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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

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BEFORE THE  
SUBCOMMITTEE ON LABOR  
SENATE COMMITTEE ON LABOR AND  
HUMAN RESOURCES

ON  
ECONOMIC IMPLICATIONS OF  
UNISEX PENSIONS

FOR RELEASE ON DELIVERY  
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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss with you our work on women's pension issues. In response to a request from Senators Hatch, Weicker, Kassebaum, and Hawkins, we have been examining the economic impact of S. 372, the Fair Insurance Practices Act, on all the various lines of insurance that would be affected. In particular, they requested our review of six specific studies of the economic implications of unisex pensions and insurance. <sup>1/</sup>

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<sup>1/</sup>The six studies which we were specifically asked to review are:

(1) American Academy of Actuaries (AAA) study presented in testimony before the House Energy and Commerce Subcommittee on Commerce, Transportation, and Tourism, May 20, 1981, and revised in testimony presented to the same subcommittee, February 24, 1983.

(2) Department of Labor (DOL) study, "Cost Study of the Impact of an Equal Benefits Rule on Pension Benefits," Draft, January, 1983.

(3) American Council of Life Insurance (ACLI) study, "Estimate by American Council of Life Insurance of the Increase in Annual Costs of Pensions Plans that would be Occasioned by the Enactment of S. 2204 [equivalent to S. 372]," November 24, 1982.

(4) New York State Teachers' Retirement System (NYSTERS) study, "Affidavit of Albert Alazraki, Actuary of the New York State Teachers' Retirement System, in the case of Hannahs v. New York State Teachers' Retirement System, No. 78 Civ. 2451 (S.D.N.Y.)," October 30, 1981.

(5) D-3 Advisory Committee report, "Private Passenger Automobile Insurance Risk Classification," Report of the D-3 Advisory Committee to the Task Force on Rates and Rating Procedures of the National Association of Insurance Commissioners, May, 1979.

(6) 1979 SRI report, "Choice of a Regulatory Environment for Automobile Insurance," SRI International [formerly Stanford Research Institute], May, 1979.

As requested in your letter, we will confine our remarks today to the effects of the bill on pensions. Since many pension plans are insured by insurance companies, however, we will also comment on the effect the bill may have on the life insurance industry.

Before proceeding further, however, I must emphasize that what I will discuss with you today represents only preliminary findings on the effects of S. 372. We are currently putting together our draft report and, before issuing a final report, will ask the Department of Labor to review our draft. Our findings must therefore be recognized as tentative.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

We have reviewed the six studies which we were asked to review, and have sought information on the effects of unfunded liabilities and on the nature and extent of redistributive effects, economic efficiency effects, and administrative costs in pensions and the various affected lines of insurance.

In many cases it is impossible to say exactly what the consequences of the bill would be. The consequences would depend upon the adjustments that insurance companies, pension plan sponsors, and state insurance regulators would make in response to the bill. We can analyze the incentives that will operate on the affected parties, and the actions that could be expected in response to these incentives, and we can identify possible outcomes. But we cannot make any definite forecast of what the effect of the bill would be. In addition, the time available to

us necessitated limiting the comprehensiveness of the information which we were able to assemble.

As indicated previously, we believe that the four major effects of the bill will be its effect on creating unfunded liabilities, its redistributive effects, its economic efficiency effects, and its administrative costs. Most of our information relating to pensions concerns unfunded liabilities and administrative costs, so we will focus today on those two areas.

#### UNFUNDED LIABILITIES

The "topping-up" provision of S. 372 (Sec. 4(c)(2)) requires that equalization must be achieved by raising payments to the sex receiving lower payments without reducing payments to the sex receiving higher payments. The average level of payments would thus rise, without necessarily being accompanied by any corresponding increase in revenue. Because liabilities would increase without being accompanied by any increase in funding, unfunded liabilities would be created or enlarged for pension plans and insurance companies. <sup>2/</sup>

#### Pension Plans

In pension plans, topping up would be required for the annuity options received by women in "defined contribution" plans,

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<sup>2/</sup>Strictly speaking, an insurance company is not permitted to have an unfunded liability. We use the term "unfunded liability" loosely here to refer to the increase in liabilities for an insurance company which must be "funded" by an increase in the company's reserves. For convenience, we refer to these increases in liabilities, along with the more conventional unfunded liabilities of pension plans, as the unfunded liabilities created by S. 372.

and for many of the early-retirement and joint-and-survivor options for men in "defined benefit" plans, thus creating unfunded liabilities in both kinds of plans.

