New York's Insurance Industry
Perspective and Prospects

New York City is the home of some of the world's largest life insurance companies and of the nation's premier market in commercial property-liability insurance. Twenty years ago jobs in the city's insurance industry accounted for nearly half of all financial employment in New York. Today this share has fallen to less than a third. Moreover, since 1950 the fraction of the nation's insurance work force employed in New York City has more than halved, from 16 percent to less than 7 percent or about 100,000 jobs. This decline stems from many causes, among them the relatively slow growth of local markets, laborsaving technological changes, the decentralization of insurance operations, and burdensome taxes and regulations.

In terms of the future, there is evidence that some of these negative influences are dissipating. The regional economy appears to be stabilizing, and New York is becoming increasingly competitive with other locations as business costs rise more slowly than in the rest of the nation. An important element in the improving business climate has been governmental actions taken in recent years. Changes have been made to reduce regulatory and tax burdens on insurance. Moreover, the brokerage and underwriting community's ability to compete worldwide has been strengthened by the recently instituted Insurance Free Zone and the prospective Insurance Exchange. These recent trends lend hope that the decline in insurance-related jobs can be arrested and might possibly be reversed.

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Structure of the insurance industry: overview

By New York State law, individual companies are licensed to sell life insurance or property-liability insurance, but not both types of policies.[1] Life insurance policies are long-term contracts to insure relatively predictable risks. Property-liability policies are written for shorter time periods (typically one year), and generally cover less predictable risks. Many of the largest insurance corporations now have subsidiary companies in both areas, but the individual companies remain operationally distinct as required by statute. The types of risks covered and the regulatory environment vary between the two sectors, fostering differing sales techniques, investment strategies, and job skills.

Life insurance companies sell individual life and individual accident and health insurance directly to consumers and also sell group insurance plans, primarily through employers. Similarly, property-liability insurance covers the so-called "personal lines" that insure homes and automobiles of ordinary consumers, as well as "commercial lines" that insure business property and liability. These distinctions are important

[1] An exception is accident and health insurance, which is sold by both property-liability companies and life insurance companies. Property-liability insurance includes automobile liability and physical damage insurance, homeowners and commercial multiple peril insurance, fire and allied lines, inland and ocean marine, workers' compensation, burglary and theft, surety, fidelity, glass, boiler and machinery, and aviation insurance

because the size and complexity of the policies issued affect the types of marketing systems employed, which in turn influence the location of insurance jobs.

Insurance is marketed through three distribution networks that overlap somewhat. Much of the individual insurance market is serviced by the American Agency System which comprises thousands of independent agents, each of whom typically represents a number of companies and is reimbursed on the basis of the premiums received from policies sold. In most areas, however, these independent agents and the "agency companies" that they represent are in direct competition with "direct writers"—companies that employ their own branch networks to sell directly to consumers.[2] In addition, large commercial property-liability risks as well as a substantial fraction of the group life and health plans are handled through a third network of insurance brokers.

Brokers differ from agents in their authority to "bind" the company to an insurance contract. Brokers submit their business to company underwriters who can accept or reject it; it is the underwriter who binds the company. Agents, however, have contracts with companies that allow them to commit the company on certain types of policies, usually up to some specified limit per policy.

Many insurance brokerage firms deal primarily in large commercial risks. The largest brokerage firms are national companies, with branch systems throughout the country. Their head offices, however, are located in the major insurance centers, where highly skilled personnel put together complex insurance contracts. Since these risks are frequently shared among several insurance companies, brokers benefit from proximity to the companies' underwriters. As a result, they have remained fairly concentrated in cities such as New York even when the ultimate market for their services is widely dispersed. In contrast, agencies and the branch offices of direct writers of individual insurance typically market standardized personal policies to consumers in their local market.[3] Because the sale of these policies does not require the same interaction of insurance professionals, there is little reason to centralize this activity. Consequently, jobs involved with the sale of individual insurance tend to locate close to the consumers.

The New York industry: early years

During the nineteenth century, the sales operations and head offices of insurance companies were concentrated in the nation's urban centers. With travel difficult, communications slow, and trade between regions limited, companies with large local markets had decided advantages. At the same time, the infrastructures of American cities facilitated home-office activities. Trolleys and later subways enabled the office district to draw workers from great distances, thus increasing the available labor force. Elevator buildings supported higher densities of activity, which made for easy personal contact. Typewriters, adding machines, and other office equipment made it technologically feasible for commercial businesses to hire pools of clerical workers to mass-produce outputs such as insurance policies.

As the country's largest, most developed urban center, New York City provided special attractions for the insurance industry. For example, because of the commercial activity of the port of New York, the city's property-liability insurers gained special expertise in large commercial risks. New York became the largest commercial insurance market in the country; and, to reach this market, property-liability companies that were headquartered in other cities also established major underwriting and administrative offices in Manhattan.

The easy personal contact afforded by New York City was especially important in the property-liability industry. The early companies were clustered together, making them readily available to brokers who typically went from firm to firm to market their risks. This close proximity also enabled companies to "spread the risk" by reinsuring with one another. When one company reinsures business with another company, it assigns all or part of the premium income from that business to the reinsurer, in return for which the reinsurer assumes the corresponding proportion of the risk.

