Sex Discrimination in the Insurance Industry

An Honors Thesis (ID 499)

By

Debra S. Fricke

Thesis Director

Dr. Numan A. Williams

Ball State University

Muncie, Indiana

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## Contents

**Chapter I**

The Problem ......................................................... 1
  Introduction .................................................... 1
  Statement of the Problem ....................................... 3
  Significance of the Study ....................................... 3
  Scope of Study .................................................. 5
  Basic Assumptions .............................................. 5
  Definition of Terms Used ....................................... 5
  Design of Study ................................................ 6
  Related Literature ............................................. 7
  Summary ......................................................... 9

**Chapter II**

Background Information ........................................... 10

**Chapter III**

An Examination of Court Opinion Concerning Rate Discrimination by Sex ........................................ 17

**Chapter IV**

The Other Side of Manhart ........................................ 26

**Chapter V**

Summary and Conclusions ........................................ 34
Abstract

SEX DISCRIMINATION IN THE INSURANCE INDUSTRY

Debra S. Fricke

Under the Supervision of Dr. Numan A. Williams

Discrimination in the insurance industry takes the form of classification of risks. Discrimination means to discern or expose differences using good judgment. The question being studied is whether exposing a difference in longevity between the sexes is unfair discrimination. The Manhart and Robertson cases say that it is unfair discrimination to rate pensions differently on the basis of sex. Others argue that the rates are based on longevity, not sex. The fact that the longevity is linked with one sex over another is not important.

The extent and rationale of price discrimination is studied in this paper. Both sides of the discrimination question are considered through the examination of the Manhart and Robertson cases.

Conclusions

Certain conclusions have been made from the findings of this study.

1) A misunderstanding of the insurance system and its actuarial basis by the general public and the justices has caused the conflict.

2) The insurance industry attempts to achieve fair pricing by classification of risks on
the basis of statistical data. Subsidization within these categories is necessary. Individual pricing is impossible.

3) Rates in insurance are discriminatory, however, they are not unfair. Classification of risks is both necessary and advantageous to the consumer.

A reasonable alternative to the present pension system is for employers to allow employees to purchase their own pension plans in the open market. This alternative does not involve any major changes in the current insurance system, but it does provide a way to avoid the problems introduced by Manhart and Robertson. The insurance industry depends on risk classification. This fact will not change.

Approved by

Date August 13, 1979
Chapter I

THE PROBLEM

Introduction

The problem to be studied is the disagreement between law makers and the public on one hand and the insurance industry on the other. The actuarial tables used by the insurance industry since the 1840's are at the base of the problem. The tables, based on statistical evidence, show that women, as a class, live longer than men do. The longevity of the female is the reason used in insurance to support higher annuity costs for women than men and by the same token, lower life insurance rates. In the case of Manhart et. al., v. City of Los Angeles, Department of Water and Power, et. al.¹ the City of Los Angeles argued that using the statistical data to charge different rates to men and women, as classes of people, was a legitimate non-discriminatory reason for different rates.

On the other hand, Marie Manhart and others, in the Los Angeles case, argue that the difference in rates or in pension payments is sexual discrimination, and is barred by Title VII of the 1964 Civil Rights Act. Associate Justice John Paul Stevens, who wrote the decision for the majority in the Manhart case, wrote that Title VII was violated. He emphasized that the 1964 act was written for the protection of individuals. "Discrimination, according to Stevens,

¹Marie Manhart, et. al., v. City of Los Angeles, Dept. of Water and Power et. al., 98 S. Ct. 1370.
occurs when individuals are treated 'as simply components of a racial, religious, sexual, or national class.' 1

The question becomes one of more than just pension plans using employer contributions. If, as the court decision indicates, pension rates cannot be based on sex, the necessary changes in rate making must follow through into other areas of insurance. Without some type of classification the subsidization of risks and the law of large numbers, upon which the insurance industry is based, cannot be upheld. All fields of insurance are affected by this decision.

Extreme classification of risks is found in the area of auto insurance. Auto premiums are determined by territory, type of car, and characteristics of driver. Whether the majority of driving is done in the city, suburbs, or rural area, and furthermore in which specific city or rural area one drives is one classification used in auto insurance. The car is also put in a group by body type and type of engine. The last classification is driver characteristics. Sex is a major factor in rating young drivers. Others include miles driven, age, health, number of citations, marital status, whether the driver is a good student (high school and college drivers), and whether they have taken drivers training courses. In the auto insurance area classification is more extensive than that used in life insurance.

Age and sex are the most prominent factors used in rating life insurance. There are other factors affecting rates. These vary from one company to another. The non-smokers group is a common one which

was originally offered only for men, but has now been extended to women. Occupation and health are also classifications which are used in determining life insurance rates.

**Statement of the Problem**

The purpose of this study is to examine the extent and rationale of price discrimination, specifically that based on sex, in the insurance industry. The study will explore discrimination in pension plans, health insurance, life insurance, and auto insurance.

**Significance of the Study**

Because insurance is a major part of most Americans' financial planning, rate determination is, or should be, of vital interest. This interest is evidenced in such cases as the *Manhart v. Los Angeles* and the *Robertson v. Indiana State Teacher's Retirement Fund*.

If, as in the *Manhart* case, the court decides that unequal contributions to pension plans based solely on sex are "in direct conflict with both the language and policy of the Civil Rights Act,"¹ this will have a tremendous effect on the rate structure of all types of insurance, not just pension plans involving employer contributions.

Declaring sex an unfair classification upon which to base rates in pension planning can carry into life insurance rate determination. In the case of life policies, women pay less than men of equal age and other characteristics. The foundation of both these differences is the statistical evidence that women out-live men of the same age. The discrimination issue can be carried into health insurance, too,

where, based on number of claims (past experience), women's morbidity rates are 228% those of men. Perhaps the area of discrimination that is most familiar to the general consumer is that found in auto insurance. It is common knowledge that young, unmarried males must pay a much higher premium than anyone else (keeping factors other than sex, age, and marital status equal). Again, the rate differences are based on statistical evidence of past experience.

Judge Stevens tried to refute the "statistical evidence" argument by saying, "'the better risks always subsidize the poorer risks...nothing more than habit makes one 'subsidy' seem less fair than another." His opinion did not question the validity of longevity studies but said that such generalizations could not be used to discriminate against every women worker."¹ If, as Stevens seems to indicate, generalizations of any kind cannot be used because they are inherently unfair, the insurance industry has no choice but to go to a general table, not merely an unsexed table, to be used in determining all rates for each specific policy. The argument being not only that a specific female might not outlive her male counterpart, but that a specific 18 year-old may not outlive a specific 60 year-old, a specific woman might not have higher health costs... and so forth.

