Individual Accounts: Lessons from Sweden

Introduction

Sweden has instituted a funded mandatory individual account system that incorporates lessons learned from the experiences of Chile and other countries, particularly ways to reduce the administrative costs of an individual accounts system. Sweden's experience may indicate how an individual account system could be put into place if one were adopted, and how such a system might work, including decisions concerning design, and problems that might be encountered.

Overview of the Swedish Retirement Income System

To understand how the individual account system functions in Sweden, it is essential to understand the retirement income system within which it operates. The Swedish retirement income system has two parts. First, public Social Security pensions cover all workers. Second, occupational pensions build on collective bargaining agreements between employers and employees. Approximately 90 percent of workers are covered by some form of collective pension plan (European Commission 2002). In addition, as a safety net for workers without any labor market experience or with low pensions, a means-tested guarantee pension provides a minimum pension. The means test is against income from the mandatory earnings-related pension.

A major reform in 1999 changed the public system from a traditional defined benefit plan to a hybrid plan with defined benefit and defined contribution features. This plan, called a notional defined contribution plan, is financed on a pay-as-you-go basis. The plan is called notional because each individual's account is a bookkeeping entry rather than an actual funded account. Rather than being funded, the system is financed on a pay-as-you-go basis. The benefits from the notional account are based on a formula incorporating lifetime earnings and unisex (nongender-specific) life expectancy at the time of retirement. The account and benefits are indexed in line with the growth rate of earnings. An unusual feature is that rising life expectancy lowers the replacement rate for subsequent cohorts when retirement occurs at the same age.

The new system also has a funded component in the form of mandatory individual accounts, the Premium Pension. While discussions of the Swedish reform have tended to focus on the notional defined contribution plan (Palmer 2001), probably because it is larger and because of its novelty, the Premium Pension is of more interest with respect to possible reform proposals in the United States involving mandatory funded individual accounts.

In 1994, Sweden passed legislation that specified the broad outlines of reform for the new public pension system. In preparation for the new system, the government began collecting contributions for mandatory funded individual accounts in 1995 and held the money in an interest-bearing government account at the National Debt Office. In 1998, the Swedish parliament passed the final pension legislation, which took effect in 1999. Participants began selecting investment options in the Premium Pension in the Fall of 2000, after a one-year postponement due to difficulties in implementing the computer system to manage the new individual accounts.

This article focuses on the individual account system, called the Premium Pension. The first section gives an overview, followed by a discussion of the mutual funds that participate in the system, and issues concerning the choice of investments by workers. The conclusion discusses lessons that can be learned from the Swedish experience.

Mandatory Individual Accounts: The Premium Pension

An Overview

As determined by the transition rules, the new system affects all workers born in 1938 or later. Workers born between 1938 and 1953 will receive a pension calculated partly according to the new system and partly on the basis of entitlements in the old system. Workers born in 1954 and later will participate fully in the new system. As of 2002, approximately 4 million people participated in the system.

The mandatory individual accounts only constitute a small portion of the new pension system, being provided on top of a generous benefit provided by the notional defined contribution plan. The total contribution rate (employee plus employer) is 18.5 percent up to a ceiling of about US$40,000 for each worker, 16 percent of earnings is contributed and is credited to a "notional" account and 2.5 percent of earnings is contributed to the Premium Pension individual account.[i] These contributions provide survivors benefits but not disability benefits. The benefits ultimately received from the Premium Pension are based on the contributions to and investment earnings on the account. The choice of 2.5 percent as the contribution rate for the Premium Pension was the result of political compromise among groups that favored a higher rate and those that favored an entirely pay-as-you-go system. Because the total contribution of 18.5 percent is approximately equal to the total contribution rate before the reform, the investment of the Premium Pension in financial markets might be considered a mandatory carve out from social security.

The Premium Pension is administered by a new government agency, the Premium Pension Agency (PPM in Swedish). The PPM acts as a clearinghouse and record keeper for the funded individual account system. This new agency was needed since the individual account system includes a broad range of new activities that would have been difficult to undertake within the traditional functions of the National Insurance Board. In addition, a central agency should help keep administrative costs low because of scale economies in administration.

The Premium Pension places a minimal administrative burden on employers. Contributions are withheld by employers from employees' pay and sent to the National Tax Authority. Swedish employers aggregate the tax and contribution withholdings for their workers and make a single monthly tax and contribution payment to the National Tax Authority.

