INSIGHTS

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Economic Costs of Racial Inequality and Injustice

Part 1—Implications for Insurance Professionals

by James R. Jones, Clinton Aboagye, Barbara Commodore, and Ernest Edem Tamekloe

Contributors

James R. Jones, MBA, CPCU, AIC, ARM, AIS, is executive director of the Katie School of Insurance and Risk Management at Illinois State University. He works with students, faculty, and industry professionals to help prepare students for careers in insurance and risk management.

Clinton Aboagye is a postgraduate student working on his master's degree in actuarial science at Illinois State University. A former teaching assistant, he currently serves as a research assistant and is an aspiring actuary.

Barbara Commodore is chief executive officer of Altruismo Charity. She holds a master's degree in economics from Illinois State University, where she served as a graduate student focusing on recruitment and retention.

Ernest Edem Tamekloe is a graduate research assistant at Illinois State University working toward his master's degree in actuarial science. He completed an actuarial internship with Cigna and plans to become a Fellow of the Society of Actuaries (FSA).

Greg Nelson, CPCU, AFIS, AIM, is retired, but previously held senior management positions at several insurance companies and agencies, including Transamerica, CIGNA, ACE, Safeco, Washington Mutual, and Western Growers Insurance Services. Since retiring, he has stayed active in the industry as a consultant and research committee chairperson for the Orange Empire CPCU Society Chapter. Nelson is also a past president of that chapter, and he has published numerous research papers and articles in national insurance and agricultural periodicals.

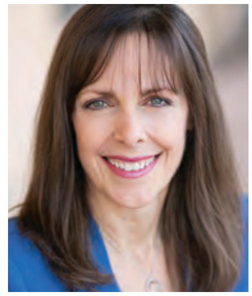
William (Billy) Mauro is vice president and head of coverage for commercial lines at ISO, a business unit of Verisk. In this role, he works with commercial coverage initiatives related to commercial property, general liability, commercial auto, commercial umbrella/excess, businessowners, and cyber, among others. Mauro also leads the Premium Audit Advisory Services, CourtSide, and ISO Emerging Issues units at Verisk, has authored articles for several insurance publications, and is a frequent presenter at industry events.

Christopher Sirota, CPCU, is emerging issues product development lead at ISO, a business unit of Verisk. In this role, he is responsible for researching emerging risks to support product development in the insurance industry and for maintaining the ISO Emerging Issues website. With over 20 years at Verisk, Sirota previously assisted product development for personal and commercial auto programs related to telematics and connected vehicles.

John Dulude, PE, MBA, is senior vice president of energy transition and impact assessment and permitting at J.S. Held. With more than 40 years of domestic and international industry experience, he has spent much of his career in the power sector, with expertise ranging from hydroelectric, fossil, nuclear, wind, and solar generation, as well as transmission facilities, system reliability, capital investment assessment, generation mix analysis, finance, equipment selection, and load profiles.

Paul Banks, PG, is executive vice president and environmental, health, and safety practice lead at J.S. Held. A licensed professional geologist in North Carolina and South Carolina, Banks has been engaged in domestic and international projects by clients in the manufacturing, chemical, power, oil and gas, and public sectors. His background includes organizational development and leadership, compliance and management system design, risk management, complex site assessment and remediation, and litigation support.

Chris Norris, MS, PMP, is senior industry adviser for power generation at J.S. Held. With more than 30 years of experience in plant management, program and project management, and operations and maintenance of power plants, Norris has managed multiple-owner, multiple interconnected facilities and led and directed decentralized power generation portfolios and projects totaling more than 2,000 megawatts, with asset values of approximately $1 billion



Judy Agnew is senior vice president at Aubrey Daniels International, a consulting firm that helps clients improve safety and business performance using behavioral science. A workplace safety expert, she has written four safety books, including *Safe by Accident? Leadership Practices That Build a Sustainable Safety Culture* and the soon-to-be-released *Safe by Design: A Behavioral Systems Approach to Human Performance Improvement*.

Heather Blevins, CPCU, AIC, AINS, AIS, ITP, SCLA, is a project coordinator in underwriting for State Farm. She is also an adjunct professor at Illinois Wesleyan University, teaching risk management and insurance. Blevins serves as the Bloomington area leader of State Farm's Military Affinity Employee Resource Group, treasurer of the Central Illinois CPCU Society Chapter, social media chair of the Claims Interest Group, and vice president of marketing for the Society of Insurance Trainer's and Educators.