The re-structuring effect that the recent court decision could have on all areas of insurance will affect each consumer of insurance, not to mention the effects of reconstruction upon the industry itself. For these reasons the significance of studying discrimination in the insurance industry is clear.

¹Tbid.
**Scope of Study**

The problem of rate determination, and classification of individuals for this purpose, has been considered by actuaries since the previous century. It is one being questioned by Justices of the U.S. Supreme Court in deciding recent cases. For these reasons, this study will not be able to look at the problem of rate discrimination in all of its facets. The study will attempt to explain the major points of each argument (for and against the use of "sexed" tables) including data of these differences collected from area insurance agents both in the fields of life and property-liability.

The areas of insurance that will be discussed are: life, pension plans, health, and auto.

**Basic Assumptions**

1. There is a need for insurance as a means of transferring the risks encountered in the usual life situations of today's society.

2. Derived from the assumption of the need for insurance is the requirement for a fair way of determining the payment necessary to provide the service of risk transfer.

3. The correct method for rate determination does not depend upon further collection of data and study, as much as it does on the decision of the consumer as to the way consumers want to be rated.

**Definitions of Terms Used**

This study will use the following definitions.

- **Annuity:** series of level payments for the length of one's life or some set period of time.
- **Discriminate:** to mark or perceive the distinguishing or peculiar features;
Design of the Study

Following is a brief outline of the manner in which this study will analyze the discriminatory practices of insurance rate determination.

(See definition of discriminate above.)

The first chapter offers an introduction to the current dispute


2Ibid., p. 385.

3Ibid., p. 387.
in insurance rate determination. A statement of the problem and sig-
nificance and scope of the study follow. Basic assumptions pertinent
to the case and definitions of important terminology, along with an
over-view of related literature, are also included in the first chap-
ter.

Chapter 2 concentrates on the background of rate-making. A
brief discussion of mortality and morbidity tables set the foundation
for studying the way risks have been classified in the past. Many
rate statistics in this chapter were gathered from agents in the
Muncie, Indiana, area.

Chapter 3 studies recent legal action which questioned both the
legality and the fairness of rate determination. Emphasis in this
chapter is on the landmark case of Marie Manhart et. al., v. City of
Los Angeles, Department of Water and Power, et. al..

Chapter 4 is the insurance industry's reply to the court action
discussed in the previous chapter. The insurance alternatives which
may be necessary after the effects of the litigation become clear
are included in this chapter.

Chapter 5 is comprised of a summary of the study and a statement
of conclusions drawn as a result of this research.

Related Literature

Because of the current interest in the classification many
relevant articles can be found in current periodicals. The most
informative to the various aspects of the problem of rate discrimina-
tion based on sex were articles found in The Journal of Risk and In-
surance.
In "Men, Women, and Life Annuities," Francis King states two characteristics of a life annuity: 1) maximum income, and 2) no chance of being out-lived. However, the stipulation of equal payments puts more limitations on the way in which the annuities are paid. One method would be to pay out only interest income earned on the savings accumulation. This would mean equal payment amounts for anyone with an equal accumulation of savings, without regard to sex or age. The disadvantages of this plan are that it provides a relatively small income, the savings is unused at the time of death, and such a savings accumulation has tax disadvantages. A second method of achieving equal payments would be to use a payment plan based on a certain number of payments. This plan would provide for the desired maximum income but does not adhere to the stipulation of guaranteed life-time payments.

Bob Hedges, in "Comment," writes that when risk is involved one cannot have equality perforce. Two of his arguments against equal payments for men and women are:

1. If recognition of sex is wrong in annuities, so then is the recognition of age. Who can imagine life insurance not taking age into consideration?

2. In response to those who claim the only way a female can live at the male standards is for the male to lower his standards, Hedges claims rationality would suggest later female retirement.

The arguments stated in these articles will be expanded on and further explained in the later chapters of this work. 


Risk and Insurance provides a good background to the area of the rationale involved in rate determination.

Summary

This chapter serves as an introduction to the study of rate discrimination, particularly that based on sex. A formal statement of the problem is followed by brief discussions of the significance and scope of the study. Some basic assumptions are declared and definitions of important terms are included. A general outline of the study's format is followed by a section reviewing the literature related to this problem.
Chapter II

BACKGROUND INFORMATION

The insurance industry bases its rate determination on statistical data and laws of probability. Inductive reasoning predicts future events on the basis of past experience. An analysis of cause is not necessary for predictions.

Life insurance applies inductive reasoning. Probabilities of death and future survival can be made from data showing length of life and ages at death. To obtain accurate data one needs a sufficiently large sample group. The accuracy of the application of the mortality table is dependent on the validity of the statistics used and the size of the sample from which they were taken. This second factor is called the law of large numbers.

"Actual experience may show a variation from the true "probable" experience, but as the number of trials is increased, this variation decreases, and if a very great number of trials are taken, the actual and the probable experience will coincide. Specifically, if the coin were flipped 10 million times, and it were a pure chance which way it would fall, the actual result would be so near 50% heads that the difference would be negligible...Prediction of future mortality rates in life insurance...can be made for a large group of persons; it cannot be made for a single individual or even a relatively small number (such as 1,000) of such persons."¹

Probability and the law of large numbers are used to establish mortality statistics. The assignment of mathematical values to the

probabilities of death is inherent in any life insurance plan. The presentation of such data in a form usable in estimating the number of future deaths is a mortality table.

Population statistics derived from census enumerations and statistics derived from insured lives are the basic sources of mortality statistics. This first source may contain significant levels of error due to incomplete and inaccurate record keeping. These statistics are approximate. However, the statistics taken from the number of insured lives are quite accurate because of the necessity of accuracy in the insurance process. Furthermore, mortality experience among this group is somewhat different from that of the general population because of the "selection of risk" that has taken place. Nearly all of the mortality tables in use today are based on data from insured lives.

Following, is an actual mortality table based on 10,000,000 males from birth through their 100th year (age 99). The core of the Commissioners 1958 Standard Ordinary Mortality Table is the column "yearly probability of dying." Using this column and the "number living at the beginning of designated year" column, one can calculate the "number dying during designated year" (multiplication) and "yearly probability of surviving" (1-yearly probability of dying).

