



Guide to determining the conversion rate

What is a conversion rate?

The conversion rate determines how the retirement assets are converted into an annual retirement pension at the time of retirement. The minimum conversion rate of 6.8% (status 01.01.2020) is laid down in the Federal Act on Occupational Retirement, Survivors' and Disability Pension Plans (BVG). Using the minimum conversion rate and the mandatory retirement assets, the minimum retirement pension to be paid is calculated (statutory minimum pension). In the extra-mandatory portion of occupational benefits insurance, the level of the conversion rate can be determined by the occupational benefits institution itself. However, the retirement pension derived from the mandatory and extra-mandatory retirement assets must correspond to the statutory minimum pension at least.

What has changed since January 1, 2019?

Since January 1, 2019, the occupational benefits fund commission (OBFC) itself has determined the conversion rates applicable for its occupational benefits fund. It will thereby bear the resulting retirement losses itself and must form the corresponding technical provisions. The Board of Trustees will announce the conversion rates that apply in the foundation for extra-mandatory retirement assets that do not result in retirement losses. In general, these rates will be used together with the definitive minimum conversion rate for the mandatory retirement assets to calculate the retirement pension.

The OBFC now has the choice to adopt these conversion rates in its decision – or to determine the conversion rates itself. This gives the OBFC far greater flexibility and decision-making scope.

If the OBFC wants to set a higher or different conversion rate, it must take the following into consideration:

1. Financial possibilities

How high is the coverage ratio? To what extent do the required provisions for financing the retirement losses impact the coverage ratio?

2. Age structure of the insured persons

What is the proportion of insured persons aged 58+ for whom provisions have to be set aside? How has this proportion developed in recent years? The larger their share of the retirement assets, the greater the provisions that have to be set aside.

3. The interest on retirement assets

Do you want to focus on a more attractive interest rate or on a higher conversion rate? Both impact the coverage ratio. Older insured persons, who are planning to draw their retirement pension, benefit from high conversion rates. However, the retirement losses resulting from this come at the expense of the other insured persons. Therefore, younger insured tend to prefer more attractive interest rates. Provided the full fluctuation reserve of 100% has been formed, taking into account the provisions for retirement losses, and unallocated assets are still available over and above the reserve, the OBFC has sufficient scope for higher interest rates.

4. Expected return

The expected return based on the chosen investment strategy also plays a role in the considerations. The size of the provisions for retirement losses places pressure on the coverage ratio and thereby impacts the financial equilibrium of the occupational benefits fund as well as its risk capacity. The retirement losses that arise impact the target return. This may result in re-examination of the investment strategy. On the question of the "correct" investment strategy, a simplified ALM study may be helpful. The OBFC can issue a corresponding request.

5. Level of the conversion rate

The conversion rate should be determined sensibly to ensure it doesn't need modification every year. Changes to the conversion rate frequently unsettle the insured. If the conversion rate is to undergo a change, the OBFC must ensure that this is communicated well.

6. Relationship between mandatory and extra-mandatory retirement assets

The larger the share of the extra-mandatory retirement assets in a portfolio of insured persons, the greater the potential to reduce the retirement losses. The closer the conversion rates are to the conversion rates without retirement losses as set by the foundation, the greater the saving. A corresponding decision by the OBFC leads to a reduction in the required provisions and to relief of the occupational benefits fund's financial burden.

7. Split or comprehensive conversion rate

In general, the occupational benefits fund can choose between a split or a comprehensive conversion rate (the same conversion rate for the mandatory and the extra-mandatory retirement assets). However, the chosen conversion rate may not lie below the conversion rate without retirement losses as set by the foundation. The payment of the statutory minimum pension must also always be guaranteed. The following examples serve to illustrate the impact of the different systems:

Method: split conversion rate

Example 1 Man 65 (Foundation's conversion rate)			Conversion rate	Retirement pension (annual)
Mandatory retirement assets	CHF	280,000.00	6.8%	CHF 19,040.00
Extra-mandatory retirement assets	CHF	150,000.00	4.764%	CHF 7,146.00
Total	CHF	430,000.00		CHF 26,186.00
Retirement loss	CHF	119,664.15	= CHF 280,000 * (6.8% - 4.764%) / 4.764%	

In this example, the conversion rate of 4.764% (men aged 65, as at January 1, 2021) as set by the foundation for the extra-mandatory retirement assets was used. As a result, only the mandatory retirement assets suffer a retirement loss.

