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The European Battle Over Sex: Human Beings are Above Statistics

By Andres Webersinke

Insurers in the European Union (EU) were busy preparing themselves for the new Solvency II regulations when the European Court of Justice (ECJ) surprised the industry with its judgment on March 1, 2011, to end gender discrimination in insurance aimed at supporting the fight against unfair discrimination.

Insurers, the public, politicians and lobbyists all have the same basic idea of eradicating any form of unfair discrimination, but it is once again the method by which this was achieved that results in disbelief and the need for a more vigorous response by the industry in addressing issues such as fairness and transparency.

WHAT HAPPENED? A BRIEF SUMMARY

To refresh memories, in 2003 the European Commission adopted a directive proposal for implementing the principle of equal treatment between women and men in the access to and supply of goods and services. During the various stages of consultation, we witnessed several controversial discussions. Nevertheless, the European Commission did not yield to the request to allow gender-specific calculations of premiums and benefits for the purposes of private insurance within Europe. In other words, back in 2003 the European Commission had already insisted on unisex rates. Since this meant a significant change in the usual practice, a transition period was offered for their implementation and, furthermore, this equal treatment rule was only to apply to new business.

Some Member States lodged objections, but finally all consented to the so-called Gender Directive (2004/113/EC), passed on December 13, 2004¹, albeit with some changes. Article 5(2) of the directive provided an exemption from the principle to eliminate gender discrimination for insurance contracts subject to special derogation rules, i.e.,

gender is a determining factor; differentiation must be based upon accurate and published data; national parliaments had to implement such an exemption prior to a set deadline. Furthermore, these Member States shall review their decision every five years taking into account a report presented by the European Commission.

Looking at nine main product lines, Table 1 lists those EU Member States which explicitly disallow gender-specific insurance pricing in some cases. Whereas all 27 EU countries opted for an exemption for life and annuity business, nine nations insist on unisex pricing for some product lines, most often in the case of motor insurance. Some countries, most notably Belgium, limited the use of gender in pricing insurance premiums to a “bare minimum.”

Table 1 – Use of gender as a rating factor according to national law

	Life	Annuity	Disability	LTC	Critical Illness	Travel	Accident	Motor
Belgium			X	X	X	X	X	X
Bulgaria							X	X
Cyprus			X	X	X	X		X
Estonia				X				X
Ireland							X	
Latvia								X
Lithuania								X
Netherlands							X	X
Slovenia								X

THIS SETS THE SCENE FOR WHAT CAME NEXT

A legal process was initiated by a Belgian consumer organisation and, it should be added, by two

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men challenging the derogation as incompatible with the EU Treaty. The Belgian Constitutional Court took the case (C-236/9) to the ECJ to decide on the validity of the exemption from the prohibition of all gender discrimination for the insurance industry. The March verdict rules that Article 5(2) is invalid with effect from December 21, 2012. From this date onwards the use of gender as a factor in calculating insurance premiums and benefits will be banned in the EU.

Given the history of the directive the judgment is no surprise. The industry underestimated the desire of the European legislative and judiciary to promote equality between men and women in all activities. The directive offered no more than an exemption. The fact that almost all Member States implemented this exemption for almost all lines of insurance “lulled” the insurers into believing that there is no change from what seems like a perfectly fair, reasonable and well-understood approach to risk differentiation.

THE INDUSTRY'S REACTION

It is somewhat remarkable to note that the industry's answer to this judgment is little more than

a shake of the head. The focus was more on the exact implementation of this ruling and only on where it mattered most (in biometric risks, such as death, longevity and health). Admittedly, the ECJ did not argue with the fact that statistics showing differences between men and women are merely used as a proxy for differences in lifestyle and behaviour but referred to fundamental rights enshrined in the EU Charter making it difficult to argue for a different position. This along with a lack of political will to re-open a drawn-out discussion already held in 2003/04 indeed directed the focus on accepting and implementing the ruling.

The moderate reaction of the industry was perhaps fuelled by the understanding that it should not prove to be too difficult to aggregate two pricing tables. All that is needed is the right gender mix.

