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## RISK CLASSIFICATION

Moderator: JAY C. RIPPS.

Panelists: CHARLES C. HEWITT, JR.\*, ROBERT J. RANDALL, SR., ANN WYNIA\*\*

1. What are the basic principles involved in criticisms of current classification practices?
2. Which elements of the common classification system are under particular attack?
3. What are the implications of recent court decisions?
  - a. Manhart
  - b. TIAA-CREF cases
4. What are the potential adverse implications, if any, of eliminating some common classification variables?

### Format

The usual format of a concurrent session, consisting of a series of independent speeches followed by a question period, was not followed. Instead, the panel conducted a mock legislative hearing on fictional State Bill 80-123, which reads as follows:

### "Nondiscrimination in Insurance Act of 1980"

"Whereas discrimination based on race, color, religion, sex, or national origin, when practiced by insurers, in connection with the terms, conditions, rates, benefits, or requirements of their insurance policies or contracts,

- (1) burdens the commerce of the state,
- (2) impairs the economic welfare of large numbers of people who rely on the protection of insurance and annuity contracts,
- (3) constitutes unfair trade practice, and
- (4) makes it difficult for employers to comply with federal laws prohibiting such discrimination against their employees."

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\*\*Ms. Wynia, not a member of the Society, is a Minnesota State Representative.

Now, therefore, on and after the effective date of this Act, no insurer shall, on the basis of any individual's race, color, religion, sex, or national origin

- (1) refuse to contract with any applicant for insurance, or
- (2) treat any such applicant or insured differently than any other applicant or insured with respect to the terms, conditions, rates, or benefits of an insurance policy or contract.

In particular, it shall be unlawful discriminatory action

- (1) to refuse to make, or to refuse to negotiate, or otherwise make unavailable or deny, or delay receiving and processing an application for, a contract of insurance of the type ordinarily made by such insurer;
- (2) to make, print, or publish, or cause to be made, printed, or published, any notice, statement, or advertisement, relating to insurance coverage that such insurer provides or will provide, indicating any preference, limitation, specification, or discrimination based on any individual's race, color, religion, sex, or national origin, or an intention to make any such preference, limitation, specification, or discrimination;
- (3) to charge and collect premium payments or contributions or to determine the amount of and to pay any periodic or lump sum benefit payment, if such charge and collection, or such determination and payment, are based, directly or indirectly, either on any individual's race, color, religion, sex, or national origin, or on any statistical table whose use would violate any provision of this Act.

Nothing in this Act shall be deemed

- (1) to prevent an insurer who regularly provides insurance coverage solely to persons of a single religious affiliation from continuing to provide insurance solely to persons of that religious affiliation, or
- (2) to require any insurer to give preferential treatment to any person because of such person's race, color, religion, sex, or national origin, making or administering a contract of insurance."

MR. JAY C. RIPPS: I would like to call this meeting of the Sub-Committee on Banking and Insurance to order.

For the benefit of those in the public gallery, let me introduce myself and my fellow Committee members. I am Representative Jay Ripps, Chairman of the Banking and Insurance Sub-Committee; the other members of the Committee are Representative Ann Wynia and Representative Robert Randall.

We are here to consider public input regarding State Bill 80-123, the purpose of which is to prohibit differential treatment of insurance policyholders or applicants on the basis of race, color, religion, sex, or national origin. This bill is closely related to similar legislation now being considered in the U.S. Congress (H.R. 100, sponsored by U.S. Representative Dingell, and S. 2477, introduced in the Senate by Senator Hatfield). It also is related in general terms to the Civil Rights Act of 1964, to our state's anti-discrimination laws, and to the recent Manhart decision of the U.S. Supreme Court.

Our only formal statement this morning will be from Mr. Charles Hewitt, representing the American Academy of Actuaries. Actuaries, as you no doubt know, are the technical experts who establish insurance company premium rates. We are most interested, therefore, in their comments on the proposed legislation, and I extend on the committee's behalf our welcome to you, Mr. Hewitt, and our thanks for your appearing before us.

After his formal statement, Mr. Hewitt has kindly agreed to respond to questions from the committee. At the conclusion of these questions, there will be opportunities for comments and questions from the public to any member of the committee or to Mr. Hewitt.

MR. CHARLES C. HEWITT, JR.: I am appearing before you today on behalf of the American Academy of Actuaries, an umbrella organization of all major actuarial bodies in the United States. The Academy includes representation from all the various disciplines of the insurance business -- life insurance, pensions, property and liability insurance, accident and health insurance (including Blue Cross/Blue Shield) and others. Members of the Academy work for insurance companies, state insurance departments, the Federal Government, academic institutions, as consultants, for private employers and for labor unions.

Actuaries, by the very nature of their profession, are trained to make judgments about the future based largely, but not entirely, upon observations taken in the past.

Actuaries may be asked to arrive at conclusions based upon their own observations and judgments, or they may simply be asked to provide a scenario of the future (generally, with appropriate numbers) from which others may draw necessary conclusions.

In any event, the conclusions are based upon facts, observations and judgments which are unadulterated with wishes, hopes and social goals.

Actuaries, as human beings, may have their own view of the world and of society. However, as previously stated, their training and professional standards are designed so as to inhibit them from applying their personal wishes and desires in their actuarial interpretations.

Furthermore, actuaries have a professional obligation and dedication to keep insured and trustee plans and programs sound and healthy; for a plan which is unable to deliver the benefits which it promises is of no value to the persons entitled and expecting to receive benefits therefrom.

