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ECONOMIC EFFECTS OF UNISEX INSURANCE

Speaker: JOHN V. WELLS, Commentators: DONALD S. GRUBBS, JR., MAVIS A. WALTERS***

MR. JOHN V. WELLS: The report which is the subject of my talk is available for free from the General Accounting Office. You can call area code (202) 275-6241 and they will send you up to five free copies.

I'm not going to summarize the report in detail today as I think its probably more sensible for you to get a copy yourself if you are interested and take a look at it. What I did want to do today is to give you a sense of the thinking that went into the report, the logic behind our recommendation, what issues we focused on primarily, and to give you a background to the conclusions we arrived at.

I think economists and actuaries share a sort of kindred professional ethos. We are all technical experts called upon on a regular basis to give technical advice on public policy issues. We are not called upon to make those policy decisions ourselves for the most part. The tradeoffs that are involved in those public policy issues are usually left to the politicians and it is a difficult role to play because we all feel strongly about those policy issues for the most part and yet we are asked to suppress our strong feelings about policy issues when we are playing our professional roles of giving technical advice. I understand from Mavis that we even tell the same kind of jokes about ourselves, the ones about economists and actuaries being people who like to play around with numbers but don't have enough personality to become accountants.

The unisex bill, I think particularly tests that professional ethos because it is one on which many of us feel quite strongly, either on one side or the other, and GAO particularly, in its role of technical advisor to the Congress, was forced into a difficult position here, because we wanted to give a technical analysis of what the impact of the bill would be. We were being lobbied fairly heavily by both sides in the issue and we were trying to balance our report and avoid taking sides on what we viewed as essentially the political issues that were raised and we tried to restrict ourselves to the technical issues to the extent we could.

* Mr. Wells, not a member of the Society, is an economist in the U.S. General Accounting Office.

** Ms. Walters, not a member of the Society, is Senior Vice-President of the Insurance Services Office in Washington, D.C.

The difficulty of rendering a technical opinion on the bill was particularly difficult because the major impact of the bill was to create large scale transfers among insurance policyholders; between pension plans and employees; between insurance companies and policyholders. If the bill were enacted there would be a large amount of money sloshing back and forth through the economy. In life insurance, men's rates would go down and women's rates would go up and health and disability insurance would be the other way around and in pension plans you would have mixed effects depending on what kind of pension plan you had. Economists generally don't like to dwell too much on transfer payments of this sort, because as professionals we don't have a whole lot to say about them. That is, we can talk about how large the transfers will be, we can talk about who gains and who loses but beyond that we don't have much from the point-of-view of technical experts that we are prepared to say. In particular, we are not prepared to say whether the gainers or the losers are more deserving. Whether the situation after the transfer takes place is better in some sort of public policy sense than the situation that existed before the transfer took place. We have no technical expertise, no professional expertise on the issue of who deserves to be a gainer and who deserves to be a loser. The issue was particularly difficult in this case because even estimating the size of the transfers was difficult and involved a lot of imponderables and even estimating the incidence of the transfers, identifying who would gain or who would lose, was a difficult issue. But it was these transfers that attracted most of the attention in the unisex debate. Would the transfer in auto insurance, for example, between women and men be $700 million as the Academy of Actuaries estimated, or would the transfer in fact be $800 million from men to women as Bob Hunter of the National Insurance Consumer Organization estimated? Would the annual cost to pension plans be $5½ billion as the Academy originally estimated or would it be $2 billion as the American Council of Life Insurance estimated or would it be something like $1 billion as our report eventually estimated? Would the unfunded liabilities for life insurance companies be $4½ billion as the ACLI estimated or would they be $2 billion as the National Organization of Women recently estimated?

We wrestled with this issue of the size of the transfer with some diffidence because we found it very difficult to resolve a lot of the difficult issues that were involved. One of the difficult issues is that the size of the transfers depends heavily on the reactions of pension plans and life insurance companies and casualty insurance companies to the passage of the bill. One of the issues that has been talked around a great deal in connection with the bill was the extent to which insurance companies would substitute other risk factors for sex and the extent to which this was possible or practicable. The advocates of the bill generally argued that mileage could be substituted for sex in auto insurance; that smoking could be substituted for sex in life insurance and that this would dramatically reduce the size of the transfers. They pointed to the case of some companies that have actually done this and argued that their experience was successful. Others argued that these other risk factors were already used in the insurance business and were used to the maximum practicable extent and therefore no further substitution would take place if sex were no longer available as a risk factor.

