Global Pension Risk Survey 2019

Swiss Survey Findings

Enter

Introduction

Introduction

Welcome to our Global Pension Risk Survey 2019, which is the eighth survey conducted every two years by Aon Switzerland Ltd. for Swiss participants. The aim of the survey is to understand the considerations and risk management strategies of the participants and how they plan to manage their assets and liabilities in the coming months and years.

The survey is carried out in all countries that have significant pension scheme liabilities, such as the United States, Canada, Great Britain, the Netherlands and Ireland. Challenges in pension scheme management vary in different countries according to local legislation and regulatory frameworks. However, the results of our survey highlight important common concerns.

In Switzerland, pension schemes are experiencing a very special investment environment. Faced with low interest rates, 10 year SWAP at 1% below zero, increasing life expectancy, inequalities and cross-subsidies between generations and also increasing regulatory scrutiny, pension schemes are forced to consider risk relating to liabilities and assets more actively. In this report, we identify the main risks faced by pension scheme's manager, trustees and sponsors.

Please contact us if you would like to obtain survey findings for other countries or a global report.

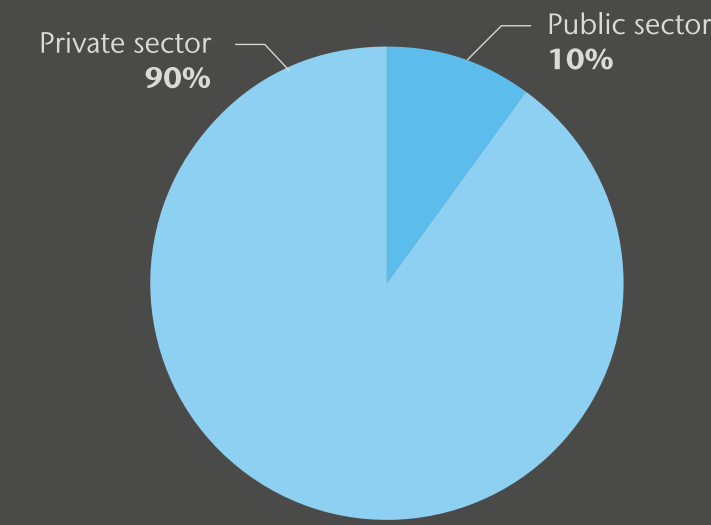
Aon Switzerland Ltd.

Survey participants

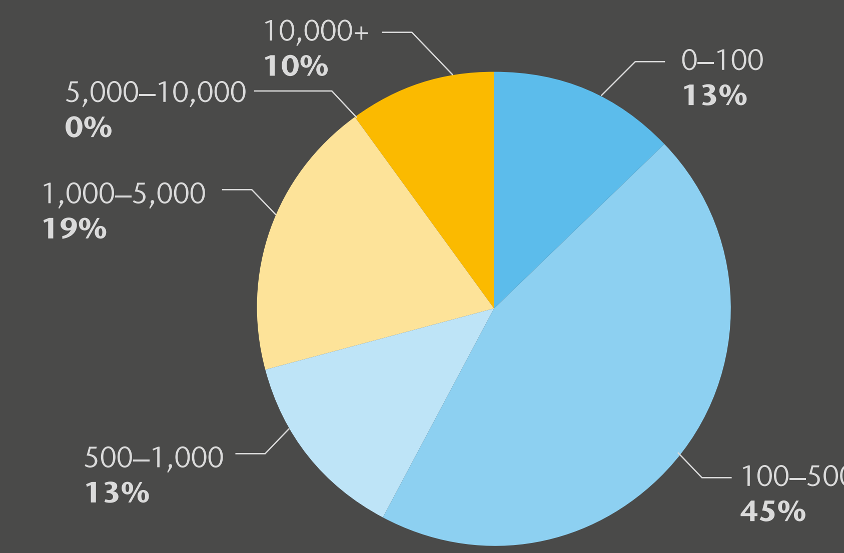
Survey participants

In Switzerland, more than thirty participants with nearly 300,000 members and total assets of CHF 80 billion took part in the Aon Global Pension Risk Survey 2019. The study covered schemes of all sizes; 30% have total assets of more than CHF 1 billion. 45% of participants' schemes covered up to 1,000 members and 20% had assets of less than CHF 100 million. A large majority (90%) of responses were from private sector employers. The responses to the survey were largely from pension scheme managers and trustees. The vast majority of participants have Swiss defined contribution plans (96%).

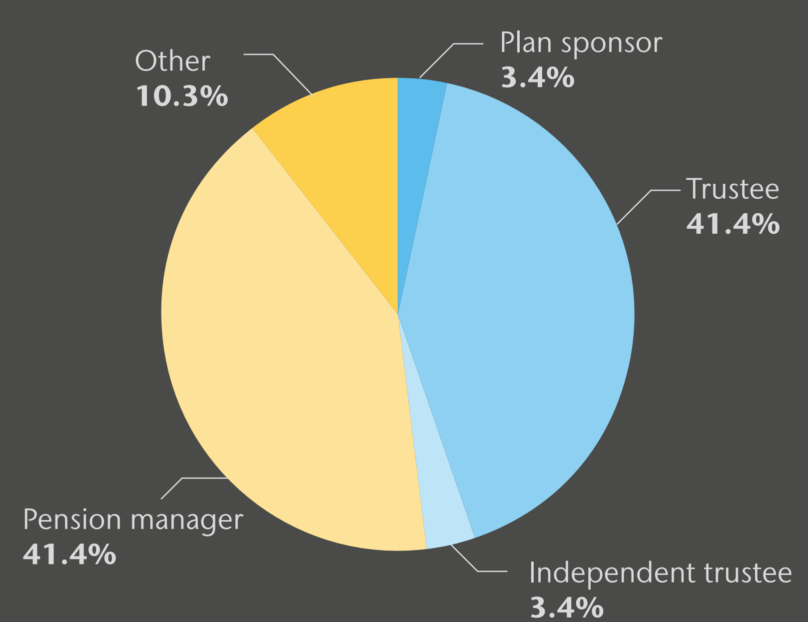
Participant activity sector



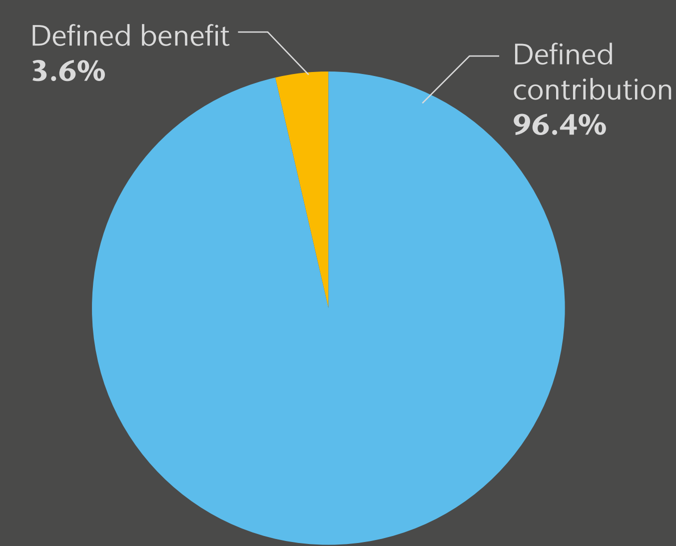
Scheme assets (CHF million)



