


The Actuarial Profession
making financial sense of the future

Life Conference 2011: Workshop B6
Jim Murphy, Milliman



**Making insurance
less sexy**

21 November 2011

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Agenda

- **Background to ECJ gender ruling**
- Use of gender at present
- Areas of legal uncertainty
- Possible market impacts
- Age & disability discrimination

History of gender Directive – birth to demise

2004	2008	2010	2011
<p>Gender Directive 2004/113/EC</p> <p><i>Article 5 provided option for Member States to allowed continued use of gender in insurance as a rating factor</i></p>	<p>Test Achats Case - 2008</p> <p><i>Consumer Group Test Achats take legal action in Belgium against legal validity of derogation for insurance</i></p>	<p>EU Advocate General Opinion - 30 Sep 2010</p> <p><i>EU Advocate General opines in favour of Test Achats who claim Gender Directive is illegal</i></p>	<p>ECJ ruling - 1 Mar 2011</p> <p><i>ECJ rules that gender specific premiums & benefits not allowed</i></p> <p><i>But recognised should be some time to transition to unisex rates</i></p> <p><i>Unisex rates should apply from 21 December 2012</i></p>

ECJ Ruling #1

- **“Article 5(2) of Council Directive 2004/113/EC ... is invalid with effect from 21 December 2012”**
 - provided a derogation from article 5(1) where justifiable on actuarial and statistical grounds.
- So article 5(1) will apply in all cases from 21 December 2012
 - “... use of sex as a factor in the calculation of premiums and benefits for the purposes of insurance and related financial services **shall not result in differences in individuals’ premiums and benefits.**”

ECJ Ruling #2

- What does article 5(1) mean?
 - Does it mean that premiums and benefits should not be different between two individuals for the same insurance policy solely because one of the individuals is male and the other is female?
 - Other factors such as age, health status, family history, smoking status could result in different premiums or benefits
 - Are these OK, provided the differences do not arise as a result of differences in gender?

Reactions to ECJ ruling – consumer groups



Reactions to ECJ ruling – EU Commission

EU Justice Commissioner, Vivian Reding, welcomed the judgement and signalled that she would

“convene a meeting with business leaders from the insurance industry in the coming months to discuss the judgement’s implications”

Reactions to ECJ ruling – HM Treasury

“The Government were very disappointed with this result, which it expects to have a negative impact on consumers. The judgment goes against the grain of the common sense approach to equality which the UK Government want to see. The Government believe 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.”

* Financial Secretary to the Treasury (Mr. Mark Hoban) 30 June 2011

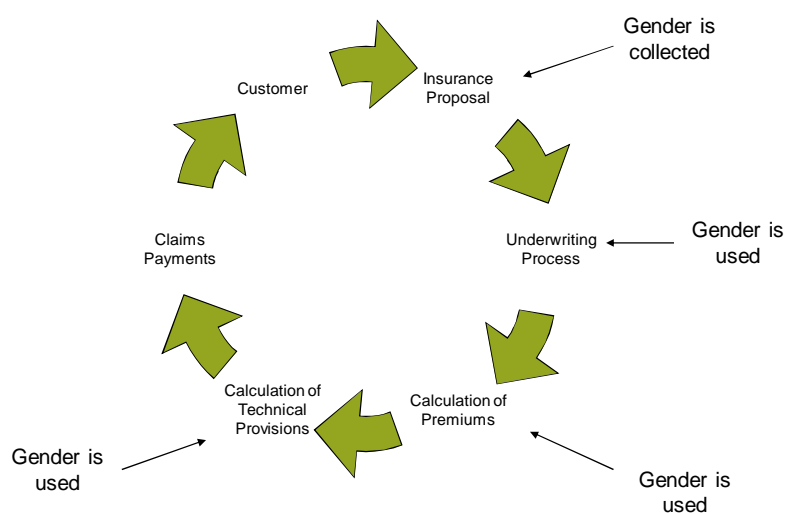
Reactions to ECJ ruling – industry



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Insurance cycle - use of gender at present