We were unable to resolve this issue. We noted the argument on both sides of the issue. In the report we list what we view as the principal arguments pro and con but it's essentially an issue that we cannot resolve. We suspect that some companies may be relatively adventurous and may try out some of these alternative risk factors, as some companies already have. Other companies will be more impressed with the administrative difficulties and verifiability difficulties in using these risk factors and will choose not to use them.

We make no estimates of the extent to which other risk factors will be used and therefore it is impossible to estimate what the size of the transfers that would take place would be.

The other difficulty is estimating the incidence of the transfers, actually identifying who gains and who loses. There are a number of ways in which the costs of the bill can be passed along to other parties. Insurance companies can change their dividend structures, they can change the way expenses are loaded. There are a variety of ways in which the costs of the bill can be passed around among policyholders from insurance companies to policyholders so that makes it difficult to make any statement, even if we were inclined to make any statement about the equity of the transfers. It is very difficult to make any statement about the equity of the transfers, when you don't even know exactly who the gainers will be and who the losers will be. You don't know how much they will gain or how much they will lose.

One particular problem that we had in the case of the pension liabilities was that the data on which our analysis was based were Department of Labor data. The Department of Labor study was based on a survey that was conducted in 1977 of pension plans which estimated the number of pension plans that used sex distinct actuarial tables as of that date; tables to convert normal benefits into optional benefits.

We understand that a substantial number of pension plans have switched to unisex tables since 1977 and that, in particular, a number of plans have switched to unisex tables since the Norris decision of last summer, and that they have switched not only with respect to their future accruals, as required by the Norris decision, but also with respect to their past accruals of active employees. To the extent that pension plans have already gone to unisex tables and in most cases this was apparently done without any increase in liability because the Department of the Treasury in enforcing the anti-cutback rule under ERISA, generally allowed pension plans to switch to intermediate unisex tables rather than topped-up unisex tables, without treating those changes as violating the anti-cutback rule, even though the optional benefits of female employees in defined benefit plans would be reduced by switching to a unisex table like that. Since we don't know how many plans have switched to unisex tables since 1977 we can't calculate how much our estimates should be reduced but to the extent that plans have switched to the unisex tables since 1977 the estimates of additional unfunded liabilities in pension plans would be overstated.

So, in general, the major effect of the bill, as we see it, is to cause substantial transfers among insurance policyholders, between employees and pension plans, between insurance companies and policyholders, but we've had difficulty saying anything definitive about either the size of those transfers or the identity of the gainers and losers.

In general, what we, as economists, have tried to focus on, has been more the net gains and losses. In a transfer of course, if it's a simple zero sum transfer, the amount the gainers gain, exactly equals the amount that the losers lose. What we try to focus on is the non-zero sum aspects of the transfer; the extent to which there are net costs associated with the transfer.

The first aspect of these net costs that we looked at was the economic efficiency effects or what we as economists tend to call economic efficiency effects. What people in the insurance business are more likely to call adverse selection effects. I don't want to go into a disquisition on the notion of economic efficiency because it generally requires a semester of the Introductory Economics course for us to really explore the issue in detail, but basically, the idea of economic efficiency is that the economy operates most efficiently when prices are closely related to the costs of producing a product or in this case a surplus. To the extent that prices diverge from the cost of producing a product, people tend to buy the wrong amount. They will buy too much of products that are underpriced and too little of products that are overpriced and it is possible to demonstrate mathematically that if the prices were equal to the cost of production rather than diverging from the cost of production that there would be more consumer satisfaction.

It turns out, however, that it is very difficult to estimate what the size of these economic efficiency losses are in the case of insurance. One problem is that it is not clear how closely prices correspond to costs today. There have been, of course, allegations that some policyholders are overpriced and some are underpriced in the current insurance market. Some lines of insurance are more competitive than others and there are arguments that some lines of insurance are used to subsidize other lines of insurance and so on. Even if you knew that the current insurance market was perfectly efficient you would then have to estimate how much prices would change as a result of the passage of the bill and as I just suggested in discussing the transfers there is a lot of argument about how much prices will change in response to the bill.

Next, if you knew how much prices were going to change you would then have to know how much people would respond to the change in prices. How elastic is the demand for insurance? If you have a 1% increase in the price of insurance how much will people reduce their purchases of insurance and there have been lots of allegations about how much people will change their purchases of insurance but no solid data. One of the characteristics of working at a place like GAO is that the documentation standards are very high. We can't really make conclusions unless the conclusions are documented in a fairly solid way. While we suspected that there would be economic efficiency losses, it was difficult to document how large those economic efficiency losses would be.

