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CONSUMER/CONSUMERIST TRENDS AND THEIR ACTUARIAL IMPLICATIONS

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With respect to the following subjects:

What is happening?
Why?
Where is it likely to lead?
What are the implications to the actuary?

1. U.S. Senate's Consumer Insurance Information and Fairness Act.

2. NAIC cost comparison and disclosure.

3. Classification of risks as related to:
   a. Growing feeling of entitlement.
   b. Changing life styles.
   c. Confidentiality of information and distrust of institutions.
   d. Definition of equity classes.

4. Availability of coverages.

5. Canadian developments, including Ontario Insurance Study (Carruthers' Report).

MR. PAUL J. OVERBERG: My part of this panel is to briefly review the consumerism activities at the Federal level as contained in the bills introduced by United States Senators Hart and Stone. I am sure you are familiar with these two bills - but for those who may have forgotten some of the details, I will refresh your memories with some of the highlights. Senator Stone's bill:

1. would require insurance companies to furnish cost disclosure and other relevant information to veterans eligible to convert their government insurance; and

2. would require the Veteran's Administration to publish an annual Shopper's Guide.

The Stone bill does not specify which method of cost comparison would be used. The industry, through the American Life Insurance Association (ALIA),

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recommended in last December's hearings that the National Association Insurance Commissioners (NAIC) method for cost comparison should be us Indications are that the bill may emerge from subcommittee sometime th year, but in a slightly modified version.

Senator Hart's bill would require several things:

1. First, life insurance companies and their agents would have to provide prospects with Joseph M. Belth's Cost Disclosure information:

    a. The prospect would have to be given the company retention figures which show the excess of the present value of expected premiums over the sum of the cost of protection, the savings arising from cash values, and the present value of illustrated dividends; and

    b. The prospect would have to be shown the Belth expected annual cost of protection.

2. Second, life insurance companies would have to give prospective customers the mode loading percents, policy loan interest rate, and the company's latest 13-month lapse rate.

3. Third, the company would be required to give the policyholder annual reports which would show the annual premium, the amount of insurance protection, cash value, the dividend, and both the annual and cumulative rate of return computed on the Belth method.

4. Fourth, the Federal Trade Commission would be required to publis an annual Shopper's Guide on participating policies comparing actual dividends paid with dividends illustrated at time of issue.

5. And lastly, the bill contains a provision to make insurance agents more independent of the companies.

The purpose of the Stone bill is to help veterans have some means to c which of several life insurance policies is the best buy.

The stated purpose of the Hart bill is to "help consumers in the life insurance market." Senator Hart contends that the individual life insurance industry "abounds with waste, inefficiency, and overcharging and that this inefficiency stems from three things:

a. a lack of effective price competition,

b. an abundance of ignorance in the market, and

c. excessive product complexity.

"Are those valid criticisms?" And if so, will the Stone and Hart bill accomplish their intended purpose?

I am sure many of us would agree with Senator Hart that some life insurance policies are better buys than others, but we may disagree on the extent to which consumers have been overcharged for this life insurance. Furthermore, we actuaries would have difficulty agreeing on which out of any 100 similar life insurance policies are the 10 best buys and which are the 10 worst buys. While we may have difficulty in ranking the relative value of several life insurance policies, Doctor Belth has eliminated this confusion. Senator Hart's bill incorporates the Belth retention method which would give the consumer a specific ranking for each policy in any group of policies that the consumer may wish to compare. On the other hand, the NAIC model regulation gives the consumer four indexes, two of which illustrate what the consumer's average annual cost will be if the policy is surrendered at the end of the 10th or 20th year and two others which give the consumer an indication of his average annual cost if the insured dies at the end of the 10th or 20th years. Thus, the NAIC method requires the consumer to do a little thinking for himself.

The Hart bill may be the subject of further hearings later this year. At those hearings the following questions may be discussed:

1. Are the Belth rankings reasonably valid?

2. Will the Belth rankings and other provisions of the Belth method decrease the "true cost" of life insurance to the consumer?

3. If agents are to be independent of the company, who is going to pay for the cost of their training?

4. Will the requirement to publish the company's 13-month lapse rate improve the industry average persistency? or

   Will it discourage companies from selling life insurance to the people in the lower income groups?

5. What will be the effect of the coexistence of the NAIC model regulation on cost comparisons and the Hart bill?

Even if a uniform cost disclosure system is adopted by the federal and state governments, there will be a great deal of time required before many life insurance consumers will begin to understand and appreciate the complexity of comparing life insurance costs. In the last analysis, we must return to the fact that the vast majority of life insurance is sold through agents, and that the services of the agents are deemed desirable by a great majority of the buying public. This,plus the reputation of the company and other services offered, cannot be included in any cost calculation. If an inordinate amount of emphasis is placed on cost indexes, will these other services deteriorate and, in the long run, will the customer suffer?

MR. DANIEL J. ANDERSEN: My goal today is to bring you up to date as quickly as possible on the activities of the National Association of Insurance Commissioners in the area of life insurance cost and benefit disclosure. I will summarize the events which have led to the adoption of a Life Insurance Solicitation Regulation by the NAIC and describe the primary provisions of that regulation. I will also describe the continuing work of the NAIC Life Insurance Cost Comparison Task Force.

