

Update on Test Achats

The European Commission, following consultation with the insurance industry during 2011, has published guidelines to facilitate compliance with the Test Achats ruling at national level. Insurers can now review their contract design and pricing against more substantive requirements but some grey areas remain.

Background

In March, we reported on the decision of the European Court of Justice in the [Test Achats case](#), which held that, from 21 December 2012, the provision in the Gender Directive which permits EU insurers to include gender as a risk factor in calculating insurance premiums or benefits payable by or to individuals, will be invalid (Judgment). Each Member State currently allows gender differentiation for some insurance products and indeed all of them permit it for life insurance, so it was immediately evident that the Judgment would have far reaching consequences for insurers throughout the EU. The insurance industry raised a number of concerns regarding the impact of the Judgment, for example whether its application was limited to "new contracts", as we highlighted in our previous briefing.

The Commission, having consulted with the industry, issued a Communication on 22 December

2011 on the application of the Gender Directive to insurance in the light of the Test Achats ruling ([Guidance](#)). At a national level, [HMT's consultation](#) on its proposed legislative changes to ensure UK compliance with the Judgment closes on 29 February 2012 and seeks responses from the industry specifically on the following issues:

- market impact;
- indirect discrimination in insurance and related financial services;
- definition of new contract; and
- impact on group insurance schemes.

The Guidance

New Contracts

The Guidance confirms that new contracts concluded from 21 December 2012 must not use gender based factors in the calculation of individuals' premiums and benefits (Unisex Rule). Recognising that the Gender Directive does not define "new contract", the Commission,

through the issuance of the Guidance,

Key Questions for Contract Design/Review

- What is a new contract?
- Is a renewal a new contract?
- Is an amendment or endorsement a new contract?
- When is a contract concluded?
- Is acceptance of an additional premium a new contract?
- Is the contract a group policy?
- Can I use a suitable proxy factor for underwriting?
- Can I design policies or benefits directed at one gender?
- Will my contract wording, underwriting, and pricing practices withstand scrutiny?

is seeking to ensure a uniform application of the "new contract" concept throughout the EU and states

that the Unisex Rule "shall apply whenever;

- (a) a contractual agreement requiring the expression of consent by all parties is made, including an amendment to an existing contract, and
- (b) the latest expression of consent by a party that is necessary for the conclusion of that agreement occurs as from 21 December 2012."

According to the Guidance, "contracts concluded for the first time as from 21 December 2012" as well as "agreements between parties, concluded as from 21 December 2012, to extend contracts before that date which would otherwise have expired", should be considered to be new contracts. On the other hand, a new contract will not be triggered on:

- (a) "the automatic extension of a pre-existing contract if no notice, eg a cancellation notice, is given by a certain deadline as a result of the terms of that pre-existing contract;
- (b) the adjustments made to individual elements of an existing contract, such as premium changes, on the basis of predefined parameters, where the consent of the policyholder is not required; or
- (c) the taking out, by the policyholder, of top up or follow on policies whose terms were preagreed in contracts concluded before 21 December 2012, where these policies are activated by a unilateral decision of the policyholder."

Insurers now need to carefully review their policy quotation, negotiation and amendment processes in respect of all of their product lines, in order to ensure that they correctly apply the Judgment in each case:

- Changes may be needed to the guaranteed period for quotations, which, if issued before 21 December 2012, will now need to expire before that date or be requoted on gender neutral bases if accepted after that date.
- Contract renewals are likely, in most cases, to be new contracts and so all elements of pricing methodologies will need to be gender neutral from 21 December 2012.
- Amendments to a contract will trigger a new contract unless the amendment takes effect solely as a result of a unilateral decision by the policyholder or insurer. The position can only be determined by reviewing the contract wording. In some cases, particularly where an insurer's standard wording is unclear, clarificatory changes should be implemented for future contracts before 21 December 2012, whilst the insurer will need to reach a decision on the impact of amendments to its existing contracts, which is sufficiently robust and justifiable in light of the Guidance.

In all of the above cases, insurers in the UK will need to ensure compliance with existing FSA rules, including that the contractual position is communicated to customers in a way which is clear, fair and not misleading.

The Guidance does not deal in detail with the issue of when a contract is "concluded" and so insurers must consider how the general contractual

principles of offer and acceptance at common law fit within their sales structure, including for example, whether their contract wordings prevent conclusion of a contract even though cover may not commence immediately or premium is not paid. Insurers using agents will also need to agree the parameters of conclusion of contracts with those agents in order to ensure that the agents do not cause an inadvertent breach of the Judgment.

Group Policies

The Gender Directive applies only to insurance and pensions which are "private, voluntary and separate from the employment relationship" (Employment Exemption). This means that group policies taken out by an employer, such as group health or accident policies, fall outside the scope of the Judgment and insurers can continue to use gender differential criteria in respect of those policies.

