Press Release

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EIOPA'S STRESS TEST IDENTIFIES SPILL-OVER RISKS INTO THE REAL ECONOMY FROM SHOCKS TO THE EUROPEAN OCCUPATIONAL PENSIONS SECTOR

- *European Institutions for Occupational Retirement Provision (IORPs) providing defined benefits and hybrid pension schemes have, in aggregate, insufficient assets to cover their liabilities*
- *Sponsors of over a quarter of IORPs might face challenges meeting their obligations*
- *Vulnerabilities could spill-over to the real economy either through the adverse impact on sponsors and/or on beneficiaries through benefit reductions*
- *Recovery mechanisms mitigate the short-term effects on financial stability, but in the longer-term put the burden of restoring the sustainability of pension promises disproportionately on younger generations*

Frankfurt, 13 December 2017 – Today, the European Insurance and Occupational Pensions Authority (EIOPA) published the results of its 2017 Occupational Pensions Stress Test. This year's exercise assessed the resilience of Institutions for Occupational Retirement Provision (IORPs) to a "double-hit" scenario, combining a drop in risk-free interest rates with a fall in the price of assets held by IORPs. The exercise also assessed the potential transfer of shocks from IORPs to the real economy and financial stability through sponsor support and benefit reductions. The stress test is not a pass-or-fail exercise for the participating IORPs.

The stress test covered defined benefit (DB) and hybrid as well as defined contribution (DC) schemes. Overall, 195 IORPs from twenty member states of the European Economic Area (EEA) participated in the exercise, representing a coverage rate of 39% of total assets. EIOPA's target coverage rate of 50% was not reached in some Member States due to the lack of power of the respective national competent authority to require participation in the exercise. Such inadequate supervisory powers constitute an additional risk because relevant authorities are not able to assess vulnerabilities during adverse market conditions.

The European DB and hybrid occupational pension sector has, on average, insufficient assets to meet pension liabilities on the national balance sheet, both in the baseline and adverse market scenario. These vulnerabilities are even more pronounced on the common, market-consistent balance sheet, providing a more comparable and realistic view of the financial position of the IORPs. The shortfalls on the common balance sheet - EUR 349 billion in the baseline and EUR 702 billion in the adverse scenario - would need to be covered by increased sponsor support and/or by benefit reductions. The DC occupational pension sector would experience a drop of 15 % in the market value of investment assets in the adverse scenario, reducing the individual accounts of DC pension scheme members and, in case the scenario persists, leading to lower pension income when the members enter retirement.

More than a quarter of IORPs providing DB and hybrid schemes are covered by a sponsor that may not be able to (fully) support the pension promise following the adverse scenario. In addition, the stress test results show that pension obligations may exert substantial pressure on the solvency and future profitability of companies with a potential spill-over to the real economy. In particular, for 25% of participating IORPs the value of sponsor support on the common balance sheet exceeded 42% of the sponsors' market value under the pre-stress and 66% under the adverse scenario. Benefit reductions have similar negative effects on the real economy by reducing household income and consumption, but also resulting in lack of trust in the pensions system.

National recovery mechanisms do allow sponsor support and benefit reductions to be spread over substantial timeframes. IORPs in financial difficulties are usually subject to long-term recovery plans. Moreover, high discount rates – relative to risk-free interest rates – provide an optimistic view of the funding situation of IORPs and act to delay recovery plan measures. Such prudential mechanisms may contribute to mitigating the short-term spill-over effects to the real economy and financial stability. However, in case the necessary adjustments are postponed too far, restoring the sustainability of IORPs can only be achieved by putting a disproportionate burden on the younger generations.

Gabriel Bernardino, Chairman of EIOPA, said: *"The stress test results show that the risks stemming from shocks on the European IORPs sector could also spill-over into the real economy with negative implications on economic growth and employment triggered by increased sponsor support or benefit reductions. To gain further insights and to deepen supervisory understanding EIOPA will conduct a horizontal assessment of potential systemic risk drivers such as search for yield, flight to quality or herding behaviour. Environmental, social and governance (ESG) aspects including climate change will be of growing importance for the pensions sector and will require cautious assessment of any financial stability implications. Younger generations should not suffer and carry a disproportionate burden because of today's complacency and lack of required actions."*

The Report of the results of EIOPA's 2017 Occupational Pensions Stress Test is available via EIOPA's Website.

Notes for Editors:

The **European Insurance and Occupational Pensions Authority (EIOPA)** was established on 1 January 2011 as a result of the reforms to the structure of supervision of the financial sector in the European Union. EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union. EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

Institutions for Occupational Retirement Provision (IORPs) are pension institutions with a social purpose that provide financial services, operating occupational pension schemes for employers in order to provide retirement benefits to their employees.

Defined Benefit (DB) pension scheme is a retirement plan that guarantees a specific retirement benefit amount for each scheme member.

Defined Contribution (DC) pension scheme is a retirement plan in which all risks are borne directly by individual plan members.

Hybrid pension scheme contains elements of both DB and DC retirement plans.

The **baseline scenario** corresponds to the situation of defined benefit/hybrid and defined contribution occupational pension schemes under the macro-financial environment at the reference date of end 2016. The baseline scenario serves as a benchmark against which to measure the impact of the **adverse market scenario**, referred to as "double-hit" scenario, combining a drop in risk-free interest rates with a fall in the price of assets held by Institutions for Occupational Retirement Provision (IORPs).

Stress test coverage: The EIOPA 2017 Occupational Pensions Stress Test includes all countries in the European Economic Area (EEA) with IORP sectors exceeding EUR 500 million in assets. As a consequence, 19 countries (Austria, Belgium, Cyprus, Germany, Denmark, Spain, Finland, Greece, Ireland, Italy, Liechtenstein, Luxemburg, the Netherlands, Norway, Portugal, Sweden, Slovenia, Slovakia and the United Kingdom) took part in the exercise, while Iceland participated on a voluntary basis in the DC part of the stress test.

EIOPA's target participation rates were not reached in Ireland and the United Kingdom with respect to the DB sector, due to the lack of powers of the relevant authorities to require participation in the exercise.