DRAKE
LAW
REVIEW
INSURANCE
LAW ANNUAL

VOLUME 25 1976 NUMBER 4

THE REGULATORY CHALLENGE TO LIFE INSURANCE CLASSIFICATION

Herman T. Bailey,† Theodore M. Hutchison††
*& Gregg R. Narber†††**

The Procrustean bed is not a symbol of equality. It is no less inequality to have equality among unequals.

Felix Frankfurter,
New York v. United States[1]

"By its very nature, the sale of insurance is discriminatory." The industry must be able to differentiate or "discriminate" between "the good risks and the bad risks." For political awareness, substitute the words "those with fewer needs" for the words "the good risks"; substitute the words "those with greater needs" for the words "the bad risks". . . . Most dangerous occupations . . . are held by men. Again, a radical view would suggest that if those hazards cannot yet be dealt with through safety and health regulations, or shared by all of us through some equitable system of rotating that hazardous work, at least the cost of protection against disability should be disproportionately borne by the privileged, by those more favored by social class.

Sally Hacker,
Minority Report to the Insurance Task Force of the [Iowa] Governor's Commission on the Status of Women[2]

† Senior Vice-President and General Counsel of Bankers Life Company. B.S. 1948, Iowa State University; J.D. 1949, University of Iowa.—Ed.

†† Associate General Counsel of Bankers Life Company. B.A. 1954, University of Iowa; J.D. 1956, University of Iowa; LL.M. 1958, University of Michigan.—Ed.

††† Assistant Counsel of Bankers Life Company. B.A. 1968, Grinnell College; A.M. & J.D. 1971, Washington University (St. Louis).—Ed.

* The views expressed herein are those of the writers and do not necessarily represent those of the Bankers Life Company.—Ed.

1. 331 U.S. 284, 353 (1946) (dissent).

2. Hacker, *Minority Report*, REPORT OF THE INSURANCE TASK FORCE OF THE GOVERNOR'S COMMISSION ON THE STATUS OF WOMEN, Addendum (1975).

I. INTRODUCTION

Basic to the concept of providing insurance[3] to persons of different ages, sexes, races, occupations and health histories, in different amounts and pursuant to contractual provisions granting different privileges and benefits, has been the right of the insurer to create classifications to recognize the many differences which exist among individuals. Certain federal and state laws and regulations, existing and proposed, constitute a potentially serious challenge to this right to classify. Should the threat become a reality, the continuing ability of the private insurance system to provide coverages to various classes of insureds at premium rates directly related to the costs of providing such coverages will be jeopardized. This article develops an outline of the history of risk classification and its basis, and summarizes regulatory proposals which threaten that classification system. Legal doctrines relating to this threat will also be examined. It is concluded that these legal doctrines do not compel the regulatory directions which now threaten risk classification. Instead, a regulatory narrowing of the classification system is believed to be a social, not a legally compelled, choice.[4] In that light, it is hoped an understanding of how and why life insurance risk classification developed will clarify the social issues involved.

II. SOURCE OF REGULATION OF INSURANCE INDUSTRY

During the early part of the second half of the nineteenth century, a few states began to regulate the life insurance industry, which, at that time, was still a minor factor in the social and economic life of the United States.[5] In 1868, in *Paul v. Virginia*,[6] the Supreme Court of the United States held that the business of insurance did not constitute interstate commerce so as to permit its regulation by Congress under the commerce clause of the Constitution. That position was reaffirmed in *New York Life Insurance Co. v. Deer Lodge County*[7] in 1913. As a result, the initial state regulatory pattern, commenced in the middle of the 19th century, continued with each state, largely independently of every other state, establishing an insurance department and adopting

3. The term "insurance" will include both individual and group life and health insurance coverages, unless the context indicates that a more limited meaning is intended.

4. Actually, on a small scale, such social choices are a familiar aspect of insurance regulation. "For example, it is common that some insurance purchasers are 'subsidized' at the expense of others when, because of political pressures for allowing people to drive even when they are poor risks and without paying the full costs, rates for 'assigned risk' insureds are not high enough to cover the cost to insurers of providing 'assigned risk' coverages." R. KEETON, BASIC TEXT ON INSURANCE LAW § 8.4(b), n.3 & authorities cited therein (1971). This has also become a feature of the state legislatures' response to the medical malpractice insurance "crisis", insofar as pooling arrangements are a feature, and, as this article develops, has begun to have an impact as well on life insurance risk classification. *See* text accompanying notes 55-59 and Table I, *infra*.

5. The *Eighth U.S. Census Bureau Preliminary Report*, at page 78, lists 47 companies having a total insurance in force of $180 million at the end of 1860.

6. 75 U.S. (8 Wall.) 168 (1868).

7. 231 U.S. 495 (1913).

a body of law directed toward regulation of the insurance industry. Then, seventy-five years after *Paul v. Virginia*, the Supreme Court was confronted with the same legal issue once again in *United States v. South-Eastern Underwriters Association*.[8] But now dealing with an industry the magnitude and pervasiveness of which in the American economy had grown to such an extent that its operation no longer could be regarded as anything less than "commerce",[9] the Court declared that the activities of the insurance industry were subject to regulation by Congress under the commerce clause.[10] Even before that decision was announced, the National Association of Insurance Commissioners (NAIC)[11] and others interested in preserving the state regulatory system were meeting to reaffirm their position and to persuade Congress that the public interest would be best served by state, rather than federal, regulation of the insurance industry. These forces were successful. In 1945, Congress enacted the McCarran-Ferguson Act[12] which declared that the business of insurance would continue to be regulated by the several states, to the extent not specifically regulated by the United States. The Sherman Act, Clayton Act and Federal Trade Commission Act were declared applicable to the business of insurance after January 1, 1948 (later extended to June 30, 1948), but only "to the extent that such business is not regulated by State law."[13]

It is generally accurate to describe the present regulation of life insurance companies and life insurance business in the United States as being principally managed by the states, albeit at the sufferance of Congress.

III. Classification Systems: Discrimination to Achieve Equity

> Under state laws and in the opinion of most observers the ideal rate is one that produces from each large group of insureds of the same quality exactly enough income to insurers to meet the insurance losses and expenses attributable to the group, and in addition whatever margin is "reasonable" for the insurers covering these risks.[14] Another

8. 322 U.S. 533 (1944).

9. The *1975 Life Insurance Fact Book* shows the number of United States life insurance companies alone to have numbered 1,810 at the end of 1974, with an in-force aggregate insurance total of just under $2 trillion and assets of $268 billion.

10. United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944).

11. The National Association of Insurance Commissioners is a voluntary organization established in 1871, having as its members the commissioners or superintendents of the insurance departments of the several states, most appointed, some elected. The NAIC has as its objectives the promotion of uniformity of legislation and regulations affecting insurance, the dissemination of information among the insurance departments and the protection of insurance policy holders.

12. 15 U.S.C. §§ 1011-15 (1970).

13. *Id.* § 1012.

14. Actually, it would be more accurate to speak in terms of anticipated losses and expenses because life insurance premium calculations must of necessity be made on the basis of mortality and morbidity tables and expected deviations, and certain expense assumptions. In addition, if the type of insurance to be purchased by the premiums results in the creation of a reserve, the expected earnings attributable to that reserve constitutes a third factor in the fixing of the premium.

> way of putting it is to say that rates should be *adequate* but not *excessive* and should *discriminate* fairly between insureds. They should be adequate in order to provide insurers with sufficient income. They should not be excessive, for excessive rates impose undue burden on insureds. And they should discriminate fairly so that each insured will pay in accordance with the quality of his risk.[15]

This statement embodies the rate-setting philosophy of the management of the modern life insurance company—not *equal* but *equitable* treatment of all. It recognizes differences between classes of insureds, with products priced at a level which will result in a payment by (or on behalf of) each insured of an amount which is fair. Such fairness is accomplished by equating the anticipated cost to the company and the amount of the premium.[16]

The vocabulary of insurance can be misleading. In the context of insurance, *discrimination* is not necessarily bad, *equality* not necessarily good. For example, in accordance with the insurance philosophy set out above, it would be inequitable to collect the same annual premium for the same life coverage from a sixty-year-old man in poor health as collected from a twenty-year-old woman in good health. To charge an *equal* premium would be inequitable. An insurer may—and must—discriminate to achieve equity, insofar as the discrimination remains fair. In fact, the statutes, regulations and case law which regulate the insurance industry compel discrimination; what they forbid is *unfair* discrimination.

Prior to the *South-Eastern Underwriters* case, about half the states had statutes prohibiting unfair discrimination. Following that case, the NAIC, in cooperation with the insurance industry, developed and sponsored the enactment of the Unfair Trade Practices Act which was, by 1960, enacted in all states and the District of Columbia, in its model form or in some variation.[17]

---

15. A. MOWBRAY, R. BLANCHARD & C. WILLIAMS, INSURANCE 411 (6th ed. 1969) (citations omitted; emphasis added). For an excellent analysis of premium setting in the property liability field, see C. WILLIAMS, PRICE DISCRIMINATION IN PROPERTY AND LIABILITY INSURANCE (1959) [hereinafter cited as WILLIAMS].

16. There are dissenters to the premise that insurance premiums should be based on cost. *See* WILLIAMS, *supra* note 15, at 12-13. Proponents of the premise argue that the premium-cost relationship is dictated by the concept of the mutual nature of the insurance relationship, in which insurers are cast in the role of middlemen combining the premiums of many to pay the losses of the few, and by the public interest nature of insurance, which precludes the charging of premiums disproportionate to costs. Dissenters argue that the public is best served by a rate structure which results in the largest possible market and yields a reasonable net profit to the companies, and that, if such a result is attained, the rates are not unfairly discriminatory, even though not cost-based.

17. ALA. CODE tit. 28A, § 237 (Supp. 1973); ARIZ. REV. STAT. § 20-448 (1975); ARK. STAT. ANN. § 66-3005 (Supp. 1975); CAL. INS. CODE § 790.03 (West Supp. 1976); COLO. REV. STAT. ANN. § 10-3-1104 (Supp. 1975); CONN. GEN. STAT. REV. § 38-61(9) (Supp. 1976) (defining as an unfair trade practice a violation of § 38-149 (general discrimination)) and § 38-150 (prohibiting discrimination, as to premiums and otherwise, between whites and persons of African descent); DEL. CODE ANN. tit. 18, § 2304 (1975); D.C. CODE ANN. § 35-715 (1968); FLA. STAT. ANN. § 626.962 (1972); GA. CODE ANN. § 56-704 (1971); HAWAII REV. LAWS § 431-643 (1968); IDAHO CODE ANN. § 41.1313 (1961); ILL. ANN. STAT. ch. 73, § 1031 (Supp. 1976); IND. ANN. STAT. § 27-4-1-4 (1975); IOWA CODE § 507B.4.7 (1975); KAN. STAT. ANN. § 40-2404 (1973); KY. REV. STAT. ANN. § 304.12-080 (1972); LA. REV. STAT. ANN. § 22:1214 (Supp. 1976); ME. REV. STAT. ANN. tit. 24A, § 2159 (1974); MD. ANN. CODE art. 48A, § 223(a) (1972); MASS. GEN. LAWS ANN. ch.

The provisions of the Act, among other things, prohibit any insurer from engaging in an unfair method of competition or an unfair or deceptive act or practice. Among the acts and practices defined as unfair are:

> Making or permitting any *unfair discrimination* between individuals of the same class and equal expectation of life in the rates charged for any contract of life insurance or of life annuity or in the dividends[18] or other benefits payable thereon, or in any other of the terms and conditions or such contract.
>
> [and]
>
> Making or permitting any *unfair discrimination* between insureds of the same class for essentially the same hazard in the amount of premium, policy fees or rates charged for any policy or contract of insurance other than life, or in the benefits payable thereunder, or in any of the terms or conditions of such, or in any other manner whatsoever.[19]

A. *Early History of Risk Classification*

For over two hundred years, life insurance companies have developed an increasingly sophisticated and refined classification system which is reflected in

176D, § 3 (Supp. 1976); MICH. STAT. ANN. § 24.12019 (1972); MINN. STAT. ANN. § 72A.-20(1) (Supp. 1976); MISS. CODE ANN. § 83-5-35 (1973); MO. ANN. STAT. § 375.936 (Supp. 1976); MONT. REV. CODES ANN. § 40-3509 (1961); NEB. REV. STAT. § 44-1504 (1968); NEV. REV. STAT. § 686A.100 (1973); N.H. REV. STAT. ANN. § 417:4 (Supp. 1975); N.J. STAT. ANN. § 17B:30-12 (1976); N.M. STAT. ANN. § 58-9-25 (Supp. 1975); N.Y. INS. LAW § 273 (McKinney Supp. 1975) (defining as an unfair trade practice a violation of § 40(10) which prohibits discrimination as to premiums or otherwise on the basis of race, color, creed or national origin); N.C. GEN. STAT. § 58-54.4 (Supp. 1975); N.D. CENT. CODE § 26-30-04 (Supp. 1975); OHIO REV. CODE ANN. § 3901.21 (1971); OKLA. STAT. ANN. tit. 36, § 1204 (Supp. 1975); ORE. REV. STAT. § 746.015 (1969); PA. STAT. ANN. tit. 40, § 1171.5 (Supp. 1976); R.I. GEN. LAWS ANN. § 27-29-4 (1969); S.C. CODE ANN. § 37-1212 (Supp. 1975); S.D. CODE ANN. § 58-33-12 (1967); TENN. CODE ANN. § 56.1204 (1968); TEX. INS. CODE art. 21.21A (Supp. 1975); UTAH CODE ANN. § 31-27-22 (1974); VT. STAT. ANN. tit. 8, § 4724 (Supp. 1975); VA. CODE ANN. § 38.1-52 (1970); WASH. REV. CODE ANN. § 48.18.480 (1961); W. VA. CODE ANN. § 33-11-4 (1975); WIS. STAT. ANN. § 207.04 (Supp. 1975); WYO. STAT. ANN. § 26.1-251 (Supp. 1975). *See also* Wilson, *Anti-Discrimination—Blessing or a Bother?*, XIX ASS'N OF LIFE INS. COUNSEL PROCEEDINGS 317 (1965).

18. This is the first mention in this paper of dividends. Like "discrimination", "dividends" has a meaning in the lexicon of insurance different from that used with respect to other industries. Mutual companies, and some stock companies, issue participating insurance. In theory, the company determines annually what portion of that year's surplus will be divided among its participating policyholders, and then returns to each class of policyholders, and to each member of each class, an equitable share of this divisible surplus, which is called a dividend. An attempt is made to recognize the contribution of each class of policyholders to the creation of the surplus in the determination of the amount of dividends to be paid or credited to the members of that class. This permits an annual matching of cost of coverage with the net (gross less dividend) premium. In practice, dividend scales of a company do not change annually but rather are adopted every few years for each class of policyholders, so year-to-year contributions to surplus are not necessarily reflected in the dividends paid for each year. *But see* notes 39-41 *infra* and accompanying text. Generally, dividends *are* paid on participating individual policies providing cash value life insurance, annuities and long-period term policies, but not on those policies providing health and disability coverages. Payment of dividends on group policies providing any sort of coverage is more closely related to the year-to-year experience of each particular large group and to the year-to-year aggregate experience of classes or types of smaller groups.

