

## Gender Discrimination

So, the worst has happened. The European Court of Justice has torpedoed gender as one of the fundamental, actuarially based pricing factors for insurance products, from motor cover to annuities.

### The history

For non-EU readers, a bit of history. In 2004 the Council of the European Union issued a directive (2004/113/EC) prohibiting the use of gender as a factor in the calculation of insurance premiums and benefits in relation to insurance contracts entered into after 21 December 2007. However, the directive did provide that member states could permit exemptions from the rule of gender-neutral premiums and benefits provided that distinctions were supported by actuarial and statistical data; the data were required to be reliable, regularly updated and available to the public.

Last year the Belgian consumer organisation Test-Achats and two individuals brought an action before the Belgian Constitutional Court challenging the 'supporting data' exemption (or derogation). The Belgian court referred the matter to the European Court of Justice (ECJ) to assess the validity of the derogation in the light of 'higher-ranking legal rules and, in particular, in the light of the principle of equality for men and women enshrined in EU law.'

On 1 March the ECJ held that the derogation from the rule of gender-neutral premiums and benefits is invalid from 21 December 2012. This is on the grounds that the derogation should not be allowed to persist indefinitely and that any exemption is contrary to the EU's objective of equal treatment of men and women, and should be considered invalid on expiry of an appropriate transitional period – the five years from 21 December 2007 to 2012.

### The present

So where from here? First, there is likely to be more to come. Aside from a determination in some quarters that every attempt should be made to get the judgment overturned (using the might of government if need be), it is unclear which contracts are affected, especially long-term ones (life, disability and annuity) as opposed to yearly renewable motor etc ones. In the case of long-term business, do the new arrangements apply to new contracts effected on or after 21 December 2012, or to contracts dating back to December 2007? The official EU documentation refers to the derogation being invalid 'on expiry of *an appropriate transitional period*' (our italics), which seems to indicate that new contracts only are affected. But it's not stated explicitly, and needs to be clarified.

### Impact on consumers and insurers

Assuming the revised directive is enforced, what will be the impact on consumers and insurers?

In the case of consumers, clearly women will lose on life cover but gain on disability policies and annuities; by implication the effect on men will be the opposite. To what extent premiums change depends largely on the proportion of males and females applying for cover, the distribution of sums assured between the sexes and how much insurers load for the costs of making the transition. Maybe of most concern, though, is the impact on men of reduced annuity payouts; retirement finances are already in jeopardy for a number of reasons – demographic, social and financial – and this will make things worse.

Insurers will have to change their premium rates, quotation systems and associated technology. And they will need to take a view on how behaviour by distributors, consumers and competitors in reaction to the new environment will affect the mix of male and female applicants. In time things will settle down to yield some reasonably reliable data, but early on some actuarial guesswork will be required.

Insurers also need to ensure their underwriting philosophy is gender-neutral. Which makes underwriting a family history of breast cancer or prostate cancer a key issue: is such recognition of biological difference now outlawed? If so, it conflicts with disability discrimination legislation that rightly insists that underwriting decisions need to be evidence-based. If underwriters rate a history of breast cancer in a male applicant (unjustified but consistent with gender discrimination law), they fall foul of the disability discrimination legislation. The only 'safe' course is to ignore the family history regardless of gender, meaning a further cross-subsidy between risk groups, albeit with the costs of (usually) a small risk among a small minority being borne by a large majority. But it represents another chip out of insurers' ability to underwrite and price risk accordingly.

Given that a ban on something is often a stimulus to find ways round it, insurers might also go on the hunt for alternative risk factors to restore or even improve the amount of detail in their pricing models. And there are of course plenty of risk factors available – as any decent life expectancy calculator shows. Whether such risk factors are verifiable without complicating the application process (currently commendably simple in most cases) with medical reports is another matter. And insurers need to avoid risk factors that are plainly proxies for gender – that would be discrimination by the back door.

### In the wider context

The decision has caused widespread dismay and outrage, and not only within the financial services industry. It would seem that most people think differently to the judges. The Court's Advocate General, Juliane Kokott, has stated that there is insufficient evidence that women live longer because of biological differences from their male counterparts. Instead, these differences 'come to light statistically.' In her opinion, insurers have been using gender as convenient shorthand for underlying causes of longevity risk, such as lifestyle and behaviours.

There is, arguably, some substance to the lifestyle/behavioural argument. For example, the 'accident hump' in the male mortality curve around ages 20 to 25 is down to risk-taking behaviour. And historically men have been more likely to smoke, and to smoke more heavily than women. But then smoking is usually reflected in basic premium rates, and the hormonal protection women have from cardiovascular disease until late-middle age is well understood. That would indeed appear to be due to biological difference.

One is inevitably led to question the deeper motivation behind this EU bombshell. One suspects that it stems from a vision of a fair, modern society in which there is blurring or obscuring of the distinction between equality (among individuals) and equity (between insurance policyholders). Modern society increasingly strives to remove disadvantage, and the psychology behind the ruling appears to be founded on the premise that one sex should not be disadvantaged against the other in respect of insurance premiums or benefits. Which in isolation is quite laudable.

But such logic inevitably drives to an end-point at which there is equality among everyone – all pay the same premium and receive the same benefits, thus making insurance truly a ‘social good’ as opposed to a commercial product. And for maximum inclusion, maybe no-one need be declined... The worry is that the ability of insurers to stratify risk will be progressively restricted. EU law also enshrines the principle of non-ageism. Will this in time lead to the outlawing of age-related premiums? That would be a huge blow to equity in favour of equality. But there are moves afoot in France to head this way.

It is important not to lose sight of the inescapable truth that individuals, by definition, are all different.

### A positive slant?

The ECJ ruling has immediate negative implications for insurers and their customers. Is there anything positive to be found in it? Well maybe. Perhaps it represents a prompt to think about the future basis of risk selection in life and disability insurance. There is an undeniable tension between understanding of risk and large-scale risk pooling. Given what we know about risk and risk factors – and what consumers know about themselves and their own risk – the pricing of risk on age, gender and smoking status, with a look back at medical history, is arguably a bit crude. Don't we owe it to consumers to tailor premiums to individual risk as much as we can?

On the other hand recognition of differential risk factors and more detailed risk selection and pricing – while reinforcing the principle of equity – inevitably benefits a proportion of policyholders while penalising others by higher premiums or reduced benefits. In the case of annuities, the UK market for which is seeing a sharply increasing trend towards more detailed underwriting, the healthy will be worse off in retirement income. Fair enough. Or is it? Is there a case here for maintaining strong pooling to avoid increasing the vulnerability of a sub-group of the old-age population?

How much is cross-subsidy between risk groups an evil or a necessity? Where does the balance lie? No doubt the legislators and regulators will find it for us. But the right sort of dialogue between them and the insurance industry would help them in their decision-making.

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