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STUDY

Occupational Pensions in Sweden

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- Sweden is known for its comprehensive welfare state, and the pension system is no exception. A single, unified statutory pension scheme provides earnings-related benefits to all Swedish workers. Sweden`s extensive system of mandatory and collectively negotiated occupational pensions is a less well known, yet vital part of the overall pension system.

- The single most important precondition for a Swedish-style approach to occupational pension provision is a robust collective bargaining system with mandatory occupational pension coverage. In Sweden 90 percent of all workers are covered by collectively negotiated occupational pension schemes.

- Most occupational pension schemes are defined contribution with individual investment choice, which add an average of 10 percent to income insured by the statutory pension system.

- Non-profit organisations owned by employers and unions administer private sector schemes, limiting the range of financial institutions offering products to occupational scheme members. This keeps management fees low and excludes risky investment vehicles.

Content

Sweden is known for its comprehensive welfare state, and the pension system is no exception. A single, unified statutory pension scheme provides earnings-related benefits to all wage-earners and the self-employed, and there is a minimum pension for low earners. Sweden's extensive system of mandatory and collectively negotiated occupational pensions *(tjänstepensioner)* is a less well-known, yet vital part of the overall pension system. Four collective schemes provide mandatory coverage to about 90 percent of Swedish employees, adding an average of 10 percent to the income insured by the statutory scheme (Lindquist and Wadensjö 2011). This article describes and analyses the structure and performance of the occupational pension system, highlighting its strengths and weaknesses.

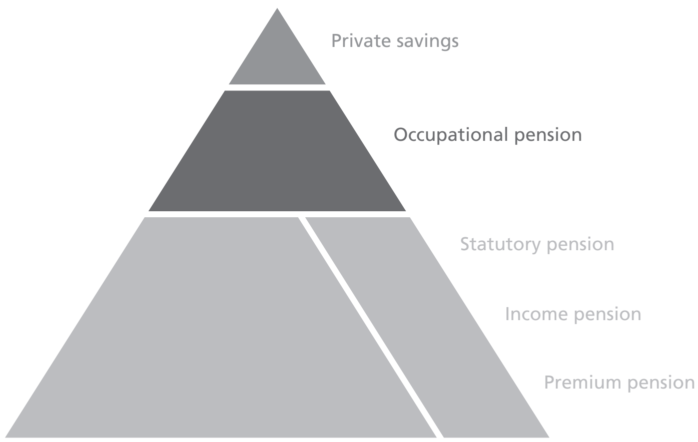
1. Context

The first occupational pensions were introduced for state employees in the eighteenth century. Local governments and private firms followed suit in the nineteenth century, introducing pensions for managerial staff. By the 1950s, most white-collar workers were covered by occupational pensions, but blue-collar workers were not (Harrysson 2000). The 1957 ATP *(Allmän tilläggspension)* reform aimed to address this inequality by introducing statutory defined benefit (DB) earnings-related pensions for all employees under a »best fifteen of thirty years« formula. Most existing occupational pension schemes were converted into contractual arrangements that supplemented statutory benefits, but blue-collar workers still lacked occupational coverage. This was finally achieved in 1973, when the Swedish Trade Union Federation (*Landsorganisationen,* LO) negotiated a mandatory occupational pension scheme with the Employers' Federation (*Svenska Arbetsgivareföreningen,* SAF; since 2001 Confederation of Swedish Enterprises, *Svenskt Näringsliv*).

Both statutory and occupational pensions have changed substantially since the 1970s. Between 1994 and 1998, Sweden adopted a far-reaching pension reform that replaced the existing DB ATP pension scheme and flat-rate basic pension *(folkpension)* with a notional defined contribution (NDC), pay-as-you-go pension (the income pension, *inkomstpension*) complemented by mandatory individual defined contribution (DC) investment accounts (the premium pension, *premiepension*) and a guaranteed pension *(garantipension)* for low earners (Anderson and Immergut 2007). Occupational pension schemes followed suit, especially in the private sector, gradually shifting from DB to DC.

