



Nachhaltige Altersvorsorge Schweiz – NAVOS

Der Umbau

Ernst A. Brugger und René L. Frey

Verlag Neue Zürcher Zeitung

Summary

1. Unacceptable situation and trends

Though fundamentally well-designed, the three-pillar system of Swiss old age provision is affected by a creeping crisis. The demographic changes facing us pose an immense challenge with long-term consequences. The current pension system has developed into an opaque structure. Confidence is already declining among wide sections of the population, particularly among the young generation.

What are the main problems?

- The burden for future generations is increasing.
- Financing is not secured in the long run.
- A guaranteed minimum income after retirement is demanded by the Constitution but not achieved in reality.
- The system is insufficiently transparent.
- There are considerable inefficiencies and excessive regulations.

In actual fact, the original three-pillar concept has become, in the course of time, a complicated and confusing system that is hard to handle. It includes old age and survivors' insurance (AHV/AVS), supplementary benefits, the mandatory part of the occupational benefit plan (BVG/LPP), the over-obligatory part of the occupational benefit plan, tax-privileged collective and individual saving. The state has become more and more important. At the same time, the personal responsibility of each individual has been undermined.

NAVOS stands for «Nachhaltige Altersvorsorge Schweiz» and means «sustainable old age pension system Switzerland». It is based on the conventional three-pillar system but restructures it basically. In the long run, a modernisation of the system is crucial. It can be done step by step provided that the overall concept of the reform plans is maintained.

2. Old age pensions as a challenge for the economy

Old age provision is usually regarded as an insurance and capital markets topic. Without doubt, this is the case to a large extent. However, even the most sophisticated insurance and financing system does not alter the fact that the supply of the non-working population with goods and services needs to be provided by the economically active population. The dynamic and the consequences of demographic change are still not taken sufficiently into consideration. A decreasing number of active people need to pay for an increasing number of pensioners with a rising life expectancy, and the accumulated capital has to last longer.

3. Three main objectives of sustainable old age provision

NAVOS takes as its base the three objectives of old age provision anchored in the Federal Constitution:

- **Secured livelihood for all old age pensioners**

Livelihood must be ensured for all old age pensioners. Under this aspect, old age and survivors' insurance needs carefully targeted strengthening in the sense of the generation contract.

- **Preservation of an adequate living standard in old age**

Old age pensioners need to be able to maintain their former standard of living. This has to be ensured by the mandatory part of the occupational benefit plan.

- **Individual pension scheme**

If people are encouraged to save individually, it is more likely that they will be able to provide for themselves in old age and thus reduce the burden for the state and the community.

These main objectives are to be pursued according to the principle of sustainability. This requires stable financing, the avoidance of burden shifting to future generations, solidarity between and within generations, efficiency and calculability.

4. Restructuring of the conventional three-pillar model

NAVOS allocates one – partially restructured – pillar of old age provision to each of the three main objectives.

The **1st Pillar** restructures today's old age and survivors' insurance as well as its supplementary benefits. It grants a pension after retirement and for cases where the breadwinner has died.

- The basic pension covers, in compliance with the Federal Constitution's directive, the minimum income and is raised to between CHF 24'000 and CHF 30'000 per year.
- The pension is a standard pension and is based on a number of contribution years at least as high as today.
- «Old age» and «in need of care» imply different risks. For this reason, care-related supplementary benefits are to be detached from those related to old age, in line with the New Fiscal Equalisation System (Neuer Finanzausgleich). The care-related elements

will come under the responsibility of the cantons, while the old age component will be incorporated into the old age and survivors' insurance.

- The financing is done through a tax-and-transfer system, with salary percentages similar to today's (4.2% each) paid by employees and employers, and contributions from the confederation and the cantons (20% of the expenditures plus the old age insurance-related component of the present supplementary benefits). The remaining financing requirement is covered by limiting indexation to price rises, longer working lives and, if necessary, a higher share of value-added tax.

The **2nd Pillar** is the mandatory occupational benefit plan, collectively organised by employers. Together with the 1st Pillar, it guarantees an adequate continuation of the former standard of living.

