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REPORT BY THE

Comptroller General

OF THE UNITED STATES

Federal Life Insurance Changes Would Improve Benefits And Decrease Costs

The Federal Employees' Group Life Insurance Act of 1980 added two options to improve postretirement insurance coverage.

GAO found that (1) the single premium rate established for each of the 1980 options is inequitable; the program requires younger retirees to pay extra premiums without providing additional benefits until age 65, (2) a change correlating postretirement benefits with length of program participation and increasing the minimum post-age 65 coverage to 50 percent would not require any increase in premiums, would eliminate certain program inequities, and would make postretirement benefits more comparable with non-Federal employer insurance plans, and (3) the continued payment of insurance company risk charges is unwarranted since no insurance risk is assumed by anyone except the Government.

UNITED STATES GENERAL ACCOUNTING OFFICE

FPCD-81-47
AUGUST 21, 1981

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B-204228

The Honorable Mary Rose Oakar
Chair, Subcommittee on Compensation
and Employee Benefits
Committee on Post Office and Civil
Service
House of Representatives

Dear Madam Chair:

On January 25, 1980, the Subcommittee requested us to assess certain aspects of the Federal Employees Group Life Insurance program (Group Life). The Subcommittee was primarily interested in improving postretirement benefits because of complaints about the 75 percent reduction in coverage that occurs after age 65.

On the basis of discussions with your office, we agreed to:

--Evaluate the attractiveness of the postretirement options added by the Federal Employees' Group Life Insurance Act of 1980 (Public Law 96-427).

--Evaluate the desirability of changing Group Life by adding an election under which newly hired employees would pay premiums for life and have no reduction in insurance coverage after retirement.

--Evaluate a change we proposed in our earlier report ("Changes to the Federal Employees Group Life Insurance Program are Needed," FPCD-77-19, May 6, 1977) to determine if minimum benefits for career employees past the age of 65 could be increased from 25 percent to 50 percent without an increase in premiums if postretirement insurance benefits were correlated to years of participation in the program and contributions were continued to age 65.

--Provide updated information on the amount of insurance company risk charges paid by Group Life. Our 1977 report had questioned the appropriateness of continuing these payments.

The objectives for our review were to evaluate alternatives for improving postretirement life insurance benefits and to obtain current data on payment of risk charges. We studied the various alternatives using a model we constructed on basic insurance benefits. The model is based on insurance coverage and death benefits by age and years of service and uses data obtained from the Office of Personnel Management (OPM). A description of the model methodology and scope of our review is contained in appendix I.

EVALUATION OF VARIOUS METHODS FOR INCREASING POSTRETIREMENT BENEFITS

After analyzing the alternatives, we believe that the proposal to correlate postretirement benefits with length of program participation is the most desirable method of improving benefits after age 65. Our study showed that, for retirees with 30 or more years of participation, post-age 65 benefits could be increased from 25 percent to 50 percent of basic coverage at no increase in premiums. Other options had inherent drawbacks which made them less desirable.

Each alternative is discussed below and in more detail in appendix I. A comparison of cost and coverage of the current program and proposed alternatives is shown in appendix II.

1980 act options

The premium rates OPM established for the postretirement options in the 1980 act are inequitable because younger retirees must pay disproportionately high premiums to subsidize costs attributable to older retiring employees.

Under Group Life, the amount of a participant's basic insurance coverage is continued into retirement and does not begin to reduce until after age 65. The amount of insurance is then reduced 2 percent a month to a minimum of 25 percent of the basic insurance amount at retirement. This postretirement coverage is provided at no cost to the retiree if the retiree participated in the program for the last 5 years of service immediately before retirement. 1/

The 1980 act added two options to improve postretirement insurance coverage. One option provides for no reduction in basic coverage after age 65, and the other provides for 50 percent reduction in coverage. Basic coverage for the retiree does not begin to reduce until age 65, and retirees over age 65 retain a minimum

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1/The 1980 act requires employees retiring after December 31, 1989, to pay premiums until age 65 or retirement, whichever occurs later.

of $250 of each $1,000 of basic coverage. Therefore, employees electing the no-reduction option purchase $750 of additional insurance for each $1,000 of pre-age 65 basic insurance coverage, whereas employees electing the 50-percent reduction option purchase $250 in additional coverage.

