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RISK CLASSIFICATION

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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?

These questions will be discussed in the context of current legislative and regulatory activity. The discussion will cover related activities by the Society of Actuaries and the American Academy of Actuaries.

MR. ROBERT SHAPLAND: A lot of discussion and action is taking place regarding laws and regulations which restrict insurers' freedom regarding risk classification for underwriting and pricing purposes. The purpose of my discussion today is to outline some of the issues involved. Hopefully, this discussion will lead to better understanding and decision making regarding risk classification.

While laws and regulations are being adopted or proposed which place limitations on both insurability determination and rating practices, my discussion is confined to restrictions on rating classification.

Basis of Rating Classification Issues: The pricing of commodities has a substantial impact on people's lives since it affects both the distribution of wealth and the distribution of commodities. If this effect under current pricing practices is perceived by someone as "unfair," laws and regulations will be suggested to prohibit such pricing practices. Since proposed limits on risk classification are based on "social issues" or perceptions regarding fairness, I feel that there should be more discussion from this standpoint and have designed my comments accordingly. Thus, most of my comments do not stem from my actuarial training.

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Of course, to the degree that social issues affect economic practices (as these do), discussion gravitates to financial or actuarial theory and practices. This is where actuaries have focused many of their comments. Even here, however, I am unaware of any thorough analysis of the probable economic impact on the insurance industry of proposed limitations on pricing --- although I am aware of some cursory analyses from the standpoint of potential harmful effects.

Social Issues: What are the social issues as I perceive them? One issue is whether or not private industry should have the right to adopt prices which are different for different members of society, where such differences are not supported by actual cost differences. Some members of society may feel that private enterprise should have this freedom and this may be because they have strong feelings about freedom in general or because they feel that any unfair effects will eventually be corrected by competition or moral persuasion or because the cost and bureaucracy needed to enforce any prohibitions is worse. Others may feel that private industry should never have this right because non-cost pricing is inherently unfair. Still others may take a middle road and support restrictions under certain circumstances based on which class of citizens is being affected adversely.

Let's take a look at some examples. Should airlines be allowed to charge lower fares for spouses, evening flights, 30-day advance bookings, etc., which are unrelated to cost savings? Should restaurants be allowed to charge lower prices for persons over age 65, or for children, which are not directly related to cost savings? Should insurers be allowed to charge different premiums by sex if cost differences are not related thereto?

A second issue is whether or not private industry should have the right to adopt uniform prices for members of society whose costs are different. This issue is seldom mentioned, but it is closely related to the first issue since it also involves prices which are in conflict with costs. Again, some examples may be helpful to understand this issue. Should restaurants be allowed to charge one price for "all you can eat"? Should stores be allowed to charge one price for all sizes of tires? Should barbers charge the same price for haircuts regardless of the amount of hair? Should insurance premiums be allowed to be uniform regardless of age or sex cost differences?

A third issue is whether or not private industry should have the right to adopt price differences reflecting cost differences if such price differences conflict with one's concept of "social fairness." Again, some examples may be helpful. Should insurers be allowed to vary prices by religious affiliation if there are actual cost differences which stem from religious practices? Should insurers be allowed to charge prices which vary by race assuming there are genetic differences? Should insurers be allowed to charge prices which vary by sex, again assuming genetic differences? Should hospitals be allowed to charge prices per stay which vary by amount

of services used, since this works to the disadvantage of the aged? This issue has far-reaching consequences since it may impact all industries, not just insurance. It probably is being applied to insurance first since costs are based on "expectations" and pooling of risks is inherent. Interestingly, other industries are evidently not voicing their opinions on this issue.

Since the definition of "social fairness" is critical, let's take a look at some of the possible determinations of social fairness. It might be noted here that the American Academy of Actuaries draft on risk classification recognizes that any classification system cannot ignore the mores of society.

Definitions of Social Fairness: One possible measuring stick of social fairness is based on "controllability." In other words, is it fair for citizens to be affected by costs over which they have no control? If not, then food, clothing, housing, and other necessities would have to undergo broad pricing changes. For example, should the price of a citizen's food be independent of his consumption as it is affected by his age, sex, body size, metabolism, or geographic location since he has little or no control over these factors?

Another measuring stick for determining social fairness is "affordability." This is really another term for "availability." In other words, should the wealthy subsidize the poor via private industry pricing? Unfortunately, it appears that politicians and regulators may be relating affordability to unrelated criteria such as sex. For example, while unisex rates for annuities may reduce the price for women, they would help wealthy women and harm poor men. Conversely, unisex rates for life insurance would harm poor women and help wealthy men.

