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Dr. Burkhard Varnholt
Vice Chairman IS&P
+41 44 333 67 63
burkhard.varnholt@credit-suisse.com

Dr. Oliver Adler
Chief Economist, CIO Office Switzerland
+41 44 333 09 61
oliver.adler@credit-suisse.com

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Authors
Dr. Jan Schüpbach
+41 44 333 77 36
jan.schuepbach@credit-suisse.com

Emilie Gachet
+41 44 332 09 74
emilie.gachet@credit-suisse.com

Thomas Mendelin
+41 44 332 42 77
thomas.mendelin@credit-suisse.com

Mind the Gap: Part Time, Timeout, Pension Shortfalls

Editorial

Dr. Oliver Adler
Chief Economist
Credit Suisse (Switzerland) Ltd.

In this study on private pension provision, we take a closer look at how Swiss women save with Pillar 3a pension accounts. Nearly 60% of gainfully employed women in Switzerland work part-time hours. As in the past, it is usually women who reduce their working hours or take a career break to care for their children – with direct consequences for their retirement provision. Because gainful employment plays a key role in all three pillars, career breaks, working part-time, and the resulting lower lifetime income will result in savings gaps unless countermeasures are taken.

Our study also finds that women pay into the third pillar less frequently than men. However, this is primarily attributable to the lower average income earned by women. The frequency and amount of deposits also varies sharply depending upon certain personal circumstances. Some groups display potential to better exploit savings opportunities.

The closing section discusses ideas to reform practices in private pension savings, which could improve the incentives to seize this potential. Besides the existing fiscal benefits of 3a savings, further flexibility in the system should be considered in order to address the changing circumstances that impact savings behavior – such as an opportunity to catch up on payments missed during maternity leave. Since living and working models for men are showing signs of change too, greater flexibility would also make sense from an overall social viewpoint. In an era of persistently low interest rates and high pressure on the first and second pillars, private pension provision becomes an increasingly important component of maintaining an acceptable standard of living after retirement.

We hope you enjoy our publication.

Mind the Gap: Key Information in Brief

Tied retirement provision (3a)

- Private saving is a **cornerstone of Swiss retirement provision**. The Pillar 3a provision acts as an individual supplement to social security (AHV/IV) and occupational pensions (pension funds).
- The **Pillar 3a market** has become significantly more important over the last 20 years. At the end of 2017, the tied pension provision assets invested with banks and insurance companies stood at **over CHF 117 billion**.
- Demographic, economic, and social developments are posing various challenges to the pension system. **In employee benefits insurance, the benefits are falling. Private pension provision** is likely to continue to **gain in importance**.

Do women pay in differently?

- The share of women who regularly pay into the third pillar is 51%, considerably lower than the 58% of men who do so.
- Much of this discrepancy can be attributed to income differences between the genders. Women earn considerably less than men, on average, due to numerous factors including fewer working hours and more frequent career breaks.
- All other things being equal (same age, income level, family situation, etc.), women are slightly more likely than men to pay into Pillar 3a.
- Employees with a family tend to make more regular deposits, but the average payment is in some cases much lower than it is for singles without children. Many Swiss families deposit nowhere near the maximum Pillar 3a amount.

3a provision profiles for women

- Women who live with a likewise employed partner and children tend to make regular payments into Pillar 3a.
- Despite what appears to be ideal conditions, nearly 40% of women in “double income, no kids” (DINKS) households do not make regular deposits, even though their income is substantially higher than that of double earners with children.
- Low-income families and divorced singles are also less likely to make regular deposits. In these cases, financial considerations are probably the issue.
- Young, single women, who make up more than one third of gainfully employed women in Switzerland, are also relatively unlikely to pay into Pillar 3a. However, at the very least a small, regular payment should be possible in many cases – often more easily than in later phases of life.

Narrow the pension gaps

- Career breaks and part-time hours have an impact on all three pillars of pension provision and thus on the assets available after retirement.
- Early and regular deposits to Pillar 3a can offset gaps in pension savings. Given the long-term investment horizon, the compound interest effect can be significant. Moreover, the return potential can be heightened when securities solutions are deployed. And, not least, the tax burden can be reduced.
- From a socio-political perspective, it appears crucial to ensure good coverage of financial needs after retirement. However, an increase in the maximum permitted deposit into Pillar 3a would mainly benefit higher-income households, since today most households deposit well below the maximum. On the other hand, a retroactive payment option for missed Pillar 3a payments (e.g. due to maternity leave) could also support middle-class families in accumulating their Pillar 3a savings.

Pillar 3a Continues to Grow

The Swiss retirement provision system is based on a three-pillar concept: The first pillar – the mandatory social security system (AHV/IV) – is intended to provide a subsistence income. The second pillar – the occupational pension (pension fund) – is designed, together with the first pillar, to allow the insured to maintain their accustomed standard of living. The third pillar – voluntary private savings – serves as an individual supplement.

Pillar 3a only available to the employed

Within the third pillar, a distinction is made between flexible pension provision (Pillar 3b) and tied pension provision (Pillar 3a). The latter is available only to individuals with earned income that is subject to AHV deductions. The tied pension provision is notable for its fiscal benefits. Contributions to Pillar 3a up to the statutory maximum (see table on page 7) can be deducted from taxable income. On the other hand, aside from a few exceptions, the capital may not be withdrawn before retirement.[1]

Private pension provision is gaining in importance

Demographic, economic, and social developments are exerting increasing pressure on social security and occupational pensions. In this context, private savings are becoming more vital to ensuring a reasonable standard of living after retirement. Consequently, the Pillar 3a market has grown considerably in the last 20 years. This growth was again evident in 2017 (see chart on page 7).

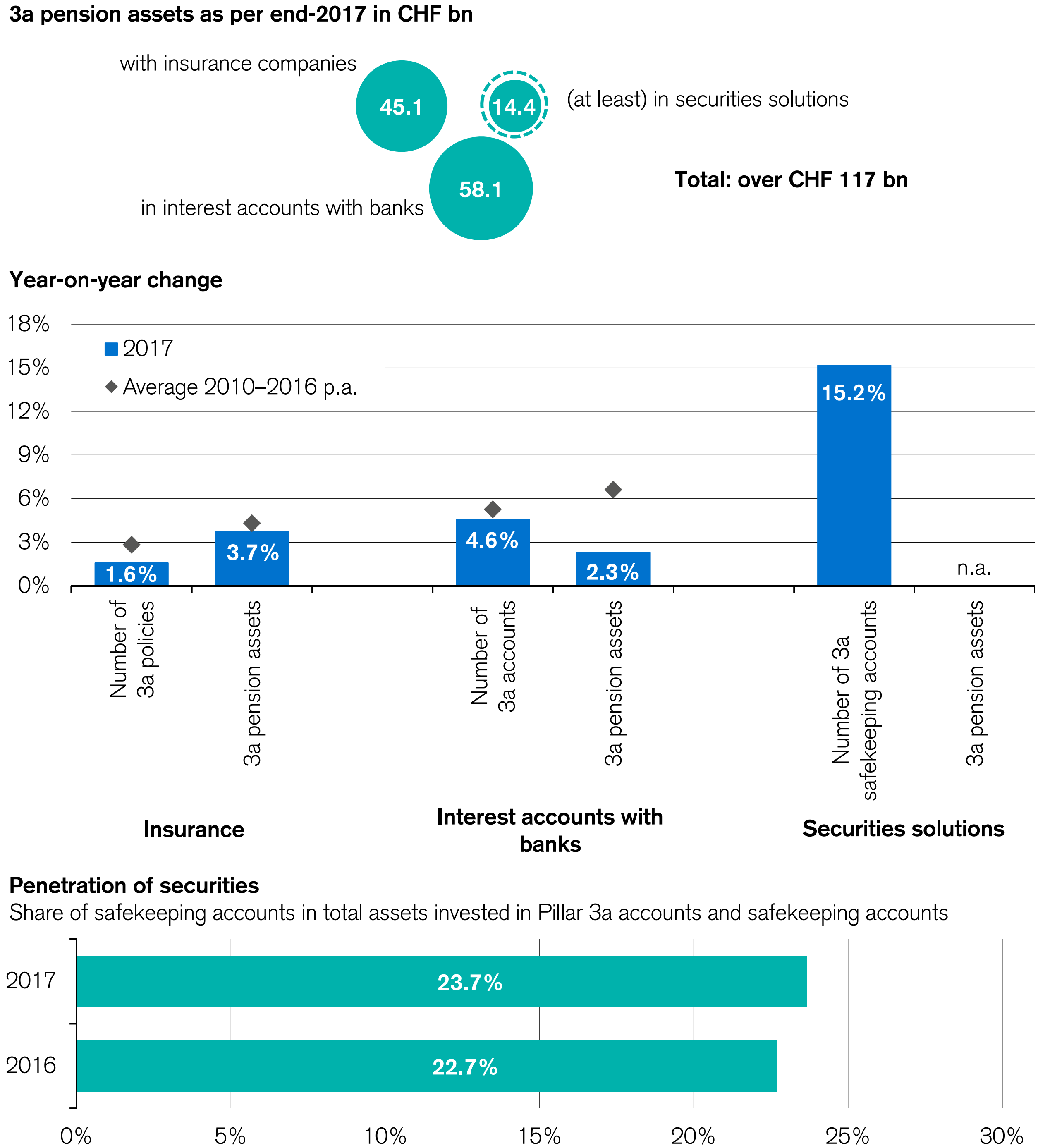
Over CHF 117 billion in Pillar 3a

Pillar 3a assets held in bank accounts or at insurance companies amounted to a total of CHF 103.2 billion at the end of 2017 (+2.9% year-on-year). These figures exclude pension capital that is invested in securities solutions, which, according to a survey by the Verein Vorsorge Schweiz (VVS), amounted to at least CHF 14.4 billion at the end of 2017. The sharp rise in the number of safekeeping accounts (+15.2% year-on-year) meant that the penetration of securities in Pillar 3a rose slightly in 2017, but remained relatively low at 23.7%.

