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The Swedish Pension Agreement and Pension Reform

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Foreword

A pension system is a long-term commitment. Inspiring trust in such a system requires a regulatory system also characterized by long-term commitment and stability. The Swedish pension scheme is financially stable and rests on a broad parliamentary majority. Thus favourable realistic conditions exist for maintaining the system in all its essentials over a number of decades. This means politicians as well as civil servants charged with the task of administering the pension scheme will be replaced by others more than once. Generations as yet unborn will eventually take over the task of administering our pension system. This places demands on effective knowledge transfer.

Extensive documentation concerning the principles of the reform and its regulatory framework exists in the form of investigative reports, departmental memoranda, bills and committee reports. Even though the fundamental principles are not difficult to grasp and it is relatively easy to gain a good overall picture of how the system works, the system in its entirety is complex. An ability to administer the pension system presupposes a profounder knowledge of the whole and of how the parts work, as well as an understanding of the background and intentions of the reform and of how the pension system interacts with the rest of society. Gleaning this knowledge from existing documentation is no easy task and is first and foremost time-consuming.

The Implementation Group that operated from 1994 to 2006 has completed its work and been succeeded by the new Pension Group. The political administration of the reform has thus been taken over by a group of politicians who were not present at its inception. Meanwhile, there is a gradual generational shift among civil servants both in the Cabinet Office and within the authorities that administer the pension system.

The purpose of this publication is to facilitate such generational shifts by providing an overview of the motives and principles behind the reform both for politicians with responsibility for the pension system and for responsible administrative staff. But a secondary purpose is to contribute to an increased knowledge and understanding of the pension system among other interested parties in society.

We know nothing of future conditions and values and how these might influence attitudes towards the pension system. What we hope to accomplish with this publication is to facilitate the work of future administrators by summarizing the motives and principles behind the pension reform.

This document has been drafted by administrative officials holding key positions in the early 1990s when the main foundations of the pension reform were laid down. The chief author is Court of Appeals Judge Lars Göran Abelson, departmental head Stefan Ackerby, Associate Professor Inger Rydén Bergendahl and Senior Adviser Stefan Oscarson. The text has been proofread for factual errors by three officials who have made significant contributions during the development of the reform: Daniel Barr, Gudrun Ehnsson and Ole Settergren.

The document is a civil service product and the authors take responsibility for the content. However, it has been scrutinized for errors in accordance with what is stated in the outgoing Implementation Group's testament by members of the former Implementation Group – Berit Andnor (Social Democrat), Rose-Marie Frebran (Christian Democrat), Margit Gennser (Moderate), Arne Kjörnsberg (Social Democrat), Lennart Klockare (Social Democrat), Bo Könberg (Liberal Party) and Åke Pettersson (Center Party).

Stockholm, October 2009

Stefan Oscarson
Secretary of the Pension Group

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Introduction

The Pension Reform stems from the five-party agreement on a reformed pension system reached in January 1994. Its main features had been outlined in the draft report presented by the Pensions Working Group in August 1992. A few months after the agreement, the group submitted its report, *The Reformed Pension System* (SOU 1994:20), which in spring 1994 resulted in a bill setting out the principles, *Reforming the National Pension System* (Proposition 1993/94:250). This bill includes the most essential features of the pension agreement but several later amendments, clarifications and supplements have been incorporated into the pension agreement. There is no single comprehensive description of the pension agreement. Available documentation consists of government bills and committee reports decided on by the Riksdag.

In June 1994, after the bill setting out the principles had been adopted by the Riksdag, the Implementation Group was appointed and given the task of filling out the details of the pension reform and generally "nursing" the pension agreement. The Implementation Group completed its work at the time of the general election in 2006. At its final meeting on 8 June 2006, the Implementation Group drew up a testament with guidelines for the continued 'nursing' of the reform.

This testament includes a summary of the content of the pension agreement together with a recommendation that a new group be appointed to continue "nursing" the pension agreement and otherwise advise on current pension issues relating to the pension agreement.

On 11 December 2007, the Pension Group was formed. The group was charged with drawing up a directive for its activities. The new Pension Group also adopted the draft compilation of the pension agreement in its directive of 10 April 2008 but included a clarification concerning pension rights for recipients of activity and sickness compensation. The directive also laid down that the draft compilation was to apply until such time as a special document on the pension reform should be produced.

The present document chiefly consists of three parts with three different aims.

- Chapter 1 is a bulleted compilation of the content and scope of the pension agreement. It is based on the summary provided by the Implementation Group in its testament from the final meeting of 8 June 2006. The new version has been adjusted and amended in a number of ways in order to achieve a more comprehensive and structured compilation.
- Chapter 2 describes the background, causes and principles of the reform. Its aim is to create an understanding of the design of the reform and of the choices that have been made.
- Chapter 3 is a description of how the pension system functions. The different parts have been written for different purposes and in such a way that each may be read independently of the other. There is thus a certain overlap between chapters.

1 The content of the pension agreement

'The pension agreement' refers partly to the regulatory system governing income-based old-age pension and guarantee pension, and partly to the underlying discussion of principles as found in government committee reports and bills. The pension agreement does not cover sickness and activity compensation or pension-related benefits such as survivor's pension according to the Act concerning Survivors' Pensions and Child Survivors' Support (2000:461) or housing supplement for pensioners. Nor does the agreement cover the administration of the pension system.

The compilation in this chapter is a further development of the version found in the agreed directive of the Pension Group. In accordance with what is stated in the directive, the summary in this chapter now replaces the version found in the directive.

1.1 Overarching principles

- A public, universal and compulsory pension system is the corner-stone of the individual's pension protection. The old-age pension system must be autonomous and separate from other social insurance categories.
- Old-age pensions must relate to individuals' earnings over all periods of gainful employment during their lives. This standard protection is complemented by a basic protection for

persons unable to earn any – or sufficient – income-based pension.

- The income-based portion of old-age pension is founded on the principle of lifetime earnings. In other words, an individual's income up to a given ceiling – provided it rises above a certain annual threshold amount – earned over a whole working life will determine pension rights and will weigh equally regardless of when it was earned.
- The pension system is strictly contribution-based, that is, pension disbursements correspond to contributions paid into the system by or for the individual. Pensions are paid out to men and women on a gender-neutral basis despite differences in average life expectancy.
- The income-based part of old-age pension has two separate components: income pension and premium pension.
- Income pension is financed as a distribution system, that is, pension contributions paid in during a particular year are used to finance the income pensions disbursed during that year.
- Premium pension is financed as a premium reserve system, that is, pension contributions paid into it are saved (placed in funds) for the individual's future premium pension.
- A contribution charge of 18.5 per cent of the individual's pension base is paid into the old-age pension system, 16 per cent being transferred to the income pension system and 2.5 per cent to the premium pension system.
- The running costs for income pensions will be tied to national economic growth so that the pension system keeps in step with earnings trends in society. The system will also adjust to changes in the life expectancy of the population.
- There is to be great flexibility and choice for individuals – from the age of 61 but with no upper age limit – when it comes to drawing all or part of old-age pension.

1.2 Birth cohorts

- Persons born in or before 1937 have their pension calculated according to earlier rules. However, even for this group, the rules concerning adaptive indexing and balancing apply, and there are special rules relating to guarantee pension for this group.
- Persons born in or after 1954 are wholly covered by the new regulatory system for old-age pension in the form of income-based old-age pension and guarantee pension.
- Persons born between 1938 and 1953 are covered by the new regulatory system but have a certain number of twentieth parts of their income-based pension calculated according to earlier rules. People born in 1938 have 16/20 while those born in 1953 have 1/20 from the old system.

1.3 Earning pension credit

- Pension credit is granted – up to the earnings ceiling – for pensionable income in the form of earnings from gainful employment, certain social benefits that compensate loss of earnings from gainful employment, and certain so-called pensionable amounts. There is no lower or upper age limit to the earning of pension credit.
- Absence from the labour market qualifies for pension credit in the form of pensionable amounts in the following cases:
  1. for people with small children, pension credit is granted for childcare years over a period of four years according to the most beneficial of three alternatives: (1) a compensatory amount up to the pensionable income of the year prior to the birth of the child, (2) a compensatory amount up to 75 per cent of the average pensionable income for all insured persons aged 16–64, or (3) an addition to the pensionable income consisting of one income base amount,

2. for national service, pension credit is granted that equates to 50 per cent of the average pensionable income for all insured persons aged 16–64,
3. for studies, pension credit is granted that equates to 138 per cent of disbursed study grants,
4. for sickness and activity compensation, pension credit is granted for 93 per cent of the notional income. How the rules for sickness and activity compensation are formulated, such as conditions for entitlement to the benefit and how assumed income is calculated, is not part of the pension agreement, assumimg the benefit is granted after the adoption of the directive for the Pension Group.

- Pension credit is based on the sum of the pensionable income and the pensionable amount up to a maximum of 7.5 income base amounts. If the sum is less than 0.423 price base amounts, however, no pensionable income is calculated for that year.
- The pensionable income is determined annually when tax returns are filed. Of this income, pension credit makes up 18.5 per cent, 16 percentage units of which then go to the distribution system and 2.5 percentage units to the premium pension system.
- For types of income that are pensionable under the new system, pension credit is also granted retroactively as far back as 1960. This also applies to pension credit for childcare years. Pension credit for compulsory national service and for studies is calculated retroactively from 1995.
- Spouses can share pension credit for premium pension through a voluntary annual transfer of premium pension credit from one spouse to another. At the time of the transfer a deduction is made for the insurance-related cost arising from the different average life-spans of women and men. The level of the insurance-related cost should mirror actual costs, and must therefore be reviewed continuously.
- The new regulatory system fully covers all those born in or after 1954, while people born in or before 1937 continue to

receive their pension according to the rules of the ATP system that applied previously. Persons born between 1938 and 1953 earn pension credit both according to the rules of the ATP system and according to the new regulatory system. This means that cohorts from these years will partly receive ATP pension, partly income pension, from the distribution system. This is achieved using a method of phasing-in by twentieth parts: the later a person's birth date during the given year, the higher the number of twentieth parts allocated to the new system – and thus the lower the number of twentieth parts allocated to the ATP system. From the age of 65, all persons born in or after 1938 earn pension credit solely according to new rules.

1.4 Pension contributions

- The pension system as a whole is to be financed by contributions levied on all incomes, on certain social benefits and on pensionable amounts which give pension credit. Pension credit received must match contributions paid in. The contribution (like the pension credit) is to be constant over time, fixed at 18.5 per cent of pensionable income and pensionable amounts respectively up to an earnings ceiling of 8.07 income base amounts.
- Individuals pay 7 per cent of their current income and certain social benefits in the form of a general pension contribution. Employers pay 10.21 per cent of current salaries in the form of old-age pension contribution. That makes a total of 17.21 per cent of salaries or other remuneration. (The sum is lower than 18.5 due to the fact that the general pension contribution is not in itself pensionable; 17.21 per cent of income is therefore equivalent to 18.5 per cent of *pensionable* income.) The agreement requires the contribution to be shared equally between individual and employer. Practical details that have

hitherto prevented a complete implementation of the agreement are to be settled as soon as possible.

- An employer contribution in the form of old-age pension contribution (currently 10.21 per cent) must also be paid for incomes over the earnings ceiling. This contribution gives no pension credit and is thus to be regarded as a tax which is transferred to the national budget rather than to the old-age pension system.
- For pensionable amounts and certain social benefits, the state pays via the national budget a state old-age pension contribution equivalent to pension credit.

1.5 The Premium Pension System

- The premium pension is wholly fund-financed. Premium pension credit has been calculated since 1995. Premium pension capital is invested according to the wish of the individual saver, who selects which fund or funds should manage the money, and asset management is done in mutual funds managed by independent fund managers. To ensure true freedom of choice for the individual saver, the number of funds must not be too limited. For those who do not choose a fund, the capital is placed in a generation fund in the Seventh AP Fund, which, unlike the other AP funds, is thus not part of the buffer fund for the income pension system. The saver must be able to select that fund and also to select an alternative fund within the Seventh AP Fund with a higher or lower risk.

1.6 Recalculation of the pension balance

- The value of earned pension credit for income pension is recalculated annually so as to reflect average earnings growth. This is done using an income index that measures real change in average pensionable income for persons aged 16–64, including income above the earnings ceiling of 8.07 income base amounts. To this is added any change in the consumer price index during the preceding year. The method of calculation is statutory and the index is fixed each year by the government.

- The value of pension credit for ATP pension is tied to changes in the price base amount.
- The value of earned premium pension credit follows the value development of the funds chosen by individual pension savers.
- The pension balance for income pension is recalculated annually to take into account inheritance gains and administrative costs. The pension balance of those who die before the retirement age is shared out in the form of inheritance gains to insured persons born in the same year as the deceased. The costs of administration are defrayed annually among the insured.
- Administrative costs for the premium pension system not covered by other means are deducted from the premium pension accounts of pension savers.

1.7 Calculation and payment of income-based pension

- Income-based old-age pension may be claimed from the age of 61, at 25, 50, 75 or 100 per cent of the full amount. There is no upper age limit for withdrawal. Income pension (including any ATP pension) and premium pension may be claimed independently of each other.
- Income pension is calculated by dividing the sum of the indexed pension credit by an annuity divisor. This is the same for men and women. The annuity divisor is based on average observed life expectancy at the time of retirement and an advance interest rate (equal to the growth norm) of 1.6 per cent.

- For people born between 1938 and 1953, ATP pension is also calculated according to the rules of the old ATP system. These people receive a pension from both old and new systems, with a set number of twentieth parts from each system depending on their year of birth. Those born in 1938 have four twentieth parts of their pension calculated according to the new rules and those born in 1953 have nineteen twentieth parts of their pension calculated according to the new rules.
- For the transitional generation born between 1938 and 1953, a special guarantee rule also applies, ensuring that they will not receive a pension lower than the one they earned in the ATP system up to 1994.
- Income pension and ATP pension are indexed to income growth in society. This means that pensions are recalculated annually to reflect the change in the income index, minus advance interest (the growth norm) of 1.6 percentage units.
- The system for income pension and ATP pension includes an automatic balancing mechanism, ensuring the long-term financial stability of the system. For each year, a balance ratio is calculated representing the ratio between the system's assets and liabilities. The balance ratio is set by the government. If the ratio falls below one (1.0000), the balance mechanism is activated. That is, a lower balance index is used instead of the income index in the recalculation of pension credit and pensions until the balance ratio once again reaches at least one. Thereafter a higher recalculation is employed until the balance index reaches the same level as the income index.
- If the system for income pension and ATP pension accumulates a surplus larger than what is needed for the system's long-term financing, the surplus is to be shared out among the insured. Exactly when sharing out a surplus becomes possible and how the sharing out is to be implemented has yet to be decided.
- Premium pension is calculated following insurance-based principles, without regard to gender, and is paid out for the

rest of the insured's life. Premium pension is also calculated by dividing the pension balance by an annuity divisor reflecting average remaining life expectancy. Inheritance gains pass to the insured population.
- During the retirement period fund capital within the premium pension system can be converted to a life annuity. When premium pension is drawn, the pension can be supplemented by a survivor's protection which, on the death of the pension saver, is paid out for life to a spouse or to a cohabiter who ranks as a married person.

1.8 Guarantee pension

- Persons who have not earned enough credit for an income-based pension are entitled to guarantee pension. A full guarantee pension requires 40 years of residence in Sweden between the ages of 25 and 64. To be eligible for any guarantee pension at all requires at least three years of residence.
- Guarantee pension may be drawn at the earliest from the age of 65.
- Full guarantee pension amounts to 2.13 price base amounts for an unmarried pensioner and 1.9 price base amounts for a married pensioner.
- For persons born before 1938 special rules apply to guarantee pension. For example, the level is 2.1814 price base amounts for unmarried pensioners and 1.9434 price base amounts for married pensioners.
- The value of guarantee pension is offset against income-based old-age pension, an equivalent foreign pension and a survivor's pension in the form of widow's pension. It is reduced to zero if the income from such a pension amounts to 3.07 price base amounts for an unmarried pensioner and 2.72 price base amounts for a married pensioner. For those born before 1938 guarantee pension is also offset against occupational pension.

- Guarantee pension is always calculated as though withdrawal of income-based old-age pension has been made at the age of 65 and as though premium pension has yielded a return in accordance with income pension.
- Guarantee pension shall as far as possible be taxed in the same manner as incomes from work and other pension incomes.

1.9 Financial questions

- The income-based old-age pension system is designed as an autonomous system wholly separate from the national budget, and calculations are to be conducted according to insurance-based principles. The system's income shall consist solely of income from contributions and yield on capital in the buffer fund or on money placed in the premium pension system. The system's expenditure shall consist solely of pensions and administrative costs.
- The system for income pension and ATP pension shall have a buffer fund for necessary reserve capital, managed by one of the five AP Funds: the First – Fourth and the Sixth AP Fund. The First – Fourth AP Funds are covered by the pension agreement and have special investment rules. The Sixth AP Fund is part of the buffer fund but is not covered by the pension agreement.
- To compensate the national budget for the extra costs occasioned by the reform, a transfer equivalent to SEK 258 billion on 1 January 1999 has been made from the AP Funds. A final decision on whether further amounts may be transferred from the AP Funds to the national budget without jeopardizing the stability of the system will be taken at the same time as the question of surplus in the income-pension system is handled.
- Guarantee pension, and its administration, is wholly financed by the national budget through annual appropriations.

1.10 Information

- The individual is to be notified annually of the past year's paid-in contributions, the total balance and a forecast for the future pension based on certain assumptions.
- An annual balance sheet showing the system's assets and liabilities shall be published by the Swedish Pensions Agency.

1.11 Other

- The mandatory retirement age from an employment – fixed by statute and not negotiable – is 67 years and in coming years may be raised further.

Agreement separate from the pension agreement

In connection with the pension agreement the parties agreed on changes to the Marriage Code division of property rules. It is a question partly of allowing private pension insurances to be included in the division of property, and partly of taking into greater account other forms of pension entitlements such as contractual pensions during the division of property after a divorce.

These issues were discussed in connection with the pension negotiations and there is also an agreement among the parties supporting the pension agreement. Nevertheless the issues have no direct connection to the pension system and should therefore be regarded as a separate agreement and not as part of the pension agreement.