Let me state, at the outset, that the American Academy of Actuaries does not feel that the insurance business, as conducted in this state, classifies individual risks on the basis of race, color, creed or place of national origin. Therefore, the only issue which we wish to discuss with you today is whether or not sex (I prefer to use the term gender) should be a basis for classification of risk in the insurance business.

#### Cost Differentiation versus Discrimination

Classification within the insurance business is based fundamentally upon cost differentiation among different groups of persons purchasing insurance. The act of differentiating on the basis of cost is not of itself discriminatory and is certainly not unfairly discriminatory. It merely represents an expectation that individuals or groups purchasing insurance should pay their own economic cost for such insurance.

Is cost differentiation by gender in insurance necessarily unfairly discriminatory? Let's review the record with respect to some major lines of insurance!

1. In purchasing life insurance, women are charged less than men simply because it is a proven fact that women live longer than men.
2. On the other hand, for exactly the same reasons, women are charged more than men for life annuities, i.e. for pension benefits.
3. In automobile insurance, generally speaking, women are charged the same as men at almost all ages above 30. For ages below 30, women are charged substantially less than men.
4. In homeowners insurance, there is no differentiation between the genders.
5. In health insurance, women, generally speaking, are charged more than men up until about age 55 and beyond that point there is no differentiation, or women may even pay less than men.
6. In accident insurance, women would be charged substantially less than men at the younger ages and approximately the same as men at the older ages.

From the above, it is clear that there is no attempt to discriminate unfairly against women (or men) in the purchase of insurance. It is just as clear that there is cost differentiation where such differences are demonstrable and, in some lines of insurance, no differentiation whatsoever.

#### Cost Differentiation and Availability

The proposed legislation clearly has as its primary goal the availability of coverage to all persons desiring to purchase insurance. Insurers have a fundamental duty to their present policyholders to be sufficiently sound financially to be able to meet all future obligations as they become due. Therefore, an insurer who disregards the proper pricing and selection of its future policyholders is risking both its own neck and that of its present policyholders.

It is precisely because classification plans cost differentiate among prospective (and present) insureds that insurers are satisfied that each class of persons or groups are insurable.

A free marketplace is affected by the attitudes of both the buyers and the sellers. Insurance is an aleatory contract. This means that the buyer pays a fixed premium in exchange for which the seller assumes certain responsibilities or liabilities on a contingent basis.

When this transfer of risk takes place upon the payment of the premium, the seller (the insurance company) is assuming that a certain set of conditions which surround the risk it has accepted have been properly assessed in advance and will remain as expected during the lifetime of the insurance contract. If a company is issuing annuities payable for the duration of the lifetime of the annuitant, it must continue such payments regardless of changes in future conditions. If some miracle cure for heart disease or cancer is discovered, the insurance company must still continue periodic payments to all of its annuitants even though the increased longevity of these same persons might not have been anticipated at the time the contract was issued.

All of the above is recited in order to remind the legislators that the attitude of the seller who is going to assume an indeterminate risk is as important in the marketplace as the attitude of the buyer. As long as the seller is permitted to cost differentiate among purchasers on the basis of a classification system which it accepts and, of course, which has been proven to be acceptable to the buyer also, there will be market stability. This stability is often in very delicate balance.

If at any point the seller views the charge for a particular group of buyers as inadequate, it will, in order to protect its solvency, avoid through whatever means possible soliciting and accepting the excessive risk from this group of individuals. This attitude on the part of the sellers, if continued for any length of time, is disruptive to the stability of the marketplace and will cause arbitrary realignments.

Arbitrary realignments in the marketplace may take a number of forms:

1. A forced discrimination among different groups of buyers in which the seller prefers certain classes of buyers over other classes. This leads to an unwillingness to insure those classes which are deemed by the sellers to be inadequately rated. This situation is not hypothetical — virtually every state in the United States has some form of automobile insurance market for those buyers unable to purchase insurance voluntarily.
2. A second form of selection on the part of the seller is to create a specialty insurance company. For example, automobile or accident and health insurance companies which insure only teetotalers or non-smokers.

3. A rather radical effect of disruption in the marketplace is the withdrawal of the seller entirely from providing certain forms of insurance. Again, this is not a hypothetical situation; a number of major property and liability insurers have, within the recent past, withdrawn from certain states, or at least from certain lines of insurance in those states largely because of inability to price or to select risks upon what they considered a reasonable basis.

The brunt of this type of disruption in the marketplace eventually falls upon the buyer. The buyer either finds it necessary to purchase insurance in the substandard market at some rate in excess of what the buyer is accustomed to paying, or the buyer may not be able to purchase insurance at all.

Persons who do not function in the insurance marketplace on a day-to-day basis may often fail to appreciate the delicate balance which does exist, and having failed to appreciate this delicate balance, cannot anticipate the disruptive effect of some arbitrary change in the system such as eliminating the use of gender in classifying insurance risks, where cost differentiation on the basis of gender is indicated.

The most drastic effect of such an elimination would be in the pension field, and a scenario delineating what would happen is set forth below.

If State Bill 80-123 is adopted, actuaries would be forced to come up with what has been referred to as a "unisex" mortality table. Because different male/female tables have been in use since the nineteenth century, the construction of a unisex table would require an assumption with respect to the proportion of males and females to be insured in the future.

An actuary who overestimated the proportion of females to be insured would produce premium rates which were too high, and these rates would attract very few male annuitants. This, in turn, would lead inevitably to a higher proportion of females annuitants than had been originally supposed. There would then be, on the basis of demonstrable favorable female mortality, adverse results which, if not corrected by rate increases, might lead to the failure of the company using these rates. The actuary who had the foresight to adjust rates to allow for the increased proportion of female annuitants, would be setting the same rates as are now being charged for female annuitants.