Kinsey Turk graduated in May 2021 with a master's degree in actuarial science and has secured employment with Allstate as an actuarial analyst. She served as a Casualty Actuarial Society (CAS) student ambassador and Gamma Iota Sigma Kappa Chapter president at Arizona State University.

Chris Hampshire, MBA, CPCU, CIC, ARM, has over 15 years of experience in the insurance industry. As a vice president for Gallagher Bassett, he currently designs claims handling programs. In addition, Hampshire serves as president-elect of the CPCU Society Leadership Council and Executive Committee and is a past president of the Philadelphia CPCU Society Chapter.

Abi Potter Clough, MBA, CPCU, is the chief executive officer of AbiLeads. She is a keynote speaker, author, and business consultant focused on leadership and strategy, personal branding, insurtech, and international risk management. Clough has over 15 years of experience in claims operational leadership, lean management consulting, and digital communications and insurtech. She chairs the International Insurance Interest Group of the CPCU Society.

Caroline West, MS, CPCU, ASLI, is an underwriting consultant for Western World. She also serves as director of student engagement for the Arizona CPCU Society Chapter and as chair of the CPCU Society Student Action Committee. West began her insurance career in excess and surplus lines. She holds a master's degree in insurance management from Boston University.

According to the conferment pledge, CPCUs swear to “ascertain and understand the needs of others.” Does this only include those needs found within the four corners of the insurance policy, or should we also ascertain and understand the broader societal underpinnings of risk? If we are professionals in an industry called to facilitate restoration and healing, are we not also called to address the catastrophic harm caused by injustice?

As you read this article and contemplate these costs, we hope you will see why we have characterized this issue as a catastrophe, one that is plaguing the world. We also hope you will agree that insurance professionals have a role in addressing it—that we are called to critically examine and understand how racial inequality and injustice restrict opportunities for people of color in areas of financial inclusion, housing, health, education, and employment.

Finally, as professionals, we should examine why the organizations we serve in and the industry we work in are not yet as inclusive as they should be. We should see our role as helping to enhance the diversity of our industry by helping to recruit, develop, mentor, and provide opportunities for people of color at every level.

Defining and Counting the Costs

We must first recognize that approaching the profound human suffering caused by racial injustice using the so-called dismal science of economics and presenting this dispassionately and quantitatively may seem cold. Our hope is that when the costs are counted and a concerted effort to manage them has finally been made, then this human suffering will be reduced.

For this article, we have chosen the terms “racial inequality” and “injustice” rather than “racism.” The first challenge of measurement is defining what to measure. For this study, the challenge is inextricably tied to the definition of emotionally charged terms such as racism, racial discrimination, racial inequality, and racial injustice.

Traditional definitions of racial discrimination and racism often include a component of overt, intentional, and malicious acts and subjective beliefs. Assessing the purpose and malicious intent of overt acts of distinction, exclusion, restriction, or preference becomes problematic from a measurement perspective because it requires both an objective assessment of cost and a subjective assessment of intent.

Consider these definitions of the causes of racial inequality and injustice from the Race & Social Justice Initiative, the last of which is subjective:

- Structural—The interplay of policies, practices, and programs of differing institutions that leads to adverse outcomes and conditions for communities of color compared with white communities and occurs within the context of racialized historical and cultural conditions.
- Institutional—Policies, practices, and procedures that work to the benefit of white people and the detriment of people of color, usually unintentionally or inadvertently.
- Individual/interpersonal—Prejudgment, bias, stereotypes, or generalizations about an individual or group based on race. The impacts of racism on individuals—white people and people of color (internalized privilege and oppression).[1]

> **"Can an industry so intricately interwoven into business and personal risk be untouched by racial inequality and injustice?"**

The motivation for this study is to measure these integrated, system-wide costs and present them holistically. Economic cost is the language understood by business and government, and measurement is how action may be encouraged and monitored. Leaning on the wisdom of the adage that "what gets measured gets managed," the hope is that by capturing existing research on the costs of racial inequality and injustice and explaining the interrelations among risks associated with these costs, these risks and their ultimate costs can be better managed.

By focusing on racial inequality and injustice, which can be analyzed more or less objectively, with established documented economic costs, we can include dozens of studies that have documented the costs of inequality and injustice.

