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UNISEX—AN UPDATE

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Current Developments on the Unisex Issue:

1. Judicial
2. Statutory
3. Political
4. Regulatory
5. Future Outlook

MS. LINDA M. KAHN: In putting together the panel today we tried to get a balanced representation. As you can see, we have two men, two women, two actuaries, two attorneys. We have those who are concerned about the effects on insurance products of this issue and those who are concerned about the effects on annuities. We also have representation from the company point of view and representation from the consultant's point of view. We hope that makes this a comprehensive update governing the judicial, the statutory, the political, and the regulatory aspects of this issue and we hope to have some insight as to the future outlook. If you have not been very involved in this issue, you may wonder what all the fuss is about and you may say, "it just seems so very rational and so clear. Anybody who understands anything about insurance, understands that sex is a major factor." It reminds me of the communication that was presented to me when I started in my current position about two years ago. This communication took the form of a cartoon. I believe it was the Wizard of Id. In this cartoon the loyal guard is running to report to his king. He is saying, "Sire, sire, the prisoner has been talking for hours and I just cannot understand a word he says," and the king says, "Well, why, isn't he answering your questions?" He says, "Sire, he is babbling away and he is talking incessantly, but I just can't get any answers from him," and the king says "but why, guard, what nationality is he?" The guard answers "why he is an actuary, sire." The basic message is that communication is very important. Particularly if you have hanging around your shoulders the name of actuary, you'd better be clear as to what message you want to get across to those who do not speak your lingo.

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Our first panelist today, does not share the designation of actuary, but she has been vitally concerned and heavily involved in this issue and she has been since, I understand, April 1974. In fact, I understand, next week marks her tenth anniversary on this issue. We are very fortunate indeed today to have with us JoAnn Sher who is Vice-President of TIAA-CREF.

She has been responsible for TIAA's litigation in this area and at the Law Department for the last 12 years. Recently her scope of responsibility has been shifted so that now she is responsible or involved in external affairs. JoAnn will give us an idea as to just what has been going on in this litigation since 1974, since she has been so very heavily involved in it.

MS. JOANN G. **SHER:** The big news, of course, was, and continues to be, the Supreme Court's decision in the Norris case, handed down in early July of 1983 - what it cleared up and what it did not clear up. Today I will share with you the thinking of a hastily convened ad hoc group of mostly lawyers and some actuaries which picked apart the Norris decision almost immediately after it was rendered in the hope of determining just how much guidance it did give, and then I would like to update you on what's happening with the TIAA-CREF litigation.

The Facts of the Norris Case

The State of Arizona offered its employees the opportunity to enroll in a deferred compensation plan. Although it was employer-sponsored - the State selected the private companies which participated in the plan; made the necessary payroll deductions and gave employees time off to learn about the plan - the employer made no monetary contribution to the plan on the employee's behalf. At retirement, the employee could elect a lump-sum, or cash, option; a fixed sum for a fixed period, or a life annuity. All the companies participating in the plan used separate mortality tables for males and females to determine the periodic annuity payment under the annuity option, and it was this practice that was being challenged in the Norris case.

The Norris Decision

1. An employer's practice of offering an option which pays lower monthly benefits to women than to men who made the same contribution under an employer-sponsored deferred compensation plan constitutes unlawful sex discrimination under Title VII.

2. All retirement benefits derived from contributions made after August 1, 1983 must be calculated without regard to sex.

Note: Norris is clear that obligation to provide equal benefits is the employer's. In fact, the Court told the employer that if it cannot find a third party who can treat employees on a non-discriminatory basis, it (the employer) must supply the benefit without the aid of the third party, or not at all.

At first blush, it looked as if the Supreme Court had clearly spoken on the issue of sex-based tables in pensions. On second reading, though, one started noticing the phrase "privilege of employment" in both the Marshall and O'Connor portions of the decision. Justice Marshall said: "There is no question that the opportunity to participate in a deferred compensation plan constitutes a condition or privilege of employment, and that retirement benefits constitute a form of 'Compensation'." Justice O'Connor: "In the situation at issue here, the employer has used third party insurance companies to administer the plan, but the plan remains essentially a privilege of employment and thus is covered by Title VII."

It is this language that then focussed attention on what types of fringe benefit plans would or could be swept under the Norris Doctrine as a "term, condition or privilege" of employment.

The threshold question is "how do you define what's a term, condition or privilege" of employment?

1. There is a lack of discussion, not to say total absence of discussion, in the Title VII cases as to what constitutes terms, conditions or privileges of employment. In general, though, the benefit "privilege" must have these basic characteristics: the privilege must have some intrinsic value; it commences with the employment relationship; does not always terminate with cessation of employment; can extend to other persons in addition to employees, e.g., spouse and family members; is probably unaffected by whether or not the employer or employee contributed in whole or in part, or in what proportion, to the cost of the benefit; need not be earned or enjoyed during the employment relationship; and lastly, it must probably be of primary benefit to the employee, but not necessarily so, e.g., where there may be a primary advantage to the employer and a secondary advantage to the employee.

Applying these criteria, one can arrive at a "but for" test: if a person would not be entitled to participate in the benefit "but for" his or her employment relationship, then such benefit would be a "privilege" of employment. And if, under the "but for" test, the benefit is a privilege of employment, then it is subject to the Norris decision.

Strenuous objections might be heard about such a broad reading of the implications of Norris, and the discussions about whether or not such a broad reading is appropriate continue. However, it has been suggested that the question of how broadly to read Norris is irrelevant for insurers and actuaries since Norris is an employer-targeted decision. Third parties will presumably do whatever the employer-clients request in order for them to comply.

Be that as it may, let us consider some of the implications of the broad reading. By the way, I am talking about insured plans, i.e., what types of collateral concerns must be dealt with? Here are a few.