Because Swedish employers report information on individual worker earnings only once a year, individual pension rights cannot be established until workers have filed their income taxes and these have been consolidated with employers' reports. Collecting contributions and then posting them to the worker's account takes about two years from the start of the tax year. When individual pension rights have been determined, the tax authorities inform the

PPM as to how much should be credited to each worker's account.

Until pension rights have been established, pension contributions are placed on an interim basis in a fund established at the National Debt Office. In 2001, the rate of return paid on those funds averaged 3.5 percent, close to that paid on government debt. Because they are secure, government bonds in Sweden, in essence provide a guaranteed rate of return. There are no other rate of return guarantees in the system. Thus, the delay in posting workers' contributions to the fund or funds of their choice is roughly equivalent to requiring that at least twelve months of workers' contributions must be held in government bonds.

Workers can challenge the income and contribution statements provided by the tax authorities, and errors inevitably do occur. In December 2001, the tax authorities informed PPM that that they had changed income and contribution figures for 50,000 workers. The tax authority had understated the income for 11,000 people, and therefore their pension entitlement. Who will make up the shortfall in investment income if the shares that should have been credited have appreciated has not been decided (Reid 2002).

When the tax authority has informed the PPM of the amount credited to each worker, individuals select how to invest their annual contributions. Similarly, all new labor market entrants allocate their initial contributions to mutual funds at the same time during the year. They also can elect to place their contributions in their spouse's account instead of their own. This feature allows spouses to choose a form of earnings sharing for determining their household pension benefits.

All the country's contributions for a year, plus the accumulated interest, are placed in the mutual funds over a period of four to five days. In the second week of April 2001, the PPM received about SEK20 billion, which was the contributions from 1999 (Jarvenpaa 2001a). This way all workers are treated equally concerning the timing of their contributions to the mutual funds. Interfund transfers, however, can be made by workers daily, except during the time the annual contributions are being placed. At the beginning of the system, the initial investment of funds represented the accumulation of several years of contributions.

The PPM keeps all records of the individual accounts and fund share values (Thompson 1999). All individual transactions concerning inter-fund transfers are aggregated at the PPM at the end of each day and are then transmitted as a net purchase or redemption to each fund. The PPM matches buy and sell orders internally, limiting its transactions with the fund managers to the net amount of the individual transactions. This procedure limits the transactions costs of the mutual funds.

The Mutual Funds

An issue in an individual account system's design is the number of choices workers are offered. One view posits that the greater the range or number of choices, the better able are workers to pick a choice that suits their personal situation. An alternative view argues that beyond a point, more choices raises the likelihood of errors in decision making by individuals lacking a sophisticated understanding of investments. Swedish policy makers decided to offer a broad range of choice of investment options in the Premium Pension. Initially, the Premium Pension offered a choice of 455 mutual funds, but by 2002 that number had risen to 625. These funds are offered by more than 80 mutual fund companies, of which nearly half are managed outside Sweden.

The large number of mutual funds raises the question, how can the average citizen be expected to make an informed choice from among 625 different options? Swedes have shown a strong preference for Swedish managed funds, however, with foreign funds receiving only four percent of all contributions (Weaver 2002). This suggests that many participants have picked mutual fund companies with which they are familiar, rather than trying to evaluate the wide variety of choices.

One reason for the policy decision to allow many funds, including international funds, is that the Swedish stock market is small and if only a few domestic funds were available they eventually would dominate the market. Any mutual fund company licensed to do business in Sweden is allowed to participate in the Premium Pension system. Thus, the system allows open entry to mutual fund providers. Generally, funds must meet European Union requirements for portfolio diversification. However, Swedish equity funds are exempt because the Swedish equity market is dominated by one company, Ericsson (Weaver 2002).

All participating funds are listed in a booklet provided to participants. This listing provides an incentive for companies to participate because it provides them free advertising. The booklet divides the funds into categories and subcategories. The funds include domestic and international stock funds, social conscience stock funds, mixed stock-bond funds, and all bond funds. Derivatives funds are not permitted because they are considered to be too risky an investment for social security accounts.

Fund companies that wish to participate must sign a contract with PPM covering the fee structure and reporting requirements. To limit the number of funds, each fund manager originally could register a maximum of 15 funds. In the case of corporate groups with several fund management companies, the maximum was 25 funds. These limits were raised to 25 funds per company and 50 per related groups when two Swedish fund providers merged.

