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:

Government response

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1 Introduction

Purpose of this document

1.1 The Treasury launched a consultation in December 2011 on the Government's proposed implementation of the European Court of Justice (ECJ) judgment on gender neutrality in the pricing of insurance premiums and benefits. This document summarises the responses received to that consultation, sets out the Government's response on key issues and confirms the legislative approach to be implemented.

Background

1.2 On 1 March 2011 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 contained in Article 5(2) of the Gender Directive, which permitted this practice, should cease to have effect from 21 December 2012. In delivering its judgment, the Court emphasised the principle of equal treatment between men and women in the access to supply of goods and services. The Court took the view that this principle applies equally to both men and women because they are comparable, and should therefore be treated as such for the purposes of insurance.

1.3 The Government was disappointed with the judgment, which it expects to have a largely negative impact on consumers. 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. However, the judgment is binding in UK Law and the Government is therefore legally required to implement it. We have been working with industry and the FSA, in particular, to ensure a handling strategy that mitigates negative impacts.

1.4 The consultation document published in December 2011 set out the Government's view that the ECJ judgment applies only to new contracts entered into after 21 December 2012 and that any contracts entered into before that date can continue unchanged. Views were sought on a draft order that would implement the judgment in line with this interpretation. The consultation also set out the Government's position on other legal issues arising out of the judgment, and sought views on these. Finally the Government sought views on its analysis of the impact of the judgment and requested additional information that could better inform this.

Responses to the consultation

1.5 The Treasury received 38 responses to the consultation, the majority of which were from the insurance sector. A list of respondents can be found in Annex C. Chapter 2 summarises the main issues raised by respondents under the six consultation questions and Chapter 3 outlines the Government's response to these. The Government position set out in Chapter 3 is not intended to represent legal advice as only the courts have the authority to interpret the ECJ judgment.

1.6 We are very grateful to those who took the time to respond to this consultation.

2 Summary of consultation responses

Question 1: Impact on consumers and industry

2.1 The consultation asked: *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 which helped 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.*

2.2 The majority of respondents agreed with the Government's analysis, suggesting this was broadly in line with industry estimates. Some also provided information from their own analysis to corroborate the key findings in the impact assessment. Other respondents simply noted that the analysis appears credible and the data sources used authoritative. Several respondents made additional observations or supplied information beyond that already included in the impact assessment. This information is summarised below.

Number of policyholders and gender mix

2.3 Some industry respondents supplied information about the number of policyholders and the gender mix in different product lines:

- Term life assurance: approximately 3 million policyholders. Where joint policies sold the estimated split was 40 per cent male, 32 per cent female, 28 per cent joint. Where no joint policies sold the estimated split was 50 per cent male, 50 per cent female;
- Critical illness: estimated split was 39 per cent male; 38 per cent female; 23 per cent joint;
- Whole life: estimated split was 45 per cent male; 55 per cent female;
- Income protection: estimated split was 66 per cent male; 34 per cent female;
- Annuities: approximately 700,000 policyholders; where joint policies sold the estimated split was 37 per cent male, 25 per cent female, 38 per cent joint. Where no joint policies sold the estimated split was between 66-78 per cent male, between 22-34 per cent female; and
- Private medical: approximately 100,000 policyholders; estimated split was 55 per cent male, 45 per cent female.

Industry implementation costs

2.4 In addition to those noted in the consultation document, respondents suggested a range of factors that may result in increased costs to industry, including: the cost of meeting consumer redress, including awarding compensation from complaints; the cost of future litigation; the cost of holding additional capital; the cost of determining and implementing a gender neutral strategy; the cost of increased cancellations in December 2012 (as those in the higher risk group leave and re-enter the market); the cost of increased switch-over between insurers (including broking costs) as premium changes prompt more consumers to shop around; and training costs.

2.5 Of those respondents who had attempted to quantify costs to their business arising out of the judgment, these estimates ranged from £200,000 – £1.1million. Others had not been able to quantify the costs but expected these to reach into the millions of pounds.

Other observations

2.6 In addition to the information supplied above, respondents made a wide range of other comments in relation to the impact of the judgment, including the following:

- It will be difficult to isolate the impacts of the judgment given other regulatory changes occurring around the same time including Solvency 2, the Retail Distribution Review and tax changes;
- In the longer term the use of telematic technology will allow motor insurers to continue to price risk on an individual basis, although this will not help in the immediate transition to gender-neutral pricing;
- The possibility of products from non-European countries being sold in the UK will introduce an additional level of uncertainty around the impact of the judgment;
- The rise in annuity premiums resulting from adverse selection may lead to fewer people paying into a pension and more people therefore relying on the state for support in retirement;
- Annuity purchases will become more common in the shift from Defined Benefit to Defined Contribution pension schemes, the ECJ judgment will not alter this trend; and
- If adverse selection occurs as suggested in the Impact Assessment then a greater number of higher risk consumers will be covering their losses. Provided the total number of policies written does not fall substantially then a potential benefit of the ECJ judgment would be increased coverage of the overall population's losses.

Question 2: Draft regulations

2.7 The consultation asked: *Do you agree that the scope of the regulations should be restricted to repealing paragraph 22 of Schedule 3 to the Equality Act?*

2.8 The majority of respondents agreed that the repealing of paragraph 22 was all that was necessary to comply with the ECJ judgment, with several noting their support for the Government's approach of making minimal changes to legislation.

2.9 However other respondents felt the repealing of paragraph 22 alone was insufficient or inappropriate. Suggestions for other legislative changes included:

- The provisions in paragraph 22 should continue to apply to life insurance and annuities, as gender neutral pricing of these policies will discriminate against men and therefore infringe the principle of equal treatment;
- Paragraph 22 should be replaced with a provision that states it is not in contravention of section 29 for an insurer to do anything in respect of life or health underwriting that reflects physiological differences between men and women;

- Paragraph 27 should be expanded to incorporate the points made in the European Commission's guidelines[1];
- A provision should be included in paragraph 23 that states it is not a breach of section 29 to do anything pursuant to a legally enforceable obligation made before 21 December 2012; and
- Paragraph 23 should state that a renewal or review of an existing contract which does not require the consent of both parties is not a renewal or review for the purposes of sub paragraph 4.

Question 3: Indirect discrimination

2.10 The consultation asked: *Do you have any comments, in relation to these draft regulations, on the scope of indirect discrimination in insurance and related financial services?*

2.11 Many respondents agreed with the Government's comments on indirect discrimination as set out in the consultation document, although some noted that in practice it would be difficult to assess whether a risk factor had a legitimate aim or whether it was simply a proxy for gender. Some respondents noted that because of this difficulty, industry had not been able to agree a common interpretation and so market uncertainty was likely to follow.

2.12 Many respondents thought that clarity on the precise interpretation of indirect discrimination could only be decided by the courts. Indeed some suggested that Government should not make any changes to the existing scope of national law on indirect discrimination as this would cause considerable confusion.

2.13 Others suggested that clarity from Government would be helpful, including on the level of proof needed to defend a claim of indirect discrimination, on factors that would be considered true risk factors in their own right, on what practices would be considered 'proportionate', and on the mechanism for enforcing the ban on indirect discrimination. Some felt this should be incorporated in legislation while others advocated guidance.

