



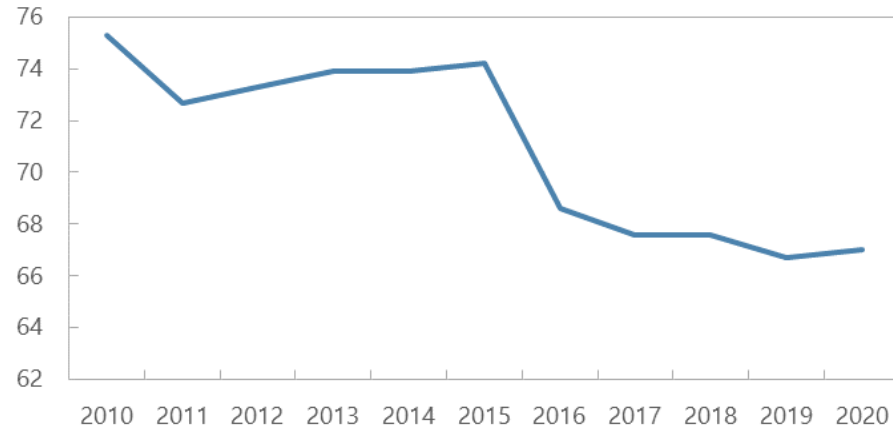
Reforming the Swiss Pension System

**Swiss Alternative Investments Forum
January 26, 2022**

Mark Horton
IMF European Department
Mission Chief for Switzerland and Belgium

Context

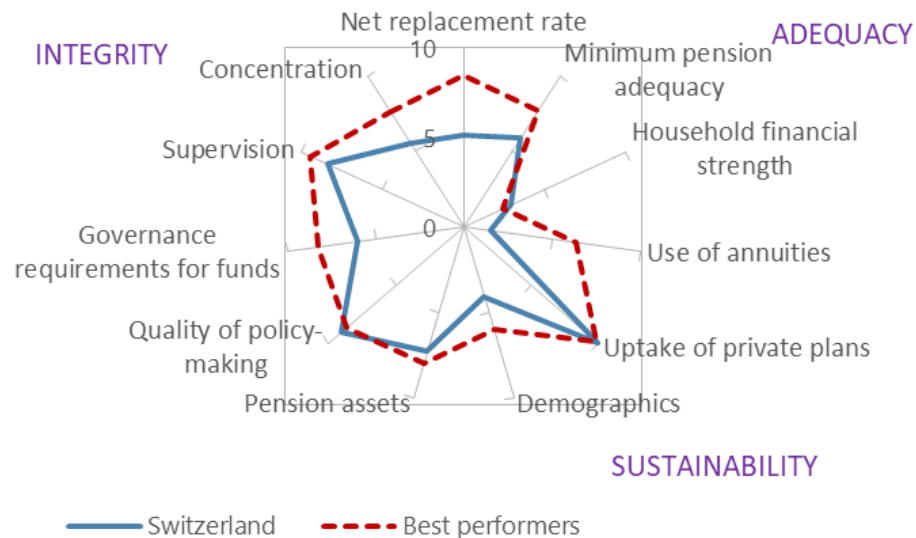
Global Policy Index 2020(%)



- Swiss pension system has performed well
 - High retirement incomes
 - Past stable funding position; high capitalization
 - Positive governance, sustainability indicators

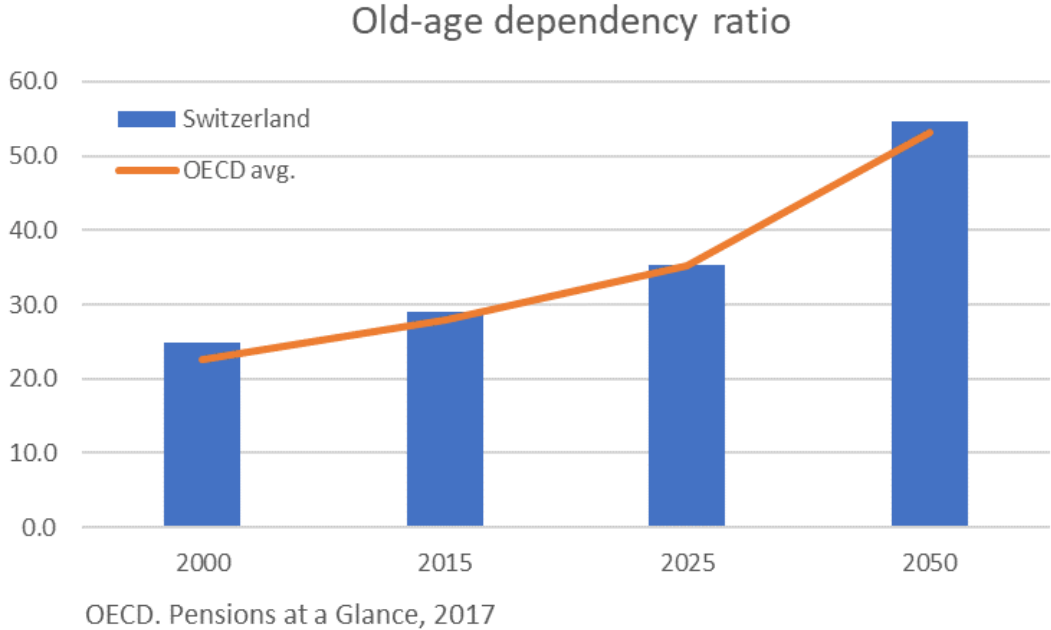
But...

