

The Gender Criterion in the Insurance Industry: How are Policy Prices Influenced

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1. Introduction

In December 2012, the EU introduced controversial new rules – the controversial CJEU ruling in *Test Achats* – which stipulates insurers can no longer take gender into account when calculating insurance premiums. Gender-neutral or “unisex” pricing must now be implemented across the industry.¹

Specifically, the rules follow the Grand Chamber declaration of incompatibility with the principle of equality of the sexes, which allows states to maintain sex-specific insurance premiums, despite the provision of unisex insurance and benefits provided for by Directive 2004/113, sanctioned by articles 23 of the Charter. The court took the unusual step of delaying the ruling's entry into force until an appropriate transitional period has expired, giving insurance companies time to comply with the ruling.²

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¹ The *Test Achats* ruling of 1 March 2011 applies gender equality – sanctioned by the Charter of Fundamental Rights (Article 21 and Article 23) and by Directive 2004/113 – to insurance contracts or, better still, to the related non-actuarial tables, admitting exceptions to this parity from that date. In the sentence, for the first time, the invalidity of an article of a community directive (art. 5 paragraph 2) is sanctioned with effect starting from 21 December 2012. Important sentence (of nullity) with deferred and not immediate effects to allow the insurance market to comply with the ruling. The judgment, which deals with the validity/invalidity of an article of the directive, is not concerned with precisely defining the legal effects on insurance contracts. This could also be affirmed by a future ruling of the Court, deepening what Advocate General Kokott anticipated in his conclusions presented on 30 September 2010. In addition to the invalidity of the law, he affirms that the effectiveness of the sentence is extended, except for those who have already filed an appeal. This clarification allows for a better understanding of the Commission's position.

² Specifically, the ruling concerns three insurance products in which sex is considered a determining factor for assessing risk, namely auto insurance, life insurance, and private health insurance. Younger drivers are considered less risky than their male colleagues and therefore pay less for car insurance; the effect is reversed for life and health insurance: women tend to live longer and use more medical services than men, resulting in higher premiums.

Currently, the use of sex as a determining factor in insurance is based on the general assumption that the different life expectancies of male and female policyholders, the difference in their risk tolerance to drive, and the difference in their propensity to use medical services – which emerge only statistically – are essentially due to their sex.³

However, the calculation of risk is a complex phenomenon in which many factors - ranging from social and economic conditions to individual habits - play an important role.

2. The Changes in the Light of the Directive 2004/113

Given social change and the consequent loss of meaning of traditional role models, the effects of behavioral factors on a person's health and life expectancy can no longer be linked to his sex. Men today are engaged in demanding and sometimes extremely stressful professional activities, members of both sexes consume a non-negligible number of stimulants. Even the type and extent of sports activities practiced by people cannot be linked from the beginning to one or the other of the sexes.⁴

The Test Achats case concerned Directive 2004/113, which extended the principle of equality between the sexes to access and supply goods and services. Article 5 of the Directive prohibits sex discrimination in the insurance sector so that the gender of the individual does not influence insurance premiums and benefits. However, Article 5 (2) allows the Member States to carve out an exception under national law where gender is a “determining factor in the assessment of risk based on relevant and accurate actuarial data”⁵.

³ Directive 2004/113, Par. 61.

⁴ Directive 2004/113, Par. 63. In reality, sex is used simply for convenience reasons, as a substitute criterion for other distinctive traits, certainly more complicated but also more precise.

⁵ Art. 5.2, Directive 2004/113. States are required to report such exemptions to the Commission and relevant data. However, apart from the obligation to review the waiver within five years, it contained no lapse clause or other deadline.

Unlike the Advocate General, the Court did not center its analysis on comparability, *i.e.* whether men and women are incomparable situations for insurance purposes. However, without any independent investigation or analysis, they have stated that they were indeed adequate comparators.

Instead, the Court took a narrower approach, focusing on the obligation of the EU legislator to act in a manner consistent with its stated objectives. It recognized that the EU legislator is free to implement the principle of equality gradually and that it may include transitional periods and limited derogations.⁶

However, once decided to extend the Directive to the insurance sector and affirm the principle of unisex pricing, to allow an indefinite derogation from equal treatment, states are in charge of implementing an organic set of provisions to make the choice effective. Therefore, a provision allowing states to derogate from the unisex premiums rule without providing for any time limitation was contrary to the objective of equal treatment for men and women and to Articles 21 and 23 of the Charter.