The investment activity of Wall Street drew early life insurers to downtown Manhattan. Although they were prevented by law from investing directly in speculative ventures, prior to 1905 many New York life insurers did so indirectly by holding interests in Wall Street banks and investment houses—investments that were relatively risky in those days.

By the turn of the century, New York insurers dominated the industry. In 1900, New York's "domestic" life

[2] Direct writers, as used here, include both those companies that employ salaried sales representatives and those companies that sell through "exclusive agents". Exclusive agents represent only one company but are reimbursed on the basis of commissions. The overwhelming majority of individual life insurance policies are sold through exclusive agencies. The sale of personal lines property-liability insurance is more equally divided between independent agents and direct writers.

[3] Although the vast majority of individual insurance is sold through agents or direct writers and nearly all large commercial policies are brokered, there is substantial overlap. Some agents do a highly sophisticated large-risk business, while many brokers sell primarily small personal-lines policies. In particular, in New York City, for historical reasons virtually all property-liability insurance is purchased through brokers.

insurance companies—those chartered by (or domiciled in) New York State—accounted for less than one fifth of the nation's life insurance companies, but they collected more than half of the total United States life insurance premiums. The property-liability industry was far less concentrated, but New York was still important. Companies domiciled in New York State accounted for nearly one fifth of the nation's property-liability premiums, although they were only a tiny fraction of the country's 2,000 fire, marine, and casualty companies. Most of New York's domestic insurance companies were headquartered in New York City, and the concentration there of sales and head-office personnel made the insurance industry one of the city's largest employers of white collar workers.

The New York industry: maturity

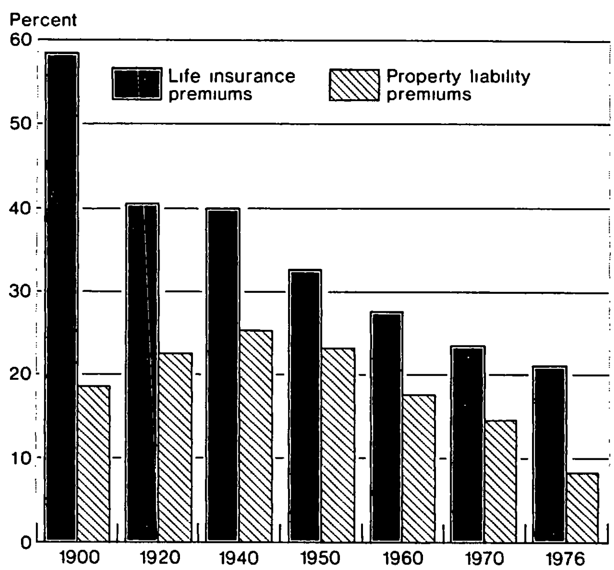
Spurred by the growth of the New York metropolitan region, the relative importance of New York's property-liability industry continued to increase during the early part of this century. The share of total United States property-liability premium income received by New York-domiciled companies increased from less than 20 percent in 1898 to more than 25 percent in 1940. Moreover, since out-of-state companies traditionally located major underwriting activities in New York City, it is likely that the insurance premiums received by New York domestic firms understated the importance of the city's property-liability industry during this period.

In contrast to the growth of property-liability insurers, in the first decades of the century New York's life insurance industry suffered a serious setback. In 1905, public criticism of industry practices prompted the New York State legislature to conduct a thorough investigation of life insurance companies then operating in the state. Widespread abuses were uncovered, and the New York State legislature responded by severely tightening its insurance regulations. Indeed, the 1906 New York Insurance Code has served as the model for twentieth century insurance regulations. The sharp erosion in the market share of New York-domiciled life insurance companies—from nearly 60 percent of United States premium income in 1900 to 40 percent in 1920—can in large part be attributed to the regulatory restrictions as well as to the somewhat tarnished image of New York companies immediately following the investigation.

Between 1920 and 1940, the market share of New York's domestic life insurance companies stabilized while that of the domestic property-liability companies continued to increase. Since 1940, however, New York City's importance as an insurance center—in both life and property-liability business—has declined steadily (Chart 1). This is evident from employment data as well as premium income data.[4] While total insurance employment in New York City expanded from 1950 to 1957, the advance was slower than for the nation as a whole. This disparity increased between 1957 and 1976, when insurance employment in the city fell by 19,000 jobs, a drop of about 15 percent, while insurance jobs in the nation rose by nearly 70 percent. Over the entire period, from 1950 to 1976, New York City's share of the United States insurance work force declined from 16 percent to less than 7 percent

Chart 1

Share of Total United States Insurance Premiums Received by New York Domestic Companies