Because of ERISA requirements, assurance is needed from the IRS that plan amendments made only to conform to Norris should not need to be submitted, nor would such amendments affect a qualified plan's status; since Title VII applied only to employers with 15 or more employees Norris applies only to such employers. But, there are state laws to be remembered. Some of them track Title VII language, apply to fewer than 15 employee situations, and are applied consistently with Title VII interpretations.

For Larger Group Pension Cases

Again the concerns have been mostly ERISA related, especially as regards the possible interpretation of a reduction in accrued benefits.

In the non-pension area, as probably everyone knows by now, the major area of concern has been in the area of group life conversion privileges and group health conversion privileges. I believe this area continues to be grappled with on a company-by-company basis.

Another way to try to evaluate the potential reach of Norris is to look at various fact situations and try to determine whether or not the product in the given situation could or should be reached by Title VII as a "privilege of employment"....

Using this approach, the bulk of the Norris-related problems involve treatment of policies and products already in force - how do we avoid impairment of existing contracts?

With that in mind, let us look at the potential problems in situations involving individual life, health and disability policies on a "sponsored" basis: For example:

If an employer merely distributes an insurer's brochures, or even distributes the brochures of many insurers, but indicates "we think X is best," is that act enough for any insurance so purchased to be considered a "term, condition or privilege of employment?" And, of course, then subject to Norris? How about a situation where the employer allows the insurer on its premises during working hours to distribute information? Does it matter if he allows only certain insurers on the premises, or if the insurers are permitted on the premises but only after working hours? There seems to be a general sense that none of these situations meet the "but for" test - the employer is doing nothing more than facilitating exposure to what is available on the open market.

What about the situation where the employer merely provides payroll deduction? The general sense seems to be that this Act, again, in and of itself, does not meet the "but for" test because an employee could obtain this type of feature elsewhere - for example through check-o-matic. If it's payroll deduction with a discount, though, or if the contract is with the employer, then you have a different story.

If the employee gets a discount, if the employer subsidizes the premium (often seen in the area of conversion) or if the issuance of a policy is guaranteed for employees (basically, no underwriting) then each situation must be evaluated on a case by case basis to see whether it meets or can avoid the "but for" test.

If participating in the plan is condition of employment, then of course by definition, it meets the "but for" test.

There is a lot of discussion about the problems surrounding conversions. The most useful note that I've heard sounded was the suggestion that the "but for" test would not be met if it can be shown that the product could be purchased without evidence of insurability in the open market.

Now, in addition to these types of post-Norris open questions, my own company, TIAA-CREF, has found out in our continuing litigation saga that for some, even the question of retro-activity in defined contribution pension plans remains an open question after Norris.

TIAA-CREF had had two cases with conflicting Circuit Court decisions pending at the Supreme Court when Norris was decided: Our Second Circuit decision in the Spirt case had enjoined the use of sex distinct mortality tables to determine benefits under Title VII, and our Sixth Circuit decision in the Peters case held that the use of sex distinct tables under Title VII was fine! As soon as Norris was decided, the Supreme Court granted Writs of Certiorari in our two cases, vacated the judgments in both cases, and remanded them to their respective Circuit Courts for "consideration in light of Norris."

The plaintiffs in Spirt, on remand in the Second Circuit, joined by the EEOC and AAUP who had been permitted to intervene on the question of remedy, filed a motion to re-instate the Second Circuit's pre-Norris decision. That would require unisex for all benefits payable on/after May 1, 1980 - retroactivity!

The thrust of the plaintiff's motion is that Norris didn't bar retroactivity in all cases, but rather permits consideration of retroactivity where it can be shown that the pension fund would not go insolvent, and they contend that such is the case in the TIAA-CREF situation. Further, they contend that TIAA-CREF should reasonably have anticipated that its plans violated Title VII because of the Manhart decision.

We, of course, maintain that this is a total misreading of Norris, and so the battle is on!

All the papers have been filed in the Second Circuit and all the parties requested oral argument, but the request has been denied by the Second Circuit. Despite a recent substitution of one of the judges on our panel, we hope this means a decision in the near future, rather than a further remand back to the District Court.

In the Peters case, which is our Sixth Circuit case, the Sixth Circuit immediately remanded to the District Court. TIAA-CREF unisexed all post August 1 premiums so we made a Summary Judgment Motion based on Norris. The plaintiffs there have made a motion to stay all proceedings in the case pending the Second Circuit's decision in Spirt. We of course, oppose such a motion.

And so, in short and in summary, we await two decisions: one from the Second Circuit where retroactivity is the issue; and one from the District Court in Detroit where the plaintiffs have asked the Court to defer to the Second Circuit, thereby reaching retroactivity through the back door. I'd say that it looks as if there's plenty of post-Norris litigation ahead on the retroactivity issue and, despite the fact that the Supreme Court has now twice said, or appeared to say no retroactivity in their Manhart and Norris decisions, the issue may well be back on its way to the Supreme Court.

MS. KAHN: Thank you, JoAnn. Our next speaker is Anthony Amodeo. Anthony is a Fellow of the Society of Actuaries. He is an Actuary of the Metropolitan Life Insurance Company. He is in their Corporate Actuarial Department and as a matter of fact, Anthony and JoAnn worked together on the committee to draft the response for the ACLI's version of H.R. 100. Anthony has been involved with H.R. 100 since it has been in its current incarnation.

MR. ANTHONY AMODEO: When this panel was planning for this session, we decided that my area of concentration would be "unisex" legislation, specifically as it applies to life insurance companies and to their individual insurance products. After the extensive discussion given this topic at yesterday's keynote discussion, it would be pointless to go into further technical detail. One thing that I may be able to add to that session, and to the excellent discussion last October at the Hollywood meeting, is an historical and a political context into which this legislation can be fit. At the Federal level, the proposed legislation is known in the Senate as the "Fair Insurance Practices Act," or S. 372, and in the House as the "Non-Discrimination in Insurance Act," or H.R. 100. Although the original bill submitted to both houses in January of 1983 was the same, I will concentrate on developments in the House version since most of the subsequent action has occurred there. The bills would prohibit discrimination in all forms of insurance on the basis of race, color, religion, sex or national

origin. Obviously, the only characteristic on this list that is used in underwriting virtually all forms of insurance is sex, and that was the motivation for the bills and has since been the focus of debate.

