Setting the global standard for investment professionals

Translation of a Roundtable Discussion: Can the Target Return Be Achieved? [Kann die Sollrendite noch erreicht werden?]

Swiss Pensions Conference, 9 March 2011, Zurich
Contributed by the Swiss CFA Society

Moderator:
Mr. Thomas Hengartner
Finanz und Wirtschaft

Roundtable Participants:
Mr. Marco Bagutti, CFA
Stiftung Auffangeinrichtung BVG: Substitute Occupational Pension Fund or Substitute Occupational Benefit Institution

Mr. Christoph Ryter
PK Migros: Migros Pension Fund

Mr. Markus Hübscher
PK SBB: SBB Pension Fund

Dr. Yvan Lengwiler
University of Basel

This session, presented in German, discusses the dilemma pension funds are facing. The risk-free interest rate is currently so low that the statutory minimum rate of return cannot be covered. Which risk mix and what adjustments to high volatility are necessary to achieve the minimum interest rate and to meet the coming storm in financial markets?

Mr. Hengartner (the Moderator): Yes, good afternoon. I cordially welcome you to this final round. Please have a seat. My name is Thomas Hengartner. I presently work for the paper *Finanz und Wirtschaft* as the editor for insurance company/pension fund issues. And I would like to quickly introduce the participants in today's discussion with you and also launch it with a quick question. Later on, you will still also have an opportunity to ask your questions. We are very excited about the kind of knowledge that will be asked for.

I would like to start with Mr. Yvan Lengwiler. He is vice president of the investment committee of the City of Basel Pension Fund, but at the University of Basel, he is also, or his main job is, economics professor at the University of Basel. And I saw . . . it is written at your site: "The connection between financial market prices and fundamental data being one of the areas ..." Sometimes, I think there is no connection, but maybe you can, or you certainly will be able to, explain your views to us on this topic. At the City of Basel Pension Fund, it also says under the investment guidelines or policies there: "A risk-optimized, diversified, and so-called efficient investment strategy is to be pursued." Now, I saw that at the end of 2010, cash is at 15 percent, which is remarkably high. Is this still efficient?

Mr. Lengwiler: Yes, this ... probably so. I mean, you need to see: We just have received ... we were funded externally. This is part of the strategy where we want to diversify risk over time. We do not want to put this much money that came in simply all in one go. This is also part of a dynamically efficient allocation, to be sure.

Moderator: And the lack of revenues now? Because cash yields virtually nothing.

© 2011 CFA Institute

Mr. Lengwiler: You know, as long as interest rates are this low, the lack of revenues is very small, naturally. The point is that, ultimately, what has priority is the avoidance of risk. This is, if you can imagine, if you suddenly receive a pile of money, and then you invest it all. You can ... Market timing is among the most difficult things; everyone here knows this. And we do not dare to take it on.

Moderator: Thank you. I would like to move along to Markus Hübscher. Since September '09, he has been managing director of the SBB Pension Fund. Previously, you were a banker with CS [Credit Suisse] and Barclays, I saw, in the institutional clients segment. At the time I think quantitative products was one of your special fields. Your pension fund was honored as the best pension fund in Switzerland by *IPE Magazine*, which certainly makes you proud. Now, the Swiss federal state has decided, or it was decided, that the federal state should contribute over one billion Swiss francs for restructuring. Do you want to put it in quantitative products right away and especially invest in hedge funds, because this is perhaps still your interest?

Mr. Hübscher: Well I think, to begin with, quantitative funds and hedge funds should not be mixed up. In one, you tend to use scientific aspects as an aid in how to invest money. Hedge funds are then, in my opinion, a completely different category. The facts that we received 1.1 billion Swiss francs for a restructuring and that we, on the other hand, were honored as "best pension fund," may amaze some people a little. The questions are, of course: Why is the fund underfunded? And has there been anything bad at the fund or mismanagement, or did it generate bad performance?

And actually, it would be easy for me to say, as a new entrant, mistakes were made before, because that was in the old days. Only, I can tell you that this was not the reason why we got into this situation. But plainly and simply, the fund, and I will only add a brief remark in parentheses and then I would like to end the topic: The fund was externally funded. When the Swiss pension funds had a funding ratio of 125 percent, we had 100 percent. And I think it is a known fact that you should have a little savings book—put money in a stocking; you should have reserves when times change for the worse. We did not have these.

And the money... what are we doing with the money? Maybe in contrast to Mr. Lengwiler, you know, even though we will receive one billion Swiss francs now, our commitments, they continue. We provide a guaranteed return every day—currently, 3.5 percent. This is a nice interest rate. And a colleague of ours said this accordingly, "The best investment is in a pension fund because you will never get so much return guaranteed again." And in that respect, following our strategy, we will invest the money accordingly, too.