2 The old-age pension reform – motives and principles

The Riksdag decision of 8 June 1994 laid down guidelines and principles for a completely new old-age pension system. In the history of Swedish pensions, 1994 thus became a milestone in the same way as 1913, when we got our first national old-age pension system, 1946[1], when the decision on a new Basic Pension was taken, or 1959, with the decision on ATP pension. The background to the 1994 decision was the assessment made by several investigations that the current system with ATP and Basic Pension was not sufficiently ”robust” in the face of socio-economic and demographic pressures.[2] This was also illustrated by the economic crisis of the early 1990s, when the government and Riksdag found themselves forced to depart from the value protection of pensions and thus lower them in real terms. In the parliamentary bill 1993/94:250, the government made the assessment that

> …the current national pension system does not, in crucial respects, meet the requirements placed of a pension system. The weaknesses of the present structure have become increasingly apparent. The ability of the pension system to deliver on its commitments is thus threatened. …. There are compelling reasons for carrying out a thorough-going reform today that will provide a new modernized pension system.

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[1] However, it was first implemented in 1948.
[2] the Pension Commission's Report, The National Pension System (SOU 1990:76) and the Pension Group’s Reformed Pension System, (SOU 1994:20).

The first political steps towards reform had been taken in the finance plan of January 1991, where the government in office pointed out that ”opportunities for financing pension pledges within a framework of unchanged levels of taxation and contributions are highly dependent on economic growth” and therefore announced that it ”intends to come back later with concrete proposals for changes in the pension system”. The starting points for a reform would be the need for greater savings and for greater incentives for gainful employment. In autumn of the same year, the then new government accepted these starting points for a reform and drew up guidelines for the Pension Working Group, which set to work in November 1991.[3]

The possibility of making changes within the framework of the ATP and Basic Pension system in order to make them fitter to withstand future pressures had been investigated by the Pension Advisory Council, among others. But when the Pension Working Group presented a first draft in August 1992, its conclusion was that ”the pension system ought to be based partly on other principles than those underlying the Basic Pension and ATP system of today.” Small changes or gradual reforms would risk exacerbating the weaknesses of the present system.

The agreement reached by the Pension Working Group in January 1994 and which to all intents and purposes became the parliamentary bill constituted a systemic shift. Sweden changed from a benefit-based to a contribution-based distribution system.[4] The pension reform attracted international attention, both because it was politically possible to implement and because the system chosen by Sweden represented something new. In the international pensions debate other types of systemic changes had been discussed, but now the Swedish pension reform offered an alternative.

ATP pension was introduced after a harrowing political battle and high drama. Prior to the 1994 decision, the five parties that

[3] In addition, the possibility of raising Basic Pension and reverting to a retirement age of 67 was to be investigated.
[4] (in the international literature named notional defined contribution, NDC)

supported the reform endeavoured to reach a consensus and maintain it. They wished to avoid a new battle over pensions. For the citizens it was important that the rules be allowed to remain the same over elections and changed majorities. This striving for unity partly manifested itself in the fact that representatives for the opposition participated in the government's preparation of the 1994 bill setting out the principles. In the Riksdag decision it was also stated that there lay ”a heavy responsibility on the contracting parties to continue to rally round the agreement”. It was further proposed that an Implementation Group be set up with the task of ”nursing the agreement” and it was expressly stated that ”party representatives had bound themselves not to unilaterally carry through any changes in the fundamental components of the pension reform.”

This section takes up the motives behind the reform and the fundamental principles underlying today's old-age pension system. The point of departure is the bill from 1994. Subsequently, parts of the reform have been developed and made more precise, involving further decisions on matters of principle.

2.1 The goal of the reform: a stable and fair system that enhances saving

2.1.1 A financially stable old-age pension system

The greatest driving force behind the pension reform was the fact that the supplementary (ATP) system suffered from inherent financial instability. It was not sufficiently ”robust” in the face of socio-economic and demographic changes. The development of pension contributions had only a tenuous link to the development of the incomes out of which they were to be financed. The risk of a long-term imbalance arising between the expenditure and income of the pension system was considerable. The ATP system was tied to benefits (benefit-based), which meant that adjustments to any such imbalances had to be made by changing the level of the rate charged. If calculations showed an imminent deficit, the rate must be increased. Changing the value of pension benefits, as happened in 1992 through decisions on reduced upward adjustment, might be viewed as a broken promise or breach of contract. The AP Fund's assets could repair temporary imbalances, but were not sufficient to cope with long-term deficits.

Expenditure for basic pension and ATP

Share of the wage sum according to different assumptions of annual real wage growth (from 1995 onwards) and with an unchanged price-indexed benefit ceiling

Growth rate	0%	1%	2%	3%
2005	33.5	30.3	27.8	25.1
2015	41.1	34.2	28.8	23.9
2025	44.2	34.1	26.6	20.3
2050	43.7	29.2	18.4	10.9

Source: Swedish Government bill 1993/94:250

The ATP system was also a so-called redistribution system – an intergenerational contract – with pensions financed directly on a pay-as-you-go basis by the gainfully employed. The risk of raised contribution rates was a threat to the credibility of this contract. Younger generations risked having to pay contributions greater than the pension benefits they themselves could count on receiving. In a period of poor growth, old-age pensions could become excessively high in relation to an average earned income. In a period of high growth, on the other hand, pensions could become excessively low in relation to wages.

The main reason for this instability was the fact that basic pension and ATP benefits were indexed to the consumer price index, but there was no link to real wages growth in the country. The level of the ATP pension was determined by average income during the fifteen best years of earning and was adjusted upwards each year in step with price growth. Normally the fifteen best years were those towards the end of a person's working life, which, put simply, meant that the pension level was determined by the insured's income during approximately 8–10 years prior to retirement. The index-tied pension was then paid out on average for approximately 17–18 years, that is to say, remaining life expectancy after the age of 65. Even basic pension, wholly independent of earnings, was adjusted upwards to match inflation. Weaker economic growth and slower development of real incomes in society affected the income-based ATP pension, but only after a very long time lag. This meant that benefits and thus expenditure for the pension system remained considerably more stable than the charge base and the system's income.

Nor did the ATP system take into account changes in life expectancy, that is to say, over how long a period the pension would on average be paid out. The expected time as pensioner had risen significantly since the mid-nineteen-seventies and the population estimates of SCB (Statistics Sweden) revised upwards future expected life expectancy even more. Even in the short space of time between the Pension Working Group's report and the bill setting out the principles, SCB demographers revised upwards expected average life expectancy, which would mean even higher expected expenditure and ultimately higher contributions to the pension system. The ATP system thus contained a demographic risk, at least if the retirement age was to remain the same.

In the view of the Riksdag this instability was unacceptable. The pension system was exposed to unacceptably high risks and it was not reasonable to regulate financial imbalances solely via the contribution charge. Therefore a greater part of the adjustment to socio-economic and demographic changes must be made on the benefits side. In other words, the economic and demographic risks were to be transferred from the pension system to the individual and thus from the working generation to the whole insurance collective.

2.1.2 A fair system with strong work incentives

The second major reason for radical reform was the conviction that the basic pension and ATP systems did not sufficiently stimulate people to seek gainful employment. The ATP system's 15-year-rule meant that people's income level during a limited part of their working life had a direct influence on their future pension. It was sufficient to have 30 years of pensionable income in order to receive full ATP pension, and for half of these years it was enough to have a very low income. Basic pension had no connection at all to gainful employment.

One consequence of the rules was that incentives to seek gainful employment were relatively weak. Increased input of work such as going from part-time to full-time work often gave no dividend at all in the pension system. Furthermore, incomes earned after the age of 64 gave no pension credit in the ATP system. The incentive to work after reaching the age of 65 was therefore slight.

At the same time, the outcome of the ATP rules did not accord well with the goals of progressive redistribution. One consequence of the rules was that the same lifetime earnings could have a strikingly different impact on a person's pension depending on the kind of income profile a person had during their working life. It was possible to have no gainful employment or to earn very little over a long period but still receive a large pension by having a high income over a limited period. Persons with a high income towards the end of their professional lives received a larger pension than those who had had a uniform income throughout their lives. People with careers were favoured, while those with more stable incomes were disadvantaged.

Pensions were financed by taxation to far too great a degree. Everyone contributed to financing the system, each according to their income, but benefits were only tenuously linked to income since benefits were determined on the basis of earnings during specific years. This meant that pension contributions had more the character of a tax than a pension premium. None of the traditional arguments for fiscal financing – fair redistribution and efficiency – could justify this state of affairs. The ATP rules were adapted to conditions at the time of their introduction, including the fact that significantly fewer women were gainfully employed. Now the situation was different and the link between pension and gainful employment had to be strengthened.

2.1.3 Increased savings

In the Financial Plan of 1991, increased savings were put forward as a major reason for pension reform. At the time, the level of national savings was considered to be too low. Sweden had had a deficit in her balance of payments over an extended period. If investments were to reach a level compatible with strong growth, total savings would be inadequate. A central goal of economic policy was therefore to increase savings. It was thought natural to increase savings within the framework of the old-age pension system, especially since a universal system weakens the individual's motivation to save for a pension. Projections also showed that the ATP system was destined eventually to contribute negatively to total savings in society.

Furthermore, both the social democratic government in 1991 and later the non-socialist parties advocated increased saving ”at the individual level”. It was considered to be less suitable to increase collective savings beyond the AP Funds, which at that time had more restrictive placement rules than today.

The savings motive behind the pension reform was soon relegated to the background. The savings ratio rose dramatically at the start of the 1990s and low savings were no longer viewed as a socio-economical problem. Instead, the major problem was the imbalance in savings between different sectors of society. Fixing the deficit in the national finances became the over-riding objective.

2.2 Principles for the new system

2.2.1 A system shift

A change of system was deemed necessary if the goals set up for a reform were to be attained. The Riksdag decision of 1994 meant that the national old-age pension system was fundamentally transformed from a benefit-based distribution system into a contribution-based distribution system with elements of individual investment funding.

All pension systems have the same basic objective: to ensure an income when the insured due to advancing age is no longer able or willing to undertake gainful employment. As individuals, we do not know in advance whether we will reach the pensionable age or how long the period of retirement will last. It is therefore rational to organize income security for old age as an insurance.

A pension insurance can be constructed in various ways. Two dimensions determine the characteristics of the system :

- How is the pension benefit calculated? In a benefit-based system, there is a promise of a fixed pension amount or a proportion of the income earned at the end of working life. In a contribution-based system the benefit is directly related to the contribution (premium) paid in during the period of gainful employment.
- How is the pension benefit secured, that is, how can it be guaranteed that there is money to pay with? In a distribution system pensions are financed on an ongoing basis by the gainfully employed and it is ultimately taxation law that safeguards pensions. In a funded system financial assets are appropriated which guarantee there will be money to pay pensions with.

By combining these options we get four different kinds of pension system (see the figure). ATP and basic pension were a benefit-based distribution system. The reformed system is a combination of a premium-based or contribution-based distribution system (income pension) and a premium-defined funded system (premium pension).

		Pension credit	
		Benefit-based	Contribution-based
Security	Distribution (taxation)	Basic pension ATP	Income pension
	Funding		Premium pension

2.2.2 Stable conditions rather than gradual adjustment

One starting-out point of the Riksdag decision was the requirement that old-age system regulations be predictable and credible. The pension promise should always be honoured and people should know in advance the form that any adjustment to changed economic and demographic conditions would take.

This was a matter of principle. An alternative approach might have been to view pension benefits in the same way as most other public commitments, which, as part of an ongoing budget process, are tested against each other and against economic trends. In good times benefits can perhaps be raised, while they must be reduced in bad times. But such adjustments have to be weighed against other public commitments. Thus pension benefits cannot be regarded as sacrosanct. On occasions, the Riksdag has felt obliged to make changes to pension rules, for example, after the rise in the price of oil in 1981 and as part of the budget sanitization of 1992. On these occasions the pension promise could not be honoured.

Under the new system, however, the terms will be established and remain unchanged. Any adjustment that becomes necessary will be automatic and not dependent on prevailing priorities at the time. This will give the system predictability and spare politicians the ordeal of passing special legislation to reduce benefits when necessary. On the other hand, stable terms will also mean old-age pensions cannot be an area for political promises of short-term improvements.

2.2.3 Unchanged role for national old-age retirement pension

In the Swedish and foreign debate on pension systems the predominant view for a long time was that the alternative to existing systems was first and foremost to gradually ”privatize” the public distribution systems and transform them into systems with private pension insurance schemes. Another alternative was extended occupational pensions managed by the parties involved. The role of the national pension system would then be reduced to providing basic protection. It was for example the recommendation that the World Bank had so far given to developing countries that were about to create old-age pension systems, as in the paper ”Averting the Old Age Crisis” in autumn 1994.

The Riksdag decision meant that Sweden would not be going down that path. A national compulsory system would continue to be the foundation of the individual’s pension protection. In the Swedish Government Bill 1993/94:250 it was expressed as follows:

> ”The division of roles existing today between on the one hand the public pension system and on the other the contractual and private pension systems is well-balanced. A key objective of the reform must be that the new pension system under normal socio-economic conditions will give the same compensation for income from gainful employment as today’s system ”

This was later defined in more detail as follows: given the average life-span current at that time, a person who had been gainfully employed for a little over 40 years with a gradual increase in income would receive an old-age pension approximately equivalent to an ATP pension, providing there had been a "normal" socio-economic development. Reasons of principle and of practicality were both cited for why the national system should retain its role.

One decisive reason was that the transition to a funded pension system similar to that of private insurance schemes would inevitably lead to one generation having to pay twice – both saving money for its own pension and paying for past pensions. It would mean levying quite a high pension contribution over a long transitional period. This ”additional tax” frightened away even those who thought privatization in principle was desirable.

A further reason was that such a transition would in the long term lead to the creation of huge pension funds. These funds with their specific placement profile and risk-taking would come to dominate the capital market and this might well have an adverse effect on market efficiency.

In addition, there remained the principle-based view that the national pension should be regarded as a generational contract, that is, that the distribution principle should be retained and that today's pensions should be largely paid for out of today's contributions. That presupposes a compulsory system. In the bill setting out principles it was also proposed that recalculation of the value of pension benefits be tied to earnings and price trends in society and not be wholly dependent of return on capital as in a private pension insurance scheme. Such recalculation of value is only possible in a public system.

Yet another reason was keeping administration costs down. Private competing insurances tend to have higher administrative costs. There are significant economies of scale in a national system.

The Riksdag decision also represented a choice not to allow increasing real earnings to gradually reduce the role of the national system. The ATP system had a high-income ceiling that gave a pension credit of 7.5 price base amounts. Growth in real earnings would result in a growing proportion of employees receiving incomes above this level. Occupational pensions in particular would thus gradually account for an ever-increasing portion of total pension protection. In the reformed national old-age pension system, the benefit ceiling is recalculated according to growth in earnings instead of price trends. Thus its role is not undermined by economic growth.

At the same time, the bill setting out principles makes it clear that benefits in the national pension system must not become too high and especially in the case of high earners should not account for total pension protection. A significant portion of the pension should be managed by labour market players, and it is reasonable that total pension protection should include individual pension insurance schemes. The latter ought to be in the nature of extra supplements. The national pension and occupational pension should together provide ”totally satisfactory pension protection”.

In one respect, however, a reduced role was built into the public system, namely, the demographic adjustment that takes into account increased life expectancy. In step with rising life expectancy, the annual pension is reduced automatically at a given retirement age. To compensate for the fact that pensions may be expected to be paid out over a longer period of time, the insured must to a greater extent than was called for by previous rules supplement their pension with occupational pensions or private pension savings or retire at a later age.

2.2.4 The life-long earnings principle – all incomes count

What has probably come to be most associated with the pension reform in the public debate is ”the direct pipeline”, that is, the direct link between income and pension benefits. Every pensionable income is to influence the level of pension. This was a breach of the earlier principle of benefit-based pension founded on the assumption that the pension system should provide a certain degree of compensation for the loss of income at the moment of retirement in the same way that sickness insurance provides compensation for loss of income in the event of illness.

The new system is contribution-based and analogous to a savings scheme. The pension is based on the accumulated pension balance built up during a person's active working life by the annual calculation of pension credit – as a proportion of pensionable income – that is to be added to the previous pension balance. Every pensionable income helps increase the pension balance and thus the future pension.

Starting out with the objective that the national old-age pension system, given current assumptions of life expectancy and a little more than 40 years' gainful employment with a smooth earnings curve, ought to provide the same pension as ATP, annual earned benefit was set to 18.5 per cent of pensionable income.

The pension credit accruing tallies with the contribution paid into the system, that is to say, combined pension contributions also amount to 18.5 per cent of pensionable income. This is a secondary meaning of ”the direct pipeline”: the value of any pension that can be expected after retirement will exactly match the contributions that have been paid in. The contribution is the fixed point, upon which the benefit is predicated. In the basic pension and ATP system, the benefit was the fixed point and the contribution was adjusted accordingly.

2.2.5 Value protection tied to income trends

The decisive change in the new system from the point of view of stability was that recalculation of the value of earned pension benefits was tied to income trends instead of to price trends, which had been the case with the basic pension and ATP systems. The value of the pension system debt owed to the pensioners of today and tomorrow was thus linked to national economic growth. Poor economic growth accompanied by a weak growth in real wages automatically results in a lower recalculation of benefits, and vice-versa. This makes the new system more robust in the face of national economic fluctuations.

A further motive for tying recalculation to income growth was that all incomes were to influence the pension equally irrespective of when they were earned during a lifetime. Given real earnings growth in society, which is the normal case, benefits earned early on in life would be of little significance if merely recalculated upwards to match price developments. A normal income at the point of retirement is significantly higher than incomes earlier in life even when adjusted for inflation. The ambition was to ensure that incentives for gainful employment should be as strong in younger years as close to retirement and that all incomes should weigh equally when it came to calculating a person's pension. Therefore the "interest" in the pension system must be income growth rather than price developments.