The vitality of these bills was generated primarily from the failure of the Equal Rights Amendments (E.R.A). Subsequent to that defeat, there arose pressure on the part of several women's groups to advance women's rights in at least some areas, in this case the various forms of insurance, and at the same time there was a desire on the part of many Congressmen to appear supportive of women's rights rather than to be associated with the failure of the E.R.A. Therefore, in order to best understand the prospects for this legislation, it should be viewed as a civil rights issue rather than an insurance issue.

I think it was clearly agreed at the keynote discussion that the major onerous provision in this legislation is its retroactive application, which would require the equalization of benefits by sex on contracts already issued, including annuities that are currently paying out benefits. The method for equalizing benefits was specified as the increase of benefits to the disadvantaged sex, the so-called "topping-up" provision. The increase in the present value of benefits without any offsetting increase in the present value of premiums results in a drastic increase in reserves. For life insurance, this increase results from male insureds, and is greatest for companies that have had sex-distinct life insurance premiums for the greatest period, and for companies with the greatest proportion of male lives. For some companies, the reserve increase would exceed surplus.

As an alternative to increasing benefits to the disadvantaged sex, there was another provision that allowed premiums to be "modified". Lowering premiums to the disadvantaged sex is one possibility, with less onerous statement effects than immediately increasing their benefits. There would still be some reserve increase because of the lower present value of future premiums. This was an important part of yesterday's discussion that I will return to later. The use of the word "modify", however, gives the implication that premiums could be increased, for example on inforce female life insurance, with permission of the state regulatory agency. Unfortunately, the practicality and legality of such an increase would certainly be questionable. Finally, only 90 days were allowed for implementation, and this period is widely held to be insufficient.

The major theoretical argument against these bills was that discrimination by sex is not inherently unfair, it is an essential part of the industry's risk classification process, and that our underwriting practices should not be mandated by law when they are fair, equitable and justified by actuarial data.

The fear is that, once insurance rates are divorced from their actuarial basis in one area, it would only be a matter of time before social policy dictates subsidy of high risks by all policyholders in other areas. Rates independent of age and health condition have been suggested as the eventual outcome. Of course, although a frightening scenario, this approach does not address the political motivations of the legislation. On a more practical side, it has also been pointed out that women would generally be the losers under this legislation, with the prime example being the increase in auto rates for young women once they have been grouped together with young men. The major potential gains for women would be in the area of pension and health benefits, but the bulk of such gains have already been won in the courts through the employer context. This approach is more geared to the political realities and has had some real impact.

The major arguments for the bills are based on equity and civil rights considerations. Sex discrimination is viewed as being as unfair as race discrimination, which was also once practiced by the insurance industry. Actuarial differences are either ignored, or explained away by the "overlap" theory or by claiming that sex is merely a surrogate rating classification for the true underlying factors such as smoking or driving record.

Facing likely passage of the bills in this form, the ACLI Board of Directors on March 10, 1983, recommended a position that conceded the future risk classification prerogatives of the industry in return for elimination of the retroactivity and for extension of the lead time in the bills. This action was reversed by a special meeting of the ACLI members in May, resulting in threats of reprisals from Capitol Hill. Senator Packwood was quoted as addressing an insurance assembly with the dire warning "You are asking to die by the sword, if you live by the sword." The entire matter was referred by the Senate for analysis to the General Accounting Office (GAO), the investigative arm of Congress, and the issue rested quietly as Congress recessed for 1983.

The first major breakthrough on this legislation occurred in February of this year, with the widespread availability of a draft of the report from the GAO. Several important concerns of the insurance industry were clearly understood for the first time, as the economic effects were studied:

1. They believed "any transition period less than one year would probably not be feasible."

2. The GAO report recognized the limited possibilities to increase premiums to the favored sex, as was seemingly allowed by the bills. The report noted that "it is not clear how practical such premium increases would prove to be."

3. They agreed that increasing benefits without increasing premiums would create "unfunded liabilities," which for an insurance company would necessarily be "funded" by increasing reserves. The draft report estimated that the legislation would create unfunded liabilities for life insurance companies of $6.6 billion to $17.1, and increase unfunded liabilities of pension plans by $7.7 to $15.1 billion, for a total of up to $32 billion. They recognized the substantial administrative costs that would result, and did not disagree with the $1.3 billion transitional cost estimate of the American Academy of Actuaries. They allowed that this process could cause what they termed "serious disruptions," which, as pointed out yesterday, means insolvencies of life insurance companies, including those providing employment to some of us in this room, and which we might then consider to be serious disruptions indeed.

4. The report clearly felt that responding to retroactivity by lowering premiums of the disadvantaged sex was less onerous than raising their benefits, because the statement effect on surplus would not be as large, and because of the possibility of adjusting future dividends. Although they recognized the resulting immediate decrease in cash flow, and the administrative problems, they did not give much weight to these or to the ultimate cost of such a program. Mr. Wells said yesterday that only half as many companies would become insolvent if they elected this method and reduced their dividends. This reminded me of the aphorism that a recession is when your neighbor is unemployed, and a depression is when you are unemployed. I don't see that the industry can take much comfort from reducing the number of unisex-related insolvencies to any number that exceeds zero. It is also discouraging that anyone here would dismiss the disruptive effects of drastic reductions in surplus, even if insolvency can be staved off. The National Organization for Women's criticism of the GAO report views reserve increases as "simply a reassignment of assets from surplus." The actuarial community should better recognize the implications whereby equity between policyholders and the vitality of the industry will surely suffer. I personally cannot agree with the contention that this issue has been overstated.

5. The report discussed the "redistributive effects" of making prices rise for some policyholders and fall for others. They correctly pointed out that the amount of such redistribution would depend on the methods by which industry implemented their unisex rates. They doubted the magnitude of the numbers quoted by supporters of both sides of the issue.