On the other hand, the actuary who underestimated the number of female annuitants would produce relatively low rates which would be very attractive to female annuitants. Since the proposed legislation would not permit an insurer to refuse to issue an annuity to a female buyer, there would inevitably be an excess of female annuitants over male annuitants when compared to the original estimate on which the unisex table was based. The scenario from here is virtually the same as the one previously described -- either an insurance company would go broke because it would not have a sufficient amount of money to pay annuities to the higher percentage of female annuitants, or the actuary would have to produce a new mortality table based upon a higher proportion of female annuitants and, hence, higher rates.

The committee must ask itself whether this scenario agrees with the intended result. Do you want to provoke a probable series of insurance company failures with annuitants unable to collect on the contract which they had purchased? Or do you want to create a marketplace so sensitive to male/female percentages of insureds that male annuitants are driven out by the high price for annuities and female annuitants who remain in the marketplace eventually pay as much as they are now paying?

#### Causal Relationships

Consumer groups have come up with a new concept -- that a causal relationship must clearly exist between a factor and the hazard to be measured in order to establish a classification system.

However, let me ask this committee to examine the idea more carefully. Would the insurance business or the recently created National Flood Insurance Program be expected to charge the same actuarial rate for flood insurance to persons who live on the top of the mountain as would be charged to persons who live in the river valley? I hope you will agree with me that the correct answer is "of course not", and yet, because living in a river valley does not of itself cause the river to flood, must one conclude that it bears no reasonable relationship to the hazard being insured against?

The purchase of insurance by the buyer presumes that there will occur, from time-to-time, events that are not foreseeable. The willingness of the seller, the insurance company, to make insurance available presumes that these events are not preventable; in other words, that the cause of the accident or event may not be removed prior to its actual happening. Classification in insurance, for non-preventable events, therefore must, of necessity, be done on some basis other than cause.

We actuaries are not saying that age or gender is a specific cause of death, automobile accidents, sickness, etc. However, these factors are often related to mortality, accident frequency or frequency of illness. Society has accepted over the years the use of classification systems in various forms of insurance without insisting upon repeated demonstrations of causal relationships.

As long as actuaries can properly demonstrate statistical relationships between such things as age, sex, marital status, etc., and the hazard to be measured, and as long as these factors are recognized by the public as being relevant to hazard, there would seem to be no injustice.

This is not to say to this committee that a classification system may be justified solely upon the basis of actuarially demonstrated cost differentials among the classes. Current social and political standards must, in good sense, be recognized. However, society should realize that the cost of such recognitions may be the unavailability or reduced availability of insurance coverage for some persons or groups of persons.

Demonstrable differences in male and female mortality, alluded to above, can be explained by biological differences. Some geneticists think that these differences are definitely biological and hereditary, as illustrated by the following quotation from Your Heredity and Environment, by Amram Scheinfeld.

" . . . the human female from before birth and throughout life today is favored far above the male."

"First, there are the general sex differences in bodily makeup and chemical functioning, which are known to endow the female with advantages in resisting or overcoming most diseases. Second, the male is much more likely to be victimized by specific and directly hereditary diseases and defects . . ."

"To account for this in some detail, we go back to the moment of conception and the initial genetic difference between the sexes: the fact that the female is started off with two Xs, the male with one X, plus a Y . . . When a female gets a recessive wayward gene in one of her X chromosomes, the changes are that there will be a normal gene for the job in her other X. But if a male gets such a wayward gene in his single X, he's in a bad spot, because there is no corresponding gene in his very small Y chromosome to do the job . . ."

Is gender at the root of what appears to be discrimination? Not if the subject matter of the particular insurance coverage is recognized.

For example, suppose there are two similar buildings to be insured against fire. One building is made of brick and is owned by a man, the other building is made of wood and is owned by a woman. Should the costs of fire insurance be identical because one owner is female and the other is male? Clearly the answer is, "no", for it is the characteristic of what is to be insured that is important -- not who owns it.

Let's examine this principle as applied to life insurance or pensions (annuities). What is being insured here is the longevity of the human body. As we have shown, the genders do possess different physical characteristics affecting longevity. It is not a mere tautology, in fact, it's the very heart of this whole issue to point out that the longevity of the body which belongs to a female or a male causes the cost-differentiation (classification).

It must be clearly understood, therefore, that it is body characteristics (male physical characteristics, biochemistry or mortality as distinguished from female physical characteristics, biochemistry or mortality) that make the difference. This difference is the basis for classification by gender in life insurance, and in pensions (annuities) not the fact that the possessor is male or female.

#### Practical Limitations on Cost Differentiations

The benefits of cost differentiation are many and of great significance in the business of insurance -- more so than in most other lines of endeavor. However, this committee should remember that there are practical limits on cost differentiation and that the public, in this case the buyers of insurance, subconsciously recognizes some of these practical limitations.

In private enterprise this phenomenon occurs almost everywhere. The bald-headed man at the barber shop who has his hair trimmed may grumble somewhat when it is time to pay the barber, but no revolution has been started by baldheaded men who refuse to pay the same price for a haircut as persons with a full head of hair.



Within the business of insurance there are other practical limitations on cost differentiation:

1. Very often a particular class of insurance risks contains so few persons or objects that the loss experience within the classification lacks sufficient credibility for rate determination.
2. It may be too expensive to make distinctions for the purpose of cost differentiating.

