Asset management: financing pension systems as a key driver

Be it in Switzerland, the U.S. or other countries, there is growth potential for asset management in the field of retirement provision in particular. That said, there are differences between the individual pensions systems.

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One of the main challenges countries all over the world will have to face in the coming decades is the financing of their pension systems. This is true for countries with well established social security systems, but also for developing countries where such systems have been established or legally embedded only recently.

In contrast to the U.S., where pension savings are essentially in the hands of the individuals, in Switzerland, the social security system is based on three pillars. The first pillar is the mandatory state-run pension scheme, the old-age, survivors and invalidity insurance (OASI or AHV), which is operated on a pay-as-you-go basis and provides a minimum pension income for pensioners, dependents and disabled people. Anyone working or living in Switzerland must contribute to this insurance, which has redistributive elements toward low-income earners. The second pillar – occupational pension funds – is designed to allow pensioners, survivors and those affected by long-term illness or a disability to maintain their usual standard of living. It is also mandatory for employees who earn at least 21,150 francs per year, which means many part-time or low-income workers are also covered. Thirdly, individuals are free to make additional voluntary contributions to private pension funds which are partially tax deductible. This is the third pillar.

Today, people are living longer than they did some 50 years ago. Hence, their pensions and savings have to last longer. Meanwhile, due to slower population growth, the contributions to old-age saving systems will not increase to the extent required in order to ensure appropriate pensions for the older generation. The current situation on the financial markets (low earnings and rates of growth) is further aggravating this financing gap. Against this background it becomes obvious that financial means to ensure pensioners' incomes must be increased. This is an issue not only in industrialized countries, but also increasingly in emerging markets, since in addition to the general rise in life expectancy, birth rates are also beginning to decline in developing countries[1].

Significant assets, different dynamics and solutions

The U.S. and Switzerland rank among the major pension markets in the world. The U.S. was by far the largest pension market in the world in 2014, with more than US$ 22,000 billion in assets, and has one of the highest ratios of pension assets to GDP at 127%, as does Switzerland at 121%[2]. Towers Watson estimates that the pension assets of the 16 largest markets totaled US$ 36,119 billion at the end of 2014, which represented an increase of 6.1% year-on-year. In the 10 years from 2004 to 2014, these countries posted average annual growth of 6.0%. Over the same period, Mexico (16.1%), Australia (11.7%), Hong Kong (10.0%) and Brazil (9.7%) posted the highest annual growth rates in pension assets. Meanwhile France recorded the lowest rate at –0.3%. Swiss pension assets rose by 4.5% a year, those in the U.S. by 6.6%. The asset management industry has thus far paid little heed to the "payout phase". The pivotal question that has to be answered in this regard is how individual pension needs can be covered as efficiently as possible with pooled investments.

At the end of 2014, the average global asset allocation of the 7 largest markets was 42% equities, 31% bonds, 2% cash and 25% other assets (including property and other alternatives) according to estimates by Towers Watson. The U.S., Australia and the UK have higher allocations to equities than the other countries. More conservative investment strategies – more bonds, fewer equities – are to be found in the Netherlands and Japan, while Switzerland is the most diversified with similar allocations to equities, bonds and other assets.

In 2011, public pension expenditure as a share of total government spending averaged 18%, ranging from just below 5% in Iceland to almost 32% in Italy[4]. The U.S. is slightly below the average with about 16%, whereas Switzerland is close to 20%. The current need to reduce government debt to more sustainable levels and the already high level of public pension expenditure, including survivors' schemes in many OECD countries, imply that additional pension reforms are likely to figure prominently on the policy agenda, because even these huge assets will not be sufficient to fund retirement over the longer run. There are different ways of achieving this goal, such as extending the coverage of mandatory pensions or insurance plans and incentives for voluntary contributions or to postpone retirement. Most countries, including Switzerland and the U.S., have implemented such measures or are about to do so in order to ensure long-term financing of their retirement systems.

Swiss financial sector transforming

Private banking has been and remains an essential core element of the Swiss financial sector. Switzerland is still by far the largest center for the cross-border wealth management business. However, cross-border private banking is increasingly being

influenced by international regulatory and economic developments and has come under heavy pressure as a result in recent years. This trend will continue to pose major challenges for the Swiss financial sector going forward.