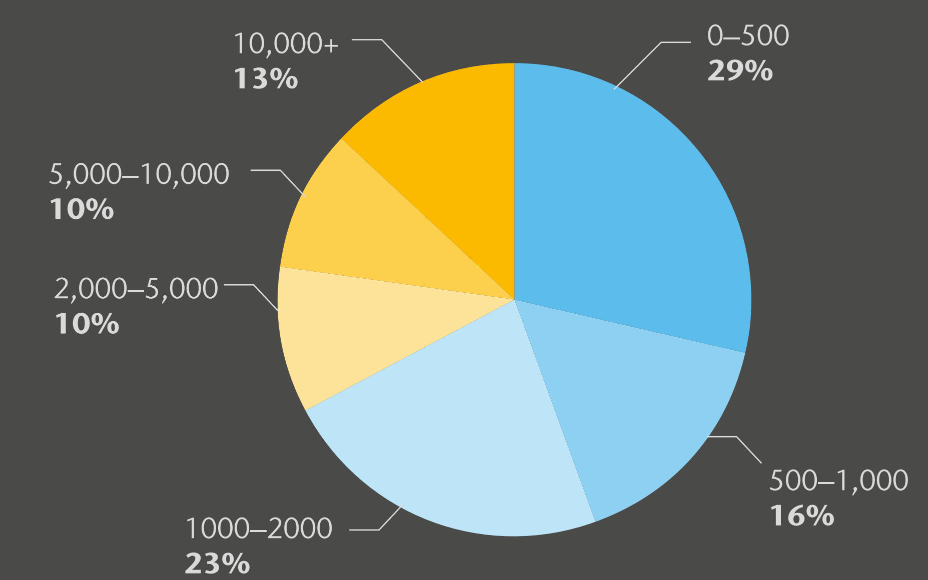
Respondent's job role



Type of plan



Size of plan



Risk management and long-term objectives

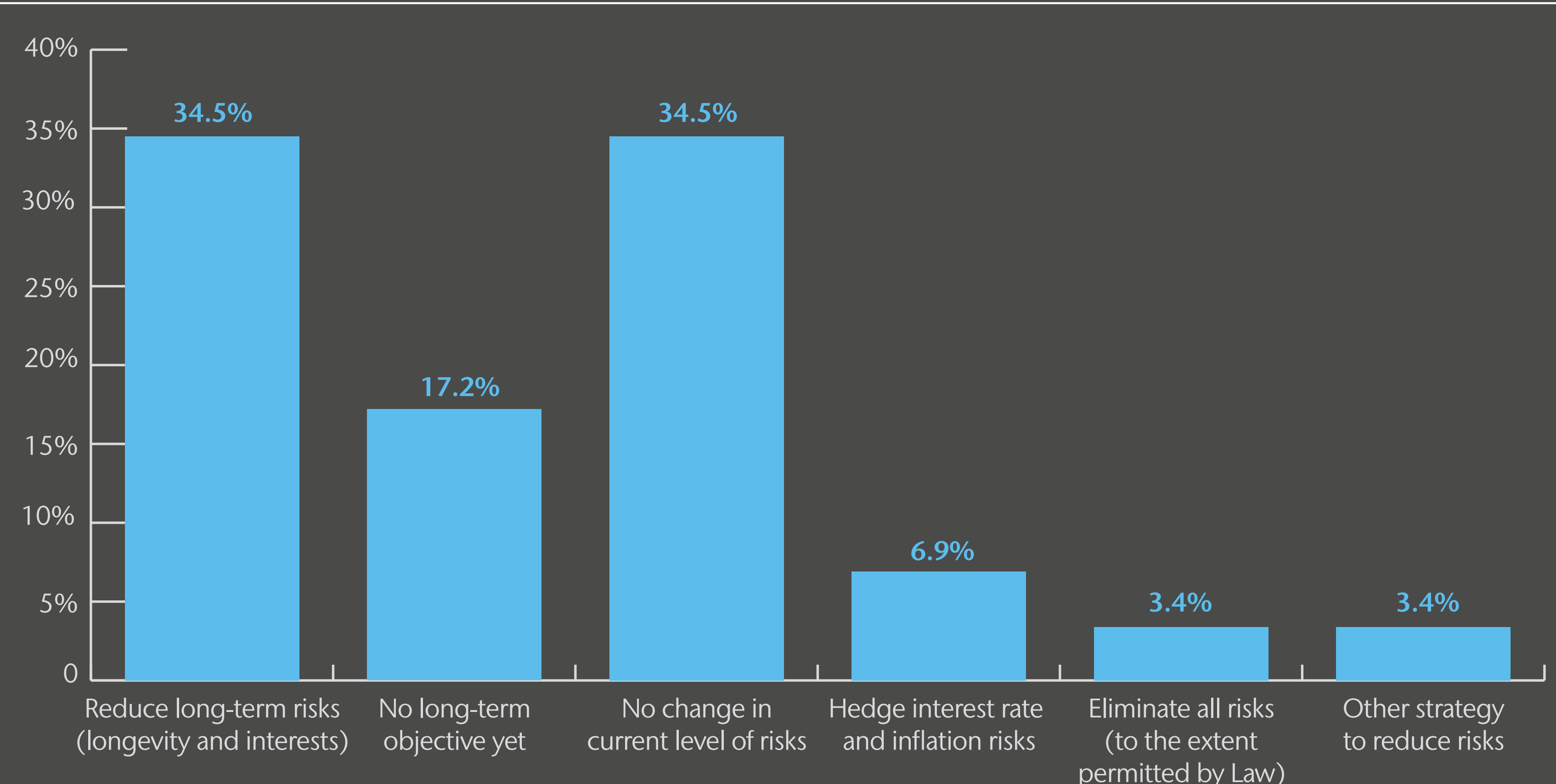
Risk management and long-term objectives

Definition of long-term objectives

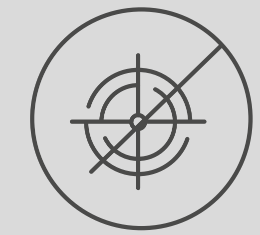
Only 17% of the participants in our study acknowledged that they have not yet defined a long-term objective for managing risks associated with the pension scheme. This demonstrates the importance given to pension planning, thus allowing better definition, control and monitoring of the risk exposures. Although more than two-thirds of respondents feel comfortable with the level of risk to which they are currently exposed, nearly half of the participants indicated that they are pursuing a risk-reduction strategy.

For more than half of the plan participants, an improvement in the performance of assets is key to achieving the long-term strategy. In the current environment of low interest rates and guaranteed level of benefits (BVG-minimum interest rate and conversion-factor), 30% of the respondents intend to increase the contributions to meet the plan objectives in the future. Furthermore, 16% of respondents will implement liability management exercises.

Long-term strategy and flightplan



Key findings

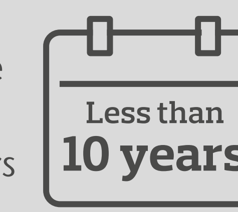


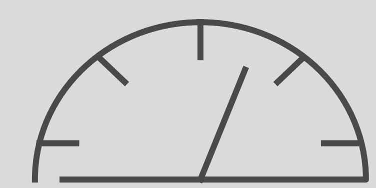
Only **17%** have not yet defined a long-term objective

More than 2/3 are comfortable with their current risk exposure

Nearly 1/2 are pursuing a risk-reduction strategy

90% of respondents see themselves attaining their targets in less than 10 years



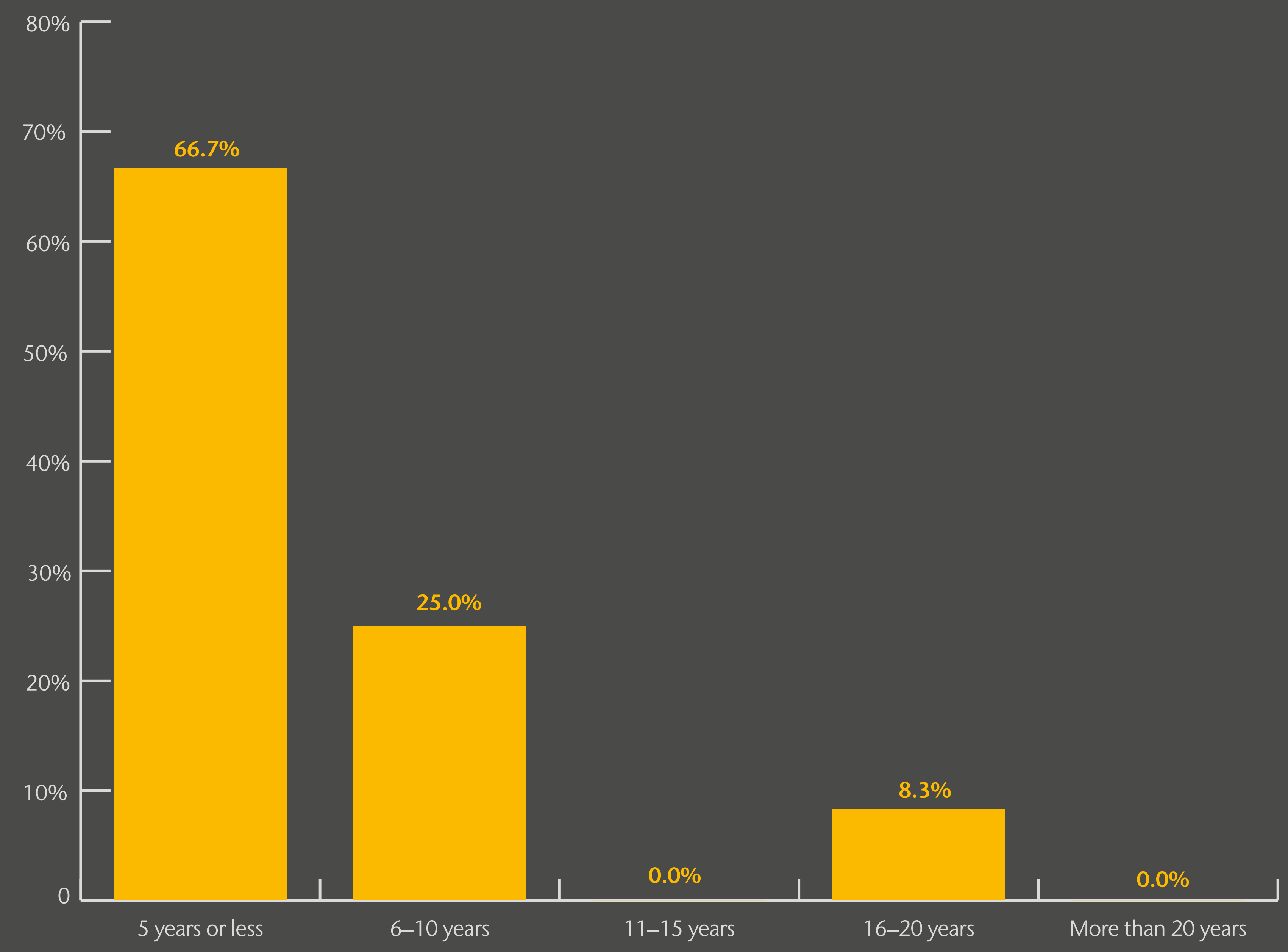


Capacity and willingness to take risks considered most important driver of speed for reaching plan goals

Time horizon

We also asked participants to tell us the timeframe in which they plan to achieve their long-term goals. This corresponds to a period of less than ten years for 90%, and 67% believe that their long-term objective can be reached within the next five years. The evolution of the economic situation, interest rate expectations and possible legislative changes may nevertheless influence the timeframe within which the objectives can be achieved.

