The Swedish old-age pension system

How the income pension, premium pension and guarantee pension work

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Introduction

The national pension system – the statutory old-age pension – is part of the Swedish social insurance system. It covers everyone who has worked and lived in Sweden. It is made up of income pension, premium pension and guarantee pension.

The national old-age pension is the main component of pension cover, and the principal means of support, for most pensioners. The core is the income-based pension, i.e. income pension and premium pension. If necessary, it is supplemented by a guarantee pension, a benefit offering basic cover for those with a low or no income-based pension. The basic cover for old-age pensioners also includes housing supplement and maintenance support for the elderly[1], both means-tested benefits.

Income and premium pensions are work-based benefits. Everyone who has worked in Sweden, paid income tax and thereby earned their pension entitlement, has an insured right to a pension. Income and premium pensions earned are paid out wherever the insured individual is resident as a pensioner. The income-based pension is financed via contributions. The income pension system is a distribution system[2] with a buffer fund. The premium pension is a fully funded system with individual funding.

The guarantee pension is a residence-based benefit. According to the main principle, it is earned via residence in Sweden and paid to pensioners resident in Sweden. Other components of the basic cover are also residence-based benefits. The basic cover benefits are financed through general tax receipts.

In most cases, the national pension does not represent the whole of the pension cover. Around 90 per cent of the gainfully employed are also covered by occupational pension insurance. The occupational pension supplements the national pension and plays a particularly important role for high income-earners. To them, the occupational pension is not an insignificant component of their total pension. Saving in a personal pen-

[1]These benefits are outside the national pension system.
[2]In a distribution system, the contributions paid in during a year are used primarily to finance the pensions payable in the same year.

sion insurance plan is another way of boosting the individual's future pension.

Here, we first describe the national income-based pension and how it is financed. We go on to describe the guarantee pension and, in brief, other basic cover benefits, survivor's pension for adults and occupational pension. The benefits, with the exception of occupational pensions, are administered by the Swedish Pensions Agency.
Finally, a number of current studies in the area are listed, along with some figures on the number and costs of old-age pensions.

The national income-based pension

An overview of the income-based pension

- The income-based pension functions as pension insurance
- The pension is defined-contribution – based on lifetime income
- Earned pension entitlement is 18.5 per cent of income up to a maximum amount, a ceiling
- Clear components of distribution are included, for example, pension entitlement during parental leave to care for young children, to compensate for loss of normal pension entitlement earned through work.
- An earned pension entitlement is represented by a contribution of corresponding size, which is booked to the individual's account
- The pension system is insurance for advanced age. Balances of account from individuals living shorter-than-average lives are distributed to survivors of the same ages – inheritance gains. In this way, a redistribution takes place from those who live shorter lives to those who live longer.
- The balance of account is made up of earned pension entitlements, yield and inheritance gains, less administration costs.
- The account, divided by average life expectancy and including advance interest, determines the size of the pension.
- The balance of account is to include pension entitlement credited on the basis of income actually earned[3]. No other eligibility requirements apply.

Of the 18.5 per cent pension contribution, 16 percentage points go to the income pension (distribution system) and 2.5 percentage points to the premium pension (fund-based system).

A new pension system

In 1998, a decision was taken to establish a new pension system. The reformed system of rules has been phased in and has been implemented in full since early 2003. The main reason for the reform was the financial instability of the former system; its lack of flexibility in responding to economic and demographic changes in society. How the value of the pensions grows relative to employment and pay is of major importance

[3]See below regarding the earnings requirement.

to the stability of the system, and how the pension system adapts to changes in economic conditions affects the general economy, in a relationship of mutual dependence. Another reason for reform was to strengthen the link between contributions and benefits - fairness in the ratio of money into and money out of the system, both from one individual to another and from one generation to another.

The income-based old-age pension was reorganised into an independent sector of insurance, separated from other social insurance sectors. It is financed entirely via contributions. On the financial side, too, the income-based pension is an independent system. Expenditure and contribution income are reported outside of the national budget.

One important aspect of the reform process has been to design a system that is not only financially, but also politically, stable. A pension insurance plan is a long-term undertaking, and confidence in the system lies in the belief in its stability in the broad sense. Political stability depends on an agreement between six of Sweden's parliamentary political parties. This agreement encompasses the old-age pension system, i.e. the rules on income pension, premium pension and guarantee pension.

Both a distribution system and a premium reserve system

The income-based old-age pension is essentially an independent and self-financed system based on a fixed contribution. It is made up of two components, income pension and premium pension. There are great similarities between the two components, how the pension is earned and calculated, but also crucial differences.

The *income pension system* is a distribution system: the pension contributions paid in during the year finance outgoing pension payments in the same year. Pension contributions are accounted for as a pension entitlement on the individual's account, but thus without any corresponding funding. If contributions paid in do not cover outgoing pension payments, the deficit is made up via financing from the system's buffer fund. The buffer fund actually consists of four independent funds: The First – Fourth AP (National Pension Insurance) Funds[4].

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[4]The Sixth AP Fund also serves as an asset in the income pension system, but neither receives contributions nor pays out pensions.

The *premium pension system* was created as part of the reform of the pension system. The reason for introducing the system was that it would offer a certain equalisation of risk in that the old-age pension will reflect both the rise in living standards in society and the return on assets. Another argument for a premium reserve system was based on its stability: the pension entitlements are funded and therefore correspond to individual capital sums that are protected by civil law. This avoids the uncertainty when the pension is based on a social contract. It was also emphasised that a premium reserve system is financially stable; the financing for pensioners is assured without the contribution needing to be increased. Several of the features that characterise the insurance-based premium pension system are incorporated into the design of the income pension.