GPI 2020: Select Sub-Indices

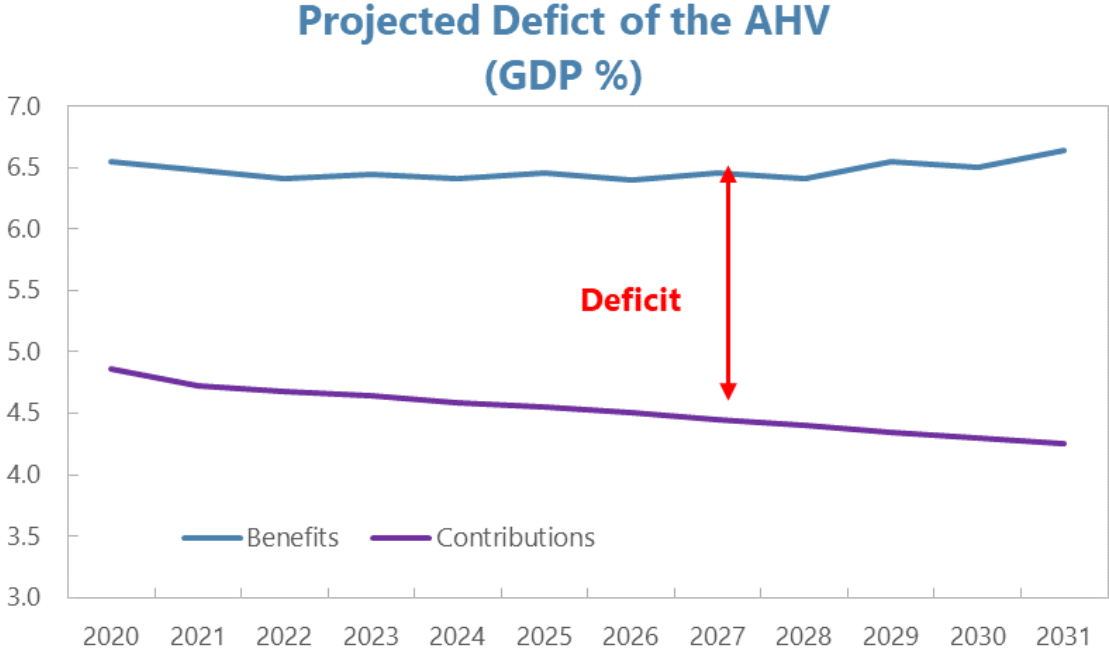


- Demographics & low interest rates are key challenges
 - Fast aging population; long time in retirement
 - Declining income replacement rate
 - Funding gaps
- Mitigating factors:
 - High levels of income, wealth, savings...but risks of greater inequality?

Current Status: Demographics and Pillar 1 (AHV) Sustainability



- Old age dependency ratio increasing steadily
- First pillar deficits are large and growing