While foreign clients previously came to Switzerland to have their wealth managed here offshore, this business will tend to be more difficult in the future. The focus is now no longer on importing (private) assets into Switzerland, but rather on exporting Swiss financial services and products to other countries. To ensure that the Swiss financial sector can continue to be regarded as a strong player globally going forward, it must safeguard exportability and position itself in such a way that it can profit from the growth potential worldwide. A significant amount of this potential is to be found in the pensions segment, and asset management for institutionals plays a pivotal role here.

The world's 16 largest pension markets 2014[3)]

	Total assets (US$ billion)	Percent of GDP[6)]
Australia	1,675	113%
Brazil[1)]	268	12%
Canada	1,526	85%
France	171	6%
Germany	520	14%
Hong Kong	120	41%
Ireland	132	54%
Japan	2,862	60%
Malaysia	205	61%
Mexico	190	15%
Netherlands	1,457	166%
South Africa	234	69%
South Korea	511	35%
Switzerland[4)]	823	121%
UK	3,309	116%
U.S.[5)]	22,117	127%
Total	**36,119**	**84%**

Asset management as an important mainstay

Asset management is a key mainstay of our financial industry, and it is set to become increasingly important in the coming years. Switzerland boasts extensive expertise in the financial business and ranks among the leading locations for wealth management and insurance worldwide. These are trump cards that have to be played in conjunction with the well-known qualities our location has to offer.

In addition to numerous traditional Swiss businesses, increasing numbers of experts and global players from these areas have come to Switzerland in recent years. Bolstering Swiss asset management could create jobs in the financial sector in Switzerland and enhance value creation. More than 21,000 people already work in this business area, which generates gross value added amounting to 7.5 billion francs annually. This could at the same time also make up for part of the downturn in the traditional banking business.

Growth potential primarily on the global market

Various studies show that the Swiss market for institutional asset management will post only modest growth of just under 2% p.a. through to 2020. Meanwhile, the growth forecasts for the global market are comparatively high at 6% p.a.[5)]. This growth is likely to come primarily in the pension segment, with pension funds, insurers and sovereign wealth funds as main investors. With the babyboomer generation reaching retirement age, this means an increase in the number of pensioners and thus higher spending in the pensions sphere. The increasingly higher life expectancy rates mean that the length of time pensions are being drawn is also rising. Meanwhile, owing to the demographic trend, pension scheme contributions are not increasing to the required extent. This financing gap is being exacerbated by the current trends on the capital markets, in particular exceptionally low interest rates, sovereign debt and low economic growth[6)].

Prerequisites for competitiveness

Private assets are also set to rise further worldwide in the coming years, with the greatest growth being beyond Europe and the U.S. That said, for the reasons set out above, the pension assets pooled in funds or managed on a mandate basis are likely to continue to post stronger increases. It must therefore be a top priority to ensure that Swiss providers are able to participate in this growth in institutional assets worldwide, as this represents the only way that Swiss asset management can be strengthened and remain competitive over the long term. For this to be possible, Swiss asset managers must actually be able and allowed to export their products and services to other countries.

This in turn hinges on our financial market legislation being in line with international regulatory standards. Since EU clients account for a significant part of the demand for Swiss financial services and products, having Swiss financial market legislation fundamentally oriented toward the corresponding provisions in the EU would appear to be inevitable. Switzerland's parliament is currently debating corresponding draft bills. Both the Financial Market Infrastructure Act (FMIA) and the concepts for a Federal Financial Services Act (FFSA) and a Financial Institutions Act (FINIA) must ultimately serve the purpose of ensuring the exportability of Swiss financial products and services. This is an investment that will more than pay off over the medium to long term for the Swiss financial sector and the economy as a whole.

1) OECD, Pensions Outlook 2014
2) Towers Watson, Global Pension Assets Study 2015
3) Towers Watson, Global Pension Assets Study 2015
4) OECD, Pensions Outlook 2014
5) PwC, Asset Management 2020 – A Brave New World
6) See also OECD, Pensions Outlook 2014

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