Again, the application of this principle to private enterprise has broad implications since it would affect the price of food, clothing, housing, and other necessities equally or even more drastically than insurance prices.

It seems to me that attempting to achieve affordability via free enterprise pricing has many shortcomings. These include the following:

1. The possible disruption and collapse of our free enterprise system which is highly dependent on close price/cost relationships.

2. The inappropriateness and inequity of trying to attain the goal of affordability via uni-prices not related to income or wealth.

3. The cost of administering and enforcing such a system.

4. The relative ease with which this goal can be more accurately attained via social wealth redistribution programs.

Yet another measuring stick for determining social fairness is the avoidance of "unfair discrimination." But "unfair discrimination" is based on a personalized gut feeling that it isn't fair to charge more to some defined class of society than to another regardless of any cost differences. Because this is based on individual mores, this feeling could relate to sex, age, religion, color, national origin, georgraphics, etc.

Another social issue is whether or not it is proper to foster social goals via private industry pricing. For example, if speeding is determined to be an antisocial act because it is harmful to one's health and its consequences create financial hardships on all members of society, then should persons who speed pay more for food, clothing, etc.? Such a pricing system would both deter speeding and offset the cost of speeding to nonspeeders. Under insurance, there have been proposals that those who exercise regularly or those who pass annual physical exams should be rewarded with lower premiums. These suggestions may be supported by a perception of price/cost relationships but could be pursued without such a relationship. It might be noted that public financing is replete with examples of cost allocation that may be partially based on social goals. These include the taxation of liquor and cigarettes and the deductibility of mortgage interest and charitable contributions for income tax purposes.

Actuarial Tasks: Let's turn now to the actuarial tasks that stem from these social issues. For example, one actuarial task is the demonstration of whether or not insurance cost differences arise because of sex. This issue is only important if it is felt that private industry shouldn't have the right to differentiate prices where such differentials are not supported by actual cost differences. The American Academy of Actuaries draft on risk classification refers to this issue as "causality" although it classifies it as a "non-consideration."

In order to shed light on this issue or problem, let's assume that an insurance company made a study of its experience by address and found that persons living at even-numbered addresses had worse experience than those living at odd-numbered addresses. Given this fact, let's then ask ourselves whether insurers should be allowed to price differentiate based on address. Most of us would presume that a person's address does not create different costs and therefore some other factor must be creating the statistical experience. Therefore, if cost differences must be used to support price differences, then many might come to the conclusion that it would be unfair to base prices on address. Again, this is because there is no presumption of causal relationship between address and cost in spite of statistical correlation. In this same vein, questions have arisen as to whether

sex is the underlying causal factor in creating statistical cost differences. Arguments can be made that statistical cost differrences have arisen because of overall differences in occupation, economic environment, work environment, etc. An example here is whether sex is a causal factor in creating experience differences under automobile insurance. It may be assumed that the real cause is not sex but the aggression of the driver (or some other factor not directly related to sex). Under this presumption, is it fair to charge a non-aggressive male driver more than an aggressive female driver? Of course, there is a counter argument that aggression is impossible to measure and insurers need some means to insure their revenues match their costs.

Another actuarial task is the demonstration that prices are equitable, where equity is defined as having been achieved if prices are related to costs. This actuarial issue is similar to the unisex pricing issue except that it also relates to the social issue of whether or not insurers should have the right to adopt uniform prices for members of society whose costs are different. It might be mentioned here that the American Academy of Actuaries' draft lists "equity" as one of the primary purposes of risk classification. If one follows the social principle that it is unfair to not reflect cost differences via price differences, then it seems to follow that companies should not continue certain pricing practices such as unisex prices under franchise disability insurance, uni-age prices under cancer insurance, and prices independent of smoking and drinking habits under life insurance and auto insurance.

