

Chicago Fed Letter

Insurance and wealth building among lower-income households

by Robin Newberger, business economist, and Michelle Coussens, senior analyst

In the summer of 2007, the Federal Reserve Bank of Chicago convened four focus groups to explore the connections between insurance, the process of wealth building and preservation, and financial access for low- and moderate-income consumers. This article examines the findings from those focus groups.

Across different lines of insurance, the common trend is that lower-income households are significantly less likely to have coverage than higher-income households.

Hundreds of organizations in the U.S. offer programs to help low- and moderate-income clients save money, build assets, and increase their wealth. These programs include homeownership counseling, earned income tax credit (EITC) filing services, and individual development accounts, among others. Several studies document the ways in which these programs have helped thousands of clients to save and purchase assets,¹ but little has been written about how insurance (e.g., home, life, or health insurance) has helped them acquire and protect their assets. In 2007, the Chicago Fed's Consumer and Community Affairs unit organized four focus groups to explore the role of insurance in helping lower-income households avoid or manage financial crises. These groups also helped us examine the reasons why people have (or do not have) insurance, as well as the distribution channels that people use to obtain insurance and their familiarity with insurance concepts.

Findings from surveys

Surveys of insurance holdings show that many of the same population segments that are less likely to use mainstream financial institutions are also less likely to have various types of insurance. These groups may be particularly vulnerable to financial setbacks that could be mitigated by insurance. Figure 1 shows coverage rates for health, life, and homeowners

insurance for various income groups. We report coverage rates from several surveys because no single survey collects information on each type of insurance (and no survey collects automobile coverage rates by income group).

Across different lines of insurance, the common trend is that lower-income households are significantly less likely to have coverage than higher-income households, with the exception of private mortgage insurance (PMI).² About 70% of those in the lowest quintile (incomes up to \$27,000) have health insurance, compared with about 90% of people in the top quintile of the income distribution; and the majority of those covered at the lowest end have government-funded coverage. Rates of life insurance ownership also rise with income. About 34% of households at the lowest end of the distribution (incomes up to \$18,000) have a member with life insurance, while 51% of those in the \$19,000–\$33,000 range have life insurance. In addition, 84% of households with incomes above \$87,000 have life insurance coverage. About 43% of the lowest-income households that have life insurance report having cash value policies³—a higher proportion than any other income group except that at the highest end of the income distribution. (Some respondents have both term and cash value policies.) The likelihood of holding homeowners

1. Insurance coverage, by income quintile

	1st quintile	2nd quintile	3rd quintile	4th quintile	5th quintile
Health insurance	\$16,275 ^a	\$37,248 ^a	\$59,793 ^a	\$88,500 ^a	\$148,307 ^a
Health insurance (%)	72.9	77.3	84.9	90.1	92.9
Private insurance (%)	21.2	46.6	66.7	77.2	81.6
Public insurance (%)	51.7	30.7	18.2	12.9	11.3
Observations	29,985	29,286	28,687	29,104	28,861
Life insurance	\$11,000 ^a	\$25,000 ^a	\$42,000 ^a	\$67,000 ^a	\$287,000 ^a
Life Insurance (%) ^b	34.4	51.4	72.1	77.9	83.9
Term insurance (%)	66.4	73.7	78.3	82.4	75.3
Cash value (%)	42.9	37.2	37.2	39.0	51.6
Observations	3,357	3,406	3,456	3,181	8,775
Homeowners insurance	\$8,500 ^a	\$24,000 ^a	\$41,000 ^a	\$65,500 ^a	\$116,000 ^a
Own home (%)	44.5	55.8	68.0	82.0	91.6
Homeowners insurance (%) ^c	84.0	91.2	94.3	96.4	97.6
Private mortgage insurance (%) ^c	11.7	13.8	16.8	16.8	12.6
Observations	8,625	8,624	8,745	8,511	8,616

^aMedian income in quintile.

^bSomeone in the family has life insurance; coverage rates for term and cash value insurance are conditioned on having life insurance.

^cCoverage rates for homeowners and private mortgage insurance are conditioned on owning a home.

