Evaluation Report

OFFICE OF THE INSPECTOR GENERAL

EVALUATION REPORT ON THE READY RESERVE MOBILIZATION INCOME INSURANCE PROGRAM

Report No. 97-166

June 18, 1997

DEPARTMENT OF DEFENSE

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Acronyms

ASD(RA)	Assistant Secretary of Defense (Reserve Affairs)
DVA	Department of Veterans Affairs
GAO	General Accounting Office
OASD(RA)	Office of the Assistant Secretary of Defense (Reserve Affairs)
OJE	Operation Joint Endeavor

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

June 18, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR PERSONNEL AND READINESS

SUBJECT: Evaluation Report on the Ready Reserve Mobilization Income Insurance Program (Report No. 97-166)

We are providing this evaluation report for information and use. We conducted the evaluation at your request. We considered informal comments on the draft of this report from the Office of the Assistant Secretary of Defense (Reserve Affairs) and the General Accounting Office in preparing the final report.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Mr. Michael A. Joseph, Evaluation Program Director, at (757) 766-9108, or Ms. Betsy Brilliant, Evaluation Project Manager, at (703) 604-8875 (DSN 664-8875). See Appendix B for the report distribution. The evaluation team members are listed inside the back cover.

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Report No. 97-166 **June 18, 1997**
(Project No. 7LF-5021)

Ready Reserve Mobilization Income Insurance Program

Executive Summary

Introduction. This evaluation was conducted in response to requests by the Under Secretary of Defense for Personnel and Readiness and the Chairman, House Subcommittee on Military Personnel, Committee on National Security, for a review of the design, implementation, and future viability of the Ready Reserve Mobilization Income Insurance Program (the Program).

In September 1991, Congress, recognizing that National Guard and Reserve members suffered financial hardships when called to active duty, directed DoD to investigate the feasibility of a low-cost, optional, self-sustaining program for National Guard and Reserve members to help moderate the financial impact of call-ups. Based on DoD surveys and RAND analyses, DoD determined that reservists were interested in an income insurance program. On February 10, 1996, Congress enacted the Program through the National Defense Authorization Act for Fiscal Year 1996, Public Law 104-106. Shortly after the October 1, 1996, implementation of the Program, DoD called up a contingent of reservists to serve in a third rotation in support of Operation Joint Endeavor. Many of the mobilized reservists were enrolled in the Program; however, overall enrollment levels were very low. Consequently, the Program owed more money each month in benefits than it collected in premiums. Pending the appropriation of supplemental funds, claims are being paid at only 4 percent of benefit entitlement.

Evaluation Objectives. The overall evaluation objectives were to evaluate the design, implementation, and future viability of the Program. In addition, we evaluated concerns raised by the Chairman, House Subcommittee on Military Personnel, Committee on National Security.

Evaluation Results. The Program was not self-sustaining, as originally designed. The Program was based on erroneous assumptions, was not effectively marketed, deviated significantly from the successful practices used in private sector and other Government insurance programs, and suffered from the consequences of circumstances beyond the control of its managers. There was serious underestimation of liability risk and drastic overestimation of likely participation levels by reservists in a voluntary program. As a consequence, the Program experienced an estimated $72 million loss the first year of operation and failed to provide an effective mechanism for addressing some reservists' concerns about income disruption.

DoD has taken action to begin addressing the Program deficiencies. In April 1997, the Deputy Secretary of Defense approved a proposal by the Assistant Secretary of Defense (Reserve Affairs) that the Program be suspended and a detailed study conducted. DoD has proposed legislation for Congress to suspend the Program and DoD conduct the study. DoD plans to complete its study by October 1, 1998. Based on the evaluation results, the Inspector General, DoD, supports the legislative proposal. We do not believe, however, that a prolonged study period is necessary.

Management Comments. We provided management a draft of this report on May 23, 1997. Because this report contains no recommendations, written comments were not required; however, informal comments were received and considered in preparing the final report.

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Part I - Evaluation Results

Evaluation Background

Our evaluation was conducted in response to a December 17, 1996, request by the Under Secretary of Defense for Personnel and Readiness for a review of the design and implementation of the Ready Reserve Mobilization Income Insurance Program (the Program). In addition, in January 1997, the Chairman, House Subcommittee on Military Personnel, Committee on National Security, requested that the General Accounting Office (GAO) review the Program as a result of concerns with the implementation and fiscal soundness of the Program. This evaluation report responds to the concerns identified in the congressional request to GAO, with whom we shared data during our work.

Ready Reserve. The Ready Reserve is comprised of military members of the National Guard and the Reserve, organized in units or as individuals, who are liable for recall to active duty to augment the active components in time of national emergency or war. The Ready Reserve consists of three Reserve component subcategories: the Selected Reserve,[1] the Individual Ready Reserve, and the Inactive National Guard. The Program was targeted at the Selected Reserve; however, reservists from the other Reserve component subcategories can enroll in the Program. For the purposes of the report, the term "reservists" includes both National Guard and Reserve members.

Program Interest. During Operations Desert Shield and Desert Storm, Congress received numerous letters from reservists and their families expressing concern about the loss of income incurred when called to active duty. Having recognized the financial hardships that reservists suffered when activated for Operations Desert Shield and Desert Storm, in the September 1991 Report on the DoD 1992 Appropriations Bill, the Senate Committee on Appropriations directed DoD to investigate the feasibility of a low-cost, optional, self-sustaining program. In June 1992, the Assistant Secretary of Defense (Reserve Affairs) (ASD[RA]) reported to the Committee that DoD had conducted a survey of reservists activated during the Persian Gulf conflict and had commissioned a study by RAND to analyze the survey data. In addition, RAND was to report on the viability and design of an income-loss insurance program for reservists.