A final actuarial task relates to the feasibility of attaining social goals via private industry prices which conflict with costs under our free enterprise system. Thus, we enter the realm of adverse selection and economic incentives as outlined in the American Academy of Actuaries draft. Here, I feel that our profession should present unbiased information to law makers, regulators, and the public. This information should include not only examples of instances where prices unrelated to costs didn't work out but examples where our industry has adopted and continues to use prices which don't reflect known cost differences without apparent ill effect. Under this same feasibility issue, the actuarial profession should also disseminate information regarding the complexities and cost of implementing social prices. For example, there are a multitude of questions as to the applicability of unisex pricing in certain situations as well as the marketing restrictions which would have to be placed on insurers in order to actually realize unisex pricing. For example, if an employer hires more women than men, should the premium charged to the group be based on actual experience or on what it would have been with the national average sex distribution? Should association members be eligible for disability plans which are experience rated if their membership is made up of mostly one sex? Should insurers be allowed to solicit their insurance in a geographic area which produces a high percentage of their sales from one sex?

In summary, differences in productivity and consumption are inherent in man. Under the normal free enterprise system, these differences result in differences in income and expenditures. As society has progressed, means have been found to combat the adverse effects of these differences on individuals on a expanding basis. This has usually been accomplished by social programs but private enterprise has also been affected by restrictions on wages and prices. As this movement has affected insurers, actuaries have become involved with the issues. Because of the broad impact of these social issues, all segments of our economic system and society should be involved in the decision-making process. And more information regarding the impact of attaining social goals via manipulation of private industry pricing and available alternatives needs to be disseminated by actuaries and economists to those making the decisions.

MR. DANIEL F. CASE: In 1979, the National Association of Insurance Commissioners (NAIC) adopted its Model Regulation on Unfair Discrimination in Life and Health Insurance on the Basis of Physical or Mental Impairment. The NAIC Model Regulation is a relatively simple document. It prohibits rejecting, limiting the coverage of, rating up, or terminating an individual solely because of a physical or mental impairment, unless the adverse action is based on sound actuarial principles or is related to actual or reasonably anticipated experience. That language is quite similar to a portion of a Michigan law enacted several years ago. In between those two events, however, there had appeared a few other state laws and one or two state regulations which caused concern in the insurance business. The Model Regulation seems to be fostering a trend away from unduly burdensome or restrictive requirements and toward reasonable standards.

For example, in 1976 the state of Washington enacted a law prohibiting rating up or rejecting on the basis of a sensory, mental or physical handicap unless bona fide statistical differences in risk or exposure have been substantiated. That wording seems to have the potential for causing problems in connection with impairments on which we have little or no experience data. This year, however, Illinois and Wisconsin have promulgated regulations essentially identical to the NAIC Model Regulation. In those states, accordingly, insurers should clearly be able to base their risk appraisals on reasonably anticipated experience when actual experience is lacking.

Even more encouraging, however, have been the reversals of earlier actions which seem to have been stimulated by the adoption of the Model Regulation. One of these reversals came in Kansas. There, a law had been passed in 1978 prohibiting the rejection of an individual solely because of a "severe disability", which was defined in the law as including blindness, deafness, totally and permanently disabling spinal cord conditions, epilepsy, autism, and some other conditions. In addition, rating up on the basis of one of those conditions was prohibited unless based on sound actuarial principles or actual experience.

The Kansas Insurance Department laid down some filing and recording requirements in connection with the above law . However, representatives of the business, with the support of the Insurancce Department, succeeded in persuading the legislature to replace the law with a new one which follows more closely the wording of the NAIC model. We are fortunate that the Assistant Commissioner of the Kansas Insurance Department is the person who guided the work of the NAIC Task Force that developed the Model Regulation. We are hoping, now that the Kansas law has been not only improved, but also broadened to cover all physical or mental handicaps, that the Kansas Department will relieve insurers of the filing and recording requirements which it imposed in 1978.

A somewhat similar situation in Iowa involved a set of rules which had been promulgated by the Iowa Commissioner a few years ago. The rules applied to blindness, partial blindness, and physical disability. Although their language appeared somewhat confusing, they seemed to say that a company could not take into account an individual's blindness or disability in classifying him for life insurance. The Iowa Life Insurance Association undertook a series of legal moves, culminating in a court proceeding, in an effort to get the rules changed to allow reasonable consideration of the impairment.

Little progress was made until three things happened:

(1) The Iowa Insurance Department began an action against an insurer which, it said, had violated the Iowa rules; (2) The NAIC adopted its Model Regulation on physical and mental impairments; and (3) A new Iowa Insurance Commissioner succeeded the one who had promulgated the rules. The upshot was that the new Commissioner withdrew the old rules and replaced them with new ones based on the NAIC model; the Iowa Association withdrew its action; and the Department's action against the insurer was settled along the lines of the requirements in the new rules.