Finally, assuming you know how much the people's purchases of insurance would change in response to price changes, you then have to calculate how much of a loss this actually represents and this depends on how much people value the marginal insurance purchase that they no longer make because, for example, the price has gone up to them and there are some standard economic tricks that you can use to put some valuations on those but they are pretty rough and ready. So we did wrestle with this problem; we tried to make some reasonable assumptions about the size of these various parameters, all of which were in a general sense unknown, and based on making a fairly wide range of assumptions about the value of these parameters, we made some estimates of the range of sizes of the economic efficiency effects and in general they were relatively small and I emphasize the word relatively because we are still talking here about millions of dollars, but they were small relative, for example, to the administrative costs of the bill. So that, in general, we did not place heavy stress in the report on the economic efficiency effects because we were not able to document that those effects would be among the more significant impacts of the bill. There were also some plausible arguments that there might be positive efficiency effects of the bill due to creating incentives for people to reduce their exposure to risk and in general we estimated that those effects would also be small but they would somewhat offset the efficiency losses.

The second general category of net losses with the bill would be the possible insolvencies among life insurance companies. We heard a lot of pooh-poohing of the possibility of insolvencies from the advocates of the bill but we gradually became convinced that insolvencies were a real problem that even if the insurance companies modified to some extent the way in which they responded to the bill in order to reduce their increased liabilities, we estimated that a number of insurance companies would probably become insolvent, if the bill were enacted as it was originally introduced. Of course, there have been modified versions of the bill circulated in draft form since then but we focused in our report on the bill as it was originally introduced.

We viewed these insolvencies as the most serious impact of the bill. Some of the economists on our staff were inclined to view the insolvencies less seriously. Economists sometimes tend to assume that resources can be shifted costlessly from one sector of the economy to another, so some of the economists on our staff were making the argument that, if one insurance company goes bankrupt then another insurance company will expand or start up and take its place. Resources will shift costlessly from one insurance company to another and there will be the same amount of insurance sold and nobody will be the wiser. We did not take that approach in the report. We were not inclined to view the shift of resources as being a costless one. We viewed the possibility of insolvency as being a serious adverse effect of the bill.

Estimating the actual impact of the insolvencies was difficult because it depends upon the actions taken by state insurance commissioners, which we were unable to estimate. The state insurance commissioners might treat the legal insolvency of a company under their jurisdiction as being due to extraordinary events and not reflecting upon the management of the company and they might allow the company to continue in business perhaps under some restrictions as to selling new policies or insurance commissioners might require firms to liquidate. We really have no way of knowing how state insurance commissioners would respond to widespread insolvencies among their companies. In general we viewed the possibility of insolvency as being a serious problem with the bill.

Finally, the third category of net cost is the administrative cost. We did not have much to add to what the Academy of Actuaries said about administrative costs. The Academy had estimated the administrative cost of the bill as $1.3 billion. We only noted that this estimate did not include the cost to the state insurance commissioners of approving new policies or dealing with insolvencies. The administrative costs estimate also did not include any factor for the possible increased cost of administering new or perhaps more complex risk classification systems. If companies in fact do substitute new risk factors for sex, these risk factors would probably be more difficult to verify, more difficult to administer and this would tend to increase administrative costs for the company. The Academy estimates do not include any factor for these increased costs.

We made two recommendations in the report. First of all, we recommend that the transition period provided in the bill between the date of enactment and the effective date of the bill be extended from the 90 days originally provided for to at least one year. The Academy concluded that the 90 day transition was infeasible and we thought this was pretty obviously the case. We didn't really know what the minimum feasible transition period would be but we suspected it would be at least one year.

The other recommendation was that the bill be amended to exempt existing individual insurance contracts from the provisions of the bill. The logic of the recommendations was something like this, We know that the transfers caused by the bill would be substantial. As I said before, it was difficult to estimate exactly how large they would be. It was difficult to estimate exactly who the gainers would be. Who is more deserving, the gainers or the losers? What is a better situation from an equity point-of-view? The current situation or the situation after the transfers took place? As technical experts we were not prepared to make any judgement and we left that issue to the Congress to resolve. So we did not base any of our recommendations on the size or direction of the transfers. Our recommendations were based on what we viewed as the net cost of the bill, the non-zero sum aspects of the transfers.

We viewed the efficiency effect as being relatively small compared to the other costs and within a reasonable range somewhat uncertain in size, so we did not base any of our recommendations directly on the effficiency effects of the bill. We saw the most serious effects of the bill as the possibility of insolvencies and also the administrative costs could be relatively substantial. It turned out that it was possible to kill two birds with one stone because by eliminating the applicability of the bill to existing insurance contracts you not only virtually eliminate the risk of insolvencies but you also eliminate most of the administrative costs. It turned out that of the $1.3 billion in administrative costs $800 million was for modifying existing life insurance contracts and $80 million was for modifying existing health and disability insurance contracts. So by eliminating the applicability of the bill to exisiting individual insurance contracts you could save $880 million out of the $1.3 billion in estimated administrative costs. So we viewed that single modification as being perhaps the single most valuable way of reducing the adverse impact of the bill. Of course we took no position on the enactment of the bill and certainly urged the Congress to make whatever judgement it thought appropriate as to the desirability or undesirability of the transfer effects that would take place.

