



HM TREASURY

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

a consultation

December 2011



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Any queries regarding this publication should be sent to us at: public.enquiries@hm-treasury.gov.uk.

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1

Introduction

1.1 This consultation document sets out the UK Government's proposed response to the ECJ judgment on Directive 2004/113/EC in Case 236/09 'Test Achats' of 1 March 2011. In its judgment, the ECJ ruled that the use of gender as a risk factor by insurers should not result in individual differences in premiums and benefits for men and women, and that the derogation permitted by Article 5(2) of the Directive should cease to have effect from 21 December 2012.

1.2 The Financial Secretary's 30 June statement set out the Government's disappointment with the judgment. The Government expects the impacts of the judgment to be broadly negative – in large part falling on consumers rather than industry. The Government believes that nobody should be treated unfairly because of their gender, but that financial services providers should be allowed to make sensible decisions based on sound analysis of relevant risk factors. Despite this, the judgment is binding in UK law. Consequently, this document summarises the UK Government's view of the judgment and requests comments on the draft legislation through which we propose to amend the Equality Act 2010 to implement the judgment in Great Britain. (The judgment will be implemented separately in Northern Ireland.)

1.3 The Government believes that the proposed approach is the simplest, minimising the risk of any conflict between UK and European law. In light of the plans of the European Commission to issue guidance on the interpretation of the judgment and its implementation, this consultation also sets out the key areas that the UK Government believes should be covered, and requests views on other areas that it would be useful for the UK Government to press that the Commission cover. A full impact assessment is also annexed.

UK legal interpretation of temporal limitation

1.4 On 30 June, Mark Hoban, the Financial Secretary to the Treasury, issued a Written Ministerial Statement which set out the UK view of the judgment and proposed next steps. The Government's view is that the derogation permitted by Article 5(2) cannot apply to any new contracts for insurance and related financial services entered into on or after 21 December 2012. In such contracts, the use of gender as a risk factor should not result in individual differences in premiums and benefits for men and women. However, any contracts with gender-sensitive pricing of premiums or benefits concluded before 21 December 2012 can, in the Government's view, continue unchanged after that date.

1.5 The draft regulations at Annex A set out the necessary amendments to the Equality Act 2010 for this to be given effect in UK law; more details on the draft itself are in paragraphs 11-17, below. There are, in addition, a number of legal issues around, in particular, the definition of a new contract and the circumstances in which it would remain open to insurers to make use of gender. We will be engaging with the Commission with a view to ensuring that, as far as possible, a common view is adopted across Europe on these matters. In order to inform the United Kingdom's approach in Europe, the Government has set out below its position on these issues and would be interested in views on whether others agree. However, this is not intended to represent legal advice, and it should be noted that only the courts can provide an authoritative interpretation of the legislative provisions.

Impact on consumers and industry

1.6 The impact assessment at Annex B sets out our detailed assessment of the likely market reaction – this is summarised in the following paragraphs. However, as we note in the impact assessment itself, data regarding the effect on different business lines are scarce; many of the factors are either incalculable or based on market-sensitive information that could not be acquired for the purposes of this impact assessment. Therefore, although consumer impacts are clearly adverse, and any available data has supported the central assumptions, it must be recognised that quantitative calculations are based on very limited sources of data.

Market adjustment – central assumption

1.7 The Government's central assumption is that overall the judgment is likely to result in an initial and marked net increase in the cost of premiums, with those in lower-risk categories suffering significant increases, subsidising the lesser reductions for those in higher-risk categories. The reason for the aggregate increase in a typical premium is because those at lower risk are likely to be disproportionately affected by the removal of gender as a risk factor in pricing premiums for the consumer, with a risk-averse approach to underwriting and the effect of adverse selection meaning that the equilibrium price is likely to settle towards the high-risk end.

1.8 At the transitional stage, competition is likely to have a limited effect, although it could be a driver for inflated premiums as insurers potentially close their books to certain sections of the market or exit altogether. As the market adjusts to the new status quo, the effect of competition is expected to help drive prices back down towards their original price before the removal of the risk factor. However, due to adverse selection (whereby the overall risk profile of an insurer's book becomes more risky as higher-risk individuals are incentivised to buy cover and lower-risk individuals depart the market or reduce their level of cover), we expect that the market will stabilise with premiums at a higher level overall than they were before.

Consumer outcomes

1.9 We believe this ruling will lead to three main outcomes, all of which fall upon consumers:

- Firstly, it will result in cross-subsidisation of premiums between the genders. So, if a (generally more careful) female driver has to pay the same price for motor insurance as a (generally less careful) male driver, then she will be subsidising the cost of his insurance.
- Secondly, adverse selection will operate to increase the cost of insurance generally and incentivise riskier behaviour. So, if gender neutral pricing is introduced into life assurance, men (who have on average a lower life expectancy) will find life insurance to be good value and will be incentivised to buy it or buy more. On the other hand, women (who have on average a higher life expectancy) will find life insurance poor value and will be disincentivised from purchasing such insurance. As fewer low risk people (i.e. women) take out life assurance, then the insurer's portfolio becomes increasingly risky, and the cost of insurance has to rise to compensate.
- Thirdly, in the field of motor insurance, studies have indicated that gender-neutral pricing would have consequences for road safety. As premiums for (generally higher risk) male drivers fall, then they may purchase higher-powered cars or increase the riskiness of their driving.

Impact on industry

1.10 Although the impacts of the ban on use of gender as a risk factor in the pricing of individual insurance policies will primarily be felt by consumers, there will also, however, be significant impacts on industry. These will likely manifest in two main ways:

- 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; and
- As industry implements the change, it is likely to incur transitional costs. This will include (but is not limited to): changes to underwriting practices; marketing changes; changes to sales approaches.

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.

Draft Regulations

1.11 The proposed draft regulations are at Annex A. As drafted, the Regulations will repeal paragraph 22 of Schedule 3 to the Equality Act 2010 with effect from 21 December 2012. This means that from that date providers of insurance and related financial services may not discriminate on the grounds of sex in the prices and benefits offered to consumers. But this repeal does not affect contracts concluded before 21 December 2012.

1.12 The Equality Act 2010 prohibits two types of discrimination – direct discrimination and indirect discrimination. Direct discrimination occurs where a person is treated less favourably because of a protected characteristic (such as sex). Indirect discrimination occurs where an apparently neutral practice puts people sharing a protected characteristic at a particular disadvantage compared to those who do not share it, and the practice cannot be objectively justified. Risk factors used by the insurance industry might potentially fall within the scope of indirect discrimination if they have a disproportionate impact on one gender, but such risk factors will be lawful if they have a legitimate aim and are proportionate.

1.13 There may also be circumstances where insurers can take advantage of paragraph 27 of Schedule 3 to the Equality Act to deliver specific services to persons of an individual sex. Paragraph 27 permits single-sex services in a range of circumstances, for example where only people of one sex have need of that service. This may be relevant where insurers are covering risks that only affect one sex, such as prostate or ovarian cancer.

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?

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?

Collection of data and use for purposes of assessing overall risk

1.14 Article 5(1) of the Gender Directive does not prohibit the use of sex as an actuarial factor; rather it says that this must not result in individual differences in premiums and benefits. This allows for the fact that insurers will need to collect data on gender and use it for the purposes of assessing the overall risk presented by a particular pool or pool of risks. For example, if a motor insurer insures a pool of people comprising 70% men and 30% women, the insurer may take the relative proportions of men and women into account for the purposes of assessing the overall risk presented by the pool, and use that risk for the purposes of calculating the unisex premium applicable to men and women in that pool.

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?

Definition of a new contract

1.15 Within the UK, the usual principles of contract law, as applied by the courts in the field of insurance, will determine when a new contract has been formed. Although it will depend on the circumstances of the case, a renewal will almost certainly create a new contract, but a review of a contract under its terms is less likely to do so. Similarly, case law will usually determine when an existing contract with a client is deemed to continue in situations of corporate restructurings or merger.

