

Analysis: Overdue fix for Swiss investment foundations

12 July 2019 By **Barbara Ottawa**

Long-awaited changes to the rules affecting Switzerland's investment foundations are badly needed to better serve the needs of the country's pension funds. Barbara Ottawa reports

Collective investment foundations – Anlagestiftungen in German or fondations de placement in French – have served Swiss pension funds for more than half a century. And despite being an invaluable tool for Swiss Pensionskassen, they have been showing their age.

Today's world of stubbornly low interest rates is encouraging investors around the world to move towards alternative asset classes and private markets like never before. Investment foundations, which are designed to aid diversification, have proven too restrictive.

Now they are being let out by the seams. In September 2018, the Swiss government tabled an amendment to reform the regulations of investment foundations and last month this was finally approved to take effect on 1 August.

Swiss Pensionskassen have a number of investment restrictions imposed on them to safeguard against becoming overly exposed to concentrated risks. For instance, if a pension fund provides loans, its exposure to a single borrower must be capped at 10%, and a single real estate asset cannot represent more than 5% of a portfolio.

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The problem for investment foundations was that these rules were also applied to them – in effect doubling up on the rules unnecessarily. Until the review, they had to ensure that all limitations applying to Pensionskassen were also met in each single product they offered. In the revised regulations, they are freed of those limitations, which will only be checked at the Pensionskasse level.

Investment foundations had been set up as collective vehicles to help smaller pension funds achieve higher diversification. But while a few smaller Pensionskassen use them to provide a complete portfolio solution, most tend to buy into them as part of broader investment portfolios.

As the association of managing directors of Anlagestiftungen (KGAST), pointed out during the recent consultation period, this “led to a not necessarily useful double diversification”.

Furthermore, Pensionskasse used to be forced to hold no more than 50% of assets in equities and 25% in alternative asset classes. This restriction was removed several years ago, but it remained applicable to investment foundations.

All these limitations meant investment foundations had less freedom compared with other forms of investment funds, putting them at a competitive disadvantage.

“Changes to the existing regulatory framework were necessary and urgent,” says Roland Kriemler, managing director of KGAST, which has been pushing for reforms.

A first revised draft of the regulation could have been approved by the government as early as September 2017. “But eventually it took almost two years to be amended – that is a long time,” Kriemler says.

In its reaction to the revised regulation, KGAST “welcomed most of the amendments”, but the association noted a number of ways that investment foundations are still treated differently to investment funds, such as tax and stamp duty.

Despite the foundations being tax-exempt in principle there are regulations in place that make it more tax-efficient for pension funds in certain cases to use a fund rather than an Anlagestiftung.

The ASV regulations are “unduly limiting Anlagestiftungen” even after the revision, says Kriemler. KGAST has vowed to “put these problems back into focus” and to “fight for investors’ interests”.

The new regulations do improve transparency and governance. Founders will only be able to propose names for the board of trustees, but the board of investors has to appoint the members.

Stephan Kloess, founder and managing director of KRE KloessRealEstate consultancy, welcomes this. “The aim was to lower the influence the founder has over the foundation,” he explains.

But for Kloess, a paragraph on delegating tasks is “formulated too loosely”. The board of trustees will be allowed to outsource “significant” tasks. “This could incentivise the board not only to outsource competences but also responsibility,” he says.

Other amendments to governance regulations have been received positively. To avoid conflicts of interests, the roles on the board of trustees in the administration and in asset management are to be strictly separated. Kloess is disappointed that the final amendment does not include the board of management in this list of possible conflicts of interest.

For Kloess another “important” amendment is the reiteration of the ban on additional funding obligations. Although it is already forbidden for an investment foundation to demand additional payments from its investors in times of market downturns, the government has now made this ban “absolute”. In the past, additional contributions had been levied via regulatory backdoors.

At the same time, investment foundations, especially in private markets like real estate, are struggling to find the right opportunities to invest Pensionskasse capital.

Kloess, who is also chairman of Swiss real estate investment foundation AFIAA, says Swiss Pensionskassen are in “dire need” of new investments. “Both Anlagestiftungen as well as funds are getting new money for new products,” he says. “Pensionskassen would clearly prefer to invest in existing structures rather than portfolios that have yet to be built by purchasing at current price levels.”

In real estate, demand definitely exceeds supply and many investment foundations have had to close for new investments due to a lack of investment opportunities.

Out of the almost 50 investment groups for real estate (both domestic as well as foreign) which KGAST reports on, only six remain open for new investors. The latest closings (Helvetia and Swiss Life) were announced in March this year.

Another trend putting pressure on the market is the practice of insurers shifting portfolios from their balance sheets to Anlagestiftungen or funds.

“The most recent cases in point were Zurich, Baloise and Helvetia,” says Kloess.

These insurers are also the latest to close their investment foundations for new entries. The trend had been triggered – among other things – by Solvency II investment restrictions that affect EU-based insurers.