COUNTRY REPORT
SWITZERLAND

Difficult 2022, recovery in 2023

COMPLEMENTA RISK CHECK-UP

The Complementa Risk Check-up is conducted annually and provides insights into the Swiss pension fund market. **Andreas Rothacher** and **Ueli Sutter** share some of the highlights of their findings

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KEY POINTS

- Swiss pension funds returned 3.7% so far this year, in stark contrast to 2022
- Average coverage ratios dropped from 115.3% to 104% in 2022 but recovered to an estimated 106.5% by the end of August
- Schemes turned away from fixed income in favour of real estate and fixed income
- Some 444 pension funds participated in the latest Complementa Risk Check-up

Swiss pension funds achieved an average performance of 3.7% in the year to August 2023, mainly driven by strong equity markets. Global equities (MSCI World) returned 11% in Swiss franc terms and Swiss stocks (Swiss Performance Index) were also up by 6.8%.

This year's positive result is in stark contrast to last year's performance, when pension funds lost 9% on average. This was the worst performance since the financial crisis and the second-worst performance in the past 20 years; 2022 was especially challenging since bond and equity valuations decreased simultaneously.

Coverage ratios decreased

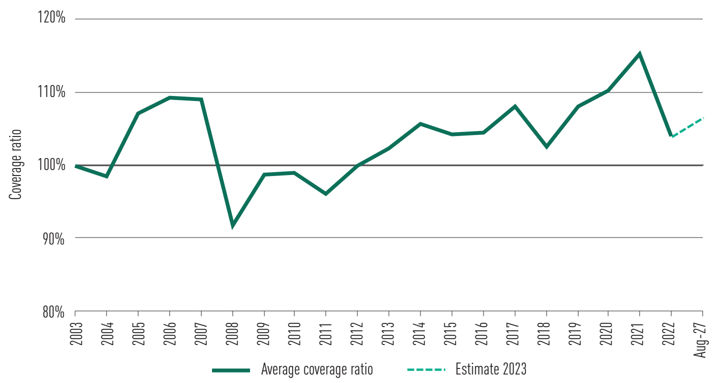
Because of the significant negative returns, the average coverage ratio dropped from 115.3% to 104% in 2022 (figure 1). Just under 9% of pension funds had coverage ratios of below 100% by the end of the year. The high reserves from previous years prevented a worse outcome. This exemplifies the importance of building reserves in strong years like 2019 or 2021.

Thanks to the positive returns till the end of August this year, the picture has improved to some extent. We estimate that the average coverage ratio increased to 106.5% by the end of August.

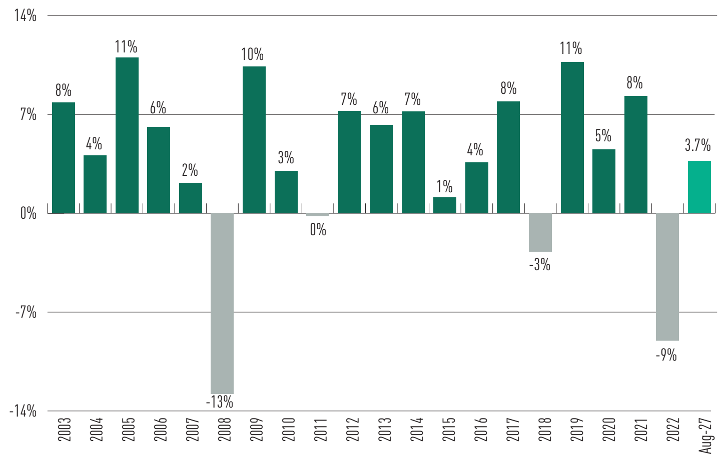
Fixed-income at new low

At the end of 2022, the fixed-income allocation of Swiss pension funds reached a new low of 31.7%. The equity allocation stood at 29.5% by the end of last year. This is a decrease of almost 2.5 percentage points compared with 2021. The real estate quota reached a new high of 24%. Over the past few years, we saw a

1. Average coverage ratio of Swiss pension funds



2. Average performance of Swiss pension funds



Source for both: Complementa

significant increase in the allocation to foreign real estate investments as pension funds struggled to to replace their real estate allocation with Swiss investments. Alternative assets also reached a new high with 10.1%.