Value recalculation is done using the income index that reflects the development of the average pensionable income in society. From the point of view of the private individual, it is natural that indexation should be tied to changes in average income. If employees receive higher real wages, there is a corresponding upward adjustment of pension benefits. But since pension benefits are recalculated according to average income, there remain risks of financial instability in the pension system. It is the income sum that is the base for contributions to the pension system and this may develop differently from average income. If for example the proportion of the adult population with pensionable incomes decreases at the same time that average income increases, the pension debt will grow faster than the contribution base. The financial risk represented by average indexation is managed by the so-called automatic balancing mechanism (nicknamed ”the brake”).

This was a choice dictated by principle. Indexation tied to the income sum instead of to average income would have provided an almost perfectly stable system financially. As it was, a model was chosen that was more responsive to the incomes of the active workforce but with a ”safety valve” that managed any remaining financial risk.

2.2.6 Four insurance-based principles

Automatic adjustment to changes in average life expectancy

As with adjustment to income growth, the demographic risk – the risk of change in average life expectancy – is managed in the new system by an automatic process. The total pension balance remains the same, but in the case of rising average life expectancy, disbursements are spread over more years by reducing the annual pension amount. Unlike what normally happens in private insurance schemes, the demographic adjustment of income pension is made annually using so-called annuity divisors, which are based on actual observed average life expectancy and not on assumed life expectancy trends.

It was nevertheless thought unreasonable to introduce such adjustment to changes in average life expectancy during the period of retirement itself. The pension calculated at the time of retirement is not directly influenced by later changes in average life expectancy after the age of 65. (However, such changes are significant for the automatic stabilization and can thus indirectly influence the size of the pension.)

Evening-out of the pension over the pension period

A principle of the old-age pension system that is often misunderstood is the evening-out of the pension level over time. Indexation of the pension benefit also continues during a person's time as pensioner. Given an increase in average real wages, this would mean that the purchasing power of the pension would rise over time and be at its highest during the final stage of life. It was thought that the vast majority would prefer a smoother distribution of purchasing power over the pension period. The pension is therefore equalized by including a part of the expected income indexation as soon as the first pension payments are made – a kind of ”advance interest”. Technically, annual pension is calculated as an annuity with 1.6 per cent interest, indexed against changes in income index minus 1.6 per cent. The purchasing power of the pension is thus higher at the start and lower towards the end of the pension period compared with if the upward adjustment were to be made in the same way as during active years and without any ”advance interest”.

The norm of 1.6 per cent was based on the assessment that real growth in average pensionable income would be a little above this level under normal circumstances. The risk that indexed recalculation might reduce the pension's purchasing power in certain years was judged to be lower than the opposite likelihood of its rising. However, the total value of the pension viewed over the whole pension period was not affected by this choice: a higher norm would have given a higher initial pension, but in return lower index recalculation.

Gender differences in life expectancy ignored

Statistically, women live longer than men, that is, their pension is paid out over a longer period of time. From a standard insurance point of view, the same pension balance -the same recalculated lifetime earnings - would result in a lower annual pension for a woman than for a man. That is how private pension schemes function. In this case, however, the Riksdag thought that all insured persons should be viewed as making up a single insurance collective and men and women are thus treated equally when annual pensions are calculated. The abstract insurance principle had to give way to the more obvious principle that two persons born in the same year and with the same lifetime earnings at the time of retirement should start with the same annual pension.

Fixed retirement age scrapped

Ever since the first national pension system, the retirement age has been a central parameter in deciding how generous and costly the system is. When the national retirement age was lowered in 1976 from 67 to 65 years, it was in the nature of a welfare reform, and when prior to the 1994 pension reform a return to 67 years retirement age was announced, it was a measure for limiting public spending.

However, the basic principle of the reformed old-age pension system is that there is no fixed retirement age. Old-age pension may be claimed at any time after the age of 61. All incomes are pensionable irrespective of the age at which they were earned. Unlike the ATP system, gainful employment after the age of 65 earns new pension credit.

Nevertheless, the retirement age norm of 65 years continued to be significant in three ways in the new national old-age pension system:

- The benefit level of the reformed system, that is, 18.5 per cent of pensionable income, was assumed to give a pension corresponding to the ATP pension at age 65.
- Guarantee pension may not be withdrawn before the age of 65.
- The annuity divisors are finally fixed for each annual cohort when it reaches the age of 65.
- Meanwhile, it was considered important that employees be given the opportunity to continue working beyond the age of 65. This would allow greater flexibility and make a higher pension a practical possibility, but a longer working life would also be beneficial both to the pension system and to

society as a whole. Therefore the chief rule must be the right to remain in employment up to the age of 67.

2.2.7 Visible distribution features

In the ATP system, it was possible for those who happened to have little or no income at the start of their working lives to compensate for this in their future pension by having a higher pensionable income later in life. Due to the lifetime earnings principle, that was no longer possible in the new system. This represented a problem primarily from the point of view of equality, since women still take greater responsibility for children and thus have lower incomes than men. The Riksdag decided that this situation should be redressed by modifying pension system rules so that pension credit was earned for notionally calculated incomes (childcare years) – so-called pensionable amounts. Thus the essential structure of the pension system remains ”neutral” and the costs for justified distribution features are made visible.

Pensionable amounts are also granted for studies and national service as well as for sickness and activity compensation.

2.2.8 A distribution system financed by individual and employer contributions

The Riksdag decided that the national old-age pension system should retain its role and that raising the overall contribution base was not an option. Thus the national old-age pension system had to be built up mainly as a distribution system, that is, pension disbursements are financed on an ongoing basis by income from contributions. For the major part of pension commitments the generation contract still held.

Old-age pension contributions, along with AP Fund assets (and, eventually, premium pension funds) were to be the only source of financing for income-based pension. Since the pension corresponded to earned pension benefits, no generation would have to pay more into the pension system than they could count on withdrawing as pensioners. In this way generational conflicts would be avoided.

However, this presupposed the payment of pension contributions for all pensionable income. Unlike before, an old-age pension contribution is levied on pensionable social benefits such as sickness allowance and unemployment benefit. This provides strong financial reinforcement to the old-age pension system – necessary for maintaining the principle of a fixed contribution corresponding to benefits. It also means that a cost for various social security systems in the form of earned pension credit is now made visible. Even before, a benefit like sickness allowance gave pension credit, but sickness insurance paid no contribution for this.

A further consequence of contributions matching benefits is that incomes which do not give pension credit will not be forced to pay an old-age pension contribution. Unlike before, when basic pension and ATP contributions were levied on total income, no old-age pension contribution is levied on income over the benefit ceiling (though such income is partially taxed).

The manner in which old-age pension contributions were to be levied became a contentious issue during the preparation of the reform. The Pension Working Group had proposed as a compromise that half the contribution of 18.5 per cent should be taken out as an individual contribution paid by each individual. Two arguments in favour of an individual contribution were put forward. One was based on principle. An individual contribution makes the cost of old-age pension visible to the individual. Individuals can clearly see how a contribution is deducted from their gross salary to help pay for a future pension. Basic pension and ATP contributions had been levied wholly in the form of employer contributions, which, it was argued, concealed the actual cost to the employee. It gave the appearance that the employer paid the contribution, even though it was deducted from the employee's salary.

The other argument in favour of individual contributions was of a practical nature. It is difficult from an administrative point of view - or at least costly – to limit contribution charges to income below the benefit ceiling if they are taken out as employer contributions. To limit extraction of individual contributions to a portion of the income is, on the other hand, a relatively simple administrative task.

At the time of the Riksdag decision on pensions, dividing up the old-age pension contribution into an individual contribution and employer contribution would have required a so-called 'contribution swap', with a reduced employer contribution linked to higher gross salaries. This aroused strong opposition. The conditions changed later during the 1990s when the individual contribution to sickness insurance was dramatically raised as part of budgetary restructuring. This facilitated a 'contribution swap' within the combined contribution base so that the existing individual contribution was transferred to the old-age pension system and the employer contributions were switched over to sickness insurance. Nevertheless, this was not sufficient to allow a division of the contribution base into two equal halves.

2.2.9 Premium pension – elements of individual saving

In the finance plan presented by the government in January 1991, the following orientation was expressed:

> "In order to stimulate a higher level of saving, there is a need for a larger element of funded pension saving in more individualized and insurance-like forms than is the case with the AP Funds."

The same formulation was repeated in the government bill on economic policy introduced by the new government in autumn of the same year.

Obviously there were going to be significant elements of funding in the reformed system. The AP Funds had large assets and the reform in itself led to a strong net financial reinforcement of the pension system. Thus there was scope to introduce an element of premium pension, with individual funding.

An important aim of the premium pension element was to increase the influence of the individual over the pension. There would be strong opportunities to influence the management of the assigned funds through the choice of fund placement. It was assumed this would lead to increased involvement and interest in the pension.

Another aim was to contribute to the supply of risk capital for business. The AP Funds had at that time limited scope for fund placement. It would be easier to give a multiplicity of individually chosen funds greater opportunities to invest in shares than would be possible for the national AP Funds. Later, that argument had less weight, due partly to the liberalization of placement regulations for the AP Funds.

A third argument was risk spreading. The element of premium pension meant that the recalculation of the national income-based pension became dependent on both wage trends in society and on yield on capital.

The size of the premium pension component was determined partly by the total charge base level of 18.5 per cent, partly by the size of the AP Fund after the decision to transfer from the pension system to the national budget. Estimates of long-term financial development of the pension system were decisive in determining the scope of premium pension components. Over a long transitional period, the premium pension would require putting aside money that thus became unavailable for pension payments. This increased the risk that the AP Fund would be insufficient to bridge over any deficits in the system and that automatic balancing would be activated as a result. The final assessment was that the premium pension should be assigned 2.5 per cent of pensionable income.

The more detailed design of the premium pension system consisted of a balance between, on the one hand, a safe management of allocated funds and, on the other hand, freedom of choice and opportunities for the individual to influence that management. The Pension Working Group had stipulated hard-to-reconcile demands concerning not only guaranteed yield, restrictions on foreign investment and the right to change fund manager but also a diversity of funds. In the final version, security aspects were played down in favour of wide freedom of choice and few restrictions on which investment alternatives were allowed.

The alternative - that the choice of premium pension should be between competing pension insurance schemes - was rejected. The total population was to be a single insurance collective. During the saving phase, the premium pension became a pure funded insurance and the premium pension choice is about choosing the fund in which investments are to be managed. Guaranteed yield was not introduced and premium pension money may, despite being one of the safeguards of basic pension protection, be invested in risky assets.

2.2.10 Basic security in the form of guarantee pension

A basic function of the national pension system has long been to ensure a reasonable standard of living in old age also for those who have had little or no income. Pensioners should not have to be tested by the social services for other incomes or capital, but the national pension system should provide an adequate basic standard. The pension decision of 1994 made a fundamental change in the design of this basic protection.

Basic protection can only be designed as (a) a guarantee amount from which other pension incomes are deducted, or as (b) an amount equal for all. On the eve of the basic pension decision of 1946, the political battle lay between these two principles, and a majority supported a basic pension that was equally large for all. When ATP was introduced in 1960, the original premise was that, since it was based on earnings during working life, it was something added on top of basic pension. Consequently, ATP pension was only calculated for incomes above a basic amount, which approximated to the basic pension level.

The basic pension level was eventually deemed to be too low and in 1969 pension supplement was introduced, based on the contrary 'deduction principle'. The pension supplement provided approximately half a base amount extra to the pension, but a krona-for-krona deduction was made against the ATP pension. In practice, this meant that a low income-based pension had no value.

Furthermore, tax regulations contributed to the basic protection. A special basic deduction for pensioners meant that a pensioner paid lower income tax than a working person with an identical income.

With the guarantee pension that resulted from the 1994 decision, the principle of one uniform basic amount was abandoned. Instead, income-based pension forms the base. However, everyone is guaranteed a minimum pension level, and for a person whose income does not reach this level, the guarantee pension provides a top-up. In this way, income pension and basic pension have exchanged places in total pension protection. The principle of the guarantee pension is the same as that of the pension supplement. But one difference is that the deduction from the guarantee amount is not total for income-based pension above a certain level, but is made as 48 per cent of this. Thus income-based pension always adds to the basic level of guarantee pension.

The special basic deduction in the tax return was abolished and guarantee pension levels were adjusted accordingly. Pension incomes were to be taxed in the same way as earned incomes.

In the 1994 bill, it was proposed that deductions from guarantee pension in the new system should also be made for occupational pensions, since the latter had been taken into account when the special basic deduction was calculated. To exclude occupational pensions was considered to be too expensive. Besides, they are obligatory for the individual and have features in common with the public system. However, this coordination between public and contractual pension systems was never carried through. In the final design of guarantee pension, no deduction is made for occupational pensions. The Riksdag considered these pensions to be more in the nature of private insurance schemes and therefore to be treated as such. Thus the band was broken between the national pension and the occupational pension, the latter having been traditionally designed to harmonize with the regulations of the public system. Nevertheless, for guarantee pension paid out to persons born in 1937 or earlier, deductions are indeed made from guarantee pensions for occupational pensions. This is because that group received a pension at the time of the transition to the reformed regulations in 2003 and the special basic deduction for old-age pensioners, which was part of basic protection, was reduced by all pension incomes including occupational pensions. The overriding goal of the recalculation was that the net amount in the new system should as far as possible equal the amount they received in 2002.

While the benefit ceiling in the reformed system was tied to income trends in society, guarantee pension remained indexed to prices. This was done as a matter of principle. The basic level should not follow the general growth in standards of living. As real earnings rise, fewer and fewer people should be dependent on a top-up from guarantee pension in order to reach the minimum level. This contributes to gradually strengthening incentives to work, which among low incomes are weakened by deductions made against income pension. It presupposes that redistribution ambitions to raise living standards for those with low incomes during their working lives can be achieved by supplementing the system with redistribution features similar to childcare years.

2.2.11 An autonomous old-age pension system

After the introduction of ATP in 1960, the national pension system was divided into basic pension and ATP, and each branch included both old-age pension and disability and survivor's pensions. The benefits in each insurance branch were designed in a similar fashion. Basic pension was financed by appropriations from the national budget. There was a special social security contribution for basic pension but it lacked any real connection with basic pension expenditure, and basic pension was an integral part of the national budget. The various ATP benefits were financed by an ATP contribution and by yield from AP Fund assets. The ATP was independent of the national budget and incomes and expenditure were reported outside of the national budget.

The pension reform in 1994 was concerned with old-age pension rules, while survivor's and disability pensions became objects for further investigation. The structure of the national pension system was thereby changed so that income-based old-age pension – income pension and premium pension – was separated off as a unique and autonomous insurance scheme. The thinking behind this was that the type of insurance risk handled by old-age pension, that is, life expectancy, is wholly different from the type of risk handled by survivor's and disability pensions. It was considered easier, not least from the distributive perspective, to design an old-age pension founded on insurance-based principles.

Even in a financial sense, the income-based old-age pension was turned into an autonomous system. Expenditure and contribution income are reported outside of the national budget. The fundamental principle is that income-based old-age pension should not be subject to considerations in the annual budget process. The terms of the insurance – premium and benefits – will remain unchanged and the financial balance will be maintained automatically. On the other hand, the top-up provided by guarantee pension continues to be part of the national budget.

Disbursement liability for survivor's and disability pensions within ATP was transferred from the AP Fund to the national budget.

The insurance-wise and financial autonomy of the premium pension system is evident. The funds paid in and the yield on them may only be used for premium pension. Saving generated within this framework is today regarded – for example in the national accounts – as private saving, and paid-out pensions are reported totally outside the public economy.

The part of the old-age pension contribution relating to income pension goes into the AP Fund, which also finances paid-out pensions. As previously, the AP Fund lies outside the national budget. However, there is a departure from the principle of an autonomous and "self-regulating" system in that income pension payments are taken into account when testing spending against the national expenditure ceiling. But taking action to limit pension expenditure should the expenditure ceiling to be threatened would be entirely against the principle of an autonomous system. There is a further indirect link to the national budget: increased pension expenditure caused by a favourable indexation due to the ceiling limit may lead to demands for reduced expenditure in other government programs.

The pension reform partly redefined the task of the AP Fund. It functions today as a buffer to handle surpluses or deficits in income pension instead of in the ATP system. Some years after the old-age pension reform, an organizational change was made to the AP Fund. It was split up into four equally large funds totally independent of each other. At the same time, the new AP Funds were given a freer investment brief than had been the case for the earlier fund. However, this reform was quite separate from the old-age pension reform, albeit supported by the same parties, and it was carried out against the background of deregulation and the internationalization of the capital market.

The pension reform meant a financial reinforcement of the AP Fund. The income of the fund increased, partly due to the state paying pension contributions for all pensionable transfers and amounts. Furthermore, the responsibility for paying disability and survivor's pension within ATP was transferred to the national budget. The deficit resulting from the gap between contribution income and pension payments which previously existed in the AP Fund and which had to be covered by the fund's yield on investment was thus transformed into a surplus. The strengthening of the AP Fund's current net income meant a corresponding weakening of the national budget. Calculations made immediately prior to the bill setting out the principles indicated that the AP Fund's current balance was greater than what was necessary to cope with foreseeable deficits due to disparity between contribution income and pension disbursements. So in 1994 the Riksdag decided that the AP Fund should compensate the national budget by means of a financial transfer. The size of this compensation was estimated at SEK 300 – 350 billion as per 1 January 1999. The basic premise was that the fund's balance should never fall below the equivalent of one half of pension payments during one year.

How large a transfer to the national budget would be compatible with this requirement was the subject of discussion during the following years. Several factors had to be taken into account: the yield that might reasonably be expected from the AP Fund, the risk of triggering the automatic balancing mechanism, and the remaining demographic threat to ATP pensions. So far, a transfer equivalent to SEK 258 billion on 1 January 1999 has been transferred. A final decision as to whether further amounts should be transferred will be taken together with the decision on how the surplus in the pension system should be distributed.

2.2.12 Transitional rules

The old-age pension system rules affect the insured throughout the whole of their adult lives. To some degree, decisions regarding studies, gainful employment and savings must take into account their possible impact on future pensions. Changed conditions in the pension system mean changed parameters for making such decisions. The closer one comes to retirement, the harder it is to compensate for this. For example, should one save more or work more? In order to wholly eliminate such retroactive impact, regulatory changes would have to be restricted to newcomers to the labour market. But in that case, necessary reforms would only be possible to implement over an unreasonably long period of time. Reforming pension systems is always a compromise between avoiding retroactivity – or what might be perceived as such – and getting new rules in place. In the case of the Swedish pension reform, the compromise consisted of setting an age limit. The rules of the new system apply in their entirety to those born in 1954 or later, that is, those who at the end of 1994 were 40 years old or younger.

