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INDIVIDUAL UNDERWRITING

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JOHN D. GIANINO, ALTON P. MORTON, KENNETH D. MITCHEM*

MR. ORLO L. KARSTEN: The forum for our discussion is the paper by Alton P. Morton, entitled "Individual Life Insurance Underwriting Principles and Practices: A 1976 Review." We are here to share our concern about the future of risk selection. Because we think this is serious, our discussion may be somber. We want to stimulate your own thought and perhaps your action.

We are honored to have the author of this provocative paper, Mr. Alton P. Morton, open our discussion.

MR. ALTON P. MORTON: In recent years, I find I am increasingly concerned and unhappy about what I see as undesirable changes in life underwriting procedures and practices in our industry. In order better to define my concerns, I wrote this paper.

I begin with a definition of what underwriting is and a discussion of the tools to be used. The paper covers mortality data and its uses; the kind of information that is practically useful for underwriting classification; and the role of costs and public acceptance in the choice of information to be sought and procedures to be used.

Inflation and its impact on underwriting costs, as well as government interference of many kinds, have sharply modified company practices. By government interference, I refer to rulings or laws regulating or restricting the gathering and use of many kinds of underwriting information. My own conclusions, which I express repeatedly in the paper without apology, are that such changes have had the clear effect of making the industry's underwriting results less fair and defensible to the individual insured person.

In a later section, I draw attention to some practices voluntarily adopted by some companies in the name of competition. The practices, for which I offer examples, tend to have the same effect -- making underwriting results less fair and defensible. They have the further embarrassing effect of putting us in a poorer position to complain about or ask for relief from unfair laws or regulatory rulings.

I see us caught up in the sweep of change and as having compromised -- perhaps seriously -- what our industry should accomplish in the name of underwriting -- undeviating and defensible fairness to all. We are similar to the many other kinds of financial institutions with which we compete -- the banks, the trust companies, etc. -- in all basic respects save one, that being the way we relate the maturing of our contracts to actuarial probabilities. Such probabilities are applied through underwriting to life insurance. If we fail to -- or are prevented from -- applying probabilities fairly and defensibly, our industry fails in its most basic characteristic. I believe underwriting should not be compromised for any temporary goals, whether social, political, or competitive.

*Dr. Wood, not a member of the Society, is Vice President of the Equitable Life Assurance Society of the United States.

In the concluding portion, I invite my fellow actuaries to pause a moment and project where these trends may ultimately lead. What action, if any, on our part may arrest them? Can we do nothing at all? Must we be merely passive victims of change -- change of such dimensions that it could, I suggest, destroy private life insurance?

MR. KARSTEN: Mr. Morton, you used a word "probability." The actuary understands that as the law of large numbers and the predictability of an event. The underwriter must reduce probabilities to classes of risks, or even to the random event of insuring one life. Could you comment on this?

MR. MORTON: Your question seems to be: "Where does a gamble or bet become a manageable actuarial probability?"

If I made a bet on your living or dying, it would be just that. But if I made insurance contracts to insure you and thousands as similar to you as is practically possible, using the same premium rate, I would be underwriting, that is, applying probabilities as I chose those who did or did not belong in the same class of risks.

MR. KARSTEN: Thank you, Mr. Morton. In your earlier remarks, you mentioned a major theme of your paper, that inflation has an impact on underwriting costs, and related company practices. I have asked Dr. Wood to elaborate on this.

DR. ROBERT G. WOOD: In recent times, considerable attention has been given to the impact of increases in medical charges and in the utilization of medical facilities and services on health insurance and publicly supported programs. Rarely is the effect of increased fees on underwriting expenses mentioned. For the Equitable, the cost of attending physician's statements averaged \$4.65 in 1965; today the average cost is \$12.29. In 1965 a medical examination cost \$10; today the cost averages \$22.50. Even the cost of paramedical reports averages \$14.42. Salaries for medical directors and underwriters are at least double the level of 1965. Obviously, we cannot survive with a "business as usual" attitude.

If the costs of various types of medical information and the mortality value of each are charted, the lines will cross for most. There are at least two methods of controlling the amount spent for medical information. First, control the cost of each individual item and, second, control the amount of information purchased. Of course, the two methods can be combined.

For a long time, we gave lip service to the second method and aggressively attacked individual fees. As you can imagine, this generated much correspondence and many headaches. Several years ago, the emphasis was switched. Two aspects of this deserve a brief mention. First, careful attention to quality permits a reduction in the number of requirements. Better selection of medical examiners and paramedical facilities permits increasing the amount limits. As examples, Equitable's regular published medical requirements no longer call for double examinations and we accept paramedical reports for as much as \$250,000 at ages through 35.