Faced with the possibility (not affirmed, but not even excluded by the Court) of prevailing ongoing contracts, the Commission considers the principle of parity without derogations applicable only to new contracts entered into after December 21, 2012.⁷

At point 10 of the guidelines, the Commission states that «the implementation of article 5, paragraph 1, requires a clear distinction between existing and new contractual agreements. This distinction must respond to the need for legal certainty and be based on criteria that avoid undue interference with existing rights and preserve the legitimate expectations of all parties. This approach is consistent with the directive's objective of

⁶ *Murphy, C.*, The Advent of Gender Neutral Insurance Premiums, European Law Blog, 2012, <https://europeanlawblog.eu/2012/12/21/the-advent-of-gender-neutral-insurance-premiums/>.

⁷ Note that Directive 2004/113 applies only to contracts signed after the deadline for transposition of the directive: 21 December 2007.

preventing an abrupt adjustment of the market by limiting the application of the unisex rule to new contracts only.⁸

For the Commission, both the contracts concluded for the first time starting from December 21, 2012, and the «agreements between the parties to extend contracts concluded before that date and which would otherwise have expired»⁹ are considered new.

The Commission, after specifying in which contexts gender can continue to be used as a risk assessment factor in general (e.g. information on gender status can be collected, stored, and used), reassures the insurance markets by explaining that the judgment produces its effects only for gender as a risk assessment factor and not the admissibility of other factors used by insurers (excluding the relevance of indirect discrimination) and does not produce its effects for the various risk factors gender (age and disability in particular). The third reassurance concerns the scope of application of the judgment: Directive 2004/113 applies only to insurance and pensions of a private nature, voluntary and distinct from the employment relationship, work, and profession being expressly excluded from its scope.¹⁰

3. Consequences of Derogation from the “Unisex Rule”

In addition to the risk that the derogation from the unisex rule could persist indefinitely, the Court also refers to the imperative principle of equal treatment between men and women.¹¹

It should be noted that the Court’s ruling is one of the first decisions of the post-Lisbon era that expressly refers to the provisions of the Charter as a touchstone for deciding on the validity of EU legislation. With effect from December 1, 2009 (the date of entry into force of the Lisbon Treaty), the Charter has the same legal status as the EU Treaties. European Commission

⁸ Guidelines for applying Council Directive 2004/113/EC, Point 10.

⁹ *Ibid.*, Point 12.

¹⁰ *Murphy, C.*, *supra* note 6.

¹¹ See art.s. 21 and 23 of the Charter of Fundamental Rights.

Vice-President Viviane Reding has already stated that the Court's ruling shows how essential it is that European institutions' proposed or amended laws comply with the Charter.

The Commissioner considered it important to note that the derogation for insurers in the Gender Directive was not part of the Commission's initial proposal for the Directive. It was the Council that only added this derogation during the legislative process.¹²

In its reasoning, the Court of Justice refers explicitly to one of the arguments put forward by the Council during the proceedings before the Court to defend the derogation from Article 5 (2).¹³

According to the Council, the respective situations of male and female policyholders may not be comparable, as the levels of insured risk may be different for men and women. The Court confirms that, in its case law, it has consistently held that the principle of equal treatment requires that comparable situations should not be treated differently. Different situations should not be treated the same unless such treatment is objectively justified.¹⁴

Since Article 5 (2) of the Gender Directive allows insurance companies to distinguish between men and women to calculate premiums and benefits and without any time limitation, a breach of Articles 21 and 23 of the EU Charter¹⁵.

¹² *Thiery, Y.*, European Union: The ECJ's Ruling Of 1 March 2011: The End of Gender-Based Insurance Pricing In Europe, Mondaq, 2011, <https://www.mondaq.com/insurance-laws-and-products/147660/the-ecjs-ruling-of-1-march-2011-the-end-of-gender-based-insurance-pricing-in-europe>.

¹³ The Council had argued that Article 5 (2) had simply the aim of making it possible “not to treat different situations in the same way”.