2. The Public-Private Mix in Pensions

Occupational pensions are strongly linked to the design of the statutory system. The statutory pension contribution is 18.5 percent of pensionable income (435,750 Swedish crowns; €46,215). Out of the 18.5 percent contribution, 16 percentage points are allocated to the income pension and 2.5 to the premium pension. Employees and employers share contributions: employees pay 7 percent of earnings up to the pensionable income ceiling, net of the individual pension contribution, and employers pay 10.21 percent on the entire salary, including income above the earnings ceiling (the contribution totals 18.5 percent after taking into account the effects of the tax system). There is no pension accrual for employers' contributions above the ceiling. The statutory scheme is NDC (notional defined contribution), so individuals accrue notional assets in their pension accounts (account balances are adjusted to wage growth every year) for their lifetime income, whereas premium pension assets develop in line with returns on individually chosen investment portfolios. Retirement is possible from age 61, with a correspondingly lower pension because the income pension and premium pension are based on lifetime income. The figure below (adapted from www.pensionsmyndigheten.se) depicts the relative importance of statutory, occupational and private pension provision.



When fully implemented, the income pension and premium pension will provide lower benefits on average than the old ATP system, increasing the importance of occupational pensions (those born in 1954 and after are fully covered by the reformed system), so current data on pension income reflects the combined effects of the old ATP and the reformed system. In 2012, the average statutory pension (11,959 Swedish crowns per month; €1,338) was 40 percent of average earnings (29,800 Swedish crowns per month; €3,335). The average occupational pension was 3,587 Swedish crowns per month (€404), raising the combined (statutory and occupational) replacement rate to 52 percent. It is important to note, however, that the share of occupational pensions in the total pension package will increase over the coming decades, raising the combined replacement rate. In addition, the 2012 statistics include many female pensioners with relatively small pensions because full-time female employment was not widespread until the 1970s. Future increases in women's average pensions should thus raise the combined replacement rate.

What will future replacement rates look like? According to the OECD's theoretical pension models that simulate future replacement rates for a typical earner who enters the Swedish labour market at age twenty in 2012, works full-time until the statutory retirement age, and earns average wages would have a statutory replacement rate of about 34 percent. Mandatory participation in a private-sector occupational pension scheme (ITP, discussed below) would add about 22 percentage points, for a combined replacement rate of about 56 percent (OECD 2013). This theoretical future replacement is not directly comparable to the figure quoted above for 2012 because the latter is the aggregate replacement rate (the average for all pensioners, including those with large occupational pensions) rather than a (simulated) individual replacement rate for the average earner.

How are occupational pension schemes organized? There are differences across schemes, but the broad pattern is that employers contribute 4.5 percent of income up to the statutory ceiling, and about 30 percent on income above it. This means that occupational pension schemes supplement statutory benefits below the ceiling and cover all the income above it. In 2014, 20 percent of men and 8 percent of women had employment income above the statutory ceiling. These design features mean that occupational schemes provide larger benefits for high earners compared to other groups. As the simulation results in table 1 show, the statutory pension replacement rate decreases as income rises. In contrast, the occupational replacement rate is the same for low (0.5 times average) and average earners, and then rises steeply for high earners (1.5 times average earnings). It bears repeating that these figures are based on simulations and do not reflect the current distribution of statutory and occupational pension income.

Employers and unions negotiate the details of occupational pensions in four sectoral collective agreements:

- SAF-LO (blue-collar private sector workers);
- ITP (white-collar workers in the private sector);
- PA03 (for state employees); and
- KAP-KL/AKAP-KL (for municipal employees).

Occupational pension schemes are largely funded DC schemes with individual investment choice. Private-sector schemes are DC, and participants choose between traditional and unit-linked annuities. Public-sector schemes combine elements of DC and DB (Lindquist and Wadensjö 2011). The majority of private-sector negotiated pension schemes operate much like the premium pension. Participants bear all risk for their investment choices, and they choose from a range of pension products offered through non-profit fund clearinghouses owned by employers and unions. Public-sector schemes follow a similar model.

