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EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

EIOPA's 2017 OCCUPATIONAL PENSIONS STRESS TEST

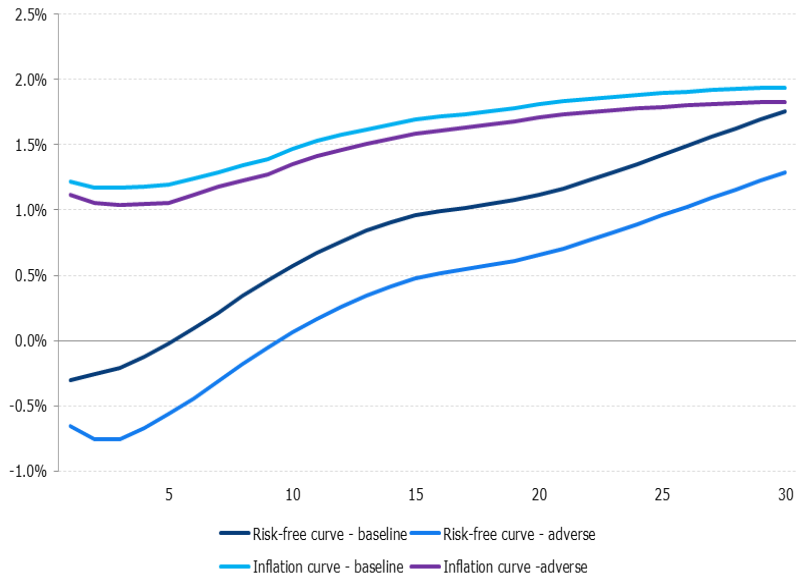
**Presentation of the stress test results at the press conference by
Gabriel Bernardino, Chairman, EIOPA – European Insurance and
Occupational Pensions Authority**

Frankfurt, 13 December 2017

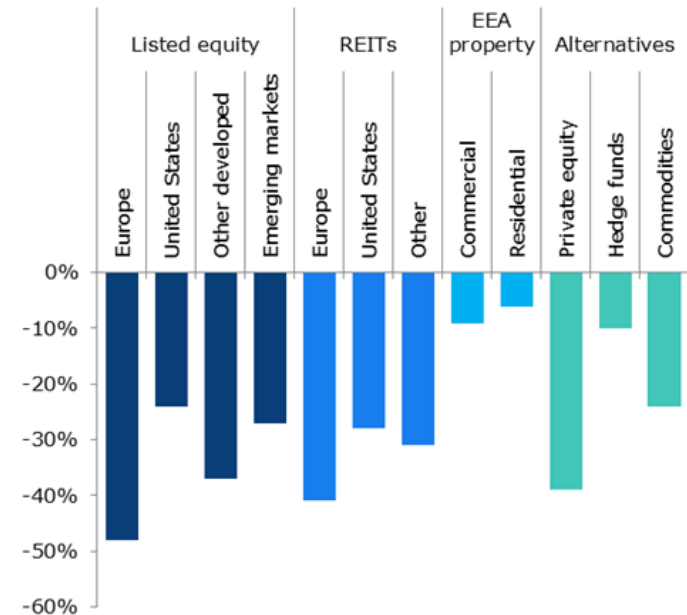
- To **assess resilience** of IORPs to an **adverse market scenario (“double hit”)**
 - National and common balance sheet for defined benefit (DB) and hybrid pension schemes
 - Market value of investment assets for defined contribution (DC) schemes
- To **assess the potential transfer of shocks from occupational pension funds to the real economy and financial markets**
- **Not a pass-or-fail exercise** for participating occupational pension funds

The adverse scenario triggered by a shock to European Union equity markets combines a drop in risk-free rates with a fall in asset prices - “double hit” – Reference date: 31 December 2016

Risk-free rate and inflation swap curve for the euro in the baseline and adverse market scenario, %