¹⁴ It also recalls its previous case law, in which it held that the comparability of situations should be assessed in the light of the object and purpose of the act making the distinction. As it is expressly stated in recital 18 of the Gender Directive that “to ensure equal treatment between men and women, the use of sex as an actuarial factor should not lead to differences in individual bonuses and benefits”, the Court considers that the respective situations of men and women concerning insurance premiums and the benefits contracted by them are comparable.

¹⁵ *Thiery, Y.*, supra note 12.

It should be emphasized that the Court's reasoning is much more direct than the arguments put forward by Advocate General Kokott in the same case. Even though the Advocate General had proposed to the Court to declare Article 5 (2) invalid, she nevertheless conceded that, in limited circumstances, direct discrimination based on sex is permissible.¹⁶

Considering that purely financial considerations, such as the danger of an increase in premiums for policyholders, would not, on the one hand, constitute a material reason that makes discrimination based on sex permissible, a danger to the financial equilibrium of the insurance company concerned could instead be accepted as justification.¹⁷

Based on the gaps that the Advocate General seemed to leave concerning the possibility of justifying direct discrimination in insurance relations, the Court of Justice could have provided the Belgian Constitutional Court with a binding reading of Article 5 (2), providing rigorous indications on the conditions under which justification could take place.¹⁸

In that case, the Court of Justice decided that the use of gender-based actuarial values (however, in the framework of the pension rights of EU officials) was not compatible with the need for the sound financial management of a pension scheme. In the *Lindorfer* case, the Court of Justice admitted that direct discrimination may be justified in some cases. There seems to be no room for any such justification in the present case. This naturally follows from the fact that the Court is moving within the confines of the Gender Directive, which excludes the possibility of justification in cases of direct discrimination.¹⁹

¹⁶ He suggested that, although he found that no relevant differences could be deduced from simple statistical differences between men and women (different life expectancy of male and female policyholders, differences in their inclination to use medical services, differences in their propensity to take risks while driving), clearly demonstrable biological differences between the sexes could be regarded as reasons justifying unequal treatment.

¹⁷ *Thiery, Y.*, supra note 12.

¹⁸ By stating that Article 5 (2) is contrary to the fundamental principle of equal treatment between men and women, the Court now confirms the strict position it had already expressed in the 2007 *Lindorfer* judgment (C-227/04 P).

¹⁹ *Thiery, Y.*, supra note 12.

4. The Policy Prices

The effect of the ruling of the European Court of Justice is important in various Member States which have derogated from the unisex principle for a wide range of insurance products²⁰.

In general, it is expected that with unisex prices, women will be worse off on auto insurance, life insurance, and loan insurance, while in the case of annuities (private pensions), males will be worse off.²¹

The prohibition of a relevant assessment factor such as gender is not achievable without cost. The ABI and the CEA (European Federation of Insurance and Reinsurance) confirm that insurers have to make large-scale changes to the prices, sales, and marketing of insurance products. In addition to the premium transformation, these changes include modifying all relevant policy documentation.²²

Customers need to be contacted with new information. The information systems must be modified, and the data must be re-evaluated. Insurance

²⁰ As a 2010 study by the Association of British Insurers (ABI) highlighted, the impact of the ban on using gender as a risk assessment factor will vary depending on the insurance product.

²¹ *Thiery, Y.*, supra note 12. On this point, how the transition to the unisex rule will affect a particular insurance product will depend on the insurance product in question and the respective proportions of men and women in the insurer's portfolio. Insurers with a more balanced insurance portfolio, which includes approximately equal numbers of men and women, may find it easier to tailor their products to unisex rates than an insurer that specializes in providing one-sex. The larger insurers in the market are also expected to have a greater ability to manage the transition to unisex premiums and benefits because they have more statistics to tailor their offerings to the actual claims experience.

²² *Schmeiser, H., Störmer, T., Wagner, J.*, Unisex Insurance Pricing: Consumers' Perception and Market Implications, *The Geneva Papers on Risk and Insurance - Issues and Practice*, 2014, 325-326. It is important to note that differentiation criteria play an important role in calculating insurers' premium and benefit. The insurance industry's goal of price differentiation is to ensure a profitable business model and avoid adverse selection effects. From the regulatory viewpoint, differentiation through discrimination, such as race or nationality, should be prevented. From an ethical point of view, differentiated premiums may appear antisocial and prohibit solidarity in the group of policyholders. Finally, we introduce new empirical results from a consumer survey that illustrate the customer's point of view.