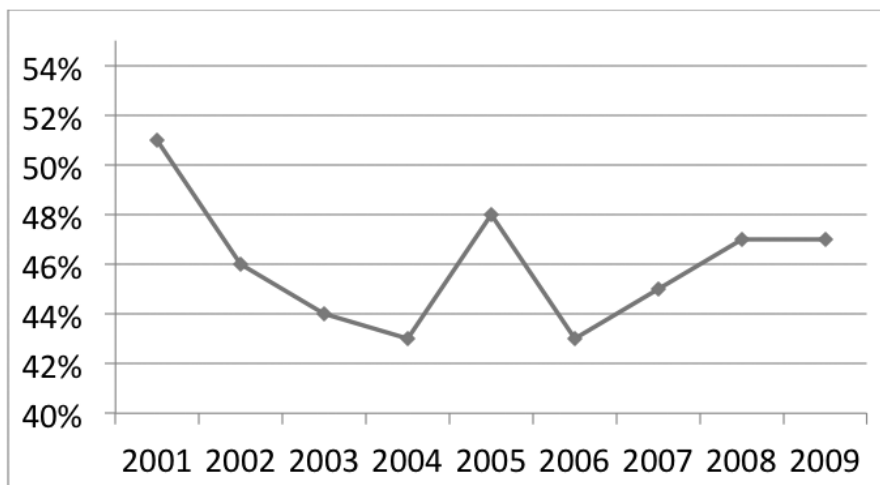
CALCULATING THE GENDER MIX

The simplest solution would be to start with the most conservative pricing basis. However, in a competitive environment or in cases where the final premium heavily depends upon the gender a new pricing factor is needed—the gender mix. The assumption on the gender mix requires an equally careful assessment as for all other pricing assumptions. Past experience is always useful but with the entire industry switching simultaneously, evaluating the competition and changing customer's behaviour will be particularly challenging.

CHANGING CUSTOMER'S BEHAVIOUR

In 2001 the German government introduced a pension plan with state bonuses and privileges for employees. Annuity providers developed qualifying plans accordingly—the so-called Riester-Annuity (named after the politician who devised the scheme). In order to qualify plans had to be gender-neutral from the beginning of 2006. Figure 1 shows that this change led to a last minute sale to men in 2005. Having said this, the share of policies sold to men in 2006 was not any different from 2004. The fact that these plans are low premium policies and state-funded will affect the

Figure 1 – Proportion of Riester plans sold to men based on a Gen Re analysis amongst several German life insurers



buying-behaviour differently to what can be expected for other insurance plans following the ECJ ruling. In any case, the need for financial protection is not going to change.

For sure the ECJ judgment will be used by agents and brokers to sell more annuity business to men in the last months of 2012. Similar effects can be anticipated for other products—sometimes increasing the share of men and other times that of women. The opposite may then take place in early 2013. This will have unpleasant consequences for reserving purposes for example since the gender mix assumption will reflect the medium to long-term expectations.

DATA ANALYSIS

These expectations can vary significantly from office to office. Looking at immediate annuity business and separately at term assurance, Gen Re conducted an analysis of data from over 20 German life insurers. The following is a brief summary of the results.

Figure 2 depicts the proportion of men (by number of policies and weighted by sum assured) for immediate annuity business. About 50% of immediate annuity plans were sold to men, but weighted by sum assured the proportion of men is just over 6%-points higher. The variation even amongst the larger players is significant. The weighted proportion varies between 52% and 59% amongst the top four writers. The maximum proportion of men increases to 77% if the next three top insurers are included. This clearly demonstrates the need for a careful analysis of the data.

Whereas immediate annuity business is sold in almost equal shares to men and women (over all companies), this cannot be said for term assurance. Here the proportion of policies sold to men is over 60%. Weighted by sum assured the share increases by 3%-points. A reason for the narrower relationship could be the lower premium level charged to women. However, surprising again is the significant differences from one insurer to the

Figure 2 – Proportion of men in immediate annuity business (top 7 immediate annuity writers within the Gen Re datapool; only policies in force for less than 10 years)