Although efforts on the part of insurance regulators and life insurance companies to provide life insurance buyers with a means for comparing the relative costs of similar life insurance policies have emerged only within the last few years, appropriate methods for making such comparisons have been acknowledged by the actuarial profession for many years. For example, the New York State Insurance Department in their 1937 "Special Study of Industrial Insurance" which was made in connection with the regular triennial examination of the Metropolitan Life Insurance Company used the Interest-Adjusted Method for comparing the relative costs of Industrial and Ordinary life insurance. In adopting a Life Insurance Solicitation Regulation, the NAIC has recognized that this type of information can be useful to the individual life insurance buyer if such information is provided to him uniformly by all companies. We began receiving suggestions regarding appropriate systems for the comparison of life insurance policies as many as fifteen years ago from academicians and members of the actuarial profession.

By 1970 we were hearing inquiries from Congress and the Veterans Administration regarding efforts to provide buyers with cost comparison information. As a result, the life insurance industry established the Joint Special Committee on Life Insurance Costs which endorsed the use of the Interest-Adjusted Cost Method for use in comparing the relative costs of similar life insurance policies.

By the end of 1971, it was clear to the NAIC that the life insurance industry would not be able of itself to produce a viable system for providing comparative cost information to all life insurance buyers. Therefore, the NAIC appointed a new Task Force on Life Insurance Cost Comparisons with the primary charge being to identify the most appropriate method for comparing life insurance costs and to draft a model regulation in order to establish that method as an industry wide standard. Having reached some preliminary conclusions by June of 1971, the Task Force embarked on a series of research projects in conjunction with the Senate Subcommittee on Antitrust and Monopoly which was conducting an investigation of the life insurance industry under the direction of Senator Hart.

The Society of Actuaries shared in this research along with the American Life Insurance Association, the Life Insurance Marketing and Research Association, the Institute of Life Insurance, and Mr. E. J. Moorhead who has served as a special consultant to the NAIC Task Force and the Subcommittee on Antitrust and Monopoly. The research reports were completed by the spring of 1975, setting the stage for completion of a Model Regulation.

Following exposure of the first draft of the proposed regulation, two events took place which heightened interest in cost and benefit disclosure both inside and outside the NAIC. On July 8, 1975, Senator Hart introduced his "Truth in Life Insurance" Bill, which proposes to mandate the use of lengthy

disclosure documents in the sale of life insurance. His proposed disclosure statement includes lengthy displays of actuarial gymnastics. His proposal not only mandates the use of a confusing array of numbers but forbids the use of any other numerical demonstrations other than those which are mandated. On July 29, 1975, Senator Stone introduced a bill which is intended to result in the provision of cost and benefit information to veterans who are interested in converting their government term life insurance. The contents of these bills were discussed by Mr. Overberg.

In the meantime, the NAIC has proceeded through numerous stages of developing what has been referred to as the NAIC Model Life Insurance Solicitation Regulation which received final adoption by the NAIC Executive Committee on May 4, 1976. This Regulation is composed of two basic features. One is a Life Insurance Buyer's Guide which contains very general and fundamental information regarding the choice of the type and amount of life insurance in addition to a description of how to compare the relative costs of similar life insurance policies. The other component of the Regulation is the Policy Summary which contains specific cost and benefit information regarding the policy which has been purchased or which is under consideration. This information includes death benefits, premiums, cash values and dividends for a sufficient number of years to clearly illustrate the premium and benefit patterns. It also includes the Life Insurance Surrender Cost Index, the Life Insurance Net Payment Cost Index, and the Equivalent Level Annual Dividend for 10 and 20 year durations.

These documents must be delivered to the prospective purchaser before the Company accepts the applicant's initial premium or premium deposit, unless the policy for which application is made contains an unconditional refund provision of at least 10 days in which event the Buyer's Guide and Policy Summary must be delivered with the policy or prior to delivery of the policy. A Buyer's Guide and a Policy Summary are also available to any prospective purchaser upon request.

This Regulation has taken a responsible approach toward providing sufficient information to life insurance buyers in order to allow them to make an intelligent purchase decision. The Buyer's Guide is short and simple and the Policy Summary has been trimmed as much as it can be while still setting out cost and benefit patterns of the policy. The timing of delivery of this information has been programmed to interfere as little as possible with the life insurance sale, yet provide the information soon enough to assist a buyer who is interested in shopping. Those of us who have worked to develop this Regulation are indebted to the Society of Actuaries for the contribution which it has made. We will now look to the actuarial profession to provide an education for the agency forces in order that they might be in a position to properly utilize the information which they will now be providing to life insurance purchasers. Since I am convinced that the success of this Regulation depends upon the extent to which it is uniformly adopted in the various states, I believe that it is imperative that professional actuaries visit their state insurance departments in order to encourage the adoption of this Regulation without change. I am also convinced that the sooner this initiative is made, the better the chances are of having one set of cost and benefit disclosure rules to live with instead of encountering variations from state to state.

In the process of developing this Regulation, the Life Insurance Cost Comparison Task Force identified a number of additional matters which it believes are in need of further study. The Task Force has now been authorized to proceed in the following areas:

1. Development of procedures for proper enforcement of the model regulation.

2. A study of methods of detecting manipulation of policy values and dividends in such a way as to produce unrealistically attractive cost indexes.

3. A study of the need for a separate disclosure system for group insurance, credit life insurance, annuities, and variable life insurance.

