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Report to the Co-Chairmen, Federal Government Services Task Force House of Representatives

April 1986

LIFE INSURANCE

Assessment of Federal Employees' Group Life Insurance Program

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United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-218782

April 7, 1986

The Honorable Michael D. Barnes, and
The Honorable Vic Fazio
Co-Chairmen, Federal Government
Services Task Force
House of Representatives

This report responds to your request that we compare the Federal Employees' Group Life Insurance Program to private sector group life insurance plans and identify any changes that may be needed in the program. The report shows that the program is financially sound, that premiums are declining, and that a large majority of employees are enrolled. However, private sector insurance programs typically provide greater coverage amounts at less cost to employees than the federal program.

As arranged with your office, we are sending copies to the Director, Office of Personnel Management, and to the Secretary of the Treasury. Copies will also be made available to other interested parties who request them.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Principal Findings

Benefit Comparability

At the time that the FEGLI program was established, more than 75 percent of private sector plans required employees to share the cost of basic life insurance benefits, but this requirement has been eliminated in most plans. In 1984 the Bureau of Labor Statistics (BLS) found that 80 percent of the employees it surveyed received free basic life insurance coverage. Hay/Huggins, a benefits consulting firm, reported that 83 percent of the employers that it surveyed in 1984 provided basic life insurance at no cost to their employees. Also, private sector employers typically provide basic life insurance coverage equal to 1.5 to 2 times pay; FEGLI provides similar coverage only to employees age 40 and younger. (See pp. 12 to 14.)

Premium Reductions

Between 1975 and 1985, the employees' share of the biweekly cost of basic FEGLI coverage was reduced from $0.355 to $0.20 per $1,000 of insurance because of (1) changes in the actuarial assumptions used in computing premiums and (2) higher-than-anticipated earnings on FEGLI investments. GAO calculated that the employees' share of FEGLI premiums could be reduced an additional 7.5 percent if (1) the economic assumptions in the FEGLI program were updated to be consistent with those used in determining the cost of the civil service retirement system and (2) the government assumed responsibility for FEGLI's unfunded liability which it created due to past funding insufficiencies. (See pp. 18 to 20.)

Investment Policy

OPM fund managers over time have employed varying strategies for investing FEGLI funds in various government securities. In contrast, other government life insurance programs administered by the Veteran's Administration, the civil service retirement system, and other government trust funds have investment policies authorized either by law or by special arrangement with Treasury that provide for the investment of available funds in special nonmarketable federal securities. GAO found these securities to be particularly appropriate because of the long-term nature of FEGLI investments. Also, GAO compared the rates of return on FEGLI and civil service retirement fund investments and found that the retirement fund earned a higher return during 6 of the past 10 years. The net return on retirement fund investments was 4.95 percent greater over the 10-year period. (See p. 24.)

because the liability had been greatly reduced in recent years. Nevertheless, GAO does not believe the government should charge future FEGLI participants for costs associated with a funding deficiency it created. (See p. 21.)

Neither OPM nor Treasury agreed that FEGLI should invest in the same type of securities as the retirement fund. OPM indicated it was not convinced that the return would be superior to the way FEGLI is now invested. Also, OPM said that such a change, if desirable, would not require legislation but could be done administratively. GAO did not base this recommendation solely on the fact that the retirement fund has been earning a higher return recently; a principal benefit of the recommendation was the consistency it would bring to the investment policies of FEGLI, other government life insurance programs, and the civil service retirement fund. GAO also observes that purchasing a single security at the special interest rate is administratively preferable to purchasing proportionate amounts of almost 100 different government securities to achieve the same rate as would be obtained with special nonmarketable securities. (See p. 26.)

Treasury said that the interest and redemption features of the retirement fund investments could be inequitable to both the Treasury and the retirement fund. While these investments could be handled in a manner that would be unfair to either party, GAO agrees with a 1983 OPM study which concluded that the retirement fund's actual investment practices are neutral and favor neither the fund nor the taxpayers. (See p. 27.)

