INVESTMENT & PENSIONS EUROPE

Debate over discount rate for pensions divides experts

22 February 2013 **By Barbara Ottawa (URL=/barbara-ottawa/2482.bio)**

EUROPE – Pensions industry experts in Germany have criticised Towers Watson and Aon Hewitt's recent call for a European discount rate based on expected returns.

In a paper previewed exclusively by IPE, actuaries Alfred Gohdes of Towers Watson and Georg Thurnes of Aon Hewitt recently called on EIOPA to abandon its market-based discount rate idea (URL=http://www.ipe.com/news/towers-watson-aon-hewitt-urge-eiopa-to-drop-market-discount-rate_50184.php?s=thurnes#.UScKTLuaWBo) for a rate based on expected returns.

On Twitter, however, Laurens Swinkels, senior investment policy researcher at Norges Bank Investment Management, seemed shocked by the idea, adding that "actuaries are not economists".

Similarly, Falco Valkenburg, pensions committee chairman at Groupe Consultatif Actuariel Européen, argued that the discount rate was "not something that can just be prescribed, [or] be the same for all pension promises".

He called for a distinction between "almost DC-like" pension promises and those with guarantees, arguing that a discount rate based on expected return would only work for the former, while the latter would require a risk-free rate.

"I would suggest we stop talking about the discount rate in its isolation," he said. "First, we should know what we have to value."

Actuaries, he said, have "the duty to inform all stakeholders in an objective, non-biased way".

Meanwhile, Towers Watson published its latest estimates for funding levels at German corporate pension plans in its German Pension Finance Watch 2012.

Based on a 140-basis-point drop in the discount rate to 3.35% over the 12 months to 31 December 2012, funding levels for DAX-listed companies dropped by 770bps to just below 60% on average.

But the consultancy added that the discount rate had already gone back up to 3.7% in January 2013, "a first sign of a normalisation of the interest-rate environment".

The consultancy said it hoped this would improve the "challenging environment" pension funds have had to endure from mid-2012.

It also pointed out that the drop in the discount rate led to a hike in liabilities for DAX companies from €259bn to €317bn by year-end 2012, and that this could not be offset by returns of around 12%.

Thomas Jasper, head of the occupational pensions consultancy business, said: "The development of the funding level in 2012 illustrates very well how volatile the valuation is depending on the discount rate."