COUNTRY SPOTLIGHT | SWEDEN

Re-building bridges

Sophie Smith **looks at the affects of recent market volatility on trust in the Swedish pension system, and the lessons to be learnt for the broader pensions industry**

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Sweden's pension system is often touted as a global example of excellence, frequently featuring in the Mercer CFA Institute *Global Pension Index* top 10.

Yet recent market volatility has shaken faith in the system, after the US banking crisis saw pension fund losses dominating headlines.

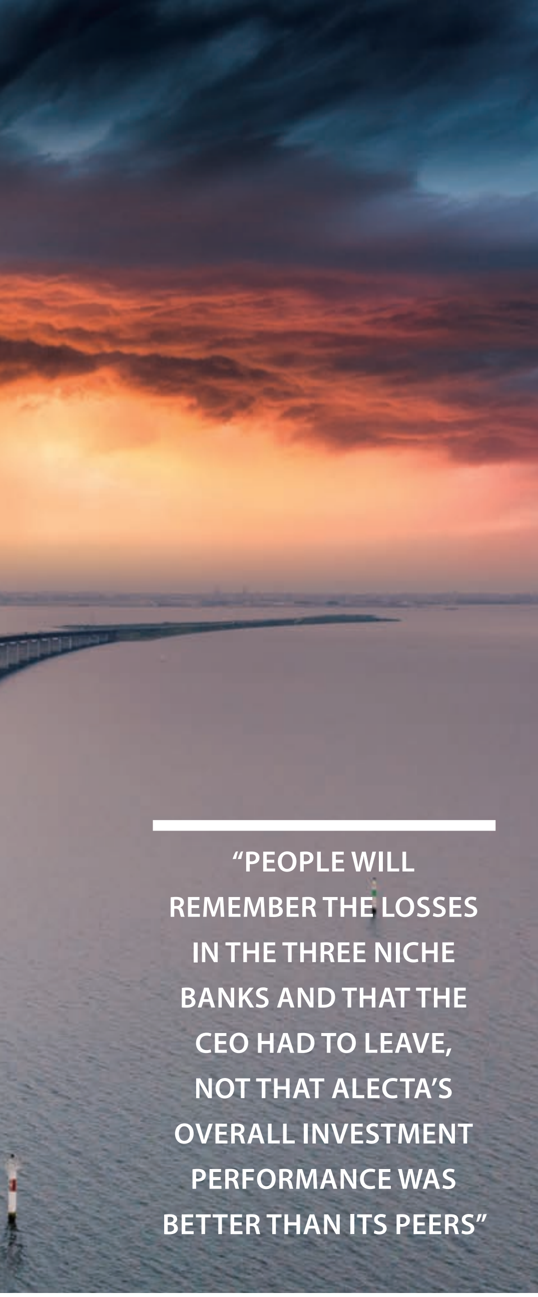
Swedish pension company, Alecta, was particularly thrown into the spotlight, after losing SEK 19.6 billion on its investments in Silicon Valley Bank (SVB), Signature Bank, and Silvergate, after the three small- to mid-size U.S. banks failed in the course of five days in March.

The scheme admitted that the lost value in the American banks would affect the pensions of its customers "to a small extent", with ITP customers with a DC pension to see a "small" impact.

However, Alecta was quick to reassure savers that its financial position remained strong, with a solvency ratio of 209 per cent as of end of June 2023. The latest accounts revealed that, despite the losses, Alecta Optimal Pension's return was 6.6 per cent in H1 2023, up from -12.7 per cent in the first half of 2022.

Savers' trust in the fund presented a more pressing concern though, as Alecta conceded that while the failed investments did not have a noticeable impact on its financial position, they had damaged trust.

"The losses in the three American banks account for a small part of Alecta's capital and the impact on the customers' pensions is very limited," then Alecta CEO, Magnus Billing commented. "But it has seriously damaged the customers' trust in Alecta... It is now up to us to prove that we deserve their trust again."



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Cutting through the headlines

Indeed, Now Pensions head of DC design, Stefan Lundbergh, says that the crisis will have also likely contributed to the erosion of the public’s trust in the Swedish pension system, suggesting that international headlines around the issue will have heightened member concerns.

“Media was effective in producing numerous articles about the losses and putting pressure on Alecta, but when the Q1 comparison was released, there was limited interest from media. This is not surprising since an article about a crisis gets more clicks than one about good news,” he states. “As a consequence, most people will remember the losses in the three niche banks and that the CEO had to leave, not that Alecta’s overall investment performance was better than its peers during this period.”

However, AP7 head of ESG and communications, Johan Florén, suggests that savers will see through these headlines once the dust settles, arguing that “the Alecta incident will not have a long-term effect on trust in the Swedish pension system, given the reassurance that the fund has since been able to share”.

