Submission to the House of Lords Select Committee on the European Union (Sub-Committee G) on the proposed European Directive on Equal Treatment between men and women in the access to and supply of goods and services

PENSIONS POLICY INSTITUTE

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Summary

The submission covers the potential consequences for retirement income in the UK if unisex annuities become compulsory as suggested by the Directive. We conclude that:

- Numerous arguments have been made for and against unisex annuities. While valid arguments are made on both sides, in our view neither side of the argument has been made conclusively.
- The PPI has quantified the likely impact of compulsory unisex annuities. This shows that unisex annuities are unlikely to be of significant or widespread benefit to people currently close to state pension age.
- A move to unisex annuity rates is unlikely to bring about a significant change in retirement income for most pensioners because:
  - Three-quarters of pensioners do not have any income from annuities.
  - Changing to a unisex pricing regime will not change annuity rates significantly.
  - Annuities form a small proportion of retirement income for most people who have them.
- Although more future pensioners will have more annuity income, there will still not be a significant or widespread benefit from compulsory unisex annuities.
- Therefore, if the Directive is implemented, it should be understood that there will not be significant benefit for all women. It is likely that more pensioners would see a lower retirement income than higher, including some women who depend upon their husband's pension in retirement.

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PENSIONS POLICY INSTITUTE

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The role of the Pensions Policy Institute

1. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI does not make policy recommendations, but exists to contribute facts and analysis to help all commentators and policy decision-makers.

2. This submission is written by Alison O'Connell, Director, and Chris Curry, Research Director. Alison trained as an actuary and has over 15 years experience in the financial services industry and pensions policy. Chris has worked in pensions for the Government and the private sector for 10 years.

3. The submission covers only the potential consequences for retirement income in the UK if unisex annuities become compulsory under the terms of the Directive. This works draws heavily on unpublished research commissioned from the PPI by the Equal Opportunities Commission (EOC). **This evidence is submitted on a corporate basis on behalf of the PPI. The submission does not necessarily reflect the views of the EOC.**

Views for and against unisex annuities are not conclusive and have not been quantified

4. Supporters of unisex annuities argue that:
   - Unequal annuity payments for the same size pension fund is discrimination
   - Different life expectancies for men and women are irrelevant as there is a considerable overlap in the ages at which most men and women die
   - Unisex annuities would increase women's retirement income
   - Gender is becoming less relevant to annuity pricing, as differences in life expectancy reduce and other factors (such as health) are used to price annuities.

5. Opponents of unisex annuities argue that:
   - Gender-specific annuities are not discriminatory because women are expected to live longer than men, and the total value of income received is equivalent
   - The overlap in the ages at which most men and women die is irrelevant
   - Unisex annuities would reduce retirement income for men and women
   - If less information can be used to price annuities then they will cost more

- A move to unisex pricing could be the 'thin end of the wedge', ending the use of other rating factors in annuity underwriting to the detriment of consumers generally
- Unisex pricing for annuities could lead to higher costs for women in other areas of insurance

6. In our view, while valid arguments are made on both sides, neither side of the argument has been made conclusively.

7. The one argument that has been used successfully elsewhere in the world for compulsory unisex annuities is that they discriminate against women – even though there are doubts about the economic logic used for this argument[1]. And in the UK annuitisation is compulsory, rather than voluntary as in the countries that already have compulsory unisex rates.

8. If a similar case of discrimination were to be successful in the UK, the precedent applies only for part of the employer-sponsored market (not including group or individual personal pension arrangements), which would amount to at most one-third of the current UK annuity market.

9. The arguments that have been made for and against unisex annuities have not quantified whether, and by how much, they would benefit women and consumers in general.