- The 2nd Pillar provides pensions and capital payments for incomes that exceed the annual income covered by the 1st Pillar, i.e. from between CHF 24,000 and CHF 30,000 up to a maximum of approximately CHF 90'000. Only 10 percent of all employees have a higher net income.
- Financing is done through an individual accounts system. The contribution of the employer must be at least as high as that of the employee. Today's grading of the contribution rates will be dropped. Depending on the bandwidth of insurable incomes, financial savings will be achieved in comparison with today.
- The standard solution is the defined contribution plan. If employers choose the defined benefit plan, the accumulated assets must cover the calculated pension benefits. All service providers – private and public pension benefit institutions, joint foundations, life insurers – are subject to the same rules with regard to ensuring benefits, solvency, risk management and transparency.
- The service providers shall offer the individual insured persons a range of investment products that can accommodate their changing needs and varying levels of risk capacity depending on their age.
- A framework law merely lays down principles and general guidelines. The government ensures that the service providers invest the savings properly according to their risk profile, but outlines minimal investment guidelines only. Guarantee provisions (such as today's minimum interest rate) will be dropped. However, the entire income on the assets (after deducting management fees, the necessary provisions and reserves, and – in the case of business models with guarantees – the cost of risk capital) will have to be credited to the insured.

- The conversion of the capital into the pension is based on expected pensioner mortality and the interest rate determined by market conditions, thus avoiding redistribution from contributors to pensioners (who are better off on average).

The **3rd Pillar** is the optional, tax-privileged provision.

- Tax privileges are maintained to enable as many people as possible to provide for themselves in old age.
- The 3rd Pillar can be arranged individually or may be organised collectively by employers. Service providers are licensed life insurers and banks and, for collective solutions, pension benefit institutions and joint foundations.
- Financing is done through an individual accounts system, while benefits take the form of pensions or capital payments.
- There will be no investment guidelines. National minimum regulations will be relaxed but will put a special focus on monitoring the solvency of providers.

5. Transparency creates confidence

All parties involved in old age provision must meet clearly defined and generally applicable requirements regarding solvency, risk management, transparency and responsibility. The state will no longer be responsible for details (e.g. investment and coverage provisions) but will – in the sense of a modern governance approach – establish a general framework and guidelines for retirement plan institutions and licensed providers, and ensure compliance with these regulations.

For this purpose, the state will reform its market supervision and enhance its quality management competences for the whole system.

6. Economic growth – promoting sustainable old age provision

Higher economic growth than in the past 15 years would facilitate not only the functioning of the tax-and-transfer system but also enable a higher yield of the individual accounts system for the benefit of the insured. Flexible labour markets need to improve the proportion between the working and non-working population. Important points in this regard are:

- Raising labour productivity through measures in economic, competition, research and educational policies, including training and further education for elderly employees.

- Gradually extending the average working life by several years, especially through lowering the age of entry into paid employment; a more flexible and consequently higher retirement age; regulations in old age and survivors' insurance and the occupational benefit plan that strengthen work incentives; plus attractive income, working and old age part-time schemes.
- Improving framework conditions to help mothers and fathers continue working or re-enter employment.
- Promoting the reintegration of (partially) disabled persons.
- Facilitating immigration for young, qualified and motivated employees.
- Investing the assets of the 2nd and 3rd Pillar with a view to promoting growth and innovation, also in fast-growing «emerging market» countries.

Old age provision is more than social policy: it interacts closely with financial, economic and, in particular, labour market policies.

7. Restructuring in stages

NAVOS is no radical new development, but it is more than mere window-dressing. Obviously, the proposed reforms need further discussions and negotiations among all relevant groups. Numerous issues require more thorough analysis. Above all, financing alternatives will need to be calculated – a complex and time-consuming venture. The restructuring of the Swiss old age pension system is no stroll in the park. The path is long and arduous. In order to reach the summit, we need to get up early – now! Any further delay will be at the expense of future generations – and if these are no longer willing to support the current system, it will ultimately also be at the expense of the entire society. However, it will not help to rush things. The individual measures can be implemented in carefully calculated steps. The prerequisite for this is that politics addresses old age provision as a comprehensive system with a notably long-term dimension and drafts a bold reform package.