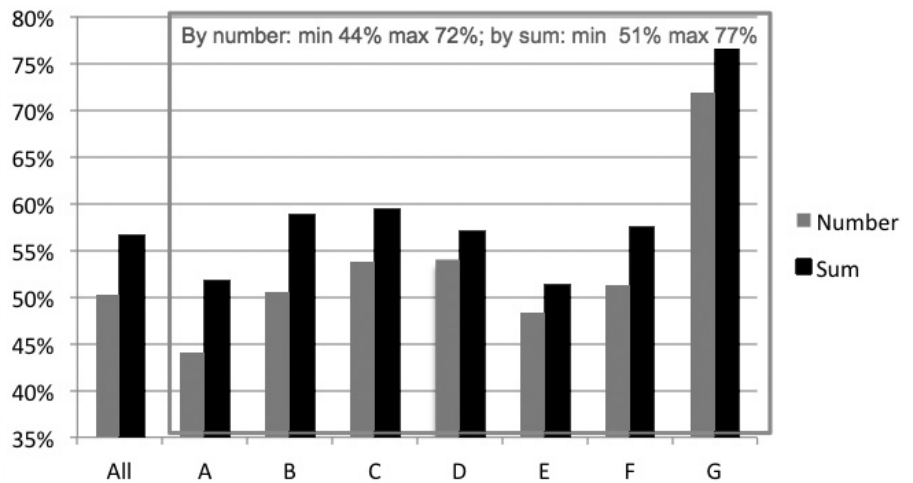
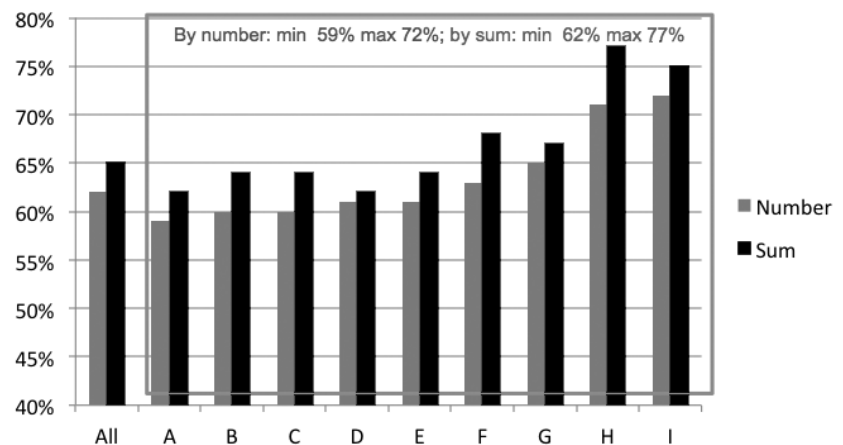


Figure 3 – Proportion of men in term assurance business (top 8 term assurance writers within the Gen Re datapool; only policies in force for less than 6 years)



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other. Whereas one insurer must calculate with a 23% share of female customers another will benefit from a rate which is two thirds higher and almost 40% (Figure 3).

The gender mix for life insurance also depends on the entry age and duration. Men typically start owning life insurance cover later in life than women—affecting the chosen duration.

However, insurers should also analyse how the gender mix is changing during the duration of a policy. Lapse rates, for example, may be different and thus change the mix over time. The gender mix for annuity and long-term care policies will change significantly with increasing duration as higher mortality and morbidity rates reduce the share of insured men paying premiums.

Other factors influencing the proportion of male customers are the target market, build-in options (may be exercised differently by men and women), trends (e.g., as a result of an increasing employment rate amongst women) distribution channel, etc. It can be expected that brokers sell higher sums assured to more men whereas the banking channel sells more annuity business to women than men (at least in the German example).

BEYOND THE GENDER MIX

Where premium competitiveness is key a new mindset is required. How can an insurance company selling term assurance via direct marketing attract more women in order to have an overall attractive premium level? How can a bancassurer ensure that annuity business is sold as expected to both men and women?

One answer to these questions is to introduce new attributes with the aim of accurately pricing the risk categories and thus offering fair and competitive terms to the target market, avoiding indirect discrimination, of course. Motor insurance is a good example. In the group of young vehicle drivers (below age 25) men have a higher claims index than women (in Germany the claims ratio is between 25 to 33%

higher²) but already today many motor insurers use carefully chosen criteria to distinguish multiple risk categories. Gender is not the sole key differentiator.

This is different for most life insurance products. Gender differences typically remain with increasing age and across most medical conditions. But the principle for further differentiation is also well understood in life insurance. Insurers offer lower premiums to so-called preferred lives (in the case of mortality or morbidity cover) or enhanced annuities to people less healthy than the average seeking a regular income at retirement age.

One can expect increasing activity in this area but not a sudden switch or rapid movement towards new types of risk categorisation. After all, established insurers cannot afford to target men or women alone. Both sexes are part of a typical target market and unless the current target market is completely changed, new attributes will only be introduced over time or where competitiveness is affected by the court ruling—in particular by those companies who have too much of the “wrong” sex.

As such the concerns around the gender mix require some managing and steering to ensure the actual gender mix is aligned or is better than the mix used in the premium calculation.