1.16 Within Europe, the precise interpretation of a new contract will currently differ between Member States as such definitions are typically a matter for national law.

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

Group insurance schemes

1.17 As the Test Achats case only concerns the Gender Directive, the Government does not believe there is any requirement to amend paragraph 20 of Schedule 3 to the Equality Act 2010. This creates an exception for insurers who provide insurance pursuant to arrangements made by an employer for its employees, and other persons, as a consequence of their employment. In such a case, the employer would be required to comply with the relevant provisions of Part 5 of the Equality Act.

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?

2

About this consultation

2.1 We would like to hear your views on a draft Order which, following the Test Achats judgment, with effect from 21 December 2012 would prohibit differentiation in premiums and benefits for men and women in provision of insurance and related financial services.

2.2 This consultation flags up a number of related policy questions which underpin this approach and are flagged in the specific questions. We would be interested in responses on these questions, as well as on our assessment of the impact of this judgment.

Intended audience

2.3 This consultation will be of particular interest to financial services providers and organisations interested in how service providers deliver equality. However, comments from other interested parties are also welcomed.

Territorial scope

2.4 These proposals will apply in England, Wales and Scotland.

Duration of this consultation

This consultation begins: Thursday 8 December 2011

This consultation ends: Thursday 1 March 2012

2.5 Responses should be sent to:

Email: sandra.holben@hmtreasury.gsi.gov.uk

Post: Test Achats Consultation Responses
C/O Sandra Holben
HM Treasury
1 Horse Guards Road
London
SW1A 5HQ

Ensure that your response reaches us by Wednesday 29 February 2012.

2.6 Please tell us whether you are responding as an individual or whether you are representing the views of an organisation. If you are responding on behalf of an organisation please tell us whom the organisation represents and, where possible, how the views of members have been sought.

Queries about this document

2.7 Any queries about this document should be directed to:

Sandra Holben

Telephone: 020 7270 4678

E-mail: sandra.holben@hmtreasury.gsi.gov.uk

2.8 We will consider any reasonable request for alternative accessible formats of this document. Please send your request to:

Email: sandra.holben@hmtreasury.gsi.gov.uk

Post: Test Achats Consultation Responses
C/O Sandra Holben
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

After the consultation

2.9 We will publish a summary of the results of this consultation on the HM Treasury website within three months of the end of the consultation period. The intention is to legislate the ban on gender discrimination early in 2012, to come into force from 21 December 2012.

Freedom of information

2.10 We may need to share any information you send us with colleagues in the HM Treasury, or to pass it on to other Government Departments, and we may also need to publish your response. All information you provide in your response, including personal information, may be subject to publication or disclosure if someone requests it under the Freedom of Information Act 2000 (FOI Act) or the Data Protection Act 1998. If you want the information you provide to be treated as confidential, please be aware that the FOI Act has a Statutory Code of Practice that we have to comply with which sets out our obligations on confidentiality. Because of this it would be helpful if you tell us why you want the information to be treated as confidential. If someone does then ask us to disclose the information we will be able to take into account your reasons for confidentiality, but we cannot guarantee that confidentiality can be maintained in all circumstances. Automatic confidentiality disclaimers generated by your IT system on emails will not of themselves be regarded as binding.

Code of Practice on Consultation

2.11 This consultation complies with the Code of Practice on Consultation¹ produced by the Department for Business Innovation and Skills (BIS).

¹ Code of Practice on Consultation - <http://www.bis.gov.uk/policies/better-regulation/consultation-guidance>

A Draft Regulations

2012 No.

EQUALITY

Equality Act 2010 (Amendment) Regulations 2012

Made - - - - - ***
Laid before Parliament ***
Coming into force - - - *21st December 2012*

The Treasury are a government department designated for the purposes of section 2(2) of the European Communities Act 1972 in relation to sex discrimination, pregnancy and maternity discrimination, and gender reassignment discrimination.

The Treasury, in exercise of the powers conferred on them by section 2(2) of the European Communities Act 1972, make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Equality Act 2010 (Amendment) Regulations 2012 and come into force on 21st December 2012.

Amendment of the Equality Act 2010

2. Paragraph 22 of Schedule 3 (services: exceptions relating to insurance etc) to the Equality Act 2010 is omitted.

Transitional provisions

3. Despite its omission by regulation 2, paragraph 22 of Schedule 3 to the Equality Act 2010 continues to apply to a contract concluded before 21st December 2012.

Date *Name*
Name
Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE
(This note is not part of the Regulations)

B

Impact Assessment

Title: European Court of Justice ruling on the use of gender in insurance policies Lead department or agency: HM Treasury Other departments or agencies:	Impact Assessment (IA)
	IA No:
	Date: 03/06/2011
	Stage: Development/Options
	Source of intervention: EU
	Type of measure: Secondary legislation
	Contact for enquiries:

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

In June 2008, Test Achats (the Belgian Consumer Association) launched a legal challenge to Belgium's implementation of the 2004 Gender Directive. Belgium had taken advantage of the opt-out in Article 5(2) of the Directive - which allowed the use of gender-sensitive pricing in insurance and related financial services - but only for life insurance products. In June 2008 this case was referred to the European Court of Justice (ECJ), where it was argued that the opt-out was incompatible with the principle of equal treatment in EU law. On 1 March 2011, the ECJ delivered its judgment that Article 5(2) was invalid with effect from 21 December 2012.

What are the policy objectives and the intended effects?

The ECJ ruled that gender sensitive pricing by insurers is contrary to the principle of equal treatment in EU law, as expressed in the Gender Directive, and that gender-neutral pricing is required in order to uphold its principle of equal treatment for all. We believe that this will have unintended and unpredictable consequences beyond simply achieving gender-neutral pricing. However, legally, we have no option other than to implement the judgment.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The ECJ has ruled on the validity of EU legislation, and therefore Member States are bound to implement the ruling. There is no right of appeal. The UK's strong view is that the better interpretation is one under which only new contracts entered into after on or after 21 December 2012 will have to employ gender-neutral pricing. This Impact Assessment therefore considers this option.

We have quantified impacts where we can. However, data regarding the effect on different business lines is scarce; many of the factors are either incalculable or based on market-sensitive information that could not be acquired for the purposes of this impact assessment. Therefore, although consumer impacts are clearly adverse, and any available data has supported the central assumptions, quantitative calculations are based on very limited sources of data. We will seek to build a more complete set of data on which to base any calculations during the subsequent consultation phase.

Will the policy be reviewed? It will not be reviewed. If applicable, set review date: Month/Year

What is the basis for this review? .Not applicable If applicable, set sunset clause date: Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes/No
--	--------

SELECT SIGNATORY Sign-off for consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister

A handwritten signature in black ink, appearing to be 'Ma M'.

Date: 6/12/11

Summary: Analysis and Evidence

Policy Option 1

Description:

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate:

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	Optional
High	Optional		Optional	Optional
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

As set out in the Evidence Base section, quantitative data is scarce, and the assessment has been based on the data available.

Male annuities could decrease by 13% per year

Younger female drivers could see their premiums increase by up to 25% per year

Female term life policies could be increased by 10-15% per year and critical illness policies by 12%

Other key non-monetised costs by 'main affected groups'

Risks to road safety

More intrusive underwriting process including full health assessments, more questions

Longer times to purchase products

Under provision of pensions for males and family incomes

Less purchasing of health insurance and more reliance on the state provision

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	Optional
High	Optional		Optional	Optional
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Younger male drivers may see a 10% reduction in their policies, but given the uncertain nature of insurance provision going forward, and the fact that motor lines are currently generally loss-making, all prices could be equalised up to the male price, potentially resulting in no savings.

