



EIOPA publishes the results of the 2019 Occupational Pensions Stress Test

NEWS
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Adverse scenario would wipe off almost one quarter of the investment assets' values in the sample, totalling EUR 270 billion

- Market risks under the adverse scenario would lead to substantial benefit reductions and increase of sponsor support
- Extended cash flow analysis shows timing of expected impact is high in the first years on sponsors, while the effects of benefit reductions would drag on for decades should the short-term effects become permanent
- First European analytical element on sustainability risks sheds light on the current management and consideration of ESG factors in the IORP sector: indicates high carbon footprint, relative to EU economy, in the sample's equity investments
- Majority of IORPs indicate consideration of ESG factors, yet less than 20% of the IORPs in the sample currently assess the impact of ESG factors on risks and return

Today, the European Insurance and Occupational Pensions Authority (EIOPA) published the results of its 2019 Institutions for Occupational Retirement Provisions (IORPs) Stress Test. This is a crucial, biennial exercise to assess the resilience and potential vulnerabilities of the European Defined Benefit (DB) and Defined Contribution (DC) pension sector, tailored to the specificities of the diverse European pension sector and its potential impact on financial stability. For the first time, this European stress test exercise covered the analysis of Environmental, Social and Governance (ESG) factors for IORPs.

In its 2019 exercise, EIOPA applied an adverse market scenario, characterised by a sudden reassessment of risk premia and shocks to interest rates on short maturities, resulting in increased yields and widening of credit spreads. That adverse market scenario was applied to the end-2018 'baseline' balance sheet of a representative sample of European Economic Area (EEA) IORPs. In the baseline, those IORPs were underfunded by EUR 41 billion on aggregate, which translates into 4% of their liabilities, according to the common methodology.

The adverse market scenario would have led to substantial aggregate shortfalls of EUR 180 billion according to national methodologies and EUR 216 billion following the stress test's common methodology. Under the assumptions of the common methodology, the shortfalls in the adverse scenario would have triggered aggregate benefit reductions of EUR 173 billion and sponsoring undertakings would have to provide financial support of EUR 49 billion. In the 2019 exercise, EIOPA employed an extended cash flow analysis, which provided important insights into the stress effects in terms of timing: IORPs' financial situation would be heavily affected in the short term, leading to substantial strains on sponsoring undertakings within a few years after the shock and resulting in potential long-term effects on the retirement income of members and beneficiaries over decades (should the short-term effects become permanent).

Assessing the potential conjoint investment behaviours of IORPs after the stress event, EIOPA observed an expected tendency to re-balance to pre-stress investment allocations within 12 months after the shock. That may indicate counter-cyclical aspects of the expected investment behaviour, yet would also come at a risk.

The majority of IORPs in the sample indicated having taken appropriate steps to identify sustainability factors and ESG risks for their investment decisions, which is important for an effective implementation of the IORP II Directive, yet only 30% of them have processes in place to manage ESG risks. Further, only 19% of the IORPs in the sample assess the impact of ESG factors on investments' risk and returns. The preparedness of IORPs to integrate sustainability factors is widely dispersed and seems correlated to how advanced national frameworks were.

Matching the participating IORPs' investment information with Eurostat's greenhouse gas emission statistics by business sectors, indicates a relatively high carbon footprint, compared to the average EU economy, of the equity investments and, concentrated in a few Member States, of the debt investments.

In total, 19 countries participated in the exercise, covering more than 60% of the national DB and 50% of the national DC sectors in terms of assets – in most countries. In total 176 IORPs participated, thereof 99 DB IORPs and 77 DC IORPs.

EIOPA will follow-up on the findings and analyse in more depth the investment behaviour of IORPs, in particular in the persistently ultra-low and negative interest rate environment. To do so, EIOPA will make use of the significantly improved pension reporting from 2020. Going forward, EIOPA wants to further improve its analytical tool set for stress testing IORPs, extending the horizontal approach and with that assessing the common exposures and vulnerabilities of the DB and DC sectors together.

Gabriel Bernardino, Chairman of EIOPA, said: 'Long-term obligations and long investment horizons arguably require IORPs to consider ESG factors and enable IORPs to sustain short-term volatility and market downturns for longer periods than other financial institutions.'

The supervisory monitoring and the applied supervisory tools need to be capable of detecting adverse market trends and market developments that can have long-term negative effects.'