19. UNFAIR TRADE PRACTICES ACT, IOWA CODE § 507B.4(7)(a), (b) (1975) (emphasis added).

premiums and dividends. As a result, they have moved toward a more exact matching of the net premium with the cost to the company of providing coverages to its various classes of insureds.[20]

The first major differentiation of insureds was based on age of the insured. In his *Outline of the History of Life Insurance in the United States*, in tracing the beginning of life insurance in England and the development of classification of insureds, E.M. McConney writes: "Life insurance on scientific lines dates from 1762, for in that year the first company to write Ordinary Life policies and to charge premiums graded according to age at issue commenced business. This company 'The Old English Equitable' was the first *mutual* life insurance company."[21] "Life insurance on scientific lines" later appeared in the United States where the few companies doing business during the first half of the nineteenth century based premiums on a crude classification system developed from mortality tables.[22] However, the big impetus to classification in life insurance in the United States occurred at the end of the nineteenth century when many assessment and fraternal companies, organized in the years immediately following the Civil War, experienced financial failure. These insurers departed from scientific principles, virtually all of them eschewing any form of classification or discrimination and collecting levies and assessments from their members in equal amounts, regardless of the member's age.[23]

By treating unequals equally, the assessment companies and fraternals of the late nineteenth century not only accorded their members inequitable treatment, but they also assured their ultimate financial disaster. As explained by McConney:

> The mortality of a state or nation per thousand of inhabitants does not vary greatly from year to year and it was the idea of the Assessment societies that when such a condition was attained in a society, there would be no further increase in the mortality rate per cent, which would then call for level assessments on all members. If assessment insurance for equal amounts was compulsory on everyone, this would be true, but as it cannot be made compulsory, the time comes, when the society has attained something like a fair average death-rate,

20. There exists a major and important exception to this statement: insurance of *groups* of people generally ignores, to a large degree, differences between individuals. This rejection of classification occurs in two ways: (1) between groups (*e.g.*, the rate for a policy covering husband, wife and children—a "family policy"—does not vary according to the number of children in the family whose lives are insured, so the family with five children may be paying the same rate for family coverage as the family with two children), and (2) within groups (*e.g.*, in the typical group policy issued to an employer insuring the lives of his employees, if employees contribute to the cost of coverage the employee contribution is usually a fixed rate per $1000 of coverage, not varying with age, although the aggregate premium as computed by the insurer and billed to the employing company for the group of lives covered is based on the ages and sex of the individuals who comprise the group). Analysis of classification systems utilized in fixing rates for group coverages, and the trade-offs between equity and equality inherent in achieving the economies of group insurance, is beyond the scope of this paper.

21. E. McConney, Outline of the History of Life Insurance in the United States 5 (1927).

22. *Id.* at 11.

23. *Id.* at 30.

> the cost per annum to the younger members is higher than it would be in a new organization composed mostly of younger members. Consequently, there is a cessation of young applicants and a withdrawal of the younger members, which cuts off the rejuvenating influence which was expected to keep the death-rate stable.[24]
>
> The practical impossibility of securing enough new members eventually when a fairly large part of the membership attained ages in the seventies and eighties is self-evident. Long before even the equilibrium age could be attained, the societies had already begun to feel the stress of their increasing death losses and their members had begun to change their membership to newer societies which could furnish cheaper insurance. Years would often elapse before this stage was reached, if the membership increased at a rate sufficiently rapid. Meanwhile, the society would go on in the blind belief that all was well until the increasing death rates gave warning that their rates must be increased. The attempt to do this was sure to create dissatisfaction, which resulted in an increased loss of membership and a diminished supply of new members, thus enhancing the trouble which they were seeking to escape. The process of dissolution thus started gathered momentum as it continued. The expedients resorted to to make good this growing deficiency, either by increasing the rates or reducing the benefits, were generally temporary compromises which merely relieved the situation for the time, until the growing deficiency again called for a new adjustment and created a fresh loss of membership. The end came when the burden of carrying the old members could no longer be met by rates which had grown too heavy to be borne, and members could no longer be secured with the fact staring them in the face that they would be compelled to make good from their own contributions the deficiencies in the past payments of these older members. The ultimate disintegration of the society would follow, leaving its members without the protection which they had perhaps been contributing for years to secure.[25]

B. *Development of the Classification System*

After the failure of the assessment system made the importance of classification by age apparent to the managers of life insurance companies, classification systems were developed which recognized age and other differences as well. Health history and general physical condition, sex, occupation, morals, use of alcohol or tobacco, and other matters pertaining to the life style of the applicant were considered in the underwriting of each risk. Premium rates were determined to recognize the effect each or any combination of these factors was expected to have on the mortality of the class of persons sharing given factors or combinations of factors. Accumulated statistical data based on shared insurance industry experience enabled actuaries to anticipate the effects on mortality and morbidity of increasingly various factors and to do so with increasing accuracy.

---

24. *Id.* at 37.
25. *Id.* at 34. *See also* I R. BULEY, A STUDY IN THE HISTORY OF LIFE INSURANCE 77-78, 115-128 (1953).

One such factor, classification based on the sex of the insured, had a long and uneven history. Life insurance premiums for women rose and fell in accord with the most recent study comparing male and female mortality.[26] The availability and cost of disability insurance underwent similar variations.[27] However, despite the early uncertainty surrounding this classification, there can be little question anymore that classifying on the basis of the sex of the insured is statistically justified.[28] Writing in the *Transactions, Society of Actuaries*, E. Paul Barnhart states:

> This paper seeks to bring to the profession a disability continuance table sufficiently based on recent industry individual policy experience to render it suitable as a standard for expected claims and for adjusted earnings purposes. . . .
>
> . . .
>
> It was found necessary to construct separate male and female tables. The female experience data in the 1969 and 1971 committee reports are too disparate from the male data for any modification of

---

26. One author has summarized the history of this classification for life insurance as follows:

> Women were a puzzle to life insurance companies for a century and more before 1900. First of all companies to write life insurance on a systematic basis was Equitable of England, 1762. They accepted women, but required extra premium. Then came general population studies of mortality in France, Sweden and Switzerland that showed women to be living longer than men. English companies dropped their surcharge until a joint survey of 17 British offices in 1843 gave the surprising information that female insureds had a higher death rate than males. Back went the extra premium. Came then American studies at the beginning of this century topped by the huge Medico-Actuarial Investigation on 400,000 female policyholders insured between 1885 and 1908. There were 15,500 deaths. In the first year of coverage, mortality ratio was 113 per cent of expected, 108 in second year, 105 in third-fourth-fifth years, 99 per cent thereafter. But, spinsters had an 81 per cent ratio, widows and divorcees 105 per cent, married women 119 per cent. Married women whose husbands were beneficiaries had a mortality ratio obviously a factor. When unmarried women bought for themselves, endowments especially, they lived to collect. When married women had insurance bought on them for others to collect, others did just that—they collected.

H. DINGMAN, RISK APPRAISAL 171 (1957) [hereinafter cited as DINGMAN]. *See also* J. MACLEAN, LIFE INSURANCE 108 (9th ed. 1962) [hereinafter cited as MACLEAN].

27. Maclean writes in his book:

> *Women.* An important innovation which took place at this time [1930] was the general adoption of higher rates of premium [for disability insurance] for women than for men. The rates of disability among women had been from 1½ to 3 times those among men. Nearly all companies announced in connection with the new 1930 contracts that rates for women would be either 1½ times or twice the rates for men. This increase, added to the general increase in rates, meant that thereafter women had to pay from 2½ to 3 times the rates they had formerly been charged for a more liberal type of contract. In addition, some companies adopted stricter selection rules in regard to women, restricting them to comparatively small amounts or in some cases granting only the waiver-of-premium benefit, while the more unfavorable classes were either refused disability benefits on any terms or given a high extra rating.
>
> At a later date, many companies discontinued issuing policies with disability income benefits to women although continuing to issue policies with a waiver-of-premium provision, often at double the rates for men.

MACLEAN, *supra* note 26, at 236-37.

28. "Female morbidity is higher than male. . . . It was a 221-100 ratio in the W.M. Gafafer (1951) analysis of 173,881 male employees in various industries, 14,113 women who were disabled for eight consecutive days or longer." DINGMAN, *supra* note 26, at 171.

the male table to suffice as a satisfactory approximation of female morbidity. The female experience costs soar far above the male costs in the 30-50 age range, and the ratios tend to rise even higher for longer elimination periods. Above age 50 the ratios fall off sharply, and above age 60 the female costs actually fall below the male costs. This general pattern is roughly consistent with the relation of female to male hospital and medical expense costs and suggests that the high incidence of female disorders in the 30-50 age range has an even more pronounced effect on disability costs than it does on hospital and medical costs.[29]

The tables developed by Mr. Barnhart show the following relationship between the annual costs of providing disability benefits for the first year of the benefit period to groups of males and females, for various elimination periods:[30]

	Male I Claim Costs	Ratio (%) Female I/Male I
		0-Day Elimination
20-29	0.153	90
30-39	0.140	176
40-49	0.171	204
50-59	0.280	120
60-69	0.380	106
		7-Day Elimination
20-29	0.086	138
30-39	0.109	176
40-49	0.153	169
50-59	0.243	121
60-69	0.386	81
		14-Day Elimination
20-29	0.054	144
30-39	0.059	292
40-49	0.105	204
50-59	0.198	110
60-69	0.315	62
		30-Day Elimination
20-29	0.017	247
30-39	0.025	364
40-49	0.052	185
50-59	0.113	139
60-69	0.261	69

These and other sources demonstrate beyond sensible challenge that groups of females: (a) live longer, and (b) through much of their lives incur higher medical expenses, and experience more frequent and longer periods of disability, than do groups of males of comparable ages.

---

29. Barnhart, *1971 Experience Modification of the 1964 Commissoners Disability Table*, XXV TRANSACTIONS, SOCIETY OF ACTUARIES 119 (1973).
30. *Id.* at 122-23.

Not only were personal differences among various classes of persons given recognition, but other types of differences also came to be seen as having an effect on the cost of providing insurance. For example, the method of premium payment on individual policies selected by the insured varies the cost to the company of providing the coverage and is almost universally reflected in the premium. Premiums are paid in advance. If an insured pays an annual premium, the company incurs the administrative expense of billing for and handling a payment only once per year and, in addition, it benefits from the use of more money for a longer period of time. These two factors are considered in the fixing of the premium and thus, an annual premium is always less than two semi-annual premiums. Likewise, two semi-annual premiums are less than four quarterly premiums, which in turn, are less than twelve monthly premiums.[31]

For the past twenty years, many companies have offered an insured the right to pay premiums monthly through checks which are drawn by the insurer on the insured's checking account, pursuant to an authorization given by the insured to the company and the bank—the "pre-authorized check plan". This premium is less than the regular monthly premium (often as low as one-twelfth of the annual), the difference being justified by the lower costs of collecting the premium and by the better persistency experienced with policies on the pre-authorized check plan.

Policy amount has also become a method of classifying insureds, with most companies charging a significantly lower premium for a $100,000 policy than ten times the premium for a like $10,000 policy issued to the same insured—the "cheaper by the dozen" concept. The propriety of classifying according to policy size, and of other valid distinctions among classes of insureds, has been endorsed by the New York Insurance Department,[32] the Wisconsin Insurance Department[33] and the NAIC at its meeting in May, 1956, when its Special Subcommittee of the Life Committee sanctioned the application of the quantity

---

31. Actually, there is a third factor which enters into the calculation. Policies which are on an annual premium basis tend to remain in force longer—have "better persistency"—than policies with shorter premium period bases, and because discontinuance of a policy in the first few years after its issue may result in a loss to the company, this increased persistency is also recognized in setting the premium.

32. New York Insurance Department Opinion (April 20, 1955), *cited in* letter from Raymond Harris, New York Deputy Superintendent of Insurance, to life insurance companies, April 28, 1955 [hereinafter cited as N.Y. Ins. Dept. Op.].

33. Letter from Paul J. Rogan, Wisconsin Commissioner of Insurance, to life insurance companies, May 21, 1956. The opinion of the Wisconsin Insurance Department was stated as follows:

> A review of the position taken by this department relative to compliance with the nondiscrimination requirements of the Wisconsin statutes applicable to premium rates on life insurance has led to the conclusion that greater equity between policyholders can be obtained by also considering factors other than "equal expectation of life" in premium calculations. All cost factors must be given proper recognition in order to preserve equity between various classes of policyholders if amount of insurance is used as an element in determining the premium rate on any policy.

discount principal by unanimous vote.[34] In an opinion dated April 20, 1955, the New York Insurance Department concluded:

> Section 209 of the New York Insurance Law prohibits any authorized life insurance company from making or permitting any unfair discrimination between individuals of the same class and of equal expectation of life, in the amount of payment of premiums, or rates charged by it for policies of life insurance, or in the dividends or other benefits payable thereon, or in any of the terms and conditions thereof.
>
> Obviously, the insurer in its underwriting and determination of premium rates must group or classify policies so that broad insurance averages may be applied. Provided the classifications are reasonable, the manner of grouping and the degree of refinement in such grouping or classification rests with the management of the insurer.
>
> The statute does not require that classes shall be limited to groups based on differences in mortality only. On the contrary, the word "class" is to be construed broadly to take account of all elements involving common characteristics of the class. However, the statute imposes a responsibility on the insurer to justify any system of groupings or rate classifications as well as the results flowing therefrom as being reasonable, equitable and nondiscriminatory. This means, in our opinion, that where premium rates vary according to the amount of insurance, consideration must be given not only to the average size of the policy, but to any greater or lesser costs attributable to other factors.
>
> Therefore, subject to the insurer's responsibility referred to above, it is our opinion that it is permissible under the statute for your company to adopt premium rates which, within a policy plan and issue age, vary by amount of insurance. As to nonforfeiture values and dividends, they should conform with principles of equity.[35]

C. *Refinement of the Classification System*

1. *More Favorable Rates*

Risk classification has, in the post-World War II era, and particularly in the last fifteen years, become increasingly sophisticated in its ability to differentiate between individuals and, as a result, its tailoring of rates to particular insureds. Although to a large extent the effect has been equitable—much wider availability of insurance and often at much better rates—it must be acknowledged that a motivation equally strong is competition between and among insurance companies.[36] The competitive aspects have long been and remain now very compelling, with the insurance industry striving to provide its

---

34. *See generally* J. BELTH, THE RETAIL PRICE STRUCTURE IN AMERICAN LIFE INSURANCE (1966).

35. N.Y. Ins. Dept. Op., *supra* note 32.

36. For example, in the sale of single premium immediate annuities, where competition is extremely keen, many companies have refined classification by age to month of birth, rather than year of birth.

product and service to as many people as possible and, of equal importance to many of the competing companies, to attract what are considered the best and most desirable insureds by classification devices which can lead to price advantages. Most recent developments in the refinement of the classification system have been of the latter variety. Two recent examples are illustrative of this trend.

a. *Policy Loan Interest Rates*

In response to the pressure of heavy borrowing on policies felt by most life insurers in recent years, a substantial number of such insurers followed the lead of Northwestern Mutual Life Insurance Company and went to an 8% policy loan interest rate in all states permitting this rate. These companies have differentiated between policyholders having 6% or lower policy loan interest rates and those with 8% rates by paying dividends on the 8% policies at a higher rate. This recognizes the relatively lower earnings realized on a block of business composed of 6% policies without a corresponding reduction in administrative costs, as compared to the 8% policies. In fact, some states have recognized the equities involved and required that policies bearing an 8% rate pay better dividends.[37] By the same token, the competitive edge of a policy offered by another company bearing a 6% policy loan interest rate is substantially ameliorated.[38]

b. *Year of Issuance*

The assets of most life insurance companies are invested in long term investments. Once a dollar is invested, its rate of return is fixed for twenty, twenty-five, or as long as thirty years. A company each year has available for investment a number of dollars equal to only a small fraction of the amount of its total portfolio. During a long period of rising rates of return on long term investments, such as has been experienced since the end of World War II, the "new money rate" has gone up faster than the "portfolio rate". This puts an

37. *E.g.*, DEL. CODE ANN. tit. 18, § 2911 (Supp. 1975) (higher dividends or lower premiums). *See also* Miller, *Loan Rates: The View from New York Life*, THE NAT'L UNDERWRITER, July 31, 1976, at 13. "[New York Life has] separate dividend scales for life insurance policies issued with an 8% policy loan rate. . . . As a matter of fact, several states did not approve our new policy filings until they had received assurance that we would make such a differentiation in dividend scales." *Id.* at 14.

38. Consideration has even been given to refining the dividend formula to reflect the amount of borrowing each policyholder has made against his policy, although we are not aware of any adoption of such a classification. *See* Schuenke, *Dividends to Policyholders*, 1974 ALIA LEGAL SECTION PROCEEDINGS 435. The concept of recognizing, in premium or dividend, the difference in cost to the company of providing coverages to two classes of policyholders, one class holding policies providing a lower policy loan rate than the other, is not new. For years, New York's 5% policy loan rate maximum has resulted in the holders of policies issued in that state—and subject to the 5% maximum rate—in receiving lower dividends than policyholders in the 6% states.

insurance company at a disadvantage vis-a-vis other financial institutions for savings dollars, if it is to credit the portfolio rate to all of its policies. In the highly competitive pension market, the companies overcame this disadvantage about 15 years ago by crediting the deposits or contributions made in any year with the "new money rate" of return realized on the particular company's investments during that year. The Equitable Life Assurance Society of the United States has extended the concept to its individual policy line by distinguishing in its 1976 dividend scale between policies issued in different years (without, however, affecting policies issued prior to 1967).[39] The equities involved are recognition of the "differences in interest earnings on funds invested and accumulated for policies issued in different years."[40] Since its dividend illustrations in prospective sales situations utilize a five year bracket,[41] there is an apparent competitive utility as well to such recognition.

