The Actuarial Profession
making financial sense of the future

consultation response

Government Equalities Office

Equality Bill: Making it work

Ending age discrimination in services and public functions

Response from the UK Actuarial Profession

September 2009

PROFORMA FOR AGE CONSULTATION RESPONSES

The consultation closes on 30 September 2009. Please let us have your response by that date.

When responding, it would be helpful if you could provide the following information.

Please fill in your name and address, or that of your organisation if relevant. You may withhold this information if you wish, but we will be unable to add your details to our database for future consultation exercises.

Contact details:

Please supply details of who has completed this response.

Name of organisation (if appropriate):	The Actuarial Profession (General Insurance Practice Executive Committee)
Address:	Staple Inn Hall High Holborn London WC1V 7QJ
Contact phone number:	020 7632 2177
Contact e-mail address:	peter.stirling@actuaries.org.uk
Date:	28 September 2009

Confidentiality

Under the Code of Practice on Open Government, any response will be made available to the public on request, unless respondents indicate that they wish their views to remain confidential. If you wish your response to remain confidential, please tick this box and say why. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

I would like my response to remain confidential (please tick if appropriate): ☐

Please say why

In what capacity are you responding (please tick if appropriate)?

As an individual ☐

On behalf of an organisation ☒

As an employer ☐

Other (please specify)

This commentary is provided by the Faculty and Institute of Actuaries. 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 legislators.

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.

Note:

- In addition to the completed proforma, you can also send other supporting information if you so wish.

Thank you for completing this response form.

Financial services

Question 4: Which of the following high levels options do you prefer, and why: Option 1 (strict implementation of the ban on age discrimination, with no specific exception), Option 2 (a tailored specific exception allowing age to be used provided that it is proportionate to risk and costs) or Option 3 (a wide specific exception, which would mean that all current practices could continue)? Please state your reasons.

Please place a cross in the appropriate box

Option 1		Option 2		Option 3	X	None of them	

Option 1

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 there is substantial statistical evidence gathered over many years linking age to 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, sometimes materially so. Not only could this be argued to be unfair, but it could also result in changed behaviour that does not benefit society, 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. This could result in increased road accidents, suffering for those affected, increased costs for the public services, and higher insurance premiums for all.

Option 2

Although Option 2 appears reasonable, we have material concerns over how this would work in practice, depending on the exact implementation of restrictions in this area. We believe that there could be a number of unintended consequences of any legislation which attempted to regulate rates in this way.

Background

General insurance in the UK is currently priced using a range of interrelated rating factors, including both those asked for at the point of sale and also those derived indirectly, eg from a customer's postcode. The number of factors considered can be quite large (for example often 20 to 30 or more in the case of motor insurance). Where insurers have appropriate internal data, detailed statistical analysis techniques are used to assess the effect of each factor on the risk, making allowance for the fact that any one rating factor may be correlated with other rating factors being considered (for example younger drives may tend to drive older cars) and making allowance for the fact that the effect of one factor may be interdependent on another (for example a 20 year old may be twice the risk of a 40 year old when driving a Fiesta but five times the risk when driving a Ferrari.)

Comparing the overall claims experience by age with the overall premiums charged by age (as was done in section 4.2.2 of the Oxera report) does provide an overall indication of whether a particular age group is being over-charged or under-charged relative to another age group, but it does not consider whether this is due to the loadings used for age or whether this results from differences in other correlated rating factors such as (in the case of motor insurance) type of vehicle, age of vehicle, use of vehicle, mileage driven, policy excess selected, No Claims Discount, additional drivers, marital status etc.

We feel that whilst considering summary information by age does provide a helpful indication of whether there is an overall cross-subsidy from one age group to another, it does not form a sound basis upon which to assess the age loadings which are being used by any particular insurer. This can be illustrated by considering the current UK legislation introduced in response to the EU Gender Directive. This requires that, for a particular age group, the premium differentials for men vs women be "proportionate" to the claims experience for men vs women. It would be quite possible for an insurance company not to rate by gender at all, yet to fall foul of this test because (perhaps unknowingly) it used an inappropriate premium loading for another factor (such as size of engine) which was correlated with gender.

