

tion fund of the City of Zurich, Vera Kupper Staub.

Overall, the direction of travel is clear. "More regulation and a limitation of flexibility for Pensionskassen can probably not be avoided altogether," says Triponez, notwithstanding OAK's efforts to introduce "proportionate" regulation and maintain dialogue with institutions. "However, as the experience of cost transparency has shown, useful regulation may also lead to innovation in the pension industry, which will in the end create value for the individual member of the pension fund."

"What is better: a too high funding level with insufficient funding – with a likelihood of the funding level dropping – or a lower funding level with moderate benefit promises?"

Christoph Ryter

"Overregulation is a constant problem," says Ryter, conceding that OAK is by no means the only source. "Every time a problem in the second pillar occurs, a new regulation is introduced creating more problems," he says.

Schnurrenberger criticises the "overpolitisisation" of the occupational pension sector: "Every politician, no matter from which side tries to co-opt the second pillar for their political campaign," he says.

And looking further ahead, the proposed reform package Altersvorsorge 2020 will doubtless introduce new regulatory requirements.

What can I expect from my pension fund?

Alfred Bühler and Lukas Riesen explain why the risk-bearing funding ratio could become the yardstick for Swiss pension funds

Risk-bearing Funding Ratio Commentary

For any pension scheme, the purpose of investing is to fund future benefits. A pension fund can offset investment risks in two different ways – either by taking advantage of existing risk capital (reserves), or by adjusting future contributions and benefits. An analysis of an investor's risk capacity therefore looks at two areas:

- Financial risk capacity (already existing reserves);
- Structural risk capacity (changes of future contributions and benefits).

Financial risk capacity

A pension fund's financial risk capacity describes its ability to offset losses without putting current or future benefits at risk. The difference between assets and liabilities is the financial risk capital. For Swiss pension funds, the most important component of the liabilities is usually provisions for benefits to retirees.

As pensions are nominally guaranteed by law, a portfolio of sovereign debt instruments of a similar maturity serves as a replicating portfolio for valuation purposes. This results in the need to use the prevailing yield of sovereign debt as a discount rate for computing the economic value of the benefits. The economic funding ratio measures the relationship between the economic value of assets and liabilities. Discounting future cashflows with the expected investment returns is not appropriate for an analysis of the financial risk capacity, as the expected return can neither be guaranteed on a short-term nor long-term basis. If a pension fund uses expected returns as discount rate, it implicitly relies on possible recapitalisation measures borne by active members and employers, blending financial and structural risk capacity.

Structural risk capacity

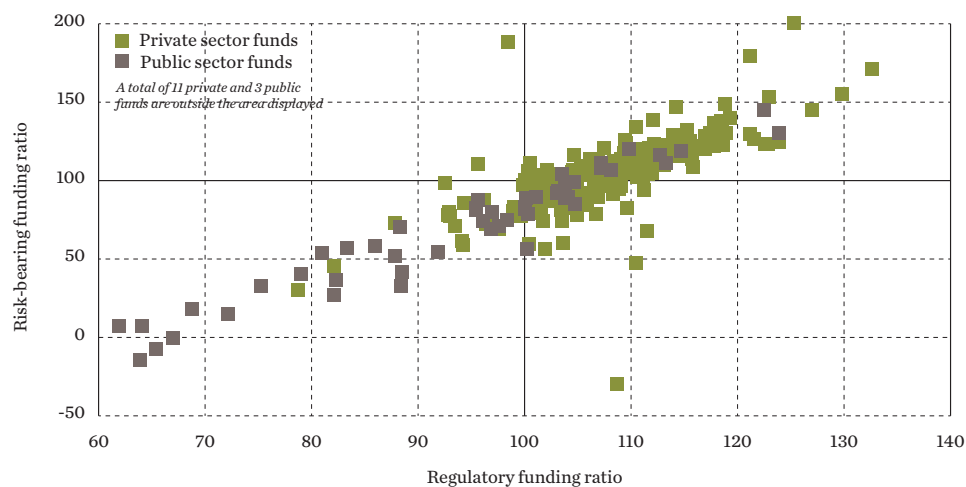
Structural risk capacity describes the ability of a pension fund to reduce benefits or increase contributions in order to improve the financial situation. The structural risk capacity is heavily reliant on pension liabilities. The higher the

share of liabilities to retirees, the lower a fund's structural risk capacity, as current pensions cannot be cut according to Swiss law. As this is the case, a scheme with no active members does not show any structural risk capacity.