6. The report also discussed the "economic efficiency effects" of how cost-effectively the economy satisfies consumer demands. The risk is that underpriced coverage will be purchased to a greater extent than the overpriced segment of the business, resulting in adverse selection by the consumer. Unfortunately, the GAO did not feel this effect to be too important.

Although these last three points are not favorable, the report generally gave credence to the concerns of the industry. When the draft report was first circulated, proponents of both sides of the issue felt it supported their views, and one newspaper article said the report "draws no firm conclusions." However, the report itself says "we believe that Congress should consider" what amounts to eliminating retroactivity and extending the transition period, and this sounds like strong wording from an entity that reports to Congress. The final report was published only last Friday, with the same conclusions as the draft, and this should be rather encouraging to the industry.

An even more encouraging development also occurred less than two weeks ago. We had previously known of two amendments that had been proposed in the House committee. One amendment, associated with Congressman Dowdy, would have eliminated all retroactivity in the bill. Another, known as the Tauzin amendment, would have made the legislation inapplicable to individual policies. On March 28, the House Energy and Commerce Committee agreed to amend the legislation by including both these limitations. Although I have not yet been able to get a copy of this revised legislation, the news accounts indicate that the bill also allows two years lead-time, and attempts to preserve state jurisdiction over discrimination in insurance. As discussed in detail at yesterday's session, about the only area in which this bill would extend more oversight than the court decisions would be in pension plans covering under 15 lives, which these decisions left unaffected.

This weakened (or to use an apt expression, emasculated) version of the bill has lost the support of women's groups, and it would seem that the immediate outlook is that the bill will go no further through the House Commerce Committee. Through a procedure called "sequential referral," however, the bill is now being studied by the Education and Labor Committee, and this could revive the earlier version. There is also the possibility of action initiated in the Senate, and there is some indication that a push for a non-retroactive bill in 1984 may be coming from that direction. The Administration is also eager to change the public perception of the President's record on women's issues. This past Thursday, in New York, Mr. Reagan said "Let there be no doubt, this Administration considers discrimination based on sex just as great an evil as discrimination based on religion or race." Whether this will translate into a stand on sex discrimination in insurance rates remains to be seen. In any event, passage of any law with disastrous retroactive features would seem unlikely in 1984 because of the short session and other problems associated with an election year.

The longer-term prospects are quite a different matter. We have to keep in mind the major reasons given by the representatives who amended this bill in our favor. As an example, Representative Albert Gore was quoted as opposing application to individual policies "because the net effect would be to raise women's insurance rates." Admittedly, there was also some concern for the financial solvency of insurers. But in no case that I have seen, has a Congressman supported the right of the insurance industry to determine its own standards of risk classification. Not having this philosophical support can cost the industry in future years when the political pressures are reapplied, and especially when various schemes are submitted to maintain female auto and life advantages at the expense of industry profits.

As actuaries, we have a tendency to believe that if we are allowed to explain the arcane workings of our business, we will be able to demonstrate the rectitude of our position. I submit that no amount of actuarial education will win the votes of the legislators, but rather that these votes can only be won through demonstration of the cases in which women are clearly disadvantaged by unisex rating. It is worth noting that although we view life insurance as an area in which women are treated more favorably than men, NOW still maintains that women are the disadvantaged sex, and that they will benefit from this legislation. As an example of the public perception of these arguments, I would point out the three letters to the editor on this subject that were chosen to be published by the New York Times in last Friday's edition. Two of these letters, by the way, were from Fellows of this Society, and they both explained the basic actuarial equity of using sex as a rating characteristic as distinct from an attempt to use race. All three letters chosen for publication, however, emphasize that sex-distinct rates favor women, and the heading given by the newspaper to the group of letters was "Unisex Insurance: A 'Fairness' Costly to Women."

One final point I would like to raise is that, lacking Federal initiatives, we can still expect pressure to arise at the state level in support of similar legislation. Montana has already passed a law, luckily after its retroactivity provision had been deleted, which applies to individual policies as well as group, and that will go into effect in October of 1985. Several other states have bills under consideration. It can only be a matter of time before the cumulative effect of many such state laws will force nationwide insurers into adopting unisex rates on a national basis.

There are two aspects of the unisex issue that I have tried to emphasize today. The first is that this is a volatile topic, with perspectives changing from week to week, most certainly over the last two months. In this environment, prediction is extremely difficult for people directly involved behind the scenes in Washington, and even more difficult for us who are removed from the activity and rely on second-hand reports.

The second aspect is that actuarial logic will not be the field on which this battle will be decided, but it will rather hinge on the public perception of what is best for women.

MS. KAHN: Thank you, Anthony. Even though they may have stolen your thunder yesterday, it sounds as though there is plenty of thunder left to share with us today. Next, we are pleased to have with us Claire Wolkoff. Claire is an Associate Consulting Actuary at George B. Buck, Consulting Actuaries in New York City. She is a Fellow of the Society of Actuaries. She is a member of the American Academy of Actuaries, the Conference of Actuaries in Public Practice and, of course, she is an Enrolled Actuary. Claire is a member of the Academy's Committee on Risk Classification and she has been involved in that committee's work on the unisex issue. She helped draft the Academy's Norris brief and she appeared at Congressional Hearings on H.R. 100 and S. 372.

MS. CLAIRE L. WOLKOFF: After the Supreme Court handed down its ruling in Arizona Governing Committee v. Norris in July, pension plan sponsors and actuaries had a busy summer getting plans in compliance with the decision. Although many plans already had unisex factors, the majority had at least some sex-distinct factors. Fortunately for them the ruling was prospective, but the lead time was short. The effective date was August 1, 1983. For defined benefit pension plans we took this to mean that benefits accrued after August 1 had to be paid on a unisex basis. This meant that retirements on or after September 1 had to have unisex benefits.

