The Actuarial Profession

making financial sense of the future

Consultation Response

HM Treasury

UK response to the 1 March European Court of Justice ruling on gender-neutral insurance benefits and premiums

1 March 2012

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

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.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. 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 – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Test Achats Consultation Responses
C/O Sandra Holben
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1 March 2012

Dear Sandra

UK response to the 1 March European Court of Justice ruling that insurance benefits and premiums after 21 December 2012 should be gender-neutral

On behalf of the Institute and Faculty of Actuaries (the Actuarial Profession), we welcome the HM Treasury consultation document on the UK Government's response to the ECJ ruling on gender-neutral pricing in insurance. We also welcome HM Treasury's aim to provide draft legislation at an early stage and we are grateful for the opportunity to comment on this. We have set out the response from the Actuarial Profession in the attached document.

The Actuarial Profession has two working parties currently focusing on this topic, from the different perspectives of Life Insurance and General Insurance. The attached response outlines the Profession's contribution from each of these areas and, where there are different considerations for each practice area, the response has been presented under separate Life Insurance and General Insurance sections.

We hope our contribution will be of interest as you seek to develop the UK Government response to this complex matter. If you have any questions about the content or if you wish to seek further views from us, please contact Sarah Mathieson, Policy Manager at the Actuarial Profession, on 0131 240 1301 or sarah.mathieson@actuaries.org.uk.

Yours sincerely,

D.Anderson

Duncan Anderson

Chairman, General Insurance Practice Executive Committee

Dave Grimshaw

Chairman, Gender Directive Working Party of the Life Practice Executive Committee

Institute and Faculty of Actuaries response to a consultation on:

UK response to the 1 March European Court of Justice ruling that insurance benefits and premiums after 21 December 2012 should be gender-neutral

Introduction

This response is made on behalf of the Actuarial Profession in the UK. Those individuals who have contributed to this response have done so in their capacity as members of the Profession. We have set out below our comments on the HM Treasury (HMT) impact assessment and also where we believe that the transition to gender neutral pricing may have unintended consequences on consumers. Where relevant, we have also referred to the recent communication from the European Commission on this topic[1] (referred to below as "the EC guidelines").

A number of the questions in the consultation relate to legal matters: whilst we would prefer to leave comment on the draft legislation to those with a legal qualification, we have provided comments on all the questions. In particular, there are a number of areas of uncertainty arising from the proposed legislation which we think have the potential to create issues for consumers and the market.

We concur with the UK Government view that preventing the use of gender as a rating factor in insurance is unlikely to produce benefits for UK consumers or for the insurance industry. It may also give rise to an increased level of legal uncertainty and a number of possible areas of detriment, which are highlighted in our response.

Executive Summary

The general insurance product that is expected to be affected the most, if not exclusively, by the implementation of the ECJ ruling is motor insurance. The impact on the market of the ECJ ruling could include potentially large volumes of loss-making business to insurers and a spike in cancellations. There may also be changes in consumer behaviours that are currently difficult to predict. An example of the impact could include changes in the number of uninsured drivers. Another example could involve gender neutral pricing leading to more powerful cars becoming more affordable to young men, with the risk of an increase in loss of life from road traffic accidents.

We expect the impact on the term-life market to be limited. The current spread of prices across providers of term assurance products is probably wider than the difference that we would expect unisex pricing to bring. In addition, the high proportion of joint life policies will also dampen the impact. However, the true impact of the ECJ ruling will be difficult to ascertain owing to other regulatory and legislative changes that occur around the same time. These include the implementation of the Solvency II rules, the introduction of the rules arising from the FSA's Retail Distribution Review (RDR) and changes to the "I-E" taxation rules for life insurance companies.

The implications for annuities are less clear. One area to which we would like to draw your attention is the potential uncertainty regarding the treatment of annuities purchased by trustees of occupational pension schemes. These are subject to pensions legislation and hence may fall outside the scope of the current legislation: if so, our understanding is that these will not be subject to gender-neutral pricing. We would encourage HMT to clarify if that is its understanding. Such a disparity between trust-based and contract-based pensions could alter behaviours at retirement, as well-advised individuals seek better annuity rates. We would encourage an understanding of any potential market distortion arising from this. The distinction between annuities purchased by individuals and those purchased from occupational schemes may also be something that HMT needs to consider when analysing any market data on annuities. We believe that some providers do not necessarily show these as separate categories because currently the same annuity product will be offered to the two categories of pension scheme.

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[1] "Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats)" published on 22 December 2011

Indirect discrimination is a complex area as many of the risk factors that insurers use may have a disproportionate effect on one gender. We recognise that insurers may need to consider the position of each of their risk factors individually. There may be a period of uncertainty as the legality of each risk factor can ultimately only be determined by the courts. We would welcome any guidance from HMT in this respect.

In terms of practical implementation, there could be a number of interpretations of how to deal with new policies and changes to existing policies. We would welcome any further guidance on how to manage "pipeline" cases when the rules take effect.