Timeframe

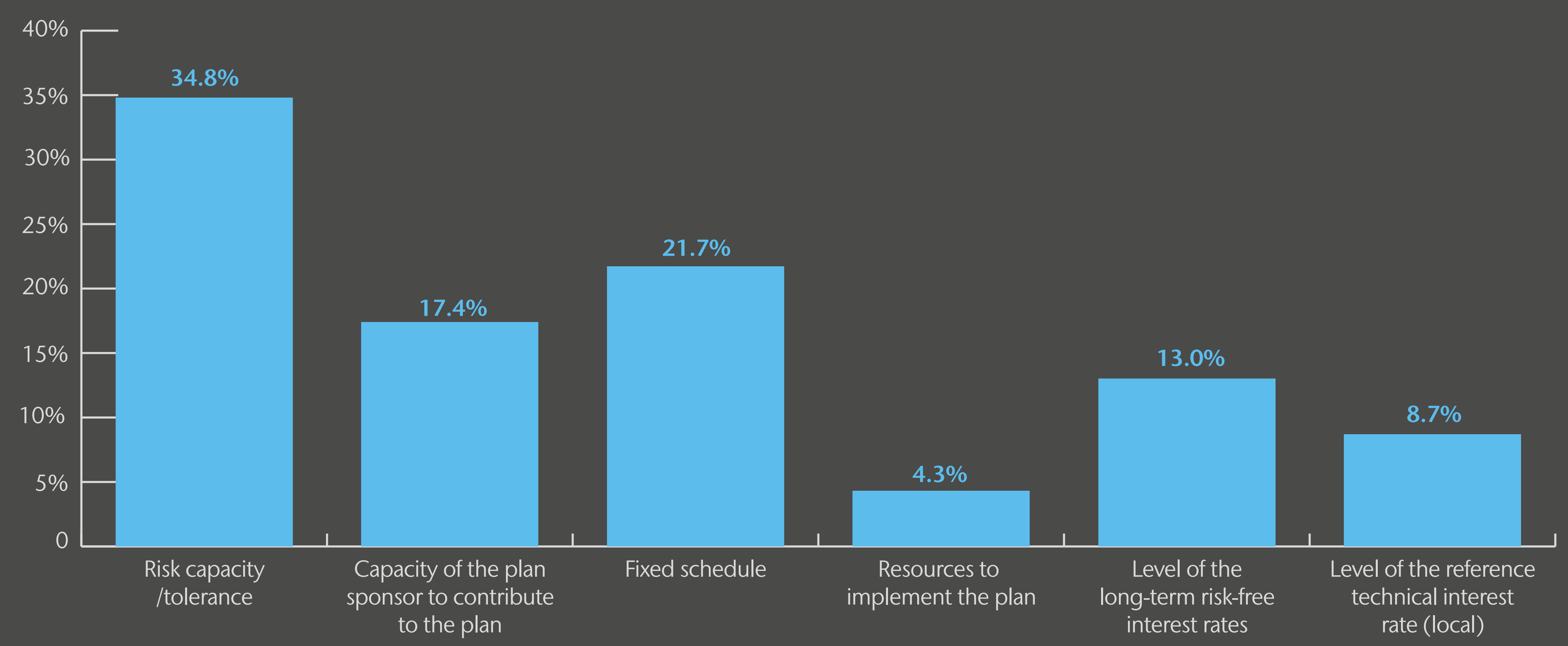


Factors influencing the time horizon

Participants were asked which factors have the biggest impact on the speed at which their planned goals can be reached.

Interestingly, the level of long-term interest rates is considered as the main risk factor which can delay (or accelerate) the achievement of the target for only 13%, while 35% state that capacity and willingness to take risks is the most important factor. A minority of 9% of participants consider that the level of the reference technical interest rate according to FRP4/DTA4 of the Swiss Chamber of Pension Actuaries (SKPE/CSEP) will affect how quickly they can achieve their set objectives. This clearly shows that beyond the reference rate published annually by the SKPE/CSEP, it is the expectation of pension schemes' asset performance that is of paramount importance in defining the intended objective of the scheme and its financing.

Factors impacting the speed at which objectives can be achieved



Risks related to future commitments

Risks related to future commitments

Defined benefit and defined contribution plans

In our 2017 study, it could be observed that the trend of switching pension schemes from defined benefit to defined contribution would continue. This evolution has also been the starting point for a broader paradigm shift in the allocation of risks between members and the employers involved in financing the pension schemes.

Conversion rate

Due to the continuing increase in life expectancy and the persistence of low interest rates on Swiss bonds for a number of years, pension benefits have been revised downwards through the reduction of conversion rates. Nearly half of the participants reported having already made a reduction in conversion rates, while further reductions are underway among more than a third of respondents. In many cases, this has been accompanied by a strengthening of the savings-building process, which may also have been partly financed by additional contributions from the members.

If the combination of these two elements helps to maintain the targeted benefit objective while ensuring greater security in the funding of these benefits, risks remain for the scheme as long as the pensions in payment cannot be reduced, even in the case of underfunding. Additional measures could result in a reduction in risk for the pension scheme (and for the employer) in so much as the risk is transferred to the active members.

Variable pensions

The introduction of pension schemes with variable pension (part of which is defined on the basis of predefined criteria such as actual performance, funding level or the rate of interest credited to members' savings accounts) means that in future, monthly payments to pensioners could be reduced, something not currently possible. This solution, however, has hardly been considered by participants in this study.

Currently some other measures to partially remove risks and transfer them to members seem to be preferred, in particular limiting pension benefits paid in the form of annuities with a preference for benefits to be taken as capital.

1e Plans

A limit on the salary included in the 'base' pension plan has increasingly been accompanied in recent years by the introduction of a 1e plan. In a 1e plan, members can choose their own investment strategy according to their risk appetite, but then consequently also face the risk of capital loss on their pension assets.

Approximately 7% of participants in our study indicated that it was likely that they would introduce a 1e plan in the next 24 months. The introduction of this measure was made possible following the introduction of Art. 19a FZG/LFLP, which means that a pension scheme no longer needs to guarantee a minimum amount in the event of leaving the scheme. The entry into force of this new legal provision was set by the Federal Council by ordinance on 1 October 2017. Employers who have introduced these plans may reflect the risk transfer characteristics in the preparation of their accounts under IFRS or US GAAP.

Key findings

Increase in Life expectancy

Low Swiss bond interest rates

Nearly 1/2 of respondents have already reduced conversion rates

1e plans being introduced alongside a limit on salary in base plan

Article 19a FZG/LFLP entered force on 1 October 2017

Article 19a FZG/LFLP

Article 19a FZG/LFLP entered into force on 1 October 2017. Pension schemes which cover only the part of the salary that exceeds CHF 127,980 (4.5 times the maximum social security pension) are now able to pay out only the actual value of a single person's retirement assets when the member leaves the pension scheme. They therefore do not need to comply with Articles 15 and 17 FZG/LFLP, under which a minimum amount must be paid out in case of a member's departure.

These '1e plans' enable members to choose between different investment strategies offered to them (from a maximum of ten). This allows members to diversify their retirement savings more widely and select the investment profile that best suits their risk profile and investment horizon. In order to offer some protection to members, at least one proposed strategy should be low risk; in other words, cash or cash-like investments or secured claims with good liquidity (where the debtor has at least obtained an A- or A3 rating).

For the employer, the risk of underfunding disappears in most cases for these plans and the employer's obligation is limited to the contributions it makes to this pension scheme. For companies that prepare their financial statements according to international accounting standards (US GAAP, IFRS, IPSAS), the door is open to a treatment similar to defined contribution plans. Nevertheless, the specific characteristics of the scheme (including the type of benefits provided at retirement and on death and disability) should be taken into account in determining the accounting principles to be applied. It is preferable to obtain the advance agreement of the Auditor with regard to the treatment to be followed.

Risks related to existing commitments

Risks related to existing commitments

Defined benefit and defined contribution plans

Overall, the participants in our study are unlikely to consider the implementation of risk management solutions for the current workforce, whether by reinsuring pensions or covering longevity risk through swap contracts (transferring to a third party the uncertainty relating to the time horizon of annuity payments), or by transferring existing commitments to another pension fund.

One of the most important challenges pension plans are facing and have decided to tackle is the increasing level of non-desired solidarities: the transfer of financial resources of the pension scheme from one category of beneficiary to another. Almost two-thirds of the respondents indicated that the definition of mechanisms to ensure fairness between active participants and pensioners was on their agenda.

In the future, an improvement in the financial situation of the pension scheme may allow for an increase in the level of benefits of pensioners. In such a case, 20% of the respondents would consider replacing pension increases with lump sum payments. Furthermore, 25% of the participants would consider different mechanisms for the adjustment of retirement benefits based on the year at which the benefits started to be paid. Considering this factor and the underlying conditions that prevailed also allows the trustees to monitor the undesired cross-subsidy of the different generations of members.

The introduction of a 1e plan for accrued benefits is a very significant decision currently being debated by professionals (pension schemes, actuaries and supervisory authorities). Such a measure should be carefully analysed and planned before being implemented as it would lead to a change of the established rules for plan members.

Key findings

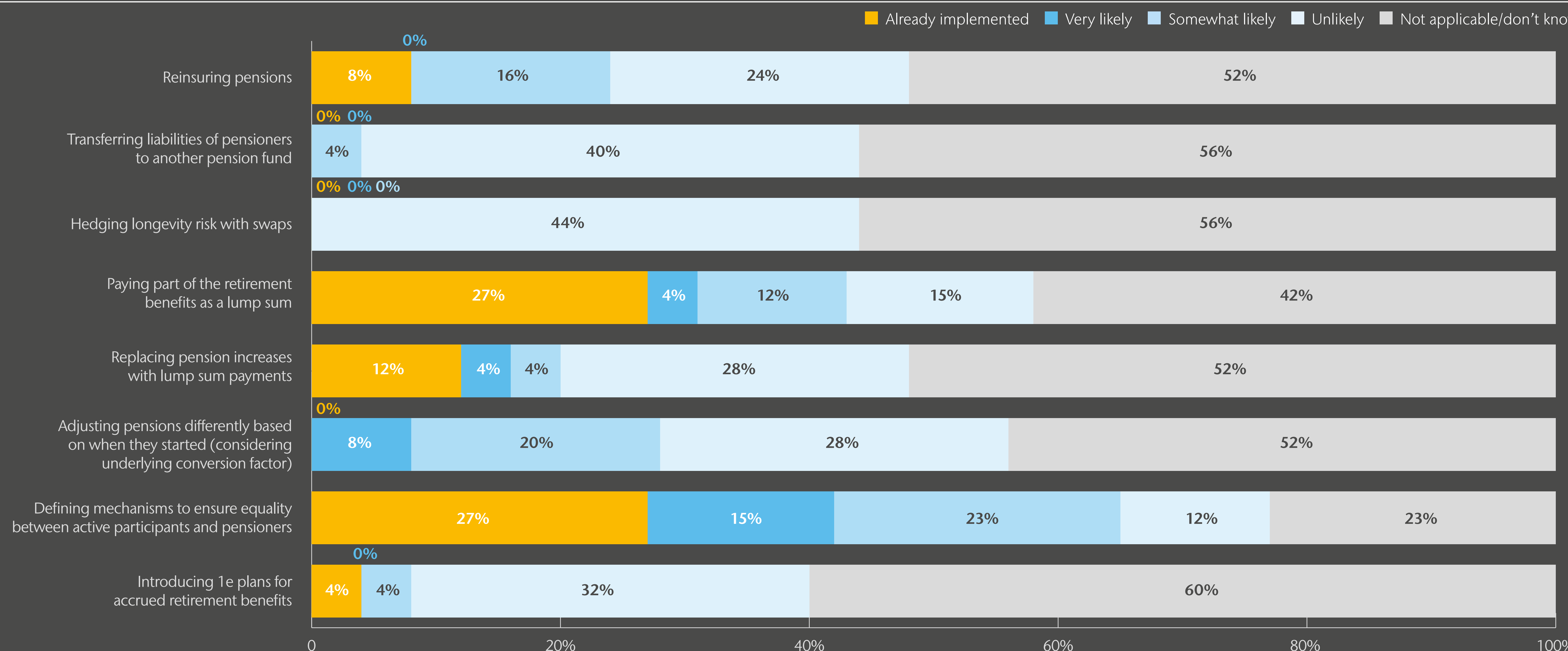
Respondents are unlikely to consider risk management solution implementation for current workforce