In summary, cost differentiation is a principal goal of risk classification in the business of insurance as long as it can be applied at a cost within reasonable bounds and supported by objective statistical information. Differentiation on the basis of gender fits well within these practical limitations.

### Conclusion

The questions must be asked:

1. What is the need for the proposed legislation?  
and
2. Do the benefits, if any, to be derived from the legislation outweigh the disadvantages which it implies?

The first question has been partially answered in my opening remarks -- there is no need with respect to matters of race, color, creed or place of national origin. This left only the hypothetical need with respect to classification on the basis of sex (or gender). Hopefully, we have demonstrated herein that where classification exists on the basis of gender, such differentiation is even-handed, sometimes males must pay more than females and sometimes less. Where it exists, cost differentiation (the reason for risk classification) is made on the basis of the characteristics of the thing to be insured, not whether the possessor of the thing is female or male.

The second question presupposes that there are benefits to be derived. But, hopefully, we have shown that, if there are any benefits, they will be far outweighed by the instability which will be created in the marketplace. Rather than increasing the availability of coverage for one gender or the other, this legislation, if imposed upon a system of private insurance, will actually interfere with free access to that marketplace.

This committee must ask itself if it can expect a free marketplace to digest voluntarily a large number of incorrectly priced risks because that is exactly what this legislation entails.

MR. RIPPS: Thank you, Mr. Hewitt. I shall begin the questions from the committee.

The United States Supreme Court stated in its opinion on the Manhart Case that the (Civil Rights Act of 1964's) "focus on the individual is unambiguous.

It precludes treatment of individuals as simply components of a racial, religious, sexual or national class. The basic policy of the statute requires that we focus on fairness to individuals rather than on fairness to classes."

State Bill 80-123 extends this principle explicitly to the business of insurance. It does not prohibit the use of other classifications. Do you disagree with the principle that individuals should not be treated as components of racial or sexual groups?

MR. HEWITT: On behalf of the Academy, Mr. Chairman, I do not disagree with the principle with respect to race; I do disagree with respect to sex or gender, as evidenced by my testimony.

MR. ROBERT J. RANDALL, SR.: Recently in area after area, sexual distinctions have been struck down as being unfair, and I think this has been a good thing. My question to you is, in what areas of economic activity has it been proper to outlaw such distinctions and if it's proper there, why is insurance different?

MR. HEWITT: Mr. Representative, speaking on behalf of the Academy, the law (Title VII) says that distinctions made on the basis of sex in employment are not proper and it is the position of the Academy to comply with the law of the land. With respect to other legislation pending, for example, the Equal Rights Amendment, the Academy has taken no position.

MR. RIPPS: I would like to follow-up on Representative Randall's question. He asked, "What is it that differentiates insurance from other areas of economic activity where sexual differentiation has been outlawed?" I'm not sure I followed your answer as to what it is that makes insurance different, if anything.

MR. HEWITT: I think the answer to your question is that the insurance contract is an aleatory contract. When actuaries establish a price, we are attempting to evaluate a contingent situation, that is, we appraise the situation that will be in existence during the entire future lifetime of that contract. The purchase of insurance differs from the purchase of a physical commodity and from the purchase of a service. In our case, the insurer, the seller of insurance, must be convinced at the time the contract is undertaken that the rate is properly established. I think that this is the fundamental difference.

MS. ANN WYNIA: Mr. Hewitt, you state that your conclusions as an actuary are based on facts, "unadulterated with wishes, opinions and social goals," yet in the first several pages of your paper you proceed to identify several examples of differential treatment on the basis of age and sex, and you defend these as "practices which have been accepted over and over again by the general public." How do you explain this apparent inconsistency? Isn't the very act of choosing a group to study (Jews versus Catholics, Irish versus Scandinavians, or males versus females) dependent upon your values and what one regards as appropriate ways of dividing or classifying the world? Are facts and values really as clearly distinguishable as you suggest?

MR. HEWITT: Well, I would hope so, and I do not see any discrepancy in the next to last statement that you made. One of the fundamental hypotheses of our profession is that by obtaining the facts in a valid manner we obtain the truth. If we begin with an incorrect preconception or opinion, we are very often diverted; while if we ignore some of the facts we eventually derive half truths or even the antithesis of the truth. As an example, in Communist countries, it is a common practice to start with the conviction that something is true and then look for the facts. This frequently causes a massive amount of facts to be hidden or distorted -- witness the type of press in Communist countries.

MS. WYNIA: Has the Society of Actuaries ever developed statistics comparing differences in mortality by religious groups?

MR. HEWITT: I do not know of any such studies, but I do not see any objection to making such a study; it is how the information is used after the study is made that seems to me to present the problem to society.

MR. RANDALL: I understood you to say that you don't know of studies on cost differentials by religion and national origin. How can you be sure that these factors aren't as significant as sex is and why wouldn't it be proper to ignore sex in your costing?

MR. HEWITT: You are correct in saying that I do not know of any studies on religion or national origin. I would point out that these two characteristics have become somewhat diffuse in recent times. An individual who espouses one religion today, may in five or six years be either an atheist or a member of another religion, whereas sex (except for the rare sex change operation) is an immutable characteristic for the lifetime of the insured.

With respect to national origin, racial intermarriage is common, so that it is not always possible to determine a person's race or national origin. This melting pot situation has existed in the United States since the middle of the 19th century. I would point out, in addition, that the proposed legislation does not forbid fraternal organizations from issuing policies to groups of a single religious denomination. Incidentally, fraternal organizations of a racial and/or religious type do exist, for example, the Sons of Italy and the Knights of Columbus.