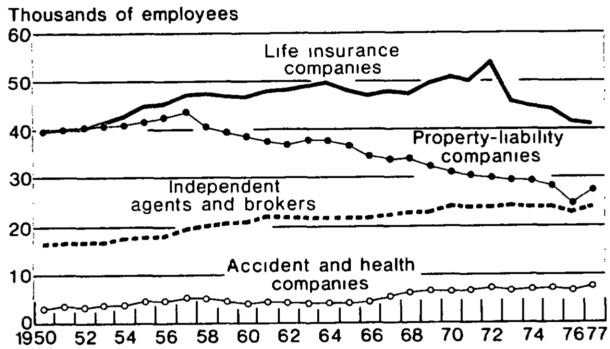


Sources New York Insurance Department, Statistical Tables from Annual Statements, American Council of Life Insurance, Life Insurance Fact Book, The Spectator Company New York, The Insurance Yearbook 1901-1902, Life and Miscellaneous, Insurance Information Institute, Insurance Facts, A M Best and Company, Best's Review, Property-Casualty Edition (December 1948) — property-liability data for 1898 were used, since 1900 data on United States property-liability premiums were not available

[4] In this article, employment is measured by the Bureau of Labor Statistics series on "covered employment", that is, employees covered by unemployment compensation Covered employment data are available for earlier years and with greater industry detail than the more commonly cited payroll employment In general, the trends of the two employment series parallel each other However, the covered employment series does not follow exactly the payroll employment series because the proportion of workers covered by unemployment compensation has increased over the years The increase in coverage has probably affected the New York and United States series similarly.

Chart 2

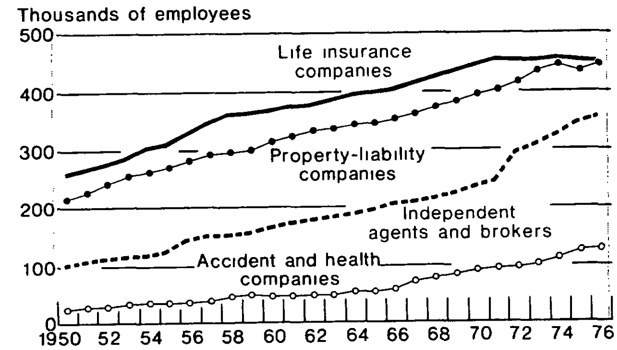
Insurance Employment by Sector: New York City



Source New York State Department of Labor

Chart 3

Insurance Employment by Sector: United States



Source United States Department of Labor

Employment trends have varied somewhat among the individual subsectors of New York's insurance industry. Employment with life insurance companies, which account for the largest number of insurance jobs in New York City, advanced until the early 1970's. Since then, however, the New York life insurance companies have sharply reduced their work force. Between 1972 and 1977, some 13,000 jobs were lost—25 percent of the 1972 total (Chart 2). Nationally, the number of employees of life insurance companies also declined in the 1970's, but the rate of decline was much slower than in New York (Chart 3). By 1976, the city's share of the country's life insurance jobs had fallen to less than 10 percent, down from 15 percent in 1950 (Chart 4)

In contrast to employment in the life insurance sector, the number of jobs with property-liability companies, the second largest employer of insurance workers in New York City, has declined almost every year since the peak in 1957. Over the ensuing twenty-year period this sector lost 16,000 jobs, or nearly 40 percent of its 1957 work force More recently, however, employment in this industry appears to have stabilized, and in 1977 property-liability companies actually increased their work force a bit in New York. With national employment in this sector expanding virtually every year since 1950, New York City's share of United States jobs with property-liability companies dropped from 18 percent in 1950 to 5 percent in 1976.

Jobs in New York with independent agencies and insurance brokerage firms and with accident and health companies have actually increased over the last twenty-five years But the employment growth has been very modest relative to these sectors nationally. Consequently, in these sectors as well, New York's share of United States total employment has fallen.

Why has New York City lost insurance jobs?

More than 200 domestic insurance companies are headquartered in New York City. In addition, New York is host to the regional sales and underwriting offices of numerous out-of-state companies that are licensed to sell in New York, as well as to the offices of the independent agents and brokers that service the New York market. In 1977 the New York insurance industry employed nearly 100,000 workers and accounted for about one third of New York City's total financial employment Despite its size, New York's insurance industry has failed to keep pace with the employment gains elsewhere in the country. Indeed, if over the past thirty years the city's insurance work force had kept pace with the rest of the industry, there would be 225,000 insurance jobs in New York today—more than twice the actual number.

Market dispersal

Much of the relative decline in New York's insurance employment ultimately can be traced to the shift of insurance policyholders away from the traditional home markets of New York companies. For example, between 1940 and 1976, the fraction of total United States life insurance premiums paid by New York State residents fell from 17.7 percent to 7.0 percent. At the same time, the fraction of total United States property-liability premium income received for risks located in

New York declined from 17.3 percent to 9.4 percent. Since insurance is one of the multitude of business service industries that are attracted to headquarters centers, these trends reflect the relocation of corporate headquarters away from New York as well as the nationwide dispersal of individual policyholders.

Faced with the relatively slow economic growth of the New York region and the geographical dispersion of the nation's insurance market, New York companies have had to compete for business in distant markets. As a consequence, between 1940 and 1976, New York-headquartered life insurance companies increased the fraction of their total premiums received from out-of-state residents from less than 50 percent to nearly 90 percent. Since insurance salesmen and the service personnel who collect premiums and process claims and policy loans are closely tied to the local market, the dispersal of business away from the New York region has been accompanied by a decentralization of marketing-related jobs.