Most of the funds are equity funds; of these, about 10 percent are index funds, investing in a broad stock market index. There are about 70 bond funds and about 80 generation funds, where the participants' investment mix of stocks and bonds varies with their age, the percentage held in bonds increasing with age. Approximately one quarter of the funds invest primarily in Sweden. Almost 60 percent of the funds were new and established for the Premium Pension system, which means no historical information on risk or past returns for those funds was available to participants. Because of the broad range of funds and the lack of political limitations on the choices offered, there is no concern about the government manipulating the investment process or limiting the range of choice of investments on political grounds.

The government has established two funds that it manages. One, a default fund, called the AP7 fund, manages the money for those workers who do not choose a fund or funds. This fund's investment strategy is to achieve a higher long-run rate of return than the average for the other funds offered through the PPM at an overall risk level that is the lowest possible compatible with the rate of return goal.[ii] Equity holdings cannot exceed 90 percent of the total value in this fund or fall below 80 percent. Of the equity holdings, as much as 75 percent can be invested in foreign stocks. In 2001, the default fund invested 90 percent of its assets in Swedish and international equities. Part of the fund is managed actively, while the rest is managed passively, meaning that it is invested in broad indexes. Part of the passive portion of the fund is invested in an indexed bond fund. In 2001, investing in the default fund was the only way for workers to have part of their pension portfolio invested in an indexed bond fund, since none of the separate bond funds that participants could invest in were managed that way.

The second government fund is an alternative for workers who want the government to manage their pension account. To participate in this fund, workers must specify it. A difference between the default fund and the second government fund is that the second fund can invest 100 percent in equities while the default must hold a minimum amount in interest-earning assets.

The government funds' investment strategies incorporate environmental and ethical concerns. They invest only in companies that adhere to the international conventions on human rights, child labor, environment, and corruption that Sweden has signed onto. They will not invest in companies that have violated UN human rights, child labor, International Labor Organization and international environmental conventions, as well as the international convention against bribery and corruption. These requirements do not apply to non-government managed funds. The government funds currently invest in between 2,000 and 2,500 companies worldwide, and during summer 2001 the government funds screened all of these companies for adherence to these standards. The results indicated that approximately 30 companies violated these conventions, so they were excluded from the portfolio.[iii] Companies have been excluded that produce land mines, discriminate against women, and are harmful to the environment. While the funds' policy only excludes companies that have violated international conventions, broken laws, or admitted wrongdoing, that group includes some well-known companies, such as Coca-Cola, General Motors, and Sears. Coca-Cola is accused of violating its workers' rights to form labor unions in Latin America, while General Motors allegedly has discriminated against female employees, according to an AP7 statement (Clow 2002).

Mutual fund management companies only know the total investment from the Premium Pension but not the identities of individual investors. Because fund managers do not know the identity of their clients, this should reduce entry costs to the Swedish market for non-Swedish funds. Mutual funds only need to provide investment management services. They do not need to spend money acquiring distribution channels, which precludes the need to hire numerous sales agents and open retail offices (Herbertsson, Orszag and Orszag 2000).

Fees

High money management fees and administrative costs can substantially reduce the accumulation of assets in individual accounts.[iv] The Premium Pension system charges only a fixed annual fee of 0.3 percent of the account balance and a money management fee. The 0.3 percent fee is collected by each fund and transmitted to the

Premium Pension Authority for its administrative expenses.

Funds must charge the same money management fees in the Premium Pension system as they charge in private markets. The fund companies' contracts with the PPM stipulate, however, that some of the fee must be rebated to the PPM. The rebate is possible because the PPM performs most of the administrative functions for the accounts, so the administrative cost for the fund managers is lower in the Premium Pension system than in private financial markets. For example, rather than interacting with numerous individual investors, the funds have a single transaction per day with the PPM.

Regulations on fees were introduced in order to create a system with a wide range of funds but that is cost effective. The fee structure is designed in part to discourage participation of funds with high fees.

The fee rebate structure is complex and non-transparent, so many workers may find it difficult to understand. The size of the rebate depends on the fund company's gross fee and the size of PPM’s investment in the fund. Funds with high gross fees and large PPM investments pay a higher rebate. Competition across funds is also used as a mechanism to limit the fees charged by different funds, which are listed in a booklet provided all workers. Some investment funds try to attract participants by advertising their low fees.

The PPM passes on to the participants all the savings from the rebate. The individual participant’s rebate consists of two parts: an individual share and a general share. The individual share depends on the fees charged by the funds in which the individual has invested and is given for funds whose usual fee exceeds 0.4 percent.[v] Once the individual rebates have been distributed, the remaining rebate is distributed equally among all participants based on account size. Since the remaining rebate is tied to the participants’ account balances and not to fees paid, it returns a higher percentage of fees to workers choosing low-fee funds.

