

Rt Hon Harriet Harman QC MP
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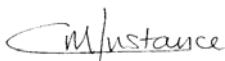
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Dear Minister

**The Equality Bill – Age Discrimination in General Insurance
Commentary from the Actuarial Profession**

Please find enclosed a commentary from the Actuarial Profession on Age Discrimination, following your statement to the House of Commons in June on the Equality Bill. Members of the Profession have been represented on HM Treasury's age discrimination working group to undertake a review of the behaviours and commercial practices in the financial services industry that touch on the age of the customer. This commentary follows on from discussions within that group.

Yours sincerely



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THE EQUALITY BILL – AGE DISCRIMINATION IN GENERAL INSURANCE COMMENTARY FROM THE ACTUARIAL PROFESSION

Introduction

1. This commentary is provided by the Faculty and Institute of Actuaries in response to the Right Honourable Harriet Harman's statement to the House of Commons on 26 June 2008.
2. The Faculty and Institute of Actuaries are the two professional bodies for actuaries in the UK; the bodies are referred to collectively as 'The Actuarial Profession'. The Profession has an obligation to serve the public interest. It seeks to do so by informed contribution to debate on matters of public interest. Our objective in submitting evidence is to offer technical expertise on the implications of different policy choices facing UK and European legislators. (Further information about the Profession is provided in the Appendix.)
3. This commentary extends to general insurance only; we do not offer information on the wider general aspects of goods / services covered by the proposed legislation, or on life insurance or savings products as the focus of our discussions with HMT has been mainly on travel and motor insurance.
4. The Profession welcomes the introduction of the UK Equality Bill and the related proposed EU Council Directive which both aim to promote a fairer society. We do, however, have some concerns around the practicalities of some of the potential solutions envisaged in the legislation.

The Current Situation

5. At present insurance companies are free to set premium rates using a range of rating factors including age. This practice reflects the fact that age is a key factor in determining the cost of providing the insurance, since it can materially influence both the likelihood of policyholders making a claim and the size of such claims when they occur. Not using age as a rating factor would result in lower risk age groups (for example ages 40-70 in motor insurance) subsidising higher risk age groups. Not rating by age could also result in changed behaviour, for example young drivers might be more inclined to drive high performance sports cars if, when subsidised in such a way, insurance for such cars became more affordable.
6. Insurers are also currently able to restrict availability of their products to certain age groups in certain cases. Examples include motor insurance where cover may be limited to drivers between 25 and 80, or travel insurance where cover is available only up to a certain age. Sometimes these age limits may vary depending on the circumstances, for example in motor insurance a minimum age of 30 might apply to those insuring larger or more powerful cars.

The Proposed UK Equality Bill

7. We understand that the three options that have currently been raised by the Expert Working Group which HM Treasury has convened on age discrimination in financial services are
 - taking no action
 - voluntary action by the industry
 - legislation.

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8. Our understanding is that in the event of legislation, in order to prevent a situation where low risk age groups pay higher premiums to subsidise higher risk customers, such legislation would allow companies to continue to charge higher prices for higher risk age groups, but that it may require that such prices are 'actuarially justifiable'. We further understand that the legislation is considering banning the current practice of declining to offer insurance to customers in certain age groups.

Practical Considerations arising from Potential Legislation

Actuarial assessment of risk costs by age

9. Actuarial techniques used in general insurance are statistical in nature and rely on the existence of a large volume of data which can be statistically analysed to determine how the cost of providing insurance varies by potentially inter-related rating factors such as age, type of vehicle (for car), socio-demographic factors, claims history and so on. These techniques work very well for mass market insurance where there are large numbers of customers which leads to large volumes of statistically credible data. The use of these techniques has led to an innovative, highly competitive market place.
10. Not all companies, however, have sufficient data to derive credible estimates of the effect of age on claims experience over and above other rating factors. For some companies this is purely a function of their small size, for others it results from specialising in particular segments of the market (for example, SAGA only insures over 50s). Companies do not make their actuarial data publicly available as it is a source of competitive advantage.
11. Consequently if the proposed legislation were introduced many companies (and all new insurers) would have insufficient data to demonstrate the statistical effect of age on the risk cost for all ages. Some companies would find themselves in the difficult position of having, by law, to quote actuarially justifiable premiums yet having insufficient data by which to do so on a statistical basis.
12. Even where it is possible to derive a credible estimate of the effect of age on claims experience, there are several potential reasons why the resulting premium might not be directly proportional to the claims cost. These include the use of fixed monetary loadings reflecting the expense of administering the policy, and marketing activity which directly or indirectly results in commercial discounts being offered for different age groups.

Offering insurance for all age groups

13. The above issues would be particularly problematic in the event of insurers being required to provide insurance quotations for all age groups.
14. There are, for example, very few 95 year olds driving so, by definition, few if any insurers will have sufficient data to rely solely on statistical techniques. Few insurers will have, for example, credible experience of insuring 18 year olds in Ferraris. Another example is travel insurance where companies may have plentiful statistics on 40 year olds taking skiing holidays, but will have very little, if any, data on 80 year olds taking skiing holidays.

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15. Actuarial techniques are less applicable for customers whose insurance needs are more unusual or for customer groups with small numbers. At present the insurance needs of such customers are often met by specialist companies who will tend to use more in-depth sales processes combined with specialist underwriting judgement to set prices. To the extent that actuarial justification requires statistical evidence, it would be very difficult to set actuarially justifiable prices for such customers.
16. The lack of credible data in such cases could also increase the amount of capital which insurers are required to hold to cover the possibility of adverse future experience. This increased capital requirement would result in increased premium rates for the policyholders in question.
17. In determining prices for insurance contracts there is clearly a continuum between mass market risks for which actuarial techniques are readily applicable and the extreme examples above where actuarial techniques are of less use. Currently companies make a commercial decision at which age points they feel unable to quote premiums based on their own data, the cost and method of distribution, capital requirements, and their business model more generally.

Age bands

18. In some cases, in particular for travel insurance, premiums vary by bands of age (eg under 30, 30-60, 61-65, 66-70) rather than by individual ages. As a result customers moving from one age band to the next may experience a large premium increase.
19. We believe that actuarial techniques could be used to replace the use of age bands with premium rates calculated individually for each age.
20. We believe that the use of age bands is driven by the need for distributors to have a product which is easy and cheap to sell rather than by technical pricing considerations.

Conclusions and Recommendations

21. We have highlighted above some of the practical considerations arising from the proposed legislation.
22. The Profession is concerned that some of the potential solutions envisaged in the proposed legislation may not be workable in practice.
23. The Profession recommends that a report be commissioned from independent experts to explore the practical issues around the potential legislation in more depth.

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Appendix

Further information about The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London. An examination system is supported by a programme of continuous professional development and a professional code of conduct.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles - from simple deposits through to complex stock market derivatives.

A majority of actuaries work for insurance companies or pension funds - either as their direct employees - or in firms which undertake work on a consultancy basis.