MS. WYNIA: You stated that if legislators were to dismiss a particular rating factor such as sex for the basis of classification, insurance might become unavailable for certain groups or that market failures might occur. I have some questions related to that statement. We know that legislation in various states has prohibited making distinctions on the basis of race in the sale of insurance. Have insurance companies failed to make insurance available for blacks now that racial distinctions are prohibited in the states?

MR. HEWITT: No, not to my knowledge.

MS. WYNIA: How many insurance companies have gone bankrupt now that racial distinctions are prohibited?

MR. HEWITT: I am not aware of any, but I do not see the relevance of your question to the issue.

MS. WYNIA: Well, I perceive the relevance in that you outlined some classic consequences which might occur if the proposed legislation began interfering with the kinds of rating characteristics that insurance companies are able to use, and this produces a dampening effect on the enactment of the proposed legislation.

You note in your original paper some statistics from the Statistical Abstract citing a 7.7 year differential in life expectancy for males and females. That same source cites a 5.7 year differential in life expectancy for whites and blacks. How have actuaries dealt with the inclusion of both blacks and whites in the same life and pension tables?

MR. HEWITT: Referring to my notes..."persons favoring the elimination of gender distinct classifications in mortality tables allege a similarity with the now extinct use of classification plans and mortality tables based upon race. Indeed, race is a prohibited classification in all states (the NAIC model Unfair Trade Practices Act). In the past, race-based mortality tables have, in fact, been available, used and justified. Today, however, no insurer or actuary uses race-based mortality tables. However, it must be realized that race is a much different factor than sex. To the extent that there may be a relationship between race and longevity, closer scrutiny shows that the race is actually a surrogate for other factors: diet, housing, medical care, public health service, education, and employment opportunities.

Let's make a more precise actuarial examination of the factor of race as found in mortality studies. The facts are that as all races have had equal access to the same factors of diet, housing, medical care and so forth, the disparity between the mortality of whites and non-whites in the United States has been declining. The 1979 Life Insurance Fact Book indicates that in 1900, the differential of life expectancy at birth between whites and non-whites was 14.6 years. In 1950, the differential was 9.1 years, in 1960 it was 7 years, in 1970, 6.4 years and in 1977, the differential was 5 years. The Fact Book states 'The difference in life expectancy between white and non-white Americans has been greatly reduced in this century. In 1977, the difference in life expectancy between whites and non-white persons at birth was 4.6 years for females and 5.4 years for males, and this differentiation decreased with age.' Pinpointing with respect to pensions, whites and non-whites who reach retirement age have closely comparable life expectancies."

I have a table indicating that the expectation of life is 5.3 at age 85 for white males, 6.8 for white females; with respect to non-whites, 7.3 for males and 9.6 for females. At age 60; for white males, the life expectation is 17.1, and 16.5 for non-white males, almost identical; the life expectation at age 60 for white females is 22.3 and for non-white females 21.0. Note that the difference between whites and non-whites has almost disappeared at age 60 and above but that there still is about a 5 year differential between male and female in either the white or non-white group. As these tables emphasize, there is now no substantial difference between the mortality rates of whites and non-whites at the older ages. However, there continues to be a disparity between the life expectancy of non-white males and non-white females just as there continues to be a disparity in the life expectancy of

white males and white females. In summary, analysis of all available data suggests that elimination of race as a meaningful classification is required not only by law but by fact. Gender is a somewhat different matter.

MS. WYNIA: In regard to life insurance and annuities, given the great diversity within the categories of male and female, are these the most valid means of assigning risk? The statement that women live longer than men is based on the distortion of "the average woman" and "the average man". Most men and women can be paired at death age. For example, data compiled by TIAA-CREF in the Manhart Case indicated that approximately 86% of the women had the same death age as 86% of the men. Thus, because less than 14% of the women did not match the death ages of 14% of the men, all women receive lesser monthly retirement benefits than all men, and all men pay higher life insurance premiums. From either sex's perspective, are not the odds greater that each will be a part of the larger group of 86% than the minority 14%? How fair is a rating system which depends so heavily on the experience of the 14% minority for the treatment of the entire subgroup?

MR. HEWITT: I will answer that by referring again to my notes. A similar argument was used in the Colby College Case and I would like to describe my answer to that argument. "Proponents of the elimination of gender distinct rates and statistical tables have tried to twist the reality in a syllogism that can best be described as scandalous. Using mortality tables for male and female lives and starting with a hypothetical 1,000 lives of each gender, male and female deaths at the same age are paired. The result is a matching of something over 80% of the male and female deaths by age of death. 10% of the unmatched male deaths occur at the younger ages and 10% of the unmatched female deaths occur at the older ages. The conclusion of the proponents of merged gender rating is that the difference in annuity rates is not justified because over 80% of the men and women in the same starting group have the same year of death."

Parenthetically, I might note it may be argued that the Pittsburgh Pirates did not win the National League Pennant in 1979, because 80% of their games against the same opponent could be paired on a win/loss basis, or that this bill fails if 80% of the legislators can be matched on a for/against basis.