Underwriting process

- Objective is to achieve optimum balance between
 - Pooling of risks
 - Affordable standard rates for high % of population

Pooling of risks



Maximise access to standard insurance rates

- Medical underwriting is a key element in the process

Medical underwriting – role of gender

- Height & weight assessment
- Alcohol consumption
- Family history
 - e.g. prostate cancer relevant for males
 - e.g. breast cancer history more important for females than males

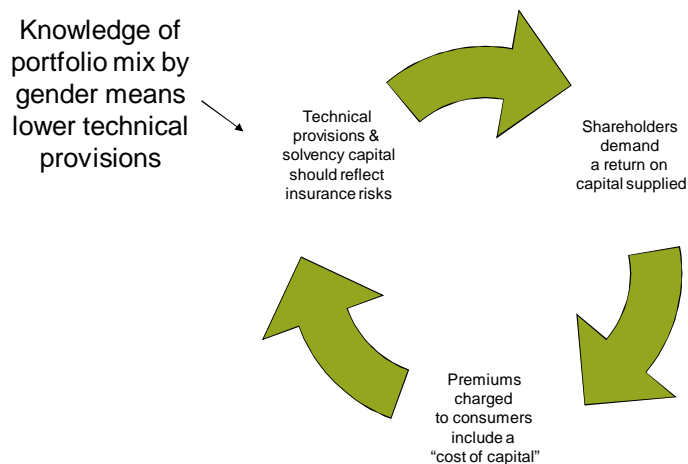
Calculation of premiums

Same
premiums
and benefits
must apply



but knowledge of
portfolio mix should
mean lower
“uncertainty”
premium for
consumers

Technical provisions & solvency capital



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Areas of legal uncertainty

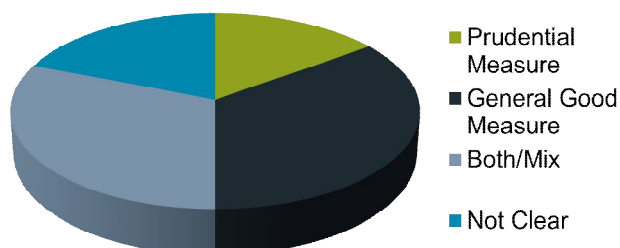
- Can insurers collect gender?
- Can insurers use gender for underwriting, aggregate pricing and reserving purposes?
- Aggregate pricing – special considerations for group schemes and bulk annuities.
- **Does the ruling apply to existing contracts?**
- Does ruling apply to non-EU insurers selling in the EU?
 - What about scope for arbitrage within the EU?

Does the ruling apply to existing contracts?

- Discussed at EU Commission Forum in June
 - As well as other areas of uncertainty
 - Commission not prepared to amend Directive
 - Will issue guidance instead – mid December?
- HM Treasury view
 - *“The Government’s view is that the judgment only applies to new contracts for insurance and related financial services entered into on or after 21 December 2012”*
 - Currently preparing draft legislation
- Other Member States
 - Initial concerns of a different approach in Belgium are abating
 - Most Member States waiting to see Commission guidance

Arbitrage: EU vs non-EU and within EU

- Implementation of gender Directive across EU:



- Inconsistent application could lead to arbitrage

* Source: Groupe Consultatif Survey
http://www.gcactuaries.org/documents/survey_gender_dir_implement_mar09.pdf

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What might we see post 21 December 2012

- Uncertainty premium built into rates?
 - Trade off between pricing conservatively and remaining competitive
 - Likely to vary by product line e.g. greatest for annuities?
- Development of alternative rating factors?
- Amendments to product design/benefits?
- Changes to reinsurance offerings?
- Lapse and re-entry effect
- New marketing strategies

Alternative rating factors?

- | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> • Marital status? • Occupation? • Diet? • Exercise levels? • Others? | <ul style="list-style-type: none"> • Desirable features of rating factors: <ul style="list-style-type: none"> – Support pooling of risks by risk grouping – Minimise risk of significant adverse selection – Are objective, verifiable, reliable, not intrusive – Minimise administration costs |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

Alternative rating factors?