Moderator: OK. Thank you.

Mr. Lengwiler: I may say this as well: We do not have the money yet; it is still a long way until the day comes when we get the money.

Moderator: But the anticipation is already here. Let us go to Christoph Ryter. You have been head of the Migros Pension Fund for a little over a year, and you have been president of ASIP, the Swiss Pension Fund Association, for about four years. You are a pension fund insurance expert and lecturer in education, for the education of leadership bodies of pension schemes.

The Migros Pension Fund now has about 55,000 participants—i.e., employees who will work one year longer until retirement, because of the changes in regulations. This is also probably a necessary step for the stabilization of the fund. Do you likewise want to offer apartments to all employees? Because I saw that your pension fund invested a quarter of its total assets in real estate, which is quite a bit.

Mr. Ryter: I believe all pension funds that did not invest 25 percent in direct real estate envy the Migros Pension Fund, at least with regard to the last, let's say, 15 years, and envy the stability that Swiss residential real estate brought to the Migros Pension Fund's return/risk profile.

© 2011 CFA Institute

You said that I am head of the Migros Pension Fund. Well, in the pension scheme institutions, the rule still is: The heads, these are the social policymakers, and I am the managing director of the Migros Pension Fund. The increase in retirement age: Actually, this is not about an increase of the normal retirement age. At the Migros Pension Fund, we are aware of the flexibility as to retirement as well; thus, from age 58, a person may go into retirement. Whether the increase of the normal retirement age will lead to an increase of the effective retirement age ... I suppose so, but ultimately we do not know yet.

Moderator: OK. Thank you. Next, Marco Bagutti. You have been head of Investments at the Substitute Occupational Pension Fund since the end of 2008. You worked as a banker before, too. I saw this on your homepage, with Pictet & Cie and Deutsche Bank. Educated at the New York Institute of Finance in derivative products.

I saw that the alternative investments at your institution represent a share of 10 percent, which is actually relatively high for the Swiss average. These holdings are also somewhat of a safety net for Switzerland. These pension funds would be here if, for example, these people succeeded in anything. Is the safety net also to some degree for the purpose of alternative investments, or are the alternative investments also to some degree for the purpose of a safety net for you?

Mr. Bagutti: In the first instance, this is often a misunderstanding that is very widespread. We are called a "substitute" institution. We do not prop up other pension funds; that's done by the Guarantee Fund. We primarily enroll people who cannot find a pension fund membership. I had to deal with the substitute institution long before I started to work there because I had hired a nanny at home who earned more than the BVG [the compulsory pension legislation] minimum, I could only insure her there. No insurance would take her.

This is a part of what we are doing. We do vested benefits. It is actually the biggest part. If people become unemployed, go abroad (I just saw we have a nice share of ice hockey players), foreigners who come to Switzerland, then leave again—their pension monies also end up with us, among others.

And the third leg that affects the capital is the unemployment risk insurance, risks in case of death and disability.

With reference to alternative investments, they should not be posted on our homepage like that. If this were the case, it would be wrong. This was before I joined; it doesn't have anything to do with me. I strongly question alternative investments. Let's say I am not opposed to them in principle, but I question them strongly. We have a strategic quota of 3 percent in hedge funds, 2 percent in commodities, that brings it to 5 percent, and that's all now what I would call "alternative." Then, there is also the real estate. If we add foreign countries, we must limit it to 2 percent. Then, we would be at 7 percent alternatives, isn't it, which qualifies it a bit. And we question them, I need to tell you, especially the hedge funds. Several people here in the room know my opinion about it, right?

Moderator: Many thanks for this introductory round. Now, the topic of our discussion is supposed to be: How does one achieve a sufficient rate of return or this target rate of return right now? And when I observe the capital market environment, I could perhaps venture the theory of, well, why not invest the maximum in stocks? Because the dividend yield, as can be observed by the dividends that are now being proposed to the General Assemblies, is probably at 3–4 percent. Mr. Lengwiler, wouldn't it be a great opportunity to simply invest all in stocks now?

Mr. Lengwiler: Yes, this is always great—putting everything in stocks. If you have sufficient ... if you have sufficient reserves, right? I mean, you can achieve any return if you can wait long enough and you can stand a sufficient amount of risk. Unfortunately, we are not in a situation where we can do this. But if we could do this, maybe we would even do it, too. Well, I actually also think that today, at the moment, bonds ... that bonds are nowhere near risk free. I mean, interest rates cannot fall any further. This can actually go in only one direction.