The premium pension is thus a fully-funded system with individual funding. An amount corresponding to the pension entitlement earned is allocated to the premium pension account of the insured individual. The pension saver themselves have the option of choosing funds for their premium pension allocation. This provides scope for global risk diversification and an ability for the insured individuals themselves to choose a level of risk based on their personal situation. Up to five different funds may be chosen from a wide range of funds (the "fund marketplace"). The assets of those not wishing to make a personal choice are invested in the AP7 Såfa fund[5]. The growth in the premium pension account is determined by the performance of the funds selected.

Income index and income base amount for more accurate economic adjustment

An income index and the income base amount were introduced in connection with the income pension system. The *income index*[6] is a measure of growth in the average income across society. The income index is used to secure the value of pension entitlements. They rise in line with the general rise in incomes; pension entitlements are therefore living standards-proofed. The income index measures the annual change in nominal

[5]State's Age Cohort/Management Options" within the Seventh AP Fund
[6]The way the income index is calculated is laid down in the Swedish Social Insurance Code. A less technical description is provided in the Orange Report published annually by the Swedish Pensions Agency. The same applies to other calculation factors mentioned in the following.

average income[7]. The income term used is pensionable income without any ceiling restriction for individuals aged 16–64 years.

The growth in the *income base amount* is determined by the income index, similarly to the way the consumer price index is used to calculate the price base amount. A maximum amount linked to the income base amount rather than the price base amount is more relevant, in that it is living standards-proofed. The income base amount for 2017 is SEK 61 500.

Guide to description of the income-based pension

The income-based pension is *one* pension, but is made up of two components, income pension and premium pension. The rules of the pension system are largely common to both components. Where the rules differ, they are nevertheless drawn up on the same principles. It is natural that there should be differences between a distribution system and a funded system – differences in the details, even if the details concerned are of great importance.

In the following, we first describe the common aspects of the income and premium pensions. How the pension is earned, what the basis of pension entitlement is, applies naturally enough to the *income-based* pension, i.e., equally to the income and premium pensions. When and how the income and premium pension can be taken are also subject to common rules. The same principles apply to how the individual's pension accounts fluctuate during the earning period, and to how the pension is calculated.

The income and premium pension systems differ in more ways than the size of the pension entitlement (16 versus 2.5 per cent, respectively, of the basis for calculation). Under the headings "Specifics of ...", descriptions are given of rules that apply specifically to each sub-system. A more key component specific to the income pension is the *balancing mechanism* for pension balances and pensions. The rules on the balancing mechanism enable the distribution system to be "self-governing" in a manner similar to that of the premium pension system.

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[7]The calculation formula for the income index has been amended, with effect from the beginning of 2017. The amended formula provides a simpler, more relevant income index.

Pensions are earned – basis of pension entitlement

Those who work and pay taxes earn pension entitlement for old-age pension

As a principle, all taxable benefits create pension entitlement: income from work and benefits under social and unemployment insurance schemes. The latter consist of transfers such as sickness benefit, parental benefit, etc. that are paid out for periods instead of wages/salaries, together with sickness benefit that replaces former employment earnings on a long-term basis.

No age limits for earning pension entitlement

Pensions are based on income that the individual has received throughout life, i.e., they are based on the lifetime earnings principle. Income early in life – even during childhood years – is included. The fact that such income is included is not primarily because of its importance in terms of pensions. It is more due to a lack of a reason for a lower age limit for earning entitlement to a national old-age pension. There are no obvious reasons either for an upper age limit for earning entitlement. For a pensioner earning new pension entitlements, the pension paid will be increased from the end of the year after the pension entitlement has been determined.

A very low annual income does not provide any pension entitlement

A minimum limit – or threshold – applies to pensionable income. The lower limit is connected to the way in which income information is collected. Pensionable income is determined on the basis of the tax authority's decision on final tax. The minimum limit for filing a self-assessment income tax return therefore represents a threshold that must be exceeded in order to have pensionable income credited. Above this threshold, pensionable income is calculated for every krona of income. A self-assessment tax return has to be filed if the individual has earned income of 42.3 per cent of the price base amount[8] or more. For 2017, this means that the threshold in the system is SEK 18 951 - the lowest annual income on which pension entitlement can be calculated.

[8] In 2017, the price base amount will be SEK 44 800.

High annual income does not provide pension entitlement either in the national pension system

An upper limit for pensionable income has applied since the national income-based pension was introduced in 1960. The upper limit, or earnings ceiling, is linked to the income base amount and is set at 7.5 times the income base amount. The earnings ceiling thus varies according to the growth in the average income. The intention is that the pension cover should not decline in scale and importance over time, and that the percentage of gainfully employed individuals with income above the ceiling should be maintained largely unchanged. In 2017, the maximum pensionable income will be SEK 461 250 per annum (SEK 38 438 per month). The occupational pension represents the pension cover for higher incomes. Around 15 per cent (mainly men) have an income above the ceiling in the national old-age pension system.

Student or parent of young children? Pension entitlement may also apply

The lifetime earnings principle, applied to its full extent, does not offer scope for any absence from work without the individual's pension being affected. But there are situations in life for which absence from work should not result in a lower pension. One such occasion is absence due to a parent being off work to care for young children. On such occasions, the insured individual is credited with a notional income – a "pensionable amount" – as a basis for pension entitlement. Pensionable amounts are granted for childcare years, studying, national service and sickness benefit and activity compensation.

Parents of young children can have pension entitlement based on a pensionable amount, provided that certain conditions are fulfilled. The conditions do not apply to the practical circumstances, such as actual custody of the child or loss of earnings, but objective factors, such as legal custody, residence and age criteria. Pensionable amounts for childcare years are calculated for the child's first four years[9]. The notional amount is calculated on the basis of which of three methods is most advantageous to the parent[10]. The parents themselves decide which of them is to be credited the childcare year. Childcare years are credited irrespective of

[9]In the case of adopted children, special rules apply, with an upper age limit of 10 years.
[10]Three methods for calculation of the pensionable amount: 1) a top-up to the pensionable income (PI) that the parent received the year before the child's birth; 2) a top-up to 75 per cent of the average PI for everyone up to age 64 years; 3) a top-up of one income base amount.

whether the parent has been simultaneously in receipt of parental benefit, income from work or other pensionable income[11].