[1] The Selected Reserve consists of individuals and units within the Ready Reserve designated by the respective Services so essential to initial wartime missions that they have priority over all other Reserves.

RAND Studies. At the request of the ASD(RA), RAND conducted a study on the economic losses of reservists. RAND issued two draft reports to DoD, "Assessing Voluntary Insurance Coverage to Protect Mobilized Reservists Against Economic Loss," August 1995, and "Selected Reservists in 1992: Attitudes, Perceptions of Unit Readiness, and Potential Problems If Mobilized," February 1997. RAND published one report, "Insuring Mobilized Reservists Against Economic Loss: An Overview," 1995. Those reports were based primarily on three DoD surveys of Reserve personnel conducted in 1986, 1991, and 1992. The 1986 and 1992 surveys were part of a continuing program to provide an ongoing examination of reservists' attitudes and opinions. The 1991 survey examined attitudes and opinions from mobilized and nonmobilized reservists after Operations Desert Shield and Desert Storm to determine the impact of mobilization on future career decisions.

The published report stated that approximately 85 percent of the officers and 75 percent of the enlisted mobilized for Operations Desert Shield and Desert Storm reported some level of economic loss from either decreased income (military pay less than civilian pay) or additional expenses. RAND further reported that, based on the 1991 survey, both officers and enlisted indicated they were interested in purchasing mobilization income insurance. RAND concluded that, based on the level of interest indicated in the survey, the fund for an income insurance program could afford an Operations Desert Shield and Desert Storm type mobilization every 7 to 8 years at $10 per $1,000 of coverage and every 16 to 18 years if the premium were lowered to $4 per $1,000 of coverage.

Proposed Legislation. In June 1994, the ASD(RA) submitted to the General Counsel, DoD, proposed legislation to establish the Program. That proposal included the requirement for program administration by the Department of Veterans Affairs (DVA). In December 1994, the Under Secretary of Veterans Affairs for Benefits, DVA, informed DoD that he would not be able to support the proposal as written because DVA analysts indicated that the Program would incur an immediate unfunded liability. The Secretary of DVA reiterated this position in April 1995 to the Director, Office of Management and Budget.

Insurance Program. During March and April 1995 congressional hearings, the ASD(RA) addressed income loss for reservists as one of several quality of life issues. On February 10, 1996, Congress enacted the Program through the National Defense Authorization Act for Fiscal Year 1996, Public Law 104-106. The public law included very specific requirements for the design of the Program, such as enrollment time frames and benefit collection periods. As the program administrator, DoD implemented the Program through DoD Instruction 1341.10, "Ready Reserve Mobilization Income Insurance Program Procedures," July 5, 1996. The Program, which began October 1, 1996, was optional and was designed to be financed by premiums paid by individual members. The Program included a one-time, 60-day enrollment period for current reservists not on active duty at that time and for new accessions to the Reserves after September 30, 1996. The basic benefit provided $1,000 coverage per month that the reservist could decrease to $500 or increase in increments of $500 not to exceed the maximum coverage of $5,000 per month. Reservists did not have to prove loss of income to enroll in the Program.

Program Premium Rate. At its annual meeting held August 9, 1996, the DoD Education Benefits Board of Actuaries[2] established the monthly Program premium rate at $12.20 per $1,000 of coverage. It provided that rate in an August 9, 1996, letter to the Secretary of Defense. In the letter, the Board also identified the following four factors that could impact the rate determination.

o Benefit payments are caused by infrequent mobilizations that can produce large numbers of benefit claims. The fund could be exhausted by an unfavorable experience in the early years.

o Mobilization experience depends on a changing world situation and the role of the Reserves, which may vary substantially from the previous experience used to compute premiums.

o Reservists who perceive substantial risk of mobilization will enroll in greater numbers and buy more insurance.

o Extending Operation Joint Endeavor[3] (OJE) call-ups beyond October 1, 1996, when the Program takes effect, may immediately endanger the fund.

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[2] The DoD Education Benefits Board of Actuaries is composed of three, part-time, professional actuaries from the private sector appointed by the President of the United States. Among their duties is the responsibility to consult with the Secretary of Defense regarding the premium rate for the Program.

[3] Operation Joint Endeavor provides support for ongoing operations in and around the former Yugoslavia (Bosnia-Herzegovina).

Evaluation Objectives

The overall evaluation objectives were to evaluate the design, implementation, and future viability of the Program. In addition, we evaluated the following concerns raised by the Chairman, House Subcommittee on Military Personnel, Committee on National Security, in his request to GAO:

o an analysis of the actuarial soundness of the Program,

o an assessment of DoD management of the implementation of the Program with specific attention to marketing strategy and the acceptance of adverse selection resulting from the decision to allow participation of members who had advance knowledge of near term call-up,

o recommendations for avoiding adverse selection during "open season" enrollment opportunities in the future,

o recommendations for making the Program more fiscally sound,

o an estimate of the funding requirements to make the Program solvent, and

o an assessment of the current need for the Program and the attractiveness of the current DoD Program to reservists.

