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CAN GENDER DIFFERENTIATED ACTUARIAL FACTORS STILL BE USED WHEN DETERMINING PREMIUMS AND BENEFITS UNDER INSURANCE CONTRACTS?

THE TEST-ACHATS CASE

1. Introduction

The European Court of Justice (“ECJ”) gave its much awaited ruling in the Test Achats case on 1 March 2011. The case stemmed from a challenge from the Belgian consumer association, the Association Belge des Consommateurs Test-Achats ASBL, asking whether the exemption in Article 5(2) of Directive 2004/113/EC (“2004 Directive”), which allows insurers to use gender related factors in determining premiums and benefits under insurance policies, is compatible with the prohibition on discrimination on the grounds of gender enshrined as a fundamental right of the European Union. The exemption allows insurers to apply differentiated terms on the basis of gender in the provision of insurance services.

2. What is the substance of the ECJ’s judgment in the Test Achats case?

The ECJ has ruled that the exemption in Article 5(2) of the 2004 Directive is invalid. However, the ECJ has granted a transitional period of relief for implementation. The effect of this is that, as from 21 December 2012, it will be unlawful to use gender-related factors for determining premiums and benefits under insurance policies. National governments of member states who opted to apply Article 5(2) of the 2004 Directive will be under an obligation to change domestic law so that, with effect from no later than 21 December 2012, it complies with the ruling. From that date, national legislation implementing the 2004 Directive is to be read on the basis that the provisions implementing Article 5(2) are invalid. This is significant for many insurers in Europe which use gender as a risk factor for pricing both general and life insurance policies.

3. What are the temporal effects of the judgment?

Whilst there is uncertainty as to the manner in which the ruling will be implemented from a temporal standpoint in domestic legislation in each relevant member state, we believe that the following principles are likely to apply.

Post 20th December 2012 Insurance Contracts

The ECJ has granted a transitional period of relief for implementation, expiring on 20 December 2012. All new contracts entered into after the expiry of that period will be required to be priced and to provide benefits on a unisex basis and not apply differentiated terms on the basis of a person's gender.

Insurance Contracts expired by 21st December 2012

Gender-specific differences in respect of insurance premiums and benefits paid under policies which expire prior to 21 December 2012 will not be subject to challenge as a result of the ruling.

Other pre-21st December 2012 Insurance Contracts

Lastly, it is necessary to consider the effect of the ruling on insurance contracts entered into prior to 21st December 2012, where premiums and/or benefits remain payable, or contingently payable, after 20 December 2012. We do not consider that the premiums and benefits paid or payable prior to 21 December 2012 under such contracts will be subject to successful challenge as a result of the ruling, even if priced on a gender differentiated basis.

As a result of the ruling, member states will be required to implement the 2004 Directive without Article 5(2) no later than 21 December 2012 through domestic legislation. Whilst the final form of the domestic legislation is obviously uncertain, we consider that it would be consistent with the ruling for such legislation to provide that, where premiums and benefits have been fixed at the time of entry into the pre-21st December 2012 insurance contract, they will not have to be repriced, and the benefits under the policy will not have to be reset, on a gender-neutral basis after 20 December 2012.

The position may be less clear in relation to premiums and/or benefits, to the extent they fall to be reviewed by the insurer after 20 December 2012 under pre-21st December 2012 insurance contracts. It is possible that, as a result of the ruling, the relevant domestic legislation may require the insurer to procure that the premiums and benefits are reviewed after 20 December 2012 on a gender-neutral basis.

Future action

In view of the transitional period, insurers will have to make their own decision about whether or not to move sooner or later to gender-neutral pricing. Where business continues to be written on a gender biased basis during the transitional period, insurers should be aware that they may be required, under their domestic legislation, to adjust premiums payable after expiry of the transitional period on a gender-neutral basis. It may therefore be wise to ensure that such business is written on terms that, so far as practically possible, will allow insurers to raise the future premiums of the more favourably treated gender to whatever is the appropriately gender-averaged and gender-neutral rate to be applied at the end of the transitional period.

Without appropriate provisions in the contract, it is possible that insurers may not be able to do this consistently with the terms of the contract. Were this to be so, insurers may have to bring the less favourable gender-based rate down to the more favourable rate in relation to premiums payable after expiry of the transitional period. Also relevant are factors such as consumer laws which may restrict or apply conditions to premium increases or unilateral variation of contract terms.