Computerization

The slow growth of sales-related employment is only part of the explanation. The home offices of New York City's domestic insurance companies also provide a substantial number of jobs, and these, too, have failed to expand in recent years, primarily because of productivity increases resulting from automation.

Insurance was one of the first industries to use the computer extensively in business operations. The sale and production of an insurance policy had traditionally involved the routine processing of numerous standardized forms by low-wage clerical workers—operations that are highly amenable to computerization. When the life insurance industry began automating in the 1950's, computers were huge, multipurpose machines that tended to be located in the head offices close to other operations. Hence, although productivity increases associated with automation reduced employment growth, the jobs continued to be in New York.

In contrast to life insurance companies, the main impetus to computerize processing in the property-liability industry did not occur until the 1960's. By then, computer technology had progressed sufficiently that companies could locate expensive computer hardware in suburban areas to take advantage of lower wages and to minimize the risks associated with centralizing such activities in problem-plagued urban centers. Indeed, property-liability companies that were in the early stages of computerization in the 1960's frequently chose to locate their electronic data processing (EDP) operations outside the city. As a consequence, employment within New York's property-liability companies fell both because of laborsaving computerization and because of the relocation of jobs outside New York.

Since many large life insurers had made substantial investments in computer hardware at their headquarters, they were less inclined to decentralize these operations in the 1960's. But by the 1970's, with further advances in teleprocessing and developments in smaller less costly computers, the life insurance companies also had begun to relocate their EDP operations outside the city.

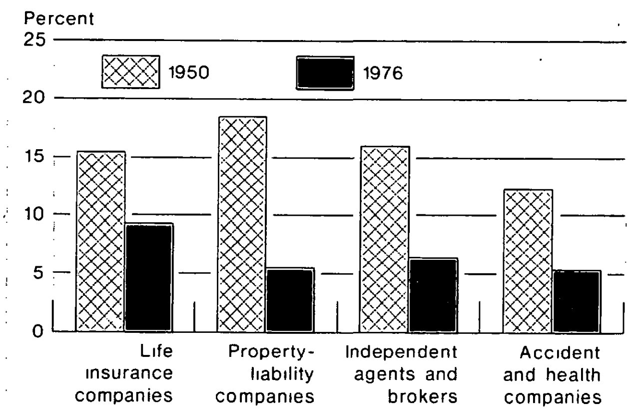
Regulation

New York State insurance regulations have dissuaded new companies from domiciling in the state, and this in turn has reduced the growth of headquarters-related jobs in New York City. This has been particularly evident in the life insurance sector where, since 1906, the New York State Insurance Code has imposed relatively conservative restrictions on investments, commissions, salaries, and the amount of business that can be written. These regulations apply to all companies licensed to do business in New York, regardless of their states of domicile. Moreover, the so-called Appleton Rule prohibits New York-licensed companies from engaging in practices in other states that are not allowed in New York State. Hence, all business of New York-licensed companies is affected by the New York Insurance Code—not just that in New York State.

As a result of New York State's pioneering consumer protection in the insurance field, New York life insurance companies' reputations for soundness and relia-

Chart 4

Share of United States Insurance Jobs Located in New York City



Sources: New York State Department of Labor and United States Department of Labor.

bility have grown over the years and consumers have undoubtedly benefited. Nevertheless, the regulations have had adverse implications for the competitiveness of New York-licensed companies and have served as a disincentive to companies that might otherwise locate in the state. A key example is the restriction on commission rates that New York-licensed companies can pay to sales personnel. As a result of this regulation, New York-licensed companies find themselves at a competitive disadvantage in markets outside the state because they cannot increase commissions to attract and retain agents.

New York's commission limitations are particularly restrictive for new companies trying to establish themselves in an area. Consequently, most new life insurance companies have chosen to become chartered in other states and have avoided the New York market altogether. Others also have domiciled out of state but have subsequently established a New York-domiciled subsidiary company licensed only in New York. This allows access to the New York market without exposing out-of-state business to New York regulations.

Because life insurance companies typically locate their home offices in their state of domicile, New York's failure to attract new life insurance companies has cost it jobs. Over the first fifty years of the century the number of New York-domiciled life insurance companies grew from fourteen to twenty-three, an increase of over 60 percent, but the number of companies nationwide posted a sixfold increase from less than 100 to close to 650. While the growth of New York companies has outpaced the nation since 1950, the vast majority of the newly established New York companies simply represents New York subsidiaries of major out-of-state insurers. As a result, the positive impact of these increases on headquarters-related employment in the region has been relatively small.

Although the number of New York domestic property-liability insurers has actually declined by one third since 1950, this has not caused an equivalent decline in New York property-liability insurance activity or in related employment. Unlike life insurers, property-liability companies frequently locate all or part of their headquarters operations outside their state of domicile.[5] Thus headquarters-related jobs in any state are only loosely tied to the number of its domestic companies.