What will happen to stocks, however, when interest rates rise is an open question. So, risks are all over the place, right? Um, well, but like I said, bonds ... of course, default risks are also a topic with bonds these days. Even reputable states don't

© 2011 CFA Institute

always pay. So, bonds are by no means a risk-free asset class, and in some areas, there is probably more risk than with stocks. In this respect, I am not averse to stocks at all.

Moderator: Mr. Ryter, directed to you now as the representative of the Pension Fund Association: Would you support this opinion, support this approach, that the pension schemes should now play the “stocks” card quite aggressively?

Mr. Ryter: Well, you addressed me as the ASIP representative, and ASIP prefers not to give tips in this regard, but we have many pension schemes that are well advised, and they can form their own ... their own opinion. The task of ASIP is, rather, the political lobbying work, which was highly relevant over the last months and probably still will be until the end of the year. And then, the education of leadership bodies. Thus, as an ASIP representative, I would not provide a tip here.

But apart from that, I can definitely follow Mr. Lengwiler’s arguments. You must be able to afford risk. The commitments, they continue. We simply have a target rate of return that must be achieved, and it must be constantly achieved. Thus, we have a certain interest in bringing a certain stability into the returns on the asset side, even though, in practice, of course, as we saw within the last four years, this is not exactly easy. But to solely rely on the asset class of stocks probably would not be beneficial for this target.

Moderator: Now, consistency of revenue could be seen like this, as well: What I am interested in is the current return—i.e., the net return from dividends, interest rates, real estate. And I cut out the fluctuations for once. Mr. Hübscher, could it not be managed somehow to have another, a different perception of *consistency* if one sidelined this whole topic of fluctuation or changes in value somehow a bit, if it is possible anyway?

Mr. Hübscher: Yes, I think this whole issue of valuation is certainly a legitimate question. And I think you, of course, you have a natural interest, especially if the liabilities are consistent and the investments tend to be variable, then you are, of course, interested in fixing the assets a little as well. Most often, the problem simply starts when you need to make reallocations because maintaining the value of stable investments ... these are the ones that normally are not liquid either in that case. They are seldom valued, which is the reason they have consistency in their, in its, in their performance and in their value. And every so often, then, there is, comes a gap, when you really want or must get rid of the things for some specific reason. Be it partial liquidations, be it restructuring of a business, or a crash in the financial markets, you need to make reallocations. Of course, the father to the thought is the wish that you could make a stabilization. And I really envy Christoph Ryter that he has so much real estate. But at the end of the day, you only get a higher return if you also take a higher risk, and if one has the opinion that you can achieve this by the stability of an asset, then, of course, you entertain ... you deceive yourself.

Moderator: Now, risk actually is, can be understood as: Something gets lost there—loss. But risk in this connection with capital market investments is also simply fluctuations or volatility. Mr. Bagutti, the pension business is a very long term business. So, do you really need to watch out for these fluctuations that much now, or isn’t there a way to be found that one can look at this in a more smoothed-out way, so that risk takes on a different dimension?

Mr. Bagutti: Actually, a huge issue, yes? If we now simply... I will begin to philosophize briefly; I will try to keep this really short: In the 1990s, I visited the Grosser—then, the Grosser Pension Fund. They had, if I remember this right, one single pensioner. The remainder were all active employees. The average age: on the order of 26, 27 years old. The coverage ratio was almost, logically, then somewhere, give or take, 100 percent. The risk capacity according to standards would be relatively low, yes? So, they could not take all that many risks. But when I am 25 and I save for age 65, then, I would—as a 25-year-old—almost exclusively take stocks. And gradually reduce it, actually, back to, until retirement. And actually, this would probably be an optimal process of asset allocation.

Only, our world does not work like this. We are insured by our employer, we join a pension fund, and we can leave it. Correspondingly, not only that, but one needs to bring the coverage along and take the coverage out again. This individual saving is not possible in our system. It would require a change to the system. And you would have to look at the coverage

© 2011 CFA Institute

ratio, which is, in fact, fixed, and stubbornly simply proceed and look at what will be available in the end for the pension. But there we are, deeply immersed in pure theory. I think this step is hardly possible. This would work only with a rather strict individualization of the pensions.

Moderator: What do the other participants think about this question? Is there in fact so little scope there?