Despite a very hectic summer working on unisex factors, there was one thing very fortunate about the timing of the Norris decision. This was the relationship between the Norris decision and Revenue Rulings 79-90 and 81-12.

Revenue Ruling 79-90 states that a defined benefit pension plan which provides optional forms of retirement benefits which are, according to the provisions of the plan, "actuarially equivalent" to the normal benefit must specify the actuarial assumptions used to compute the amounts of such optional benefits. This is necessary to satisfy the definitely determinable benefits requirement of section 1.401-1(b)(1)(i) of the IRS regulations.

There are several possible ways to comply with Revenue Ruling 79-90. Two acceptable fixed standards are:

1) specifying the actuarial assumptions (interest, mortality, etc.), or
2) including the actual factors.

For plan sponsors who prefer to vary their factors (for example, to reflect current interest rates), there are two acceptable variable standards:

1) referring to insurance or annuity rates for a specific contract from a specific insurance company, or

2) having a variable interest rate tied to an independent outside index, such as a designated percentage of the prime interest rate of a specified bank.

Although Revenue Ruling 79-90 was issued March 12, 1979, plans that were in existence on that date have until the first plan year beginning after 1983 to comply.

Now why do I say it was fortunate that Norris became effective before Revenue Ruling 79-90? Revenue Ruling 79-90 specifies that option factors and early and late retirement factors must be included in a pension plan. Revenue Ruling 81-12 states that once the actuarial factors, or the basis for determining the factors, are included in a plan, the factors become part of the accrued benefit. Any change in factors after that point is a plan amendment and cannot result in a decrease in the accrued benefit. As a result, if the Norris decision had been reached after Revenue Ruling 79-90 was generally effective, most plans would have had to "top up" their option factors or add to their administrative problems by grandfathering the accrued benefit on the old option factors.

Since the Supreme Court did not require benefits to be topped up in its Norris decision, plans had a variety of approaches open to them when they switched to unisex factors. The most generous approach is to top up the factors, using the current factors applicable to the "favored" sex (generally women for early retirement and option factors in defined benefit plans) to apply to both sexes in the future. Since the law does not require such an approach and it is the most costly to the employer, few plans have chosen to top up their actuarial factors.

Most plans have based their unisex factors on blends of the sex-distinct factors. The most common such approach is based on the plan's work force mix. For example, if the plan population (based on compensation in a pay-related plan) is 75% male and 25% female, the factors are derived using a unisex mortality table for J&S beneficiaries which is 25% male/75% female. In a survey by Buck Consultants of 147 companies with defined benefit plans which switched to unisex after the Norris decision, about 41% of the companies were using a work force mix for their unisex tables.

Another blending approach is to use a 50/50 mix which is representative of the population at large. About 10% of the companies in the Buck survey took this approach. Although for most companies the cost of this blend is slightly higher than using a work force mix, some clients have chosen it because it is a percentage mix that may be easier to communicate and explain and because, with increasing numbers of working women at all job levels, it may better reflect the future work force mix.

Another blended approach which has been popular is basing the factors on the percentage of male and female employees electing optional benefits upon retirement. Historically many more males elect J&S options than females, so in the cases we have examined this approach generally leads to a blend which is over 90% male. This is the approach that we have tended to use for clients who want to convert to unisex on a no-cost basis. Assuming the sex mix of participants electing options doesn't change in the future, basing the factors on the percentages of those electing options should result in no additional cost to the plan. In the Buck survey about 12% of companies took this approach.

A final approach consists of "bottoming out" or using the present least favorable factors to apply to both sexes in the future. Generally this means using the male factors for everyone. Although this is clearly allowed under current law, it is not an approach I would recommend. However, about 8% of companies in our survey said they were using straight male factors. I believe this approach is most common in hourly plans with heavily male populations.

In addition to determining the basis for their unisex factors, plan sponsors had to decide on the format of the option factors. Traditionally factors for optional forms of benefit have been true actuarial equivalent factors. Early retirement factors have often used simplified empirical reductions which were included in the plan, such as a reduction of 5% a year for each year before age 65 or the IRS 1/15 - 1/30 factors. Often there are subsidized early retirement benefits. However, option factors such as for J&S benefits have generally been on detailed tables varying by age and sex of both pensioner and beneficiary and producing the true actuarial equivalent value in each case. Now, as a result of the Norris decision and of Rev. Rul. 79-90, the trend appears to be toward simplified empirical factors and away from the theoretical factors. I believe there are two main reasons for this:

1) Once unisex factors were required, "true" actuarial equivalence as we once knew it was destroyed. Once that occurred, many plan sponsors and actuaries felt it was a good time to further simplify plans.

2) Revenue Ruling 79-90 requires that either all factors or the basis for determining the factors be included in the plan document. One approach is to state the actuarial basis (unisex mortality table and interest rate) in the plan.

This is straightforward and could be done in one sentence. However, specifying the basis out front like that could subject the plan sponsor to many questions, such as on the unisex assumption. Also, if the valuation interest rate was used for the factors, it would require amending the plan each time the interest rate changed. It thus seemed advantageous to put the factors themselves in the plan, often in an appendix. Generally we have recommended a simplified empirical table which generates factors by a formula, instead of a large table of factors to numerous decimal places, which are produced by theoretical calculations.

The simplified empirical factors work something like this. Suppose the 50% J&S factor is .90 at age 65. The factors could increase, say by .005, for each year the participant is under age 65 at retirement. The factors are also adjusted if the beneficiary's age is different from the participant's. The formula can be established initially to closely reproduce theoretical factors on the chosen unisex table and interest rate. However, since the basis of the factors is not stated, the plan sponsor need not feel obligated to change the factors when the actuarial assumptions are changed for funding purposes.