Question 4: Collection of data and use in assessing overall risk

2.14 The consultation asked: *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?*

2.15 All respondents agreed with the Government's assessment that insurers can continue to collect information on gender and use this to assess the overall risk of a pool, provided this does not result in individual differences in premiums and benefits. Several respondents noted that the European Commission guidelines had been helpful in clarifying this point and further confirmation in UK legislation or guidance would be useful.

2.16 One respondent noted that insurers should also be able to continue to use gender for other purposes, such as: target-selling at one gender; allowing salespersons to negotiate different premiums or benefits within a pre-set gender-neutral range; offering gender-specific commissions to distributors (which might result in individual premium differences where such commissions are reinvested into the contract).

[1] European Commission: 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) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:011:0001:0011:EN:PDF

Question 5: Definition of a new contract

2.17 The consultation asked: *Do you have any comments on the definition of a new contract in the context of implementation of the ECJ judgment?*

2.18 A substantial number and wide range of responses were received to this question.

2.19 Many respondents commented on the body of law from which the definition of a new contract should be drawn. The majority of respondents felt that insurance contracts are a matter of national law and therefore the definition of a new contract should be drawn from the national law applicable in each member state. Many respondents acknowledged that this may result in differences of approach between member states but were concerned about the concept of an EU-wide contract law. Some thought that because the renewals process varies across Europe it may be impossible to derive a common EU definition of a new contract, and indeed some noted that the European Commission guidelines did not seem to reflect UK law on the issue of automatic extensions to an existing contract (tacit renewals).

2.20 A few respondents conversely suggested that a de minimis definition of a new contract should be agreed at EU level that would apply to all member states, in order to create a level playing field across Europe. Others simply felt that clarity from Government over which legal framework applies would be helpful.

2.21 Many respondents submitted comments or questions on the extent to which changes to an existing contract (such as mid-term adjustments or tops ups) constitute a new contract. Responses indicated a wide divergence in industry views. On the one hand some respondents suggested that any change to an existing contract that alters the risk insured or the premium charged would constitute a new contract. On the other hand some respondents suggested that any changes made within the parameters of an existing contract should not be deemed to constitute a new contract.

2.22 The full range of suggested triggers of a new contract included: whether there is a fundamental re-assessment of risk; whether the premium on the policy would change as a result of the adjustment; whether consent is needed from both parties; whether options for mid-term adjustments were included in the original contract; whether premium changes for adjustments (or the methodology for calculating premium changes) were fixed in the original contract; whether the insurer is fulfilling a contractual obligation; whether the change to the contract was a 'guaranteed' option in the original contract.

2.23 Comments were also received on when a contract can be deemed to be 'concluded'. A few respondents thought there was uncertainty around whether this was the date on which cover starts, the date on which the policyholder's application is received or the date on which the premium is received. Others felt this was more straightforward in that in the UK the standard English contract law principle of 'offer and acceptance' applies.

2.24 Some respondents felt that clarity was needed on exactly what constitutes a new contract for the purposes of applying the ECJ judgment and that guidance from Government would be helpful. Others felt that the usual principles of contract law apply and no further guidance is necessary. Some respondents noted the potential ambiguity on this issue but suggested it was ultimately for each insurer to determine which changes to an existing contract constitute a new contract. Some also suggested that while the divergence of views across industry would result in different approaches by insurers to pipeline business, there would be little consumer detriment as a result.

2.25 A range of other comments were received in response to this question, including the following:

- The transition to gender-neutral pricing will create a degree of unfairness and confusion for consumers, for example where a quote is offered prior to 21 December but not accepted until after that date;
- Insurers should not be encouraged to adopt artificial structures ahead of 21 December in order to extend gender priced contracts where they would not normally do so;
- Government should state whether it agrees with the European Commission guidelines on this issue, particularly where English contract law appears to differ from the principles in the guidelines; and
- The transfer of a contract from one insurer to another, or the bulk buying of group annuities where individual annuities are issued by the new provider, should not constitute a new contract.

Question 6: Group insurance schemes

2.26 The consultation asked: *Do you agree that no amendment is needed to paragraph 20 of Schedule 3 to the Equality Act 2010 as a result of the ECJ judgment?*

2.27 The majority of respondents agreed with the Government's assessment that paragraph 20 does not need amending in order to comply with the judgment. A range of additional comments were received in relation to this question, including the following:

- Group policies of any nature should be exempt from the judgment, not just those related to employment, as the gender directive is aimed at individuals only;
- As group insurance schemes and business to business transactions are out of scope of the judgment, this could lead to more products being offered through these routes, allowing those in lower risk groups to access preferential rates;
- The provision of insurance through an employer should also be subject to gender-neutral pricing to prevent an unlevel playing field emerging between these policies and those available on the open market;
- The gender directive excludes all types of group employment cover, whereas paragraph 20 in the Equality Act does not seem to specifically exclude situations where insurance is taken out directly by the organisation providing cover;
- Paragraph 20 should incorporate the wording from the gender directive to be clear that only policies that are 'private, voluntary and separate from the employment relationship' are subject to the judgment; and
- Where males and females receive the same benefits through a group scheme then the gender directive and ECJ judgment does not apply. However if an individual opts to take out additional cover on top of a policy provided through a group scheme then both apply and gender neutral pricing is required.

Work based pension schemes

2.28 A large number of comments were received specifically in relation to the applicability of the judgment to work based pensions and annuities purchased from such schemes. These comments centred around the difference between the Equal Treatment Directive which applies to occupational pensions and still permits gender-specific pricing, and the Gender Directive which applies to other types of pensions and does not.

2.29 Many respondents suggested that it was not clear whether the Gender Directive or the Equal Treatment directive applied in the case of annuities purchased from money purchase occupational pension schemes. Most thought it was clear that if an individual uses their occupational pension lump sum to purchase an annuity themselves on the open market then the Gender Directive applies and the annuity must be priced on gender neutral terms. However it was suggested that the situation is less clear when an annuity is purchased by the trustees of a pension scheme for the benefit of an employee.

2.30 Some respondents also questioned the extent to which Group Personal Pensions (GPPs) are covered by the Gender Directive and whether this is dependent on the level of employer involvement in arranging the pension benefits. It was suggested that the ECJ judgment may result in a disparity of treatment between occupational pension schemes, GPPs and private pension schemes.

2.31 Some respondents felt that the guidelines from the European Commission did not provide absolute certainty on which directive applies when an annuity is being purchased using money from a work based pension scheme. It was suggested that Government should seek clarity on this issue.

2.32 Many respondents thought that a market where gender-specific annuities are available to some people through work based pension schemes, whilst privately bought annuities must be priced gender neutrally would be detrimental, for the following reasons:

- It provides an unfair advantage to people who have access to a work based pension scheme as these people may be able choose to between gender-specific or gender-neutral benefits. In particular this provides an advantage to women, who will always be able to access the open market where they can get the best deal from a gender neutral annuity;
- A 'two-tiered' annuity market would be confusing for consumers, and people may not understand how they can get the best deal on an annuity. This confusion may create a negative perception of the insurance industry;
- It would be burdensome for insurers to have to price both gender specific and gender neutral rates in order to cater to a split annuities market; and
- A market where better rates may be accessible by sticking with an annuity offered by an employer, may discourage people from exercising their Open Market Option (OMO). This may be out of step with recent Government and industry efforts to encourage people to take advantage of their OMO.