We are expecting few benefits in the annuity markets.

Other key non-monetised benefits by 'main affected groups'

Both females and males would be treated in accordance with the ECJ ruling.

Key assumptions/sensitivities/risks Discount rate (%)

Sensitivities would lie around the potential decrease in premiums given the uncertain nature of the market having to produce gender neutral premiums and potential under-provision of capital required to pay out claims. Consequently, overall, we expect that insurers will take a cautious approach which assumes a high mix of the riskier gender in a particular pool. Therefore, we do not expect any gains through lower premiums to match the increases.

A change to gender neutral pricing and premiums is also likely to have reputational impacts on the industry. There is also likely to be a reduction in the purchasing of private insurance policies.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	NA

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			21/12/2012		
Which organisation(s) will enforce the policy?			FSA		
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A	Non-traded: N/A	
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs: N/A	Benefits: N/A	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro N/A	< 20 N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties¹ Statutory Equality Duties Impact Test guidance	Yes	
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	
Small firms Small Firms Impact Test guidance	Yes	
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

¹ Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	ABI Research Paper No 24, 2010 – The use of gender in insurance pricing
2	Institute and Faculty of Actuaries Working Party
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

Problem under consideration

The Gender Directive and Test-Achats

1. The Gender Directive implements the principle of equal treatment between men and women in the provision of goods and services. Article 5(1) provides that the use of sex as an actuarial factor in insurance and related financial services should not result in differences between individuals' premiums and benefits (referred to as "gender neutral pricing"). However, Article 5(2) permits Member States to derogate from gender neutral pricing in limited circumstances, so that use of gender as an actuarial factor is permitted to deliver differences in premium between men and women (a practice referred to as "gender sensitive pricing").
2. The Test-Achats case (Case 236/09) sought the ECJ's judgment on whether Article 5(2) was compatible with the principle of equal treatment in EU law. The Advocate General of the European Court of Justice disagreed, concluding that gender sensitive pricing was incompatible with the fundamental principle of equal treatment in EU law.
3. The ECJ gave judgment on 1 March, to the effect that Article 5(2) of the Gender Directive is invalid with effect from 21 December 2012. In delivering its judgment, the Court emphasised the principle of equal treatment between men and women in access to the supply of goods and services. The Court took the view that this principle applied equally to both men and women because – according to the Gender Directive - they are comparable, and an unlimited derogation was incompatible with the principle of equal treatment in EU law.

Policy objective and rationale for intervention

4. The Government is disappointed by this judgment. We believe the judgment will have unintended and unpredictable consequences beyond simply achieving gender-neutral pricing – including for women and vulnerable groups who can least afford it, such as the elderly. We made very clear our concerns about any move to prevent the use of gender as a risk factor in the pricing of individual insurance policies. We believe that the ability of insurers to price on the basis of risk is integral to their need to conduct business efficiently. Due to the nature of the ruling, however, there is no right of appeal against the outcome. The only option available is to implement the ruling, in this case by secondary legislation, which is likely to be made in the spring of 2012.
5. In the meantime, the Government will continue to work closely with the Financial Services Authority and Association of British Insurers in order to ensure that the negative impacts for customers and industry are reduced as far as possible.

Broad impacts

6. Like most EU countries, the UK has taken advantage of Article 5(2) in its domestic law. This has allowed gender sensitive pricing to be used for insurance and annuities – resulting in, for example, cheaper car insurance for women. We believe this ruling will lead to three main outcomes, all of which fall upon consumers:

- Firstly, it will result in cross-subsidisation of premiums between the genders. So, if a (generally more careful) female driver has to pay the same price for motor insurance as a (generally less careful) male driver, then she will be subsidising the cost of his insurance.
- Secondly, adverse selection will operate to increase the cost of insurance generally and incentivise riskier behaviour. So, if gender neutral pricing is introduced into life assurance, men (who have on average a lower life expectancy) will find life insurance to be good value and will be incentivised to buy it or buy more. On the other hand, women (who have on average a higher life expectancy) will find life insurance poor value and will be disincentivised from purchasing such insurance. As fewer low risk people (i.e. women) take out life assurance, then the insurer's portfolio becomes increasingly risky, and the cost of insurance has to rise to compensate.
- Thirdly, in the field of motor insurance, studies have indicated that gender-neutral pricing would have consequences for road safety. As premiums for (generally higher risk) male drivers fall, then they may purchase higher-powered cars or increase the riskiness of their driving.

The effects of adverse selection and competition

7. At present, the price of insurance policies is determined by both competition and the information that insurers can gather on the risk that they are covering. These factors help to determine the premium that must be set for different risk categories, in order to fully allow for the likelihood of a claim and the cost of those claims. The more information that an insurer can gather, the more accurately any policy can be priced.

8. Gender is one of the most important risk indicators that an insurer can use to price a number of business lines. However, if insurers were unable to take gender into account when assessing the risk that they are covering, insurers are likely to have to average prices between high and low-risk individuals in those lines where gender is a risk factor. In such a scenario, a policy at an average price would be more attractive to higher risk individuals, as the policy would not be priced according to their risk. Conversely, lower risk individuals would find the product unattractive, as they would effectively be overcharged when compared to their fully risk-priced premium. This is likely to result in adverse selection, whereby the overall risk profile of an insurer's book becomes more risky as the 'adverse' high-risk individuals are incentivised to buy cover and low-risk individuals depart the market.

9. To avoid excessive exposure to 'adverse' risks, insurers may price policies assuming worst case risk characteristics for those factors where they are not allowed to distinguish, and hence assume most customers are male or female according to whichever group is riskier. This would drive up the average price of a gender-neutral policy, meaning that following the initial market

adjustment it would be higher than the original risk-based price, as the overall increases in premium cost are likely to be greater than any reductions.

10. Although removing the use of gender would result in an initial market adjustment, driving up premiums, the UK will still be privy to one of the most competitive insurance markets in the world. Therefore, the rise in premiums is likely to be tempered by the competitive nature driving down prices. This will mean that the market is, overtime, likely to stabilise – albeit with premiums on average higher than they were before gender-neutral pricing. This is because adverse selection will serve to make overall pools more risky than they were previously.

11. The market adjustments, and in particular the effects of competition and adverse selection on premiums is illustrated by *Figure 1* below.