Two adjustments are made to the statistical evidence before the mortality table is complete: (1) graduation to smooth rates into a curve, and (2) a safety margin might be added to the curve. These two adjustments might be needed because of the non-uniform volume of experience and its insufficiency in providing totally reliable statistics.
Any data which does not seem to correlate with the true characteristics of the population is eliminated through graduation. No matter which method is used the curve becomes smooth without losing the basic characteristics found in the data.

Margins are added to maintain high levels of security for the life insurance contracts. Margins keep the rates at the conservative level necessary for financial security.

The mortality tables used for annuities differ from those used in life insurance due to the differences in the two types of contracts. People who purchase annuities are usually in good health. At higher ages the annuitants have lower mortality rates than life policyholders. To use a life insurance mortality table as a basis for annuity rates would overstate the annuity rates.

Another reason for using separate tables is the decrease in mortality rates over time. For life insurance this just adds to the margin of safety but decreases the margin for annuities. Generally, annuity tables are not based on past statistics but represent a projection of the future.

While the Commissioners 1958 Standard Ordinary Table is a prime example of the use of probability and statistics to determine mortality rate, many companies use their own tables based on the recent experience of their own company or a group of companies.

Life insurance is based on the accumulation and savings of large sums of money. Therefore, rates are not only determined by the probability of death, but also, on the funds invested to earn more dollars. Insurance companies can plan on making money on their investments. The anticipation of these earnings allows the premium of insurance to
be discounted. Interest, the price paid for money, is vitally im-
portant in insurance rate making.

Many considerations must be made in rate computations. A major
factor is whether the premium will be paid in a lump sum or on an
installment basis, and, if using installments, whether they will be
paid at the inception of risk or at some other time. The means of
investment and the rate of return are two more considerations. Also,
how and when the claim will be paid affects the calculation of rates.

To maintain secure operations insurance companies must 1) choose
very secure methods of investment, and 2) in rate determination, se-
lect a rate of interest that the firm can be sure of earning. These
two factors promote financial conservatism in the industry.

In calculating rates for health insurance, one looks at the mor-
bidity experience. As with life insurance rate determination, health
rates depend on benefits, lapse rates, interest rates, and general
business expense. However, health insurance rates are also dependent
on the economic cycle and cost variations in different geographic
locations, and the effect on cost caused by various elimination peri-
ods or deductibles. Health insurance rates use past claims experi-
ence as one factor of determination. Unlike life insurance, interest
rates are less significant in the calculation of health insurance
rates. This is because claims are paid in the earlier years of the
policy and this prohibits substantial reserve accumulation. Another
factor affecting these rates is the number of policy lapses. Rates
are affected by lapses because of the higher establishment expense
during the first year and because claim rates tend to increase over
the years.
Rate making in general is a process of data analysis and the establishment of various classifications of insureds. Basic variables used in rating health insurance are age, sex, occupational classifications, geographical area classifications, elimination periods, and dependent classifications.

Varying rates of insurance can be achieved by using different time periods of income benefit. These different periods, ranging from 7 to 180 or even 365 days, provide benefits that suit the various income-replacement needs of the insureds as well as allowing them an affordable option.

Dependent classifications usually charge a rate per child rather than for all children. The premium rate on children varies by type of coverage plan, but not according to age or sex of the child. Generally children's hospital expenses are minimal. The variable of sex alone affects health insurance rates for women by increasing them to nearly twice the rate of their male counterparts. For example, a female between the ages of 18 and 25, with a professional, non-cancellable, guaranteed renewable disability policy, pays $62.89 annually per $100 per month while her male counterpart pays $33.38 per $100 per month for equal coverage. A 228% difference by sex in the morbidity tables accounts for this difference.¹

Risk classification for use in determining auto insurance rates is generally more intensive than classifications used in determining life or health rates. Three general classifications are used to separate the risks. They are geographic area, auto, and driver.

First, the country is divided into territories. Each of these

territories is then rated by past claims experience, so the rates are not merely determined by rural, suburban, or urban classifications.

Next, the automobile is considered. Is it used for farm use, pleasure, or business? The type of auto is also a factor. The body style, (ie. stationwagon, coupe, sedan, hatchback, two- or four-door) engine size, and year of model are three sub-classifications under the classification of auto body. Insurance companies use symbol groupings for classification in this area.

The third general classification, driver characteristics, has many subdivisions used to rate the driver. Sex and age are two of the most controversial divisions.

Males under age 30 usually pay higher rates than their female counterparts. A married male under 30 pays less than if unmarried but is still considered in a higher risk age bracket. On the other hand, females are categorized as "all other" as soon as they are married and do not have to pay more because they are under a certain age. The male is not placed in the lower priced, "all other" category until he reaches 30 years of age.

Student drivers' rates are affected by their grades. Many companies give a good student discount for drivers with a "B" average or better. Whether or not new drivers have taken drivers' training classes also is considered in rate determination. These drivers receive a lower rate due to their training experience.

All drivers' insurance rates are affected by accident experience or traffic violations. If a driving record has caused a previous cancellation, this too, will affect the availability of insurance.

Health, including any problem which could affect vision or hearing, is considered in auto insurance rating.
Each of these factors, and any others, used in rate determination are based on actual claims experience. Of course, there are exceptions in any of these classes, but individual underwriting is not feasible because of the increased cost and amount of time it would require.