4. A study of the feasibility of developing a more extensive disclosure system which would be made available upon request, including a system which would be applicable to dissimilar policies.

5. A study of the need for modification of our disclosure system to accommodate special sub-groups of the life insurance buying public including veterans, college students, and senior citizens.

6. A study of the feasibility of developing a central data bank of cost comparison information.

7. A study of the need for developing alternative systems for improving the general public's understanding of the life insurance product through means other than point-of-sale disclosure.

8. A review of the existing NAIC Replacement Regulation in order to determine the need for revision.

9. A study of the feasibility of mandating the use of a standardized portfolio of life insurance products.

10. A study of characteristics of the current system of marketing life insurance, including commission arrangements and exclusive service contracts, which may tend to encourage an agent to sell an inappropriate policy.

First on our list of priorities is the development of a regulation for the control of life insurance dividend practices. This will include control of dividend illustrations as well as maintenance of equity in the distribution of surplus. The Society of Actuaries has recently appointed a new Committee on Dividend Philosophy which is chaired by Mr. J. Edwin Matz. The charge of that committee is as follows:

> The purpose of this Committee is to (1) study in depth the underlying actuarial principles and practical problems relating to the calculation and illustration of dividends, including related matters of philosophy, and (2) to develop a report on its findings and recommendations.

The NAIC Task Force plans to meet with the Society Committee on Dividend Philosophy in the near future in order to reach mutual agreement as to the nature of the study which that committee will be undertaking as well as the extent to which the NAIC can relay on the Society of Actuaries to provide the necessary basis on which to construct a regulatory framework.

It has been especially encouraging to me to see the spirit of cooperation between the actuarial profession and insurance regulators. I believe that as we continue to work together, our cooperative effort will result in a life insurance industry which merits the respect and confidence of the general public and which is better equipped to meet growing life insurance needs in a truly competitive atmosphere.

MS. CYNTHIA MADURA RYAN: Many of today's challenges for business are to be found under an ever-growing umbrella loosely labeled "Consumerism." They run the gamut of truth-in-lending, environmental protections, equal opportunity, to mention a few. The current consumer movement has discovered insurance among its many areas of attention. We, as an industry, are on trial just as is the case with the major institutions in this country. The watchword of the day is no longer "caveat emptor" -- buyer beware, but rather "caveat vendor" -- seller beware.

In 1975, over 200 consumer bills were placed in the congressional hopper. Although only a small portion of those proposed bills were enacted, 1975 set in motion the impetus for the passage of potent consumer legislation in 1976. Chronic inflation heightens the institutionalization of consumerism and generally feeds the fires of consumer unrest. Furthermore, in the wake of Watergate and the erosion of public confidence, consumer legislation is recognized by the political leadership of both parties, especially in an election year, as one means of restoring "consumer-voter confidence." In 1976 and in the coming years, Congress appears headed for stronger consumer protection legislation. The increasingly liberal domination of Congress assures passage of new consumer legislation involving complaint handling and controversies, credit and finance, advertising and deceptive sales practices, individual protections (data collection and disclosure of information), and antitrust. Many of these new proposals seek greater accountability on the part of life insurers. Such proposals would affect practically every facet of the business, urging increased accountability for product cost and design, for marketing techniques, for product failure (i.e., lapsation), for product availability (i.e., risk classification and equality), and for the necessary acquisition, use and storage of personal data. Indeed, pressures for accountability go so far as to involve the way life insurance companies are run -- their use of assets, their relationships to communities, even the make-up of their Boards of Directors.

Although there are countless examples of the federal government stepping in to aid the consumer on a legislative or regulatory basis, the most notable example is the controversial "Consumer Protection Agency Bill" -- which, as proposed, would establish an independent, non-regulatory agency to act as the consumer advocate. In general, this agency's role would be one of advocacy -- to balance the close relationship which allegedly exists between existing regulatory agencies and regulated industries. This agency would direct research and investigations to support its cases, and would have the use of interrogatories to obtain needed information from business to protect the health and safety of the consumer, or to discover fraudulent practices. This consumer protection agency would also be the focal point in government consumer complaints. The current bill requires the agency administrator to promptly transmit to the appropriate federal, state or local agency any complaint that discloses an apparent violation of law or agency rules, or that discloses a practice detrimental to the interest of the consumer. The agency is also required to promptly notify the subjects of the complaints and afford them time to respond. Finally, it must publicly display a list of all filed complaints and the business responses it has received. The consumer activists, especially Ralph Nader, support this measure and believe it will keep consumerism before the public and stimulate new demands for accountability and openness.

In general, the consumerist climate is fully reflected in the relentless pressure of a more sophisticated and better educated public who will take the initiative to exercise their rights regarding insurance coverage, and this has had a definite effect upon insurance operations -- specifically upon the consumer complaint decision-making process. Also, there is an increasing interest on the part of the media to lend support to the consumer movement by making available their resources and talents to advocate consumer views. Recent discussions with consumer activists reveal that they firmly believe that consumerism has, in fact, become institutionalized.