2.33 Several respondents suggested that in order to prevent a two-tiered annuity market emerging Government should legislate to extend gender-neutral pricing to all annuities. Others noted that doing this would be difficult, either because it would be out of step with the intention of the European Commission or that action in this area would be premature as the boundary between the Equal Treatment directive and the Gender Directive is unclear.

2.34 Some respondents commented on the impact of the judgment on the drawdown tables produced by the Government Actuaries Department (GAD). They noted that uncertainty around how the annuities market will respond to the ECJ judgment would make it hard for GAD to produce meaningful tables that align drawdown amounts with amounts available through annuities. Several respondents suggested that GAD should use male tables for all drawdown customers for at least four months after the judgment takes effect. One respondent raised a concern that if men cannot drawdown as much on their pension pot in future then they may have more left in their pension pot at death and will subsequently be taxed more at this point. Some respondents felt that in the longer term a review of the drawdown rules would be desirable.

Other comments

2.35 Some respondents submitted general comments in addition to answering the specific questions posed in the consultation. These included the following.

2.36 Many respondents noted that they shared the Government's disappointment with the ECJ judgment and agreed that it would have a negative impact on consumers and industry. Several respondents also explicitly agreed with the Government's interpretation that the judgment only applies to new contracts concluded after 21 December 2012.

2.37 One respondent suggested that in implementing the ruling in the UK it would be important for providers, financial advisors, consumers, the UK Government and EU institutions to have a common understanding of the judgment and for unnecessary complexity to be avoided.

2.38 One respondent felt that the judgment should not result in unjustified premium increases and that increases purported to be resulting from the judgment should be subject to scrutiny. Others felt that there were many justifiable reasons why prices were likely to increase, both as a result of the ECJ judgment and as a result of other upcoming changes to insurance regulation.

2.39 In commenting on the guidelines issued by the European Commission several respondents observed that the precise legal status of these guidelines was unclear. Respondents who noted they were not legally binding suggested that following the guidelines could still leave insurers open to legal challenge. Some respondents requested that Government state whether it agrees with the Commission's guidelines, particularly in areas where these seem to be at odds with assertions in the Government's consultation document (issued before the guidelines were published).

2.40 Several respondents suggested that further guidance from Government would be useful in helping industry understand how to interpret the judgment, including clarity around the scope of the Gender Directive in relation to group schemes and work based pensions. Others felt clarity in legislation would be preferable.

3 Government response

Impact on consumers and industry

3.1 Government would like to thank those who helped provide information for the purposes of better informing our understanding of the impact of the ECJ judgment.

3.2 We are conscious that much of the information submitted on the number and gender mix of policyholders is representative of only a part of the market, and in some instances is only indicative of one firm's data. Any conclusions extrapolated from this data would be extremely tentative and we have therefore decided not to revise our Impact Assessment at this stage (see Annex B). However, our overall assessment of the additional data received is that, while incomplete, it broadly supports the assertions made in the impact assessment, particularly in relation to term life and annuities policies where our original data was limited.

3.3 The additional data received is a useful base from which we hope to further build our understanding of the quantitative impacts of the judgment. We intend to have further discussions with industry over the coming months to try to gather a broader set of data on which to do so. We are also grateful for the additional information provided on the changes that insurers will need to make to comply with the judgment and the costs of these changes. This information helps to illustrate the extent to which the judgment will require a substantial change in market practice.

3.4 We hope to continue to work closely with industry as the market transitions to gender neutral pricing from 21 December this year. Whilst the Government is limited in its ability to mitigate the negative impacts of the judgment we are nevertheless keen to understand these impacts. This awareness is important in order for Government policymakers to take a strategic overview of the challenges facing industry and consumers, and take account of these challenges when setting future policy in relation to the insurance sector.

3.5 In relation to the concern raised by respondents about the possibility of non-EU insurance providers selling gender-priced products in the UK market, we would like to note that where such activities contravene UK law they will be dealt with appropriately.

Draft regulations

3.6 We are grateful for the comments received in relation to our draft regulations. We are satisfied that there is sufficient support for our proposed change to the Equality Act 2010 to proceed with this approach. We therefore confirm our intention to repeal paragraph 22 of schedule 3 with effect from 21 December 2012 (see draft regulations at Annex A).

3.7 In relation to those comments which suggested the regulations should go further, we do not consider there to be sufficient rationale to do so. On the proposal to allow paragraph 22 to continue to apply to life insurance and annuities we think this would be contrary to the ECJ judgment and therefore in contravention of binding European law. The other suggested amendments to the Equality Act are, in our view, either not necessary because they are issues that have been addressed in guidance from the European Commission, or not appropriate in that they represent specific interpretations of what constitutes a new contract, on which there is already a large body of contract law. Therefore no other changes will be made to the Equality Act 2010 as a result of the ECJ judgment.

Indirect discrimination

3.8 We are mindful of the concerns raised by those in industry who suggested that it may be difficult for providers to assess whether risk factors that correlate with gender have a legitimate aim or are proportionate. On this issue we think the European Commission guidelines are helpful in confirming that the use of risk factors which correlate with gender should still be possible within the scope of the judgment, provided they are true risk factors in their own right. This would suggest that where insurers can point to a robust 'cause and effect' relationship between a given factor and the level of risk presented by policyholders regardless of their gender, reflecting this level of risk in the premium charged is unlikely to be considered unlawful. For example, taking into account claims records or engine size for the purposes of motor insurance is likely to be lawful, but taking into account a person's weight might not be. However, ultimately insurers will need to seek legal advice and make their own assessment of which risk factors they are content to continue to use after 21 December 2012.

3.9 We agree with those who suggested that further clarity on the precise interpretation of indirect discrimination could only be provided by the courts. We are also mindful of those who commented that Government should not make any changes to the existing scope of national law on indirect discrimination as this would cause considerable confusion. Therefore we do not intend to make any legislative changes in relation to the issue of indirect discrimination, nor do we feel further guidance from Government is necessary or appropriate.

Collection of data and use in assessing overall risk

3.10 Our assessment continues to be that Article 5(1) of the Gender Directive does not prohibit the use of sex as an actuarial factor provided this does not result in individual differences in premiums and benefits. We are satisfied that industry as a whole agrees with this assessment and we agree with those respondents who noted that the European Commission Guidelines are useful in confirming this position. This means that where, for example, an insurer insures a pool of people comprising 70 per cent men and 30 per cent 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. We think this point is well understood and we do not think further guidance from the Government is necessary.

3.11 In relation to the comments received on the use of data beyond assessing the overall risk of a pool, we would note that the Gender Directive and section 29 of the Equality Act 2010 are only concerned with the insurer's treatment of their customer or potential customer. So, for example, the use of data on gender for the purposes of reinsurance will remain unaffected by the judgment. We also consider that simply collecting data on gender will not be contrary to Article 5(1) of the Gender Directive, provided it does not result in individual differences in premiums and benefits. However, whether other activities are contrary to the Equality Act 2010 will depend on the circumstances. For example, target selling at one gender might be unlawful if it is done in such a way as to give the impression that insurance will not be provided to the other gender. Insurers will need to seek legal advice to determine which of their practices involving the use of data on gender are permissible after 21 December 2012.