Almost 2/3 have equality between active participants and pensioners on the agenda

20% **would consider** replacing pension increases with lump sum payments

25% **would consider** adjustments to benefits based on the starting year

Managing existing liabilities



Hedging pension risk

Hedging pension risk

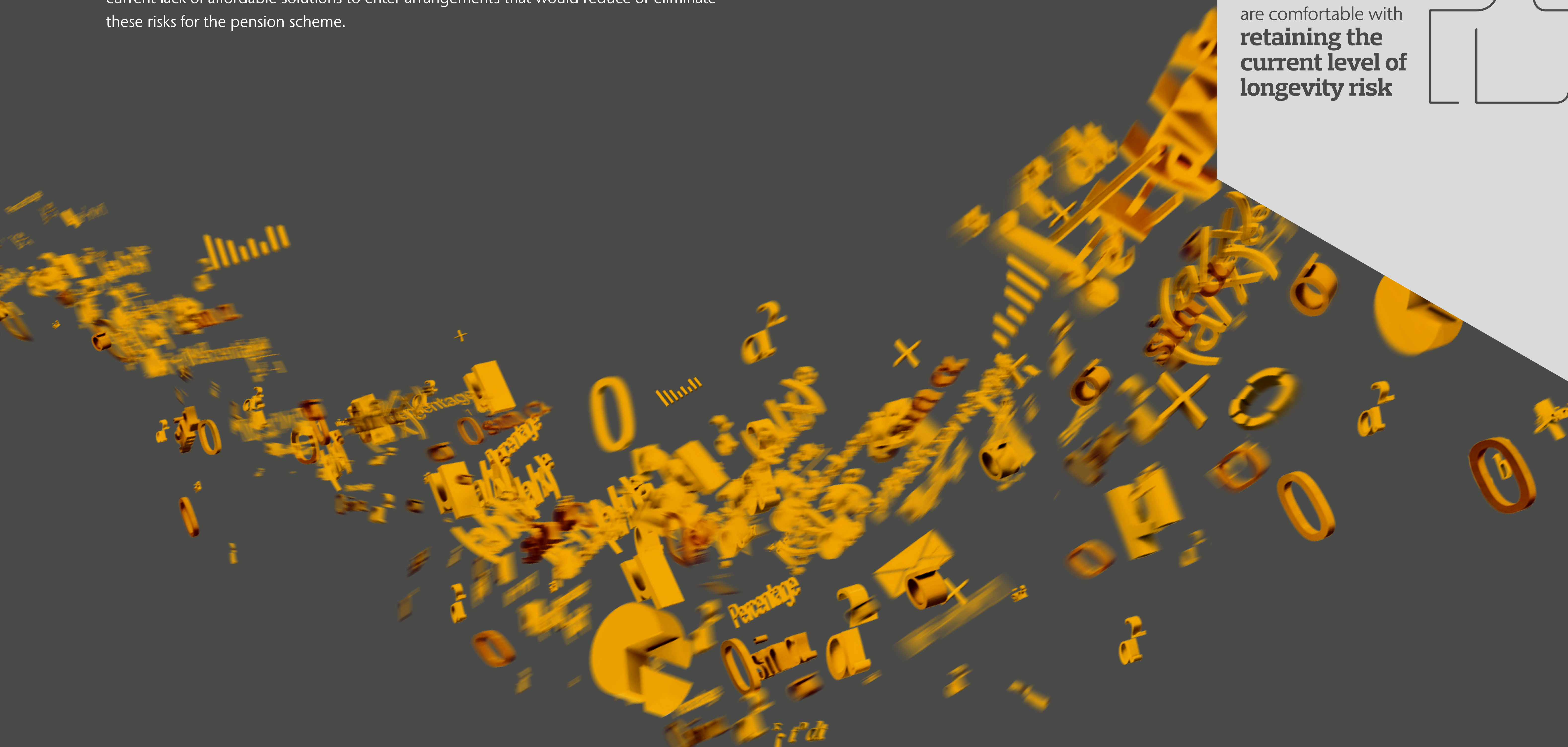
Longevity risk under control for the majority of participants

A majority of the participants in the study confirmed they feel comfortable with retaining the level of longevity risk they currently have in their scheme. They do not expect to hedge their longevity risks, or have not considered doing so, probably considering the current lack of affordable solutions to enter arrangements that would reduce or eliminate these risks for the pension scheme.

Key findings

Majority

are comfortable with **retaining the current level of longevity risk**



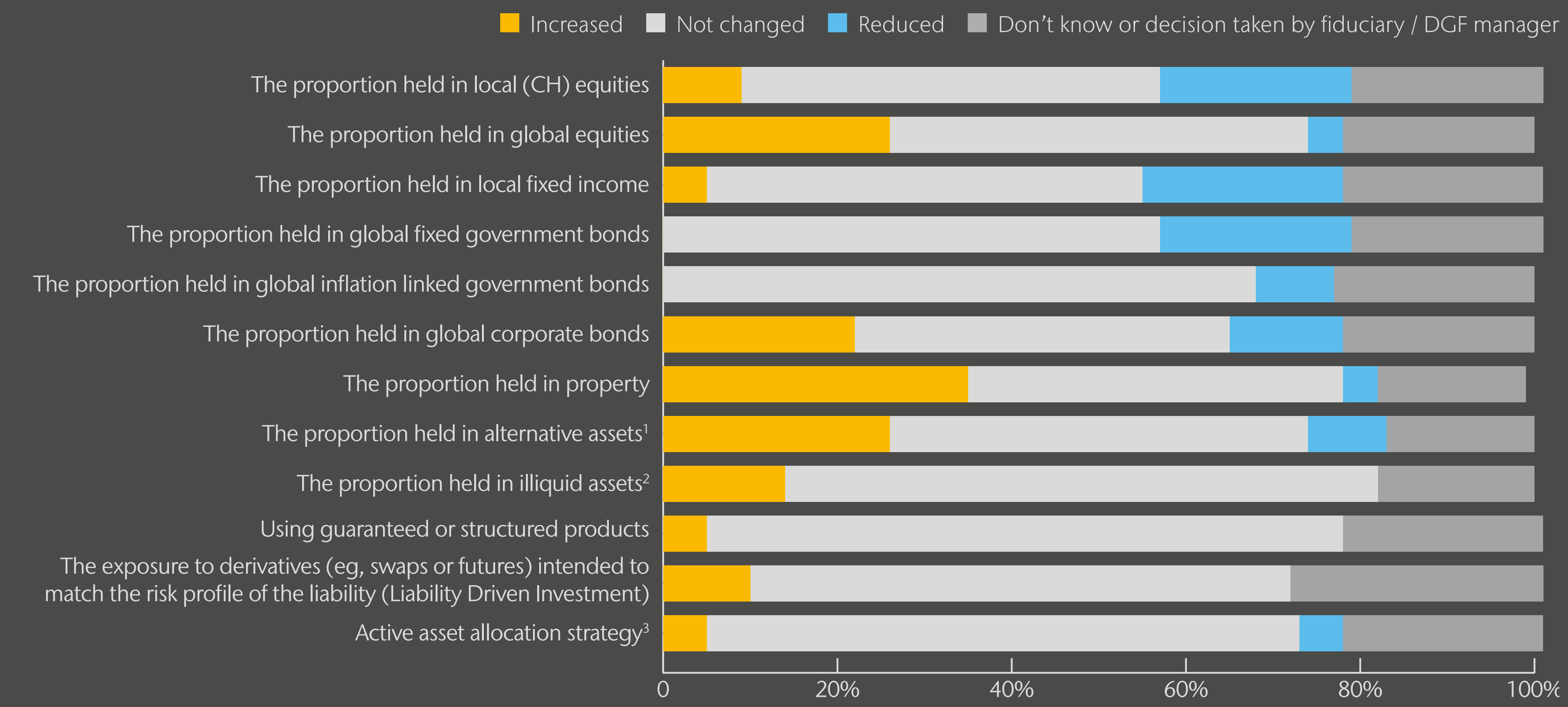
Investment risk

Investment risk

Increased allocation to property and illiquid assets while maintaining equities

The majority of respondents (approx. 60%) reported having barely altered their allocation to major asset classes over the last 12 months. The biggest changes have been a reduction of government bonds (28% of respondents reported having reduced or wanting to reduce the asset class). The largest allocation increases planned in the coming 12 months are still in property, alternative and illiquid assets, while maintaining the current allocation to equities is likely to enhance the expected return. The move from bonds to equities and the increase in diversification that took place in recent years therefore look set to continue. One could observe that the average equity weight increased from approx. 25% three to five years ago to approx. 35% today. So, it is expected that further reduction of the weight of fixed income to reduce the impact of rising yields will flow into private markets and other alternative strategies as there is no more possibility to enter the Swiss real estate market without paying huge premia. In the private market categories, the interest in Private Equity is rising again.