Table 1 Simulated Pension Outcomes

	Statutory pension			Occupational pension			Combined pension		
Earnings as multiple of average earnings	0.5	1.0	1.5	0.5	1.0	1.5	0.5	1.0	1.5
Pension as percentage of individual earnings	48.6	33.9	25.7	21.7	21.7	42.2	70.2	55.6	67.9

In all occupational schemes, wage-earners typically face five kinds of decision:

- Choice of financial service provider;
- Choice between a traditional (fixed) and a unit-linked annuity;
- »Repayment protection« *(återbetalningssydd),* which is essentially a form of survivor's coverage. Here, a designated beneficiary receives the capital in the pension account when the member dies. If a member does not choose this, her capital reverts to the collective upon death, and she shares in the collective's inheritance gains.
- Additional survivor's coverage
- Pay-out period (minimum five years). All schemes offer a default option consisting of a lifelong fixed annuity with repayment protection.

3. The Four Sectoral Schemes

The ITP *(Industrins och handelns tilläggspension)* covers private-sector white-collar workers. ITP is undergoing a gradual transition from DB to DC, so it has two parts: ITP-1 (for members born in 1979 and after) and ITP-2 (all others). ITP-1 was introduced in 2007 and is entirely DC. Employers pay 4.5 percent of income below the statutory ceiling and 30 percent on income above it. One half of the contribution is allocated to fixed annuity products, with members choosing among four fund providers. For the other half of the pension contribution, members choose among five providers offering fixed or unit-linked annuity products. Members may also trade a slightly lower pension for »repayment protection« and/or survivor's coverage. Non-choosers' contributions are placed in a default option based on a lifetime fixed annuity with repayment protection.

ITP-2 covers those born in 1978 or earlier and provides a specific share of the final salary after thirty years of service: 10 percent of the final salary up to the annual statutory earnings ceiling, 65 percent for income between 435,751 and 1,162,000 Swedish crowns (€46,215 to €123,241), and 32.5 percent for income between 1,162,001 and 1,743,300 Swedish crowns (€123,242 and €184,862).

ITP-2 DB benefits are complemented by a DC scheme, ITPK. Employers contribute 2 percent of the pension base to individual accounts, and participants choose how the money is invested. Participants may choose between fixed and variable annuity products.

Occupational pensions for manual workers in the private sector are similar. LO and SAF agreed in 1996 to transform their existing DB pension into a DC system with individual investment choice. Employers contribute 4.5 percent of wages up to the statutory pension ceiling and 30 percent of wages above the ceiling for workers aged twenty-five and older. Members may choose between six traditional pension insurance companies and five companies offering unit-linked annuities. There is a default fund for non-choosers, and there are strict limits on the amount of risk that any of the funds may take. The default fund is a fixed annuity provider; 65 to 70 percent of members are in the default fund. Participants may also choose survivor's coverage and additional survivors' cover.

The KAP-KL scheme, established in 2006, has its roots in the SKP *(Sveriges Kommunalanställdas Pensionskassan)* established in 1922. KAP-KL covers municipal employees aged twenty-one and older and born before 1986. Employers pay 4.5 percent of wages up to the statutory ceiling into individual pension accounts, members allocate their contributions to either a fixed or unit-linked annuity product. Three companies offer fixed annuities and twelve offer unit-linked annuities. A participant may choose between four and forty funds depending on how many are offered by the selected company (Ministries of Finance and Social Affairs 2013: 35). The default fund for non-choosers is a fixed annuity fund. Participants may also opt for repayment protection or survivor's benefit, but this reduces the overall pension. This DC pension is supplemented by a DB scheme that covers income above the statutory ceiling for those age twenty-eight or older. Participants accrue pension rights for years worked since 1998; thirty years of contributions are required for a full pension. Starting in 2015, AKAP-KL covers those born since 1986. There is no minimum age for membership, and the scheme is entirely DC. Employers contribute 4.5 percent of wages up to the statutory ceiling and 30 percent above it. Members' investment choices are largely the same as in the KAP-KL scheme.

