

Client briefing on Test-Achats case judgment

On 1 March 2011 the European Court of Justice (ECJ) handed down its keenly anticipated judgment on a case concerning a provision of the Gender Directive which allowed insurance companies to differentiate premiums and benefits to some extent based on gender related factors. The judgment will have the effect of making a fundamental change to the way insurance premiums are calculated in some member states including the UK, Belgium, France, Germany, Ireland, Spain, Italy and Holland. From 21 December 2012 EU insurers will not be permitted to take gender into account as a risk factor in calculating premiums or benefits payable under insurance products. There is no right of appeal against the judgment.

Background to the case

Article 5 of the Gender Directive (Dir. 2004/113/EC), which is directly effective in all European Union member states, provides that the use of sex as a factor in calculating premiums and other benefits in respect of insurance should not result in differences in premiums or benefits to an individual. However, Article 5(2) contains an exemption to this prohibition which permits proportional differences in such premiums or benefits where the sex of an individual is a determining factor in the assessment of risk (based on relevant and accurate actuarial and statistical data) for the purposes of determining the level of premium. Insurance companies in a number of member states have relied on this exemption to continue to use gender as a factor in calculating premiums.

The Belgian consumer group Association Belge des Consommateurs Test-Achats challenged Article 5(2) on the basis that it conflicts with the overarching principle of equal treatment of men and women under EU law, and brought the case Association Belge des Consommateurs Test-Achats ASBL and others before the ECJ. The subject matter of the case was a Belgian law enacting, amongst other things, the provisions of Article 5(2) in Belgium.

In September 2010, Advocate-General Juliane Kokott produced an opinion in support of the consumer group's case, advising the ECJ that she unequivocally believed Article 5(2) should be declared invalid as being an infringement of the general prohibition on discrimination on the grounds of gender.

Test-Achats - the court's decision

On 1 March 2011 the ECJ delivered its ruling in the Test-Achats case: the derogation in EU law (i.e. Article 5(2) of the Gender Directive) which allows for sex-specific differences in insurance premiums and benefits where sex is a determining risk factor will be invalid from 21 December 2012. This means that EU insurers will no longer be permitted to take gender into account as a risk factor in setting the costs of and payouts from insurance products. In delivering this ruling the ECJ agreed with the Advocate-General's opinion that different insurance premiums for men and women constitute sex discrimination and this is not compatible with the Charter of Fundamental Rights of the European Union (the Charter).

The ECJ recognised in its judgment that:

"The Court has consistently held that the principle of equal treatment requires that comparable situations must not be treated differently, and different situations must not be treated in the same way, unless such treatment is objectively justified"

However, the ECJ's decision was based on technical grounds (rather than on the substantive issues raised by Advocate-General Kokott).

By way of background, Article 5(2) was a last minute addition to the Gender Directive and was contrary to the Commission's original recommendation that

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gender should not affect the pricing of insurance products. In its proposal for the Gender Directive (COM(2003) 657 final) the Commission concluded that:

"...equal treatment for women and men is a fundamental right and the Commission believes that the freedom to set tariffs must be subject to that right. The separation of men and women into different pools leads to an unjustified difference of treatment and a resulting disadvantage for one sex or the other. The practice must be judged to be discriminatory and the legislator should therefore take action to prohibit it... The Commission concludes therefore that differences of treatment based on actuarial factors directly related to sex are not compatible with the principle of equal treatment and should be abolished."

However, the Commission accepted that, due to the widespread use of gender as a risk factor in insurance pricing, a transitional period was necessary to allow insurers to phase out this practice. Article 5(2) was therefore included, but without any expiry date. The ECJ judgment holds that a transitional period cannot be without limitation, as that would defeat the objective of the Directive:

"It is not disputed that the purpose of Directive 2004/113 in the insurance services sector is, as is reflected in Article 5(1) of that directive, the application of unisex rules on premiums and benefits...there is a risk that EU law may permit the derogation from the equal treatment of men and women, provided for in Article 5(2) of Directive 2004/113, to persist indefinitely.

Such a provision, which enables the Member States in question to maintain without temporal limitation an exemption from the rule of unisex premiums and benefits, works against the achievement of the objective of equal treatment between men and women, which is the purpose of Directive."

Article 5(2) is therefore held to be invalid.

As the judgment was given on such narrow grounds and on an assumption that the Directive was correctly based on a premise that for the purposes of applying the equality principle in the Charter the respective situations for men and women with regard to insurance premiums and benefits contracted by them are comparable (and the court did not indicate whether or not it considered this premise to be correct) it is in our view possible for the Commission to identify specific cases where this premise may not in practice be correct and that where the situation of men and women is not comparable it would in fact be appropriate not to treat them as being the same.

What effect will the judgment have on insurers?