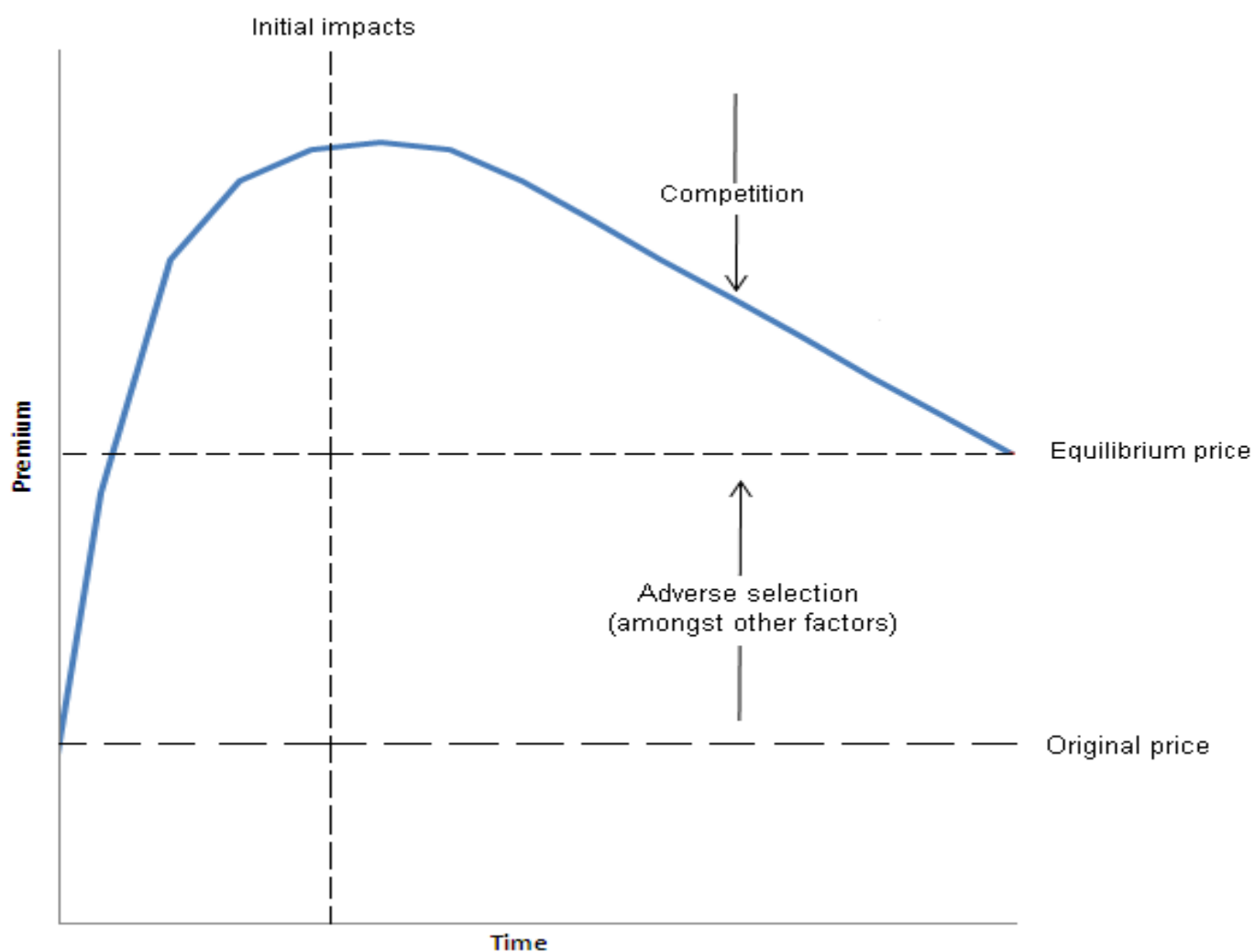


Figure 1: Graph illustrating market adjustment following the removal of the use of gender as a risk factor in the pricing of individual policies

12. *Figure 1* is an iterative graph showing, very broadly, the likely aggregate impacts of removing the use of gender as a risk factor when setting individual premiums. Overall there is likely to be an initial and marked net increase in the cost of premiums, with those in lower-risk categories

suffering significant increases, subsidising the lesser reductions for those in higher-risk categories. The reason for the *aggregate* increase in a typical premium is because those at lower risk are likely to be disproportionately affected by the removal of gender as a risk factor, with a risk-averse approach to underwriting and the effect of adverse selection meaning that the equilibrium price is likely to settle towards the high-risk end.

13. At the transitional stage, competition is likely to have a limited effect, with insurers adapting their business models, although it could be a driver for inflated premiums as insurers potentially close their books to certain sections of the market or exit altogether. As the market adjusts to the new status quo, the effect of competition is expected to help drive prices back down towards the original price at which they were before the removal of the risk factor. However, due to adverse selection, we expect that the market will stabilise with premiums at a higher level overall than they were before.

Consumer costs across business lines

14. This preliminary assessment considers the costs and benefits of implementing the judgment, compared to a do-nothing baseline. There is no alternative option to be considered. The judgment requires the pricing of insurance policies to be costed in a gender-neutral manner. The arguments as below are based on the premise that the judgment affects all new contracts entered into after 21 December 2012. This will affect different business lines to varying degrees.

15. It should be noted that data regarding the effect on different business lines is scarce; many of the factors are either incalculable or based on market-sensitive information that could not be acquired for the purposes of this impact assessment. Therefore, although consumer impacts are clearly adverse, and any available data has supported the central assumptions, quantitative calculations are based on very limited sources of data. Through our consultation we will seek to build a more complete set of data on which to base any calculations.

Motor

16. The area in which there is the most obvious difference between premiums for males and females is motor insurance. This is also the business line in which there is the starkest difference in the risks posed between the genders. *Figure 2* below indicates the difference in motor insurance premiums charged to individuals according to age and gender. There is a clear disparity between males and females of the same age, particularly for those younger drivers at the extreme end of the spectrum.

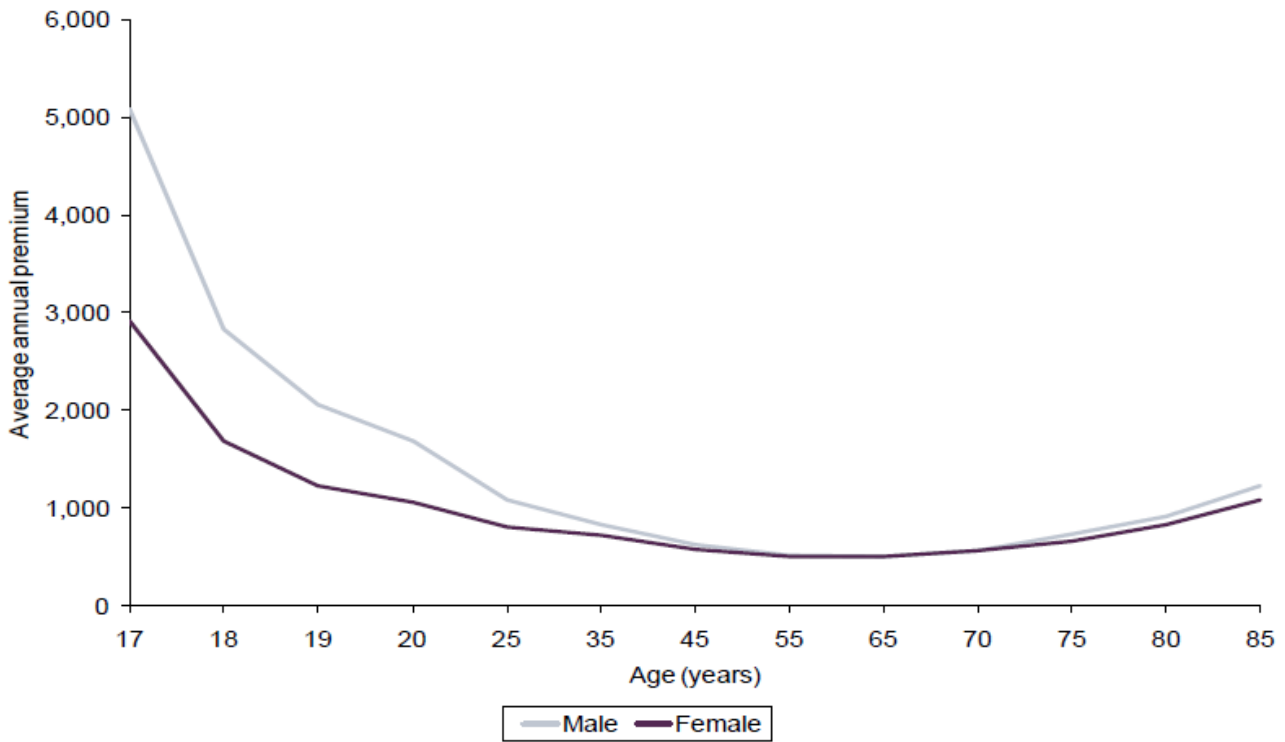


Figure 2: Graph illustrating average annual premium for motor insurance according to age and gender

Source: ABI Research Paper No 24, 2010 – The use of gender in insurance pricing

17. The reason for the disparity between the premiums charged is because statistics clearly indicate that males, and younger males in particular, are far more likely to suffer death or serious injury whilst driving than females. This means that insurers will pay out more in claims costs for male drivers as opposed to females, which is highlighted in *Figure 3* below. The differing cost of claims is reflected in the respective premiums charged for motor insurance.