In a defined contribution plan, equally situated men and women now get equal amounts if they select a lump sum benefit, but women who select a life annuity option may get lower monthly annuities to compensate for their greater expected longevity. For men and women who selected the annuity option and are already retired, S. 372 would require that women's benefits be topped up to equal those of men. For men and women who are still working, S. 372 would require that future annuities be paid out on a unisex basis. Increased benefits to current retirees would increase costs to defined contribution plans. It is not clear, however, to what extent the topping up provision, when applied to past accruals for active employees, would increase costs for defined contribution plans. Some defined contribution plans have made commitments to a particular monthly annuity or to a particular rate at which lump sums are to be converted into annuities. These commitments are generally conservative, and the actual annuity or conversion rate is usually more liberal than the annuity or conversion rate which has been promised.

Nonetheless, the bill would require that both men and women be granted no less than the higher of the two annuity or conversion rates that have been promised. In many cases, the higher of these two promised rates is less than the rate actually paid to women, because interest rates have turned out to be higher

than the conservative interest rates assumed. In these cases, topping-up would impose no costs. In a few cases, however, where less conservative interest rates are assumed, the rate promised to men could be higher than the actual rate paid to women, so that the topping up requirement would impose a real cost. It is thus uncertain what proportion of past accruals in defined contribution plans would impose real costs when topped up.

In a defined benefit plan, the normal benefit is a single life annuity, which is already paid on a unisex basis. But sex-distinct actuarial tables are used in many cases to convert the unisex annuity into other optional benefit forms. When a joint-and-survivor option is chosen, for example, under which the annuity continues through the life of the retired employee's surviving spouse, men receive lower monthly benefits than women, to compensate for the fact that a male employee's wife is more likely to survive him than a female employee's husband is to survive her. Similarly, men electing early retirement and lump sum options in some plans receive lower benefits because of the use of sex-distinct actuarial tables.

We reviewed several studies of the size of the unfunded liabilities created by S. 372, including four studies (the AAA, DOL, ACLI, and NYSTERS studies) which we were specifically asked to examine. None of the estimates presented in these four studies is directly applicable to estimating the overall pension liabilities imposed by S. 372. The AAA has withdrawn the estimate given in their study. The NYSTERS study applies to only one plan.

ACLI's estimate is derived from the DOL estimate, incorporating adjustments to reflect different methodological and actuarial assumptions. We have therefore focused on the DOL study. Our adjustments to the DOL estimates are shown in Tables 1 and 2 which are attached to this statement.

We estimate unfunded pension plan liabilities of \$7.7 to \$11.0 billion, of which \$2.9 to \$3.6 billion would be borne by state and local governments, \$4.0 to \$6.4 billion would be borne by private employers, and \$0.8 to \$1.0 billion would be borne by insurance companies.

At the request of ACLI, the actuarial firm of Milliman and Robertson assembled estimates of unfunded liabilities from the forty largest public plans in the United States representing about 70 percent of all state and local government employees.

Milliman and Robertson report that these plans estimate \$5.0 billion in total unfunded liability created by the bill. Of this total, perhaps \$1.6 billion is for topping up of future accruals which we do not believe would be required under S. 372 once the Norris decision is implemented. The net unfunded liability would thus be about \$3.4 billion. If we expand this figure to include omitted plans, the total would be about \$4.9 billion. This exceeds DOL's estimate (as adjusted by GAO) of about \$2.9 to \$3.6 billion. Since it is difficult to say which is more accurate, we would conclude that the total liabilities for public plans are likely to fall between the two estimates, i.e., between \$2.9 and \$4.9 billion.

There is some chance that the actual increase in liabilities will be less than these estimates imply. Some pension plans may be able to reduce their liabilities somewhat by reducing future pension accruals. Others may attempt to drop some of the options (such as the annuity option in a defined contribution plan or the early-retirement option in defined benefit plans) which they currently offer in their plans, because it is these options that produce the unfunded liabilities. Such actions could face legal challenges to the extent that dropping the option impaired employees' contractual rights under the plan or reduced the value of their accrued benefits, however.

#### Insurance

About 28 percent of pension fund assets are in plans insured by life insurance companies. The security of these plans could be affected by unfunded liabilities created for these companies in their life insurance lines.

The only study we have of unfunded liabilities for insurance companies is an ACLI survey of its members. ACLI asked its members to compute the unfunded liabilities created by the bill. Apparently, most of the firms responding assumed that their adjustment to the unisex environment would be achieved by topping up coverages and cash values without changing premiums. On this basis, the 153 member companies responding to the survey, which represented about eighty percent of the assets of the life insurance industry, reported unfunded liabilities totalling \$14.5 billion.