Mr. Hübscher: I would like to add here, well, I think risk is not a bad thing per se. Risk in that case is good if you have a feeling of ... if there is a return on it. And I think, banal as it may sound now, right, but I just mean an aspect—hedge funds now, for instance—you may ask yourself: Very well, then, indeed, hedge funds carry a risk; will this be compensated with an effective, risk premium, with an expected, sustainable return? And if one cannot clearly answer this question with a yes, then I think the risk is not worthwhile. And I think there are other categories—currencies, perhaps. We will come to this subject later on. If one takes risks that are not being compensated, of course, one should keep his hands off of those.

Moderator: Yes.

Mr. Ryter: You also mentioned the price development, which possibly interferes strongly. If we look at the development of BVG since '85, I think we have made certain progress here already by accounting for the asset side of the balance sheet now at fair value. And in certain things, we see more transparency today, don't we? Transparency has become a major topic in recent years, and rightly so. Today, we see in a more transparent way what the financial situation of pension schemes looks like. If you created a mechanism, as to the volatility of the prices in properties by, like, the creation of hidden reserves that perhaps quietly and secretly slipped away again, if we returned back there, that, in my view, would really be a step backwards. The system that we have—mark-to-market valuation but on the other side, a risk book for the reserves for fluctuations in value—that I actually find a good and transparent system. And it maybe makes it somewhat easier for the insured individuals to understand this and to understand why, at the moment, only low interest can be credited to their retirement assets and why a distribution of nonexisting disposable funds cannot be begun.

Mr. Lengwiler: The subject actually is the target rate of return, right? And it seems to me, what we as a pension fund actually promise to our insured (and I think it was Mr. Hübscher who said that, if I remember rightly) is an investment in a pension fund is the best because they promise 3 1/2 percent. Of course, you must see, this is just a promise, and we will see if it can be kept. Ultimately, what we are doing is, of course, not quite honest. Because what return you can generate without risk depends on quite a lot of things.

And this also might have something to do with what you mentioned before: The connection between economic fundamentals and financial market prices. How big the risk-free interest rate is depends on the innovative spirit of a country or on insecurity or confidence in general. But the largest, the biggest influence is the expected inflation rate. And it is a nominal promise that we make. At the same time, the inflation rate fluctuates across a very large range. So, it would actually be more honest if we made an index of it all.

Moderator: So, perhaps this slight dishonesty is also one of the reasons for the mistrust that unfortunately exists toward the pension industry today in large parts of the population.

I would like to bring up another important area of investments after stocks—bonds, which constitute a substantial part. Here, one now speaks of interest rate increases, of risk that bond values are dropping, that performance suffers because of that. How do you deal with this question at your place? Is there a magic bullet for it? What do you provide for? Mr. Bagutti.

Mr. Bagutti: Principally, we like higher interest rates, right? It makes our life a little easier again, too, in that case. And, of course, under marking to market, with a quick rise in interest rates, the value of our bonds will fall then. And as the case may be, likewise, the degree of coverage after that. That's the way it is. I would simply like to point out, also still to Mr. Lengwiler regarding the interest rate expectation or the ... Everyone agrees that interest rates will increase. I would say this discussion started in 2003.

© 2011 CFA Institute

So far, as I recall, a consultant, a well-known one, who will not be named here, has already said, "How can one be on 'long duration'?" No? And one should have been. No? Thus, I ... it is simply ... it is the way it is. I am not writing this off. There are many indications that interest rates will rise. But we are not really sure, and there is ... we could indeed show you scenarios in which we have a constant interest rate level or even a little lower. We were at 1 percent in the 10-year Swiss government bonds [referred to colloquially as "Eidgenossen"]. This is, well, I find this is also quite ... something already, hopefully, this is the utmost. Because this is not really good for economic growth, right?

So, once again, we ... This is an issue for us. We look at it. It is even ... it is with us. I find this challenging for my work. With the vested benefits, we pay interest that can be adjusted every three months; it is actually almost a money market account. But, on the other hand, there are pension funds that should be invested longer term. There, we try to perform a balancing act, and we certainly cannot put everything in the 10-year bond; otherwise, we have a problem.

Mr. Lengwiler: I may say something to it quickly now. In my opinion, the fair value measurement of assets is possibly already an advancement with regard to the transparency of accounting. However, the problem is: If you hold a 10-year federal debt obligation, then, for a period of three months it is ... it presents a huge risk, of course. If you hold it until maturity, it does not have any risk. And, of course, when we assess the market every day or every month, then we generate a risk on the balance sheet that, in fact, does not even exist. If we do not sell these bonds at all, it is actually not clear why we need this kind of inferior capital somehow. So, that's a problem.

The thing about the interest rates: You're right about that. The interest rates ... I believed forever that interest rates would rise, so I have been mistaken for a long time already. But 0 percent is, of course, the absolute limit.