The Guidance reiterates that the focus of the Gender Directive is the prevention of differences in *individuals'* premiums and benefits as a result of the use of gender based risk factors and that it does not prohibit the use of gender as a rating factor in general. The Guidance states that "such use is allowed in the calculation of premiums and benefits at the aggregate level, as long as it does not lead to differentiation at individual level" but does not specifically refer to group policies in this regard. However, it seems possible that group policies, where the policyholder is not an individual, can continue to use gender based rating factors provided these do not impact the individual beneficiaries' premiums and benefits.

Occupational Pension Schemes

The Guidance confirms that these fall within the Employment Exemption in the Gender Directive and that the setting of different levels of benefits between men and women is permitted in relation to occupational pensions is *not* discriminatory when justified by actuarial calculation factors. The Commission points out that this gender differentiation is specifically permitted under the directive relating to the equal treatment of women and men in relation to occupational pensions, which is drafted in a very different way from the Gender Directive. It is worth noting that the Commission has publicly acknowledged that, in the light of Test Achats, it will need to pay close attention to the drafting of similar provisions in future.

Gender differentiation in relation to occupational pensions will remain permissible, even if the scheme relies on an insurer to pay out the benefit. On the other hand, if the individual employee has to conclude an insurance contract directly with the insurer without the involvement of the employer, for example, to convert a lump sum into an annuity, the Gender Directive will apply and gender neutral criteria must be used by the insurer. While it is clear that trustees of occupational pension schemes may continue to use gender based criteria to set pension benefits, bulk annuity providers will need to consider the scope of the employment exemption and group policy position and examine their contracts in order to determine if they can continue to use gender based rating factors both at the point of "buy in" as well as at the point of "buy out", when the insurer may enter into a direct contractual relationship with an individual for the

first time. Issues may arise, particularly in relation to pricing, if different principles are to be applied at each stage, for example, gender differential factors may have been properly applied at "buy in" but application of the Gender Directive requires gender neutral factors at "buy out" stage or in the calculation of transfer values. The structure and pricing of future BPA deals will need to be carefully considered in light of the Guidance.

Permitted use of gender related information

The Guidance confirms that insurers may continue to "collect, store and use" gender related information for;

- reserving and internal pricing, which should ensure a more robust solvency position;
- reinsurance pricing, provided the reinsurance does not result in gender differentiation at an individual level;
- marketing and advertising, which is outside the scope of the Gender Directive; and
- life and health underwriting, where gender may need to be taken into account in light of physiological differences between men and women (see Annex 3 of the Guidance for further detail).

Proxy Factors

The Guidance recognises that the use of other factors may result in indirect discrimination against one gender and confirms that the Gender Directive permits such indirect discrimination if the aim is legitimate and the means of achieving it are appropriate and necessary. The Commission goes on

to say that the use of risk factors which "might be correlated with gender therefore remains possible, as long as they are risk factors in their own right". By way of example, price differentiation on the basis of large size of vehicle engine is permitted even if statistically more men drive such cars than women but differentiation on the basis of weight of the individual in respect of a motor policy would not be permitted. Insurers wishing to use proxy factors will need to be able to provide evidence that they have considered and applied this test prior to introducing those factors in their product pricing.

Status of the Guidance

Guidance such as this, which is issued by the Commission in the form of a Communication is not binding on Member States. However, it does set out the Commission's interpretation of the legal principles which the Commission will apply in its monitoring and enforcement of the Gender Directive. The Guidance confirms that the Commission will monitor the situation to ensure that national legislation is fully in compliance with the Judgment "on the basis of the criteria set out" in the Guidance.

The Commission emphasises the need to ensure a uniform implementation of the Gender Directive throughout the EU and clarifies that the concept of "new contract" is an "autonomous concept of EU law". This brings with it the risk that EU law, as ultimately determined, may conflict with existing UK legal principles on the formation and conclusion of new contracts. Although supporting a consistent approach

throughout Europe, HMT recognises this risk in its Consultation Paper and will use the responses to the consultation to inform the UK's approach in Europe. There is a further risk, acknowledged in the Guidance, that a subsequent ruling by the ECJ may result in a different interpretation of the Gender Directive than that taken by the Commission in this Guidance. Insurers must therefore remain alive to the possibility of further changes as the EU law in this area develops.

Next steps

HMT's Consultation Paper adopts a minimal approach to legislative change by proposing to simply remove the regulation which permits the use of gender by insurers. However, HMT notes that the Government is disappointed by the Judgment and has concerns about the unpredictable and unintended effects of the Judgment. HMT will monitor the effects and will aim to ensure that the negative impacts for both customers and the industry are reduced as far as possible. HMT encourages industry to respond to

their consultation, which seeks additional data on the impact of the Judgment on consumers and insurers, and views on some of the key issues arising from the judgment.

It is not yet clear if HMT will publish any further guidance for UK based insurers following its consultation process. The FSA is not, we understand, intending to publish any guidance, although it will consult in the usual way in respect of any technical changes to the FSA Handbook. In the meantime, it falls to insurers to take the steps necessary to ensure they are fully compliant with the Judgment, as interpreted by the Commission in the Guidance, by 21 December 2012.

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