Definition of a new contract

3.12 Government is conscious that issues surrounding the definition of a new contract are of concern to many in the insurance industry. Whilst we understand the desire for certainty on these issues we must be clear that Government cannot provide further clarity on the interpretation of the Gender Directive with any authority. As there is no definition of a new contract within the Gender Directive, it will ultimately be for the courts to determine whether the definition used by Member States is in keeping with the directive and the ECJ judgment. Any further guidance provided by Government would not necessarily align with decisions the courts may make in future and would therefore only serve to provide false certainty to industry.

3.13 We agree with the European Commission that significant disparity in how Member States implement the judgment may not be beneficial as this could result in an unlevel playing field between providers across Europe. Therefore the guidelines produced by the Commission may be considered useful in helping to align interpretations of insurers across member states. While the guidelines are not law, they do represent the Commission's interpretation of the intended application of the Gender Directive and courts may therefore find them to be persuasive and influential.

3.14 That said, because Member States have built up a body of contract law at a national level, it is to be expected that there may be discrepancies between the European Commission guidelines and national contract law. We do not consider this to be a significant problem in the United Kingdom, because national law in this area is broadly in line with the interpretation suggested by the Commission. Many respondents to the consultation noted that the treatment of automatic extensions to an existing contract (tacit renewals) may be one area where there is a divergence. However, if this is the case, then national law on automatic renewals would result in more consumers being subject to gender neutral pricing than under the Commission's interpretation. This is compatible with the Gender Directive, and hence the European Commission's guidance, because the Gender Directive is a minimum harmonisation directive. It may therefore be that applying national law on automatic extensions represents a more risk-averse approach, and may help to minimise the risk of successful legal challenge in the future. However insurers should obtain their own legal advice on the individual circumstances relevant to their own contracts.

3.15 Finally, we agree with those respondents who said that insurers should not attempt to put in place artificial structures before 21 December to circumvent the impact of the ECJ judgment after this date. Any activity of this nature would clearly be contrary to the spirit of the judgment and is unlikely to be looked upon favourably by the European Commission or the courts.

Group insurance schemes

3.16 We are satisfied that there is broad support for our intention to leave paragraph 20 of schedule 3 of the Equality Act unchanged. Group insurance schemes which provide benefits to employees in pursuance of arrangements made by an employer may continue to use gender to price such insurance policies. Of course, in such cases the employer would be required to comply with the relevant provisions of Part 5 of the Equality Act 2010 in determining the benefits under such a scheme.

3.17 Whether other group insurance schemes are caught by the Equality Act 2010 depends on the circumstances of the case. In particular, an insurer will need to consider whether they are providing a service to the public or a section of the public for the purposes of section 29 of the Act. As noted in paragraph 3.2 above, even if the scheme is caught by the Act, we consider that simply collecting data on gender or using it to assess the overall risk of a pool does not in itself contravene the Act (or the Gender Directive in light of the ECJ judgment). If an employer takes out insurance for the purposes of funding benefits which the employer wishes to provide to its employees, then we do not consider that the insurer is providing a service to the public. However, the employer would have to comply with applicable discrimination law. In every case, insurers and employers should obtain their own legal advice on the exact circumstances applicable to their scheme.

Work based pension schemes

3.18 Government is grateful for the extensive comments provided by respondents on the issue of how work based pension schemes are impacted by the ECJ judgment. We are mindful that there is at least some confusion within industry on whether annuities purchased using money from an occupation pension scheme or a work-based personal pension scheme (sometimes called a Group Personal Pension) are covered by the Gender Directive.

3.19 We understand that respondents attribute this confusion to the lack of a clear dividing line between the Equal Treatment directive (which does not apply to arrangements which are not in pursuance of arrangements made by the employer) and the Gender Directive (which only applies to contracts which are private, voluntary and separate from the employment relationship). The European guidelines on the Gender Directive further elaborate by stating that the directive applies to annuity purchases where the employer is not involved.

3.20 We accept that there may be a degree of ambiguity around what exactly is meant by 'separate from the employment relationship' or what constitutes 'involvement' from an employer. However, again it is important to note that such ambiguity at a European level can only ultimately be resolved by further clarity in European law or by the courts. The Government is therefore not in a position to provide further clarity on the exact interaction between the two directives beyond that already provided for in domestic legislation.

3.21 In domestic UK legislation, equality provisions applicable to work-based pension arrangements are contained in Part 5 of the Equality Act 2010, whilst provisions applicable to other types of pension schemes and annuities are contained in Part 3 of that Act. Paragraph 20 of Schedule 3 to that Act excludes the provision of financial services including personal pensions from the scope of Part 3 where they are 'pursuant to arrangements made by the employer'. Guidance from the European Commission on the ECJ judgement suggests that where an annuity purchased using funds held in a work-based pension scheme is purchased without the involvement of the employer or the scheme, the purchase would fall within the scope of the Gender Directive (implemented by Part 3 of the Equality Act) and therefore would be subject to the ECJ judgment.

3.22 Separate from the issue of which annuities are currently covered by the Gender directive and ECJ judgment we acknowledge the concerns of those who believe that the judgment will result in a two tiered annuity market and that such a market will be detrimental to consumers and industry. Some respondents to the consultation have called for the government to extend the Equality Act to cover work based pension schemes as well as personal pension plans. On this issue, whilst we remain concerned about negative impacts of the judgment we do not feel there is sufficient evidence at this stage to justify extension of the requirement to provide gender-neutral pricing of annuities to work-based pension arrangements as well as personal pensions. We would need to consider whether there are grounds for this extension, taking into account the impact on members across the different types of pension schemes and the extent to which insurers start to offer a single pricing regime across all schemes. Any such proposal would require further consultation.

3.23 We therefore intend to keep this issue under review and monitor carefully the impact of the ECJ judgment on the annuities market. If evidence of overall consumer detriment is identified Government will consider what further action may be appropriate at that stage.

3.24 We recognise that decisions facing members of work based pension schemes at retirement may potentially have an additional element of complexity once the ECJ judgment takes effect and this reinforces the importance of the work already done by the Government and the pensions industry to focus on encouraging members to consider the open market option. We believe that considering the open market option will continue to be important for members to ascertain the best source of retirement income.

3.25 Several respondents raised the issue of how the drawdown tables produced by the Government Actuaries Department (GAD) should be modified as a result of the ECJ judgment. Government has been in discussions with industry on this issue to identify a way forward that is both fair and minimises confusion for consumers and industry. There is a similar issue in relation to the method for calculating the tax exempt element of Purchased Life Annuities (PLAs), as such calculations have previously been based on gender-specific actuarial tables. The Government intends to provide separate statements on these issues in due course and in advance of the 21 December implementation date.

Other comments and conclusion

3.26 We are grateful for the additional comments provided by respondents to the consultation, beyond the questions we posed. We agree with those who suggested it would be beneficial for a common interpretation of the judgment to be held by all relevant parties. However at the same time we are conscious that many of the issues involved in the interpretation of the judgment are complex and we judge that it may take time for a common interpretation to emerge.

