

Annuities in Sweden: Risk-sharing with a Monopoly Provider

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Overview of the Presentation

- Pension Landscape in Sweden
- The Public FDC Scheme – Administered by the PPM
- PPM Annuity Provision

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**

Individual Benefits. Percent of final earnings.

Age of entrance 22, real growth of 2 %, real financial return of 2% & (5%),
LE for cohort born 1975.

Age	NDC Contribution rate of 16 %	PPM Contribution rate of 2.5 %	Occupational Contribution rate of 3.5 %	Total Contribution rate of 22 %
61	32	5.0 (9.6)	7.0 (13.4)	44 (55)
62	33	5.4 (10.4)	7.6 (14.6)	46 (58)
63	35	5.7 (11.2)	8.1 (15.8)	49 (62)
64	37	6.0 (12.1)	8.7 (16.9)	52 (66)
65	39	6.3 (12.9)	9.2 (18.1)	54 (70)
66	42	6.7 (13.7)	9.7 (19.3)	58 (75)
67	44	7.1 (15.0)	10.2 (21.0)	61 (80)
68	47	7.5 (16.2)	10.7 (22.8)	65 (86)
69	50	7.9 (17.5)	11.2 (25.0)	69 (92)
70	53	8.3 (18.7)	11.7 (26.0)	73 (98)

Assets and premium payments to occupational, individual voluntary and PPM plans, 2006

	<u>Assets</u>	<u>Premiums</u>
All occupational and individual voluntary insurance, billions of kronor	2 270	193*
Percent of GDP	80 %	6.8 %*
PPM	267	26
Percent of GDP	9 %	0.9 %

*Voluntary individual insurance accounts for about 15 %.

Source. Palmer (2007), based on data from the PPM and Financial Supervisory Authority

The Mandatory FDC Plan

- **Administered by the PPM (Premiepensionsmyndighet)**
- **Tax Authority collects contributions**
- **Individuals choose 1-5 funds, with a publicly administered default fund. PPM purchases/sells fund shares with daily aggregate transactions vis á vis private funds**
- **PPM keeps accounts**
- **PPM is the monopoly provider of retirement products**

PPM Annuity Products

- At retirement accounts are either converted to a
 - Fixed rate annuity – Swedish "traditional insurance" model: **Guarantee + (profit-sharing) bonus**
- Or to a
 - Variable rate annuity – **money remains in unit-linked accounts**

The Mandatory PPM Plan in the Context of the Swedish Insurance Product Market

Products	Occupational/ Voluntary Insurance	PPM Insurance
<i>Traditional Products</i>		
Lump sum	Yes	No
Phased withdrawal, 5 or 10 yrs	Yes	No
Full life annuity, single or joint	Yes	Yes
Survivor benefit	Yes	Yes
<i>Unit-link (5,10 or life withdrawal)</i>	Yes	Yes (life)
Fixed rate	Yes	Yes (life)
Variable rate	Yes	Yes (life)

Data on PPM Pension Choices

- 5.8 million participants at year's end 2007
- 450 000 pensioners
- 85 % variable rate annuities – i.e. people have chosen to make their own investment decisions
- 90 % single life
- 7 632 persons had transferred their balances to their spouses – almost all from men to women

The PPM as the Annuity Provider - Who bears the risks?

	Investment risk	Longevity risk
Accumulation phase	individual	individual
Life annuity		
<i>Traditional fixed rate</i>	Guarantee + bonus (shared risk)	Guarantee + bonus (shared risk)
<i>Variable rate</i>	individual	individual

The PPM as the Annuity Provider

- The Investment Risk

- **Traditional life – funds are invested by a contracted investors**
 - **73 % in interest bearing instruments, public investor**
 - **27 % in equities, private sector investors (from December 2007):**
 - **1 fund with Swedish equities**
 - **3 global equity funds**

The PPM as the Annuity Provider

- the Longevity Risk

- **Variable rate annuity**
 - **LE according to Statistics Sweden's Baseline Scenario (shorter longevity)**
- **Fixed rate annuity**
 - **LE according to Statistic Sweden's low mortality scenario**

The PPM Life Expectancy Assumption. Illustrated with LE from birth

	2004	2050
<i>Baseline scenario</i>		
Men	77.9	83.6
Women	82.3	86.2
<i>Low mortality scenario (PPM)</i>		
Men	78.0	87.5
Women	82.4	89.9

Risk Sharing

- **Old Policy to April 2007:**
guarantee = 2.75 % + bonus depending on portfolio performance
- **New Policy from April 2007**
guarantee = nominal value of contributions + bonus depending on portfolio performance
- **The new policy increased the solvency ratio (ratio of assets to guaranteed liabilities from ca 1.045 to 1.169 in December 2007)**
- **New Policy Goal: Create more room for a greater share of equities in the investment portfolio**
- **Consolidation (Ratio of assets to liabilities including the rate of return) should be within 0.95-1.05.**

Bonus and consolidation (assets/liabilities, including the annualised rate of return. 100+/-5%). Source: PPM's Annual Report, 2008

	Bonus	A/L		Bonus	A/L
2006			2007		
April	6 %	103,4%	April	6 %	103,2%
May	6 %	100,6%	May	6 %	103,8%
June	6 %	100,5%	June	6 %	102,8%
July	6 %	100,1%	July	6 %	101,8%
Aug	6 %	101,0%	Aug	6 %	101,7%
Sept	6 %	101,9%	Sept	5 %	101,1%
Oct	6 %	102,4%	Oct	5 %	100,9%
Nov	6 %	101,8%	Nov	5 %	99,7%
Dec	6 %	102,5%	Dec	5 %	99,6%
2007			2008		
Jan	6 %	102,8%	Jan	4 %	98,4%
Feb	6 %	102,7%	Feb	4 %	
March	6 %	102,9%	March	4 %	

Remarks – Towards More Choice?

- **Make joint annuities the default option (with the consent of both partners needed for single annuities)**
- **Allow participants to move between PPM and occupational accounts?**
- **Allow participants to combine PPM + Occupational accounts in purchasing annuities?**
- **Allow purchases of PPM annuities from private providers?**