The pensionable amount for *studying* is based on study grant paid and for *national service* on part of the average income for insured individuals aged 16–64 years.

The pensionable amount is calculated for years in which *income-based sickness benefit or activity compensation* is paid. The benefit is pensionable and the pensionable amount provides an extra increment to a higher benefit level in relation to an assumed individual income from gainful employment.

Earnings requirement

The income-based pension is thus not strictly based on the individual's income alone. On the other hand, it should not be based on notional income alone. For pensionable amounts for childcare years, studying or national service to pay a pension, the individual must also have worked and earned pensionable income. The *earnings requirement* must be fulfilled. The earnings requirement means that the insured individual must have had a pensionable income, for at least five years, of no less than two income base amounts.

Pension base

The insured individual's pension base is the sum of pensionable income and pensionable amounts. The pension base is limited by the earnings ceiling. For 2017, the earnings ceiling is SEK 461 250. An individual with the maximum pensionable income is thus not entitled to pensionable amounts, even if the terms and conditions are otherwise fulfilled. The pension entitlement corresponds to 18.5 per cent of the pension base. For 2017, the maximum possible earned pension entitlement is SEK 85 331. The pension entitlement is credited to the individual's pension accounts.

Pension account during period of earning entitlement

Pension earning takes place over a long period. The first earned pension entitlements are often more than 40 years old when the time comes for the pension to be claimed. This means that the growth in value of the

[11]Subject to an earnings ceiling of 7.5 times the income base amount.

pension entitlements during the period of saving is crucial to the size of the final pension. Growth during the period of the pension also affects the size of the pension.

The pension entitlements on the individual's account generate a yield. This yield arises in different ways in each of the income and the premium pension systems. The pension system is structured on insurance principles. This includes distribution of inheritance gains (death benefits): the pension assets of deceased persons are distributed among survivors of similar ages. This provides an extra annual yield that is added to the pension entitlements. An amount to cover the costs of administration of the system is deducted annually from the pension account.

Pension withdrawal

Pension may be drawn from no earlier than age 61 years. The later the pension is drawn, the higher the monthly amount is. The period as a pensioner becomes shorter, and the balance of the individual's pension account will be paid out over a shorter period. A pension can be drawn in full or partly as 75, 50 or 25 per cent of the whole. Drawing a pension does not mean that the individual has to stop working. The individual can draw their pension in full or in part and can continue to earn new pension entitlements. The decision to draw a pension has lifelong effect, but is not irrevocable. The pensioner can instruct pension payments to cease and subsequently for the pension to resume at any time. Income pension and premium pension are drawn independently of each other.

The basic principle of the pension calculation is that the total amount in the pension account is spread over the estimated average number of years the new pensioner is expected to live. The pension amount is paid out lifelong. The fact that some live longer than the average is counterbalanced by the fact that others live shorter lives, on the principle of distribution of inheritance gains. In addition, the pension amount is credited with advance interest, an advance on what the annual yield may generate over the years ahead. The advance interest means that the just-approved pension is higher – giving more money earlier. On the other hand, growth in the pension is slower, as the advance is deducted from future index adjustments. This means that the fall in income that follows from the transition from gainful employment to retirement is attenuated, and that the pensioner enjoys relatively higher income at the beginning of retirement than towards the end.

To put it another way: the annual amount for the pension is calculated by applying an annuity divisor to the account. The size of the annuity divisor is determined by the remaining average life expectancy at the age of pension withdrawal, together with the advance interest rate. The annuity divisor is the same for women and men, and specific to each age cohort.

The pension is paid out wherever the insured individual is resident as a pensioner – in Sweden or abroad. Small amounts are paid out semi-annually or annually instead of monthly.

Specifics of the income pension system

The pension entitlement for income pension represents 16 per cent of the pension base. The amount is credited to the individual's account – this is termed the pension balance within the income pension system. No actual allocation or funding takes place, since the income pension is a distribution system. The way in which the value of the income pension is to be calculated, before and after the date of retirement, is laid down in the Swedish Social Insurance Code (Swedish acronym: SFB).

Living standards-proofed with income index

Pension entitlements can be earned on a lifelong basis. For the lifetime income principle to have real significance to the individual, pension entitlements earned early in life must retain their relative value up to the time of retirement. Within the income pension system, this is effected via an income index that indicates the change in the average income across society. Income indexation is the yield chosen for the system.

Balance index

Pension entitlements earned thus change to reflect the change in the average income. The intention is that a pension entitlement earned early in life with an average income, will also represent an average income at retirement. To the insured individual, the choice of the average income means that the incomes for different years will be essentially of equal value. The growth in the average income will affect the growth in the system's pension liability.

In terms of the system's economic adjustment to the general economy, the average income is a good choice, but not always the best one in all situations. It depends on how closely the change in the average income corresponds to the sum of incomes. The sum of incomes is the basis on which contributions in the system are calculated. Growth in the sum of incomes affects the growth in the assets within the system. To maintain stability, changes in assets and liabilities have to follow a similar trend.

If the mean income across society were to rise more sharply than the total sum of incomes, in such a way as to jeopardise the financial stability of the system, the *balancing mechanism* is activated so as to restore stability[12]. The balancing mechanism prevents the cost problems of today

[12]It should be added that indexation using the sum of incomes would not, either, exclude the possibility of indexation activating the balancing mechanism. More information on the balancing mechanism is provided later in this report.

being deferred until future generations.

During periods when the balancing mechanism is activated, the income index is replaced by the *balance index*. The income index and balance index also determine the annual growth in the pensions paid out.

