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PENSION POLICY NOTES

SWITZERLAND

December 2019

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• **Equalise the retirement age between men and women; lower the conversion rate; and, introduce an automatic link between life expectancy and the retirement age and/or the conversion rate.**
• **Link the AVS pension level at retirement to wage growth.**

The mandatory pension system combines highly redistributive public pensions and private occupational pensions. There are two mandatory earnings-related components: a PAYGO public scheme (AVS) and a funded private occupational scheme for people aged 25 and older (LPP 2a). While there is no contribution ceiling in the AVS, AVS benefits are capped, generating a relatively flat benefit structure and a high degree of redistribution within the scheme. In the LPP 2a scheme, there is an upper ceiling to pensionable earnings, just below the average wage; beyond this level, offering LPP is optional for employers (so-called super-mandatory LPP 2b scheme). The government sets the minimum level of both investment returns and the conversion rate used for pricing annuities in LPP2a. Upon retirement, workers may request to withdraw 25% (or more if pension fund rules permit) of their accumulated LPP capital as a lump-sum. The voluntary LPP part plays a limited role at the average-wage level, but it can be important for high-income groups. Means-tested supplementary (PC) benefits represent the first layer of protection when earnings-related benefits and other sources of income are insufficient to cover basic living costs. In 2017, about 13% of the population aged 65 and over received PC benefits of up to 23% of gross average earnings for general living expenses (this number applies to singles excluding housing).

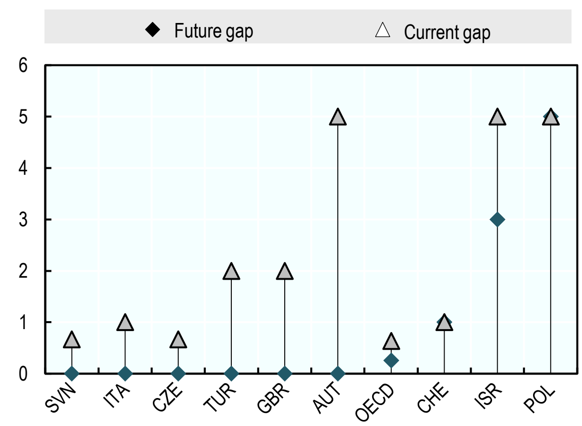
Key indicators: Switzerland and OECD average

	Mid-1980s	Mid-1990s	Mid-2000s	Latest available	Latest OECD	Long term	Long term OECD
Normal retirement age for a full-time career starting at the age of 22	65 (60)	65 (62)	65 (64)	65 (64)	64.2 (63.5)	65 (64)	66.1 (65.7)
Statutory retirement age	65 (60)	65 (62)	65 (64)	65 (64)	64.5 (63.8)	65 (64)	66.5 (66)
Net replacement rate, average earner						44.3 (43.0)	58.6 (57.6)
Effective contribution rate (average earner)				16.6	18.4		
Total pension spending, % of GDP	7.5	9.5	10.8	11.8	10.0		
Public pension spending, % of GDP	5.7	6.3	6.4	6.8	8.4		
Public debt, % of GDP	..	50	57	42	80		
Employment rate 55-64, %	..	79.0 (46.4)	74.9 (55.6)	79.1 (66.1)	68.5 (54.8)		
Labour-market exit age	67.9 (67.1)	66.7 (66.6)	65.0 (64.9)	66.4 (65.0)	65.4 (63.7)		
Old-age poverty rate, %				19.5	13.5		
Life expectancy at 65, years	15.2 (19.3)	16.5 (20.4)	18.5 (21.8)	19.9 (22.7)	18.1 (21.3)	23.9 (26.6)	22.5 (25.2)
Old-age to working-age ratio	0.23	0.24	0.25	0.31	0.31	0.58	0.58
Fertility rate	1.5	1.5	1.5	1.5	1.7	1.7	1.7

Note. The figures for women appear in parenthesis where they differ from those for men.
Long term: Around 2060 based on all legislated reforms up to mid-2019.

