longial
Die Pensionsberater

Determination of adequate discount rates for the valuation of post-employment benefit obligations according to IAS 19

According to IAS 19 the rate used to discount post-employment benefit obligations shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. The currency and term of the corporate bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations (IAS 19.83).

In practice, a reporting entity is allowed to apply a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid (IAS 19.85).

If there is no deep market in bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments, a reporting entity may extrapolate the yield of long-term bonds from the yield of short-term bonds along the yield curve (IAS 19.86).

Longial provides their clients regularly with recommendations for adequate discount rates via the website www.longial.de .

These recommendations are based on the market yield of European corporate bonds with a rating of AA, which are adequately interpolated form clustered index values. Zero coupon yield rates of high quality corporate bonds are derived from these market yields using bootstrapping techniques.

For long maturities these yield rates are extrapolated along the yield curve for European government bonds with a rating of AAA, which are published by the European Central Bank. A fixed spread between corporate and government bonds is applied within the extrapolation range.

Finally the yield curve for high quality corporate bonds gained by these techniques is applied to sample portfolios of post-employment benefit obligations to determine the appropriate weighted average discount rate according to IAS 19.85.

The sample portfolios used by Longial represent characteristical cash flows of corporate pension plans in Germany. We have confined ourselves to three sample portfolios: “Rentner”, representing a portfolio with a high portion of pensioners and a duration of about 10 years, “Mischbestand”, representing a well-balanced mix of aspirants and pensioners with an overall duration of about 15 years and “Anwärter”, representing a portfolio with a high portion of aspirants and a duration of about 20 years.

Normally the adequate discount rate for the valuation of a real portfolio will be located within the margins of these sample portfolios. However, in some case the adequate discount rate may also lie beyond these margins. For example, this may be the case for portfolios with significantly shorter or longer maturities or for lump-sum benefit promises.

Our consultants are at your service and will support you with the choice of the adequate discount rate for your specific portfolio of benefit obligations. If you have any questions, please do not hesitate to contact us.

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