CONSUMER FEDERATION OF AMERICA: A CONSUMER LOBBY

The lobbying approach is still the mainstay for most consumer organizations, such as the Consumer Federation of America, which is a principal consumer organization in the United States, composed of labor and consumer groups. Recently, at the 1976 Consumer Federation of America's Annual Meeting, where many of the major candidates were presenting their platforms relative to consumer issues, this organization called upon state and federal authorities to require a reasonable minimum cost/benefit relationship in all types of insurance. The following points are highlights of the Consumer Federation of America's position paper for 1976:

- Truth in Insurance

  Regulatory action is needed to reduce the unnecessarily ambiguous terminology of almost all insurance policies sold to consumers. At the same time, we urge full disclosure of all relevant information. We support federal "truth-in-insurance" legislation which would establish standards and establish forms describing the language permissible in all insurance policies. Where

policies have features and clauses that needlessly limit the rights and benefits affecting consumers, they should be removed. Unnecessary proliferation of policy types should be stopped and policies should be standardized to allow better understanding and comparison of policies being sold.

- Life Insurance

  We support required disclosure of the comparative costs of life insurance policies through standardized methods, such as the interest-adjusted or other similar methods at the time of sale. We support standardized and mandatory disclosures of important buyer information as embodied in the Consumer Insurance Information and Fairness Act (Hart Bill).

- Mutual Insurance Companies

  We urge that policyholders of mutual-type companies be restored their due rights to control and direct the affairs of their own companies. We urge consumer voting control of Blue Cross and Blue Shield and other health and medical insurance plans.

- Federal Review of State Insurance Regulations

  We urge that Congress initiate an investigation of its responsibilities to insurance consumers. Reconsideration of its position favoring state regulation, as spelled out under the 1945 McCarran-Ferguson Act, is long overdue in the face of growing revelations of failures in state regulation of insurance.

- Cooling-Off Period

  We favor extension of the concept of the cooling-off period to all forms of insurance. Many forms of insurance involve extended and even lifelong periodic payments, and consumers must be notified of their rights in order to reject the policies at no cost. In the case of life insurance, consumers need 30 days to rescind the policy.

- Discrimination

  The unfair and inequitable discrimination in the availability, issuance, rating, administration, and cancellation of insurance on the basis of age, sex, race, marital status, or sexual preference must be prohibited.

- Maternity Coverage

  We recommend that maternity needs be treated the same as any other health and disability need in group health, sick leave, and disability benefit programs.

- Individual Retirement Accounts

  We find that many small investors have been actually and potentially harmed by sale failures to disclose important costs and penalty aspects of the plans. We deplore the failure of the Internal Revenue Service to require adequate disclosure regulations that include standardized death rate of return measures, sales commission and overhead disclosure,and prominent warnings as to risks and penalties.

- Accountability

  We call on the National Association of Insurance Commissioners and the individual Insurance Commissioners to adopt strict rules on conflict of interest, to balance industry domination of regulatory meetings and regulatory proceedings by sponsoring and encouraging informed public participation, and by diligent efforts to educate consumers on their needs for public support and financial assistance in substantive efforts to reform virtually all sectors of this $500 billion dollar industry.

The Consumer Federation of America's Position Paper is merely an example of an "Advocacy" position. The Industry takes issue with a number of the points listed. Thus, the need for more "Consumer-insurance education and dialogue" with public interest groups is very necessary.

ROLE OF GOVERNMENT

Certainly Senator Hart is ruminating about the role of the federal government in life insurance and questioning how the industry sells its products, what it discloses to the consumer, and whether it is effectively regulated. Both Ralph Nader and Herbert Denenberg, former Pennsylvania Insurance Commissioner, are encouraging Congress to pass a Truth-in-Insurance bill. Unlike the traditional state concern regarding solvency of insurance, Senator Hart and his consumer colleagues are concentrating on consumer protection and competition.

Despite the McCarran-Ferguson Act, the insurance industry has for some time, and more intensely at the present moment, been subject to various antitrust attacks by the Justice Department, the Federal Trade Commission, and, of course, private litigants. There are currently two major issues in the antitrust area, both of which could have a tremendous impact on the life insurance business. The first matter involves a high-ranking study being conducted by the Department of Justice for the White House Domestic Review Group on Regulatory Reform. This study will determine possible amendments to the McCarran Act. Although aimed primarily at the property-casualty business, any such changes could greatly impact the life insurance industry by affecting traditional state regulation and industry immunity from federal antitrust laws -- including, again, intrusion by the Federal Trade Commission. The second issue is that of interlocking directorates. A great majority of life insurers have on their Boards of Directors persons who are also directors or officers of banks - and vice versa. While both businesses have long viewed this as proper and appropriate, the

Department of Justice last year decided that such situations are in violation of Section 8 of the Clayton Act. As a result, the Justice Department brought suit against several insurance companies and banks. The progress of this litigation, which is expected ultimately to reach the Supreme Court, will be of great interest to all companies.

To compound matters, we are facing, with regard to liability, a new era in litigation with costly class action suits and outrageous punitive damage awards. In addition, the California Supreme Court gave insurers no comfort in the Silberg decision relative to wrongful denials or delays of policyowner claims. Therefore, anticipation and identification of consumer complaint problems before they become litigation-bound is imperative.

We are living in a time when we may see included in the penumbra of constitutional protections, the "right to entitlement" -- which has crept into our way of life and impacted our way of doing business. The concept behind national health care is a primary example of the new wave of entitlement. Even Democratic Presidential hopeful, Jimmy Carter, has joined the ranks of his competitors in supporting a universal mandatory comprehensive national health care insurance program. Although Carter hasn't spelled out the details of his proposal, he outlined its concepts:

- That coverage must be universal and mandatory because every citizen must be "entitled" to the same level of comprehensive benefits.