For those born before 1937, the old rules still apply, with one important exception: so-called flexible indexing is used even for pensions calculated according to the old rules, though with the aim of adjusting pensions to socio-economic growth rather than spreading out pension evenly over the retirement period. This change in pension indexation may be regarded as an internal ATP system reform. The consequences of this change depend on earnings growth in society. With real growth of average pensionable incomes over 1.6 percent annually, the upward recalculation of pensions will be greater than under the old rules. This has been the case so far.

For the generations born between 1937 and 1954, a gradual phasing-in was chosen, pension benefit being determined by both old and new rules, the new rules increasing in importance the younger the generation. Another difference compared with the old rules is that all people born in 1937 or later may earn new pension credit after the age of 64. This is calculated wholly according to the new rules. Thus the transitional generations enjoy the same conditions of work after the age of 65 as those fully covered by the new system.

3 The national pension system after the reform

The purpose of this chapter is to describe how the national old-age pension system functions today, some fifteen years after the 1994 Riksdag decision on the principles for a reform.[5]

In sections 3.1–3.3, we are told that the national old-age pension now consists of three subsystems and that the reform involved substantial changes to age limits, calculation of pension levels and value protection of pensions.

In section 3.4 there is a description of how the right to income-based old-age pension is gradually built up on the basis of pensionable incomes while at the same time contributions are paid continuously for all incomes and pensionable amounts..

In sections 3.5–3.6 the system for income pension and ATP pension is described. In section 3.7 we tackle premium pension and in section 3.8 guarantee pension.

3.1 Three subsystems

As a result of the pension reform, the system consisting of basic pension and ATP has been replaced by three subsystems:

- Income pension. Under this system, ATP pension is paid to persons born in or before 1937, ATP and income pension are

[5] Appendix 1 describes the series of decisions leading up to the reform and how it has been implemented.

earned by and paid to persons born between 1938 and 1953, and income pension is earned by and will be paid to persons born in or after 1954.
- Premium pension. Premium pension is earned by and paid to persons born in or after 1938.
- Guarantee pension. This system provides basic security within the national old-age pension scheme. Guarantee pension for persons born in or before 1937 differs to some extent from guarantee pension for persons born in or after 1938.

Income pension, ATP pension and premium pension are income-based benefits, since they are determined by pension credit allocated on the basis of the work income of individuals and certain social benefits received by them over their lifetime. The basic rules for the reformed system are found in the Income-Based Old-Age Pension Act (1998:674).

The guarantee pension is determined by the level of income-based pension and is designed as a top-up when the insured's income-based pension is low. Guarantee pension is also payable when a pensioner has no entitlement at all to income-based pension. Provisions for guarantee pension can be found in the Act on Guaranteed Pensions (1998:702).

The transition from the basic pension and ATP system to the new rules for earning and calculating old-age pension is being implemented gradually in accordance with transition rules which result in some differences between different age groups. Under the new rules, pension points credited under ATP system rules remain valid for the old-age pensions of many people.[6]

For persons born before 1938, only pension points credited under the ATP system - together with basic pension under the earlier rules – form the basis of income-based old-age pension. This age group is not in any way affected by the premium pension system.

[6] Appendix 2 provides a short description of the earlier system with basic pension and ATP.

For the *transitional generation*, that is, persons born between 1938 and 1953, both allocated pension points and pension credit earned under the reformed rules determine old-age pension. This is the result of so-called *phasing-in by twentieth parts*. Within this group, the later the birth cohort the smaller the proportion of pension calculated on the basis of pension points and the larger the proportion calculated according to the reformed rules.

A person born in 1938 receives an ATP pension representing 16/20 (80 per cent) of the amount calculated according to earned pension points and an income pension representing 4/20 (20%) of pension credit earned and calculated according to the reformed rules. Those born in 1944 receive 10/20 (50%) of their pension calculated as ATP pension and 10/20 (50%) calculated as income pension. The youngest birth cohort affected by the *phasing-in by twentieth parts* consists of those born in 1953. They receive ATP pension representing 1/20 part of the pension calculated according to earned pension points and an income pension representing 19/20 parts of pension credit calculated according to the reformed rules.

The transitional rules mean that those born in 1954 are the first birth cohort to be wholly covered by the reformed rules governing the earning and calculation of pensions.

3.2 Age limits and annuity divisors

The reform means that several age limits in the pension system have been changed. The lower age limit for withdrawal of income-based old-age pension has been raised from 60 to 61. For entitlement to guarantee pension there is a lower age limit of 65.

In the ATP system, pension points could be earned from the individual's sixteenth birthday onwards up to the year in which the age of 64 was reached. In the reformed pension system there are no age limits, neither downward nor upward. Persons born in 1938 or later who continue to work after the age of 64 also continue to earn pension credit for income pension and premium pension; there is no upper age limit to the earning of pension credit. Moreover, the *phasing-in by twentieth parts* no longer applies to persons in the transitional generation after the age of 65. Pension credit is earned wholly according to reformed rules from the age of 65 onwards.

In both the reformed system and the ATP system, the age at which the pension is withdrawn is crucial, since later withdrawal results in a higher pension level. In the ATP system, basic pension and ATP were reduced if claimed before the age of 65. People who postponed withdrawal until after the age of 65 received a higher level of pension.[7]

In the reformed old-age pension system, the pension level is also affected by the individual's year of birth. Younger cohorts have a longer life expectancy than older ones, which means they will receive, on average, a pension over a longer retirement period. For both income pension and premium pension, the pension level at the time of withdrawal is calculated by taking the accumulated and invested pension rights earned over a person's lifetime and dividing them by annuity divisors. These are based, among other things, on demographic life expectancy data for different birth cohorts. For example, annuity divisors for persons born in 1954 are higher than annuity divisors for persons born in 1952.

One consequence of pensions being calculated using annuity divisors is that younger birth cohorts, in order to achieve the same percentual pension level as older cohorts, must compensate their higher average life expectancy with a longer period of gainful employment before drawing their pension.

On average, a person born in 1930 who retired in 1995 at the age of 65 could look forward to just over 17 years as a pensioner. According to one estimate made in 2008, a person born in the 1960s is likely to have a little more than three additional years of

[7] Under the earlier rules, so-called premature withdrawal of basic pension/ATP reduced pensions by a certain percentage per month up to the month of a person's 65th birthday, and so-called postponed withdrawal after the month in which the person reached the age of 65 up to the month the person reached 70 increased the pension by a certain percentage each month. In the reformed pension system there is no upper age limit for pension withdrawal.

life after the age of 65. In order to compensate for this, persons born in the sixties must work for just over two additional years. Meanwhile, on drawing their pension they may nevertheless expect to have a longer life as a pensioner than someone born in 1930.[8]

Within the income pension system, according to the Income-Based Old-Age Pension Act (1998:674), annuity divisors are to be determined before the birth cohort's sixty-first year on the basis of life expectancy statistics. The annuity divisors are adjusted before the birth cohort's sixty-fifth year to reflect ongoing changes in life expectancy statistics. After the persons in the birth cohort reach the age of sixty-five, no further adjustments are made to the annuity divisor for that cohort.

The premium pension system also uses annuity divisors. These are decided by the Swedish Pensions Agency according to so-called 'standard insurance practice' as regulated in the Insurance Business Act (SFS 1982:713). The Swedish Pensions Agency is the insurer for the premium pension system.

The use of annuity divisors ensures that the reformed old-age pension system largely reflects demographic trends.

3.3 Pension value over time

An important feature of various old-age pension insurance systems is how pension rights and pensions are affected on the one hand by rising prices, on the other by shifts in the real wages of the gainfully employed and thus in general living standards in society. During the earning period, it is a matter of how earned pension rights over the years may 'provide a yield'. During the retirement period, it is a matter of how the pension is recalculated to take into account price trends and whether the pension is affected by developments in living standards, positively or negatively.

[8] The Swedish Social Insurance Agency (2008) *Pension Levels and Indicators of Welfare Dependence* (report to Ministry of Health and Social Affairs S2008/2496/SF)

In the system with basic pension and ATP, price trends were taken into account by calculating pensions at withdrawal on the basis of the price level that year. Subsequently, basic pension and ATP were recalculated to reflect price trends (the price base amount) at every year-end. That meant the purchasing power of the pension was secured. But the pension level remained the same in real terms. Old-age pensioners thus did not share in current growth in living standards during their period of retirement.[9]

In the income pension system, both current price trends and current improvements in living standards in society are taken into account not only during the earning period but also during the period of retirement. During the earning period, the accumulated income pension credit is recalculated using an *income index.* This index reflects the development of average income of persons of working age. During the retirement period, income pension and ATP pension are influenced both by price developments and by current growth in living standards through the application of the so-called *economic adjustment index*.[10] During the period 2002-2009, pensioners with income pension and ATP pension have been compensated for inflation and received real increases in pension levels for seven years out of eight. In 2010. however, pensions decreased by 3 per cent. Over the period 2002-2010, pensions have seen an overall increase in real terms of 2.5 per cent.

Within the premium pension system, it is the capital return on private money invested in premium pension funds that is responsible for inflation-proofing during the earning period. This is also true of the pension disbursement period provided the individual chose the alternative with continued fund insurance after withdrawal. If the individual chose instead to withdraw the premium pension as a traditional pension insurance, premium pension is paid out as a guaranteed nominal amount together with a supple-

[9] During the earning period, however, it may be said that growth in living standards was to some extent taken into account, since ATP was calculated on the basis of the average of the 15 best ATP years. In Appendix 2, there is a description of the ATP system.
[10] Economic adjustment indexation is explained in section 3.5.

mentary amount depending on results in the Swedish Pensions Agency life insurance business.[11]

For guarantee pension, indexation linked to price trends had been retained.

Calculating the income index

In order for the pension system to take into account average earnings growth among the gainfully employed, an income index is fixed at the start of each year. This reflects changes in real income during the three preceding years as well as price developments during the preceding year. Work income above the earning ceiling is also included in the calculation of the income index, though only after deduction of an amount corresponding to the national pension contribution of 7 per cent paid by the insured.

The income index for 2010 is calculated partly on the basis of average real wage growth and certain social benefits received by all persons aged 16–64 years during the years 2007–2009 divided by the number of such persons each year, and partly on the basis of price developments during the twelve-month period prior to the month of July 2009. The base year for the income index is 1999, that is, that year the index was set to 100. The index has since risen, so that in 2010 it amounted to 139.74.

One consequence of the index design is that the income index need not be changed at the same rate as the sum of earned incomes (the wage sum), since the index is also influenced by changes in the number of persons with pensionable incomes and by changed benefit levels within social insurance and unemployment insurance.

[11] Premium pension is described in more detail in Section 3.7.

The income base amount and a changed earnings ceiling

The creation of the income index led in turn to the creation of an *income base amount*. At the same time, the term *price base amount* was introduced for the amount reflecting price developments.

The income base amount determines, among other things, how large a share of the individual's earnings is insured within the national system. The ceiling for annual accrual of income-based pension is calculated in the reformed system as 7.5 multiplied by the income base amount. Income indexation of the earnings ceiling was introduced in 2002.

The development of the income index and earnings ceiling since 1999 is shown in the following table. The table also shows by way of comparison what the earnings ceiling would have been if the ceiling rule had not been changed.

Year	Income index	Earnings ceiling	Earnings ceiling if rules had not been changed
1999	100	279 000	279 000
2000	101.73	279 750	279 750
2001	103.20	282 750	282 750
2002	106.16	291 000	290 250
2003	111.79	306 750	295 500
2004	115.64	317 250	300 750
2005	118.41	324 750	302 250
2006	121.65	333 750	303 750
2007	125.57	344 250	308 250
2008	131.18	360 000	313 500
2009	139.26	381 750	327 000
2010	139.74	382 250	332 250

In the ATP system, as of 1995, the earnings ceiling was calculated as 7.5 multiplied by *the increased price base amount*. This special base amount was introduced in connection with the adjustments to the calculation of old-age pension decided in response to the economic crisis in the 1990s.[12] Even after the pension reform, the increased price base amount is used to calculate pension points for the birth cohorts in the transitional generation where this still applies.[13]

Financial stability

The method chosen by an insurance system to secure the value of pension rights and pensions is crucial for the system's financial stability, that is, its long-term ability to finance its commitment. One weakness in the ATP system was that in times of negative real earnings among the working population, contributions to the pension system tended to claim an ever greater share of the wage sum, since basic pension and ATP according to the rules were secured in respect of purchasing power. This lack of *socio-economic indexation* was apparent during the economic crisis of the early 1990s and it became necessary to deviate significantly from the current calculation rule-book for basic pension and ATP.

The reform has provided the *income pension system* with a battery of features ensuring that it is able to finance its commitment: a clear link between contributions and benefits, demographic flexibility and the economic flexibility created by indexation. This provides the system with a high capability of self-regulation in the face of economic and demographic changes. In addition, the AP Fund constitutes a buffer for the system.

However, the connection between the commitment of the income pension system and its financing is not absolute. If total income from contributions does not grow at the same rate as aver-

[12] During the 1990s, the recalculation of the base amount relative to actual price developments was subdued over a period of years until the very large deficits in the national budget had been reduced. Nevertheless, an unreduced base amount was to be used for the calculation of ATP points and of the earnings ceiling. This came to be called the increased price amount.

[13] In 2010, the price base amount is SEK 42 400, the increased price base amount is SEK 43 300, and the income base amount is SEK 51 100.

age earnings, total pension rights will increase more than total system income. If this continues over a longer period, the financial stability of the system may be jeopardized. For this reason, the income pension system includes a further safeguard in the form of the *automatic balancing mechanism*. This is based on the income statement and balance sheet that are drawn up annually for the system.[14]

The premium pension system is a funded system, where contribution revenue is invested on an ongoing basis in securities that provide economic yield over time. It is the assets in the premium pension funds and the yield from these that determine the level of premium pension. Developments in capital markets have a direct impact on individual fund saving and future pension level. Pension savers themselves bear the economic risk of their investments.

As mentioned above, *the guarantee pension system* is index-linked to the price base amount. The motivation for this is partly that old-age pensioners with guarantee pension should be protected from real deterioration even in times when the income index drops as a result of falling real earnings in society. As the long-term income level in society rises, the scope of the guarantee pension is expected to gradually decrease.

3.4 From contribution to pension credit

The lifetime earnings principle is fundamental to the reformed system – calculation of the national income-based pension must take into account all income during a lifetime, including certain social benefits. For every year that an individual receives *a pensionable income,* pension rights accrue. During the transitional phase, birth cohorts in the transitional generation continue to be allocated pension rights according to ATP rules up to the year in which the members of the birth cohort reach the age of 64.[15]

[14] This is described below in section 3.6.

[15] In 2010, those born in 1946 reach the age of 64. During this year, those born between 1946 and 1953 can still be allocated pension points.

As a further basis for annual pension credit, there are *the pensionable amounts*. These compensate for some undesirable effects of the lifetime earnings principle. Such effects include the lower incomes normally associated with time spent as parents of small children and during periods of study and national service. Recipients of sickness or activity compensation are also allocated a pensionable amount during the time they receive the compensation. The various amounts are not in themselves incomes but serve as a basis for calculating the pension credit to be allocated. The amounts are added to pensionable income when pension credit for the year is determined.[16]

Payment of contributions

Income-based pension is contribution-based. Annual pension credit is determined on the basis of a contribution of 18.5 per cent of the individual's *pension base*. The pension base includes income from gainful employment, certain social benefits and, when applicable, pensionable amounts.

The individual makes a *national pension contribution* to the pension system of 7 per cent of his/her salary and of income from social and unemployment insurance and certain other social benefits. The payment of the contribution is made in conjunction with preliminary tax collection.[17] The pension contribution itself does not give pension credit; it is therefore deducted from taxable income, and the contribution amount is not included in the pension base. This means that a national pension contribution is paid on taxable income up to 8.07 income base amounts. After a deduction of 7 per cent, this gives a maximum pensionable income of 7.5 income base amounts.

[16] The calculation rules for the various pensionable amounts are described in Chap. 1. The number of persons for whom pensionable amounts were determined in 2008 is shown in Appendix 3.
[17] As a result of rules gradually introduced during the years 2002–2007, individuals today receive a tax reduction for contribution amounts.

For employees, employers pay an *employer contribution* for old-age pension of 10.21 per cent of each employee's salary. Self-employed persons pay in addition to the national old-age pension contribution an individual self-employed person contribution of 10.21 per cent corresponding to the employer contribution. These contributions are also paid on salaries and incomes of self-employed persons that exceed the limit of 8.07 income base amounts. But since earnings exceeding this limit do not give pension credit, that portion of the contribution payment constitutes a tax. The equivalent amount is therefore transferred to the national budget instead of to the pension system.

The state pays a *state old-age pension contribution* to the pension system, both for social benefits that qualify for pension credit (10.21 per cent) and for pensionable amounts (18.5 per cent).

The paid-in contributions are shared out in such a way that the 16 percentage units pertaining to the income pension system are transferred to the AP Funds. The 2.5 percentage units pertaining to premium pension are transferred to *temporary management* at the National Debt Office until such time as the money becomes available for individual pension savers to invest it in premium pension funds.[18]

The point of the reform has been to create a clear connection between contributions and benefits. Meanwhile, the financing of future pensions has been strengthened by the fact that contributions are paid in on an ongoing basis corresponding to all accrued pension rights.[19]

[18] This distribution of paid-in contributions applies in full to those born in or after 1954. For those born between 1938 and 1953, the distribution is influenced by the twentieth-parts phasing-in. For a person born in 1946, 1.5 percentage units (12/20 multiplied by 2.5) of contributions are paid to the premium pension system and 17 percentage units (18.5 minus 1.5) to the AP funds.

[19] Basic pension and ATP were also largely financed by contributions, but there was no direct connection between pension level and the sum of contributions paid in during active working life. Furthermore, no contributions were paid to the ATP system for pensionable social benefits.

