

Study on the use of age, disability, sex, religion or belief, racial or ethnic origin and sexual orientation in financial services, in particular in the insurance and banking sectors

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Overview

- Introduction
- Current practices of financial service providers
- Actual and potential problems of discrimination
- Existing measures at national level
- Recommendations

Methodology

- Desk research
- Surveys of stakeholders (industry, authorities, equality bodies/ombudsmen, civil society organisations) ~ 240 responding organisations
- Interviews ~ 80 across Europe
- Legal analysis/case studies of selected MS (Belgium, Germany, Sweden, United Kingdom, Cyprus, France and the Netherlands) + third countries (Canada, New Zealand)
- Documented examples of alleged discrimination ~ 73 cases

Use of factors – basic concepts /1

- **Consumer financial services** are often standardised products with little variation in their terms, other than price
- **Pricing** of consumer insurance and credit products based on segmenting the population of covered risks and placing them into groups having similar characteristics (and similar levels of risk). Premiums for each group are arrived at by the statistical analysis of loss data and actuarial modelling
- **Factors such as sex and age** are criteria which are believed to reflect or influence the probability of loss. Many of the **factors** used by providers of financial services for risk assessment **are not so much causes of loss as proxies for other things that may cause loss**

Use of factors – basic concepts /2

- **Adverse selection** ('hidden knowledge') can arise if the insured has better information about the risk he/she represents than the insurer → If, for example, the insured knows that he/she is in much poorer health than most people (e.g. perhaps of smoking), insurer will tend to under-price. Clients who are in good health will have to cross-subsidise the former through the premiums they pay, meaning that the risks they represent will be over-priced
- **Problem:** if 'good risks' are over-priced, they decamp to another insurer → insurers have incentive to distinguish between risks as precisely as possible and charge premiums as accurate as they can be in actuarial terms

Use of factors – basic concepts /3

- **Possible limits** to an insurer's ability or willingness to finely segment the risk population and charge accurate premiums:
 - Incentive to do so will be reduced if the market is not competitive, especially if product is mandatory by law (some smaller EU insurance markets highly concentrated)
 - Availability of information and the costs of acquiring it (e.g. medical examinations, GPS technology to track the use of motor vehicles)
- **Problem:** High-risk consumers may be priced out of the market or refused insurance altogether ('redlining' problem)
- Solutions include 'declined cases' agreements → risks that are unacceptable to individual insurers are pooled and spread across the market (e.g. motor insurance)

Use of factors – basic concepts /4

- **Moral hazard** ('hidden action') is the risk that insurance cover will bring about a change in behaviour of policyholder which makes the insured event more likely to happen
- Standard techniques to combat problem:
 - Restricting cover to losses which are 'fortuitous' (accidental) only
 - Restrict payments to exact compensation or less (e.g. deductible)
 - Restrictive policy terms which reduce coverage for high-risk policyholders (in advance of losses or as consequence of claims)
- **Incentive to take care** if policyholder knows that premium rises if claim and falls if no claim (e.g. bonus-malus system)
- Levying of premiums according to risk plays a part in combating moral hazard as well as adverse selection

Products selected for in-depth scrutiny

- **Motor insurance**
- Travel insurance
- Term Life insurance
- Private health insurance
- **Mortgage loans**

Motor insurance – Use of age

- **Pricing**: Age is significant factor and used by most, if not all motor insurers
- **Availability of cover**: Some insurers refuse youngest drivers (especially if other adverse risk factors are present), many insurers decline to quote for new customers above a certain age
- **Contractual terms**: Age is likely to affect contractual terms (e.g. no availability of ‘any driver’ cover, higher deductibles)

Motor insurance – Use of sex

- **Pricing**: Sex is regarded by some insurers as a proxy for driving behaviour (female drivers have fewer accidents). The difference between premiums is most marked in young ages
- **Availability of cover**: Some companies provide insurance exclusively to women
- **Contractual terms**: Unlikely to vary significantly, if at all, between men and women in the vast majority of cases

Motor insurance – Use of disability

- **Pricing**: Case-by-case assessment. Disability might be a factor which influence the need for additional medical checks
- **Availability of cover**: Disability does not cause exclusions
- **Contractual terms**: Disability rarely influences the contractual terms or benefits of motor insurance policies

Mortgage loans – Use of age

- **Pricing**: Age is a minor factor
- **Availability**: Legal restrictions for people under age of majority. Upper age limit generally apply when entering a contract and when ‘exit’ (repayment)
- **Contractual terms**: Age may affect length of repayment periods and need for financial ‘check ups’