“Even though circumstances implied the problem was very serious, I think it was over dramatised from a financial perspective,” he continues. “They had a concentrated portfolio and large AUM. If any holding gets serious problems the impact will be substantial in terms of money. That comes with the strategy, which doesn’t have to be wrong in itself.”

This is echoed by AP4 head of sustainability, finance and communication, Tobias Fransson, who says that there have not been any negative effects relating to the general trust in the pension system.

And the public pension system in particular, according to Fransson, has delivered over time and is stronger than ever.

Most funds in the industry have not reported a rise in queries after the incident, either, suggesting that savers have not been pushed so far as to take action.

Despite this, AMF head of asset management, Tomas Flodén, emphasises that it is “of course important that we as an industry do what we can to safeguard the general public trust in our ability to deliver good pensions, not least during financially challenging times”.

And work to tackle this is underway, and since Alecta announced the losses, its management and board have worked to isolate the losses and work through the processes within asset management to understand how the situation arose.

Rebuilding and reassuring

This included the departure of the group’s CEO, Magnus Billing, who has since been succeeded by Peder Hasslev. The group also appointed Magnus Tell as its new equity manager, while Pablo Bernengo was appointed as its head of asset management.

Changes were also made within the administration, including a reduction of the risk with high ownership stakes in individual companies far from Sweden, with a focus on concentration in the American holdings.

A strategic review of its asset management also identified a number of further “lessons learned from what happened in March 2023”, with the group confirming that its active management will have a downwardly adjusted risk, with an increased number of companies and lower ownership shares in companies outside the Nordics.

“Confidence in Alecta has been negatively affected by the losses in the American banks in March,” said Alecta board chair, Ingrid Bonde. “With these proposals for changes, we learn from the spring’s events, adapt the model to higher volumes and lay the foundation for continued high returns and adapted risk for our different categories of customers.”

Lessons to be learnt

Alecta was not the only pension organisation to have invested in SVB, however, with Norway’s Government Pension Fund Global reportedly holding around NOK 1.7 billion in the American Bank.

And the case could serve as an example for other schemes and

countries, as Lundbergh highlights the crisis as "a failure in practical governance".

"Running a concentrated equity portfolio is nothing new," he continues. "Carefully implemented, such portfolio should beat the broad market indices, but when an individual holding ends up in trouble, or even goes bankrupt, it results in a performance dent.

"The practical governance failure was that the non-executives did not have a plan for how to act in the case that their equity strategy would face a serious headwind. Being caught unprepared, forced the board to think on their feet and make 'forceful' decisions in the heat of the situation. This is not an ideal context for making informed decisions."

Taking stock

The incident has yet to prompt many funds to make changes. However, Fransson says that AP4 bases its allocation decisions on its long-term asset liability management study and its view on medium-term macro and market trends. "How Alecta manages its assets does not affect how we make allocation decisions," he says.

Adding to this, Flodén says that whilst the AMF continuously reviews its exposure and allocation, not least when specific industries or sectors suffer from challenges, the fund is "secure in the fact that we have a good spread of risk, and an allocation that is adapted to its mission".

Broader reviews are underway, however, as the Swedish Financial Supervisory Authority (FI) launched a review to investigate Alecta's risk management and, in particular, how Alecta measures the risks in various investments.

"We will now investigate whether Alecta has had control over its risks in the manner required by the regulations. Basically, it's about securing and protecting pension savers' money," said FI head of risk supervision, Ellinor Samuelsson.

And this has not been the only area highlighted by the regulator, as FI also more recently announced plans to investigate whether Alecta followed regulations on its investments in Heimstaden Bostad.

Lundbergh says the first investigation was not surprising from a behavioural perspective, stressing however, that any outcomes from the review need to be balanced and avoid making it more difficult for Swedish pension funds to pursue strategies off the beaten path.

Rather than a change in governance model, Lundbergh says it is about making sure that non-executive boards have the right tools and processes to make better informed decisions. "This requires that board members are competent, cognitively diverse and that biases, such as group think, are mitigated," he explains. "This particular crisis illustrates the importance of thinking through potential scenarios in order to be prepared when something bad happens or just asking themselves: How do we explain this to the press and public in a period of distress?"

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The Swedish Fund Selection Agency (FTN), meanwhile, highlights the case as evidence of the need to focus the qualitative and quantitative evaluation of funds on the investment philosophy, investment process and risk management of the fund.

"And even more important, any inconsistencies between the processes described and past performance," an FTN spokesperson states. "This is crucial for any procurement of funds or fund management service in the pension system. Thorough evaluation needs to be done not only during the procurement phase to ensure that funds of high quality are procured, but also once selected to maintain a high quality over time."

With a new procurement process underway for premium pensions, changes are already being seen.

Despite the turmoil, a recent report from FI found that the financial position of life insurance and occupational pension undertakings is stable. With the latest update from Alecta also painting an optimistic picture for the future, savers are likely reassured that their pensions remain secure, but whether funds are prepared for the next crisis is yet to be seen.