2. *Broader Availability*

In the early years of life underwriting, the present health and health history of an individual was weighed, and he was found to be either insurable or uninsurable. There were only two classes. Then certain companies, most notably Lincoln National Life Insurance Company, began writing large amounts of "substandard" business with considerable success. Soon the underwriting departments of other companies began to define classes for health problems of varying degrees of seriousness and potential impact on the mortality or morbidity of classes, and today most large insurers recognize and underwrite as many as fifteen to twenty-five substandard classes, at premium rates in excess of standard rates but based on the anticipated cost of providing the coverage. The result has been a broader availability of insurance to persons who would have been unable to secure coverage fifty years ago. This broader availability is directly a product of the increasing sophistication of the life insurance risk classification system. For example, such insureds as the following have been included:

---

39. Other insurers may have adopted similar practices but, as of late September, 1976, have made no public announcement to such effect.

40. *Equitable's View of '76 Dividend Scale*, THE NAT'L UNDERWRITER, May 29, 1976, at 15.

41. *Id.* The equitable underpinnings of this change have been sharply criticized. Belth, *Great News—Except for Equitable's Old Policyholders*, 3 THE INS. F., April, 1976. ("Although the actuaries may be able to defend it as an improvement in equity, I fear that it is fundamentally an expedient way to deal with temporary market conditions. . . ."); Josephson, *Dividends—1976 Style*, 23 PROBE, May 15, 1976, at 1. ("If there were a way to make a precise determination of the interest actually earned on the premiums paid by each policyholder, I would still oppose its use in dividend formulas, because it would constitute a clear-cut negation of mutuality. But obviously there is no way of accomplishing this. No policyholder's dollars—premiums or reserves—are earmarked, and hence there is no way of tracing them. Even if only single premium policies were sold, could we say that the premiums of every 1940 policyholder were invested at 4% and have remained in the same place ever since?"); Josephson, *The Demise of the Portfolio Rate*, PROBE, April 15, 1976, at 1.

1. With diabetes mellitus. Since 1946, when such business was initially sold, through 1971, data on 954 claims representing 61,555 policy years was accumulated.[42] Statistically significant data established numerous distinctions between diabetics in terms of mortality experience by build, blood pressure, duration of the disease, control and nature of treatment (insulin vs. diet).[43] As a result, many individuals so afflicted may purchase life insurance for the first time or at rates better than formerly available to them.
2. With chest pain/heart disease. Experience has been accumulated on a range of complaints from chest pain of indeterminate origin to proved myocardial infarction (one form of "heart attack").[44] Although extreme risks continue to be declined, underwriters now can differentiate between different heart histories and even between individuals with non-specific chest pain by such devices as history, activities, and habits such as smoking. These factors indicate probable actual risks and allow insurance companies to make coverage available accordingly.
3. With histories of drug use or experimentation. Increasingly, attention is given to the nature of the drug abused and the pattern of abuse. Thus, while an individual who has used heroin might continue to be uninsurable, another who uses marijuana on a casual basis might be acceptable as insurable at standard premium class rates.[45]
4. With histories of alcohol or tobacco use. Distinctions between moderate use of alcohol and habitual heavy use—and on the continuum between—have long been drawn but have recently received statistical support and become more refined.[46] The massive accumulation of data on cigarette smoking in recent years has produced a similar trend but in the opposite direction; some insurers offer more favorable rates to non-smokers, others decline to offer insurance at favorable rates previously available to smokers.[47]
5. With high blood pressure under treatment. In the past, high blood pressure has been the basis for substandard premium rating or declining to insure. However, on the basis of a study involving approximately 500 lives, individuals receiving successful treatment[48] for high blood pressure can obtain life insurance at more favorable rates. Because the study shows the treatments ultimate-

---

42. Barch, *Diabetes—A Continuing Mortality Study*, LII PROCEEDINGS OF THE HOME OFFICE LIFE UNDERWRITERS ASS'N 66 (1971).
43. *Id.* at 66-67.
44. Hunzicker, *Chest Pain—Differential Diagnosis and Underwriting*, LI PROCEEDINGS OF THE HOME OFFICE LIFE UNDERWRITERS ASS'N 154 (1970).
45. This reflects the present practice of the Bankers Life Company and many others and is responsive to increasing knowledge about the distinctions among drugs and their effects.
46. *E.g.*, Davies, *The Influence of Alcohol on Mortality*, XLVI PROCEEDINGS OF THE HOME OFFICE LIFE UNDERWRITERS ASS'N 159 (1965).
47. This reflects an increasingly general practice, although so-called "nonsmokers" policies have been available for several years. *See State Mutual Experience Confirms Non-Smokers are Better Insurance Risks*, INS., May, 1976, at 19.
48. Successful treatment in this context is lowered blood pressure over time.

ly extend mortality, such individuals may even be insured at standard rates.[49] This has occurred primarily in the last five years.

There have been parallel trends to more refined and specific rating of insurance risks in other than life insurance.[50] Although related, these developments are outside the scope of this article.

IV. The Movement From Equity Back to Equality: Legislative and Regulatory Constraints

The expansive role of states in regulating the insurance industry is traceable to the impetus provided by the *South-Eastern Underwriters*[51] case and the congressional response to that decision, the McCarran Act.[52] Facing always the prospect of specific federal preemptive legislation, states thereafter began regulating insurance in broad brush and certainly beyond the potential purview of federal antitrust legislation. Unfair Trade Practices Acts, which prohibit unfair discrimination between those in the same class and thus require equitable risk classification, were uniformly adopted. In the civil rights era, some states adopted statutes providing specifically that race (and often creed, national origin and religion) was not to be a criterion for determining whether insurance would be available to a given individual;[53] other states assumed this result under their unfair discrimination statutes.[54] There is some question about whether there ever was much attention to race in insurance underwriting. More usually, occupation, income and the like, still utilized as underwriting criteria, would reach that result without attention to the specific factor of race.

---

49. McCue, *Treated Hypertension—Significance in Insurance*, LIII Proceedings of the Home Office Life Underwriters Ass'n 67 (1972).

50. Examples include attention to location of housing for purposes of underwriting fire policies (the attention to "high risk" neighborhoods has been criticized in recent years as "red-lining") and the discounts given by auto insurers for such things as driver education, good grades, etc.

51. United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944).

52. 15 U.S.C. §§ 1011-15 (1970).

53. *E.g.*, Conn. Gen. Stat. Rev. § 38-150 (1969); Ky. Rev. Stat. § 304.12-085 (Supp. 1976); N.Y. Ins. Law § 40(10) (McKinney 1966); Pa. Stat. Ann. tit. 40, § 1171.5 (7)(iii) (Supp. 1976); *see* G. Couch, Cyclopedia of Ins. Law § 23:14 (2d ed. 1960).

54. This approach can be criticized on the basis of statistics reflecting that black mortality experience is worse than that of whites. Recent insurance industry statistics have not been found, however. Henry W. Dingman, in discussing Negro mortality, states: "In general, 150 per cent mortality must be expected in the business and professional type, 200 per cent in the semi-skilled and laborer types." Dingman, *supra* note 26, at 119. Recent census data substantially confirms this difference. U.S. Dep't of Health, Educ. & Welf., II Vital Statistics of the United States, 1973, § 5, Life Tables (1975). *See also* Bragg, *Mortality Differences and Trends in the United States of America, Taking Account of Color, Sex, and Socio-Economic Status*, Transactions of the 20th International Congress of Actuaries in Tokyo, 25th October-1st November, 1976, at 391 (1976). Racially blind underwriting may, then, be unfair discrimination. To the extent that racial classifications are totally absent from current underwriting practice, the premise that premiums should be based on cost is substantially undermined. Rather, the argument that a rate structure permitting the sale of insurance to the largest possible market cannot be unfairly discriminatory is supported. *See* Wilson, *Anti-Discrimination—Blessing or a Bother?*, XIX Ass'n of Life Ins. Counsel Proceedings 317 (1965); note 16 *supra*.

In any case, race criteria are not explicit in present day insurance underwriting. Until very recently, with this exception, state law has encouraged increasingly detailed risk classification.

However, the recent legislative and regulatory trend toward obliteration of the differences between people has operated to limit or deny certain of the refinements in risk classification of recent years. For example, North Carolina has legislatively determined that availability of coverage for individuals having the sickle cell trait or hemoglobin C trait is not to be limited, nor are higher rates to be charged for such coverage.[55] Several other states include like prohibitions in either proposed legislation, or rules, regulations or guidelines now being considered.[56] Many of the characteristics to be legislatively rendered irrelevant to insurance underwriting practice are characteristics specific to one racial or ethnic group—*e.g.*, sickle cell trait generally encountered only in Negroes,[57] Tay-Sachs in Jews.[58] Others, however, are less obviously related to identifiable racial or ethnic groups—*e.g.*, "genetic traits"[59]—and reflect instead an apparent social choice that characteristics over which one has no control will not actuate the perceived "penalties" of higher insurance premiums or uninsurability.

Other proposals and enactments relate in obvious ways to such movements as (1) "gay liberation"—availability not to be denied on the basis of sexual preference; (2) "women's liberation"—availability not to be denied on the basis of sex or marital status; and (3) the civil rights movement and attendant legislation. Table I summarizes recent state regulation impacting on life insurance underwriting practice.

---

55. N.C. GEN. STAT. § 58-195.5 (Supp. 1975).

56. *See* Table I *infra*.

57. Sickle cell trait, like sickle cell anemia, predominately affects blacks. W. NELSON, V. VAUGHAN III & R. MCKAY, TEXTBOOK OF PEDIATRICS 1056 (9th ed. 1969) [hereinafter cited as NELSON]; Conley, *Hemoglobin, The Hemoglobinopathies, and the Thalassemias*, in P. BEESON & W. MCDERMOTT, TEXTBOOK OF MEDICINE 1454 (14th ed. 1975) [hereinafter cited as Conley]. Unlike sickle cell anemia, which has a high mortality rate, sickle cell trait has a relatively benign clinical course, being associated with only some disorders of the kidneys and hypnoxia resulting from shock or high altitude flying. It does not usually affect longevity, although, if both parents carry the trait, children have a 25% chance of having sickle cell anemia. Hemoglobin C trait also occurs predominately only in blacks. In the heterozygous state (the trait gene coming from only one parent), there are few symptoms; in the homozygous state (the trait gene coming from both parents), moderately severe hemdytic anemia may manifest itself. NELSON at 1057; Conley at 1455; *cf.* Smith v. Olin Chem. Corp., 12 CCH EMPLY. PRAC. REP. ¶ 11,084 (5th Cir. July 19, 1976) (reversing a lower court dismissal of a laborer's complaint that his discharge from employment on the basis of disability, caused by sickle cell anemia, was employment discrimination because of the disproportionate effect on blacks).

58. Tay-Sachs is associated predominately with individuals of Ashkenazi Jewish background (mainly associated geographically with Russian and Polish Jews). Crocker, *The Lipidoses*, in NELSON, *supra* note 57, at 461.

Other diseases and traits this type of legislation deals with are similarly ethnically specific to varying degrees. Cystic fibrosis is principally a caucasian disease. Sant'Agnese, *The Pancreas*, in NELSON, *supra* note 57, at 856-57. Cooley's anemia primarily affects persons of Mediterranean origin. Conley, *supra* note 57, at 1456.

59. *See, e.g.*, Table I *supra*. "Genetic traits" and "congenital defects or birth abnormalities" may obviously happen without regard to racial or ethnic background. Similarly, hemoglobin C trait, Cooley's anemia and cystic fibrosis are not limited *solely* to one race.

TABLE I

RECENT REGULATION AND LEGISLATION RELATING TO LIFE INSURANCE UNDERWRITING PRACTICES (1974-1976)

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
Prohibits higher rates or restrictions on availability of life contracts to individuals with genetic defects	New Jersey		S. 1287 (pending) (genetic traits, including sickle cell trait, hemoglobin C trait, Cooley's anemia, cystic fibrosis and Tay-Sachs)
	New York		S. 4575 (pending) (sickle cell trait)
	North Carolina	N.C. GEN. STAT. § 58-195.5 (Supp. 1975) (sickle cell trait, hemoglobin C trait)	
	Pennsylvania		Proposed guidelines for implementing § 5(a)(7) of Unfair Insurance Practices Act (genetic traits); proposed regulation § 140.1 (sickle cell trait, other physical, genetic or mental characteristics)
	Ohio		H. 400 (failed) (up to $2500 life policies not to consider congenital defects or birth abnormalities in determining insurablity)

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
Availability not to be denied on the basis of the insured's/proposed insured's sex or marital status	Arizona		H. 2404 (pending) (dead in House Judiciary Committee)
	Arkansas	rule and regulation 19 (not applicable to fraternal insurers unless membership open to both sexes); ARK. REV. STATS. § 66-3005(1) (1966)	
	California		Proposed reg. ch. 5, subch. 3, art. 15 (pending); A. 3800 (failed)
	Illinois	H. 730; rule 26.05 (not applicable to fraternal insurers unless membership open to both sexes)	
	Iowa	510 IOWA AD. CODE ch. 15 (1976)	H.F. 730 (not acted upon)
	Kentucky	H. 529 (amending KY. REV. STATS. 344.100 (Supp. 1976)) (employee benefit plans exempt) (also basis of color, race, religion, national origin)	
	Maryland	MD. ANN. CODE art. 48A, § 234A (Supp. 1975); (basis of sex, race, color, creed, national origin, place of residence)	
	Massachusetts	H. 6174 (MASS. GEN. LAWS ch. 175, § 24A (Supp. 1976)) (basis of sex only)	

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
	Michigan		H. 5366 (pending); S. 1170 (pending)
	Minnesota		Proposed rule 116
	Nebraska		Proposed rule 28
	Nevada	regulation M-7	
	New Jersey		A. 3451 (pending)
	New York	N.Y. INS. LAW § 40e (McKinney Supp. 1976); N.Y. CODES, RULES & REGS. tit. 11, § 217 (McKinney 1971)	
	North Dakota	H. 1176 (N. DAK. CENT. § 26-30-04 (Supp. 1975)) (also basis of color, race, creed, sex or national origin)	
	Ohio	OHIO REV. STAT. §§ 3901.19, .21, .22 (1970) (also basis of color, race, religion, national origin)	
	Oregon	Ins. Dept. rule IC-61	H. 2272 (failed)
	Pennsylvania	Unfair Insurance Practices Act § 5(a)(7) (also basis of race, religion, national origin, age, family size, occupation, place of residence); PA. STAT. tit. 40, § 1171.5(7)(iii) (Supp. 1976)	Proposed guidelines for implementing § 5(a)(7) of Unfair Insurance Practices Act
	Vermont	VT. STAT. ANN. tit. 8, § 4724(7)(B) (Supp. 1975)	
	Virginia		H. 375 (failed) (also basis of color, race, religion, national origin)

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
	Washington	H. 1544 (amending WASH. REV. CODE ANN. § 48.30 (Supp. 1975))	
	Wisconsin	regulation 6.55 (not applicable to fraternal insurers unless membership open to both sexes)	
	NAIC		NAIC Model Regulation to Eliminate Unfair Sex Discrimination
	United States		H.R. 4354 (pending); S. 2359 (pending) (health policies)
Prohibits refusal to renew, sell or issue life or disability policies (or charge higher rates) solely on basis of disability*	Florida	FLA. STAT. § 626.9705 (Supp. 1975) (severe disability only (any spinal cord disease or injury resulting in total and permanent disability, amputation of any extremity that requires prosthesis, permanent visual accuity of 20/200 or worse with best correction or peripheral field of less than 20 degrees)); H. 4056 (physically handicapped; disability policies only; may not charge unfairly discriminatory rates)	S. 1060 (pending) (all physically handicapped—disability coverage only)

*Unless otherwise noted, losses directly attributable to the disabling condition need not be paid.