Mortgage loans – Use of sex and disability

Generally, play no part in the provision of mortgage loans, however:

- Few national associations state that **sex** was relevant
- **Disability** is likely to be relevant in cases where it may restrict the earning capacity of the borrower or in cases where the borrower is required to arrange insurance in connection with the mortgage

Credit scoring

- **Age and sex** are sometimes used in credit scoring and this may affect the provision of banking/loan products
- Credit-scoring models often assume that the risk of default reduces with age, making younger borrowers a greater risk
- Age and sex appear to be a relatively minor component, although according to one agency, sex and age combined can equal up to 20% of the overall credit score

Use of factors – Racial/ethnic origin, religion/belief and sexual orientation

- According to the **industry**, very little direct use, with the sole exception of products which are compliant with Islamic law
- According to **national authorities, equality bodies and CSO** slightly greater number of exceptions (alleged use of ethnic origin and sexual orientation)

EU and national legal frameworks

- Existing directives in the area of gender and race envisaged to be complemented: *Proposal for a Council Directive on implementing the principle of equal treatment between persons irrespective of religion or belief, disability, age or sexual orientation, COM(2008) 426 final*
- The EU legislative framework would then **prohibit** the use of racial/ethnic origin, religion/belief and sexual orientation, and **permit** the use of sex, age and disability in the provision of financial services under certain circumstances (exception for financial services)
- Nearly half of the Member States already have various legislative provisions in place that broadly anticipate this legal framework

When is use of factors discrimination?

(according to the envisaged EU framework)

- The use of **racial or ethnic origin, religion or belief, or sexual orientation** is considered to be *discriminatory under all circumstances*
- The use of **sex, disability, or age** is considered to be *discriminatory if* (for the product in question):
 - Differences in treatment/individuals' premiums and benefits are not **proportionate**
 - Sex, disability, or age are not a **determining factor** in the assessment of risk
 - The assessment of risk is not based on **relevant and accurate actuarial and statistical data** (+ *other evidence?*)
- *Implications of Judgment of the Court in case C-236/09?*

Proportionate differences

- *Who decides what proportionate means in practice?*
 - Case-by-case decision (court, equality body etc)
 - No guidance available at EU level
- **Service providers** find it difficult to demonstrate proportionality of differences in premiums/treatment because they do not use a simple (in the mathematical sense), strictly proportionate approach to underwriting with regard to each factor used in risk assessment
- **Equality bodies, ombudsmen** or **courts** find it difficult to decide whether or not differences in premiums/treatment are proportionate, in case provider behaviour is challenged (actuarial know-how required)

Number of complaints

- 17 Member States reported relevant discrimination complaints
- In total 375 complaints were received and registered by product category on average per year for the period 2007-2009
- Taking in addition the estimates from a small number of organisations into account, the average figure of complaints is approximately 1,075 to 1,675 per year. This is roughly equal to **0.6%** to **1.0%** of cases reported by major EU ADR schemes specialised in financial services