Another fortunate development came about in Michigan. That is the state whose law provided the inspiration for the NAIC Model Regulation. The Michigan law, however, applies to all lines of insurance. Also, in Michigan as in some other states, there have been complaints about the availability or pricing of certain casualty lines of insurance in inner city areas. The Michigan Insurance Bureau decided it needed a regulation to interpret its new law.

The Michigan Bureau spent a couple of years developing its proposed regulation. It welcomed, and indeed actively sought, the views of insurers and the public. It held three formal hearings and several informal meetings. As far as procedures went, the Bureau could not be faulted.

However, some of the proposed requirements seemed to go beyond the intent of the law and represented severe burdens and restrictions. For example, at one time the Bureau proposed that each insurer be required to have males and females, old and young, handicapped and nonhandicapped, and persons of various races and occupations, represented in its inforce in approximate proportion to their prevalence in its area of operation. Informally, Bureau personnel assured us that they intended only to prevent flagrant examples of unfair discrimination against members of one or another of the classes which are "protected" by the law. It was clear, however, that such a requirement could lead to immense amounts of paper work and, at worst, violations of sound underwriting principles.

Another feature of the proposed Michigan regulation was a prohibition against rejection on the basis of age, occupation, or handicap unless the premium rate for the individual would be so high as almost to equal the amount of the insurance, or the variance of expected loss made it impossible to set a meaningful rate, or the insurer's solvency would be threatened. This would have required insurers to issue in substandard ranges above those which they are otherwise willing to issue. This proposed requirement survived into the final version of the Bureau's proposed regulation.

As it happens, Michigan's administrative procedures call for every proposed regulation of a state governmental department to be reviewed by a joint committee of the legislature. In this case the legislative committee was convinced that the Bureau's proposed regulation exceeded the authority given to the Bureau by the law. The proposed regulation was rejected. The Bureau now cannot promulgate the proposed regulation, although it can begin again to develop some other proposed regulation under the same law.

On a less optimistic note, surveys seem to indicate that large numbers of the public do not favor classification on the basis of handicap, including perhaps conditions such as heart disease. We are still trying to sharpen our picture of the public's thinking.

Increasing attention is being paid to the question of differentiating insurance and annuity purchase rates by sex. The NAIC is studying the question in the areas of automobile insurance and health insurance. There are companion bills in the U.S. Congress which would mandate unisex rates in all lines of insurance. A hearing on one of those bills, S. 2477, was held on April 30 of this year.

S. 2477 is backed chiefly by Senators Hatfield and Metzenbaum. It would do away with all sex distinctions in insurance, not only for future issues, but also for premiums received in the future under policies already in force. Only four witnesses testified at the April 30 hearing, one of them being Barbara Lautzenheiser, F.S.A., who spoke on behalf of the American Council of Life Insurance (ACLI) and the Health Insurance Association of America (HIAA). These associations opposed the bill, stating that sex is a legitimate and

significant classification criterion and that to prohibit its use might seriously impair the efficiency of the life and health insurance businesses.

Senator Metzenbaum requested mortality data and premium rates by sex for life insurance and annuities. Evidently, he wishes to see whether women are getting fair treatment in life insurance in the light of the treatment they are getting in annuities. Figures based on a small sample of companies suggest that the women's percentage break on life insurance may be greater than the men's percentage break on individual immediate annuities.

If S. 2477 and the companion House bill (H.R. 100, by Congressman Dingell) never pass, we will be left with the state requirements. All states have for many years prohibited unfair discrimination among individuals of the same class and equal expectation of life (or equal expectation of loss, in the case of health insurance). A few states have included, in their sex discrimination regulations, provisions requiring that where premium rates differ by sex, the differential be fairly based on sex-distinct mortality data. (The wording varies from one state to another.) California has a law, enacted in 1978, that will require, if the valuation and nonforfeiture laws are amended to become based on sex-distinct mortality tables, that the premium rates for individual life insurance and annuities be based on separate mortality experience by sex. All these state requirements appear to be ones with which insurers can live.

The advent of nonsmoker discounts is potentially significant. One wonders what the size of the sex differentials will become if all individuals are classified for life insurance on the basis of both sex and cigarette smoking.