These options provide immediate insurance coverage for employees retiring at ages over 65. However, employees retiring at younger ages pay premiums to purchase deferred insurance and obtain no immediate extra coverage. For example, employees retiring at age 55 start paying premiums upon retirement, but since they retain full basic insurance coverage until age 65, they pay premiums for 10 years with no additional coverage until the basic insurance reductions begin at age 65. The average age of annuitants retiring in 1980 was 58.6. (See pp. 1 to 3, app. I.)

Modified supplemental post-age 65 election

A modified election, which would allow new employees to choose a plan providing no reduction in post-age 65 coverage, could not be paid for by continuing contributions until death without increasing premiums. Also, this modification may not be attractive to new hires because of its deferred benefit feature and, as a result, may not attract enough participants to make it a viable part of Group Life. The rates for employees making this election would be higher during their careers than current basic rates but could be less costly than the current option in the long term because postretirement premiums would be lower.

This election would provide no reduction in basic coverage during the retired employee's high-risk years; that is, over age 65. We assumed the participants would have to make this election within their first year of Government employment. Although this election would not provide any additional coverage until after age 65, premium payments would be made throughout the employee's life. Employees under age 35 who make this election would be required to pay higher premiums for at least 30 years without any additional benefit since during those years the employees would have been fully covered under the Group Life basic insurance. (See pp. 3 and 4, app. I.)

Correlating benefits with length of program participation

Correlating postretirement benefits with length of participation in Group Life would make the program's postretirement coverage for career employees more comparable with non-Federal plans and would also eliminate a serious inequity that now exists in the program. Benefits for retirees with at least 30 years' participation could be increased to 50 percent of basic pre-age 65 coverage without an increase in premiums by paying those premiums to age 65. Only those employees who participated less than 15 years would have their benefits reduced.

Under the current law, the same Group Life insurance benefits are provided to all retirees regardless of length of participation in the program. Employees who waive basic coverage are permitted to later join the program provided

--they are under 50 years of age,

--more than 1 year has expired since the insurance was waived, and

--they furnish proof of medical insurability.

Retiring employees retain their basic coverage if they have participated in Group Life for the last 5 years of Government service immediately before retirement. Therefore, employees who do not begin participating in Group Life until late in their careers receive the same insurance benefits upon retirement without paying premiums for their entire careers. An employee who participated and paid premiums for only 5 years would receive the same insurance benefits upon retirement as a career employee who paid premiums for 30 years or more. Since the premiums include postretirement costs, a significant inequity exists. Equity would result if the law were changed to correlate the amount of postretirement coverage with the length of time a retiree participated in the program as an active employee. This would be similar to the civil service retirement system where basic annuities are computed on the basis of length of service.

OPM has previously concurred in our correlation suggestion. In June 1979 testimony on Group Life before the Subcommittee, OPM officials stated:

> "* * * as a matter of equity any increase in post-retirement benefits should be correlated with the length of program participation and payment of premiums." (Also, see p. 4, app. I.)

CONTINUED PAYMENT OF RISK CHARGES UNWARRANTED

The Federal Employees' Group Life Insurance Act of 1954 (Public Law 83-598) required the use of reinsurers. The relationship between the Government and insurance companies in Group Life differs considerably from the relationships between other employers and insurance carriers under their group life insurance plans. Under Group Life, the Government, for all practical purposes, assumes all risks, establishes and collects premiums, establishes reserves, and manages most of the funds. In non-Federal plans, these functions are primarily the responsibility of the insurance carriers.

The Government, in effect, is a self-insurer of Group Life but does not reap all the advantages that could accrue from such a relationship. Even though it is a self-insurer, the Government annually pays $850,000 in risk charges to the insurance companies, although they do not assume any risk for Group Life.

The major function of reinsurers is to share the risk of catastrophic loss with the prime insurance carrier so that no one company is unduly burdened by such a loss. The amount is usually subject to some maximum liability for each catastrophe, and the reinsurer is paid for the assumption of that risk. However, OPM's contract with the prime insurer does not include a catastrophic loss provision. Therefore, since the Federal Government reimburses the prime insurer for all claims paid in good faith regardless of reason, no insurance risk is being assumed by anyone except the Government. However, because of the legal requirement, OPM's policy with the prime insurer continues to provide for risk charge payments.