- That barriers must be reduced relative to early and preventative care in order to pare the need for hospitalization.

- That the benefits should be insured by a combination of resources (i.e., employer and employee shared payroll taxes, and general tax revenues).

- That there must be strong and clear built-in cost and quality controls.

- That rates for institutional care and physician services should be set in advance, prospectively.

- That consumer representation in the development and administration of the health program should be assured.

Carter, in summing up his consensual support for the Kennedy-Corman National Health Care Bill, stated that, while public officials have continued to dispute whether coverage should be catastrophic at first, or comprehensive immediately, the system has become a comprehensive catastrophe. Further, he endorsed this new trend of entitlement when he said, "We must achieve all that is practical while we strive for what is ideal, taking intelligent steps to make adequate health services a right for all our people."

Another issue of great magnitude is the issue of an individual's right to privacy -- concerning which extensive activity is now going on at both the state and federal levels, concurrently. Within a few years, and especially in California, state privacy legislation has gone from dormancy to a situation of high activity. State level activity has been accelerated in the last few years and especially with the passage of the Federal Fair Credit Reporting Act of 1970. A number of state bills based on this Act were subsequently enacted, the most serious of which recently became effective in California. This California law includes several provisions that will exceed the federal statutes in its severity. A significant new twist to the federal government's entry into the insurance industry scene was unveiled last week with the announcement -- without any attending fanfare -- in the Federal Register that the "Privacy Protection Study Commission" will hold three days of hearings in May -- on the record-keeping practices of insurance institutions.

The hearings are a part of the Commission's consideration of whether the principles and requirements of the Privacy Act of 1974 should be applied to insurance institutions and whether any other recommendations may be necessary to prevent insurance records from being used in ways that intrude upon personal privacy. The Privacy Commission, in explaining its decision to undertake an in-depth examination, said that preliminary inquiries into the record-keeping practices of insurers, their agents, inter-insurer data banks and service organizations, and other insurance institutions had revealed:

- That nearly every American will be touched a number of times over the course of life by the activities of insurance institutions.
- That insurers will acquire and use personal information about individuals with whom they do business, and consider access to such information in great depth to be essential to their continued and successful operation.
- That there appears to be both heavy concentrations of recorded personal information in a relatively few firms within each field of insurance, and wide dispersion of such information.
- That insurers often transmit personal information about individuals with whom they do business to third parties, both governmental and private, and usually without knowledge or consent of the individuals concerned.

Thus, by virtue of the fact that the insurance industry is a major collector of personal information, and because questions about the adequacy of legal protections for the records that insurance institutions maintain on policyholders and claimants exist, the Commission is considering whether the standards set for the federal government's protection of privacy should be extended to the private insurance sector. In addition to the privacy study, several amendments were recently proposed to the Fair Credit Reporting Act of 1970 by Senator William Proxmire. These amendments would enlarge the scope of the Federal Trade Commission, as well as require extensive disclosures which would affect insurance sources and the preservation of medical information. Coincidentally, hearings

at this time are also going on by the Federal Trade Commission on alleged violations of the Fair Credit Reporting Act by Retail Credit, a leading investigative reporting agency that is utilized by insurers. If the hearings result in an adverse decision which is upheld by the courts, this would undoubtedly provide further ammunition for Senator Proxmire's criticisms and reform efforts.

With the Brown "New Spirit" Administration in Sacramento, California, there is some strong evidence that it will place emphasis in the area of consumer protection. More and more we are discovering that the local consumer affairs offices (as well as the State Consumer Affairs Department) are enlarging their jurisdiction to include insurance in their repertoire for review. With the cost of the 1975 legislative session in California, Governor Brown saw fit to approve a sizeable budget increase for the Department of Consumer Affairs, and signed legislation permitting the State Department of Consumer Affairs, for the first time, to initiate legal proceedings on behalf of the consumer, and intervene before regulatory bodies on the same basis. In addition, there is an increasing pressure being placed upon the California State Insurance Department to aggressively represent the consumer. While the Brown Administration has apparently taken a cost-conscious approach with most governmental department budgets, the Insurance Department, like the Department of Consumer Affairs, was permitted an augmentation in their budget, with said increase earmarked for the consumer complaint unit for its surveillance-computer monitoring programs and staffing.

THE IMPACT OF LEGAL EQUALITY ON THE RISK CLASSIFICATION PROCESS

The current drive for equality of both opportunity and results poses a significant challenge to insurers' risk classification processes. One of the goals of today's egalitarians is a "risk free" society in which the bias of individual contingencies is redressed in the direction of equality. To the proponents of social equality, the risk classification process is seen as a barrier which makes insurance unavailable or too costly for those with the greatest need. Such persons argue that insurance must not only redistribute risk, but must also redistribute wealth so that insurance benefits will be available to all at a price they can afford. As a consequence, equal rights advocates are challenging some of the principal bases used by insurers to classify risks, such as sex or marital status, personal habits and physical condition.

