

Guidance on sex in insurance: the UK and the European Commission issue their views on *Test-Achats*

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The decision of the European Court of Justice (ECJ) in the test case of *Association Belge des Consommateurs Test-Achats ASBL and Others v Conseil des Ministres C-236/09 (Test-Achats)* was one of the most noteworthy of 2011². It threatened to cause upheaval in the insurance industry because it seemed to prohibit the use of sex as an actuarial factor when calculating premiums and benefits for insurance contracts effected on or after 21 December 2012. Amid consternation and uproar from the industry since its publication last March, the ruling has been the subject of numerous articles and studies attempting to predict its impact on the insurance industry.

Two recent developments have now helped clarify the situation for insurers in the UK. These are the publication of the European Commission's guidelines on the application of the *Test-Achats* decision and the launch of the UK government's consultation on the UK's response to the decision. Both are described in this article, together with an overview of the ruling itself.

EU law and the *Test-Achats* decision

Equal treatment for men and women is a fundamental right under European Law (Article 6 of the EU Treaty). Expanding on that principle, in December 2004, the Gender Directive (2004/113/EC) was adopted requiring EU member states to legislate for equal treatment in access to and supply of goods and services. Article 5 of the Directive provides that, for all new contracts concluded after 21 December 2007, the use of sex as a factor in the calculation of premiums and benefits for insurance and related financial services must not result in differences in individuals' premiums or benefits (the **Unisex Rule**).

However, as the Directive recognised, the use of actuarial factors related to gender was widespread in insurance when the Directive was adopted in 2004, so a transitional period was incorporated that gave until 21 December 2007 for the differences to be abolished. Further, an exemption under Article 5(2) allowed proportionate premium and benefit differences where gender is a determining factor in the assessment of risk, based on relevant and accurate actuarial and statistical data. In practice, this is most commonly applied to motor, life and health insurance, and annuities. However, the Directive included no long stop date for an end to this exemption.

Article 5(2) was challenged by Belgian consumer group Association Belge des Consommateurs Test-Achats on the grounds that it was incompatible with equality of treatment enshrined in EU law. In September 2010, Advocate-General Juliane Kokott (AG) issued her opinion that Article 5(2) was invalid because the exemption focussed on gender-based statistical differentials and did not take proper account of other factors influencing risk. As expected, the ECJ decision handed down in March agreed with the AG's conclusion that Article 5(2) was incompatible

with EU law. It ruled that Article 5(2) will be invalid from 21 December 2012.

The ECJ's concise reasoning was that the indefinite application of Article 5(2) contravened the intention of the Gender Directive. The Gender Directive, the ECJ said, was based on the premise that, "*for the purposes of applying the principle of equal treatment for men and women, the respective situations of men and women with regard to insurance premiums and benefits contracted by them are comparable*". On this basis, an indefinite exemption could not be justified.

Commission Guidelines on implementation

After spending nine months mulling over the ECJ decision and consulting with insurers and other interested groups on how it could best be implemented, the European Commission issued Guidelines on the application of the Gender Directive in light of the *Test-Achats* decision (the **Guidelines**) on 13 January 2012. The Guidelines attempt to answer many of the doubts that had been raised but, ultimately only reflect the Commission's view on how to interpret the legislation.

New contracts

With the Article 5(2) exemption eliminated, Article 5(1) of the Gender Directive prohibits "*the use of sex as an actuarial factor in the calculation of premiums and benefits*". The Guidelines confirm that this applies only to "*new contracts*", which (for these purposes) means "*whenever a contractual agreement requiring the expression of consent by all parties is made, including an amendment to an existing contract [where] the latest expression of such consent by a party that is necessary for the conclusion of that agreement*" occurs on or after 21 December 2012. Examples of new contracts include contracts where the offer was made before 21 December but accepted on or after that date, as well as agreements made after 21 December to extend contracts concluded before that date that would otherwise have expired.

Contracts that are not "new" (for these purposes) and which need not comply with the Unisex Rule include the automatic extension of a pre-existing contract, certain adjustments made to a pre-existing contract that do not require the consent of the policyholder, the policyholder's decision to take out top-up or follow-on policies whose terms were pre-agreed in a contract concluded before 21 December 2012, and contracts in a "straightforward" portfolio transfer from one insurer to another.

As well as describing some of the circumstances where a new contract may be created, the Guidelines also describe a number of insurance practices that are gender related but still lawful. The Unisex Rule prohibition is on differences in premiums and benefits for individuals that arise as a result of using gender as a calculating factor. It is not prohibited to use gender as a risk-rating factor in general, and gender can be used in calculating premiums and benefits at the aggregate level, as long as it does not lead to differentiation at the individual level. Further, the collection, storage and use of gender information for reserving and internal pricing, for reinsurance pricing, and for marketing and advertising is still permissible (at least to the extent that these practices are consistent with European law in

general). In life and health underwriting, the Unisex Rule means premiums and benefits cannot be different for two individuals simply because their gender is different, but other risk factors such as health status or family history which may involve gender issues, such as a family history of breast cancer, can be taken into account.