Risk-bearing funding ratio

The economic funding ratio describes the financial risk capacity, and the share of liabilities to retirees is the relevant factor for the structural risk capacity. It is on this basis that PPCmet-

Swiss pension fund funding ratios at year-end 2013



	Pension funds in the data set		
	Private	Public	Total
Number of pension funds	237	53	290
Number of active members	1,746,876	624,919	2,371,795
Number of pensioners	420,539	290,987	711,526
Assets CHFbn	315.8	203.0	518.8
Freizügigkeitsleistungen CHFbn	173.7	105.3	279.0
Assets for pensions in payment * CHFbn	110.0	115.1	225.1
Regulatory funding ratio %	107.9	87.8	99.2
Risk-bearing funding ratio %	105.6	54.2	86.2
Overfunded ** CHFbn	16.2	1.3	17.5
Underfunded ** CHFbn	6.4	49.5	55.9

* Assets required, including reserves needed to cope with increasing longevity

** Compared with risk-bearing funding ratio

Source: PPCmetrics

rics developed its concept of the risk-bearing funding ratio. As pensioners do not contribute to the structural risk capacity, they can be excluded without reducing the structural risk capacity of the remainder of the fund. Setting aside assets corresponding to the economic value of liabilities to retirees allows a risk-free funding of pension benefits. The ratio between the remaining assets for covering the liabilities to active members is equal to the risk-bearing funding ratio. It is used to measure the overall risk capacity of a pension fund, aggregating the financial and structural risk capacity. It further allows a comparison between pension funds, independent of their share of liabilities to retirees.

Each pension fund can calculate the risk-bearing funding ratio by converting the actuarial liabilities to retirees disclosed in the balance sheet into their economic value, using the factors listed on our dedicated website*. The economic value of liabilities to retirees can then be subtracted from the total asset base. The ratio between the remaining assets, belonging to the active members, and the liabilities to active members results in the risk-bearing funding ratio.

If the risk-bearing funding ratio is above 100%, then pensions are fully funded without burdening active members with additional investment risk. Where the risk-bearing funding ratio falls below 100%, then active members should expect either benefit reductions or recapitalisation measures, and employers can also be asked to



Alfred Bühler and Lukas Riesen

make additional contributions in the future. As a result, the measure captures the potential burden on employees and employers as risk bearers of the pension fund.

The importance of the risk-bearing funding ratio

PPCmetrics holds data on 290 Swiss pension funds with CHF519bn (€432bn) in assets. Of these, 237 private funds had an average risk-bearing funding ratio of 105.6% at the end of 2013 (see table). On average, current pensions

are fully funded and the remaining assets cover all liabilities to active members. The graph shows the actuarial funding ratio as published in annual reports in comparison to the risk-bearing funding ratio, which highlights two areas.

First, there are many private pension funds with a risk-bearing funding ratio between 50% and 100%.

Second, two pension funds with identical actuarial funding ratios can have very different risk-bearing funding ratios – with differences of 50% not uncommon. Assessing the ability to bear risk solely on the basis of the actuarial funding ratio can result in significant misperceptions.

Data leads to transparency

The risk-bearing funding ratio increases transparency for active members regarding the likelihood of increased contributions or reduced benefits. Such transparency is indispensable when making decisions regarding your employer (and its pension fund), the acquisition of benefits or early retirement. Transparency can only be achieved through figures that have a straightforward interpretation and can be calculated without understanding complex insurance mathematics. The risk-based funding ratio meets all these requirements.

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**See www.deckungsgrad.ch*