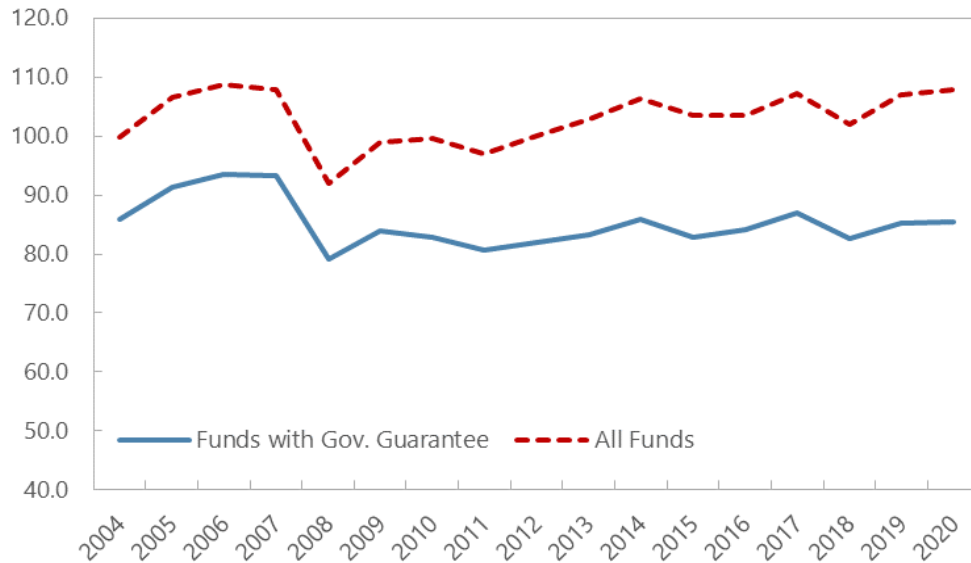
Deficit = difference between pensions to be paid out (benefits) and contributions levied on income, excl. federal contributions, other revenues.

Source: BSV

Current Status: Sustainability of Pillar 2 (BVG)

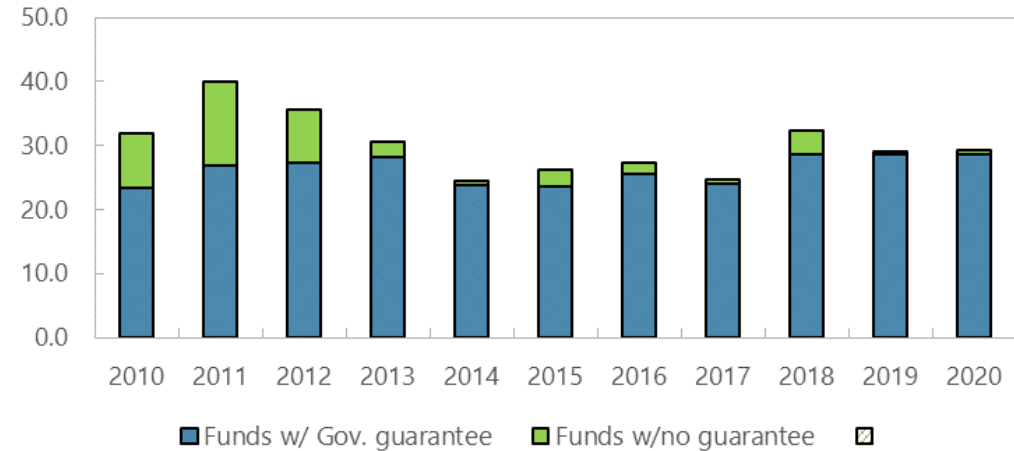
Prolonged low interest rates and pension parameters are straining sustainability of Pillar 2 (BVG)

Asset-Weighted Coverage Ratio



Source: BFS

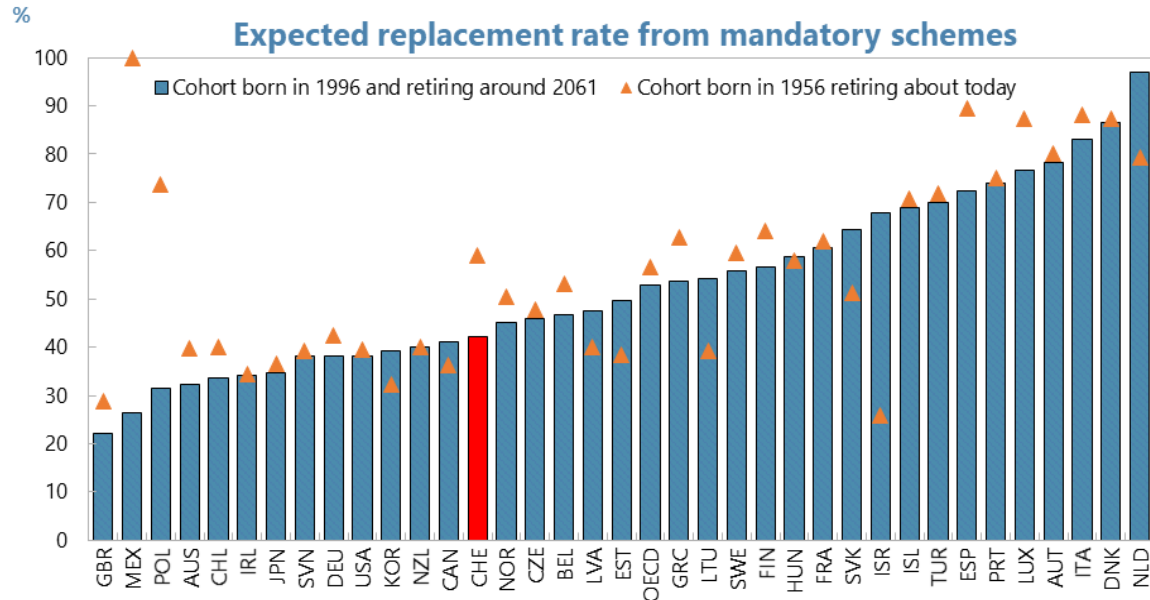
Pension Funds Estimated Underfunding (CHF bln)