3.27 We understand the desire for further guidance from Government on the ECJ judgment, however for reasons already mentioned in this response document we do not think this would be helpful or appropriate. Only the courts can provide an authoritative interpretation of the judgment and additional guidance from the Government would not help to minimise the risk of legal challenge to insurance providers.

3.28 Therefore this response document constitutes the most clarity Government believes it can provide and it is important to note that this is not intended to represent legal advice. We urge insurers to seek their own legal advice when considering how to amend their practices to comply with the ECJ judgment and the Gender Directive.

3.29 Finally we intend to continue to work closely with industry during the transition to gender neutral pricing and would appreciate further feedback from insurers and consumer groups on initial observations after 21 December 2012. We also intend to continue to engage with the European Commission to discuss whether and how further clarity can be provided on the application of the Gender Directive.

A Draft regulations

STATUTORY INSTRUMENTS

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.

Name
Name
Date 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	Impact Assessment (IA)
Lead department or agency: HM Treasury	IA No:
	Date: 03/06/2011
Other departments or agencies:	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 .... 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 duties [1] 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 ion 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 in 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.

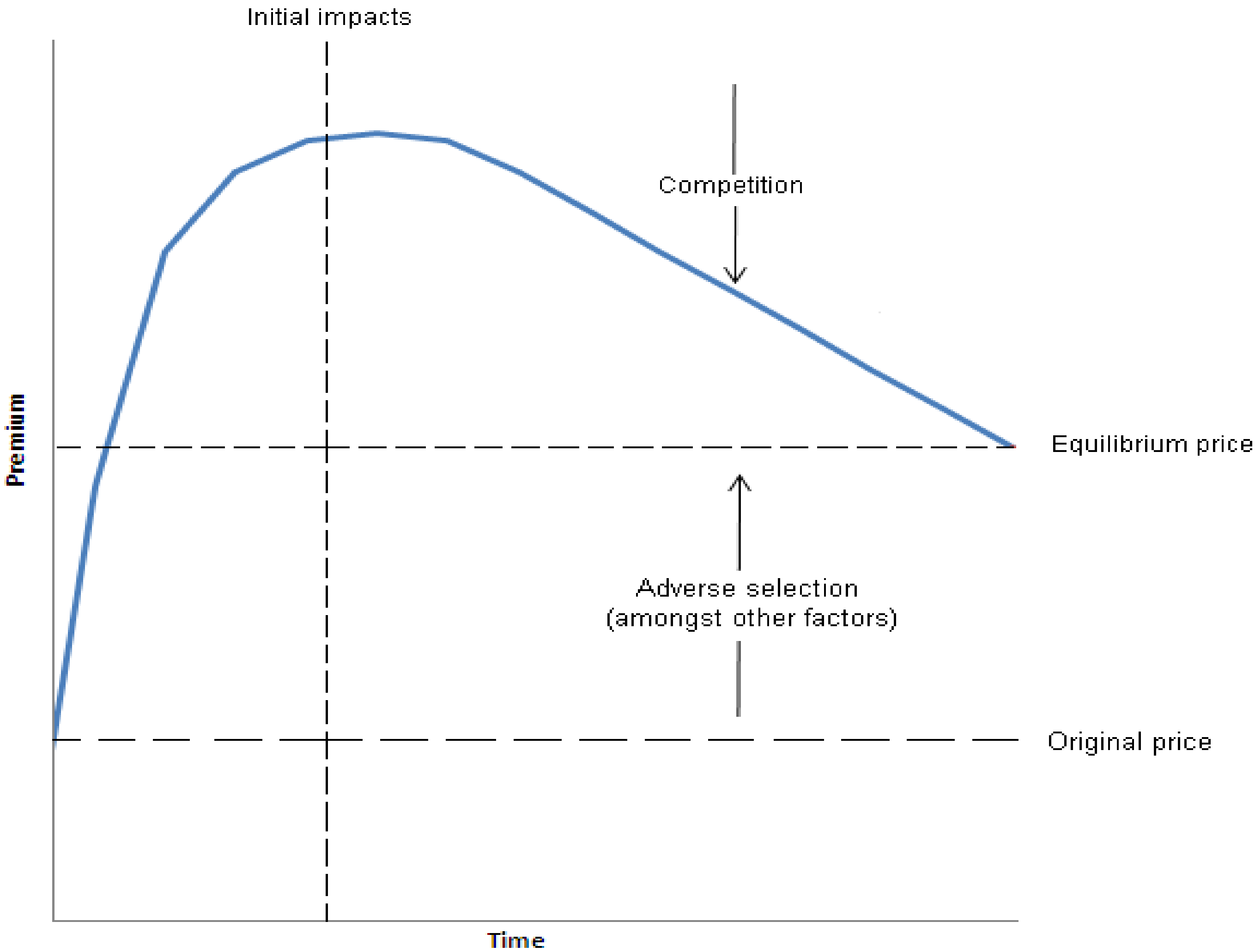

Figure 1: Graph illustrating market adjustment following the removal of the use of gender as a risk factor in the pricing of individual policies

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 that 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 in to 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.

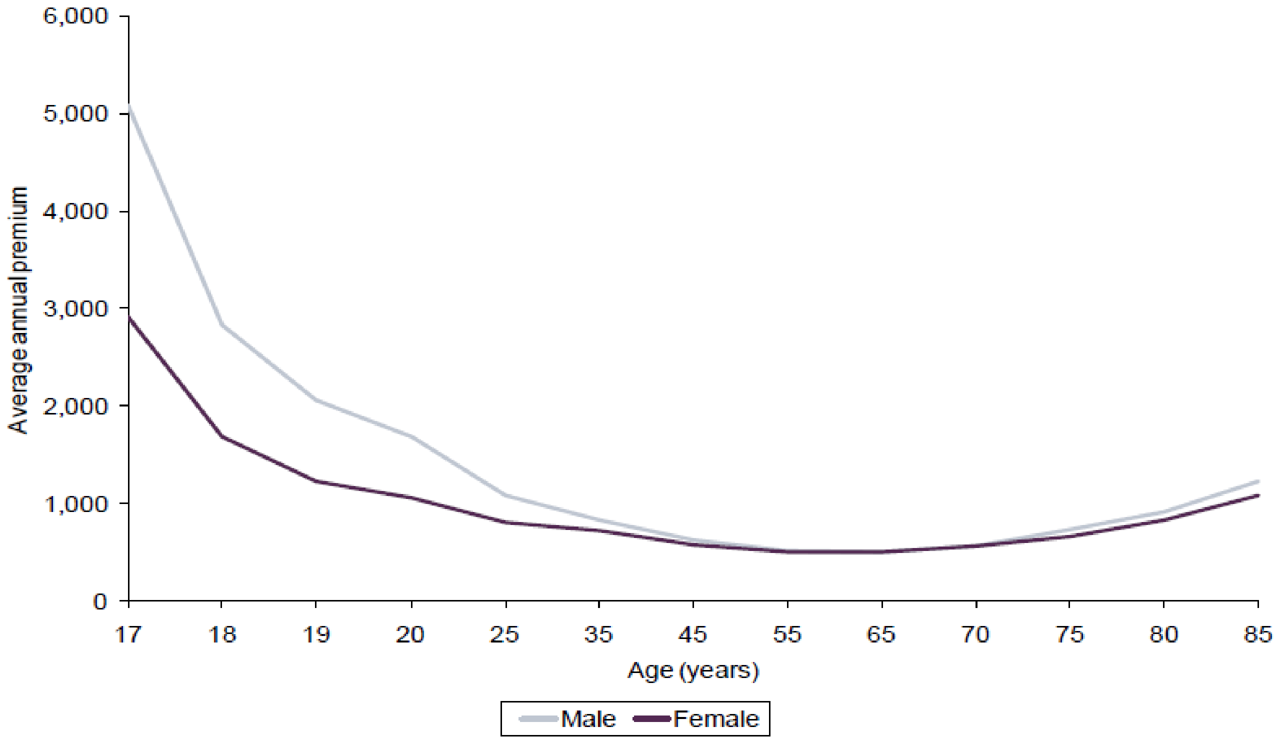

Figure 2: Graph illustrating average annual premium for motor insurance according to age and gender

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.

