Switzerland's pensions debate: Negative for longer

November 2016 (Magazine) **By** Liam Kennedy **(URL=/liam-kennedy/1368.bio)**

Switzerland is engaged in a debate not just about its pension reforms, but also wider issues of intergenerational fairness and the stability of the second-pillar pension system.

'Lower for longer' might sound like a hackneyed phrase now but it is a firm reality for Swiss pension managers. 'Lower and negative for longer' might be a fitting description of the current situation. Just two years ago, Swiss 30-year government bonds were yielding above 1%; since July 2016, yields have hovered around zero, mostly in negative territory.

That long-dated, high-quality European government paper should yield below zero is unprecedented. It might be tempting to view the problems of Swiss pension funds as a more extreme version of those faced by pension funds elsewhere in Europe. But Switzerland's problems yesterday are Europe's problems today as the rest of the Continent grapples with lower and negative interest rates. The yield on German 10-year Bunds has also remained consistently below zero since Brexit, and the 30-year yield plumbed lows of 0.34%, piling the pressure on domestic Pensionskassen and insurers with fixed guarantees.

Negative rates not only raise practical questions about the discounting of liabilities. They have also forced Swiss pension funds to accelerate their diversification plans and allocate assets away from domestic government bonds. As liquidity diminishes, investors are also seeking to hold assets to maturity, as the pioneering Lombard Odier pension fund has done under the leadership of Theodore Economou. Others, such as the pension fund for the Swiss Federal Railways, Pensionskasse SBB, are increasing exposure to fixed income in areas like corporate, high-yield and emerging-market bonds.

Increasing non-domestic exposure of course adds currency risks to portfolios. The decision by the Swiss National Bank in 2015 to cut the peg to the euro penalised pension funds with foreign holdings and reignited the debate around currency risk. According to consultancy Complementa, the share of foreign assets in pension portfolios has increased since 2008 to reach 47% last year, while currency exposure has declined slightly to about 17%.

Low rates and low returns mean scrutiny on fees, particularly in light of the transparency requirements for pension funds to declare total expense ratios on a per-mandate or per-fund basis and seek to save basis points where they can. There are already signs that asset managers are responding to this pressure by offering greater transparency and designing new products for funds in these difficult times.