The total risk charges paid in 1979 and in 1975 were $850,000. The distribution of it, however, has changed. The amount paid to the Metropolitan Life Insurance Company (the prime insurance carrier) increased to $72,000 in 1979, compared to $46,000 in 1975. The number of reinsurers and the total paid to them decreased from 363 and $804,000, respectively, in 1975, to 224 and $778,000, respectively, in 1979. The amount paid to any one reinsurer is relatively insignificant as shown below.

Amount of risk charge	Number of reinsurers	
	1975	1979
Less than $250	57	27
$251 to $1,500	94	46
$1,501 to $4,000	185	122
$4,001 to $10,000	21	20
More than $10,000	6	9
Total	363	224

CONCLUSIONS

We share the Subcommittee's interest in improving post-age 65 benefits for retirees. Although the 1980 act added provisions to do this, we found significant shortcomings in these provisions. The single premium rate OPM established for each of these options is inequitable and does not reflect mortality risks. This program also requires younger retirees to pay premiums without providing any additional benefits until age 65.

Changing Group Life by adding a modified supplemental post-age 65 insurance election for new hires can not be provided without a premium increase, even with continuing contributions until death, and may not attract enough participants to make it a viable part of Group Life since no benefits would be derived from the higher premiums until after age 65. Although this option could be less costly in the long term than the current option providing no reduction of postretirement coverage, we still believe, as stated in our 1977 report, that equity with non-Federal programs justifies correlating benefits with length of program participation and increasing Group Life coverage for post-age 65 retirees.

Correlating postretirement benefits with length of program participation and increasing the minimum post-age 65 coverage to 50 percent, for employees with 30 or more years of service, is more desirable. Such a change would (1) not require any increase in premiums, (2) eliminate certain program inequities, and (3) make postretirement benefits more comparable with non-Federal employer insurance plans.

We continue to believe the payments for risk charges are unwarranted and the legal requirement for them should be repealed.

RECOMMENDATIONS

We recommend that the Congress amend the Federal Employees' Group Life Insurance Act to (1) increase the minimum post-age 65 coverage to 50 percent of the coverage at retirement and correlate postretirement benefits with length of participation in the Group Life program and (2) rescind the requirement that Group Life pay insurance company risk charges.

AGENCY COMMENTS

On June 23, 1981, we provided the Director of OPM with a draft of this report for review. We requested that he provide comments within 30 days as provided by Public Law 96-226. The Director did not provide comments in this time frame; hence, the report is being issued without OPM's official position on these matters.

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We are sending copies of this report to the Directors, Office of Management and Budget and Office of Personnel Management, and to the Chairmen, House Committee on Government Operations, Senate Committee on Governmental Affairs, and House and Senate Committees on Appropriations.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

BACKGROUND AND ADDITIONAL INFORMATION SUPPORTING REPORT CONCLUSIONS AND RECOMMENDATIONS

BACKGROUND

In our 1977 report, we compared death benefits available to Federal employees from insurance, retirement, and workers' compensation programs with those provided to employees of 21 corporations and State and local governments. The comparison showed that, overall, the death benefits were generally comparable; however, life insurance in the non-Federal sector, which was usually free to the employee, was superior to the Federal Employees Group Life Insurance program (Group Life). Moreover, death benefits for younger Federal employees and retirees over age 65 were less than those received by their non-Federal counterparts.

In line with our 1977 recommendations, the Federal Employees' Group Life Insurance Act of 1980 improved Group Life's benefit structure and increased the amount of insurance available to Federal employees. The act did not increase Group Life's basic benefits for retirees but provided two options for additional levels of postretirement coverage in which retirees may participate: (1) 50 percent reduction--amount of insurance reduces 1 percent a month after age 65 to a minimum of 50 percent of the basic insurance amount at retirement or (2) no reduction after age 65 in the basic insurance amount at retirement. The full cost of either option is paid by the retiree, with the premiums beginning at retirement and continuing for life.