brokers need to have the right pricing information and marketing materials to be up to date. At least in the short term, these factors are responsible for an increase in premiums for both women and men.²³

One of the possible effects of a ban on gender-based insurance pricing is that insurance companies explore alternative factors closely related to risk and are still verifiable. Socio-economic circumstances, such as employment or accommodation of the insured person, and individual habits such as sporting activities can be thought of. While using such risk factors certainly leads to increased costs, competitive advantages could be generated for those who can develop such risk pricing methods. Although alternative risk factors that are such a proxy, such as certain occupations (firefighters or nurses?), could lead to a finding of indirect discrimination, at least indirect discrimination can be justified by showing a legitimate purpose and by demonstrating that the means of the achieving this are appropriate and necessary.²⁴

Considering the abovementioned ban on gender-based discrimination, “insurers and policyholders have unequal access to information on gender characteristics, which may result in further adverse selection effects [...]. Even if the gender characteristic of customers is taken into account by the insurer at the overall portfolio level, adverse selection effects are enhanced, whenever one group of policyholders has to pay an increased risk premium for a statistically lower risk”²⁵.

This aspect may impact the demand for insurance products, at least in the markets with low price inelasticity. In the extreme situation of full adverse selection, the subsidizing policyholder group (second group) no longer takes out any insurance policies at all.²⁶ Consequently, the portfolio may be formed

²³ *Thiery, Y.*, supra note 12.

²⁴ *Ibid.*

²⁵ *Schmeiser, H., Störmer, T., Wagner, J.*, supra note 22, 344-345. See, on the same point, *Akerlof, G.*, The Market for “Lemons”: Quality Uncertainty and the Market Mechanism, *The Quarterly Journal of Economics*, 1970, 488-500.

²⁶ *Ibid.* See also, *Thiery, Y., Van Schoubroeck, C.*, Fairness and Equality in Insurance Classification, *The Geneva Papers on Risk and Insurance—Issues and Practice*, 2006, 190-211.

solely by the members of the first group, which has a higher claims expectancy.²⁷

5. Conclusions

The ECJ examined the remaining practice of actuarial calculation based on the gender criterion in 2011.

The gender criterion is least accepted in pricing, closely followed by age. Especially for annuity and private health insurance, the gender criterion is less accepted than other criteria.

The results illustrate that using gender criteria within the business lines health, annuity, and term life insurance is not accepted by consumers as soon as the number of prevalent price differences is compared side-by-side.

The implications of a prohibition on gender-based discrimination are substantial for actuarial calculation.

In particular, the decision of the Court of Justice on gender discrimination in setting premiums and insurance benefits must be considered of paramount importance. This is the first time the European Court of Justice has declared itself so clearly opposed to the use of sex-specific actuarial factors in calculating premiums and benefits.²⁸

²⁷ The resulting decrease in customer demand "may lead to a future limitation on the product offering and a possible withdrawal by competitors from certain less profitable product lines. Once insurance solutions have been abandoned, substitute products may become attractive. Forms of self-insurance or mutual/investment funds for retirement arrangements may be preferred". *Schmeiser, H., Störmer, T., Wagner, J.*, supra note 22, cit., 345. Overall, the insurance market may decrease in size along with the quality of the insurance benefits. These effects "may be stronger in the annuity and life insurance market, as such insurance is not compulsory, unlike motor insurance, for example. On the other hand, for compulsory insurance lines (for example, motor insurance), further moral hazard behavior may occur, meaning that excessive risks may be taken and the average risk level may increase". Ibid.

²⁸ *Thiery, Y.*, supra note 12. In the eyes of the Court, the respective situations of men and women are comparable as regards premiums and insurance benefits. As comparable situations should not be treated differently, "the Court found the possibility of differences

Although the Court of Justice encourages insurance companies to use alternative, closely related risk factors, no assessment has been made concerning the feasibility of a solution where gender is combined with alternative risk factors.

Considering these assumptions, insurance companies must find other economically viable market solutions that may link the insurance prices closer to personal risk.²⁹

in premiums and benefits for women and men to be discriminatory. It also found no justification for the unequal treatment of women and men in insurance matters". Ibid.

²⁹ An advantage is that they will at least be able to do so on the same level playing field, no longer dependent on the choices that different Member States have made regarding the derogation under Article 5 (2).