Regardless of the format of the unisex factors, unless a plan topped up its factors, some factors will be lower for some employees (generally for women in defined benefit plans). If the factors were not in the plan, the sponsor is not required to grandfather the old factor. However, many plan sponsors have chosen to grandfather the old factor times the accrued benefit as of August 1, 1983 as a minimum benefit. This minimum optional benefit will phase out quickly as service and salary increase, but will serve to protect women who retire early or with an optional form of benefit in the near future. None of the defined benefit plans I am familiar with chose to keep the old factors permanently for the part of the benefit accrued before Norris.

The Buck survey I referred to earlier also covered defined contribution plans. 100 of the 309 defined contribution plans surveyed provided annuity options and were thereby affected by Norris. 16 were already on a unisex basis. Of the other 84, 26% are eliminating annuity options and 68% are going to a unisex basis with 6% undecided at the time of the survey. Of the plans keeping annuity options and adopting unisex factors, 70% are applying the unisex factors to the total account balance while 19% are applying the unisex factors to future contributions only (the remaining 11% were undecided). As with defined benefit plans, the most common basis for the unisex factors appears to be the company's work force mix. One difference in the basis for the unisex factors is that a significant number of defined contribution plans are using insurance company tables.

What has been the impact of the change to unisex? The cost impact for the plans I work on has been negligible. Most of the plans already had unisex empirical early retirement factors, so the only impact was on optional elections. By proper choice of a unisex basis, minimal additional cost has been incurred here either. Since few of our plans allow lump sum elections, there really is not much concern about antiselection increasing the costs over the future. An employee chooses between a straight life or a J&S annuity based on his own family and financial circumstances and his health, not based on whether he thinks he is getting a good buy based on the J&S factor.

Antiselection could be a concern for a plan providing lump sum benefits, which is often the case in defined contribution plans. Here a male employee could take a lump sum from the plan and purchase an individual annuity (possibly through an IRA) for a greater benefit. The passage of the original version of H.R. 100/S. 372 (the bills against sex discrimination in insurance) would eliminate this possibility.

So far the only unisex requirements relate to benefits paid from an employer-sponsored plan. Actuaries are still free to use sex-distinct tables (mortality being the most common) for funding a plan. Of course this could be changed by Congress.

Unless Congress acts in a surprising way on H.R. 100 or S. 372, the unisex chapter is closed for employer-sponsored pension plans. All plans should have unisex factors by now and should be incorporating them in the plan document this year.

MS. KAHN: Thank you, Claire. Our last speaker has a background primarily in labor relations and labor law with a heavy emphasis on employee benefits. Although he is a relatively new entrant on the scene, he has not in the least bit let this hinder his enthusiasm for this topic. We are very pleased to have with us Gary Simms who is currently on the staff of the American Academy of Actuaries as its General Counsel. As it turns out, Gary has worked with Claire on the Academy's Committee on Risk Classification. Gary, of course, has a unique perspective being based in Washington and so involved in the Washington scene. I expect he will share with us today some of what he perceives to be the prognosis for the future resulting from legislative developments today.

MR. GARY D. SIMMS:

POST-NORRIS DEVELOPMENTS

Ladies and Gentlemen; Perhaps I should say, in the spirit of *Norris*, gentlepeople, but I for one will refuse to agree to such mouth-twisting changes in the English language. At least until the Oxford Dictionary folks tell me that the time has come for a change.

I am of course pleased to be addressing such an august assembly of actuaries. In truth, until I assumed my position with the

American Academy of Actuaries last summer, I had only the vaguest understanding of what actuaries did. Some of you may recall an article which appeared in a recent edition of the Academy's Update, in which we reported on a man-on-the-street interview, asking perfect strangers what an actuary did. One man answered confidently, "Oh, an actuary is someone who actualizes. Like when your house burns down, and it is insured for $100,000, he comes to you and says, 'well actually, we'll only pay $80,000'."

Before going further, let me state that the views I express are my own, and not necessarily those of the Academy.

You have already heard a lot about the Norris decision, and developments in what the cognoscenti call the post-Norris period. Without being too repetitive, I thought I would speak for a few minutes on two recent developments: one just being completed, and the other a potential activity which should rightfully send shivers down the spine of actuaries, and the insurance industry.

We all know, at least those of you who have been listening this morning, that the the Norris case restricts employers from using sex-based criteria in employee benefits. It did not, however, bar the use of sex-based premiums (or payments) in the private insurance marketplace. Congress is now considering adding this nail to the coffin of alleged sex discrimination under bills numbered H.R. 100 and S. 372. As is often the case with Congressional deliberations, Congress requested a study by the General Accounting Office, known affectionately as the GAO, to ascertain the impact on insurance (and the insured) of prohibitions similar to Norris on the private insurance market.

The major conclusions of the GAO study were that:

1. Women would pay more for life insurance, and men less.

2. Unisex health premiums would shift costs from women to men, while mandatory maternity coverage would increase costs for both men and women.

3. Automobile premiums would increase for women, and decrease for men.

4. Pension plan costs would increase, with some women receiving increased benefits under defined contribution plans, and some men receiving increased benefits under defined benefit plans.

5. Substantial administrative expenses would be incurred.

6. The most severe economic consequences would arise from legislation which would require the alteration of inforce insurance contracts, and previously earned pension benefit. This is the cost of "topping up" and "retroactivity."

7. The planned 90 day implementation period would be inadequate.

The American Academy of Actuaries' Committee on Risk Classification reviewed a draft of the report, and concurs with these general findings. Where differences arise between the GAO report and Academy estimates, it is generally in terms of the order of magnitude of these changes. The Academy's forecasts, made several years ago, were accurate at that time. But increases in the total in-force insurance, and in vested pension benefits, taken together with inflation, tend to magnify rather than decrease the size of the cost transfers between men and women, and to heighten the overall economic consequences of unisex enactment. Let me present two examples of the cost analysis differences. The GAO draft concludes that our estimate of a $700 million annual cost shift from men to women represents an upper bound estimate of the impact of S. 372. This is not correct. Actually, the growth in total automobile insurance since our 1981 report would result in a much larger shift of costs from young men to young women if the Bill were enacted this year.