Annual pension credit

As a part of income taxation, the Swedish Tax Agency determines an individual's pensionable income and the Swedish Pensions Agency calculates the pensionable amounts that an individual may be entitled to. The sum of pensionable income and pensionable amounts constitutes the pension base. This may not exceed 7.5 income base amounts. By multiplying the individual's pension base by 18.5 per cent, the annual pension credit is established for income-based pension.[20]
As a result of these decisions

- new pension credit is allocated to the individual's income pension account
- pension points for ATP pension are allocated to persons in the transitional generation up to the year in which they reach the age of 64[21]
- new pension credit is allocated for premium pension. Funds are then transferred from temporary management at the National Debt Office to the Swedish Pensions Agency system so that individuals may decide which investments to make in premium pension funds.

The decisions appear in the *orange envelope* with an annual value update that is distributed to those earning an old-age pension in the national system.[22] The envelope also reports on how the individual's combined pension credit in the income pension and pre-

[20] Taxable income has been earned previously. Pension credit determined according to the statement sent out at the beginning of 2009 thus referred to income from gainful employment during 2007.
[21] Pension points will be determined within the income-pension system up to 2017, when those born in 1953 reach the age of 64.
[22] The envelope is sent to all those born in or after 1938 who are at least 21 years old and resident in Sweden. It is also sent to people younger than 21 who have earned pension credit and to people living abroad who have earned pension credit.

mium pension systems has changed over the past year. It also contains a forecast of the individual's old-age pension.[23]

3.5 Income pension and ATP pension

Earning a pension in the income pension system

In 2009, the statement in the orange envelope for an average person looked like this:[24]

Changes in your pension account for income pension during 2008	SEK
Value 2007-12-31	639 035
Pension credit added for 2007	28 956
Inheritance gain	1 987
Charge for administrative costs	-156
Change in value	40 140
Value 2008-12-31	689 622

Pension credit added

Pension credit for income pension is calculated as pension base in the form of pensionable earnings and any pensionable amounts multiplied by 16 per cent. For cohorts born between 1938 and 1953, the calculation is influenced by twentieth-part phasing-in. For example, the annual right to income pension of a person born in 1946 is calculated as 12/20 of 16.0 per cent of the pension base.

[23] As of the financial year 2001, the Swedish Insurance Agency publishes a comprehensive annual report on the national old-age pension system. This is now referred to as *Orange Report* for the particular year.
[24] The table is based on information in what the *Orange Rapport 2008* calls the Average Swede's envelope.

Inheritance gains

In an old-age pension insurance system, assets are redistributed from individuals with shorter-than-average life spans to those who live longer than average. This is also true of the income pension system. Every year during the earning period, deceased persons' pension balance is shared out among survivors in the same birth cohort in the form of *inheritance gains*. This is distributed proportionately to the recipient's pension balance. The inheritance gains reported in the Orange Envelope distributed at the start of 2009 came from the distribution of pension assets of persons who had died during 2008.

Charge for administrative costs

Administrative costs for the income pension system at the Swedish Tax Agency, Swedish Social Insurance Agency and other authorities are financed by deducting a certain percentage each year during the earning period from the individual's pension balance. In 2008, this deduction for expenses amounted to 0.226 per cent. The deduction is only made up to the time that individuals claim their income pension.

Change in value

The item 'Change in value' indicates how the value of the pension balance has developed over the year. The orange envelope distributed at the start of 2009 showed how the closing balance for 2007, the pension credit earned during 2007, and the amount of inheritance gains, are recalculated in accordance with the current income index at year-end 2008/2009. In addition, reductions had been made for administrative costs during 2008.

Summing up the individual's pension balance reveals the yield from annual pension rights for income pension. The following table shows the annual yield during the years 1995–2010 resulting from changes in the income index:[25]

Year	Per cent
1996	1.8
1997	1.8
1998	2.8
1999	3.4
2000	1.7
2001	1.4
2002	2.9
2003	5.3
2004	3.4
2005	2.4
2006	2.7
2007	3.2
2008	4.5
2009	6.2
2010	0.3

Average yield over the whole period was 2.9 per cent, with an average annual variation of 1.5 percentage units.[26]

The pension balance of an individual may include pension credit earned prior to the reform. The pension rights registered as ATP points during the years 1960–1994 were converted in the spring of 2000 to pension credit for income pension in accordance with a retroactive decision. In order that pension rights in the form of ATP points might provide yield in accordance with the principles of the reformed system, a series of income indexes were calculated from 1960 onwards. The income index for this first year was set at 6.54.

[25] Swedish Social Insurance Agency *Orange Report 2008*.
[26] The variation is calculated as a standard deviation.

Pension points

For persons in the transitional generation still below the age of 65, the annual orange envelope also contains information on pension points for ATP pension registered on the basis of pensionable income. Since the earnings ceiling for income pension and ATP pension is now tied to the income index, the highest possible score is no longer 6.5 as in the ATP system. For incomes earned in 2010, maximum pension points are 7.85.

Withdrawal of income pension

The first year income pension is to be paid out, the pension level is calculated by dividing the pension balance by the annuity divisor. As mentioned in section 3.2, this divisor is partly influenced by the individual's age at the time of withdrawal and by remaining life expectancy in the year of withdrawal for the birth cohort to which the individual belongs. Remaining life expectancy is calculated on the basis of observed mortality over the past five years and is the same for men and women.

An important choice facing reformers was how the income pension system should take into account future income developments during the individual's retirement period. In principle, an insurance system for old-age pension may be designed in various ways to deal with this.

In many pension systems, the pension level after withdrawal is recalculated only in accordance with price trends at coming year-ends. This was true of the ATP system but was not an alternative seriously considered for the reformed pension.

One possible alternative would have been to calculate income pension at withdrawal using an annuity divisor that solely reflected remaining life expectancy and then let the pension level be recalculated according to the income index at coming year-ends. This would have meant the pension level in real terms being at its lowest at the start of the retirement period and at its highest towards the end (provided the income index had continued to develop positively).

In order to create a system that both ensured a reasonably stable real pension level over the whole retirement period and also allowed pensioners a share in expected continued growth in real earnings over the long-term, the alternative opted for was *economic adjustment indexation.* This is a combination of the two above-mentioned alternatives. In the year of withdrawal, income pension is calculated using an annuity divisor that partly takes into account life expectancy, partly provides an *advance payment* on future earnings growth. This advance is based on a so-called *growth norm* of 1.6 per cent.

Economic adjustment indexation means that the annuity divisor is lower and the pension higher at the time of withdrawal compared with an annuity divisor that only takes into account life expectancy. If the change in the income index every year-end during the retirement period should in fact be 1.6 per cent, the pension level would be constant in real terms for all years.

In practice, the change in the income index will vary from year to year. This means that when real change in the income index at year-end is less than 1.6 per cent, *economic adjustment indexation* produces a recalculation of income pension that is lower than that of indexation exclusively tied to price developments. Conversely, if real change in the income index at year-end should exceed 1.6 per cent, the pension will be recalculated upwards more than would be the case using price indexation alone.

Fixed annuity divisors

As the birth cohort reaches the age of 61, annuity divisors are determined on the basis of current life expectancy statistics for those years the persons in the birth cohort are aged between 61 and 64. When the birth cohort reaches the age of 65, new annuity divisors are determined on the basis of fresh life expectancy statistics. These annuity divisors then remain fixed for the rest of the birth cohort's retirement period.

	Age				
Cohort	61 years	62 years	63 years	64 years	65 years
1938	17.87	17.29	16.71	16.13	15.56
1939	17.94	17.36	16.78	16.19	15.62
1940	18.02	17.44	17.86	16.27	15.69
1941	18.14	17.56	16.98	16.39	15.81
1942	18.23	17.65	17.06	16.48	15.89
1943	18.33	17.75	17.16	16.58	15.99
1944	18.44	17.86	17.28	16.70	16.11

	Age				
Cohort	66 years	67 years	68 years	69 years	70 years
1938	14.99	14.42	13.84	13.27	12.71
1939	15.04	14.47	13.89	13.32	12.76
1940	15.11	14.54	13.96	13.39	12.82
1941	15.23	14.65	14.08	13.50	12.94
1942	15.31	14.74	14.16	13.59	13.02
1943	15.41	14.84	14.26	13.68	13.11
1944	15.54	14.96	14.38	13.80	13.23

Withdrawal of ATP pension

Under the transitional rules, pensioners born between 1938 and 1953 receive, in addition to income pension and premium pension, ATP pension in accordance with the twentieth-part phasing-in. At the time of pension withdrawal, ATP pension is calculated in principle according to former rules for basic pension and ATP, although taking into account the number of twentieth parts associated with the birth cohort.

For pensioners in the transitional generation, there is also a *special guarantee rule*. This means that a calculation is made at withdrawal of what the total pension from the income pension system would be if it were to be exclusively calculated according to ATP rules and with ATP points earned by the individual up to 1994, the year the reform was passed by the Riksdag. If the pension amount according to this calculation is higher than the amount from the twentieth-part phasing-in, compensation is paid in the form of a so-called guarantee supplement.[27]

Pensioners born in 1937 or earlier draw income-based pension solely in the form of ATP pension. In 2003, when pensions began to be paid out in accordance with the reformed rules to this age group, those in the age group were 66 or older. At this point, basic pension and ATP were converted to ATP pension.[28]

Annual recalculation of income pension and ATP pension

At every year-end, the income pension and ATP pension to be paid out is recalculated according to the rules of *economic adjustment indexation* described above.

Since the calculation of income pension at withdrawal includes an advance payment equivalent to 1.6 per cent of annual earnings growth, *economic adjustment indexation* means the pension is recalculated at year-end of each succeeding year based on changes in the income index minus the prepaid interest (the norm) of 1.6 per cent.

Economic adjustment indexation also applies to ATP pension, unlike basic pension and the old ATP, which were recalculated to reflect only price developments.[29] This means that ATP pension

[27] For persons in the older transitional generation birth cohorts who claimed old-age pension in the mid-first decade of the 21st century, the special guarantee rule affected approximately 30 per cent, in the majority of cases by marginal amounts.
[28] Older pensioners with a low supplementary pension received guarantee pension in addition.
[29] However, supplementary pension drawn before the individual reaches the age of 65 is recalculated to reflect changes in the price base amount. The transition to economic adjustment indexation takes place the year the person reaches the age of 66. (In the case of

can increase in real terms, even if not at the same rate as the income index. Conversely, it can also decrease in real terms if income index development is negative.

At year-end 2009/2010, *economic adjustment indexation* functioned as follows:

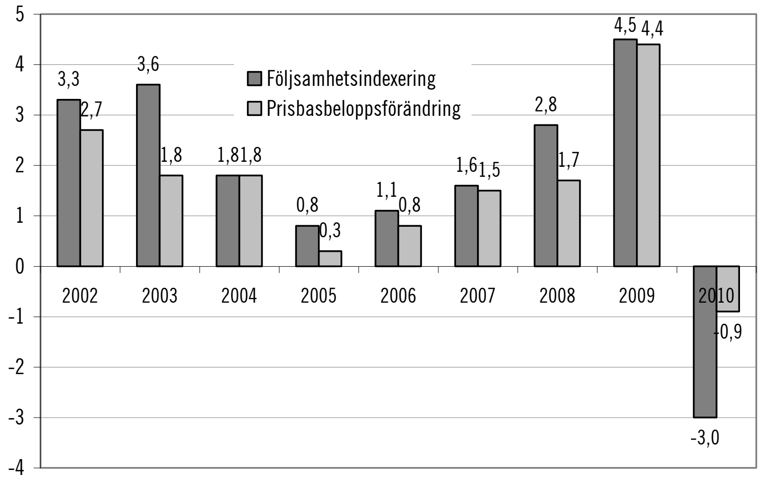
- The income index for 2010 (139.74) was divided by the income index for 2009 (139.26), which gave 1.003. Average income had thus increased by 0.3 per cent.
- The ratio between the income index for 2010 and 2009 was divided by the norm 1.016, which gave 0.988. Thus the prepaid interest of 1.6 per cent had been subtracted and income pension and ATP pension recalculated by -1.2 per cent.
- At year-end 2009/2010, it was also necessary to activate automatic balancing (see section 3.6) for the first time. The balance ratio was set at 0.9826. *The economic adjustment indexation* ratio of 0.988 was multiplied by 0.9826, which gave 0.97. Income pension and ATP pension are therefore recalculated as a whole by -3,0 per cent.

Results of economic adjustment indexation

Economic growth during the first decade of the 21st century ensured that the transition to *economic adjustment indexation* produced real-term improvements for pensioners. During the years 2002–2010, the level of income pension and ATP pension increased every year – except for 2004 and 2010 – more than would have been the case if a recalculation based on the price base amount had been used. The real increase during the period was 2.4 per cent.

premature withdrawal, moreover, the monthly amount has been reduced in accordance with the rules for reduced withdrawal in the ATP system.)

The following diagram shows the indexation of supplementary and income pensions since 2002 and compares this development with changes in the price base amount:[30]



After the transition to *economic adjustment indexation,* income pensions and ATP pensions will reflect earnings growth among the working population in both good and bad times. The importance of earnings growth to both employed persons and pensioners means that different generations have a common interest in sound economic growth.

The balance ratio and the buffer fund in the income pension system

The income pension system is a redistribution system founded on a contract between generations whereby younger generations always provide the pensions of older generations. The income

[30] Press release from the Swedish Social Insurance Agency, August 2009.

pensions and ATP pensions that are paid out are financed on an ongoing basis by contribution income paid into the system.

Within the income pension system, the reform has created a strong link between earned pension rights and the contributions financing pension payments. However, the link between liabilities and assets in the income pension system is not absolute. If the sum of contribution payments fails to grow at the same rate as average earnings, pension commitments will outgrow total income to the system. If this continues over a longer period of time, the financial stability of the system will be at risk.

The automatic balancing mechanism

It is critical to long-term financial stability that the income pension system commitment – the pension debt – is not allowed to exceed the system's assets other than temporarily. The automatic balancing mechanism is a rule that stipulates in advance when and how an imbalance between system commitment and assets is to be restored. The aim is to ensure that pension payments may be sustainably financed using a fixed contribution rate of 16.0 per cent.

The annuity divisors with their link to average life expectancy trends and to economic growth, make the pension system highly stable financially. In spite of this, some features of the system allow it under certain circumstances to get out of balance, so that gains and losses do not cancel out each other. This is true of certain features of the regulatory system that are not financially optimal but have been chosen for social reasons. One example is the way pensions follow the development of average earnings in society despite the fact that in the long term it is overall and not average earnings that determine the system's finances. However, the average-based method was adopted because it was thought fairer if pensions followed the earnings growth of working people. Another example is the fixed annuity divisor: the annuity divisor does not change after the age of 65 even if average life expectancy increases during the retirement period. As a result of these 'deviations', the system may end up being under-financed. To deal with this scenario, the automatic balancing mechanism was introduced.

The insurance-based nature of the reformed income pension system makes it possible to calculate the system's assets and liabilities in an annual financial report. On the basis of the annual report, a *balance ratio* is determined. This consists of the ratio between the assets and liabilities of the system. The balance ratio is determined for the year following that covered by the financial report.[31]

If liabilities in the annual report exceed the value of assets, the balance ratio for the following year will be less than one. In that case, a so-called balance index comes into play: the change in the income index is multiplied by the balance ratio. Thus the recalculation of both pension assets and pension disbursements becomes somewhat less than would be the case if income index and *economic adjustment indexation* were applied in full.

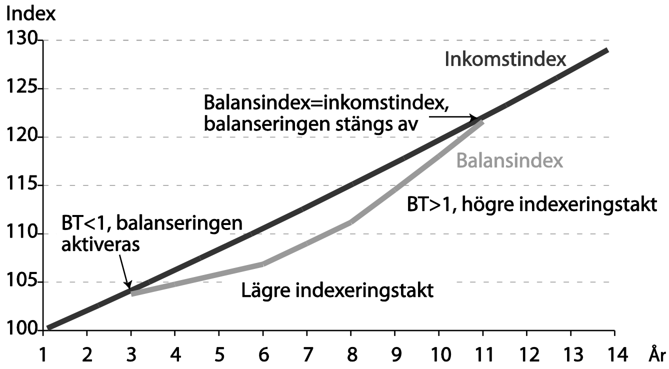
If, for example, the change in income index is 4.5 per cent and the balance ratio is set to 0.9950, the balance index will be 3.9.[32] In that case, pension assets increase by 3.9 per cent instead of by 4.5 per cent and *economic adjustment indexation* of outgoing pensions is 2.3 per cent instead of 2.8 per cent.

If the balance ratio the following year again exceeds one, upward adjustment is begun so that the income index eventually returns to the level it would have had if the balance mechanism had not been activated.

[31] Under certain circumstances, the system may end up accumulating surpluses so that the balance ratio exceeds level one over a long period and by a wide margin.. The Swedish Government Official Report, SOU 2004:105 *Distribution of surplus in the income pension system*, contains proposals for methods of determining such surpluses and distributing them to the insured.

[32] Själva beräkningen sker på följande sätt: 1,045 x 0,9950 = 1,039, vilket ger en uppräkning med 3,9 procent.

The following diagram illustrates the sequence:



System assets including the buffer fund

The claim of the income pension system on future contribution revenue is the largest item on the asset side. The value of future contribution revenue is called *the contribution asset.* This is based on the intergenerational contract that underpins a redistributive system. The contract has been secured by the decision of the Riksdag to approve compulsory pay-as-you-go contributions to the national pension system.

The contribution asset is evaluated insurance-wise by multiplying average contribution income over recent years by system *turnover time.* The latter represents the average time from when pension credit is earned until it is paid out as income pension.[33] The longer the turnover time, the larger the pension debt that can be financed by contributions. The contribution asset shows how large a pension debt future contribution flow is able to finance. In the annual financial report of the income pension system in 2008, the value of the contribution asset amounted to SEK 6 477 billion.

On the asset side there is also *the buffer fund* in the form of the First - Fourth AP Funds and the Sixth AP Fund. The AP fund

[33] Turnover time may also be defined as the time a krona on average remains in the system.

system arose in connection with the pension reform of 1960 when the ATP (National Supplementary Pension scheme) was first introduced. The intention was, in part, to maintain favourable conditions for long-term financing of pension expenditure and to build up a buffer in order to even out short-term discrepancies between contribution income and pension payments.