The current status of the bill is that about two weeks ago the House Energy and Commerce Committee had a mark-up session on the bill and voted to report out a drastically curtailed version, that essentially codifies the Norris decision, involved no retroactive liabilities for pension plans at all; and completely eliminates the applicability of the bill to all individual insurance contracts. As a result, the version that was reported out of the House Energy and Commerce Committee would essentially have no economic costs beyond those required by the Norris decision.

We're not sure what the future of the bill will be in this Congress. The women's groups generally seem to take the position that the bill is dead for this Congress and they are talking about coming back next year. Congressman Florio, who is the chairman of the House Sub-Committee with jurisdiction over the bill and who is one of the major sponsors of the bill, is talking about resurrecting the bill on the House floor or perhaps in the House Education and Labor Committee which has requested sequential referral on the bill.

We don't know what action will take place in the Senate. The Senate has been holding off on taking further action until our report came out. Whatever happens in this Congress, however, I think it's clear that the bill will be back next year as a major priority of the women's groups. Although the pension liabilities will probably gradually decline as the number of retired employees receiving sex distinct benefits gradually declines and as plans comply with the Norris decision, certainly the same issues will arise in the individual insurance line. I suspect that we will not have very much to add if we are asked next year to comment on the bill to what we have already said this year. One of the conclusions that we came to in the report was that probably further study of the technical aspects of the bill would not tell us much more about the impact of the bill than what we already know. Most of the imponderables about the impact of the bill are due to the uncertain reaction of insurance companies and insurance regulators to the enactment of the bill and we don't have any better idea of what that reaction will be next year than we do now.

One of the features of the House Bill that was reported out of the Energy and Commerce Committee was that it established a study commission to study the appropriateness of prohibiting sex distinctions in the individual insurance line. One of the members that study commission is the counsel general, my boss, and we're not very enthusiastic about this provision since we suspect that this will be one of those Washington study commissions that labors mightily and produces a report that doesn't add anything to the existing level of knowledge. So perhaps we will be back here next year talking about the same issues but I hope not.

MS. MAVIS A. WALTERS: First I would like to start by commending the GAO on their final study. I can attest to the fact that Jack had a tremendously difficult job to do.

One thing, I believe has been proven by this report is the wisdom of the action taken by the House Energy and Commerce Committee about 10 days ago. By that action they have eliminated retroactivity, essentially codified Norris and did eliminate from the bill consideration of individually purchased insurance contracts. I believe that the legislation as amended and as passed out of the House Energy and Commerce Committee would cover some groups and some group contracts which are not covered by Norris. That is the small groups with 15 or fewer employees.

Jack mentioned also that they spent a great deal of time deliberating about transfer costs or, as they are referred to in the report itself, redistributive effects and GAO had difficulty coming up with a bottom line recommendation as to which way it goes.

Well those distinctions and those cost shifts are extremely important and in fact I think they go to the heart of the bill (HR100 in the House or S372 in the Senate). These bills are being promoted as women's rights legislation. Well, I believe very strongly, upon the basis of all the analysis including what's in the GAO report, that the facts are conclusive that this legislation as initially drafted would result in women paying more for automobile insurance and women paying more for life insurance. Now in the disability and health insurance areas there are different effects and the effects depend on what your situation is. Most of us here recognize that the vast majority of Americans get their disability and health coverage through their place of employment and, in those instances, men and women, if they contribute anything, contribute the same. It is in individually purchased contracts of life insurance and auto insurance where women would be hurt economically and if this legislation is supposed to be women's rights legislation I find it strange indeed that, in order to promote equality of rights, women would be called upon to pay more.