4. Direct and Indirect Discrimination Prohibited

4.1 The principle of equal treatment as set out in the 2004 Directive prohibits both direct and indirect discrimination:

Direct discrimination is defined in the 2004 Directive as:

“where one person is treated less favourably, on grounds of sex, than another is, has been, or would be in a comparable situation”¹

Indirect discrimination is defined in the 2004 Directive as:

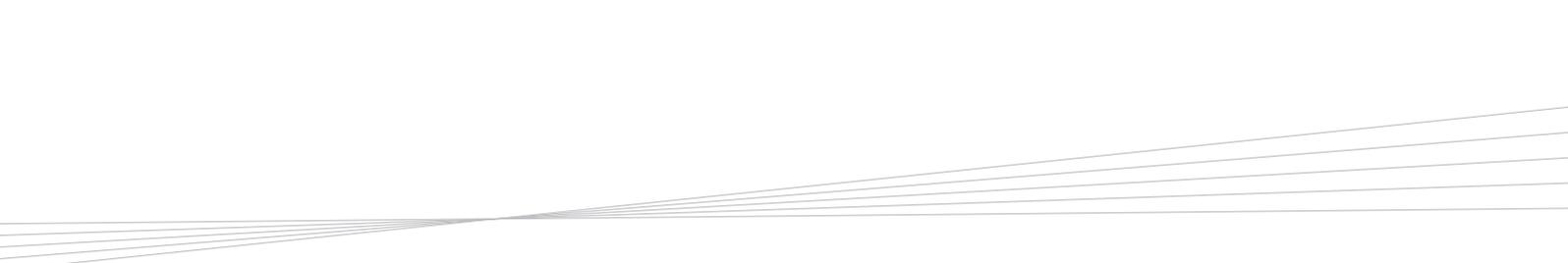
“where an apparently neutral provision, criterion or practice would put persons of one sex at a particular disadvantage compared with persons of the other sex, unless that provision, criterion or practice is objectively justified by a legitimate aim and the means of achieving that aim are appropriate and necessary”²

The 2004 Directive has been implemented in various jurisdictions through regulations and statute.

- 4.2 Examples of direct discrimination in the provision of insurance services are, in practice, likely to be relatively easy to identify. It will be important for insurers not to use apparently gender-neutral factors, such as weight/height etc., if they are doing so as a deliberate proxy to establish gender, with pricing differentials being applied accordingly.
- 4.3 Indirect discrimination may be more difficult to identify, because the insurer may not intend to apply gender differentiated pricing structures. However, indirect discrimination can arise if a particular underwriting practice indirectly has that effect. In the event that the insurer’s underwriting practice results in indirect discrimination against a person, it will then be for the insurer to show that the practice is legitimate and proportionate.
- 4.4 Questions of indirect discrimination are more likely to arise in situations where insurers are assessing risks by reference to factors unrelated to gender, but where the incidence of those factors affects one gender disproportionately, compared with the other. Insurers may therefore be at risk in pricing their underwriting premiums on such a basis even though they have no intention of using those factors as proxies for a gender differentiated pricing policy. If the application of those factors is held to result in a gender discriminatory pricing structure, the insurer will then have to show that the result of that underwriting practice is justified by a legitimate objective and is an appropriate and necessary means of achieving it.

