Immigration Insurance

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Abstract: The author proposes a new insurance product to protect businesses from the potentially significant economic impact of legislation aimed at curbing illegal immigration.

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I. INTRODUCTION

Illegal immigration is one of the most hotly debated topics in the 2008 U.S. Presidential campaign. The political discussions typically start with

a staggering statistic: the twelve million illegal immigrants who live in the United States. While the politicians center their discussions on how to enforce the border and deport those who break the law, the perspective of American businesses is much different. Many companies depend on the work of immigrants, both legal and illegal. Various forms of legislation being discussed would have a significant impact on the American economy. The purpose of this document is to propose an insurance system that would protect businesses against potentially catastrophic losses.

II. ECONOMIC BACKGROUND

Illegal immigration has had a powerful economic impact on the U.S. Starting with the number of twelve million illegal immigrants, one rough estimate of the impact is as follows:

1. Estimate the number of illegal immigrants who are employed.

The average number of people per household in the U.S is 2.54, per the 2005 American Housing Survey. A household may have more than one employee, which would produce a total population/employee ratio of less than 2.54. On the other hand, there are households with no employees.

To compare the total population with the illegal immigrant population, consider the following: some anecdotal evidence suggests that many immigrants live alone in the U.S. and send money back to their country of origin. However, other evidence suggests that immigrants bring multiple family members to the U.S., all of whom live under one roof. Using an average of three immigrants per one worker produces a slightly higher ratio than the U.S. average. The ratio of 3:1 produces an estimate of 4 million illegal workers from the estimated illegal immigrant population of 12 million.

2. Estimate the economic output per illegal worker.

In traditional economic theory, output equals income. However, given the wage inequalities that are presumed to exist for illegal immigrants relative to other workers, in my opinion income is not a good approximation for output.

Economic output per worker can be calculated by dividing the total output by the number of workers:

Total output is measured by the U.S. Gross Domestic Product (GDP), which for the third quarter of 2007 was approximately $14 trillion on an annualized basis.

The number of workers in the U.S. economy for the same period was roughly 146 million.

Dividing $14 trillion by 146 million workers produces an output of roughly $100,000 per worker.

As illegal immigrants tend to be employed in low-wage industries, the average output per illegal worker is probably less than $100,000 per year. However, assuming an output of 50% of the average American worker, or $50,000, the total economic output of $50,000 per worker times 4 million workers = $200 billion.

$200 billion roughly equals 1.5% of the total U.S. economic output of $14 trillion. Given that illegal immigrants are estimated to number 12 million, which is 4% of the total U.S. population of 300 million, the $200 billion value is perhaps a bit light but doesn't seem unreasonable.

III. INSURANCE BACKGROUND

Clearly the economic impact of illegal immigrant labor is significant. The output produced by illegal immigrants equals income earned by their employers. To the extent the labor of such employees is threatened by legislation, so too is the income of many businesses across the nation.

Before discussing the aspects of an insurance system to protect the economic interests of business owners, it needs to be stated that one of the central tenets of insurance is that it is against public policy to insure illegal acts. Just as an owner of an automobile is not insured for driving behavior that deliberately injures others, there should not be insurance for employers who willfully break the law by knowingly hiring illegal immigrants.

The insurance system discussed here is for employers who unknowingly hire illegal workers. Included would be employers who hired individuals who are later, after enactment of future laws, found to be in the country illegally.

While the future of immigration law is uncertain, it seems likely that changes will be enacted that increase the possibility of current employees being declared ineligible to work in the United States.

A worst-case scenario would be that a significant number of employees would be deported, which would have potentially catastrophic consequences for some businesses. While straits this dire are probably not likely, we can anticipate an increase in economic losses for many businesses. A best-case scenario could involve 1) a small percentage of employees being deported and 2) many employees, perhaps a majority of illegal employees, having to take time off of work to become legitimate. Even this situation would present many employers with significant economic losses.

Thus, it appears that employers have an insurable interest. The exposure is similar to that covered in business interruption insurance. A question that needs to be addressed is that of insurability. There does appear to be a degree of adverse selection built in to such an insurance product, as many employers would appear to have no risk, while others have a very high risk of loss. However, there is great uncertainty regarding the future of immigration law. Employers who do not appear to have much risk now could incur losses under tighter laws passed in the future. In this regard, "immigration insurance" can be thought of as similar to earthquake insurance, as some earthquakes occur in areas with no known faults. Another analogy is insurance for flood losses, which can occur in areas not designated as flood plains.

IV. PRICING/UNDERWRITING

At this point in the analysis the exposure appears to be appropriate for insurance coverage. Clearly risks vary widely in exposure to loss.

Appropriate pricing variables could include the following:

- employer history of immigration law violations
- management history of immigration law violations
- availability of replacement workers in the area
- local enforcement of immigration law
- industry experience with immigration law violations

The list above is not intended to be exhaustive. Carriers offering this coverage will undoubtedly develop a comprehensive set of variables to reflect exposure to loss. Certainly consideration must be given to how likely variables are to be approved by state insurance departments.