Let me mention briefly some efforts to improve communication with the public. The American Council of Life Insurance (ACLI) contracted last year with Professors Dan M. McGill and J. David Cummins for the writing of a paper on risk classification in life insurance. The target date for completion of the paper is September 1, 1980. We contemplate that the paper can serve as an authoritative reference in our dealings with legislators, regulators, and the public. It may also give our member companies some ideas as to how risk classification might be improved or, at least, made more appealing to the public without significant adverse effect on the soundness of the business.

The Society and the Association of Life Insurance Medical Directors of America (ALIMDA) are planning a public education campaign on risk classification. They are selecting a few target audiences and will then consider how best to approach those audiences. They may enlist the aid of ACLI and the Health Insurance Institute.

Efforts are also being made to update and strengthen the risk classification data base. These efforts include the intercompany impairment study, the project to produce a successor volume to the

first Medical Risks, and the "information repository", which has been moved from ALIMDA to the Medical Section of ACLI.

MRS. JOANN SHER : I shall describe the regulatory and judicial developments in the so-called "unisex" issue, which led TIAA-CREF to announce last December that it would seek insurance department approval of "unisex" rates for the nationwide pension system it administers.

In order to set the stage, we should briefly review the legislative and regulatory underpinnings of this issue. We will be talking about two Federal laws, The Equal Pay Act of 1963, and The Civil Rights Act of 1964, with special emphasis on Title VII which is part of the latter Act. We will talk about The Equal Employment Opportunity Commission (EEOC), the agency administering those Acts, and the regulations or guidelines issued pursuant to those Acts, which are not the same as the Acts themselves.

The unisex issue actually had its roots in The Equal Pay Act of 1963. This Act was aimed specifically and solely at wage differentials between the sexes; that is, its purpose was to be certain that men and women performing the same tasks for the same employer receive the same compensation. Then, one year later, The Civil Rights Act of 1964 was passed. The Civil Rights Act concerned itself not only with equal wages for men and women, but its scope was expanded to require equal treatment among employees of not only different sexes, but different races, national and religious origins and marital status. It also went beyond requiring solely equality of wages - it addressed itself to equality of all other terms, conditions and privileges of employment as well.

Both laws, that is, The Equal Pay Act and The Civil Rights Act, as well as those which followed at the Federal level and those which have proliferated at the State level, concerned themselves with equality, or non-discrimination, in the fringe benefit area.

Governmental agencies, many with overlapping jurisdiction, charged with the responsibility for eliminating discrimination in employment, were now beginning to make demands regarding the design of fringe benefit programs, in the name of Equal Employment Opportunity.

Former HEW Secretary Caspar Weinberger said it this way in his Memorandum to then President Ford, which accompanied the final draft of Title IX's Regulations addressing sex discrimination in employment in higher education:

> "With little legislative history, debate, or, I'm afraid, thought about different problems of application, the Congress enacted a broad prohibition against sex discrimination."

At first these Federal agencies had an "either/or" rule for fringe benefits: If an employer either made equal contributions for similarly situated male and female employees, or if such employees received equal benefits (and in annuities that means equal periodic benefits), the employer's plan would be in compliance. Under this approach, both the defined benefit and defined contribution plans passed muster.

But in 1972, the EEOC issued a set of revised sex discrimination guidelines for enforcement of Title VII of The Civil Rights Act, and in the area of pensions and insurances the revised guideline departed from the "either/or" guideline, stating instead simply that "an employer is required to provide equal benefits." EEOC has been interpreting its guideline to require equal periodic benefits under all options in retirement programs in order to be in compliance.

Title VII of The Civil Rights Act provides that "[i]t shall be an unlawful employment practice for an employer....to fail or refuse to hire or discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions or privileges of employment because of such individual's race, color, religion, sex or national origin...." As shall become apparent, Title VII's emphasis on the individual is the key in this controversy.

Although Title VII itself does not specifically address retirement programs, the EEOC's 1972 guidelines state: "it shall be an unlawful employment practice for an employer to discriminate between men and women with regard to fringe benefits" and the guidelines define fringe benefits to include "medical, hospital, accident, life insurance and retirement benefits; profit-sharing and bonus plans; leave; and other terms and conditions of employment." Consequently, many courts have ruled that retirement plans are subject to Title VII. Finally, with regard to fringe benefits, the 1972 EEOC guidelines state: "it shall not be a defense to a charge of sex discrimination in benefits that the cost of such benefits is greater with respect to one sex than the other".