Much of the contraction in the number of property-liability insurance companies has resulted from legal reorganizations that have had limited effects on New York's headquarters-related employment. Following New York State's decision in 1949 to allow multiple-lines underwriting, a general consolidation took place nationwide as property companies merged with casualty companies.[6] The ensuing reduction in the number of New York companies was substantial. Between 1948 and 1958, the New York domestic industry contracted from 307 to 231 companies, a decline of 20 percent. There was not, however, a concurrent decline in insurance sales, and employment with New York property-liability companies actually grew over this period. Moreover, although the consolidation may have resulted in some contraction of the work force to eliminate duplication, merged companies did not in general disappear from the New York insurance scene. Even when a New York company was merged into a company domiciled out of state, it typically continued to do the same business out of the same New York office as before.

Taxes

In addition to the regulatory burden, increases in New York's insurance taxes during the late 1960's and early 1970's also reduced the willingness of insurance companies to domicile in the state. High taxes are themselves a disincentive. In insurance, however, the impact of high taxes imposed by any one state is magnified by the prevailing system of so-called interstate retaliatory taxation.

Insurance companies are taxed by each state on the policies they write on risks located within that state. Furthermore, all states with domestic insurance companies also levy retaliatory taxes. Suppose, for example, that all states levy a standard premium tax of 2 percent, and that one state, say New York, chooses to raise its rate to 3 percent. Companies domiciled outside New York would pay the higher rate, but only on the policies they wrote on risks located in New York. In contrast, New York's domestic companies would be required to pay 3 percent, not only on the business they wrote in New York, but also on their business in any other state with retaliatory tax laws. Hence, the burden of any general increase in a particular state's insurance tax falls more heavily on its own domestic companies than on out-of-state companies licensed to sell insurance in that state.

Retaliatory taxes were originally designed to pro-

[5] New York City has been the major beneficiary of this trend. Numerous out-of-state companies maintain major underwriting operations in the city to gain access to the New York market, and several companies domiciled in other states also have their executive offices in New York.

[6] Prior to this time, New York-licensed property companies were not allowed to write casualty policies and vice versa. To be able to provide their customers with a full range of insurance services, many property (casualty) companies organized casualty (property) subsidiaries and some even issued joint policies. When the legal proscription on multiple-lines underwriting ended, many of these subsidiaries were merged.

tect each state's domestic companies from high taxes in other states by penalizing the domestic companies of any states charging the higher rates. They also have had the effect of discouraging insurance tax increases in general. For many years, 2 percent was the standard premium tax throughout the country; and, even today, most states continue to charge this rate.

In 1968, New York State raised property-liability premium tax rates from 2 percent to 2.25 percent, and life premiums from 1.75 to 2 percent. However, to prevent retaliation, these increases applied to the New York business of only New York domestic companies. The tax on the New York premiums of out-of-state companies remained unchanged.

By 1974, New York's premium tax on domestic property-liability companies and domestic life insurance companies had been raised to 2.6 percent and 2.25 percent, respectively. Some property-liability companies, which were members of insurance groups containing out-of-state companies, responded by transferring their New York business to the out-of-state companies to avoid paying the tax. Other companies, unable to make this transfer, began to redomicile to other states to reduce their tax burden.

In 1974, New York State acted to institute an insurance tax that did not discriminate against New York State companies. The straight premium tax was replaced by a combined income tax and premium tax. Under the current system, the premium tax rate has been reduced to 1.0 percent on life premiums and accident and health premiums and to 1.2 percent on property-liability premiums. But in both cases the premium tax is supplemented by an income tax of 9.0 percent. In addition, each company's total state tax liability is limited by a "cap", or maximum, equal to 2.6 percent of total premiums.

When the 1974 tax changes were instituted, it was hoped that other states would not retaliate against income taxes and that the reduction in the premium tax would solve the problem of retaliation. Neither hope has been realized, however. Since the current tax *is* applicable to the New York business of out-of-state companies, many states seek to apply their retaliatory provisions to the income tax. When the premium tax equivalent of a New York company's total New York State tax exceeds the rate charged in another state, the New York company is normally assessed the difference in retaliatory taxes. As before, the New York companies most affected are profitable firms with a substantial proportion of their insured risks located out of state.

The retaliatory squeeze on New York's domestic companies has been significantly lessened, however, by the provision that allows them a credit against their New York State taxes equal to 90 percent of the retaliatory taxes that they pay to other states.[7] Since their institution in 1974, the credits granted by New York State against retaliatory taxes have more than doubled from $2 million to $5 million.

The 1974 tax changes reduced the tax burden on New York's domestic insurance industry but, by then, a significant number of the state's property-liability companies had redomiciled. Nevertheless, the impact on jobs and income has not been large. Redomiciling is not the same as relocating, and the major commercial underwriting operations of nearly all the firms that have obtained new charters from Delaware, Connecticut, or New Hampshire continue to be located in New York City. Indeed, the majority of these remain in downtown Manhattan. Hence, redomiciling has had more impact on insurance companies' tax liabilities than it has had on their New York jobs.

Some of the states to which firms have redomiciled have required that the insurance companies locate certain jobs there in exchange for their charters. So far, these requirements do not appear to have caused the city to lose many jobs. In any case, the jobs that have left appear to be concentrated in back-office operations such as data processing—operations that gradually have been relocating outside the city for some years.