Secondly, we are trying to eliminate requests for information which are not productive. There are several situations which generate underwriting requirements. Sometimes additional information is necessary before a decision can be made. However, there are times when an underwriter is afraid to make a decision or, for one reason or another, thinks additional documentation is necessary. Obviously, my position is that only the first reason is valid. It is necessary for all of us constantly to guard against backsliding in this regard.

It is appropriate, also, to comment about some changes which have had positive effects on underwriting. The national publicity given hypertension has increased public awareness of the problem and stimulated professional acceptance of the industry's position that there is increased mortality with blood pressure levels previously ignored by physicians. More people are having hypertension diagnosed earlier and treated sooner.

Another plus: Many applicants have had one or more medical checkups and can provide us with a great deal more information than was available twenty or twenty-five years ago. We are, in effect, beneficiaries of preapplication underwriting by proposed insureds and their physicians.

At one time or another, most companies have considered or actually adopted a front-end review program to screen those applications which do not require definitive underwriting decisions. This was called the "jet unit" at the Equitable. In 1973, this function was moved to our Field Service offices. Approximately 50% of our applications do not require any underwriting decision and can bypass the underwriters.

Another idea: It is common practice to assign small amount cases to new underwriters and gradually increase the underwriter's authority on the basis of experience. I think this is backwards. We cannot afford to pay for additional information on the small case. When inexperienced underwriters are used for the small cases, either they will not learn how to use requirements or they will get too many.

Last year we started a "short cut" underwriting program. It can best be defined as an effort to take final underwriting action on all applications referred from the screening program in which the amount applied for is \$25,000 or less and the proposed insured is age 35 or less. We use experienced underwriters and they are instructed to make a decision without additional requirements. When a doubt exists, the decision is made in favor of the proposed insured. There are some exceptions, such as a nonmedical application when the proposed insured has a history of diabetes, cancer, or heart trouble; significant MIB information was not admitted; a previous Equitable policy was rated; or omissions in the application. About 70% of referred cases are issued by this process. Approximately 6% of the "short cut" cases are rated. Agents have been advised that the rating can be appealed. However, when the appeal is made, the original offer is withdrawn and the only offer available will be the result of the regular underwriting process. Less than one case in 200 is appealed.

MR. KARSTEN: Those are dramatic increases in the cost of medical information. Your company has certainly developed some innovative ways of making the underwriting decision with less medical details. Does this also take place in other areas of underwriting?

DR. WOOD: Yes, we have liberalized our inspection report limits to \$100,000 and over at ages through 50 and \$50,000 and over at the older ages. We are relying directly on the agent and the insured for more information, such as driving records.

MR. KARSTEN: Dr. Wood, I believe your company's experience is typical: with rising costs, you have had to survive with less underwriting information. Now let me put you on the spot: Do you agree with Mr. Morton that companies no longer underwrite as fairly as they can, but only as fairly as they can afford to?

DR. WOOD: Your use of the word "fairly" is troublesome. Is it unfair if insurance is provided at a lower cost to all by not obtaining some underwriting requirements? We have the capability today of making some underwriting distinctions which were not possible ten years ago. In the broad sense, I believe that underwriting classes are as fair as they ever have been.

MR. MORTON: Do you have figures on aggregate costs? Have you stemmed the tide?

DR. WOOD: We have had some success. All underwriting requirements have been reduced about 4 or 5 percent in number. We are now requesting attending physician statements on about 15% of all cases. These figures should be considered in the light of the increase in average policy size in recent years, which otherwise would have resulted in still more requirements.

MR. KARSTEN: I'd like to turn our attention now to a companion thesis of the paper -- that risk selection is also subject to increasing social pressures. John, do you feel that social pressures are decreasing the value of underwriting?

MR. JOHN J. GIANINO: Yes, I do. I suspect that most of us feel that the constant concern for privacy rights must necessarily lead to a decrease in the amount of information that we receive. Also, it is obvious that as we are forced to insure people whom we would like to decline and to offer standard coverage to those whom we would like to rate, the value of underwriting must be diminishing.

In order to test these feelings, I studied two sets of data. First, I looked at the trend in effect rates produced by the inspection report studies done in the John Hancock over the last 15-20 years. By effect rates, I mean the percentage of cases which were rated or declined as a result of an inspection report. In the 1960's, these rates were uniformly 3.5% to 4.0%; in the 1970's, they are running around 2.5% to 3.0%. This means that the John Hancock rates or declines at least 1,000 fewer cases every year than it would have in the 1960's.

