

Novartis Pension Funds



Annual Report 2018

Purpose and Organization

The *Novartis Pension Fund 1* with close to 28000 insured members and retirees and assets worth 12.8 billion francs is one of the largest autonomous pension organizations in Switzerland. It is joined by the *Novartis Pension Fund 2* with assets of 565.4 million francs.

As shown in the recently published annual reports for 2018, the Novartis Pension Funds are in a good shape to meet present and future challenges.

Not least among these are the changes resulting from the Alcon spin-off and the announced restructuring measures. Given the number of employees affected by these transactions, the Novartis Pension Funds will initiate a so-called partial liquidation in order to ensure equal treatment of the groups of leaving and remaining insured members. This means that not only the vested benefits but also a portion of the superannuation and fluctuation reserves will be transferred collectively to the new employers' pension funds, in due course.

The Novartis Pension Fund 2 – an innovative approach

Even the regulated field of occupational pensions in Switzerland has leeway for flexible solutions. Besides offering insured members ways of tailoring their pension to meet their needs, these solutions also require them to take more personal responsibility. One example is the option to select the investment strategy in the non-mandatory area of pension arrangements.

Novartis Pension Fund 2, for instance, shows how this approach can work in practice. Insured members can choose from five investment strategies with different risk profiles. A total of 2361 of the 5423 participants availed themselves of this option by the end of the reporting period. The overall performance amounted to –3.25 percent.

The Board of Trustees of the *Novartis Pension Fund 1* is made up equally of 7 employer's and 7 employees' representatives.

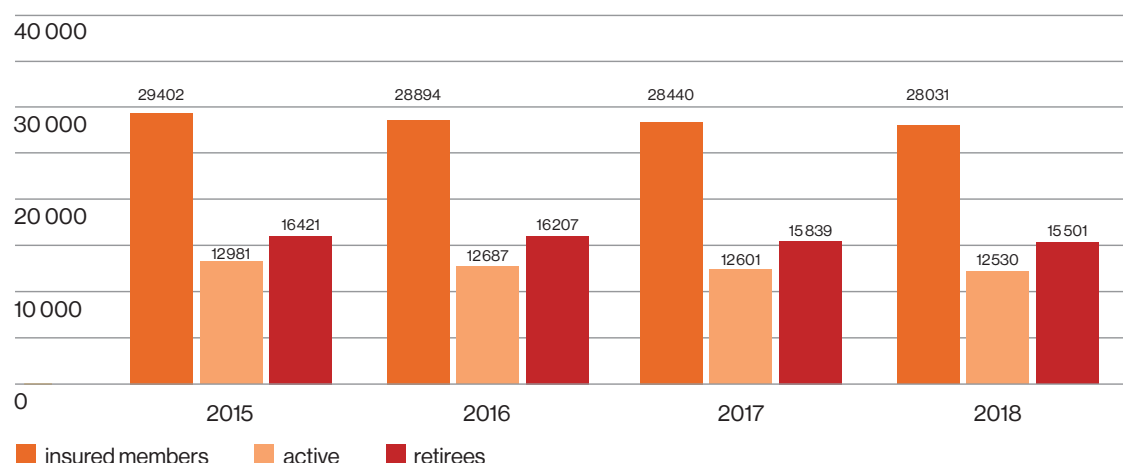
Organization Novartis Pension Fund 1 (as of December 31, 2018)

Board of Trustees (Period of office from January 1, 2017 until December 31, 2020)	Management Dr. Markus Moser, Managing Director Marco Armellini, Deputy Managing Director
Employer's Representatives Daniel Weiss (Chairperson) Dr. Thomas Boesch Bertrand Bugnon Isabelle Defond Felix Eichhorn Dr. Matthias Leuenberger Dr. Christian Rehm	Statutory Auditor PricewaterhouseCoopers AG, Basel
Employees' Representatives Claudio Campestrin (Deputy Chairperson) Simone Danner Thomas Fuchs Dr. Stefanie Katja Kniep Davide Lauditi Daniel Linder Brigitte Martig	Actuary Libera AG, Zurich
Retirees' Committee Erhard Eichenberger, Schönenbuch Gilbert Fahrni, Reinach Rudolf Haas, Basel	Statutory Inspectorate BVG- und Stiftungsaufsicht beider Basel (BSABB) Eisengasse 8, 4001 Basel

Statistical Data

Let us start with some statistical data on *Novartis Pension Fund 1* as reported in the actuarial statement: On 31 December 2018, there were 12530 (previous year: 12601) actively insured members compared with 15501 (previous year: 15839) retirees, of whom 9940 had reached retirement age, 381 were drawing a disability

pension, and 4786 were drawing a widow(er)'s pension. Orphans' and children's pensions accounted for a further 394 current pensions. The average current pension income amounted to 40577 (previous year: 40549) francs.