Since these estimates were prepared independently by the 153 responding companies, we have not reviewed the methodologies used in this study in detail, and thus cannot comment on the accuracy of this estimate. More importantly, however, the estimate is predicated largely on one particular assumption about how insurance companies will respond to S. 372. The bill specifically authorizes insurance companies to adjust premiums (subject to state approval) rather than coverages and cash values. Adjusting premiums on contracts currently in force may prove quite difficult, but to the extent premium adjustments prove to be a practical alternative, the increase in unfunded liabilities would be much smaller.

#### PBGC

Finally, PBGC estimates that its unfunded liabilities resulting from the bill would be about \$25 million. This includes only increased costs for plans already under PBGC's trusteeship, not the possibly increased costs of plans which might terminate because of the unfunded liabilities imposed by the bill. The increase in pension liabilities could induce some defined benefit plans to terminate, potentially increasing the liabilities of PBGC, which insures such plans. PBGC staff, however, have told us that they believe that the possibility of plans imposing substantial new liabilities on PBGC due to terminations resulting from the requirements of S. 372 is slight, partly because the increase in liabilities imposed by the bill is small relative to the total liabilities of the plans, and partly because most plans

which terminate with substantial unfunded liabilities not covered by their net worth terminate for reasons other than the cost of the plan (e.g., bankruptcy).

#### Effects of Unfunded Liabilities

In the long run, the major impact of these unfunded liabilities will be redistributive, that is, they will result in financial transfers from one group of people to another. The \$7.7 to \$11.0 billion estimated by DOL (as adjusted by GAO) represents the present value of the increased pensions that will be received by retirees. It thus represents both \$7.7 to \$11.0 billion in benefits received and \$7.7 to \$11.0 billion in costs imposed.

The initial increases in pension benefits will be enjoyed by both men and women. Women will experience benefit increases from defined contribution plans, while men will experience benefit increases from defined benefit plans. The actual proportion of benefits received by men and women is uncertain, because benefits are likely to be shared with spouses to some extent, and some of the benefit increases will be received directly by surviving spouses rather than by retired employees. DOL has estimated that 55 to 95 percent of the benefit increases would go to men. That estimate does not take into account benefits received by surviving spouses and does not take into account sharing of pension benefits with spouses while the retired employee is alive. If one incorporates the effect of higher benefits to surviving spouses and assumes no sharing of income between married retired employees and their spouses, women would receive 26 to 36 percent

of the benefits. On the other hand, if one assumed that all benefits to married retirees should be thought of as shared equally with their spouses, women would receive 56 to 58 percent of the benefits.

Increased benefits mean higher costs to pension sponsors. Eventually, the sponsors will recover most of these costs, but it is impossible to predict the pattern in which these costs will be recovered. Retired employees may receive smaller ad hoc pension increases; active employees may receive smaller wage increases and/or smaller pension and other fringe benefit increases, or even benefit reductions; employers may pass costs on to customers or perhaps suppliers; state and local governments may pass costs on to taxpayers in the form of tax increases or service reductions. There may be some redistribution from younger active employees to older active employees and retired employees.

In the short run, the unfunded liabilities created by S. 372 will cause some disruptions. The severity of these disruptions will depend upon (1) the size of the unfunded liabilities; (2) the time available for insurers and pension plans to adjust to the unfunded liabilities; (3) the uncommitted financial reserves available to the institutions to meet these increased liabilities; and (4) the legal constraints on the flexibility of the institution to respond to these liabilities.

Pension plan sponsors have some degree of flexibility in dealing with the increased liabilities. The plan sponsor could reduce the rate at which pension benefits are earned in the

future or reduce ad hoc increases for retirees that might otherwise have occurred. The sponsor might also be able to reduce the plan's liabilities to some extent by changing its actuarial assumptions, as long as they were considered actuarially reasonable. Finally, the sponsor could rearrange the pattern in which payments must be made by changing its actuarial cost method. This would not reduce the total expenses incurred, but might make the payments more bearable by rearranging them in time.

Perhaps the more serious adjustment problem arises with respect to life insurance companies because they are required by state law to carry full reserves to back up the actuarial present value of their liabilities. If their liabilities increase, they must increase their reserves or become legally insolvent. Recall, however that the effect of S. 372 on insurance company liabilities depends on how insurance companies adjust to the unisex environment.

