

# Economico Flash ⚡ #49

Cost-benefit ratio of a pension fund: risk and return

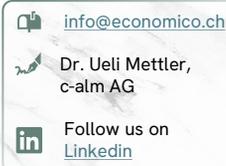
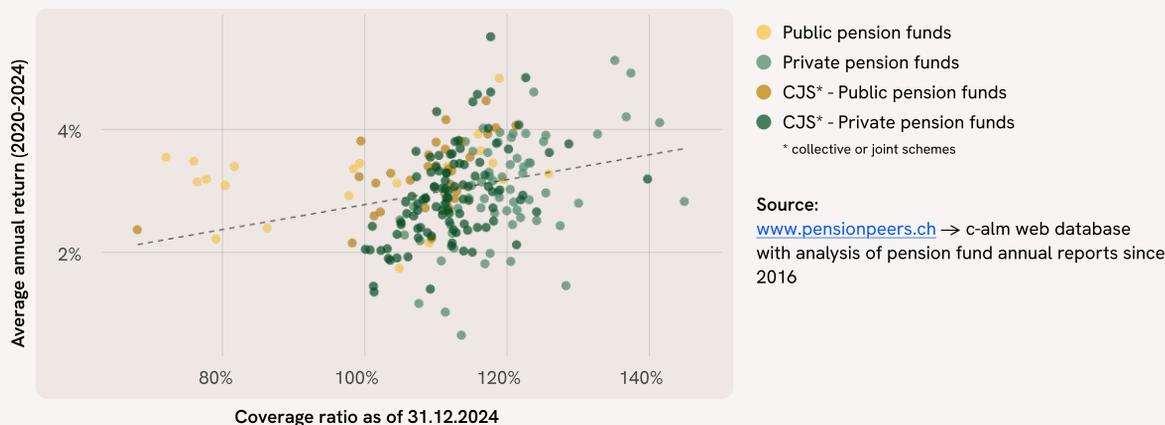


Chart of the week: Coverage ratio as a measure of financial risk capacity vs. achieved investment return



Our quantitative comparisons of pension fund key performance indicators (KPIs) are based on the web database [www.pensionpeers.ch](http://www.pensionpeers.ch) from c-alm. Since 2016, over 50 KPIs have been painstakingly extracted annually from pension fund annual reports with considerable effort and meticulous attention to detail. This database can be used for a wide variety of purposes.

For example, for discussing the risk-return characteristics of a pension fund.

The **theory** is as follows: **The more risk-tolerant a pension fund is**, the more risk it can invest. And the more risk it invests, **the higher the returns** it will generate (on average!). And naturally, everyone wants to be insured with a pension fund that generates the highest possible returns.

At the heart of this cycle, therefore, lies **risk tolerance**. Those who want to be with a high-yielding pension fund must choose a risk-tolerant one. The **legislator stipulates** in Art. 50 para. 4 BVV 2 how the risk tolerance of a pension fund is to be understood. Instead of defining one metric, he defines two: Firstly, the financial situation of a pension fund – measured by its **coverage ratio** – is crucial for its risk capacity. Secondly, the **insured structure of a pension fund** must be considered for its risk capacity: the more active members and the fewer retirees a pension fund has, the more risk-tolerant it is and the more investment risk it can bear.

Now from theory to practice: if the theory is correct, one would expect that pension funds with a higher risk tolerance would assume more investment risk and thus achieve higher returns over a longer period.

In this week's chart, we compared the average investment returns achieved by **pension funds over the past five years**, based on their **coverage ratio**, with their financial reserves.

And indeed, the suspected correlation – indicated in the chart by the rising trend line – appears to exist. The higher the coverage ratio, as a measure of a pension fund's (financial) risk capacity, the higher the investment return was between 2020 and 2024.

However, a word of caution: The comparison shown may also be subject to a chicken-and-egg effect. A high coverage ratio can, at least in part, also be a result of the above-average investment returns of recent years.

Nevertheless, when looking for a **pension fund with strong future returns**, it is advisable to look for pension funds with a high risk capacity. These have a **sound structure** with many active members and few retirees and possess financial reserves in the form of a **high coverage ratio**.

## Takeaways

- A pension fund with a high risk tolerance can bear high investment risks.
- A pension fund with high investment risks achieves higher average investment returns.