Summary of Report 2017:14

Women's and men's Premium pensions today and in the future

An analysis of gender differences and Premium pension dispersion

Swedish Social Insurance Inspectorate

www.inspsf.se

Stockholm 2017

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Summary

Women's and men's Premium pensions today and in the future: An analysis of gender differences and Premium pension dispersion

The Swedish Social Insurance Inspectorate (Inspektionen för socialförsäkringen, ISF) is an independent supervisory agency for the Swedish social insurance system. The objectives of the agency are to strengthen compliance with legislation and other statutes, and to improve the efficiency of the social insurance system through system supervision and efficiency analysis and evaluation.

The ISF's work is mainly conducted on a project basis and is commissioned by the Government or initiated autonomously by the agency. This report has been commissioned by the Government.

Background

The Swedish public pension system underwent a major reform at the end of the 1990s. The former defined-benefit ATP system was abolished, and a new defined-contribution system was gradually introduced. Individuals born in 1938 are covered to 20 per cent by the new pension system, and for each cohort the percentage increases by 5 percentage points. Cohorts born in 1954 and later are entirely covered by the new system. The contribution is 18.5 per cent of the individual's pensionable income, of which 2.5 percentage points are destined to be invested in mutual funds in accordance with the individuals' own choice (the Premium pension). In the event individuals do not make an active choice of funds, the capital is invested in the default fund (Såfan) managed by the state. The pension is thus based on earned income from the individual's entire working life, and individual investment choices need to be made for parts of it. As a consequence of this reform, individuals have greater responsibility for their future pensions than before.

The introduction of individual investment choices into the pension system (the Premium pension) has been the subject of discussion. There is a concern that this will lead to increasing pension dispersion in the future, which is regarded as particularly problematic in a mandatory public pension system.

On average, men have considerably higher pensions than women due to gender differences in labour incomes. If men and women make different investment choices, they may potentially amplify this income inequality.

Pension income differences may be a matter of concern not only for individuals but also for society as a whole. For example, if the rules of the pension system create or increase differences between women's and men's pensions, they may be detrimental to gender equality. It is therefore important to investigate the causes of gender differences in pensions.

Apart from differences in labour income, there are other factors that can contribute to pension dispersion. Individuals can choose among 800 mutual funds with different levels of risk, fees, and types of assets; this has a direct impact on the dispersion of investment returns and therefore also on the dispersion of paid premium pensions. Furthermore, individuals can choose to switch from unit-linked insurance to life annuity insurance, and in both cases sign for a policy with or without survivor's insurance when making the first pension withdrawal, or later. These choices, as well as the percentage (25, 50, 75 or 100) of the first withdrawal and the individual's age at that time, can also contribute to dispersion and gender differences in premium pensions.

Objectives

This report examines gender differences in premium pensions and in the dispersion of premium pensions today and in the future. Separate analyses are also conducted for high- and low-income groups.

The analyses show how premium pension differences and premium pension dispersion arise and how these might evolve in the future.

Methods

The study uses longitudinal register data from Statistics Sweden and the Swedish Pensions Agency. The data from the Swedish Pensions Agency consist of all chosen portfolios and annual earned pension credits from 1995 to 2014.

The Swedish pension system is a three-tier system consisting of public pensions, occupational pensions, and individual private pensions. Public pensions include the guarantee pension, income pension, premium pension, survivor's pension, housing allowance (*bostadstillägg*) and social assistance for the elderly (*äldreförsörjningsstöd*). Only the premium pension is analysed in this study. Throughout this report, pension dispersion is measured by percentile ratios (90/10) and Gini coefficients.

Analysing the gender differences and dispersion of today's pension payments is a quite straightforward matter, as they are included in Statistics Sweden's records. Analysing future pension payments is much more complicated. In this report, the future pensions of persons born between 1985 and 1990 are predicted; this requires a number of assumptions. Assumptions about the future pension contributions are based on labour incomes for persons born between 1938 and 1990, and assumptions about individual future investment choices are based on portfolio choices made by different age groups since the system was introduced in 2000.

Predictions of future outcomes are always uncertain. Not only are future labour incomes uncertain, but pensions are also affected by the development of the economy, demography, and the stock market. This must be emphasized in the analysis of future gender differences and dispersion in pensions.

Findings

Women have lower premium pensions than men, but the gap has decreased

The differences in premium pensions between men and women are almost entirely explained by the fact that women have lower labour incomes, and thus lower earned pension credits than men. The dispersion in premium pensions among men and among women is also largely explained by the dispersion of their earned premium pension credits.

Women thus have lower premium pensions than men, but the difference has declined over time in all income ranges. Gender differences can also be explained by other factors, however. It is more common for women to make withdrawals on a level lower than 100 per cent compared to men, which increases the gap. On the other hand, it is more common for men than for women to add a survivor’s pension to their premium pension insurance when making the first withdrawal. This reduces the gap somewhat, as these men's pensions are lower than they would otherwise have been. Furthermore, men transfer pension credits to their partners more often than women do, which also reduces the gender gap, particularly among those with the highest pensions.