- What about indirect discrimination?
 - Will rating factors that are highly correlated to gender be allowed?
 - Probably depends on whether other rating factors are direct proxies for gender or whether they simply exhibit similar outcomes?

“where an apparently neutral provision, criterion or practice would put persons of one sex at a particular disadvantage compared with persons of the other sex, unless that provision, criterion or practice is objectively justified by a legitimate aim and the means of achieving that aim are appropriate and necessary”

Amendments to product design/benefits

Examples:

Guaranteed Term Assurance	Critical Illness	Hospital Cash Benefits
<p>Guaranteed term assurance is a benefit that provides a death benefit to the policyholder's beneficiary if the policyholder dies during the term of the policy. It is a type of life insurance that is guaranteed to pay out, regardless of the cause of death.</p> <p>Guaranteed term assurance is a benefit that provides a death benefit to the policyholder's beneficiary if the policyholder dies during the term of the policy. It is a type of life insurance that is guaranteed to pay out, regardless of the cause of death.</p>	<p>Critical illness is a benefit that provides a lump sum payment to the policyholder if they are diagnosed with a critical illness, such as cancer, heart disease, or stroke. It is a type of life insurance that is guaranteed to pay out, regardless of the cause of death.</p> <p>Critical illness is a benefit that provides a lump sum payment to the policyholder if they are diagnosed with a critical illness, such as cancer, heart disease, or stroke. It is a type of life insurance that is guaranteed to pay out, regardless of the cause of death.</p>	<p>Hospital cash benefits are a benefit that provides a lump sum payment to the policyholder if they are hospitalized for a certain period of time. It is a type of life insurance that is guaranteed to pay out, regardless of the cause of death.</p> <p>Hospital cash benefits are a benefit that provides a lump sum payment to the policyholder if they are hospitalized for a certain period of time. It is a type of life insurance that is guaranteed to pay out, regardless of the cause of death.</p>

Again, need to consider indirect discrimination

Changes to reinsurance offerings

- Reinsurance is not covered by the Directive
 - Only applies to 'retail' contracts
 - So reinsurance not directly affected by the ECJ ruling
- How will reinsurers react?
 - Continue to price on gender specific basis
 - Offer a choice of gender specific or unisex rates
 - Reinsurers cannot influence mix of business so likely to build a further uncertainty premium into their unisex rates

Lapse & re-entry risk

- Transitional impact for life cover, critical illness, PHI
 - No impact for annuities
- Main exposure is for recently issued policies:

Age	Term	Premium	Age	Term	Premium
35	20	23.33	36	19	23.12
45	20	50.24	46	19	50.31
55	20	138.41	56	18	138.88

- Mitigating factors
 - Joint/dual life contracts
 - Intrusive underwriting process for consumer
 - Rates may harden for other reasons e.g. 'I-E' tax changes

Marketing strategies #1

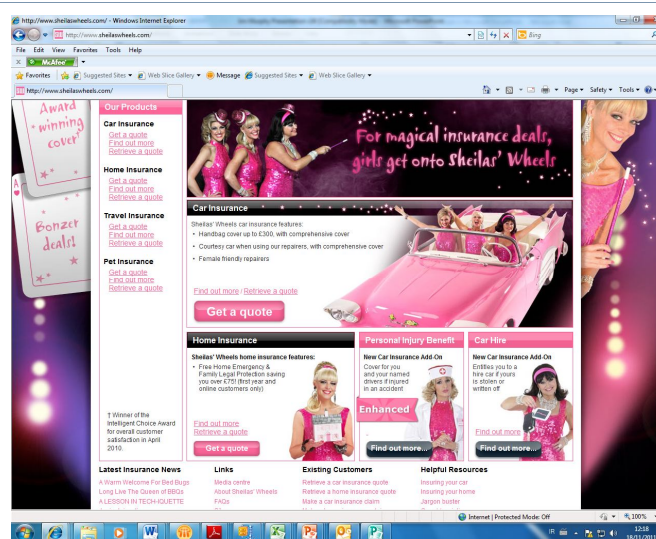
- Advertising is excluded from the scope of the Directive
 - “This Directive shall not apply to the content of media and advertising ...”*