Quantification shows that unisex annuities are unlikely to be of significant or widespread benefit immediately

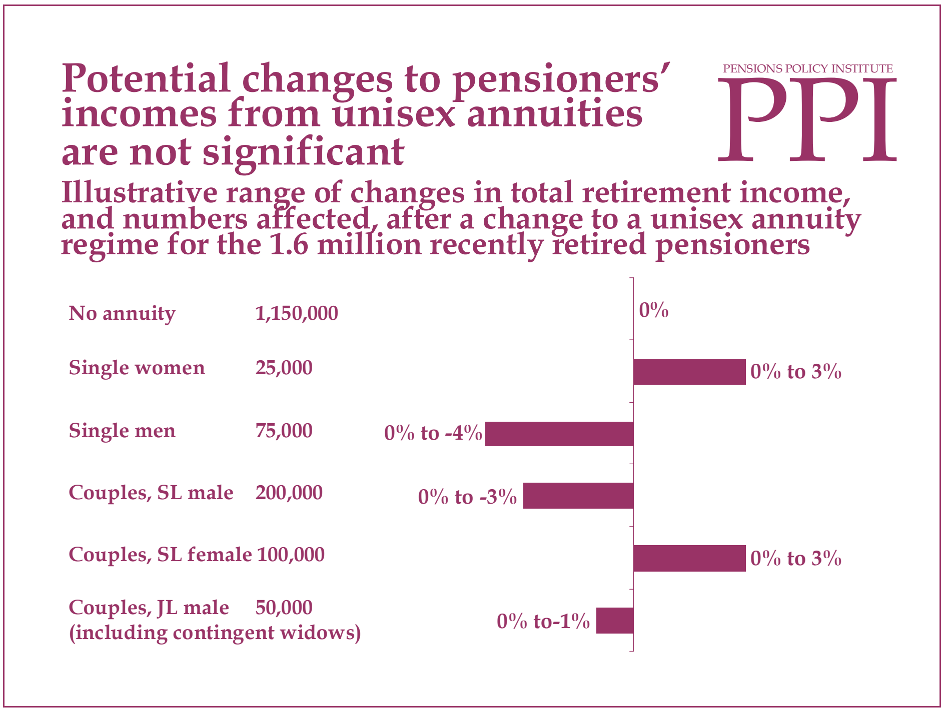
10. To help place the above arguments in context, the PPI estimated the possible impact of a change to unisex annuity pricing in the entire annuity market. Firstly, we estimated by how much annuity rates would change if unisex pricing were made compulsory. We then assessed how much difference a change to unisex annuity rates could make to the retirement incomes of both women and men, today and in the future.

[1] For example, in the US and Canada any annuity bought with the proceeds of defined contribution occupational pension schemes must be unisex. In the US unisex annuities have been justified using the overlap between the ages at which most men and women die, even though the same data shows an identifiable and significant difference in the expected length of time an annuity would be paid to women and men. In both countries alternatives to annuities are available (and much more popular than annuities), and the number of unisex annuities purchased is relatively small.

A move to a unisex annuity regime is unlikely to bring about a significant change in **retirement income** for most pensioners (Chart 1).

- Fewer than one-quarter of pensioners would see retirement income change.
- More than three times as many pensioners could see a lower retirement income as benefit from a higher one.
- The average gains and losses would be small.
- Some wives and widows would receive lower income.

Chart 1[2]



11. This pattern of gains and losses arises for 3 main reasons:
    - Most pensioners do not buy annuities
    - Changing to a unisex regime will not change annuity rates significantly
    - Most annuities are small

[2] See appendix for further details. SL is single life, JL is joint life. The figures show the range of outcomes between the 'worst case' and 'best case' scenarios, defined in paragraphs 14 and 15 of this submission. 'Recently retired' means within 5 years after state pension age. This age group was used to represent people currently close to state pension age.

Most pensioners do not buy annuities

12. Three-quarters of pensioners do not have pensions that require them to buy annuities, and so will not be annuity purchasers.

Changing to a unisex regime would not change annuity rates significantly

13. 80% of current annuity purchasers have funds worth less than £30,000. For these small funds annuity rates are not competitive. A change to compulsory unisex rates would not make the market work more competitively. A worst case scenario is therefore that unisex rates are no better than the female rates that are offered today. This could mean that annuity rates for women would not change, but men's annuity rates could fall by 13%.