I admit there is some confusion perhaps in the minds of those who have not studied this issue at great length. Jack said, in evaluating the American Academy of Actuaries work versus that which was done by the National Insurance Consumers Organization, they institutionally had no way really to determine which one of those studies should be given greater weight. I would submit to this group and to any group of professional actuaries that further study on that one single point would be absolutely conclusive to the overwhelming majority of actuaries. The American Academy of Actuaries study found that women would pay $700 million more per year for auto insurance and $360 million more per year for life insurance. Let me speak about auto insurance since I am more familiar with that. Indeed that $700 million figure is 3 or 4 years old and was based on premium volume in 1980. Today a most reasonable and, in fact, conservative estimate would be that women today would pay between $825 and $850 million dollars per year more for automobile insurance. The GAO report suggests that figure may be too large because the Academy study did not take into consideration the possibility that there might be alternative rating variables which might replace substantially the predictive power lost by eliminating sex as a rating variable for auto insurance. I think that's not correct. I served on the committee that made that estimate. We did recognize that there were lots of suggestions for alternate rating variables and on the basis of our work and our familiarity with the literature, we did not believe that any suggested alternative rating variables would significantly affect our estimate.

In fact, when you compare the study or the work submitted by Mr. Hunter, his estimate of substanital savings to women was full of outrageous technical errors and serious methodological flaws and his basic assumptions were totally invalid. I believe scrutiny by the profession would show this to be true. Two quick examples. In estimating the amount of premium volume that would be affected by this type of change he used assumptions which we know from real data, overstated at least by double, the affected group of people. He used an estimate of 19%-our best guess is no more than about 7 or 8%. That is not a best guess- that's our estimate based on real numbers. His was an assumption based on U.S. population figures; not even driving population; not even those with driver's licenses; just general population.

Also critical to his assumption is the fact that single women over the age of 25 have the same driving pattern and habits as women of all ages, married and single; youthful and older women. I would submit that it's far more likely, that single women over the age of 25 have a much more similar driving pattern to that of men of all ages, and if that's true, there is no savings to women. They vanish based on his methodology so that just gives you a rough idea what the differences are there.

I do not believe those two studies are of equal technical substantiation or validity. The only shortcoming in the Academy figures which have been on public display and subject to scrutiny for several years now is a subjective one and that is maybe there are other rating variables which if substituted would do a better job. The Academy didn't consider it so it's a very subjective judgemental criticism whereas we have numerous page after page of technical flaws and serious methodological errors with the Hunter study.

On the economic efficiency costs and as we would know it the theory of adverse selection. The discussion is indeed interesting and informative. I continue to have just one problem with it and that is it focuses on a standard economic view as to what is likely to be the behavior of the buyers who seek to purchase insurance. The report says that those who would be undercharged in the future are likely to go out and buy more coverage. In the area of auto insurance it suggests that young males who would be underpriced, would buy lower deductibles rather than high deductibles. If they don't have to pay a cost-based price young males will buy lower deductibles and maybe that's socially not worthwhile.

I would like to have seen a discussion of this aspect from the perspective of sellers. It is my very strong belief that economic laws are far more powerful than laws that might be passed by Congress and I believe it is extremely difficult if not impossible in a competitive environment with many sellers competing for business to compel a firm to provide a product below cost. This is what I see would happen with the unisex insurance rates for auto insurance. You cannot legislate against knowledge. Insurers and their underwriters know young males are far more costly to insure than young females and if you cannot charge them a price commensurate with that cost, there are not going to be a lot of sellers out there seeking to provide insurance voluntarily to young male drivers. So it's not a question of young males going out and buying as much coverage as possible and low deductibles. They are going to have trouble getting any coverage at all.

In the discussion of efficiency costs gains and losses there was reference to a study done by Stanford Research Institute (SRI). SRI did identify problems which I don't believe are fully mentioned in the final GAO report. In fact SRI was quoted as stating that flattened rates, rates which depart from costs, whether they come about through legislative mandate or regulatory fiat or whatever, result in real economic costs; supply shortages and cost subsidizations and they were very strong in suggesting there should be a great deal of study about this before any decision comes about. In their study SRI discussed four standards of fairness only one of which is actuarial fairness. In the SRI report those four standards are mentioned. However, the report doesn't make clear that SRI suggested and stated very strongly that the presumptive standard of fairness in a competitive free market economy is actuarial fairness. There was some suggestion about whether or not individuals would really change their buying habits if there were resulting price changes as a result of unisex insurance. Jack's example was - would a 1% price differential make any difference? Intuitively most of us might say it doesn't sound like very much. There is one thing I discovered in working on this issue for the last couple of years and that is that consumers don't speak in percentages and they don't understand them. Consumers understand dollars. In auto insurance we're not talking about percentages of just 1 or 2%. We're talking about percentage increases for young women in the neighborhood of up to 50 and 60% and in dollars these are differences of up to $200 and $300 per year for auto insurance for young drivers. I believe those differences will cause consumers to stand up and take notice.

MR. DONALD S. GRUBB, JR.: Let me accent what Mavis said about the difficulty of the task that was facing GAO. The problem of trying to estimate the magnitudes of cost and liability changes without adequate data posed serious problems. I felt that GAO made a serious attempt to be fair and objective and was not trying to load the thing one way or another. While I disagree with some of the specific answers that they reached, I would like to commend them on their objectivity.