"Let us try to untwist this syllogism to the reality whence it came. Using the same mortality tables, I have prepared, for illustrative purposes, an exhibit (which I'd be glad to make available to this committee) showing an annuity of \$10,000 a year paid out to two groups of persons aged 65, one group of males and the other of females. Total payments to the female group are larger than total payments to the male group, in all years. For example, by age 70, the excess is \$1,410,000; by age 85 it is \$22,090,000; by age 100, \$40,610,000. At the death of the last life, the total payment to female groups would have been something in excess of \$215 million as compared to the male total payment of \$175 million. The excess of payments to females is about \$41 million simply because women live longer than men. If we are to use a pairing argument, let's use it correctly. The proper method is to pair the females and the males on the basis of the order of death. Then we would see how many payments the first man and the first woman to die would have received respectively, how many payments to 100th man and the 100th woman to die would have received, etc. Again, I have an exhibit, which I would like to furnish this committee, that shows the excess of payments to

females and males on this basis. Generally speaking, females will have received somewhere between \$40,000 and \$50,000 more than their male counterparts. If each purchaser of one of these annuities were to be charged the same amount, there would be a clear discrimination against every one of the 1,000 males in the example."

MS. WYNIA: As I listened to you read the different amounts which a female might expect to receive, as compared to a male, it occurs to me that some males are going to receive many thousands more in payments than other males simply because some males live longer than other males. The perspective that I would like you to consider is: how do you tell a female who has a history of heart disease, who smokes and is overweight, that she is going to receive a smaller monthly annuity because she belongs to a group who, because they happen to be female, have an average longer life expectancy? Can she be more appropriately grouped with a set of risks that possess other characteristics?

MR. HEWITT: I might respond in a number of ways. One of the ways I would like to respond to the general intent of your question is to point out that if you were to differentiate on the basis of age rather than sex, you would find a considerable overlap between people aged 60 and aged 65. Do you consider it an obligation to explain to a group of 60 year old people that they are going to receive a smaller annuity than the 65 year old people when, in fact, some of them will die just as early as some persons aged 65? If that type of logic were to prevail, then it seems to me this legislature ought to try to outlaw discrimination on the basis of age or discrimination on the basis of anything really, because in any grouping of risks, you are always going to have some overlap between the risks in one class and risks in another class...it's inevitable.

MR. RANDALL: Mr. Hewitt, have there, in the past, been instances where women were unable or unequally able to obtain insurance of various types?

MR. HEWITT: Yes, there have. I'm sure there have.

MR. RANDALL: And has the insurance industry reacted by changing its practice without governmental pressure; or has governmental pressure, legislation or regulation been necessary?

MR. HEWITT: I think in the Accident & Health area, there was a study by the State of New York Insurance Department which found clear differences between the morbidity of the two sexes. A final report, signed by Superintendent Harnett, stated that the differences generally were justifiable. However, some discrimination against women was found in the placing of Accident & Health Insurance. The New York Insurance Department ordered it to be stopped, and it had been stopped.

MR. RIPPS: In their November, 1978 report, the Rates and Rating Procedures Task Force of the Automobile Insurance Sub-committee, National Association of Insurance Commissioners reported as follows:

"Public policy considerations require more adequate justification for rating factors than simple statistical correlation with loss; in this regard, the task force recommends consideration of criteria such as causality, reliability, social acceptability, and incentive value in judging the reasonableness of a classification system. Based on these criteria, the task force concludes that as rating characteristics, sex and marital status are seriously lacking in justification and are subject to strong public opposition, and should, therefore, be prohibited as classification factors."

I have a number of questions about this. You have spoken to us about causality, but there are a number of other items mentioned here by the NAIC: reliability, social acceptability and incentive value. Does the American Academy of Actuaries agree or disagree with the general principle that statistical correlation alone is not adequate justification for a rating factor?

MR. HEWITT: We do not believe that statistical correlation alone can be the sole basis for classification.

MR. RIPPS: Then what is the Academy's position with respect to the importance of reliability, social acceptability and incentive value?

MR. HEWITT: We believe that reliability is a fundamental part of risk classification. The establishment of a group of risk classes should anticipate that once data is collected and experience is available, one may rely on that experience for the future. Some rates are made many, many years in advance. Reliability is a principal characteristic of classification plans.

Social acceptability is difficult to define and discuss because what is socially acceptable in the northern part of the United States is not necessary socially acceptable in the southern part of the United States. What is socially acceptable in the rural area is not always socially acceptable in the urban area. I think the insurance industry, as almost all other businesses and people, must rely on the government to legislate or to judicially interpret what is socially acceptable. I do not believe we can rely on individual advocates, individual persons or newspaper editorials to tell us what is socially acceptable.

MR. RIPPS: Finally, Mr. Hewitt, does the American Academy agree or disagree with the task force's conclusion about the use of sex and marital status in automobile rating?

MR. HEWITT: We disagree.

MS. WYNIA: Mr. Hewitt, this legislation is before us because of a genuine belief that the focus on gender as a rating characteristic has been detrimental to society. Consider the perspective of women who constitute over 70% of the senior citizens living in poverty. Current insurance practices magnify the already disadvantaged economic position of these women by allowing smaller pension and annuity payments simply on the basis of sex. Consider a recent study by researchers at Harvard University noting that 13% of the national population consumes over half the hospital resources each year.

They found that potentially harmful personal habits such as drinking, smoking, and obesity were indicated in the records of high cost patients more often than in those of low cost patients. Would not a classification system based on conditions controllable by the insured rather than gender provide an incentive for loss control or reduction?

MR. HEWITT: I think that you'll find that the life insurance business is already recognizing habits as smoking and overweight. The important question is how much of an incentive a change in an insurance rate can be. Is an increase in an insurance rate going to cause a smoker to quit smoking? In the automobile insurance area: are you going to convince a man who has had four drinks at a bar at 2:00 a.m. that he shouldn't drive his car because it might raise his insurance rates? Generally, there is little incentive to be derived for altering behavior by the raising or lowering of insurance rates.