Historic changes to asset allocation



[1] eg, hedge funds, commodities, insurance linked securities.
[2] eg, infrastructure, property debt, direct lending
[3] eg, dynamic asset allocation advice or medium-term asset allocation advice

Key findings

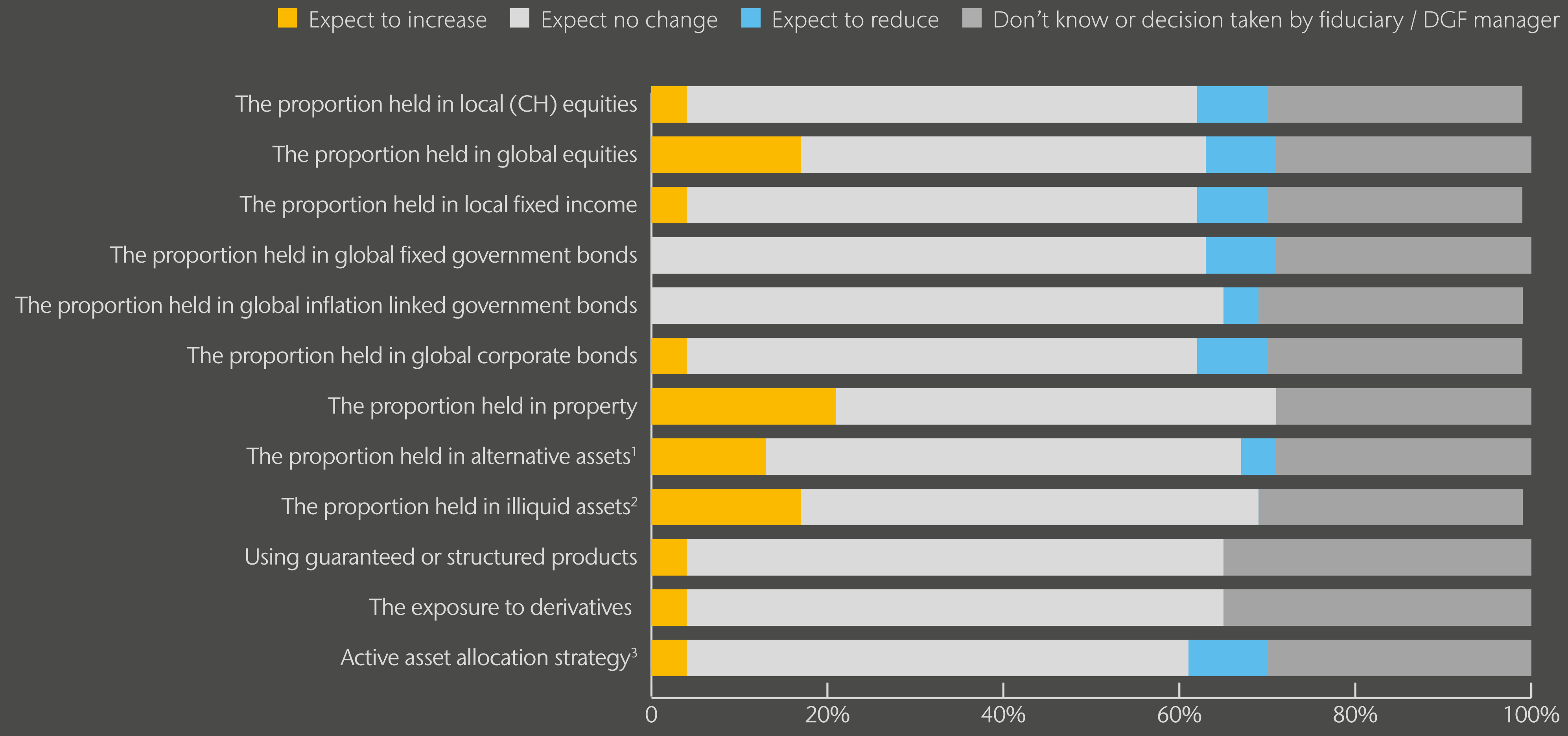
Approx **60%** have barely altered their major asset allocation over last 12 months

28% **have reduced or would like to** reduce allocation to government bonds

Largest planned increases for the next 12 months

Property | **Alternative** | **Illiquid**

Planned strategy change in the next 12 months



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[3] eg, dynamic asset allocation advice or medium-term asset allocation advice

Planned strategy change in the next 12 months

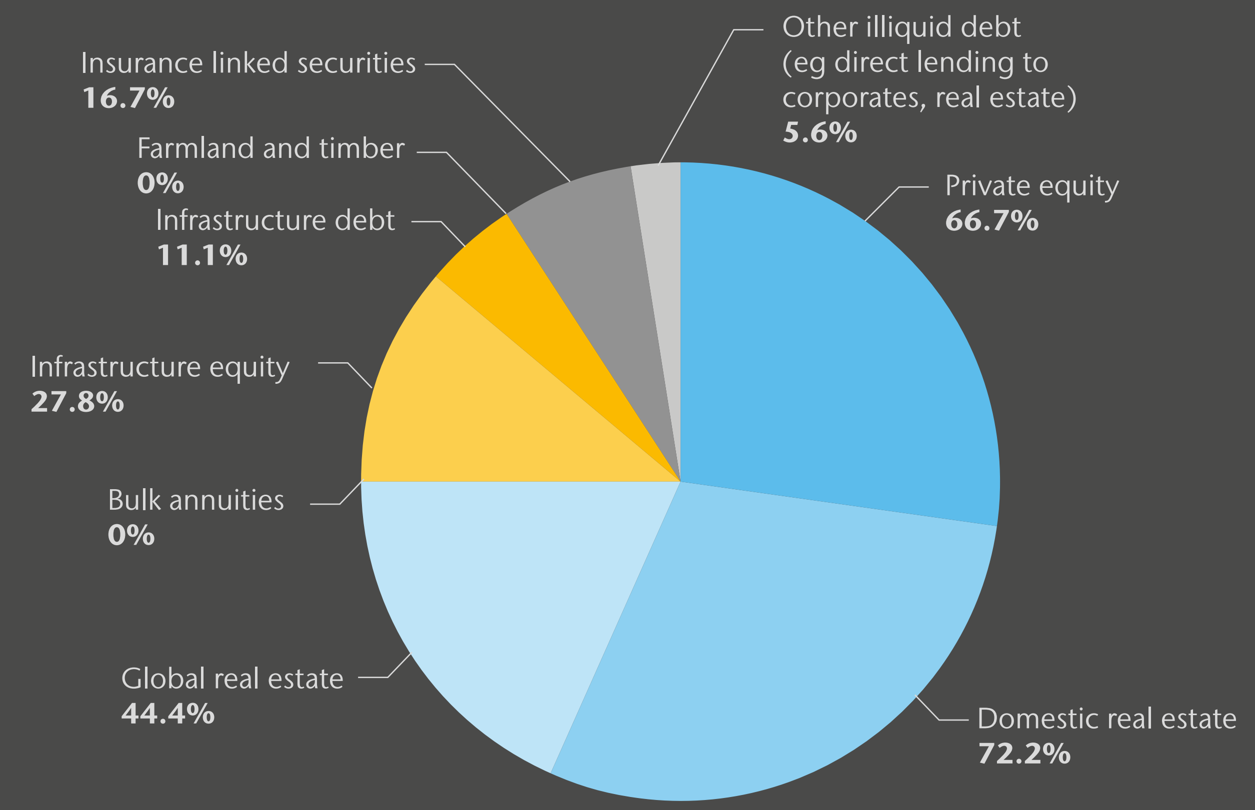
The planned changes reflect the expected returns for the different asset classes. Expected annual performance and risk for the next ten years according to Aon are as follows (as at 31.03.2019):

Asset Class	Performance p.a. (%)	Risk (volatility) pa. (%)
Cash	-0.4%	0.5%
Swiss bonds	0.2%	3.5%
Global government bond (hedged)	-0.2%	2.5%
Global corporate bonds (hedged)	0.6%	3.8%
Swiss equities	5.4%	19.0%
Global equities	6.2%	19.2%
Swiss property	4.5%	9.3%
Global property	4.4%	16.8%
Private equity	8.1%	27.4%
Hedge Fund (hedged)	2.4%	9.1%
Commodities (hedged)	2.9%	11.4%

What illiquid assets are being chosen?

The following graph shows how the interest and focus is for alternative / illiquid assets. As multiple answers were possible, the total adds up to more than 100%. Local real estate leads the field, followed by private equity. Domestic real estate is strongly represented because of the focus of the last 10 years on investing in domestic real estate. Now that investment opportunities there are rarer, there is a shift for future focus towards private equity (67%) and global real estate (44%). Much less focus is on ILS (17%) and infrastructure (40%). Investment in farmland and timber was, and still is, not a priority or of interest for Swiss pension schemes.