Example 2 Woman 64 (higher extra-mandatory conversion rate)			Conversion rate	Retirement pension (annual)
Mandatory retirement assets	CHF	250,000.00	6.8%	CHF 17,000.00
Extra-mandatory retirement assets	CHF	100,000.00	5.2%	CHF 5,200.00
Total	CHF	350,000.00		CHF 22,200.00
Retirement loss, mandatory retirement assets	CHF	96,868.00	= CHF 250,000 * (6.8% - 4.901%) / 4.901%	
Retirement loss, extra-mandatory retirement assets	CHF	6,100.80	= CHF 100,000 * (5.2% - 4.901%) / 4.901%	

In this example, a higher conversion rate of 5.2% was chosen by the OBFC for the extra-mandatory retirement assets. The conversion rate without retirement loss as set by the foundation would amount to 4.901% (women aged 64, as at January 1, 2021). As a result, there is a small retirement loss for the extra-mandatory retirement assets together with the retirement loss for the mandatory retirement assets.

Method: comprehensive conversion rate

Example 1 Man 65 (as for example 1, split conversion rate)			Conversion rate	Retirement pension (annual)
Mandatory retirement assets	CHF	280,000.00	–	–
Extra-mandatory retirement assets	CHF	150,000.00	–	–
Total	CHF	430,000.00	5.8%	CHF 24,940.00
Minimum retirement pension according to the BVG of CHF 19,040 (=CHF 280,000 * 6.8%) fulfilled (check per insured person)				
Retirement loss	CHF	93,509.65	=CHF 430,000 * (5.8% – 4.764%) / 4.764%	

With the lower comprehensive conversion rate of 5.8% on the entire retirement assets, the minimum retirement pension according to the BVG is still fulfilled. Although this reduces the retirement loss and the provisions, it also reduces the size of the retirement pension.

Example 2 Man 65 (low extra-mandatory retirement assets)			Conversion rate	Retirement pension (annual)
Mandatory retirement assets	CHF	280,000.00	–	–
Extra-mandatory retirement assets	CHF	30,000.00	–	–
Total	CHF	310,000.00	5.8%	CHF 17,980.00
Total raised to BVG minimum retirement pension			6.8%	CHF 19,040.00
Minimum retirement pension according to the BVG of CHF 19,040 is not fulfilled (check per insured person)				
Retirement loss	CHF	89,664.15	=[CHF 280,000 * (6.8% – 4.764%) / 4.764%] – 30,000	

With the lower comprehensive conversion rate of 5.8% on the entire retirement assets and the small proportion of extra-mandatory retirement assets, the minimum retirement pension according to the BVG is not fulfilled. Hence the minimum retirement pension of CHF 19,040 becomes payable.

Example 3 Man 65 (high extra-mandatory retirement assets)			Conversion rate	Retirement pension (annual)
Mandatory retirement assets	CHF	280,000.00	–	–
Extra-mandatory retirement assets	CHF	350,000.00	–	–
Total	CHF	630,000.00	5.8%	CHF 36,540.00
Minimum retirement pension according to the BVG of CHF 19,040 is fulfilled (check per insured person)				
Retirement loss	CHF	137,002.50	= CHF 630,000 * (5.8% – 4.764%) / 4.764%	

With the lower comprehensive conversion rate of 5.8% on the entire retirement assets and the large proportion of extra-mandatory retirement assets, the minimum retirement pension according to the BVG is fulfilled. However, if we were to calculate this example using the split model (6.8% / 4.764%), this would result in a lower retirement pension (amounting to CHF 35,714.00) than with the supposedly lower comprehensive conversion rate of 5.8%. The cause is the very large individual proportion of extra-mandatory retirement assets.

8. How high are the provisions and how do these develop?

AXA can support the OBFC in setting the conversion rate by calculating the level of the required provisions using a simulation tool. This tool can also demonstrate the development of these provisions over the next 5 years.