Inheritance gains

The pension balance is credited with inheritance gains. In the income pension system, inheritance gains are distributed explicitly only before retirement. After retirement, the distribution of inheritance gains is included in the annuity divisor used to calculate the pension.

Administration costs

The grand total credited, the pension balance, is reduced by a deduction for administration costs. No such deduction is made from the pension paid out. The cost deduction from the pension balance is being gradually phased in. In 2021, the deduction will equate to the entire administration cost.

Technically, the distribution of inheritance gains and the cost deduction are effected by multiplying the pension balance annually by an inheritance gain factor and an administration cost factor.

Calculation of the income pension

When the pension is drawn, the pension amount is calculated by applying an annuity divisor to the pension balance. The size of the annuity divisor is determined by the remaining life expectancy according to official life expectancy statistics and by the advance interest rate.

Calculation of the income pension amount is thus based on observable life expectancy. However, the trend has been that we are living longer and longer. If this trend persists, the annuity divisor will underestimate how long the recently-retired of today will be collecting their pension. This could contribute to a weakening of the system's economy and stability; in other words, a situation that, if such arose, would be addressed by activating the balancing mechanism.

The advance interest rate is set at 1.6 per cent. This choice is to an extent a compromise. A high advance interest rate will increase the recently-approved pension – the individual receives a higher degree of compensation. On the other hand, the pension paid out will increase more slowly. The pensions will not maintain the same rate of growth as the incomes for those who are gainfully employed at the same time. The risk of the pension actually declining in the future increases. A high advance interest rate combined with low future growth would result in such a scenario.

Pension balance becomes pension amount

When the insured individual retires, the pension balance is converted into an outgoing pension amount. When full pension is drawn, the whole pension balance is converted into a pension amount. In the case of part-pension withdrawal, the corresponding proportion of the pension balance is converted to a pension amount.

Economic adjustment indexation

The income pension is adjusted annually to reflect any change in the income index, as described above for the pension balance. Because the pension amount has already been credited with an interest rate of 1.6 per cent, a deduction equal to that amount is made from the index adjustment. The change in the income index is reduced by 1.6 percentage points.[13] This is called "economic adjustment indexation". If the balancing mechanism is activated, the balance index is used instead of the income index. Indexation based on the balance index has the effect that the pension paid out during the balance activation period is lower than it would otherwise have been.

The balancing mechanism – long-term economic confidence in the income pension

The decision to base the income index on the average income rather than the sum of incomes has the effect of prioritising stability in the ratio of the income for the gainfully employed to the income for pensions over financial stability. If the situation develops such that income indexation becomes a burden to the system's economy, the balance mechanism will be activated – the indexation of the pension balances and pensions will become less generous. The balance mechanism prioritises a fixed pension contribution and promotes economic fairness between generations, ahead of the yield on contemporary pensions[14].

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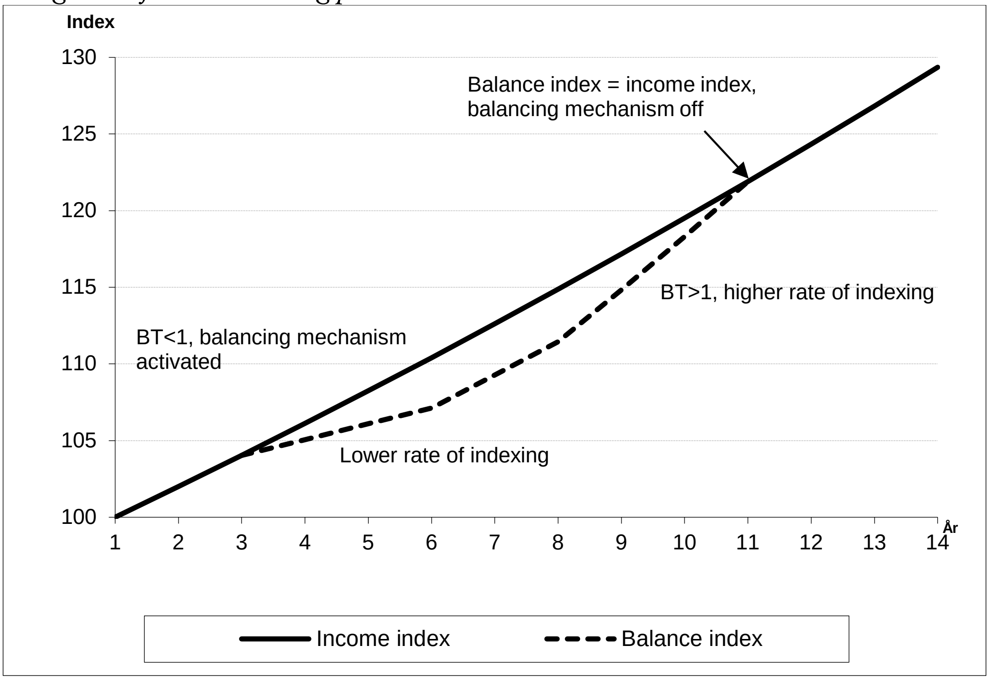
[13]In fact, the ratio between the income index for the year and the previous year, divided by 1.016.

[14]Other factors, such as the value of the AP Fund and consequences of the fixed annuity divisor can also trigger the balancing mechanism.

Weaker financial conditions within the income pension system may thus lead to the balancing mechanism being activated. The yield is then applied via the balance index rather than the income index. To begin with, the balance index produces a lower yield than the income index. When the economy improves, the opposite applies. Once the balance index has caught up with the income index, the balancing mechanism is deactivated.