With this rebate structure, the rebate received by the PPM from funds charging high fees is not entirely returned to the workers choosing those funds. Part of it is distributed across all participants. This fee structure favors low-cost funds; workers choosing those funds receive a larger rebate in comparison to the fees they paid than those workers choosing funds with high fees. Thus, while fee level differences across funds provide incentives for workers to choose low-fee providers, incentives to do so are increased through the structure of rebates. This system leaves workers free to choose high-fee providers if they wish, but encourages workers to choose low-fee providers, such as index funds. The rebate system discourages the participation of high cost funds that invest heavily in advertising.

Mutual fund companies are not permitted to charge flat amount fees, so as to not disadvantage low wage workers with small accounts. They cannot charge fees for switching from one investment fund to another, so as to not discourage workers from switching funds. Also, because the government is the sole provider of annuities in the system, no fees are charged for converting an account balance to an annuity. The mutual fund fee covers all the expenses of the fund except transactions costs arising from the purchase and sale of securities. Those fees are incorporated in the net rate of return the workers receive on their account balances.

The funds charge fees range from 20 to 397 basis points. A majority of funds, however, charge fees of between 100 to 124 basis points. Participants generally have picked low-fee funds; 48 percent of the money invested in the system was invested in funds with fees ranging between 25 and 49 basis points.

Participant Investment Choice

The PPM has the goal that as many participants as possible actively choose their account investments. The initial choices in the system were made by participants in the Fall of 2000. Participants' selections were staggered by region of the country and took place over a three-month period. All participants who wanted to make an active choice were required to submit a form to the PPM. Participants who did not choose or who wanted their funds to be invested in the government default fund did not have to do anything. About two-thirds of participants submitted the form. Women were somewhat more likely than men to make a choice, as were high-income participants and participants aged 25-55. Investment behavior also varied with level of contributions. Workers with large contributions were less likely to invest in the default funds, while about half of participants with low contributions did invest in the default fund. Since no action was necessary to invest in the default fund, it is impossible to separate investors in that fund into those that actively decided that they wanted to invest in the default fund and those who ignored the selection process.

In 2001, fewer than one-fifth of the new PPM participants made active investment fund choices. Of the 500,000 new contributors to the system in spring 2001, 325,000 were age18 to 27. Only 18 percent of the total chose their funds; the remainder invested in the default fund.

Survey results indicated some participants may have been confused about the investment process-- while 18 percent of new participants in 2001 actually made a choice, 34 percent thought they had. Also, a number of workers chose the default because they felt it was safer than other options, which is an inaccurate assessment of its risk (Betson 2001). Another survey indicated that the majority of people who made an active choice could not remember which funds they had invested in. Of those who made a choice, 73 percent could not name all the funds they had invested in and 41 percent could not name any of them (Jarvenpaa 2001b).

About two-thirds of participants invested in equity funds and half the money invested was put in equity funds. Since balanced funds, generation funds, and the default fund also invest in equities, taken together, more than 80 percent of contributions were invested in equities (Weaver 2002). One resulting risk is that workers who invest solely in the Swedish economy will be inadequately diversified because of the relatively small size and narrow range of economic activity in the Swedish economy, with its stock market dominated by a few large corporations. The statistics on participants' investments indicate, however, that a majority of workers have some investments outside of Sweden.

Workers can invest in a maximum of five funds. On average, participants invested in three. The most common choice was to pick five funds, and only 15 percent of participants who chose a fund chose only one. Because some funds invest in a fairly narrow segment of the stock market, such as high tech, it is possible for participants to invest their entire Premium Pension account in a high risk, poorly diversified asset.

<u>Plan and Investment Information for Participants</u>

Ensuring that workers receive adequate information is an important aspect of the government's efforts to help participants make well-informed decisions. Providing adequate information is especially important because of the large number of investment options workers face. As part of the implementation of the reform, the National Swedish Social Insurance Board undertook a major campaign to inform and educate people about the new pension system. Information about the Premium Pension was part of this overall campaign. The PPM also provided additional information and materials to participants in connection with the investment elections.

The PPM recognized that participants are a heterogeneous group in terms of their financial knowledge and their interest in investing. It identified three groups: (i) motivated participants, mainly consisting of high-income males with a college degree and previous investment experience; (ii) passive participants who reported no interest in choosing mutual funds; and (iii) participants who were interested choosing mutual funds but reported to lack knowledge to make investment choices. The PPM estimated that about half of all participants fell into the third group.