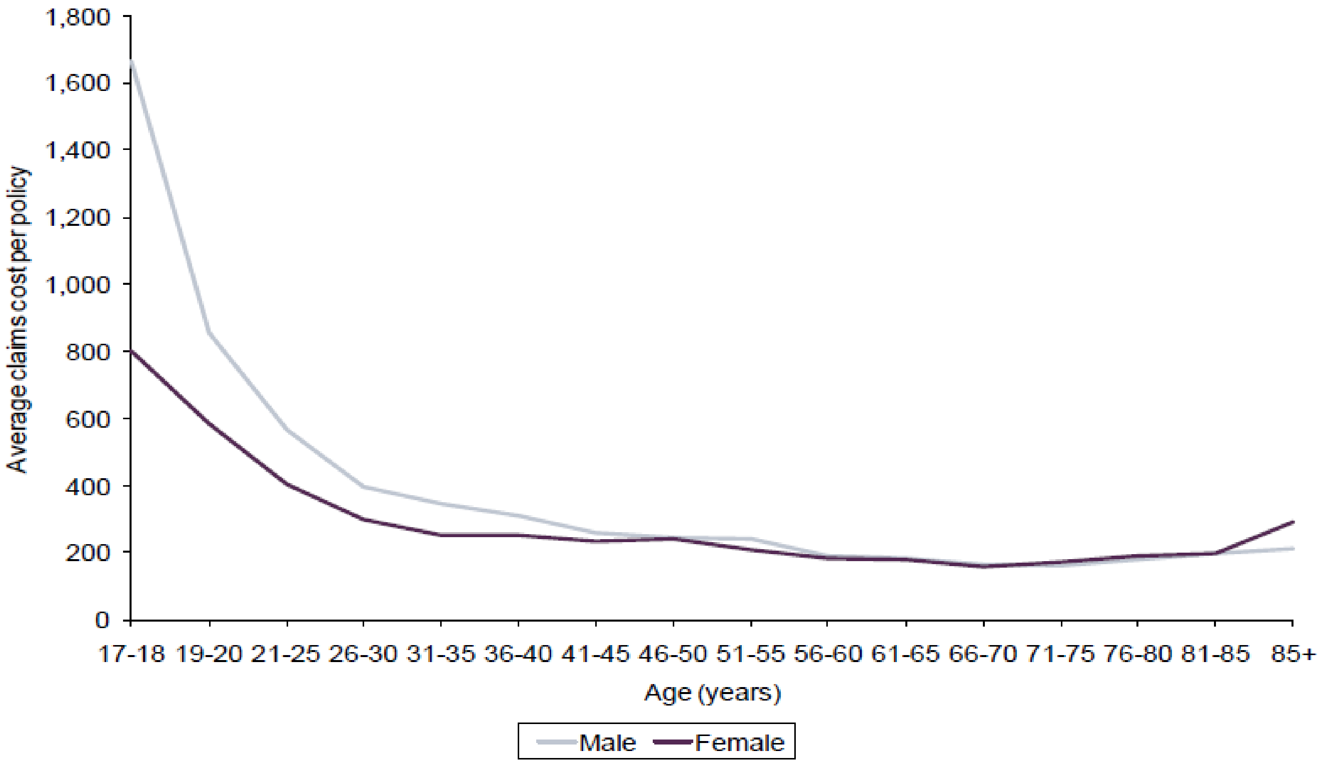

Figure 3: Graph illustrating average claims cost per policy for motor insurance according to age and gender

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.

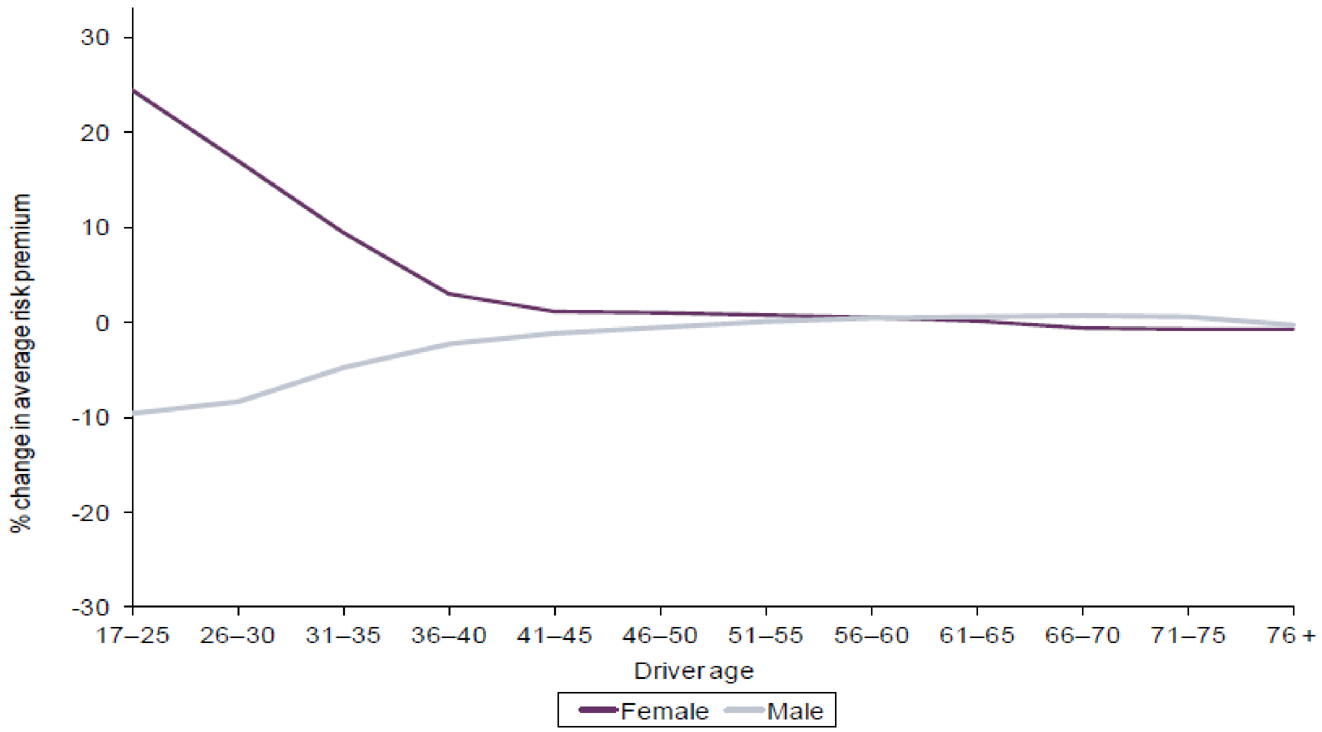

Figure 4: Graph illustrating the percentage change in average premium for motor insurance according to age and gender, following the removal of gender as a risk factor in the pricing of individual policies

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.