[1] For more detailed information, see Credit Suisse (2018), Private Retirement Provision: Pillar 3a Savings in Switzerland

Pillar 3a market continues to grow, but penetration of securities remains relatively low

Market volume in CHF bn; year-on-year change in %; penetration of securities in %



Source: Federal Social Insurance Office (insurance, interest accounts with banks), Verein Vorsorge Schweiz (securities solutions and penetration), Credit Suisse

Pillar 3a: maximum amount 2019

For employed persons with pension fund	CHF 6,826
For employed persons with no pension fund	20% of net earned income, maximum CHF 34,128

Source: Federal Social Insurance Office

Do Women and Men Pay in Differently?

As of 2015, 55% of Switzerland's working population between the age of 18 and the official retirement age were making regular deposits into Pillar 3a. However, the 51% share of women is clearly lower than the 58% of men.

Why this discrepancy between the sexes? Which factors affect the deposit behavior of male and female Swiss citizens into Pillar 3a – and in what direction, to what extent?

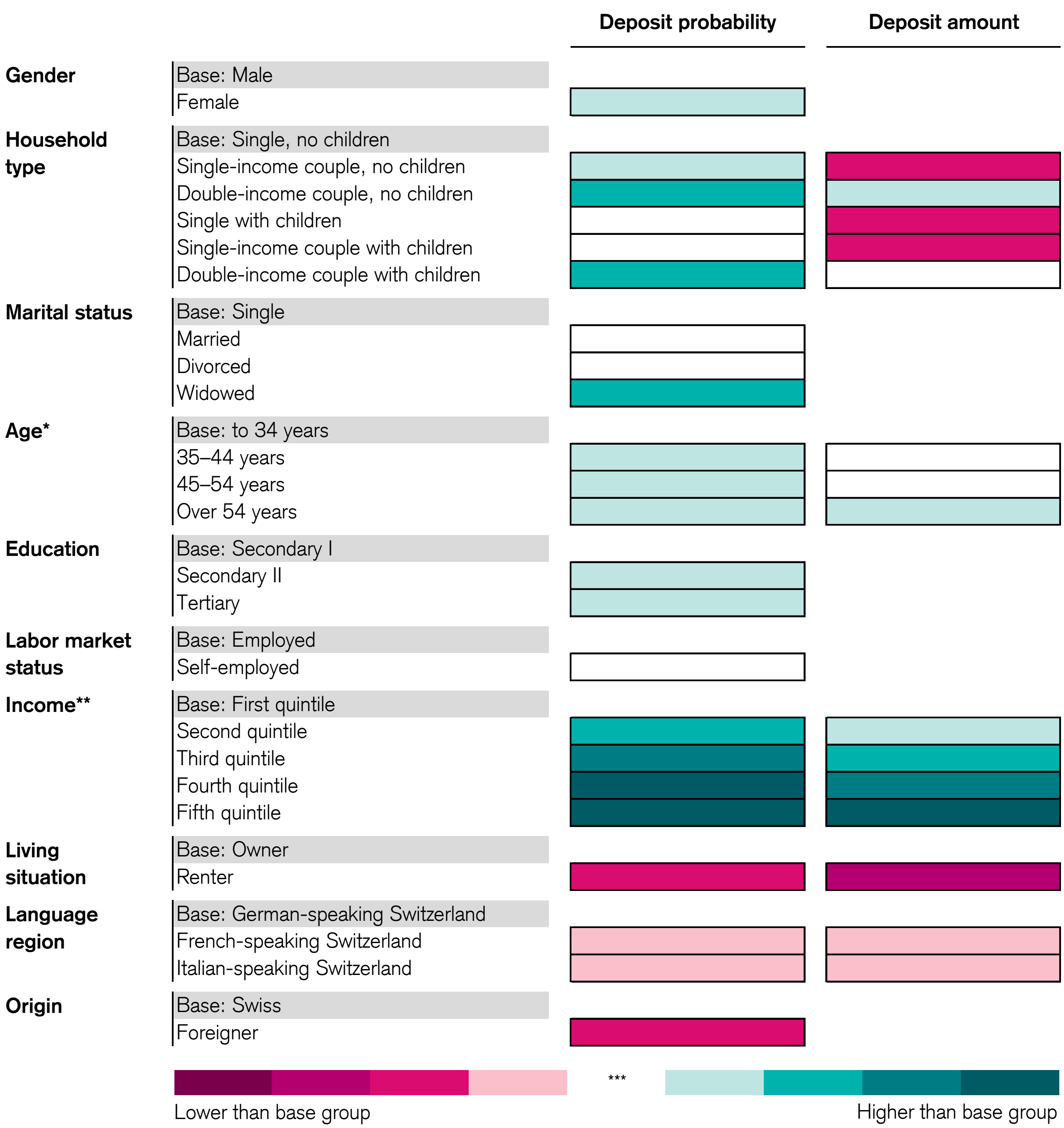
What determines the probability and amount of deposits?
To answer these questions, we refer to data from the Swiss Labor Force Survey (SLFS) 2015 and logistical regression models to examine how the probability of regular 3a contributions changes depending upon various personal socio-demographic and economic characteristics. Besides gender, we also consider factors such as income, housing situation (as a proxy for the level of wealth), and household type (whether the individual lives alone, with a partner, and with or without children below the age of 25).

The results are summarized in the first column of the table on the next page, and can be interpreted to indicate that when other variables are kept constant, the factors highlighted in red tend to lower the likelihood of paying into a 3a account, while those in turquoise tend to raise it, in each case in comparison to a base group (see the example in the table). The parameters in white have no statistically significant impact on the likelihood of 3a deposits.

In addition to the probability, it is also interesting to examine how these factors affect the amount of a deposit into Pillar 3a. Certain indications are provided by the Household Budget Survey (HBS) by the Swiss Federal Statistical Office. These results are listed in the second column of the table. In contrast to the SLFS, however, the HBS is a survey of households, not individuals. For this reason, not all of the personal characteristics can be examined for their impact on the deposit amount. Note that these data do not support conclusions on any differences between the sexes.

All other things being equal, women are slightly more likely than men to make deposits

Impact of various factors on the likelihood of making regular Pillar 3a deposits and amount of payment. Deposit probability: employed persons between the ages of 18 and 63 (women) or 64 (men), 2015; deposit amount: per employed household member, only employed workers below age 65, 2012–2014



* For deposit amount: age of the person who contributes most to household income; ** for deposit probability: earned income; for deposit amount: gross household income per employed household member; *** difference to base group is not statistically significant at the 10% level.

Example: an individual in the highest 20% of income (5th quintile), but with otherwise similar characteristics (gender, age, civil status, etc.), has a significantly higher probability of making regular Pillar 3a deposits than an individual in the lowest income category (1st quintile = base).

Source: Swiss Federal Statistical Office (SLFS/HBS), Credit Suisse

All other things being equal, women make more frequent Pillar 3a payments

As mentioned previously, just 51% of women make regular deposits into tied pension savings, in contrast to 58% of men. Our analysis shows, however, that all other things being equal (e.g. same age, same income level, similar family situation), women's Pillar 3a deposits are not less, but actually slightly more frequent than men's. Women are around 14% more likely than men to make regular deposits.[2] So the decisive factor for regular deposits into Pillar 3a is not primarily gender *per se*, but rather other factors among which there are significant differences between the sexes.