Diagram of the balancing process



When and how the balancing mechanism is activated

The balancing mechanism is activated if the assets of the income pension system become less than its liabilities. The ratio between assets and liabilities is termed the balance ratio. If the balance ratio falls below that figure, the balancing mechanism is activated. The balance ratio affects indexation. As long as the balance ratio is less than 1.0, indexation will be lower than the change in the income index. When the balance ratio exceeds 1.0, indexation will be higher than the change in the income index. The yield on the pensions and pension entitlements is higher, but a yield deficit remains that has to be made up – see the diagram above.

For the balancing mechanism method to be used, it must be possible for the assets and liabilities of the distribution system to be calculated annually. The assets of the system are made up of the buffer fund and what are called the contribution assets. The contribution assets are an estimate of the future flow of contributions, but only on the basis of the conditions on the day, i.e., those that apply at the time of estimation. The liabilities of the system consist of the pension liability towards the gainfully employed and current pensioners. For a description of how the calculations are performed, see the Orange Report, the Pensions Agency's Annual Report. The report also contains calculation formulae for the annuity divisor, etc.

A brake for pensions

The balancing mechanism may be likened to a stock market fall within the premium pension system. The pension balance earned before activation of the balancing mechanism will not have been affected after the balance activation period has ceased. After the balance activation period, the value of that part of the balance will be as high as it would have been without the balancing mechanism. The pensions paid out during the balance activation period are lower than they would have been without the balancing mechanism. When the balance activation period is over, the pension paid out will have recovered its value in the same way as the pension balances. In the case of pension entitlements earned during the balance activation period, the similarity with the premium pension system ceases. Without specific action, pension entitlements earned during the period are favoured. These would acquire an extra high uprating during the latter part of the balance activation period without having previously suffered a corresponding write-down. To prevent an effect of this kind and instead achieve equal treatment of pension entitlements, the recently earned pension entitlement is reduced before being added to the balance. The reduction corresponds to the aggregated impact of the balancing mechanism on the pension balance at the same point in time. After the balance activation period, the value of the pension entitlements earned during the period is just as high as it would have been without any balancing mechanism. To sum up, the only (short-term) effect of the balancing mechanism on the individual is lower pension payments during the balance activation period.

Specifics of the premium pension system

The pension entitlement for premium pension represents 2.5 per cent of the pension base. The amount is credited to the individual pension account. The premium pension is a fully funded system with individual funding. The insured individuals themselves choose how their premium pension saving is to be invested. The premium pension business is to be conducted in accordance with insurance principles. The Pensions Agency, which acts as insurer for the premium pension, is responsible for calculations for the premium pension system.

Fund performance determines yield

The change in value of the pension entitlements is determined by the returns on the funds chosen. Value growth will therefore not be the same for all. Despite equal earned entitlement, the balance of the premium pension account will differ according to the individual fund choice.

Inheritance gains

"Insurance principles" includes distribution of death benefits – termed "inheritance gains" in the national insurance system. The premium pension assets of the deceased are distributed among survivors of similar ages, both gainfully employed and pensioners.

Administration costs

The costs of administration may be divided into costs of asset management and costs of other administration. The costs of asset management vary according to the fund(s) chosen and are deducted directly from the assets under management. The deduction, depending on size, may substantially reduce the future pension, since it takes place over so many years. The insured individuals themselves can influence this portion of the costs. Other administration costs are deducted directly from the premium pension account.

Calculation of the premium pension

The annual premium pension, which is paid out, is calculated by dividing the balance on the premium pension account by an annuity divisor. The annuity divisor for the premium pension is based on forecast future life expectancies. The annuity divisor is credited with an advance interest rate equal to 3 per cent. The premium pension account remains in place during the retirement period. The account is adjusted for discrepancies between forecast and outcome and is updated to reflect the changes that occur.[15]

Two options for form of pension payment

When the pension is drawn, the insured individual decides whether their pension assets are to remain in the chosen funds or whether the pension is to be drawn in the form of traditional insurance. In the first case, the premium pension amount is determined by the growth in the value of the fund units. With traditional insurance, a minimum amount is guaranteed for the pension. The insured individual's fund units are sold, and responsibility for the investment passes to the Pensions Agency, which is the insurer. A transfer to traditional insurance is also possible subsequently during the retirement period. On the other hand, it is not possible to go back to fund insurance from traditional insurance.

One decision that has to be made when the premium pension is drawn for the first time is the question of survivor's cover for the insured individual's spouse. With survivor's cover, the pension is paid out as long as either of the spouses live, although at a lower monthly amount than without survivor's cover.

Transfer of premium pension entitlement

There is an option to transfer the premium pension entitlement between spouses. It is a way of improving individual pension cover for spouses with a low income. The transfer is carried out annually and consists of the earned pension entitlement for the calendar year. It is mostly the husband who transfers his pension entitlement to his wife. Because women generally live longer than men, such transfers represent an additional expense to the system – the transferred pension entitlement will on average be paid out over a longer period. To prevent any additional expenses being transferred to the collective, a charge is levied. The charge is currently levied at 6 per cent of the assets transferred.

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[15] Annually for value growth, distribution of inheritance gains and deduction of contributions. New life expectancy forecast every three years

Pension entitlement represented by pension contribution

The income-based pension is a contribution-based system. Every pension entitlement credited is represented by a contribution of corresponding size paid into the system. The pension contribution, 18.5 per cent of the pension base, is divided between the two sub-systems. The largest portion of the old-age pension is the income pension. The pension contribution for this component is 16 per cent. The share of the pension base represented by the premium pension is 2.5 per cent.

Who pays what?

The payment of contributions is shared among the insured individual, the employer (including the self-employed) and the State. The insured individual and the employer pay the contribution for pension entitlements on the basis of income from work, while the insured individual and the State pay the contribution for transfers (sickness benefit, etc.) providing pension entitlement. The State pays the whole contribution for pensionable amounts (notional income items credited).