Moderator: Yes, well, likewise, you also benefited for years that the bonds' performance ... the performance of the segment bonds rose because the price level rose continuously with the decline of the rate of return.

Mr. Bagutti: I would perhaps like to simply add briefly: It is still relatively difficult to be long duration in Switzerland. Well, I mean, the liabilities ... they count actually in the context, after all, of what you have on the balance sheet. And I do not know a single Swiss pension fund that ever was long duration. But, rather, we are all "short" or even "shorter." And that raises the question of how short you ought to be or how long you can get, technically speaking.

And this raises the following question: Are the people actually aware of how large the bet—the wager, the risk, the bet—is that is made, simply with regard to the duration in relation to the liabilities? I believe ... I dare to claim that not quite that many pension funds in Switzerland know about, in fact, how strongly this is revealed.

Moderator: Perhaps, on this occasion, may I again appeal to you in the plenum to submit us your questions. I have two now.

Perhaps, in keeping to the subject of bonds: What is your status regarding your appetite for such new instruments now? Insurance-linked securities we heard about today or, now, still newer from the market stalls, CoCo [contingent convertible] bonds. Is that maybe something for the Migros Pension Fund? The banks, the Swiss banks must get to risk-based capital, hybrid capital.

Mr. Ryter: Well, it is certainly an instrument that we will look at, but at the moment, one does not know all that much about these CoCo bonds and their profitability and what this looks like exactly. But this is certainly an area we are going to investigate. The appetite for other investments, inflation-linked bonds: I think at the Swiss pension funds, we make a nominal promise, not a real promise. Such being the case, from a performance promise, inflation is not really a big risk.

And unfortunately, it is still the case that people prefer a pension increase of 2 percent at an inflation rate of 4 percent to a pension increase of 0 percent at an inflation rate of 1 percent. This is unfortunately the case, and therefore, somewhat cynically, one could say: Pension schemes hope for a moderate inflation. Life would become a little easier. And the financial situation of many funds would be in somewhat better shape very soon.

© 2011 CFA Institute

Moderator: Thus, you would advocate for education not only for the leadership bodies of the pension schemes but for the population as a whole, so that it will be better understood?

Mr. Ryter: This is certainly a basic concern of ASIP, too.

Moderator: Yes, okay. Perhaps also for you the question regarding these special bonds?

Mr. Bagutti: We always look at all new products just out of sheer curiosity, so I am quite simply interested from a professional perspective. What we certainly won't do is chase after any trends. I would like to mention one here that everyone is talking about, which is emerging market bonds. I can tell, too ... I actually needed to gather statistics about who calls me and for which products; maybe this is even a contrarian indicator—that it is heading south in the near future, right? I get a great deal of calls for emerging markets. There are good reasons for it, which I do not want to dispute here. Just take a look at the 10-year rate of return of Mexican government bonds and then compare it with the ones from Spain and Italy. Mexico is lower as to the rate of return than the two other countries. There are quite certainly reasons for this, but it was not always like that. And I am telling you: It will not always remain this way, in any direction, wherever. However, there are certain things about which I ask myself if too much money is rushing into a certain investment group. You have got to ask yourself: Well, is this sustainable, right? I do not want to give an answer yet, but you must ask yourself some good questions; let's put it like that.

Moderator: How do you do this in Basel?

Mr. Lengwiler: Well, I mean, I don't think that we will really seriously consider CoCos. I find it to be an interesting form of funding that CS has chosen there. One simply needs to be aware of this: These are extremely unattractive assets actually, because the ... Actually, these are bonds, and when CS is doing badly, you get stocks for it. Super.

Moderator: Yes, structured products in a way, a bearer bond ...

Mr. Lengwiler: Of course, but—and when these CoCos get triggered, then—either by FINMA or automatically—the odds are of course that ... I mean, you become a participant in a diluted share portfolio, in a firm that is already doing badly. Well, I don't know, but I would demand a very high return for these CoCos. I find them hugely unattractive, if at all, compared with CS shares.

Moderator: Okay, well, we are not doing stock picking now, but we are still a little on the topic of these bonds. And a question from the audience goes in this direction—that is to say, about investments in emerging markets. I assume this means, I guess, bonds as well as stocks, from emerging markets? What is your attitude, Mr. Hübscher, toward these emerging market investments? The SBB, it travels in Switzerland, not in the emerging markets, but the pension fund might perhaps.