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Abbreviations

AD&D	Accidental death and dismemberment
BLS	Bureau of Labor Statistics
FEGLI	Federal Employees' Group Life Insurance
GAO	General Accounting Office
OPM	Office of Personnel Management

(2) no reduction after age 65. The retiree who elects either the 50 percent or the no reduction alternative must pay a premium for the additional coverage. The amendments also provide that employees who retire on or after January 1, 1990, will be required to pay the same premium as active employees until age 65.

Employees with basic FEGLI coverage are eligible to elect additional coverage under three optional insurance programs. However, they must pay the entire premium (no government contribution) for optional life insurance until age 65 or retirement, if later. The premium increases as the participant grows older. The three options are:

- Option A: Standard Optional Insurance. This option provides $10,000 coverage and AD&D protection. Beginning at age 65 or retirement, if later, option A coverage is reduced 2 percent each month until $2,500 in coverage remains.
- Option B: Additional Optional Insurance. This option, added by the 1980 amendments, provides coverage in increments of one, two, three, four, or five times basic pay rounded to the next higher $1,000. AD&D protection is not provided, and at age 65 or retirement, if later, coverage is reduced 2 percent each month until coverage reaches zero.
- Option C: Family Optional Insurance. This option, added by the 1980 amendments, provides coverage for the employee's family members in the amounts of $5,000 for the spouse and $2,500 for each eligible child. AD&D protection is not provided, and when the employee reaches age 65 or retirement, if later, coverage is reduced 2 percent per month until coverage reaches zero.

Under the FEGLI program, life insurance (but not AD&D) continues in force for 31 days after termination of employment. Basic life insurance and options A, B, and C may be converted to individual policies with private insurance carriers within the 31 days without medical evidence of insurability. Insurance for family members under option C is also convertible to individual policies upon the death of the employee or retiree.

FEGLI Premiums

Effective August 1, 1985, the biweekly premium is $.30 per $1,000 of basic life insurance coverage. The U.S. Postal Service pays the entire premium for its employees. Nonpostal federal employees, on the other hand, pay two-thirds of the premium for basic life insurance, and their agencies pay one-third.

We reviewed the OPM actuarial valuations used to set FEGLI premium rates and examined FEGLI financial statements prepared by OPM to determine the appropriateness of premiums being charged. We also interviewed Department of the Treasury officials to obtain information on the investment policies of other government trust funds in order to compare them with FEGLI investment policies.

We identified two studies conducted during 1984 that included data on many features of private sector employers' life insurance programs. These were the only comprehensive studies that we found in our literature search. We did not verify the data in these studies. The studies were as follows:

- The Department of Labor's Bureau of Labor Statistics (BLS) June 1985 report, Employee Benefits in Medium and Large Firms, 1984. The report covered 23.5 million professional, administrative, technical, clerical, and production workers in firms employing as few as 50, 100, or 250 full-time employees, depending on the industry surveyed. It included information on life and health insurance, holidays, vacations, personal and sick leave, sickness and accident insurance coverage, long-term disability, and pension plans.
- The Hay/Huggins Company, The 1984 Hay/Huggins Benefits Comparison, (n.p.: Hay Associates 1984). This report contained information on employee benefits provided by 869 companies (size not specified). The Hay/Huggins Company is a management consulting firm specializing in private sector pay and benefits programs.

We obtained data on premium rates from four insurance companies that regularly advertise their plans in publications directed to federal employees. This information was used to develop illustrative comparisons of FEGLI benefit and premium amounts with other life insurance plans that federal employees could purchase as alternatives to FEGLI.

Our work was performed from April 1984 through July 1985. Except as noted above, our work was conducted in accordance with generally accepted audit standards.

improve FEGLI. Both bills were vetoed. The legislative changes would have increased the basic insurance coverage to 1-1/3 times the employee's annual salary rounded to the next higher $1,000, plus $2,000. Also, the premium sharing ratio would have been changed with federal employees paying 60 percent of the premium for basic life insurance and the government paying 40 percent. The Presidential veto messages cited cost considerations as a major reason for rejecting the changes.