Includes only funds without a full insurance solution
Source: BSV

- Coverage gaps, especially for guaranteed funds
- Low interest rates, high conversion rates lead to greater risk taking

Current Status: Adequacy and Inequality



Note: Theoretical gross replacement rates at retirement for a full-career male worker. Per cent of individual earnings for an average earner.

Source: OECD, 2019

- Reforms are also needed as:
 - Replacement rates may fall to just above the ILO's minimum recommend level of 40%
 - Extra-mandatory saving and supplementary benefits will become increasingly important to maintain living standards.
 - Existing inequalities could widen, along with
 - Gender pension gaps
 - Inter-generational gaps

Recent Reforms: Positive Start

First Pillar (AHV)...*approved by the Swiss Parliament*

- Harmonization of retirement age of men and women (increase in women's retirement age for 1 year)
- Compensatory measures for most affected cohorts of women
- Increased contributions from from VAT (increase in VAT rate by 0.4%)
- Incentives to work beyond retirement age
- No earmarked use of SNB profits

Second pillar (BVG)...*under consideration by the Swiss Parliament*

- Reduction of the conversion rate from 6.8% to 6%
- Reduction in the coordination deduction (expanding coverage under the second pillar)
- Possible compensatory measures???

...positive impacts, but challenges continue and will not ensure LT sustainability

Why are further reforms needed?

Challenges of the current system

- Intergenerational transfers from young to old (*intergenerational gap*)
- Riskier investment behavior to compensate for lower investment revenues
- Uneven playing field among pension funds, depending on their structure (primarily mandatory savings vs. primarily voluntary savings)
- Reemergence of pension system deficits will:
 - Crowd out of other productive spending (education, training, infrastructure, climate) or require higher taxes => *both have implications for growth*
 - May lead to bail outs of underfunded pension funds

Switzerland's Situation – Similar to elsewhere in Europe

Most countries in Europe face high deficits and continuing and future expenditure pressures

Important reforms were enacted at the time of the Global Financial Crisis

- Tightened early retirement options and increase of retirement ages
- Changed indexation rules and benefit formulas
- Cut benefits, with expansion of non-pension social safety nets
- Revenue measures (ceilings, thresholds)

However, reforms favored retirees over workers and recent reversals have eroded gains

- Deficits remain high: average pension deficits are currently 2½ percent of GDP
- ...And are expected to increase: 4 percent by 2050

Leaving many pension systems dependent on state transfers that crowd out other spending.

Further reforms are needed

First pillar

- Harmonization of retirement age is a positive step, but more is needed to cover funding gaps
 - Further increases of retirement age and linkage to increases in life expectancy (recently rejected by the authorities...)

Second pillar (BVG)

- Reduction of conversion rate from 6.8 to 6.0% is a positive step, but not enough to align with market realities
 - A much lower conversion rate (4.5-5%) is needed (or raising the retirement age to 70 years)