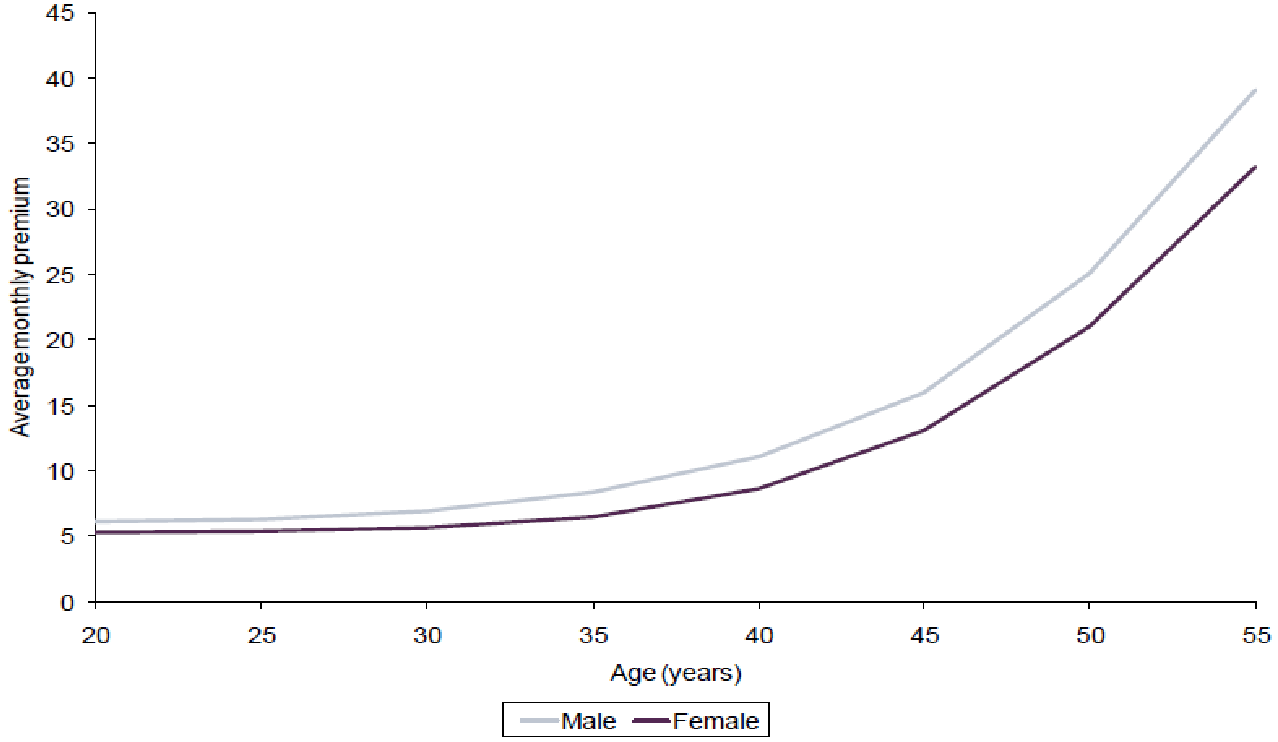

Figure 5: Graph illustrating the differences in average monthly premium for life insurance according to age and gender

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.

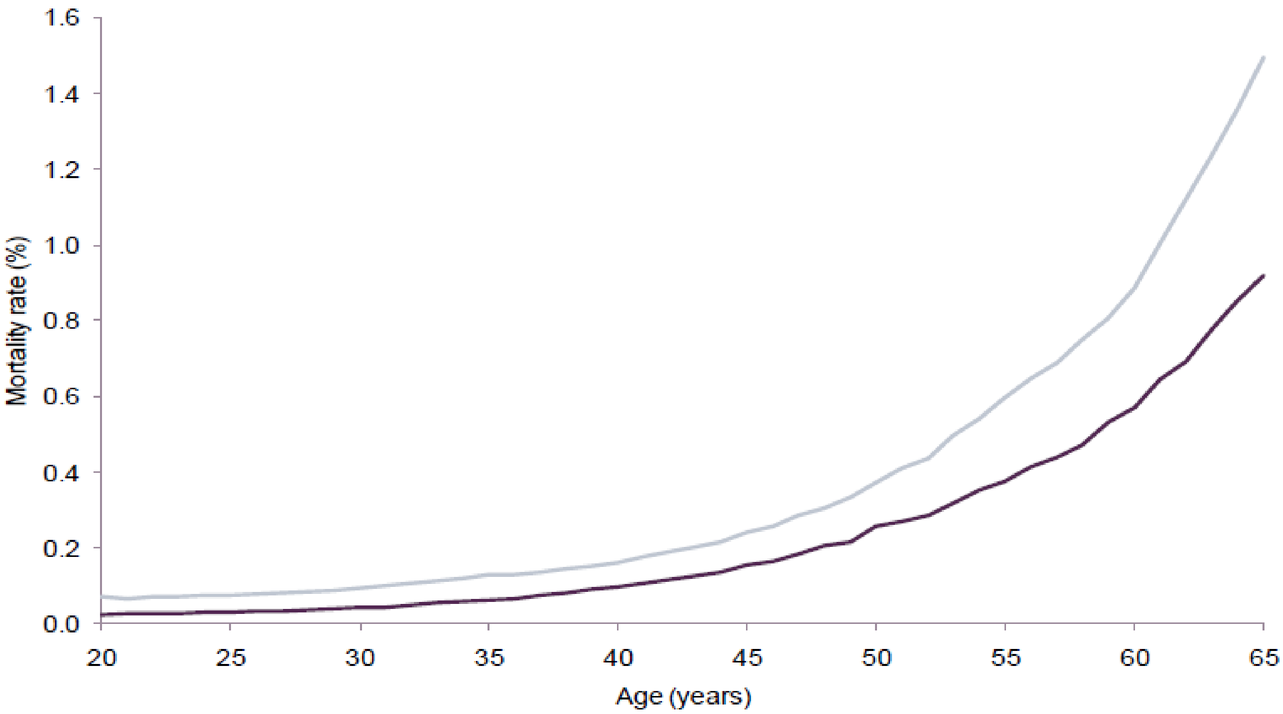

Figure 6: Graph illustrating the differences in mortality rates according to age and gender

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

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.

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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.