Mr. Hübscher: Yes, we do have investments in emerging markets, the ... I mean, emerging markets and emerging market debt as well. I think this kind of investment ... they have developed quite substantially, after all, and absolutely belong to a well-diversified portfolio these days. I think in a pension fund, you really must give serious thought to no longer measuring yourself against the MSCI World Index but against the MSCI World including emerging markets. I think this is fair. What's not fair is if you measure yourself against the MSCI World and, afterward, you polish up your performance with emerging markets. I think this should be really measured fairly as well. Absolutely a topic.

Moderator: Okay.

Mr. Ryter: Yes, it is part of the investment universe, both with regard to stocks and in terms of bonds. With regard to stocks, it is in our core portfolio and thus belongs to the world equity portfolio. And we have invested there. Approximately—because we do not place very active bets in the core area—sort of like the MSCI All Country World Index would index.

©2011 CFA Institute

Moderator: Okay. Thank you. Another question for you is as to the major risks: Just how are they being monitored and managed? And one thing— perhaps I will sharpen the question just a little bit—one of the major risks of the past year was foreign currencies. So, whoever was on the right side or was correctly positioned, properly positioned, got out a far better performance than the ones that were way under, unprotected. Perhaps a question there: How do you deal with these risks? Above all, perhaps specifically, with reference to the currency risk?

Mr. Lengwiler: Well, with stock portfolios what we do is that we ... Most of our equity positions are unhedged, but opportunistically, we do currency hedging. With regard to bonds, we maybe are somewhat extreme: We do not have any foreign bonds. We do this because we actually believe in interest rate parity. There is actually no reason to enter into interest ri ..., uh, currency risks there. The only reason, in our opinion, to hold foreign currency bonds would be better liquidity in the market. But a pension fund, it was already said, is, per se, able to live with bad liquidity.

Moderator: Mr. Bagutti?

Mr. Bagutti: A topic we have been actively involved in, even before last year and now again during the course of last year—Mr. Hübscher hinted at it—that we share this opinion. In our opinion, there is no risk premium for the holding of currencies. There are somewhat different views, although, I believe, by and large there we agree that there are none. Now, there are reasons ... the reason for diversification could be added, in that it contributes to diversification that works fine for some. But from a Swiss franc perspective, the return is so small for the large risk that one takes. This is not correct either in this regard, this effect. From the perspective of a non-Swiss-franc investor, it may make sense to hold foreign currency risks, especially in safe haven currencies, as is the case with the Swiss franc, for example. In fact, I think, that when crises occur, the Swiss franc, along with other currencies, invariably rises. From this currency's perspective, this is good then. And for us, the exact opposite is true: When the crisis hits, then we lose on the currency. This has resulted in us wanting to, ideologically, to hedge all currency risks, which is a big discussion: Why should one hedge currency risks of stocks, right? This is economically controversial. Actually, I needed to hedge currency risks at Nestlé as well. But in that case, I needed to know what the CFO [chief financial officer] was doing there, right? We do not know this.

We now have to ... we have foreign currency bonds, we have stocks, we have foreign currency exposure in commodities as well, and a little less in real estate and hedge funds. We are hedging 85 percent strategically and have a range of 75 percent to 95 percent.

Moderator: Thank you. Again I appeal to you, if there are still questions. I will get to them in a moment. Thank you.

For the moment, staying with the argument, or the line of argument, about how to achieve the target rate of return, how to achieve the best possible performance. Maybe the question that should be asked is: How do you solve investment questions in a way that the activity can be affected favorably, so that in the end, the net return is enough? Are there any more tips from your side? Mr. Hübscher?

Mr. Hübscher: Well, it is very difficult to give tips there, but at the end of the day, I simply think you have to ... It goes a little into risk and risk management. Look, the interest is there, where the interest rates are. And you can either make forecasts for yourself and have the feeling, well, this will change by tomorrow or the day after tomorrow. Or you can have the feeling you have to deal with these realities, that the interest rates are low.

And look, if you ... when you ... if we produce what I previously meant by guarantees, right? When we produce at a certain interest rate level but the interest rate level indeed and in reality is somewhere completely different in the financial markets, then you can either hope that it will change, or you can think about what you are going to do to change it. Production: You can either joggle a little on the investment side then and say: Let us take some more risks. Then we will have a little more return in the expected value. And if this does not work out, then we joggle a little more yet, and then, we have yet a little more expected return.

You can do this as long as the sponsor or the risk takers also have the financial means for it. I can tell you a thing or two about which consequences this may have. Or you have to also seriously give thought to how you generate the return. What are the guarantees we actually make on a daily basis? What adjusting screws does one have there? I believe that, especially also in a foundation, you need to discuss these topics fairly and squarely: Which adjusting screws do you have? Where can you turn, and how much can you turn to bring the targeted rate of return that is needed somewhere into proximity, as the financial market maybe permits. Which does not mean that you have to turn these things every three months. But one should not cherish, uh, hopes for four years that the interest rates may increase.