14. The remaining 20% of annuity purchasers may be able to obtain a competitive unisex annuity rate. A best case scenario is that unisex annuity rates could settle around a quarter of the way between current male and female annuity rates. This would mean that annuity rates may improve by 10% for women, but worsen by 3% for men. Therefore, women relying on their partner's annuity could be worse off by around 3%.

Most annuities are small

15. The median annuity purchase price in 2003 was less than £10,000. Less than 10% of annuities were worth £50,000 or more. Annuity income is therefore only a small part of retirement income for most pensioners. A 10% change in annuity rates would change average retirement income by less than 3%.

Future pensioners

16. It will take a number of years for recent changes in pension provision (such as the growth of personal pensions and the increase in Defined Contribution occupational pension schemes) to increase the numbers of people with annuities, and the amount of retirement income they provide.

17. However, the impact on retirement income from a change to unisex annuities is still likely to be small. A large proportion of retirement income is still likely to be provided by the state, and the above pattern of benefits and losses is likely to remain[3]. This means that a move to compulsory unisex annuities is unlikely to change future retirement income significantly.

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[3] See appendix for further details

APPENDIX

A1. To estimate the impact of compulsory unisex annuities, the PPI has:

- **Defined a number of individuals with income characteristics representative of recently-retired pensioners**. There are six types of individuals considered:
    - Single women,
    - Single men
    - Couples who have purchased a single life annuity
    - Couples who have purchased a joint life annuity
    - Widows who have income from a joint life annuity
    - Widows who have income from a joint life annuity, but before the switch to compulsory unisex annuities had income from a partner's single-life annuity

  For each group, there are examples representing the highest, middle and lowest quintile[4] of incomes.
- **Identified the possible amount of annuity income within the total income of each of these individuals.** The annuity income is that separately identified as personal pension income plus a high-end estimate of the occupational pension income that is from Defined Contribution rather than Defined Benefit schemes.
- **Re-calculated the annuity income on the basis of introducing unisex annuity rates now to the recent-retirees.** Two scenarios are used for the new unisex rates, as described in the last chapter. The first is that in a competitive market rates should settle one-quarter of the way between female and male rates. The second (producing lower income) is that the buyer does not have the opportunity to shop around for a competitive rate, and the actual rate obtained is no better than current female rates.
- **Re-calculated total retirement income with the new annuity amounts,** and compared it to that before the change to compulsory unisex annuity pricing for the different types of pensioner.
- **Estimated how many pensioners could be affected now by how much as a result of compulsory unisex annuity pricing.** This has been done by estimating how many pensioners there are of each type in the current recently-retired population. This is not likely to change significantly in the near-term.

[4] One quintile is 20%, so the bottom quintile of the Pensioners' Incomes Series represents the 20% of pensioners with the lowest incomes

- **Estimated the possible impact of compulsory annuity pricing in future.** This reflects any expected changes in the numbers of pensioners of each type, and the relative importance of annuity income, especially because of the trend away from Defined Benefit occupational schemes and the rise of Defined Contribution schemes.

A2. The estimates produced show the impact on people with a broad range of levels of annuity income and total retirement income. Some pensioners will be in more extreme situations than those represented (such as a very large annuity income but little other income), and may see a greater change in retirement income than that shown in the examples. Others will have less annuity income, and so see smaller changes in retirement income. However, the examples are likely to cover the vast majority of annuity purchasers.

PPI analysis suggests that more people could lose from the switch to unisex annuity rates than would gain

A3. A move to a unisex annuity regime is unlikely to bring about a significant change in retirement income for most pensioners. Specifically:

- Fewer than one-quarter of pensioners would see any change to their retirement income.
- More than three times as many pensioners could see a lower retirement income as benefit from a higher one.
- The average gains and losses would be small.

