Potential Impact of the ECJ Decision on 1 March 2011

The full implications and scope of the ruling will not be known for some time as there will need to be decisions about how far reaching it is and then many companies will have to decide how they will react to it.

Background

On 30 September 2010, Dr Juliane Kokott, an Advocate-General at the European Court of Justice (ECJ), delivered the opinion that sex discrimination in underwriting insurance policies is incompatible with EU law.

The EU's 2004 Gender Directive and current UK equality legislation allow insurers to charge different rates for insurance premiums based on sex if it can be proven, using actuarial and statistical data, that gender is a determining factor in assessing risk.
However, in reference to Article 6 of the Lisbon Treaty, Dr Kokott notes that EU law "shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms" and the EU's own catalogue of justiciable rights, the Charter of Fundamental Rights, which was given full legal effect for the first time by the Lisbon Treaty. The Charter stipulates that "Equality between women and men must be ensured in all areas, including employment, work and pay."

On March 1, 2011, the ECJ delivered a judgement in the Test-Achats case that gender discrimination in the pricing of insurance is outlawed from December 21, 2012.

EU Directive 2004/13 prohibits sex from being taken into account as a factor in calculating insurance premiums and benefits in respect of insurance contracts which are concluded after December 21, 2007. However, that Directive makes provision in Article 5(2) for Member States to permit sex-specific differences in insurance premiums and benefits insofar as sex is a determining risk factor that can be substantiated by relevant and accurate actuarial and statistical data. This aspect of the Directive is subject to reassessment by December 21, 2012 but may allow the opt-out, which the UK took advantage of, to last indefinitely.

We set out below possible impacts that could affect divorce cases. It should be clear that any impacts stated here are based on this ruling being applied to the specific feature being considered.

Cash Equivalents

Opinion is divided on whether this will also extend to methods used to calculate Cash equivalents. If it does, Cash Equivalents will have to be calculated using the same factors for male and female. However, even if it does, the actual impact may be quite small.

If you consider a 60 year old man at retirement, his life expectancy might be approximately 25 years compared to a woman who would have a life expectancy of 28 years. A typical pension scheme might have a spouse's pension of 50% of the main pension and the standard industry assumption is that men are three years older than their wives.

Therefore in valuing a pension for a 60 year old in a defined benefit scheme, the pension could be expected to be paid for 25 years with the reversionary pension at half the amount

for a further six years (wife being three years younger and it paid to death at an age three years older) thus the equivalent of 28 years being broadly similar to a CE for a female of age 60. Thus a move to non gender specific ages might not affect the CE too much.

Commutation Factors, Early Retirement Factors and other actuarial factors

Commutation Factors are the amount of lump sum you receive for every £1 per annum of pension that you give up if you commute the pension for cash at retirement. Early Retirement Factors are the amount by which a pension is permanently reduced if the member chooses to start to receive it early.

It would seem that those schemes that still offer different rates for male and female will have to change; which could marginally improve both lump sums and early retirement pensions for male members.

Annuities and Drawdown rates

Despite comprehensive evidence to justify the different rates, it does seem that by the deadline date, the market will move to unisex annuity rates.

Those commentators who are suggesting a significant improvement in female rates and similar reduction in male rates so that they become equivalent to the average of the current rates are in a minority.

Already the impact on car insurance premiums is suggested to be increasing rates for women but minimal if any reduction for men. A number of years ago when "safeguarded rights" had to have unisex rates, most providers seemed to give the same as their female rates for unisex rates.

In the case of annuities, then there is the additional factor of consumer behaviour which in most fields show consumers switching products as a result in the change in value.

The worsening rates for single life male annuities which seems inevitable, will push consumers away from such a product and the expectation would be that an annuity that also pays a reversionary annuity for a spouse would not see such a significant worsening as the spouse of the male (assuming female) would also have the unisex tables applied. Thus although a single life male rate might worsen, the consumer would not be buying such a poor value product if they added a spouse's pension for their spouse and therefore we would expect to see more males having annuities with reversionary pensions.

Women buying single life annuities will not be disadvantaged and indeed any move that makes the unisex annuity rates better than female rates will allow them to select against the annuity provider.

It is therefore the case that the annuity providers are likely to be astute and alert to the probable trend change ("selection risk") in take up of different products and conclude that they will have to provide unisex annuities close to the current female rates. As stated above this is what happened with the safeguarded rights some years ago.

Certainly in the short term any male able to and considering purchasing a single life annuity is likely to do so before the change.

Key Point:

The above two points would suggest that the income calculations for defined benefit schemes which offer the external option will not be significantly changed where the scheme member is the Husband.

It is possible that the revised Drawdown limits, due to be effective from April 6, 2011 will require further revision.

Cost of Insuring Death in Service benefits, protection of maintenance and other lump sum death benefits

Death lump sum assurance is likely to be worse value for women, but again we are unlikely to see much movement in rates as the majority of assurance is in respect of males at present.

Deferred annuities for Buy Outs

This is where the defined benefits payable from a defined benefit scheme which is being wound up is bought out with an insurer. It is unclear whether the cost will change as this does not directly affect a consumer and a provider could potentially provide the Scheme with a cost based on gender specific data although it is possible this may be outlawed as well.

Pension Credit calculations in public sector pension schemes

Once again although the ruling does not specifically refer to this, it would seem possible there will be yet another change to the public sector pension sharing calculation basis so that men and women will receive the same income for the same pension credit capital value.

As we stated above the actual impact on CETVs is unlikely to be significant and on the current gender specific basis the difference is only approximately 0.5% of the total value in a lot of cases.

Where we will see a noticeable difference is in the pension credit calculation which if it has to use unisex factors is likely to see an increase in the pension credit payable to the female non member spouse.

Clearly this does not confirm with the regulation that states that Pension Sharing should be cost neutral to the scheme but the ruling may be taken to mean the Schemes have to change and adopt unisex factors.

This places practitioners in a dilemma given that the new basis may be nearly two years in coming out and there is no certainty that the ruling will be extended to this. In the majority of cases where the member is male, it is possible that the actuarial terms will be better once the new basis is introduced. However, as it has not yet been confirmed that a new basis will be provided and at present you would be looking at adjourning the overall settlement for nearly two years (with consequent risks of death in the meantime) to take advantage of it, practitioners would have to think carefully about the appropriate action.

Key Point:

The possible improvement of the pension credit for a Wife is however something you should be aware of and as time passes, we should be able to get a better understanding of if and when a new basis will be produced and practitioners should be aware of the possible need to wait for a new basis.

Funding calculations for defined benefit schemes

There is no indication whether the ruling will be extended to the calculations actuaries do to check the funding level of pension schemes.

The impact of such a ruling could have significant impacts. It is hoped it will not affect an actuarial valuation as this will not affect the members directly. In the worst case, it could mean that pension schemes on the edge of solvency could be pushed over the edge and fall into the PPF because of the ruling.

Other impacts would be an overestimate of the liabilities in male dominated schemes leading to employers being required to provide too much funding then as the schemes gradually wind down (very many are closed to future accrual or at least new entrants), this would lead to a surplus with few members left but the scheme funded for longer life expectancies than is the case.

The worse case would be where a scheme is female dominated (and the fact is that as schemes wind down and members get older they will be dominated by women members and widows of members) and valuing liabilities in this case on unisex life tables would lead to insufficient funding in the Scheme and a problem arising very many years after the service from which the liability arises was done.

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March 2011