

Sex and driving

How will the European Court of Justice's ruling on gender-based insurance rating affect motor insurance in the UK?



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As had been widely expected, on 1 March 2011 the European Court of Justice ruled that gender discrimination in insurance pricing would be outlawed in Europe with effect from December 2012.

This was not a major shock. Equal treatment between the sexes has long been a fundamental principle within the European Union. However, the implications are still considerable and will affect a variety of life, health, pensions and general insurance products. This note will avoid comment on issues relating to life, health and pensions products and will focus instead on what this ruling means in practice for motor insurance in the UK.

BACKGROUND

The Gender Directive, which came into effect in December 2007, sought to achieve equality in the provision of services. However, the Directive allowed insurers within member states, via an opt-out process known as derogation, to continue charging differential premiums to males and females, provided that such differentiation could be justified by reliable, up-to-date and publicly available actuarial and statistical data. In the UK, such information was available and thus price differentiation has continued under the derogation.

Belgium also opted for derogation for some types of insurance (though not for motor insurance—the country implemented unisex rating for this coverage). However, a Belgian consumer group subsequently challenged what it considered to be the discriminatory behaviour of insurers. In September 2010 the Advocate General of the EU agreed to the validity of the challenge by opining that the derogation was invalid because it contravened the Treaty on European Union's commitment to "respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms."¹ The European Court of Justice has now upheld that view.

WHAT ARE THE IMPLICATIONS OF THIS CHANGE ON THE MOTOR INSURANCE MARKET?

Currently, men and women with otherwise identical risk profiles are charged different premiums for their motor insurance. That difference is greatest within young drivers. This is because, in general, women drivers, particularly young women, have a better accident record than that of their male counterparts. The immediate presumption would be that, when the new rules are implemented, insurers would charge composite rates, based on an average of the premiums currently charged. In such a scenario,

male drivers would see reductions in their premiums and female drivers would see increases. But in practice that is unlikely to happen. Composite rates would tend to overcharge women and undercharge men; were an insurer's portfolio of risks to become more weighted towards male drivers than it had expected then it is likely to be undercharging through its use of composite rates and hence making a loss. Motor insurers are already struggling to make profits² and we believe that many of them would wish to charge rates closer to those currently charged for males, so as to avoid the downside risk of an imbalanced portfolio.

However, this will be difficult to achieve. Some insurance brands have successfully targeted female drivers and have portfolios that are weighted strongly towards women. Their expected claim cost base is less than that for other more balanced motor portfolios and they could afford to charge lower premium rates. The ease with which consumers can access and compare prices, particularly via the Internet and aggregator sites, means that the UK motor insurance market is extremely competitive. Those insurers with the lowest prices could see a surge in business, at the expense of the other insurers. So, while insurers would like to be able to price at profitable levels, the need to retain policies and to remain in business would continue to place downward pressure on premium rates.

We also expect there to be much more activity in marketing to women drivers. Heavy use of pink in website design and references to handbag cover don't exclude males from taking out policies issued by Sheilas' Wheels, but it certainly doesn't encourage the majority of men to do so. Other similarly targeted brands may well appear, and this part of the market will become very competitive.

SUNSET ON THE STATUS QUO

Of course, if insurers were able to charge a premium that reflected the underlying risk, there would be no need to try to balance portfolios between male and female drivers. Indeed, this was one of the points made by the Advocate General, who had said that the sex of individuals per se did not make them better or worse drivers; rather, it was a myriad of other factors. Gender was used merely as a crude proxy for those factors. The Advocate General suggested that insurers should identify those factors and should rate on the basis of those, which would probably provide far better assessments of the underlying risk. Indeed, this addresses part of the complaint from consumers that, for example, most young males

¹ Article 6(2) of the European Community Treaty

² According to Milliman's report *Driving For Profit*, published in August 2010, total pre-tax profits in the UK from motor insurance were negative for the period 2005-2009. It is expected that, when the relevant figures become publicly available, they will indicate further losses for 2010.

are not bad or dangerous drivers, but they get lumped together with those that are and charged accordingly.

The challenge now is for insurers to identify such factors. By this we don't mean lazy stereotypical factors such as the number of pairs of shoes that a policyholder owns—such factors would rightly be seen as crude attempts at proxies for gender, and would thus be outlawed—but rather, the driving characteristics that make one more or less likely to have accidents and the extent to which those accidents are likely to be expensive. Identifying these characteristics is one challenge; validating them within each policyholder is another. While the driver might claim never to speed, always to accelerate gently, to drive only rarely at night, etc., it is difficult to confirm these claims. If driving behaviours were to become standard rating factors, then we believe that insurers would need a means of monitoring actual behaviour. There have already been some experiments with in-car monitors, which have not proved popular with consumers, but we would expect these to be extended.

Insurers will need to take care that factors that they use could not be taken as proxies for gender, which would be a gift for lawyers.

WHAT HAPPENS IN DECEMBER OF 2012?

One thing that is not entirely clear is what actually happens in December 2012. It will no longer be possible to sell insurance products with premium rating based on gender. But what about policies already in force? To the extent that the premiums have already been paid, the terms of the cover for males and females would be identical and so one would expect there to be no change, at least until the next renewal. Does that also apply to policies where premiums are paid in instalments? Would there be scope for insurers to attract female drivers by starting to offer longer-term cover now that lasts beyond December 2012? An insurer that offered such cover would bear greater risk through not being able to re-underwrite every 12 months, but there may be an opportunity here for some insurers to increase their share of the female market prior to the change.

Will the change benefit consumers? As with all change, there will be winners and losers. It is likely that, ultimately and with all other things being equal, women will pay more for their motor insurance

and men less. However, the effect will be significantly diluted as insurers find other factors that better reflect the propensity of drivers to have accidents. When the dust has finally settled on the changes, some women might be better off and some men worse off under the new system. Some insurers might introduce more imaginative products in order to manage their exposure to risk (e.g., policies that cover driving only between, say, 6 a.m. and 9 p.m.; or that limit the number of passengers). For the majority of policyholders, those that don't fall into the *young drivers* category, we would expect that the changes caused by the European Court's ruling will be swamped by the need for insurers to increase rates to meet rising costs and current losses.

We believe that the change will increase pressure on motor insurers. Few in the UK are currently profitable; the market remains competitive with control of prices largely in the hands of consumers, and we think it likely that insurers will need to invest in additional technology in order to assess policyholders' underlying risks. This might provoke a shakeout within the industry, reducing consumer choice. Having said that, because of the poor performance of the industry over the past few years we have been expecting some degree of rationalisation for some time and it has yet to materialise.

WHAT'S NEXT?

A final question: What might be next? Along with gender equality within financial services, the lawmakers have also been considering age equality. Much of this has been focused upon anti-ageism. But there has been talk that, like gender, age is merely a proxy for other factors and that it is unfair to charge people different rates for, say, motor insurance simply because they are different ages. The difference in motor insurance premium rates between a teenager and a 50-year-old is far greater than that between a teenage male and a teenage female. The effects of a ban on age differentiation in financial services would be more profound even than the effects of a ban on gender differentiation. The industry will no doubt monitor this issue closely, since the removal of these time-tested rating criteria diminishes the supply of tools for accurately managing and pricing risk.

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