Comparison With Private Sector Benefits and Premiums

Private sector employers' life insurance programs usually provide more insurance coverage at less cost to employees than the federal program. The amount of coverage after retirement is reduced for both private sector and federal employees. A comparison of the FEGLI program with typical private sector basic life insurance programs is shown in table 2.1.

Table 2.1: Comparison of FEGLI and Typical Private Sector Life Insurance Programs

Program features	FEGLI	Typical private sector life insurance programs
Premium payments	Nonpostal employees pay two-thirds of the premium and the employing agencies pay one-third. Employer pays for postal employees.	Employer pays.
Basic insurance coverage:		
Employees	Employee's annual salary rounded to the next higher $1,000, plus $2,000. For employees age 35 or younger, the basic coverage is multiplied by two. Beginning at age 36, the multiplication factor decreases by one-tenth of one percent annually until it reaches 1.0 times the basic coverage at age 45.	1.5 to 2 times pay.
Retirees	Reduced by 2 percent each month until 25 percent of coverage remains.	Although coverage is reduced, there is no typical pattern in the amount of reduction. Reduced coverage generally ranged from 10 to 50 percent.

The 1984 BLS employee benefits study found that 96 percent of the full-time private sector employees surveyed were participating in life insurance plans in 1984. Of these, 80 percent had the cost of a basic plan paid wholly by the employer. Similarly, the 1984 Hay/Huggins report showed that 83 percent of the private sector basic group life insurance plans in the companies surveyed were provided at no cost to the employee. If the government paid the full premiums for basic insurance, its costs for

Agency Comments and Our Evaluation

OPM said that it did not believe that the FEGLI law should be amended to provide basic insurance benefits in multiples of 1.5 to 2 times salary to all employees free of charge, as is the prevailing private sector practice. OPM bases its position on the belief that group life insurance has historically played a slightly different role in private sector benefit plans than in the federal system. OPM said that in the private sector, group life insurance has served in many instances as the primary means of providing benefits for certain surviving spouses who are not eligible for social security benefits, whereas the primary protection for survivors of federal employees is provided by the civil service retirement system. OPM pointed out that changes to FEGLI to make it compatible with private sector practices are being considered by the Congress in connection with the development of a new retirement program for post-1983 employees, whose survivor benefits will be modeled far more closely after private sector practices.

We are aware of the proposals being considered by the Congress. As we testified on September 9, 1985, before the Senate Governmental Affairs Committee on the design of a retirement program for post-1983 employees, we believe that both retirement and life insurance benefits for federal employees should follow the prevailing private sector practice, and we continue to advocate that the programs be designed accordingly. As OPM's comments indicate, the proposals being discussed do not apply to employees and retirees under the current retirement system.

In our report Comparison of Federal and Private Sector Pay and Benefits (GAO/GGD-85-72, Sept. 4, 1985), we stated that the Congress may wish to make decisions concerning future changes and adjustments to elements of the federal compensation program from the perspective of their effect on overall compensation levels. We also pointed out that the studies we reviewed suggest that federal employees' overall compensation lags behind the private sector. Therefore, we believe it is appropriate for the Congress to consider raising life insurance benefits for all employees to the private sector level because it would bring overall federal compensation more in line with private sector compensation levels.

A 1984 report of the Hay/Huggins consulting firm showed overall federal compensation lagged the private sector by 7.2 percent and life insurance by 0.3 percent. Hay estimated the lag increased to 9 percent because the 1985 federal pay raise was less than the average increase in the private sector.

those used in the civil service retirement system. This change would reduce employee and government premium costs by 3 percent. Second, the government could assume responsibility for the unfunded liability, which would reduce employee premiums by 4.5 percent.

