

# 2022 CLIMATE STRESS TEST ON IORPs

## FREQUENTLY ASKED QUESTIONS

### GOAL

#### What is an IORPs stress test?

A stress test is an important risk management and supervisory tool. It is used by financial institutions and supervisors to explore vulnerabilities and assess the resilience of financial institutions such as Institutions for Occupational Retirement Provision (IORPs).

Stress tests assess how well IORPs can cope with adverse shocks. They provide an indication of the impact and potential losses upon the materialization of variety of risks and help to indicate areas where further supervisory attention and actions are needed.

#### Is the 2022 Climate Stress Test on IORPs different compared to earlier stress tests?

Yes, 2022 IORPs Climate Stress Test is first European climate stress test done on IORPs. The purpose of this Climate Stress Test is to understand potential risk drivers and identify potential pockets of risk stemming from a disorderly transition to a greener economy.

Climate stress tests therefore in general differ from traditional market scenario stress tests. Compared to earlier stress tests, the risks are not characterized by a market downturn or a liquidity crisis. The climate change scenario is also not calibrated to a certain low probability of occurrence.

#### Is the EIOPA stress test a pass-or-fail exercise?

No, it is not a pass-or-fail exercise. The aim is to reveal risks and vulnerabilities and potential implications for the real economy and financial stability.

#### What was the stress test scenario of this exercise?

The 2022 IORP Climate Stress Test was testing the resilience of European IORPs against a climate change scenario. It reflects a sudden, disorderly transition to climate neutrality due to delayed policy action, which results in a sharp rise in carbon prices. The increase in carbon prices leads to a strong price increase in fossil fuels and therefore energy prices.

Conceptually, such cost-push shocks affect carbon dependent sectors more. The general economic outlook worsens, which also has an impact on financial markets. Equity markets fall, especially in carbon intensive sectors. Similarly, corporate credit spreads for brown industries rise sharply, mirroring the perceived difficulties of specific industries to decarbonise quickly or face rising emission permit costs. The cost of issuing sovereign debt also increases with yields rising across jurisdictions. A limited degree of uncertainty is also felt in real estate markets, where downward corrections are mild.

## What are the objectives of the exercise?

The stress test focuses on the impact on IORPs' investments, yet also addresses the effects on IORPs' financial situation, including the financing by sponsoring undertakings. Therefore, the climate change scenario is applied to the balance sheet - both national valuations and the common balance sheet. The scenario sets out sector-specific shocks that provide insights into the IORPs' investment portfolios, reflecting the corresponding impairment of the investments, broken down by the most relevant sectors and business activities.

The exercise also includes two specific questionnaires:

- first one is a follow up on the [ESG analysis of the 2019 IORP stress test](#) and
- second one is examining the potential effects of inflation on members' and beneficiaries' retirement income, focusing on the extent to which scheme characteristics and national frameworks provide for mitigating measures or adaptations to protect against inflation.

## DESIGN OF THE EXERCISE

### Why has EIOPA decided to do a climate stress test?

Sustainability and the management of environmental risks have become key considerations for long-term investors, like IORPs. EIOPA decided to carry out a climate stress test for European IORPs to gain insights into the vulnerability and sensitivity of IORPs to climate related risks.

### Which institutions assisted EIOPA in designing the stress test scenario?

The European Central Bank (ECB) and the European Systemic Risk Board (ESRB) developed in cooperation the narrative and the methodology and calibrated a climate scenario. The individual risk factors of the climate scenario are calibrated on the basis of scenarios developed by the Network for Greening the Financial System (NGFS).

### Which climate-related risks did the exercise cover?

The scenario explores risks stemming from the transition to a greener economy. It reflects a sudden, disorderly transition following delayed policy actions (the so-called delayed transition scenario). It does not take into account physical risk, as they wouldn't fully materialise in the covered period.

## SCOPE

### Which countries participated in the stress test?

IORPs from 18 Member States participated in the stress test: Austria, Belgium, Cyprus, Germany, Denmark, Spain, Finland, France, Ireland, Italy, Liechtenstein, Luxembourg, The Netherlands, Norway, Portugal, Sweden, Slovenia and Slovakia.

### What is the market coverage of the exercise?

The target sample defined by EIOPA (in cooperation with the national competent authorities) encompassed 187, registered in 18 European jurisdictions. The selected sample covered more than 65% of assets in defined benefit (DB) schemes and defined contribution schemes (DC).

## DISCLOSURE

### What information is being published?

As with the approach taken for the previous EIOPA IORPs stress tests, the 2022 IORP Climate Stress Test report only refers to aggregate results by the Member State from the European Economic Area. The report does not provide any individual IORP results but reflects the resilience of financial institutions at country level.

To ensure the confidentiality of the data of IORPs from Members States where fewer than three IORPs participated, the data from those countries were combined and aggregated in the geographical category 'Other'.

### What is the reference date for the climate stress test results?

The reference date is 31 December 2021. This means that all quantitative data and qualitative answers refer to this date.

### What are the main conclusions?

The stress test mainly focussed on the assets of IORPs. IORPs with DB schemes lose on average 12.9% of their assets and IORPs managing DC pension schemes around 10.1%. However, as liabilities were also affected by the rising interest rates, the impact on the financial position of DB IORPs was relatively limited.

Furthermore, as part of the follow up on the [ESG analysis of the 2019 IORP stress test](#), the exercise showed that more IORPs incorporate ESG factors into their decision-making policies than three years ago.

### What are the lessons learnt?

The 2022 Climate Stress Test on IORPs is the first climate stress test for IORPs in Europe. It provides useful results but also insights for future improvements.

For example, it appeared that results are dependent to a certain level on the granularity of the exercise. Results might, to a certain extent, differ if more granular data is being used.

Furthermore, the availability of data for such analyses is constantly evolving. The scenarios and methodology chosen in this report therefore reflect meaningful progress in terms of quantifying possible transition risks at European level. However, they should be seen as part of a learning process for supervisors and participants, rather than as definitive scenarios or necessarily the only or most suitable approach.

### Which institutions supported EIOPA in conducting the 2022 Climate Stress Test on IORPs?

The Climate Stress Test involved EIOPA, European Systemic Risk Board (ESRB), NCAs and individual IORPs. EIOPA coordinated the process with the involvement of the NCAs.

The NCAs selected and contacted the IORPs that participated in the exercise and IORPs performed the calculations and provided the data.

The NCAs were responsible for the local validation, whereas NCAs also participated in EIOPA's central validation of data.

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## LEARN MORE



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