In the ACLI study, where many firms assumed that the adjustment would be through higher coverage and cash values, most nonetheless appeared to have sufficient funds available in their surplus accounts to meet the increased reserve requirements imposed by S. 372. But 24 of the 153 firms responding to the survey reported that they did not have sufficient surplus funds to provide the increase in legally required reserves. There are likely to be other firms not members of ACLI, or who did not respond to the survey, who would also have insufficient surplus funds.

Some of these firms might be able to avoid insolvency if they had more than the ninety days permitted in the bill to adjust to the requirements of the proposed act. Others might be able to avoid insolvency through various other means. If state insurance regulators permitted premium increases, and if the courts approved the breaking of contracts that would be involved, it is possible that no insolvencies would take place.

If a firm did become insolvent, the state insurance commissioner would be required to seek a rehabilitation order from the state courts to give the commissioner legal control of the company's assets. Depending upon the company's prospects, the state insurance commissioner could allow the company to continue operating as a going concern (under restrictions imposed by the commissioner), could encourage it to merge with a stronger firm, or could force it to liquidate. If the firm were liquidated, pension plans insured by the firm would have to be reinsured by another firm, and the assets of the pension fund could be impaired. We can not predict how many, if any, firms would become insolvent, or to what extent insolvencies would lead to loss of pension fund assets. It would depend upon actions taken by the firms themselves and by their state regulators.

#### ADMINISTRATIVE COSTS

S. 372 would entail substantial administrative costs to revise existing pension plan provisions. These costs include actuarial, legal, computational, and clerical costs of revising plan provisions and costs of notifying employees of the changes.

The American Academy of Actuaries has estimated that the costs of developing the new unisex pensions and annuities would be about \$200 million. Some of these costs will already have been incurred to implement the recent Norris decision. This estimate is a rough extrapolation from the experience of a few plans but we have not found any reason to believe that it is either too high or too low.

The Pension Benefit Guaranty Corporation has estimated that its administrative costs for recalculating benefits in the plans for which it is trustee would be about \$10 million.

#### OTHER EFFECTS

S. 372 will change the relative benefits of different kinds of pension options, and will therefore to some extent probably change the option choices which employees make. For women, single life annuities will become more attractive, and more women will probably choose this option. For men, lump sums, early retirement, and joint-and-survivor options will become more attractive, and more men will probably choose them.

From the point of view of the pension plans, these changes in option selection constitute "adverse selection," which will tend to increase the costs of the plan. We have illustrated the impact this effect might have in a footnote to Tables 1 and 2. Other kinds of increased costs due to adverse selection, to the extent that they occur, would probably be smaller. Also, to the extent that men increased their selection of the joint-and-survivor options, female survivors would receive increased

benefits, and the share of women in total benefits would rise from the levels we have estimated.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions you or other committee members might have.

Table 1  
Annual Costs to Pension Plans  
Derived from DOL Estimates  
(millions of dollars)

Row	Types of Costs	Column I <sup>1/</sup>	Column II <sup>2/</sup>
A	Original DOL estimate:	\$ 1195-1662	
B	Deletion of Type 4 costs CUMULATIVE TOTAL:	(-) 378-403 <u>(=) 817-1259</u>	
C	DOL Type 2 adjustments: CUMULATIVE TOTAL:	(+) 200-214 <u>(=) 1017-1473</u>	
D	DOL Adjustment for topping-up early retirement factors: Current DOL estimate:	(+) 308-383 <u>(=) 1325-1856</u>	
E	GAO Correction for double vesting adjustments: CUMULATIVE TOTAL:	(+) 272-148 <u>(=) 1597-2004</u>	
F	GAO Deletion of Type 3 costs CUMULATIVE TOTAL: <sup>3/</sup>	(-) 671-890 <u>(=) 926-1114</u>	\$ 815-880

<sup>1/</sup>DOL estimate of effect of S. 372, plus adjustments by GAO.

<sup>2/</sup>Effect if Type 2 costs for defined contribution plans are excluded.

<sup>3/</sup>We have also calculated a possible adjustment for the cost incurred if men increase the rate at which they select the joint and survivor option. If the percentage of men electing this option rose from 30 percent to 40 percent, liabilities would rise by \$167 to \$181 million. We used 40 percent for illustrative purposes. We are not forecasting how many men will elect the joint and survivor option under S. 372.