New York's life insurance companies are also at a tax disadvantage. Indeed, virtually all the state's $5 billion in retaliatory credits have been paid to life companies. But, unlike the property-liability companies, no life insurance companies have chosen to redomicile, in part because of fear of a challenge by the New York State Insurance Department.[8] Nevertheless, the new tax indirectly constrains life insurance employment growth by affecting product mix. Under the income tax portion

[7] To obtain the full 90 percent credit, a certain minimum fraction of a company's risks must be located in New York. Otherwise 90 percent of the retaliatory taxes payable to other states could exceed the total tax liability to New York State. In such a case, the company's tax payments to New York could fall to zero before offsetting the full 90 percent of the retaliatory taxes paid elsewhere.

Ironically, in such a case, redomiciling to a low tax state could lower the tax liabilities of the company involved *and* at the same time raise tax receipts to New York State. If the same number of employees were to stay in New York, the premiums and income allocated to New York State for tax purposes would remain the same, but there would be no offsetting retaliatory credits.

Even in those cases where a company's New York tax liability is large enough to receive the full 90 percent credit, the remaining 10 percent of the retaliatory taxes is 10 percent that it would not be required to pay if it redomiciled.

[8] Such a challenge could involve, among other things, the complicated legal problem of how to allocate the liability of the New York Life Insurance Guarantee Corporation for policies of any New York domestic life company that would domicile elsewhere.

of the tax, investment income is taxed more heavily than premium income. Because of the "savings" component of individual whole life insurance, such policies generate a larger portion of investment income per dollar of premiums received than group or term insurance. Consequently, the switch from a straight premium tax to a combination premium and income tax creates incentives for New York companies to focus increasingly on group and term insurance. Since these areas are less labor intensive than individual whole life business, the tax may be contributing to a further reduction in New York City's life insurance jobs.

The tax also increases the incentives for all insurance companies to relocate jobs to other states. In figuring its income tax liability, an insurance company must apply the 9 percent rate to that portion of its net income attributable to its business in New York State—*i.e.,* to its "allocated entire net income". The proportionality factor is a weighted average of the fraction of the company's total premiums that are paid by New York residents and the fraction of its total payroll in New York.[9]

Even though the weight given to premiums in the allocation formula is nine times the weight given to payroll, the potential for reducing a company's allocated net taxable income by relocating jobs could be substantial. For example, assume one company pays 50 percent of its total payroll in New York while another pays only 10 percent of its wages there, and both write 10 percent of their premiums in New York. In this case, New York State levies its tax on 14 percent of the net income of the company paying 50 percent of its payroll in New York and on only 10 percent of the net income of the other company. Hence, embodied in New York's tax laws is a definite incentive for insurance companies to run their businesses from outside the state.

What types of jobs continue to locate in New York?
As a result of the increased productivity of home-office workers, the dispersal of sales personnel, and the relocation of data processing installations outside New York, the size of the insurance work force in the city has declined substantially over the past twenty years. Yet, New York continues to be an attractive location for many insurance operations. Indeed, for those companies headquartered in the city, New York continues to house the major underwriting, investment, and legal functions, as well as the senior administrative offices, and all the support facilities for these areas.

In particular, the sales and underwriting facilities for large, nonstandard policies tend to be centrally located in New York. This business requires sophisticated brokerage and underwriting expertise, and often necessitates face-to-face communication. Thus, despite the dispersal of other economic activity away from the region, New York's concentration of corporate headquarters, insurance brokers, and insurance companies has continued to attract this segment of the industry to the city. In the life insurance sector, this includes group insurance policies and pension management, important products of New York companies. Similarly, large commercial property-liability policies and reinsurance continue to be concentrated in New York.

New York—an international insurance center?
Large commercial property-liability risks are highly mobile—not just within the United States but also across national boundaries. Relative to other insurance centers in this country, the New York market clearly has a comparative advantage in this type of business. The companies operating in New York together provide sufficient underwriting capacity to absorb a substantial fraction of the large risks. They also offer specialized skills and services unavailable elsewhere in the country. Worldwide, however, London is the primary insurance center, and, in the past, many risks that might have been placed in New York instead moved on to London. Consequently, New York's continued growth in these areas depends on its successful competition with London for what is becoming an increasingly international insurance business.

In the past, part of the problem of the New York property-liability insurance industry reportedly has been that large commercial risks were overregulated in New York. The delay and added expense resulting from the regulatory process may have motivated brokers and customers to avoid placing risks in the New York market and to opt instead for out-of-state and foreign providers of insurance. Indeed, approximately half of the premium income received by Lloyd's of London originates in the United States. A number of recent changes in New York's insurance law will improve the national and international competitiveness of the New York property-liability industry.

Regulation 20
The first move to improve New York companies' ability to compete for international risks was an amendment to "Regulation 20". Adopted in 1977, this amendment relaxed the legal restrictions on New York companies that reinsure with "nonadmitted" reinsurance companies—*i.e.,* those not licensed in New York State.