METHODOLOGY AND SCOPE OF REVIEW

Our conclusions are based on evaluations of several options for increasing post-age 65 retirement benefits without increasing Government contributions. We used a model to evaluate a modified supplemental post-age 65 option and various potential modifications of the basic Group Life benefit structure, including correlating benefits with years of premium-paying participation and establishing premium-paying periods (1) throughout the participant's life, (2) until the participant reaches age 65, or (3) throughout the participant's career.

We constructed a model of Group Life's basic insurance coverage and death benefits, by age and years of service using Office of Personnel Management (OPM) data. We used this model to calculate adjustment factors for changes in both benefit payments and insurance coverage subject to premiums for each potential program change. We applied these factors to the then-current annual rate per $1,000 basic coverage ($7.67) to estimate the revised basic coverage rate. We assumed that other costs and administrative expenses would remain the same.

Our fieldwork was conducted from April 1980 to February 1981 at OPM headquarters, Washington, D.C., and at the Metropolitan Life Insurance Company, New York, New York. We examined legislation, documents, records, and reports relating to Group Life's funding practices, income and expense, and benefits. We also examined contractual relationships between OPM, the Metropolitan Life Insurance Company, and Group Life's 224 reinsurers. We discussed the results of our work with OPM officials during our review and considered their views in reaching our conclusions.

OPTIONS ENACTED IN 1980 ARE NOT ATTRACTIVE FOR YOUNGER RETIREES

OPM set the following rates for the new options:

--No reduction of the basic Group Life coverage will require an annual premium of $21 per $1,000 of coverage.

--To convert the basic insurance reductions to 1 percent monthly after age 65 with a maximum reduction of 50 percent will require an annual premium of $7.80 per $1,000 of coverage.

OPM officials told us that single premiums, rather than age-related rates, were established because they were easier to administer and made the program more affordable to older retirees.

Because of the deferred benefit feature, option insurance payments made by younger retirees are similar to investments which earn interest. For comparison purposes, we used a 7-percent rate of interest in our calculations because this rate used in the insurance industry is considered acceptable and conservative.

Differences in premiums paid for the same $1,000 insurance coverage are shown in the following comparison of options with an employee retiring at age 55 and at 65.

No Reduction Option

Age	Actual insurance provided	Cumulative premiums plus 7 percent interest: Employee retires at 55	Cumulative premiums plus 7 percent interest: Employee retires at 65	How much more the 55-year-old retiree pays
65	$ -	$ 301	$ -	$301
68	a/720	439	70	369
72	750	672	189	483
73	750	741	224	517
78	750	1,165	439	726

a/The 25-percent minimum provided through basic coverage would not be reached until age 68 and 2 months.

50 percent Reduction Option

Age	Actual insurance provided	Cumulative premiums plus 7 percent interest: Employee retires at 55	Cumulative premiums plus 7 percent interest: Employee retires at 65	How much more the 55-year-old retiree pays
65	$ -	$112	$ -	$112
68	a/360	163	26	137
72	250	249	70	179
73	250	274	83	191
78	250	432	163	269

a/The minimum 50-percent coverage would be reached at age 69 and 2 months.

Appendix II compares these current options to other alternatives we examined. It shows the premiums and coverage that would be provided to a hypothetical employee who starts Government service at age 25 with a salary of $15,000 and receives annual salary increases of 5 percent until retiring at age 55.

MODIFIED POST-AGE 65 ELECTION FOR SUPPLEMENTAL INSURANCE

We calculated annual premiums for this election (which would be in addition to basic coverage premiums) based on the employee's age when entering Government service and assuming premium payments throughout life. Annual premiums for employees under age 35 would be $2.30 for each $1,000 of insurance. During 1979, 79 percent of the newly hired employees were in this age group. Premiums for older employees starting Government service would be higher.

Our estimates of annual premiums per $1,000 insurance for this option follow:

Age group	Increased annual rate per $1,000 insurance payable for life based on entry age
Under age 35	$ 2.30
35-39	3.60
40-44	4.80
45-49	6.40
50-54	9.60
55-59	14.60
60 and over	25.00

Rates are based upon age at the time the employee makes the election and would remain constant for each incremental increase in insurance amounts regardless of age at the time of the incremental increase. Appendix II illustrates the premiums and coverage that would be provided the same hypothetical employee discussed previously and compares this with other options.