This may be achieved by means of innovative product design, better use of target group typology, targeted sales documentation, discounts for partner policy and appropriate sales incentives to name a few. This is familiar ground for sales and marketing experts. Having said this, other industries such as the car or grocery sector are ahead of the insurance industry in terms of influencing and understanding the buying pattern of customers.

OPEN QUESTIONS – INDIVIDUAL RISK ASSESSMENT

The judgment left a number of questions unanswered. Particularly noteworthy is the question of its applicability on individual risk assessment in life insurance.

In Critical Illness insurance, for example, a particular family history of breast cancer may lead to a specific exclusion for a female applicant. For men, however, the decision may be a different one. It seems inappropriate to apply in all cases an exclusion so as not to differentiate between the sexes, or better said, not to discriminate between the sexes.

Extra mortality loadings for unfavourable health conditions are calculated comparing standard mortality with that of a diseased population. These studies are gender-specific to identify differences by gender. Even if the relative extra mortality is the same for both sexes, different disease prevalence amongst the sexes will result in an imbalance of the total extra premium charged across a portfolio, if these loadings are applied to unisex rates. This list of issues can be extended to include different laboratory norm values for different sexes, different meanings of a positive electrocardiogram reading for men and women (in particular in younger ages), etc. It is important that the industry voices its opinion to avoid that the changing Gender Directive will adversely impact the way the industry goes about individual risks assessment.

SUMMARY

The ECJ judgment on gender equality has a number of immediate and long-term consequences for the industry. At this stage only the decision is known. The European Commission promised a report providing guidance on the interpretation of the judgment. This report, however, can only be expected in early 2012. The European Committee on Women's Rights and Gender Equality had a first debate on the ECJ judgment and its implementation on May 25, 2011, providing a first glimpse into the thought process of decision makers⁴. The committee's Rapporteur (Zita Gurmai, Group of the Progressive Alliance of Socialists and Democrats in the European Parliament) made it already clear that the ECJ's decision was a very important one and that she will make sure that "consumers will not pay higher premium rates for not being discriminated against." Other opinions ranged from underlining the principle of the "fight

against discrimination being more important than economic consideration" (as voiced by Raúl Romera I Rueda, Group of the Greens/European Free Alliance and Rapporteur for the outstanding anti-discrimination directive on age and disability) to the pragmatic question of "what do we try to achieve" (as asked by Marina Yannakoudakis, European Conservatives and Reformists).

While this debate is ongoing, insurers should be preparing for the new unisex environment. This will definitely include the analysis of the gender mix in new business by various factors as described above but also the effects this has on reserving. Which reserving basis should or can be used in future? Insurers should maintain a degree of flexibility in order to react swiftly should competitors introduce innovative product ideas or use new attributes with better risk selection effects. This will require new management tools to monitor the gender mix for both reserving purposes and new business development.

The long-term effects, however, should also be considered. The notion of the right to underwrite is once again openly debated. To categorise risks is the principle of private insurers. The EU continues to debate the insurer's right to differentiate risks by age and disability. Some politicians and lobbyists gained impetus from the recent ECJ ruling on gender. Sooner or later this will impact other jurisdictions with perhaps similar results. The industry is called upon to make its processes more transparent. Every decision to rate or decline a risk, every decision not to pay the full claim amount should receive a thorough examination on fairness. At the same time the industry needs to organise itself better and across national boundaries to educate the decision makers and lobbyists about the way risks are assessed and how competition ensures that more and more individuals—almost everyone—in the society can have access to financial protection products at a fair price. □

END NOTES

- ¹ The Directive entered into force on December 21, 2004, giving the Member States a period of three years to implement the provisions into national law.
- ² CIVIC Consulting. July 16, 2010. Study on the use of age, disability, sex, religion, or belief, racial or ethnic origin and sexual orientation in financial services, in particular in the insurance and banking sectors – Part III: Annexes.
- ³ Based on calculations from the German Insurance Association (GDV): http://www.gdv.de/Themen/Lebensversicherung/Altersvorsorge/Produktfragen/Beruecksichtigung_des_Geschlechts_bei_Kalkulation/inhaltsseite22105.html, accessed on August 19, 2011
- ⁴ Parliamentary Committee Meeting. Event: Committee on Women's Rights and Gender Equality (FEMM). Brussels, May 25, 2011, 09:14 - 10:55. Accessed through the multimedia library (<http://www.europarl.europa.eu/en/multimedia-library/>).