

Summary

The Complexity of the Occupational Pension System

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**A summary of a report in Swedish with the title "Den komplexa tjänstepensionen" (SNS Förlag)*

We are living longer and longer after we have finished working. Remaining life expectancy at 65 years of age has increased by 5 years in the last 50 years. We can now expect to spend over 20 years in retirement, while for some of us it will extend to over 40 years. The years we spend as retirees constitute a larger and larger part of our lifetime. In order to maintain financial security after retiring, we now need to put aside a larger part of our life-time earnings as pension savings, either through the public or occupational pension system, or through private savings.

The complexity of the occupational pension system has made it difficult for us to understand how our financial situation will be during retirement. A rational saver needs to obtain a good insight as to how the different parts of the pension system interact with one another.

As the responsibility for pensions has been reassigned from the government to the individual, the number of choices has increased. Pension savers

are faced with many options that might affect their future pension in different ways. More freedom to decide over one's pension savings is reasonable when the saver carries more risk, but it might also increase the complexity of the pension system.

For high-income individuals the occupational pension makes a large contribution to their pension. For low-income individuals the occupational pension contributes with a small, but important, part of their pension. It is therefore important for all savers, independent of their income level, to understand the occupational pension system. However, the current system makes it difficult for savers to understand how large their pension will be in the future. The occupational pension is very complex, which the title of this report implies. In this report we seek answers to several questions related to the complexity of the occupational pension system.

How did the occupational pension become so complex?

First of all – how did the occupational pension system become so complex? To answer this question, we describe how the system has developed over the years. We discuss how the system has become more clear-cut, but also how it has become more complicated. We examine in what ways the increase in labour market mobility has contributed to make the system more complex over the years. Nowadays, it is common that a worker changes employer or industry several times throughout his or her working life. Consequently, many pension savers are covered by a number of occupational pension contracts from different industries, which in turn makes it more difficult for the saver to get a good overall view of his or her savings.

Do the pension savers have good enough knowledge of the occupational pension?

The second question we seek to answer is what the pension savers know about the occupational



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pension. Using the results from a new and extensive survey we show that savers seem to have an alarming ignorance of the occupational pension.

Half of the respondents say that they think it is hard or very hard to understand the workings of the occupational pension. Almost every fourth respondent does not know whether they are covered by an occupational pension or not.

The survey also contained knowledge questions such as how large the monthly payments into the occupational pension are, if the saver can choose where to place his or her occupational pension savings or how large share of the overall pension savings that comes from the occupational pension. A third of the respondents had zero or just one correct answer on this type of questions.

Across all age groups, 75 percent of the respondents believe that they do not have enough knowledge to understand how their own choices affect their future pension income. Many respondents answer that they will seek this knowledge when they approach retirement. Strikingly, young and older respondents are equally likely to state that they will seek the knowledge when they approach retirement. There seems thus to be a widespread “I-will-do-it-tomorrow” mentality which for many savers will worsen the probability of making good decisions for the future.

What consequences might ignorance about the occupational pension have?

Deriving from what we have learned from the survey, we seek to answer this question: What problems arise from a complex occupational pension system and a widespread ignorance among the pension savers? Savers with little knowledge often worry that their pension income will be too small, but they do not try to calculate the size of their forthcoming pension income. We show that different types of incentives might give unforeseen consequences when there is ignorance about the workings of the occupational pension system. We focus especially on tax exchange (*löneväxling*), which means that part of the income can be taxed at retirement instead of in the year when it was earned. We show that tax exchange is something that few people seem to know about and use. We also discuss the choice of pension payout length. Research shows that among people with little knowledge about the system, the choice of payout length is more heavily influenced by the design of the payout forms.

Suggested areas for improvement

The report ends with seven specific suggestions for developing and improving the occupational pension system:

1. Harmonise new contracts
2. Extend the right to move vested pension benefits (*fribrev*)
3. Introduce a common marketplace for occupational pension funds
4. Dismantle mandatory traditional insurances
5. Further develop *Minpension.se*
6. Set up a joint organisation for the occupational pension system
7. Improve education on the pension system at universities and in upper secondary schools.

The goal is that these suggestions will help savers to get an overview of the amount of capital they save through their occupational pension, which in turn will help them understand how large their monthly pay-outs will be after retiring. It is necessary that the saver understands how large his or her occupational pension will be in order to know how much to save on their own. We do not propose new legislation. This is because we recognize that there is great value in the occupational system being evolved through dialogue and negotiation between the Swedish labour market parties.

We are fully aware of the fact that besides savers there are many actors involved in the occupational pension system and that there will be both practical and principal objections to some of these suggestions. Our aim is to raise further discussion and evaluation of these areas.

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This report is part of the research program “New Challenges for the Pension System”. The program takes an overall perspective on the pension system and deals with questions that concern both the occupational pension system and the state pension.