Since 2016, the allocation to alternative assets has remained above 9% of assets under management, with private equity and infrastructure the most popular subcategories. Regarding invested capital, private equity makes up the largest portion. Infrastructure remains the most popular subcategory, with 45% of schemes investing in infrastructure assets.

On average, Swiss pension funds invest around half of their assets abroad. This number has remained relatively stable over the past six years. Pension funds hedge most of their currency exposure, and foreign country exposure stands at 17.1%.

The increases in real estate and alternative asset quotas in 2022 are also driven by the denominator effect caused by falling bond and equity prices.

In the year to end-August 2023, equity markets showed positive developments, while bonds remained broadly neutral (on a year-to-date basis in Swiss francs). Consequently, the equity allocation has increased more than 1 percentage point compared with the end of last year and stands at almost 31%. The bond allocation on average remained fairly stable at above 31%. The real estate quota has decreased slightly in relative terms. We estimate that this was close to 23% as of end of August. High levels of real estate investment at the end of 2022 were a key driver, as pension funds significantly slowed down further investments into real estate this year. Price corrections on Swiss and especially foreign real estate vehicles also played a part. Alternative allocations have remained stable compared with the end of last year, and should be seen in the context of existing capital commitments in infrastructure and private equity from previous years, some of which were called this year.

Rising interest rates

The main focus of this year's Complementa Risk Check-up study is interest rates. Since the end of 2021, interest rates have increased significantly. Through a questionnaire we surveyed 168 pension funds on whether various asset classes still have a place in the asset allocation in the new interest rate environment.

Our study reveals that pension funds still hold very positive views on real estate and infrastructure investments, despite the higher interest rate environment. Over three quarters of survey respondents believe that Swiss real estate still has a place in the strategic asset allocation, even at higher interest rate levels. One fifth of respondents hold a neutral view. Two thirds of respondents believe that infrastructure still has a place in the investment strategy.

We also wanted to know whether pension funds' strategic bond allocations might increase again. One fifth of respondents plan to do so, and another fifth is still deciding. The rest of the respondents do not plan to increase their bond quota. Pension funds are also concerned about potential further increases in interest and inflation rates. In addition, their strategic asset allocations are structured so that they remain viable despite higher rates and inflation, by, for example, adding real real estate and infrastructure.

Discount rates rise

The technical interest rate is the discount rate at which future liabilities are discounted. Due to the rise in interest rate levels, pension funds have more leeway for setting this discount rate. Thus, around 30% of the participants are planning, or at least discussing, an increase in the discount rate. A possible trend reversal already took place last year. After years of steady reductions, the average discount rate was increased by 0.1 percentage point to 1.7% for the first time in the past 20 years. This reduces the value of pension liabilities, which has a positive effect on the coverage ratio.

Conversion rate decreases

As in previous years, the overall conversion rate was further decreased to 5.3%. The conversion rate represents the rate at which pension assets are converted into annuity payments upon retirement of an insured person. The current rate is significantly below the mandatory conversion rate of 6.8% which is only applicable to the mandatory part of the pension. In reverse, this also means that conversion rates on the non-mandatory part of the benefits are significantly lower. According to the survey, further reductions to 5.1% have already been decided for the next five years.

Worst returns since 2008

In conclusion, 2022 was a difficult year for pension funds. Investors saw simultaneous markdowns on their bond and equity investments, and pension funds on average achieved the worst annual returns since the financial crisis (figure 2). The average coverage ratio of Swiss pension funds decreased significantly. Accumulated reserves from previous years mitigated an even worse outcome. In 2023 investors saw a recovery, particularly in equity markets. Coverage ratios increased somewhat.

The significant rise in interest rates compared with the end of 2021, prospectively increases return perspectives for pension funds. On the other hand, tighter monetary policy and decreasing growth expectations pose some challenges for investors going forward.

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