See Appendix A for a discussion of the evaluation scope and methodology.

Ready Reserve Mobilization Income Insurance Program

The Program was not self-sustaining, as originally designed, because of the following reasons.

- o There was no sound basis for estimating actuarial risk.
- o Enrollment was lower than estimated.
- o There were program design problems.
- o The timing of the third call-up for OJE coincided with the implementation of the Program.

As a consequence, the Program was not fiscally sound, resulting in an estimated $72 million loss the first year of operation.

Estimating Risk

The Program was not self-sustaining, in part, because there was no reliable way to estimate the duration, number, and time of future mobilizations and the number and specialties of reservists that would be called up. In developing the Program design and the rates, DoD made several assumptions about the duration and frequency of mobilizations, and the mobilization force structure, based on experience of the previous 50 years. The role of the Reserves during the 50 years of the Cold War is a very uncertain basis for forecasting events in the post-Cold War period. In the past 50 years, there had been an average of one action every 10 years, averaging 17.8 months in duration. That mobilization history does not reflect the present. In the last 5 years, the Reserves have been involved in three regional contingencies varying in duration from 16 months to over 2 years.

Program Enrollment

The Program was not self-sustaining partly because overall enrollment was drastically lower than the enrollment estimates made by either the DoD actuaries[4] or RAND. The following were possible explanations for the lower than expected enrollment.

o Enrollment estimates were overstated and, in reality, many reservists were not interested in purchasing supplemental income insurance.

o The marketing of the Program was inadequate, consequently, reservists were not provided sufficient time and information to make an informed decision.

o The premiums were higher than many reservists were willing to pay.

o The Program design defaulted to declination rather than election of coverage.

However, an aggressive marketing plan, lower premium rates, or changes to the Program features may not have resulted in sufficient enrollment for the Program to be self-sustaining, if most reservists are simply not interested in purchasing supplemental income insurance.

Enrollment Rates. Enrollment estimates were overstated and most reservists may not have been interested in purchasing supplemental income insurance. Overall enrollment in the Program was 2.6 percent of the Selected Reserve. Enrollment varied among the Reserve components, with less than 1 percent of the Air National Guard members enrolling in the Program compared to an enrollment rate of 5.5 percent for the U.S. Army Reserve members.

Overall Enrollment in the Program. Approximately 24,000 of the 928,000 Selected reservists elected to enroll in the Program. The following table shows the enrollment totals as of April 1997 for each Reserve component as compared to the Selected Reserve end strength for FY 1996 for that Reserve component.

[4] The DoD Office of the Actuary resides within the Office of the Deputy Under Secretary of Defense (Requirements and Resources) and is staffed by full-time, civil service employees.

Selected Reserve End Strength and Program Enrollment			
Reserve Component	FY 1996 End Strength	Program Enrollment as of April 1997	Percent Enrolled
Army National Guard	369,975	5,556	1.5
Army Reserve	226,211	12,367	5.5
Navy Reserve	97,956	2,108	2.2
Marine Corps Reserve	42,077	775	1.8
Air National Guard	110,484	758	0.7
Air Force Reserve	73,668	2,415	3.3
Coast Guard Reserve	7,663	230	3.0
Total	**928,034**	**24,209**	
Percent of overall enrollment			**2.6**

Included in the enrollment totals were over 2,100 reservists deployed for OJE, some of whom may not have enrolled in the Program had the enrollment period not coincided with their notification for possible deployment.

RAND Estimates. In its report, "Insuring Mobilized Reservists Against Economic Losses, An Overview," RAND estimated that 67 percent of the enlisted and 55 percent of the officers indicated an interest in buying mobilization insurance if the monthly costs were $10 per $1,000 of coverage. If the rate were $4 for $1,000 of coverage, 73 percent of the enlisted and 60 percent of the officers said they would buy the insurance. Most reservists also stated they would buy insurance ranging from $500 to $2,000. Those estimates were based on the 1991 DoD survey. That survey collected data on actual income losses and additional expenses incurred from a sample of reservists mobilized during Operations Desert Shield and Desert Storm, and on interest in an income insurance program from both mobilized and nonmobilized reservists. The survey, as documented by RAND, intentionally oversampled[5] the medical specialties, a group that enrolled at a much higher rate than most other specialties. While the survey identified interest in an income insurance program by both mobilized and nonmobilized reservists, the report did not state

[5] Approximately 50 percent of the surveys received were from enlisted or officers in the medical field. However, the medical field represents only 11 percent of the total Reserve force.

whether there was a difference in opinion from those reservists mobilized during Operations Desert Shield and Desert Storm and those not mobilized. In addition, the survey was done immediately after Operations Desert Shield and Desert Storm when concern about income loss was great. As a result, current interest in income insurance may not be accurately reflected in the 6-year old survey.

DoD Actuaries Estimates. The DoD Office of the Actuary concluded that the participation rate would be less than the rate RAND estimated. The actuaries estimated that 42.5 percent of the reservists would participate in an income insurance program. The actuaries began their estimate of the participation rate with the survey data. They combined the results of the survey questions concerning interest in a program with the results of the questions concerning the amounts of coverage that the respondent would purchase. They estimated that 51 percent of the reservists would participate if the monthly premium rate was $4 for each $1,000 of coverage and that the enrollment rate would fall to 44 percent if the premium rate was increased to $10 per $1,000 of coverage. They then extrapolated the participation rate for a premium rate that exceeded $10. Based on a $12.20 premium for $1,000 of coverage, the actuaries estimated a final participation rate of 42.5 percent.