CORRELATING POSTRETIREMENT BENEFITS WITH LENGTH OF GROUP LIFE PARTICIPATION

Correlating postretirement benefits with length of participation in Group Life would permit postretirement benefits for career participants to be increased without additional cost.

If postretirement coverage were established at 3-1/3 percent for each year of participation, an employee retiring with 30 years' or more participation would accrue full postretirement coverage. Postretirement coverage for others would vary depending on the length of participation in the program. Participants for more than 15 years but less than 30 years would also receive an increase in post-age 65 basic benefits. However, those individuals with less than 15 years' participation would have their benefits reduced.

The reductions in program costs that would result from such a change would be enough to pay the costs of changing post-age 65 coverage to 50 percent of preretirement coverage, rather than the present 25 percent. Coverage would reduce at the rate of 1 percent a month after age 65, until age 69 and 2 months. We estimate that the annual basic Group Life insurance premiums would be comparable to current rates and would be paid until age 65 or retirement, whichever occurs later. This postretirement benefit for career employees would be comparable with benefits of most non-Federal employer plans that we previously reviewed.

Using the same hypothetical employee as in the previous illustrations, the premiums and coverage provided by the other options are compared to our suggested alternative in appendix II.

COMPARISON OF CURRENT PROGRAM

TO PROPOSED ALTERNATIVES (note a)

	Current basic insurance			Combined basic and current no-reduction option			Combined basic and current 50% reduction option (note b)			Combined current basic and modified supplemental post-age 65 election (note c)			Basic insurance with proposed correlated postretirement benefits		
		Premiums			Premiums			Premiums			Premiums			Premiums	
Age	Coverage	Annual	Cumulative	Coverage	Annual	Cumulative plus 7% (note d)	Coverage	Annual	Cumulative plus 7% (note d)	Coverage	Annual	Cumulative plus 7% (note d)	Coverage	Annual	Cumulative
25	$34,000	$106	$ 106	$34,000	$ 106	$ 106	$34,000	$106	$ 106	$34,000	$145	$ 146	$34,000	$106	$ 106
35	54,000	168	1,510	54,000	168	1,510	54,000	168	1,510	54,000	230	2,312	54,000	168	1,510
45	42,000	262	3,676	42,000	262	3,676	42,000	262	3,676	42,000	359	6,367	42,000	262	3,676
55	67,000	418	7,108	67,000	418	7,108	67,000	418	7,108	67,000	572	14,164	67,000	418	7,108
65	67,000	-	10,870	67,000	1,411	31,037	67,000	941	18,343	67,000	154	26,952	67,000	-	10,870
66	50,920	-	10,870	67,000	1,411	33,921	58,960	941	20,546	67,000	154	28,237	58,960	-	10,870
68	e/18,760	-	10,870	67,000	1,411	40,284	42,880	941	21,764	67,000	154	31,084	42,880	-	10,870
72	16,750	-	10,870	67,000	1,411	55,909	33,500	941	27,551	67,000	154	38,074	33,500	-	10,870
78	16,750	-	10,870	67,000	1,411	88,909	33,500	941	39,773	67,000	154	52,836	33,500	-	10,870

a/This chart illustrates the premiums and coverage that would be provided to a hypothetical employee who starts Government service at age 25 with a salary of $15,000 and receives annual salary increases of 5 percent until retiring at age 55.

b/The minimum 50-percent basic coverage would be reached at age 69 and 2 months.

c/Employees making this election would start paying premiums immediately, but the purchased benefit is deferred to the latter of retirement or age 65. The employee making the election at age 25 does not receive any benefit for 40 years. This deferred benefit option is in the nature of an investment which should accrue interest. Payments for basic insurance, however, purchase immediate insurance coverage. Thus they are not considered an investment earning interest.

d/The cumulative premium amount includes premiums for basic insurance without interest value added, plus premiums for the option with 7 percent interest added.

e/The minimum 25-percent basic coverage would be reached at age 68 and 2 months.

APPENDIX II

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