Income is the most powerful driver

The probability of having a Pillar 3a account, and making regular deposits into it, tends to increase as income rises. Individuals in the highest income class are seven times more likely to make regular deposits into their tied pension savings than individuals in the lowest income class. The amount of the deposits also increases markedly in line with higher income. Swiss households paid around CHF 2,550 per year and employed household member into Pillar 3a in 2012–2014. All other things being equal, households in the top 20% income class (5th quintile) deposit over CHF 2,900 more, on average, than households in the lowest 20% (1st quintile; see chart next page).

Women earn less

The fact that the share of employed women who make regular Pillar 3a deposits is indeed lower than the share of men is probably due in large part to gender differences in income. The average annual gross earned income of women who contributed to private pension savings in 2015 is CHF 51,600, around 35% lower than the figure for men (CHF 79,730).

Part of this income gap can be attributed to part-time work or career breaks, both of which are more common among women than men. For example, the percentage of women who work part-time is nearly 59%, while the figure for men – despite increasing in recent years – is only 17.5% (as of 2017). After the birth of a child, it is still more likely to be the mother than the father who reduces their working hours or discontinues paid employment altogether for a certain period in order to care for children. This has correspondingly adverse effects on earned income – and thus on pension savings (see section "Wealth Accumulation in the Life Cycle" beginning page 18).

[2] Opportunity: probability that a certain event (here, regular Pillar 3a deposits) will occur in the observation group (here, women or men), divided by the probability that the event will not occur.

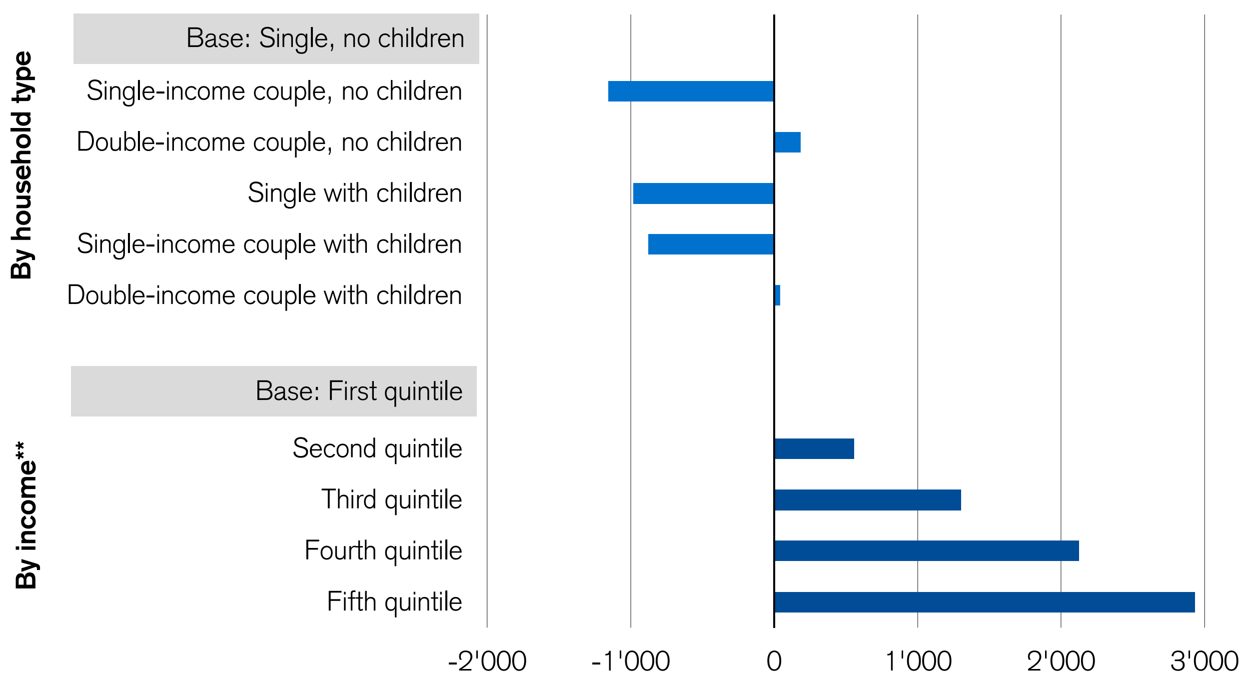
Effects of the family situation on Pillar 3a deposits

Besides differences in income, different lifestyles and family situations also have an impact on Pillar 3a deposits. Individuals who live with a partner (whether married or not) and/or with children are more likely to pay into tied private pension savings, all other things being equal, than singles without children[3], and the effect is most pronounced for households with two incomes (see table on page 9). This suggests that once in a committed relationship and/or once children are part of the family, concerns about financial security after retirement become more pressing.

Families tend to pay into the system more regularly, but the average deposit is in some cases much lower than it is for singles. For example, annual Pillar 3a deposits by single parents are CHF 980 lower, on average, than those by singles without children, all other things being equal. Single-income couples with children also pay in CHF 875 less on average, while double-income couples with children deposit approximately the same amount (per person) as singles without children (see chart).

The average Pillar 3a deposit is linked closely to income level

Amount of annual Pillar 3a deposit in CHF per employed household member; compared to base group, all other things being equal; only employed workers below age 65, 2012–2014



Source: Swiss Federal Statistical Office (HBS), Credit Suisse; * difference to singles without children is not statistically significant at the 10% level; ** gross household income per employed household member

[3] For single-income couples with children and singles with children, however, the positive effect on the deposit probability is not statistically significant.

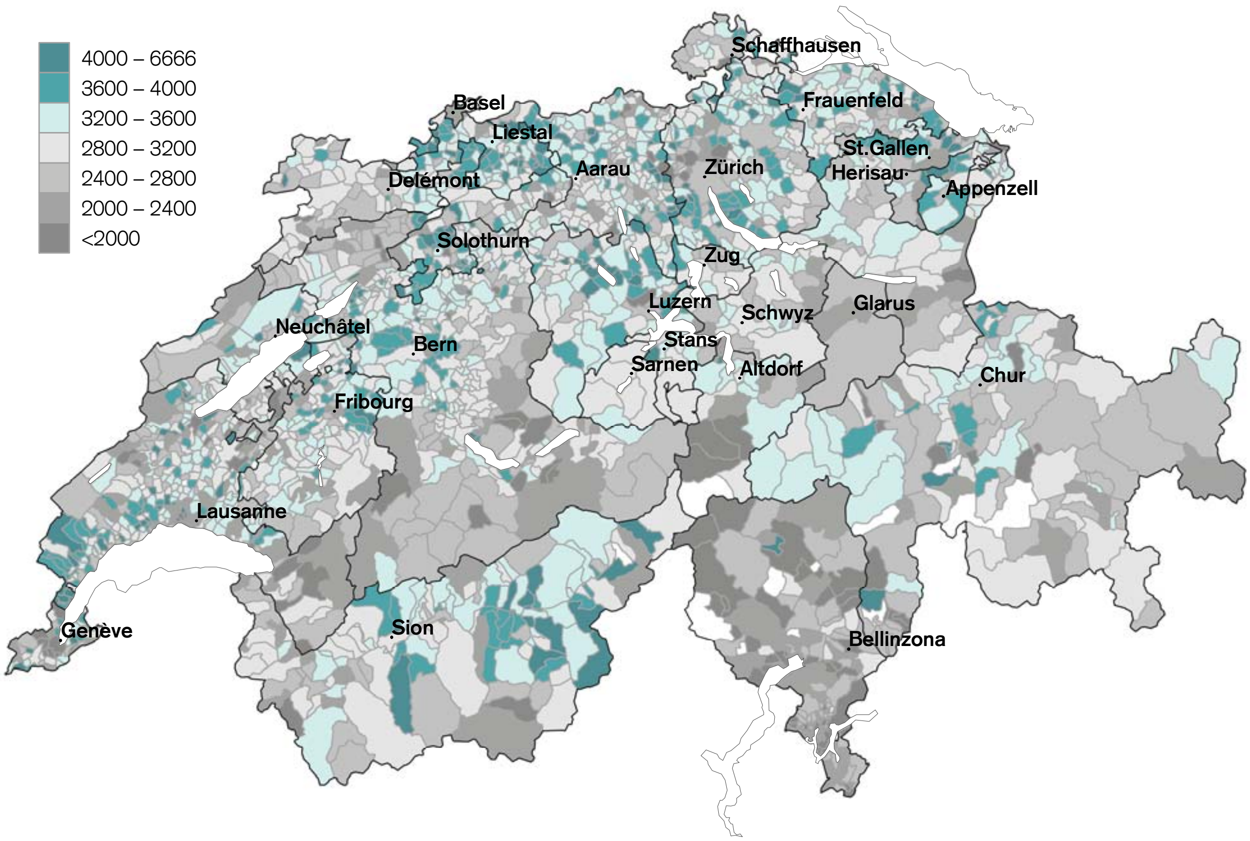
In Stans or Solothurn, families pay nearly twice as much into Pillar 3a as they do in Geneva

Deposits into Pillar 3a by Swiss families also differ from a regional perspective. The chart on the next page uses the example of a double-income married couple with children to show the average actual Pillar 3a deposits deducted from taxable income in 2015 in each municipality. The figures differ from one municipality to another, in some cases quite dramatically – even within the same language region. As individuals with higher incomes are typically able to invest more in their private pension provision, this partly reflects socio-economic differences between the regions and/or municipalities. In smaller towns, the average values are affected to a greater extent by individual observations than is the case in larger municipalities. However, double-income families with children in the German-speaking part of Switzerland tend to deposit more into Pillar 3a than those in French- or Italian-speaking regions. Geneva and Bellinzona were among the cantonal capitals with the lowest deposits, averaging CHF 1,721 and CHF 1,886 per employed person, respectively. Meanwhile, in Aarau, Altdorf, Liestal, Solothurn, and Stans, the average deposit was nearly twice as high at more than CHF 3,000. The national average is just about CHF 2,870 per person.