Reservists' Interest in the Program. Reservists' interest in purchasing income insurance was mixed. Many reservists who deployed to Operations Desert Shield and Desert Storm did not appear to be interested in the Program. Less than 4 percent of those deployed in 1990 who are still in the Ready Reserve chose to enroll in the Program. However, there were groups of reservists that wanted a supplemental income program.

The high incidence of adverse selection (this is discussed later in the report) distorted actual enrollment experience; however, the enrollment pattern tends to corroborate higher levels of concern regarding income disruption among certain groups. Of the approximate 5,500 military specialties within the Reserve components, about 1,930 specialties, or 35 percent, had some reservists enrolled in the Program. Reservists from 420 of the 5,500 military specialties enrolled at a level of 10 percent or more. Of the 420 specialties with enrollment levels at 10 percent or more, 250 were in the aviation, legal, and medical fields. Although the military specialties with enrollment of 10 percent or more account for less than 8 percent of the total military specialties within the Reserves, they made up over 25 percent of the total reservists enrolled in the Program. While most of those specialties had enrollment rates just over 10 percent, 40 were as high as 100 percent for specialties composed of a small number of reservists.

In addition, most of the specialties that enrolled at rates exceeding 10 percent were not reservists deployed for OJE. Only 11 percent of those reservists were deployed.

Program Marketing. Due to inadequate marketing, reservists were not given sufficient information or time to make an informed decision about enrollment. Enrollment began on October 1, 1996, with the implementation of the Program. Each reservist was to be provided a 60-day decision period to enroll, beginning with receipt of notification of the Program. Because declination of the Program was irreversible, the decision was meant to be a life-time decision. To make an informed decision during the 60-day enrollment period, it was important that each reservist received complete and accurate information in a timely manner. Two major problems with marketing the Program were:

o inadequate time available before implementation for reservists to obtain and review the Program materials; and

o lack of a comprehensive marketing plan, which resulted in marketing materials being distributed in an inconsistent manner among the Reserve components.

Time Available. The time available to implement the Program was not sufficient. Information about the Program was released as early as April 1996. However, because the Office of the Assistant Secretary of Defense (Reserve Affairs) (OASD[RA]) did not receive the finalized premium rates until August 9, 1996, it could not provide the Reserve components with the necessary information for enrollment packets until August 13, 1996. The Reserve components used the DoD-provided sample enrollment packets to create their own enrollment notification packets and marketing information. The Reserve components had slightly more than 1 month before implementation of the Program to get marketing materials printed and released and the unit commanders trained on the Program in order to sufficiently educate the individual reservists.

Smaller Reserve components, such as the Coast Guard Reserve, were able to distribute materials as early as the first week in September. However, the Army National Guard, the largest Reserve component, contracted with a vendor to print 400,000 copies of the enrollment packets and was not able to distribute the information to the state Army National Guard military personnel offices until the end of October. In addition, most reservists were provided the materials at drill sites during their monthly drills in the last quarter of the calendar year. Only Individual Mobilization Augmentees, Individual Ready Reservists, Coast Guard reservists, and Marine Corps reservists were mailed individual enrollment packets at their homes.

Marketing Approach. The Reserve components did not adopt a comprehensive marketing plan for educating reservists on the Program. While the OASD(RA) preferred to distribute the information directly to the individual reservists, some Reserve components believed that would usurp their chain of command and did not approve of that course of action. Therefore, each Reserve component released the information in a different manner and, in the case of the National Guard units, the information went through many levels before it reached the individual National Guard member.

In addition, the methods used to disseminate information on the Program varied by Reserve component. The variation resulted in the inability to centrally determine whether all reservists received the information. The primary method for informing the reservist was the enrollment packets. However, information was also distributed using a variety of marketing techniques, including the Internet, Reserve magazines, reservists' leave and earning statements, and toll-free telephone numbers. Some Reserve components, such as the Army and Coast Guard Reserves, used all available sources, while others, such as the Army and Air National Guard, used only a few sources. The varied marketing approaches resulted in uncertainty as to whether the reservists were not interested in the Program, not given adequate time to make a knowledgeable decision, or not informed about the Program.

A RAND telephone survey conducted in February and March 1997 supported concerns raised about the marketing effort of the Program. We did not verify the statistical validity of the survey. RAND interviewed 395 reservists who were eligible for the mobilization insurance to obtain post implementation information. It asked each reservist questions concerning knowledge of the Program and interest in mobilization income insurance. The results of the survey indicated that 27 percent of those responding had either no knowledge of or no offer to participate in the Program. The survey further revealed that an additional 16 percent of those responding believed they did not have sufficient time or information to enroll in the Program.

Premium Rates. The monthly premium rate for the current Program is $12.20 for each $1,000 of coverage. That rate is higher than either of the rates specified in the 1991 DoD survey. In the survey, reservists were asked whether they were interested in purchasing income insurance at a monthly premium rate of either $4 or $10 for each $1,000 of coverage. According to the RAND study, when the rate increased from $4 to $10 per $1,000 of coverage, interest in purchasing income insurance decreased by 5 to 6 percent for both enlisted and officers. However, even with the premium rate increase, interest in purchasing some level of income insurance remained at over 50 percent. Nonetheless, overall enrollment was less than 3 percent with a monthly premium rate of $12.20 per $1,000 of coverage. A premium rate over $12 could have been higher than some reservists were willing to pay.