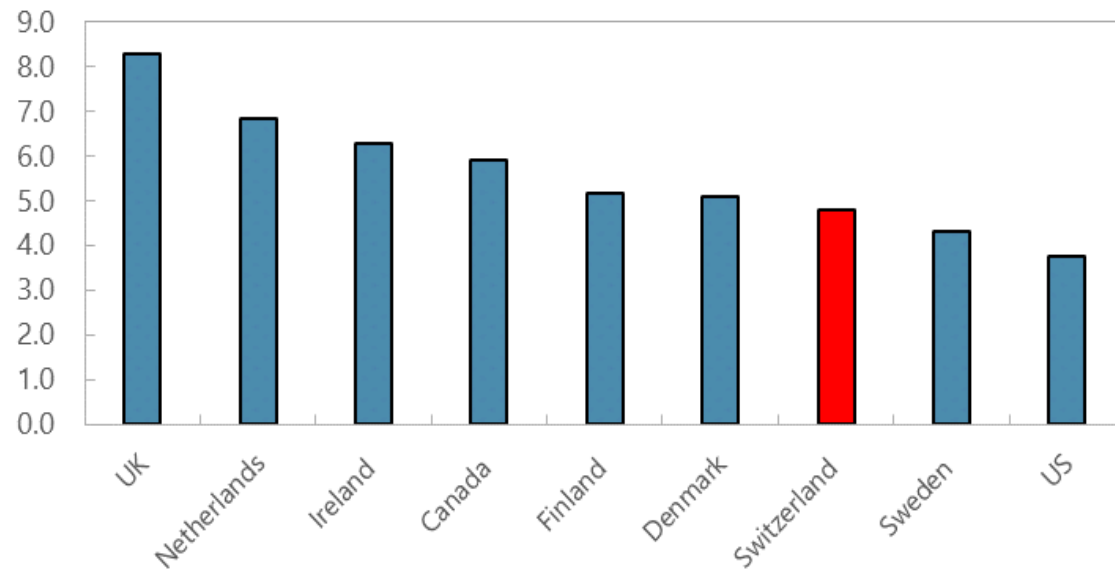
Fund governance and performance

- Improve risk-oriented allocation framework, greater transparency, and risk management capacity
- Promote further consolidation with greater transparency to benefit from economies of scale

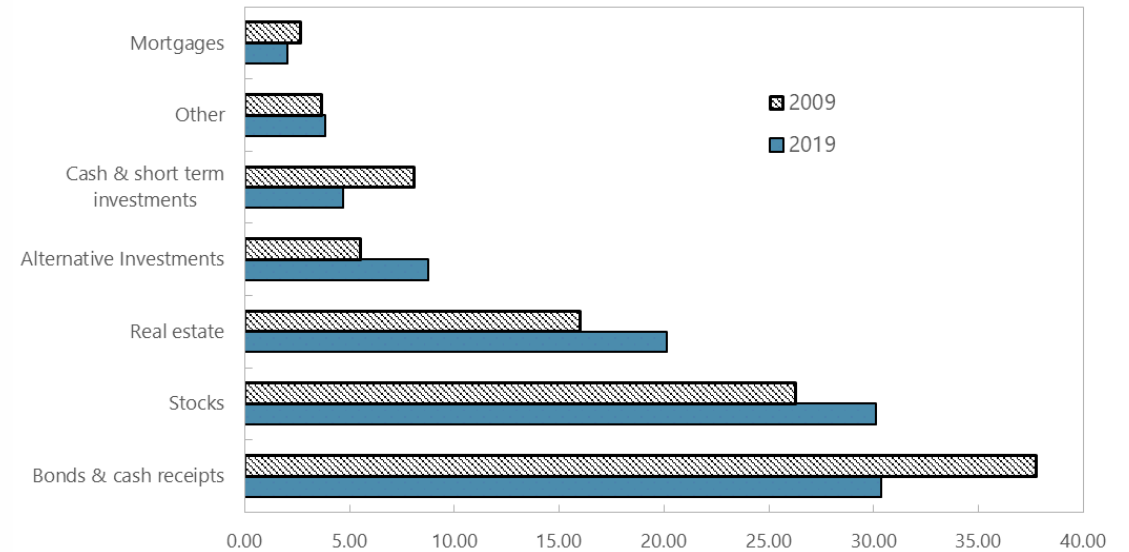
Policy Options for Long-term Sustainability

Investment performance in a low interest rate environment: can asset allocation improve?

