2022 CLIMATE STRESS TEST ON IORPs

In its first climate stress test, EIOPA assessed the exposure of the European IORP (Institutions for Occupational Retirement Provisions) sector to environmental risks. Unlike traditional stress tests that typically examine the impact of low-probability shocks, the scenario for this exercise simulated a sudden, disorderly transition to a green economy that results from the delayed implementation of climate policy measures.

For the sake of a broader view, EIOPA adopted a full balance sheet approach and calculated the impact of the adverse scenario not only on IORPs’ asset portfolios but also on their long-term liabilities.

While the stress test is not a pass or fail exercise, findings indicate that IORPs have a material exposure to transition risks.

KEY ELEMENTS

OBJECTIVES

> assess the sector’s vulnerability to transition risks as part of a learning exercise in an emerging field
> better understand potential risk drivers and identify pockets of risks
> complement quantitative analysis with qualitative surveys on ESG factors and inflation management

SCENARIO

> abrupt, disorderly transition to a less carbon-intensive economy following delayed policy action
> instantaneous economic shock triggered by a sharp increase in the price of carbon emissions
> developed in cooperation with the ESRB and the ECB based on previous work by NGFS

APPROACH

national balance sheet (NBS): based on national valuation regulation AND common balance sheet (CBS): marked-to-market to allow for meaningful comparisons investments related to carbon intensive industries

SCOPE

187 IORPs from 18 countries covering all European Economic Area (EEA) countries with significant IORP sectors

1.98 trillion € in assets = 65.3% market coverage in EEA based on total assets
IMPACT ON ASSETS ACCORDING TO COMMON METHODOLOGY

The first climate stress of the sector at a European level shows that IORPs have a material exposure to transition risks.

The stress test scenario provoked a sizeable overall drop of 12.9% in assets, corresponding to asset valuation losses of some €255 billion.

A drop in liabilities due to rising risk-free rates helped cushion the impact of asset-side losses on IORPs’ funding ratio, but it did not fully offset it. Financial positions therefore still worsened slightly (-2.9 percentage points).

Post-shock funding ratios in defined benefit (DB) schemes stay above 100% in most Member States due, in part, to strong pre-shock positions. The funded status of defined contribution (DC) schemes is balanced by definition.

More than 90% of IORPs consider ESG factors when determining their investment policy. Nonetheless, IORPs still experience hurdles in allocating investments to climate risk-sensitive categories.

MAIN FINDINGS BASED ON COMMON METHODOLOGY

RESULTS

<table>
<thead>
<tr>
<th>IMPACT OF CLIMATE CHANGE SCENARIO</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PRE-STRESS</strong></td>
</tr>
<tr>
<td>TOTAL ASSETS - CBS</td>
</tr>
<tr>
<td>FUNDING RATIO* - CBS</td>
</tr>
<tr>
<td>FUNDING RATIO* - NBS</td>
</tr>
</tbody>
</table>

*defined benefit schemes

LEARN MORE


© EIOPA, 2022
Reproduction is authorised provided the source is acknowledged. For any use or reproduction of photos or other material that is not under the copyright of EIOPA, permission must be sought directly from the copyright holders.