

BBS briefing note

European Court Ruling on Unisex Insurance Rates

On 30 June 2011, the Financial Secretary to the Treasury issued a statement confirming the UK Government's position on the European Court of Justice (ECJ) Judgement on the Test Achats case. The Judgement, issued on 1 March 2011, concluded that the continued use of gender in pricing insurance products would be unlawful from 21 December 2012.

This *BBS briefing note* summarises the main points of the ECJ ruling, and explains how they might affect pension schemes.

BACKGROUND

The use of sex in pricing insurance products was ruled unlawful by the ECJ on 21 December 2007, but the ECJ permitted individual member states of the European Union (EU) the option of continuing the practice, subject to a review every five years, and with the approval of the European Commission. Member states taking advantage of the opt-out included the UK and Belgium.

The validity of the opt-out was challenged in 2009 by the Belgian consumer association Test Achats, which argued that it was unlawful to price insurance products in this way as it contradicted the wider European principle of gender equality. The ECJ agreed with this view, and ruled that any option to continue using sex in pricing insurance products would no longer be permitted after the end of the current five-year review period.

The Financial Secretary to the Treasury, Mark Hoban MP, confirmed the Government's view on this ruling in June 2011. The Government believes the ruling will be applicable only for those who enter into an insurance contract on or after 21 December 2012 and, by implication, the

Government does not intend to bring the changes into UK law any earlier than this. This will allow insurers and others more time to plan for the changes.

IMMEDIATE IMPACT OF THE RULING

Most of the attention in the media has focused on the effect of the ruling on motor insurance premiums, particularly for young drivers, where women currently pay significantly less than men. The ruling is therefore likely to mean premiums for men reducing, but premiums for women increasing.

Similarly, women are likely to pay more for life insurance in the future, but may pay slightly less for health insurance, whilst the opposite is true for men.

However, the largest impact in financial terms is likely to be on the annuities market, where men are currently offered more favourable terms as they do not tend to live as long as women. If the insurance market moved to price all annuities on female terms, this could see a worsening in rates for men by up to 10%. However, given that around 80% of annuities (by value) are currently bought by men, it is more likely that rates will move to somewhere between those for males and females currently, meaning that males will receive less whilst women are likely to receive more. The extent to which insurers recognize that the market is heavily weighted towards male annuitants and reflect this in their premiums remains to be seen.

IMPACT ON PERSONAL PENSION SCHEMES

The ruling will directly affect those in personal pension schemes (including Group Personal Pensions and Stakeholder arrangements) where, apart from those with large fund values, there is no real option but to buy an annuity at retirement.

The changes are likely to be unfavourable for males and slightly favourable for females, on the grounds that the majority of annuities purchased in the market are by male annuitants.



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The ruling could encourage the use of 'personalised annuity rates', where premiums are tailored to each individual. The effect would be to produce different annuity rates for males and females, but based on their personal circumstances as opposed to their gender. However, there are clearly risks that these arrangements could fall foul of other aspects of anti-discrimination legislation, and it remains to be seen how far the market will develop.

Men in personal pension schemes who hold significant fund values may prefer to opt for 'income drawdown' arrangements or even look to transfer their benefits to arrangements outside the EU in order to secure a better annuity rate, leaving those members with smaller fund values in the UK annuity market. If this does happen to a significant extent, it would shift the balance of the UK annuity market more towards females, resulting in a general worsening of the rates offered.

IMPACT ON OCCUPATIONAL PENSION SCHEMES

The effect of the ruling on occupational pension schemes is less clear.

Defined Benefit (DB) schemes use actuarial factors, such as early retirement factors, cash equivalent transfer value factors or cash commutation factors, to convert benefits from one form to another when members exercise options under the scheme. Defined Contribution (DC) schemes use actuarial factors to convert accumulated funds to a pension at retirement, although members also have the option to do this themselves, through the purchase of an annuity in the open market.

In 1993, the court case of *Neath v Hugh Steeper* led the ECJ to rule that the use of sex specific actuarial factors in occupational schemes was permitted, and this was later re-affirmed by the UK's Equality Act in 2010.

It is not known whether the latest ECJ ruling invalidates this previous ruling. If it does, it could result in occupational pension schemes having to adopt new unisex actuarial factors.

If occupational schemes are permitted to continue using sex-based actuarial factors, it may theoretically be possible for Trustees of DC schemes to purchase annuities on gender-based terms in the annuity market, and effectively therefore to pass these terms on to their members. This could create a disparity between members of these schemes and members of contract-based schemes, such as Group Personal Pensions, who will only be able to secure annuities on a unisex basis.

BBS VIEW

Whilst the ruling was not unexpected, it has caused a significant amount of concern in the insurance market, and will have far reaching implications on the future pricing of insurance and pension products.

It is too early to say how the market will react, but we would expect most rates to gravitate towards a weighted average of the theoretical male and female rates in the longer term. Insurers will, however, be keen to avoid the possibility of being selected against, or may adjust their rates to include a loading to cover this.

Many DB schemes have already adopted unisex actuarial factors, and those that have not should review the position, given the uncertainty over the impact of the judgement.

Although occupational DC schemes may be permitted to continue offering gender-based annuities, the availability of such annuities in the market may in practice limit this option. We would therefore expect to see all schemes providing unisex terms before too long.

BBS will continue to monitor the position and advise on any significant developments.

This BBS briefing note is based on BBS's understanding of the law and is provided for information only. It should not be relied upon as a definitive statement of the law and detailed legal and financial advice should be obtained on the specific circumstances before proceeding.

