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NEWSLETTER

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Understanding your pension statement

Dear Sir or Madam,

At the start of each year, or with salary changes during the year, employees receive a new statement from their pension fund. It contains many special terms and even more figures. The aim of this newsletter is to help you understand what the statements mean. Pension certificates have not been standardised, and thus may vary from pension fund to pension fund.

The pension system in Switzerland consists of three 'pillars' (state, occupational, private). The first pillar is the OASI/AHV, a state provision following the pay-as-you-go method. Contributions paid are recorded in an individual account and form the basis for claims on future pensions. There is no insurance statement. The state does not need to tie up capital for pension obligations either; these are merely financed via future contributions – otherwise, federal debts would be three times as high as they are now.

The second pillar is the occupational provision. Contributions are recorded and saved as individual pension capital. Any money paid in is going to this fund – for this reason it is called defined benefits scheme. The accounting of the pension fund provider and the sum of the individual pension statements are in line with each other. A major part of the national wealth is invested in occupational benefit fonds. Let us have a look at an insurance statement:

From a certain salary threshold upwards, all employees are obliged to have a pension provision via second pillar, the occupational provision – self-employed may join on a voluntary basis.

Coordination deduction
Most pension funds start insuring with the compulsory amount, currently CHF 21'150 p.a., up to max. of CHF 84’600 p.a. Only this salary component is subject to insurance as stipulated by law (BVG), the rest is voluntary and depends on your employer’s choice.

To what extent do defined contribution plans and benefit plans differ?
The defined contribution plan sets the provision according to already paid contributions, and is mostly and increasingly the preferred model. The defined benefit plan defines clearly set pension payments, and contributions are calculated accordingly this.

They used to be very popular with state pension funds and major corporations, but due to high costs to the employer, the defined contributions plan has increasingly replaced it.

The determining factor is the cost for the employer. The defined contributions plan is the easiest to calculate, as only actual payments are considered for the benefits.

Division of contributions

Both employee and employer contribute to the pension premium. Very often the contributions are split equally; however, some major corporations and government employers often contribute more than the employee (e.g. 2/3 to 1/3).

The annual premium to be paid is mainly made up of the savings contribution. This amount is paid in, and the total amount of contributions, plus interest and supplements, make up the current savings capital.

The risk part is the contribution to insurance. Risks such as disability and death are covered by an insurance premium. Additionally administrative fees are mostly charged.

To allow inflation adjustments for risk-related pensions there is a fund, and adjustments are periodically. Adjustments to retirement pensions are voluntary. Based on the current economic data this is currently not relevant. As the purchasing power of money goes up and prices of many products go down even a pension reduction could be an option. The current return rates of 0 to 2% cause problems for a number of pension funds. A pension reduction has not been provided for by law. Based on the demographic changes this one day could be an issue.

Some companies have several provision plans, e.g. a basic plan, a supplementary plan and a management plan. For this reason an employee can receive an insurance certificate comprising several systems, or receive separate statements. Together they give information about available capital, future benefits and risk benefits.

Benefits

On reaching retirement age, the capital on the retirement account can be withdrawn, provided statutory time limits are complied with. Be that the case, either all or part of the capital can be withdrawn, depending on your pension plan's policy. However, this requires some financial knowledge to plan private consumption in such a way that there is enough money available for old age. As this is often not the case, there are regulatory trends to restrict or even ban withdrawal of capital. This would just leave the retirement pension. The statement of the expected retirement pension can be seen on the insurance statement.

If an employee still has under-age children when reaching retirement then, on top of the retirement pension, a pensioner's child pension is paid. This also applies to OASI/AHV.

If the employee becomes disabled before retirement, due to accident or illness, a disability pension will be paid.

With benefits like a widow’s pension or a lump sum capital on death it is worthwhile to have a close look at the pension funds terms and conditions. Depending on age constellation, a purchase into a pension fund might be worthwhile.

The conversion rate shows at what rate the capital is being converted into a yearly pension. The current and future returns form the basis for this conversion. A dynamic model allowing employees to profit from the performance does not exist. The target is the pension rate, and the difference from actual performance constitutes either profit or loss for the pension fund.

Withdrawal benefits respectively pension benefits
There is no standard vocabulary for the terms used in insurance statements. On top of that, each employer has its own individual provision solution, this requires an in-depth analysis for a meaningful comparison.

The vested pension benefit includes the capital that is transferred from one employer to another once jobs are changed. Generally, all contributions that have been paid in (by both employer and employee) will be transferred. Occasionally this is called withdrawal benefit as well.

Once you have a new employer, according to law the vested pension benefits must be transferred to the new pension fund. Thus when reaching retirement, the benefits of the pension fund of previous employers are also available as capital. The actual benefit consists of the total of all contributions, plus interest, plus allowances, and so on. The transfer from the previous pension provider to the new employer, respectively its pension fund, has to be done promptly after leaving as before. The employee receives a statement of the transfer.

Purchase calculations and home-ownership promotion
The balance at the pension fund can be used to buy your own home. There are two options. The first is that the existing capital is pledged, and as a consequence the financing requirements for the property purchase are reduced. Economic equity is being used. Apart from the pledging of pension assets, nothing else happens, and the pension arrangements continues. The second option is a pay-out. This means the retirement capital is reduced, and it is subject to tax, the future benefits are also reduced. Generally, pledging is therefore the preferred option. Professional advice is recommended in this case.

The pension is defined by contributions made and paid in. The maximum amount of the pension is set by the salary. After a rise in salary, there is a contribution gap (number of years in work multiplied by the salary increase). If there is potential for additional savings, then a purchase into a pension fund generally makes sense, as they are tax deductible. Any capital paid in remains tied in until retirement.

If you join a pension fund at a later stage, after your 25th birthday – for example students or persons newcomers to Switzerland, the possible purchase into the pension fund is calculated. This can be worthwhile, but needs planning. When a 60-year-old person moves to Switzerland from abroad with an annual salary of CHF 100’000, he or she has a purchase option of several hundred thousand francs. However, a full purchase makes no sense as current salary minus purchase results in a taxable income of zero whereas all future pension benefits are subject to income tax. The tax system in Switzerland strongly promotes sufficient pension provisions – as capital withdrawals are taxed at preferential rates and are widely available at retirement age. Individual advice is recommended to allow you to enjoy retirement age with plenty of material security thanks to tax savings.

We do hope this newsletter has provided you with an overview of the most important terms and their significance for you as an insured person. Should you have specific questions, we are at your disposal.

And despite or because of all provisions, please consider this: there is a life before death!

Kind regards
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