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
	Maine	ME. REV. STAT. ANN. tit. 24A, § 2159A (Supp. 1976) (blindness only); S. 637 (amending § 2159-A) (for health policies eliminates exclusion of blindness-related losses)	
	Massachusetts	MASS. GEN. LAWS ANN. ch. 175, § 108A (Supp. 1976) (blindness and deafness only) (accident and sickness policies only)	
	Minnesota	MINN. STAT. ANN. § 70A.04(2) (Supp. 1976) (permits rate differential based on actuarial statistics or claims experience)	
	Ohio	OHIO REV. STAT. § 3999.16 (Supp. 1976) (handicapped only; permits rate differential based on reasonable classifications; health policies only)	
	Pennsylvania		Proposed guidelines for implementing § 5(a)(7) of Unfair Insurance Practices Act (physical handicap (impairment of mobility, dexterity or use of the senses, such as loss of, or loss of use of, limbs, eyes or hearing))

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
	Rhode Island		S. 2639 (pending) (permits rate differential based on actuarial statistics or claims experience)
	Washington	H. 1544 (amending WASH. REV. CODE ANN. § 48.30 (1961))	
Rates not to discriminate between men and women	Arizona		H. 2402 (pending) (dead in House Judiciary Committee)
	Michigan		S. 1170 (pending); H. 5366 (pending)
	New York		A. 6288 (would specifically prohibit 3 year age setback for women)
	Oregon		H. 2272 (failed)
Availability not to be denied on the basis of criminal record	Minnesota		S. 967 (failed) H. 1147 (failed)
	New York	S. 9924-A (amending N.Y. EXECUTIVE LAW § 296 (McKinney Supp. 1975)) (unfair practice to make any inquiry about an arrest which does not end in conviction in connection with insurance underwriting)	

PRACTICE REGULATED	STATE	STATUTE OR REGULATION	PROPOSAL AND STATUS
Availability of insurance not to be denied on basis of sexual preference	Illinois	rule 26.05	
	Massachusetts		H. 2582 (failed)
	Michigan		H. 5366 (pending)
	Pennsylvania		Proposed guidelines for implementing § 5(a)(7) of Unfair Insurance Practices Act
Prohibit refusal to issue life policy to children solely because mentally retarded (or charge higher rates for such coverage)	Connecticut		H. 5743 (amended to substitute a bill concerning mobile home inspection—passed in form unrelated to insurance)
	Florida	H. 4056 (mentally handicapped, all ages; disability policies only; may not charge unfairly discriminatory rates)	
	Massachusetts	MASS. GEN. LAWS ANN. ch. 175 (1972), *as amended by* H. 2496 (all ages) ($1500 maximum policy)	H. 3043 (pending) (increase maximum policy to which prohibition applies to $2000)
	New York		S. 2083 (all mentally retarded) ($1500 maximum policy); A. 6289 (same); A. 6656 (same); A. 5555 (same); all above failed
	Pennsylvania		S. 49 (failed); proposed regulation § 140.1 (mental characteristics)

Note that, in the above table, the clearest trend is to assure that coverage, in like kind and amount, is uniformly available to individuals without regard to sex or marital status. While some states have achieved this result by legislation, most have tried to reach the same result by adoption of regulations under their Unfair Trade Practices Acts. Generally the latter are patterned after the NAIC Model Regulation to Eliminate Unfair Sex Discrimination[60] which, together with other regulations and guidelines, proposed or in effect, indicate that state regulatory authorities will concentrate upon making coverage available but permit valid rate distinctions. For example, an Iowa insurance regulation provides:

> Availability of a contract shall not be denied to an insured or prospective insured on the basis of sex or marital status of the insured or prospective insured. The amount of benefits payable, or any term, condition or type of coverage shall not be restricted, modified, excluded, or reduced on the basis of the sex or marital status of the insured or prospective insured except to the extent the amount of benefits, terms, condition or type of coverage vary as a result of the application of rate differentials permitted under the Iowa insurance code. However, nothing in this regulation shall prohibit an insurer from taking marital status into account for the purpose of defining individuals eligible for dependents' benefits.[61]

Identical or similar regulations in the enacting states prohibit some or all of the following practices:

(1) "Denying coverage to females gainfully employed at home, employed part-time or employed by relatives when coverage is offered to males similarly employed."[62]

(2) "Denying policy riders to females when the riders are available to males."[63]

(3) "Denying maternity benefits to insureds or prospective insureds purchasing an individual contract when comparable family coverage offers maternity benefits."[64]

(4) "Denying, under group contracts, dependent coverage to husbands of female employees, when dependent coverage is available to wives of male employees."[65]

(5) "Denying disability income contracts to employed women when coverage is offered to men similarly employed."[66]

---

60. *E.g.*, *compare* NAIC MODEL REGULATION TO ELIMINATE UNFAIR SEX DISCRIMINATION [hereinafter cited as NAIC MODEL], *with* ARK. INS. DEPT. RULE AND REG. 19 *and* 510 IOWA AD. CODE ch. 15 (1975).

61. 510 IOWA AD. CODE § 15.53 (1976).

62. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 5a; ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

63. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 5b; ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

64. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 5c; ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

65. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 5d; ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

66. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 5e; ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

(6) "Treating complications of pregnancy differently from any other illness or sickness under the contract."[67]

(7) "Restricting, reducing, modifying, or excluding benefits relating to coverage involving the genital organs of only one sex."[68]

(8) "Offering lower maximum monthly benefits to women than to men who are in the same classification under a disability income contract."[69]

(9) "Offering more restrictive benefit periods and more restrictive definitions of disability to women than to men in the same classification under a disability income contract."[70]

(10) "Establishing different conditions by sex under which the policyholder may exercise benefit options contained in the contract."[71]

(11) "Limiting the amount of coverage an insured or prospective insured may purchase based upon the insured's or prospective insured's marital status unless such limitation is for the purpose of defining persons eligible for dependent benefits."[72]

(12) Different waiting periods under insurance contracts for males and females.[73]

(13) Requiring females to submit to medical examinations when males are not required to.[74]

(14) Denying, cancelling, refusing to issue or renew, or providing on different terms coverage because an insured or proposed insured is residing with someone not related by blood or marriage.[75]

(15) Applying arbitrary waiting periods for pregnancy benefits in a manner which would exclude premature births (in a contract covering normal births).[76]

Most of the regulations are promulgated under the authority granted to the insurance department by the Unfair Trade Practices Act "to promulgate reasonable rules, as are necessary or proper to identify specific . . . practices which are prohibited by section 4 or 5, although the rules shall not enlarge upon or extend the provisions of such sections."[77] The only prohibited practice identified by the Act to which such regulations might relate is the prohibition of unfair discrimination between insureds of the same class for

67. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 6; ILL. INS. DEPT. RULE 26.05, § 3(a); 510 IOWA AD. CODE § 15.53 (1976).

68. NAIC MODEL; *accord*, ARK. INS. DEPT. RULE AND REG. 19, § 6; 510 IOWA AD. CODE § 15.53 (1976).

69. NAIC MODEL; *accord*, 510 IOWA AD. CODE § 15.53 (1976).

70. NAIC MODEL; *accord*, ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

71. NAIC MODEL; *accord*, ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

72. NAIC MODEL; *accord*, ILL. INS. DEPT. RULE 26.05, § 3(A); 510 IOWA AD. CODE § 15.53 (1976).

73. *E.g.*, N.Y. Superintendent of Ins., *Opinion and Report Pursuant to § 278 of Insurance Law* (Jan. 28, 1975).

74. *E.g.*, ILL. INS. DEPT. RULE 26.05, § 3(A).

75. *Id.*

76. *E.g.*, ARK. INS. DEPT. RULE AND REG. 19, § 6.

77. *See* IOWA CODE § 507B.12 (1975).

essentially the same hazard.[78] The Act does not restrict the mode of discrimination or classification once a different hazard is established. Contrarily, the broad language of the Model Regulation restricts modes of classification whether or not the hazard is different. So far as classifications based on gender or marital status are concerned, it literally may preclude an insurer from using the modes of unavailability, amount of benefits, and benefit restriction or exclusion, thus limiting the permissible mode to rating.[79] While the statutory authority for this approach might be questioned, it is workable with respect to policies issued directly to individual insureds. If the hazard is greater, a separate risk classification will be established and the insured will pay a fair premium for the coverage. This rationalization breaks down with respect to group policies issued to an employer, union, association or trustee to cover employees or members, unless the regulation is interpreted to require the insurer to offer the coverage choice to the *group* policyholder but not each employee or member. The economies of group insurance depend upon offering employees or members a restricted range of benefits and charging each employee or member an average rate. The cost of expensive mandated benefits for higher hazards is borne by the employer and each employee or member. It is questionable whether the Model Regulation should or was intended to mandate all group policies to provide these benefits without granting the group policyholder, employee or member the opportunity to be heard on the desirability of these benefits vis-a-vis others, especially when the hazard is different and it is not clear that the law governing employment discrimination requires that the benefits be provided.

V. Legal Restrictions on Classification

The recent state legislative and regulatory actions discussed in part IV are an outgrowth of broader movements originally concerned with unfair discrimination against certain burdened classes of persons in other relationships, such as employment, public accommodations, housing and education.[80] The initial

78. *See* text accompanying note 19, *supra*.

79. Several proposals would go beyond this to force the same rates regardless of hazard. *E.g.*, Ariz.—H. 2402; Mich.—H. 5366, S. 1170; *cf.* N.Y.—A. 6288 (which would prohibit 3 year age setback for women). Legislation now in force, precluding higher rates for greater hazard, restricts losses caused by the condition or involve only small policies. *E.g.*, Conn.—H. 5743 ($2,500 maximum policy); Fla. Stat. § 626.9705 (Supp. 1975) (losses attributable to the severe disability); Mass. Gen. Laws Ann. ch. 175, § 120 (1972), *as amended by* H. 2496 ($1,500 maximum policy); Pa.—proposed guidelines for implementing § 5(a)(7) of the Unfair Insurance Practices Act. *But see, e.g.*, Me.—S. 637, *amending* Me. Rev. Stat. Ann. tit. 24A, § 2159-A (Supp. 1976) (to eliminate exclusion (in health policies) for blindness-related injuries); Mass.—H. 3043 (to raise policy dollar maximum to $2,000).

80. For a discussion of the broader questions of employment and public accommodation discrimination see Bonfield, *State Civil Rights Statutes: Some Proposals*, 49 Iowa L. Rev. 1067 (1964) (note especially the constitutional framework discussed at 1086-95); Landau & Dunahoo, *Sex Discrimination in Employment: A Survey of State and Federal Remedies*, 20 Drake L. Rev. 417 (1971); Note, *Classification On The Basis of Sex and the 1964 Civil Rights Act*, 50 Iowa L. Rev. 778 (1965). For discussions of these questions in the specific context of insurance, particularly of classification by sex, see Gerber, *The Economic and Actuarial Aspects of Selection and Classification*, 10 Forum 1205 (1975);

reaction to these movements was an effort to eliminate discrimination which was arbitrary and unfair with respect to classes thought to be most in need of protection. Elimination of discrimination moved by cautious steps and exceptions were made where a countervailing policy or fairness demanded. As the momentum picked up, the tendency developed to challenge all classification involving persons in protected classes without always considering whether the classification was unfair or arbitrary or reasonably related to a proper goal. A disproportionately high adverse effect on a protected class was felt to be enough without proof of discriminatory purpose.[81] Additional protected classes were added, sometimes without careful consideration of the different relationships, goals and policies involved, or the extent of the burden borne by the class. Restrictions upon classification in employment were extended administratively to include insured fringe benefits, indirectly affecting classification with respect to insurance products.[82] With many questions concerning unfair discrimination

---

Gillooly, *The Developing Issue of Sex Discrimination in Insurance—An Overview*, XXIII Ass'n of Life Ins. Counsel Proceedings 271 (1974).

81. Albemarle Paper Co. v. Moody, 422 U.S. 405 (1975); Griggs v. Duke Power Co., 401 U.S. 424 (1971). But compare the recent Supreme Court decision in *Washington v. Davis*, 96 S. Ct. 2040 (1976) where the court rejects application of the disproportionate adverse effect rule in a fifth amendment due process-equal protection challenge and perhaps a title VII challenge to employment testing practices.

82. Standards governing discrimination by employers indirectly affect classification in insurance products and plans designed to provide employee fringe benefits. Some of these standards are found in:

a. The Equal pay Act of 1963, 29 *U.S.C.* § 206(d) (1970). This Act is limited to sex discrimination in employment, providing that "No employer . . . shall *discriminate* . . . *between* employees on the basis of *sex* by paying wages to employees . . . at a rate less than the rate at which he pays wages to employees of the opposite sex . . . *for equal work* on jobs the performance of which requires equal skill, effort, and responsibility, and which are performed under similar working conditions . . . ." *Id.* (emphasis added). The regulations issued by the Wage and Hour Division indicate that no prohibited wage differential exists if either the employer contributions to purchase insurance benefits or the employee benefits are equal. 29 C.F.R. § 800.116(d) (1975). This statute strives for a balance between equality and equity by requiring equality only where the work and the job are equal.

b. 42 *U.S.C.* §§ 2000(d)-(h) (1970), *amending* Civil Rights Act of 1964. This Act prohibits discrimination against employees falling in several classes, with some exceptions. It is unlawful for an employer

> 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*; or
>
> . . . to limit, segregate, or *classify* his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin.

42 U.S.C. § 2000e-2(a) (Supp. 1972) (emphasis added). Over a period of time the Equal Employment Opportunity Commission (EEOC) has moved toward the position that *all* distinctions with respect to those in the protected classes are prohibited rather than only arbitrary distinctions which cannot be justified. The EEOC has issued guidelines on discrimination because of sex which deal with both fringe benefits and employment policies relating to pregnancy and childbirth. 29 C.F.R. §§ 1604.9, .10 (1975). The EEOC has indicated that it will insist upon equal benefits and not settle for benefits of equal cost or value. The employer is prohibited from making benefits available to male employees but not female employees. If the employer has health or temporary disability insurance, disabilities caused or contributed to by pregnancy, miscarriage, abortion, childbirth and recovery therefrom must be covered the same as any other temporary disability. The Supreme Court has indicated that an employer ignoring the guidelines acts at his own risk, being barred from asserting the defense of good faith in order to avoid back pay awards. Albemarle Paper Co. v. Moody, 422 U.S. 405 (1975). On the other hand, the Act is

in employment remaining unanswered, attention is now being focused directly upon classification by insurers without always considering how this approach differs from an indirect restriction on classification. For example, the indirect approach might be to mandate that employers provide disability benefits for employees unable to work because of normal pregnancy and childbirth; the direct approach would be to mandate that insurers selling disability insurance products provide a disability benefit for any insured, whether or not an employee, if that insured is unable to work because of normal pregnancy and childbirth. While the result as to any particular member of the class may be the same, the relationships, interests and policies to be balanced are quite different, and, in addition, the rights of the employers and employees are in danger of being ignored.

The basic legal standard which governs insurance classification is the "unfair discrimination between persons in the same class" test found in unfair

---

not absolute in its prohibition. Use of the words "discriminate against" suggests arbitrary discrimination. Furthermore, the Act provides an exception in instances where religion, sex or national origin is a bona fide occupational qualification reasonably necessary to the normal operation of that particular business or enterprise. Additionally, courts have recognized an exception arising out of business necessity. *E.g.*, Robinson v. Lorillard Corp., 444 F.2d 791, 798 (4th Cir. 1971).

Some commentators have suggested that the EEOC guidelines may go beyond the intent of the Act, if the Act is restricted by the boundaries of the equal protection clause enunciated in *Geduldig v. Aiello*, 417 U.S. 484, 494-97 (1974). *See* Note, *The Impact of Geduldig v. Aiello on the EEOC Guidelines on Sex Discrimination*, 50 IND. L.J. 592 (1975); Comment, *Geduldig v. Aiello, Pregnancy Classifications and the Definition of Sex Discrimination*, 75 COLUM. L. REV. 441 (1975). *See also* text accompanying note 135 *infra*. In *Aiello*, the Court stated that there is no prohibited discrimination if a distinction is drawn between males and females based on traits exclusive and peculiar to one sex, absent a showing that the disparity was a mere pretext designed to effect invidious discrimination. Geduldig v. Aiello, 417 U.S. 484, 496 n.20 (1974). It has been suggested that, if the Court is to uphold the EEOC guidelines, it will have to withdraw or distinguish this statement. *See, e.g.*, Note, *Pregnancy and Sex-Based Discrimination in Employment: A Post-Aiello Analysis*, 1975 U. CIN. L. REV. 57.