The initial complaints about insurers' underwriting and rating practices come from women's groups who accuse insurers of denying equality to applicants for insurance on the basis of sex or marital status. The most widespread complaints cover four main categories: (1) Coverage, (2) Underwriting, (3) Rates, (4) Manuals and Forms.

- Coverage:

  Largely because of historically unfavorable morbidity experience for females as compared to males, in the past insurers have admittedly not made disability income coverages equally available to men and women. Other limitations cited are that women's policies often have longer elimination periods, that guaranteed renewable

policies are limited to females in "permanent career type occupations," and that working women often have been precluded from having coverage for dependent husbands, even if the males are permitted to include their wives. Also, group pension plans with a two-tier program based on salary level, are said to be discriminatory, since women are concentrated among lower-paid workers. Many of these restrictions once again relate to conditions, such as pregnancy, which are unique to females, but in some cases they reflect the historical status of women in our society.

- Underwriting:

In general, the underwriting process involves selection, qualification, and rating of risks. Its fundamental purpose is to make sure that the group insured has the same probabilty of loss and probable amount of loss, within reasonable limits, as the universe on which premium rates are based. In group insurance, this process is applied to potential groups and in individual insurance to individual applicants. The object of the underwriting process is to classify subjects into groups with about the same expectation of loss. Traditionally, it has been recognized that the probablility of loss and the average severity are affected by age, sex, occupation, health, type and amount of benefit, income, and cost factors and moral hazards. Although women live longer than men, for reasons not fully explained, statistics show that they tend to incur more short-term ailments, whether psychologically or physiologically based. Since this difference is reflected in claim experience, underwriters have concluded that they should be charged premiums which are considerably higher than those for males for disability coverage. Also, the coverage, in general, has been extended in smaller amounts and usually for shorter periods than for men. Noncancellable and guaranteed renewable disability income policies for women usually contain a clause which reduces benefits if the insured is not gainfully employed full time, away from the place of residence. Consequently, women who work in their homes have not been eligible for disability coverage, except for optionally renewable coverage where the insurer can terminate if the experience is unsatisfactory. Acceptance of the above principles has led underwriters to a greater use of attending physicians' reports for women than for men. Another unexplained conclusion is that for hospital expense and major medical expense insurance coverage, women have a higher incidence of claims than men up to age 55, but beyond that age, their claim experience is more favorable than that for men. Traditionally, relatively small amounts of disability income insurance have been sold to women. One of the results of this is that substantial amounts of claim experience have not been as available to underwriters as they would like, to develop more objective criteria. It is anticipated that increased volume with the changing in the work force may provide such criteria and result in more favorable claim experience for women; thus permitting more liberal underwriting standards for females in disability income coverage.

- Rates:

  Insurance rates are established on the same aforementioned basis of classification. By establishing reasonable categories with the risk or cost of insurance as nearly uniform as possible within those categories, a premium rate can be established that is adequate, but not excessive, for the insureds that fall within a given category. The purpose is for each insured to pay his or her fair share of the cost of insurance and thus make every insured equally desirable as a prospect for a policy. The establishment of a class of insureds who basically have the same average characteristics and loss experience has long been recognized by insurance statutes in the states. Some typical rating classifications used for pensions, life policies, and health policies are: age, occupation, state of health, and sex. With respect to life insurance, the normal practice is to charge women the same premiums that would be charged a man three years younger. This three-year setback reflects mortality experience on insured lives and the fact that the state law permits a setback of up to three years in determining both cash values payable and liabilities companies must provide for under such a policy. Critics, however, maintain that mortality data indicates women live at least six years longer on the average than men and that the differential is not adequate. Some insurers agree, and have petitioned insurance departments to permit this differential to be more accurately reflected. The commonly held opinion, however, is that the standard non-forfeiture laws must first be amended, and this is a time-consuming proposition involving a presentation of an amendment to the legislators of the various jurisdictions in the United States. Nevertheless, the American Life Insurance Association is urging companies to be able to demonstrate that premium rates for life insurance issued to women adequately reflect their more favorable mortality experience.

- Underwriting Manuals and Forms:

  There are already indications that insurance regulators may require companies to file underwriting manuals, agent's promotional materials, training manuals, and related materials with insurance departments -- not to mention other equal opportunity regulatory agencies. These undoubtedly will be reviewed for sexist content, as much as the policies themselves.

In summary, the common charges made against the insurance industry are that insurers refuse to make the same kind of coverage available to women as is available to men; that rates charged women are unfair and coverage for maternity is unavailable or restricted; that insurers do not offer disability income insurance to homemakers; that insurers discriminate against single, separated or divorced persons. On the matter of rates, some women's rights proponents advocate the use of equal rates, particularly for annuities and health coverages where women's rates have been traditionally higher. Others acknowledge that there are differences in male and female mortality and morbidity experience. They urge that insurers be required

to justify any differences in rates by sex on the basis of sound statistical evidence. Thus, the validity, as well as the propriety,of the classification system is under scrutiny.

Recently, in California, the Commission on the Status of Women and the Joint Assembly and Senate Committee on Legal Equality announced that the insurance industry has inadequately responded to the changing role of women as it relates to industry practices and products. The Commission charged that discrimination is rampant in the sale and development of insurance. The Commission stated that discrimination is based on stereotypes and,because the stereotypes or myths are so ingrained in our society, so much a part of our backgrounds and upbringing, that we are frequently unaware of them and the ways in which they affect us in our thinking. The Commission pointed out that the myth or stereotype about women, which appears to be "alive and well and living" in the insurance industry, is that women are a homogeneous group, primarily interested in being homemakers and totally dependent upon their husbands. The reality is something quite different. In the United States, 50% of all women over the age of 16 hold jobs; they comprise 40% of the work force; 2/3rds of them are single, widowed, divorced or separated, and another 21% live with husbands earning less than $7,000 a year.