Question 1: As part of this consultation process, the Government would welcome views on whether the impacts set out in the impact assessment, and the underlying assumptions, are reasonable. The Government would welcome any data that would help us get a better understanding of whether our assumed market impact is correct. We are, in particular, seeking data on two key areas:

> **a) the number of term life policyholders and annuitants, and the gender mix, to allow extrapolation to estimated aggregate impact; and**
>
> **b) industry implementation costs.**

1.1. GENERAL INSURANCE

1.1.1. Nature of motor insurance

Within General Insurance, the impact of gender neutrality falls almost entirely within motor insurance, as other products, such as household insurance, differentiate far less by gender, if at all.

We note that motor insurance is increasingly a third party liability cover, with the majority of claims costs relating to payments to cover the liability of the insured to a third party (in respect of either bodily injury or property damage) rather than payments to the insured in respect of their own losses. This has consequences for the interpretation of benefits under motor insurance policies.

In particular we note that paragraph 17 refers to younger males being more likely to "suffer" death or serious injury, when in the context of the cover provided by an insurance policy. We suggest that this should read "cause" death or serious injury.

1.1.2. Equality of premiums and benefits

In a number of places, the ECJ ruling refers to equality of both premiums and benefits. In the context of UK motor insurance, it is not possible in practice to achieve both equality of premiums and the value of the benefits simultaneously.

Take, for example, a young female driver and a young male driver. Under a UK motor policy, by legislation, both will have a benefit of unlimited third party bodily injury cover. However, the expected value of such a benefit is very different, with that of the young male driver being substantially higher than that of the young female driver. As the value of the benefit depends on the riskiness of the driver, there is no action that an insurer can take to force equality of the value of the benefit. Current market practice is to attempt to reflect the relative riskiness by price differentiation instead.

This contrasts with fixed value benefits payable under some types of life assurance, whereby the insurer can force both equality of monthly premium and fixed benefits (measured from the perspective of an individual policy holder) simultaneously (albeit that this nevertheless introduces cross subsidies).

Note that even in this example, the total premium paid will be on average less for males due to the shorter life expectancy, all other things being equal.

1.1.3. Uninsured driving

For some insurance products, the consumer has the choice not to purchase. This is not the case for third party liability motor insurance, which is a legal requirement in the UK. Legally leaving the market can only be done by choosing not to own a vehicle or registering it as off-the-road. However, some consumers (particularly younger drivers with the highest premiums) may choose to leave the market illegally by driving uninsured.

The increase in young female premiums may increase uninsured driving within this group. Conversely, the decrease in young male premiums may decrease the uninsured driving within that group. It is possible that the increase in female uninsured driving exceeds the decrease in male uninsured driving, given that the expectation is that increases in female premiums will be greater than decreases in male premiums. The net effect of gender neutrality may therefore be to increase the overall level of uninsured driving. This may be further exacerbated by the possibility that once comfortable with the idea of driving uninsured, it will require more than a modest decrease in premium to encourage uninsured drivers back to the insurance market.

It should be noted however that this effect may be reduced by the recent introduction of Continuous Insurance Enforcement, which makes registered keepers of vehicles responsible for ensuring their vehicle is insured and liable to be contacted if it appears it is not insured.

The consequence of any increase in uninsured driving will be an increase in claims being made to the Motor Insurers Bureau (MIB). This will increase the MIB levy on insurers, which in turn would be passed on to the premiums of those who continue to purchase insurance.

1.1.4. Pricing Risk

Paragraph 1.10 of the Introduction suggests that “The lowest-risk categories of consumer, who stand to lose the most from this change, may in some cases leave the market or take a lower level of cover, which will affect revenues taken by insurers. Insurers with a largely low-risk pool (for example in motor insurance, those solely targeting females) may initially be able to minimise losses by providing a more competitive quote than those composed largely of a higher-risk pool. However this may then attract higher risk customers, which would change the overall risk pool and consequently lead to increased premiums”

We believe that insurers understand that the gender profile of the pool of risks they write may change as a result of gender neutral pricing and are therefore unlikely to charge a gender-neutral price that assumes their current gender profile. They are likely to adopt a strategy designed to mitigate the risks associated with a changing profile (although the detail of that strategy is likely to differ between insurers).

The Impact Assessment notes in paragraph 21 that in motor insurance the compulsory nature of the cover eliminates the impact of adverse selection. Although the motor market as a whole may not be exposed to adverse selection, individual insurers could be exposed to the risk of under-pricing as a consequence of writing a higher risk pool of risks than anticipated in their price.

Owing to the highly competitive nature of the UK motor insurance market, and the existence of price comparison sites that enable consumers very easily to identify cheaper premiums where they exist, there could be vicious financial consequences for those that under-price policies. It is possible to write large volumes of loss-making business very quickly.

1.1.5. Transitional Costs

The consultation refers to the industry incurring transitional costs (paragraph 1.10). Such costs may well be passed on to the consumer.

We would suggest expanding the list of costs to include the cost of determining and implementing a gender neutral strategy. This could include, for example, the investigations required to determine the approach to mitigate the impact of a changing gender profile and the frictional costs of implementing ongoing selective marketing actions.