** Again, need to consider indirect discrimination*

*** Gender stereotyping rules do not apply to actuarial presentations ...*

Marketing strategies #2



Agenda

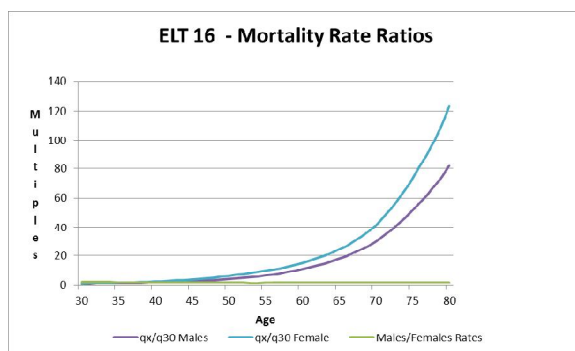
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Thin end of the wedge?

- ECJ gender ruling restricts freedom to underwrite
- Equality Directive concerning age, disability* in the pipeline
 - Equal access to goods & services
 - Derogation for financial services similar to the Gender Directive had been envisaged but now ... ?
- Possibility of legal action by Test Achats on use of age & disability in insurance
- Groupe Consultatif position paper on use of age & disability in insurance will be issued shortly

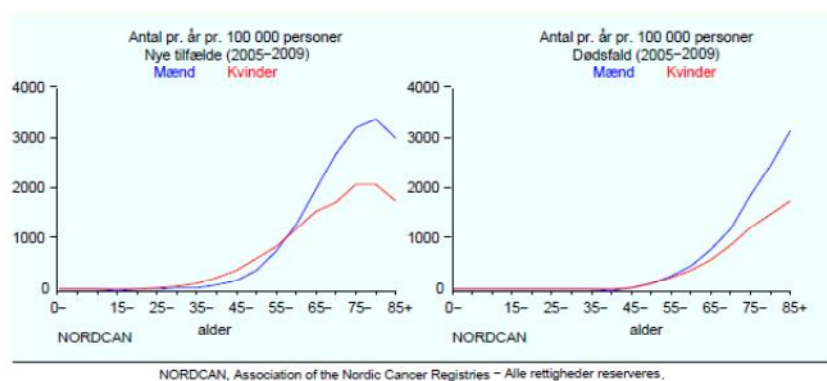
** understood to mean 'health status' in insurance context*

Age vs. Gender – Life Assurance



- Age much more significant than gender for life insurance
 - Ratio of male:female qx typically 1.5x to 2x
 - Ratio of qx:q30 up to 120 times for males

Age vs. Gender – Critical Illness



* Population incidence and death rates for cancer excluding skin cancer by age and gender in Denmark from 2005 to 2009 (males are blue line, females are red line)

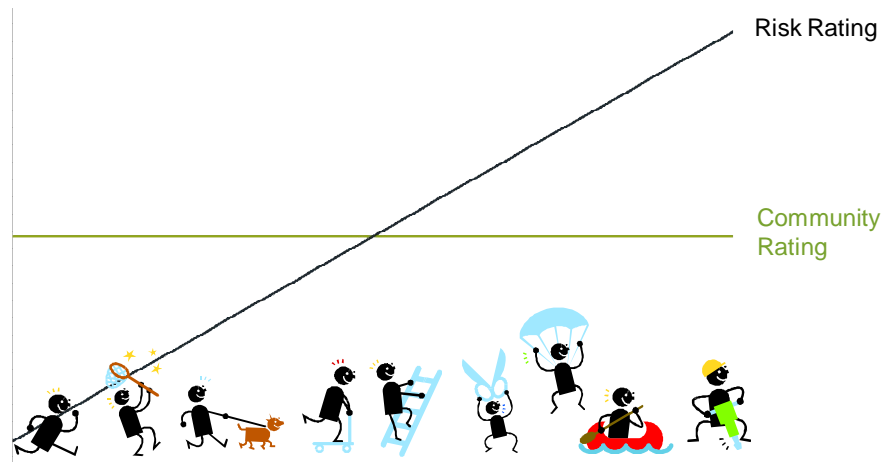
Community Rating #1

- Same premiums charged to everyone for same insurance cover regardless of age, gender, health status etc.
- Exists in some markets or market segments e.g.
 - Compulsory insurance systems
 - Health insurance markets (e.g. Ireland, Netherlands)
 - Group life cover (quasi community rating)
- Why does it work in these cases?
 - Market or segment exhibits (quasi-)compulsory features
 - Explicit or implicit controls on level of cover