Moderator: Mr. Ryter, Migros Pension Fund, do you have something like a budget program for the best possible cost control?

Mr. Ryter: Well, costs are always an issue, of course. The Migros Pension Fund manages a large part of the assets of its own employees. There is, of course, also the background that the salary level of our employees is probably somewhat lower compared with other large institutions in Switzerland and that we display a more favorable cost structure than if we exclusively assigned mandates. However, I find the discussion—and, of course, it will continue during the year once the data of a study commissioned by the BSV in the sector of asset management costs has been published—will continue.

There is no asset management for free, to be sure. And the major newspaper columns that monitored periodic fees were sometimes slightly embarrassing. Thus, the problem certainly will not be solved by imposing more provisions while trying harder to shape everything in a uniform way. I think that the leadership bodies, the social partners, are in a position to analyze the cost–benefit ratio, to critically challenge, to also consider the value of hedge funds. Indeed, how much do they cost? If all costs are truly considered, I think I will find a manager who is actually worth his money and who even brings something extra to my portfolio. But just by uniformity and with more provisions in this sector, one does not advance. I believe the second pillar, both in the past and today, was able to demonstrate that collective investment schemes are certainly more efficient than the investment of individually insured persons. And I also hope that this will ultimately be a result of this comparative cost analysis.

Moderator: Okay.

Mr. Bagutti: I would like to ...

Moderator: Yes?

Mr. Bagutti: ... say something about it, too...

Moderator: You're welcome.

Mr. Bagutti: The issue of costs is almost a hobby to me. I just think one statement is important to me. Now, with the return rates being this low, one talks more intensely of the costs, it is logical and explicable. But they always ought to be a subject. It is absolutely wrong to make this the subject of discussion only now. They always are.

And the camps are clear: We who are sitting up here in the front, it is our job to keep the costs as low as possible. Many of you, probably, who are sitting in the room here and represent asset managers have the exact opposite interest, and somehow we need to get together, right? And the cost alone does not determine anything; I share this opinion as well. But I also believe that the costs … As has been heard today in the discussion: We are safe in Switzerland; costs are already very low. But as long as I still get a lot of phone calls and business calls from asset managers, I know that we have not quite reached rock

bottom. Because if one person says he will no longer do business with us, then I will know we have now stepped over the mark, probably.

Moderator: Okay. Another question from the audience goes to all of you. If you perhaps would also like to join the presently popular SNB bashing (bashing the Swiss National Bank). Does the SNB, with its expansionary monetary policy, damage the second pillar and, consequently, the Swiss national economy? Mr. Lengwiler.

Mr. Lengwiler: Yes, well, I mean, what did we hear previously? We all hope for a little more inflation. I think this is the way to get a little more inflation. Yes, I mean, no. *[murmurs]* This is the first that is to be said about it. Second, I believe, the SNB has, does not think about the second pillar in its policy. It is in some kind of a crisis-processing mode, and the second pillar is kind of an afterthought for the SNB.

Moderator: Any opinions on this yet?

Mr. Hübscher: I think, as long as ... look, we are not just anxious about having incredibly low long-term interest rates. And as long as it does not buy Swiss—the rare, long Swiss bonds, right?—and thus push the interest rates even lower, right? and it does not do this, I think, I do not consider us, the second pillar, to be a big influence.

Moderator: Good, then perhaps the final question, if I still may—two to three minutes. Is the way to achieve this target rate of return, and this is also a question from the audience. Should you then, should you try this out by simply driving down the performance promises? Down further, put it like that. Because the pension funds now are that "evil" (in quotation marks) already and circumvent the, in total, and circumvent the referendum of the Swiss people in the conversion rate by just paying about 6.4 percent or 6.5 percent maybe, encompassing, and not the 6.8 percent, to which you go down now as per approval. Thus, perhaps here the question is: Is a further scaling down of this performance promise necessary to accomplish the rate of return? Mr. Bagutti?

Mr. Bagutti: Well, it is ultimately a question of interest rate development, I think. Thus, if interest rates remain this low for long, still longer, this cannot be excluded. So, we can ... They have an influence. Well, inflation, interest rates—they have an influence on the rate of return to be achieved, and in that case, they must affect the performance promises as well. That is what matters. Here, if we come into a world where inflation rises, where the interest rates are again at, let us say, 5 percent, then this discussion won't come up any more. I refer to the absolute rate and not to the relative rate of return, OK?