Central government employees aged twenty-three and older are covered by PA03. Two percentage points of the total 4.5 percent employers' contribution on earnings up to the ceiling are placed in fixed annuity products (the *Kåpan tjänste*). For the remainder (2.5 percentage points) members choose between fixed and unit-linked annuity products. There are nine providers of fixed annuities and thirteen providers of variable annuities. Each company offers a range of funds, varying between four and thirty-one. The default fund for non-choosers is a lifelong fixed annuity. Participants also may opt for a survivor's benefit financed by the balance in the participant's pension account at death, but this reduces the overall pension. DB principles apply to incomes up to the statutory ceiling, as well as to members born before 1973.

4. Balancing Choice and Security

Occupational pension schemes are designed to balance two somewhat contradictory goals: individual choice and security. Once employers and unions decided to introduce funded DC pensions, they needed to create an organisation and rules that would facilitate individual investment choice at minimum cost and offer a minimum level of security. Individual DC investment accounts are administered by clearinghouses modelled on the statutory premium pension. Employers and unions own the fund clearinghouses for SAF-LO and ITP schemes (Fora and Collectum, respectively). Employers and unions use their bargaining power to negotiate favourable contracts with financial service companies, keeping management fees very low. Employers and unions also carefully screen financial providers to exclude high-risk funds. The LO-SAF scheme does not allow high-risk fund choices in its fund catalogue; its goal is to contract with funds that offer high-performance pension products with low fees. The same is true for negotiated pensions for white collar workers. The clearinghouses also maintain a web-based fund platform that individuals use to make fund choices.

Like the statutory premium pension scheme, occupational pension schemes have other mechanisms for encouraging (or even requiring) pension contributors to avoid risky investments. Both the large public-sector schemes require participants to place half of their pension contribution in a fixed (i.e. guaranteed) annuity product. Participants in private-sector schemes are free to choose any fund option within the range selected by employers and unions. Participants with little appetite for risk may choose a fixed annuity product. In 2012, about 65 percent of Fora's participants had chosen (either actively or by default) to place their capital in the default fund (www.fora.se). The numbers are similar for white-collar workers in the private sector. The default fund in both private sector schemes is a fixed annuity product with no survivor's coverage.

Information concerning retirement planning and investing is an important element of all occupational schemes. The pension schemes for the private sector provide new participants with extensive information packages to help them understand the system and make appropriate fund choices. Collectum and Fora also provide web-based decision aids to assist participants in their fund choices.

There is one important exception to these trends, however. Nearly all occupational pension schemes allow participants to choose between a lifelong pension annuity and a defined pay-out period with a minimum of five years. There are no national statistics on how many occupational pensioners choose a short pay-out period, but data for private sector white-collar pensioners suggest some pointers. In 2014, 20 percent of new ITP pensioners chose pension pay-out periods of ten years or less. A shorter pay-out period results in a higher pensions, but it also means that the occupational pension payments end after the specified period, leaving the pensioner with only statutory (and private) pension income. Given that life expectancy at 65 is 22 to 24 years, this trend means that many retirees risk sharp decreases in overall pension income (Collectum 2014). Data from AMF, one of the largest providers of occupational pension products, confirm this tendency (AMF 2014).

5. Evaluation

What does the shift to DC and individual investment accounts mean for the future of retirement security in Sweden? On the positive side, DC pensions provide employers with greater certainty regarding non-wage labour costs. Non-wage labour costs are high in Sweden, and controlling their growth has been a political issue for three decades. The introduction of DC schemes in the private sector also addressed an important impediment to labour mobility: DB schemes were costly for older workers and hindered mobility. DC schemes also provide full coverage for low incomes (there is no minimum threshold), at least in actuarial terms. The statutory guarantee pension tops up the income of pensioners with low statutory and occupational pension entitlement. Finally, like the old DB occupational schemes, current schemes perform well in supplementing statutory pension income for below-average and average earners; this is especially important given that the reformed statutory system is less generous than the ATP system it replaced.

