KPMG

Tangled up by personal interests

Challenges of pension planning

Time and again, surveys show that pension planning is one of people's greatest concerns. The topic is relevant for each and every company as well as every board of directors. That sense of concern is a feeling shared by every generation surveyed and the need to take action is well-established. In its latest publication entitled Clarity on Pensions, KPMG examined the question of how to break the reform deadlock. This article provides a summary of the findings detailed in the publication.

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Confidence in uncertain times

Rarely is there a political issue that impacts each and every individual as directly as that of pension planning. It is one of the cornerstones of our modern-day society and a prerequisite for people to eagerly look forward to their third stage of life. Word has now spread, however, that this accomplishment might be on shaky financial footing, the topic of pension planning has started popping up in surveys where it is being cited as one of people's biggest worries. How dramatic is the situation?

Situation analysis of the pension system

The key figures provided here illustrate how general conditions in Pillars 1 and 2 have changed over the past few decades:

- Interest rates for 10-year government bonds have tumbled from 4.8% in 1985 to the current level of around -0.5%. While a pension fund could aim for a nearly risk-free return of around 5% in 1985, an investment strategy subject to a multitude of risks currently only generates an expected value of return of around 2%. That means the risks borne by pension funds are much higher in today's environment, as the revenue they receive is significantly lower than previously. One repercussion of this has been a substantial decrease in the benefits paid out over the years.
- Life expectancies for 65-year-old women and men have risen from 85.0 and 79.9 years, respectively, in 1985 to a current life expectancy of 87.7 and 84.0 years (based on mortality tables). This increase in life expectancy is enormous, as illustrated by this example: A person who turns 65 tomorrow has a life expectancy that is two hours longer than a person who turns 65 today. Accordingly, the length of time a person receives a pension is increasing continuously.

- In 1990, the ratio comparing the number of people aged 65 or older to those between the ages of 20 and 65 amounted to 26.7% (an indicator referred to as the OASI old-age dependency ratio). Given that this indicator is expected to rise to 41.3% by 2030, the working population will be required to pay ever-higher contributions in order to finance the retired generation.
- Currently, the OASI benefits received by 92% of recipients are higher than what they originally paid into the system. These shortfalls must be offset in part by people with high incomes, a practice in line with policies designed to redistribute wealth, while the government has also been making substantial contributions to the system for years. In fact, the government already finances one third of total Pillar 1 expenditures. That clearly shows that increasing the number of people paying into the system will not solve the problems with the OASI because, as it is currently structured, the scheme works somewhat like a snowball system over the long term.

KPMG has estimated the change in the Pillar 1 pay-as-you-go deficit (vs.) between now and 2050. Based on the legislation currently in place, we expect the pay-as-you-go deficit to exceed CHF 20 billion for 2050 alone. Until then, the system will have amassed a cumulative pay-as-you-go deficit of up to CHF 400 billion. These figures need to be looked at alongside other present-day expenditures. The federal government currently spends CHF 8 billion on education and research, CHF 6 billion on national defense and CHF 4 billion on agriculture. The federal debt position at the end of 2019 amounted to CHF 97 billion. When compared with the OASI's financial forecast, the CHF 31 billion pledged by the federal government up until August 2020 to manage the COVID-19 crisis can be seen from another perspective. Unintended redistributions are already having a significantly negative impact on pension funds. The Occupational Pension Supervisory Commission (OPSC) has estimated that this has added up to CHF 7 billion for 2019.

Societal aspects

The situation currently facing our pension scheme is essentially clear. Major challenges, if not systemic threats to the scheme, have to be resolved. Despite that, implementing urgently needed reforms has proven to be an insurmountable task during the past 20 years or so. Why?

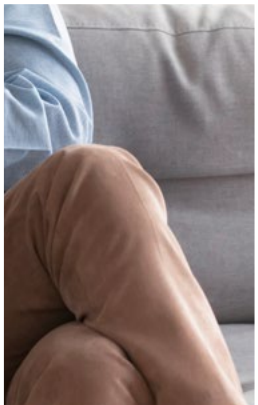
We live in an era that features a "democracy based on affectedness". Personal interests are regularly accorded greater importance than the interests of society as a whole. Every proposal for a reform meets with resistance from enough groups who consider their highly divergent interests threatened by some specific aspect of the proposal. "Personal accountability" is increasingly turning into just a hollow cliché. The prevailing mentality is that of comprehensive coverage with the federal government as the insurance provider. The result is a never-ending stream of "unholy alliances" that end up being the death knell for many attempted reforms.

Political environment

The only way to solve the problems found in the pension scheme is by taking steps that are all extremely unappealing. Either contributions have to be raised, pensions reduced or the retirement period shortened, which means raising the age of retirement. As a result, pension schemes are quite obviously a minefield in the political arena and (professional) politicians constantly weigh whether they really want to jeopardize their re-election with forward-looking reform proposals. The pension scheme has long since degenerated into a partisan plaything. How can the reform deadlock be broken?

Greater knowledge and transparency

Ensuring that the general populace becomes more knowledgeable about pensions and financial matters as well as creating transparency are pivotally important. These measures will enable the electorate to make informed decisions at the polls that also factor in the interests of society as a whole.



The financial aspects of the pension system are highly complex, yet financial literacy studies repeatedly come to the conclusion that large swaths of the population only have an extremely rudimentary knowledge of them. It is therefore up to several different players, including schools, employers, pension funds, the media, etc., to boost that level of knowledge. Additionally, there is an urgent need for more reliable figures that would enable the general populace to gain an understanding of the situation as a whole. For example, the government does not currently provide any official figures on the trend the OASI could potentially follow over the next 30, 50 or more years. While the prominently published ranges of figures are limited to a time horizon of 10 to 15 years, the situation surrounding the OASI will only take on dramatic proportions after this period.

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Elements of a reform

Pension planning is one way of taking steps to prevent financial hardships from arising in the future. Accordingly, a pension scheme has to be designed in such a way that its commitments can be met over the long term, across multiple generations. Our Pillar 1 and Pillar 2 schemes have not been able to meet this requirement for some time now. This needs to change. It is extremely unlikely, however, that popular approval will be gained for large reform packages. The larger the package, the more it clashes with specific interests. The solution probably lies in a rapid series of small reforms.

Reforming the pension system in such a way that it adopts a sustainable approach will be impossible without taking drastic measures. Past reforms have largely focused on increasing contributions without making any real changes to the age of retirement or amount of the pension benefits paid out. Proposals, such as setting the same age of retirement for men and women, increasing the age of retirement while introducing a flexible retirement date, making pensions more flexible to increase benefit payers' risk capacity, regularly and without fail, trigger an impressive defensive strategy that ultimately takes the entire process back to square one.

Where there's life, there's hope

We are the government. We are still capable of securing our pension system over the long term. Yet our efforts will only be met with success if we join together to make courageous decisions that benefit society as a whole and attach less importance to personal interests.

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