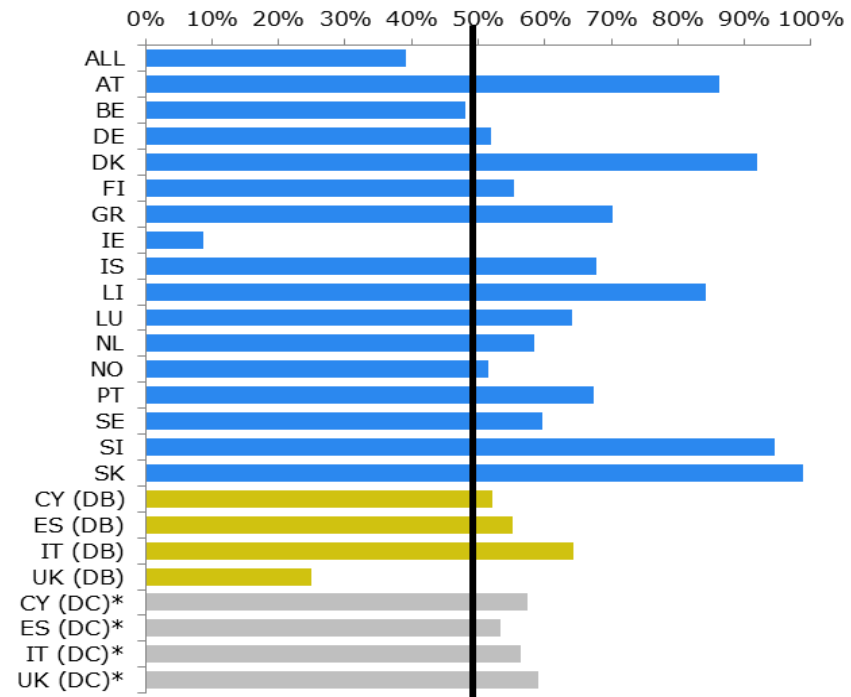


Changes in non-fixed income asset prices in adverse market scenario, %



PARTICIPATION

- **European Economic Area (EEA) countries with material IORPs sector** (over EUR 500 million in assets)
- **Target participation rates were not reached in some Members States** attributed to the lack of powers of the respective authorities to request participation in the exercise



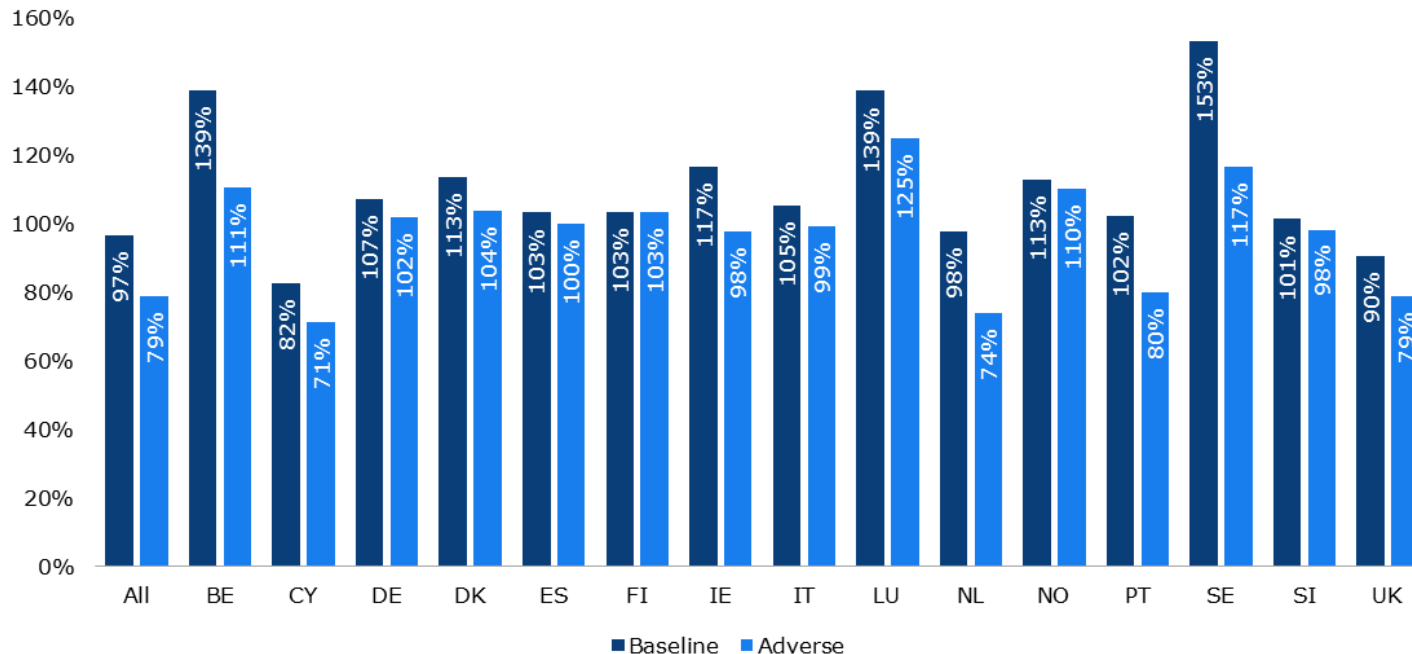
Note: Dark blue bars refer to total coverage in % of total assets both for DB and DC sectors. Light blue bars refer to coverage in % of total assets of the DB sector only. Grey bars refer to coverage in % to total members of the DC sector only.