Default to Declination. The default to declination design of the Program also contributed to low enrollment. Reservists who did not elect to enroll were automatically disenrolled from the Program. If the default had been to enrollment, the reservist would have been required to make a conscious decision to decline coverage (disenrolling is available to the reservist at any time). The default to declination could have been critical considering the short time frame to enroll and the inadequate marketing.

Another voluntary insurance program offered to reservists, the Servicemen's Group Life Insurance program, has a 99-percent enrollment rate, partly because it requires the reservist to affirmatively decline coverage. Defaulting to coverage ensures that reservists not enrolled have taken positive action to select that option. Had the Program included the requirement to positively decline coverage, enrollment may have been larger, and DoD could be more confident that reservists declining coverage were given sufficient time and information to make their decision.

Program Design

Another reason the Program was not self-sustaining is that the design deviated from successful practices used in the private sector and other Government insurance programs, such as the Servicemen's Group Life Insurance program discussed above. In addition, the Program was deficient in that it did not provide sufficient safeguards to reduce the effects of adverse selection. Adverse selection occurs when the insured has greater knowledge of the actual risk than does the insurer. The following four factors contributed to program design problems.

o The type of insurance coverage provided was value-form, not indemnity, in that no proof of income loss was required.

o There was no waiting period before eligibility for program coverage.

- o There were no exclusions for current or ongoing military operations.
- o There was no up-front capitalization.

Design of the Program was one of the contributing factors to program problems. However, because of the uncertainty involved in predicting the timing and duration of contingencies, incorporating controls, such as proof of income loss, a waiting period, or excluding current operations, would have reduced the risk of adverse selection, but never completely eliminated it.

Adverse Selection. Although adverse selection cannot be totally eliminated in an insurance program, steps can be taken to reduce its impact. The potential for adverse selection can occur if reservists can subscribe to insurance at any time, allowing the reservist to wait until a call-up is imminent before purchasing coverage. Adverse selection also occurs if reservists know their relative deployment priority for mobilization or have prior knowledge that their unit would be mobilized. Those problems can be reduced significantly, but not eliminated, in three ways. First, the Program could eliminate coverage for current or ongoing operations. Second, enrollment could be restricted to the time the reservist first becomes a member of the Reserves, or, for current reservists, during a one-time enrollment period. However, one-time enrollment periods can be impractical because individuals' insurance needs change throughout their lifetime. Finally, adverse selection can be reduced by placing a waiting period clause in the Program that allows benefits only after a specified period following enrollment into the Program.

Proof of Loss. The design of the Program was based on value-form insurance, which pays benefits based on the amount of coverage chosen by the reservist, regardless of the actual losses incurred. The premium rate is set for a specified amount of insurance coverage. In value-form coverage nothing prevents reservists from subscribing to amounts of coverage significantly greater than their actual losses.

A program designed for indemnity insurance seeks to replace all or a portion of the actual dollar losses experienced by a mobilized reservist. Such coverage requires the reservist to document the actual losses incurred or to provide proof of income. The premium rate is set based on a specific amount of coverage to cover the actual losses. Indemnity coverage provides a mechanism to prevent reservists from subscribing to amounts of coverage significantly greater than their actual losses. Indemnity coverage also results in increased administrative costs to verify the actual losses. DoD selected value-form coverage because verifying losses from self-owned businesses, lost commissions or bonuses, or additional expenses incurred might be difficult and would delay timely payment of benefits. Instead, DoD limited coverage to a maximum of $5,000 per month.

Waiting Period. The design of the Program did not include a waiting period before reservists were eligible for program coverage. Reservists who enrolled in the Program and were involuntarily called up were immediately eligible for program coverage. They were not required to be in the Program for a minimum length of time to be eligible to collect the benefits. The design, instead, restricted coverage to deployments over 30 days, excluded benefit payments for the first 30 days of mobilization, and limited benefit payments for up to 12 months in any 18-month period.

Exclusions for Current Operations. The Program design did not provide for exclusions for current or ongoing military operations. The Program design allowed reservists to sign up for coverage for a current military operation. Reservists were eligible to sign up for coverage when they knew they had a high likelihood of being called to active duty in support of OJE. Although overall enrollment was less than 3 percent, enrollment for those who were subsequently deployed in support of OJE was over 65 percent. However, reservists on active duty at the time the Program was implemented, including those already deployed for OJE by October 1, 1996, were ineligible for the insurance.

Up-Front Capitalization. The Program did not include up-front capitalization because the Program was designed to be financed by premiums paid by individual members. During the March 1995 congressional hearings, the ASD(RA) stated that the Program would be at no cost to the Government because the Program would be self-sustaining. An insurance consultant hired by the OASD(RA) as part of the recent program review reported that one of the major problems with the Program design was that it had no capital base or reserve funding. He further stated that in the private sector, insurance regulations require adequate capital for underwriting the risk and adequate reserves to cover losses. The Chief, DoD Office of the Actuary, also expressed concern about funding unsubsidized programs. Instead of up-front capitalization, the law prescribes that the Secretary of Defense submit a supplemental appropriation request to cover any unfunded liability in the event of insufficient assets.