One thing is very clear from the data provided by the Swiss Federal Tax Administration: many families across the country do not exploit the maximum permitted amount for Pillar 3a accounts – which was CHF 6,768 for employed persons in 2015.

Many Swiss families deposit nowhere near the maximum Pillar 3a amount

Average Pillar 3a deposits by double-income couples with children, in CHF per employed person, only employed taxpayers subject to normal taxation, 2015



Canton	Municipality	Average deposit in CHF
GE	Geneva	1,721
TI	Bellinzona	1,886
BS	Basel	2,047
VD	Lausanne	2,090
FR	Fribourg	2,093
GL	Glarus	2,259
SG	St. Gallen	2,289
LU	Lucerne	2,560
AR	Herisau	2,577
NE	Neuchâtel	2,583
SH	Schaffhausen	2,643
AI	Appenzell	2,661
GR	Chur	2,680

Canton	Municipality	Average deposit in CHF
ZH	Zurich	2,687
JU	Delémont	2,692
TG	Frauenfeld	2,846
BE	Bern	2,859
SZ	Schwyz	2,873
ZG	Zug	2,943
VS	Sion	2,974
OW	Sarnen	2,975
AG	Aarau	3,101
UR	Altdorf	3,153
BL	Liestal	3,221
SO	Solothurn	3,291
NW	Stans	3,314

Source: Swiss Federal Tax Administration, Credit Suisse, Geostat

Young, Single, Carefree – and No Pension

Besides the question of which factors typically encourage Pillar 3a deposits, it is also interesting to note the living situation of those who make deposits and those who do not. We used a cluster analysis to identify typical profiles of employed Swiss women – those who were eligible to pay into Pillar 3a. This process allows us to recognize and characterize naturally forming clusters, in terms of, say, age, income profile, educational level, household type, and living situation. Employed Swiss women can be allocated to eight distinct groups (see chart on page 15).

Young, single, no children – and often with no private pension provision (yet)
The women in the first group are the youngest, with an average age of 30. Generally single and without children, these women work full-time or close to it, earning an average income of around CHF 51,000. However, despite having a relatively high income at a young age, only about one third of these group members make regular deposits into private pension provision.
Group 2 comprises similarly young women, with an average age of 36, very well educated, single – and with the best condition for paying into a private pension provision, earned income averaging some CHF 76,000. But here too, only around 45% make regular contributions to a Pillar 3a account. Either they prefer alternative pension options or the awareness of private pension provision only develops later in life.

Divorced single mother: difficult conditions to build a third pillar
As in the first two groups, the women in group 3 are also single, but considerably older with an average age of 49. These predominantly divorced women tend to have a mid-range educational level and earn an income of CHF 60,000 on average. Not quite half of them make regular deposits into private pension provision. One reason for this is likely that 52% of the group are single mothers with children at home, and may not have the budget to make such a deposit.

Overview of 3a provision profiles for Swiss women

Typology of women based on various socio-demographic characteristics and identification of 3a deposit behavior



	Young, single, no children		Single	Families			DINKS	
	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group 8
	Mid-range income and education level	High income and education level	Mid-range income part-time 78%, divorced	Low income part-time 65%, low education level	Low income part-time 49%, mid-range education level	Mid-range income part-time 56%, high education level	Mid-range income part-time 49%	High income at full-time hours
Share of women who make regular 3a deposits	33%	45%	48%	35%	61%	70%	60%	63%
Age	30	36	49	44	42	42	51	45
Earned income	51'000	76'000	60'000	35'000	36'000	58'000	47'000	82'000
Employment level	80%	85%	78%	65%	49%	56%	49%	83%
Pct. of households with children	5%	5%	56%	78%	99%	99%	3%	8%
Household type								
Single, no children	78%	70%	37%	8%	0%	1%	2%	2%
Single-income couple, no children	2%	2%	1%	9%	1%	1%	8%	3%
Double-income couple, no children	15%	23%	6%	5%	0%	0%	87%	87%
Single with children	2%	3%	52%	3%	0%	2%	0%	2%
Single-income couple with children	0%	0%	1%	8%	2%	2%	3%	6%
Double-income couple with children	2%	2%	3%	67%	97%	94%	0%	0%
Marital status								
Single	95%	89%	4%	4%	4%	5%	9%	8%
Divorced	2%	9%	92%	8%	1%	2%	4%	9%
Married	0%	1%	2%	84%	94%	93%	86%	82%
Widowed	3%	1%	2%	4%	0%	0%	1%	1%
Education								
Secondary I	6%	4%	11%	100%	0%	0%	8%	7%
Secondary II	94%	0%	75%	0%	100%	0%	92%	0%
Tertiary	0%	96%	14%	0%	0%	100%	0%	93%
Share of gainfully employed women	19%	16%	10%	6%	18%	12%	10%	9%

Age, earned income, and full- or part-time work indicate the average value for employed women in each group. For single-income couples, only the woman is in paid employment.

Source: Swiss Federal Statistical Office (SLFS), Credit Suisse

Double-income families with children contribute relatively frequently
The cluster analysis identifies three different groups of women, most of whom are in a double-income marriage with children.

Of the eight groups, the one with the highest percentage of regular Pillar 3a deposits is group 6, with 70%. Nearly one in eight employed women belongs to this profile. This group consists of well educated women who earn CHF 58,000 on average working part-time (56%). Although the individual incomes are significantly lower than those of the women in double-income couples without children, this group invests much more often in private pension provision (70% make deposits, versus 60% in group 7 and 63% in group 8).

The average income for women in group 5 is considerably lower at CHF 36,000. Here, though, the women are also working fewer part-time hours (49%). Nonetheless, 61% pay into a 3a account regularly. The overall financial situation of the household probably makes it easier for regular investments to be made in private pension provision. This employment profile is relatively common, applying to 18% of female employees.

The average income for group 4 is similar, but the women work part-time at 65%. Besides double-income families with children, 17% of the households in this group are single-income couples; in other words, the woman is the breadwinner. In this group, only about one in three women makes regular deposits into private pension provision. It seems evident that these households are more dependent on the second income, so that accumulating 3a pension assets is less of a priority.

DINKS: despite having the best conditions, only 60% save with Pillar 3a
The last two groups – comprising around one fifth of employed women – are mainly "double income no kids" couples, or DINKS. The typical woman in group 7 is 51 years old, has a degree at the secondary II level, works part-time (49%), and earns around CHF 47,000. Group 8, in comparison, is a bit younger, better educated, with a higher percentage of working hours. The average income here is CHF 82,000, the highest of all the groups. Despite these ostensibly good conditions, relatively few women make regular Pillar 3a deposits; just 40% in group 7 and 37% in group 8.

Women without children, in particular, could save more in 3a
The cluster analysis shows that among double-income couples, the women with children already make more Pillar 3a deposits than those without, although they work fewer hours and earn less money on average (see chart). So Pillar 3a savings can partially make up for lower benefits in the second pillar, and possibly the first pillar. Mothers with lower incomes make regular deposits less often – and the deposited amount will be considerably lower.