Concerns

Our concerns with Option 2 can be summarised as follows:

- An understanding of the effect of rating factors on claims experience is a source of competitive advantage and as a result there is currently no data in the public domain which is appropriate to provide sound justification of the use of any particular set of age related premium loadings. Data from other markets will be of limited relevance given that the loadings that are appropriate for age depend upon the other rating factors being used, the nature of the product coverage, and general market differences in claims experience.
- A requirement to publish appropriately detailed data would force existing insurers to disclose commercially sensitive information not relating to age which could reduce competition and which could also potentially contravene existing competition regulations.
- Smaller or newer companies, or companies starting to write business to age groups they have not previously underwritten, will not have access to internal (or external) data to provide sound justification of the use of any particular set of age related premium loadings. If a requirement to provide objective justification of age loadings were introduced, 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 sound statistical basis. This means that an inadvertent consequence of Option 2 could be to increase barriers to entry and to reduce competitiveness.
- Larger companies will have access to appropriate internal data, however demonstrating that age loadings used in premium rates are proportionate to risk costs requires a detailed statistical analysis that is hard to specify within legislation and cannot adequately be demonstrated by referring to summary statistics by age.
- More generally, we believe that insurers, and professionals, are becoming increasingly wary of litigation. If insurers feel at risk of legal challenge, perhaps via class action, over the sufficiency of data to justify premiums, or of the interpretation of the meaning of legislation in the context of many correlated rating factors, then those insurers may well choose to withdraw certain products from the market, reducing competition and consumer choice.

Option 3

Oxera concluded that there is not currently any systematic under-charging or over-charging of particular age segments in motor and travel insurance (these being the two general insurance classes of business which are most relevant to the debate). Given this, and given our above concerns with Options 1 and 2, we believe that Option 3, the status quo, is preferable.

We do, however, feel that insurers could improve the manner in which they communicate with their policyholders some of the reasons why rates change with age, and that also the publication of some overall market level data could be helpful. We discuss these further in our responses to Questions 13 and 14 below.

If, for reasons of social policy, the government or society feels that premiums which reflect risk are unacceptably high for certain segments of society (eg very old people wishing to travel internationally) then the state could subsidise an element of the insurance cover directly or indirectly via appropriate incentives to insurers. The topic is considered in more detail in the recent report "Vision for the insurance industry in 2020" from the Insurance Industry Working Group.

Question 5: Do you believe that the following is an adequate description of what might be acceptable evidence: "acceptable evidence should be about a risk identified by actuarial, statistical, medical or other information relating to the person's age. It should include public or private empirical, actuarial, statistical, qualitative research or other material or data, and evidence of costs, including but not limited to administrative or operating costs. It could be from UK or international sources, based on industry-wide data, firm-specific data or the experience of another firm, provided that it was relevant, accurate and from a source upon which it was reasonable to rely"? Please state your reasons and if there are other factors that should be included or whether some elements should be removed.

Please place a cross in the appropriate box

Strongly agree	Agree	Neutral	Disagree	Strongly disagree
			X	

Our concerns in this area, including the issue of unavailability of appropriate data and the anti-competitive consequences of disclosing such data, are discussed in our response to Question 4 above, extracts from which are repeated below.

- An understanding of the effect of rating factors on claims experience is a source of competitive advantage and as a result there is currently no data in the public domain which is appropriate to provide sound justification of the use of any particular set of age related premium loadings. Data from other markets will be of limited relevance given that the loadings that are appropriate for age depend upon the other rating factors being used, the nature of the product coverage, and general market differences in claims experience.
- A requirement to publish appropriately detailed data would force existing insurers to disclose commercially sensitive information not relating to age which could reduce competition and which could also potentially contravene existing competition regulations.

