentially political reactions to marketplace realities.

Even so, the insurance industry retains its distinct profile and continues to serve the purpose for which it was created hundreds of years ago. Within the holding company structure proposed in the financial modernization legislation, insurance underwriting would take place in one affiliate of the holding company while banking would take place in a completely separate affiliate. Indeed, the segregation of banking activities and the federal deposit insurance that banks enjoy is a fundamental principle of financial modernization.

As discussed earlier, property/casualty insurance companies have a relatively simple financial profile. They actuarially assess risk, collect premiums from customers, and invest in safe, highly liquid, short-term financial instruments. Nearly all of the investments are paid out in operating expenses or in claims to policyholders who suffer losses. In good years, funds are left and remain in policyholder protection funds.

Therefore, any new investment obligation, or tax, as described earlier, would decrease policyholder protection funds (surplus). A smaller surplus would weaken the industry financially, limit its ability to add customers, diminish its ability to pay claims and offer innovative services, or alternatively, cause companies to increase premium charges to policyholders.

Insurers are the third largest investors in municipal bonds, after individuals and mutual funds. Insurers held $255 billion in municipal bonds in 1997. [10] Insurers invest in a variety of public projects including airport, hospital and highway construction, as well as housing and pollution control projects. Insurers also purchase general obligation bonds used to finance ongoing local government operations. There is an obvious economic consequence of those investments, but there are political and social benefits as well. Mandated CRA investment would likely decrease insurer investments in these markets.

Special "targeted" investments include more than $200 million invested by insurance companies in the secondary market established by Neighborhood Housing Services of America. This financing increases the availability of affordable housing capital for low-and moderate-income borrowers.

[9] *Fairness and Balance in Residential Property Insurance: A National Survey of Homeowners' Attitudes*, Insurance Research Council, 1996, page 6.

[10] Schedule D – Summary by Country, Statistical Compilation of Annual Statement Information for Property/Casualty Insurance Companies in 1997, National Association of Insurance Commissioners, 1998.

VI. Extending CRA to Insurance

The theory of expanding CRA to insurance companies includes several assumptions that must be examined in the context of the purpose and regulation of the insurance industry versus the purpose and regulation of the banking industry.

Insurance companies are chartered to provide insurance, not credit
Insurance companies are chartered and licensed under state law to provide insurance. They receive premiums in accordance with their policies — contracts — with their policyholders. Property/casualty insurance companies invest the money they receive in short-term, liquid investments in order to meet their obligations to policyholders to pay claims. They are *not* chartered to extend credit. The limited amount of lending done by insurance companies is an incidental part of investment activities done primarily by life insurance companies.

Banks receive a state or federal charter for the purpose of taking deposits and extending credit. Accepting deposits and making loans are the defining characteristics of federally insured depository institutions — it is their business to leverage insured deposits into loans.

An examination of the differences between depository institutions and insurance companies reveals that applying CRA to insurance companies would be ill-conceived and impractical. As mentioned earlier, CRA ratings are based on lending, investment, and services tests. The lending test is the most important: CRA (12 U.S.C. 2901) states that depository institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business and that the convenience and needs of communities include the need for credit services. Insurance companies are chartered to cover risk, not to extend credit. Insurance companies would violate their fiduciary duty to policyholders as well as safety and soundness requirements of state insurance investment laws if they were to extend credit in the manner and to the degree contemplated by the CRA lending test.

The CRA investment test evaluates community development investments. As noted before, insurance companies are subject to state investment laws that specify permissible investments, so companies are limited in this regard. Insurance companies currently engage in many voluntary community development activities, both individually and as an industry.

COIN, the three-year-old "California Organized Investment Network," is sponsored by the California Department of Insurance, and has been established so that insurance companies can make voluntarily investments to promote the overall growth and development of California's low-income communities. So far, insurers have invested more than $200 million through COIN.

Banks enjoy federal benefits not available to insurance companies
Depository institutions receive lucrative federal benefits that are linked to the imposition of community reinvestment obligations. First, deposits held in national and state chartered banks and savings associations are insured up to $100,000 by the Federal Deposit Insurance Corporation. The FDIC's insurance is backed by the full faith and credit of the United States — that is — by U.S. taxpayers.

VI. Extending CRA to Insurance

The enormity of this obligation was shown as recently as 1989 when taxpayers paid hundreds of billions of dollars to make good on deposit insurance for savings associations during the thrift crisis. Most of those dollars have not been repaid.

Contrast the federal deposit insurance system with the state guaranty funds that protect policyholders in the event of an insurance company insolvency. The industry-financed guaranty funds operate with no federal backing. The insurance industry alone shoulders the burden of protecting policyholders; it does the job well.