The following tables list some of the statistics which back the present means of classification. Also presented are price comparisons for four 21-year-olds where sex and marital status are the only variables.
### Table 1: Age of Drivers in Accidents

<table>
<thead>
<tr>
<th></th>
<th>1972 Drs in Fatal Accidents</th>
<th>Per Cent</th>
<th>1972 Drs in Non-Fatal Accidents</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under 18</td>
<td>4,100</td>
<td>6.0</td>
<td>398,000</td>
<td>7.6</td>
</tr>
<tr>
<td>18-24</td>
<td>19,800</td>
<td>28.7</td>
<td>1,545,000</td>
<td>29.5</td>
</tr>
<tr>
<td>25-34</td>
<td>14,900</td>
<td>21.6</td>
<td>1,142,000</td>
<td>21.8</td>
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<td>35-44</td>
<td>10,000</td>
<td>14.5</td>
<td>775,000</td>
<td>14.8</td>
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<tr>
<td>45-54</td>
<td>8,700</td>
<td>12.6</td>
<td>665,000</td>
<td>12.7</td>
</tr>
<tr>
<td>55-64</td>
<td>6,300</td>
<td>9.1</td>
<td>435,000</td>
<td>8.3</td>
</tr>
<tr>
<td>65-</td>
<td>5,200</td>
<td>17.5</td>
<td>277,000</td>
<td>5.3</td>
</tr>
<tr>
<td>TOTAL</td>
<td>69,000</td>
<td>100.00</td>
<td>5,237,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>

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<th></th>
<th>1971 Drs in Fatal Accidents</th>
<th>Per Cent</th>
<th>1971 Drs in Non-Fatal Accidents</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under 18</td>
<td>4,300</td>
<td>6.3</td>
<td>355,000</td>
<td>6.8</td>
</tr>
<tr>
<td>18-24</td>
<td>19,100</td>
<td>28.1</td>
<td>1,487,000</td>
<td>28.5</td>
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<td>25-34</td>
<td>14,300</td>
<td>21.0</td>
<td>1,164,000</td>
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<td>35-44</td>
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<td>6,200</td>
<td>9.1</td>
<td>444,000</td>
<td>8.5</td>
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<tr>
<td>65-</td>
<td>5,000</td>
<td>7.4</td>
<td>261,000</td>
<td>5.0</td>
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<td>TOTAL</td>
<td>68,000</td>
<td>100.0</td>
<td>5,219,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Table 2: Sex of Drivers in Accidents

<table>
<thead>
<tr>
<th></th>
<th>1972 Drs in Fatal Accidents</th>
<th>Per Cent</th>
<th>1972 Drs in Non-Fatal Accidents</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>57,200</td>
<td>82.9</td>
<td>3,833,000</td>
<td>73.2</td>
</tr>
<tr>
<td>Female</td>
<td>11,800</td>
<td>17.1</td>
<td>1,404,000</td>
<td>26.8</td>
</tr>
<tr>
<td>TOTAL</td>
<td>69,000</td>
<td>100.0</td>
<td>5,237,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>1971 Drs in Fatal Accidents</th>
<th>Per Cent</th>
<th>1971 Drs in Non-Fatal Accidents</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>57,000</td>
<td>83.8</td>
<td>3,888,000</td>
<td>74.5</td>
</tr>
<tr>
<td>Female</td>
<td>11,000</td>
<td>16.2</td>
<td>1,331,000</td>
<td>25.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>68,000</td>
<td>100.0</td>
<td>5,219,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Brochure entitled "Speed Kills."  
Travelers Insurance Company, 1973  
C-10389 Rev. 1973  
John G. O'Brien, Hartford, Connecticut
COMPARISON OF AUTO RATES*

Background factors which apply to each case:

Auto: 1978 Chevrolet Monte Carlo, symbol age 6/2

Coverage:
- Bodily injury .................. 25/50
- Property damage ................. 25
- Medical .......................... 5,000
- Uninsured motorist ............... yes
- Comprehensive amount .......... ACV
- Collision deductible .......... $100

Use: for pleasure or under 3 miles (one way) to work
- principle operator

Territory: Muncie, Indiana

<table>
<thead>
<tr>
<th>Insured</th>
<th>Six Month Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 21 year old, single female</td>
<td>$152.94</td>
</tr>
<tr>
<td>2. 21 year old, single male</td>
<td>317.82</td>
</tr>
<tr>
<td>3. 21 year old, married female</td>
<td>139.20</td>
</tr>
<tr>
<td>4. 21 year old, married male</td>
<td>180.42</td>
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</tbody>
</table>

AN EXAMINATION OF COURT OPINION CONCERNING RATE DISCRIMINATION BY SEX

The case of Marie Manhart et. al., v. City of Los Angeles, Department of Water and Power, et. al. is a landmark decision in the area of sex discrimination in pension plans. Manhart, representing the plaintiffs, brought suit challenging a retirement plan which required women employees to contribute 15% more from their wages than their male counterparts. The basis of this added 15% is the longer average life expectancy of women.

The plan was held in violation of Title VII of the Civil Rights Act of 1964 by the United States District Court for the Central District of California. A refund of all excess contributions made on or after April 5, 1972 was awarded to the plaintiffs. Appeal was made by the City of Los Angeles, Department of Water and Power. Circuit Court Judge Duniway upheld the lower court opinion.

A brief summary, with excerpts from the case, serves to represent the main argument that sex discrimination is unfair as a basis for pension contribution rates.

Circuit Judge Duniway summarizes the problem:

The question presented in this case is whether a retirement plan which requires women employees to contribute from their wages 15% more than similarly situated male employees because of the longer average life expectancy of women violates the Civil Rights Act of 1964, Title VII, as amended by the Equal Employment Opportunity Act of 1972, 42 U.S.C. paragraph 2000e-2.¹

¹Marie Manhart, et. al., v. City of Los Angeles, Dept. of Water and Power, et. al., 553 F2d 583.
The part of Title VII that Duniway refers to (paragraph 2000e-2) states:

(a) It shall be an unlawful employment practice for an employer-(1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin. 1

The Department of Water and Power (from now on referred to as "Department") justifies the 15% contribution difference by the statistics which show that, on the average, women live approximately five years longer than men.

On July 18, 1974, the plaintiffs filed their second amended complaint in which they stated four separate claims for relief. The claims, all based on the same set of data, are: Title VII, the Civil Rights Act of 1871, 42 U.S.C., paragraph 1983, the Fourteenth Amendment, and Article 1, paragraphs 1 and 21 of the Constitution of California. The plaintiffs used the claim based on Title VII as their main argument.

In response to the Department's appeal the case discussed the merits of the court's judgment:

The basis of the defendants' appeal is that, while requiring women to make larger contributions discriminates against women, there is a sound basis for the requirement, making it discrimination based on longevity, not sex, and therefore, not the kind of invidious discrimination that Title VII was intended to abolish. We disagree.