Scale of the problem

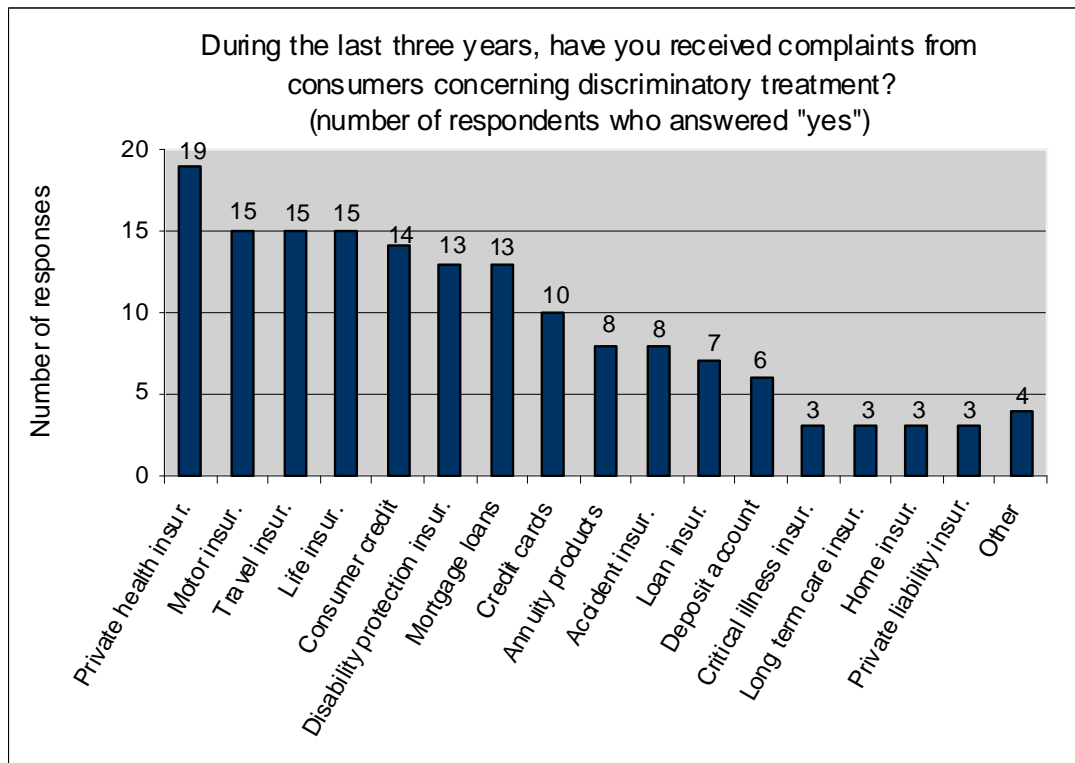
- The **overall number** of complaints reported by respondents to our survey about alleged discrimination in financial services appears to be **low** compared to other types of consumer complaints
- However, on basis of data collected it is not possible to come to a firm conclusion about the likely scale of the problem of perceived discrimination in financial services or the total numbers of complaints involved across the EU because of likely **underreporting**

Reasons for underreporting of complaints

- **Civil society organisations** which work on issues of discrimination in financial services often do **not exist**
- Civil society organisations may **either not collect complaints data or may not classify complaints**
- Some national **equality bodies** have been **formed or restructured recently**
- Existing consumer complaints bodies sometimes do not accept complaints concerning problems that occur **prior** to a contract
- Groups that potentially face discrimination may be **vulnerable** and thus less likely to pursue a complaint

Documented complaints /1

Products subject to complaints

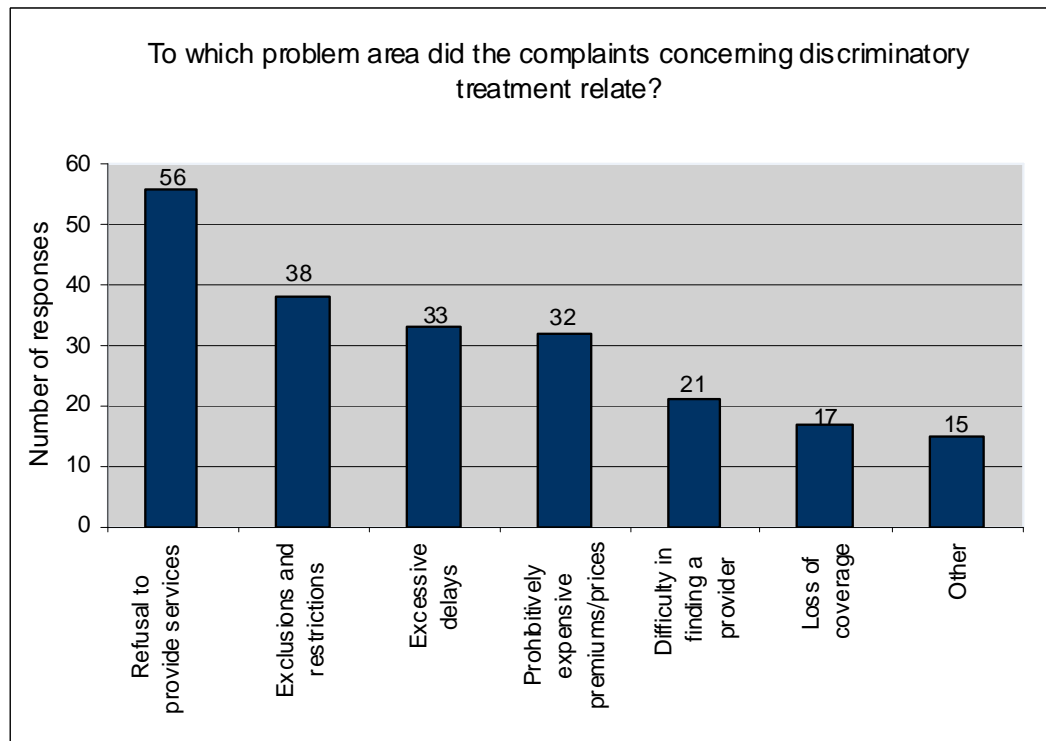


Insurance products more likely to be subject to complaints than credit and banking products