Subsequent to a reorganization of the AP fund system carried out in 2000, the First – Fourth AP Funds are now an integral part of the income pension system, receiving payments of pension contributions each month while financing pension disbursements. The assets of the Sixth AP Fund are also included in the income pension system's buffer fund, even though this fund has a different brief compared with the four other AP funds.[34] The value of the buffer fund stood at SEK 707 billion in the annual report for 2008.

The capital in the First - Fourth AP Funds is to be administered in such a way as to ensure the greatest possible benefit to the income pension system. Thus management focus is to be primarily on the system's obligations. The aim is a high rate of return in the long term in relation to the investment risk. Furthermore, the role of the Funds as a buffer motivates the requirement that they maintain liquidity.

The reform has clarified the role of the AP Funds in the national pension system inasmuch as the funds' assets are included in the calculation of the balance ratio. Originally it was the value on 31 December that was used. However, the Pension Group decided that the buffer fund value should be calculated as an average of the values of the three preceding years as per 31 December, starting with the calculation of the balance ratio for 2010. The motive for the change was to smooth the value so that dramatic stock market fluctuations would be spread out over several years. Thus these have a direct influence on the balancing mechanism, The task of the First–Fourth AP Funds is, as far as possible within

[34] The funds are not to have any commercial or economic policy objectives in their management. On the other hand, environmental and ethical aspects are to be taken into account when investing, without renouncing the overall goal of high yield.

the scope of their influence, to avoid activation of the balancing mechanism, though not in any narrow, short-term sense. [35]

Liabilities of the system

The total pension debt in the income pension system consists of two parts – the debt to the active population, that is, those who have not yet started to receive their pensions, and the debt to those already receiving a pension.

The pension debt to the *active population* relating to income pension is the sum of pension assets reported each year in the orange envelope sent to the insured together with an estimate of earned pension credit over the past calendar year. In the annual report for 2008, this debt amounted to SEK 5 157 billion. The pension debt to the active population relating to ATP pension is calculated using a special calculation model and was estimated to be SEK 806 billion at year-end 2008. The ATP pension debt to the active population is gradually decreasing and will in principle disappear after 2018.

The pension debt to *pensioners* for ATP pension and income pension is calculated by totalling all pension payments in the month of December one year and multiplying by twelve for each birth cohort of pensioners. This gives theoretical annual amounts. For each birth cohort, the annual amount is multiplied by the birth cohort's average economic life-span. After that, the estimated pension debt of all birth cohorts is totalled.[36] The pension debt to pensioners for ATP pension in 2008 amounted to SEK 1 896 billion and the debt to pensioners for income pension to SEK 375 billion.

In total, the pension debt in the income pension system in 2008 amounted to SEK 7 428 billion.

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[35] The mission of the Funds was stated in the government bill 1999/2000:46 *The AP Fund in the reformed pension system*. The government informs annually about AP Funds' activities in a written report to the Riksdag, such as Report 2008/09:130 *Account of AP Funds' activities up to 2008.*

[36] The measure of economic life-span is based on the statistics of paid-out pensions.

Annual result

The annual result for the income pension system is partly influenced by current contribution income and disbursements of income pension and ATP pension. In 2008, income from contributions amounted to SEK 203 billion and outgoing pension payments to SEK 199 billion. Net income from contributions was thus positive in 2008, although it was less than in 2007. When the large birth cohorts born in the 1940s claim their pensions in greater numbers, net income from contributions will be negative.

The income side of the system also includes yield on the AP Funds' capital assets. On the expenditure side, there are annual costs for insurance administration at the Swedish Social Insurance Agency and the Swedish Tax Agency as well as internal administrative costs for the AP Funds.[37]

In addition, the annual result is influenced by changes in contribution assets and pension debt and thus by demographic and socio-economic factors.

In 2008, the average income increased more than the sum of incomes in society. The average income affects the growth of the pension debt, while the sum of incomes drives the development of contribution revenue and thus how the value of contribution assets develops. The difference between the change in average income and the sum of incomes was one reason why the result for 2008 showed a deficit. The result for 2008 was also impacted negatively by the fact that turnover time fell by two months, which meant an increased debt of SEK 33 billion.

In 2008, the continuing increase in average life expectancy meant that pensions would have to be paid out 27 days longer than in the preceding year. This increased the size of the pension debt by SEK 27 billion. Moreover, the positive development of the income index led to the pension debt increasing by SEK 385 billion.

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[37] In addition there are the AP Funds' net reported capital management costs for financial fees, brokerage, etc. These costs are not deducted as administrative costs from the pension assets for income pension but are deducted directly out of AP Funds' yield.

The effect of the deficit of SEK 82 billion was that the accumulated surplus in the income pension system fell from SEK 18 billion at the start of 2007 to minus SEK 243 billion one year later.

Development of the income pension system since 2003

The following table shows the development of the income pension system 2003–2008:

SEK billion	2003	2004	2005	2006	2007	2008
Buffer fund	577	646	769	858	898	707
Contribution assets	5 465	5 607	5 712	5 945	6 116	6 477
Total assets	6 042	6 253	6 490	6 803	7 014	7 184
Pension debt	5 984	6 244	6 461	6 703	6 996	7 428
Accumulated surplus	58	9	28	100	18	-243
Balance ratio	1.0097	1.0014	1.0044	1.0149	1.0026	0.9672*
(set for year)	(2005)	(2006)	(2007)	(2008)	(2009)	(2010)

* Legislative change after the publication of the Orange Report for 2008 resulted in the balance ratio being set to 0.9826

In the annual report for 2008, the value of debts exceeded assets by 3.28 per cent, corresponding to a balance ratio of 0.9672.

3.6 Premium pension

Earning premium pension

Savers in the premium pension system are those people born in 1938 or later who have accrued pension credit in the national pension system on the basis of incomes earned in 1995 or later.

For persons born in 1954 or later, pension credit in the premium pension system is calculated as 2.5 per cent multiplied by the pension base.[38] For persons in the birth cohorts born between 1938 and 1953, the calculation is influenced by the twentieth-part phase-in up to the year the person reaches the age of 64.[39]

Premium pension is to be financed by the private pension capital created as a result of individuals' pension contributions gradually being invested in fund shares in the premium pension system. This capital will then produce yield in line with developments of the value of the fund shares on the capital market.

The premium pension system is to function according to insurance-based principles. This means that the insurance activities must comply with the provisions of the Insurance Companies Act (1982:713) relating to technical provisions, the calculation of life insurance provisions and actuarial guidelines and calculation bases.

The right to premium pension falls under the protection of property in the Instrument of Government. Civil legislation concerning, for example, division of property or gifts are not applicable to the right to premium pension. It is possible annually to transfer premium pension rights between spouses and registered partners and there are regulations for survivor protection during the retirement period. The pension reform also proposed that survivor protection prior to the retirement period should be included in the premium pension system. However, the Pension Group noted in September 2008 that such survivor protection would probably result in a deficit for which no financing was available. Survivor protection will therefore not be introduced into the premium pension system.

[38] In the years 1995–1998, the contribution to the premium pension system made up 2.0 per cent of the pension base. As of. 1999, it was raised to 2.5 per cent, at the same time as the contribution to the income pension system was reduced from 16.5 to 16.0 per cent.

[39] For an insured person born, for example, in 1941, pension credit for premium pension in 2005 was calculated as 7/20 multiplied by 2.5 per cent (= 0.875 per cent) of the pension base. A person born in 1940 reached the age of 65 in 2005 and was allocated premium pension credit for earned income in 2005 at 2.5 per cent, that is, under the same rules as those applying to people born in or after 1954.

The contributions to the premium pension system paid in continuously over the earnings year are transferred each month from the Social Insurance Agency to an account at the National Debt Office until such time as the individual pension saver's annual pension credit is determined. This means that contribution money is on average in the hands of temporary management for 17 months.

This management shall be conducted with minimum risk-taking and, while taking into account the demand for liquidity, shall provide maximum yield. The yield from the temporary management of funds during a specific income year is shared out among pension savers according to the pension credit determined for individual savers.

Pension credit determined annually

The Swedish Social Insurance Agency determines premium pension rights each autumn on the basis of pension savers' pensionable incomes and pensionable amounts during the preceding year. The corresponding amount of money is then transferred to individual pension accounts for investment in fund shares, an operation which, as of 2006, takes place in December of the year following the income year.

Once pension savers have started accruing pension credit for premium pension, they are kept informed via the annual value statement (the orange envelope) sent out after year-end once pension credit has been determined. The information brochure includes a description of how the fund share system works and a list of available investment alternatives.

For a pension saver who has been in the system over a longer period the report in the orange envelope may appear as follows:[40]

Changes in your premium pension account during 2008	SEK
Value 2007-12-31	51 747
Pension credit deposited for 2007	5 016
Inheritance gain	110
Administration fees, etc	-73
Change in value	-17 690
Value 2008-12-31	38 860

Pension credit deposited

Pension credit for premium pension is calculated as the individual's pension base multiplied by 2.5 per cent. For persons in the transitional generation, the part that is transferred to the premium pension system is affected by the twentieth-part phase-in. For older people in the birth cohorts born in 1938–1953, premium pension is a matter of relatively small amounts.

Inheritance gain

In the premium pension system too there is a redistribution of assets invested in fund saving from individuals with shorter than average lives to those who live longer. This redistribution is calculated according to insurance-based principles.

[40] The table is based on information referred to as Mr Average's Envelope in *The Orange Report 2008*.

Administration fees

A fee paid by each pension saver finances the costs for collection, calculation of pensionable income and other pension administration. During 2008, pension savers paid on average 0.16 per cent of their premium pension capital towards this administration.

As of 2007, there is a ceiling on the administration fee of SEK 100 per pension saver and year.[41] In 2007, just over 2 million savers paid this maximum fee.

In addition to the administration fee, the annual value statement lists expenses incurred by fund managers which are also charged to the individual's premium pension savings account. These affect the item 'Change in value' in the list of items in the annual value statement.

Change in value

'Change in value' shows how the saver's premium pension capital has developed over the year as the result of changes in the value of the fund shares, as the result of new pension credit earned on the previous year's income, and as the result of ongoing deductions of costs by fund companies from the individual's savings.

An important function of the Swedish Pensions Agency is to ensure pension savers low costs for fund saving by concluding cooperative agreements with the fund managers. The agreements oblige fund managers to provide a discount on their normal fund charges. The discounts are credited to savers' premium pension accounts.[42]

[41] The deduction for Premium Pension Authority administration costs amounted in 2008 to SEK 4 370 million, corresponding to 0.16 per cent of pension savers' premium pension account in May 2008. The fees have not so far covered the setting-up costs of the Premium Pension Authority. During the setting-up phase and up to 2018, the Authority is financed through a combination of fee deductions and interest account credit for working capital needs, etc. By 2018, it is planned that the whole of used interest account credit will be amortized.

[42] It is the fund companies' total capital in the premium pension system that forms the basis for calculating the discount. Furthermore, the discount is progressive and is calculated for different intervals. This means that companies that manage a lot of capital pay a higher

In 2008, fund companies' management fees amounted to approximately SEK 2.0 billion. Of this amount, approximately SEK 1.2 billion will be repaid to savers in the form of discounts during 2008. Percentually, this means the average fund management charge is reduced from 0.79 per cent to 0.30, that is, a discount of 0.49 percentage units.

Transfer of pension credit

Within the premium pension system it is possible to transfer annual pension credit between spouses.[43] Such transfers involve a reduction in the value of the pension credit since more transfers to women from men than from women to men are to be expected and, since women on average live longer than men, transferred premium pension credit is likely to be paid out over a longer period of time than premium pension credit which is not transferred. The cost of the transfer is to be borne by the recipient of the transfer and not by all pension savers collectively. The reduction will be the same for men and women.[44]

For the income year 2007, 7 789 transfers of premium pension credit were made. Of these transfers, 98 per cent were from men to women.

Investment in funds

During the earning period, the premium pension system is designed like a fund insurance, where individual savers may themselves decide on the management of the money placed in funds on their behalf. The Swedish Pensions Agency provides the fund administration making it possible for savers to choose between a

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discount than companies that manage a little capital. The thought is that there are economies of scale in capital management that ought to benefit pension savers.

[43] Once a transfer has been requested, it continues by default until the saver requests that it be cancelled. Kostnaden för överföringen beslutas av försäkringsgivaren.

[44] Currently, the deduction for a transfer is 8 per cent.

large number of alternative investments with various fund managers. Confidentiality is observed concerning information on individuals' choice of fund and change of funds. In other words, the fund managers do not know which pension savers have chosen their funds.

Fund managers must meet the following requirements:

- they must be qualified to operate a fund management company in Sweden in accordance with the Swedish Investment Funds Act (2004:46).
- a cooperative agreement with the insurance provider must be concluded, covering, among other things, management fees.
- they must provide information to pension savers who choose or consider choosing one of the fund manager's funds in the premium pension system,
- they may not charge redemption fees.
- they must report annually to the insurance provider total costs charged to the fund.

Under the cooperative agreements, fund managers are obliged to offer a discount on normal fund management fees. Discounts payments are calculated individually, that is, all discount payments are re-invested on behalf of the pension savers who have or have had shares in the fund during the life of the discount.

Choice of funds

Savers can choose to invest their capital in up to five different funds. For those persons who refrain from making an active choice, the capital is placed in the Premium Savings Fund. This is managed by the Seventh AP Fund. In 2009, the Pension Group decided in favour of certain changes to the premium pension system. The changes mainly involve the scrapping of the Premium Savings Fund in May 2010 and its replacement by pre-selected options with a generational profile. In this way, pension savers who do not actively choose funds are given a fund placement where the level of risk is related to the saver's age and to the risk in the total national old-age pension. It will also be possible for savers who previously made active choices to actively select pre-selected options. To increase freedom of choice, savers who wish to have a different risk profile than the pre-selected option but who do not themselves wish to select funds on the fund market will be offered default premium pension portfolios with varying risk levels from the Seventh AP Fund.

At year-end 2008, just under 2.5 million pension savers had their capital in the Premium Savings Fund. The Fund's share of total market value amounted to 27.2 per cent.

The insurance provider may decide the maximum number of funds that can be registered with a fund manager. At year-end 2008, there were 83 fund managers with a total of 773 funds in the premium pension system. The market value of combined fund assets at year-end 2008 amounted to approximately SEK 231 billion. 52 per cent of the capital managed in the premium pension system was invested in foreign shares, 22 per cent in domestic shares and 23 per cent in interest-bearing securities.[45] Divided among a total of approximately 6 million pension savers, this equated to almost SEK 39 000 per pension saver.

Premium pension entitlement began to be credited as of the income year 1995. The first selection of funds was made in April 2000 when pension rights earned during the years 1995–1998 were invested. Of the 4.4 million pension savers who were then able to select funds for the first time, a total of 3 million (68 per cent) made an active choice. This proportion has gradually declined. When funds were selected in spring 2008, the proportion of new pension savers making an active selection had sunk to a mere 1.7 per cent.

Up to the end of 2008, 57 per cent of all pension savers made an active choice, their share of the capital amounting to 72.8 per

[45] Alternative investments (mainly relating to the Premium Savings Fund and the Premium Choice Fund in the Seventh AP Fund) accounted for 2 per cent.

cent. Somewhat more women than men had made an active choice. Over recent years, the proportion making an active choice has levelled out.

Changing funds

The saver is free to change funds at any time and free of charge. The costs for changing funds are thus borne by the total saving collective. However, in autumn 2009, the Pension Group decided in favour of allowing the Swedish Pensions Agency to charge fees for changing funds in order to spread out the costs for changing funds more evenly among active and passive savers. The number of changes of fund has increased over time. In 2007, a total of 2.6 million changes of fund were made; in 2008, the figure was 3.2 million. The increased numbers may be explained by the fact that more and more pension savers review their saving as the balance in their accounts increases. Much of the increase may also be attributed to the fund management companies which, in recent years, regularly change funds on behalf of their customers.

Yield on capital within the premium pension system

Up to the time of the initial selection of funds in April 2000, premium pension capital was managed by the National Debt Office, resulting in a relatively even and moderate yield. Turbulence on the securities markets in the first years of the new millennium then led to a dramatic fall in yield within the premium pension system.

During the period 1995–2008, average annual yield within the premium pension system developed as shown in the following table:[46]

Year	Per cent
1995	4.6
1996	4.6
1997	4.6
1998	5.0
1999	3.7
2000	0.7
2001	-8.6
2002	-31.1
2003	17.7
2004	7.9
2005	30.5
2006	12.2
2007	5.6
2008	-34.2

For many savers, the fall in value at the beginning of the millennium meant an actual decrease in the value of premium pension assets. Subsequently there has been a recovery. Over the whole period, average yield amounted to minus 0.8 per cent. There have been considerable variations between different years, which is reflected in an average annual variation of 14.7 percentage units.[47]

Withdrawal of premium pension

Premium pension may be drawn from the age of 61 and savers can choose to withdraw 25, 50, 75 or 100 per cent of the premium - pension. Premium pension is calculated as a lifelong benefit, but it

[46] The table shows so-called capital–weighted yield. Source: Orange Report 2007.
[47] The variation is calculated as a standard deviation.

is possible to suspend withdrawal and to alter the proportion of the premium pension withdrawn. Withdrawal of premium pension does not presuppose withdrawal of income pension or vice-versa.

At withdrawal, the saver can choose either to let the balance in the premium pension account continue to be invested in fund shares during the retirement period (continued fund insurance) or to withdraw the pension as traditional pension insurance (life insurance). During 2008, just over 112 000 requests to withdraw premium pension were granted, of which 87 per cent were in the form of continued fund insurance and 13 per cent were in the form of traditional insurance.

Continued fund insurance after withdrawal means that individuals can modify their fund holdings by changing funds also during the retirement period. The Swedish Pensions Agency gradually sells off the saver's fund assets for the ongoing payment of premium pension and the pension amount is recalculated each year to reflect developments in the value of the individual fund shares. People who choose fund insurance can change to traditional insurance later.