Economic Assumptions

In determining premiums, OPM must make assumptions about the future behavior of certain economic factors that influence the cost of insurance benefits. OPM uses a salary growth assumption to reflect periodic increases in pay for federal employees and an interest rate assumption to reflect the average long-term return on the FEGLI fund's investments. Salary growth increases the cost of benefits, while interest income reduces the cost of benefits. The greater the spread between the interest and the salary assumptions, the lower the premiums will be, provided that the interest rate assumption is always the higher figure.

The last time that OPM adjusted the economic assumptions for FEGLI was in September 1982. OPM calculated basic FEGLI premiums using a 7.5 percent annual salary increase assumption and an 8 percent interest rate assumption, or a difference of 0.5 percent. OPM officials told us that they chose these assumptions because the rates produced a spread that is conservative but consistent with (1) the difference between the yield on FEGLI funds and general schedule salary increases over the 25-year period before 1982 and (2) the 0.5 percent spread between the salary and interest rate assumptions used by the civil service retirement system at that time.

The FEGLI program and the civil service retirement system cover essentially the same universe of federal employees; both invest their funds in government securities. In May 1985, OPM recalculated the cost of the civil service retirement system using updated economic assumptions resulting in a spread of 1 percent between the salary and interest rate assumptions. No action was taken at that time to update the economic assumptions in the FEGLI program in order to see whether premiums should be further reduced. OPM officials told us that there was not enough time to do this because the new rates for open season in June 1985 had already been published.

Unfunded Liability

The unfunded liability for the basic FEGLI program has decreased during the past 3 years from about $2.7 billion in September 1982 to about $1.9 billion in April 1985. OPM attributes the decrease primarily to higher-than-anticipated yields on fund investments.

the same group of employees and invest their funds in government securities. These assumptions were consistent before OPM updated the retirement system's assumptions. Also, we continue to believe that the government should assume the responsibility for FEGLI's unfunded liability. The unfunded liability exists because of past funding insufficiencies and is unrelated to the cost of providing FEGLI benefits to new employees. Furthermore, we believe that the government should assume responsibility for the unfunded liability of the FEGLI program for the same reason that it has assumed responsibility for the civil service retirement system's unfunded liability (i.e., the unfunded liability was created by the government).

Under the current FEGLI financing arrangements, the government is paying one-third of the unfunded liability. Therefore, if the government assumed responsibility for the remaining two-thirds, its cost over the next 97 years would increase by $1.3 billion. However, the additional costs could be offset by any higher-than-expected earnings on fund investments. Extra earnings were the primary reason for the $800 million reduction in the unfunded liability over the past 2-1/2 years.

Agency Comments and Our Evaluation

OPM said that the revised economic assumptions used to determine the cost of the retirement system were not available at the time that it made the valuation on which current FEGLI premiums are based. OPM was concerned that in applying economic assumptions used in valuation of the retirement system to FEGLI, we appeared to be "picking and choosing" among sets of numbers developed for different programs at different times to produce a slightly lower premium. In so doing, OPM concluded that we were suggesting that it should have ignored the actual assumptions used in the retirement system's cost calculations because use of them would have increased FEGLI rates.

We did not intend to suggest that the actual retirement system assumptions be ignored. In fact, we used them to determine the spread between the two key assumptions (interest and salary rates) for recalculating the cost of FEGLI. Our analysis began with the same complete set of FEGLI assumptions that OPM chose in its 1982 valuation. We concurred with OPM's determination that an interest rate of 8 percent was a reasonable assumption on the basis of fund earnings. OPM also determined in 1982 that historically there had been a 0.5 percent spread between interest earnings and salary increases if the most recent years of high interest rates were ignored. Therefore, OPM backed off 0.5 percent from the interest assumption to arrive at its salary increase assumption of 7.5

Investment Policies of Other Trust Funds

We found that the investment policies of 17 other government trust funds are authorized by law and provide for investing available funds in special issue federal securities. Three other funds reached agreements in prior years with Treasury to permit investment in these special securities without legislative authorization. Treasury officials told us that they would not make a similar agreement for other government funds and that OPM would need legislative authorization for the FEGLI program to invest in the special securities.