One thought about using employer and management history is that the current environment of enforcement is in all likelihood lax compared to the future environment. Therefore, employers who have incurred losses in the current environment may incur an unreasonably high level of losses going forward and may not be qualify for coverage based on some companies' underwriting guidelines. If there is a large number of uninsurable risks, a significant residual market will emerge. Initially carriers may resist accepting either assessments for or assignments from a residual pool. The government may need to step in and provide insurance (either directly or indirectly by way of subsidy) for such risks. Usually I am not in favor of governmental involvement in the private insurance market, but given that it is the federal government's more restrictive immigration laws that are creating the expected increase in exposure, I believe governmental involvement at least needs to be up for consideration. The analogy between this product and flood insurance, which is provided by the government, would appear to lend credence to the notion of governmental involvement.

Initial pricing relativities would need to be based on expected losses. Frequency estimates for a carrier's commercial accounts for the new product could perhaps be based on information from government databases on immigration law infractions. Severity estimates could be based on current revenues, which carriers would have from writing other commercial lines.

Pricing revisions would need to be based on actual experience. Frequency would appear to be fairly straightforward, with a claim being defined as the occurrence of an employee being unable to work due to either being detained or having to miss work to undergo the process of becoming legal. These two categories would need to be captured separately and would certainly have different severities. An interesting question is whether or not an employee who voluntary leaves employment due to fear of deportation would trigger coverage. While this scenario would appear to be a legitimate concern for the employer, verification would appear to be problematic.

Severity would be measured as the difference between the revenue in the prior period and the revenue in the current period, similar to business interruption insurance. Another component of severity would be the extra expenses incurred to hire and train replacement employees.

V. OVERALL PRICING LEVELS/REINSURANCE

Given that the insurance product under discussion is not currently in the market, some employers may have to be convinced of its need. The coverage would have to be initially priced at a level affordable for commercial customers. However, from the perspective of actuarially sound rates, this runs counter to the great uncertainty in the exposure, which would call for a very large profit and contingencies factor. One solution might be a stop loss reinsurance program that applies above a certain loss ratio. If the private reinsurance market has an unwilling appetite, perhaps there could be a federal reinsurance backstop. The above comments on governmental involvement apply here as well.

VI. GOING FORWARD

At this juncture probably the most important topic to address is the market for such an insurance product. Considering the attention the issue of illegal immigration has received in recent years, it is assumed that the employer community has had high-level discussions regarding ways to manage the exposure. However, it is unknown to me how much momentum there is in the employer community for an insurance product designed for this purpose. Discussions with the broker community and perhaps the Chamber of Commerce would be insightful.

A major consideration for employers is the uncertainty regarding future laws. A reasonable course of action would appear to be a "wait and see" approach. However, it is very unlikely that any changes that result from the 2008 elections will be permanent. Laws implemented will likely change very quickly. It would be reasonable to expect laws implemented in the aftermath of the 2008 elections to be changed frequently, with changes likely to occur until the 2010 mid-term elections, at which point new laws are likely to be enacted. The immigration issue seems likely to be a political football for the foreseeable future. For employers, waiting until "the dust settles" seems to be an approach that is too passive, as the exposure is real and arriving quickly, as changes in laws are expected regardless of the outcome of the 2008 elections and may even occur before November 2008.

From the insurers' perspective, 2008 is shaping up to be another year of flat-to-declining premium volume. Premium written from a new product could help ease the top-line burden from the soft market. Looking at a multi-year premium projection, it is not likely that much premium would be written in 2008. An extreme projection would have significant premium levels in 2009 to cover a one-time mass deportation of illegal workers, followed by rapidly declining premium levels. However, as stated earlier, such an occurrence would impose significant disruptions on the U.S. economy and is not likely. A more likely situation would involve premium levels escalating fairly rapidly in the first couple of years. At some point in the not-too-distant future premium levels probably peak, as action is decided upon regarding the majority of illegal workers. However, existing cases will linger, and when combined with new workers who will continue to enter the workforce illegally, the descent in premium levels is likely to be gradual, if there is a decline at all.

The timing of the market will need to be addressed, in addition to the pricing, underwriting, coverage, and reinsurance issues discussed above. Also, companies will need to decide how to offer the product: as a stand-alone product, endorsement to a CGL policy, an additional coverage under business interruption, or another way.

Clearly the questions greatly outnumber answers at this point. My goal is for the community of actuaries, underwriters, other insurance professionals, employers, and governmental leaders to consider all relevant factors in developing the best possible mechanism for helping to sustain a significant part of the American economy.

Biography of Author

Kelly McKeethan is a pricing actuary for Bank of America responsible for pricing debt cancellation products for consumers and small businesses. He has a B.S. in Mathematics from the University of Tennessee in Knoxville. He is a Fellow of the Casualty Actuarial Society, a Member of the American Academy of Actuaries, and holds the designations of Chartered Property and Casualty Underwriter, Associate in Regulation and Compliance, and Associate in Services. He has worked in pricing and reserving for personal lines companies and as a consultant. He can be reached at kellyvol@comcast.net.