The validity of the sex guidelines and their requirement that disability caused by pregnancy and complications be treated as are other disabilities is presently before the Supreme Court. Gilbert v. General Elec., 375 F. Supp. 367 (E.D. Va. 1974), *aff'd*, 519 F.2d 661 (4th Cir.), *cert. granted*, 96 S. Ct. 36 (1975) (No. 74-1590). The same issue was presented in *Wetzel v. Liberty Mutual*, 372 F. Supp. 1146 (W.D. Pa. 1974), *aff'd*, 511 F.2d 199 (3d Cir. 1975), *vacated*, 96 S. Ct. 80 (1976). However, the Supreme Court did not reach this issue in *Wetzel* since the Court, on certiorari, dismissed the appeal and vacated the judgment of the court of appeals because the district court's order was interlocutory. The Supreme Court decision in *Aiello* has, however, caused a federal district court to dismiss a similar complaint in *Communication Workers of America v. AT&T*, 379 F. Supp. 679 (S.D.N.Y. 1974). However, the Second Circuit reversed on the grounds that the dictum of *Aiello* should not be relied upon outside the facts of the case, especially since it appeared in a footnote. Furthermore, the court of appeals noted, the issues in *CWA* involved the interpretation of a statute enacted under the commerce clause and not the equal protection clause, and should be decided only after development of a full record and with great deference to the guidelines. Communication Workers of America v. AT&T, 513 F.2d 1024, 1031 (2d Cir. 1975).

c. The Age Discrimination in Employment Act of 1967, 29 *U.S.C.* §§ 621-34 (1970). This Act prohibits employers from "*discriminat*[*ing*] *against* any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's age . . . ." 29 U.S.C. § 623(a) (1970). This protection is restricted to employees between the ages of 40 and 65. 29 U.S.C. § 631 (1970). An exception provides that it is not unlawful for the employer "to observe the terms of . . . any bona fide employee benefit plan such as a retirement, pension, or insurance plan, which is not a subterfuge

trade practices acts, and as interpreted by regulations. Added restrictions on classification are not mandated by the McCarran Act, nor must they be adopted because of existing constitutional provisions or civil rights statutes.[83] Quite the opposite is true, with the narrow exception prohibiting classification by race.[84] Under our constitutional system, the decision by the states to increase the intensity of the regulation of business—albeit for the express purpose of avoiding existing and proposed federal statutes and regulations[85]—subjects the legislation, the regulation, the regulator's administrative acts and

---

to evade the purposes of this act . . . ." 29 U.S.C. § 623(f) (1970). The statement of findings and purpose at the beginning of the Act make it clear that it is aimed at *arbitrary* discrimination in employment, not all classification by age. 29 U.S.C. § 621 (1970). While the Wage and Hour Division has adopted disability regulations similar to those in the EEOC sex guidelines, the regulations apply the equal contribution or equal benefit rule. 29 C.F.R. § 800.116(d) (1975). The regulations expressly provide that older workers need not be provided with the same retirement, pension or insurance plan as younger workers. 29 C.F.R. § 800.120(a).

d. Various other restrictions imposed upon employers having a special relation with the federal government.

1. Exec. Order No. 11,246, 3 C.F.R. § 339 (1973). This order contains a general requirement that government contractors and subcontractors not discriminate on the basis of race, color, religion, sex or national origin. Executive Order No. 11,141, 3 *C.F.R.* § 179 (1973) effects a similar requirement with respect to age, with an exception for retirement plans.

2. Rehabilitation Act of 1973, 29 U.S.C. §§ 793-94 (Supp. IV, 1974). Sections 793 and 794 provide that certain government contracts must establish affirmative action programs to employ and advance in employment qualified handicapped individuals—those with "a physical or mental disability which for such individual constitutes or results in a substantial handicap to employment and [who] can reasonably be expected to benefit in terms of employability" from the vocation or rehabilitation services provided. 29 U.S.C. § 706(b) (Supp. IV, 1974). There is no special provision with respect to benefit plans in the statute or regulations. While the employer is to make reasonable accommodation to the physical and mental limitations of the employee, business necessity and financial cost and expenses are items which may be considered. 41 C.F.R. § 60-741.6(d) (1976).

3. The Department of Health, Education and Welfare has adopted sex, marital and parental bias rules for educational institutions receiving federal funds under the authority of the Education Amendments Act of 1972 § 3(a), 20 *U.S.C.* §§ 1681-83 (Supp. II, 1972). These rules adopt an equal benefit or equal contribution rule and provide that pregnancy shall be treated as a temporary disability for all job related purposes, including: commencement, duration and extensions of leave; payment of disability income; accrual of seniority and any other benefit or service; reinstatement; and any fringe benefit offered to employees by virtue of employment. 45 C.F.R. 86 (1976).

e. A wide variety of state statutes and municipal ordinances dealing with discrimination in employment. For example, the *Iowa Code* provides that "[i]t shall be an unfair or discriminatory act for any (a) Person to . . . otherwise discriminate in employment against any applicant for employment or any employee because of the age, race, creed, color, sex, national origin, religion or disability of such applicant or employee unless based upon the nature of the occupation. . . ." IOWA CODE § 601A.6(1)(a) (1975). There is an exception for sex and age discrimination in "any retirement plan or benefit system of any employer unless such plan or system is a mere subterfuge adopted for the purposes of evading the purposes of [the Iowa Civil Rights Act]." IOWA CODE § 601A.12 (1975). Apparently disregarding this exception, the Iowa Civil Rights Commission adopted sex guidelines almost identical to the EEOC sex guidelines. 240 IOWA AD. CODE §§ 4.1-.10 (1975). On the other hand, the age discrimination regulations recognize the retirement plan and benefit system exception, business necessity and bona fide underwriting criteria as bases for providing fringe benefits varying by age. 240 IOWA AD. CODE § 6.6(1) (1975). The regulation with respect to fringe benefits for disabled persons permits benefit variance based upon bona fide underwriting criteria. 240 IOWA AD. CODE § 7.4(3) (1975).

83. *See* Part II, *supra*; text accompanying notes 87-150 *infra*.

84. *See* text accompanying note 131 *infra*.

85. *See* text accompanying notes 10, 41 *supra*.

the regulated business's acts to the scrutiny of the highest court of the state or nation. States should take this into account before becoming involved in detailed regulation of risk classification. If a state is determined to so regulate, it should consider whether the legal doctrine and method of analysis applied to resolve the constitutional and civil rights issues which arise will provide a workable model for interpretation of the state statutes and regulations.

Three distinct types of broad provisions found in the United States Constitution and civil rights acts, and the court decisions interpreting and applying them, must be reviewed to understand their direct effect upon state action governing classification in insurance: (1) the equal protection clause; (2) the civil rights acts; and (3) the equal rights amendments.[86]

A. *Equal Protection of Laws*

The equal protection clause of the fourteenth amendment to the United States Constitution provides that "No *state* shall . . . deny any person within its jurisdiction the equal protection of laws."[87] A literal interpretation would limit the prohibition to action by state governments which did not result in absolutely equal treatment. The final interpreter of this clause, the United States Supreme Court, has expanded it to cover some acts of private persons who are subject, at least to some degree, to state regulation, and has restricted the prohibition to classifications judged arbitrary or unfair upon application of one of several standards chosen according to the nature of the rights involved and the class affected. While the Supreme Court has not considered the applicability of the equal protection clause to risk classification by private insurers,[88] a United States district court in *Stern v. Massachusetts Indemnity and Life Insurance Co.*[89] has rendered an opinion dealing with insurance classification by gender. *Stern* elaborates several difficult questions under the equal protection clause and the civil rights acts as they might apply to insurance classification and demonstrates the interplay of state unfair discrimination statutes and equal rights amendments.

Plaintiff Stern's suit against the insurer and the Pennsylvania Insurance Commissioner alleged that refusal to make a disability income policy available to her on the same terms and conditions as available to men constituted a

---

86. For an analysis which recognizes and discusses the legal aspects of classification problems in the insurance industry see Comment, *Gender Classifications in the Insurance Industry*, 75 COLUM. L. REV. 1381 (1975) [hereinafter cited as COLUM. Comment]. For a comprehensive analysis of the legal framework applicable to a different field see Note, *Sex Discrimination and Intercollegiate Athletics*, 61 IOWA L. REV. 420 (1975) [hereinafter cited as IOWA Note].

87. U.S. CONST. amend. XIV (effective July 28, 1868). The same protection is afforded with respect to federal action under the due process clause of the fifth amendment. *See, e.g.*, Mathews v. Lucas, 96 S. Ct. 2755 (1976); Frontiero v. Richardson, 411 U.S. 677, 680 n.5 (1973).

88. The Supreme Court has considered the related question of the constitutionality of a state disability insurance program which excludes disability by reason of normal pregnancy. Geduldig v. Aiello, 417 U.S. 484 (1974). *See also* note 82(b) *supra*.

89. 365 F. Supp. 433 (E.D. Pa. 1973).

violation of the equal protection clause of the fourteenth amendment, the Civil Rights Act of 1871,[90] the Pennsylvania equal rights amendment and the Pennsylvania statute prohibiting discrimination between individuals of the same class. The federal causes of action were challenged by motions to dismiss and for summary judgment, raising the issues of state action and the appropriate standard of review under both the equal protection clause and section 1983 of the Civil Rights Act. The court found: (1) the existence of state action by the insurance commissioner and insurer; (2) that offering an insurance benefit to men and not women was a prima facie violation of the equal protection clause and section 1983 unless a compelling interest justifying gender classification could be shown; and (3) that a fact issue based upon actuarial justification was presented. Because thereafter settled, the case did not resolve the question of whether the insurer's gender classification violated the equal protection clause, the Civil Rights Act of 1871, the Pennsylvania equal rights amendment or insurance unfair discrimination statutes.[91]

1. *Private Action as State Action*

The first question to be considered is whether the state insurance department or the regulated insurer has acted in such a way that the acts of either constitute state action. So far as the state insurance department is concerned, it is a question of specific state action, whether or not authorized, or possibly state inaction where action is required.[92] So far as the insurer is concerned, the question is more difficult and the concept more narrow.[93]

In past decisions, the Supreme Court has emphasized such factors[94] as acting under the color of state law,[95] control by state regulation,[96] existence of

---

90. The statutory remedies under the Civil Rights Act of 1871, 42 *U.S.C.* §§ 1983, 1985(3) (1970) are discussed in the text accompanying note 124 *infra*.

91. The comments by one author tend to overstate the holding: "[I]n Stern . . . these practices were *successfully challenged* under the fourteenth amendment. The court found that there was state action in the insurance regulations of the state of Pennsylvania and held that any such regulation which grants benefits or privileges to men and not to women is prima facie unconstitutional unless the state can show a compelling state interest." Conlin, *Equal Protection v. Equal Rights Amendment—Where Are We Now?*, 24 DRAKE L. REV. 259, 307 (1975) (emphasis added) [hereinafter cited as Conlin].

92. The courts have extended the state action test under section 1983, discussed in Part *v(b) infra*, to include acts of public employees which are in violation of state law. "[I]f the Commissioner's actions in this case could be interpreted as in contravention of Section 626 of the Pennsylvania Insurance Companies Law [the standard act prohibiting unfair discrimination between individuals in the same class by insurers] or of Article I of the Pennsylvania Constitution, these actions may still fall within the proscriptions of Section 1983." Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433, 437 (E.D. Pa. 1973); *accord*, Monroe v. Pape, 365 U.S. 167 (1961).

93. "While the principle that private action is immune from the restrictions of the Fourteenth Amendment is well established and easily stated, the question whether particular conduct is 'private,' on the one hand, or 'state action,' on the other, frequently admits no easy answer." Jackson v. Metropolitan Edison Co., 419 U.S. 345, 349-50 (1974).

94. For a summary and citations see Annot., 42 L. Ed. 2d 922-42 (1976). *See also* IOWA Note, *supra* note 86, at 433-35.

95. *E.g.*, Moose Lodge v. Irvis, 407 U.S. 163 (1972); Shelley v. Kraemer, 334 U.S. 1 (1948).

96. *E.g.*, Gilmore v. Montgomery, 417 U.S. 556 (1974); Gray v. Sanders, 372 U.S. 368 (1963).

a monopoly,[97] and private performance of a public function.[98] In recent decisions, however, it has stated the proper inquiry to be whether a sufficiently close nexus exists between the state and the challenged action of the regulated entity so that the action of the regulated entity may be fairly treated as that of the state itself.[99] This determination is made after a detailed inquiry into and sifting of the facts and weighing of the circumstances.

In the *Stern* case, the district court found sufficient state action to deny defendant's motion to dismiss but the discussion of the similar issue under section 1983 and the fact that the state insurance department was a direct party make it difficult to tell when the court is speaking to the constitutional issue. The cases reviewed by the *Stern* court are concerned mainly with whether the state licensing of establishments to serve liquor is enough to make the licensee's action "state action." The court rejected defendant's analogy to the Supreme Court decision in *Moose Lodge v. Irvis*,[100] accepting instead plaintiff's analogy to a district court opinion concluding that licensing by the state did make the licensee's action state action.[101] The court emphasized that the control by the state insurance department is more pervasive than that of liquor licensors since the insurer not only must be licensed before it can do business in the state, but it may not sell a policy until the insurance department first approves the terms, conditions, premium rates and policy forms. While the pervasive regulatory scheme may be pertinent to the cause of action against the state insurance department, the question of whether private action is state action requires a more specific inquiry into the departmental review which occurred with respect to the particular policies involved.

The *Stern* court might have benefited from the subsequent Supreme Court opinion in *Jackson v. Metropolitan Edison Co.*[102] The issue before the Court in *Jackson* was whether the action of a regulated public utility in terminating service for nonpayment of bills constituted state action subject to the fourteenth amendment due process requirements. The Court refused to conclude that private action was state action merely because of extensive state regulation, the possible existence of a monopoly, or other public interest arguments. It found the public utility commission had approved a general tariff submitted by the utility which provided for termination of service for nonpayment of bills but, though there had been a hearing on the general rate increase, there was never any scrutiny of the provision dealing with termination and notice. Furthermore, it was unclear whether the regulatory body would have had the authority

97. *E.g.*, Jackson v. Metropolitan Edison Co., 419 U.S. 345 (1974).
98. *E.g.*, Evans v. Newton, 382 U.S. 296 (1966).
99. Jackson v. Metropolitan Edison Co., 419 U.S. 345, 351 (1974); Moose Lodge v. Irvis, 407 U.S. 163, 172 (1972); Burton v. Wilmington Parking Authority, 365 U.S. 715, 722 (1961).
100. 407 U.S. 163 (1972).
101. Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433, 438-39 (E.D. Pa. 1973).
102. 419 U.S. 345, 352 (1974).

to reject the tariff. At most, the regulatory body's action (or failure to act) indicated the utility was authorized to employ the practice if it so desired. The court concluded this did not amount to state action. The earlier decision in *Public Utilities Commission v. Pollack*[103] was distinguished in that, in *Pollack*, the regulatory body had commenced an investigation and held a full hearing on the exact practice involved.

An examination of recent Supreme Court decisions indicates the answer to the threshold question of whether an insurance company's risk classification practices constitute state action will depend upon the extent to which the state insurance department has specifically reviewed and approved the particular insurance company practice or provision at issue, even though the state insurance department's inaction may be state action so far as the insurance department is concerned if supervisory responsibility is established.[104]

2. *Standard of Review*

If state action is found to exist,[105] the next step is to select and apply the appropriate standard of review. The Supreme Court has found it impossible to develop a single standard by which to review state action under the equal protection clause. The result is a set of three standards which adjust what must be proved and the burden of proof according to the circumstances involved.[106]

In the case of classification which "impermissibly interferes with the exercise of a fundamental right or operates to the peculiar disadvantage of a suspect class,"[107] the Supreme Court has applied a "strict scrutiny" standard under which the state has the burden of proving the challenged classification promotes a compelling interest and perhaps, that there is no alternative means to achieve the end sought.[108] Examples of rights found to be fundamental[109]

---

103. 343 U.S. 451 (1952).