The special federal securities purchased by the other funds are par-valued, which means that they are purchased and redeemed at their face value. By law, the interest rates on these securities are set on the basis of the average market yield on all outstanding marketable Treasury securities maturing or callable in more than 4 years. Half of the trust funds purchase securities maturing within 1 year or less, while the other funds purchase securities maturing in 1 to 15 years. Since the securities are not marketable, their value does not fluctuate.

We noted that the Veterans Administration, which administers all of the other government life insurance programs, including Servicemen's Group Life Insurance Fund and Veterans Special Life Insurance Fund, invests in par-valued special issue securities. Also, the civil service retirement, social security, and railroad retirement trust funds invest in such securities.

Comparison of Rates of Return

We compared the rates of return earned by the FEGLI and by the civil service retirement funds to determine how the different investment policies affected fund earnings. We found that the retirement fund earned a slightly higher rate of return for 6 of the 10 years between 1975 and 1984 and that the net return over the 10-year period was 4.95 percent greater. Also, the average interest rate being received on all retirement fund investments as of December 30, 1984, was 11.72 percent, or 1.5 percentage points greater than the average interest rate on FEGLI fund investments at that time.

A comparison of the rates of return on the two funds' investments is shown in table 4.1.

The relatively higher rate of return earned by the retirement fund in our 10-year analysis is not the only reason that we believe that FEGLI should invest in the securities used by the retirement fund. As OPM concluded in a 1983 study of the retirement fund's investment policy, investment in the Treasury's special nonmarketable securities is a neutral investment policy. The study recognized the potential for gains or losses during periods of rising or falling interest rates but concluded that the fund was following a neutral investment policy that favored neither the fund nor the taxpayers and did not attempt "to play the market" to its advantage. OPM observed that because the retirement fund's investments are spread over 15 years, they are less sensitive to short-term fluctuations in interest rates. We concur with the conclusions of the study.

OPM also said that our proposal could be adopted administratively, without the need for legislation. It is possible that FEGLI fund managers could purchase Treasury securities in a mix that would produce a return equivalent to the special nonmarketable securities. However, instead of purchasing a single special security for each investment, they would have to purchase proportionate amounts of almost 100 different securities to achieve the same rate of return. There would be no particular benefit to be derived from such a procedure, and, administratively, it would be more costly. Therefore, we favor purchase of the special securities.

Treasury was concerned that the average interest rate feature of the special nonmarketable securities might result in gains (or losses) to the fund at the expense (or benefit) of Treasury and taxpayers in general during periods of rising or falling interest rates. As previously discussed, OPM's 1983 study recognized the potential for gains or losses but concluded that overall purchase of these securities represented a neutral investment policy. We agree with the OPM conclusion.

Also, Treasury was concerned that premature redemption of these special securities might result at times in a hidden subsidy to the fund while at other times might result in a loss to the fund. As we stated earlier, FEGLI fund investments are only redeemed at maturity.

Finally, Treasury said that most government trust funds invest in the same type of security that FEGLI is purchasing. We did not study the investment policies of all government trust funds; therefore, we cannot comment on the portfolio needs of all such funds. We believe that sound conclusions about the most appropriate investment policy for FEGLI can be made by comparing FEGLI to the civil service retirement fund and

Many federal employees are also taking advantage of the FEGLI optional programs, as shown in table 5.3.

Table 5.3: Participation in FEGLI Optional Programs

	Percent of participation by eligible employees	
Coverage	1980	1983
Standard optional insurance (option A)	30	38
Additional optional insurance (option B)	Not applicable	29
Family optional insurance (option C)	Not applicable	37

Alternative Life Insurance Plans

Federal employees may choose to purchase individual life insurance policies directly from insurance companies, rather than participate in the FEGLI program. A major consideration in comparing the cost of alternative insurance coverage is the fact that the basic FEGLI premium paid during an employee's working years includes the cost of post-retirement coverage. This cost represents 54 percent of the basic insurance premium.