As Tony mentioned earlier, the House Commerce Committee has reported an amended version of H.R. 100 which would significantly reduce these costs by eliminating coverage of individual lines of insurance, and by eliminating any requirements for topping up of benefits. In addition, the bill as amended truly eliminates any retroactive application, and in that sense is a codification of the Norris decision's method of prospective application. While critics of this approach have called it an "economic amnesty" for the insurance industry, it does help to avoid the constitutional problem of amending existing contracts and pension obligations. I would only add to Tony's remarks that there may be a push to force consideration of the original bill, unamended, as an amendment on the floor of the House, in order to get a recorded up or down vote on the record. That is where we are today on legislative developments.

THE "EFFECTS TEST"

When Congress first considered the Civil Rights Act in 1964, Title VII of that act barred employment discrimination against individuals based on race, religion, national origin, and color. In an ironic attempt to defeat the bill, a prominent Virginia Congressman proposed the addition of "sex" as another prohibited category, assuming that it would kill consideration of the bill. To his shock and consternation, Congress agreed to his amendment and included it among the protected classes in the bill.

In any case, the bill as originally drafted and adopted outlawed discrimination against these groups of people in employment. Through a long series of decisions, the courts reviewed allegations which brought to the fore the question of whether there had to be an intent to discriminate, or whether the impact of a policy by an employer standing alone could be a basis for a

finding of discrimination. The Supreme Court eventually ruled in a case called Griggs V. Duke Power, that if an employment policy which did not on its face discriminate, but which had the effect of discrimination--as shown by a disparate impact on the group involved--then discrimination would be established and the employment practice in question would be outlawed. So as a result, any intent to discriminate was irrelevant, and a showing of disparate selection rates among racial or sexual groups established a presumption of discrimination.

For example, many companies had as an employment qualification, a requirement that the applicant had to have a high school diploma. This on its face, was a "facially neutral" policy, which did not overtly discriminate against any particular protected class of individuals. But, because certain minority groups had markedly lower rates of high school graduates, the effect of this facially neutral policy was a disproportionate impact on the protected class. Hence, the requirement of the high school diploma had a "disparate impact" on the protected class, and was illegal. Employers could no longer use this criterion in employee selection processes.

What does this have to do with insurance and with post-Norris developments? Well, Congress is now considering outlawing *discrimination based on race, sex, religion, and national origin* in the sale of insurance policies. If, and I underscore if, this "effects test" used for employment purposes under Title VII was to be applied to insurance sales, we can imagine some very difficult and unbelievable scenarios. For example, we know that most insurance companies charge higher fire insurance premiums for multi-family wood frame houses, as opposed to single-family brick homes. A very proper risk classification factor, all of us here would agree. And yet, we also know that minorities tend to be inhabitants of multi-family wood frame houses in numbers quite disproportionate to the general population. If the "effects test" was to be applied to insurance sales, companies might not be able to charge higher premiums for inner-city wood frame houses.

Another example. Thefts of automobiles are generally higher in center cities than in rural areas. The "effects test" might well outlaw higher auto theft premiums for ghetto dwellers.

One last example. Women as a class drive fewer miles than men. Insurance companies which offer lower rates to those who drive fewer miles would be discriminating on account of sex if the "effects test" was to be applied to insurance sales, because men would be paying higher rates than women.

I am not being a total alarmist. The application of the "effects test" in civil rights statutes other than Title VII of the 1964 Act has been rejected to date by the courts. Nevertheless, several women's groups have claimed that H.R. 100 would effectively ban red lining of inner city areas for theft or fire insurance, which implies that they believe that the "effects test" would be applied to such legislation.

Clearly, there is a danger that the entire concept of risk classification has been endangered by such proposals. It is imperative, therefore, that the limits of such legislation be clearly understood if such legislation is eventually enacted. In any case, it must be clearly understood that any federal legislation which might be enacted applies only to the stated prohibitions of the law: and that companies cannot and should not be held culpable for the unintended discriminatory impacts which neutral and valid risk classification factors might engender. After all, the basis of risk classification is discrimination. But all discrimination is not necessarily unfair; and some discrimination serves valid societal purposes.

This issue is not necessarily limited to federal legislative developments. As you are probably aware, attempts to mandate unisex requirements in insurance have been introduced in many state legislatures. Montana enacted such a law, to be effective in 1985. To date, California, Maryland, New Mexico, and Washington have considered legislative proposals, but have rejected them. Several other states, including Michigan, Illinois, and North Carolina are now considering the matter through study commissions of one sort or another.

I mention this in order to urge you as members of a profession, and not necessarily as representatives of an industry, to get involved in the legislative developments of your own state. Actuaries have generally not become actively involved in such matters, and this is a good opportunity for you, as a professional, to fulfill your obligations as a citizen. I am paid, in part, to attend hearings and listen to what transpires. You would be amazed at the amount of disinformation which passes for testimony in the halls of Congress, and the same thing is true at the state legislative level. I believe that you would all do well to consider active involvement at the state level on issues, such as unisex, which have a direct and major impact on how you do your work.

I thank you for your time and attention, and with my fellow panel members, would be pleased to respond to questions.

MS. KAHN: Thank you Gary. I hope your urgings will get some of our participants actively involved in this issue. We do have a few minutes left for comments and questions, if any of you wish to make some. I believe Stewart Lyon wanted to give us some insight as to the European concerns on this issue.

MR. STEWART LYON*: I have been very interested in the discussion both this morning and yesterday morning on unisex, and in many respects considerably heartened by what appears to be common sense prevailing. On the other hand, the worries that Mr. Simms expressed a few moments ago about what might happen,

*Mr. Lyon, not a member of the Society, is President of the Institute of Actuaries.

(in particular if an "effects test" were introduced) must give us all food for thought. In Great Britain the position at the moment is that there is general legislation on sex discrimination that has been in force for a number of years and which affects all insurance, except where there is actuarial evidence that would justify discrimination in rating.

