

## UK pension schemes should plan to adapt to unisex insurance costs following *Test-Achats* ruling

UK occupational pension schemes are not directly subject to the widely-publicised decision on Tuesday in the case of *Test-Achats*, in which the European Court of Justice (ECJ) ruled that insurers will have to use unisex rates. But they will have to adapt to it and plan for the future.

Technically what the ECJ did was to strike down an a provision under which EU member states can let insurance companies charge different premiums to individual men and women. Following the Court's decision, that exception will cease to be available from 21 December 2012.

So what are the knock-on effects for occupational pension schemes?

### Actuarial factors can remain unequal for now

The ECJ decision does not directly apply to occupational pension schemes. UK law allows them to use sex-specific actuarial factors in a number of situations, particularly transfers, commutation and early retirement. This is backed up by the 1993 ECJ ruling in *Neath v Hugh Steeper*, one of the *Coloroll* cases, in relation to commutation and transfer values in funded schemes. In that case the ECJ ruled that schemes can use sex-specific factors where the differences reflect differences in the actuarial cost of the benefits. Many schemes continue to use different factors for the two sexes. The *Test-Achats* decision itself does not change the UK law or reverse the Court's previous decisions on those points.

However pension schemes cannot afford to be complacent. Unisex annuity rates are already required in a number of EU states, as well as in the US. The *Test-Achats* decision stresses that, in the Court's view,

the EU Treaty requires "the progressive elimination of inequality between the sexes". Challenge may follow in the occupational pensions context and the Government may review the permissive legislation. We suggest that schemes should plan for this. It seems reasonable to assume that any change would be required from a future date. There is a deadline of 15 February 2013 for review of the Equal Treatment Directive in the pensions context and that would seem a likely date.

Also schemes will have to manage the interface between the occupational and insurance worlds from December 2012, and possibly sooner as some insurers may act before the deadline. There will be opportunities and threats as members and trustees consider whether advantage can be taken of the difference between the regimes.

### Annuity purchase for DC pots will change

From 21 December 2012, men and women who use a money purchase "pot" (or cash balance pot) to buy a pension from an insurer at retirement will have to be offered it on the same terms. Men will typically get a smaller pension than before. Women will typically get a bigger one – though the increase for women will be less than the reduction for men, because most people buying annuities are men so the factors will be weighted towards male factors. Also the factors are closer together for joint life annuities than for single life annuities because a man is likely to leave a female survivor. However we understand that the gender difference is likely to be smaller than the differences that already exist in market pricing for members willing to shop around, specially if they can buy an impaired life annuity.

## Enhanced transfer value exercises will have to recognise unisex annuity purchase

The ECJ ruling has a direct implication for enhanced transfer value (ETV) exercises, where members are offered financial advice on what retirement benefits they can expect if they transferred into a personal pension scheme. As a result of the Test-Achats decision, advice given in the past may not now be borne out in reality if it assumed that men and women would end up buying annuities on sex-specific terms. Presumably the IFA will have caveated any advice given in the past. For exercises currently under way or in preparation, trustees and employers need to consider whether to base ETVs on unisex factors, and IFAs will need to consider how to build in likely future annuity purchase rates when giving advice.

## Trustees insuring benefits will be unaffected

Occupational schemes themselves often insure some of the benefits they provide. The group premiums that a pension scheme (or an employer) pays to insure, say, a lump sum death benefit are not directly affected. As long as the benefit is equal, which it has been required to be since the Barber decision twenty years ago, there is no basis for complaint by members. It may suit insurers to make the pricing unisex though. Different approaches by insurers may provide opportunities for schemes to shop around for lower costs.

For the same reason, the ECJ ruling need not affect the cost of buy-in policies (where a scheme takes out insurance policies replicating the benefits of a group of scheme members). Again it will depend on whether insurers continue sex-specific pricing where allowed. A buy-in policy is effectively an investment contract. The same applies to longevity swaps and other investment products, where taking account of the gender make-up of the relevant population will continue to be possible.

Similarly when it comes to buying out annuities on wind up, either if benefits are bought out in full or if they are reduced pro rata where funds are not sufficient, it would seem that the way the insurer calculates the premium will not affect individual members. No change will therefore be required.

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