104. *Compare* Reichardt v. Payne, 396 F. Supp. 1010 (N.D. Cal. 1975), discussed in Part V(B) *infra*. In *Reichardt*, the court dismissed the section 1983 claim against the insurer because of an insufficient nexus between the state insurance department and the alleged discriminatory action by the insurer. However, the claim against the insurance commissioner was not dismissed because state action existed where the commissioner had jurisdiction to act, but had not acted.

105. It is not unrealistic to suggest that some courts will assume state action arguendo to reach the classification issue, especially if they find the classification not subject to challenge. See the Supreme Court's analysis of *Pollack* in *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 356 (1974).

106. For a summary of these standards, see IOWA Note, *supra* note 86, at 440-44. The intermediate scrutiny standard was recognized and developed in Gunther, *The Supreme Court 1971 Term—Forward: In Search of Evolving Doctrine on a Changing Court: A Model for a Newer Equal Protection*, 86 HARV. L. REV. 1 (1972). *See also* Conlin, *supra* note 91, at 265-69 (suggests that because the Supreme Court is not likely to present a unified concept and because strict scrutiny is not applied to gender classification, the equal rights amendment should be ratified); Johnston, *Sex Discrimination and the Supreme Court 1975*, 23 U.C.L.A.L. REV. 235 (1975).

107. Massachusetts Bd. of Retirement v. Murgia, 44 U.S.L.W. 5077, 5079 (June 25, 1976).

108. Frontiero v. Richardson, 411 U.S. 677, 690-91 (1973). *See also* Comment, *Toward Sexual Equality: An Analysis of Frontiero v. Richardson*, 59 IOWA L. REV. 377 (1973) [hereinafter cited as IOWA Comment].

109. *See* IOWA Note, *supra* note 86, at 442; IOWA Comment, *supra* note 108, at 380.

include rights of a uniquely private nature,[110] the right to vote,[111] the right of interstate travel,[112] rights guaranteed by the first amendment[113] and the right to procreate.[114] Rejections include the right to government employment[115] and the right to education.[116]

Suspect classifications include race,[117] alienage,[118] and national origin.[119] In refusing to find other classifications such as age and illegitimacy suspect, the Supreme Court has indicated that, in determining whether a class merits extraordinary protection, it will consider factors such as a history of purposeful unequal treatment, relegation to a position of political powerlessness, isolation from society, stereotyped characteristics not truly indicative of abilities, the apparentness to the observer that a person falls within the class and the pervasiveness of discrimination against the class.[120]

Applying these factors to a state statute mandating retirement of police officers at age 50, the Supreme Court, in *Massachusetts Board of Retirement v. Murgia*,[121] concluded that age is not a suspect classification, refusing to apply the strict scrutiny standard. The majority applied the "rational basis" standard: "This inquiry employs a relatively relaxed standard reflecting the Court's awareness that drawing of lines that create distinctions is peculiarly a legislative task and an unavoidable one. Perfection in making the necessary classifications is neither possible or necessary . . . . Such action by the legislature is presumed to be valid."[122] The majority held that the age classification was rationally related to the state objective of removing individuals from police service whose fitness is diminished. In his dissenting opinion, Justice Marshall

---

110. *E.g.*, Roe v. Wade, 410 U.S. 113 (1973).
111. Bullock v. Carter, 405 U.S. 134 (1972).
112. Shapiro v. Thompson, 394 U.S. 618 (1969).
113. *E.g.*, Williams v. Rhodes, 393 U.S. 23 (1968).
114. Skinner v. Oklahoma, 316 U.S. 535 (1942).
115. Massachusetts Bd. of Retirement v. Murgia, 44 U.S.L.W. 5077 (June 25, 1976).
116. San Antonio School Dist. v. Rodriguez, 411 U.S. 1 (1973).
117. McLaughlin v. Florida, 379 U.S. 184 (1964).
118. Graham v. Richardson, 403 U.S. 365 (1971).
119. Oyama v. California, 332 U.S. 633 (1948).
120. *See* Massachusetts Bd. of Retirement v. Murgia, 44 U.S.L.W. 5077, 5079, 5082 (June 25, 1976) (majority and dissenting opinions); IOWA Note, *supra* note 86; IOWA Comment, *supra* note 108. *Compare* Mathews v. Lucas, 44 U.S.L.W. 5139, 5142 (June 29, 1976) (fifth amendment).
121. 44 U.S.L.W. 5077 (June 25, 1976). Legislation dealing with age discrimination recognizes that there may be a rational relationship between age and employment performance and age and benefit plan risk by restricting the protected age bracket and creating exceptions for benefit plan classification. *See* note 82(c) *supra*. Testing of age classification outside of these laws under the equal protection clause has been restricted to governmental programs which mandate retirement at certain ages. The question is whether each employee is entitled to individual review of job performance of a certain quality or may be retired automatically at a present age. While there are arguments on both sides, to date most courts have approved retirement programs. There has been no activity in connection with private employer's programs because of a lack of state action. Age is not a suspect classification. *See* Larken, *Constitutional Attacks on Mandatory Retirement: A Reconsideration*, 23 U.C.L.A.L. REV. 549 (1976); Note, *Too Old To Work: The Constitutionality of Mandatory Retirement Plans*, 44 S. CAL. L. REV. 150, 167 (1971).
122. Massachusetts Bd. of Retirement v. Murgia, 44 U.S.L.W. 5077, 5079 (June 25, 1976).

suggested that the standard might be chosen with an eye toward the result desired since the state action is usually struck down when the strict scrutiny standard is applied and upheld when the rational basis standard is applied. He urged for overt recognition of an intermediate standard which has, in fact, been applied and which demands a closer scrutiny of legislative goals and means and of the significance of the personal rights and interests invaded.[123]

In *Stern*, the court faced this issue when it considered the standard to be applied when gender-based classification is used in fixing the terms of disability insurance. Justice Brennan's plurality opinion in *Frontiero v. Richardson*[124] was cited to suggest the strict scrutiny standard be applied to statutes which classify on the basis of gender,[125] though the majority of the Court continues to prefer either the rational basis standard or a somewhat stronger intermediate standard.[126] After reviewing the authority, the court in *Stern* determined that the strict standard should be applied. While rejecting the idea that there is a fundamental right to insurance coverage, the court found gender an inherently suspect classification subject to close judicial scrutiny and requiring a justification more compelling than mere convenience, simplicity or efficiency.[127] This position is subject to challenge on several grounds. The *Frontiero* majority did not conclude that sex is a suspect classification.[128] More importantly, a

123. *Id.* at 5080.

124. 411 U.S. 677 (1973).

125. Justice Brennan equates classification by gender with classification by race. Such equation overlooks some differences, for example, a majority versus a minority, social equality versus social inequality. *See* IOWA Note, *supra* note 86, at 425-26 n.29. In *Weinberger v. Wiesenfeld*, 420 U.S. 636 (1975), a majority of the Court concurred in Justice Brennan's opinion in which he drew a close analogy to *Frontiero v. Richardson* but did not state that sex classification is suspect. In finding that the fifth amendment prohibits payment of social security benefits to a widow and not a widower, the opinion emphasizes that an overbroad classification which precludes proof of dependency of a widower on his wife is even more pernicious than one which merely creates a rebuttable presumption of nondependency. Note that in both *Frontiero* and *Weinberger* there is an alternative open which allows dependency to be a fact question by subjecting it to determination upon application for the benefit. This is quite different from the insurance situation where the insurer must estimate and determine the risk in the future based upon facts at the time of the application.

126. The Supreme Court has stated the standard as follows: "The Equal Protection Clause of that amendment does, however, deny to states the power to legislate that different treatment be accorded to persons placed by a statute into different classes on the basis of criteria wholly unrelated to the objective of the statute. A classification must be reasonable, not arbitrary and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike." Reed v. Reed, 404 U.S. 71, 75-76 (1971). The same test has been applied since *Reed* and *Frontiero* in *Kahn v. Shevin*, 416 U.S. 351, 352 (1974); *Geduldig v. Aiello*, 417 U.S. 484, 494-99 (1974); *Schlesinger v. Ballard*, 419 U.S. 498 (1975).

127. Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433, 441-42 (E.D. Pa. 1973).

128. Frontiero v. Richardson, 411 U.S. 677 (1973). The court's statement in *Stern* that "Frontiero is the first Supreme Court case to *mandate* a stricter standard of review in testing sex-based classifications" is overly strong. Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433, 441 (E.D. Pa. 1973) (emphasis added). However, Justices Brennan, Douglas and Marshall in the dissenting opinion of *Geduldig* agree that *Reed* and *Frontiero* mandate a stricter standard of scrutiny. Geduldig v. Aiello, 417 U.S. 484, 498 (1974).

majority of the Supreme Court has refused to take this position since *Frontiero*.[129]

Equal protection as applicable to risk classification by insurers has developed to this point: while classification by race is subject to the standard of strictest scrutiny, which casts the burden upon the insurer to demonstrate a compelling interest and lack of reasonable alternatives, classification by gender, age or physical or mental impairment is subject to less strict standards.[130] Classification by age or physical or mental impairment[131] has not been subject to court tests forcing application of any standard stricter than that the classification have a rational basis. Gender classification is most likely subject to the intermediate standard that the classification be fairly and substantially related to some legitimate goal.

Where the state action ranges between general supervision of the insurer and specific approval of rating, it is difficult to identify specific legitimate state goals except by reference to statutes which prohibit unfair discrimination and recognize the need for a balance between spreading the risk and doing equity among policyholders. Should the court consider only those objectives with respect to which the state has expressed a concern? Can or should it go further and consider the legitimate objectives of the private insurer or would that just serve to raise the threshold question of whether state action was involved?

The standard of review applied and the basis for classification can be critical to the breadth of the classification allowed and the extent to which administrative convenience is an acceptable objective. In *Frontiero* and *Weinberger v. Wiesenfeld*,[132] the Court rejected overbroad classification by gender which presumed absolutely, or subject to rebuttal, that a wife is dependent upon her husband but a husband is not dependent upon his wife. Applying the intermediate scrutiny standard, the Court found as a reasonable alternative that dependency could be determined by examining the facts at the time the benefit is applied for, even though this would entail some added administrative cost. In *Mathews v. Lucas*,[133] the Court applied the rational basis standard in approving a statutory social security scheme whereby certain illegitimate children have the administrative burden to prove dependency, thereby saving administrative expense, stating:

---

129. *See* Weinberger v. Wiesenfeld, 420 U.S. 636 (1975). *But compare* Hanson v. Hutt, 83 Wash. 2d 195, 517 P.2d 599 (1974) (the state court applied a strict scrutiny test to an employment compensation statute denying benefits to pregnant women).

130. *See* Frontiero v. Richardson, 411 U.S. 677, 686 (1973).

131. Legislation dealing with discrimination by mental and physical handicap has been restricted because of a recognition that there may be a rational relationship between physical and mental condition and employment performance. *See* note 82(d)(2) *supra*. Emphasis has been more upon job opportunity and facilities which permit handicapped persons to take advantage of these opportunities. Due to a lack of state action approving discrimination, there has been little equal protection challenge. Activity with respect to insurance has been in the legislature rather than in the courts and requires special treatment of certain impairments. *See* Table I *supra*.

132. 420 U.S. 636 (1974); *see* note 125 *supra*.

133. 44 U.S.L.W. 5135 (June 29, 1976).

> Congress' purpose in adopting the statutory presumptions of dependency was obviously to serve administrative convenience. While Congress was unwilling to assume that every child of a deceased insured was dependent at the time of death, by presuming dependency on the basis of relatively readily documented facts, such as legitimate birth, or existence of a support order or paternity decree, which could be relied upon to indicate the likelihood of continued actual dependency, Congress was able to avoid the burden and expense of specific case-by-case determination in the large number of cases where dependency is objectively probable. Such presumptions in aid of administrative functions, though they may approximate, rather than precisely mirror, the results that case-by-case adjudication would show, are permissible under the Fifth Amendment, so long as that lack of precise equivalence does not exceed the bounds of substantiality tolerated by the applicable level of scrutiny. . . .
>
> In cases of strictest scrutiny, such approximations must be supported at least by a showing that the Government's dollar 'lost' to overincluded benefit recipients is returned by a dollar 'saved' in administrative expense avoided. . . . Under the standard of review appropriate here, however, the materiality of the relation between the statutory classifications and the likelihood of dependency they assertedly reflect need not be 'scientifically substantiated.' . . . Nor, in any case, do we believe that Congress is required in this realm of less than strictest scrutiny to weigh the burdens of administrative inquiry solely in terms of dollars ultimately 'spent,' ignoring the relative amount devoted to administrative rather than welfare issues. . . . Finally, while the scrutiny by which their showing is to be judged is not a toothless one, . . . the burden remains upon the appellees to demonstrate the insubstantiality of that relation.[134]

As these cases show, the existence of a reasonable, though expensive, alternative will pass the rational basis standard but perhaps not the intermediate standard.

In situations involving private insurance, it is necessary to keep in mind the nature of insurance and the distinctions between private insurance and public insurance programs. The insurer cannot know a person's actual mortality or mobidity until the insured event occurs. Nevertheless, it must bind itself to the risk based upon known physical characteristics and statistical data concerning classes with these characteristics, without the opportunity to get added premiums through taxes if it is wrong or change the coverage by amending a statute. Furthermore, broad classification or assumptions which reduce administrative costs and narrow classifications which isolate the risk are directly related to the private insurer's ability to provide insurance to the public at a reasonable premium.

The Supreme Court has indicated a willingness to consider various other valid objectives of a challenged classification. In *Geduldig v. Aiello*,[135] the

---

134. Mathews v. Lucas, 44 U.S.L.W. 5139, 5143 (June 29, 1976).
135. 417 U.S. 484 (1974).

Supreme Court found that a state disability insurance program's exclusion of females temporarily disabled by normal pregnancy from temporary disability benefits was not invidious discrimination in violation of the equal protection clause. It analyzed the facts in terms of the test applied by the district court below: did the classification have a rational, substantial relationship to a legitimate state purpose? In concluding that the sex classification did not violate the equal protection clause, the court considered not only the state's legitimate interest (1) in maintaining a self-supporting insurance program, (2) in distributing the available resources in such a way as to keep benefit payments at an adequate level for disabilities that are covered and (3) in maintaining the contribution rates at a level that will not unduly burden participating employees, but specifically noted the inequity of treating unequals equally by reference to the fact that female plan participants already received more benefit payments than male participants.

Challenges to gender classification in insurance include not only the treatment of all females as a class but the provision of limited benefits with respect to illness unique to the female or pregnancy. There is a question whether this even involves discrimination. The majority opinion in *Geduldig* questions whether discrimination is gender based or risk based where one class includes pregnant females and the other includes nonpregnant females and males.[136] A similar question can be raised about risk classification for sickness or disease most often found in one sex, race or ethnic group.[137]

B. *Federal Civil Rights Statutes*

The more recently enacted federal civil rights statutes, though literally stating more absolute rules against unfair discrimination, have no application to insurance products except when the product is part of a benefit plan involved in a protected relationship such as employment.[138] However, the Civil Rights

---

136. In a footnote the Court, in *Geduldig*, states:

> Absent a showing that distinctions involving pregnancy are mere pretexts designed to effect an invidious discrimination against the members of one sex or the other, lawmakers are constitutionally free to include or exclude pregnancy from the coverage of legislation such as this on any reasonable basis, just as with respect to any other physical condition. The lack of identity between the excluded disability and gender as such under the insurance program becomes clear upon the most cursory analysis. The program divides potential recipients into two groups—pregnant women and nonpregnant persons. While the first group is exclusively female, the second includes members of both sexes. The fiscal and actuarial benefits of the program thus accrue to members of both sexes.

Geduldig v. Aiello, 417 U.S. 484, 496-97 n.20 (1974). *See also* note 82(b), *supra*. For a critical comment see Note, *Pregnancy and Disability Insurance*, 23 DRAKE L. REV. 806, 811-14 (1974).

137. In view of the *Geduldig* analysis, statutes restricting classification with respect to those with a sickness or disease most often found in one race or ethnic group are based on a social policy decision that this relatively small group of persons is entitled to have insurance which is subsidized by the healthier lives. *See* text accompanying notes 55-59 *supra*.