The other set of data of interest is the number of cases rescinded in recent years. This number has decreased every year so that in 1977 the John Hancock will rescind approximately 75% fewer cases than we did five years ago. Looking at these cases by source of postissue information, the number with an inspection report as the trigger has decreased by 75% and the number with the MIB as a trigger has fallen off by 85%.

Some people might argue that these numbers do not necessarily indicate that the quality of information is decreasing, but merely that we are underwriting more liberally today. Even if this were true, I still feel that they are an

indication of the impact of social pressures, because most of the liberalizations in these areas have resulted from legal or consumerist forces.

MR. KARSTEN: How do you suggest that we respond?

MR. GIANINO; On the privacy issue, I suggest that we try to anticipate how far we will be expected to go and then take those steps voluntarily before we are forced to do so, while we still have a few options. Our emphasis probably should be on informing the applicant of our actions as briefly and as simply as possible every step of the way -- especially in those areas that are controversial.

It may become necessary to find ways to develop more information through our agents, using the carrot and the stick. We may also have to discover some way under law to exert greater pressure on the applicant to be thorough in giving us relevant information. Paramedical facilities are providing excellent medical history information through the direct interview procedure; it should be possible to obtain the same information through the field force. If the current information system doesn't work, it should be possible to devise a different system which will work.

An applicant who deliberately lies regarding pertinent information is a thief. If the law penalized bank robbers in the same fashion as it does insurance thieves, the situation would be as follows: the criminal would have to be apprehended within two years of the crime; the crime could be investigated only through those sources that the criminal authorized; if convicted, his only punishment would be return of the money; but of course he would be reimbursed for all of his expenses. It's pretty difficult to make a profit when the game is played by these rules.

In the area of regulated underwriting, there are a few things I feel should be done. First, I'd like to see the various industry groups which are attacking the problem brought together under one guiding force. The joint ACLI-HIAA Task Force, the American Academy of Actuaries' Task Force on Risk Classification, and the Society of Actuaries-ALIMDA Liaison Committee all seem to be making major contributions. However, I would like to be sure that they are all working on distinct aspects of the problem and that they are not working in conflicting directions. The development of credible statistics is vitally important to the industry and I would like to feel that it is being done with the greatest efficiency.

Also, rather than having a steady string of legislators' pet diseases being mandated for coverage, I would rather see the matter brought to a head. Both of these desires of mine probably could be satisfied by Al's idea of a special commission comprised of legislative, consumerist, and industry spokesmen.

If we are going to be forced to insure more and more lives at rates that we feel are insufficient, perhaps we should consider establishing an industry pool for sharing the risk, possibly with some government sharing in those cases where a company feels it does not want to retain the case on its own books. Presumably such business would have very low commissions; death benefits might be graded; and premiums might be on a guaranteed renewable basis. Among other things, such a pool would provide an appropriate vehicle for highlighting the extra cost. Also, it would provide a source of data for developing the appropriate statistics.

MR. KARSTEN: These ideas are all good and most of them have more than a germ of truth. We must do all that we can to improve public acceptance of the underwriting process, whatever it is or may become. At that same time, we need to make a major effort to let the public -- and their spokesmen, the legislators and consumerists and privacy advocates -- know that any business transaction, but especially life insurance, involves surrendering in some degree the individual's right to privacy.

MR. MORTON: The idea of a pool for uninsurables derives naturally from its use in non-life insurance. From what I read, however, it hasn't worked very well and many unresolved problems have developed. There is even less reason to believe that it would work for life insurance risks where the elements of voluntary choice reside much more strongly with the individual.

MR. KARSTEN: Our panel seems to have substantiated Mr. Morton's contention that social urgencies are having an impact on underwriting. If so, the selection process must inevitably change, blurring the distinction between private insurance and social insurance. I have asked Ken Mitchem to outline some of those distinctions.

KENNETH D. MITCHEM: In an effort to inform, educate, stimulate interest and encourage questions, I would like first to define underwriting. The process of underwriting can be defined as the selection and classification of individual life insurance risks so as to achieve future mortality results consistent with the assumptions used in the premium formulas and to make sure that each individual contributes his fair share of the risk involved. In order to maintain equity, only those applicants with comparable degrees of risk should be placed in the same premium class.

Over the years, about 92% of all applicants for individual life insurance have been "normal" risks and have qualified for insurance at standard rates. About 5% of those applicants have been impaired risks, medically or otherwise, and were issued insurance on a rated or substandard basis. The remaining 3% of all applicants have been found to be unacceptable or uninsurable and rejected or declined.