Annual Statement for 2018

The investment strategy is aimed at achieving long-term security for the benefits of the pension plans, taking into account the concrete asset-liability status of the Fund, i.e. its actual financial situation as well as

the structure and likely development of its insured membership. As a Pension Fund we have to be able to guarantee the fulfilment of our long-term obligations at any time.

Change in fund value for the current business:

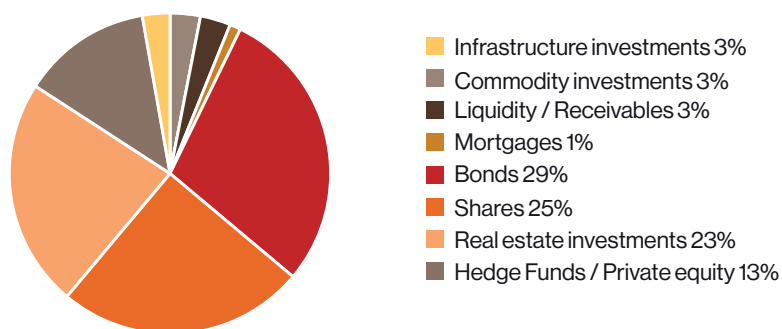
Income (CHF millions)	2018	2017
Employee contributions	114	112
Employer contributions	200	196
Joining fees and follow-up funding	121	176
Deposits on take-over of insured members	7	3
Earnings from investments	83	81
Realized gains from investments	521	59
Miscellaneous	0	-3
Total income	1046	624
Expenditure (CHF millions)	2018	2017
Pension payments	-650	-661
Lump-sum payments	-29	-23
Portable sums, home ownership payments	-142	-169
Administrative costs	-5	-4
Payables	-4	10
Total expenditure	-830	-847
Net cash flow	216	-223
Cumulative change in asset values	-1 041	
Change in fund value	-825	

Based on the result from cash flows (CHF 216 million) and taking into account the cumulative change in value of the assets (CHF -1041 million), the overall decrease in the Fund's value in 2018 amounted to CHF 825 million.

The following *Balance sheet* provides an overview of the assets of *Novartis Pension Fund 1* in terms of their market value.

Assets (CHF millions)	31.12.2018	31.12.2017
Liquidity deposits	438	514
Receivables	22	31
Bonds	3 762	4 040
Shares	3 213	3 686
Hedge funds and private equity	1 673	1 598
Infrastructure investments	407	414
Commodity investments	291	417
Mortgages	89	101
Real estate investments	2 934	2 826
Currency overlay	37	34
Collateral	-52	-22
Total assets	12 814	13 639
Obligations and deferrals	-38	-42
Net fund value	12 776	13 597

The composition of assets breaks down as follows:



Liabilities (CHF millions)*	31.12.2018	31.12.2017
Actuarial reserve and technical accruals	11 780	11 798
Fluctuation reserves	978	1 581
Free funds	18	218
Total liabilities	12 776	13 597

* Not including obligations and deferrals

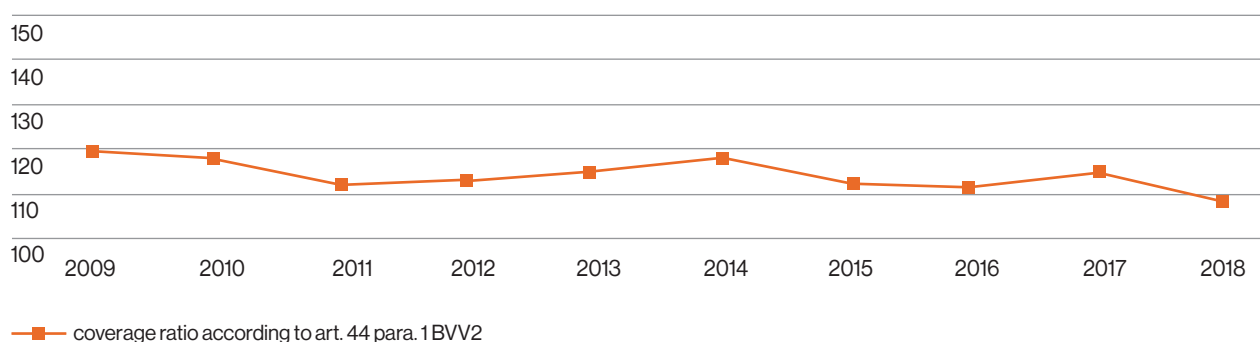
The assets are compared with the required *actuarial reserve* and technical accruals of 11 780 million francs as per 31 December 2018, calculated in accordance with recognized actuarial principles based on art. 53