Asset focus



Risk management

Risk management

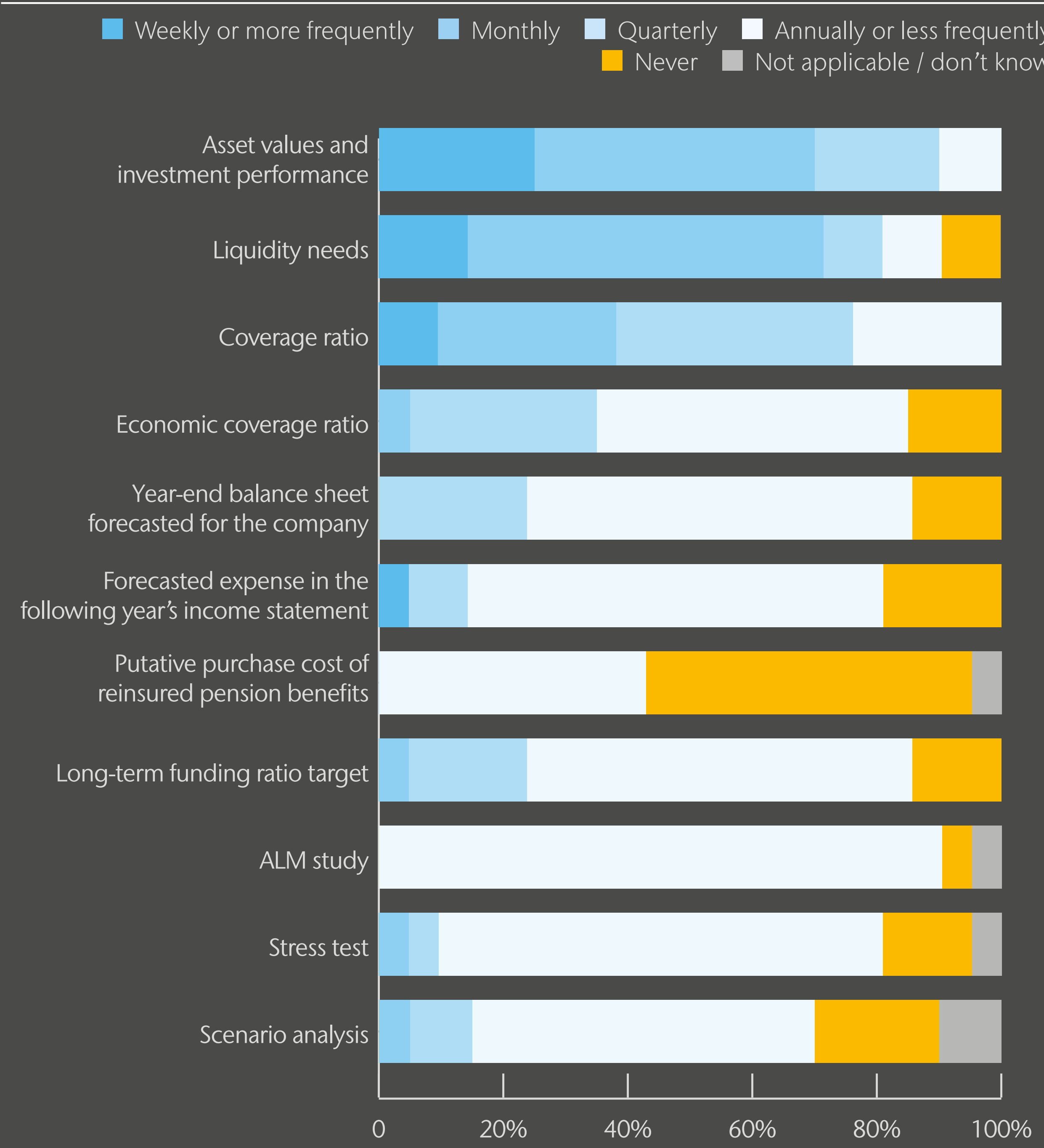
Risk indicators

As part of our study, we looked at the frequency at which various risk indicators related to the pension scheme were monitored.

ALM frequency

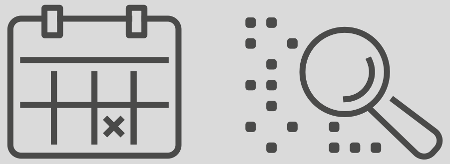
More than 66% of respondents indicated that they conduct an asset liability monitoring study (ALM) every three to five years, enabling them to monitor their long-term objectives and to make adjustments required by changes to the membership profile or the economic situation. These studies also serve as a means of highlighting the implications of a change in the scheme for the development of the financial security and financial situation of the scheme.

Frequency of review



Key findings

More than **66%** **conduct an ALM study** every three to five years



71% **conduct a yearly stress test**

55% **conduct a yearly scenario analysis**

Other tools like scenario analysis and stress tests

Only a smaller number of participants use additional risk indicators such as scenario analysis or stress tests, which is somewhat surprising since many of the pension schemes have access to tools for this type of analysis on the asset side, through their investment consultant or custodian.

Hedging longevity risk

As noted earlier, the possibilities for buyout with an insurance company are rarely considered given the current economic environment and the resulting market conditions. 54% feel comfortable to retain the risk and do not expect to hedge it or outsource it.

Scenario analysis and stress test

To measure the risk or to be able to analyse it, 71% of the participants conduct a yearly stress test and 55% a yearly scenario analysis. 20% never conduct a stress test and 30% never do a scenario analysis.

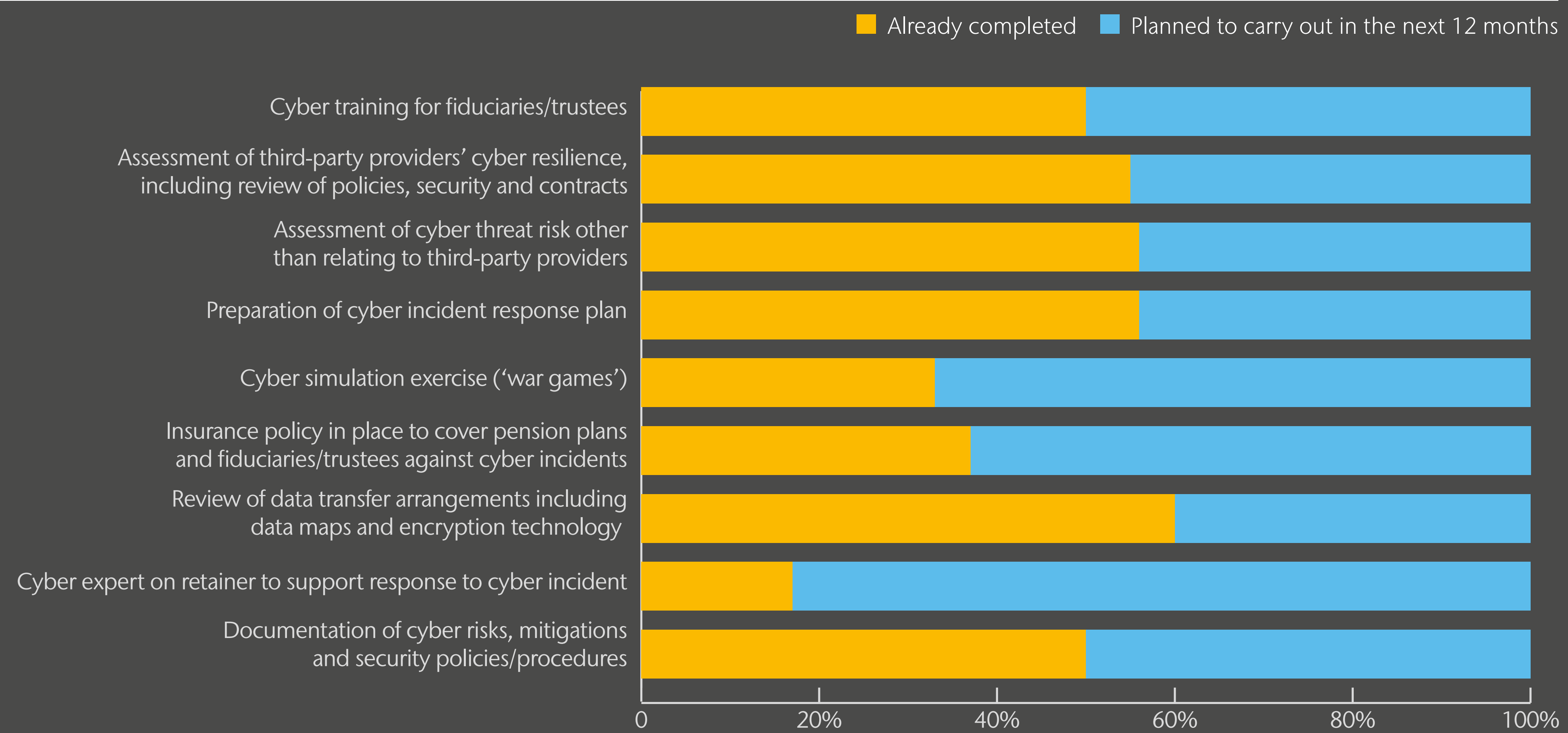
Cyber risks and digitalisation

Cyber risks and digitalisation

What precautions are taken against cyber risk?

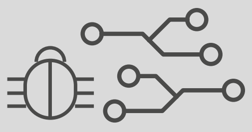
A number of new questions in this survey look at how pension funds are addressing the risk of cyber crime. None of the participants indicated they have faced a cyber incident in the past. Half of the respondents have documentation in place and policies and emergency procedures. And the other half plan to put this in place during the next 12 months. Only one third did a stress test of their organisation / infrastructure or carry out a simulation or 'war game'. This seems to be an area where schemes are developing greater awareness. But there is still work to be done, as half of the participants do not yet have plans, procedures and documentations ready.