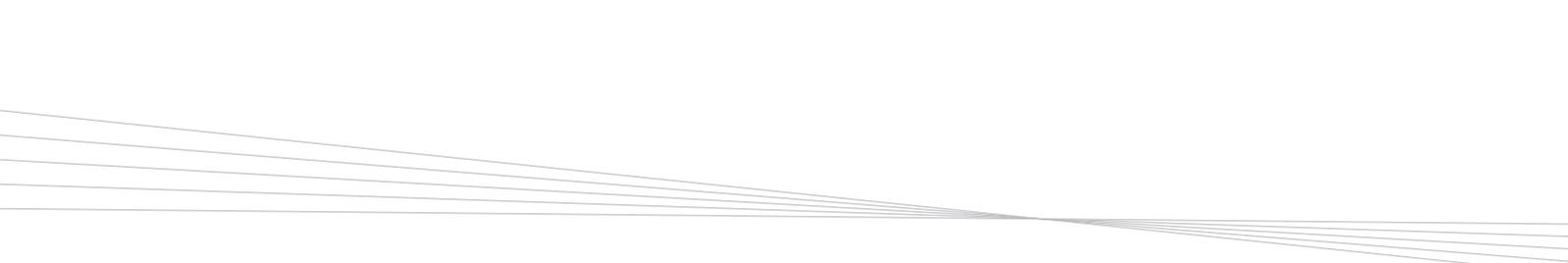
¹ Article 2(a) 2004 Directive

² Article 2(b) 2004 Directive

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- 4.5 A key element in determining whether there has been any indirect discrimination will be to identify the correct comparator with the situation of the person alleging discrimination. Arguments as to the correct comparator are likely to be an insurer's first line of defence in an indirect discrimination claim since, if an insurer succeeds in this argument, it will not have to demonstrate that the risk factor is a proportionate means of achieving a legitimate aim.
- 4.6 So, for example, if life insurance premiums for smokers in a particular age group are higher than for non-smokers in that age group (but within that age group there is a substantially greater number of male, than female, smokers) the insurer's first line of defence to any discrimination claim would be to show that the correct comparator is a smoker of the opposite sex in that age group, not a non-smoker of the opposite sex in that age group. The insurer would then simply have to show that there is no premium differential between male and female smokers within that age group, at least insofar as it relates to the smoking risk factor.
- 4.7 However, in our example, the smoking premium affects many more males than females. It might therefore be argued that, in taking the risk posed by an individual's smoking habit into account, the pricing structure disproportionately affects the males. The argument would then continue that, in order to assess whether this amounts to indirect discrimination against the male smoker, it is necessary to compare the male smoker with the female non-smoker within the age group, so that the legitimacy and proportionality of the smoking premium, with its proportionately greater consequence on the smoking male cohort within the age group, can be tested. Whilst it may be unlikely that such an argument would succeed, if it were to do so, the insurer would then have the burden of showing that the practice of differentiating between smokers and non-smokers was (a) in fulfilment of a legitimate aim and (b) a proportionate means of achieving that aim.
- 4.8 This would then require the insurer to show, no doubt using medical evidence, that the premium for smokers, compared with non-smokers, is proportionate to the increased risk that they pose.
- 4.9 At this early stage, it is very difficult to predict how rigorous the Courts are likely to be in determining the comparators which they will use in applying these rules. However, there is scope for insurers increasingly to be required to justify pricing structures in relation to non-gender related risk factors which affect one gender to a greater extent than another.

5. Some further general points

- 5.1 It seems likely from the 2004 Directive that only individuals (as opposed to bodies corporate) can be victims of sex discrimination. However, when they are dealing with corporates, insurers could nevertheless contravene the rules if those dealings are conducted on the basis that they will result, to the insurer's knowledge, in discriminatory behaviour by bodies corporate towards individuals.
- 5.2 The extent to which it is possible to take into account the gender profiles of different groups of individuals in providing a gender-neutral price to individuals in a particular group is a very difficult question. However, if there are no material differences between two groups, except for the gender



profile, there is certainly a risk that this may contravene the rules, if the rate offered to individuals in one group differs from that offered to individuals in the other group. Great care will need to be taken in setting the group to avoid, for example, the group itself becoming a proxy for gender. To avoid the risk of comparisons being drawn between individuals within different groups, care must be taken to ensure that each group is distinguished by characteristics other than just the gender profile of that group.

- 5.3 Subject to 5.2 above, it is legitimate to take the expected gender profile of future tranches of business into account in setting margins for future business, provided a gender-neutral price is then offered to each individual within that tranche of business. The same principle applies in taking the gender profile of existing business into account in fixing reserves for that business. In each case, the business itself must be priced on a genuinely gender-neutral basis so that a gender-neutral price applies to each individual.
- 5.4 In the case of reinsurance cover, the particular circumstances of each case will need to be considered. A reinsurer should be able to take the gender demography of the insured's customers into account in fixing its price to the insurer if this does not impact the customers receiving cover from the insurer on a gender-neutral basis. Insurers may need to look at existing reinsurance contracts to check what implications the transition to gender-neutral pricing by the insurer may have under those contracts.

Cautionary Notes

1. As a general rule, legal advice in the area of discrimination law is always qualified by the caveat that there is much less predictability of outcome in this area of the law than many other areas of the law (at least until there have been a number of decisions of the ECJ and the national courts which settle the main issues).
2. The advice contained in this note is general advice and should not be relied on for taking a specific course of action. Specific advice should be taken from your usual adviser on a specific course of action.
3. Particular regard should be paid to the manner in which the ruling is implemented in any revised directive and any domestic implementing legislation.

Contact

Please contact your usual adviser at Slaughter and May, A&L Goodbody, De Brauw Blackstone Westbroek, Uría Menéndez, Bonelli Erede Pappalardo, Hengeler Mueller and Bredin Prat if you have any queries on the consequences of the ECJ ruling in the Test Achats case.

2 March 2011