Survey of stakeholders

Documented complaints /2

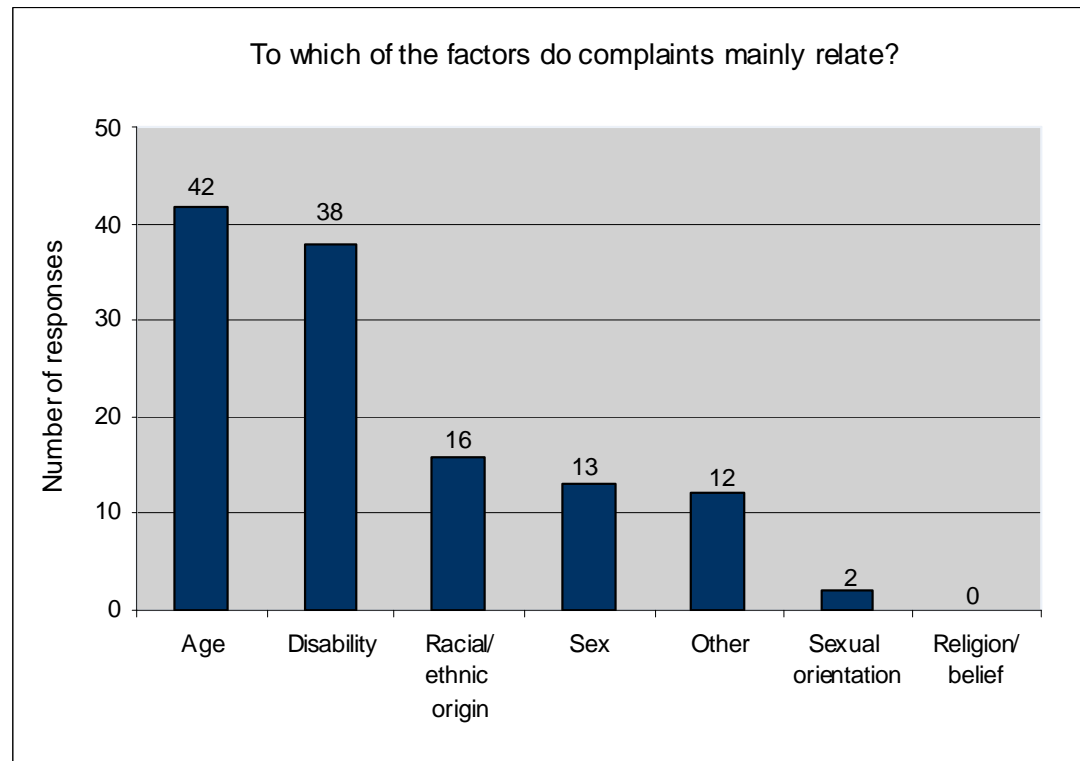
Problem areas



Denial of access to financial services is the main reason for complaints

Survey of stakeholders

Documented complaints /3



Survey of stakeholders

Alleged **age** discrimination most frequent. Perceived discrimination on the grounds of **racial/ethnic origin** often relates to denial of access to banking products due to nationality and length of residency requirements

Identification of problems

Existence of complaints \neq Problems

Are complaints justified?

Analysis of decisions that have been subject to an **inquiry by an equality body, an ombudsman or court** and of the criteria applied for the judgment

- **Evidence** used by financial service providers to justify differential treatment
- **Proportionality** of the behaviour of the provider as judged by the body conducting the inquiry

Identification of problems: *Evidence*

Evidence provided by financial services providers has been challenged. Investigations have led to different conclusions depending on the circumstances of the case

Key obstacles to investigate evidence

- Required level of actuarial expertise
- Limitations of the data that is provided by the defendant or available from other sources

Example: Age and motor insurance /1

Ireland: A 77-year-old man who was refused motor insurance on the grounds of age had suffered discrimination, according to a decision by the Equality Tribunal. One of the grounds for the decision was that the insurer was not able to produce in full detail the actuarial or statistical data that guided their over-70s policy. This data was shown to contain 'black holes' where the relevant data relied on was incomplete or no longer available and there were questions about its integrity. It therefore was not deemed to be "from a source on which it is reasonable to rely"

