COUNTRY SPOTLIGHT SWEDEN

To reform or not to reform?

Despite its status as one of the world's best pension systems, Sweden's industry is not without its issues. Jack Gray reports on the problems facing the industry and the debates surrounding potential pension reform

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The Swedish pension industry is going through a period of reform. Despite recent strong returns and scoring highly for its sustainability, integrity and living standards, the issues of a developed nation are becoming apparent. The country is struggling, like many in the developed world, to adequately support an ageing population, while feeling the effects of the strained global economy. In an effort to maintain the system's high-quality performance, the Swedish government has been issuing reforms that are splitting opinions.

Returns

In the first half of last year (2019) the Swedish national pension fund, AP1, returned €3 billion (9.7 per cent). In the 10-year period up to July 2019, the fund had a return of 7.7 per cent, surpassing its long-term goal of 4 per cent. Its AP2 fund told a similar story, with a 10.7 per cent return in the first half of 2019 and a 10-year average of 8.1 per cent.

Furthermore, the growth was not limited to just the national pension funds, with the pension and insurance group, Folksam Group, returning 6 per cent in the first half of 2019 due to positive growth for its pension funds KPA Pension and Folksam LO pension.

However, the forecasts for returns in the near future are not as positive. "The beginning of 2019 saw a strong recovery in the world markets after the major downturn at the end of 2018, however, this was followed by growing concern that global real economic growth may lose momentum," AP2 CEO Eva Halvarsson said in a statement.

"This concern was amplified by uncertainties regarding Brexit and, in May and June, the escalating trade conflict between USA and China. This political uncertainty seems to have played a part in a declining investment climate the world over."

Following the warnings of a worsening economic environment, AP1 has reduced its 10-year return target down from 4 per cent to 3 per cent.

Negative interest

In July 2009, Sweden's Riksbank was the first central bank in the world to implement a negative interest rate in an attempt to stimulate economic growth and put banks off of hoarding cash. However, falling bond yields in combination with increasing life expectancies and falling investment return expectations have widely led to the negative rates not having the desired effect for pension schemes.

The stunted investment returns led many pension schemes taking on high-risk strategies, which can be dangerous for both funds and members. In late 2019, the bank raised it from -0.25 per cent back to zero, despite warnings that the nation is heading for an economic slowdown after years of positive economic outcomes. However, Riksbank said that this is just consistent with international trends.

Riksbank said previously: "The slowdown is occurring after several years of high growth and strong developments on the labour market, and overall it means that the

Swedish economy is going from a stronger-than-normal cycle to a more normal situation."

Getting old

Like many developed nations, Sweden is fighting to adapt to an ageing population. A study by Hans Lundström, *Mortality Assumptions for Sweden. The 2000-2050 Population Projection*, predicts that the average life expectancy of a Swede would consistently increase for men and women, up to 82.6 and 86.5 from 80 and 84.4 by 2050, respectively.

RobecoSAM senior SI country analyst, Max Schieler, notes that the Swedish pension industry addressing the issues presented by an ageing population is "one of the areas where it can still improve".

He continues: "Like many other advanced economies Sweden is faced with the issue of ensuring the sustainability of its pension system in the long term due to unfavorable demographic trends and adverse prospects for future returns given the current international interest rate environment."

Reform

To help alleviate longevity concerns, the Swedish government has raised the retirement age. Since 1 January 2020, the minimum age at which Swedes can take out their premium pension has been 62, up from 61 previously.

It also decided to introduce a calculation on increasing the age at which citizens can obtain their guaranteed pension, which currently stands at 65. The guaranteed pension is provided to those in Sweden who have had little to no work income during their lifetime. The new calculation will link average life expectancy to guaranteed pension age.

Although there are no concrete legislative proposals on the application of the target age yet, it is proposed that the age at which the guaranteed pension can be obtained should be increased to 66 from 2023 and that the newly calculated target age should then be used from 2026. The forecast predicts that the age will then be 67 years. The guaranteed pension age will be calculated for the first time this year and is planned to be applied in 2026.