National pension contribution

The contribution paid by the individual is called the national pension contribution. It is charged on income components that provide pension entitlement. There is therefore a ceiling for contributions deducted, a contribution ceiling. The contribution ceiling is slightly higher than the earnings ceiling. This is because the contribution itself is not pensionable. It is deducted from income before the pensionable income is determined. The individual's income is therefore always higher than the corresponding pensionable income established. The national pension contribution is 7 per cent and is paid on incomes up to 8.07 income base amounts (the contribution ceiling). For a salary of 8.07 income base amounts, the pensionable income is – after deduction of the contribution – 7.5 income base amounts[16] (the earnings ceiling).

The national pension contribution is paid in conjunction with the payment of preliminary tax. However, in the final tax assessment, the final tax of those in gainful employment is reduced by an amount corresponding to the national pension contribution paid, with the result that the contribution is in practice paid by the State.

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[16] 8.07*0.93=7.5. Similarly, for an individual with a salary of, for example, 5 income base amounts, the pensionable income will be 4.65 income base amounts.

Old-age pension contribution

Naturally, where gross income instead of pensionable income is used as the contribution rate, the contribution base is lower. 18.5 per cent of pensionable income equates to 17.21 per cent of the income before the deduction of the national pensionable contribution. This means that a charge of 10.21 per cent remains for the employer to pay in old-age pension contributions. It should be added that an employee acquires full pension entitlement even if the employer has not effected payment of the old-age pension contributions in full. On the other hand, in the case of self-employed individuals who have not paid their contributions in full, their pension entitlement will be correspondingly reduced. The old-age pension contribution is one of the constituents of employer's contributions and self-employed's contributions.

State old-age pension contribution

In the case of pensionable transfers, the State pays a State old-age pension contribution of 10.21 per cent. For pension entitlements based on pensionable amounts, the State pays the entire contribution. In that case, the State old-age pension contribution amounts to 18.5 per cent[17]. With regard to the pensionable amount, the pension base and the contribution base are the same. The pensionable amount is a notional income figure, which does not equate to any actual income for the insured individual. The amount is therefore not included in the base for the national pension contribution.

How contribution revenue is apportioned

The national pension contribution is transferred in entirety to the income pension system. The employer's contribution (old-age pension contribution) is charged on the total salary amount. Because income components above 8.07 income base amounts (the contribution ceiling) do not provide pension entitlement, that part of the contribution is considered as a tax and is transferred to the State budget instead of the pension system. The old-age pension contribution below the contribution ceiling and the State old-age pension contribution are divided between the income and premium pension systems.

The contributions in the distribution system (i.e. the income pension system) go to AP Funds and finance contemporary pension payments. The premium pension contributions are transferred to the Swedish Na-

[17]Also applies to income-based sickness benefit and activity compensation. The benefit is not included in the base for the national pension contribution.

tional Debt Office and are invested in fixed-income assets until the premium pension entitlements of the insured individual have been established in conjunction with their tax assessment. Then, the money is invested in the funds that the insured individual has chosen, or in the AP7 Såfa fund.

Contributor and type of contribution base. Contribution deduction and where the contribution is transferred.

Contributor	**Type of contribution base**					
	Wage/Salary		**Transfers**		**Notional income**	
	Contribution	*Transferred to*	*Contribution*	*Transferred to*	*Contribution*	*Transferred to*
Insured	7%	Income pension	7%	Income pension		
Employer's, self-employed's contributions	10.21%	Income pension, Premium pension*				
State			10.21%	Income p. Premium pension	18.5%	Income pension Premium pensions

*Contribution based on salary components above the ceiling is transferred to the State budget

Transitional rules

The old-age pension is a long-term undertaking. The insured individual may have adapted their gainful employment to current rules, such that their finances in retirement feel secured. The reformed rules for old-age pensions are therefore being phased in gradually, with increasing impact on the age cohort the younger the cohort is.

The system of rules described above applies in full to individuals born in 1954 or later. Pensioners born in 1937 or earlier are paid their entire pension in accordance with the rules of the former ATP system. Individuals born in 1938 are paid 4/20ths of their old-age pension earned under the new rules, and 16/20ths of their pension earned under the former ATP rules. For individuals born in 1939, the ratio is 5/20ths and 15/20ths, and so on until 19/20ths and 1/20ths for individuals born in 1953.

Guarantee pension

The guarantee pension is a direct supplement to the national income-based pension. It is paid to those who have earned only a low pension or no pension at all.

The guarantee pension forms the basis of the tax-funded basic cover for old-age pensioners. Those who have not earned any national income-based pension at all receive a full guarantee pension. To those who receive a low income-based pension, the guarantee pension is a top-up. The intention of the guarantee pension is to enable personal consumption to be assured, in addition to housing costs. The system of rules described here applies to individuals born in 1938 or later.

An overview of the guarantee pension

- Earned via residence and paid to pensioners living in Sweden
- Offset against the national income-based pension and widow's pension
- Price-indexed
- Paid out no earlier than at age 65 years
- Eligibility: three years of residence

Residence requirement

For entitlement to a full guarantee pension, the individual must have been resident in Sweden for 40 years between the ages of 25 and 64 years, i.e., throughout this period. The years between 16 and 24 years may be counted as years of residence if the individual has at the same time earned pensionable income[18]. In the case of individuals resident in Sweden for less than 40 years, the pension is calculated in 40th's of the full guarantee pension[19]. No less than three years of residence are required for entitlement to guarantee pension[20].

The guarantee pension is paid to pensioners resident in Sweden, but may also be paid in the case of residence in another country, especially in the EU/EEA.

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[18] Also applies to those who have been in receipt of income-based activity compensation.
[19] In particular situations, earning of entitlement may include period of residence in the former country of residence.
[20] Two of these years may consist of residence in the EU/EEA.