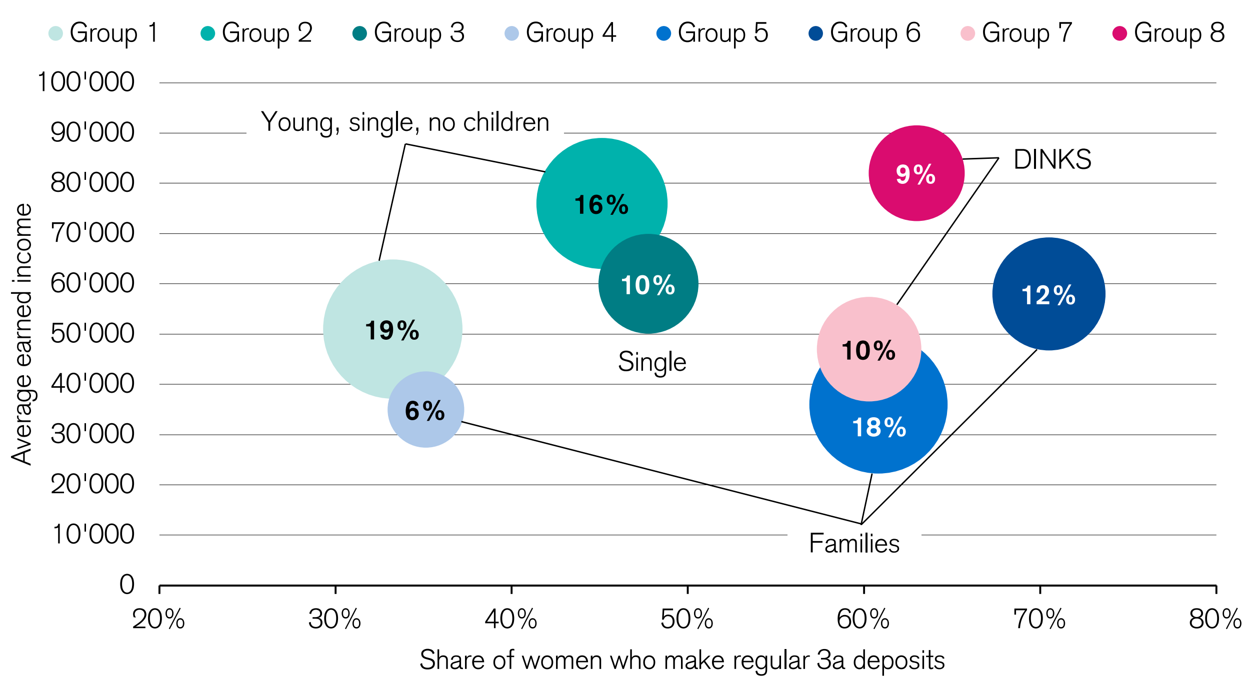
Women without children have particular potential to make more regular Pillar 3a payments. By making more consistent use of Pillar 3a, the women in groups 7 and 8, who are often very well off, have no children, and have a partner who is likewise employed, could help to counteract any pension savings gaps in the second pillar (for example, in the case that they have been working part-time). Moreover, this lowers the tax burden.[4]

Furthermore, young single women (groups 1 and 2), who make up more than one third of employed women in Switzerland, could also take greater advantage of private pension provision. A small, regular deposit, at least, should be financially feasible in many cases – often more easily than in later phases of life. This would make sense in terms of wealth accumulation. After all, those who begin saving for retirement in their early years can profit from compound interest. Given the long-term investment horizon, return opportunities can be enhanced by deployment of securities solutions.

In the following section, we examine how factors such as income level, part-time working, and career breaks affect the income situation after retirement. Deposits into private pension provision can serve as a supplement to the first and second pillars, reducing pension gaps and thus securing the desired lifestyle after retirement.

DINKS and young women could make more regular deposits

Average income and frequency of deposits for the eight distinct groups; circle size: share of gainfully employed women



Source: Swiss Federal Statistical Office (SLFS), Credit Suisse

[4] An overall financial perspective of 3a saving can be found from page 33 in Credit Suisse (2018), Private Pension Provision: Pillar 3a Savings in Switzerland

Mind the gap: Identify and Minimize Gaps in Pension Savings

The preceding sections highlighted significant differences in the frequency and amount of Pillar 3a deposits. Driving factors include living situation and, particularly, the employment level (full or part-time) and thus the amount of income earned. Women often display earning and depositing patterns that hamper wealth accumulation not only in the third pillar, but in all aspects of pension provision. This is because gainful employment plays a key role in all three pillars.

Gainful employment impacts all three pillars

In the first pillar, the amount of an AHV pension depends upon uninterrupted payment of social security contributions as of the age of 21, but also upon the average income during one's career. Retirees only receive the maximum pension, currently CHF 2,370 for a single person or CHF 3,555 for a married couple, if there are no gaps in contributions and if they have earned at least CHF 85,320 p.a. on average over the years. For years in which there were children under 16 in the household, a parenting credit may be allocated when the pension is calculated. This raises the average annual income used to calculate the AHV pension and can influence the amount of the pension.

In the second pillar, career breaks and reduced working hours dramatically hinder the accumulation of pension capital. Individuals with lower incomes are disproportionately affected, because around half the pension schemes reduce the insured wage by a coordination deductible that is fixed regardless of the income level.[5] On top of that, an employee must currently earn a wage of at least CHF 21,330 to qualify for mandatory BVG insurance. As a rule, the later in life a career break takes place, the greater the resultant contribution gaps. This is because wages generally increase over time, and BVG contributions also rise with increasing age, from 7% at age 25 to 18% at age 55.

[5] Since around half of all Swiss pension funds now use either a flexible coordination deductible or none at all, in the following scenarios we apply a lower value than CHF 24,885 according to the Federal Occupational Old Age, Survivors' and Invalidity Pension Provision (BVG is the German acronym).

Finally, deposits into a Pillar 3a account are also linked to gainful employment. This system is available only to individuals with earned income that is subject to AHV deductions. So during a lengthy career break, the individual also loses the opportunity to make 3a deposits, and it is not currently possible to make retroactive deposits for missed years.

Wealth accumulation across the life cycle: scenarios

The effects of career breaks and part-time work on all three pillars can be examined with our model, which analyzes in detail wealth accumulation in pension provision.

As an illustration, we observe the wealth accumulation in scenario A in an occupational pension plan and in Pillar 3a for a single person in the mid-range income segment, with no career breaks (see upper chart on page 20). To stay as close as possible to reality, we consider the specific case of a teacher[6] and assume that the salary will progress from CHF 70,000 at age 25 to CHF 100,000 at retirement. Applying the usual BVG contributions and assuming average annual interest on the pension fund assets of 2%, by the time the teacher retires there will be around CHF 519,000 in the pension fund. If on top of this the teacher makes regular deposits of the maximum 3a amount, given the same assumed annual yield of 2%[7], there would be another near CHF 436,000 in 3a assets.

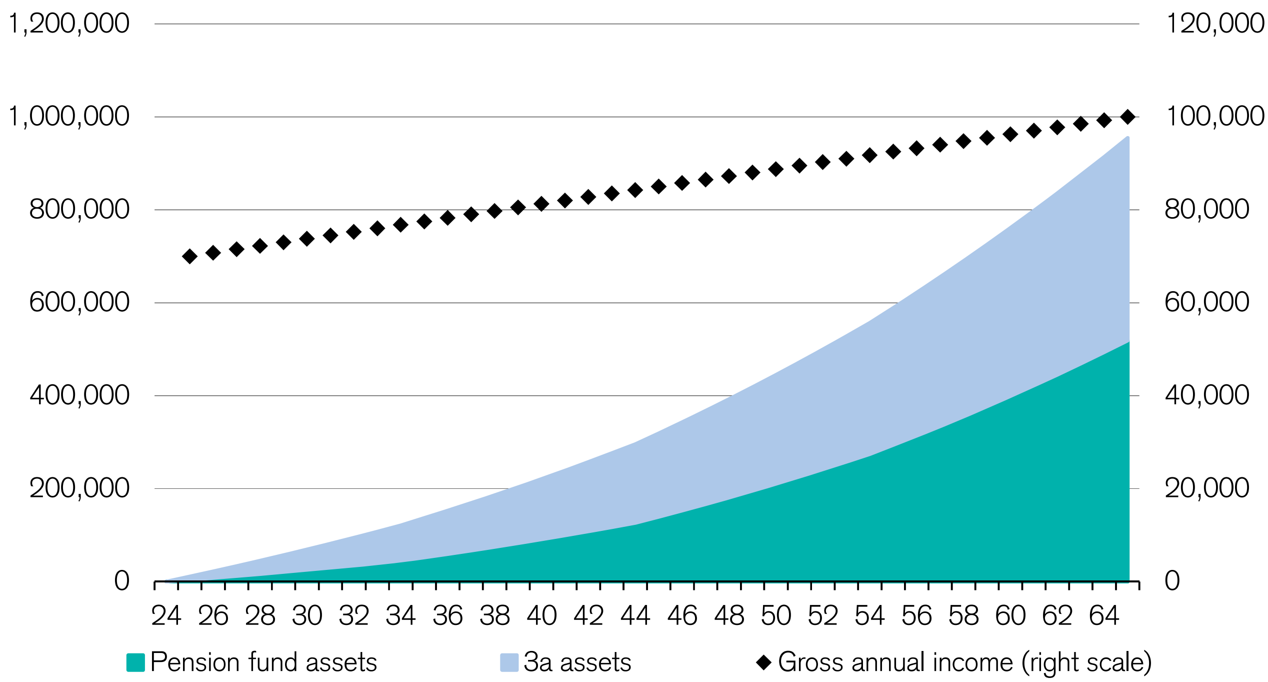
Scenario B (see lower chart on page 20) depicts the asset accumulation if the teacher takes a 6-year career break from age 30 to 35. During these years, no income is earned and thus deposits into the Pillar 3a account are not permitted. At the end of the career break, the teacher returns to work with a 60% part-time contract for the next eight years, and then works full-time until retirement. Because of the lower deposits and the reduced compound interest effect, the pension fund assets amount to CHF 424,000 upon retirement. And if in every year of gainful employment the maximum 3a amount is deposited, the 3a assets add up to around CHF 356,000. The career break and part-time working reduce the pension fund savings by approximately CHF 95,000 and the Pillar 3a by CHF 80,000.