The PPM's goal is to provide information that targets all three groups. For motivated investors it is important to provide detailed information on the various funds, whereas for the second and third groups the PPM concentrates its efforts on raising participant's knowledge and motivation. To this end, the PPM provides basic financial information such as explaining the different types of funds and the value of diversification, as well as more in-depth information on the various funds. It provides the following basic information about financial markets. Over the long term stocks have had a higher rate of return than bonds, although there is no guarantee that this will continue to be the case. The value of stock funds varies more over time than does the value of bond funds. Although changes in exchange rates affect the value of funds invested abroad, international investments provide greater risk diversification.

At the start of the system, the PPM mailed information to participants. It launched a major advertising campaign that included advertisements in newspapers, brochures, and public service announcements on television and radio. The PPM estimates the television ads reached 86 percent of participants and that each participant saw the ads on average 12 times. The PPM also organized a series of outreach activities to groups with special needs, for example immigrants with limited knowledge of the Swedish language and individuals with disabilities.

Some funds also organize their own advertising campaigns, which include ads in magazines and direct mailings. Because the funds do not know the identity of the workers participating with them, they are unable to target their advertising to workers who do participate in their fund, or to offer incentives to workers to switch their accounts. This feature of the system was designed to reduce marketing and customer acquisition costs. The funds, however, have attempted to target their advertising to particular groups by direct mail or by advertising in particular publications or in particular geographic areas, for example, where high-income workers live.

Before choosing funds, each participant received the funds catalogue, which contains information for each fund about its investments, risk level, past returns (for pre-existing funds), and fees. The same information is also available on the PPM website. All information is provided in Swedish as well as in the most common languages of immigrants.

Managers of funds participating in the system must provide information on fund asset values daily. This information is available to participants through various outlets, including the major daily Swedish newspapers, over the Internet, and at social security offices.

Individual participants receive a single year-end statement summarizing their investments in the Premium Pension. Individual can also receive this information over the telephone through an automated service and via the PPM website.

<u>Annuities</u>

The new pension system allows participants a great deal of flexibility as to when they can start receiving benefits from the Premium Pension. Individuals can claim benefits from the Premium Pension starting at age 61 or later. There is no maximum age by which benefits must be claimed. Benefits can be claimed at the same age as the worker claims benefits from the Social Security notional account plan, or the worker can claim benefits from the Premium Pension separately starting at a different age. Workers can also claim full or partial (one-quarter, one half or three-quarters) benefits and continue working and contributing to the system (Palmer 2001).

This flexibility as to the timing of benefit receipt is important for reducing the risk associated with the annuitization of benefits. A worker can begin receiving benefits from the notional account plan, but if the worker believes that interest rates will rise, making it more favorable to annuitize Premium Pension benefits later, the worker can postpone annuitization of the Premium Pension. Once participants have claimed Premium Pension benefits, they can suspend payment of them for a period or change the percentage of a full payment that the participant receives. Participants could first claim Premium Pension benefits starting in 2001, but because benefits then were small due to the short accumulation period, those benefits were paid only for the month of December.

Starting from the date when Premium Pension benefits are first claimed the entire account balance in the Premium Pension must be paid out as an annuity. Lump sum payments of even a portion of the account are not allowed. The PPM is the sole provider of annuities for participants in the Premium Pension. Participants can choose a fixed or variable annuity. If a fixed annuity is chosen, the PPM guarantees a fixed monthly payment for life. The monthly amount may be increased by a bonus, depending on the PPM's investment experience The level of the annuity is based on standard insurance practices, with the interest rate used to determine the annuity varying based on market interest rates. Thus, participants bear interest rate risk with respect to their timing as to when they take the annuity. The PPM uses unisex life tables of persons in the age cohort from the year the calculation is made. Since women and higher-wage workers have on average longer life expectancies than men and lower-wage workers, the system redistributes money from men to women and from lower-wage workers to higher-wage workers. If a worker chooses a variable annuity, the Premium Pension may vary, since the amounts paid out will be affected by the value of the funds. Benefits are taxable under the personal income tax at the same rate as labor earnings.

Participants may voluntarily choose the Premium Pension's survivor benefit. It is available on a separate basis for the pre-retirement and retirement periods. Participants pay the cost of purchasing a survivor benefit pre-retirement from the funds in the individual worker's account, so it is only available to workers with a sufficient amount in their account to cover the cost of purchasing the option. This option became available starting in 2002. If the participant elects a survivor benefit and then dies before retirement, the benefit pays a fixed amount (without regard to the participant's account balance) for 5 years. Beneficiaries of this benefit include children under age 20, a spouse or a registered partner or cohabitant, including same-sex partners. If the individual dies after retirement, the survivor benefit will be paid as a life annuity to the surviving spouse, registered partner or person previously married to the deceased or with whom the deceased had children.