Means testing

The guarantee pension is a pension for those with a low national income-based pension. Means testing is therefore only applied in relation to the national pension. The guarantee pension is offset against Swedish and foreign national income-based individually earned pension and widow's pension. In this context, no account is taken of actually earned premium pension. Instead, offsetting is applied as if the whole of the income-based pension were income pension[21].

One reason for this calculation method is to simplify administration.
Transfer of premium pension entitlement or choice of survivor's cover does not affect the size of the guarantee pension. The calculation is performed as if such choices have not been made. This is because if, for example, a transferred pension entitlement is "offset" against a lower guarantee pension, the importance of the transfer to the beneficiary is lessened. Furthermore, the idea is not that the guarantee pension should compensate for a pension entitlement transferred to the individual's partner. Since account is taken only of (an upwardly adjusted) income pension, the automatic effect is that choices in the premium pension will not affect the size of the guarantee pension.

The fact that the growth in value in the premium pension is not taken into account in the guarantee pension is, of course, a positive outcome for pensioners who have been successful in their fund choices – the pensioner can always keep the higher return intact. On the other hand, a pensioner seeing poorer value growth in their premium pension than in their income pension will lose out with this calculation method – the guarantee pension will be lower than if the pensioner's actual conditions had been taken into account.

Indexation with price base amount

The guarantee pension is linked to the trend of prices: amounts and deduction frequency are expressed in terms of price base amount[22]. This means that guarantee pensioners do not share in increases in real incomes that have befallen to the average gainfully employed individual. So, the guarantee pension is index-linked but not living standards-linked.

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[21]That is, as if the income pension had been earned at 18.5 per cent instead of 16 per cent.
[22]In 2017, the price base amount will be SEK 44 800.

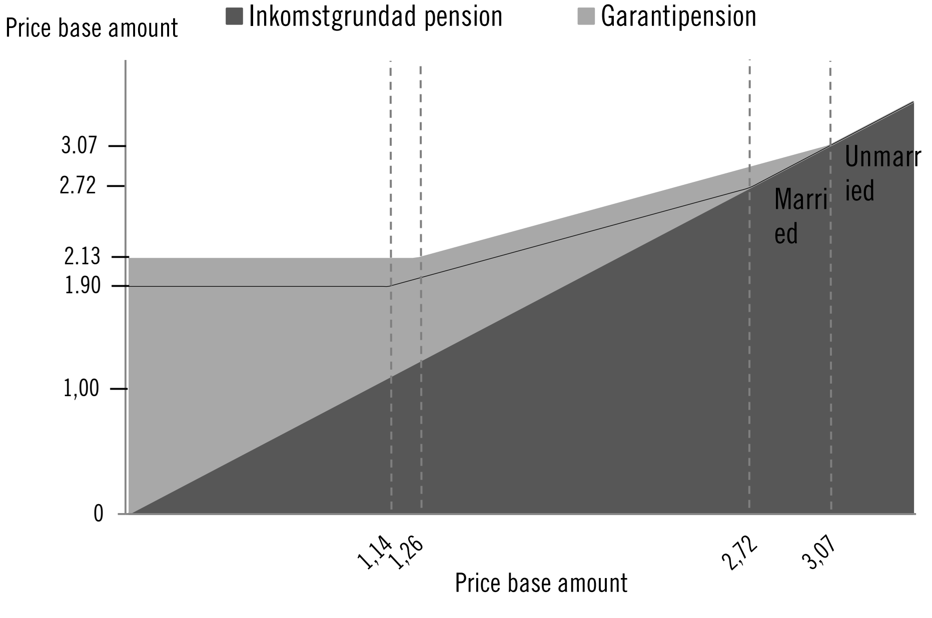
How the guarantee pension is calculated

The full guarantee pension in 2016 for a single pensioner is SEK 7 952 per month before tax deductions (2.13 price base amounts per year). The amount for a married pensioner is slightly lower, SEK 7 093 (1.90 price base amounts). The guarantee pension is reduced by the income-based pension in two stages.

A low pension reduces the guarantee pension, krona by krona. In other words, the total monthly pension is unchanged at SEK 7 952 and SEK 7 093, respectively, at this initial stage. For our purposes here, a low pension is a monthly amount of no more than SEK 4 704 (annual amount, 1.26 price base amounts) for a single pensioner and SEK 4 256 (1.14 price base amounts) for a married pensioner.

This second stage deals with pension components above these levels. In these higher ranges, the guarantee pension is not reduced as sharply. The guarantee pension is reduced by only 48 per cent of the income-based pension above SEK 4 704 and SEK 4 256, respectively. The reason for this lesser deduction is to reduce the marginal impact to make it worthwhile to work and earn a higher income-based pension. Individuals with a higher pension may be assumed to have a longer-term association with the labour market, and this should also be reflected in the total old-age pension.

Income-based pension deducted from guarantee pension



Withdrawal age 65 years

Guarantee pension may be drawn from the age of 65 years. Later withdrawal does not give a higher pension. The annual amounts based on 2.13 and 1.90 price base amounts are fixed, irrespective of withdrawal age.

Guarantee pension is paid out only in conjunction with income pension to those who are entitled to a pension of this kind. The income pension may be drawn before the age of 65 years, in which case it will be lower than if it had not been drawn until 65 years. However, the coordination of income and guarantee pension is structured such that the guarantee pension does not compensate for early withdrawal. Guarantee pension is always calculated as if the income pension is drawn from the age of 65 years. Income pension earned after 65 years is also deducted from the guarantee pension on the principle that it is entirely possible to draw a pension and continue to work.

Other benefits for old-age pensioners

Alongside the national old-age pension (income, premium and guarantee pension), there are two further benefits, which are components of the basic cover for those who have reached 65 years: housing supplement and maintenance support for the elderly. The housing supplement is a supplementary benefit that is available when necessary to supplement the guarantee pension. Maintenance support for the elderly is, like the guarantee pension, a supplementary or standalone benefit for those who have neither earned an income-based pension nor are entitled to a guarantee pension. Both the housing supplement and the maintenance support for the elderly are tax-free benefits.