These statistics reflect the selection or underwriting process which is carried out by the Home Office underwriter. It should be realized that insurance agents or "field underwriters" also exercise an underwriting function since sales efforts are directed toward particular markets, specific social and economic groups, occupations, and income strata. There is also a third variety of underwriting which I will call self-selection. Every individual makes a deliberate decision whether or not to purchase insurance and how much. The composite or net effect of all three kinds of underwriting produces an insured life group having different characteristics and mortality levels from the general population. I will comment later on one major difference between these two groups of lives.

Over the years, actuaries and underwriters have identified many physical risk factors that influence mortality and have determined the degree and pattern.

In addition to the physical impairments, there are also financial considerations which have a bearing on expected mortality and should be evaluated by the underwriter. The first is "insurable interest" which must be present in order to avoid antiselection and excess mortality. The beneficiary should stand to gain more by the continued good health of the insured than by his

death. The amount of insurance should be consistent with demonstrated needs and bear a reasonable relationship to the income of the proposed insured. Overinsurance is speculative and experience shows it results in considerable extra mortality. As someone has said, the underwriter should not let the "perfume of a case" mask the "odor of the risk."

As a consequence of the various selection processes, there are distinctive patterns of mortality exhibited by various groups of insured lives. At one end of the spectrum are the annuitants whose mortality rates are surprisingly low as a result of self-selection. I have not been able to determine a composite death rate for annuitants which could be compared to other insured lives or the general population. Group life mortality, because of the required participation percentage and the actively-at-work requirements, is much better than general population mortality. There are two distinct subgroups of individually insured lives, depending upon whether or not a medical examination was used in the underwriting process. Since the risks normally accepted on a nonmedical basis are the younger lives, their annual death rate is approximately 500 per 100,000. Medically examined lives are concentrated more at the older ages where physical impairments are more common and their death rate approximates 650 per 100,000. In contrast to the death rates on the various categories of insured lives, the general population death rate stands near 900 per 100,000.

A more detailed comparison of individually insured mortality and general population mortality by major cause of death is shown in the chart. For all of the causes of death shown, the mortality rates for the general population are higher than those for insured lives and the total general population mortality rate is 40% higher than that for insured lives. Both insured lives and general population mortality show an improvement in 1976 compared to the 1971-1975 experience, with insured lives improving about 10% and the general population about 4%.

COMPARATIVE DEATH RATES FOR MAJOR CAUSES OF DEATH
INSURED LIVES VERSUS GENERAL POPULATION

<u>Causes of Death</u>	<u>1976 Death Rate per 100,000</u>		<u>1976 Death Rate as a Percent of that in 1971-75</u>	
	<u>Metropolitan Life Standard Ordinary</u>	<u>General Population</u>	<u>Metropolitan Life Standard Ordinary</u>	<u>General Population</u>
All Causes	612.9	889.1	90%	96%
Major cardiovascular diseases	304.8	454.3	85	94
Cancer	155.8	174.5	97	104
Accidents	28.1	45.4	85	87
Influenza and pneumonia	12.3	29.2	85	106
Cirrhosis of liver	10.2	14.3	85	91
Bronchitis, emphysema and asthma	9.6	11.2	79	83
Diabetes mellitus	9.1	16.4	81	93
Suicide	8.5	11.6	100	98

The figures in this table indicate that, for the year 1976, the Metropolitan Life Standard Ordinary death rate for all causes was 70 percent of the comparable general population rate. For various causes, the percentage comparison of Metropolitan to general population death rate ranges from 50 percent to 90 percent with cancer having the smallest differential.

If the selection process is increasingly hampered or undermined by outside forces as suggested by Mr. Morton in his paper, there is a real possibility that government will provide for most of the insurance needs of the general population and leave only the high risk cases for the private insurers. Such a group could be expected to exhibit even higher death rates than general population and create serious problems in underwriting and pricing.

MR. KARSTEN: Mr. Mitchem has emphasized something well understood by actuaries, but perhaps not by critics of the life insurance business. That is, selective or underwritten lives have entirely different death rates than the general population.

In his paper, Mr. Morton traced the path we have just trod. That is, the selection process has lost effectiveness through the pressures of inflated cost and mandated coverage, and that could lead to the eventual demise of private insurance.

I am sure Ken would be the first to agree that the factors he enumerated as used to evaluate individual applications are factors of convenience, that is, they do not include those items such as social-economic class, smoking, and so on which we all know strongly influence mortality. These are factors which we consider unusable in the present state of the art, either because of the cost or because of the lack of public acceptability.