Effective Date

Importantly for insurers the ECJ's decision will not come into force immediately nor will it have any retroactive effect; instead the ECJ has given insurers until 21 December 2012 to comply with the change in law. In our view the decision will apply to all new contracts of insurance entered into or renewed after this date.

Implementation was identified as a difficult issue at the time of implementation of the Directive and Article 5(1) clearly refers to new contracts. By analogy at the end of the transitional period when Article 5(2) ceases to apply as a result of the judgment the same principle of no retroactive effect should apply. Therefore we would expect that the judgment and any related amendment Directive would not require the amendment of existing contracts such as annuities entered into prior to that date but under which benefits continue to be paid afterwards. However, the position is not free from all doubt as the point is not addressed in the judgment and it could be open to the Commission and/or individual states to impose such a requirement though in our view it would be impractical to implement.

There is greater uncertainty in the case of deferred annuities which are purchased before 21 December 2012 but where payment is delayed until after that date. In many cases the annuity will constitute a new contract and as such would need to be gender neutral, but any projections provided before now are likely to have taken gender into account. The principle of treating customers fairly may require insurers to take early action to inform customers of the impact of the judgment on the size of their projected annuity.

The transitional period will give the Commission time to review the impact of the ECJ's judgment and enact an appropriate amending directive, which will then have to be transposed into national law in each member state.

In a statement issued on 1 March 2011, EU Justice Commissioner Viviane Reding stated that:

"The European Commission will now carefully examine the implications of the Court's decision for the EU's law on equal access to goods and services for women and men, as well as for the insurance sector and consumers...I will convene a meeting with business leaders from the insurance industry in the coming months to discuss the judgment's implications."

This transitional period may also present an opportunity for insurers to approach the Commission and seek more specific derogations from the prohibition on using the gender of an individual as a determining factor in the assessment of risk for the purposes of determining the level of premium or benefit. There is support for such an approach in the judgment as it recognises that it is the responsibility of the EU legislature to determine when it will take action to promote equality between men and women, having regard to the development of economic and social conditions in the EU. When action is decided on, the EU legislature must contribute to the achievement of equality subject to the possibility of providing for transitional periods or derogations of limited scope.

Effect on costs, pricing and consumers

The independent think tank Open Europe has calculated that UK insurance providers will need to raise an extra £936m in capital to cover themselves against the new uncertainties created in the market.

In principle, insurers will be able to use gender factors to quantify risk in their portfolio and determine appropriate technical provisions. However it is likely that where males and females have different risk profiles but the products are priced on a uniform basis there will be an additional risk to quantify and reserve against arising from the balance of the portfolio. This additional risk may lead to insurers proactively seeking to maintain appropriate balance in the portfolio. Marketing biased towards one sex only may itself be discriminatory as may refusing cover directly or indirectly on grounds of sex.

There is widespread concern that the ECJ judgment will ultimately be bad for consumers, especially in the fields of motor insurance, term life insurance, private medical insurance and annuities. CEA Director General Michaela Koller:

"The decision of the judges not to recognise that gender is a legitimate factor in insurance pricing and that insurance pricing is based on a fair risk assessment process could be bad news for insurance customers."

In its press release on 1 March the CEA added:

"Although insurers will ensure that their products remain as competitively priced as possible, some insurers will now face significant additional costs in reassessing data, transforming premiums and changing terms and conditions and marketing materials for certain products. From an actuarial point of view there is therefore good reason to believe that this judgment could ultimately have an impact on the prices insurers need to charge consumers."

Insurers are also likely to seek other ways to reflect differentiation of risk which was previously linked to gender and this may lead to more detailed and complicated application processes including more questions based on lifestyle and health.

Generally the expectation is that equality will be achieved by increasing the lower premiums and reducing the higher benefits. This is particularly likely for annuities where insurers are already likely to be under pressure from Solvency II capital requirements. However, such increases may be tempered by the amount of competition in the market and those insurers who do manage to develop more sophisticated pricing approaches which meet the gender neutrality requirement are likely to be the winners. Those who rush to comply with gender neutrality by raising premiums or reducing benefits are likely to suffer reduced market share in a highly competitive market.

TCF impact and FSA guidance

In relation to the treating customers fairly implications of the ECJ's decision, some industry specialists have expressed the view that the Financial Services Authority should provide guidance for insurers on how to communicate with customers, particularly in the run-up period to 21 December 2012. However, an FSA spokeswoman did not reveal any current plans to issue regulatory guidance:

"At the moment, we're assessing the implications of the ruling for firms and consumers. The judgment doesn't mean firms are relieved of TCF obligations. It's up to firms how to interpret TCF needs in relation to dealing with customers, until then, firms can write business as they have been. Existing business is not in the judgment."

