Securing Lifelong Retirement Income

Annika Sundén

The Swedish Pension System

Compulsory system

Contribution = 18.5 % of earnings

16 % to Income Pension (NDC)

- Lifetime earnings
- Benefits indexed to life expectancy changes
- Indexed by average wages
- Automatic Balancing Mechanism

2.5 % to Premium Pension (FDC)

- Funded individual accounts

- Occupational schemes for 90 % of employees
- Contribution = typically 4.5 % of earnings

Retirement

•Benefits can be withdrawn from age 61. Mandatory annuitization in the income pension and the premium pension

$$\boxed{\text{Annuity}} = \frac{\text{Account value at retirement}}{\text{Divisor}}$$

•The divisor is calculated from unisex life expectancy at retirement age, at an interest rate of 1.6 % in the income pension

•Guarantee pension from age 65 provides a minimum benefit and tops up the income pension for individuals with low benefits

Benefits follow economic growth

Income pension

– Accounts grow with contributions and a rate of return equal to average earnings during accumulation

– Retirement benefits are indexed annually with income growth minus 1.6 percent

– When liabilities exceed assets, balancing is activated. Benefits are indexed less than wage growth or even reduced until financial stability is restored

Guarantee benefits

– Follow prices

– Provides some insurance for individuals with low benefits during balancing

Sida

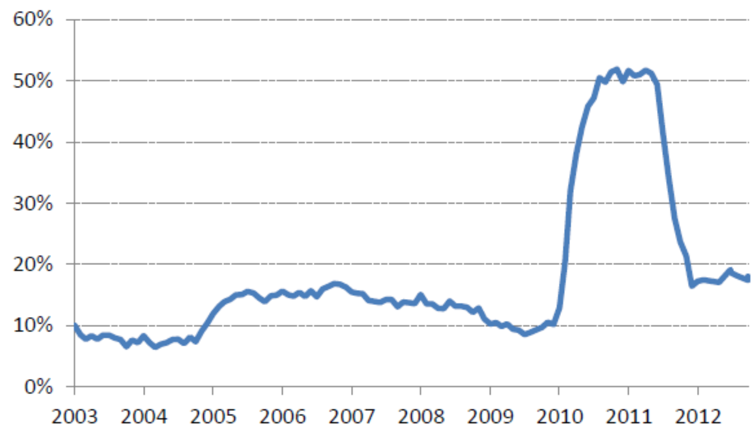
Premium Pension Benefits Depend on Capital Markets

Premium pension

– Accounts grow with contributions and the rate of return on investments during accumulation

– At retirement, participants can choose between unit-linked insurance and traditional insurance. The default is unit-linked insurance and most participants are in the default.

Share of participants in traditional insurance

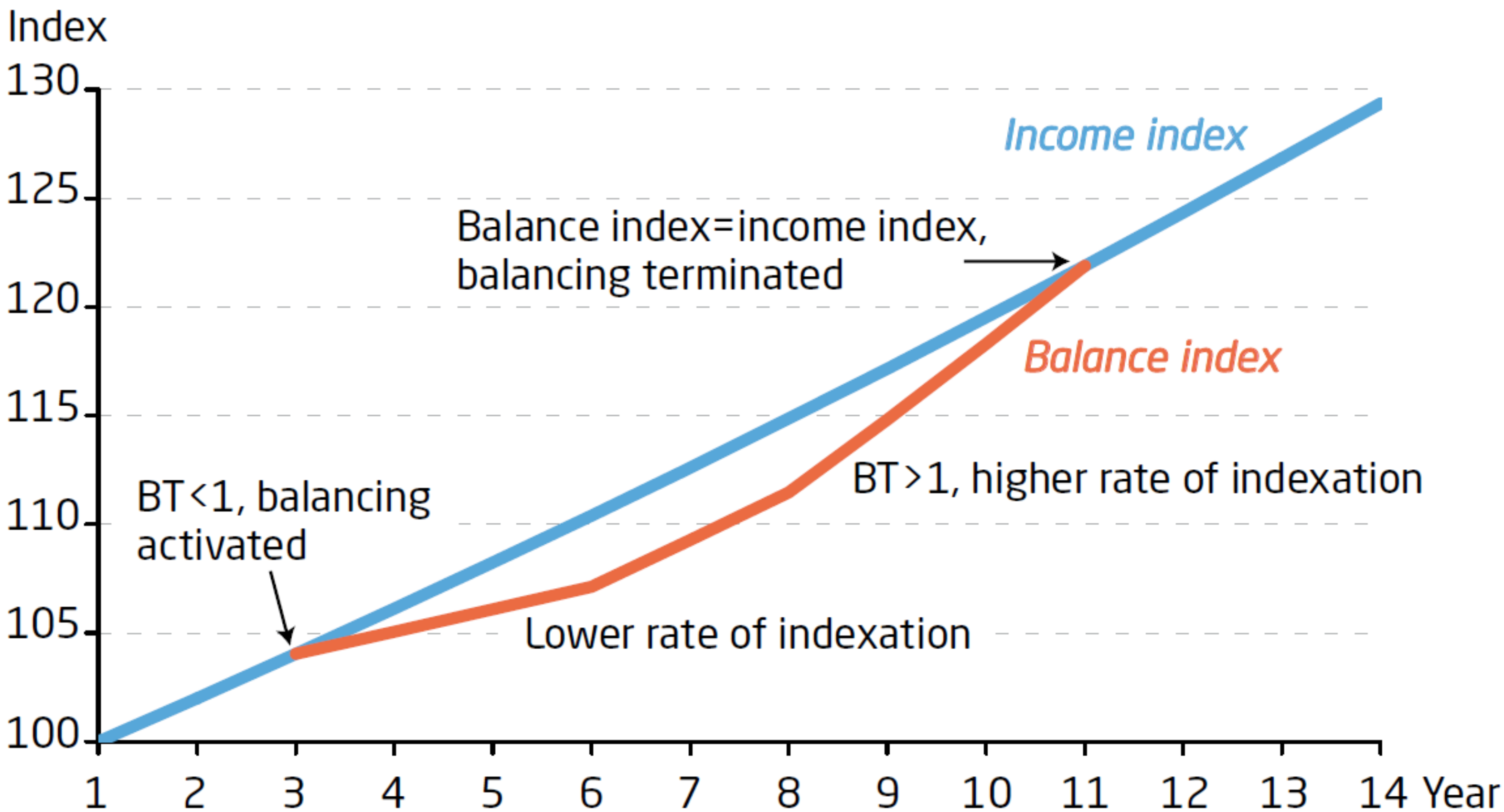


Later Retirement Necessary to Maintain Level of Benefits

Cohort	Public Benefits at 65 (%)	Total Benefits at 65 (%)	”Necessary” Retirement Age to Adjust for Changes in Life Expectancy	Public Benefits at ”Necessary” Retirement Age (%)
1930	58.5	66.3	age 65	58.5
1950	47.6	60.3	66 and 4 months	52.2
1970	46.6	60.0	68 and 1 month	56.8
1990	44.4	61.4	69 and 1 month	57.3

Sida

Balancing



Index
130
125
120
115
110
105
100
Income index
Balance index=income index,
balancing terminated
Balance index
BT>1, higher rate of indexation
BT<1, balancing
activated
Lower rate of indexation
1 2 3 4 5 6 7 8 9 10 11 12 13 14 Year

Volatile Benefits from Income Pension Due to Balancing

Conclusions

- Pension system is financially stable
- Risk on participants
- Current balancing period has produced significant volatility in benefits
- Policy makers are discussing changes to indexation and the balancing mechanism