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Monash Centre for Financial Studies director, Professor Deep Kapur, said in a report: "It's essential the state pension or retirement age is reconsidered in line with increasing longevity – a step some governments have already taken – to reduce the costs of publicly financed pension benefits."

Alongside the age reforms, the Swedish government increased the guaranteed pension by up to £16 per person each month.

PPM changes

The government has also announced plans to reform the premium pension system. It argues that the premium pension system should be redesigned so that index funds are prioritised over actively managed funds by 2023. This will allow long-term savers to select funds into which an allocation of their compulsory pension contributions are delegated. Reforms are needed, according to the government, to close pre-existing loopholes which mean investors' money could be at risk through scams and unethical marketing.

The key features of the planned legislation will include requiring the operator of the premium pension system – the Swedish Pensions Agency – and the relevant fund to improve their communication with one another, minimum capital requirements for registering funds, banning telephone sales and increased scrutiny on funds by the Swedish Pensions Agency. It will also require registered funds to provide at least a three-year return history and a three-year business history.

However, there has been some criticism of the plans. A report by the Swedish Investment Fund Association (Sifa) finds that the returns on index funds are not as high as actively managed funds for funds in the same categories. The organisation argues that only savers that have a desire to manage their own fund portfolios in the premium pension system should be doing so, saying that the changes proposed by the government will over-complicate the system for savers and that even those who want to manage their funds will be forced into index funds.

The Sifa suggests that a preselection of funds should be the starting point for all savers, taking into account that they may have no financial knowledge, with savers allowed to choose the level of risk they want to take on. If they feel confident then they, according to the association, should be allowed to manage their fund choices further.

Sifa chief executive officer, Fredrik Nordström, said in a release: "In the premium pension system, savers can choose actively managed funds at a very favourable price. Our review of returns in different fund categories shows that index funds have not given savers a higher return.

"Thus, as the investigation suggests, there is no reason to specifically redesign the system to highlight index funds. The savers do not get better returns, the system is unnecessarily complicated with a new step, and the pension money is concentrated to a few players."

"OUR REVIEW OF RETURNS IN DIFFERENT FUND CATEGORIES SHOWS THAT INDEX FUNDS HAVE NOT GIVEN SAVERS A HIGHER RETURN"

Another report on the premium pension changes is predicted for later in 2020, while an oversight committee is expected to be formed to ensure that the present fund marketplace has been wound down and replaced by the new system in 2023.

Responsible success

Despite the ongoing and seemingly necessary reforms to the pension system, Sweden continues to perform well in its commitment to responsible investing. In a recent RobecoSAM country sustainability update, Sweden came second, only slightly behind the leader - Norway.

Schieler notes: "Sweden's environmental, social and governance (ESG) profile reveals, above all, a very strong environmental performance, a robust and reliable institutional framework, a very low level of corruption, a healthy innovation and regulatory environment.

"The country is one of the frontrunners in the fight against climate change and its CO2 emissions per unit of GDP are significantly below the OECD average. The country also enjoys a low level of political risk and inequality, and the population benefits of a high living standard and far-reaching civil liberties & political rights."

SSGA EMEA Institutional Client Group head of the Nordics, Arnaud Bruyneel, explains that one of the reasons that Sweden is thought of as a trailblazer in terms of ESG investments is that they have greater regulations that help ensure responsible investment.

He says: "The SSGA Nordic Team is entrusted with assets across the 5 Nordic countries and 90 per cent of these assets have ESG screens applied on them – that level reaches 96 per cent specifically for Sweden.

"These ESG screens are norms- based exclusionary screens which are either custom and fully directed by the clients and implemented through the use of segregated mandates or applied through our pooled funds range. There is a growing focus on company engagements across the Nordics and especially in Sweden." ■