In response to these and similar charges, the NAIC has adopted a model regulation eliminating unfair sex discrimination. In its final form, the regulation covered only discrimination in availability of insurance coverage on the basis of sex or marital status. Regulations which are similar to the NAIC model have been adopted in Arkansas, California, New Jersey, New York, Oregon and Pennsylvania. In the matter of justification of rate differentials, the New York Insurance Department is conducting an extensive study of recent individual disability income experience of some of the largest writers of this coverage. It is expected that the results of this study will establish criteria which can be used by New York and other states for determining the propriety of sex-based rate differentials for this type of coverage. In addition, in California there are a myriad of bills dealing with the subject of unfair rate discrimination, either by way of a study, or by actually mandating justification of rate differentials, or by mandating unisex tables. At the federal level, the Equal Employment Opportunity Coordinating Council is currently trying to develop a universal federal policy which either will permit only equal periodic pension benefits for male and female employees, or will allow the alternative of unequal periodic benefits purchased by equal contributions under employee pension plans. Meanwhile, the subject of risk classification and the questions it creates regarding life insurance product equality will be most visible this year as the Supreme Court rules on a case dealing with whether normal pregnancy should be treated like any other disability under a privately sponsored employee benefit plan (General Electric v. Gilbert).

Extending the legal equality issue even more broadly, the fact that an increasing number of individuals are living in what has been considered to be unconventional life styles recently led to accusations from women and gay activists that insurers are unfairly discriminating on the basis of life styles. Such public interest groups appeared at a hearing on the proposed California regulations on unfair discrimination. As

finally promulgated, the regulation makes California the first state to specifically require equal availability of coverage regardless of sex, marital status, or sexual orientation of the insured or prospective insured.

One of the more recently espoused well-intentioned goals of the equal rights movement is equality for the physically handicapped. The risk classification issue becomes vastly more complicated when it involves persons who are physically or mentally impaired in some way. The principal issues of concern to the insurance industry arising from legislation or regulation mandating coverage of the handicapped are the treatment of progressive diseases, the treatment of pre-existing conditions, and the justification of differences in classification. Although it would seem obvious that insurers should not be forced to insure a handicapped applicant and then begin paying claims on account of the applicant's pre-existing handicap, most of the legislation directed toward ending discrimination against the handicapped in insurance fails to take this problem into account.

CROSS-JURISDICTIONAL DISPUTES

In the rush to ensure equality of treatment, particularly as to sex, some state and federal regulatory agencies have established or attempted to extend their regulatory authority beyond their traditional sphere of activity. On the one hand, insurance departments have tried to enforce nondiscrimination in employment and, on the other hand, state human relations or civil rights commissions have tried to assert jurisdiction over insurance products. Thus the overlapping of federal, state, and local agencies relative to jurisdiction in this area is having a serious spillover effect on the insurance industry. The potential result of the current confusion is to have drastic changes imposed upon the insurance industry's method of operation by well-intentioned agencies (such as EEOC) which are actually charged with the responsibility for regulation of other areas of our society and which have no appreciation of the consequences of their regulations when they impact on insurance.

SUMMARY AND FUTURE OUTLOOK

It is evident that pressures for equality on the part of legislators, regulators, and the courts may have a profound effect on the ways in which we underwrite and justify our classification of risks. These pressures may force insurers to abandon some precision and equity in classification in order to achieve broader social equality.

The validity as well as the propriety of the classification system is now under scrutiny. While the classification system is an essential element of the insuring function, it is the actuaries who will have the burden of showing that their distinctions truly affect risk rather than reflect moral judgments. And, in an era characterized by a pervasive philosophy of entitlement, that burden will not be easy to bear.

The overall impact of Consumerism on our industry demands sophisticated responses and serious rethinking of many cherished industry practices. Many future adjustments will have to be made to the system and anticipation

and constructive response to such issues will be the prudent and protective approach in maintaining the traditional insurance system. Concomitant with such anticipatory measures, insurers should embark upon a program to enlighten the public as to the insurance product itself, the need for confidential-source information, and the purpose of the risk classification process. In addition, the industry should clearly describe in "lay terms" the need for equity rather than pure equality in insurance and explain that basically, by spreading risk equitably, all insurance is meeting important social objectives. Further, the development of productive business relationships with consumer and equal rights organizations and related governmental bodies is necessary and proper business activity -- because the establishment of credible relationships in conjunction with initiation of voluntary compliance efforts may reduce the pressure for legislative or regulatory action or provide the necessary dialogue for palatable and well-reasoned legislation and regulation.

Since our way of doing business is not a right, but a privilege, and one granted and revocable by the public, we have a tremendous challenge ahead, as well as opportunity to contribute to consumer satisfaction and consumer understanding.