[9] A company's entire net income that is allocated to New York State is obtained by multiplying its total United States income by

$$\left(\frac{9}{10}\left[\frac{\text{New York premiums}}{\text{United States premiums}}\right]\right)+\left(\frac{1}{10}\left[\frac{\text{New York payroll}}{\text{United States payroll}}\right]\right)$$

Insurance companies are required by law to hold reserves equal to their estimated losses, loss adjustment expenses, and unearned premiums.[10] When a block of business is reinsured, the reinsurer must increase its reserves to cover the assumed liabilities while the direct insurer typically reduces its reserves by a similar amount. Prior to the amendment to Regulation 20, New York-licensed primary insurers were not able to take credit against their reserves for any business ceded to nonadmitted reinsurers. Obviously, if the primary insurer cannot free reserves for new business, reinsuring with nonadmitted reinsurers becomes costly. Normally nonadmitted reinsurance companies are willing to make additional arrangements to cover the liabilities they assume: for example, they may grant the primary insurer a letter of credit on a New York bank. Moreover, to make it easier for American companies to reinsure with them, many foreign reinsurance companies have established United States branches that are licensed in New York State. Nonetheless, the New York restrictions were viewed as limiting the ability of New York companies to accept large risks and causing some large risks to move directly to London.

At the same time, New York companies operating in foreign insurance markets were at a disadvantage. If they reinsured with admitted reinsurers, New York State allowed them to credit their reserves. But by reinsuring here rather than in the country where the direct premium income originated, they increased their foreign exchange exposure. In any case, foreign regulations often forbid reinsuring in the United States, requiring instead that at least part of the reinsurance be placed locally (in the foreign country) with government-controlled reinsurers. Unlike many privately owned foreign reinsurers, these government reinsurers have had no inclination to become licensed in New York State. Consequently, New York companies dealing in these countries were forced to reduce their capacity to write new business because they could not credit their reserves for this reinsurance.

The amendment to Regulation 20 relaxed these reinsurance restrictions. New York-licensed companies can now automatically credit their reserves for 85 percent of most insurance ceded with nonadmitted reinsurers. This should facilitate New York companies' expansion of their activities abroad. It should also heighten competition in the United States reinsurance market as foreign reinsurers increase their activity here.[11]

An insurance "free zone"

The amendment of Regulation 20 was followed in 1978 by major legislation that established a New York Insurance Free Zone as of September 1, 1978. In effect, this amounted to a partial deregulation of large insurance contracts throughout the State of New York. Previously, all commercial insurance policy forms had to be submitted to the state insurance department for approval—a process that resulted in increased costs and delay. Under the Free Zone legislation, companies that obtain special licenses are authorized to write insurance contracts that are exempt from the New York Insurance Department's rate and policy filing requirements so long as they carry annual premiums of at least $100,000 for one kind of insurance or $200,000 for two or more kinds of insurance. Similarly exempt from regulation are certain special, exotic, and difficult-to-place risks such as kidnap and ransom or skydiving insurance. However, Free Zone insurance must still comply with the minimum standard policy provisions of the New York Insurance Law. The Free Zone legislation also provides for income from risks located outside the United States to be exempt from New York States taxes.

This partial deregulation of large nonstandard insurance contracts should enable New York companies to compete effectively for most United States risks that brokers have, in the past, preferred to place in London. Moreover, with the exemption of foreign risks from New York taxes, it is expected that the New York insurance industry will be able to attract an increasing share of the insurance business originating in other countries. Early indications are promising. By February 1979 Free Zone licenses had been granted to sixty-three companies which in the aggregate have a capital and surplus equal to $9 billion. Using the basic limitation of 20 percent of capital and surplus for Free Zone writing, the Free Zone could provide a potential market of $1.8 billion in insurance premiums.

The New York insurance exchange

The 1978 legislation also provided for the establishment in New York City of an insurance exchange—an entirely new institution designed to attract risks from

[10] Property-liability premiums are typically paid one year in advance. If a customer cancels the policy before the year is over, the company refunds the "unearned" fraction of the premium paid; hence, it must hold reserves to cover unearned premiums.

[11] Many of the foreign firms that have recently opened branches in New York are reinsurers who "domesticated" in response to restrictions in the New York insurance law limiting the credit allowed primary insurers on premiums reinsured abroad. Since these restrictions have been eased, the rate of domestications of foreign branches may fall, but the activity of foreign companies in the New York market will probably increase.

around the world. Although the New York Insurance Exchange is still in the organizational stages, the recently approved constitution and bylaws provide for an institutional arrangement that is similar in many respects to Lloyd's of London.[12] Underwriters, operating on behalf of syndicates of investors, will locate on an "exchange floor" where member brokers will come to market their risks. Because the exchange is particularly suited for the writing of large insurance and reinsurance contracts, it is envisioned that each syndicate will accept only a small portion of any one risk. Consequently, brokers are expected to follow the Lloyd's practice of presenting a risk to several different syndicates in succession. Moreover, the member syndicates and brokers must maintain principal offices in New York for the purpose of transacting insurance and reinsurance business on the exchange.