NOTE: The population samples and income distributions are different for each insurance type because the data are drawn from three separate national surveys.

SOURCES: Health insurance data from the U.S. Census Bureau, 2007, *Current Population Survey*, March supplement; life insurance data from Federal Reserve Board, 2004, *Survey of Consumer Finances*; and homeowners data from U.S. Census Bureau, 2005, *American Housing Survey*.

insurance increases with income; however, these rates are relatively high across the income distribution, since this type of insurance is mandatory for homeowners with a mortgage.

Focus group results

Our four focus groups comprised a total of 35 low- and moderate-income individuals across demographically distinct neighborhoods in Chicago. Three of the groups included parents with a dependent child at home, and the fourth group consisted of individuals more than 50 years old to capture the perspective of people whose longer life experiences might lead to a different set of concerns or plans with respect to insurance. The annual incomes of the participants across all groups ranged from approximately \$15,000 to \$40,000.⁴

We set out to examine four assumptions: namely, that 1) information or more direct access to insurance complements the strategies and goals of asset development/preservation programs; 2) people who are eligible for asset development programs need insurance and want to know more about insurance; 3) people who are eligible for asset development programs represent a potentially large segment of the market for insurance companies;

and 4) the sale of or counseling for insurance is a way to broaden access to the mainstream financial system.

The responses from the focus group participants give clear support to our first three assumptions, and they lend some credence to our fourth assumption—that is, the sale of or counseling for insurance coverage can lead to broader financial access. First, the focus groups supported the notion that information or more direct access to insurance complemented the strategies and goals of asset development/preservation programs. Asset-building organizations base their work on the principle that the ability to accumulate assets (e.g., to buy a home, pay for higher education, and save for retirement) is critical to a person's economic advancement. Nearly all participants of the focus groups could recount a litany of financial setbacks that had depleted their assets in recent years, related mainly to changes in family structure (e.g., adoptions or deaths) and job losses. Many had also dealt with “insurable” emergencies, such as medical and dental problems, fires, floods, and home and car repairs. These setbacks tended to call for funds in the thousands or tens of thousands of dollars—well in excess of the few hundred dollars most

held in their bank accounts. (About one-third of the respondents had savings of less than \$100, and a little more than one-half had total savings under \$500.) Focus group participants did not rely on insurance most frequently to address their financial problems. Many dealt with their crises by finding additional or alternative employment and/or by borrowing. They borrowed from credit cards, payday lenders, pawn shops, car title lenders, and their home equity (12 of the 35 participants were homeowners). Many with cash value insurance or pension assets also cashed out these long-term investments.

Although participants did not think of community-based organizations as places to obtain insurance information, they did think an “impartial source” that could take the time to answer their questions could be a valuable resource. (None of the focus group participants were enrolled in asset development programs.) Participants also tended to agree that they would benefit from information offered in conjunction with lessons about money management and budgeting. People expressed an interest in understanding how insurance, particularly life insurance, could relate to their savings goals and other efforts they made to build or preserve their assets. When asked, the participants said that they did not view buying insurance as a substitute for saving. People tended to agree that insurance would be even more important if one had savings.

The focus group participants needed insurance and wanted to know more about it; therefore, we found support for our second assumption. They owned assets, including cars, electronics, jewelry, and family heirlooms, that they wanted to protect. They thought about life insurance as a way to plan for their own futures and those of their children. These favorable attitudes echoed other studies that have shown that lower-income and minority consumers tend to have positive views about insurance.⁵ This finding is also likely related to the selection of participants. Most were parents, and they came with a mind-set to learn. The more insurance was discussed, the more people were persuaded of its importance.

Those who did not have (optional) insurance, such as health, life, or full-coverage auto, often cited income limitations as the reason. Insurance had to compete with a long list of other demands, including credit card payments, gasoline, child care, cell phones, and laundry. Data from the U.S. Bureau of Labor Statistics' *Consumer Expenditure Survey* indicate that the lowest quintile households (annual incomes at \$17,000 or lower) would have to spend about 11% of their incomes (at the median) if they were to purchase vehicle, renters, and life insurance (combined). And households in the second lowest quintile would have to spend about 4.5% of their annual incomes (at the median) on these types of insurance. This compares with spending of about 2% of annual income (at the median) for the highest-income households if they were to purchase car, homeowners (instead of renters), and life insurance.