1.1.6. Impact on policy cancellation rates and policy renewal rates

Gender neutral prices will apply to new contracts after 21 December 2012. As a result, it may be in the interests of some policyholders to cancel their existing policy shortly after this date and to purchase a new otherwise identical policy. This will contribute to insurer expenses and may result in a further short term increase in overall premium levels.

Similarly, we anticipate that the transition to gender neutral pricing may also increase the extent to which policyholders switch insurers on renewal. It is more costly for insurers to issue new policies than to renew existing policies. A lower average renewal rate across the market would increase average expenses and in turn contribute to higher overall premium levels.

1.1.7. Magnitude of impact on premiums for young policyholders

For young males, we feel the Impact Assessment could appear sometimes contradictory – e.g. paragraph 1.9 refers to young male premiums falling, but paragraph 22 implies this is negligible. We think that the actual magnitude of any decreases in male premiums will depend in part upon the strategies that insurers adopt to mitigate the risk of a changing gender profile.

The Impact Assessment notes both the competitive and loss making characteristics of the industry. It is therefore unclear as to how the industry might respond to gender neutrality. However, it should be noted that the younger driver market tends to produce some of the biggest claims and is also associated with greater uncertainty of outcome. It is therefore reasonable to assume that in this market segment insurers may be less inclined to compete vigorously on price than in other segments.

The UK market has seen in recent years the introduction of niche usage-based insurance products, aimed at the young driver market, which make use of telematics technology installed in the vehicle. In the longer term, these products will enable insurers more accurately to price the risk presented by young drivers, by reference to individual driving characteristics, mileage and road trip information, and without reference to gender. However, the need for the installation of cost-effective devices and the development of an associated IT infrastructure and consumer proposition means that these initiatives are likely to have little impact on the pricing and overall cost of insurance in the coming months during the transition to gender neutral pricing.

1.1.8. Impact on capital requirements

The removal of a known and established risk characteristic, such as gender, reduces the accuracy with which an insurer can price a policy. As part of the pricing process, an insurer will now need to make an assumption about its expected business mix between genders. This in turn builds additional uncertainty into the resulting claims experience (ie the clams experience may vary from expected because the mix of business by gender is different). Insurers are required to set aside capital to protect against the downside of uncertainty. The cost of providing such capital is one aspect of the premium that insurers charge. We would therefore expect the increased uncertainty in pricing brought about by gender neutral pricing to increase the cost of capital that will need to be allowed for in the premium charged to all policyholders.

Further uncertainty may be introduced by the impact of gender neutral pricing on lump sum settlements of claims. If we assume that these will be determined using gender neutral annuity rates, then this may encourage a greater proportion of women to seek periodical payment orders. This introduces further uncertainty in the final cost of claims and hence the cost of capital that will need to be allowed for in the premium charges to all policyholders.

1.1.9. Interpretation of Figure 4

Figure 4 reproduces a graph that was published by the ABI in Research Paper no 24, 2010. The source of this graph (as credited in that ABI paper) is research carried out by EMB, a firm of consulting actuaries, now part of Towers Watson. As described in the ABI paper, that research was, with the permission of the contributing companies, based upon data first collected from several major insurers in 2008 in connection with an Institute of Actuaries Working Party.

It is important to note the correct interpretation of Figure 4. It presents the average percentage change that different age bands of policyholders might experience if premiums moved from gender differentiated rates to gender neutral rates, without factoring in the actual strategies that insurers might adopt in practice. The results reflect the simple scenario that all insurers move to an average rate based on their existing risk profiles, without attempting to protect themselves from the impact of a changing gender profile.

The percentage increases for young females are greater than the percentage decreases for young males as young female premiums currently being charged by the market are lower than those being charged for young males. The percentages also depend upon the gender profile as contained in the data contributed to the study. There has been no attempt within the study to factor in causes of increases in overall premium levels, such as strategies to counter a change in gender profile, increased capital costs, transitional costs, higher transaction costs as, or if, insurers attempt to influence their gender balance through additional marketing or the application of more expensive risk prediction processes (e.g. telematics, psychometric testing) or potential higher MIB levies.

We would also like to make the following further comments on the calculation of the net cost to motorists. We are unsure from the table whether the DVLA data has been adjusted to allow for:

- those drivers who do not have an insurance policy in their own name (but drive as named drivers on the policies of other drivers)
- those drivers who are uninsured (we would expect the impact of this to vary by age, with there being a greater proportion uninsured at the youngest ages)

Because the Average Premium data, the Number of Policyholders data, and the Average Percentage Data are derived from different sources, the data within the calculation is not internally consistent. This has resulted in the new premiums calculated in the analysis (Average Premium adjusted by the calculated Change in Premium) not being gender neutral. For example, for ages 17-25, Males have a new premium of £1902 (£2090-£188) whereas Females have a new premium of £1686 (£1360+£326).

1.1.10. Impact on road deaths

There is a risk that, under gender neutral pricing, the decrease in premiums for young male drivers could lead to greater affordability of more powerful vehicles for this segment. This may have an impact on the driving behaviour of these young men, which could potentially lead to a greater number of motor accidents, particularly involving loss of life. This has the potential to undo recent progress made in the UK in this respect. However, the extent of this risk and if it is likely to be sustained over a period of time would require further investigation.