MS. WYNIA: Would you then just dismiss loss control as a consideration in establishing rates?

MR. HEWITT: Far from it. Where it is possible within the bounds of good costing to recognize loss control, you will find it is recognized. In most lines of commercial, property and liability insurance, there are scheduled rating plans which either penalize or reward the insured -- in this case generally it's a commercial enterprise -- for doing certain things or failing to do certain things. So where it is economically feasible to design a cost incentive plan, it has been done.

However, this is more appropriate for commercial lines than other lines of insurance, because of the cost factor. Consider smoking. If an individual on an application says he doesn't smoke, should an insurer police him for the balance of his life, perhaps 40 to 50 years, in order to determine that he hasn't started smoking again? Many things are not economically feasible to police.

MS. WYNIA: I'd like to ask another question on this topic. You stated in your paper that actuaries respond to the changing social attitudes in the rate making process. Could you describe some of the creative alternatives that actuaries, either individually or through their professional associations as the Academy, are pursuing in order to develop more socially acceptable rating classifications today?

MR. HEWITT: As I said in answer to Chairman Ripps' question, it is not always possible to determine what is socially acceptable because we are not living in a monolithic society and not all people have the same social values. Actuaries are not at the prow or the cutting edge of our society in making these decisions. Although actuaries are aware of, and adapt to, judicial or legislative action which reflects or is caused by changing social values, we do not consider ourselves pioneers in this area.

MS. WYNIA: Our problem, as legislators, is that we have been asked to consider the elimination of sex as a rating characteristic. While we do not necessarily want to eliminate sex, we would like to have more information regarding other possible alternatives to gender. Has the actuarial profession investigated other kinds of factors that might give us some insight?



MR. HEWITT: Something I failed to mention is that there is an ongoing study to find other factors for which sex may be a surrogate. Remember that in private enterprise there is an ongoing competition among various insurers. If an insurer can detect a factor that reflects the true measure of a hazard, it will evolve a new classification system and presumably get an advantage over its competitors. I think that in private enterprise, the most important factor concerning risk classification is constant research that may uncover new factors resulting in a different classification system. In this manner some of the factors you mentioned might be recognized.

MS. WYNIA: Are you suggesting that this research is a trade secret?

MR. HEWITT: No, some of the research is conducted jointly among the companies and is available to State Insurance Departments.

MR. RIPPES: Mr. Hewitt, you have indicated in your statement that in insurance, generally, and in the area of pensions, in particular, the elimination of sex differentiation would have some other dire consequences -- market disruptions, insurance company failure, instability of rates, etc. Late last year, I believe, the Teachers Insurance & Annuity Association, TIAA, which is a major pension system, announced that they will start to use merged gender or "unisex" tables. If TIAA actuaries could figure out how to make that work, why can't the rest of the profession?

MR. HEWITT: I think you have to recognize that TIAA is in a special situation. They have, in effect, a captive audience in which they know in advance the relative proportion of the male and female lives. I am not criticizing them. I would not criticize any insurance company which wanted to use a merged gender table. One of the beauties about private enterprise is that anyone can do this if he wishes. Any of you representatives who felt that women were being abused under the current pension situation could form an insurance company insuring only female lives, that is your privilege.

MR. RANDALL: Mr. Hewitt, if fair sexual discrimination in insurance classification should be permitted and an unfair discrimination banned, what should be the criteria for judging fairness? What objections would you have to legislation which contained such criteria?

MR. HEWITT: This legislation is not necessary or advisable. However, if you feel that unnecessary discrimination should be banned, then I would respectfully suggest to this committee that this bill be amended to provide that fair sexual discrimination be permitted. It could state that only if statistically significant information were available would differentiation on the basis of gender be allowed. I think that would be an important change and would make your bill acceptable to the Academy. Addressing your question, as how to police and enforce this requirement, it could be effected by the various state insurance departments. I might point out that in the casualty insurance business we are accustomed to justifying everything statistically. In most states a rate approval is not obtained unless we have statistics to back up our filings.

MR. RIPPS: My staff and I have scanned records of legislative and regulatory testimony on this subject on both the state and federal levels, and I found a number of statements by insurance company sponsored organizations. I have not seen anything from the American Academy of Actuaries. This brings to mind several questions. Are you a new organization, or simply newly interested in this subject? If not, where have you been?

MR. HEWITT: The American Academy of Actuaries is not a new organization, it has been in existence approximately 16 years. We are significantly interested in this topic. For two years we have had a committee working on the general problem of differentiation in classifications, not just gender but other types of differentiation as well. Our committee has prepared a draft of the basic statement of principles of classification that has been distributed to the membership. It has received a feedback consisting of 37 or 38 suggestions and is about to submit to its Board of Directors a final draft of the statement of classification. We have testified in the U.S. Congress on many other pieces of legislation, not necessarily of the type of this particular bill, but we are appreciative of the opportunity to be here today.

MR. RIPPS: I have two related questions about the Academy. What is your relationship to the insurance industry, that is, to the insurance companies? And I seem to recall having heard of a group called the Society of Actuaries. What is your relationship to that group?

MR. HEWITT: Let me respond to your first question. As I explained in my opening remarks, the Academy is an umbrella organization. It does not consist solely of life insurance company, state insurance department, and pension actuaries. It is an amalgamation of all of these groups of actuaries. It speaks for academicians, for actuaries in the regulatory area, for pension consultants, and for life insurance company actuaries. So we should not be conceived of as espousing a particular cause, either a company cause or regulatory cause. With respect to your second question, the Society of Actuaries is a separate and distinct entity that has been in existence much longer than the Academy and was one of the six founding organizations of the American Academy of Actuaries.

