Securing Lifelong Retirement Income

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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• Benefits can be withdrawn from age 61.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

\[
\text{Annuity} = \frac{\text{Account value at retirement}}{\text{Divisor}}
\]

• 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
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

<table>
<thead>
<tr>
<th>Cohort</th>
<th>Public Benefits at 65 (%)</th>
<th>Total Benefits at 65 (%)</th>
<th>&quot;Necessary&quot; Retirement Age to Adjust for Changes in Life Expectancy</th>
<th>Public Benefits at &quot;Necessary&quot; Retirement Age (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930</td>
<td>58.5</td>
<td>66.3</td>
<td>age 65</td>
<td>58.5</td>
</tr>
<tr>
<td>1950</td>
<td>47.6</td>
<td>60.3</td>
<td>66 and 4 months</td>
<td>52.2</td>
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<tr>
<td>1970</td>
<td>46.6</td>
<td>60.0</td>
<td>68 and 1 month</td>
<td>56.8</td>
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<tr>
<td>1990</td>
<td>44.4</td>
<td>61.4</td>
<td>69 and 1 month</td>
<td>57.3</td>
</tr>
</tbody>
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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