In addition to federal deposit insurance, banks and savings associations exclusively enjoy another "federal" benefit – direct access to Federal Reserve payment services. In fact, banks have a monopoly in providing payment services to the public, including insurance companies, because only depository institutions can maintain clearing accounts at the Federal Reserve. Corporations and individuals spend billions of dollars on the payment services they receive from banks, including check clearing and collection, purchases and sales of U.S. government and agency securities, wire transfers of funds, and automated clearinghouse services.

These government-conferred benefits have real value. Testifying before the House Commerce Finance and Hazardous Materials Subcommittee April 28, 1999, Federal Reserve Board Chairman Alan Greenspan stated that banks enjoy a federal subsidy in the form of deposit insurance and access to emergency loans, that give them "a distinct competitive advantage" over nonbanks. Greenspan cited a Federal Reserve study which concluded that banks pay up to 12 basis points less than bank holding companies for debt capital and hold an even greater advantage over nonbanks in their cost of capital.

Insurance companies do not enjoy such federal benefits. Some argue that the insurance company "exemption" from antitrust laws granted by the McCarran-Ferguson Act is a federal benefit that justifies the imposition of CRA on insurance companies. Persons making that argument misunderstand the effect and purpose of that exemption. Federal law permits insurance companies to share information about losses in order for them to better underwrite risk and price their products competitively – to help, not hurt, consumers. The Act specifically applies the antitrust laws to the insurance industry and simply authorizes, but does not require, states to enact regulatory systems which create partial exemptions. McCarran-Ferguson only "works" as long as there is "active" state regulation.

Insurance companies do not unfairly discriminate

The impetus for applying CRA to the banking industry was the assertion that banks unfairly discriminated against residents of certain areas by taking deposits from those areas but not offering credit in return. Some have tried to draw a parallel between this and recent charges against the insurance industry. These charges are premised on the assumption that insurance companies deny insurance to qualified applicants, especially in urban areas. The insurance industry rejects this assumption for the following reasons.

First, insurance companies survive by accurately assessing risk. Low-income neighborhoods and properties may present a degree of risk that is unacceptably high for some insurance companies. The

premiums charged for properties with poor wiring, lack of maintenance and upkeep, and crime may be unaffordable to some property owners. However, insurance companies collectively can and must take on such risk through their participation in industry-funded state FAIR plans for property insurance which were described earlier. Insurance companies fund the plans and contribute according to their market share in each state.

Second, state insurance laws prohibit redlining. States look for redlining during market conduct examinations of insurance companies. These examinations are performed as part of the regularly scheduled safety and soundness examinations and also may be separately commenced at any time.

Finally, state insurance departments' consumer complaint systems are often more comprehensive and effective than those of the federal banking regulators. Allegations of redlining and unfair practices are fully investigated under strict timetables imposed by statute or regulation.

Further, many insurance companies do not have a geographic community. CRA requires depository institutions to identify on a map each community (assessment area) in which they draw deposits and extend credit. The assessment area must include the geographies in which the bank has its main office, branches, and deposit taking automated teller machines, and surrounding areas in which the bank has originated or purchased a substantial portion of its loans. Assessment areas are geographically based.

By contrast, many insurance companies draw premium payments from many communities across the country. In fact, insurance companies attempt to limit their concentration of risk in any particular geographic area. Most life insurance companies are licensed nationwide and have policyholders and agents throughout the United States. The same is true for moderate to large property/casualty companies. Smaller property/casualty companies may operate in a geographically defined area, such as one county or one state, but such companies usually underwrite only a particular type of insurance, for example, fire insurance for farms. In many cases, it is impossible to meaningfully evaluate an insurance company's activities on a geographic basis, yet that is precisely what CRA requires.

VII. The Insurance Industry's Investments in Our Communities

Insurance companies' investment activities also are not geographically based. Insurers rarely originate residential mortgages though they participate in the residential market through the nationwide purchase of mortgage-backed securities originated by depository institutions that are subject to CRA. While insurance companies purchase these securities as investments to help meet contractual obligations to policyholders, their support of the market may indirectly promote CRA.

The insurance industry – companies, employees and agents – invests in our nation's urban and rural communities every day. Lately, many industries and businesses have discovered the returns to be obtained from being a good corporate citizen. From its very beginnings, the U.S. insurance industry has realized the returns, both economic and social, from investing in the communities where its policyholders live and work.

Community-focused solutions that assist and improve America's minority neighborhoods capture the spirit of America because they involve teamwork, cooperation and partnership. Improved communities are better places in which to live and thrive. They are also better risks and provide better business opportunities. The insurance industry has demonstrated that empowering and developing communities makes good business sense. Thriving communities are hotbeds of insurance activity, both in personal lines insurance and in commercial lines.

