

Beware EU Changes Impacting UK Insurance plc

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Overview

- New European Supervisory Authorities
- Omnibus II and Solvency II
- IMD II and PRIPS
- Discrimination and Unisex Pricing

New European Supervisory Authorities

- De la Roslere Report in February 2009
- Divergent rules and gaps in regulation
- European systemic Risk Board (ESRB) to monitor macro-economic threats to financial stability
- Three new European Supervisory Authorities (ESAs)

New European Supervisory Authorities

- European Banking Authority (**EBA**)
- European Securities and Markets Authority (**ESMA**)
- European Insurance and Occupational Pensions Authority (**EIOPA**)
- Made up of a board of representatives from national supervisors and a chairman

EIOPA

EIOPA has power from January 2011 to:

- develop binding technical standards (once endorsed by the Commission)
- take decisions where there is a manifest breach or non-application of EU law by a Financial Institution
- intervene/mediate where national supervisory bodies disagree

EIOPA

- prohibit or restrict harmful activities or products in “emergency situations” declared by national governments or the EU Council
- collect information and issue guidance

Example: Solvency II

- Level 1 directive, Level 2 rules likely to be based on EIOPA (CEIOPS) guidance, Level 3 guidance
- Areas still unclear in Solvency II include SCR liquidity premium, contract boundaries and equivalence assessments
- EIOPA will have a big role in this

Omnibus II

- Proposed delay to January 2013 of Solvency II and power to make transitional provisions
- Up to 10 years – valuation, calculation of technical provisions and transitional SCR, capital instruments,
- Up to 5 year- equivalence
- Up to 3 years - governance and reporting

IMD

- Covers introducing, arranging, advising on or concluding insurance contracts and assisting in their administration or performance on behalf of a customer.
- UK introduced rules in 2005 and applied IMD to insurance companies
- FSA has to keep a register of intermediaries
- Only authorised people can be involved in the sales process

IMD

- Requirements to disclose status and costs (e.g. IDD)
- Requirement to provide statement of demands and needs
- Know your customer and suitability if advising
- Requirements re fitness, training and experience of staff involved

IMD Consultation

- EU Consultation paper November 2010 closed February 2011
- Summary of responses
 - greater disclosure (e.g. ownership of providers)
 - definition of advice included
 - definition of freedom of services / establishment
 - new rules on (Package Retail Investment Products = **PRIPS**) aligned to MiFID

IMD Consultation

Other areas still unclear include whether:

- introducing will still be included and
- commission disclosure will be mandated for non-investment products

PRIPS Consultation

- EU Consultation on PRIPS closed January 2011
- Issues similar to RDR, conflict of interest and investor confidence
- Identified need to improve pre-sales disclosure and conduct of sales
- PRIPS to include UCITS and Unit –Linked Insurance Contracts
- Standardisation across wrappers

Definition of PRIPS?

Proposed:

A PRIP is a product where the amount payable to the investor is exposed to **fluctuations** in the market value of assets or payouts from assets, through a combination or **wrapping** of those assets or **other mechanisms than a direct holding**

What will it mean?

The Commission's preference seems to be:

- For **pre-sales disclosure**, to have new **EU rules** on the requirements likely to be based on having a Key Initial Information Document (KIID), similar to UCITS documents and to deem that to comply with other directives eg insurance/MIFID
- For **sales rules** to align the existing directives (eg by making changes to IMD and MIFID)

Discrimination and Unisex Pricing

- Review of EU and UK gender discrimination legislation
- Background to ECJ ruling in *Test-Achats*
- Consequences of ECJ ruling for insurers
- Effect of ECJ ruling on EU and UK legislation
- Future of risk assessment

European Union law

- The Charter of Fundamental Rights
 - *“Everyone is equal before the law”* (Article 20)
 - *“Any discrimination based on any ground such as sex, race, colour, ethnic or social origin, genetic features, language, religion or belief, political or any other opinion, membership of a national minority, property, birth, disability, age or sexual orientation shall be prohibited”* (Article 21(1))
 - *“Equality between men and women must be ensured in all areas, including employment, work and pay.”* (Article 23)
- Article 6 of the Treaty on European Union enshrines the Charter into EU law – enforceable against EU and member states

Gender Directive (Directive 2004/113)

- Implements the principle of equal treatment between men and women in the access to and supply of goods and services
- Article 5(1) – prohibits gender being a factor in the calculation of premium and benefits in insurance contracts

*“Member States shall ensure that in all new contracts concluded after 21 December 2007 at the latest, the use of **sex as a factor** in the calculation of premiums and benefits for the purposes of insurance and related financial services shall **not result in differences in individuals’ premiums and benefits.**”*

Gender Directive – Article 5(2)

- Article 5(2) – derogates from the prohibition in Article 5(1):

- *“Notwithstanding paragraph 1, Member States may decide before 21 December 2007 to permit **proportionate differences** in individuals’ premiums and benefits where the use of sex is a **determining factor** in the **assessment of risk** based on relevant and accurate **actuarial and statistical data**. The Member States concerned shall inform the Commission and ensure that accurate data relevant to the use of sex as a determining actuarial factor are compiled, published and regularly updated. These Member States shall **review their decision five years** after 21 December 2007, taking into account the Commission report referred to in Article 16, and shall forward the results of this review to the Commission.”*

UK Law

- Gender Directive implemented in the UK through:
 - Sex Discrimination Act 1975 as amended from 6th April 2008
 - Equality Act 2010 (mostly in force 1 October 2010)
 - “protected characteristics”: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation
 - derogation contained in Schedule 3, Part 5