para. 2 BVG. In addition to these liabilities, there are fluctuation reserves set aside for the market-specific risks associated with these assets so that the Pension Fund retains its ability to handle financial risk.

The *funding ratio* is computed as the ratio of tied assets to free assets. Based on the statutory method of declaration in accordance with art. 44 para. 1 BVV2, the funding ratio amounted to 108.5 percent. This means that the fluctuation reserves dropped below their target level and that the capacity of *Novartis Pension Fund 1* to manage financial risk is therefore restricted. At the same time, there are no further free funds available. Also reflected in the funding ratio are the

substantial increases of the actuarial reserves for pensions over the past years (most recently, by year-end 2017, the actuarial discount rate was adjusted to 2.0%) and the provisions set aside for financing compensation credits in the context of the conversion rate adjustments enacted in January 2016. With all these measures, due account was taken of the persistent low interest rate levels and the continuously rising life expectancy.

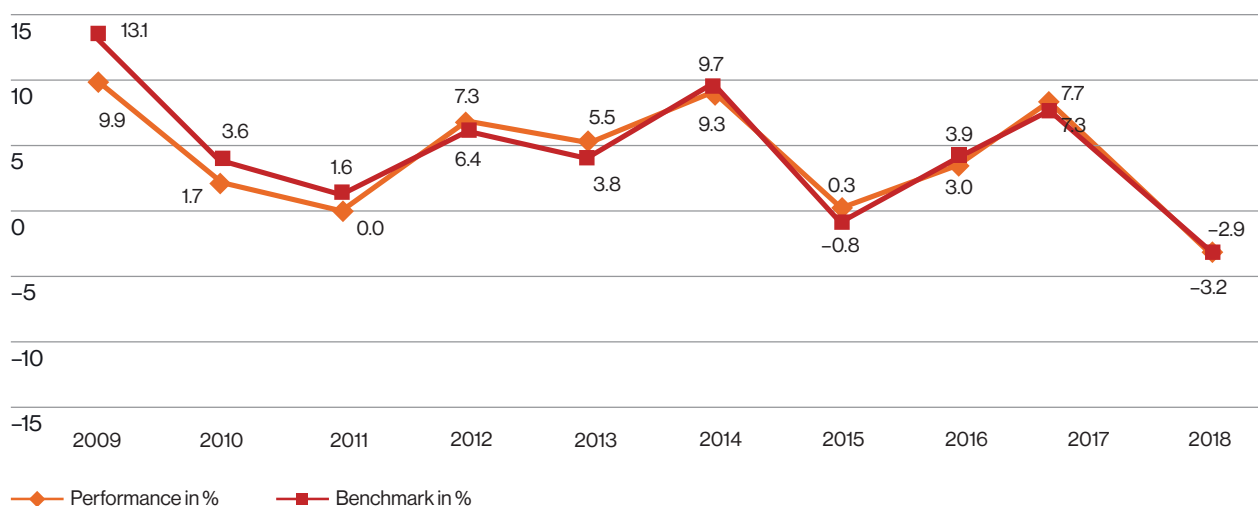
Development of Funding ratio 2009–2018, in %



Performance 2018

The fourth quarter 2018 was marked by uncertainty about global economic growth, geopolitical uncertainties and the fourth interest rate hike by the US Fed in the past year. The European Central Bank ended its bond purchase program at the end of the year. Instead of the hoped-for year-end rally, the losses on the stock markets that occurred towards the end of September continued to widen. Due to rising interest rates and low spreads on corporate bonds, bond investments remained under pressure.

Overall, with negative contributions from most asset classes with the exception of real estate, the YTD performance for *Pension Fund 1* was down –3.21%, lagging the benchmark (–2.93%) by 28 base points.



Would you like more information?

The detailed annual report for 2018 can be obtained from the Pension Fund Administration:

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Basel, March 2019

Markus Moser / Thierry Beck-Wissmann