As noted above there may be specific TCF issues in relation to personal pension products and deferred annuities.

Process

The European Commission will now carefully examine the implications of the ECJ's decision for the EU's law on equal access to goods and services for women and men, as well as for the insurance sector and consumers. Commission officials at the Directorate General for Justice have not yet decided on a concrete plan for performing this examination, but have stated that they will now complete the report on the use of sex as a factor in the calculation of premiums and benefits that was overdue under Article 16(2) of the Gender Directive and will consult with stakeholders and with the insurance industry.

Indications are that this consultation will be on the implications of the decision for the industry, rather than a consultation on potential changes to the Gender Directive to reflect the insurance industry's concerns. There is no standard Commission procedure for amending a directive in light of a court ruling invalidating part of the Directive, but it could be anticipated that a version of the Gender Directive with the invalidated Article 5(2) removed would be circulated by the Commission.

There is a possibility that the Commission could accompany its report with proposals to modify the Directive. Thus it would be open for the amending directive to do more than simply delete Article 5(2). For example, there may be cases where gender neutral premiums would themselves be discriminatory because there are clear differences in the risks covered due to gender and the effect of neutral premiums is that one sex subsidises the other which subsidy could be considered a form of indirect discrimination as it disadvantages one sex. Such a situation might justify a specific derogation.

Reinsurance

To the extent that gender is used as a factor in pricing reinsurance contracts it is thought that this will not constitute gender discrimination as it simply determines the price set between insurer and reinsurer. Care will have to be taken to ensure that there is no direct or indirect effect on policyholders. However, in order to bring their reinsurance arrangements into line with gender neutral insurance policies insurers and reinsurers may wish to review current reinsurance agreements to adjust the pricing of the underlying policy.

Bulk annuity contracts and group policies

In contrast to annuity contracts sold to individuals one view, on the basis that the benefits payable under a bulk annuity contract are predetermined and gender neutral, is that as long as the price of bulk annuity contracts quoted by the annuity provider to the trustee does not affect the benefits payable to the members directly or indirectly because of their gender this will not constitute gender discrimination.

However, in our view it is uncertain whether annuity providers will still be able to take into account gender-specific factors when pricing group contracts. Although such contracts do not result in differences amongst group members, they may result in gender differences as regards another group. For example, if a single-sex association entered into an insurance contract for the benefit of its members the pricing of such contract may be considered to result in a gender discrimination, if the price is higher or the pay-out is lower than it would have been had the group been of the opposite sex.

Pension buy-ins and buyouts/bulk annuity contracts

In contrast to annuity contracts sold to individuals, our view is that bulk annuity contracts issued to pension trustees as part of a buy-in or buyout process should not be affected by the decision, and such contracts may continue to be priced on the basis of gender-specific factors. This is on the basis that the directive only applies to insurance that is "private, voluntary and separate from the employment relationship" which would not normally be the case with a bulk pension contract.

Following a buy-in or buyout, the insurer may well offer individual members options to convert their benefits, for example for a lump sum. Whether these options should be offered on a gender-neutral basis is unclear. Our view on balance is that they need not be (given that, for the time being at least, pension schemes themselves (which are not caught by the 2004 Directive) can continue to use gender based factors). However, some providers may wish to take a cautious approach, and either conclude buyout contracts before December 2012, or move to gender neutral conversion factors going forward.

Summary

The consumer group at the heart of this case has hailed it as a victory for consumers, but it is likely to result in uncertainty in the insurance market for some time, as the implications of the case are digested. It seems likely that consumers will be paying higher prices for their insurance or receiving lower benefits. We anticipate that insurers will be seeking increasingly to price risk by reference to non-gender related personal characteristics, perhaps leading to a greater focus on other characteristics such as health/lifestyle.

A German perspective

In line with Article 5(2) of the Gender Directive, the German General Act on Equal Treatment (*Allgemeines Gleichbehandlungsgesetz*, AGG) provides for a specific exemption from the general prohibition of gender-based unequal treatment with respect to insurance products provided that – based on accurate actuarial and statistical data – a policyholder's gender is a risk-relevant factor. This exemption is currently widely used in calculating premiums in the German insurance industry.

Against this background, the German insurance industry and the relevant industry organisations such as the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft*, GDV) as well as the German Association of Actuaries (*Deutsche Aktuarvereinigung e. V.*, DAV) have criticised the judgment.

Given that certain statistical differences between insured persons of different gender in particular with respect to motor insurance (women are statistically less likely than men to get involved in car accidents and may therefore currently obtain cheaper motor insurance) as well as life insurance and annuities (since women in the average have a higher life expectancy) must no longer be taken into account, it is feared that this ruling will result in higher average premiums. However, the specific long-term effects of the judgment still need to be analysed.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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