1.1.11. EU Commission Guidance

Paragraph 25 of the guidance from the Commission for the interpretation of the gender ruling states that "The Commission would like to encourage a competitive and innovative industry such as the insurance sector to make the necessary adjustments and offer attractive unisex products to consumers without an unjustified impact on the overall price levels. The Commission will remain vigilant in following the evolution of the insurance market in order to detect any unjustified rise in prices attributed to the Test-Achats ruling, including in light of the tools that are available under competition law in the event of alleged anti-competitive conduct"

The Actuarial Profession notes that there are many justifiable explanations for an impact on overall price levels, as outlined in both the Impact Assessment and the comments made in this response.

1.2. LIFE INSURANCE

The proven causality between gender and mortality, in particular, means that preventing life insurers from using gender could have the potential to distort the market. However the Actuarial Profession considers that gender differentials in life insurance premiums are potentially less significant than other rating factors, such as age and disability. We would suggest that the inability to use age and disability as rating factors would present a far greater threat to a competitive life insurance market.

1.2.1. The number of term life policyholders and annuitants, and the gender mix

The Actuarial Profession currently does not possess detailed data on the requested business mix. However, we consider that both markets are segmented so that any high-level, aggregate analysis for each of the term assurance and annuity markets may not capture the true impact.

We would like to make a number of comments on the possible impact of the changes on the UK market place. The changes can be considered in three parts:

- There is likely to be a cost to consumers in respect of any additional loadings applied by insurers to cover the new risk that insurers will now carry of an uncertain gender mix;
- There will be a cross-subsidy between the genders; and
- The change in price may impact on the behaviour of consumers and insurers.

The third factor is the most difficult to assess since it depends on the interpretation of the legislation, for example in relation to employment-related purchases, and whether there are barriers to prevent EU consumers purchasing insurance from outside the EU on gender-specific rates.

We would suggest that this combination of changes makes the impact unpredictable. It may also be very difficult to assess the true impact of the move to gender-neutral rates after the event, owing to other changes affecting the insurance market:

- Solvency II will impact the capital requirements of insurers. This is due to take effect from 1 January 2014, but it applies to all business on insurers' books, and so the impact of the change will gradually influence the prices of long-term insurance during the period leading up to its implementation;
- The introduction of the FSA's Retail Distribution Review (RDR) rules on financial advice is expected to alter the dynamics of the broker marketplace.

1.2.2. Term-Life

At a high-level we note that, in monetary terms, the overall cost to consumers is expected to be the additional loadings applied by insurers to cover the additional risk insurers will now carry. As noted in the consultation document, it will be difficult for insurers to estimate the gender mix they will receive, particularly early on in 2013, and so it would be prudent and reasonable to take an additional margin to protect against getting it wrong. We think this margin may vary between insurers, not just because of different perceptions of the risk but also because some insurers may consider that their distribution process provides a more predictable gender mix. This margin has not been required previously and so this is an additional cost that insurers could seek to pass onto the consumer in order to maintain profitability. The protection market is approximately £800m of new business a year – a 1% charge on this business, over the lifetime[2] of the policies written would amount to approximately an extra £40m of present value of premium for consumers to pay.

In addition to the general changes in the market, noted above, we note that the change to gender-neutral premiums occurs at almost the same time as the removal of protection business from the I-E tax regime. This is expected to increase the price for Term Life Insurance and Accelerated Critical Illness policies by around 10%; which may create more market distortion than the move to gender-neutral pricing.

For Term Life insurance we believe the overall impact of gender-neutral pricing will be relatively limited in terms of impact on market volumes. Generally we note that there is no alternative product for life insurance and so consumer needs tend to drive the purchase. There is, however, the view that the purchase of life assurance for personal purposes is budget constrained and so we may see males purchasing slightly more cover and females slightly less. For mortgage related insurance purchases, the cost of insurance is generally small relative to the overall mortgage outgo and so we would expect little impact on these cases.

Considering the case of single life policies, we note that the possible magnitude of price changes, on the introduction of unisex rates, may be less than the current differences between insurer quotes today. This further reinforces our suggestion that market impact will be limited. Table 1 below illustrates this for a 40 year old. The unisex rates are calculated assuming a 50%/50%[3] male female mix, with a 2% loading for business mix risk. No allowance is made for I-E tax changes. As this illustrates, male rates are projected to decrease by around 8% which is the same magnitude as the difference between the cheapest and 3rd price quote. For females the increase is around 11%-15% which is broadly the difference in price between the 1st and 5th place quote.

Table 1 Current market premium rates and possible unisex premium rates for a life aged 40 buying a 20 year policy with a £150,000 sum assured.

	Male			Female			Possible Unisex Rate			
	Rank	Premium	Difference to 1st	Rank	Premium	Difference to 1st	Rank	Premium	Difference to Male Rate	Difference to Female Rate
Aviva	1	13.09	0%	2	11.14	1%	1	12.36	-6%	11%
LV=	2	13.71	5%	1	11.07	0%	2	12.64	-8%	14%
Bright Grey	3	14.83	13%	4	11.85	7%	3	13.61	-8%	15%
Legal and General	4	14.94	14%	3	11.84	7%	4	13.66	-9%	15%
Aegon	5	15.7	20%	8	No Quote					
Ageas	6	15.73	20%	6	13.45	21%	6	14.88	-5%	11%
PruProtect	7	15.85	21%	5	13.11	18%	5	14.77	-7%	13%
Scottish Provident	8	16.9	29%	7	13.64	23%	7	15.58	-8%	14%

Source: Direct Life and Pensions Website – accessed 23 January 2012.