MR. MORTON: Ken's 92% standard figures reflect the industry's current standards of what to include or exclude as standard risks. In terms of numerical ratings, a standard risk represents the range from 75 or less to 130 or even higher, where 100% is the measure of aggregate standard mortality. Any company can lower its level of overall mortality by excluding more risks with numerical ratings above 100 and trying to get more below that level. The individual companies' agency arrangements play the largest role in determining who applies for insurance. Most of the marketing and social pressures in recent years have been to squeeze in more at the top of the standard range.

I raised the question in my paper as to the wisdom of limiting our own mortality studies and used the example of policemen and firemen whom almost everybody accepts as standard risks. We have no individual mortality experience to prove whether or not this practice is correct today. We do have, thanks to our group insurance colleagues, data which give us a glimpse of what we probably are accepting. The 1970-1974 data show policemen and firemen included with an unknown proportion of clerical government employees experiencing mortality of 110% to 125% of overall group experience according to kind (Federal, State, or Local). A large volume of data on obviously favorable occupational groups reflects relative mortality ratios of 80% or below. It is therefore clear that policemen and firemen related to overall non-hazardous risks experience mortality of 140% to 150%. Related to an appropriate individual life select mortality base, the ratios would, of course, be much higher. This illustrates only one of the many exceptions for marketing convenience to our standard limits of 125% or 130% numerical rating.

MR. KARSTEN: Increasingly, regulators and legislators are requiring that insurers not be permitted to discriminate among applicants in the absence of "credible statistics." One example should be sufficient to illustrate the folly of this requirement. Just a few years ago, there were no statistics at all on hang-gliding, because this sport did not even exist. It began innocently enough, with a few young people gliding from the top of sand dunes, in flights which were reminiscent of the first successful flight by the Wright brothers. There may have been a few twisted ankles or broken arms, but it was not a hazardous sport.

At the present time, to the best of my knowledge, the world altitude record for hang-gliding is 26,000 feet, and the long-distance record is 150 miles. The news media now regularly report hang-gliding fatalities, such as among the mountain cliffs of California. I do not believe there are any credible statistics -- and certainly no actuarial study of exposures and claims -- to define the degrees of extra risks in certain types of hang-gliding activity. Nonetheless, a conscientious underwriter cannot ignore this hazard in assessing an individual risk.

MR. GIANINO: The whole area of hypertension, and particularly treated blood pressure, is another example of the difficulty of requiring credible statistics. Although a new study is now well under way, the latest available industry data were published in 1959, and do not include any information on the effect of treatment. The jury is still out on exactly what may be considered credible, and underwriters have sharply divided opinions on this.

MR. MITCHEM: How can we have insurance statistics on people we have not insured, at least not in large numbers? For example, what do we really know about former drug addicts? Does the lack of data serve to discourage innovation and risk-taking?

MR. KARSTEN: Mr. Morton, do you have any comment to add about this statistical void or any other concluding comments?

MR. MORTON: I raised the question of whether the drift away from basic underwriting principles and techniques is creating problems which are becoming increasingly unmanageable. When it comes to giveaway programs designed to serve some social-economic purpose, everyone wants to get into the act. We are going to find it increasingly more difficult to say that the industry should not subsidize any class that is being sponsored by some political group. In short, if we run our business in this manner, we will soon need less underwriting information. We won't be allowed to use it for classification purposes. We will simply take the risks we are told to. Isn't it time we sat down with all interested groups and talked it over?

MR. KARSTEN: I want to thank the panel for your well-prepared remarks. Now it's time to hear from our patient audience.

MR. EDWARD A. LEW: I want to pay tribute to Al Morton for his tactful and thoughtful observations on current principles and practices relating to the underwriting of individual life insurance. He has skillfully summarized the key issues stemming from inflation, growing government intervention and changing attitudes toward life insurance companies.

His tact is manifest in having stopped at making specific suggestions on the courses we might take. In my judgment, higher limits for standard insurance,

perhaps somewhat similar to those used in Great Britain and Sweden, and broader underwriting classifications might be helpful in countering rising expenses and improving relations with the public. This line of action appears desirable because (1) the cost of the extra mortality can be closely estimated and balanced against savings in expenses, (2) mortality among insured lives has been declining, as indicated by the experience on recent issues, and is likely to continue to do so as long as an increasing proportion of ordinary insurance is written on the better-to-do segments of the population, thus permitting some of the extra mortality to be absorbed in the downward trend, and (3) the competitive edge on ordinary life insurance costs depends more and more on the weight of field and administrative expenses and the persistency of the business than on mortality costs.