For example, consider that COVID-19 was caused by a disease with no overt intention but exacerbated by structural and institutional causes. On the opposite end of the spectrum are Equal Employment Opportunity Commission cases involving people who acted with overt intention and malice.

The Catastrophe of Racial Inequality and Injustice

In viewing the economic damage inflicted on our country, we can surely characterize racial inequality and injustice as a catastrophe without fear of exaggeration. In fact, the costs of this catastrophe are much greater than any insured disaster in history, yet it does not appear on any heat map of risks. We believe that it should be.

While many costs could be included in this discussion, Part 1 focuses on:

- Cost of racial wealth gap ($9.8 trillion)
- Cost of financial exclusion ($60 billion annually)

Exhibit 1 consolidates these economic costs and their causes, effects, and interrelationships, illustrating their systemic implications and common nexus.

In addition to the two factors listed above, some of the key areas contributing to inequality and injustice include:

- Unequal business opportunities
- Segregated housing
- Unequal health care

Cost of Racial Wealth Gap

As shown in Exhibit 1, a primary cause of the racial wealth gap is segregated housing. How does this increase the wealth gap? The difference is based on home equity, not merely home ownership.

For all intents and purposes, Americans live in largely segregated communities, with home-value appreciation rates lower in communities of color.[2] This inequality stems in part from weak enforcement of the Fair Housing Act and disparate lending to people of color, regardless of credit score. This is both a historic and current problem.[3]

Another contributing factor is credit—or lack thereof. In 2013, only 1.7 percent of the $23 billion in Small Business Administration loans went to Black-owned businesses; in 2007, that figure was 8.2 percent. Even then, the '07 figure underrepresented the actual amount, based on demographics.[4]

It's important to distinguish income from wealth. Income is primarily earned in the labor market, while wealth is primarily transferred from one generation to the next. Wealth is far more unevenly distributed than income.