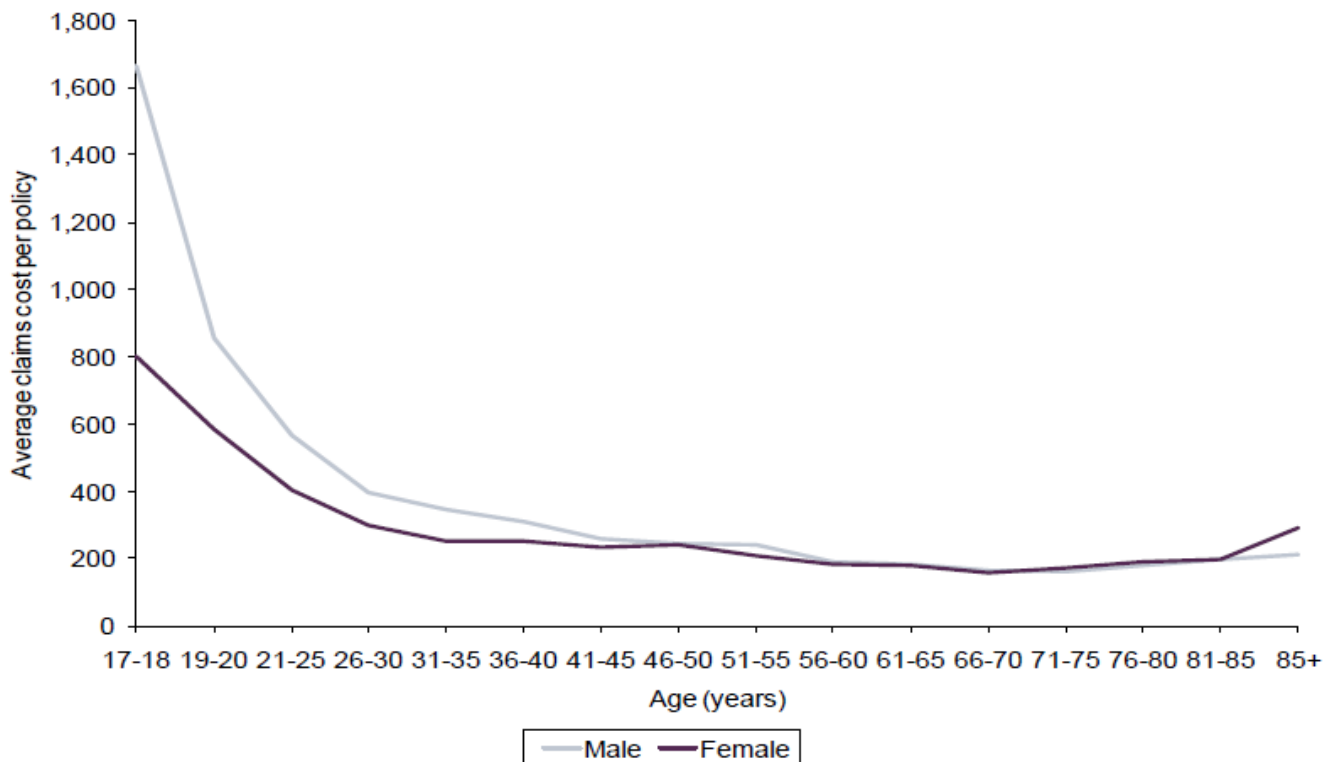


Figure 3: Graph illustrating average claims cost per policy for motor insurance according to age and gender

Source: ABI Research Paper No 24, 2010 – The use of gender in insurance pricing

18. *Figure 3* shows a strong correlation between claims cost and premium charged. The ruling will require insurers to ignore data indicating the different risks posed by the genders, and the claims costs incurred, pricing in a neutral fashion. As a result young female drivers, who currently receive a lower quote, will pay significantly more for their motor insurance in order to subsidise the risk posed by young males, who will pay slightly less. *Figure 4* indicates the differing amounts by which premiums could change for males and females, if gender was no longer used as a risk factor in the pricing of insurance policies.

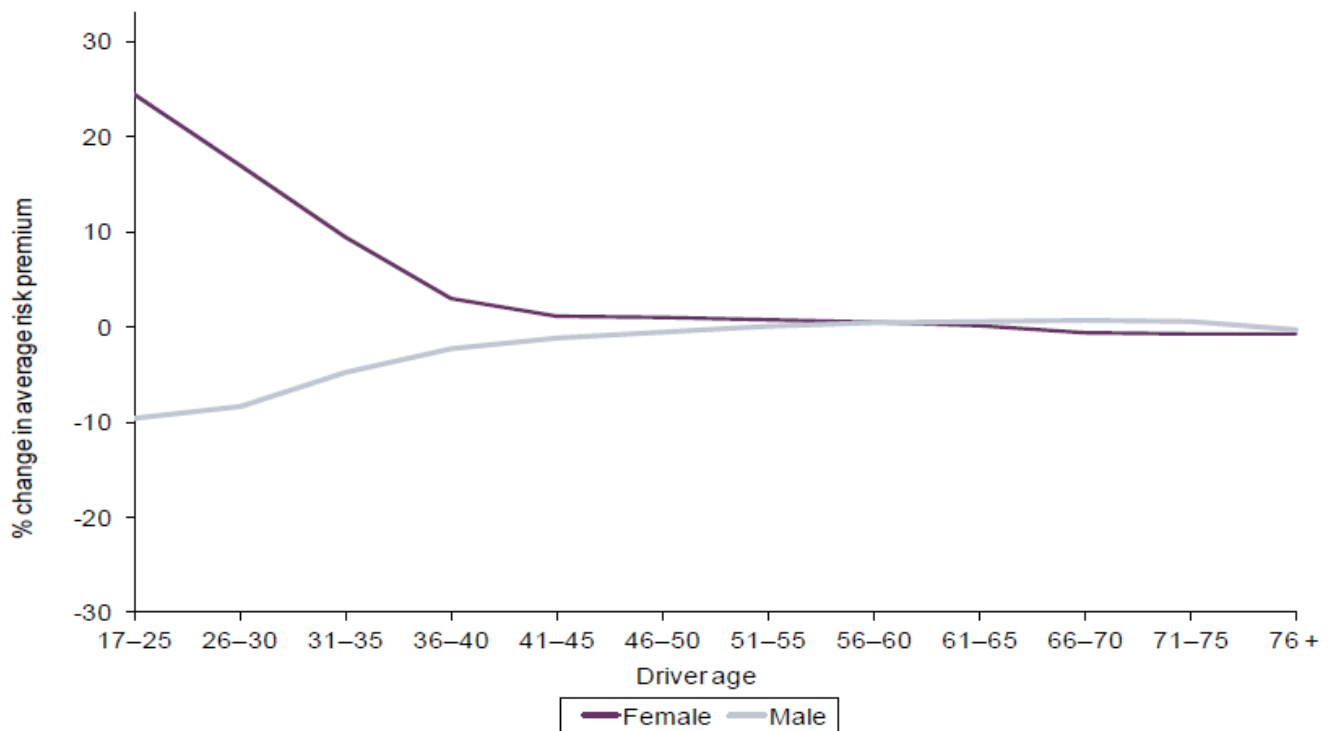


Figure 4: Graph illustrating the percentage change in average premium for motor insurance according to age and gender, following the removal of gender as a risk factor in the pricing of individual policies

Source: ABI Research Paper No 24, 2010 – The use of gender in insurance pricing

19. Figure 4 reinforces the proposition in Figure 1 that, overall, there will be a net increase in premium charged across the board, as the increase for females at the high-risk age category tends to outstrip any decrease for males by at least double. As the risk profile of an insurer’s motor insurance book is likely to increase, any benefits for males are likely to be tempered as insurers compensate for a heightened risk profile and take a more risk-averse approach to writing new business.