The New York Insurance Exchange will differ in one important respect from Lloyd's of London. Lloyd's syndicates are essentially unrestricted in the types of property-liability risks they can underwrite. In New York, however, most types of *direct* insurance risks located in the United States will not be placed through the exchange. Syndicates on the New York Insurance Exchange will be constrained to underwriting: (1) reinsurance and (2) direct insurance on risks located outside the United States. The only exceptions to these restrictions will be on risks that have been refused by Free Zone-licensed companies: these can be underwritten directly by syndicates on the exchange. However, syndicates will not be restricted to writing either property-liability or life insurance. The same syndicate can qualify to participate in both types of insurance simply by increasing its capital from $3,550,000 to $6,550,000.

By concentrating on reinsurance, the exchange will be promoting a market that has been growing rapidly in the United States. Since 1952, the total amount of American premiums reinsured has increased by more than 10 percent per year, and the fraction of that total reinsured with American companies has grown even faster. Before World War II, more than half of all American reinsurance premiums was ceded to foreign reinsurance companies; but, in 1976, only about one fourth of American reinsurance was going abroad. To some extent, this trend reflects the willingness of foreign reinsurers to establish United States branches and subsidiaries to obtain easier access to the American market. The activity of the reinsurance departments of United States primary insurers has also grown rapidly.

The New York Insurance Exchange is viewed as a complement to the Insurance Free Zone. While the New York Insurance Department will monitor the operations of the New York Insurance Exchange, like Lloyd's of London it will be largely self-regulated. The constitution establishes minimum capital requirements for underwriting members. It also empowers the board of governors of the Insurance Exchange to establish procedures for ensuring the financial soundness and ethical conduct of the exchange's membership.

London's preeminence in insurance is the result of two factors: its huge capacity which enables it to handle very large risks and its adaptability to the world's rapidly changing insurance needs. The New York Insurance Exchange and the Free Zone together should go a long way toward improving New York's relative competitiveness in the international insurance market. The existence of a central market place, with its easy interchange of brokers and underwriters, is expected to foster competition and increase the efficiency of the New York market to write reinsurance and to place international risks. The insurance exchange should also make the New York insurance industry more accessible to individuals with capital to invest, thereby expanding the capacity of the New York market. In addition, the relaxation of certain statutory controls applicable to large commercial risks within the Free Zone and the self-regulation of the Insurance Exchange should vastly increase the flexibility of New York underwriters.

These regulatory and institutional changes will attract business from other insurance centers and increase the concentration of large nonstandard property-liability insurance activity in New York—to the benefit of the city's employment and income. Although such effects are difficult to project, the Governor's economic affairs cabinet has estimated that within two years after their implementation, the Insurance Free Zone and the New York Insurance Exchange will together contribute between 1,100 and 2,500 new jobs to New York City's insurance work force. If one also considers the additional induced effect on noninsurance employment, the city's total job increase is projected to be between 3,500 and 4,500 after two years and as much as 8,000 after ten years. Clearly, the potential contribution to the city's economy could be significant.

Outlook for the future

Insurance employment in New York City is likely to stabilize in the next few years. Some of the forces contributing to the past erosion of jobs appear to be eas-

[12] The constitution and bylaws that were approved by the state legislature February 26, 1979 allow the New York Insurance Exchange to begin functioning on or after March 1, 1979, but in all likelihood the earliest it can begin business is in October.

ing, and their negative impacts are likely to be offset, at least in part, by new jobs attracted to the city by the development of the Free Zone and Insurance Exchange.

While total employment is likely to stabilize, the composition of insurance jobs probably will continue to shift. New York is likely to lose additional low-paid clerical positions. Automation continues to reduce the number of these jobs industrywide, and advances in communications and computer technology have already increased the geographical autonomy of insurance processing centers to the disadvantage of New York City. There is little evidence that incentives for dispersal of processing operations have been reduced significantly. However, by now, this process may have largely run its course.

The prospects for other headquarters-related jobs depend on the relative costs of doing business in New York. Sophisticated communications systems have made it possible for many headquarters functions to locate anywhere in the country, but at the same time there have been more moderate increases in New York City's wages, consumer prices, office rents, and taxes over the last two years than in most other cities. If these trends continue, New York's future as a headquarters center can be expected to brighten.

Sales-related employment gains depend on the growth of the market served. The growth of sales personnel dealing in individual insurance in New York will be closely related to the expansion in the local economy, which is likely to lag the rest of the nation over the next few years. In contrast, significant employment gains are possible in the sales and underwriting of large nonstandard policies. These activities continue to be attracted by many of the same forces that originally drew the industry to the city—the concentration of corporate clients and the easy personal contact made possible by New York's well-developed office infrastructure. In addition, the recently instituted Insurance Free Zone and forthcoming New York Insurance Exchange should enable the city's property-liability industry to increase its share of the worldwide market in large commercial risks.

As clerical and processing jobs decline and insurance marketing personnel become more dispersed nationally, New York's insurance jobs are becoming increasingly concentrated in the underwriting, brokerage, and management functions. This is the core of the industry that most depends on what New York has to offer—a market environment that encourages easy face-to-face communication. By building on its ability to provide such an atmosphere, New York should be able to retain and promote this key sector of the insurance industry.

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