[6] For the income segments in this section, we consider the following cases: Teacher with certification, non-management function; salesperson in retail with occupational training, non-management function; attorney in legal services with university degree and mid- to upper-level management function towards the end of the career (source: Salarium – Individual Wage Calculator 2016, Swiss Federal Statistical Office).

[7] We assume a mixed 3a model with an interest account and securities solution.

Scenario A: Asset performance with no career breaks

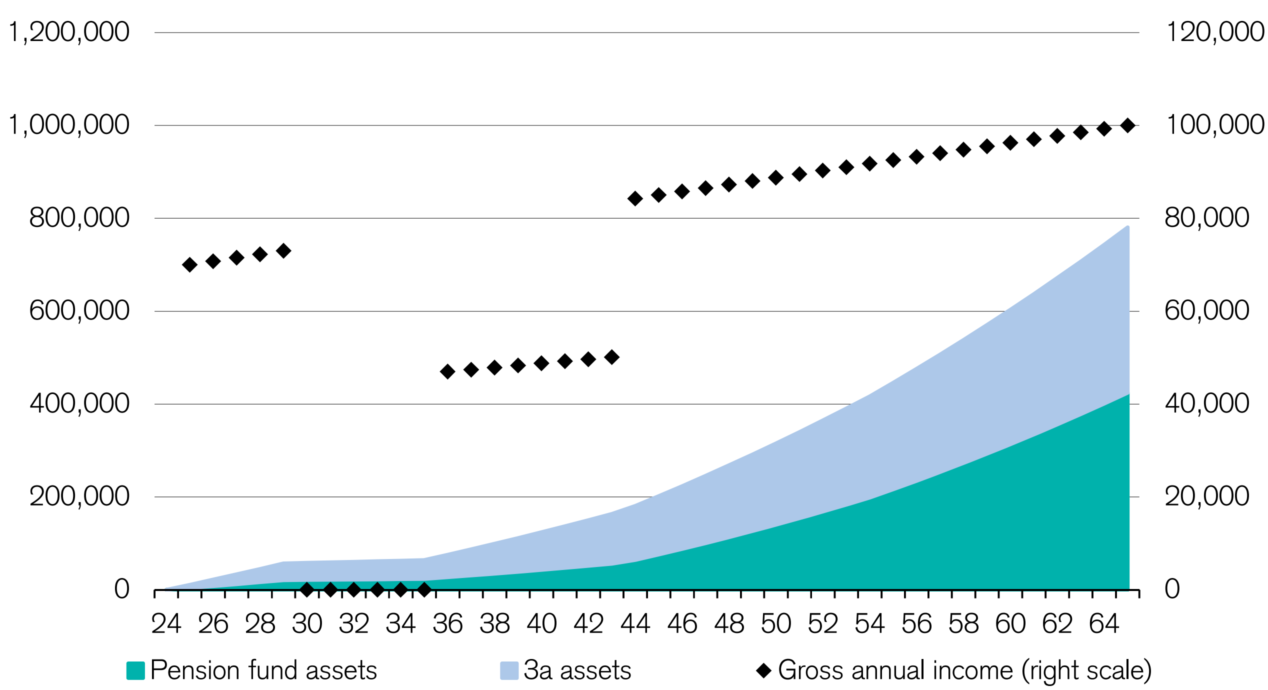
Asset performance in the second and third pillars on a salary of CHF 70,000–100,000, annual deposit of CHF 6,826 into Pillar 3a, average interest/return of 2% p.a.



Past performance and financial market scenarios are not reliable indicators of future performance.
Source: Credit Suisse

Scenario B: Career break and part-time work markedly impact accumulation of pension savings

Asset performance in the second and third pillars on a salary of CHF 70,000–100,000, 6-year career break followed by 8-year period of working 60%, annual deposit of CHF 6,826 into Pillar 3a (except during career break), average interest/return of 2% p.a.



Past performance and financial market scenarios are not reliable indicators of future performance.
Source: Credit Suisse

AHV and pension fund alone often fail to maintain the standard of living

At retirement, the teacher in scenario A without a career break would receive an AHV pension of around CHF 27,500 p.a. (see upper chart on page 22). The pension fund benefits would amount to around CHF 33,500. The teacher would thus receive a gross income from AHV and pension fund of just over CHF 61,000. In scenario B, the gross income is around 14% lower at CHF 53,000, because both AHV and pension fund benefits are lower. The payout targeted by the mandatory pension system, under which AHV and pension fund benefits add up to around 60% of the most recent wage, would thus only be achieved in scenario A.

The financial needs after retirement differ from one individual to another and must be reviewed in detail for each case. As a general rule of thumb, it is often assumed in financial planning that one will require 80% of the previous wage after retirement. In the case of the teacher, that would amount to CHF 80,000. The savings gap, i.e. the difference between the teacher's financial needs and the actual benefits from social security and occupational pension, would range from CHF 19,000 to CHF 27,000 depending upon the scenario.

Let's consider the same scenarios for lower and higher income segments. Our sample workers will be a salesperson (wage progression from CHF 50,000 to 70,000) and an attorney (CHF 95,000 to 200,000). For the lower income, the scenario with a career break and part-time work shows gross income that is around 14% lower than in scenario A in the first two pillars; for the higher income segment, the reduction is around 11%.

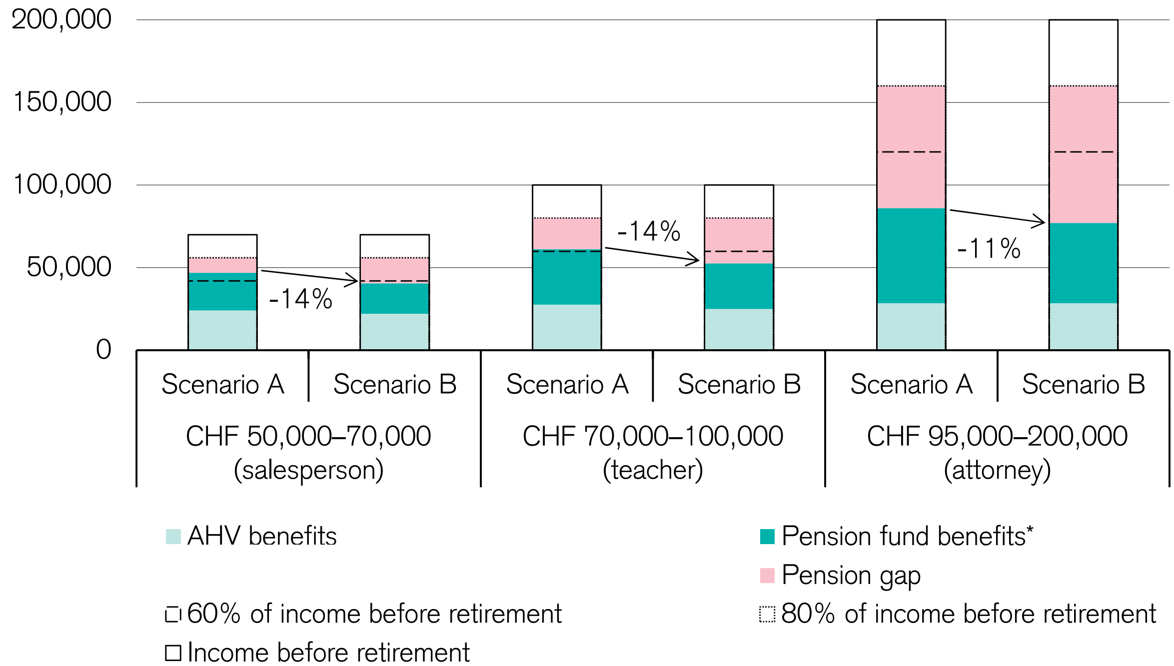
Savings gaps are evident in all three cases, and they become steadily higher as income rises. On the one hand, AHV pensions do not vary as greatly due to the legally defined minimums and maximums, and on the other, conversion rates in the extra-mandatory segment of occupational pensions (wage segments above CHF 85,320),on average, are already well below the 6.8% currently stipulated for BVG mandatory benefits. Since the trend towards declining conversion rates in the extra-mandatory segment is still intact, private savings are an increasingly important factor in maintaining the standard of living after retirement.