The lack of information was another reason that participants did not have insurance. While a few participants were knowledgeable about insurance, some people had only bought insurance after an insurable loss—e.g., after their homes had been broken into, after their vehicles had been stolen, or after a funeral expense had been paid. For those who expressed confusion about insurance topics, their questions related to insurance vocabulary, the exclusions to their policies that appeared “in the fine print,” and other conditions that hindered their making comparisons among different companies' policies. Many agreed that they could use help figuring out what policy to get, how much coverage they needed, and what would be a “good or bad deal.” While some people were strongly in favor of renters insurance, others either thought of it as “an unaffordable little luxury” or had never heard of it.

These results also relate to our third assumption—that households who qualify for asset-building services represent a potential market for insurance companies. Overall, participants were not only open to receiving information about insurance from insurance representatives, but anticipated using an insurance agent to purchase insurance. Those who were

not already buying one type of insurance saw themselves as part of the customer base for another type. With few respondents suggesting otherwise, participants who wanted insurance had generally been able to find a property/casualty or life insurance policy, although participants did not necessarily know if the policy was offered through the preferred, standard, or substandard markets, or even if they received a Fair Access to Insurance Requirements (FAIR) plan or forced place policy.⁶ (A few participants reported that they had been denied health insurance because of a pre-existing condition or lack of a Social Security Number.) While many said they used the Internet to get information, several preferred to buy insurance in person—and they were most likely to go to insurance agents to do so. Many also had long histories with their agents, or their families had long-standing relationships.

We did not receive much support for our fourth assumption—that the sale of or counseling for insurance products and services could be a way to broaden financial access. For example, if consumers could purchase insurance from a bank, they might be more inclined to use other services provided by the bank. Since the passage of the Gramm–Leach–Bliley Financial Services Modernization Act of 1999, insurance companies, banks, mortgage companies, and securities firms have been allowed to merge with and acquire one another for the first time since the Great Depression. Many respondents indicated they would not readily use a bank to buy insurance. People said they did not trust bankers to give advice about insurance and that banks were not the right place to get information about insurance. These concerns raise doubts about the potential to integrate insurance education (or the purchase of insurance) with efforts to promote the use of the mainstream financial system for other financial transactions.

Yet financial institutions may already be addressing some of the concerns that participants expressed about obtaining insurance through a bank. For example, participants did not like the idea of a bank offering the products of one particular carrier; in fact, banks often own

independent insurance brokerages that offer customers the chance (in theory) to compare policies and choose from a variety of companies. Participants also expressed concerns about the credibility of some insurance agents, but purchasing insurance through a bank would have the advantage of dealing with a “vetted” insurer. Given that many participants were interested in receiving financial counseling on life insurance, banks may be better equipped than many insurance agencies to provide comprehensive financial advice.

Fundamentally, many focus group participants understood the interrelationship between insurance and the financial services system. Borrowing, even more than insurance, was the main method for dealing with emergencies. Borrowing on one's home, annuities, or other investment assets was only possible for those who had access to either the credit system or investment vehicles. Many understood that insurance companies consider one's credit score when setting (or resetting) prices, and that “higher-end” companies might deny someone based on their credit score. They also understood that by accruing credit card debt or borrowing on their home equity, they often lowered their credit scores

Charles L. Evans, *President*; Daniel G. Sullivan, *Senior Vice President and Director of Research*; Douglas Evanoff, *Vice President, financial studies*; Jonas Fisher, *Economic Advisor and Team Leader, macroeconomic policy research*; Richard Porter, *Vice President, payment studies*; Daniel Aaronson, *Economic Advisor and Team Leader, microeconomic policy research*; William Testa, *Vice President, regional programs, and Economics Editor*; Helen O'D. Koshy, Kathryn Moran, and Han Y. Choi, *Editors*; Rita Molloy and Julia Baker, *Production Editors*.

