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Occupational Pension Schemes – Impact of the New Regulatory Regime

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- Less systemic risk potential
- Investment of assets
- Stricter liquidity requirements

1. Current Regulatory Regime

The current three pillar principle in Switzerland is based on the (i) Old Age and Survivors' Insurance (AHV), Invalidity Insurance (IV) and its supplementary benefits (Pillar 1), (ii) the compulsory occupational pension schemes (Pillar 2) and (iii) voluntary private pensions (Pillar 3). The Pillar 2 and 3 schemes, i.e., the occupational pensions (Vorsorgeeinrichtung) and the investment foundation (Anlagestiftung) (together the Occupational Pension Schemes), are subject to the Federal Law on Occupational Retirement, Surviving Dependants' and Disability Pensions (BVG).

While the Pillar 1 institutions are subject to special public law provisions, engaging in financial activities with their assets is allowed and supported by the law for Occupational Pension Schemes (Ordinance on Occupational Retirement, Survivors' and Disability Pension Plans (BVV2)). Investment restrictions are eased and simplified. The aim of the BVV 2 is to prevent the concentration of risks in single investment classes and to allow international diversification of pension fund investments. The limits on investments in individual firms or with individual debtors are set at five and ten percent respectively, regardless of their nationality.

2. Overview of the New Financial Market Regulation

Occupational Pension Schemes will – to some extent – be subject to certain new regulatory obligations. Due to their classification as institutions with less systemic risk potential, they are exempt from the obligations imposed by the Federal Financial Institutions Act (FINIG) and the Federal Financial Services Act (FIDLEG). At the same time they qualify as "professional clients" under FIDLEG when it comes to determining the degree of protection they require when receiving financial services from financial services providers. The aforesaid, however, only applies if the Occupational Pension Schemes operate with a professional treasury department.

Under the new Federal Financial Market Infrastructure Act (FinfraG), however, they are subject to certain regulatory obligations. While the FINIG and the FIDLEG specifically exclude the Occupational Pension Schemes (and the investment foundation from their statutory scope as addressees of their statutory obligations), the FinfraG classifies them as Financial Counterparties in article 93 paragraph 2(g) FinfraG and imposes certain regulatory obligations on them, i.e., for their derivatives business operations. In that sense, the legislator treats them as any other financial institution despite the lower level of systemic risk due to their stricter liquidity requirements. Occupational Pension Schemes must be aware that – in addition to their previous (and continuously advancing) obligations under the BVG, the various regulations such as the BVV 1, 2 and 3 and the cantonal provisions – they will need to implement specific obligations under the FinfraG (which are explained below) and they will be subject to supervision by the Swiss Financial Market Supervisory Authority FINMA.

3. Selected Key Points for Occupational Pension Schemes

Occupational Pension Schemes will be subject to certain clearing obligations for their OTC-derivatives trading.

Reporting requirements will also apply in respect of their derivatives business, because transparency is one of the key elements of global regulatory efforts in that area. Transaction information is reported to trade repositories and made accessible to the regulator. Trade repositories then publish aggregate trading positions by class of derivatives accessible to all market participants. Occupational Pension Schemes will face significant and expensive internal hurdles. They will need to update internal processes, create teams, train their staff and tweak their systems (or outsource such tasks) and replace existing workflows with new electronic processes, i.e., for their timely reporting.

Occupational Pension Schemes shall make sure that appropriate processes for portfolio reconciliation, risk management, identification and resolution of disputes, daily valuations of transactions and the exchange of collateral for uncleared derivatives are in place. A core element of risk mitigation procedures under the new Swiss regulatory regime is the portfolio reconciliation process. Counterparties shall ensure adequate processes to reconcile their portfolios in order to identify discrepancies at an early stage.

In conclusion, Occupational Pension Schemes are bound by the new Swiss regulatory regime in respect of their derivatives business and the categorization will trigger different regulatory obligations, which can be complex and expensive. Thus, Occupational Pension Schemes need to assess their new statutory obligations at an early stage. Understanding the EU and US regulatory regimes and being familiar with their implementation hurdles will help to understand the level of sophistication required and the amount of time and work that will need to be sacrificed to be compliant once the FinfraG becomes applicable law.

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