We need to bring home to the insurance buying public that the mindless egalitarianism which sometimes passes for social policy merely makes Peter pay for Paul. I wonder whether enough Peters realize what is being done to them in the name of alleged social welfare. Equitable pricing has long been a fundamental characteristic of private life insurance. This essential principle is being compromised by attempts on the part of various pressure groups to mandate that special classes of persons be accepted at rates that ignore the magnitude of the risks involved. We must strive harder to get authoritative information on the magnitude of different life risks to the public, regulatory authorities and the courts, so that elementary fairness will prevail.

I do not regard a number of the statements and statistics offered this morning by Dr. Jean Mayer as credible information for underwriting. As to Dr. Mayer's dogmatic views on obesity, I would report to you that I have just returned from a two day conference on obesity sponsored by the National Council on Obesity and National Institutes of Health. One of the key reports presented at this conference reads as follows:

"In spite of the fact that obesity has long been recognized to be a medical and public health problem of major proportions, our understanding of this complex disorder remains poor and its treatment inadequate. It is clear, however, that human obesity, rather than being a single disease, is a heterogeneous group of disorders and in this respect is more appropriately considered as the obesities. Only rarely, in perhaps less than 5% of the cases, can a specific cause of obesity be identified in man; in the majority of obese individuals an underlying cause cannot be ascertained and specific therapy aimed at prevention or cure is therefore not available."

I can tell you that by mid-1978, the Ad Hoc Committee on a New Build and Blood Pressure Study, of which I am the chairman, should be in position to present to the Society of Actuaries and the Association of Life Insurance Medical Directors credible statistics on the association between overweight and mortality, based on more than 20 years' experience among 4.6 million insured lives. Supplementary figures on the mortality experience among overweights among 1 million subjects will also be available to us from the American Cancer Society's Cancer Prevention Study, covering the period from 1959 through 1972.

This investigation has developed some highly significant new information on the hazards of cigarette smoking. Cigarette smokers were classified by the amount of tar and nicotine delivered by the brand of cigarettes usually

smoked in 1959 and in 1965. Among the subjects who smoked the same number of cigarettes a day, death rates from coronary heart disease and death rates from lung cancer were found to be somewhat lower for those who smoked low tar-nicotine cigarettes (introduced in the late 1950's) than for those who smoked high tar-nicotine cigarettes. The death rates of subjects who smoked low tar-nicotine cigarettes were nevertheless far higher than the death rates of subjects who never smoked regularly. If the trend towards lower tar-nicotine cigarettes continues, it is probable that the differentials in mortality between smokers and non-smokers will diminish appreciably in the course of time, so that this difficult-to-make distinction in risk should become of lesser consequence.

MR JOHN H. COOK: I would comment, in response to Mr. Lew's suggestion, that if some companies expanded their standard classes to 150%, they would have strong pricing competition from those who retain the 120% maximum for standard issues. I think the classification process is going the other way. We have more knowledge today that enables us to become more refined in the classification process.

MR. CHARLES N. WALKER: I would like to draw a distinction between underwriting and betting. If I "insure" one life, that is a bet. But I believe that if I insure thousands of one-of-a-kind risks, I am exercising the insurance principle. Companies have always done this. Our problem is how best to describe the application of underwriting judgment to these unique risks.

MR. EDWARD A. LEW: The meaning of "credible statistics" can range broadly. Most of the conclusions of medical science are based on sample sizes that would not qualify under a statistical definition of "credible" data. And, in many cases, further numeric evidence is not really necessary. It would seem that we could satisfy much of the credible statistics requirements by proper interpretation of data such as is found in Medical Risks and in the New Build and Blood Pressure Study.

MR. WALKER: I think the industry should oppose statutes and regulations embodying the concept of credible statistics. This will have the inevitable impact of reducing the underwriter's ability to apply judgment to individual cases.

MR. MITCHEM: This requirement could force life insurance companies into the difficult position of Massachusetts auto companies that face the possibility of determining the rate for an individual on his own past claim experience. On this same principle, all life risks will be considered standard so long as they have died fewer than the average number of times.

MR. GIANINO: There appear to be two basic problems with credible statistics requirements. First, the statistics which are available are often not relevant to a specific applicant. Secondly, the end result of such requirements -- mandated coverage for many individuals at rates lower than indicated by the risks involved -- is not socially desirable.

MR. ANDREW C. WEBSTER: The life insurance policy is the consummation of a contract. Do not both contracting parties have rights? Must the company accept the risk in all cases? Under the "free look" provisions, the insured generally has a period during which he may void the contract.