Guidelines issued by the EEOC, while entitled to "great deference" by courts, do not have the full force and effect of law. The EEOC however, also has the power to bring suit to enforce compliance with the provisions of Title VII, and generally the issue in such suits is whether or not the EEOC guideline is a proper interpretation of the requirement of Title VII. At issue in suits in several Federal courts at the moment, nine of which involve TIAA-CREF is EEOC's narrow definition of equal retirement benefits as only those which are periodically equal. The real issue in these suits is the propriety of the use of sex-distinct mortality tables to determine retirement benefits.

Last July, as part of President Carter's program to streamline the bureaucracy, the EEOC was given the responsibility for enforcement

of The Equal Pay Act, as well as Title VII, and for overall coordination of enforcement of Equal Employment Opportunity law.

Prior to this development, employers had to contend with the often conflicting demands of at least eleven agencies at the Federal level alone, not to mention the additional confusion inflicted by the state agencies.

Resolution of the conflict among Federal agencies on these pension and insurance guidelines had been attempted by President Ford in 1975 when he directed the Equal Employment Opportunity Coordinating Council, which was a creature of Title VII created to resolve just such conflicts, to examine the issue and recommend a uniform approach to be followed by all the Federal agencies.

The Coordinating Council, which consisted of representatives from the Departments of Labor, EEOC, Health, Education & Welfare, Justice and the U.S. Civil Rights Commission, did come up with a recommendation. It recommended that legislation be passed which would require equal periodic pension benefits for male and female employees electing single life annuities, effective January 1, 1980. At that time the EEOC refused to endorse the recommendation because it wanted the rule to be applied to all options, not merely single life options, a position it continues to hold to this day.

Although no legislation surfaced as a result of the Coordinating Council's study, and the agencies are still struggling to reach a uniform Federal approach, the recent spate of proposed legislation, regulation and court decisions all seem aimed in the same direction. The issue in the legislative and regulatory arena initially boiled down to whether or not only plans providing equal periodic benefits would be permissible, and more recently appear targeted at demanding equal contributions and equal benefits, but in the courts we were seeing yet another wrinkle.

Without cataloging the chronology of relevant cases and decisions, I would like to comment on a few of them which are of particular significance.

Pre-Manhart, I should mention a class action suit brought in the Indiana State Courts against the Indiana State Teachers' Retirement Fund Board. It is significant because it was the first court to rule on the use of separate mortality tables for males and females in this context. The lower court held: "Defendants' adoption and application of the 1971 Group Annuity Mortality tables with a 5 year setback for females, and the establishment of procedures for providing greater monthly annuity payments to males than females "based solely on sex" constitutes unlawful discrimination, under both the Indiana and Federal Constitutions" - notice that this was not a Title VII employment discrimination suit, but one brought under Equal Protection concepts.

At about the same time a similar case was brought against the Oregon Public Employees Retirement Board, but this suit was brought under Title VII. The District Court held that "Plaintiffs are entitled to a declaration that Title VII of the Civil Rights Act prohibits the use of sex-segregated life expectancy tables in calculating refund annuity benefits to State employees." But that court refused to order that "unisex" tables be used unless and until the decision was affirmed on appeal.

The appeal process was never completed. Instead, the Supreme Court rendered its decision in the Manhart case shortly afterward, and the Manhart decision became the basis of a settlement of the Oregon suit. Under the terms of that settlement, the Oregon Public Employees Retirement System can no longer use sex-segregated mortality tables in calculating the refund annuity for employees retiring effective July 1, 1978.

And now, let's turn to the Manhart case. The Manhart case, (full title: Manhart vs. The City of Los Angeles Department of Water and Power) involved an employer-operated group plan, which required female employees to make greater contributions than their male counter-parts in order to receive the same periodic benefits, because of their longer life expectancy. The Supreme Court held that requiring greater contributions from female employees violated Title VII.

Initially there was a split in the reactions of commentators. Some saw it as a very narrow decision because of the Supreme Court's statement that "all that is at issue today is a requirement that men and women make unequal contributions to an employer-operated pension fund." While holding such unequal contributions violative of Title VII, the court also said "Although we conclude that the Department's practice violated Title VII, we do not suggest that the statute was intended to revolutionize the insurance and pension industry." This was, in the eyes of many, a pretty clear indication that the Supreme Court didn't intend to extend Manhart to the activities of independent insurers.