Expanding our view away from single life policies we would expect joint life cases to be largely unaffected by the change because the vast majority of joint life policies consist of one male and one female. Overall data that we do have suggests 30% of policies written are joint life policies. This proportion is higher for mortgage related sales and lower for personal protection sales.

We note two areas of uncertainty which may have a larger impact on the market size and premium considerations:

- The extent to which business related covers can and will remain on gender-neutral terms – if purchased through a company then it is assumed that, as a business to business transaction, gender differentiated terms will be permitted.

[2] We have used a factor of 5 to convert one year of premium into the total present value of expected income over the lifetime of a policy. This factor allows for discounting and lapses.
[3] The mix is based on quotation data we have available to us and reflects the proportion of single life male or female quotes in the market in Q1 2011. The proportion varies in accordance to a range of factors; most notably at higher sums assured the mix is more male orientated.

- The extent to which sales of products priced using gender differentiated terms from other territories will be permitted and, indeed, successful in the UK market.

In making the comments above we have concentrated on Term Life Insurance as this is the largest product line and the product line highlighted in the consultation document. We would suggest that comments in respect of Term Life Insurance can be read across to Accelerated Critical Illness insurance, which is in many ways similar in terms of gender margins and the drivers for purchase.

The one long-term protection product line that we think will behave differently is Income Protection Insurance. With Income Protection insurance we note a far wider gender differential and that indeed the gender differential works the opposite way to the other protection products – that is females are typically charged a rate between 50% and 100% more than males. Additionally, Income Protection already falls outside the I-E tax regime and so will be unaffected by the life insurance company taxation changes. Income protection is also the smallest of the protection lines of business. The key difference for Income Protection is that gender neutral rates could be at a significant discount to the current female rates meaning lapse and re-entry could be a very real issue.

1.2.3. Annuities

We have estimated the number of annuitants buying individual annuities from Insurance Companies in 2012 to be 450,000 with total premiums of £13bn. Market data is difficult to obtain, in part because a proportion of pensions savings policies convert to annuities with the same insurer and consequently are not recorded as “new business”. Many of these annuities are purchased around retirement age and, as discussed in our response to Q6, below, it is unclear to us which of these will be affected by this legislation. If annuities purchased by trustees for members of occupational schemes are not covered by this legislation, the impact could be difficult to quantify. Many annuity providers may not currently hold information about the source of the pension fund. There could also be potential changes in purchasing behaviour as well-advised individuals seek better annuity rates.

There is a wide divergence in individual premium sizes and with the option for policyholders to take out single life or joint life policies. Accordingly the gender mix is difficult to estimate and may not be representative without a very granular analysis. Approximately 55% of new policies are joint life, with this proportion increasing over recent years and we would expect this trend to continue. Of those joint life policies the majority (estimated at 75%) have male first life. The impact on a joint life policy of gender neutral pricing is expected to be materially less than for single life policies. For the single life policies, the gender split is less dominated by males with approximately 65% male policyholders and 35% female policyholders. We think the situation is further complicated by differences in the proportions of males taking out annuities at different ages. At age 60, the proportion of females is higher than at age 65 owing to the historical retirement ages of males and females in occupational pension schemes and state pension provision. Although this difference in retirement ages is expected to reduce in time, it will probably take a number of years to do so. We also think that gender-neutral annuity rates could affect consumer behaviour, with males becoming less likely to purchase annuities.

The difference between an annuity offered to a male life and a female life with the same age varies by the life expectancy. Therefore for older policyholders, or those with reduced life expectancy due to illness, the difference between a male and a female annuity may be up to 13% per year. For younger lives who are healthy the difference falls to around 6% or lower. Where an annuity increases at a fixed rate or in line with inflation the difference in the male and female annuities increases.

Therefore for the majority of those retiring and assuming a 65%/35% male/female split, a male taking out a single life level annuity could expect a fall in annuity income as a result of gender-neutral pricing of approximately 2%-3%. This figure falls where there is a joint life annuity. For females taking out a single life policy the increase in annuity as a result of gender neutral pricing is 3%-4%. Table 2 shows that the potential spread between annuity rates of different companies could easily be greater than these suggested changes from gender neutral prices, similar to the market situation illustrated for term assurance rates in Table 1.

As annuities are priced using market interest rates the value of the annuity received for a retiree will vary over time according to the prevailing interest rates. The volatility, resulting from market movements in interest rates, to annuity rates over a 6 month period could be greater than the difference between male and female rates.

As a person approaches retirement they have three main options: to annuitise, defer retirement or defer commencing the annuity or, if the person has a large pension fund (or alternative retirement income), to put the pension proceeds into an income drawdown product. We think there is a risk that, due to lower perceived value, males with large pension funds may defer annuitising or tend to favour income drawdown products, so altering the mix of males and females annuitising.

