

Three Ways a Pension Fund Can Close Half Its Funded Status

The CERN Pension Fund, like many defined-benefits pension schemes, has faced persistent challenges in achieving a fully funded status. As of 2015, the fund had a total asset value of CHF 3.97 billion but was only 72.3% funded, indicating a significant shortfall. Despite the fund growing its assets to CHF 4.7 billion by 2022, the funding ratio had only slightly improved to 77.1%. Addressing this shortfall requires strategic interventions beyond merely hoping for better investment returns. Below are actionable proposals to improve the fund's financial health.

1) Optimizing Portfolio Construction

A critical observation of the CERN Pension Fund's investment strategy is the small size of individual allocations within the portfolio. For instance, in 2015, the fund committed CHF 39 million across 8 new primary Private Equity funds, resulting in an average position of just CHF 5 million, or 0.12% of the overall fund. This allocation strategy presents two challenges: it either requires extensive due diligence and management resources or exposes the fund to significant risks due to inadequate oversight.

Proposal: By capping the number of positions within the portfolio—to a maximum of 100—CERN can streamline its investment management processes. This approach would not only reduce the cost and complexity of managing numerous small positions but also enable more focused and effective oversight of larger, more significant investments.

2) Controlling and Reducing Fees

Investment management fees significantly impact the long-term financial health of pension funds. In 2015, CERN Pension Fund's fees were nearly 1% of total assets, much higher than the sub-0.2% targeted by best-in-class public pension funds. High fees erode the fund's capital over time, exacerbating the funding shortfall.

Proposal: The fund should negotiate more favorable fee structures by increasing the size of individual positions. Larger positions often allow for better fee negotiations, which can substantially reduce overall costs. A reduction of fees by just one-third could generate an additional CHF 600 million over 20 years, which represents nearly 40% of the 2015 deficit. This change would significantly bolster the fund's financial position without requiring improved investment returns.

3) Pooling Resources with Other Funds

The operational costs of managing a pension fund also contribute to its financial strain. In 2015, running the CERN Pension Fund cost nearly CHF 5.5 million. While some of these costs are non-negotiable, particularly those related to staff, there is potential for cost-saving through pooling resources with other pension funds.

Proposal: CERN should consider collaborating with other funds to pool resources, particularly in areas such as investment management and data infrastructure. Pooling resources can lead to economies of scale, reducing operational costs while maintaining or even improving service levels. The success of similar initiatives in the UK, where pension funds have pooled resources to build joint data infrastructure, serves as a viable model for CERN.

Conclusion

These proposals offer a strategic pathway to improve the CERN Pension Fund's financial health by focusing on cost reduction, portfolio optimization, and resource pooling. If implemented, these measures could close a significant portion of the fund's shortfall, helping it move closer to a fully funded status without relying on unpredictable investment returns.