Sweden: Competition in the Pensions Sector – A Low Cost Model

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Overview of the Presentation

- Review of Pension Landscape in Sweden
- The Public FDC Scheme – Design with a Goal of Minimizing Costs
- Participant Rules and Participants
- Fund Participation Rules
- The PPM Cost Structure
- The Outcome for Fund Managers
- Some Closing Remarks
Pension Landscape in Sweden

• Public System
  Universal, mandatory system that covers earnings up to a ceiling of all employees and self-employed. Ceiling (2008) 360 000 SEK or 60 000 USD.
  - NDC – 16 %
  - FDC – 2.5 %

• Occupational Schemes – 3.5-4.5 %
  Cover ca 90 % of all employees.
  - FDC: Supplement below public benefit ceiling
  - FDC: Whole benefit above ceiling, private sector workers
  - NDB: Above ceiling, public sector workers

• Individual voluntary insurance
The Public FDC Scheme – Design with a Goal of Minimizing Costs
Design Goals for the Mandated Public Financial Scheme

- Cost minimizing administration

- Promote individual investment choices – “Empowering” people to make private investment choices was also viewed as an opportunity to increase financial market literacy.
Overview of Organization

- **Contributions – collected by the tax authority**
  Information flows through the Social Insurance Board, which coordinates all O-A pension information. Money flows through the National Debt office to custodian banks.

- **Transactions and accounting - the clearinghouse (PPM)**
  The PPM makes all transactions on behalf of participants, keeps daily individual accounts, provides customer services, has daily contact with funds in system.

- **Investments – private fund managers**
  All funds registered to do business in Sweden can register with the PPM and be chosen by participants. In 2007 ca 785 registered privately managed funds were offered by ca 85 companies, in addition to a publicly managed default fund for non-choosers.

- **Annuities – The PPM is the monopoly provider**
  Products specified in the legislation

- **Supervision – Swedish Financial Supervisory Agency and Ministry of Finance**

- **Information provision – the PPM**
  The PPM provides information on returns, costs, measure of risks for all funds. Web-site, call center, local social insurance offices. Information in major daily newspapers, electronic information at local bank offices, etc.
Participant Rules and Participant Choice Patterns
Participant Rules

- Participants can hold accounts in up to five registered funds – on average choosers have held ~3.3 funds per person from the very beginning.
- Participants pay the fund charges.
- Switching can occur daily (using the PPM’s web site, by mail) - no direct charge.
- First-time choosers who do not make a choice go to a publicly managed default fund.
- Once one opts out of the default fund it is not possible to opt back in.
First choices 2000: Probability of making a choice was higher for persons with:

- prior experience of investing
- higher education
- higher income
- other pension plans
- married persons

...but no gender or geographic differences, only small age differences (the youngest chose less)

...and people chose 3.4 funds per person, with on average 90% equity content

Active Choosers, 2000-2006.
The percentage of new entrants choosing actively has declined to around 10% in 2006.

Source: The Premium Pension Authority, PPM
Rates of Return Since Entrance, December 2006  
Source: The Premium Pension Authority, PPM

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Active choosers</th>
<th>Default choosers</th>
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<tbody>
<tr>
<td><strong>All</strong></td>
<td>6.3</td>
<td>6.0</td>
<td>6.7</td>
</tr>
<tr>
<td><strong>Men</strong></td>
<td>6.3</td>
<td>6.0</td>
<td>6.6</td>
</tr>
<tr>
<td><strong>Women</strong></td>
<td>6.3</td>
<td>5.9</td>
<td>6.8</td>
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<tr>
<td><strong>Age</strong></td>
<td></td>
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<tr>
<td>18-24</td>
<td>7.8</td>
<td>9.4</td>
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<td>40-49</td>
<td>5.8</td>
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<tr>
<td>50-59</td>
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<td><strong>Education</strong></td>
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<tr>
<td>Elementary</td>
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<tr>
<td>Secondary</td>
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<tr>
<td>University</td>
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<td>5.9</td>
<td>6.6</td>
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<tr>
<td>University (+PhD)</td>
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<td>Unknown</td>
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<td>6.1</td>
<td>6.7</td>
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Participant Information

- PPM catalogue - sent to all first-time choosers
- PPM brochure - general advice on how to evaluate one’s risk tolerance and investment strategy
- PPM Web based support program
- PPM information targeted on groups
- Pension calculator

Nevertheless, only about 10 % believe they have the right knowledge to make informed choices!
(Will time, participant maturation and focused information improve this? What should we expect?)
Fund Participation Rules
Participation Requirements for Funds

- Fund Managers must be licensed to do business in Sweden - which means being under the supervision of the Financial Supervisory Agency.

- and sign an agreement with the PPM to
  - provide fund share values for all working days, electronically
  - provide periodic reports of costs
  - provide other information upon request
  - agree not to charge withdrawal fees
  - accept the PPM discount schedule for fees
PPM System Costs
Overview of Costs

- PPM management costs (transactions, accounts, client relations, information, statistics, management)
- Private Investment Fund Costs
- Other costs
  - Tax Authority for collection of contributions
  - Social Insurance Agency for overall public pension records, joint annual statement to all participants
The PPM Discount Schedule Caps Fund Management Costs

• The Principle – the marginal cost of investing additional funds decreases with the volume of PPM assets invested.

• As the scale of their PPM business increases, required fund discounts increase, too.

• Charges are expressed as a % of PPM assets held by all the PPM funds owned by the managing company.
# Costs of the PPM Plan, Percent of Assets

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<th>2007</th>
<th>~ 2020</th>
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<tbody>
<tr>
<td>Fund charges, gross</td>
<td>0.84</td>
<td>-</td>
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<td>PPM discount</td>
<td>-0.51</td>
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<td>Fund charges, net</td>
<td>0.33</td>
<td>0.20-0.24</td>
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<td>PPM’s etc. costs</td>
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<td>Total costs</td>
<td>0.45</td>
<td>0.23-0.27</td>
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The Outcome for Fund Managers
Distribution of Individual Choices Among Funds

- Default fund ~ 29 % of total assets

- The 6 largest private funds hold about 18 % of total PPM assets. The 20th largest fund has 0.7 % of total assets.

- High equity content:
  - 2000-2002 ~ 90 %
  - 2003-2005 ~ 70 %
  - 2006-Sept 2007 90 %
  (thereafter a shift to bonds?)

- ~ 80 % of the default fund’s assets are invested in equities
Distribution of Individual Choices Among Fund Companies

• The seven largest providers of private insurance (with 95 % of total assets in private insurance)
  - manage 43 % of total PPM assets
  - and 33 of the largest 45 PPM funds.

• The big seven together with the default fund manage 72 % of total PPM assets.
The Future? More Constraints or Continued Free Choice?

• Should fund choices be limited - or can the system simply work this out itself?
• How much risk should the participant be allowed to take?
• Should allowable risk be age-adjusted? … and during the annuity period?
• Should those who switch pay for the cost of switching?