Typically many policyholders take out an annuity with a guarantee period of 5 or 10 years. This means that the income is guaranteed to be paid whether the policyholder dies or survives in the first 5 or 10 years. The presence of a guarantee reduces the impact of the difference in male and female annuity rates.

Table 2 on the following page shows a comparison of the best annuity rates for males and females on 24 January 2012. A number of variants are shown to illustrate the differences between single and joint life, with and without guarantees and for smokers compared to non-smokers.

The main conclusion we draw from the data is that the higher the proportion of joint life business, the lower the impact to customers and risk to the insurance company of gender neutral pricing.

Table 2 Current market annuity rates; monthly income for a £50,000 purchase price.

	Male or Male first life			Female or Female first life			Difference		
	Level	**3%**	**RPI**	**Level**	**3%**	**RPI**	**Level**	**3%**	**RPI**
Non-smoker Single life age 65									
Hodge Lifetime	£254	n/a	n/a	£237	n/a	n/a	-6.7%		
Canada Life	£245	£170	£143	£237	£162	£136	-3.3%	-4.7%	-4.9%
Saga	£242	£168	£141	£231	£160	£133	-4.5%	-4.8%	-5.7%
Legal & General	£241	£166	£140	£233	£162	£134	-3.3%	-2.4%	-4.3%
Smoker Single life age 65									
LV=	£304	£228	£201	£290	£215	£189	-4.6%	-5.7%	-6.0%
Reliance Mutual	£302	£229	n/a	£292	£221	n/a	-3.3%	-3.5%	
Just Retirement	£298	£226	£205	£283	£213	£193	-5.0%	-5.8%	-5.9%
Partnership Assurance	£292	£218	£183	£275	£204	£171	-5.8%	-6.4%	-6.6%
Smoker, 10 yr gtee, joint life, 50% spouse, both age 65									
Reliance Mutual	£264	£193	n/a	£263	£192	n/a	-0.4%	-0.5%	
LV=	£262	£189	£161	£260	£188	£160	-0.8%	-0.5%	-0.6%
Just Retirement	£255	£187	£167	£244	£177	£158	-4.3%	-5.3%	-5.4%
Partnership Assurance	£246	£175	£146	£243	£173	£145	-1.2%	-1.1%	-0.7%
Smoker, JL no gtee, 50% spouse, both age 65									
Reliance Mutual	£269	£196	n/a	£266	£194	n/a	-1.1%	-1.0%	
LV=	£267	£192	£163	£263	£189	£162	-1.5%	-1.6%	-0.6%
Just Retirement	£260	£190	£170	£249	£180	£160	-4.2%	-5.3%	-5.9%
Partnership Assurance	£250	£178	£148	£246	£175	£146	-1.6%	-1.7%	-1.4%
Non-smoker Single life age 74									
Hodge Lifetime	£337	n/a	n/a	£306	n/a	n/a	-9.2%		
Canada Life	£325	£249	£221	£307	£233	£205	-5.5%	-6.4%	-7.2%
Standard Life	£318	£243	£241	£299	£228	£226	-6.0%	-6.2%	-6.2%
Saga	£306	£231	£202	£288	£218	£188	-5.9%	-5.6%	-6.9%

Source: the Money Advice Service

1.2.4. Industry implementation costs

The Actuarial Profession does not have access to industry-wide figures to estimate implementation costs.

We are aware that estimates were submitted to the FSA during 2011; however these estimates may have been produced when there was a high level of uncertainty surrounding the prospective legislation, and hence may no longer be relevant. In particular, there are a number of reasons why a current best estimate of the prospective implementation costs might be substantially lower than would have been estimated in early 2011, given the current expectations that:

- There will be no retrospective implementation of the judgment;
- Insurers will be able to collect, store and use gender as described in section 2.2 of the EC guidelines; major changes to IT systems and processes would have otherwise been required; and
- Insurers will be able to use broadly-similar approaches to medical underwriting to those used currently, (again based on the EC guidelines).

However we also note that some costs will already have been incurred by insurance companies. In particular we understand there was a concern that the ECJ judgment might have immediate effect in March 2011, and believe some insurers would have incurred costs in developing contingency solutions that were, with hindsight, found to be unnecessary.

Question 2: Do you agree that the scope of the regulations should be restricted to repealing paragraph 22 of Schedule 3 to the Equality Act?

We suggest that limiting the changes to repealing paragraph 22 of Schedule 3 to the Equality Act leaves a number of areas of uncertainty which could create market instability. The EC guidelines are helpful in clarifying some of the areas of uncertainty created by the judgment but the guidelines are not legally binding so could leave a risk of legal challenge. We suggest that it would be helpful if the UK regulatory changes could go further and address the points covered in the EC guidelines, for example, in respect of medical underwriting.

We think it would also be beneficial to have greater clarity around areas where gender specific mortality tables are currently required to be used outside pricing such as:

- To calculate the maximum level of income drawdown;
- To value the lifetime transfer in discounted gift schemes;
- To determine the income tax liability (on the capital element) of a Purchased Life Annuity; and
- To determine awards in personal injury and fatal accident cases (the Ogden tables).

