COMMENT

Greater focus on returns – a must for Swiss pension funds

Swiss Funds & Asset Management Association managing director Markus Fuchs **explores how a rethink is necessary in the world of Swiss investment**

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The negative interest rate environment has had surprisingly little impact on the portfolio structures of Swiss pension funds. However, a rethink is necessary in the assessment of investment possibilities if the future challenges in financing occupational pensions are to be addressed. Weaknesses in regulations and requirements also need to be eliminated, and specific measures introduced to promote a returns-oriented pensions system.

On behalf of the SFAMA, the St.Gallen Institute of Management carried out a survey of Switzerland's largest pension funds last year, and the results presented a detailed picture of their investment behaviour. The report was aimed at increasing transparency with regards to the decision-making criteria, as well as the interplay between return and cost factors in the investment processes of Swiss pension funds, while also contributing to the current discussion on the development of Switzerland's pensions system going forward. The survey shows that Swiss pension fund managers regard diversification as the most important criterion in making decisions on the structuring of their portfolios. The risk-return ratio, followed by the net returns, are viewed as being the key figures in assessing the appeal of an investment. Most portfolios are rebalanced and restructured less than once a year.

SWISS PENSION FUND MANAGERS REGARD DIVERSIFICATION AS THE MOST IMPORTANT CRITERION IN MAKING DECISIONS ON THE STRUCTURING OF THEIR PORTFOLIOS

Portfolio structure and costs

In the past, returns made up more than a third of retirement assets. The performance of the financial markets will make it increasingly difficult for this 'third contributor' to maintain this level going forward. Surprisingly, the current negative interest rate environment has thus far had only a limited impact on the portfolio structure of most Swiss pension funds. That said, more than 50 per cent of pension funds are increasingly turning to private equity and real estate, and reducing their bond holdings slightly. The average total expense ratio of the pension funds surveyed is 0.6 per cent, with portfolio management costs accounting for three quarters of this amount. In 2015, bonds (0.1 per cent) and equities (0.3 per cent) entailed the lowest costs. However, their gross returns were also relatively low at 0.1 per cent and 0.6 per cent respectively. There was a different showing for private market investments, with private equity funds posting 12.1 per cent gross returns at 5.8 per cent costs. This demonstrates a positive correlation between portfolio costs and gross returns on the net performance generated. Despite the low net returns, the majority of pension fund managers still seem satisfied with the cost-return ratios of bonds, stocks and real estate, and take a more cautious stance on private market and hedge fund investments. This gives reason to assume that pension funds are not distinguishing sufficiently between the specific cost structures of different asset types to assess their investment options. While cost awareness is an important means of achieving net returns, high costs are not automatically a bad sign. Greater attention should be paid to net returns when comparing different asset classes. Cost efficiency should also be assessed at the level of an individual asset class.

NEGATIVE INTEREST RATE ENVIRONMENT HAS HAD SURPRISINGLY LITTLE IMPACT ON THE PORTFOLIO STRUCTURES OF SWISS PENSION FUNDS

Weaknesses in regulations – specific measures for improvement

The shortcomings in the regulations and requirements for Swiss pension funds are also weakening the occupational pensions system. The fact of the matter is that pension institutions are generating returns that are too low. If the operating conditions remain the same, this will inevitably lead to reductions in benefits. This would in turn jeopardise the purpose set out in the Swiss constitution, namely for occupational pensions together with the first and second pillars to enable the insured person to maintain their previous lifestyle in an appropriate manner. Pension funds also have limited room for maneuvre, due to various restrictions.

This is further exacerbated by the fact that the ordinances and practice have increasingly moved away from the wording set down in the act. For example, there is no provision in the act for the strong focus on nominal security. The security of benefit delivery should be brought back to the fore. Focusing on nominal values is not expedient, and not a sustainable solution for the security of our occupational pensions system. With simple measures, significant improvements can be made to the second pillar through specific adjustments to the ordinances. By adopting an approach geared toward returns, pension institutions will be better able to use the capital market as a source of contributions. SFAMA has various proposals in this regard, including a requirement to give reasons for imminent cuts in benefits, the lifting of the current restrictions for individual asset classes, and reporting and information requirements focused on decisions. As part of the public debate on this issue, these proposals are aimed at highlighting the weak points in the present system and at introducing possible measures to promote a pensions system that focuses on returns. ■