A sense of corporate responsibility permeates the industry from its investments in local municipal bond issues to its present focus on urban markets. As many insurance executives have stated: Giving back is good business and good citizenship.

This section gives a sense of the scope of the insurance industry's involvement in and contribution to community development, particularly in urban and minority communities.

Six Areas of Investment in Communities

Many insurance companies, their employees, and agents invest in their communities. Numerous insurer-supported programs geared to inner-city and low-income populations specifically benefit minority communities. Insurance companies support the local chapters of several national organizations with programs targeted at minority communities.

Insurance companies, their employees, and agents provide program support or funding in six broad areas that serve minority communities. These six areas are:

- urban and civic organizations,
- health and safety programs,
- business development,
- education,
- volunteerism, and
- community improvement and development programs.

A few examples of the insurance industry's investment in communities follow. [11]

Contributions or matching gifts to urban and civic organizations help provide mortgages and affordable housing, insurance and investment products, and consumer goods to members of

[11] "Empowering Communities: A Sampling of the Insurance Industry's Contribution to Community Development," Insurance Information Institute, 1998.

minority groups. For example, 10 percent of one insurance company's taxable income each year funds Habitat for Humanity. Programs or funding for business development in the minority community include agent partnerships, funding of minority business organizations and mentoring programs. One insurance company supports minority banking, while another has instituted agent/insurance company networking sessions.

Insurance companies, their employees, and agents provide programs or funding for education serving the minority community. Seattle's 20-year old *Accounting Career Awareness Program* for middle and high school students increases the number of minorities in accounting and related business areas. A program with Howard University and other local universities brings young people into the insurance industry, trains them and provides jobs. Across the country, insurers are taking steps to increase the number of minority agents writing insurance in order to make coverage more accessible to minority customers.

Many programs promote volunteerism that chiefly benefits the minority community. The *Insurance Industry Charitable Fund* contributes both valuable charitable dollars and volunteer hours to make a difference in communities. Minority communities are served in areas including disaster preparedness, health and quality of life and targeted educational programs.

Insurance companies, their employees, and agents provide programs or funding for community improvement and development. Consider the following programs, which are all funded in part by the insurance industry:

- Jubilee Housing funds individual housing restorations in Baltimore City.
- Chicago's Neighborhood Housing Services rebuilds neighborhoods by providing assistance with conventional lending, budgeting, home ownership and insurance counseling.
- The Indianapolis Neighborhood Housing Partnership, a nonprofit housing intermediary, provides counseling services, training classes and affordable loan products to help families achieve homeownership.
- An African-American savings and loan provides mortgages in the inner city.
- Community development corporations rehabilitate substandard housing for home ownership and offer a full range of support services including budget counseling and training on the responsibilities of home ownership.

Model Programs and Good Corporate Citizens

The insurance industry is particularly proud of a number of additional programs that could be used as model programs elsewhere.

The Washington Insurance Council, which represents 48 insurance companies and organizations doing business in the state, provided core funding to inaugurate the **Seattle Neighborhood Action Program**. SNAP reduces crime and improves the quality of life in the inner city.

Supported by the property/casualty insurance industry, the **Urban Insurance Partners Foundation** is dedicated to maximizing property insurance availability in America's urban communities. It serves as a resource for insurance companies seeking to become more actively involved in urban markets.

VII. The Insurance Industry's Investments in Our Communities

The Foundation currently works in eight urban insurance markets creating programs and partnerships that can be duplicated in other urban communities nationwide.

A number of insurance companies are the catalysts and financial prime movers behind a wide array of community development programs. Among many good corporate citizens, these are especially noteworthy:

State Farm Insurance Companies' associates support their community by providing leadership skills, talent, tens of millions of dollars in financial contributions, and elbow grease. In 1996 alone, more than 2,500 employees and agents worked on neighborhood cleanups, paint-a-thons, and NeighborWorks programs for the more than 70 NHS organizations State Farm supports. In addition, 78 employees, agents and executives serve on various boards of directors, boards of trustees committees and projects for these NHS organizations. State Farm is working proactively to restore the urban core.

Nationwide Mutual Insurance, a company which helped create the Urban Insurance Partners Foundation, has expanded its presence in urban markets with the opening of sales and service centers and significant financial investments and grants to housing groups. Nationwide has invested $10 million with the Neighborhood Housing Services of America and another $10 million with the National Equity Fund to help meet the housing needs of low-income renters and homebuyers across the country. Nationwide has an active plan to grow market share and recognizes that urban markets represent a great business opportunity.