DEFINED BENEFIT/HYBRID (I) NATIONAL BALANCE SHEET



Funding and valuation standards - highly heterogeneous among countries, on aggregate - insufficient assets to cover IORPs' liabilities - funding ratio decline from 97% in baseline to 79% in adverse scenario corresponding to 3%/21% deficit of excess of assets-over-liabilities (EUR 49bn/301bn)

Funding ratio in baseline and adverse market scenario, % liabilities

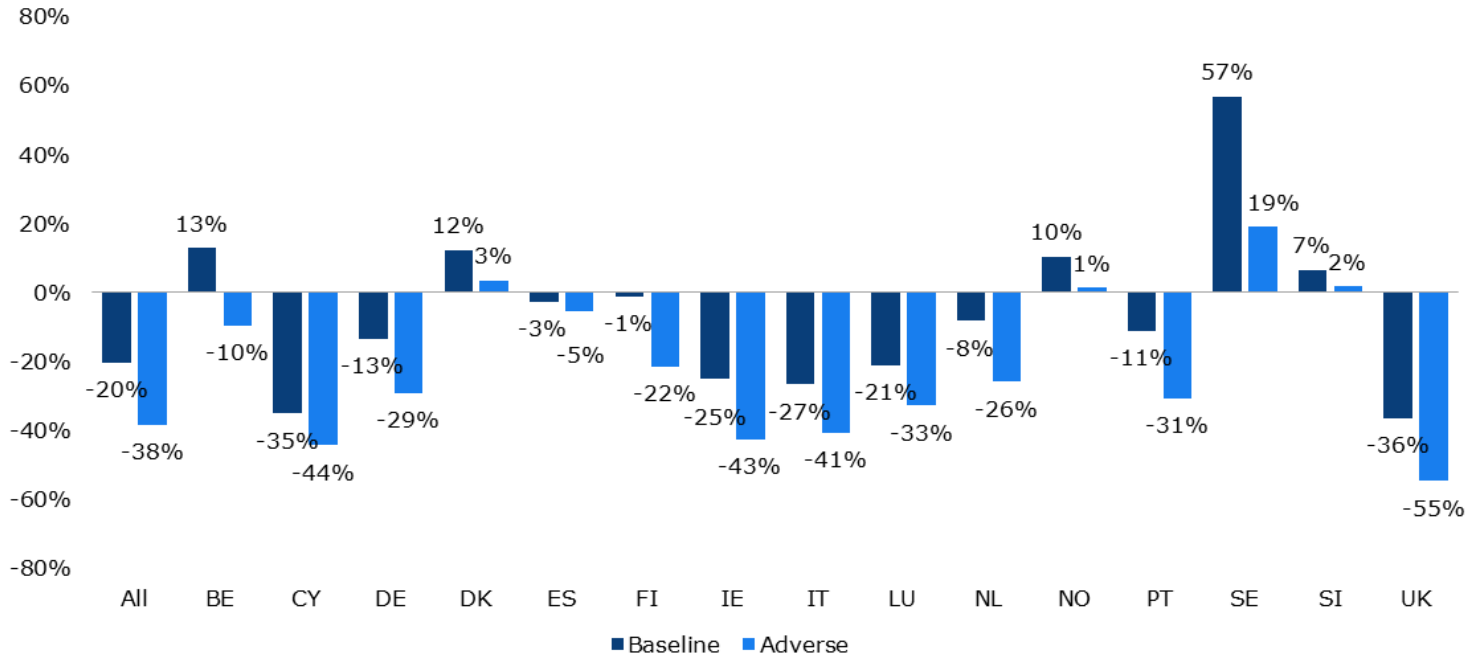


DEFINED BENEFIT/HYBRID (II) COMMON BALANCE SHEET



On aggregate, increase of deficit from 20% of liabilities in baseline (excluding sponsor support, pension protection schemes and benefit reductions) to 38% in the adverse scenario (EUR 349bn/702bn)

Excess of assets over liabilities (excl. sponsor support, pension protection schemes and benefit reductions) in baseline and adverse market scenario, % liabilities (excl. benefit reductions)



DEFINED BENEFIT/HYBRID (III) SPONSOR SUPPORT AND BENEFIT REDUCTIONS