Indirect discrimination

The Guidelines also comment on indirect discrimination, and factors such as age and disability, which were identified as potential difficulties after the *Test-Achats* decision was handed down. Indirect discrimination is where an apparently neutral risk factor puts one sex at a disadvantage, the frequently cited example being motor premiums being decided on the size of car engine, as statistically men tend to drive cars with bigger engines. Under the Gender Directive, indirect discrimination is lawful only if the aim is legitimate and the means of achieving it are appropriate and necessary; the Guidelines further clarify that in motor insurance, price differentiation based on the size of a car engine “*should remain possible*” as that is a true risk factor, but differentiating on the basis of a person’s size or weight would not be allowed as these matters are not.

Age and disability as risk-rating factors are not affected by the *Test-Achats* decision, and they are not currently regulated at EU level. There is a proposal for a directive on equal treatment irrespective of religion, belief, disability, age or sexual orientation, but this does not contain a general principle akin to the Unisex Rule. Therefore the proposed directive would recognise that two people of different ages are not in comparable positions with regard to life insurance and so proportionate differences of treatment based on a sound risk assessment would not constitute discrimination.

Annuities

Finally, the Guidelines consider annuities. The Gender Directive applies only to private, voluntary insurance and pensions which are separate from the employment relationship, so annuities provided for under occupational pension schemes will still be covered by Directive 2006/54/EC on equal opportunities and equal treatment in employment, and not the Gender Directive. In contrast, if an individual employee concludes an insurance contract directly with the insurer and without the employer’s involvement, such as converting a lump sum into an annuity, then this will come under the Gender Directive. The Guidelines state that the Commission considers that the *Test-Achats* ruling does not affect the setting of different levels of benefits between men and women in the “*different and clearly separable*” context of occupational pensions. Such differences are allowed under Article 9(1)(h) of Directive 2006/54/EC, where different benefits are not considered discriminatory when justified by actuarial data.

As noted above, the Guidelines reflect the Commission’s views and, while they may be persuasive and therefore create a degree of comfort for insurers, they are not binding. A firm that follows them slavishly could still find itself in hot water if the Guidelines are flawed, if they are misinterpreted and/or misapplied. Further, while the Guidelines do help clarify some

doubts over the effects of *Test-Achats*, they also appear to create their own problems. For example, they explain that insurers can use marketing and advertising to influence the mix of their portfolio, but any attempt to do so must still be consistent with the balance of the Gender Directive, and EU and UK law in general, which is something of a minefield. The Guidelines also seek to draw distinctions that may be difficult to use in practice, such as the lines between existing and “new” contracts, between what is and is not discrimination, and between direct and indirect discrimination. Insurers should be particularly wary of these areas when amending their practices to comply with *Test-Achats*. Insurers should also consider whether any portfolio transfers that will become effective on or after 21 December 2012 are “straightforward”. In view of the Commission’s Guidelines, there is at least a risk that a non-straightforward portfolio transfer that becomes effective after that date will create new contracts of insurance that are subject to the Unisex Rule. Similar issues could also arise in reattribution and other contexts.

The UK position

In December 2011, shortly before the Guidelines were published, HM Treasury opened a consultation on the UK’s response to the *Test-Achats* ruling. The government had already expressed its disappointment with the judgment through a formal statement by Mark Hoban, Financial Secretary to the Treasury, in June 2011. While recognising the government’s obligation to implement the judgment, Mr Hoban said that financial services providers should be allowed to make sensible decisions based on sound analysis of relevant risk factors. The consultation was opened to seek views on the likely impact of the judgment on consumers and industry as well as the government’s proposed approach for implementation in December 2012.

Impact assessment

The government believes that the judgment will result in a marked net increase in the cost of premiums, with the most significant increases for those in lower-risk categories. For example, in the field of motor insurance, it is suggested that cross-subsidisation of premiums between genders will result in (generally more careful) female drivers paying the same price for insurance as (generally less careful) male drivers and thus the female subsidises the cost of the male’s insurance. The government has estimated a “benefit” of approximately £600m for males due to the reduction of their premiums and a “cost” to females of approximately £900m, creating a net cost to motor insurance consumers of approximately £300m. There could also be a detrimental effect on road safety since gender-neutral pricing might encourage (or at least allow) male drivers with lower premiums to purchase higher-powered cars or increase the riskiness of their driving.