Because there are no published actuarial data relating to motor insurance, it is now no longer possible for automobile insurance to be rated by sex. This must mean that women pay more than they otherwise would. The sort of developments that have taken place that might have mitigated that would be, I suppose, one-driver policies where a lady driver might choose to take out that kind of cover and that would be cheaper because it was a one-driver policy. Maybe not so many men are prepared to take out policies with that restricted cover. And, of course, the system of "no claims" discounts that we have that build up over the years will benefit women if they are in fact more careful, or less accident prone than men.

The battle at the moment is raging over whether the actuarial evidence actually stands up or not. In particular, there is a body called the Equal Opportunities Commission which is a statutory commission which has been citing cases in the courts, in particular where disability income contracts have got higher premiums for women than for men or have got restrictions on cover. It is normal practice for disability income benefits where, let us say, the benefits are deferred 13 weeks and premiums are up to 50 percent higher for women than for men. These ratings are really justified on the basis of experience, but the Equal Opportunities Commission argues that "not very many women are covered by these policies, they are not a representative group, and if only more women were covered the statistics would change." I do not think this is true but this is the line of argument. The Equal Opportunities Commission also argues about other types of contracts where the costs are higher for women than for men, annuities of course, but they do not have so much to say where premiums are lower for women than for men.

The other thing that has happened fairly recently is that the European Commission has published a draft directive on what it calls equal treatment in employee benefit plans. It has based its directive on some very strange arguments about mortality, saying "if we do not distinguish particularly between occupations, why should we distinguish between sex because the effect of occupation on mortality can be greater than the effect of sex."

It is not quite clear whether the directive is aimed at employers, as the Norris case here, or whether it is being drawn so widely that it could even stop insurance companies and actuaries from taking into account differences in mortality between the sexes in premium rates and perhaps even in the valuation of pension plans.

So the actuarial profession has made representations on this to the European Parliament, not seeking to oppose the equal treatment directive as such, but seeking to establish that the responsibility for ensuring that men and women would receive equal benefits would lie on the employer and that there would be no obligation on actuaries and insurers to base their costings on ignoring the mortality differences.

The other point that has been made with some force is that the directive should not apply to options. I am interested to hear what has been happening here on options. We could envision the situation in which an employee could commute part of his pension at retirement age for cash on a unisex rate and then go and apply that in the open individual market to produce a bigger annuity. That, of course, would be an option favorable to men. The debate has really just been joined on this issue in Europe. Most of the European countries, apart from Britain, are not very worried about it, because they do not have funded Pension plans. The U.K. is making a fair amount of fuss, particularly the actuarial profession, and the difficulty is to communicate the reasons for our concern.

MS. KAHN: Thank you. Does anyone else want to comment?

MS. TWISS BUTLER*: I am Twiss Butler with the National Organization for Women (NOW). I have appreciated the courtesy with which I have been received at these meetings, but I would also point out that the presentation of the issue of "sex neutralizing" insurance has been somewhat lacking, in both major sessions, in not providing any representation of the point of view of the proponents of the legislation, those who are prepared to state the case for the benefits to women and to the situation in general of making insurance and pensions sex neutral.

Because I have not been invited to make a formal presentation, I will certainly not attempt to do so informally, although I have indeed much to say on many of the points that were presented this morning. I would like to call to the attention of those who have not been aware of it, that the letter addressed by NOW to the General Accounting Office (GAO) on March 22nd (challenging the methodology that the GAO used in developing its cost figure and thus its recommendation with respect to the exemption of on-going contracts) is available at the meeting, thanks to the courtesy of Mr. Bartlett. I am holding a copy of it in my hand and there are many copies on the information table in the lobby.

The NOW letter to the GAO raises three issues concerning the GAO Report. The first two involve GAO acceptance of invalid American Council of Life Insurance (ACLI) cost estimates. These

*Ms. Twiss Butler, not a member of the Society, is a member of the National Organization for Women.

cost estimates use a method of complying with S. 372/H.R. 100 that are sex discriminatory and therefore invalid. Also the ACLI method assumes an unnecessarily expensive approach.

The third issue is that the valid cost to women under the status quo is not addressed by the ACLI. This last issue I would particularly like to address involving the tendency to try to separate the idea of principle from the idea of cost. I would like to suggest that every Civil Rights issue is measured in terms of economic harm to the victims. While much of the discussion here has looked at cost to employers or insurers, I would suggest that if you would look at the status quo, which is sex discriminatory, you would be looking at cost to the victims of sex discrimination and those are very real costs. With respect to the attempt to perhaps exploit a kind of battle of the sexes mentality, I would like to stress that proponents of this legislation are doing exactly the opposite. We consider that men and women are two halves of the same species and have quite a bit of common interests. We also have quite a bit of overlapping in the way of characteristics, and the attempt to rest the argument for sex discrimination on the idea that women benefit from it is about as untenable as asking us to believe that racial discrimination was invented to benefit minorities.

The industry has perhaps made a mistake in attempting to rest its case on presumed benefits in auto and life insurance, because these have been shown to be falsely perceived. Information on both of those areas is available from the National Organization for Women. I would suggest that in the case of the four states which have used unisex auto insurance, because it was deemed to affect men, it was correctly perceived for what all of this is - consumer abuse. Those States which, I believe Mr. Simms said, found other factors ineffective to use, have seen no diminution in the writing of insurance by auto insurers in those States.

I suggest that excellent as these presentations have been, there is still much to be learned on this issue and the public is showing a very marked ability to learn it. They are quite capable of understanding that when an insurer, or I should say a lobbyist for the industry, tells them that women pay less for life insurance, that it may also be true that life insurance (and I refer here particularly to whole life) very frequently costs women more. As evidence of that I would refer you to the appendices in the GAO commentary with reference to Metropolitan contracts.

EDITORS NOTE: Attempts were made to invite a representative from the National Organization for Women or the Women's Equity Action League to appear on the panel. Because of time contraints for finalizing arrangements, we were not successful. Ms. Butler was so informed.