It is disputed that the overriding purpose of Title VII is to require employers to treat each employee (or prospective employee) as an individual, and to make job related decisions about each employee on the basis of relevant individual characteristics, so that the employee's membership in a

1 Ibid.
racial, ethnic, religious, or sexual group is irrelevant to the decisions...To require every individual woman to contribute 15% more into the retirement fund than her male counterpart must contribute because women "on the average" live longer than men is just the kind of abstract generalization, applied to individual women because of their being women, which Title VII was designed to abolish. Not all women live longer than all men, yet each individual woman is required to contribute more, not because she as an individual will live longer, but because the members of her sexual group, on the average, live longer.¹

In response to this argument the Department claims that it was not the intent of Congress for Title VII to prohibit making sexual distinctions when statistics could provide a reason for such distinctions and when it is impossible to determine when the person is going to die before the actual occurrence. The argument follows that because there is no dispute to the fact that women do generally live longer, and because one cannot determine which women will live longer, higher contribution requirements for all women should not be prevented by Title VII.

In previous Title VII litigation the court has used two basic policies as guidelines. The first is the major emphasis of the statute: the policy against characterizing individual members of a group by the traits common, in general, to that group. The second guideline allows relevant employment factors to be used in discriminating among individuals. These two guidelines are in conflict in the Manhart case.

In the present case a relevant characteristic in determining how large an individual's retirement contribution should be is an informed prediction as to how long the person will live. But this characteristic, unlike those in the

¹Ibid., 585.
prior cases, is impossible to determine on an individual basis at the time when the contribution must be made. Thus, the policy of allowing relevant factors to be considered can be met only by allowing the group longevity statistics to be attributed to the individual members of the group. Yet this is exactly what the thrust of Title VII prohibits. We are therefore faced with the unique case in which the policy against per se discrimination directly conflicts with the policy of allowing relevant factors to be considered.  

The Department supports its argument for the use of actuarial distinction with the "bonafide occupational qualification exception" in 42 U.S.C. paragraphs 2000e-2(e) and the Bennett Amendment to Title VII (42 U.S.C. paragraphs 2000e-2(h). Both policies are very general and neither specifically covers actuarial distinction as is being questioned in this case.

The "bonafide occupational qualification exception" allows discrimination on the basis of religion, sex, or national origin where those factors are bonafide occupational qualifications reasonably necessary for performance of normal business operations. However, discrimination against women concerning their retirement contributions has no affect on the ability of the Department to serve the City of Los Angeles with water and power. The court goes on to say that actuarial classification based on longevity factors (smoking, drinking, normality of weight, family medical and longevity history) are not used to determine levels of contribution. Based on these two arguments the court finds that the "bonafide occupational qualification exception" does not permit sexual classification.

The second support of the Department's argument is the Bennett Amendment which allows discrimination on the basis of sex in

1ibid., 586.
determining wages or compensation if the payment is made pursuant to seniority, merit, measurement of earnings by quantity or quality of output, or any non-sexually based differential. (The Equal Pay Act)

It is this final allowance, permitting discrimination based on any non-sexual differential, which the Department says allows actuarially based discrimination. However, the court claims that sex is what the actuarial data is based on, and therefore, it is not a non-sexual differential.

We emphasize that our holding rests on the clear policy behind Title VII of requiring that each employee be treated as an individual; it treats each employee only as a member of one sex. We do not pass judgment on the legality of a plan which determines contribution rates based on a significant number of actuarially determined characteristics, one of which is sex. Our holding is limited to the proposition that when sex is singled out as the only, or as the predominant factor, the employee is being treated in the manner in which Title VII forbids.\(^1\)

The court also held that the excess payments made by the women must be returned to them in an effort to balance the equities even though the reimbursement would leave the retirement plan underfunded.

In an article in The Journal of Risk and Insurance, Gerald D. Martin discusses the arguments used in the Manhart and other similar cases. Martin is Associate Professor of Finance at Eastern Kentucky University and appeared as a witness for the plaintiff in the Mary Robertson, et. al., v. Indiana State Teacher's Retirement Fund Board, et. al.\(^2\) case. The Indiana case also involved discrimination

\(^1\)Ibid., 590.

\(^2\)Mary Robertson, et. al., v. Indiana State Teacher's Retirement Fund Board, et. al., Vanderburgh Circuit Court, Ind. Civil No. 4098
between the sexes concerning pension plans, however, it challenged unequal benefits rather than unequal contributions. The time period during which the discrimination takes place is a major difference between these two cases. When it is the benefits that are unequal, females receive less after they have retired. Unequal contributions discriminate before retirement. At any rate, the arguments used to show economic disparity between the sexes in the Indiana case are applicable to the California case.

The general arguments used can be categorized as the "overlap" argument, the argument for individuality, and the measurable degree of discrimination.

The "overlap" argument, diagrammed on the following page, matches 82.5% offsetting deaths.

Through age 83, male deaths, according to the converted GAM (Group Annuity Mortality) table, are expected to exceed female deaths by 17,096, and after age 83 female deaths exceed male deaths by the same number. Among the 200,000 (total) persons en- tering at age 65, the number dying in the overlap area is...approximately 83 of every 100.\(^1\)

For example, at age 82, 4,234 male deaths and 3,774 female deaths would occur from the original 100,000 males and 100,000 females who entered the sample at age 65. According to this argument, each of the 3,774 females who died were discriminated against because they did not live longer than their male counterparts. Martin claims that "the argument that females live longer than males is a generality that applies to a minority and not the majority."\(^2\)


\(^2\)Ibid., p. 209.
Mortality Distribution of 100,000 Males and 100,000 Females Entering at Age 65*

different periodic taxation burdens as between a
man and a women. (See 26 U.S.C. paragraph 72(c)
(3) (A); Regs. paragraph 1. 72-9.)1

After addressing the insurance side of the case from the court's
point of view, it is necessary to look at the further arguments made
in Chapter 3. First, rebuttal to the "overlap," or matching of 83%
of the deaths, will be discussed. Second, the argument for use of
individuality in rate determination will be considered. And, finally,
reply will be made to Martin's argument concerning the inequality
of male versus female standards of living and the measurable degree
of discrimination.

The "overlap" argument, originally discussed in Chapter 3,
states that 82.9% of the deaths in any group of males and females can
be matched on a one-to-one, male-female basis. Because of the high
percentage overlap, the conclusion is made that many females do not
outlive their male counterparts and therefore should not be charged
a higher rate for annuities.