Private pension provision to close the savings gaps

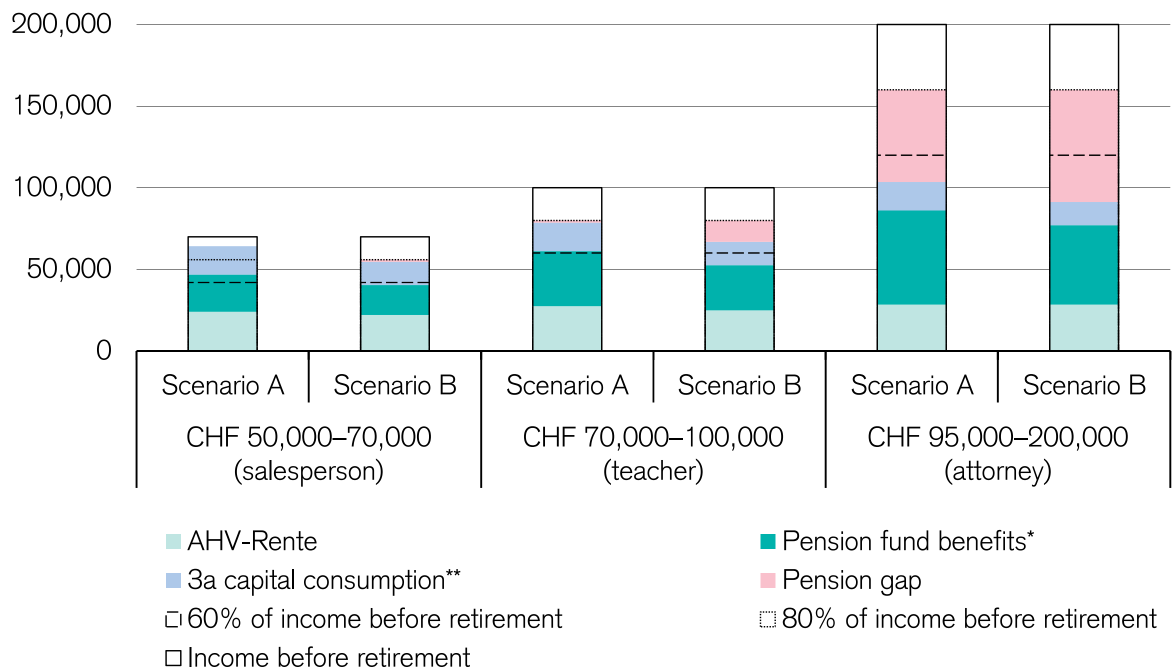
Early and regular payments into the Pillar 3a – and, at a later date, payments into the pension fund if appropriate – can help counteract gaps in pension savings. The lower chart on page 22 shows how making regular deposits of the maximum amount into the Pillar 3a can reduce savings gaps. In scenario A, the teacher can nearly reach the 80% target. In scenario B, the gaps caused by a career break and part-time work are fully compensated. All it would take to reach this objective would be an annual deposit of around CHF 3,500. However, even with the 3a maximum amount, the result falls around CHF 13,000 short of the 80% target. In this case, the untied, non-tax-privileged forms of saving (Pillar 3b) can be applied.

Career break and part-time work reduce pension income from the first and second pillars...

Gross annual income from first and second pillar pensions and from 3a capital consumption in CHF for various wage progressions and scenarios described above: scenario A = uninterrupted gainful employment, scenario B = 6-year career break followed by 8 years of working 60%



... but savings gaps can be minimized by deposits in Pillar 3a



* Occupational pension benefits: for the calculation, we assumed conversion rates of 6.8%, 6.5%, and 5.8% for the salesperson, teacher, and attorney, respectively. ** 3a capital consumption: it is assumed that the capital will be depleted over a span of 25 years. For the sake of simplicity, neither taxes on lump-sum withdrawals nor interest/yields on 3a assets are taken into consideration.

Past performance and financial market scenarios are not reliable indicators of future performance.
Source: Credit Suisse

For a lower income (salesperson), regular maximum Pillar 3a deposits could practically ensure closure of pension gaps even in scenario B. In reality, however, the average deposits into Pillar 3a are well below the maximum statutory amount (see page 12). Only 55% of employees make regular deposits into Pillar 3a. If financial means are not sufficient to make the maximum deposit, even smaller, regular payments can help to close the savings gap.

In the case of high incomes, the savings gap cannot be closed by payments into Pillar 3a alone. If a retiree actually needs 80% of their previous income, this can be achieved through savings in the Pillar 3b system. Moreover, depending upon the risk profile, securities solutions can raise the return opportunities in Pillar 3a. In the second pillar, there are 1e pension plans for wage segments above CHF 127,980 that offer the possibility to select an investment strategy, depending upon risk preferences, and so potentially generating higher investment returns. Note, however, that the insured persons bear the investment risk themselves.[8]

[8] For more detailed information, see Credit Suisse (2018), Private Retirement Provision: Lump Sum or Annuity?, page 19ff.

Should the Pillar 3a be Expanded?

From a socio-political perspective, it is crucial to ensure adequate coverage of financial needs after retirement. The fiscal incentives to save for retirement in tied pension provision (Pillar 3a) reinforce workers' responsibility to secure an appropriate standard of living after retirement. Given the falling conversion rates in the extra-mandatory segment of occupational pensions, savings in the third pillar are becoming an increasingly important complement to the mandatory segment. Thus politicians and commentators frequently raise the question of whether this savings opportunity should be expanded.

Increase in the maximum contribution
One suggestion currently before Parliament is to increase the tax-deductible maximum deposit allowed in the third pillar. A motion supported by center-right lawmakers proposes to raise the maximum amount from the current CHF 6,826 to CHF 15,000 for employed workers and from CHF 34,128 to CHF 45,000 for workers not enrolled in an occupational pension plan.[9]

The Federal Council opposes such an increase. In its position paper, it notes that according to the Household Budget Survey, even households with a gross income of CHF 105,000 – the mid-range income segment – today save only about CHF 10,000. Moreover, only around 13% of taxpayers today deposit the current, lower maximum amount. Increasing the maximum amount would mainly profit insured persons with a taxable income of more than CHF 100,000 and would cause a shortfall of around CHF 350 million annually in tax receipts.

In many cases, there are doubtless financial obstacles to making a significant increase in Pillar 3a deposits. Nonetheless, we cannot automatically conclude from the *current* budget allocations that additional incentives for Pillar 3a savings might not lead to a higher savings ratio – also among households with mid-range incomes. But in fact, there are probably limits to the effectiveness of this measure in securing old-age provision for individuals with meager retirement benefits. Furthermore, the measure is not entirely uncontroversial. A representative survey carried out by Verein Vorsorge Schweiz (VVS) indicates that a slight majority

[9] See www.parlament.ch (Curia Vista business database): Motion 18.3836.

(52%) of the Swiss population would welcome an increase in the maximum 3a amount, 28% would be against it and 20% undecided (see chart).

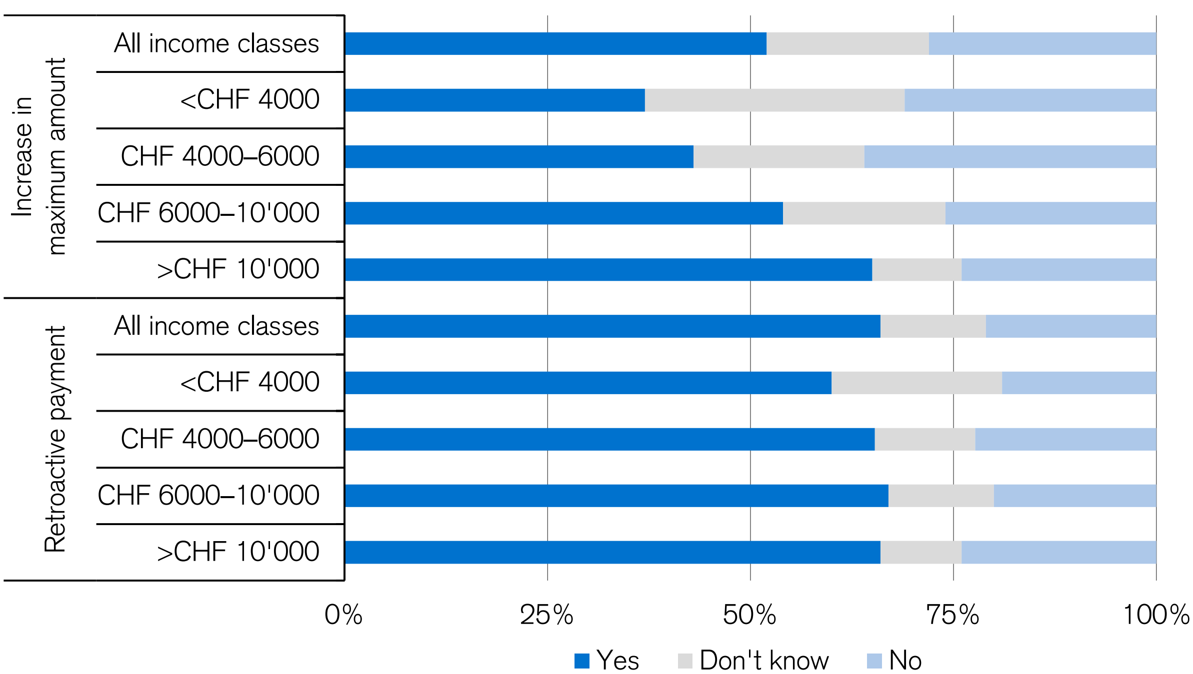
Make accessible to those not gainfully employed