The dispersion in labour income has increased slightly over the generations, and dispersion is greater for women than for men. It has also increased at a slightly faster rate for women than for men. At the same time, the gap between men and women's average payments to the premium pension has decreased.

Investment returns have a large impact on the dispersion of premium pensions among people with high income

The differences in premium pensions between men and women among those in the highest rank of the income distribution (90th percentile) is explained almost as much by differences in investment returns as by differences in earned pension credits. Dispersion of investment returns has a great impact on the dispersion of premium pensions among individuals within the highest quartile of income distribution. Individuals in the highest income distribution rank have often earned pension credits at the maximum level, due to the existing ceiling on pension-qualifying income. The dispersion of premium pensions in this group is thus mostly explained by the dispersion of the investment return.

One question often raised is how big the difference in premium pension can become between people who had the exact same income during their working lives. The only persons who consistently had the same income since the premium pension system was introduced are those who earned the maximum pension credit every year. Within this group there were some who were more successful than others. Those who managed their assets the best (90 percentile) received a premium pension that was 1.5 times higher than those who managed the worst (10 percentile). On average men managed their investment better than women.

During retirement, premium pensions develop better for men than for women

The average amount of premium pension paid out in 2001 was very low, due to the gradual transition to the reformed pension system and few years of capital accrual among the cohorts that were entitled to make their first pension withdrawal. The average premium pension paid out for the first time in 2014 was 25 times higher than in 2003. However, dispersion of premium pensions remained fairly constant among both men and women between 2003 and 2014.

Women's premium pensions during retirement have developed on average worse than men's pensions. This is mainly because men who chose unit-linked insurance during retirement managed their investment better than women with unit-linked insurance did.

During retirement, the dispersion of premium pensions between pensioners increases. Those who chose to keep their capital in unit-linked insurance during retirement had a better development of their premium pension on average than those who chose to switch to annuity insurance. On average, higher portfolio risk delivered a better development of the premium pension during retirement than portfolios with lower risk. The premium pension developed more poorly among those who kept their investments in the default fund compared to those who had other funds.

The dispersion of the premium pensions is expected to be slightly higher in the future

The predictions of future premium pensions show that the dispersion of premium pensions will be marginally larger than that observed today for cohorts born between 1985 and 1990. The dispersion will be slightly higher among women than men. According to the predictions, individuals with the highest pensions in the income distribution (90th percentile) will have a premium pension that is about 3 times higher than the premium pension among those within the lower range of the income distribution (10th percentile).

The dispersion of the predicted future earned pension credits explains 56 per cent of the dispersion in future premium pensions among men and 63 per cent among women. The dispersion of future investment returns explains 35 per cent of men’s future premium pension dispersion and 29 per cent of women’s. The remaining 8 per cent for men and 7 per cent for women are explained by other factors, such as the point in life when the pension credits are earned or when the choice of portfolio is made.

Concluding remarks

The dispersion of the premium pensions is expected to increase in the future compared to today. This is partly due to the fact that the dispersion of earned pension credits will increase, and partly due to the fact that earned pension credits will be invested in the capital market for a longer time than for today’s pensioners. The dispersion of investment returns is therefore expected to increase compared to the returns for today’s pensioners.

The difference in the average premium pension payment between men and women is expected to decrease as women's earnings increase relative to men's earnings. But this does not apply to all income groups. The gap between women’s and men’s earnings is expected to shrink among people with high income. On the other hand, the income gap between women and men with low income is expected to remain in the future.

Peoples’ lifetime incomes follow a similar pattern across all cohorts. However, due to increases in real wages, the income trajectory is at a higher level for younger cohorts compared to older cohorts. There are no indications that this pattern will change over the next decades.

If this historical income pattern holds in the future, the dispersion of earned premium pension credits will increase slightly more among women than among men. At the same time, the average gender gap in earned pension credits will decrease but not disappear. There will still be a gender gap for ages below 50 years of age, at least until the year 2050. The Swedish labour market is heavily gender-segregated; women typically work in industries and occupations where the average wage is lower than in industries and occupations where men are in majority. Women also work part-time to a greater extent than men do. This leads to women having lower earnings than men, and thus will receive lower pensions in the future. Reducing the gender gap in future pensions requires increasing the number of working hours for women. Reducing unjustified income differences in the labour market between men and women is also necessary.

Differences in investment returns are expected to accentuate the dispersion of future premium pension payments. However, a large proportion of the young labour market participants choose to invest their premium pension capital in the default fund, which will contribute to a dispersion that will be smaller than it otherwise could have been. As many choose the default fund while entering the premium pension system, and keep it until they retire, they emphasize the responsibility of the state to design and manage this fund properly.