The countering viewpoint is that for every 82.9% of the deaths
which do overlap, 17.1% do not overlap. In this 17.1% of unmatched
deaths all male deaths occur before age 83, (a break-off point used
in the study) in fact, most male deaths in this group occurred
around 74 years while female deaths in the category (17.1%) did not
take place until well after 90 years.2

Further study finds that the 82.9% overlap is found when com-
paring males age 60 and 65. A five-year age differential creates

1Ibid., p. 598.
2Bob Meyers, "Further Comment," The Journal of Risk and Insurance,
March 1977, p. 144.
the same effect as the sex difference. This finding does not, however, back a movement for use of a "uni-age" table. There are many additional factors affecting mortality, (health, occupation, race, heredity, locale, personal habits) but no two factors are as strongly influential as age or sex.

The viewpoint that female longevity denies equality for women does not consider this basic requirement of annuities:

...that annuities must be paid over the entire lifetime of every male and every female to whom the life income commitment is made. All lives must be taken into account. The "overlap group" cited in the argument is merely hindsight observation of coincidental dates of death of part of the group. It fails to take into account the fact that income amounts must be set in advance and must be paid as long as there are any male and female survivors.¹

The following table shows the actuarial survival experience of 1,000 males and 1,000 females from retirement at age 65 to death. One can easily see evidence of female longevity. It is these data and more like them which are the basis for annuity payments under the present system. This system is shown graphically in chart 1. As a comparison, chart 2 graphs payments under a "50-50 unisex" payment program. Obviously, the total dollars paid out to women under the second program far exceed the total dollars paid out to men under the same program. Chart 1 (the present system) shows an "evening out" of total dollar payments to men and women over the years from 65 to 100. By this system neither sex (as a group) receives more benefits than the other.

This leads to discussion of the merits of rating on an individual

Survival Experience of 1,000 Males and 1,000 Females Retiring at Age 65
A-1974 (1, 2½) Annuity Table*

<table>
<thead>
<tr>
<th>Age</th>
<th>Number of Males Surviving</th>
<th>Number of Females Surviving</th>
<th>Surviving Females as a Percentage of Surviving Males</th>
</tr>
</thead>
<tbody>
<tr>
<td>65</td>
<td>1,000</td>
<td>1,000</td>
<td>--</td>
</tr>
<tr>
<td>70</td>
<td>907</td>
<td>956</td>
<td>105%</td>
</tr>
<tr>
<td>75</td>
<td>775</td>
<td>882</td>
<td>114</td>
</tr>
<tr>
<td>80</td>
<td>596</td>
<td>762</td>
<td>128</td>
</tr>
<tr>
<td>85</td>
<td>383</td>
<td>584</td>
<td>152</td>
</tr>
<tr>
<td>90</td>
<td>179</td>
<td>357</td>
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</tr>
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<td>95</td>
<td>49</td>
<td>144</td>
<td>294</td>
</tr>
<tr>
<td>100</td>
<td>6</td>
<td>29</td>
<td>483</td>
</tr>
</tbody>
</table>

1,000 males and 1,000 females retiring at age 65 electing single life annuities. Each male receives $5,000 a year and each female receives the actuarial equivalent, $4,490.

1,000 males and 1,000 females retiring at age 65 electing single life annuities. Under "unisex" each male and each female receives $4,730 a year.

basis. Insurance rating has always been based on statistical data taken from large test groups and on laws of probability. (See Chapter 2.) Historically, the industry has used these data to continually refine and further classify groups of insureds. Classification of risk has allowed lower premiums for those in lower risk groups, thus preventing extreme subsidization of high risk insured by low risk insureds.

The use of unisex and/or no sex mortality tables prevents the classification of risk by sex. In pension plans men, the lower risk, would need to subsidize the higher risk insured, women. The reverse would be true in life insurance, where women pay less because of their predicted longevity. Men's life insurance premiums would be subsidized by women if no sexual classifications could be enforced in this area. The effects could be drawn into health insurance, too. Women pay much higher premiums in health insurance because their morbidity rate is 228% greater than the morbidity rate for men. If no sex distinctions can be made, the male population would have to absorb the higher cost of health insurance for women. In the property-liability field of insurance, nearly everyone's rates would increase to account for the high-risk, young, unmarried male.

Bob Hedges states:

The use of mortality tables attempts to predict only the life expectancy of the group and does not consider the individual female. These tables cannot predict the life expectancy of any particular individual, regardless of sex. Since actuarial tables do not predict the length of any individual's life, any claim that such tables may be used to assure equal ("fair"? "non-discriminatory"? "identical"?) pension benefits to males and females over their lifetime, must fail.¹

From these arguments one can conclude that equal benefits can only be achieved if probability is not considered and payments are for a guaranteed amount for a guaranteed period of time. Equality perforce and accountability for risk are mutually exclusive characteristics of a pension plan.

Hedges also responds to Martin's argument (Chapter 3) that the difference in male and female living standards created by the difference in pension payments is the measurable degree of (unfair) discrimination. Hedges' solution for a higher standard of living for females, based solely on pension plan payments, is for women to retire later. Taking into account women's longevity, the years after retirement would equalize for females and males, thus, equalizing pension benefits and payments, if women would work longer (retire later) than their male counterparts.

After looking at both sides of the argument, it is natural to look to what the consequences might be, if the court decision causes a change. As a result of the Manhart decision, the Equal Pay Act might be amended to require equal contributions and equal benefits for men and women in similar situations under employer-sponsored pension plans. The problem caused by this is one for the employer. The proposal does not apply to the pension and insurance companies, directly. These companies can continue to use sex-based mortality tables to figure pension benefits. It is the employer, because he is subject to the provisions of the Equal Pay Act, who must make up the difference, to comply with the new guidelines. Certainly this situation would be very costly for any institution affected by the guidelines, and would create litigation which could continue for years.
It is questionable how much the recent decisions will affect the insurance companies directly. Justice Stevens, writing for the majority in the Manhart case, states that it was not the intent of the court to revolutionize the insurance industry.

Although we conclude that the Department's practice violated Title VII, we do not suggest that the statute was intended to revolutionize the insurance and pension industries. Nothing in our holding implies that it would be unlawful for an employer to set aside equal retirement contributions for each employee and let each retiree purchase the largest benefit which his or her accumulated contributions could command in the open market.¹

The degree of influence seems to hinge on whether one believes that the decision is aimed at the employers (as exemplified above) or that it is promoting the use of no sex unisex tables.