If a participant dies before retirement or dies after retirement and has not elected a survivor benefit, the balance of the participant's account is not distributed to the participant's surviving spouse but is distributed among the accounts of all participants in proportion to account balance, raising their rate of return.

Policy Lessons for the United States

Swedish mandatory individual account pensions are similar in some respects to individual accounts that could be adopted in the United States. Therefore, it may be useful to examine what the Swedish experience may suggest were such a policy to be implemented in the United States.

1. A new government agency was established in Sweden because the range of activities required was substantially different from those of its existing Social Security agency. There have been suggestions that the Thrift Savings Board in the United States, which manages the Thrift Savings Plan for federal government workers, might serve as a model for such an agency in the United States. Any such entity would need to coordinate with the Social Security system on a wide range of operational issues.
2. To reduce the administrative burden on employers, employer and employee contributions in Sweden are collected from employers by the National Tax Authority for the notional account Social Security program and the funded individual accounts.
3. There is a tradeoff between administrative costs and quick processing of contributions. To reduce administrative costs in Sweden, pension rights are established after the end of the tax year when income tax returns are filed.
4. Workers have a choice of roughly 500 different mutual funds. Because of the large number of choices, extensive efforts to educate and inform workers about different types of investments are necessary.
5. To reduce administrative expenses, the government maintains all the pension records. Individual mutual funds do not know who their

investors are. The mutual funds deal only with the government agency, receiving aggregated contributions from the agency, and making aggregated payments to it.

6. All the country's contributions for a year, plus the accumulated interest on those contributions, are invested in the mutual funds over a period of four or five days. This procedure would not work in the United States because the large amounts of money involved could not be absorbed into capital markets over such a short period without depressing stock prices.
7. Because many workers choose the default fund by not making an active investment choice, the investment portfolio of the default fund requires careful public policy consideration.
8. Participating mutual funds are not permitted to charge flat administrative fees so as not to disadvantage low wage workers with small accounts.
9. Sweden provides a considerable amount of flexibility as to the ways that retirees can receive benefits from their individual accounts. Individuals are not required to start collecting their individual account benefits at the same age they collect their Social Security benefits. However, the benefits must be received as an annuity, and the government is the sole provider of these annuities.

Assessment and Conclusions

Because the system of funded mandatory individual accounts in Sweden has only operated for a short time, it is too early to assess fully its operation. For example, administrative costs relative to assets under management are expected to fall over time as experience is gained with the system and as assets in the system grow, leading to economies of scale.

In considering applicability to the United States of the Swedish experience, it is important to take into account the context within which it operates. First, Sweden is a small country. The same system in a much larger country might encounter problems arising from size that would add to the difficulty of administering it. For example, placing all contributions to the system for a year in the mutual funds over a several-day period may work in a small country like Sweden but would not work for a large country because of the effect it would have on financial markets. A possible solution for this problem is to have the holding account for contributions invest in a weighted average of actual worker selections in order to minimize market disruptions when the money is shifted to the individual accounts.

Second, when considering the risks of the retirement income system for low-income workers, it should be kept in mind that the poverty rate in Sweden is low. The poverty rate for Sweden's elderly was 0.8 percent in 1995, with the comparably measured rate for the United States in 1997 being 12.0 percent (Smeeding 2001).

Third, the Swedish individual account system operates on top of a very generous base provided by the Social Security notional account system. This base reduces the overall risk level for Swedish workers, and for a given level of risk aversion allows them to be more willing to accept financial market risks. This factor may explain why the Swedish system allows participants to take considerable risks in terms of investing in funds covering limited segments of the financial market and why the default fund is invested heavily in equities.

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[i] The income that is taxable for the pension includes unemployment benefits, so workers who are unemployed continue to accrue retirement benefits.
[ii] The five-year return should be in the top quartile of the returns for all funds.
[iii] The effect on returns was very small. Simulations done by the fund indicates that the portfolio excluding the 30 companies had a rate of return that was 15 basis points lower than the full portfolio.
[iv] For an individual paying into the system for 40 years, every percentage point of the fee reduces the account balance by 20 percent.
[v] The rebate is 25 percent of the difference between the gross fee and 0.4 percent.