- Smaller or newer companies, or companies starting to write business to age groups they have not previously underwritten, will not have access to internal (or external) data to provide sound justification of the use of any particular set of age related premium loadings. If a requirement to provide objective justification of age loadings were introduced, 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 sound statistical basis. This means that an inadvertent consequence of Option 2 could be to increase barriers to entry and to reduce competitiveness.
- Larger companies will have access to appropriate internal data, however demonstrating that age loadings used in premium rates are proportionate to risk costs requires a detailed statistical analysis that is hard to specify within legislation and cannot adequately be demonstrated by referring to summary statistics by age.
- More generally, we believe that insurers, and professionals, are becoming increasingly wary of litigation. If insurers feel at risk of legal challenge, perhaps via class action, over the sufficiency of data to justify premiums, or of the interpretation of the meaning of legislation in the context of many correlated rating factors, then those insurers may well choose to withdraw certain products from the market, reducing competition and consumer choice.

Question 6: Do you think that age based pricing should not require strict mathematical proportionality?

Please place a cross in the appropriate box

Yes	X	No		Not sure	

We believe that demonstrating mathematical proportionality is problematic for all the reasons given in response to Question 4 above.

Additionally, we believe even if the exact effect of age on claims experience were known and demonstrable there are several good reasons why the resulting premium should not necessarily be directly proportional to the claims cost. These include:

- the use of fixed monetary loadings reflecting the fixed element of the expense of administering the policy
- considering the expected period for which the customer may remain with one insurer (eg young policyholders tend to change insurer more frequently, decreasing the period over which the marketing costs of acquiring the policy can be spread)
- marketing activity which directly or indirectly results in commercial discounts being offered for different age groups.

Question 7: To what extent do you think that commercial considerations should be allowed to be taken into account in financial services provision and which factors should be permitted?

Please place a cross in the appropriate box

Should be allowed very widely		Should be used widely	X	Just used where appropriate		Should be Controlled		Should not be allowed	

As discussed above, we believe that there are good reasons why premiums should not necessarily be proportional to claims costs. Additionally we believe that allowing insurers to vary price away from the theoretical technical cost of writing the policy increases competition and ultimately benefits all consumers through lower prices and the wider range of products on offer.

Question 8: Do you think restrictions should be placed on the use of age bands within financial services provision? If so, please state your reasons, with examples where relevant.

Please place a cross in the appropriate box

Yes		No	X	Not sure	

From a pure actuarial perspective, we believe that actuarial techniques could be used to replace the use of age bands with premium rates calculated individually for each age.

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 and that imposing restrictions on the way in which age bands are used could reduce the availability of some forms of insurance and could reduce competition.

Question 9: What are your views on the advantages and disadvantages of narrowing age bands? What size should the age bands be (eg. 1 year, 2 years, 3 years, 4 years, 5 years)? Where risks are broadly similar, is a wider age band reasonable? How could firms justify a particular banding structure?

Please place a cross in the appropriate box

1 year		2 years		3 years		4 years		5 years		Other	X

For some products there may some ranges of age where risk does not vary very much and where a wide range might therefore approximate to the theoretically correct price. For other ages it may vary quite a lot from year to year. Insurers may want to use bands of different width over different part of the age range and this could be perfectly reasonable in terms of matching risk.

However as discussed in our response to Question 8, 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 and that imposing restrictions on the way in which age bands are used could reduce the availability of some forms of insurance and could reduce competition.

Question 10: Do you think that firms should be able to continue to set minimum and maximum age limits for products – quoting only to people within those age limits? Please state your reasons why with examples where relevant.

Please place a cross in the appropriate box

Yes	X	No		Neutral		Not sure	

Background

Insurers are 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.

Actuarial techniques are in general used to analyse the expected cost of claims based on past claims experience. Such methods are, however, 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.

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 (including brand) more generally.

Concerns

Our concerns set out in response to Question 4 would be exacerbated in the event of insurers being required to provide insurance quotations for all age groups. This is not only the case for insurers, such as Saga, that specialise in one age group, but all insurers. There are, for example, very few 95 year olds driving so, by definition, few if any insurers have sufficient data to rely solely on statistical techniques. Few insurers 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 are likely to have very little, if any, data on 80 year olds taking skiing holidays.