138. *See* note 81 *supra*.

Acts of 1866,[139] 1870[140] and 1871[141] have been so expansively interpreted by the Supreme Court in recent years that their application to insurance products must be considered.[142]

42 *U.S.C.* sections 1981[143] and 1982[144] provide that all persons shall have the same rights to make and enforce contracts and hold and convey property as those enjoyed by white persons. The discrimination prohibited is literally limited by race, and perhaps alienage,[145] but the prohibition extends to private action as well as state action.[146] The most recent illustration of the principle that private parties cannot refuse to contract with nonwhites is *Runyon v. McCrary*,[147] in which the Supreme Court held that a commercially operated nonreligious private school without any state connection must contract with parents of qualified black children.

A lower federal court has held that these statutes prohibit a private fraternal insurance company from refusing to enter into insurance contracts with black persons.[148] Because a commercial insurer cannot argue a countervailing policy based upon associational freedom,[149] a stronger case can be

---

139. 42 U.S.C. §§ 1981, 1982, 1985 (1974).
140. 42 U.S.C. § 1981 (1974).
141. 42 U.S.C. §§ 1983, 1985 (1974).
142. For a detailed historical analysis of these sections see Note, *Federal Power to Regulate Private Discrimination: The Revival of the Enforcement Clauses of the Reconstruction Era Amendments*, 74 COLUM. L. REV. 449 (1974) [hereinafter cited as COLUM. Note].
143. "All persons shall have the same right . . . to make and enforce contracts . . . as is enjoyed by white citizens . . . ." 42 U.S.C. § 1981 (1974).
144. "All citizens shall have the same right as enjoyed by white citizens thereof . . . to hold and convey . . . personal property." 42 U.S.C. § 1982 (1974).
145. While it would not appear that section 1981 protects against sex discrimination, one district court has refused to dismiss a count charging sex discrimination under sections 1981 and 1983. Parmer v. National Cash Register Co., 346 F. Supp. 1043 (E.D. Ohio 1972). The court cited *Johnson v. Cincinnati*, 450 F.2d 796 (6th Cir. 1971), as authority though the court in that case was concerned only with sections 1983 and 1985, which do not contain references to white citizens. The Supreme Court, in *Jones v. Mayer Co.*, 392 U.S. 409 (1968), makes it quite clear that section 1982 is limited to nonwhite discrimination.
146. Sections 1981 and 1982 were passed under the power established by the thirteenth amendment to abolish all badges and incidents of slavery, making them susceptible to broad application and giving them the weight to outbalance countervailing rights such as association freedom, privacy, and childbearing and rearing. The Supreme Court's original narrow construction, limiting the scope of these sections to racial discrimination, was abandoned in *Jones v. Mayer*, 392 U.S. 409 (1968), which also made it clear that section 1982 applies to private action. Subsequently, it has been held that there is no state action limitation with respect to either section 1981 or section 1982. Johnson v. Railway Express Agency, Inc., 417 U.S. 929 (1973). But see the concurring and dissenting opinions in *Runyon v. McCrary*, 44 U.S.L.W. 5034, 5042-51 (June 22, 1976), questioning whether Congress intended section 1981 to require a private person to enter into a contract.
147. 44 U.S.L.W. 5034 (June 22, 1976); *see* Note, *Section 1981 and Discrimination in Private Schools*, 1976 DUKE L.J. 125 (commenting on the lower court decisions).
148. Sims v. Order of United Commercial Travelers of America, 343 F. Supp. 112 (D. Mass. 1972).
149. The association freedom argument has not prevailed in race discrimination cases. Runyon v. McCrary, 44 U.S.L.W. 5034 (June 22, 1976); Tillman v. Wheaton-Haven Recreation Ass'n, 410 U.S. 431 (1973). In a district court case, the court found, based on the facts alleged in the complaint, that the Order of United Commercial Travelers of America actually stood in the position of a commercial insurance carrier. Sims v. Order of United Commercial Travelers of America, 343 F. Supp. 112, 113-14 (D. Mass. 1972).

made that section 1981 prohibits refusal to contract with persons of a particular race as a class. As previously mentioned, statutes in several states expressly prohibit refusal to accept an insurance application based on color.[150]

42 *U.S.C.* section 1983 provides a remedy for individuals who, under the color of state law, are deprived "of any rights, privileges or immunities secured by the Constitution and laws."[151] That section may be used to challenge state action which violates the equal protection clause of the Constitution. The state action test is more specific than under the equal protection clause, applying to persons who are acting under color of any statute, ordinance, regulation, custom or usage of any state or territory.[152] In *Reichardt v. Payne*,[153] the purchaser of a disability policy sued the California Insurance Commissioner, the insurer from whom an insurance policy was purchased and several other insurers, joining claims under sections 1983 and 1985(3) and several pendent claims under state law. The complaints all alleged gender discrimination because the policy sold by the insurers to females and approved by the Commissioner, as compared with policies available to men, contained shorter disability periods, longer elimination periods and lower monthly benefit ceilings. The court granted defendant's motion to dismiss the claim under section 1983 against the issuing insurer holding that, under *Jackson v. Metropolitan Edison Co.*,[154] there was an inadequate nexus between the Commissioner and the alleged discriminatory action by the insurer to find that the insurer acted under the color of state law.[155] In this case the Commissioner did no more than review the economic soundness of the policy and his tacit approval did not raise private action to the level of state action. On the other hand, the court refused to dismiss the 1983 action against the Commissioner finding that, while the Commissioner may not have the express power to regulate rates, he has a duty to disapprove a policy which does not conform to California law. (The court pointed out that the California Unfair Trade Practices Act prohibits discrimination between insureds of the same class.[156]) The *Stern* case, on similar facts, reached the opposite conclusion on the state action issue with respect to the

150. *See* note 53 *supra*. It has not been determined whether these state statutes or sections 1981 or 1982 prohibit classification of risks in the rating process by race, though it is not the practice of commercial insurers to do so. A more difficult question is whether an insurer, absent a state statutory prohibition, could exclude a disease common to one race, such as sickle cell anemia.

151. "Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any state or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress." 42 U.S.C. § 1983 (1974).

152. *Id.*

153. 396 F. Supp. 1010 (N.D. Cal. 1975).

154. 419 U.S. 345 (1974).

155. Reichardt v. Payne, 396 F. Supp. 1010, 1015-16 (N.D. Cal. 1975). Claims against the other companies under section 1983 were dismissed for lack of standing. *Id.* at 1010.

156. *Id.* at 1014-15.

insurer but did not have the benefit of the *Jackson* decision.[157] Courts are inclined to apply the same standard to determine whether private acts are under "color of state law" under section 1983 as when they determine if the same acts are state action under the equal protection clause.[158] Once state action is found the equal protection clause issue under the Civil Rights Act of 1871 is the same as that presented in a direct equal protection clause challenge.

Section 1985(3)[159] provides not only a remedy for conspiracy to deprive of certain rights but creates other substantive rights. In *Griffin v. Breckenridge*,[160] the Supreme Court held the words "depriving, either directly or indirectly, any person or class of persons of equal protection of the laws, or equal privileges and immunities under the laws" creates a right separate from that provided for under the equal protection clause to the extent that, in situations where discrimination is based upon race, the prohibition extends to private action.[161] Though the Court in dicta refers to discrimination based upon other factors, "racial or perhaps otherwise class-based, invidiously discriminating animus behind the conspirators' action," it was careful in a footnote to reserve judgment with respect to other factors such as sex.[162] The complaint in *Stern*, discussed above in connection with the equal protection clause, alleged conspiracy by the insurer and the insurance commissioner under section 1985(3). The *Stern* court, having previously concluded that classifications based upon gender are suspect and subject to strict scrutiny, found that sex classification also satisfied the "class-based" test of *Griffin*, thereby

157. Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433, 438 (E.D. Pa. 1973); *see* text accompanying note 102 *supra*.

158. Magill v. Avonworth Baseball Conf., 516 F.2d 1328, 1331-32 (3d Cir. 1975) (significant state involvement with private party required); Ouzts v. Maryland Nat'l Ins. Co., 505 F.2d 547, 550 (9th Cir. 1974) (significant state involvement after sifting the facts). *But cf.* Girard v. 94th Street and Fifth Avenue Corp., 396 F. Supp. 450, 453-54 (S.D.N.Y. 1975) (reciting a three pronged test of degree of state involvement: significant state involvement with the activity that caused the injury; nexus; and state's involvement aids, encourages or connotes approval of complained activity; no state action was found after applying that circuit's stricter test with respect to sex discrimination of whether the alleged discrimination was impregnated with governmental approval—indirect governmental participation in the management of the organization being adequate). *See also* United States v. Price, 383 U.S. 787, 794 (1966).

159. "If two or more persons in any State or Territory conspire . . . for the purpose of depriving, either directly or indirectly, any person or class of persons of the equal protection of the laws, or of equal privileges and immunities under the laws; . . . whereby another is injured in his person or property, or deprived of having and exercising any right or privilege of a Citizen of the United States, the party so injured or deprived may have an action for the recovery of damages . . . ." 42 U.S.C. § 1985(3) (1974). Some feel that this remedy is limited to race discrimination cases, *e.g.*, COLUM. Note, *supra* note 142, at 517, although the court in *Stern* did not.

160. 403 U.S. 88 (1971).

161. *Id.* at 96-97. *See also* COLUM. Note, *supra* note 142, at 495; COLUM. Comment, *supra* note 86, at 1895-96.

One commentator has suggested that section 1985(3) may offer a way to avoid the state action requirements of the equal protection clause and section 1983 with respect to gender classification. The plaintiff would first sue the insurance commissioner to force the insurer to cease discrimination and if the commissioner did not act as requested, the plaintiff would bring an action under section 1985(3) alleging conspiracy without having to allege state action. *Id.* at 1395. Of course, this assumes that the Supreme Court would find gender classification on a parity with race classification.

162. Griffin v. Breckenridge, 403 U.S. 88, 102 & n.9 (1971).

eliminating the necessity for finding that the insurer's action was state action.[163] The same result was reached by the district court in the *Reichardt* case though that court admitted that the courts of appeals are split on this issue.[164] These courts' conclusions must be questioned in light of the Supreme Court's continued refusal in recent cases to find that sex classifications are suspect.[165]

C. *Equal Rights Amendments*

Equal rights amendments (ERAs) impose broad brush standards which may bear directly upon gender classification. Commentators look upon them as the best quick answer to total elimination of gender discrimination[166] and criticize them as throwing out the good with the bad.[167] Others feel that they will have little effect on gender classification in insurance.[168] The proposed ERA to the United States Constitution provides that "Equality of rights under the law shall not be denied or abridged by the United States or by any State on account of sex."[169] While these standards are not now, and may never be, in effect on a national level,[170] a number of states have passed equal rights amendments to their constitutions.

The state action issue as applied to state insurance departments should be the same as under the equal protection clause. Although ERAs are literally

163. Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433, 442-43 (E.D. Pa. 1973).

164. Reichardt v. Payne, 396 F. Supp. 1010, 1018 (N.D. Cal. 1975).

165. *Compare* Dombrowski v. Dowling, 459 F.2d 190 (7th Cir. 1972) *and* Bellamy v. Mason's Stores, Inc., 508 F.2d 504 (4th Cir. 1974) (refusing to extend section 1985(3) to private conspiracies challenged under the fourteenth amendment) *with* Cameron v. Brock, 473 F.2d 608 (6th Cir. 1973) *and* Westberry v. Gilman Paper Co., 507 F.2d 206 (5th Cir. 1975) (extending section 1985(3) to private conspiracies).

166. *See* Conlin, *supra* note 91.

167. *See* Ryman, *A Comment on Family Property Rights and the Proposed 27th Amendment*, 22 DRAKE L. REV. 505 (1973) [hereinafter cited as Ryman].

168. COLUM. Comment, *supra* note 86, at 1396-98.

169. "Section 1. Equality of Rights under the law shall not be denied or abridged by the United States or by any State on account of sex. Section 2. The Congress shall have the power to enforce, by appropriate legislation, the provisions of this article. Section 3. This amendment shall take effect two years after the date of ratification." H.R.J. Res. 208, 92d Cong., 2d Sess., 86 Stat. 1523 (1972).

170. The proposed twenty-seventh amendment has been ratified by 34 states out of the 38 necessary for it to become effective: Alaska (April 5, 1972); California (November 13, 1972); Colorado (April 22, 1972); Connecticut (March 15, 1973); Delaware (March 23, 1972); Hawaii (March 22, 1972); Idaho (March 24, 1972); Iowa (April 21, 1972); Kansas (March 29, 1972); Kentucky (June 26, 1972); Maine (January 18, 1972); Maryland (May 26, 1972); Massachusetts (June 21, 1972); Michigan (May 22, 1972); Minnesota (February 12, 1973); Montana (January 25, 1974); Nebraska (March 29, 1972); New Hampshire (March 22, 1972); New Jersey (April 17, 1972); New Mexico (February 28, 1973); New York (May 3, 1972); North Dakota (February 3, 1975); Ohio (February 7, 1974); Oregon (February 8, 1973); Pennsylvania (September 26, 1972); Rhode Island (April 14, 1972); South Dakota (February 5, 1973); Tennessee (April 4, 1972); Texas (April 19, 1972); Vermont (March 1, 1973); Washington (March 27, 1973); West Virginia (April 22, 1972); Wisconsin (April 26, 1972); Wyoming (June 26, 1973). Rapid ratification has given way to studied deliberations in the remaining states. Though this has been characterized as being centered around the issues of the draft, the rights of homemakers and the toilets, in Conlin, *supra* note 91, at 331, there is equal concern about the breadth of the amendment and uncertainty as to just how laws and rights will be affected. *See* Ryman, *supra* note 167.

directed against federal and state action, experience with expansion of the equal protection clause suggests ERAs may ultimately reach private action as well.[171]

It is unclear whether the ERA's language strikes down all gender classifications, only those gender classifications which are not rationally related to a legitimate purpose or only those gender classifications which infringe upon a fundamental right. With the federal ERA not in force and few decisions under state ERAs, interpretation is speculative, though there are equal protection clause precedents to follow, interpretative guides suggested by various experts, and an effort to establish three interpretative models which courts might use.[172]

The absolutist interpretation is that sex cannot be a factor in classification. However, it is admitted, with some support in the congressional history, that exceptions may exist with respect to interpersonal relationships, the right of privacy, and gender classification arising from physical characteristics peculiar to one or the other sex.[173] An example of the latter exception is a statute providing for the payment of childbearing expenses—it does not provide a benefit for all women and no men but only for some women and no men.[174] The emphasis is upon provable biological and physiological differences rather than differences which are provable but cannot be so attributed to biological or physiological differences. Under this reasoning, special insurance provisions for childbearing or relating to biological or physiological differences between males and females, whether providing special benefits, limited benefits, or varying rates by gender, would be exempt from the sweep of the ERA. This is similar to the approach suggested by *Geduldig*.[175]

A second suggested interpretation would apply the strict scrutiny discussed above with respect to the equal protection clause, *i.e.*, gender classification is suspect and justified only if supported by a compelling countervailing interest

---

171. The ERA in Montana is drawn so as to make it clear that private action is covered: "The dignity of the human being is inviolable. No person shall be denied the equal protection of the laws. Neither the state nor any person, firm, corporation, or institution shall discriminate against any person in the exercise of his civil or political rights on account of race, color, sex, culture, social origin or conditions, or political or religious ideas." MONT. CONST. art. II, § 4; *see* Uda, *Equality for Men and Women, Three Approaches: Frontiero, The Equal Rights Amendment and the Montana Equal Dignities Provision*, 35 MONT. L. REV. 325, 333-34 (1974) [hereinafter cited as Uda].

172. *See* Brown, Emerson, Falk & Freedman, *The Equal Rights Amendment: A Constitutional Basis for Equal Rights for Women*, 80 YALE L.J. 871, 892-93 (1971) [hereinafter cited as Brown]; Emerson, *In Support of the Equal Rights Amendment*, 6 HARV. CIV. RIGHTS-CIV. LIB. L. REV. 225 (1971); Uda, *supra* note 171; IOWA Note, *supra* note 86, at 485-94.