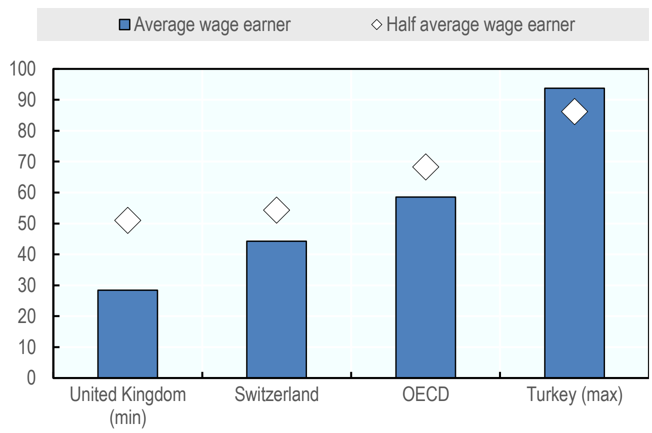
Future replacement rates from mandatory schemes are low. In net terms for a full career starting in 2018, they are projected at only 54% for low-wage earners, 44% for average-wage earners and 32% for high-wage earners, against 68%, 59% and 55% for the OECD average, respectively. AVS pensions are an important component of old-age income for many retirees, especially for people with low occupational pensions, e.g. due to low earnings histories or interrupted careers. Current AVS benefits for a full career range – depending on individual earnings – between 16% and 33% of the gross average wage, but the AVS replacement rates are set to decrease for future retirees. Indeed, AVS pension levels are indexed to the average of wage growth and price inflation, thus mechanically driving down replacement rates in the long run under normal economic conditions. Despite a highly redistributive public pension scheme, relative old-age income poverty (which does not account for wealth) is high, at 19.5% compared to 13.5% on average in the OECD. However, the material and social deprivation rate at older ages, which is an indicator of absolute poverty, is among the lowest in the OECD. In Switzerland, 3.6% of the 65+ face material and social deprivation, against 10.6% on average in European OECD countries.

Switzerland is one of only few countries where women will continue to have lower retirement ages than men



Source: Pensions at a Glance 2019.

Long-term net pension replacement rates from mandatory pensions in the private sector are low in Switzerland



Source: OECD pension models.

Economic and demographic conditions put pressure on pension finances, but reforms are politically difficult. The sharp projected increase in the old-age dependency ratio over the next decades and historically low levels of interest rates put pension finances under stress. In addition, the conversion rate applied to calculate annuities in the occupational scheme is high, making annuities actuarially costly for pension providers. A major pension reform proposal (AV2020) aimed at addressing some of these challenges, but was rejected by referendum in 2017. The proposal suggested a set of modifications, including an equalisation of the statutory retirement age for men and women at 65 years and the reduction of the LPP 2a conversion rate from 6.8% to 6%. The rejection of this reform, along with previously rejected proposals, highlights that reforming the pension system is politically difficult in Switzerland. A less comprehensive reform of the AVS scheme was accepted by referendum in May 2019. The latter increases social security contributions by 0.3 percentage points, raises the share of VAT revenue assigned to the AVS scheme and increases the government's contribution to the AVS scheme from 19.6% to 20.2% of AVS revenues. The government is currently working on a new reform.

Future efforts are necessary to ensure social and financial pension sustainability. Despite the recent AVS reform, the finances of the pension system are fragile. The AVS reserve fund, which manages public pension payments, would be depleted in the 2030s if no additional pension reforms were passed. Furthermore, the high level of the minimum conversion rate is not actuarially consistent with expected life expectancy. Further reforms are necessary to render AVS and occupational pensions financially sustainable without compromising pension adequacy. In particular, the retirement age of men and women should be equalised and the LPP 2a conversion rate reduced. Beyond one-off adjustments, an automatic link should be introduced between pension parameters (e.g. retirement age, conversion rate) and remaining life expectancy at older ages. Indexing the evolution of AVS pensions on wage growth rather than a mix of wage growth and inflation would prevent the mechanical erosion of AVS replacement rates.

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