Some commentators suggested that the court was saying that when an employee is dealing directly with an insurer, as for example the employee who gets the single sum distribution to be applied to the purchase of a single premium annuity from a commercial insurer, there is no Title VII problem. However, in striking down the Los Angeles Department of Water and Power method of operating its own plan, some believed that the court, in part of its option, fully adopted the EEOC position on the use of separate mortality tables. The EEOC has said, "All that sex segregated actuarial tables purport to predict is risk spread over a large number of people. The tables do not predict the length of any particular individual's life. In our view any use of sex segregated actuarial tables that result in the payment of different periodic benefits to males and females is highly suspect. Because actuarial tables do not predict the length of any individual's life, any claim that such tables may be used to assure equal

pension payments over a lifetime between males and females must fail." Although the Supreme Court acknowledged in Manhart that "this case does not, however, involve a fictional difference between men and women. It involves the generalization that the parties accept as unquestionably, true; women as a class do live longer than men", it also said "the statute's focus on the individual in unambiguous. Even a true generalization about the class is insufficient reason for disqualifying an individual to whom the generalization does not apply."

The first Federal court to have had the opportunity to apply the Manhart decision in a situation involving a private employer and insurer was First Circuit Court of Appeals in the case of EEOC vs. Colby College and TIAA-CREF. The facts in that case are significant: Colby College, a private employer, makes equal contributions on behalf of its similarly situated employees to TIAA-CREF, an independent third-party insurer. Colby and the insurer have no written contract between them; rather the insurer issues individual contracts directly to each Colby employee. The suit charged the employer, Colby College, with a violation of Title VII, but the insurer was also named as a defendant because it is a party having an interest in the outcome of the litigation. As I mentioned earlier, this is but one of nine such lawsuits which have been brought against TIAA-CREF and participating institutions.

The District Court, that is, the lower court, dismissed the EEOC's suit, and EEOC immediately appealed. While the appeal was pending, the Manhart decision came down from the Supreme Court, and the Appellate Court in Colby reversed the lower court's dismissal, and sent the suit back down to the lower court for a full trial on the merits. In doing so, the Appellate Court refused to ruled that, because of Manhart, the Colby-TIAA/CREF plan was to be held illegal. But it is important to note that the Appellate Court repeated the Supreme Court statement that the focus of Title VII is on the individual. The Appellate Court in Colby further noted: "This is not to say, in anticipation of returning this case to the District Court, that we do foresee difficulties, possibly very great difficulties, that did not arise in Manhart in light of the Court's opinion that the statute was not intended to revolutionize the industry". The First Circuit said that the thrust of the Manhart opinion envisaged the use of a unisex rate, but it also referred to the Manhart court statement that it did "not suggest the Title VII of The Civil Rights Act was intended to revolutionize the insurance and pension industries". The court concluded that it could not resolve at this stage "whether, or how, unisex insurer operated plans can be achieved without revolutionizing the insurance industry". A full trial was completed in the lower court, but there has been no decision yet.

There have also been two other post-Manhart Federal District Court decisions in the TIAA-CREF cases. Both decisions also rely heavily on the Supreme Court's analysis in Manhart that "the statutes' focus on the individual is unambiguous.... Even a true generalization

about the class is an insufficient reason for disqualifying an individual to whom the generalization does not apply."

Result? The courts in Spirt vs. Long Island University and TIAA-CREF and Peters vs. Wayne State University and TIAA-CREF have found that unequal periodic benefits resulting from the use of separate mortality tables violates Title VII. And both courts have enjoined the defendant university and TIAA-CREF (or just CREF) from using sex-distinct mortality tables to compute periodic benefits. Interestingly, one court held that TIAA, as an insurer, has the protection of the McCarran-Ferguson Act, and is therefore, not subject to Title VII. The other court said TIAA is not an insurer, is not protected by McCarran and violates Title VII.

And so, although neither TIAA-CREF nor any defendant university has conceded liability under Title VII, judicial opinion to date has clearly been unsympathetic to the use of sex-distinct tables.

I should also mention one more case to you: Norris vs. The Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans.

In the Norris situation, males and females who choose to participate make equal contributions to a retirement account. There is no employer contribution. The Arizona Governing Committee made the selection of certain companies as funding medias, which include life insurance companies with annuity contracts. Upon retirement, women receive lower monthly payments than men because the annuity tables show that females as a class live longer than males as a class. All companies participating in the State Deferred Compensation Plan use sex-distinct mortality tables.

The Norris court first had to determine whether a Deferred Compensation Plan, as distinguished from a retirement plan with mandatory participation, is a benefit and privilege of employment which must be the same for men and women under Title VII. They held the answer to be affirmative.