MR. PAUL YEARY: I would like to say that the statement, "The net payment cost index is the cost if the consumer dies."is an inaccurate comparison to the surrender cost index, since one index takes into account the benefit to be received and the other one doesn't. In other words, the surrender index includes the cash value that will be returned at the end of 10 or 20 years, but on the other hand the net payment index leaves out the actual death benefit.

I'm disappointed that the NAIC Model legislation does not contain more exemptions for small amount policies. I would like to have seen anything below $5,000 completely exempt. It seems as though small amount companies are being forced into a bad position.

I was disappointed that the interest rate was changed from 4% to 5%. It seems that is an arbitrary rate and some companies which have tried to be responsive to consumerism by publishing indexes in their present rate manuals are now faced with the expense of eventually republishing.

On the issue of participating versus nonparticipating business, it seems that the industry was in a very bad position in that either the stock or the mutual companies were going to win. Being from a mutual company, I have concern because if something is put into doubt, such as how valuable is the dividend, it seems to give the consumer a hard decision to make. I know that the guide addresses itself as best it can to that problem, but it seems unfortunate that the people who represent us had to be in a position of having one group lose. Does anybody care to comment on this?

MR. OVERBERG: Let me give an overall comment first about the NAIC model regulation. I believe that if you ask most members of the industry committee on cost disclosure, you will find that they will agree with the statement that the NAIC model regulation is not a matter of the stock

companies winning or the mutual companies winning but is a great compromise. It is the best compromise that was possible. There has been a lot of give and take. Nobody is satisfied with this regulation completely, neither the regulators nor the stock companies nor the mutual companies. I think you also underestimate the ability of your agents and our agents. The agents will eventually learn to live with the interest-adjusted cost model regulation and they will do a good job, and I think you will find your sales will not be hurt by this regulation. A good agent will use it and use it well. Do not underestimate their ability.

With respect to the net payment index, consider your auto insurance. In asking how much your auto insurance costs, do you ever deduct the claim payment the insurance company made on your behalf? You do not. When we talk about life insurance costs, let us talk about the cost to the owner of the policy. The owner is often not the insured. If the insured dies, what was the cost of that insurance protection? The cost of that insurance protection was just a sum of the premiums paid if he had a nonparticipating policy or a guaranteed cost contract.

On your point regarding the change in interest rate from 4% to 5%, it will not significantly change a company's ranking. When this matter came up, it was done with no great debate. We are just trying to get a regulation that we can all live with.

The original model regulation did exempt small policies. A number of companies and some regulators felt that the exemption should be there, but from a consumer standpoint, an argument is made that the small insurance buyer needs the most protection.

MR. ANDERSEN. I think that is a valid observation. The argument was that, if you provide suitable information to allow for an intelligent choice in the buying process for the large buyer, why is it that you would not provide the same type of information to the small buyer who is pinching pennies? That is the type of argument we had and it is very difficult to face the people when we call hearings on these regulations and explain to them why we do not provide that type of information to the little people.

MR. ROBERT SHAPLAND. I would like to comment upon the apparent conflict that exists between two sides of the consumer movement. We have cost disclosure which may pressure companies to avoid low income markets and substandard risks because of the force on competition of cost disclosure. On the other hand, there are consumerist movements that are trying to assure equal treatment in these markets. Who wins and who loses by having cost disclosure?

MS. RYAN. That is a very valid observation. Who is going to lose. It will be the insurance companies if they do not respond in certain ways. We are going to have a proliferation of regulations in this area beyond what we see now in terms of disclosure and it will affect the cost of insurance. At the same time, we will be required to have affirmative action programs which also will be costly, and each requirement will affect the other in terms of conflicts and responsibility. Yet, we

are going to be responsible for both and that is why I have been suggesting that we need to be in the legislative process more. Only by doing that will we be able to get some of the initial regulations and legislation into a more workable form.

MR. OVERBERG. I want to point out and emphasize something that Ms. Ryan said. She emphasized the fact that we in the industry should work with the consumerist groups. She was careful and purposely did not say that we were not doing anything. We have done a lot in the last several years, but what we have not been doing is working close enough with the consumer groups.

I would also like to mention the distinction between consumerists and consumers. There are a lot of consumerists who are highly vocal just to get their names in print. I do not believe that all consumerists represent all the consumers and I believe that a lot of consumers disagree with a lot of things that some of the consumerists are saying.

MS. RYAN. In California we have many substantial consumer groups. They are all forming public opinion and, when you couple the media response that is occurring with the fact that there are a number of local governmental consumer affairs agencies that are operating, we feel that we need to be dealing with all of these consumerist groups.

MR. JOHN K. BOOTH. I would like to raise an issue which comes from the proposed Illinois Insurance Department regulation on unfair sex discrimination. This is the first such regulation that addresses the question of rate differentials on the basis of sex. What may the life insurance industry expect as various groups ask insurance commissioners to determine whether or not rate differentials on the basis of sex or some other classification are reasonable?

MR. OVERBERG. From the regulatory standpoint, companies are going to have to document health insurance experience and life insurance experience and be able to show that their data are not inconsistent with the rates that are being charged.

MR. ANDERSEN. I think Paul is right. We are visited by the various groups representing special interests. They are putting on pressure to make sure that we are able to assure them that we are scrutinizing rates in order to determine that the rate differentials are justifiable. The New York Insurance Department is doing a study on rate differentials by sex in the disability income line. We will see results from that study within a fairly short period of time and I think it will be worth your review.