20. The decrease in premiums for younger male drivers is likely to be limited, because the move to gender-neutral pricing must be set against a backdrop of motor insurance having been significantly loss-making for insurers in recent times.

Adverse selection

21. It should be noted that the adverse selection issues highlighted previously are likely to have a more limited impact on motor insurance. The mandatory nature of this type of insurance means that, although more risky drivers could enter the market, the option to exit the market for those suffering significant price increases are reduced. Some policyholders may find that their motor insurance becomes unaffordable, and they may give up the use of their vehicle and therefore their insurance. However, this is not likely, as the elasticity of demand for motor insurance has remained relatively stable despite price increases in recent years.

22. The decreased likelihood of females exiting the market, coupled with the negligible decrease in premiums for males, means that the risk profile for motor insurance providers is likely to be unchanged. We therefore assume that adverse selection will have little to no impact for the purposes of motor insurance. Again, this may not be reflected in prices, as insurers will be increasing their prices to compensate for other factors that have led to them suffering a high loss ratio on motor insurance. The reasons for those price increases are beyond the scope of this impact assessment.

Quantitative calculations

23. As mentioned previously, data for the effects of the ruling on the market is difficult to obtain as it either is not calculable or is market-sensitive. As a result, significant assumptions must be made for any quantitative estimation to be carried out on the effect of removing gender as a risk factor in the pricing of individual policies in motor insurance. ABI estimates indicate that women aged 25 and under could see the cost of cover rise by 25%, which equates to an extra £420.

24. Whilst individual experiences are indicative, it is important to be able to estimate the negative impacts of this decision across the domestic insurance market in the UK. Therefore, we have used as much existing accessible data as possible. *Table 1 and Table 2* below demonstrate the net cost of the ban on the use of gender in motor insurance, for males and females respectively. The net cost stands at approximately £300m.

Males

Age band	Average premium (£)	Average % change	Change in premium (£)	No. policyholders	Total benefit of banning use (£)
17-25	2090	-9	188	1,826,467	343,558,443
26-30	1000	-8	80	1,489,043	119,123,440
31-35	1000	-5	50	1,632,215	81,610,750
36-40	900	-3	27	1,942,366	52,443,882
41-45	700	-2	14	2,209,991	30,939,874

Total: £627,676,389

Table 1: Impact on the ban on the use of gender for male motor insurance policyholders

Females

Age band	Average premium (£)	Average % change	Change in premium (£)	No. policyholders	Total cost of banning use (£)
17-25	1360	+24	326	1,618,168	528,170,035

26-30	900	+18	162	1,331,569	215,714,178
31-35	900	+10	90	1,441,337	129,720,330
36-40	700	+3	21	1,715,449	36,024,429
41-45	700	+1	7	1,943,250	13,602,750

Total: £923,231,722

Table 2: Impact on the ban on the use of gender for female motor insurance policyholder

25. The Tables above use data from the Oxera Report in order to estimate the average premium currently paid by individuals in differing age bands. Those aged 45 and over have been excluded for these purposes, as data indicates that this group would be minimally affected by any ban on the use of gender in insurance underwriting. The percentage change in average premium has been calculated and represented in monetary terms. DVLA data has been used in order to estimate the number of motor insurance policyholders in the UK. It should be noted that an assumption has been made that all those with a full driving licence in the UK hold a motor insurance policy. The cumulative effects of the ban have been estimated by multiplying the change in premium by the number of policy holders. For males, this represents a 'benefit' of approximately £600m due to the reduction in premiums. For females, this conversely represents a cost of approximately £900m, with a **net cost to motorists of approximately £300m.**

Protection market

26. The protection market includes life and term-life insurance, income protection, and critical illness policies. For these lines of business, premiums tend to be lower for the 'healthier' of the two genders, with statistics indicating that this is often females. The imposition of gender neutrality will therefore affect premiums for females more than males in the protection market.

Term-life insurance

27. The differences between the premium incurred by males and females are somewhat less prominent than those shown for motor insurance. There is, however, a difference between the genders, as indicated by *Figure 5* below.

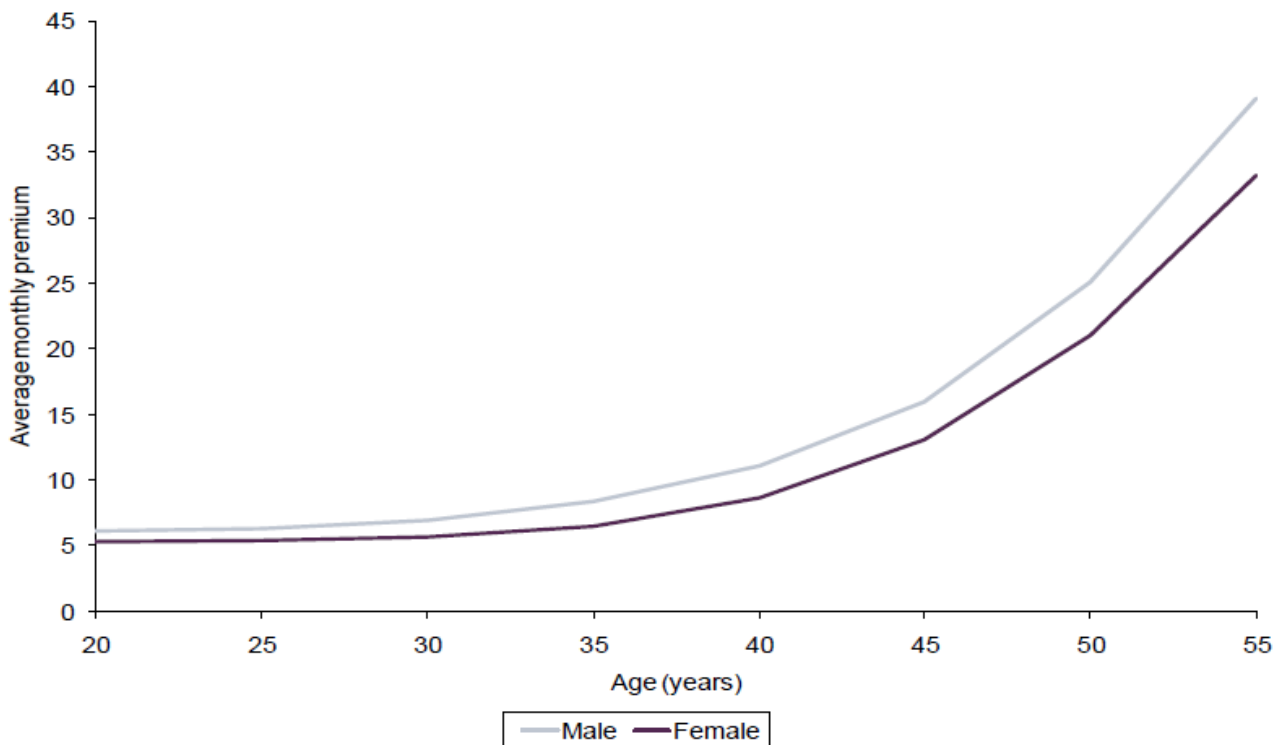


Figure 5: Graph illustrating the differences in average monthly premium for life insurance according to age and gender

Source: ABI Research Paper No 24, 2010 – The use of gender in insurance pricing

28. On average, females live longer than males by approximately 4 years. As a result, premiums differ between the genders because of the varying risks that they pose. Mortality rates for females, at any given age, are lower than those for males.