Example: Age and motor insurance /2

Ireland: A 31-year-old man alleged age discrimination. He had obtained quotes for car insurance for a 31- and 41-year-old and found the difference in premiums to be “excessively wide”. The investigation involved extensive analysis of the risk assessment model and underlying statistical data used by the insurer in calculating its premiums. The Equality Officer decided that the quotations were based “on actuarial or statistical data from a source on which it is reasonable to rely” and the complaint was not upheld

Example: Disability and loan insurance

Belgium: A woman previously suffered from hepatitis C and had difficulties in finding loan insurance. According to the Insurance Ombudsman, the refusal of coverage or specific conditions should be based on a so-called 'objective and reasonable justification'. After being addressed by the Ombudsman, the insurer proposed to cover the woman through a surcharge, based on and justified by statistics. During negotiations, the Ombudsman learned that the surcharge was fixed on the oral recommendation of the advisory physician of the insurer. Documentary proof was however not available. The Ombudsman asked to review the case. After new analysis, the company agreed to cancel the surcharge

Identification of problems: *Proportionality /1*

- A majority of documented decisions focus on the issue of proportionality of provider behaviour
- Reasoning of the bodies appears to draw on a relatively **common understanding** of the concept of proportionality
- Rooted in the **justification test** to deal with alleged discriminatory character of unequal treatment, developed in case law of the European Court of Justice, the European Court of Human Rights and national constitutional courts

Identification of problems: *Proportionality /2*

More than half of the documented decisions of courts, ombudsmen and equality bodies concern the **refusal to provide a service** (including because of age limits). Denial of access to a service not based on a proper risk assessment was **often considered to be not proportionate** by the investigating body, or led to settlements to avoid a decision

Example: Age and credit

Hungary: A 77-year-old complainant applied for a consumer credit seeking to buy a washing machine for the sum of 260 Euro. An employee of the credit institution refused the credit application without specifying a reason. The complainant's financial standing provided sufficient security for the repayment of the loan and he had no other credit contracts. The Equal Treatment Authority of Hungary found that the bank could have used several other ways of securing the payback of the loan and that refusal based on age was unlawful

Example: Disability and health insurance /1

Sweden: A child that was denied access to private health insurance due to a hearing loss with undiagnosed cause. The insurer argued that the overall risk was too high and that it could not exclude the hearing loss from the insurance, since the reason for the hearing loss had not been ascertained. The Swedish Equality Ombudsman, however, judged the denial to be not proportionate as the insurer could have granted cover with exclusions relating to the hearing loss

Example: Disability and health insurance /2

Germany: A court found the denial of contracting to be compatible with non-discrimination law in the case of a child that was denied access to complementary private health insurance because it suffered from a rare disease. The insurer had argued that there was only insufficient data on rare diseases and that therefore the risk was not insurable

Legislation planned

Access to financial products is an area of debate and change in some Member States

- **Direct legislative measures**, e.g. Belgium: a new law facilitates access to home loan insurance for people with aggravated health risks
- **Non-statutory solutions**, e.g. the UK: improved signposting approach (or referrals to available insurers) in the context of age legislation, particularly in motor and travel insurance

Non-regulatory Measures

Voluntary initiatives of industry associations can play an **important role**:

- Provide **better access** to financial products
E.g. Germany (basic banking), France (loans)
- **Guide** insurers and banks when applying non-discrimination legislation in practice
E.g: codes of good practice, statements and commitments regarding HIV

Conclusions

- The factors **age, sex and disability** are widely used in the design and supply of financial products
- Nearly half of the Member States already have various legislative provisions in place that prohibit the use of racial/ethnic origin, religion/belief and sexual orientation, and permit the use of sex, age and disability in the provision of financial services under certain circumstances, and thereby broadly **anticipate** the legal framework proposed by the European Commission
- Study results confirm the **existence of problems** of discrimination in the provision of financial services that need to be addressed through adequate measures

Key recommendations

for action at EU, national and industry level

1. EU-wide consumer research to establish scope of problem
2. Commission guidance for interpretation of key terms
3. Consumer complaints infrastructure and reporting
4. Industry codes of good practice at EU level, complemented by national codes
5. Sectoral agreements to make available specific products to high-risk consumers
6. Signposting systems to guide specific consumer groups to specialised providers