Abstract

"Solvency II's Smith-Wilson method for discounting pension liabilities"

The Smith-Wilson method is a central element of the framework for fair valuation of liabilities under Solvency II. We describe and analyze this method and we compare it to financial theory's better known methodologies for constructing zero-coupon interest rate curves such as the family of Nelson-Siegel models. We find that the Smith-Wilson method has several weaknesses. The most critical of these is the externally specified ultimate forward rate (UFR) which leads to significant underestimation of pension liabilities.

Bio

Peter Løchte Jørgensen earned a cand.scient.oecon. degree from Aarhus University in 1991 and a PhD in Finance from Aarhus School of Business in 1994. He re-joined the ASB in 2006 as Professor of Finance and served as Head of the Finance Research Group until 2011 when the ASB was merged into AU´s Department of Economics. PLJ has taught a variety of finance courses on e.g. fixed income, investments, derivatives, and corporate valuation. His research interests are centered around asset and derivatives pricing theory. PLJ is also an experienced lecturer at the executive education level and has served as a consultant to numerous private companies.

Photo

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