The Norris court then went on to say: "the question before this Court, therefore, is the same question that was before the Court in Manhart. Is the existence or non-existence of "discrimination" to be determined by comparison of class characteristics or individual characteristics." And noting that the Supreme Court in Manhart said an employer could not avoid his responsibilities by delegating discriminatory programs to corporate shells, the Norris court held that the administration of the Deferred Compensation Plan of the state of Arizona violates Title VII, and permanently enjoined defendants from carrying out their obligations through the use of sex-distinct actuarial tables. And, in addition, the court ordered that annuity payments to females already retired be made equal to similarly situated male employees. This decision is being appealed.

And so it was, with courts and regulators pointed in the same direction, with TIAA-CREF simultaneously defendant in nine lawsuits and the EEOC poised to bring more, with participating institutions threatening to drop out of the TIAA-CREF system over it, and with senior management (and indeed staff at every level) embroiled in this issue to an ever-increasing degree, that on December 18, 1979, TIAA-CREF announced that it would seek approval of a merged gender mortality table to determine benefits earned by future premiums.

Although you would probably like to have a fairly detailed description of the construction of the merged gender, or MGM table, I can tell you only that it is based on TIAA-CREF's own annuitant population and is based on a roughly 50-50 male/female split. Beyond that, I refer you to Tom Walsh, our chief actuary and his colleagues, many of whom are attending this meeting.

Tom Edwards, chairman of TIAA-CREF explained:

> "This decision results from the weight of opinion from recent judicial, legislative and regulatory developments, and from concerns of all participating institutions. What's happening is that today's social pressures are taking precedence over using the known differences in male and female life expectancies for determining retirement benefits."

And so, today the insurance industry's most basic tool of risk selection and classification is being perverted to eliminate a "discrimination" based on sex perceived to be contrary to current Equal Employment Opportunity legislation.

And looking toward tomorrow? There is already a Federal statute entitled the Age Discrimination in Employment Act. I urge you to familiarize yourselves with it, for I suggest that it will provide the basis for the next social onslaught against risk selection and classification. How about "uni-age mortality tables?" Think that phrase has a nice ring to it?

MR. RICHARD DASKAIS: Mrs. Sher stated the use of sex-distinct mortality tables quite accurately. In each instance, note that the Equal Employment Opportunity Commission (EEOC) is concerned about the use of sex-distinct mortality tables for the purpose of determining benefits. The EEOC is not at all concerned with what insurance companies charge an employer as long as the resulting benefits are equal. That is a very important distinction for most single-employer and multi-employer pension plans involving medium sized and large-sized employers, and even for small employers in the case of defined-benefit plans.

MR. COURTLAND C. SMITH: The life insurance industry has repeatedly learned to do what was previously thought to be unfeasible or unnecessary.

In 1950, the industry differentiated between men and women in annuity premium rates, but not in life insurance rates. It was said that women had smaller policies with higher unit costs which offset any mortality advantage. In 1980 we take policy size into account and find we can differentiate in insurance rates as well as annuities.

In 1960, the industry gave no discount to non-smokers. There was evidence of favorable mortality, but it was felt that an applicant's non-smoker declaration could not be verified. Now with the State Mutual's favorable experience and competitive pressure, many companies have developed non-smoker or combined preferred/non-smoker discounts.

In 1970, companies did no underwriting of life annuities except for the readily observable variables, i.e., age and sex. Now, a few companies devise, underwrite, and price structured settlements for severely injured persons in connection with casualty claims. However, the industry still does not give a reduction in single premium rate for retired persons who are certifiably chronically ill. If interest rates continue going down, even moderate differentials in mortality (300-500%) may produce significant differentials in annuity purchase rates.

In the early 1940's some California storekeepers publicly "reserved the right not to deal with anyone." This would be unacceptable today.

In 1970, nearly all life companies reserved the right not to issue individual life insurance to declinable risks. In other words, they "reserved the right not to deal with anyone," just like those storekeepers back in the 1940's. Now, some companies have simplified issue and guaranteed issue programs, and a few companies issue regular individual policies to lives even at age 80, for legitimate estate tax purposes. However we still make no provision for routinely issuing individual life insurance to everyone.

As far as mildly substandard annuities or highly substandard insurance risks are concerned, I suppose we shall again have to wait for some company or other to show us how to do it profitably, or else for the legislators and regulators to force us into it.