

# **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:**

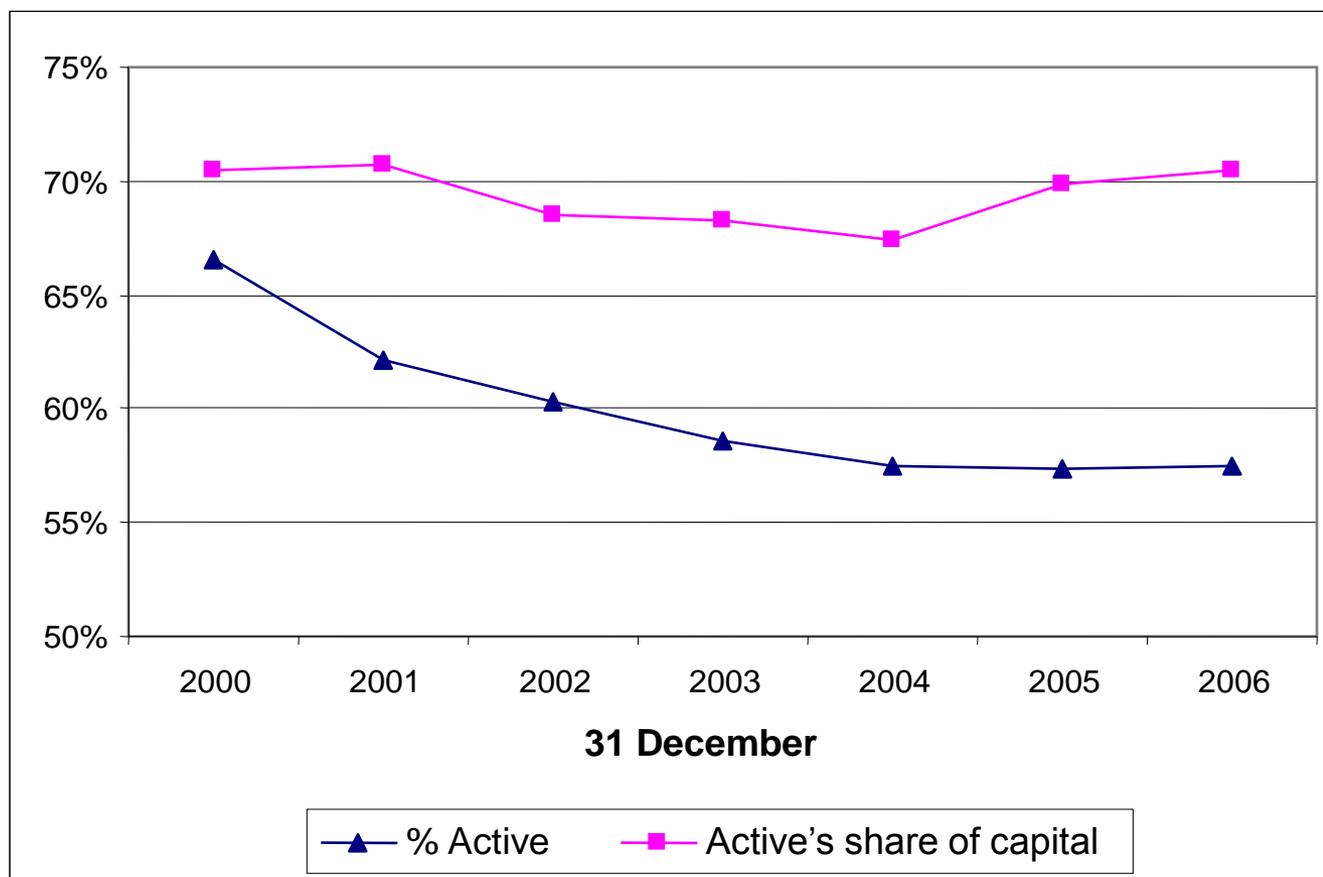
- **prior experience of investing**
- **higher education**
- **higher income**
- **other pension plans**
- **married persons**
- **...but no gender or geographic differences, only small age differences (the youngest chose less)**
- **...and people chose 3.4 funds per person, with on average 90 % equity content**

Source: Engström and Westerberg. 2003. "Which Individuals Make Active Investment Decisions in the New Swedish Pension System," *Journal of Pension Economics and Finance*, vol. 2, pp. 225-245.

# 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

	<b>All</b>	<b>Active choosers</b>	<b>Default choosers</b>
<b>All</b>	6.3	6.0	6.7
<i>Men</i>	6.3	6.0	6.6
<i>Women</i>	6.3	5.9	6.8
<b>Age</b>			
<i>18-24</i>	7.8	9.4	7.5
<i>25-29</i>	8.1	8.2	8.1
<i>30-39</i>	6.2	5.9	6.5
<i>40-49</i>	5.8	5.6	6.0
<i>50-59</i>	5.8	5.7	6.0
<i>60+</i>	5.9	5.7	6.2
<b>Education</b>			
<i>Elementary</i>	5.9	5.8	6.1
<i>Secondary</i>	6.1	6.7	6.0
<i>University</i>	6.2	5.9	6.6
<i>University (+PhD)</i>	6.2	5.9	6.8
<i>Unknown</i>	6.3	6.1	6.7

# 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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	<u>2007</u>	<u>~ 2020</u>
<b>Fund charges, gross</b>	<b>0.84</b>	<b>-</b>
<b>PPM discount</b>	<b>-0.51</b>	<b>-</b>
<b>Fund charges, net</b>	<b>0.33</b>	<b>0.20-0.24</b>
<b>PPM's etc. costs</b>	<b>0.12</b>	<b>0.03</b>
<b>Total costs</b>	<b>0.45</b>	<b>0.23-0.27</b>

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Source. PPM's Annual Report for 2007 and author's approximation for 2020.

# **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?**