Chicago Fed Letter is published monthly by the Research Department of the Federal Reserve Bank of Chicago. The views expressed are the authors' and are not necessarily those of the Federal Reserve Bank of Chicago or the Federal Reserve System.

© 2008 Federal Reserve Bank of Chicago
Chicago Fed Letter articles may be reproduced in whole or in part, provided the articles are not reproduced or distributed for commercial gain and provided the source is appropriately credited. Prior written permission must be obtained for any other reproduction, distribution, republication, or creation of derivative works of *Chicago Fed Letter* articles. To request permission, please contact Helen Koshy, senior editor, at 312-322-5830 or email Helen.Koshy@chi.frb.org. *Chicago Fed Letter* and other Bank publications are available on the Bank's website at www.chicagofed.org.

ISSN 0895-0164

and raised the cost of borrowing, as well as increased their cost of insurance.

Conclusion

The focus groups were designed to launch a discussion about the relationship between insurance, asset development, and financial access, and to broaden our thinking about the types of financial services lower-income people need to build and keep their assets. At present, there are few well-known examples of asset development organizations that provide guidance about insurance or

make access to insurance a piece of their strategy. One such organization is Neighborhood Housing Services, whose local sites partner with insurance companies in homeownership training seminars across the country. Another is the San Francisco-based Earned Assets Resource Network Inc. (EARN), which has developed a pilot program to match graduates of its individual development account program with financial advisors to help them evaluate their property/casualty and life insurance options.

However, many asset development/preservation organizations may already be set up to deliver this type of guidance by helping clients sort through their basic expenses or by helping job seekers compare the insurance benefits offered by different employers. We invite readers to send us examples of other organizations, either in the asset-building or insurance fields, that offer insurance products or services aimed at promoting asset ownership and asset preservation among lower-income households.⁷

¹ See the websites for CFED (Corporation for Enterprise Development), www.cfed.org/focus.m; the Center for Social Development, <http://gwbweb.wustl.edu/csd/asset/index.htm>; and the New America Foundation, www.newamerica.net/programs/asset_building#.

² Coverage rates do not control for employment or demographic factors. PMI is extra insurance that lenders require from most home buyers who obtain loans that are more than 80% of a home's value.

³ There are two major types of life insurance—whole life (cash value) and term. Whole life is sometimes called permanent life insurance. Whole life insurance policies provide a payout upon death but also accumulate a tax-deferred cash value based on policy interest rate parameters. Policyholders may be able to borrow against or withdraw the cash value to help fund retirement or to pay college tuition or mortgages. In contrast, term life insurance policies build no cash value.

⁴ The recruitment and facilitation for the groups was carried out by Research Support Services (RSS). Survey respondents were chosen based on their income eligibility for participation in asset-building programs—typically family income of no more than twice the federal poverty level (about \$21,000 for a family of four). Further information on sample characteristics and methodology are available in an upcoming article in *Profitwise News and Views*.

⁵ See Michael A. Stegman, Allison Freeman, and Jong-Gyu Paik, 2006, "Home equity and other differences in the wealth of low- and moderate-income homeowners: A work in progress," draft prepared for presentation at Federal Reserve System/CFED 2006 Assets Learning Conference, Phoenix, AZ, September 19–21, available at www.frbsf.org/community/research/assets/HomeEquityandOtherDifferencesinWealth.pdf; Jongho Lee, Celina Torres, and Yin Wang, 2005, "Living in the present,

hoping for the future: Latinos and insurance: A Los Angeles case study," Tomás Rivera Policy Institute, report, August, available at www.trpi.org/PDFs/insure.pdf; and the polling company inc., 2005, "tpc survey finds minorities and lower-income households abandoned by life insurance providers," press release, Washington, DC, June 13, available at www.pollingcompany.com/viewPage.asp?pid=105.

⁶ FAIR plans are insurance pools that sell property insurance to people who cannot obtain coverage in the voluntary market. FAIR plan policies may cost more than private insurance and may offer less coverage. Forced place insurance is homeowners insurance assigned by mortgage servicers to borrowers whom they believe do not otherwise have insurance.

⁷ Please send examples to Robin.G.Newberger@chi.frb.org.