There are really three viewpoints towards the whole issue of unisex insurance legislation. Those who are for it with retroactivity are represented by the women's groups. Those who are opposed to it entirely and those of us who are in favor of the legislation but without any retroactive provisions of which I'm one. If you would like to get a flavor of the reaction to the study from the other side not represented here you might want to write the National Organization of Women who have prepared comments on the draft report; comments that I don't share but you might find it interesting to get another viewpoint.

One of the difficulties in analyzing the cost of the bill and one that GAO simply did not face is the ambiguity of the legislation itself. Nobody really knows what's covered. In particular it's not at all clear in the legislation whether uninsured benefit programs, pension plans and welfare plans are covered by this bill at all. You would think that something as fundmental as that, ought to be clearer. The thing is that it covers insurance and insurance is defined as an arrangement provided by an insurer and an insurer is defined as someone who provides insurance. I'm sure that if enacted that item itself would lead to a circle of ligitation that would last for years. The GAO report assumes that non-insured pension plans and other non-insured programs are covered. I think that ought to be clearly stated and it ought also to be stated that there is some ambiguity in the law. The proponents of the bill did indeed want to cover non-insured pension plans but some earlier statements indicated that they didn't. That was partly because they wanted to avoid anything that might look like they were covering something other than insurance because that would give the Labor Committee the right to insert jurisdiction and so on the one hand they were denying they were covering uninsured plans and on the other hand trying to cover them.

A second kind of ambiguity deals with the fact that this covers contracts. Now even if non-insured pension plans are covered the question is - are they contracts? Collectively bargained plans usually are contracts or at least established under contracts but most other plans do not involve contracts in the usual legal sense of the word. Again the GAO report has assumed that all of these are contracts defined by the statute. I think that assumption ought to be stated in the report.

Jack mentioned the change that has come about as a result of Norris on the pension side and although that change is mentioned in the report as a qualifying feature they did not make any effort to adjust the liabilities and in summary they say we believe that the bill would be likely to increase unfunded liabilities from $7.7 to $15.1 billion in pension plans. They go on to state that because of Norris it might be less. I think that's simply ignoring the facts. We know that, since Norris, all plans have or are in the process of making changes to comply with Norris; at least all plans affected by Norris which is plans with 15 or more employees, and every defined benefit plan with which I am familiar is making this apply retroactively with respect to all active employees. I'm sure there are exceptions to this somewhere but certainly the overwhelming majority of pension plans are applying the unisex rates actuarial equivalent factors in most cases to benefits accrued before Norris. So by and large in defined benefit plans the only effect of this legislation would be in it's application to people who retired before Norris. This would be a small fraction of the numbers we have quoted there.

The issue of the costs on the insurance side and there would be substantial increases in the liabilities for insurance companies, that's part of why I opposed retroactivity, but the magnitude of the increases in costs appear to have been so exaggerated by the insurance industry as to cause them to lose credibility. There are essentially two ways in which insurance companies might respond to the bill if there is inequity. Let's take life insurance as an example. Suppose a man is paying a premium 10% higher than a woman and you say that now you have to adjust for unisex. One thing that you can do is to adjust the benefits saying, since the man is paying 10% more, we ought to increase all the benefits by 10%. The other thing that we can do is adjust his premiums downward to make the premiums equal to what the female is paying. In it's instructions asking it's members to determine what the increase in unfunded liabilities would be the ACLI chose the more costly route. The determination that there were 24 companies that might become insolvent was based upon that instruction. GAO, in its report, has recognized this. It has stated that, in the one particular case it looked at the alternative approach would have resulted in only about half as much increase in unfunded liabilities and yet we have an estimate of the number of insolvencies that assumes that the company faced with insolvency would chose a route which would double roughly the increase in its unfunded liabilities. That seems hardly likely to me. The number of insolvencies assumes that the insurance companies would do nothing to try and offset this. For example, I have seen a memo in one particular insurance company indicating that their liabilities would go up by $1.4 billion and since they only had $1.3 billion of surplus they say we are insolvent.

Insolvency is determined in one of two ways. Under most state insurance laws either by the inability to make payments when due and the other is annual statement insolvency where your assets exceed the sum of your liabilities and the minimum required capitalization. It's the second kind of insolvency we are talking about which is determined only by the annual statement and ordinarily determined only on December 31. This particular company which I was mentioning seemed to assume they would do nothing in the face of all this. That they would again set up $700 million for payment of dividends during the coming year and put that as a liability into the annual statement. Would a major insurance company, faced with actual insolvency, again continue to set up $700 million as a liability item for dividends during the coming year? That doesn't seem likely to me. I'm not saying that it's not possible that there are some companies out there which could become insolvent but merely that the insolvency side of the thing has been substantially overstated. The problems for the company I mentioned would be severe even though it would not be insolvent and that's why I oppose retroactivity.