Over the last few decades, several proposals have been submitted to make the Pillar 3a savings system available to individuals who are not gainfully employed. This would mean that persons not working outside the home, e.g. due to parenting or elder care responsibilities, could also benefit from the tax-privileged private pension provision. Making the program available to children and young adults is also conceivable.

Although a private pension option for individuals without gainful employment has certainly found support, it has never been realized. According to the Federal Council, implementing it within the framework of occupational pensions would have only exacerbated the complexity of the system. However, implementation as part of tax legislation has also been put on the back burner: gainful employment is still the cornerstone of pension provision.

Retroactive deposit option seems capable of winning a majority

Approval of raising the 3a maximum amount vs. a retroactive deposit option in Pillar 3a, by monthly gross wage segment, survey in May 2018



Source: Verein Vorsorge Schweiz/Sotomo, Credit Suisse

Retroactive deposit option

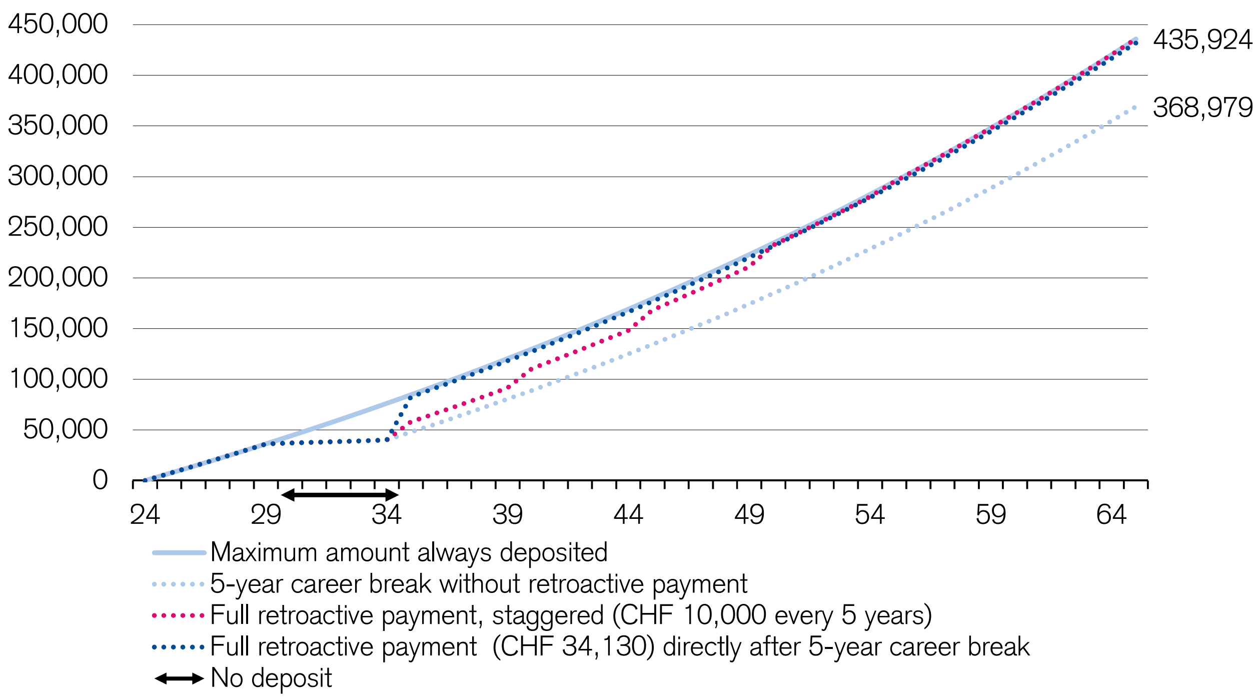
There is a more feasible alternative to extending the 3a system to those not gainfully employed, and it involves compensating for missed deposits during a career break. The VVS survey found that a two-thirds majority support the notion of retroactive deposits when the maximum amount was not deposited into Pillar 3a in individual years (see chart on page 25). The approval is high across all income segments and among members of all political parties. What might such retroactive 3a deposits look like?

The reform proposal from VVS foresees the possibility of making up for lost deposit opportunities, similar to the current option of buying into an occupational pension plan. In contrast to raising the maximum deposit, the tax benefits in the third pillar per se would not be expanded. It would merely create an incentive to close savings gaps.

The chart below illustrates several models for retroactive Pillar 3a deposits. Regular deposits of today's maximum amount (CHF 6,826) at an average return of 2%

Staggered retroactive payments for the middle class is more realistic

Asset performance given an annual deposit of the current maximum amount of CHF 6,826 into Pillar 3a (except for during career break), average interest/return of 2% p.a.; variations of a retroactive payment option



Past performance and financial market scenarios are not reliable indicators of future performance.
Source: Credit Suisse

p.a. would result in savings of nearly CHF 436,000 by retirement, almost CHF 67,000 more than in the case of a 5-year break in deposits from age 30 to 34 (light blue line).

The VVS suggests that these gaps could be closed by retroactive deposits. The potential buy-in sum can be calculated as the difference between the highest possible amount of 3a assets at a specific point in time (i.e. if the maximum amount had been deposited each year, plus interest and investment income) and the amount actually saved in a 3a account. Purchases could not be made until the age of 30 and thereafter once every five years at most, and the buy-in amount could not exceed CHF 34,130 (five times the current maximum amount). Capping the buy-in amount lowers the risk that the purchase is made simply for tax optimization purposes, e.g. that a large amount is deposited briefly, only to be paid out in an (advance) capital withdrawal shortly thereafter. Similar to the regulations governing purchases into the second pillar, a lock-up period between buying in and advance capital withdrawal could be defined.

So after a five-year break in deposits, the following year, in addition to the normal maximum amount, an insured person could buy-in up to five maximum amounts (dark blue line). A supplementary payment of more than CHF 40,000 is surely not realistic for many households – especially after a lengthy career break. Rather, a staggered purchase would be more feasible. The gaps could thus be gradually narrowed or closed over several years, perhaps with a buy-in of CHF 10,000 every five years (red line). The proposal would thus support less affluent individuals in building up their third pillar assets.

Flexibility of Pillar 3a should be reviewed

The reform proposals discussed here would all have an impact on the government's tax revenues. Increasing the maximum amount, expanding the circle of eligible account holders, and introducing a retroactive deposit procedure would all encourage higher payments into Pillar 3a. Since the amount deposited can be fully deducted from taxable income, this would mean lower tax receipts. Moreover, during the entire term of the investment, neither wealth tax, nor income tax, nor withholding tax are applied to the 3a capital. Some of the shortfall could be recuperated through the correspondingly higher taxes paid upon capital withdrawal.

However, a reform of the third pillar might make sense even if tax receipts were somewhat lower. Stronger incentives to build up private pension provision, in addition to mandatory savings, would have a positive impact on the financial situation after retirement. This is all the more relevant as pension fund benefits shrink due to falling conversion rates in the extra-mandatory segment.

Retroactive deposits would be particularly helpful in closing 3a payment gaps caused by breaks in gainful employment. This would especially benefit women, students, those in occupational training, and other individuals who for good reason take time away from the labor market. It would also be beneficial for those who are gainfully employed but have made small or no deposits into the system, among whom are many young people. The increased flexibility of the system would allow individuals to deposit more money in “good” years and thus compensate for missed payment opportunities.

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CREDIT SUISSE AG
Postfach
CH-8070 Zurich
credit-suisse.com