The proposed reform of the AP Funds is expensive and will lead to lower pensions, published 23 October 2015 in *Dagens Nyheter*

"Ill-defined and bureaucratic. The proposal concerning new regulations for governing the activities of the Swedish National Pension (AP) Funds features several changes for the worse. It increases the risk of short-term politically-motivated micromanagement and puts an end to long-term investment in sectors such as real estate and infrastructure. In all probability, it will result in lower pensions," write the chairs and CEOs of Sweden's AP funds.

The four large funds of the Swedish state income pension system, the First, Second, Third and Fourth AP Funds, have been operating for 15 years now. In 2001, the funds were commissioned to manage capital of just over SEK 550 billion. This now amounts to around SEK 1,200 billion. And a total of over SEK 50 billion has been disbursed to the Swedish pension system during this period. These solid results have contributed to the AP Funds now accounting for 14 per cent of total pension assets, compared with 10 per cent when they were first established. That's over SEK 350 billion more than expected when the system was set up 15 years ago. International comparisons also show that the AP Funds compare well with other pension funds, both in terms of returns and low costs, as the Swedish government's own evaluation found.

The current legislation has worked well, both with regard to results and confidence in the AP Funds. The fundamental principles of the existing AP Funds Act are to promote high returns at low risk, to ensure the independence of the Funds and to provide the conditions for long-term investments that incorporate environmental and ethical considerations. This is achieved today through clear and simple governance which, without detailed regulation, aims to generate the greatest possible benefit for the pension system.

We are now raising major concerns about the future of the Swedish pension system because the proposed 'New Rules for the AP Funds' will make the system worse in a number of respects. We see significant risks in the proposal and it is our duty to highlight these for those who depend on the returns generated by the AP Funds – namely, current and future pensioners.

The proposal is a compromise based on a previous compromise and has weaknesses in numerous key areas.

- Neither the new National Pension Fund Board (that is proposed to oversee important issues) or the AP Funds are guaranteed sufficient independence from government.
- The AP Funds' ability to invest will be restricted compared with the present as they would be governed by a reference portfolio and a cost cap determined by a National Pension Fund Board and the government, respectively.
- The AP Funds' boards will not be granted sufficient authority to take operational decisions because, under the proposed legislation, the management of unlisted assets and large parts of their administration will be coordinated. This proposal neither promotes risk diversification or efficiency, nor does it provide any economies of scale.

Furthermore, the proposal is incomplete as it lacks two key elements – an impact analysis and a calculation of what these proposed extensive reforms will cost. We wish to highlight a number of consequences that are not mentioned in the proposal:

The proposal is highly likely to lead to lower pensions. If the proposal is implemented, the remaining AP Funds will have little opportunity to generate higher returns as the AP Funds have done until now by making long-term investments with sound risk diversification. There will be significantly less scope for conducting professional, strategic and proactive asset management and less opportunity to act as a responsible shareholder. The AP Funds will be completely disconnected from the overall goal of generating the greatest possible benefit for the pension system. The proposed reference portfolio will instead guide the AP Funds towards short-term low-yield index tracking and will lead to the selling-off of Swedish assets and the end of long-term investments in areas like property and infrastructure. Furthermore, there is a risk that greater bureaucracy and inefficient management will lead to less opportunity for the AP Funds to make profitable investments. In financial terms, this will involve significant losses for pensioners. The last eight years, the four AP funds jointly contributed to the pension system with SEK 20 billion in 'active return' only.

The proposal increases the risk of short-term political micromanagement. The AP Funds are currently only subject to Swedish parliamentary legislation to endeavour to achieve the highest possible return and to consider ethical and environmental issues without compromising returns. The proposed governance of the funds is unclear and bureaucratic. The proposals to establish a National Pension Fund Board and the ability for the government to have an influence will mean that power over the AP Funds will shift from parliament to the government and will present the prospect of short-term political micromanagement. The fact that the current government does not plan to make use of this ability has no bearing on what future governments may do. Pension capital should be managed on a long-term basis without political micromanagement.

The proposal will lead to high reorganisation costs. The proposal lacks a proper impact analysis, which makes it difficult to assess the implications of the reforms. The Funds have therefore asked an external party to calculate the risks and costs for the reorganisation involving the closure of certain AP Funds, the coordination of operations and the establishment of a new governance structure. During such a reorganisation, planned to start in 2016 and continue for almost two years, there is a risk that the AP Funds will lose their focus on long-term asset management which will have a negative effect on results. If this were to lead to even a 0.1 per cent decrease in returns this would still amount to some SEK 1,200 million. Other costs are also significant. Over the two years the reorganisation is estimated to cost several billion kronor. This contrasts with the only expected saving stated in the proposal of around SEK 50 million annually. It will be several generations before these costs are recouped.

Those of us who have been tasked with managing the AP Funds' capital responsibly for the benefit of current and future pensioners, with the pension system facing significant challenges over the next 15 to 20 years, believe the proposed New Rules for the AP Funds will not lead to better pensions, quite the contrary. This proposal therefore cannot form the basis for a reform of the AP Funds.

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