Timing of Program Implementation

The Program was not self-sustaining partially because the timing of the implementation of the Program coincided with the third rotation in support of OJE. The Program began on October 1, 1996, and initial notices to reservists deployed for the third rotation were released in late October.

Third Rotation for Operation Joint Endeavor. On October 25, 1996, shortly after the Program start date, the Secretary of Defense announced a call-up of Selected Reserves for the third rotation supporting OJE. The timing of the call-up resulted in severe adverse selection, because the reservists about to be activated simultaneously had an opportunity to enroll in the Program. As of mid-April 1997, 3,293 reservists were deployed for the third rotation. Despite the low overall enrollment, 2,143 (65 percent) of the 3,293 reservists deployed enrolled in the Program and 1,807 (84 percent of those enrolled) elected the maximum coverage amount of $5,000 per month.

Program Continuation. The Program, as outlined in the National Defense Authorization Act for FY 1996, stated that the Secretary of Defense may define any additional category of members of the Ready Reserve to be excluded from eligibility to purchase insurance. The OASD(RA) interpreted that language to mean specific categories of reservists, for example, members of the National Guard or members of the Individual Ready Reserve, and not classes of military occupational specialties or individuals called up for a particular deployment.

The DoD did not request amending the legislation to exclude OJE because the Administration's position before October 1, 1996, was that the operation would be over in December 1996. However, if OJE was extended, the ASD(RA) believed that with a 40-percent enrollment rate, the impact of an OJE call-up could be managed. Consequently, notification for the Program was released in September 1996 and the Secretary of Defense extended OJE on October 25, 1996, after enrollment packages had been sent out and some reservists had enrolled.

First Year Program Deficit

In March 1997, DoD submitted to Congress a supplemental budget request of $72 million to fund the first year shortfall in the Program. DoD actuaries estimated the cumulative benefits due members through the end of FY 1997 at $68.7 million in excess of premiums collected. That estimate included partial and full month payments for members mobilized and demobilized throughout FY 1997 (OJE third and fourth rotations). DoD originally estimated FY 1997 administrative costs for the Program at $9 million; however, that may be overstated due to the low enrollment and the costs associated with processing fewer enrollment forms. DoD plans to apply the difference between the actual claims benefits paid in FY 1997 and the $72 million requested to cover other program-related costs. Based on the actuarial assumptions developed by the DoD actuaries, including use of actual enrollment data, DoD adequately computed the supplemental request of $72 million.

DoD Actions

In December 1996, the Defense Finance and Accounting Service, the agency responsible for assisting in the financial management of the Program, reported that January payments could be made, but the fund would not cover any subsequent payments. DoD expected substantially increased enrollments in December and January, but that did not occur. The law requires that if funds are not available to pay benefits completely, DoD shall submit a request to Congress for a special appropriation. If funds are not provided, then the Secretary shall reduce the benefits paid to an amount that does not exceed the assets in the fund. Four actions were taken to address the situation.

o The Under Secretary of Defense for Personnel and Readiness requested this Inspector General, DoD, review of the Program.

o The ASD(RA) established an Executive Steering Committee and a Senior Working Group to analyze the Program.

o The ASD(RA) reduced the insurance benefit payments so liabilities would not exceed assets in the insurance fund and notified enrolled reservists of that action.

o The Under Secretary of Defense (Comptroller) submitted a supplemental budget request to Congress to cover the program shortfall.

Analysis of the Program. On January 10, 1997, the ASD(RA) established two key committees, the Executive Steering Committee and the Senior Working Group. The Executive Steering Committee was to provide guidance and oversight for the analysis of the Program and the Senior Working Group was to conduct the analysis. The Senior Working Group created subgroups to review adverse selection, data, enrollment, and rate structure issues. The four subgroups met in January and February 1997 and reported their results to the Senior Working Group at the end of February. To further support the work done by the subgroups, the OASD(RA) contracted with two consultants who were knowledgeable in insurance and Reserve benefits issues.

Program Alternatives. The Executive Steering Committee identified six alternatives to the Program. Five of the six alternatives included key considerations for increasing participation, reducing adverse selection, and stabilizing the fund. To increase participation, a replacement program would include open enrollment windows, default to coverage, and payroll deductions. Reducing adverse selection would be addressed through a waiting period, no coverage for ongoing mobilizations, and requiring proof of probable loss for higher amounts of coverage. Stabilizing the fund would be accomplished by including a 30-day deductible and exploring methods to resolve short-term cash flow problems. The six alternatives were:

o termination of the Program;

o mandatory program for all Selected reservists at a basic amount;

o mandatory program for all Selected reservists with optional tiers of coverage up to $5,000;

o mandatory program for all new Selected Reserve accessions for the first 3 years, plus optional coverage for all other Ready reservists;

o voluntary coverage for all Ready reservists for both basic and optional amounts (similar to the current program); and

o voluntary coverage for all Ready reservists that would cover only major regional contingencies.

Only the last alternative structured the premium to fund insurance benefits for a major regional contingency. OASD(RA) presented the alternatives to senior Service management for their opinions and consideration. There was no consensus on which alternative to adopt. The results of the Services' meetings were the basis for the final package prepared by the ASD(RA) and submitted to the Secretary of Defense recommending Program suspension and further study.