Map of Economic Cost of Racial Injustice and Inequality

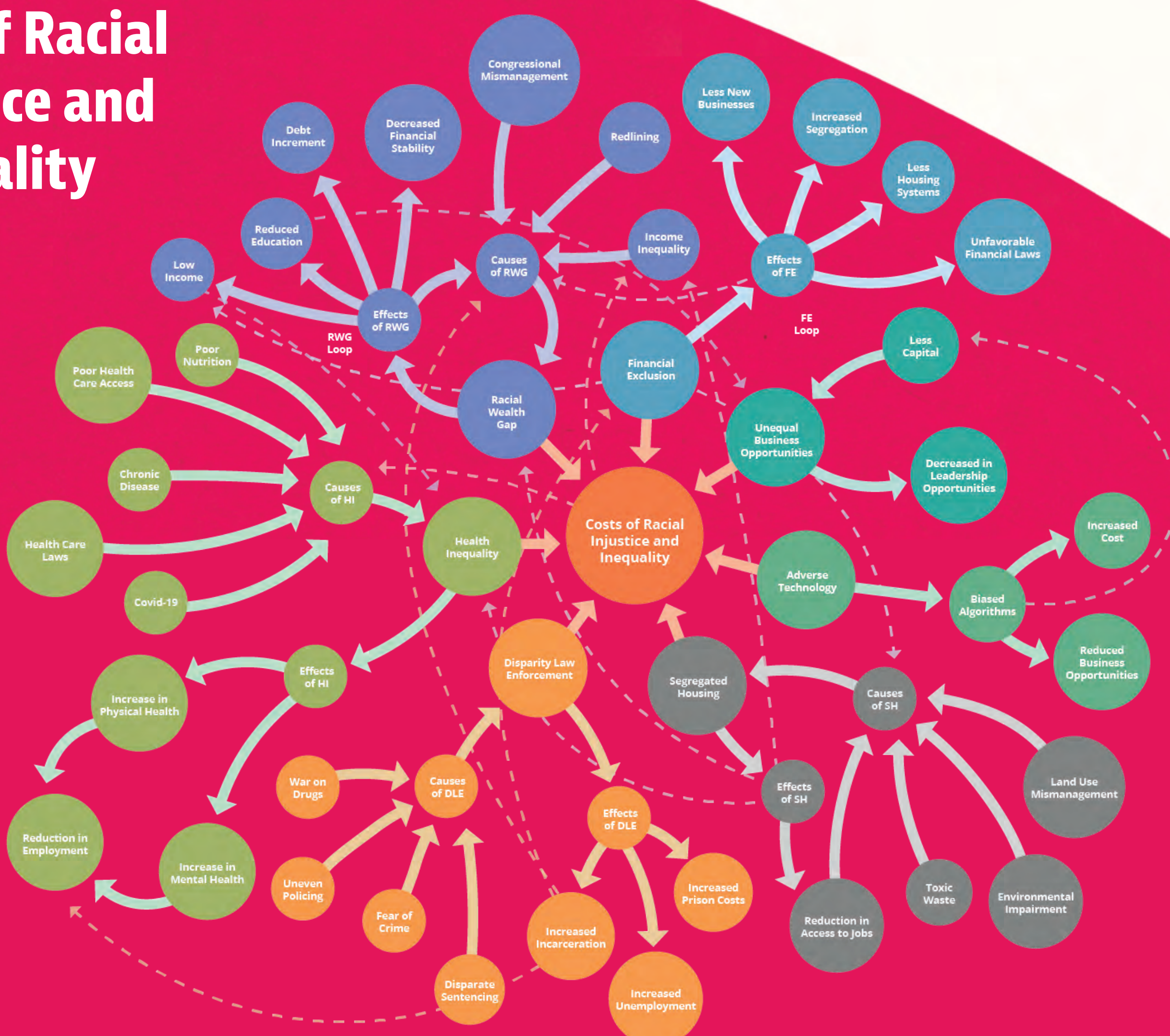


Exhibit 1
Source: Katie School of Insurance & Risk Management, 2021

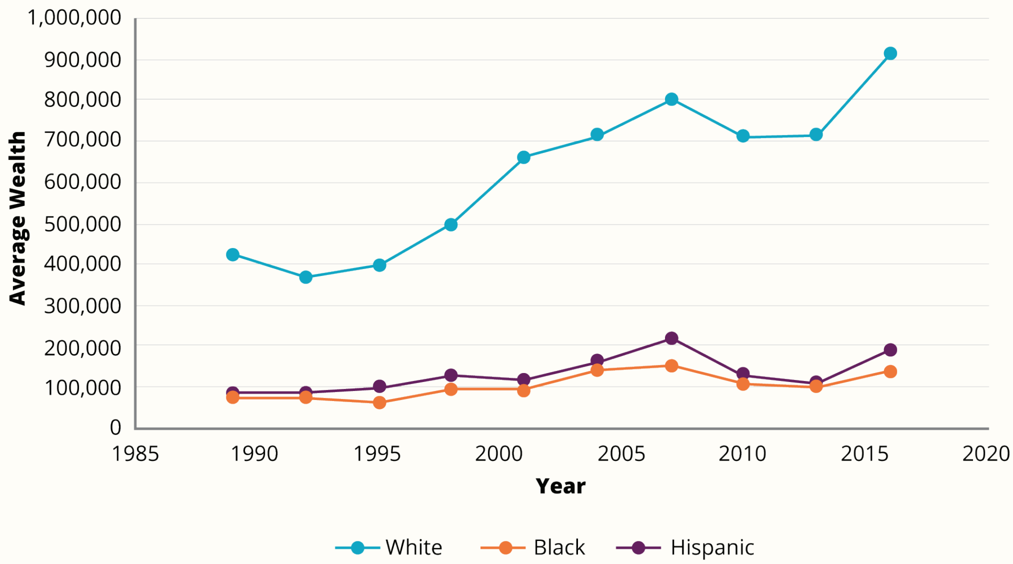
In 2019, the white-to-Black wealth gap was about 10 to 1, with the median white family having roughly 162,640 in wealth versus the median Black family's wealth of $16,216. Exhibit 2 shows that in 2016, the average wealth of white families was $919,000, while for Black families it was $140,000.[5] With 14 million Black households in the United States, the cumulative cost of this is $9.8 trillion.[6]

Exhibit 3 elaborates on this phenomenon, showing the median wealth gap and that this gap exists even when controlling for full employment and educational attainment.[7] When compared with their college-educated peers in the same group, the racial wealth gap persists over time. In 1989, the Federal Reserve Bank of St. Louis reported that the median wealth of a Black family with a college-educated head of household had 31 cents of wealth for every dollar similar white families had; by 2016 this declined to 17 cents.[8]

Exhibit 4 summarizes some of the causes of this gap.