Cyber risk



Key findings

No respondents
have faced a cyber incident



1/2

have documentation and emergency procedures in place. The other half plan to put in place during next 12 months

Hot topics

Hot topics

Hot topics

Hot topic
Actuarial assumptions in international accounting standards

Hot topic
Key objectives for the pension fund

Hot topic
Technical interest rate

Hot topic
Application of GDPR

Hot topic
Digitalisation

Key findings

1/2 of respondents have started to review their actuarial assumptions

60% expect a future decrease in conversion factors

70% believe there are potential issues in allocating of scheme resources between its beneficiaries

Only 18% consider the actuarial guideline change to recommendation of the technical interest rate as 'very important'

Only 1/2 of respondents are looking to comply with GDPR at all levels

4 out of 10 offer plan participants an online secured platform

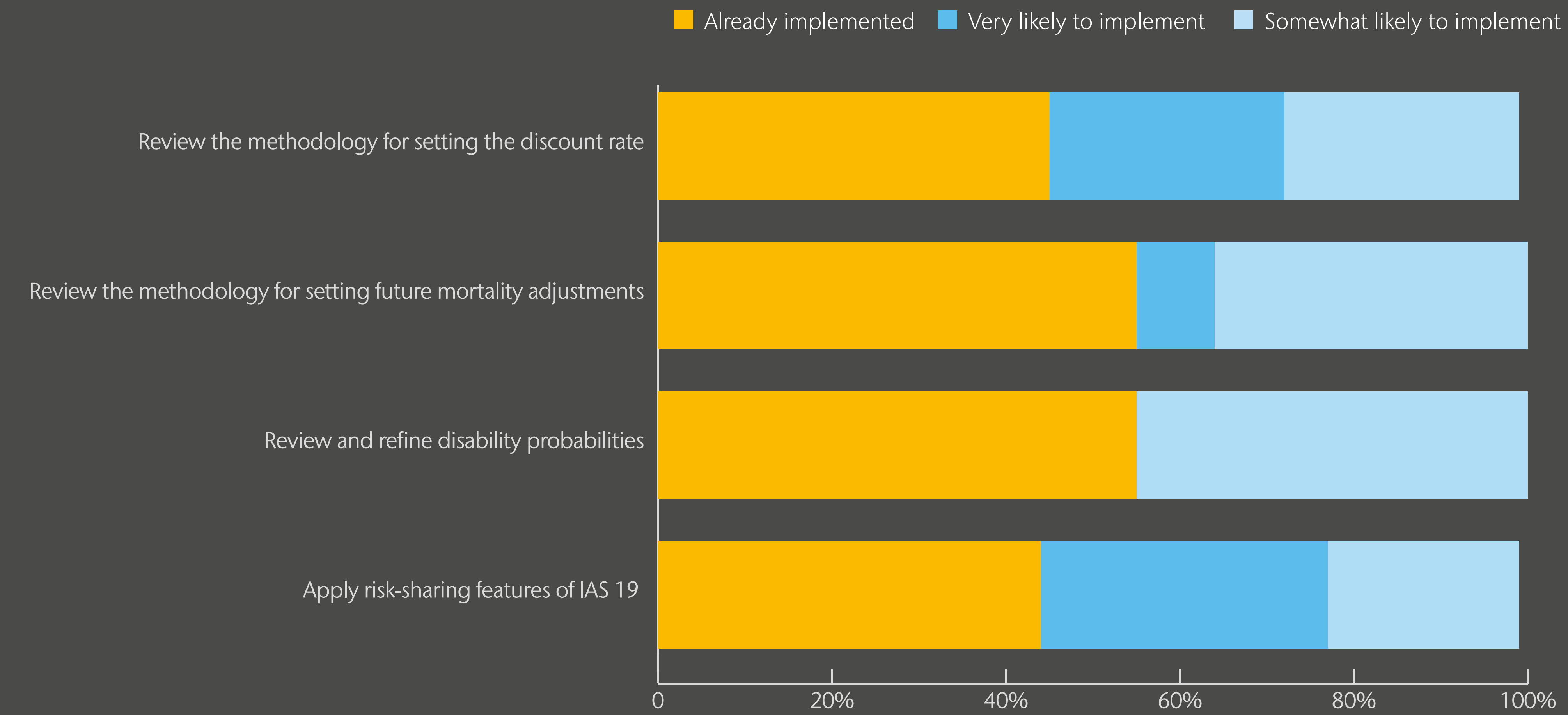
Hot topics

Actuarial assumptions in international accounting standards

The current persistence of low interest rates pushes many companies in this situation to review and optimise the different assumptions they have to make in assessing the elements relating to employee benefits in the preparation of their financial statements.

We saw from the answers of the respondents that half of them started to review their actuarial assumptions, but there is still 'room' for further adjustments, especially in the application of risk-sharing features of IAS 19 and refining the methodology for setting the discount rate.

Hot topics



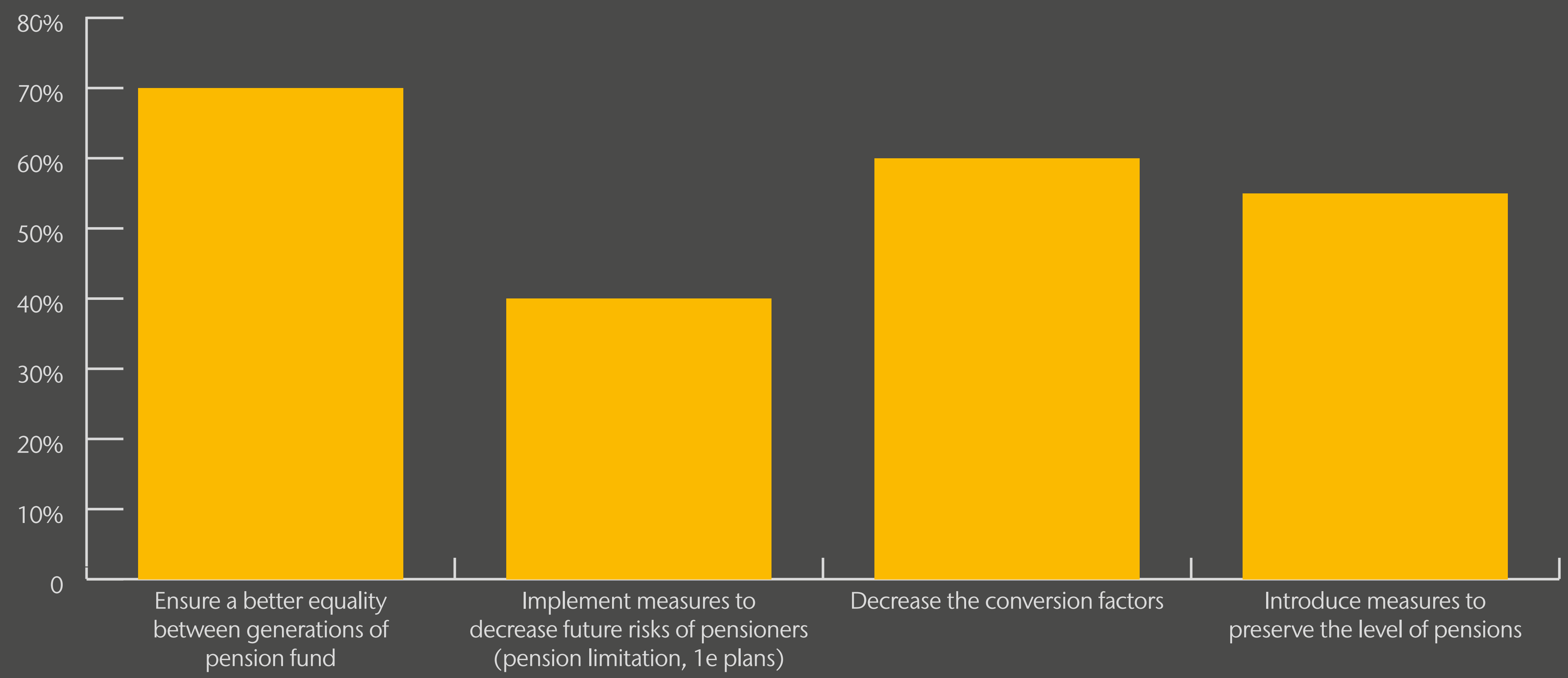
Hot topics

Key objectives for the pension fund

Almost all pension funds are facing the same challenges in the complex current environment of low yields. Most of the participants (60%) acknowledge that a future decrease in the conversion factors is expected to take place in the future. Meanwhile, they are concerned with the level of retirement benefits they can provide, with 55% of them considering the introduction of measures to preserve the level of pensions (eg, increase in contributions to the scheme).

For the large majority of respondents (70%), the equilibrium in the allocation of the resources of the pension schemes between its beneficiaries is at risk. The cross-subsidies between the different generations within the pension scheme is nowadays clearly the most important topic of discussion for trustees who are then seeking ways to reduce these effects in order to maintain the long-term sustainability of the scheme.