We would also request that an indication is sought of the DWP’s intentions in respect of gender-based factors for occupational pension schemes.

Question 3: Do you have any comments, in relation to these draft regulations, on the scope of indirect discrimination in insurance and related financial services?

In a free and competitive market place, the risk factors insurers usually choose to use will be those that either have a direct causal influence on, or are highly-correlated with, the underlying risk. The use of the various risk factors then produces more homogenous pools of lives than in the population as a whole. UK insurers have effectively been in this position, subject to the legal requirement not to use certain factors such as race and ethnic origin.

We note the definition of indirect indiscrimination in paragraph 1.12 and agree that this is a helpful way in which to distinguish indirect discrimination and legitimate risk factors. While we think the prohibition on using gender directly as a risk factor is relatively straightforward, in practice we think it may be complex to establish whether a factor is a risk factor with a legitimate aim or could be seen to be acting as a proxy for gender. The following life insurance example seeks to illustrate this point:

A review of the data may suggest that the health risk of a coal miner is greater than the health risk of the general population. Discussions with medical experts could suggest that the principal reason for the increased risk is the exposure to coal dust. However, it might also be argued that the risk is increased because the majority of coal miners are male, while the general population is made up of both males and females and so the observed mortality is compounded by the gender differential.

If a term assurance premium was calculated to meet the expected cost of claims, we would expect this to reflect both the exposure to dust and the gender mix. It may therefore be argued that this premium is indirectly discriminating against the coal miners on the basis of gender.

Alternatively, the insurer might attempt to isolate the impact of the coal dust by comparing the health risk for male miners with the male population. However, applying this differential to a unisex rate will systematically underestimate the risk profile of miners because the base unisex rate does not reflect that there are more of the higher-risk males in the coal miner risk pool relative to the overall risk pool. The business can then be expected to be unprofitable, because there is no cross-subsidy from female coal miners to male coal miners.

This is an example of a risk factor that is linked to the economic and social conditions as well as the habits of an individual. Advocate General Kokott proposed in her opinion delivered on 30 September 2010 that the following habits would be regarded as appropriate distinguishing features of the health risk of an individual:

- Professional activity carried out
- Family and social environment
- Eating habits
- Consumption of stimulants and/or drugs
- Leisure activities
- Sporting activities

A wide range of risk factors are currently used in Life and Health insurance including, but not limited to, salary level, benefit level, occupation, marital status, smoker status and pastimes. Many of these may have a disproportionate gender mix (although this will not usually be as extreme as in the example above) and hence it is unclear to us whether insurers can legitimately reflect the full extent of observed mortality differentials in pricing. We note that paragraph 17 of the EC guidelines states that “The use of risk factors which might be correlated with gender therefore remains possible, as long as they are true risk factors in their own right.” but this stops short of saying **<u>how</u>** they can be used.

Ultimately the decision on whether the use of a risk factor represents indirect discrimination rests with the Courts; however there is the potential for a long period of uncertainty until the legal situation is clarified. Guidance from HMT or the EC in advance of 21 December 2012, perhaps focussing on the appropriateness of some of the rating factors currently used within the market, could be helpful in reducing the uncertainty and the risk this creates.

Question 4: Neither the collection of data on sex nor the use of sex for the purposes of assessing overall risk are prohibited by the Directive or the Equality Act 2010. No provision is therefore needed in the Regulations. Do you agree?

We would prefer to leave comment on whether this should be explicitly addressed in the Regulations to those with a legal qualification. However, the Actuarial Profession considers that insurers should continue to be permitted to collect data on gender and to use this for purposes other than pricing for a number of reasons:

1. Gender is a key characteristic of an individual and is needed to ensure that insurers are paying claims only when the insured event has occurred to the life that is covered under the policy.
2. In order to provide customers with premiums that do not vary by gender, insurers will be required to cross-subsidise expected policy costs. Gender is required to ensure that the level of cross subsidy is consistent with that assumed and to be able to monitor trends. We would expect the additional charge for uncertainty of gender mix is likely to be higher if insurers are unable to monitor the gender mix in their portfolio, resulting in higher premiums to consumers.
3. Gender is a key risk factor in determining expected future claim costs and is required to enable insurers to hold appropriate reserves.
4. We anticipate that implementation costs could be substantially increased, as a result of the need to alter systems and processes, if insurers could no longer collect gender.

We were pleased to note that the ability to collect data on gender was confirmed within the EC guidelines.

Question 5: Do you have any comments on the definition of a new contract in the context of implementation of the Test Achats judgement?

The definition of a new contract affects two distinct areas of insurance company activity – the processing of new contracts and changes to existing policies. These are considered separately below; however we first note that it is unclear to us whether the views of HMT and the European Commission are consistent in so far as:

- The statement in paragraph 1.16 of the HMT paper that "... the precise interpretation of a new contract will currently differ between Member States as such definitions are typically a matter for national law." appears to contradict paragraph 8 of the EC guidelines.