Barbara J. Lautzenheiser of Bankers Life-Nebraska is strongly opposed to no sex, unisex tables, "...the no sex, unisex table or equal monthly benefits would appear to provide more inequities, more unfair discrimination, than we have now."² This is based on the biological and actuarial fact that women live longer than men. Lautzenheiser says there is a dual mortality, thus, the duality of mortality tables. Discrepancy in the interpretation of Federal regulation causes some people to promote the use of one table for both sexes. However, this is not an appropriate solution to the problem because the no sex, unisex tables treat unequal groups equally. This only serves to further distort insurance and pension programs, claims Lautzenheiser.


The National Underwriter names four examples of types of unfair discrimination which, according to Ms. Lautzenheiser, can be caused by no sex, unisex tables.

1. If a company chooses to use a proportioned unisex table, it eventually will discover that as the proportion of women participants increases, the cost of the benefit program also increases. The company may then move toward limiting the number of women employees.

2. A reverse discrimination occurs in life insurance programs. The cost for women increases and the cost for men decreases. In sex biased actuarial tables, the cost for women is lower because of their expected longevity. The no sex table, in effect, forces women to subsidize male insurance rates. Men then receive more insurance per dollar than they would under sex biased tables. Ms. Lautzenheiser notes that this could be construed as pay discrimination.

3. The use of unisex tables discriminates against small companies. In a large company the addition of a few male or female employees does not have a major effect on a proportioned unisex table. But in a small company the addition of even one more male or female employee could distort the proportioned actuarial table. A company could choose to select its employees to conform to the ideal proportion of its actuarial plan.

4. Adverse selection of pension plans would result with the use of no sex, unisex tables. Companies with a high proportion of women would choose a no sex, unisex program because the initial costs would be lower. Companies with many male employees might choose to discontinue pension programs rather than adopt a no sex table and advise their employees to participate in an individual retirement account program.¹

¹Ibid., p. 14.
Chapter V

SUMMARY AND CONCLUSIONS

This chapter summarizes the study of rate discrimination practices presented in the previous chapters. It also provides a list of conclusions which can be drawn from the study. Summary comments are divided into sections corresponding to the preceding chapters. Specific conclusions pertaining to each chapter follow these comments. General conclusions complete the chapter.

The Problem

Summary. The case of Marie Manhart et. al., v. City of Los Angeles, Department of Water and Power, et. al. served to introduce and popularize the problem of unfair discrimination based on sex in the insurance industry. This case was used as a core for this study.

The formal statement of the problem was presented as:

The purpose of the study is to examine the extent and rationale of price discrimination, specifically that based on sex, in the insurance industry. The study will explore discrimination in pension plans, health insurance, life insurance, and auto insurance.¹

Chapter I also contained discussion on the significance of the study. Public interest is evidenced by the recent litigation in the courts. The scope of the study and basic assumptions used as a foundation in the study are found in Chapter I. Definitions of pertinent terms, an over-view of the design of the study, and

¹This problem statement appears in Chapter I, supra, p. 3.
discussion of some of the related literature complete the information found in Chapter I.

Conclusions. The problem develops at the point where present rate determining rationale used by the insurance industry is questioned by the court system. The rulings made by the justices, with little or no background in actuarial science or insurance, will be more than suggestions or guidelines. They will become laws which must be met by the insurance industry.

The problem, then, is caused by basic misunderstandings of the insurance system and its actuarial basis by the general public (those bringing suit) and the justices who are in a position to decide the suits. Those questioning the present system advocate making no distinction between the sexes even though some characteristics, longevity in this case, differ from one sex to the other. It hardly seems logical that this viewpoint, held by people who are not experts in actuarial science, should regulate the insurance field.

Changes, at this point, will be determined by the impact of present rulings and future litigation. If methods of price determination in insurance are forced, by law, to change, changes in the entire industry are inherently forthcoming.

Background information

Summary. Chapter II discusses the background of rate-making. An introduction to the basic principles of actuarial science and statistics used in rate-making is provided before the rate-making in specific areas of insurance is discussed.

The foundation of insurance pricing is found in the statistical data, number of claims experience whether in life, health, annuities,
or auto, and in the laws of probability. Then, the statistical data and the laws of probability are applied to the prospective insureds. In taking the data, the law of large numbers must be strictly adhered to in order for the data to be accurately applied.

In life insurance this information is compiled to make mortality tables. The Commissioners 1958 Standard Ordinary Table is shown as an example of such a table. (It is found in Chapter II of this study.) This table shows the probability of death for any age male from 1 to 100 years based on 10,000,000 lives. In addition to mortality rates, the accumulation and savings of large sums of money are used to determine life rates. Insurance companies use their holdings to invest and increase these amounts. This allows the discounting of insurance premiums.

Calculation of annuity rates also depends on mortality, however, the mortality tables used in pension cost planning differ from those used in life insurance pricing. The differences are due to the characteristics of potential buyers of the two contracts. Buyers of annuities are generally in good health, so, the mortality rates of this group are lower than whole life policy holders of equal ages. Annuity mortality tables, rather than being based on experience, must represent future projections of mortality because of the constantly decreasing mortality rate of the population.

Rate-making for health insurance is based on morbidity experience. Major determinants of these rates are benefits, lapse rates, interest rates, and general business expenses incurred. Past claims experience is the main source of data for morbidity statistics. The claims of women in the health insurance field are 228% those of
men. This is the reason for women's health rates being nearly double men's rates.

The classification for insurance rates in auto insurance is more extensive than classification in other areas. Geographic area, the auto(s), and the driver(s) are the areas that are classified to determine insurance rates. The vehicle is classed by age, use, and style and type of auto. Three main characteristics of the driver that affect rating are: sex, age, and marital status. The reasoning behind different rates based on all these characteristics is claims experience.

Conclusions. The determination of rates, based on statistical data, is the insurance industry's attempt at fair pricing. Through further classification of risks, the lower-risk insured benefits by receiving lower rates than an insured whose characteristics indicate a greater probability of loss. By not classifying risks or using fewer classifications, insureds would be further subsidizing other insureds causing the low risk to pay for the higher risk. In other words, the more classifications used, the fairer the price. This is one way for the industry to come close to individual pricing while still using the currently used statistical data and law of large numbers.