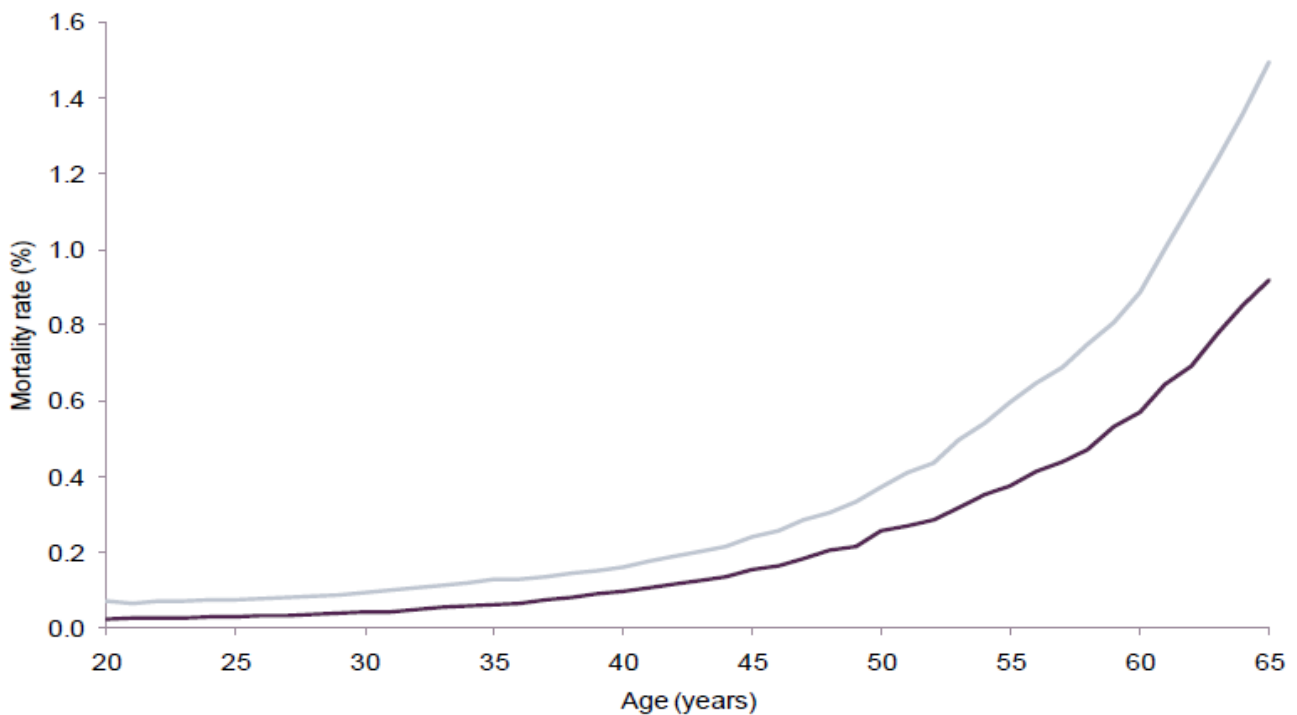


Figure 6: Graph illustrating the differences in mortality rates according to age and gender

29. The strong correlation between mortality rates and the premium charged to males and females vindicates the approach taken in a risk-based pricing model. The move to unisex pricing means that females will lose out on the reduced premium they currently enjoy as a result of the reduced mortality rate in their risk pool. The industry estimates that indicate females will lose out are explained below.

Quantitative calculations

30. A typical monthly premium for a term-life policy has been estimated to be £17 (2) for a female, and £22 for a male. If the corresponding premium following the removal of gender as a risk factor in the pricing of individual policies were £20.50 there would be a loss of £3.50 for every female term-life policyholder, and a gain of £1.50 for every new male term-life policyholder, all else being equal. The figure of £20.50 has been suggested, rather than the average of £19.50, as a result of more males purchasing term-life cover than females.

31. In order to extrapolate this figure across the market, we would need to be able to determine the number and gender mix of term-life policyholders in the UK. This is the type of data we are hoping to acquire as part of this consultation.

32. It should also be noted that:

- A significant proportion of policies are sold on a Joint Life basis (covering a man and a woman); these will be largely unaffected.
- The changes in premium are modest (e.g. in relation to income) and hence it can reasonably be expected that the change will have only a minor impact on demand.

Annuities

33. Annuities pay out a fixed sum per annum on retirement, in return for investment in a 'pot' by an individual over the course of their working life. Annuities can also be index-linked to adjust for inflation. As mentioned previously, males tend to live shorter life-spans than females, and are consequently more risky in the protection market. For annuities, the result of males living shorter lives than females is that they receive a higher payout for the same 'pot' size, as that investment must last a shorter period of time compared to females. *Figure 7* shows males receive a higher average annual annuity payment as compared to females.

2 Source: Institute and Faculty of Actuaries Working Party. Based on a 50 year-old, non-smoker, covering a sum of £150,000 for a term of 10 years.

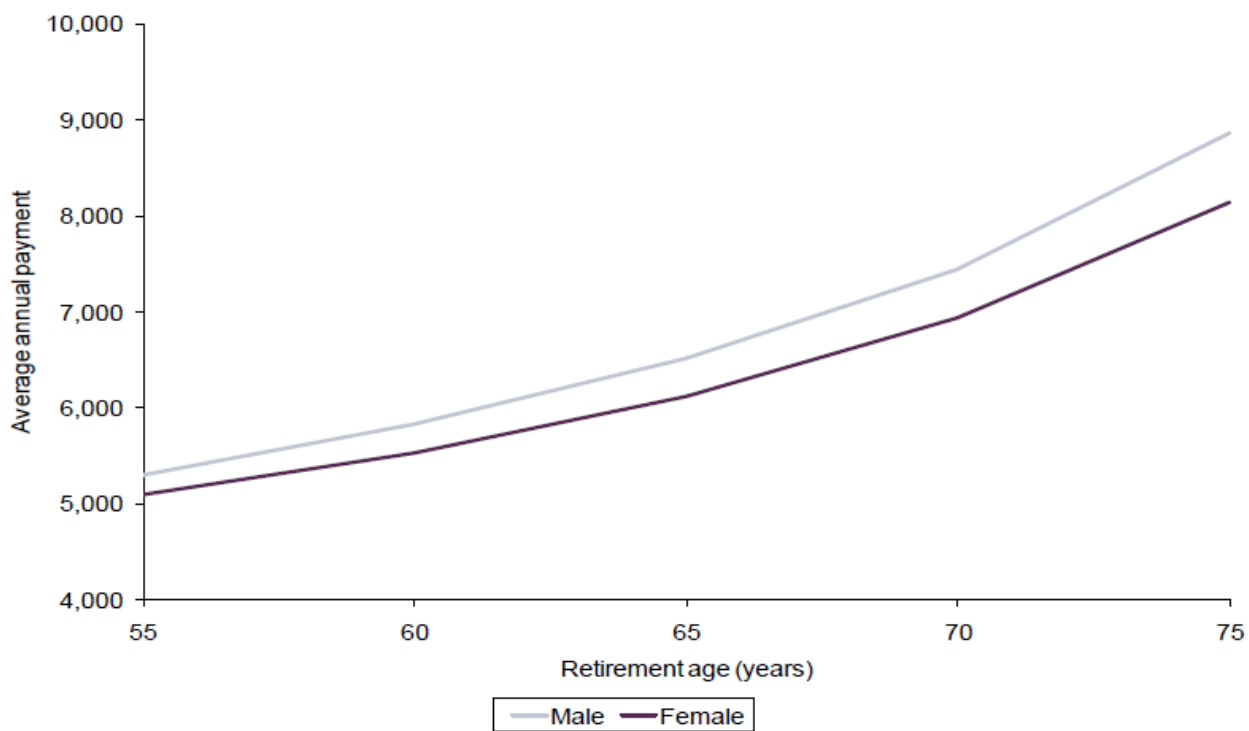


Figure 7: Graph illustrating the differences in average annual payment for a pension annuity according to age and gender
 Source: ABI Research Paper No 24, 2010 – The use of gender in insurance pricing

34. The reasoning behind the higher average annuity return for a male as compared to a female, with all else being equal, results from the lower life expectancy in their risk pool. The same lump sum is expected to last a shorter period of time, therefore meaning they receive a higher annual rate of return.