The **deficit on the common balance sheet** needs to be covered by **sponsor support and benefit reductions**

	% liabilities		EUR billion	
	Baseline	Adverse	Baseline	Adverse
Deficit common balance sheet	20%	38%	349bn	702bn
- Sponsor support	17%	24%	287bn	445bn
- Benefit reductions	4%	14%	77bn	262bn

Notes:

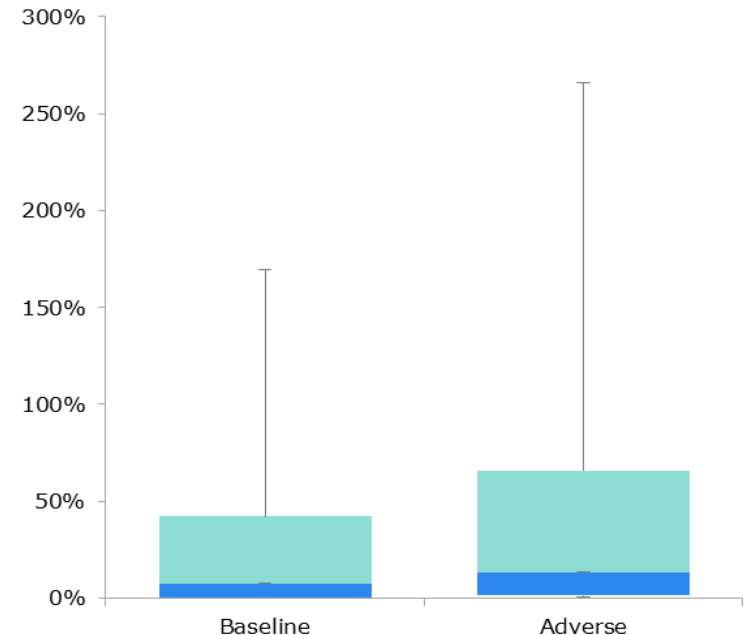
- The values of sponsor support and benefit reductions in the baseline scenario do not exactly add up to the deficit on the common balance sheet because the deficit (including sponsor support and benefit reductions) is not zero but rather a surplus of +1% of liabilities (EUR 15bn)
- The values of sponsor support and benefit reductions (in EUR bn) in the adverse scenario do not exactly add up to the deficit on the common balance sheet because the deficit (including security and benefit reduction mechanisms) is not zero but rather a slight surplus (EUR5 bn).