A statement from HMT may be helpful in providing insurers with a higher degree of certainty regarding the legal framework in which they operate. A further observation is that we understand the renewals process varies across Europe and it may therefore prove impossible to derive a common definition of a new contract that has consistent practical implementation across territories.

5.1. LIFE INSURANCE

5.1.1. Processing of new contracts

Although insurers are able to conclude a high proportion of policies very quickly, a proportion take considerably longer, for example where an insurer is seeking medical evidence regarding the health of the life insured. It would be helpful if insurers are aware of the approach that will apply considerably far in advance of 21 December 2012, so that they can manage these "pipeline cases". This will help to avoid policyholders being unnecessarily disadvantaged and to communicate their intentions to advisors and prospective policyholders.

In this regard, our interpretation of the draft UK legislation is that it is consistent with the EC guidelines, in which paragraph 11 appears to provide a definitive statement that any new contract that has not been concluded by 21 December 2012 must be issued on unisex rates. Whilst this clarity is helpful, this is likely to result in insurers adopting different approaches to the impending change in the months leading up to 21 December 2012. For example, some insurers may provide an indication of the premium rate that will apply after 21 December 2012 if the contract has not concluded by then and seek customer agreement to both the gender-specific and the unisex premiums. Other insurers may find the IT costs prohibit such an approach.

Such inconsistencies of practice could create confusion for consumers; consequently, it would be helpful if HMT could clearly state their view of the position for the UK well in advance of the effective date of the new legislation.

In addition, we have previously noted the change in taxation of life contracts that takes effect from 1 January 2013 and suggest that it might be advantageous if the definition of a new contract applicable to that change is explicitly stated to be consistent with that applying to the gender legislation.

5.1.2. Changes to existing policies

The other areas that the definition of a new contract affects are in relation to changes to existing contracts. A number of these areas are addressed in the EC guidelines; for example these indicate that automatic renewals, inflation increases and guaranteed options on pre-defined terms can all generally be considered as not triggering a “new” contract. However, we anticipate that the precise interpretation may often still depend on specific policy wordings. For example:

- A policy that gives a policyholder the right to increase the amount of life cover (perhaps in specific circumstances such as “lifestyle” changes such as marriage and birth of a child) can be expressed either as an option to increase the sum insured or may explicitly state that the option is to effect a new policy in respect of the increase. Whilst the latter is almost certain to be deemed “new” (and hence to be issued on unisex rates), we suspect that this will often also apply to the former situation as (gender-specific) premium rates will not be explicitly defined within the contract.
- “on the basis of pre-defined parameters” may be open to interpretation in the context of reviewable rate protection business.

We consider this diversity of scenarios as inevitable but we feel it would be helpful if HMT could state whether they concur with the EC guidelines.

We anticipate that consumers may be disadvantaged by insurers becoming less inclined to accommodate non-contractual alterations to long-term policies. For example, an insurer might previously have been prepared to reduce the sum insured for a male life insured under an assurance contract but such a change would not be “on the basis of pre-defined parameters” and it might now be deemed necessary to re-price the whole contract onto unisex rates, which would considerably reduce the profit the insurer had expected to earn. Conversely, a female seeking a small increase in sum insured could face a disproportionate increase in premium if the insurer has to re-price the whole contract onto unisex rates.

Question 6: Do you agree that no amendment is needed to paragraph 20 of Schedule 3 to the Equality Act 2010 as a result of the Test Achats judgment?

6.1. LIFE INSURANCE

The Actuarial Profession believes that there might be a risk that the current wording leads to different interpretations and implementations by life insurance companies. This could result in confusion for consumers. This may be an inevitable consequence of the separation in legislation regarding consumer access to goods and services and employment benefits. It would be helpful if further clarity could be provided through the Equality Act or associated guidance.

The key areas where we have identified differing interpretations or potential changes in market practice include: (i) the treatment of occupational pension schemes purchasing annuities and (ii) the rates available through group insurance arrangements. Further details are set out below.

6.1.1. Occupational pension schemes

By excluding benefits that are payable in pursuance of the employers arrangements for employees, it could be suggested that occupational defined contribution schemes may be able to purchase pension annuities on gender-differentiated rates. This approach could change member behaviour such that females may secure financially improved terms by using the funds provided by the scheme to purchase a gender neutral annuity, whereas a male may benefit from taking an annuity purchased from within the scheme. This could lead to members of occupational defined contribution schemes on average securing better annuity rates than other customers making the same purchase from a different pensions vehicle (for example, a personal pension).

6.1.2. Group insurance

The Actuarial Profession believes the current wording allows gender specific pricing where insurance companies are pricing employee benefits that are pre-defined for the employee. We note that the EC guidelines indicate that article 5(1) prohibits gender differentiation in individual premiums but not at the general or aggregate level. We concur with this approach where the pricing does not affect the outcome or benefit to the end customer.

We believe a change in market practice could be experienced if group insurance schemes are able to consider gender as a risk factor when offering financial services to employees on behalf of employers. This could lead to an increased number of insurance products offered through employers. Members of the lower risk groups with access to these schemes may be able to access preferential rates compared to other customer groups.

We suggest that more clarity within the legislation, or associated guidance, could ensure consistency of market practice and avoid the risk of future legal challenges.