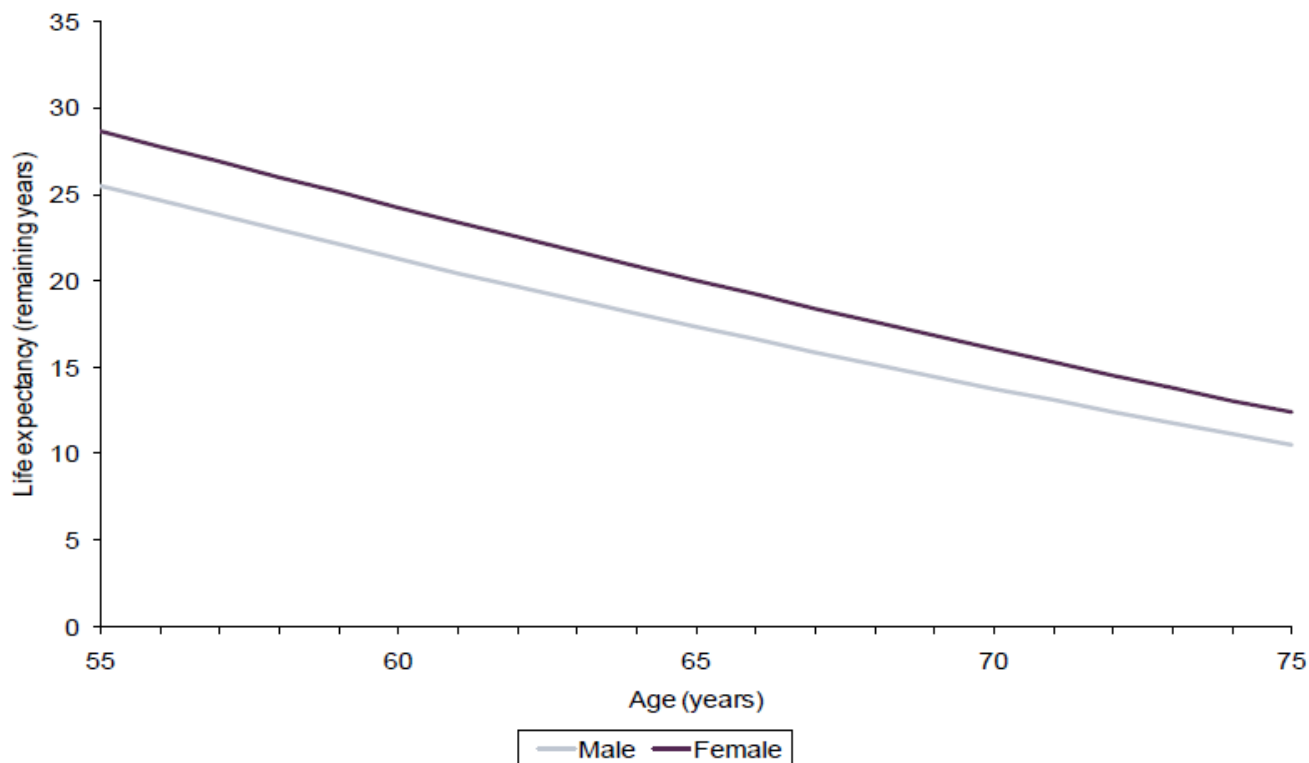


Figure 8: Graph illustrating differences in life expectancy according to age and gender

35. As gender-neutral pricing will have to be implemented, males will lose out on the benefit of being identified as belonging to a risk pool with a lower life expectancy. Males will therefore have to accept a lower payout from an annuity than they currently receive. This lower payout is likely to act as disincentive for men to invest in annuities instead of other retirement provision. Therefore, although women will enjoy and up-front uplift in rates, which might encourage greater female take-up of annuities, in the medium term, the adverse selection impacts are likely to bring down annuity rates for both sexes – potentially leading to a greater reliance on State provision. (Although the impacts on the welfare system are beyond the scope of this impact assessment.)

Quantitative calculations

36. A male annuitant may currently receive an average payout of £6,642 (3) per annum, whereas a female annuitant may currently receive £6,243 (4) per annum. If the corresponding payout following the removal of gender as a risk factor in the pricing of individual policies was £6,574 there would be a loss of £68 per annum for a male annuitant and a gain of £331 per annum for the female annuitant. However, the figure for the post-change annuity reflects the current mix of annuities between males and females at age 65, whereas there is a clear potential for the change to affect the decision of males as to whether or not to purchase an annuity. If the proportion of males reduces, then the post-change annuity will settle nearer to the current female annuity.

37. In order to extrapolate this figure across the market, we would need to be able to determine the number and gender mix of annuitants in the UK. This is the type of data we are hoping to acquire as part of this consultation.

38. It should be noted that, again, the effect of the change is dampened by the popularity of joint life annuities, which are often chosen to pay a lower income to the spouse after the death of the pensioner (the figures above relate to single life annuities).

Impact on industry

39. The inability to use gender as a risk factor in the pricing of individual insurance policies will primarily be felt by consumers. There will also, however, be significant impacts on industry.

40. As indicated above, consumers belonging to the lowest risk categories are likely to lose out the most as a result of the ruling, paying a higher premium. This could mean that these low-risk categories leave the market, which will affect revenues taken by insurers. The cost to different insurers will depend on the mix of risk types within their overall risk pool. This means that insurers with a largely low-risk pool (for example those solely targeted at females) will be able to take a

3 Source: Institute and Faculty of Actuaries Working Party. Based on a 65 year-old, purchase price £100,000.

4 Source: Institute and Faculty of Actuaries Working Party. Based on a 65 year-old, purchase price £100,000.

bigger hit in terms of revenue lost and provide a more competitive quote than those composed largely of a higher-risk pool.

41. The costs to industry are likely to be felt in the transitional period. This will include, but not exclusively:

- Underwriting changes
- Marketing changes
- Sales changes
- Losses as a result of consumer premium changes

42. The quantitative impacts of these various changes are very difficult to calculate for industry at this early stage, with no data being available to estimate costs. We have therefore omitted these costs for the purposes of this impact assessment, and seek further data in this area as part of this consultation.

Equal treatment and underwriting practises

43. Article 5(1) provides that the use of gender as an actuarial factor should not result in individual differences in premiums and benefits between men and women. It is our view that this prohibition does not prevent an insurer from making a proper and realistic assessment of the underlying risks and to reserve or purchase reinsurance according to that assessment.

44. It is our view that the use of gender in the marketing and distribution of products (and setting appropriate reserves for that business once written, and also in transactions with reinsurance companies) may continue, provided it does not result in individual pricing differences on the grounds of gender. For example:

- An insurer may reserve on the basis of gender as part of prudent risk management (for example: a provider of life assurance may hold more in reserves if their business book has a higher concentration of males; or a annuity provider may hold more in their reserves if they have a higher concentration of females; or a motor firm may hold more in their claims reserve provisions for young male policyholders)
- An insurer might buy reinsurance that is priced on the basis of the gender mix in the business they are reinsuring
- Some firms may target advertising at one gender (for example: motor insurance specifically targeted at female drivers)



List of consultation questions

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.

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?

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?

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?

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

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?

HM Treasury contacts

This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

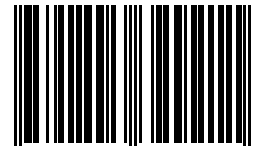
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