MR. ALAN N. FERGUSON: A recent New York Times article told of the effort of a divorced woman to obtain a gasoline company credit card. She felt that she had a right to the card regardless of any of her risk factors. Society must recognize that at some point everyone does not have a right to all privileges.

Another article in a news magazine laments the "arbitrary" categories of young and unmarried for automobile insurance. The article asked whether such drivers had more accidents because they were young or because they were unmarried. In fact, the higher accident rate in this category is probably due to inexperience rather than the other characteristics. This illustrates the need to use categories which appear to be reasonable.

MR. RICHARD E. BAYLES: As the father of a handicapped child, I am opposed to legislative requirements that standard insurance be issued up to prescribed limits. This is contrary to the basic concept of risk selection. It is a very different matter if an individual company makes the judgment that there is no significant excess mortality involved or that it is willing to accept such coverage at standard rates within self-determined limits. Such legislation is basically political in nature; it permits transference of this additional cost to a private group with no direct impact on taxes.

We should also consider the perspective of the handicapped. Many areas of modern living are difficult and they view life insurance as one more hassle. However, such requirements do set a precedent. Eventually we could lose the right to discriminate by age.

MR. DANIEL F. CASE: Certainly it would be nice if insurers had complete freedom to contract or not as they chose. Insurers do, however, have a legal obligation. All states have antidiscrimination laws which prohibit making any unfair discrimination between individuals of the same class and equal expectation of life. Those laws compel us to classify risks fairly. It might be a good idea, however, to flesh them out so that everyone has a reasonably good idea of what is meant by "unfair discrimination." For example, can an insurer's ratings be contrary to significant available data? On the other hand, what can an insurer do in the absence of credible data? The American Council of Life Insurance (ACLI) is studying the possibility of proposing a model bill which would, in effect, define "unfair discrimination."

In response to Mr. Gianino's question regarding the coordination of industry activity, the actuaries and the companies are different constituencies, each of which deserves to have its own representation. At the same time, of course, we want to avoid unnecessary duplication of effort. As you know, John Cook performed valuable liaison between the ACLI-HIAA (Health Insurance Association of America) Task Force and the Association of Life Insurance Medical Directors of America (ALIMDA)-Society Committee. Meanwhile, I served as liaison between the industry bodies and the Academy of Actuaries Task Force, and attended all the task force's meetings. By the way, one of the other recommendations of the Academy Task Force, I believe, was that there be a study of the risk classifications which are now used. It would be useful to have a scientific analysis of the classifications we have been using over the years to see whether they are, indeed, as valid as other classifications which might be used instead.

On the matter of potentially damaging court cases, one of them has now reached the United States Supreme Court. It is Manhart v. City of

Los Angeles, Department of Water and Power. The case involves a pension plan under which monthly pension benefits are equal for similarly situated males and females, but females were required to contribute at a higher rate than males. ACLI has retained a law firm to prepare a friend-of-the-court brief for filing in the case. The case concerns employee benefit plan design, but ACLI is entering it mostly because of the possibility that the Supreme Court, in its opinion, may say things which could affect the actual pricing of insurers' products.

MR. ALLAN D. GREENBERG: Most of the speakers so far have discussed the difficulties of existing or proposed legislation, which is essentially a political problem. The industry is also facing the danger of litigation which could involve retribution for past discrimination and be potentially disastrous.

MR. FERGUSON: This morning, we heard Dr. Jean Mayer present statistics indicating that post-separation mortality was better for officers than for enlisted men. While these differences are probably due to other more fundamental factors, the "credible statistics" requirement would probably be met. The use of previous military rank as a basis for underwriting classification would be socially irresponsible and would damage the image of the industry.

MR. MORTON: The general feeling in the country is more and more that insurance is a matter of right. There may be some justification for the need for auto insurance where the ability to be self-supporting is dependent upon a driver's license. This concept would be threatening, however, if applied to life insurance. The industry has not done a good job of explaining the averaging concept and the risk classification process to the public.

MR. GREENBERG: I agree that actuaries have not done a good job of explaining the insurance concept in the public domain. The wide acceptance of the "overlap theory" in sex discrimination cases (first used in the Indiana Teacher's case) is an example.

MR. KARSTEN: The 1959 Build and Blood Pressure Study was soon out of date due to the introduction of treatment for blood pressure. Even now, we have no significant data on treated blood pressure. As a result, the best we can do is apply individual judgment to such cases and attempt to develop statistical analysis of the mortality impact -- as the industry is now doing. It is a healthy situation if companies arrive at different judgments regarding the impact of treatment of blood pressure but it is unfortunate if companies simply liberalize to meet the competition.