Community Rating #2

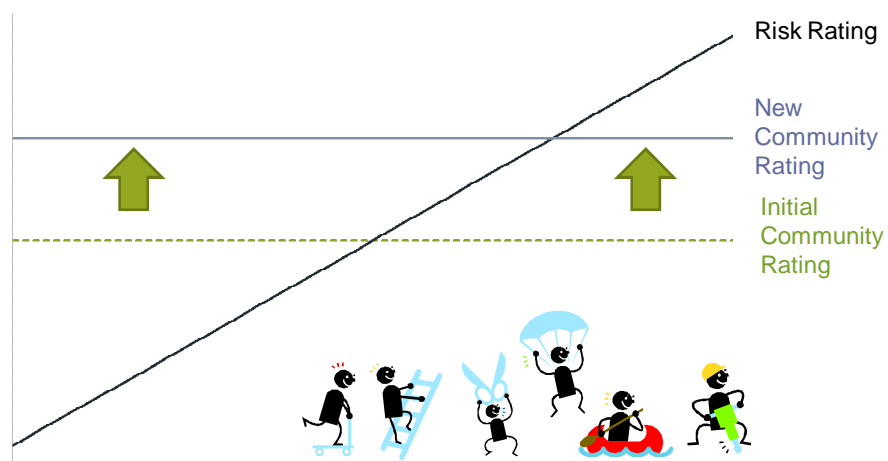
- Other private voluntary markets segments are not sustainable on a community rated basis.
- Risk of adverse selection is too high without risk rating
 - High risks effect proportionately more cover
 - Premiums expensive for lower risks
 - Lower risks exit
 - Community rated premium increases
 - More low risks exit and so on
 - 'death spiral' effect

Death spiral effect



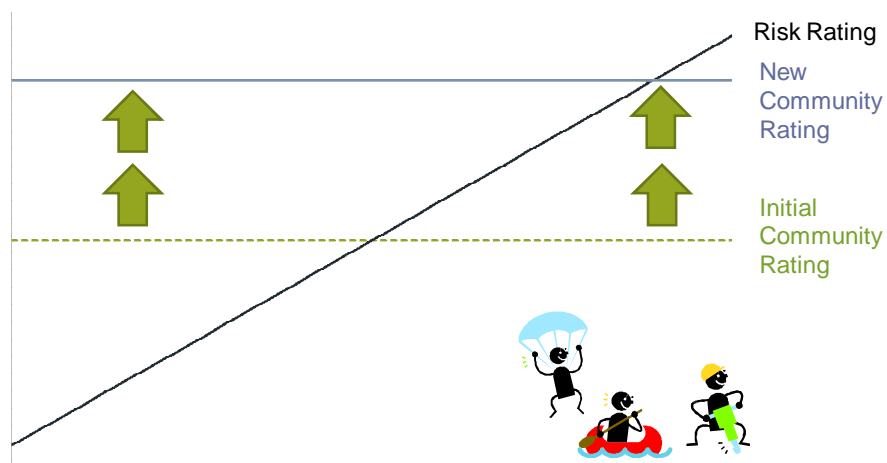
34

Death spiral effect



35

Death spiral effect



In conclusion ...

- Just over a year to go to 'G-Day'
- Still a lot of uncertainty, in particular:
 - application to existing contracts?
 - use of gender for underwriting, aggregate pricing, reserving?
 - possibility of arbitrage from outside EU and within EU
- EU Commission guidance due mid December
- Draft legislation expected soon from HMT
- Age & disability equality is a very live topic

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



38