



First EIOPA Stress Test for Occupational Pensions

1. What is a stress test?

Stress test is an important risk management tool. It is used by financial institutions as well as micro- and macro-prudential supervisors to explore vulnerabilities and assess the resilience of financial institutions (e.g. Institutions for Occupational Retirement Provision, IORPs) and the whole systems (e.g. the occupational pensions sector) to severe but plausible shocks. Stress tests assess adverse outcomes under a variety of risks. They provide an indication of the capacity to absorb losses on materialization of these risks, and help to indicate areas where further supervisory actions are needed.

2. What are the objectives of the first EIOPA Stress Test for Occupational Pensions?

The objectives of the stress test were to produce a comprehensive picture of the heterogeneous European occupational pensions landscape; to test resilience of defined benefits (DB) and hybrid pension schemes against adverse market scenarios and increased life expectancy; to identify potential vulnerabilities of defined contribution (DC) schemes; and to reveal areas that require further supervisory focus.

3. Which countries participated in the exercise and what is its market coverage?

EIOPA's aim was to cover all the European Economic Area (EEA) countries with the material IORP sector, which is over EUR 500 million in assets. This aim has been achieved.

17 European Economic Area countries participated in the stress test: Austria, Belgium, Cyprus, Germany, Denmark, Iceland, Ireland, Italy, Luxembourg, the

Netherlands, Norway, Portugal, Slovakia, Slovenia, Spain, Sweden and the United Kingdom. Iceland volunteered to participate while Finland abstained due to minor importance of its IORP market compared to its state pension system.

More precisely in the DB/Hybrid module the following countries participated: Belgium, Cyprus, Germany, Denmark, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

The following countries took part in the DC Satellite module: Austria, Cyprus, Iceland, Italy, the Netherlands, Portugal, Slovakia, Spain and the United Kingdom. The target coverage rate was to reach at least 50% of assets of the total IORP sector per country for Defined Benefit (DB)/hybrid IORPs and at least 50% of members for Defined Contribution (DC) IORPs. For the majority of countries participating in the stress test exercise, the market coverage over 50 % in terms of total assets was achieved. The overall coverage rate (DB/Hybrid/DC) amounted to 43 % of assets, which is very satisfactory for the first IORP stress test.

4. What does the Stress Test for Occupational Pensions 2015 consist of?

The exercise consists of the module for Defined Benefit (DB) and hybrid schemes and a satellite Defined Contribution (DC) module.

The DB/hybrid module analyses the resilience of IORPs against the following shocks: Two adverse market scenarios

- ✓ **Adverse market scenario 1** – drop in assets prices (more severe than in scenario 2) and a decrease in interest rates and a decrease in inflation rates
- ✓ **Adverse market scenario 2** – drop in asset prices, drop in interest rates (more severe than in scenario 1) and an increase in inflation rates

and one increased longevity scenario.

The satellite DC module tests the resilience of income of three representative plan members that have 35, 20 and 5 years before the expected retirement date. Their income is stressed against two asset price shock scenarios (identical to adverse market scenarios 1 and 2 for DB/Hybrid schemes), two low return scenarios and one increased longevity scenario (identical to longevity scenario for DB/Hybrid schemes).

5. What is the assessment basis of the stress test?

This assessment was based on the National Balance Sheet (NBS) as well as on a Common Methodology.

The NBS assessment is characterised by a high degree of heterogeneity among countries. Valuation methods for the NBS are country specific, being based for assets either on market or book values and for liabilities on discount rates varying between risk-free rates and expected returns on assets. Also different national funding requirements coexist as well as different prudential mechanisms are in place to deal with the funding deficits.

In order to make the stress test results more comparable, EIOPA developed a Common Methodology where harmonised (market-consistent) valuation methods are used. This is particularly relevant for liabilities as the Common Methodology uses realistic assumptions and market risk-free rate for discounting.

The Common Methodology reflects future developments by including different security and benefit adjustment mechanisms. Therefore, the gaps revealed under stress scenarios are to be fully covered by sponsor's support, pension protection schemes and benefit reductions.

6. Which institutions supported EIOPA in conducting the exercise?

The stress test and the satellite module represent a cooperative effort involving IORPs, National Competent Authorities (NCA), EIOPA and the European Systemic Risk Board (ESRB).

The market adverse scenarios for the DB/Hybrid stress test have been developed in close cooperation with the ESRB.

The NCAs identified and contacted prospective participants in the test.

After the launch of the exercise, EIOPA organised a workshop with its participants and in May – August 2015, conducted a Q&A procedure in order to support the participating IORPs in completing the exercise.

7. What is the reference time for the Stress Test for Occupational Pensions 2015?

31 December 2014.

8. Why does the pensions sector need EIOPA's Common Methodology (known as Holistic Balance Sheet concept)?

The European pensions' landscape is highly heterogeneous. In different Member States IORPs play different roles while national competent authorities use different prudential mechanisms for the pension supervision. The common framework developed by EIOPA is suitable to be implemented at the EU level because it takes into account all such differences in particular by including all the existing security and benefit adjustment mechanisms.

Furthermore, the Common Methodology strives for realistic approach towards assets and especially towards pension liabilities by introducing a market-consistent balance sheet. It also allows for more transparency on the sponsor's support, pension protection schemes and on the possible adjustment of benefits.

9. What are the benefits of the exercise?

The European Union occupational pensions' sector will increase risk awareness about sustainability of DB/hybrid pension schemes and about resilience of DC plan designs.

Supervisors will increase their understanding of the risks with regard to the sustainability of different pension schemes as a consequence of the common, transparent risk sensitive methodologies used in the exercise.

Supervisors and IORPs will acquire experience and insight into the operation of a market-consistent valuation framework.

10. Will the results for the individual pension schemes be published?

No, while conducting its stress tests EIOPA is always looking at the pensions sector from the European perspective.

11. Some countries and even individual IORPs are voicing concerns and criticism of this exercise and its credibility. What is EIOPA's answer to such criticism?

As part of its mandate for contributing to and safeguarding financial stability EIOPA has to carry out regular stress tests in order to assess the resilience of financial institutions to adverse market developments and potential systemic

risks. The sound management of pension schemes is crucial to safeguard financial stability and ensure the adequate pension level for the European citizens.

12. What will be the focus of the second stress test for occupational pensions?

EIOPA will continue to work on its Common Methodology and to further analyse how prolonged adverse market conditions can affect the sponsors' behaviour and the possible consequences for financial stability and the real economy.

13. Will EIOPA's Common Methodology developed for this stress test have an impact on the review of the IORP II Directive?

No, the occupational pensions stress test is part of EIOPA's regular task to initiate and coordinate European stress tests to assess the resilience of financial institutions to adverse market developments. To that end, EIOPA has to develop a Common Methodology to ensure comparable outcomes between Member States.

EIOPA's Common Methodology is applied for the stress test purposes and is out of scope of the current IORP II discussions.