

FTN

Mission possible: Improving returns for Swedish pension savers



The Swedish Fund Selection Agency executive director, Erik Fransson, discusses the process of procuring funds for the Swedish premium pension system

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In 2000, the Swedish 'premium pension' system was launched in its current form, offering people the choice on how to invest part of their income pension on a state-provided open fund platform.

From an economic standpoint, the system has demonstrated success. In 2022, 83.6 per cent of savers who independently selected their funds achieved an annual return exceeding the income index by 2 percentage points. The good performance is noteworthy given the challenges faced during the system's initial two decades. Individual rogue operators employing aggressive sales tactics led savers astray, investing capital with

unscrupulous and, sometimes, criminal entities.

To address these challenges, the government authority The Swedish Fund Selection Agency (FTN) was created in 2022. FTN is tasked with procuring and continuously evaluating funds within the premium pension system.

The transition from an application-based to a procured platform marks a significant change. The state now takes on an active role to ensure the availability of high-quality, sustainable, controllable and cost-efficient funds on the fund platform.

Around €100 billion will be procured over the next few years. This makes FTN one of the largest procurers of funds globally. The premium pension system's assets are anticipated to double by 2040, with continued net inflows of capital until 2060.

The search process, initiated in 2023, is gaining momentum, with FTN set to announce at least six procurements totalling around €20 billion.

The aim is to improve security and increase the average return for savers who invest in external funds. FTN envisions a 50 basis points (bps) increase in the average annual return without altering the risk level. Achieving this objective requires the synergy of several parts.

Firstly, negative selection targets identifying and avoiding unsuitable funds not adhering to mandatory requirements. This is done by the Operational Due Diligence team responsible for continuously reviewing and monitoring funds on

the platform, as well as for evaluating tenders based on operational requirements during procurement.

Looking at historic data in the premium pension system, divesting the worst performing 10 per cent in each category would improve average annual returns by 40 bps.

The second component, positive selection, leverages assessment criteria and analysis to identify funds of high quality and thus likely to outperform. A starting point for quality assessment is the three Ps – people, philosophy, process – that has been proven academically and through best market practice as alpha forecasters. The due diligence process involves thorough analysis of multiple dimensions of the investment activities of the fund managers.

The third component of value creation addresses a fourth P: Price. The current average annual fee among all external funds stands at 33 bps. Consolidating funds from approximately 450 to 150-200 enhances competition and raises the average ticket size, compelling asset managers to offer more competitive pricing.

In analysing the potential for increased returns for Swedish savers by transitioning to a procured system, we confidently assert that the mission is possible. There are pitfalls and challenges to be overcome, but with help from an adaptive fund industry willing to evolve, we anticipate the premium pension system to stand stronger and continue to be a financial success for future generations.