I agree that the transition period be extended. One of the serious problems we have had with legislation of a variety of kinds is legislation with a short time fuse that didn't give us time to respond and comply with the law. It was indicated that the bill would have the effect of codifying Norris but the House bill would go beyond that in that Norris applied only to employers who were subject to Title 7 of the Civil Rights Act, in general, employers with 15 or more employees. This would extend it to all employers.

The problems of providing insurance on a unisex basis prospectively under new policies is a problem that can be solved. In fact we find insurance companies solving it certainly in the life insurance industry. When I entered the insurance business, all life insurance policies were being sold on a unisex basis, except for settlement options. Recently some of the largest insurance companies have begun selling unisex policies for the purpose of their group insurance conversions, recognizing that the failure to do so might be a violation of Norris and so it is clear that it can be done.

MR. WELLS: When Mavis questioned whether the transfers occasioned by the bill were equitable given that she estimates that they will cost women money and that the bill is being labelled as Women's Rights Legislation she well may be correct. Again that is an issue we ducked. We did not feel that, as technical people, we were qualified to comment on the issue of whether a transfer was a good transfer from an equity point of view or a bad transfer. While some of the advocates of the bill such as the National Organization of Women have taken the position that any transfer that would hurt women is bad, other groups such as the Women's Equity Action League have taken the position that in some cases the bill might indeed hurt women but they support it anyway because they think the principle is an important one and they are willing to pay something to support that principle.

I would agree with Mavis that I think that the NICO study overestimated the size of the adult female single population that would be affected by going from sex distinct rates to mileage based rates if mileage based rates were substituted. I think that is probably the strongest argument that the industry made in it's comments on the NICO study. The other issues that she raised we were more uncertain about and weren't really prepared to take a definite position on them.

On the issue of efficiency costs and the question whether it's possible to compel a firm to sell insurance at a price less than the cost of providing it, there are, of course, substandard insurance markets and one possible impact of the bill would be to force more male drivers into the substandard market and into the assigned risk market. There is some question about that, of course, because the bill prohibits not only sex distinct pricing but also sex distinct underwriting and if it were clear that males were being bumped into the substandard market in a discriminatory fashion, there might be some enforcement action on that. However to the extent that men are bumped into the substandard market, they would still be paying higher rates and consequently the transfer between males and females would be reduced.

It is true that the SRI study says that actuarial efficiency is the presumptive standard for setting rates. However it goes on from there to say that where other factors are relevant such as considerations of equal treatment for males and females; black and whites; that presumptive standard might well be set aside by the Congress and our view is that the question of whether the presumptive standard should be set aside is an open one and is an issue for the Congress to resolve.

Economists have done lots of studies of the question of elasticity of demand; the extent to which people change their purchases of insurance in response to price changes. Unfortunately we did not have a study in the insurance market itself, so we had to make inferences about the responsiveness of people to price changes in insurance based on studies in other product areas. We basically made assumptions based on how responsive people were in other product areas. Those studies are based on actual experience of how much people actually change their purchases. It is not a mere speculative estimate based on 1% increases and the presumption that people will not be very responsive to a 1% increase.

I agree with Don Grubbs that the bill is badly drafted. We didn't really go into that issue because our comment was a more economic impact comment than a legal comment. We did rely heavily on the advice of our general cousel's office and and they thought that the bill did cover pension plans even if those plans were not strictly speaking insurance. There might be some litigation on that but our general counsel felt there would probably not be much and the outcome of that litigation would be that it was clear that the bill did cover pension plans. That certainly seems to be the intent of the Congress.

The question of whether we took adequate account of the unisexing of pension plans since Norris I think is a real one. We did insert some comments in the report on that issue but we did not throw out the estimates of unfunded liabilities for pension plans because of that uncertainty.