MR. RIPPS: I would like at this time to open the hearing to questions from the public. You may feel free to direct questions to Mr. Hewitt or to any members of this panel.

MR. JOSEPH W. MORAN: I am a member of an Academy task force that is working on risk classification. My comment is with respect to the absence of any reference in the discussion that a mandated or "unisex" pricing, in effect, would represent a tax on one segment of the public, indirectly through insurance companies, for the benefit of another segment of the public. Is it appropriate for the Academy to employ such a "taxation concept" argument in commenting on the appropriateness of special legislation?

MR. HEWITT: I mentioned briefly in my example of the 1,000 female lives, the 1,000 male lives, and the \$10,000 a year annuity, that the males would in effect be overcharged. The question of a subsidy by one portion of a group to another portion of the group is a rather delicate question to deal with. It is true that there are no such things as absolutely homogeneous risk

classifications. The problem with a risk classification is that we generally do not know in advance which members of the group will subsidize others and which members will be subsidized. If we can find a basis for making that distinction, then we can create one or more new classes. Inevitably, in almost any line of insurance, one group of insureds does pay more than it should have in comparison to another group of insureds. There is always some element of subsidy in any kind of risk classification. It is clear to me that if this legislation were enacted, in the pension area the male members would subsidize the female members, in the life insurance area the reverse would be true and in the case of automobile insurance, the younger females would be subsidizing the younger males.

MR. RIPPS: Speaking as a member of the Society, I agree that this is the kind of point we ought to be making and need to be making; not necessarily as a bar to legislation like this, but at least to clarify its financial consequences, as perceived by the actuarial profession.

MS. WYNLA: I think that the concept of a "unisex" table in the pension area implying a tax on males for the subsidy of females makes sense only if one perceives society as consisting of two groups -- males and females. But, one may segment society into other groups, according to one's subjective evaluation of what is significant. Hence, I see nothing wrong, per se, in males subsidizing females in pensions or females subsidizing males in life insurance or in smokers subsidizing nonsmokers. I'm intrigued, to some extent, by this preoccupation with sex. That is only one way of looking at the world. It seems to me that there are many other ways of looking at the world.

MR. RICHARD J. HORN: This is more a statement than a question. First of all, the life insurance industry has been responsive in areas where it has determined that there is a significant difference in risk. For example, the industry is beginning to differentiate between smokers and nonsmokers. Now, with respect to differentiation of the sexes, we rate according to the risk involved. If a male and a female were equally risky, they would be charged the same premium and would receive the same annuity benefit. Age, of course, would be recognized as a distinct risk classification. But where the risk is the same, there is no differentiation between the sexes.

MR. RONALD E. BACHMAN: It seems to me that the freedom to price a product is very similar to the freedom of speech (guaranteed by the first amendment); it is a company's speaking of what it thinks are the most important risk characteristics of pricing. I think it would be nice to have a similar type of amendment on pricing so that the government cannot interfere and must allow a company the freedom to price its products as it wishes. As Mr. Hewitt has pointed out, if a company prices incorrectly, it has to suffer the consequences of the marketplace.

Regarding social responsibility and equity, Mr. Hewitt said that he thought the government ought to help establish these because there are many different opinions throughout the country. I would take exception. I think the people themselves can decide and they decide best through the marketplace. They purchase the products that they feel are correct and they do not need to have the government control the market. Freedom of choice is as important as freedom of speech or freedom of religion, and it is time that the erosion of our freedoms by governmental infringement ceased.

MR. RANDALL: I would like to make two remarks in response to your eloquent statement about freedom in the marketplace. First, legislators are not divorced from the people. They are elected by the people and enact laws that the people approve. Secondly, laws have been enacted that prohibit employment discrimination against women, and I think they have had a good effect. The marketplace did not work effectively to eliminate employment discrimination before those laws were passed, so I think the issue of freedom may be considered from several sides. Not every law is an encroachment on personal freedom. It may act to increase it.

MR. DAVID L. RENZ: I think the point Mr. Hewitt made of eliminating age discrimination is valid. There are 80 year olds today who will outlive children born to them. It's largely a matter of whose ox is being gored. Representative Wynia may remember that about three years ago a bill mandating unisex ratings in Minnesota did not pass the House. Immediately thereafter a bill mandating a five year age setback in life insurance was introduced. I think we need to be consistent.

MS. WYNIA: I remember the bill very well, since I was the author of the bill mandating the unisex rating. Although I did not author the bill that had to do with the five year setback, I was very much interested because at the time of the hearing on the unisex bill, the insurance industry came in and provided us with information that indicated a seven or eight year differential in the life expectancy of males and females. I regarded it as very amusing and inconsistent when the industry later supported a bill prohibiting a differential of more than five years in the rating of males and females.

MR. RIPPS: I would close with a notion that the historical record does not make it clear — certainly not to those who are considering legislation in this area — that the insurance industry or any industry for that matter, left to its own devices in a perfectly free competitive environment, will conduct its economic activities in a manner which is always beneficial to society as a whole. Whether or not you and I believe that the industry is capable of competitively evolving to that kind of situation, the key factor to recognize is that most people do not believe that of the insurance industry; and most legislators and regulators do not believe it. So, this will be an active area over the next few years. I encourage your participation and interest in the ongoing debate and I thank you for attending.