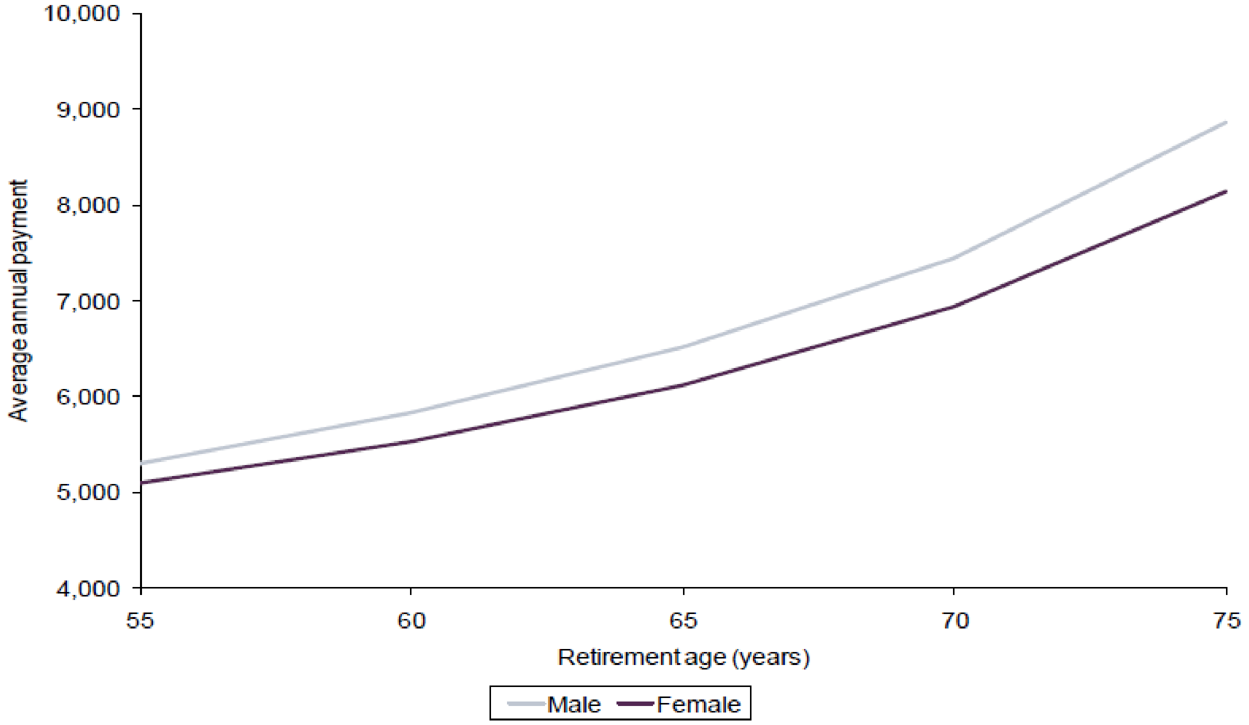

Figure 7: Graph illustrating the differences in average annual payment for a pension annuity according to age and gender

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.

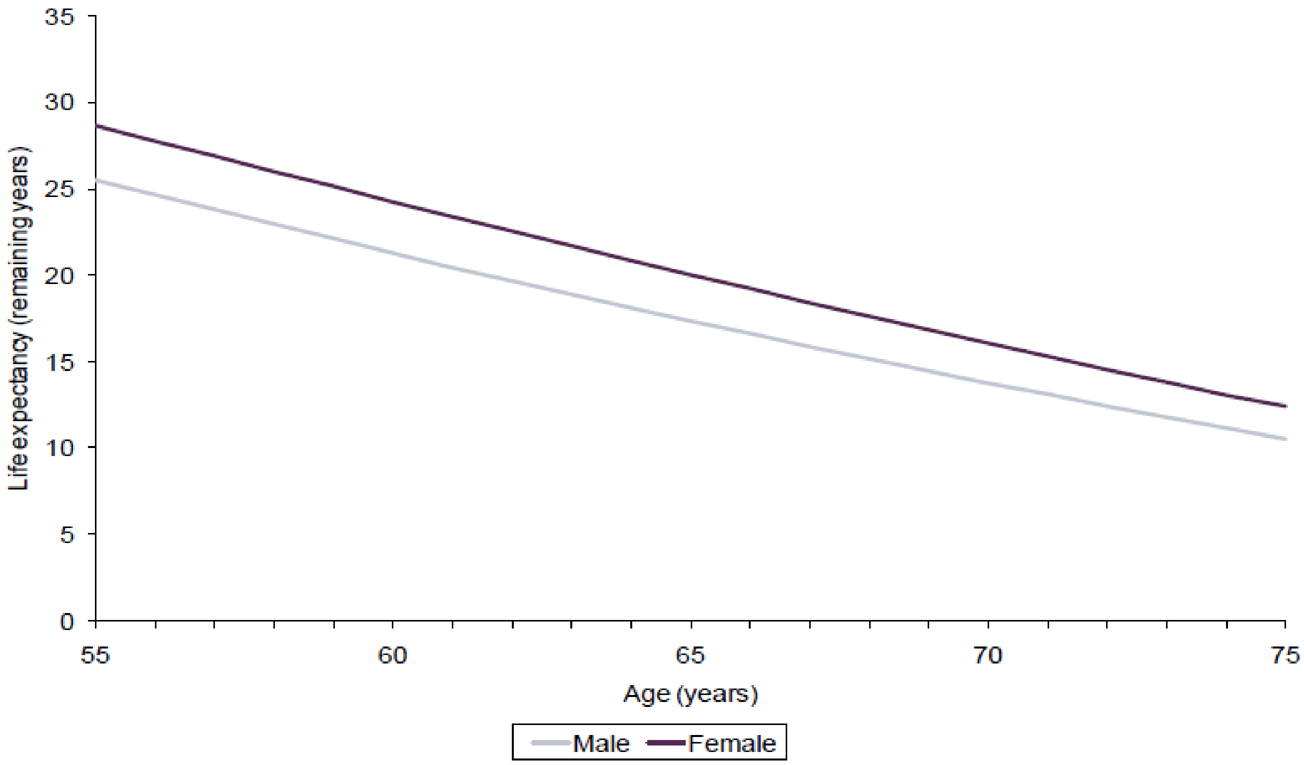

Figure 8: Graph illustrating differences in life expectancy according to age and gender

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

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

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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 reassurance 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

C List of respondents

C.1 The Government would like to thank all organisations and individuals who responded to this consultation. Responses were received from two individuals and 36 organisations, including the following:

Association of British Insurers (ABI)

Association of Member-directed Pension Schemes (AMPS)

Association of Pension Lawyers (APL)

Aviva

Barclays Bank plc

British Insurance Brokers Association (BIBA)

Capita Life and Pensions Regulated Services Limited (CLPRS)

Chartis Europe Limited

Cooperative Banking Group

DAC Beachcroft LLP

Equality and Human Rights Commission

Friends Life

Group Risk Development (GRID)

Hannover Life Re (UK)

Investment and Life Assurance Group (ILAG)

Just Retirement

Legal and General Group plc

Liverpool Victoria

Lloyd's Market Association

Lloyds Banking Group

MetLife Europe Limited (UK branch)

MGM Advantage

Partnership

RGA UK Services Limited

Royal and Sun Alliance Insurance plc (RSA)

Sackers

Standard Life UK

Swiss Re

The City of London Law Society (CLLS)

The Equitable Life Assurance Society (ELAS)

The Institute and Faculty of Actuaries

The Law Society of Scotland

The Society of Pension Consultants (SPC)

Towers Watson

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

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