Mr. Lengwiler: I believe we are coming back to what I already mentioned in the beginning. I mean, ultimately, you can only achieve a rate of return ... you know then, this is a more or less funded scheme, correct? Ultimately, you can ... you cannot achieve a higher rate of return than the real physical capital, as a matter of fact. Now, legally, we have a ... On paper, we have given a nominal promise, and this can, of course, come into conflict with ... just because of the development of the inflation rate. And I simply would, in principle, advocate for more honesty in this respect. I believe it would simply be more open to say that there is a certain real rate of return one can achieve, and it definitely should be achieved and paid out. This means, of course, if one were to go in this direction, then inflation would not let us ... This would not be a bailout for us anymore, right?

Moderator: Mr. Ryter, does it take a further reduction of performance, of benefits?

Mr. Ryter: I would rather request—and, yes, I have a decided opinion here—it takes to build in more realistic return expectations when making performance promises. And this ultimately means nothing else but to also reset the parameters for performance—if you like to have high benefits, high conversion rates. After that, you can also increase the retirement age, or otherwise you must go down a little with the performance promises. This is a highly unpopular message. Many of us probably

will still be used to, from the 1960s, the 1970s, the 1980s, the 1990s, that social welfare institutions tend to be expanded, that more benefits are being promised, that we have problems like: How do we distribute the disposable funds? And now we have the same discussion with a minus sign in front. And here, it has to do again with, ultimately, well, to adapt the promises we make to our insured for 20, 30, 40 years to reality. And this means, ultimately, of course, an increase in efficiency on the investment side, cost awareness, but also a reduction of benefits or more realistic promises of performance.

Moderator: Thank you. Mr. Hübscher?

Mr. Hübscher: Yes, of course. I can't add any more to this opinion, actually. It falls into line with the opinion I previously tried to introduce, too. So: The financial realities are as they are. And then, moreover, it effectively begs the question, of course, of whether due to the fact that people grow ever older and the pension must be spread over a longer period, whether this is, in fact, a reduction of benefits. It is truly nice that we live longer, right? At the end of the day. But you can distribute the capital simply only as long as the people really are existent, in that case. To consider this as a benefit reduction ... this is ... one certainly need not talk about it, right?

Moderator: OK! I thank you for the committed discussion here on the podium, and you [to audience] for the attentive attention you devoted for us. Thank you so much!

[applause from audience]

Mr. Dreyer: Thank you as well from my side to this exciting podium. Now, for the third and last time, I would like to direct your attention to the feedback sheet, which needs to be finished now. The content-related part of the first Swiss Pensions Conference is hereby over. I would actually like to feature some sound bites that I wrote down.

"Extrapolation is for dummies" –de Grey.

"Expectations will wait." –Mr. Deprez, this morning, assumptions, of course, about the development of longevity.

"There is no risk-free return—just return-free risk."

"Market cap is stupid." Interesting, too.

Correlation: There is a correlation between the keeping of dogs and the Norwegian Pension Funds

And, in closing: "There is no business like show business." We also heard this one.

My conclusion, actually, from today, in a nutshell, is just the question: Glacier walk or north face of the Eiger? I think what is truly relevant is, in short, investing in process quality and teams. And in the end, with all due quality and investing in this quality, modesty. This is probably also a question of the "new normal."

Now, it only remains for me, in view of the time—it is 5:31 p.m.—to say a quick thank you. And of course, first of all, thank you to all speakers and panelists who made their contributions today. My thanks also to the media partners, to *Finanz und Wirtschaft*, *IPE*, and *VPS* as well as to the industry partners, ASIP, IZS. The sponsors of course: these are especially Clariden Leu, Schroders Investment Management, Goldman Sachs, LGT, Sarasin, State Street Global, T. Rowe Price, these were the gold sponsors. Silver sponsors Dexia, Eurex, Liechtensteinische Landesbank, Mercer, OLZ, you see, some really distinguished names for this first conference—an excellent thing.

© 2011 CFA Institute

After that, and very officially, on behalf of the Swiss CFA Society and the Liechtenstein Society of Investment Professionals, we would like to thank the organization committee, the people who also committed themselves, and of course, also the volunteers who pulled off the operation of this conference so smoothly, at least from what I saw. And, last but not least, of course, also the team of GDI that, with its excellent work here, made the quality of this event possible, and I think they deserve applause for that.

[Applause]

*****THIS DISCUSSION HAS BEEN TRANSLATED AND EDITED*****

To view the original webcast, please visit www.cfainstitute.org.

The information contained in this piece is not intended to and does not provide legal, tax, or investment advice. It is provided for informational and educational use only. Please consult a qualified professional for consideration of your specific situation.