Examination of Court Opinion

Summary. The Manhart case is a landmark decision for insurance rating in pension plans. For this reason it is the basis of the discussion of court opinion in Chapter III. The court's statement of the Manhart problem is presented by Circuit Judge Duniway:
The question presented in this case is whether a retirement plan which requires women employees to contribute from their wages 15% more than similarly situated male employees because of the longer average life expectancy of women violates the Civil Rights Act of 1964, Title VII, as amended by the Equal Employment Act of 1972, 42 U.S.C. paragraph 2000e-2.1

Chapter III, specifically the Manhart case, addresses itself to the legality of making sexual distinctions when such distinctions are the result of actuarial statistics. The court claims that sexual distinctions, whether statistically based, or not, are not in compliance with the Civil Rights Acts, Title VII. Title VII requires people to be treated as individuals and not members of a specific group or sex. Conversely, the insurance industry, as stated in Chapter II, is based on grouping people and applying group generalizations to the individual members of that group.

Chapter III also discusses some of the general arguments used to prove unfair discrimination. The "overlap" argument which states that 82.9% of the deaths in a population of equal number of males and females can be matched or offset, is a major defense of unfair discrimination.

Further argument is made on the basis that no individual's time of death can be predicted, therefore, the trait of the longevity of a group should not necessarily be applied to any individual member of that group. For example, just because women, as a group, have a record of longevity, there is no proof that a particular woman will have this trait.

A final argument discusses the inequality of standards of living

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1This quote appears in Chapter III, supra, p. 17.
for males and females if the standard is based on pension alone. A female has no chance of living at the (higher) male standards because of the lower pension limits for females. This argument continues to say that men could opt to live at the standard of living allowed by the lower, female pension payments and invest or save the difference. This provides males with the option to leave savings to their survivors, an option which females do not have the opportunity to exercise.

Conclusions. There are arguments for dispensing with the current actuarial system, however, the reasoning behind such theory is based on a misunderstanding of the current actuarial method.

The decision of the court, that one cannot use longevity as a basis for rate differentials because it is a trait attributed to one sex and not the other, indicates a misunderstanding of the terms "equal," "fair," and "discrimination." Rates for men and women (other factors being the same) are not equal (numerically the same). The rates are discriminatory; they do distinguish by discerning or exposing differences. (See definitions, Chapter I, page 5.) However, neither of these facts makes the rates unfair. Webster's definition of unfair is: marked by injustice, partiality, or deception.\(^1\)

It seems that the court advocates ignoring one major point in this problem: the longevity of women. Because longevity makes the rates unequal, which has been inaccurately construed as being unfair, the courts wish to discard this information. Obviously, one cannot disregard certain evidence on this basis and still look at the problem (or the solution) objectively.

Summary. This chapter begins with statements of the opinion of Circuit Judge Kilkenny. He closes his statement of the dissenting opinion to Manhart with the conclusion "...that the discrimination, if any, fostered by this plan is of a type which did not concern Congress when enacting Title VII...."¹

Chapter IV continues by offering response to the arguments made in Chapter III. Referring first to the 82.9% "overlap" argument, Chapter IV points to the 17.1% of deaths that do not overlap. The chapter further refutes the "overlap" argument by showing that this same matching of deaths can be found with a five-year age difference variable. The reasoning of the original "overlap" discussion could be extended, with this new information, to "prove" that age does not affect probability of death. The absurdity of this line of reasoning serves to disprove the original ideology.

The argument for not applying group traits to individual members of the group is also addressed in this chapter. Evidence of the longevity of women is shown in tabular form. Graphically, charts 1 and 2 show total pension payments for men and women under the present system and under a theoretical system based on a "50-50 unisex" payment program. The graph (Chart 1) showing payments under the present system, which differentiates between the sexes, shows that total payments to men and women as groups are evened out over the lifetimes of the group members. It is for this reason that the insurance industry does distinguish between male and female.

¹This quote appears in Chapter IV, supra, p. 27.
As to the argument that pension plans promote different standards of living, one solution, based on the acknowledgment of female longevity, is for women to retire later than males. This would equalize the years from retirement to death thus, equalizing pension benefits and payments.

The chapter concludes with a list of four types of unfair discrimination which can result from the use of no sex tables. **Conclusions.** The presentation made in this chapter is of a more scientific measure than the mere cries of injustice and the reasoning in Chapter III. To deliberately not classify groups which can statistically be classified is in opposition to the basic premise on which insurance operates.

The points made here, in favor of classification by sex, are expressed by experts in insurance and actuarial science. Their expertise and knowledge in the area adds weight to the arguments they present.

Many people today are much too eager to label situations as discriminatory or unfair without consideration for what the words actually mean. Likewise, classification of people has taken on a more negative connotation than it deserves. Some classifications are just—much more so than would be the case should classifications be deliberately ignored when differences are obvious.

**General Conclusions**

At the outset of this study some basic assumptions were made. The assumptions hold.
1. There is a need for insurance as a means of transferring the risks encountered in average life situations of today's society.

2. Derived from the assumption of the need for insurance is the requirement for a fair way of determining the payment necessary to provide the service of risk transfer.

3. The "correct" method for rate determination does not depend upon further collection of data and study, as much as it does on the decision of the consumer as to the way consumers want to be rated.

Without the truth of these assumptions the problem presented here would not be a problem. If the need for insurance were not so great the dissatisfied consumer could merely opt not to buy. However, the problem was presented and the study was made. The necessity involved will force an equitable solution.

Although the court has ruled in the Manhart case, and in others relating to sex based discrimination in insurance, the consequences of the rulings are not definite. At this point, the Manhart decision is affecting what employers must do more than what is required of insurance and pension companies. While the rulings will cause some changes, the basis for the industry (classification of risks) is just that and change there will be incremental.

The reasonable alternative to the present system, in light of Title VII of the Civil Rights Act, is for employers to allow employees to purchase their own pension plans in the open market. In this way the employers can follow all regulations set for them and the insurance industry can continue using their present method of rate determination. However, if the regulations are extended to the insurance companies themselves, the entire system would have to be revised.
Such a revision would cause more problems than it would solve by satisfying the Manharts and Robertsons. A very elementary example of the problems inherent in not using a classification system for rate determination can be seen in the situation of auto insurance. While the young, unmarried male is unhappy with his rates until he reaches the "all other" category, after reaching it, he does not want to subsidize the higher risk drivers who are not in the "all other" category.

If the insurance industry was not allowed to use past claims experience to categorize risks, the subsidization would be much, much greater than it is under the present system. This applies in all areas, not just auto.

After an elementary introduction into rate determination (as found in Chapter II) one can see that classification of risks is not only necessary under the present system, but also advantageous to the consumer in the long-run. The greater the degree of classification allows for a lesser degree of subsidization of higher risk by the lower risk.
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