MR. MORTON: We don't even know the makeup of our own standard portfolios because we stop studying the mortality impact of a given impairment, occupation, or other variable as soon as we start to issue it on a standard basis. There may now be a considerable amount of cross-subsidization within the standard group. For example, most companies began taking policemen and firemen at standard rates 30 years ago. No one really knows the experience of this individual risk class but group data indicates that it may be 50% higher than that for clerical employees. Is this equitable? Could we defend it in a public forum?

MR. COOK: Dan Case mentioned that I served as liaison between the ACLI-HIAA Task Force and the ALIMDA-Society committee. The Academy committee began

its work concentrating on sex discrimination but expanded to the broader concept of risk classification as they saw the problems which face the industry. There were four recommendations, namely, that the Academy communicate to the membership on the restriction of risk classification already prevailing and that task forces be established to determine the financial and actuarial implications of such restrictions, to determine the best way to communicate these consequences to legislators, jurists, and the public, and to initiate study of those classifications now being used. The ACLI-HIAA Task Force, on the other hand, deals more directly with regulations and bills as they arise in these areas.

MR. WEBSTER: If we don't stand up and be counted now, we will be forced to accept risks we don't want to cover. Otherwise, there will be more and more classes of people feeling discriminated against and seeking legislative or judicial remedies.

MR. MILTON P. GLANZ: I would like to know how the members of the panel feel about a government subsidy for those cases that you would write standard only when they are mandated.

MR. COOK: In response to Mr. Webster, the ACLI-HIAA Task Force has developed a model bill for use in individual states.

The basic objective of life insurance underwriting is to establish a premium rate appropriate for the proposed insured's level of risk. The result of the combined consumerist activity would be equal premium rates for all. As actuaries, we know what that would do to the price of insurance coverage for those who wished to buy it. The real objective of underwriting is to avoid the chaos which would result from equal premium requirements.

MR. BAYLES: It would be worthwhile to meet with groups representing the handicapped and others to discuss the concepts of fair and unfair discrimination. The competitive nature of the underwriting process should be emphasized. We have all seen significant differences in ratings for similar risks. We should emphasize that the industry is not a monolith with a single source of data.

MR. COOK: The Equitable has its own inspection network. We are also obtaining more information from the Part II than we used to, especially in the area of drug usage.

MR. FERGUSON: I don't think it's unfair to reduce the amount of underwriting information and be less precise on class distinctions if it reduces the overall cost of insurance.

MR. COOK: The effective rate of underwriting protective value of inspection reports dropped from about 3½% to about 2½% in the early 70's. It has since climbed back to about 3½%, however. This may be related to the unemployment rate.

MR. L. B. KENNEDY*: I generally agree with the statistics indicating a temporary drop in the effectiveness rate of inspection reports. Equifax's statistical analysis indicates a reduction in effectiveness in 1971, followed

*Mr. Kennedy, not a member of the Society, is Vice President of Equifax Services, Inc.

by increases through 1976 and some decrease again this year. We surveyed our field on this question in late 1976 and early this year. The general response was that the changes in questions made in response to the Federal Fair Credit Reporting Act made it more difficult to obtain specific information. The situation is now somewhat better.

MR. MORTON: The comments by the panel and by the audience, including two written but not presented during the discussion period, add greatly to the paper's value. I single out for brief mention the information given by Dan Case which places in our record some definitions of the problems and tentative thoughts of our industry associations, the ACLI and the HIAA in this area of risk classification.

Broader limits for issuing insurance at standard rates as mentioned by Ed Lew have already been adopted in some form by a few companies. Their rationale is that the attendant cost of underwriting decisions which would successfully distinguish risks, say, in the range of 120-130% mortality from those 130-150% of standard may equal or even exceed the extra premiums that would be foregone if all were issued standard. This validation is sound at the younger ages but probably not at ages much beyond 35 or 40.

In a written discussion, Mr. Lew further observed that we must strive harder to get authoritative information on the magnitude of different life risks to the public, regulatory authorities and the courts, so that elemental fairness would prevail. He put in the record information about mortality studies now underway, or planned to be undertaken soon both by groups within and outside of the insurance industry. Even more may be needed as I suggested; there is a nearly total lack of valid statistical data, which the industry will increasingly need if it is to make proper defense of many of its existing practices or defeat future unwise and improper legislative proposals.

Not just defense material is needed; rather we need to make an aggressive effort to educate many people; both those outside of and within the industry and our clientele, the public at large. Widespread knowledge of what underwriting is and of its basic importance to a sound private insurance industry seems to be the best way to preserve it.