The other alternative at withdrawal is a *traditional pension insurance* provided by the Swedish Pensions Agency. The individual's entire holdings of mutual funds are realized and the revenue is transferred to an insurance policy that provides life-time payment of a guaranteed nominal monthly amount. The monthly amount may be augmented by a so-called additional amount (dividend interest) depending on the results of the Swedish Pensions Agency's life insurance business. The additional amount is recalculated each year and can both increase and decrease. A person who has chosen withdrawal in the form of traditional insurance cannot change back to fund insurance.

According to the Income-Based Old-Age Pension Act (1998:674), premium pension shall be calculated equally for women and men and the system shall follow insurance-based principles. This means that it is the Swedish Pensions Agency that makes decisions on annuity divisors, guaranteed amounts in the traditional insurance, etc.[48]

Survivor protection during the retirement period

When premium pension is drawn for the first time, survivor protection during the retirement period may be selected. This means that premium pension is paid out to either of two spouses or cohabitants as long as one of them is living. The pension saver's own premium pension is reduced by as much as is statistically necessary for the balance in the premium pension account to suffice during the lifetimes of both spouses. Assumptions of gender neutral mortality are used.

In 2008, the number of withdrawals of premium pension with survivor protection amounted to just under 19 000. Of these, men accounted for 67 per cent and women for 33 per cent.

According to the original agreement, survivor protection should be an option prior to the retirement period. The rules for this were drawn up but never implemented. This was because it was impossible to eliminate the risk of a deficit. This category of insurance would in that case not be self-financing, which was against the overarching principle that standard insurance practice should be followed and each part should cover its own costs. Therefore, in 2008, the five parties agreed to abandon the option of survivor protection prior to the retirement period.

Assets and liabilities in the premium pension system

The Swedish Pensions Agency shall present an annual report under the provisions of the Swedish Act on Annual Accounts in Insurance Companies (1995:1560). The premium pension system

[48] On this point the premium pension system differs from the income pension system, where there are statutory rules controlling how levels for annuity divisors and other actuarial factors are to be calculated.

shall also be reported alongside the income pension system in a consolidated account for the complete system of income-based old-age pension.[49]

The value of the insurance assets and the pension debt in the premium pension system has developed as follows during the period 2003–2008:

SEK million	2003	2004	2005	2006	2007	2008
Insurance assets	94 155	125 118	193 077	269 447	310 711	233 333
of which, fund insurance	94 124	125 024	192 770	268 708	309 423	231 600
of which, traditional insurance	31	94	307	739	1 288	1 733
Pension debt	94 157	125 120	193 077	269 447	310 517	233 082
Annual result	-109	48	57	56	222	-100

3.7 Guarantee pension

The pension reform replaced the previous system for basic security within old-age retirement with the guarantee pension system. The guarantee pension provides basic protection for persons with little or no income during their lifetime. Its size thus depends on how much income-based pension has been earned. For persons who have had no work income at all during their lifetime, guarantee pension is payable according to a basic rate fixed in terms of the price base amount. For persons who have earned only a small income-based pension, guarantee pension provides a topping-up.

[49] This is published in the Swedish Insurance Agency's Orange Report 2008, the Pension System's annual report.

In addition, many guarantee pensioners are entitled to housing supplement for pensioners.[50]

Both older pensioners (born 1937 or earlier) and pensioners covered by the reformed rules for earning a pension may be entitled to guarantee pension. The principles are the same but the calculation rules differ for the two age groups. As with the earlier basic pension rules, the levels for married and unmarried persons are different in the guarantee pension system.[51]

Guarantee pension is payable first when a person reaches the age of 65. Thus, in 2008, it is pensioners born in 1943 or earlier who qualify for guarantee pension.

To receive unreduced guarantee pension, it is necessary to have been resident in Sweden for 40 years. If the number of years of residence in Sweden is less than that, the pension is calculated with regard to how great a proportion of 40 years the person has resided in Sweden. Furthermore, entitlement to guarantee pension requires that a person has been resident in Sweden or elsewhere in the EEA (European Economic Area) for at least 3 years.[52]

Guarantee pension for those born in or after 1938

For an unmarried pensioner with no income-based pension, the annual guarantee pension is payable at a base level of 2.13 price base amounts.

The top-up that a person with a limited income-based pension is entitled to under guarantee pension rules is calculated through coordination between guarantee pension and income-based pension. In addition to earned old-age pension from the national system, such coordination also takes into account widow's pension,

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[50] Of the approximately 765 000 guarantee pensioners in 2009, approximately 225 000 received housing supplement.

[51] By married person is meant a person who permanently cohabits with someone he or she has been married to or with whom he or she has had children.

[52] The qualifying condition further requires that a person must have been resident for at least 1 year in Sweden. The design of the condition is partly based on rules for social insurance systems within the EEA.

occupational disability annuity and any foreign income-based pension. On the other hand, guarantee pension for those born in 1938 or later is not affected by income from occupational pensions. The coordination is designed with two ranges depending on the level of earned old-age pension.

For an unmarried pensioner with an income-based pension (including any other pension income involved in the coordination) that does not exceed 1.26 price base amounts, the sum of guarantee pension and income-based pension remains constant, equalling 2.13 price base amounts; guarantee pension is reduced krona for krona.

If the calculated income-based pension exceeds 1.26 price base amounts, guarantee pension is reduced by 48 per cent of the amount by which the income-based pension exceeds 1.26 price base amounts. This means that the sum of guarantee pension and income-based pension is somewhat higher given an earned pension higher than 1.26 price base amounts. Meanwhile, the top-up provided by guarantee pension is reduced. If the pension level exceeds 3.07 price base amounts, guarantee pension is reduced to zero.

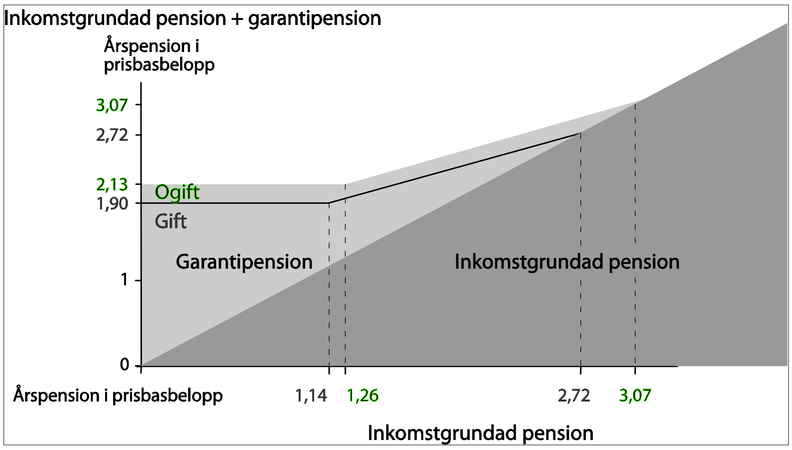
In 2009, the price base amount was SEK 42 800. That year, an unmarried pensioner with an income-based pension of SEK 107 000 (2.5 price base amounts) received a top-up guarantee pension of SEK 11 761:

Calculation factor		*SEK/year*
Unreduced guarantee pension	2.13 * price base amount in 2009	91 164
Reduction by 100 % in range of income-based pension 0–1.26 price base amounts	100 % * 1,26 * price base amount in 2009	- 53 928
Reduction by 48 % in range of income-based pension exceeding 1.26 price base amounts	48 % * (income-based pension – 1,26 * price base amount in 2009)	- 25 475

= Top-up in form of guarantee pension	= 11 761
Income-based pension	+ 107 000
Sum of income-based pension and guarantee pension	= 118 761

Guarantee pension for a married pensioner functions in a similar fashion. However, the base level for guarantee pension is lower – 1.90 base amounts instead of 2.13. The limit for each range in the coordination with income-based pension is also lower; 1.14 price base amounts instead of 1.26. Guarantee pension for a married pensioner is reduced to zero if the pension level exceeds 2.72 price base amounts. For an unmarried person in 2010, this means that the 48 per cent reduction limit starts with an income pension of SEK 53 928 per annum, and that guarantee pension is reduced to zero with an income pension of SEK 148 588

The way the guarantee pension system functions is shown in the following diagram:



The national income-based pension used in calculating guarantee pension is in some ways an *estimated income pension*.[53] In the first place, the income pension/ATP pension that is paid out or should be paid out to the pensioner upon withdrawal at the age of 65 is what is used in the calculation. Irrespective of when the person draws his/her income-based old-age pension, guarantee pension is calculated *as if withdrawal was made at the age of 65*. Thus it is not possible for a person to gain the right to a higher guarantee pension at age 65 by claiming his/her income-based pension before the age of 65.

In the second place, the calculation is based on the assumption that income-based pension *consists to 100% of income/ATP pension.* It is thus not the sum of real income/ATP pension and real premium pension that determines the level of guarantee pension. Thus, the consequences of the selection of premium pension funds made by the individual during the earning period are neutralized.[54]

Recalculation of guarantee pension

Every year-end, the various limits and levels within the guarantee pension system are recalculated in accordance with the price base amount of the following year.

For a pensioner who only receives guarantee pension, this means a recalculation based on price developments that occurred during the 12-month period up to June of the preceding year.

[53] To this is added, as mentioned above, any widow's pension, occupational disability annuity and any foreign income-based pension.
[54] For the first birth cohorts withdrawing premium pension, the proportion of premium pension relative to combined old-age pension is relatively small. One motive behind the calculation's assumption of 100 per cent income pension was to facilitate guarantee pension administration. When the size of the premium pension has become larger, the method of calculation may be modified. In the appropriation directions for 2008, the PPM (Premium Pension Authority) and the Swedish Social Insurance Agency were commissioned by the government to analyze the effects of a change to the rules in this respect. On 1 October, a report was submitted to the government (reg no. S2008/8030/SF) for processing by the Pension Group.

For a guarantee pensioner with limited income-based pension, the recalculation is made by estimating what his/her estimated income pension would have amounted to at age 65 after *economic adjustment indexation*.[55] Thereafter, a new guarantee pension top-up amount is calculated in accordance with the rules of the system.

At year-end 2009/2010, the price base amount for 2010 was set to SEK 42 400 while income pensions and ATP pensions were recalculated by -3 per cent. For the guarantee pensioner in the example above, the recalculation that year-end meant a new combined pension of SEK 116 224 per annum, of which income-based pension made up SEK 103 255 and guarantee pension SEK 12 969:

Calculation step		*SEK/year*
Unreduced guarantee pension	2,13 * price base amount 2010	90 312
Reduction by 100 % in range of income-based pension 0–1.26 price base amounts	100 % * 1,26 * price base amount 2010	– 53 424
Reduction by 48 % in range of income-based pension exceeding 1.26 price base amounts	48 % * (income-based pension 2009 – 1,26 * price base amount 2010)	– 23 919
= Top-up in form of guarantee pension		= 12 969
Income-based pension	0,97 * income-based pension 2009	+ 103 255
Sum of income-based pension and guarantee pension		= 116 224

55 In the context, any pension credit earned after the age of 65 is also taken into consideration.

In the example, it is assumed that the pensioner has not earned any income-based pension since 2006.

Since new pension credit for income-based pension is added to the individual's pension balance with a one-year delay, the calculation of guarantee pension to be paid out first at the age of 65 will be somewhat reduced at the following year-end, assuming the person has accrued pensionable income and/or pensionable amounts during his/her 64th year. Guarantee pension is also affected if the pensioner has continued to earn pension credit after the age of 64.

Marginal effects

An important intention behind the design of guarantee pension is that increased work effort should be rewarded in the form of higher future old-age pension also for lower-income groups. At the same time, it was essential to minimize as far as possible the marginal effects that would inevitably arise. The decision to allow guarantee pension above pension levels of 1.26 and 1.14 price base amounts to be reduced, not kronor for kronor, but by 48 per cent, was motivated by the belief that increased incentive for doing paid work should concentrate on income levels where people were expected to have stronger links to the labour market.

For retirees at the lower levels of guarantee pension (up to the limit of 1.26 price base amounts for unmarried persons and 1.14 price base amounts for married couples) the marginal effect is 100 per cent. For two unmarried pensioners with an estimated income pension of up to 1.26 price base amounts, the sum of income pension, ATP pension and guarantee pension is the same, irrespective of whether the estimated income pension of one of them amounts to, for example, 0.25 price base amounts and that of the other to 1.00 price base amounts.

In the range with income pension above 1.26 price base amounts for unmarried persons (and 1.14 price base amounts for married couples), guarantee pension is reduced by 48 per cent of the estimated income pension. For two unmarried pensioners, where one of them has, for example, an estimated income pension of 2.2 price base amounts and the other has an income pension of 3.07 price base amounts, the difference will be a 52 per cent increase of the amount by which the total pension exceeds 1.26 price base amounts.

Levels and limits within guarantee pension are part of the pension agreement. They represent what was considered to be a reasonable level within the framework of the agreement relative to normal levels for national income-based pension. Excessively high levels in the guarantee pension system would risk undermining the incentives for work built into the pension system. Higher levels of basic protection would lead to more pensioners falling within the ranges where marginal effects are very high.

Pensioners born in or before 1937

For pensioners born in or before 1937, the national income-based pension consists solely of ATP pension. From the start of 2003, old-age pension for this age group was converted to ATP pension reflecting the basic pension and ATP received up to that time.

The change-over meant guarantee pension replaced the basic pension and pension supplement that together with SGA (a special tax allowance for old age pensioners) had provided basic security in the ATP system. As of 2003, pensioners no longer received any special tax allowance. For a pensioner with basic pension, pension supplement and low ATP, the SGA had meant either total tax exemption or lower taxation than was paid by working persons and other pensioners.

Designing the guarantee pension for those born in 1937 or earlier was thus complicated by the fact that it also had to compensate for the value of the special tax allowance. However, the change-over did not mean pensions were lower after tax. On the contrary, pensions generally showed a net increase of between SEK 300 and SEK 600 by year-end 2002/03, depending on the municipal tax rates where the recipient lived.

Calculation of guarantee pension for those born in or before 1937 is done using a so-called calculation base. This includes all the incomes prior to the change-over that affected the special tax allowance – basic pension, pension supplement and ATP, as well as certain other benefits such as widow's pension, occupational pension and foreign pension. This calculation base is recalculated according to special rules and gives an amount equalling the pensioner's total gross pension. The latter is then taxed like other pension income. By deducting from this total gross pension the amounts for ATP pension and other income-related benefits included in the calculation base, one arrives at the guarantee pension amount.

For pensioners born in or before 1937 who are not entitled to income-based pension, the basic level of guarantee pension amounts to 2.1814 price base amounts for unmarried pensioners and 1.9434 price base amounts for married.

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Appendix 1 Chronology of the Reform

This appendix describes the gradual development of the pension reform from when the Pension Working Group began its work at the end of 1991 to the early years of the new millennium, by which time the rules of the new system had become operational. The assignment given to the Pension Working Group by the government was to draw up a proposal for a new national retirement system in light of the Pension Commission's final report, The National Pension System (SOU 1990:76),) and the consultative comments on this.

The following table shows, partly, Riksdag enactments of bills that have transformed the pension system, and partly, when important reports were presented, when various rules came into force, and other important events.

Riksdag decision	Year	Certain reports, enactment of bills, and other events
	1991	At the end of 1991, the Pension Working Group was appointed by the government.
	1992	In August 1992, the Pension Working Group presented the memorandum, *A Reformed Pen-*

		sion System – Background, Principles and Outline (Ds 1992:89).
Prop. 1993/94:250 Reforming the national pension system (8 juni 1994) **Prop. 1994/95:41** Changes in the financing of the national pension system, etc. (20 December 1994)	**1994**	In January 1994, the Pension Agreement was reached between five of the seven parties in the Pension Working Group. In February 1994, the Pension Working Group issued its report *The Reformed Pension System* (SOU 1994:20) based on a common agreement.
	1995	National pension contribution of 1 %, i.e. an individual contribution by all persons, starts to be deducted from all pensionable incomes up to the earnings ceiling of 7.5 base amounts. The part of the employer ATP pension contribution comprising incomes above the earnings ceiling starts to be paid into the national budget.

		11 % of paid-in ATP pension contributions starts to be transferred to the National Debt Office for financing future premium pensions.
	1996	
	1997	
Prop. 1997/98:151 Income-based old-age pension, etc. (8 June 1998) **Prop. 1997/98:152** Guarantee pension, etc. (8 June 1998)	**1998**	In January, a new agreement was reached between the five parties which meant, among other things, that the premium pension proportion was raised to 2.5% and the income pension proportion was lowered to 16 %.
	1999	New system for contributions to the national pension system becomes operational 1 Jan 1999. This requires that * insured persons pay an

Prop. 1998/99:98 Certain premium pension issues (3 June 1999) **Prop.1999/2000:12** State management of premium pension assets, etc. (15 December 1999)		individual contribution in the form of a national old-age pension contribution up to the earnings ceiling * employers pay an employer contribution (amounts representing incomes above the earnings ceiling being paid into the national budget) * a national old-age pension contribution is paid out of the national budget to the pension system to finance pension credit accruing from social insurance benefits and pensionable amounts.[56] The sum of SEK 45 billion is transferred from the AP Fund to the national budget. In spring 1999, persons born in or after 1938 receive their first so-called orange envelope with a statement of their earned pension credit according to the reformed system for income years 1995, 1996 and 1997 as well as an estimate of their future old-age pension.
	2000	The sum of SEK 45 billion is transferred from the AP Fund to

[56] The first year that earned pension credit was fully financed by paid-in contributions was 2000, when the national old-age pension contribution that had been 6.95 per cent in 1999 was raised to 7 per cent.