Average Family Wealth by Race/ Ethnicity, 1989–2016

Exhibit 2



Median Household Net Worth By Employment and Educational Attainment

Exhibit 3

Factor	White	Black
Fully employed	$144,220	$11,000
College educated	$268,028	$70,219
Post-college	$455,212	$141,115

Causes and Effects of Racial Wealth Gap

Exhibit 2
Source: Katie School of Insurance & Risk Management, 2021

> **"The causes identified do not suggest a need for direct redistribution of wealth, simply to address injustice"**

Effects of Racial Wealth Gap

The racial wealth gap affects many areas of the insurance and financial services sector.

In 2020, Americans inherited about $765 billion in gifts and bequests (excluding transfers that go to spouses and that support minors).[9] Most of this wealth transfer was tax free.

Further, white people will transfer 10 times more wealth to the next generation than Black people will. What effects will this wealth transfer have, and what implications does it have for risk and insurance? Here is a partial list:

- Reduced access to funds during times of financial instability, such as pandemics. This means that people of color will feel the effects of such crises more acutely.

- Less investment in discretionary expenditures, such as home technology, summer camps, tutors, and extracurricular activities.
- Lower educational investment.
- Less support for older teens' and young adults' costs for housing, transportation, and health insurance as they transition to the adult workforce.
- Less funding to support small businesses.

Each one of these consequences has an economic cost and human toll on those affected. And the resulting wealth gap challenges professionals who help people manage risk to become educated about the surrounding issues.

Exhibit 4 shows several documented causes of the racial wealth gap. Some are historical but have ramifications that are still felt today, while others exist currently and continue on unmitigated. Most are well-documented, such as the G.I. Bill, which has disadvantaged Black veterans but provided educational and home-ownership opportunities to white ones.

The causes identified do not suggest a need for direct redistribution of wealth, simply to address injustice.

Cost of Financial Exclusion

Financial inclusion is a critical bridge between improved economic opportunity and wealth, but many people face financial disparities based on race. Car loans offer an easily understandable example.

Owning a car is often necessary for work but is more expensive for those facing financial exclusion. A 2020 study found that when car shopping, a person of color who is a better-qualified applicant than a white counterpart is 62.5 percent more likely to be offered more-expensive financing, costing people of color an additional $2,662 over the life of the loan. The study put the annual economic cost at $60 billion.[10]

The benefits to Black customers of closing the wealth gap include:

- Accumulating long-term wealth
- Having sufficient funds to purchase insurance against key risks
- Gaining greater access to credit
- Increasing the ability to plan for big goals (such as starting a business and paying for college)

The cost of financial exclusion may be most stark when it comes to access to capital for business startups. Entrepreneurship is often touted as a way for communities of color to generate economic development, build wealth, and create jobs.[11] But their disparate ability to access capital greatly thwarts any attempts at business formation.

"Black entrepreneurs have trailed their white counterparts with respect to access to loans and venture capital"

Black entrepreneurs have trailed their white counterparts with respect to access to loans and venture capital. The Stanford Institute for Economic Policy Research found that "the average level of investment is $81,697 for white firms … [compared with] Black firms investing only an average of $34,462." Racial differences in business and owner characteristics may contribute to Black-owned businesses' having lower financial investments than white-owned businesses. Founder wealth explains some of the gap, but in addition, "at startup, Black-owned firms borrow about one-half as much as they put in of their own capital, whereas white-owned firms borrow about 1.7 times what they put in of their own capital." Finally, capital from outside equity and venture capital was over 36 times higher for white-owned business startups than Black-owned ones, which find venture capital to be "exceedingly rare."[12]

Financial inclusion could help close the wealth gap. This means reassessing existing loan-underwriting guidelines to eliminate race-based discrimination and providing mentoring for Black entrepreneurs so that they can get greater access to venture capital. By building trust in the banking system, costs can be recovered by reducing needless fees and credit costs associated with being underbanked and relying on payday loans.

Further Study

- Look in the next issue of Insights for Part 2 of this discussion, which will address:
- Challenges of unequal business opportunities, an important engine for ameliorating the racial wealth gap
- Overall costs of racial inequalities of health care ($245 billion annually)
- Most recent cost of racial inequalities related to COVID-19 mortality and hospitalizations ($226 billion mortality costs and $5 billion in hospitalizations)
- Litigation costs related to racial bias in the U.S. ($225 million)
- The loss of human and social capital and leadership opportunities that many CPCUs have experienced
- The role of insurance professionals, and the industry in addressing these catastrophic costs and inequalities ■

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