Reduced Benefits Payments. On January 27, 1997, the ASD(RA) sent letters to each reservist enrolled in the Program to notify them that their benefit payments would be reduced because of program funding shortfalls. The OASD(RA) staff met with Office of the Under Secretary of Defense (Comptroller) personnel and the DoD actuaries to determine the amount that could be paid. The final decision was to reduce payment benefits to 4 percent of the elected coverage amount. The reduced payments prevented paying benefits that exceeded assets. The DoD intends to pay full benefits to each eligible enrollee after supplemental funds are appropriated.

Supplemental Request. On March 3, 1997, the Under Secretary of Defense (Comptroller) submitted a supplemental budget request to the Chairman, House Subcommittee on National Security, Committee on Appropriations, for $72 million to cover the expected shortfall in the Program fund for FY 1997. Funding to address shortfalls for FY 1998, estimated to be $7 million, would be covered by a Special Appropriation, or by DoD reprogramming if such authority is granted by Congress.

Result of DoD Actions

On April 3, 1997, the ASD(RA) submitted a proposal to the Secretary of Defense that the Program be suspended and that a detailed study be conducted. The ASD(RA) stated that the study would answer the following five crucial questions.

o Do reservists and their respective Services want and need a mobilization income insurance program?

o Are the Military Departments willing to require reservists' participation in such a program if it is determined that only a mandatory program would be viable?

o Is it feasible to outsource a mobilization income insurance program?

o Are the Military Departments willing to underwrite some level of future program deficit risk if the private sector is unwilling to shoulder the program's financial risk?

o Are there better means of addressing Reserve component concerns about Reserve recruiting, retention, and quality of life issues than a mobilization income insurance program?

The Deputy Secretary of Defense approved the recommendation to request that Congress suspend the Program and that DoD conduct a comprehensive study. Proposed legislation has been developed and submitted to Congress to support the recommendations. DoD plans to complete its study by October 1998.

Program Need

The overall need for the Program involves two separate issues. First, what is the need of DoD for recruiting and retaining qualified reservists. Second, what is the need of the individual reservists for financial support. There does not appear to be a major recruitment and retention problem within the Reserve components. Recruiting and retention goals for the most part are being met. For FY 1996, total Reserve component staffing was at 98.8 percent of authorized strength. The actual staffing of the Reserve components, when compared to authorized staffing, varied from 95.8 percent for the U.S. Coast Guard Reserve to 99.6 percent for the U.S. Air Force Reserve. However, there are some specialties that are not staffed at desired goals. For example, based on the FY 1995 DoD Health Manpower Personnel Data System statistics, overall physician staffing was 83 percent and overall dentist staffing was 86 percent of authorized strength.

As for the reservists' needs, the low overall participation in the Program calls into question the existence of a widespread quality of life issue even allowing for factors such as poor marketing and high premium rates. However, as stated earlier, there are categories of reservists that are interested in the financial support provided through a supplemental income insurance program and the RAND study indicated that many reservists suffered economic losses during Operations Desert Shield and Desert Storm.

Future Viability

The Program under its current design, with its current level of enrollment, is not fiscally sound, as demonstrated by an estimated $72 million loss the first year of operation. In addition, the proposed alternatives to replace the current

Program would not be fiscally sound if underlying assumptions do not come to fruition. The ASD(RA) asked several insurance consultants to review the proposed replacement alternatives DoD identified. The consultants expressed concerns with all the proposed replacement alternatives. One of the consultants stated that none of the alternatives were entirely consistent with basic insurance principles. Insuring against casualty events requires some level of predictability of the factors affecting mobilizations, such as duration, frequency, and number, as well as need and interest on the part of the reservists. The DoD Education Benefits Board of Actuaries, the Department of Veterans Affairs, and private sector insurers indicated those factors are not predictable. We agree.

To determine costs for the Program alternatives, the OASD(RA) developed assumptions of future mobilizations and provided those to the DoD actuaries for developing costs for revised program options. However, there is no way to predict the frequency or duration of mobilizations, therefore, it is difficult to predict whether an income insurance program can ever be fiscally sound.

Replacement Program. A replacement program needs to meet three critical goals to be fiscally sound. First, the program requires sufficient participation to spread the risk. Second, it must have a design that minimizes adverse selection. And third, it must have a stable funding base. The insurance consultants reported to the OASD(RA) that the voluntary options will not meet the three goals because they would perpetuate the small premium base and the adverse selection problems. In addition, the insurance consultants suggest that no voluntary program would be viable.

A mandatory program would better meet the three goals. It would provide sufficient participation because 100 percent of the Selected reservists would be enrolled. Adverse selection would be reduced because the premium base would cover those reservists with both high and low probabilities of deployment. In addition, the funding base would be more stable because premiums would be collected from all Selected reservists, thus giving a program greater income.

Mandatory Options. The replacement alternatives include three mandatory options. The first option, coverage at a basic level of $1,000 for all Selected reservists, will not meet the needs of many reservists interested in the program because the basic level is insufficient for higher paid professionals and self-employed business owners. The third option, mandatory for new accessions and voluntary for current reservists, would only insure a portion of the Ready Reserve and would be subject to higher adverse selection by those reservists electing voluntary coverage. The option that offers the most promising solution and, at the same time, appears to meet the financial needs of the reservists is the second option, mandatory coverage for all Selected reservists at a basic level with options up to $5,000 per month.