Prudential Property and Casualty Company conducts a cooperative program with the ACORN Housing Corporation to increase the availability of homeowners insurance in Philadelphia's low- and moderate-income neighborhoods. Participants receive a premium discount for homeowners insurance. Prudential has eliminated minimum property value as a criterion for insuring houses. The company will locate an insurance office and sales representative in the community to make access to the program easier.

Prudential's Urban Availability Task Force surveys company activity in urban areas of each state to determine if problems exist that the company can confront with the assistance of appropriate community groups.

VIII. Conclusion

This paper has evaluated whether government mandated social investment by the property/casualty insurance industry represents good public policy.

It began by summarizing the Community Reinvestment Act as it applies to the banking industry, since the law itself is little understood by many who discuss these issues. This section described the circumstances that led to CRA's creation and the tests used by regulators to determine whether banks are meeting the credit needs of their communities.

An introduction to insurance described how insurance benefits society, a profile of the U.S. insurance industry, how insurance companies work and how they are regulated. The discussion noted that insurers lack the government benefits, such as federal deposit insurance, enjoyed by the banking industry.

The paper analyzed the environment in which the CRA debate takes place. Social factors were considered, including the perception of discrimination and the introduction of insurance organizations that work to improve the availability of property insurance in urban areas. The political environment examined the debate over CRA in the context of financial modernization legislation in Washington and state CRA legislation in Massachusetts. Economic factors included the marketplace convergence of financial services and the current investment of the industry.

In conclusion, while extending CRA to insurance companies may be appealing to some policymakers in theory, it does not withstand scrutiny. The property/casualty insurance industry is a good corporate citizen operating in a complex social, political and economic environment. However, it is very different from the banking industry and will remain so, despite industry trends toward consolidation.

Next, the paper highlighted several differences between insurance companies and banks that must be considered when discussing CRA. These differences render key CRA requirements inapplicable to insurers. The three key points in this section included:

- **Insurance companies are chartered to provide insurance, not credit**
  Insurance companies would violate their fiduciary duty to policyholders as well as safety and soundness requirements of state insurance investment laws if they were to extend credit in the manner and to the degree contemplated by the CRA lending test.

- **Banks enjoy federal benefits not available to insurance companies**
  Federal deposit insurance and access to the Federal Reserve's payment services and to its discount window amount to a "distinct competitive advantage" according to Federal Reserve Chairman Alan Greenspan. These benefits constitute the quid pro quo for CRA requirements

- **Insurance companies do not unfairly discriminate**
  Insurers are, in fact, seeking to expand their business in urban areas. In addition, state laws prohibit unfair discrimination, insurance regulators enforce discrimination laws and residual markets exist to cover high-risk properties.

VIII. Conclusion

Unlike banks at the time of CRA's adoption, the insurance industry has an excellent record of voluntary investment in low-income, inner city and minority communities. The paper looked at six areas of investment, including urban and civic organizations, health and safety programs, business development, education, volunteerism, and community improvement and development programs. It also described model programs currently in place with some insurance companies.

Further, most insurance companies do not have a geographic community. The Community Reinvestment Act is by definition oriented to a specific geographic "community." Many insurers have no similar geographic orientation.

To the extent that property/casualty insurance companies are required to meet a new obligation to "reinvest" in communities, they would, in effect, serve as private tax collectors assessing policyholders for the revenue required to meet the industry obligation. This hidden tax would be burdensome to policyholders, inefficient to administer and destructive to the industry. Over time, it could lead markets to create new risk sharing mechanisms that can offer the protection of insurance without the mandated obligation – or tax – imposed on the policyholders of the traditional insurance company.

Problems do exist in our nation's urban centers. Some of these problems are the result of ineffective or misguided government policy. Imposing lending and social investment obligations on other financial services companies, especially insurance companies that are not in the lending or social program business, will not solve the problems. It will only create new ones.

A new CRA mandate on insurance companies would cause policyholders' premiums to increase and policyholder protection funds (surplus) to shrink, thus weakening insurers' ability to pay claims, expand, and offer new services. In short, it would erode the industry's financial and competitive positions.

Several factors affect the ability of the industry to survive in the future and provide needed products to families and businesses. These factors include government-mandated obligations that have the effect of redirecting assets used to pay claims to policyholders and causing insurance prices to increase, and surplus to decrease.

Attempts to legislate community involvement on an industry already making a considerable investment would serve precious few while harming many. The insurance industry should be given credit for its proactive stance rather than burdened with additional legislation. The record shows that the insurance industry contributes to communities because giving back to one's own community is good business and is the socially responsible thing to do.