Prop. 1999/2000:46 The AP Fund in the reformed pension system (12 April 2000) **Prop. 1999/2000:127** Guarantee pension for persons born in or before 1937. (25 October 2000) **Prop. 1999/2000:138** Adjustments in the old-age pension system for the year 2001, etc. (25 October 2000) **Prop. 2000/01:16** Certain old-age pension issues, etc. (12 December 2000)		the national budget. In spring 2000, persons born in or after 1938 receive in the orange envelope a statement of the recalculation according to the rules of the reformed system of pension rights earned within the ATP system during the years 1960–1994 together with information on pensionable amounts accruing for the years 1960–1994. The AP Fund System is changed on 1 May 2000 through the establishment of four equal-sized buffer funds with identical investment rules (the First, Second, Third and Fourth AP Funds). At the same time, the sixth and seventh fund boards are renamed as the Sixth AP Fund and the Seventh AP Fund. New investment rules then come into force on 1 Jan 2001. First premium pension selection in autumn 2000. This means that persons born in or after 1938 had the opportunity to select fund managers for earned premium pension assets from the years 1995, 1996, 1997 and 1998.
	2001	Old-age pension starts to be paid

Prop. 2000/01:70 Automatic balancing of the old-age pension system (16 maj 2001) **Prop.** 2000/01:78 The right to work up to the age of 67 (16 maj 2001)		out according to the reformed rules in January 2001 to pensioners born 1938–1040. For those born in or after 1938 basic pension and ATP have thus been replaced by income pension and premium pension and, for the group born 1938–1953, by ATP pension as well. The point at which national pension can be claimed at the earliest is raised from 60 years to 61 years. The sum of SEK 155 billion is transferred from the AP Fund to the national budget. The provision of so-called retirement obligation in the Employment Protection Act LAS giving workers the right to remain in employment up to age 67 becomes mandatory.[57] The age limit for when an employee only has one month's notice period and no preferential right is raised from 65 to 67 years.
	2002	As of year-end 2001/2002, the earnings ceiling for pension credit in the pension system exceeds the

[57] Bestämmelsen trädde i kraft 1 sept. 2001. Kollektivavtal som ingåtts före lagens ikraftträdande gällde längst fram till utgången av 2002.

Prop. 2001/02:84 Adjustments due to the transition to reformed rules for old-age pension (24 April 2002)		earlier limit of 7.5 multiplied by the price base amount. As per 1 January 2002, income and ATP pensions are recalculated using *economic adjustment indexation* instead of price indexation. This means that pension amounts are raised by 3.3 per cent (instead of by the increase in the price base amount of 2.7 per cent). Compensation in the form of tax allowance in five stages for the national old-age pension contribution is introduced and affects the taxation of incomes earned in 2002. The first annual report of the pension system is presented by the National Social Insurance Board in June 2002. It shows the system's result for 2001 and the balance sheet as per 31 December 2001.
	2003	For pensioners born in or before 1937 pension that has been recalculated according to reformed rules starts to be paid out during January 2003. This means that basic pension and ATP also for older pensioners has been replaced

		by old-age pension according to reformed rules (in the form of ATP pension and, when appropriate, guarantee pension). For those born in or after 1938 the new rules for guarantee pension come into force. On the basis of the pension system annual report 2001, a balance ratio is determined for the first time. This ratio amounted to 1.03 for 2003.
	2004	As of income year 1999, there is no longer any age limit on earning pension credit for old-age pension. The rules come into force on 1 January 2004.
	2005	
Prop 2006/07:1 Budget proposal for 2007 (12 December 2006)	2006	
	2007	During 2007, old-age pension credit for persons with sickness and activity compensation is calculated at 80 per cent instead of 93 per cent of assumed income.

Prop 2007/08:1 Budget proposal for 2008 and Report, 2007/08:FiU1 (21 November 2007)		In conjunction with the preparation of the budget proposal for 2008, representatives of the government parties and the Social Democrats agree that old-age pension entitlement for persons with sickness and activity compensation shall be restored to the rules that applied prior to 2007. In its report the finance committee presupposes that the government will get back to the Riksdag with a proposal to that effect in the course of 2008.
Prop 2008/09:219 Smoothed buffer fund value in calculation of the balance ratio	2009	Changed way of establishing buffer fund value in calculation of balance ratio. Instead of using the value per 31 December, a smoothed value will be used, calculated as an average of the last three years' value per 31 December.
Prop. 2009/10:44 Changes in the premium pension system	2009	To better adjust investments to savers who do not wish to manage premium pension themselves, the Premium Savings Fund is shut down and replaced by a pre-selected option with a generational profile. It will be possible to actively choose the pre-selected option also for those savers who previously made active choices.

		Savers who wish to have a different risk profile than the pre-selected option, but who do not themselves wish to choose funds on the fund marketplace, will be offered ready-made premium pension portfolios at varying risk levels from the Seventh AP Fund. The Swedish Pension Agency will be allowed to charge a fee for changing funds in order to better spread out the costs of such changes among active and passive savers. Survivor protection prior to retirement as yet unused shall be removed.

Appendix 2 Basic Pension and ATP

This appendix provides an overview of the national old-age pension system prior to the reform.[58] This consisted of basic pension and the National Supplementary Pension scheme (ATP). The major benefits provided by the two sub-systems were old-age pension, disability pension and survivor's pension.[59] In addition, pension supplement was paid to pensioners who received a low ATP or none at all. Even prior to the reform there were benefits in the form of housing supplement for pensioners.

Also of significance for many pensioners prior to the reform were special tax benefits in the form of special basic deductions from taxation (SGA). These meant that an old-age pensioner who only received basic pension and pension supplement was in practice exempt from income tax.

ATP, basic pension and pension supplement followed price developments and were adjusted upwards annually to reflect changes in the consumer price index.

[58] The starting year of the reform may be said to be 1995, since pension credit for premium pension has been earned from the income year of 1995 onwards and since the special guarantee rule covering persons born between 1938 and 1953 grants the right to a supplement to income/supplementary pension at a level corresponding to the ATP earned up to 1994.

[59] Besides the three main benefits, there were also the basic pension benefits named disability allowance and care allowance.

National Supplementary Pension (ATP)

Within the ATP system, pension benefit was determined by pensionable income (PGI) during working years and the number of years for which PGI had been determined. For each year with pensionable income, the insured received ATP points. Points were calculated by dividing pensionable income (minus one base amount) by the base amount.[60] Pensionable income could not exceed 7.5 times the basic amount and total ATP points could not exceed 6.5.

PGI was accruable from the year a person reached the age of 16 and up to the year he or she reached the age of 64. Income that was pensionable included earnings from gainful employment and from certain benefits that replaced such earnings, for example, sickness benefit, parental benefit and unemployment benefit. To meet the condition of 30 years of earned ATP points, parents were also allowed to count years taking care of children under the age of three.

To qualify for ATP required three years with ATP points. People who had thirty years with ATP points received full ATP. For people with less than thirty years with points, the pension was reduced proportionately. Thus, a person who had 28 years with ATP points received twenty-eight thirtieths of full ATP.

The annual amount of ATP pension was calculated on the basis of the average for the fifteen best years with ATP points as follows:

0.60 * MP * BB where

MP = average ATP points for the 15 best years with points (alternatively, average ATP points for persons with fewer than 15 years with points)

BB = base amount the year ATP was paid out.

[60] Basic pension corresponding to the first base amount.

Basic protection

The basic pension scheme provided, among other things, basic protection in case of old age, and benefit was in principle payable in standard amounts irrespective of an individual's previous income or payment of contributions. In 1993, however, basic pension became dependent on the length of time the individual had been insured. In order to qualify for basic pension and pension supplement, a person had either to have been resident in Sweden for at least three years or to have at least three years with ATP points. Full basic pension or pension supplement required either forty years' residence in Sweden or thirty years with pension points.

Old-age pension in the form of basic pension amounted to 96 per cent of the base amount for unmarried persons and 78.5 per cent of the base amount for married and cohabiting persons. Pension supplement was calculated equally for unmarried and married/cohabiting persons and could not exceed 56.9 per cent of the base amount. Pension supplement was reduced krona for krona against any ATP a person had.

In addition to basic protection provided by the pension system, certain tax rules applied to pensioners in the form of the special tax deduction, SGA. A person receiving only basic pension and pension supplement was exempt from income tax. If the individual's pensions exceeded the level of basic pension and pension supplement, SGA was reduced. The reduction was made in relation to all pension incomes. Even occupational pensions affected the special tax deduction.

Appendix 3 The National Pension System 2008

The aim of this appendix is to provide a picture of the scope of the national pension system in 2008. The appendix describes the number of persons receiving different types of national pension, average pension amounts, and various payments in and out for the three pension sub-systems.

Pensioners and different types of pensions

Number of pensioners

In December 2008, the total number of persons receiving whole or partial pension from the national old-age pension system amounted to 1 806 126.

Different age groups

The number of persons with old-age pension in the birth cohorts *born in or before 1937* amounted to 1 141 204, accounting for 63 per cent of all old-age pensioners in December 2008. In general, all older pensioners received full old-age pension.[61]

The number of persons with old-age pension in the birth cohorts *born between 1938 and 1943* amounted to 567 000.

[61] The number of pensioners among those born in or before 1937 with partial withdrawal was 22.

Almost all of these pensioners had withdrawn full pension.[62] Entitlement to guarantee pension starts at the age of 65, so the youngest birth cohort entitled to receive guarantee pension in 2008 was the cohort born in 1943.

The number of persons with old-age pension in the birth cohorts *born between 1944 and 1947* amounted to 88 900. The proportion of these pensioners who had withdrawn full pension was just over 72 per cent. The youngest birth cohort in 2008 entitled to receive old-age pension in December 2008 consisted of persons born in 1947.

The table below refers to December 2008 and shows how the proportion of persons in each birth cohort with newly-granted national pensions, relative to the number of possible pensioners in the birth cohort, grows successively with increasing age.

Proportion of persons with newly-granted national pensions at different ages, per cent

Birth cohort/ withdrawal age	61	62	63	64	65	66	67	68	69	70
1938	3,7	2,3	2,3	2,1	77,4	4,0	3,2	0,8	0,3	0,3
1939	4,0	1,9	2,1	2,3	75,9	6,3	2,3	0,8	0,3	
1940	3,1	2,2	2,5	3,2	76,2	4,9	2,5	0,7		
1941	3,0	2,3	3,1	3,7	73,3	6,1	2,7			
1942	3,6	3,0	3,5	3,9	71,0	5,9				
1943	4,0	3,0	3,5	5,1	66,7					
1944	4,7	3,3	4,5	5,7						
1945	5,1	4,1	5,1							
1946	6,0	4,7								
1947	6,3									

The birth cohort born in 1943 reached the age of 65 during 2008. At the end of this year, 83 per cent of the birth cohort had claimed national pension.[63] For the birth cohort born in 1938 the

[62] Among those born between 1938 and 1943 the number of pensioners with partial withdrawal was 3 805.

[63] However, the proportions do not include persons who only withdrew premium pension.

proportion was more than 96 per cent, while the proportion of those born in 1947 – the youngest birth cohort entitled to withdraw national pension during 2008 – was 6.3 per cent.

Income/ATP pension, premium pension and guarantee pension

The number of persons receiving *income/ATP pension* in December 2008 was 1 625 000. In the years up to 2011, the number of persons with income/ATP pension is expected to increase by between 57 000 and 67 000 annually.

The number of persons receiving *premium pension* in December 2008 was 555 200. In the coming years, the number of persons claiming premium pension is expected to increase by between 116 000 and 134 000 annually.[64]

The number of persons receiving guarantee pension in December was 778 000, of which 607 000 (78 per cent) were born in or before 1937. Compared with the same month in 2007, the total was approximately 25 000 fewer guarantee pensioners. The number of pensioners covered by basic protection in the national pension system is decreasing, since more and more pensioners have income-based pension and the new pensioners on average have more earned pension credit than the oldest pensioners.

Moreover, the *economic adjustment indexation* of income pension and ATP pension during the years that have passed since the pension reform has meant that these pensions have increased more than if they had been recalculated upwards with the price base amount. This further reduces the number of persons with guarantee pension since entitlement to limited guarantee pension may end when income/ATP pension increases in real terms at a year-end.

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[64] The difference between the number of additional premium pensioners in the coming years and the number of additional persons with income/supplementary pension in the coming years is due to the difference in mortality between the group with income/supplementary pension (includes all older people) and the group of premium pensioners (persons born at the earliest in 1938).

The proportion with guarantee pension is higher among older pensioners:

	Only guarantee pension	Guarantee pension and income-based pension	Only income-based pension
Born in or before 1937 with old-age pension	10 %	43 %	47 %
Born 1938–1943 with old-age pension	2 %	24 %	74 %

The youngest old-age pensioners

The pensioners who had not reached the age of 65 in 2008 were those born between 1944 and 1947. Among these old-age pensioners, many had chosen to withdraw only income/ATP pension or only premium pension:

	Income pension/ ATP pension and premium pension	Only income pension/ ATP pension	Only premium pension
Those born 1944-1947 with old-age pension	46 %	31 %	23 %

Among the 68 000 who withdrew income/ATP pension, 88 per cent made a full withdrawal. Among the 8 000 who made a partial withdrawal of income/ATP pension, half withdrew 50 per cent and almost a third withdrew 25 per cent.

Among the 61 300 who withdrew premium pension, 65 per cent made a full withdrawal. Among the just over 18 000 persons who made a partial withdrawal, a very high proportion (88 per cent) made a 25 per cent withdrawal of premium pension.

Average pension amounts

The oldest pensioners

Practically all pensioners in the birth cohorts born in or before *1937* made a full withdrawal of old-age pension and just over 10 per cent received only guarantee pension.

The calculation rules for guarantee pension for the oldest age-group in 2008 meant that the highest monthly amount for an unmarried person who received only guarantee pension was SEK 7 453. For a married person with only guarantee pension the highest monthly amount was SEK 6 640.

The average amounts paid out in December 2008 calculated for all pensioners in the age-group born in or before 1937 are shown in the following table.

	Only ATP pension	ATP pension and guarantee pension	Only guarantee pension
Born in or before 1937	13 371 SEK/month	6 355 SEK/month	4 951 SEK/month

The difference between the group with only ATP pension and the group with ATP pension and guarantee pension is partly due to the fact that the proportion of women in the first group is 32 per cent and the proportion of women in the other group is 79 per cent, women having on average less earned entitlement to income-based pension.

The average amounts for the two groups receiving guarantee pension are affected by the fact that all pensioners are included, even those who have not been resident in Sweden during 40 years prior to retirement and who therefore receive reduced guarantee pension.[65] Moreover, among older pensioners with guarantee pension, there are persons who at the time of the reform received reduced basic pension/ATP due to premature withdrawal – which also affects their guarantee pension. These circumstances contribute to the fact that among pensioners in the two groups receiving guarantee pension, there are persons whose guarantee pension does not reach the levels following from the main rule for calculation.

Pensioners born between 1938 and 1943

Practically all pensioners in the birth cohorts of 1938–1943 made a full withdrawal of old-age pension. A very small proportion (2 per cent) of pensioners in that age group received only guarantee pension.

According to the rules for the age group, the highest monthly amount in 2008 for an unmarried person receiving only guarantee pension amounted to SEK 7 278. For a married person with only guarantee pension, the highest monthly amount amounted to SEK 6 492.

[65] Many of those who have not resided 40 years in Sweden prior to retirement live abroad as pensioners. The proportion of pensioners residing abroad with guarantee pension was 12 per cent, while the proportion of the total living abroad amounted to 5 per cent.

The average amounts paid out in December 2008 to pensioners in the birth cohorts 1938–1943 is shown in the table below:

	Only ATP pension	ATP pension and guarantee pension	Only guarantee pension
Born 1938–1943	11 516 SEK/month	6 394 SEK/month	3 550 SEK/month

The table does not include amounts that pensioners born between 1938 and 1943 receive as premium pension.

Also within the group of pensioners born between 1938 and 1943, the proportion of women with both ATP pension and guarantee pension is high (79 per cent), which brings down that group's average compared to the group with only ATP pension.

The average amounts for the two groups with guarantee pension is influenced by the fact that all pensioners are included in the calculation, even those who were not resident in Sweden during 40 years prior to retirement and therefore have their guarantee pension reduced accordingly.[66]

Premium pensioners

During 2008, withdrawal of premium pension was approved for 112 100 persons. The total number of persons who had withdrawn premium pension by December 2008 was 555 200. Since premium pension can be claimed first at the age of 61, it is a question of persons born between 1938 and 1947. 87 per cent chose withdrawal with continued fund insurance and 13 per cent chose withdrawal in the form of traditional insurance. Among the premium pensioners, 15 per cent had chosen the alternative with survivor protection during the retirement period.

[66] Among pensioners born between 1938 and 1943, the group receiving only guarantee pension numbered only 10 225 persons, 24 per cent of whom lived abroad.

The level of premium pension depends to a large extent on which birth cohort the premium pensioner belongs to. The annual amount in 2008 for a person born in 1938 who had withdrawn full premium pension averaged SEK 900 in the case of fund insurance and SEK 700 in the case of traditional insurance. For a premium pensioner born in 1945 who had withdrawn full premium pension, the corresponding amount in 2008 averaged SEK 2 800 and SEK 2 300 respectively.

Expenditure and income for the three sub-systems

Income pension

In 2008, ATP pension disbursements to pensioners born in or before 1937 amounted to SEK 123 042 million. Income/ATP pension disbursements to pensioners born between 1938 and 1947 totalled SEK 79 464 million, of which 69 per cent comprised ATP pension and 31 per cent income pension.

In 2008, a total of almost SEK 203 billion was paid out from the income pension system. By 2010, it is estimated that income pension and ATP pension disbursements will have increased to SEK 223 billion.

During 2008, the pension base for income pension for the income year 2006 was registered as 5.3 million persons. Pensionable amounts were determined for 1.2 million persons, 27 per cent of whom were granted pensionable amounts for childcare years. The corresponding proportion for studies was 35 per cent, for national service 1.3 per cent and for sickness/activity compensation 40 per cent.

Allocations in the 2008 national budget relating to national old-age pension contributions for pensionable amounts are shown in the table below:

	SEK million
Childcare years	4 833
Studies[67]	1 850
National service[68]	432
Sickness/activity compensa tion[69]	12 387

Premium pension

In 2008, premium pension disbursements amounted to SEK 905 million. In 2010, total premium pension disbursements are expected to reach SEK 1.5 billion.

In 2008, the premium pension system was augmented by SEK 30 118 million in the form of newly-allocated pension rights as well as repaid fund management fees and yield on capital during the temporary administration of the National Debt Office.

Guarantee pension

The guarantee pension system is financed by public tax revenue via the national budget. During 2008, the national budget allocation for guarantee pension amounted to SEK 19 609 million.

[67] A small part of the amount relates to pensionable income (PGI).
[68] A small part of the amount relates to pensionable income (PGI).
[69] The amount relates to contributions for both pensionable income (PGI) and pensionable amounts.