DEFINED BENEFIT/HYBRID (IV) IMPACT ON SPONSORS



- For **25%** of participating IORPs, the value of **sponsor support** on the common balance sheet **exceed 42% of the sponsors' market value in the baseline** and **66% in the adverse scenario**
- For **10%** of the sponsors, the value of the **support exceed even 169% in the baseline** and **266% in the adverse scenario**
- Figures suggest that a **significant number of sponsors are substantially impacted by their commitments to support the IORP, even under baseline scenario**

Distribution of sponsor support in the baseline and adverse market scenario, in % of market value of sponsor, all sponsors



DEFINED BENEFIT/HYBRID (V) DISTRIBUTION OF SPONSOR SUPPORT AND BENEFIT REDUCTIONS OVER TIME

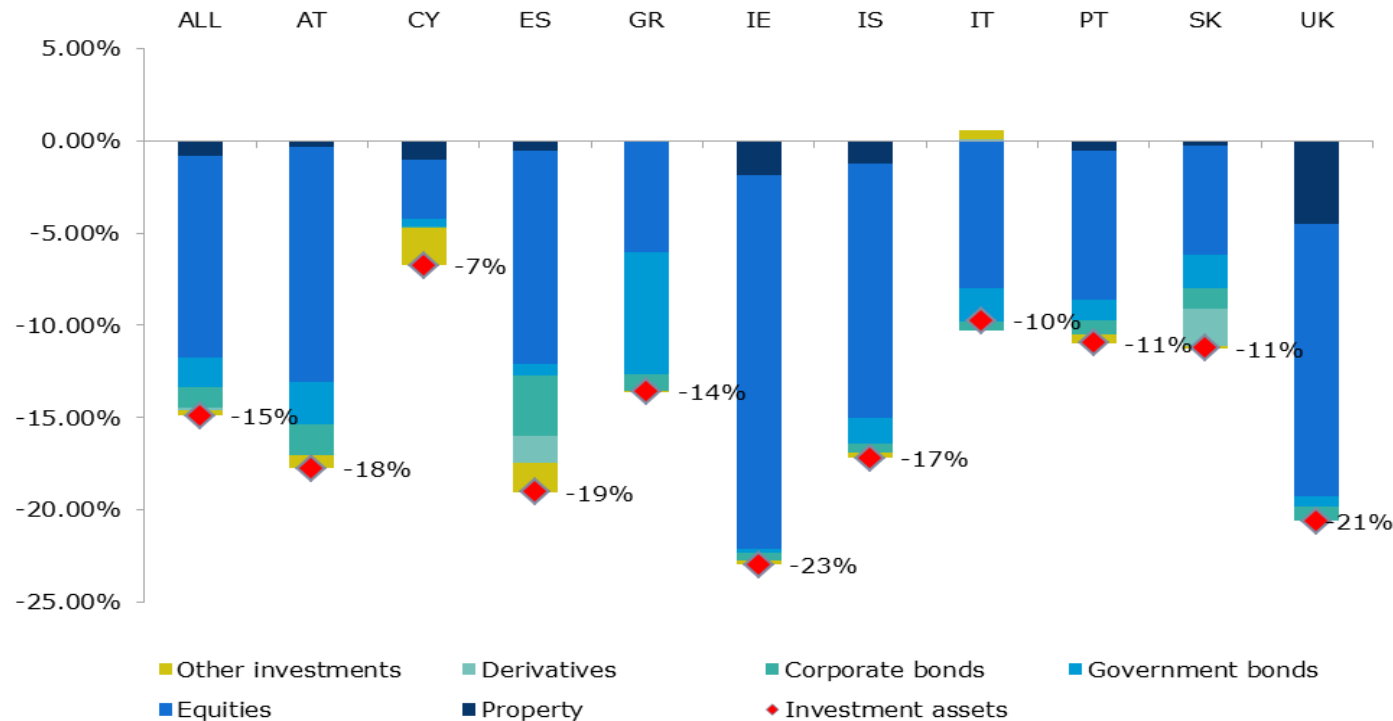


- **National prudential mechanisms** allow for spreading of sponsor support and benefit reductions over time
 - IORPs are often subject to **long-term recovery plans**, usually taking into account the future performance of investment assets
 - Many Member States use **high discount rates** – relative to the risk-free interest rate – **providing an optimistic view of the IORPs' financial position** and delaying recovery measures
- Mitigating tools contribute to **dampening the short-term effects on the real economy** and financial stability
- **Necessary adjustments to restore sustainability** of occupational pension schemes **fall disproportionately on younger generations**