On the question of whether insurance companies will actually become insolvent, it is certainly true that the ACLI in its survey asked its members to assume that they would equalize by topping-up coverages rather than by cutting premiums which we viewed as an equally permissible way of equalizing and it is certainly true that cutting premiums dramatically in many cases reduces the increased reserve required. However, we think one of the things to keep in mind is that, of the 153 companies in the ACLI survey, only 24 would become insolvent, even if they topped-up coverages. The remaining firms had enough in their surplus accounts to cover the increased reserves. Our sense was that topping-up coverages is administratively simpler. It is easier to send a letter to your policyholders and tell them their coverage is being increased by 10 or 15%, than changing the billing on every insurance policy to reduce the premium. Furthermore, cutting the premiums means that you reduce your cash flow and we thought that if a company had adequate surplus funds so that it could cover the increased reserve requirements associated with topping-up coverages, in most cases they would probably choose to do so because it is administratively simpler and keeps your cash flow going. For companies that are in a more marginal financial situation, we figure most of those companies would in fact choose to cut premium. Those companies are a minority of the total population of companies. So we took those considerations into account but felt that nevertheless a substantial number of companies would probably top up coverages rather than cut premiums even though it was more costly to do so as long as they could provide those increased reserves out of their surplus accounts.

We also took into account the possibility of firms cutting dividends and we have some data from the ACLI survey on individual firms. Some companies were willing to divulge those data for those individual firms. It turns out that of the 24 companies in the ACLI survey who would become insolvent even if you assumed that their increased reserve was cut in half because they cut premiums rather than increase coverages and if you assumed they eliminated one year's worth of dividends and used that to try to cover the reserve increase, about half of the companies would still become insolvent. That was part of what led us to believe that even if companies adopted some more reasonable strategies to avoid insolvencies a number of them would still become insolvent.

Both Don and Mavis are of course correct that the reported bill coming out of the House Energy and Commerce Committee does cover the small plans. Similarly the amendment that has been circulated in draft form and in the Senate would extend the coverage of the bill to small pension plans. I estimated that to be something like 3 - 5% of the total employees so it is a fairly marginal addition.

MS. BARBARA A. KELLER: We have in recent years, a considerable problem on the life insurance side with persistency particularly with term policies of large issue size. In the GAO report, without retroactivity, have you considered the effect of large scale lapsing among male policyholders to pick up new policies that have the lower unisex rates?

MR. WELLS: We don't address that issue specifically. We are aware that there is a lot of turnover in the life insurance market currently. As interest rates have risen, the interest rates used in valuing reserves have gone up and consequently the cost of providing life insurance has in effect gone down with people taking advantage of lower prices on newly issued policies. To the extent that that occurred it would tend to reduce the increase in unfunded liabilities. We did not make any specific estimate of that effect in making our estimate for unfunded liabilities.

MR. ERNEST J. MOORHEAD: Mr. Grubbs referred to a company where unisex rates were in effect and said that the settlement options however were not unisex. However, at that time, I think Don would agree that a very large part of the business on the books of that company had settlement options that were unisex and the history of those settlement options is perhaps worth contemplating.

The differentials in mortality between men and women were understood far back into the 19th century but it nevertheless was true that companies, major and minor, went ahead for many years well into the 20th century issuing policies in which the settlement options were not only unisex but were also based on an insurance table rather than an annuity table. When the dangers of this became obvious there was a period in which great concern was being felt about the liabilities that these policies imposed upon the companies involved and there were various calcuations made to calculate what kind of special reserves should be set up to provide for those errors of the past. What happened historically was that the growth, particularly in the inflationary times, of the volumes of business that were on the settlement options that had non unisex values in them simply swamped the effect of those policies in which that error had been made.

It has been the case down through the years that the errors that actuaries have made have been rendered less serious than they would otherwise be simply by the large growth in the insurance and annuity business and by the declining value of the currency in which those contracts were and still are expressed. As a result, when Mr. Wells was talking about the transition period, he surprised and shocked me when I found that he was talking about a difference of between 90 days and 1 year because I think that the solution to many of the problems that we have such as this involves the passage of time that is much in excess of either of those periods.

MR. LARRY J. BRUNING: I am a little bit bothered by the free use of surplus to cover increases in reserves as to whether it is a violation of the contribution principle of how different groups of policyholders have built the surplus up. Another problem I see is if we have this free use of surplus and it gets wiped out what are the economic impacts on limiting our ability to grow with the heavy surplus strains on putting on new business. We draw on the surplus many times to cover that.

MR. GRUBBS: I concur that the increase in reserves required would be a serious problem and that is why I oppose retroactivity. I merely indicate that the magnitude of that increase is probably overstated by the industry and that the insolvency problem has in my judgement been substantially overstated.

MR. WELLS: We note in the report that the surpluses are not a free bag of money that can be used for anything. Those surpluses are there for a reason and reducing those surpluses substantially would restrict the flexibility of the companies to operate in the way they normally operate. I suspect that if the bill were enacted with the retroactive provision and the surpluses were dramatically cut, the price of life insurance would certainly rise at least in the short run as companies felt that they needed more revenue in order to rebuild those surpluses.