173. *See* Conlin, *supra* note 91, at 332. For an example of this absolutist interpretation without the recognition of exceptions in connection with gender discrimination by providing a dual system of athletics, see *Commonwealth v. Pennsylvania Interscholastic Athletic Association*, 334 A.2d 839 (Pa. 1975). The results of this decision question the wisdom of the absolutist position. Females forced to compete with males will find no program because of present inability to compete at that level. Comment, *Commonwealth v. Pennsylvania Interscholastic Athletic Ass'n*, 14 DUQUESNE L. REV. 101 (1975). *See also* IOWA Note, *supra* note 86, at 490-91.

174. Brown, *supra* note 172.

175. *See* text accompanying note 136 *supra*.

with no available reasonable alternative.[176] The ERA would have the effect of a legislative declaration that sex classification, like race classification, is suspect or presumptively invidious. This does not mean that the relationship of the classification to ends sought is not important, *i.e.*, a sound actuarial basis, but would mean that other objectives such as administrative convenience and financial integrity, would be scrutinized more carefully.[177]

A third interpretation suggests limitation of the protection to fundamental "rights under the law." Classification by sex would be subject to scrutiny only with respect to rights deemed fundamental or basic, and protected by the law.[178] Examples would be rights deemed fundamental by the Supreme Court under the equal protection clause.[179] The right to contract for insurance has not yet been declared a fundamental right.

The proposal and adoption of ERAs have some important side effects. Courts and administrators trying to resolve difficult questions involving conflicting policies, such as the equal protection clause question, will give weight to the legislative recognition of a policy favoring the elimination of gender classification.[180] In addition, the ERA would encourage more specific federal legislation, create a new cause of action under section 1983,[181] and provide the basis for a cause of action for conspiracy under section 1985(3), which in turn gives rise to the argument that section 1985(3) establishes a cause of action in the event of a private conspiracy.[182]

D. *Summary of Legal Restrictions*

The initial response of some legislators and insurance regulators to charges of *illegal* discrimination in insurance classification was to either prohibit or impose severe restrictions upon classification involving classes protected for other purposes, especially those classes to whom they were politically responsive. As analysis matured, it has become clear that broad based constitutional and legislative proscription of private discrimination is limited. Newer civil rights acts address themselves to specific relationships. Older civil rights acts have been expanded by the courts only to proscribe private discrimination against racial groups as a class. Indirect application of the equal protection clause, civil rights acts, and ERAs to private action as state action is limited to

176. Freund, *The Equal Rights Amendment is Not the Way*, 6 HARV. CIV. RIGHTS-CIV. LIB. L. REV. 234 (1971); Note, *Sex Discrimination and Equal Protection: Do We Need a Constitutional Amendment?*, 84 HARV. L. REV. 1499, 1523-24 (1971).

177. In the *Stern* case, the district court determined that the strict scrutiny standard applied but reserved as a fact question the actuarial justification for the gender distinctions. Stern v. Massachusetts Indem. & Life Ins. Co., 365 F. Supp. 433 (E.D. Pa. 1973).

178. *See* IOWA Note, *supra* note 86, at 486.

179. *See* text accompanying notes 109-116 *supra*.

180. Passage of the ERA by Congress has been cited by the Supreme Court in a plurality opinion as a basis for arguing that sex classification is suspect and subject to strict scrutiny. Frontiero v. Richardson, 411 U.S. 677, 687 (1973).

181. *See* text accompanying note 151 *supra*.

182. *See* text accompanying note 163 *supra*.

situations where the state becomes specifically involved in the risk classification process. Once the state does decide to become involved in the details of the risk classification process, its actions become subject to these laws. However, classification is not prohibited. Rather, a particular risk classification is subjected to varying levels of scrutiny, all of which require a rational relationship between the classification adopted and the risk. However, the levels vary in the required burden of proof and the court's willingness to consider certain policy arguments. The level of scrutiny to be applied to age and handicap does not exceed that traditionally applied under unfair discrimination statutes. The level of scrutiny applied to gender classification may impose a greater burden upon the insurer but allows for an even handed consideration of actuarial, underwriting and practical justifications. These laws do not require the insurance department to reject arguments based on cost and administrative convenience, to impose a burden on the insurer to justify its classification by compelling evidence, or to require establishment of a compelling interest, lack of reasonable alternative, actual personal cost experience justification, or proof that statistical differences are based on physiological or biological differences. Furthermore, the interests of the employer and all employees and members in distributing available resources is properly considered.

VI. Conclusion

Providing insurance to large numbers of individuals on terms and conditions that are fair and equitable to all requires the insurer to classify and discriminate. Such classification is in truth always somewhat an exercise in the dark, the precise life span and morbidity of any particular individual being unpredictable.[183] But once an insurance contract is sold, for as long as required premiums are paid, the insurer is bound for the life of the contract—often thirty to forty years or longer (unless, *e.g.*, there are material misstatements in the insurance application caught and acted on during a two year or shorter contestable period). While precise predictability is not possible, insurers have learned to identify certain factors—age, sex, family and health histories, and occupation, among others—from which statistically probable life spans and morbidity experience can be projected. On the basis of such projections, the insurance principle—a product priced in accordance with the cost of providing the coverage to large numbers of people—can be actuated.

The insurance industry has experienced the disastrous results of treating unequals equally—the financial failure of the undifferentiated assessment system in the United States, in part the result of a very human rebellion against treating unequals equally. Working against the insurance industry's movement toward more refined risk classification and more equitable treatment of insureds is a

183. The prospect of 100% predictability, as treated in speculative fiction at least, seems unpalatable in any event. *See* Jennings, *Science Fiction and Insurance Themes*, Best's Rev. 16 (life/health ins. ed., May, 1976).

legislative and regulatory trend which would compel a return to the sort of total equality which marked the assessment system in its pure form. If, as we believe, the concept of insurance and its multifaceted economic contributions to our society are worth preserving, this trend must be identified and analyzed. This article has sought to demonstrate that this trend is not compelled by constitutional doctrines or the federal civil rights laws, although in large measure the impetus for this regulatory trend comes from the civil rights movement and like movements of other affected groups. It is believed that the civil rights legislation, constitutional doctrines and substantial portions of the civil rights movement are addressing *unfair* discrimination, not discrimination *per se*.[184] Insurers are not concerned with stereotyping individuals on the basis of whim, prejudice or surmise, but rather seek to classify them on the basis of factors with statistically demonstrable relationships to the cost of providing coverage. They also recognize that there is a limit beyond which humans will not go in allowing unequals to be treated as equals.[185] That the risk classification system is imperfect is not an argument for its abolition; rather it is an argument for its further refinement. For example, the three year age setback for women utilized by many life insurers has fared poorly under statistical scrutiny[186]—it appears either an additional setback should be adopted or a separate female mortality table be constructed. However, abolition of gender classification would compel use of a unisex table which would compound the inequity by reducing life insurance premiums for men and raising them for women.[187]

---

184. *See* note 82 *supra*, summarizing employment discrimination legislation which refers to unfair or arbitrary discrimination.

185. For an example of recent express regulatory recognition of this principle, see Fla. H.B. 2366 (requiring that insurers, whose group policies include maternity benefits, reduce premiums for women who present medical documentation of physical inability to bear children). *See also* Trowbridge, *Insurance as a Transfer Mechanism*, 42 J. RISK & INS. 1 (1975).

> 3. The insured must consider the classification system, by which risks are grouped for rate setting purposes, equitable (or at least reasonably so).
>
> This third condition for customer satisfaction is of more importance than is sometimes recognized. No insurance purchaser wants to be pooled, for pricing purposes, with other insured persons whose probability of having a claim is recognizably higher. Moreover, since insurance systems . . . are essentially voluntary systems with premiums paid by the insured, a risk classification system that does not recognize at least the most visible of the groupings by which the probability of claim varies will not survive in competition with otherwise similar systems that do. The classification problem calls for risk differentiation on as scientific a basis as possible, to increase customer satisfaction on one hand, and to prevent anti-selection against the system on the other.

Id. at 3-4.

186. *See* notes 26-30 *supra*, and accompanying text.

187. *See* COLUM. Comment, *supra* note 86, at 1391-92 (noting the probability that unisex ratings would distort market forces—insurers selling at an average rate could be expected to market mainly to individuals with *actual* lower loss potentials—and potentially make less insurance available to women). One commentary which strongly advocates unisex rating argues that it is unworkable absent a federal mandate and universal application.

> If there is to be regulation in this area at all, it must occur on the national level. For any one insurance company to adopt a unisex table, or for any one state to require such a table, would drive insureds to insurance companies not covered by such action. Since it would be cheaper for a woman to go to an insurance com-

Beyond the legal arguments and those grounded in equitable classification of risks, there are pragmatic difficulties as well with the state regulatory response limiting insurers' right to classify. Fifty states are likely to produce many responses of varying breadth in spite of efforts to encourage uniform legislation. This occurred with policy loan interest rates, with some states allowing rates no higher than 5%, many no higher than 6%, others as high as 8%. Since policy loan interest rates impact on costs—a fact known in the insurance industry and recognized legislatively[188]—inequities have been created on a national basis by the disparate state responses. Far greater inequities would result if some states, but not others, were to require the same premiums from men and women. Any constraint on the right to classify will cause some segments of the general insurance-buying public to subsidize others. And, if various of these regulatory measures are not universal, there will be significant pressure to do business only in some places or to limit sales efforts to certain classes. Likewise, if such regulations are selectively applied—fraternal insurers are frequently excepted—great competitive advantages would inure to certain fraternal insurers which, by their ability to discriminate in membership, may base premiums on member mortality experience not unlike that underlying general life insurance risk classification in the present day. Equal mixes of business as between all insurers is not realistically possible.

Legislation which forces the sale of insurance policies to persons afflicted with a single disease, affliction, or handicap—with *e.g.*, Tay Sachs—will not in the final analysis much affect the insurance industry or insureds as a whole, particularly if benefits are restricted. At most, since such a small percentage of the population is so afflicted, the subsidy to be paid by non-afflicted policyhold-

---

> pany with dual tables for life insurance, and cheaper for a man to go to an insurance company with unisex tables for life insurance, the end result would be the same as if there were dual tables.

Note, *Sex Discrimination and Sex Based Mortality Tables*, 53 B.U.L. REV. 624, 655 (1973).

On the basis of extensive research into risk classification as it relates to property and casualty insurance, the Stanford Research Institute reached similar conclusions:

> Restrictions on the risk assessment process lead to market dislocations, subsidies among consumers, and availability problems for some consumers. We therefore conclude that risk assessment should not be restricted and that insurers should be free to make full use of classification information. We reach this general conclusion while recognizing that there are well-founded public concerns about the risk assessment process, particularly its reliability and social acceptability. Our analysis demonstrates that there are large differences in risk among individual policyholders. The present effectiveness of the risk assessment process is still far from the theoretical limit. . . . [R]egulators and legislators, as public representatives, should recognize that direct control of risk assessment is an unnecessary and undesirable interference with the free market forces. This interference has all the negative effects of rate control. In addition, it requires legislating against the use of knowledge, which is likely to be futile. . . . Regulators and the industry should keep some issues clearly separated: those that concern the risk assessment process per se, and those that are primarily social issues of equity and justice. Much energy has been wasted in resisting changes motivated by social concerns primarily outside the purview of insurance.

B. CASEY, J. PEZIER & C. SPETZLER, THE ROLE OF RISK CLASSIFICATION IN PROPERTY AND CASUALTY INSURANCE: A STUDY OF THE RISK ASSESSMENT PROCESS 3, 25-26 (Executive Summary Report, SRI Project 4253-4, 1976).

188. *See* note 37 *supra*, and accompanying text.

ers would be a small one. However, ignoring many other sorts of afflictions on a piecemeal basis, or gender across the board, can only have far-reaching effects on every insured and nearly every insurer. If this result is not compelled by equal rights, equal protection or other legal considerations, it has to be viewed as the social choice it is. It also must be understood that there are alternatives to mandated equality of premiums which could be utilized to accomplish like social ends:

(1) direct government payments to afflicted persons, not related to or having any characteristics of insurance; or
(2) direct state (or federal) subsidies to permit standard premium rate insurance for the uninsurable or marginally insurable so as to spread the burden of subsidizing afflicted individuals to all taxpayers of a state (or the United States) so concerned rather than just to a given private insurer's universe of insureds (wherever located); or
(3) pooling arrangements in which all life insurers doing business in a given state would be made to participate in providing insurance at higher than standard premium rates to the uninsurable or marginally insurable, spreading the risks to all insureds with the government bearing the added administrative costs; or
(4) further refinement of the life insurance risk classification system so that some of the afflicted individuals or some of those in a class can be insured.

Of these alternatives, the fourth does not provide any insurance for the highest risks. If the government determines that an uninsurable individual should have a right to some minimal level of benefits, the fourth would have to be used in connection with either the first, second or third, and only then upon finding that a compelling need justifies such a substantial deviation from the principles of equity.

The life insurance risk classification system, although motivated to a degree by competitive considerations and certainly by demonstrable dictates of economic survival, is ultimately grounded on the imperatives of the marketplace to offer a product on an equitable basis. The creation of an equitable premium structure is based upon scientific principles—statistical data and actuarial projections—which utilize as the raw data for their application differences between individuals. The system consciously and necessarily discriminates. It is submitted, however, that generally it has not done so unfairly and that competition has made insurance more generally available, as classification has become more refined, and at premiums which ever more reflect the costs of providing the coverage. By many piecemeal and overbroad legislative and regulatory measures, enacted or proposed, states are interposing challenges to that system to achieve a variety of social ends. If it is realized that these measures address social rather than legal issues, it may then be seen that the appropriate response is not to compel private insurers on a catch-as-catch-can basis to effect the social end. Instead, the goal must be acheived, in the case of the uninsurable, as a governmental function or through a pool in which all

insurers must participate and, in the case of proposals dealing with a broad class or the marginally insurable, through finer classification. To date, insurance has not been considered a fundamental right, although recently regulators have moved toward the creation of such a right by mandating that private carriers provide certain coverages to groups of people sharing characteristics making them poorer than average insurance risks. While in many situations the private insurers lack the experience necessary to permit them to price their product equitably for these groups, that experience will eventually be acquired. It is another matter entirely to tie to availability a requirement that valid statistical risks be ignored in making products available.

PRODUCTS RELIABILITY—A REASONABLE EXPECTATION—THE ULTIMATE GOAL

Sol Kroll†

I. INTRODUCTION

The last decade of products liability judicial expression affords industry, both domestic and international, an opportunity and the incentive to design and manufacture products which are safe and reliable. That result is a just and reasonable expectation of users and purchasers, and is tacitly held out by industry as the ultimate goal. The expansion of products liability should and must be considered in positive terms of fostering product reliability.

It is clear that products liability awards, in terms of frequency and amount granted per claim, are significantly increasing, thus requiring the products liability insurer to increase exposure. It is equally clear that such an increase in insurance premiums should have the effect of making it economically worthwhile for industry to spend those sums required in planning, design and manufacture, so as to ultimately design safe products with a view toward reducing the cost of products liability insurance in the future.

This article will demonstrate that the position of injured plaintiffs in products liability litigation can best be met by meeting the challenge of products liability litigation. In this respect, technological developments have advanced sufficiently so as to permit, in most cases, the development of safe products, designed with appropriate protective devices and manufactured in such a manner as to meet the reliability standards expected by consumers. It is suggested that the application of cost-benefit analysis to products design and manufacture will yield ultimate economic benefit to manufacturers, as well as permit such manufacturers to meet their expected social responsibilities.

Though this article generally relates to the development of reliable products as a solution to the products liability expansion, it is worth noting that the worldwide insurance markets have been confronted with an asserted inability to provide sufficient insurance to meet the requirements of industry for their protection as against exposure to damages. Thus, contemporary judicial thinking that concepts of liability can and should be easily expanded since insurers, as institutions of "risk-spreading" will ultimately bear the losses, may be based on an invalid assumption. Insurers, writing products liability insurance policies which indemnify insureds based upon when an "occurrence" develops, have found themselves incapable of determining potential risks and jury awards deriving from "occurrences" years, even decades, following the manufacture of a product. Numerous such occurrences are not reported to insurers until

† Partner, Kroll, Edelman, Elser & Wilson, New York City, New York. LL.B. 1942, St. John's University. Member of the New York, District of Columbia, and United