In life assurance, the government considers that adverse selection may increase the cost of insurance generally since life assurance will become a good value product for men (who have a lower average life expectancy) but a poor value product for women. As lower-risk female customers are disincentivised from purchasing such insurance by higher premiums

and/or lower benefits, the general level of risk of the insurer's portfolio increases, and thus the cost of insurance will rise to compensate. However, as mentioned above, the Guidelines provide that health status or family history, which may involve gender issues, can still be taken into account when setting life assurance premiums. Although competition in the market may eventually push prices back down, the government anticipates that the market will even out at a higher level than before.

Further problems are predicted on an industry level. The government suggests that lower-risk categories of consumers may leave the market or purchase cheaper products, thus affecting revenues. Transitional costs are also expected to be incurred in implementing changes to underwriting policies, marketing and sales approaches, although the government has requested responses from insurers to confirm the expected level of such costs.

Limiting the scope of the judgment

The government's interpretation of *Test-Achats* highlights the limits of the decision, which may be of some comfort to insurers. Firstly, it stresses that the Gender Directive only prohibits the use of gender in the pricing of premiums and benefits, and that sex may still be used as an actuarial factor. This point is also emphasised in the Guidelines, and it allows insurers to continue to collect data on gender and use it in order to assess the overall risk of a particular pool of risks.

Secondly, the government confirmed that in its view, the judgment must be limited to those insurance contracts entered into on or after 21 December 2012, the effective date of the judgment. This would mean that insurers could continue to operate any contracts entered into before that date in which gender impacts the pricing of premiums or benefits. Again, this view has subsequently been supported by the Guidelines which also give further clarification on what constitutes a new contract.

Incorporation into UK legislation

To effect the legal mechanics of implementation, the government proposes to amend the Equality Act 2010 in spring 2012 by removing paragraph 22 of Schedule 3, which implemented the Article 5(2) exemption to the Gender Directive into English, Welsh and Scottish law (the judgment will be implemented separately in Northern Ireland). Without this exemption, there is a danger that risk factors that impact one sex more than the other, ie they constitute indirect discrimination, would be affected as the Equality Act 2010 prohibits both direct and indirect discrimination. However, indirect discrimination will not be unlawful if the insurer has a legitimate aim and the means of achieving it are appropriate and necessary. Furthermore, paragraph 27 of Schedule 3 will still be available to insurers who wish to provide single-sex insurance services to cover such risks as prostate or ovarian cancer.

What next?

The *Test-Achats* decision is final and cannot be appealed. The UK government's consultation ends on 1 March 2012, after which the Treasury will publish the results on its website and

implement the amendments to the Equality Act 2010 so that they come into force from 21 December 2012. It will be interesting to see whether opposition to the decision softens in light of the publication of the Guidelines, which generally provide for pragmatic implementation. However, they are unlikely to dispel a general sentiment that removal of gender as a pricing factor will result in some overall premium increases (and benefit reductions) as insurers must reassess data, alter their income structures, and change policy terms and marketing materials. Further, as noted above, the Guidelines also create their own problems of interpretation. In particular, despite reassurances that indirect discrimination will be lawful where the aim is legitimate and the means are appropriate and necessary, this test is subjective and may encourage consumer challenges to pricing structures. For example, although car engine size is specified as one factor that “should remain possible”, there are countless other factors that may also be tested. If the policyholder’s occupation is used (which is likely to be complicated and problematic of itself), how difficult will it be to show that the insurer’s aim is “*legitimate*” and the means it has used are “*appropriate and necessary*” if the result favours concentrations of women doing care jobs or is prejudicial to men in construction? Clearly the extent of what is acceptable indirect discrimination remains unclear.

The European Commission plans to monitor implementation by individual states (currently only Belgium, Cyprus and the Netherlands restrict gender as a rating factor in many non-life insurance lines) and it has also pledged to remain vigilant in following the evolution of the market in order to seek to identify any unjustified rise in prices attributed to *Test-Achats*. In fact, the country whose consumers brought the *Test-Achats* case is also the best-placed to allay concerns about its practical consequences: Belgium has had unisex motor insurance since 2007 but has not seen the market problems feared by insurers. Premium growth has been restrained by strong competition and safer drivers of both sexes who build up no-claims bonuses have benefited.

For now, the rest of Europe’s insurance industry has a couple of years to adapt to the new rule. In 2014, the Commission will report on the implementation of *Test-Achats* in national law and in insurance practice as part of a general report on implementation of the Gender Directive.

Endnotes

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² This decision was previously discussed by Glen James in BILA Journal 122 (see www.bila.org.uk/closed/cug/articles/archive/BILA_p5-17.pdf)