An analysis of unisex annuity rates

This research analyses the issues surrounding the compulsory use of unisex annuity rates for all annuities in the UK and the potential impact of such a change.

Key findings

- Annuity income makes up only a very small proportion of total retirement income for most pensioners. Gains and losses to annuity rates will only have a small impact on incomes in most cases.
- Fewer than one-quarter of pensioners have annuities. Although the use of annuities will become more widespread in the future, the pattern of gains and losses is likely to remain similar to today.
- In a compulsory unisex pricing market, the best rates are likely to be between the current male and female rates. They could increase by 10 per cent for women and fall by 3 per cent for men.
- 80 per cent of people have small pension funds of less than £30,000. Most people will be unable to shop around for the best rates and will be tied to their pension provider. In this case women will see no change in their rates and men could see a fall of up to 13 per cent.
- Three-quarters of pensioners with annuities are likely to see a drop in retirement income. This would include some wives and widows who were dependent on their husband's annuity.
- The introduction of unisex annuities is therefore unlikely to be of widespread or significant benefit.
- None of the arguments commonly put for and against the introduction of compulsory unisex annuities have been quantified, and none has been made conclusively.
- The only successful argument for their use elsewhere is that they discriminate against women in a legal employment context (USA). If a similar approach was taken in the UK, unisex annuities would become compulsory for Defined Contribution occupational pension schemes. This would represent up to one-third of the UK annuity market.
- Better advice and guidance to help annuity purchasers to choose the best options may be of more practical use than compulsory unisex annuity rates.

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Introduction

An annuity insures against an individual's pension savings running out because he or she lives longer than expected. The UK has a large annuity market worth over £6 billion a year, and growing. Nearly all annuities are bought on a gender specific basis. Women receive lower monthly annuity payments than men from the same amount of pension saving because annuity providers take into account the expectation that women will live longer than men.

The case for and against unisex annuities

There are arguments both for and against the introduction of unisex annuities but neither side has been made conclusively, nor have they been quantified to assess whether, and by how much, they would benefit women and consumers in general.

The one argument that has been used successfully is that they discriminate illegally against women. In the USA and Canada, any annuity bought directly with the proceeds of an employer-sponsored Defined Contribution (DC) pension fund must be unisex because they must not discriminate on grounds of gender. If a similar approach was taken in the UK, unisex annuities would become compulsory for DC occupational pension schemes, currently representing up to one-third of the UK annuity market. Unisex annuities are also used within the state pension system in the UK and Sweden.

Potential impact of unisex ratings

The best annuity rates are likely to be better than the current unisex rates available. They could settle around one-quarter of the way below the male rate and three-quarters of the way above the female rate. As a result, the best rates could improve by 10 per cent for women, and worsen by 3 per cent for men. The best joint life annuities for men could fall by 1 per cent.

80 per cent of people have small pension funds worth less than £30,000 and will not have access to the best rates because most providers have a minimum fund value below which they will not accept a transfer. So the majority of people are likely to remain with their existing pension provider when purchasing an annuity. Women in this situation may see no change in annuity rates compared with today, while men could see a fall in rates of up to 13 per cent. Joint life annuities for men could fall by 4 per cent.

Potential impact on retirement income

Analysis suggests that unisex annuity rates are unlikely to be of significant or widespread benefit. Fewer than one-quarter of pensioners have an annuity so only a minority of pensioners would see any change to their retirement income. Of those who did, more than three times as many pensioners could see a lower income rather than benefit from a higher one. This would include some wives and widows who were dependent on their husband's annuity.

Annuity income makes up only a very small part of total retirement income for most pensioners, particularly low income pensioners who receive most of their income from the state. Thus the average gains and losses would be small.

The way forward

The research suggests that there is no reason why compulsory unisex annuities could not be introduced, but the impact on overall retirement income would be small, with more losers than winners. Although annuities will become more widespread in future, the pattern of benefits and losses is likely to remain similar to today. As developments in annuity pricing reduce the relevance of gender as a rating factor, access to better advice when purchasing an annuity and a greater ability to shop around may be more beneficial for everyone, particularly those with smaller savings.

An analysis of unisex annuity rates by Chris Curry and Alison O'Connell, Pensions Policy Institute, is published as an EOC Working Paper. It can be downloaded from the web address below or is available as hard copy.

For further information about EOC research and statistical work:
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