Mandatory Program Drawbacks. A mandatory program has drawbacks, as well. The fairness of forcing all reservists into a program that is likely to benefit only certain groups is questionable and may be viewed by some personnel as an erosion, not an augmentation, of benefits. Not all reservists need the Program. The Army conceptually supported a mandatory program; however, it stated that more conclusive analysis is needed to determine whether reservists want, and the DoD needs, mobilization insurance. The Navy questioned the need for the Program because it has not experienced significant reductions in retention rates. The Air Force does not want the Program because it believes the Program would have a negative impact on both recruitment and deployment volunteerism. The Marine Corps stated that it has no medical personnel and 85 percent of its reservists are E-5 and below. The Marine Corps believes that many of those reservists do not need a supplemental income program. The Coast Guard indicated that primarily port security units would be mobilized for a foreign deployment; less than 500 of its total 7,700 reservists. None of the mandatory options are intended to cover the benefit costs that would be incurred for a major regional contingency. DoD estimates that, if the Nation experiences a major regional contingency the size of Operations Desert Shield and Desert Storm, an additional $1 billion would be needed to pay the costs of the income insurance coverage.

Future of the Program. The Program is not fiscally sound, and reservists' interest in the Program is questionable in light of the low overall enrollment. Definitive need for the Program is unproven and its financial stability cannot be assured. Therefore, we support the decision to suspend and study the Program. However, we do not support a prolonged study period.

Part II - Additional Information

Appendix A. Evaluation Process

Scope

The evaluation focused on the overall design, implementation, and future viability of the Program by the Office of the Secretary of Defense and the Reserve components. We did not review the implementation of the Program at the National Guard and Reserve unit level.

Methodology

We conducted interviews and collected data and reports from key personnel at the Office of the Secretary of Defense, the Military Departments, the Reserve components, and the DoD Education Benefits Board of Actuaries. We reviewed DoD and Reserve Affairs directives, guidance, and policies regarding the Program. We collected and analyzed documents used in support of OJE, enrollment data, materials used by the Reserve components to market the Program, and National Guard and Reserve recruitment and retention data covering September 1991 through April 1997. We reviewed the legislation and supporting documents authorizing the Program.

We participated in the four subgroups supporting the Executive Steering Committee and Senior Working Group that the ASD(RA) established to evaluate the Program. We reviewed the RAND studies and interviewed the principal research analyst for the RAND report, "Assessing Insurance Coverage to Protect Mobilized Reservists Against Economic Losses."

We interviewed the insurance consultants that DoD hired to support the analysis of the Program. In addition, we conferred with an insurance representative from the Prudential Life Insurance Corporation of America to gain a better understanding of casualty insurance principles and practices and to gain their perspective on the Program.

Coordination with the General Accounting Office. Close coordination was established between the Office of the Inspector General, DoD, and the GAO to prevent a duplicate review of the Program. The Office of the Inspector General, DoD, had already started an evaluation of the Program at the request of the Under Secretary of Defense for Personnel and Readiness when the Chairman, House Subcommittee on Military Personnel, Committee on National Security, requested that GAO evaluate the Program. We met with GAO and incorporated its concerns and questions into the evaluation design.

Quantitative Analysis. Technical support was provided by representatives from the Office of the Inspector General, DoD, Quantitative Methods Division and Technical Assessment Division. Those individuals conducted an analysis of the basic assumptions used to develop the premium rates for the Program and developed estimates for various deployment scenarios to determine fiscal soundness.

Use of Computer-Processed Data. We relied on computer-processed data contained in the Reserve Component Common Personnel Data System and the DoD Health Manpower Personnel Data System. In addition, we obtained enrollment and recruitment data from OASD(RA). We did not validate the accuracy of the data because of the short time constraints dictated by the requests.

Evaluation Period and Standards. This program evaluation was performed from December 1996 through April 1997 in accordance with standards issued and implemented by the Inspector General, DoD.

Contacts During the Evaluation. We visited or contacted individuals and organizations within DoD, Prudential Life Insurance Corporation of America, and RAND. Further details are available upon request.

Summary of Prior Audits and Other Reviews. Since the Program is new, there were no prior audits or reviews of the Program.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Personnel and Readiness
  Assistant Secretary of Defense (Reserve Affairs)
    Deputy Assistant Secretary of Defense (Manpower and Personnel)
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Manpower and Reserve Affairs)
Auditor General, Department of the Army
Chief, National Guard Bureau
Chief, U.S. Army Reserve

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Assistant Secretary of the Navy (Manpower and Reserve Affairs)
Deputy Chief of Staff (Manpower and Reserve Affairs Department), U.S. Marine Corps
Auditor General, Department of the Navy
Director, U.S. Naval Reserve

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Assistant Secretary of the Air Force (Manpower, Reserve Affairs, Installations, and Environment)
Auditor General, Department of the Air Force
Chief, U.S. Air Force Reserve

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Director of Reserve and Training, U.S. Coast Guard
Office of Management and Budget
General Accounting Office
  National Security and International Affairs Division
    Technical Information Center
  Health, Education, and Human Services Division

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

  Senate Committee on Appropriations
  Senate Subcommittee on Defense, Committee on Appropriations
  Senate Committee on Armed Services
  Senate Committee on Governmental Affairs
  House Committee on Appropriations
  House Subcommittee on National Security, Committee on Appropriations
  House Committee on Government Reform and Oversight
  House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform and Oversight
  House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
  House Committee on National Security
  House Subcommittee on Military Personnel, Committee on National Security

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