Key objectives



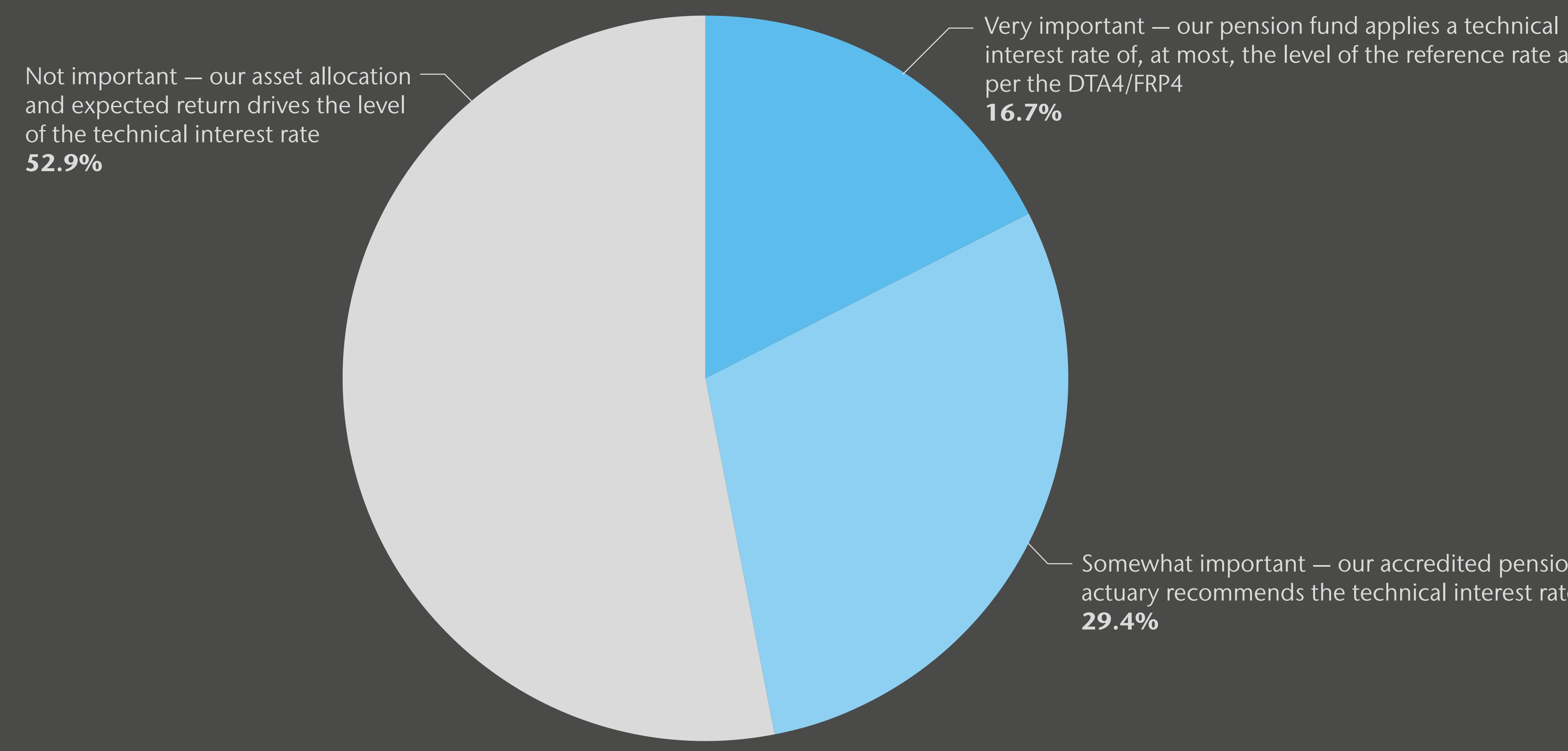
Hot topics
Technical interest rate

In April 2019, the Swiss Chamber of Pension Actuaries adopted a new version of its actuarial guideline related to the recommendation of the technical interest rate to the Pension Fund (FRP/DTA 4). Later this year, this actuarial guideline was declared mandatory by the Independent Regulatory Commission.

It is very interesting to observe that only 18% of the respondents consider this change as 'very important'.

Meanwhile, more than half the respondents considered this change as not important and do not expect it to result in fundamental changes for their scheme. This result shows that a majority of practitioners already considered that the definition of the technical interest rate should be driven by the specific characteristics of the pension scheme (expected return on assets, structure etc).

FRP/DTA 4 Revision in 2019



Hot topics
Application of GDPR

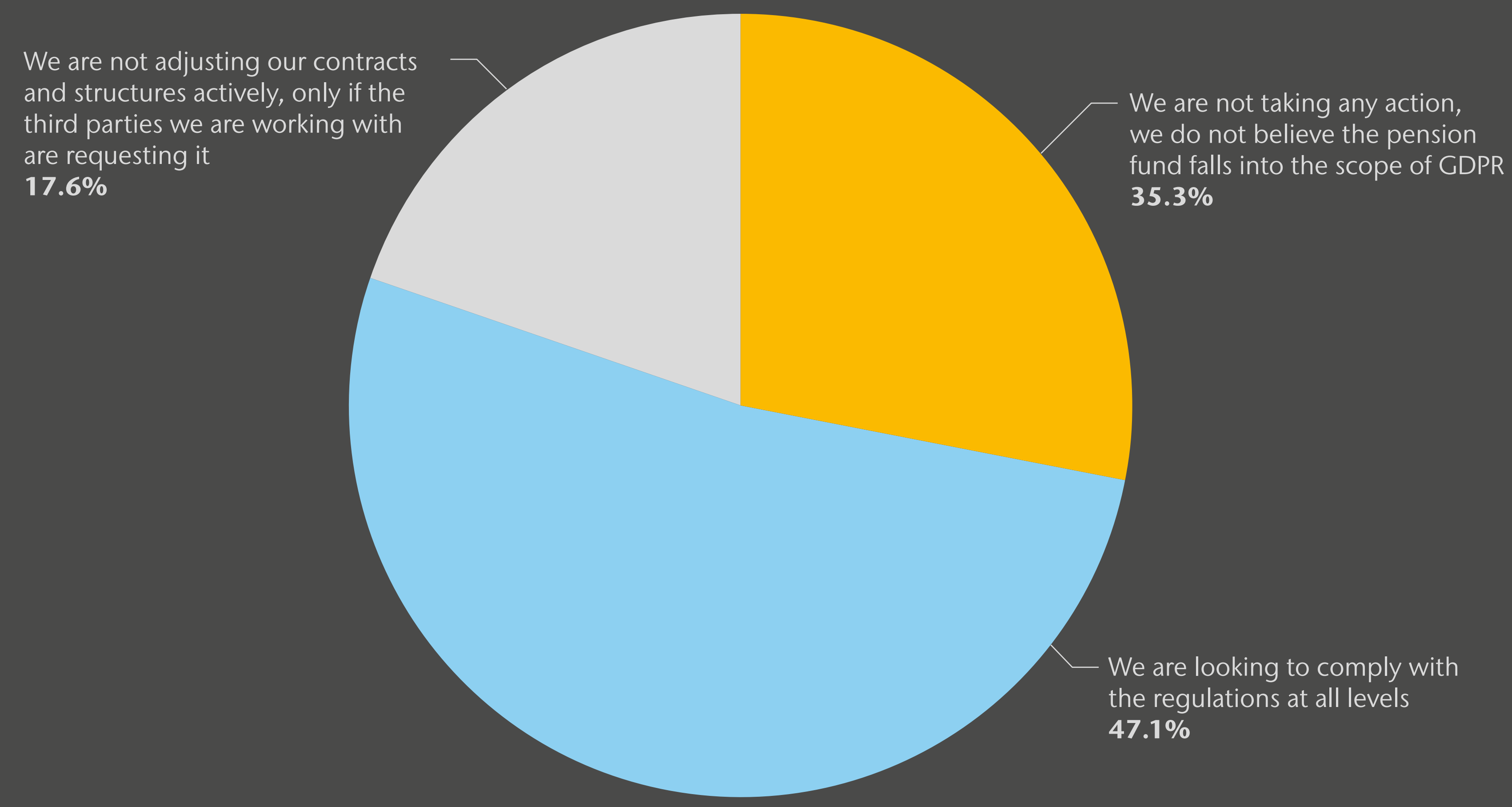
The General Data Protection Regulation entered into force in the European Union in May 2018 and has rapidly become an important topic of discussion for companies. These regulations aim to protect individuals with regard to the use of their personal data.

When asked about their practices here almost half of the respondents indicated that they were looking to comply with the applicable regulations at all levels (47%).

A minority of respondents are not actively taking action to ensure the principles set forth in the GDPR are implemented by the pension schemes, and slightly more than one-third of the respondents do not believe that pension funds fall into the scope of GDPR.

Security of personal data of insureds and beneficiaries is, however, becoming increasingly important for pension schemes. This trend will certainly continue in the near future, as discussions are currently taking place in the Swiss Parliament for a full review of the Federal Law on data protection, and Swiss pension schemes will have to monitor this evolution closely to ensure they fulfil the applicable requirements on data protection.

GDPR



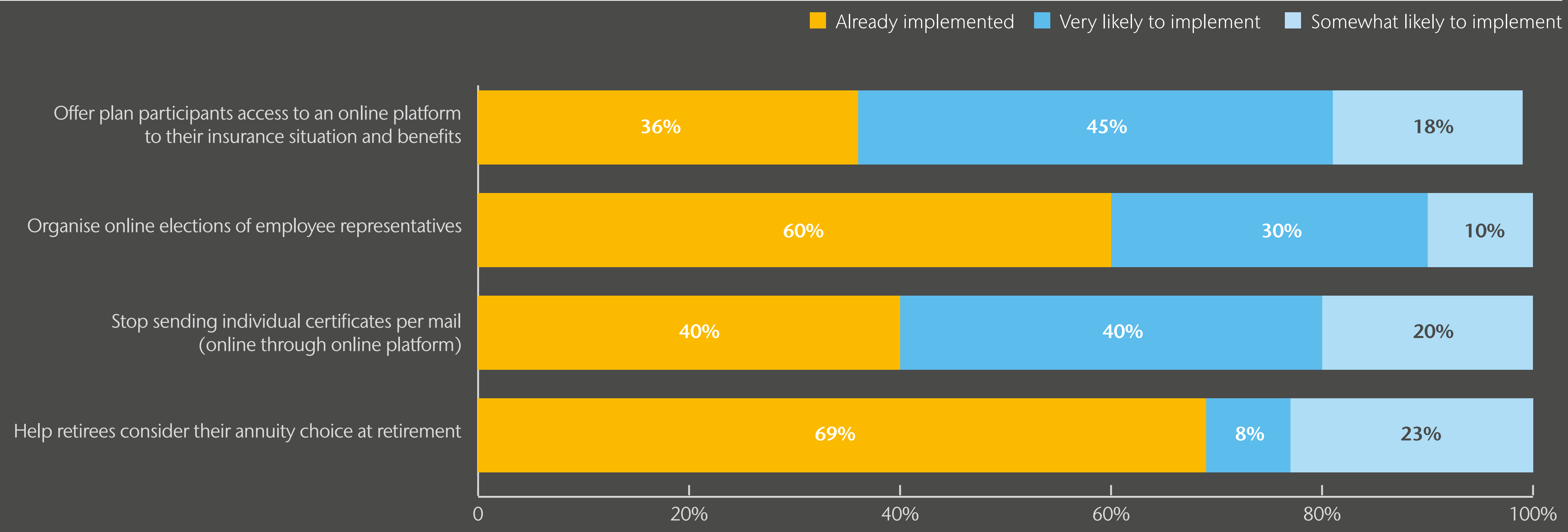
Hot topics
Digitalisation

The topic of digitalisation for pension funds has grown rapidly over the last year as there is an increased willingness to offer to participants and beneficiaries a more modern, rapid and interactive way to consider their pension benefits.

Close to 4 respondents out of 10 have achieved a big step in this process, offering plan participants an online secured platform to access their individual insurance situation. As a consequence, they have stopped sending individual insurance certificates by mail. These platforms usually allow the members to see their level of insured benefits, and perform simulations in case of early retirement, purchase, change of level of contributions or withdrawal for home ownership.

60% of the respondents already organise online elections for the employee representatives in the pension board, while 70% provide the required support to their members when it comes to the time to retire, helping them to consider the advantages and disadvantages of a retirement pension or a lump sum.

Steps towards digitalisation



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