A comparison of the employees' portion of the annual FEGLI basic premium with the cost of four insurance plans that employees can purchase as an alternative to FEGLI is shown in table 5.4. Although federal employees can enroll in FEGLI either when they are hired or during an open enrollment period without proof of insurability, the four alternative plans that we used for illustration require such proof.

Agency Comments From the Office of Personnel Management

Office of the Director

UNITED STATES
OFFICE OF PERSONNEL MANAGEMENT
WASHINGTON, D.C. 20415

DEC 19 1985

Honorable Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
Washington, DC 20548

Dear Mr. Bowsher:

We have reviewed your draft report on the Federal Employees Group Life Insurance (FEGLI) Program and we have the following comments.

We cannot agree with your recommendation that the FEGLI law be amended to provide the Basic insurance in multiples of 1.5 to 2 times salary to all employees free of charge. While we acknowledge that this is indeed the prevalent practice in the private sector, we believe group life insurance has historically played a slightly different role in private sector benefit plans than in the Federal system.

Group life insurance has served in many instances as the primary means of providing benefits to survivors of private sector employees, especially to younger spouses and those without dependent children who are not eligible for Social Security benefits. In contrast, the primary protection for survivors of Federal employees lies in the Civil Service Retirement and Disability System which provides an annuity for the surviving dependents of any covered employee with more than eighteen months of service. Thus, while FEGLI is certainly an important aspect of survivor protection in the Federal sector, it has not carried quite the same burden as group life insurance for private sector employees. As I'm sure you are aware, changes to Basic FEGLI in the direction you recommend are being considered in connection with the development of a new retirement system for post 1983 employees, whose survivor benefits will be modeled far more closely on private sector practice.

With regard to your suggestion that OPM adopt, for the purposes of FEGLI rate setting, the "spread" between the interest rate assumption and the salary increase assumption utilized by the Board of Actuaries in its most recent valuation of the retirement system, I would like to make two points. First, the Board of Actuaries' work was not available until long after the valuation of FEGLI on which the current rates are based was completed. Second, it is critical in sound actuarial practice that economic assumptions be adopted as sets so that the logic behind one assumption carries through to the others. You suggest in your report that once the Board's conclusions were available, we should have ignored their actual assumptions (for this would have increased FEGLI

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a compelling case for a fundamental change in the management of the FEGLI Fund, and further, the change that you seek, even if desirable, has little to do with the legislation you recommend.

The FEGLI Program is 30 years old and it has, no doubt, evolved in some ways that were not totally foreseeable at its inception. I am pleased that your very thorough review has substantiated my own impression that it is a basically sound program that has served the interests of the Federal workforce well. I appreciate this opportunity to comment on your report.

Sincerely,

Constance Horner
Director

sloped, a one-year investment would result in a hidden subsidy to the Fund and corresponding cost to the Treasury. Conversely, at times when the slope of the market yield curve is negative, a one-year investment would result in a gain to the Treasury at the expense of the Fund. Similarly, the par redemption feature can result in gains (or losses) to the Fund at the expense (or benefit) of the general taxpayer.

For example, premature redemption at par of a security with a relatively low coupon interest rate at a time when market rates of interest are rising would result in a hidden subsidy to the Fund, since the true market value of the security would be less than par. Conversely, at times of declining market interest rates premature redemption at par of a relatively high coupon investment would result in a loss to the Fund, since the true market value of the security would be greater than par.

To avoid the above inequities, the Treasury had designed market-based special issues for most Government funds which permit fund managers to invest directly with the Treasury in securities priced on the basis of outstanding Treasury securities in the market. Fund managers may select any marketable Treasury issue for purchase from or sale back to the Treasury at current market prices. This is the Treasury's recommended approach for Government investment accounts. The market-based special issue procedure is used by the vast majority of these accounts, including the FEGLI fund and the recently created military retirement fund.

In view of the foregoing, we recommend against authorizing the FEGLI Fund to invest in par value special obligations.

Sincerely,

Charles O. Sethness

Mr. William J. Anderson
Director
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