Fewer than one-quarter of pensioners have an annuity

A4. 15% of recently retired pensioners already have income from annuities. A further 5% may have annuities from occupational pensions. However, annuities do not have to be purchased until age 75, so there will be some pensioners who do not have annuity income yet but will have in the future. By the time all of today’s recently retired pensioners reach age 75, one-quarter of them may have bought an annuity. The remainder do not have personal pensions or income from a Defined Contribution scheme.

Most single women pensioners with annuities could see retirement income increase by less than 3%

A5. Single women pensioners gain from the switch to unisex annuity rates, while single male pensioners lose out. But twice as many single men have income from annuities as single women.

Pensioner couples could have retirement income up to 3% lower

A6. Couples are more likely to have more income from personal pensions than single pensioners. And in 80% of couples with annuity income it is the husband who buys the annuity.

A7. However, as with single pensioners, most pensioner couples could see small changes in retirement income, often less than 2%. Only the richest pensioner couples, with the largest annuities worth more than £250 a week could see retirement income changing by 3%. This would require a pension fund of £190,000, in the highest 1% of pension funds.

Couples buying joint-life annuities could see smaller changes in their retirement income, of up to 1%

A8. Widows could see retirement incomes fall by around 1%. Widows receiving income from a unisex joint life annuity could see a reduction in total income of around 1% compared to the income from a joint life annuity before compulsory unisex annuities.

A9. If compulsory unisex rates led to the husband buying a joint life annuity rather than a single life annuity, then the widow's income could be up to one-quarter higher. However, their initial income as a couple would have been between 5% and 10% lower. Given this initial drop in income for the pensioner couple, it is unlikely that a change to unisex annuities would, by itself, lead to a significant change in the proportion of joint-life annuities bought.

Even though annuities will become more widespread in future, the pattern of benefits and losses will remain

A10. Annuities are expected to become a more important part of retirement income for more people in future. One-third of recently retired pensioners may have annuity income in 10 years time, compared to one-quarter today. However, the extent of this is not so great as to make annuity income a very much bigger part of total retirement income for most people.

A11. There are a number of factors that will determine the pattern of annuity purchase in the future:

- **The total amount of annuity income bought is expected to increase 10% a year over the next 10 years**. This is largely due to a combination of a larger number of people retiring (as the baby-boom generation reach their 60s) and the availability of personal pensions after their introduction in 1988.

- **The number of people purchasing a pension annuity could increase to around 400,000 per year by 2012**. In 2002 around 250,000 people purchased an annuity.
- **One-third of people with personal pensions likely to be retiring in the next 10 years are women**. There could therefore be between 100,000 and 150,000 women a year buying annuities by 2012, compared to between 50,000 and 100,000 today. One-third of people buying an annuity are likely to be women, as compared to one-quarter today.
- **Only 10% of women likely to retire in the next 10 years currently have personal pensions**. It will still be the case that a minority of women pensioners buy an annuity. Almost twice as many are likely to rely on a partner's annuity.

A12. Most annuity income is currently derived from personal pensions. Most occupational pension income is from Defined Benefit schemes and so not explicitly provided through an annuity.

A13. It will take a number of years for the change in employer schemes from DB to Defined Contribution to feed through into a large number of workers being in a DC scheme. In 2000, less than 10% of occupational pension scheme active members (0.9 million) belonged to a Defined Contribution arrangement.

A14. As DB schemes generally are closing only for new entrants (most likely to be younger workers) but staying open for continuing employees (most likely to be older workers) it will take even longer for this to feed through in to a substantial proportion of overall retirement income.

A15. In 20 years time annuity income may have a larger influence on retirement income. If trends in occupational pension provision continue, a majority of occupational pensioners may eventually have at least part of their occupational pension income from an annuity.

A16. However, the impact on retirement income from a change to unisex annuities is still likely to be small. A large proportion of retirement income is still likely to be provided by the state. Even if <u>all</u> retirement income other than state pension income were derived from annuities (a massive overstatement of the likely reality) the richest women pensioners might only gain 9% in retirement income, and the richest men pensioners might lose 11%. As today, most men and women would see a much smaller change in their retirement income.