Table 2  
Unfunded Liabilities for Pension Plans  
Derived from DOL Estimates  
(millions of dollars)

Row	Types of Costs	Column I <sup>1/</sup>	Column II <sup>2/</sup>
A	Original DOL estimate:	\$ 6708-9047	
B	Deletion of Type 4 costs CUMULATIVE TOTAL:	(-)3235-3449 (=)3473-5598	
C	DOL Type 2 Adjustment: CUMULATIVE TOTAL:	(+)2255-2406 (=)5728-8004	
D	DOL Adjustment for topping up early retirement factors: CUMULATIVE TOTAL:	(+)1786-2200 (=)7514-10204	
E	GAO Correction for double vesting adjustment: CUMULATIVE TOTAL: <sup>3/</sup>	(+)1475-798 (=)8989-11002	\$ 7743-8361

<sup>1/</sup>DOL estimate of effect of S. 372, plus adjustments by GAO.

<sup>2/</sup>Effect if Type 2 costs for defined contribution plans are excluded.

<sup>3/</sup>We have also calculated a possible adjustment for the cost incurred if men increase the rate at which they elect the joint and survivor option. If the percentage of men electing this option rose from 30 percent to 40 percent, liabilities would rise by \$1880 to \$2030 million. We use 40 percent for illustrative purposes. We are not forecasting how many men will elect the joint and survivor option under S. 372.

Differences in estimates of the unfunded liabilities among the various studies of the effect of mandating unisex pensions arise partly because different studies include different categories of costs. For convenience, we can divide the possible kinds of increased payments into four types. The first type is future payments to current retirees. These would definitely have to be topped up under S. 372. The second type is future payments that have already been earned by active employees (i.e., those still working). We believe that these would have to be topped up for defined benefit plans, but might not for many defined contribution plans, since in many such plans no advance commitment to a particular payment has been made. The third type is future payments to active employees that have not yet been earned. Under the Supreme Court's recent decision in the Norris case, pension benefits to be earned in the future are to be earned on a unisex basis. Therefore, we believe that no further topping up would be necessary as a result of enacting S. 372. The fourth is past payments to retired employees. These payments are clearly exempted from the topping-up requirement by Sec. 4(c)(2) of the bill.

The DOL study presented estimates of the liabilities generated under various possible interpretations of Title VII of the 1964 Civil Rights Act, and we have suggested various adjustments to it to make its estimates conform to the requirements of S. 372. Our adjustments are shown in Table 1 and 2. Table 1 shows the annual costs of the bill; Table 2 shows the corresponding

unfunded liabilities (i.e., the present value of all additional future costs). Column I in each table begins with the original DOL estimate (shown in row A), followed by a series of adjustments.

The first adjustment (row B) deducts the "Type 4" costs (past payments to retired employees). These costs were included by DOL because, at the time that DOL prepared its study, they were potentially liabilities under Title VII of the Civil Rights Act, for which DOL was asked to estimate costs. They are clearly not imposed, however, by S. 372.

The second adjustment (row C) incorporates some minor adjustments which DOL recently made to its estimates for topping up past accruals by active employees.

The third adjustment (row D) was performed by DOL in response to a suggestion by Donald Grubbs, an independent actuary. Grubbs noted that many defined benefit plans use sex-distinct early retirement factors which would have to be topped up under S. 372, and that the DOL study had not accounted for these increased liabilities.

The fourth adjustment (row E) was added by us in response to a suggestion by ACLI. They argued, and we agreed, that DOL had erroneously adjusted twice for the fact that some employees will not vest, and therefore will not collect any topped-up benefits. Removing one of these double adjustments increases the unfunded liabilities. ACLI had also suggested an adjustment for the rise in women's share of the labor force, but we believe that such an

adjustment is not appropriate, since the rise in women's labor force share would be compensated by a fall in men's labor force share, and the size of any such shift is highly speculative in any case.

The fifth adjustment (row F) deducts the "Type 3" costs (future accruals by active employees) included in the DOL estimate. We do not believe that any further topping up of these accruals will be necessary after the Norris decision is put into effect. (This adjustment is not shown in Table 2 because DOL never calculated unfunded liabilities for future accruals.) A final possible adjustment is shown in footnote 3. The adjustment shows the effect of more men selecting the joint and survivor option in response to the more favorable terms under which it would be offered men in a unisex environment. For illustrative purposes, the calculation shows the effect of one particular assumption about the response men will make; however, we have no way of predicting whether the response we have assumed is a reasonable estimate.

Column II in each table shows the effect of adjusting DOL's estimate and ours to account for possible overstating of Type 2 costs (previous accruals by active employees) for defined contribution plans. As discussed previously, we do not know what proportion of past accruals for active employees in defined contribution plans will actually have to be topped up. We therefore show the range of costs if all of these accruals must be topped up (Column I) and if none are (Column II). We believe the true cost would be somewhere within this range.