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Denmark's ATP pension switches to 15-year guarantee

By Editorial Staff *Thu, Aug 14, 2014*

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The Danish statutory pension fund ATP is shortening the length of its return guarantees on pension contributions to 15 years to increase its investment flexibility and therefore the potential pensions it pays out, IPE.com reported. The new regime starts January 2015.

ATP manages Denmark's workplace-based pension, which supplements the basic state pension. Contributions to the plan finance a lifetime income rather than a lump sum at retirement, with payments based on a guaranteed rate of return.

"The purpose of the current adjustment is to better safeguard the purchasing power of pensions, while taking the lower liquidity [of long-dated bonds] into account," said ATP chief executive Carsten Stendevad.

ATP took the step largely to decrease the interest-rate sensitivity for young members, he said. Today's 20-year-old plan members, for example, are highly dependent on the initial return guarantees they are given. All existing guarantees will remain unchanged, and the change will apply only to new contribution payments, affecting members born in 1964 or later, ATP said.

While current guarantees set a return for as long as 80 years, under the new system, each year's contribution will be guaranteed a certain return for 15 years, based on prevailing interest rates.

When this 15-year period ends, that year's contribution will be guaranteed a return for another 15 years, again set at the latest market interest rate, and so on until retirement.

From the participant's point of view, the guarantee will only increase, and never decrease, ATP said.

This is because the initial 15-year guarantee assumes a zero rate of return following that 15-year period, whereas in reality that portion of the pension will then grow at the rate set under a subsequent guarantee.

Under this new method, ATP members technically have a very low level of guaranteed lifelong pension income at the beginning, but are given a prognosis of the amount their eventual pension is expected to be under subsequent 15-year return guarantees.

By promising scheme members a rate of return on their contributions that is only fixed for 15 years at a time, ATP reasons it will be able to get higher returns with lower costs because it will have a wider variety of financial instruments to choose from to hedge those promises than is the case now. This is because liquidity at the long-end of the yield curve is much lower than it is around the 15-year mark.

"Giving a guarantee for 80 years forces us to the longest end of the curve where liquidity has been falling," Stendevad said. "Here, it gets us to the point of the curve where it's more liquid."

Apart from this, interest-rate derivatives, which are used for hedging, have become more expensive at longer maturities of 40 years, for example, and are expected to become still more costly in the future, according to ATP.

Stendevad said the most important aspect of the change was that it helped scheme members because it was more reflective of the actual level of interest rates over the years, while for ATP as an investor, the move provided more investment flexibility.

ATP said it would still hedge the new guarantees fully, but that the interest-rate sensitivity of these guarantees would be considerably lower than that of the current guarantees.

The change should be seen in the context of the new discount yield curve ATP implemented last autumn to value its existing pension liabilities, the pension fund said.

It said this had reduced the interest-rate sensitivity of existing guarantees by 25%.