What are the potential pitfalls of the occupational pension system? First, the introduction of individual, funded DC occupational pension accounts is certain to lead to greater inequalities in retirement income, both across and within birth cohorts. Individuals employed in the same sector, with the same income, during the same period may end up with significantly different occupational pension income because of differences in investment income. This trend will be stronger for future private-sector retirees with income above the earnings ceiling, because a much larger share of gross income is invested. Because the public-sector schemes rely on DB for income above the ceiling, this trend will be weaker in these schemes.

A second concern has to do with investment risk. The introduction of individual investment accounts in the statutory and occupational pension schemes means that a very large proportion of Swedish workers' overall pensions is now based on individual risk. This trend will grow over time, because the role of individual choice and investment risk is significantly more important in occupational schemes, and the size of the occupational system will increase relative to the statutory system. Indeed, members of schemes with full investment choice could theoretically lose all of their assets, although this is highly unlikely given built-in safeguards.

The single most important precondition for a Swedish-style approach to occupational pension provision is a robust collective bargaining system with mandatory occupational pension coverage. Despite recent attempts by the centre-right government in power from 2006 to 2014 to weaken the trade unions, largely by increasing the costs and incentives of union membership, union density remains high (68 percent in 2013). Collective agreements cover 90 percent of the labour force, and employers show no signs of abandoning the bargaining model. Not everyone is happy with the shift from DB to DC and individuals' increased dependence on the vagaries of financial markets, but unions and employers have structured the occupational pension market to minimize risk and excess profits for financial service providers. Indeed, one of the biggest players in occupational pension provision is AMF, a non-profit owned by LO and SN (Confederation of Swedish Enterprises) with assets of 534 billion Swedish crowns (€56 billion). In short, funded, DC pensions need not be left to the free market – unions and employers can decisively shape occupational pension markets.

Table 2 Occupational Pension Schemes in Sweden in 2015

Occupational pension scheme	Contributions (paid by employers)		Eligibility	DB/DC	Additional Benefits	Pay-out period
	up to statutory ceiling	above statutory ceiling				
PA03 State employees	DB for those born before 1973 DC (4.5%) for those born 1973 or later	DB: Funds are set aside in the budget when pensions are earned.	Age 23–65	DB benefits based on salary, length of service and age DC benefits: 2 percentage points guaranteed annuity and 2.5 percentage points choice between guaranteed and variable annuity	DC scheme includes optional survivor's cover *(återbetalningsskydd)* and salary sacrifice for higher benefits	44% of the DC pension can be taken for a defined pay-out period (minimum of 5 years)
KAP-KL Public employees (county councils and municipalities) born before 1986	DC: 4.5%	DB: Funds are set aside in the budget when pensions are earned.	Age 21–67 for DC scheme Age 28–65 for DB scheme	DB benefits based on salary, length of service and age DC: choice between guaranteed and variable annuity (with investment choice) and pension provider	DC scheme includes optional survivor's cover *(återbetalningsskydd)*	The DC pension can be taken for a defined pay-out period with a minimum of 5 years
AKAP-KL Public employees (county councils and municipalities) born after 1985	4.5%	30% of income between ceiling and SEK 1,743,000 (€184,862)	no minimum age–67	Choice between guaranteed and variable annuity (with investment choice) and pension provider	Optional survivor's cover *(återbetalningsskydd)*	Choice between lifelong pension or defined pay-out period of 5–20 years (minimum 5 years)
ITP White-collar workers (private sector)	4.5%	30%	Age 25–65	DB: ITP2 for those born before 1979. There is also a DC part (ITPK) DC: ITP1 for those born 1979 or later. Half of the contribution finances a guaranteed annuity and half is a choice between guaranteed annuity and mutual funds	Optional survivor's cover *(återbetalningsskydd)*	Choice between lifelong pension or defined pay-out period of 5–20 years (minimum 5 years)
SAF-LO Blue-collar workers in private sector	4.5%	30%	Age 25–65	Choice between guaranteed and variable annuity (with investment choice) and pension provider	DC scheme includes optional survivor's cover *(återbetalningsskydd)* and survivor benefits *(familjskydd)*	Choice between lifelong pension or defined pay-out period of 5–20 years (minimum 5 years)

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