DEFINED CONTRIBUTION (I) INVESTMENT ASSETS

Countries with IORPs that are more exposed to non-fixed income assets are more affected by the adverse scenario

Impact adverse market scenario on investment assets by country, %

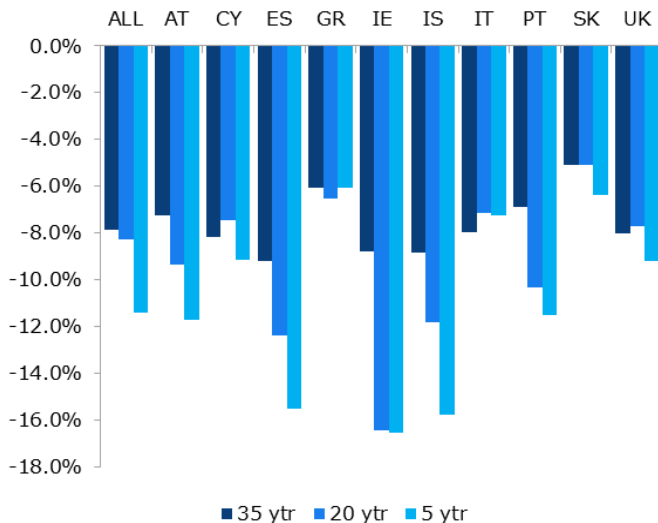


DEFINED CONTRIBUTION (II)

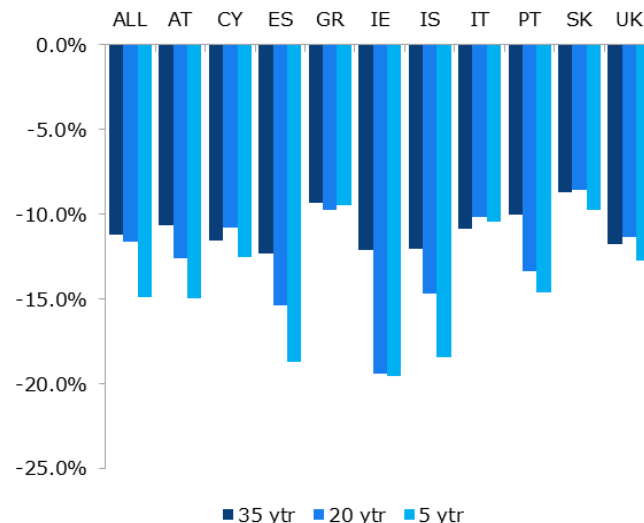
IMPACT OF ADVERSE SCENARIO ON REPLACEMENT RATES

- Stress scenario has a **more severe impact for older members closer to retirement** due to higher accumulated pension wealth
- The **impact on replacement rate is more severe** than the impact on accumulated assets at retirement

Impact of adverse market scenario on accumulated assets at retirement as a percentage of final wage of representative members by country, members weighted average, % change compared to baseline



Impact of adverse market scenario on replacement rate inflation-linked annuity of representative members by country, members weighted average, % change compared to baseline



MAIN FINDINGS (I)

IMPACT ON THE REAL ECONOMY



- Risks from the IORPs sector could **spill-over into the real economy** either through the adverse impact on sponsors or on beneficiaries through benefit reductions
- Pension liabilities of sponsors may be a **strain on the companies' future growth prospects** with possible **negative implications on economic growth and employment** levels
- On DC schemes the **short-term impact on the real economy** depends on whether members take into account lower projected retirement income in current consumption-saving decisions

MAIN FINDINGS (II)

IMPACT ON FINANCIAL MARKETS AND THE WAY FORWARD



- **Impact on Financial Markets**

Variety of responses from IORPs, both DB/hybrid and DC, to the adverse market scenario, **indicating absence of herd behaviour** in periods of stressed market conditions

- **Going forward**

- EIOPA to conduct a **horizontal assessment of potential risk drivers**, such as search for yield, flight to quality, herding behaviour
- **Environmental, social and governance (ESG) aspects** including climate change of **growing importance** for the pensions sector requiring **cautious assessment** of financial stability implications



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Thank you for your attention!

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