If a requirement to provide objective justification to age loadings were introduced, many 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 sound statistical basis for certain segments of their portfolio.

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.

Additionally, being required to quote for all ages could necessitate the introduction of more detailed underwriting assessment in the sales process. The expertise, resource and changes to the distribution process which this would require could result in may insurers withdrawing from offering the entire line of insurance for some classes, such as travel, thus reducing consumer choice and price competitiveness in the market.

Question 11: Should age-related special offers, such as age-related saver accounts and marketing still be permitted? Please state the reasons for your answer.

Please place a cross in the appropriate box

Yes	X	No		Not sure	

To the extent that this question relates to general insurance please see our response to Question 7.

We believe that allowing insurers to vary price away from the theoretical technical cost of writing the policy increases competition and ultimately benefits all consumers through lower prices and the wider range of products on offer.

If not all insurers offer cover for all age groups, then specialist companies are likely to move into areas that are not universally served, which will increase consumer choice. Not allowing age-based marketing would make it hinder this, which would not be in the consumer's interest.

Question 12: Do you think signposting and / or referrals would be helpful for customers looking for various financial services? Which do you prefer? How do you think such a system could best be set up?

Please place a cross in the appropriate box

Yes	X	No		Not sure	

If you answered 'Yes', which do you prefer?

Signposting		Referrals		Both	

We note the Oxera conclusion that there is an adequate supply of insurance at all ages and that the issue is more related to linking the demand to the supply than it is to a shortage of supply. We think that the issue of whether signposting or referrals (or both) is preferable is more an issue for the Association of British Insurers (ABI), individual insurers, brokers and consumer groups to debate.

Question 13: Do you think a requirement to publish data at industry level would serve a useful purpose for consumers and/or the financial services industry? Please state your reasons. If yes, what sort of data would you like to see published?

Please place a cross in the appropriate box

Yes	No	Neutral	Not sure
X			

As discussed in our response to Question 4, we do not believe that it would be appropriate or practical to publish data which would allow appropriate justification of the age loadings used by any one insurer.

We do, however, feel that it would be helpful if the UK insurance industry as a whole published summary data to demonstrate broadly, and at a market level, the relationship between premiums charged and claims incurred by age groups. Specifically we feel that graphs setting out loss ratios (the ratio of claims incurred to premiums earned) like those shown in figures 4.13 to 4.16 of the Oxera report should be produced periodically by an industry body such as the Association of British Insurers.

The production of such graphs would identify whether or not there was an overall market failing for any age group. Oxera's conclusion from such graphs was that "For both motor and travel insurance, there is no evidence of a systematic overcharging of certain age groups. If there is a bias in pricing relative to the risk and cost of provision, it tends to work in favour of older people (as well as the young in the case of motor insurance)". If this continued to be the case, this could continue to provide comfort to consumers that no age group was being systematically overcharged. If failings in the market did develop, such graphs could identify such failings and could highlight commercial opportunities to new entrants and existing insurers which could help alleviate such failings.

We believe that the publication of anything more detailed than this would have little additional benefit and would result in insurers ceding competitive information which ultimately would not be in consumers' interest.

Question 14: Do you think that there is a better or alternative method of achieving greater transparency, to increase confidence that age is being used appropriately within financial services?

Please place a cross in the appropriate box

Yes	No	Not sure
X		

We believe that overall confidence that age is being used appropriately within financial services could be increased if insurers improved their communication with their policyholders (either directly or indirectly via the ABI) and provided more explanation of the link between rating factors such as age and the risk being insured. As an example, few policyholders may appreciate that travel insurance claims are dominated by the costs of medical expenses, and that these increase dramatically with age. Simple explanations of this (perhaps supported with graphs such as those in figure 4.10 of the Oxera report) could address some of the perceived issues around fairness of rates.