In addition, most old-age pensioners nowadays have a collectively agreed occupational pension. The rules on occupational pensions distinguish between collective agreement areas, but have major similarities.

The survivor's pension has been mentioned in conjunction with the premium pension. In the social insurance system otherwise, this is a benefit that is in the process of being phased out for the elderly – see below for more information.

Housing supplement

The level of the guarantee pension is not set such that it is also intended to cover the cost of housing. Provisions concerning the guarantee pension's level, etc. assume that a housing supplement will also be in place as part of the basic cover for old-age pensioners. The housing supplement can be paid out from the age of 65 years to those who are resident in Sweden[23] and in receipt of a full old-age pension. The benefit is means-tested at household level; it is tested against the income and assets of the household. The housing supplement amounts to a maximum of 95 per cent of the housing cost up to SEK 5 000 per month. In addition, an extra sum of SEK 340 may be paid. The extra amount has no bearing on the housing cost, it is intended rather as a means-tested subsidy for personal consumption. The amounts are calculated in kronor, i.e., they are not linked to the growth in prices or the like.

[23] In special cases, dispensation may be given for payment in the case of residence abroad.

Those who are in receipt of housing supplement may also receive a special housing supplement. The special housing supplement provides extra support for those paying high rents and is intended to ensure that the pensioner's income, after deduction of housing costs, is sufficient to allow a reasonable standard of living. When maintenance support for the elderly was introduced in 2003, the special housing supplement became less important to old-age pensioners.

Maintenance support for the elderly

Maintenance support for the elderly is the ultimate safety net. It is intended to guarantee a reasonable standard of living for everyone over the age of 65 years, once the cost of housing has been paid. Those who may be eligible for the benefit consist in the main of pensioners with no, or a very low, earned pension, who are not in receipt of full guarantee pension owing to a short period of residence.

Maintenance support for the elderly is means-tested at household level, based on the same income classes, including assets, as for the housing supplement. "Income" also includes housing supplement paid. The test is applied to the incomes after deduction of tax. The ceiling for housing costs is the same as for the special housing supplement, SEK 6 200. The maintenance support for the elderly is calculated as the difference between a reasonable standard of living and the pensioner's income after deduction of tax and deduction of the housing cost (although subject to a maximum of SEK 6 200 per month).

The amount calculated for a reasonable standard of living is linked to the price base amount. For a single pensioner, this is set at 1.473 price base amounts per year, equivalent to SEK 5 500 per month in 2017. For a married pensioner, the amounts are 1.204 price base amounts, equivalent to SEK 4 495 per month.

Occupational pension

Around 90 per cent of the gainfully employed are covered by occupational pension insurance, in addition to the national pension. The structure of the occupational pension is determined by agreement between the labour market partners, and may differ from one collective agreement area to another. A common denominator is, to the extent that an earnings ceiling applies within the occupational pension insurance, that this is considerably higher than the earnings ceiling in the national insurance system. The occupational pension is therefore of particular importance to high income earners.

The rules on occupational pensions have also been reformed in most areas. The changes that have been made have been focused towards a transition to defined-contribution pensions and pensions with individual funding, where the employee can choose from a limited number of investment options. The importance of the occupational pension to the individual may be exemplified by the rules to manual and non-manual employees employed in the private sector[24]. In the case of incomes up to 7.5 income base amounts, an amount corresponding to 4.5 per cent of salary is allocated to pension. In the case of salary components over 7.5 income base amounts, the allocation is 30 per cent. Occupational pension entitlement is earned from the age of 25 years.

Survivor's pension for adults

The premium pension system provides an option for survivor's cover. This is the only form of survivor's pension for the elderly in the national pension system. The former widow's pension is in the process of being phased out with extensive transitional rules. A woman can still be entitled to a widow's pension from her husband if the couple have been married since 1989. However, the widow's pension is coordinated with the woman's own earned pension entitlement.

Under the rules now prevailing, a survivor's pension is paid out as an adjustment pension to the surviving woman or man. The benefit is for a limited period and is only paid out to survivors who have not reached the age of 65 years.

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[24]Administrative employees born in 1979 or later.

Concluding comments

The national pension system is structured with a very high level of automation and adjusts automatically to changes in financial conditions. This means that the rules could essentially remain unchanged for a very long time. However, the outside world is changing and, with that, expectations and demands for society's safety net – in this case with regard to the financial conditions for the elderly – are changing too. There is thus good reason to review, and perhaps re-evaluate aspects of the system of rules. Such reviews have been in progress for some years and are now primarily concerned with the premium pension and the age limits for drawing old-age pension.

The *Orange Report*, *the Annual Report of the Swedish Pensions Agency*, has more information on the national income-based pension system. This includes information on how the system functions, i.e. on factors that affect the system and how, the situation of the system today, and how it will develop in various future scenarios and subject to different calculation formulae. A glossary is also included.

Some figures for 2015

Around 20 per cent of the population is in receipt of an old-age pension. The number of old-age pensioners totals 2.1 million. This number will increase in the next few years, partly as a result of rising average life expectancy, which leads to longer periods in which pension is claimed. Nearly all old-age pensioners have earned an income-based pension. A third of these are in receipt of a top-up via the guarantee pension system. A considerably higher proportion of women benefit from basic cover, guarantee pension or housing supplement than men. This is a result of the historical trend of the labour market, in which women have had lower rates of participation in the workforce and lower income from work.

2015	Number of beneficiaries		Expenditure, SEK bn
	Women	Men	
Income-based pension	1 074 287	983 280	273.5
Guarantee pension	612 155	158 033	15.8
Housing supplement	222 051	68 613	8.6
Maintenance support for the elderly	11 520	9 308	0.8