Annual real investment rates of return of retirement savings plans, 2009-2019



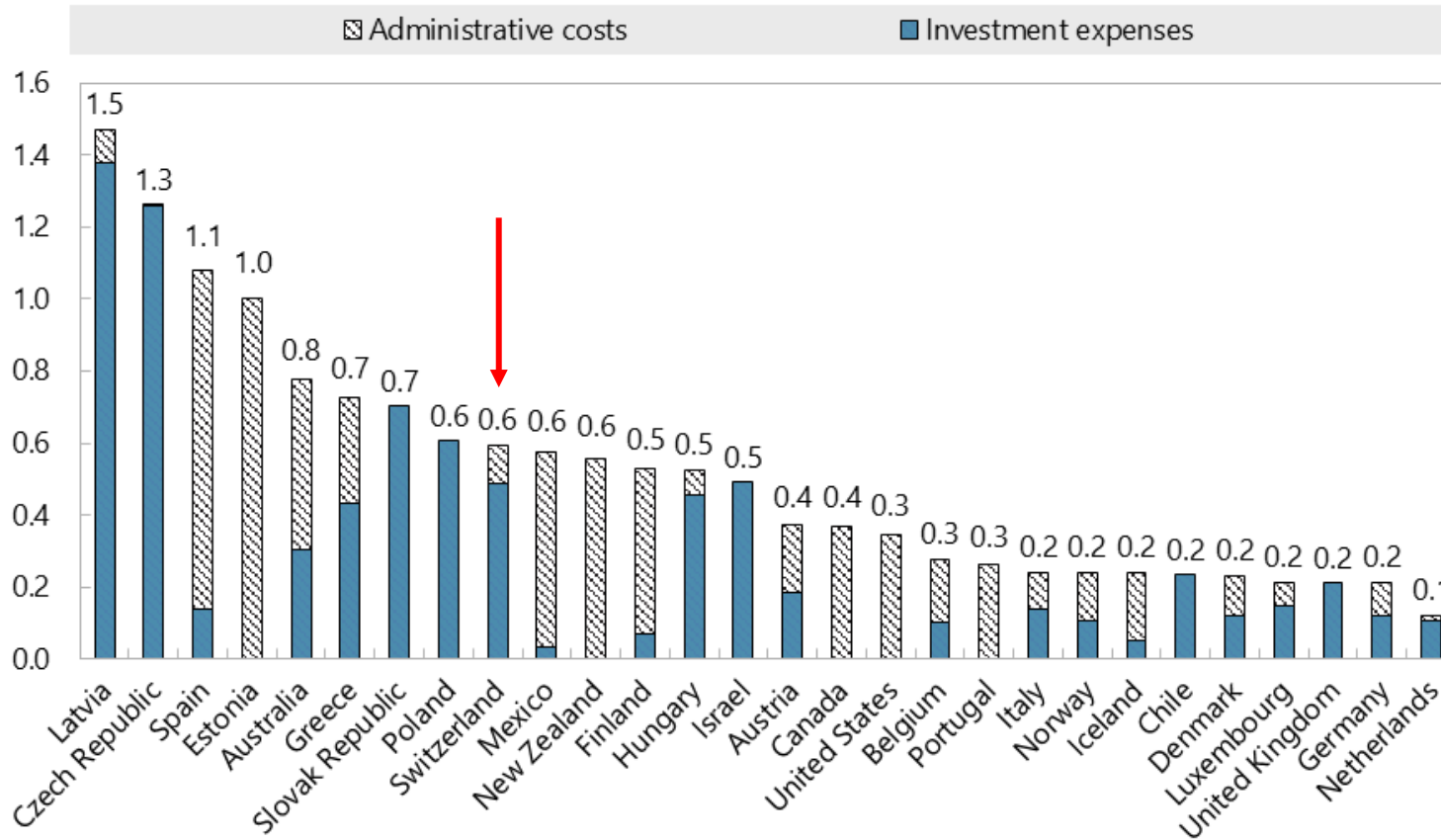
Pension Funds Asset Allocation



Source: OECD Global Pension Statistics.

Policy Options for Long-term Sustainability

Addressing pension funds investment performance: gains from further consolidation?



Source: Global Pension Statistics

- Currently 1000+ pension funds
- Relatively high investment costs
 - Delegating to costly vehicles
- Economies of scale matter
- Strike a balance to reduce costs and improve benefits
 - Encourage competition and flexibility to meet members needs, while seeking economies of scales

Final considerations

- Aging costs, mounting in the long run
- Need to balance trade-offs:
 - ✓ Pension spending competes with other priority expenditures and weighs on growth
- Intergenerational Sustainability
 - ✓ Balance burden-sharing by current and future pensioners
- Adequacy
 - ✓ Incentives to remain in the labor force longer—old-age poverty often reflects lack of employment income, short careers, informal work
- Design matters—need to build consensus around package of measures and increased awareness/literacy



Thank you!

mhorton@imf.org

See: Switzerland and the IMF at
<https://www.imf.org/en/Countries/che>