Rates as low as 1% squeeze Northern European pensions

By Editor Test *Tue, Jul 10, 2012*

In Sweden, where 10-year rates fell to as low as 1.02% on June 6, the financial regulator has proposed a temporary floor on the discount used by pension insurance companies.

The Netherlands is moving to introduce a new discount rate methodology that it hopes will avert the benefit cuts that underfunded pensions in that country must enact by law at the end of this year if their solvency ratio does not improve.

The hope is that applying the Solvency II-inspired ultimate forward rate (UFR) will give funds the necessary boost, according to a report from *IPE.com*.

Denmark is also planning to introduce the UFR, which is based on long-term expectations of inflation and short-term rates. The Danish government announced it was in talks with the pension industry to help it manage the current difficulties. Danish 10-year yields dropped below 1% at the beginning of June before climbing to around 1.37% by 20 June.

In Sweden, where 10-year rates fell to as low as 1.02% on June 6, the financial regulator has proposed a temporary floor on the discount used by pension insurance companies. Institutional investors would otherwise have short-sold equities and other risk bearing assets, thus adding to the current financial woes, it was reported.

Yields in Sweden subsequently rose to about 1.4%. One pension insurer, the labor market provider AMF, said its solvency ratio was adequate.

These short-term measures are not expected to address the long-term structural problems that persistent low rates will cause for institutional pensions, however. As Japan’s experience has shown, ultra-low interest rates and volatile, range-bound equity markets can persist for many years.

In the Netherlands, the concern has already been raised that the UFR methodology may underestimate the long-term cost of the benefit entitlements of younger members – essentially just postponing a crisis with a temporary fix.

Lars Rohde, CEO of Denmark’s ATP, has said that funds, employers and employees must prepare for lower benefits as pension stakeholders deal with the higher contributions necessary to secure equal benefits in the future or lower benefits if current contribution levels are maintained.

With contributions already topping 20% of salary in the Netherlands, and UK pension sponsors facing an aggregate funding level of less than 75%, the cost of maintaining promised benefits is already a high burden for financially straitened members and sponsors alike.