ECJ: *Test-Achats*

- Is it compatible with the fundamental rights of the EU to take the sex of the insured person into account as a risk factor on the formulation of private insurance contracts?
- Belgian consumer organisation declared domestic law transposing Gender Directive “*unconstitutional*”
- Opinion of Advocate General Kokott
 - gender discrimination contrary to human rights
 - Article 5(2) of the Gender Directive incompatible with EU law
 - recommended 3 year transition period

Test-Achats - ECJ judgment

Delivered **1 March 2011** followed (in part) Advocate General opinion

- Article 5(2) - allowing derogation to “*persist indefinitely...works against the achievement of the objective of equal treatment*” in the Gender Directive
- “***Article 5(2) is invalid with effect from 21 December 2012***”

Commission response to ECJ ruling

- Statement by EU Justice Commissioner
 - *“Belgium, Bulgaria, Cyprus, Estonia, Latvia, Lithuania, the Netherlands and Slovenia apply unisex premiums for car insurance...insurers across the EU [must] follow this good example regarding all insurance contracts.”*
 - *“It is now clear that an insurance company must not distinguish between women and men; all customers must be treated equally. This is a matter of respect for fundamental rights. It is now also becoming a matter of good business practices.”*
 - **A “meeting with business leaders” will be convened “in the coming months to discuss the judgment’s implications.”**

Impact of ECJ ruling: UK legislation

- Domestic law will need to be neutral in terms of gender
- Derogation is contained in Part 5 of Schedule 3 of Equality Act 2010
- Government needs to repeal the opt-out in Equality Act 2010 by 21 December 2012

Impact of ECJ ruling: insurers

- Considerations for insurers:
 - prepare for unisex rate/ensure no discrimination on grounds of gender
 - targeted marketing?
 - pricing on other factors (note AG comments that gender was used as a substitute criteria for other factors) including proxy
 - assessment of socio-economic conditions (e.g. diet, consumption of stimulants, lifestyle)
 - use of aggregators/trend for fewer questions

Impact of ECJ ruling: life insurers

- Difficulty of estimating mix of male/female business for particular lines of business
- Most impact on annuity and term insurance but clearly impact on sickness and health
- Likely impact for reviewable rate policies and certain types of guarantees –NB: nature of review – pay charges for a fix period based on current rates?
- Raised the use of genetic testing and the ABI position

Impact of ECJ ruling: wider discrimination

- Proposal for an Equal Treatment Directive:
 - designed to implement the principle of equal treatment irrespective of “religion or belief, disability, age or sexual orientation” outside the labour market
 - currently, EU legislation prohibiting discrimination on grounds of religion, disability, age or sexual orientation applies only to employment, occupation and vocational training
 - draft directive proposed in 2008
 - approved by European Parliament (with amendments) 2010
 - European Council debate or examination expected June 2011

Impact of ECJ ruling: wider discrimination

- Effect of the draft Equal Treatment Directive:
 - prohibits potential discrimination on grounds of religion or belief, disability, age or sexual orientation BUT
 - currently contains a similar provision for financial services where the use of age or disability is a determining factor in the assessment of risk based on relevant actuarial principles, accurate statistical data or medical knowledge, but instead of it being an exemption it is **deemed not to be discrimination** if objectively justified and use is proportionate.

Impact of ECJ ruling: wider discrimination (continued)

- However (unlike the Gender Directive) not a temporary derogation, but not “discrimination”
- Following *Test-Achats*, pricing based upon these characteristics could also be found to be incompatible with EU law (note the Charter) and may need an EU protocol
- UK Government Equalities Office consultation (published 3 March 2011)
- FSA consultation

Equality Directive

- Need to lobby for age and health factors not to be discrimination
- Need to consider other factors (eg socio economic – ie postcode underwriting?)
- Watch this space!

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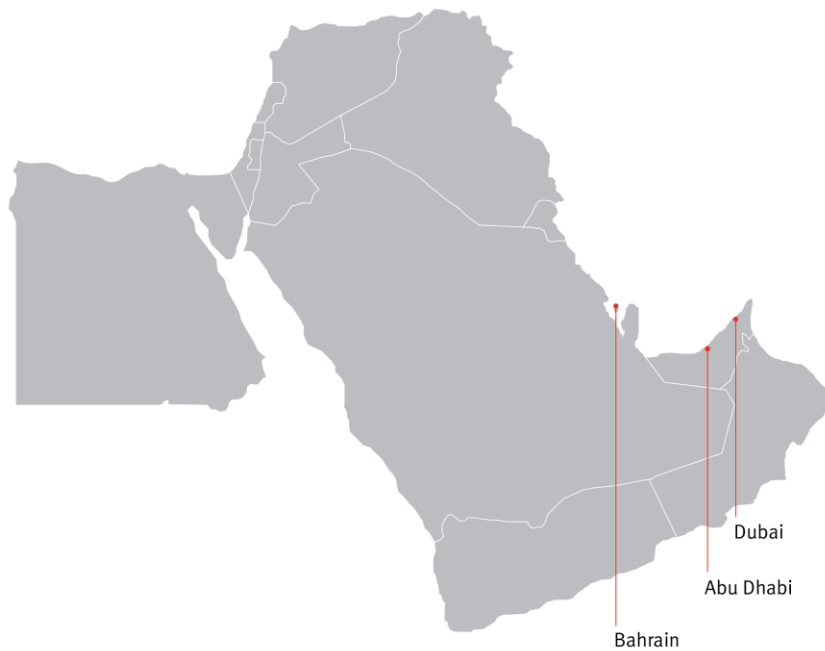
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