14 December 2017

Press release

EIOPA draws too strong conclusions from the IORP Stress Tests

European Insurance and Occupational Pensions Authority (EIOPA) published the results of 2017 IORP (Institutions for occupational retirement provision) stress test on 13 December 2017. 195 IORPs from 20 countries participated in this second Europe-wide IORP stress test whose objective was to assess the resilience of IORPs to an adverse market scenario, and to analyze the second-round effects on the real economy and financial markets. PensionsEurope is not surprised by the outcomes.

EIOPA makes very strong allegations about the healthiness of IORPs based on its own theoretical model that has not been adopted by the EU or any member state. The actual prudential rules that are in place at national level don't support EIOPA's findings. The differences in findings highlight how EIOPA's model is not fit for purpose. EIOPA's model gives only a snap-shot picture of liabilities and values them based on risk free market rates which at the moment mean that the assets of pension fund funds would yield almost no return. In reality pension funds invest in the real economy, in growth and riskier assets and have in the short and long term had much better returns than what risk free interest rates provide. This means that their ability to manage their liabilities is much better than what EIOPA concludes.

Janwillem Bouma, Chair of PensionsEurope, said:

"The assets of the European IORPs providing DB/hybrid schemes exceed liabilities in most countries. The excess of assets over liabilities of -3% of liabilities is not a serious European problem and it does not contain serious spill-over risks into the real economy, as IORPs that do not meet the national funding requirement usually have to draw up a recovery plan to be approved by the national supervisory authority."

"A possibility to draw conclusions on the impact on sponsors is very limited, as the stress test sample and provided answers were also very limited. However, the aggregated data on sponsors show that the values of the liability towards the IORP are rather small and barely visible. The indirect impact of the adverse scenario on the average sponsor is relatively modest. Finally, I would like to stress that it is not a role of EIOPA to supervise the sponsors."

"The results confirm IORPs' countercyclical behavior and important role in stabilizing financial markets. As long-term investors, IORPs are able to mitigate financial shocks and work as stabilizing factor for the financial sector. IORPs' long-term investment horizon and their ability to follow contrarian investment strategies support the proposition that IORPs can act as shock absorbers in the economy by providing liquidity and by not being forced to sell assets when asset prices are squeezed. The results confirm that IORPs have buy-and-hold asset strategies. It is important that legislation continues to allow IORPs' countercyclical behavior."

Matti Leppälä, Secretary General/CEO of PensionsEurope, said:

"EIOPA's own methodology is not fit for purpose and it would be much more useful to use a cash flow analysis instead. This means looking at how much money goes out, how much comes in, is there a problem, when and how can the IORP deal with it? Market capitalisation of the sponsor company does not give any meaningful information about the possible pension problems. EIOPA's report itself doesn't support the conclusion that over a quarter of IORPs might face challenges meeting their obligations, but regardless EIOPA aims to raise unnecessary concerns about the health of the sponsor companies. Even the actual results presented in the report don't support the strong allegation published in EIOPA's press release."

PensionsEurope will now carefully read EIOPA's publication, and in February/March 2018 aims to provide a position paper on EIOPA IORP stress test 2017, which will also contain PensionsEurope further proposals on cash flow analysis.

Below are some first comments about the four main conclusions of EIOPA.

1. *European Institutions for Occupational Retirement Provision (IORPs) providing defined benefits and hybrid pension schemes have, in aggregate, insufficient assets to cover their liabilities*

- **According to the national balance sheet, the assets of the European IORPs providing DB/hybrid schemes exceed liabilities in <u>most</u> countries.** For instance, Belgium, Luxembourg and Sweden stand out with aggregate assets ranging from 139% to 153% of liabilities.
- **According to the aggregated results, the funding ratio of all IORPs included in the sample amounts to 97%. This excess of assets over liabilities of -3% of liabilities (or EUR -49 bn) is <u>not</u> a serious European problem and it does <u>not</u> contain serious spill-over risks into the real economy, as IORPs that do not meet the national funding requirement usually have to draw up a recovery plan to be approved by the NSA.** The recovery plan outlines how compliance with the funding requirement is restored within a given period of time. The shortfall may be resolved by reducing risk through changes in the asset allocation or derivative hedging, additional sponsor contributions, suspension of conditional or discretionary benefits and/or benefit reductions.

2. *Sponsors of over a quarter of IORPs might face challenges meeting their obligations*

- In its publication (page 46), **also EIOPA recognizes its limitations to draw conclusions on the impact on sponsors based on the limited stress test sample** (EIOPA did not target the representativeness of sponsors) **and based on the limited received answers**. **The aggregated data on sponsors show that the values of the liability towards the IORP are rather small and barely visible. The indirect impact of the adverse scenario on the average sponsor is relatively modest.**

3. *Vulnerabilities could spill-over to the real economy either through the adverse impact on sponsors and/or on beneficiaries through benefit reductions*

- National law often allows sponsor support and benefit reductions to be distributed over considerable time frames. **Distributing sponsor support and benefit reductions over time means that they are not impacting instantaneously to the full extent on sponsors and members/beneficiaries, but that the impact is smoothed over a longer period of time.** Therefore, the impact is not as direct, and in particular smaller in a given period of time, as would otherwise be the case.
- **When a benefit reduction is triggered, as stipulated in national law, it can be implemented in different ways mitigating the effects on real economy**: there could be an across-the-board

reduction of accrued pensions/pensions in payment. Active/deferred members will then not be affected directly until they retire. Current beneficiaries will be affected instantly, as the pension payment they receive will be reduced, resulting in lower retirement benefits during their remaining years in retirement. In order to even further reduce the immediate impact on current beneficiaries, a benefit reduction of for example 5% could be implemented as a reduction of 1% per year over a period of five years.

- **When sponsor support is triggered, as stipulated by national law, it can also be implemented in different ways:** sponsor support may take the form of additional contributions to the IORP. These additional contributions could either be paid at once, for example to achieve an instant recovery of a funding shortfall. They could also be distributed over an appropriate period of time, which would reduce the immediate impact on the sponsor, while still allowing the IORP to pay full benefits and resolve a shortfall in the time allowed. In some countries sponsor support takes the form of a subsidiary liability towards the members and beneficiaries. This means that when an IORP cuts benefits, as stipulated by national law, the sponsor will have to take over paying the difference between the full and cut benefits when benefits are due. This means that sponsor support is distributed over the remaining period in which the benefits will be paid. Members and beneficiaries will receive full benefits, just partly from a different debtor, i.e. the sponsor instead of the IORP.

4. *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*

- **As the actual funding problems of IORPs are not severe the recovery mechanisms are able to cope with them.**
- Typical recovery periods vary considerably between countries, ranging from short (< 1 year) in DK, NO and SI, relatively short (3-5 years) in BE, ES and PT and medium (up to 10 years) in CY, FI, IE, IT, the NL, and UK. **If the recovery plan is successfully implemented, the impact of IORPs' short/relatively short period of time underfunding is very small on the intergenerational balance.**

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the **buy-side** on the financial markets.

PensionsEurope has **24 member associations** in 19 EU Member States and 3 other European countries with significant – in size and relevance – workplace pension systems[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **25 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns;

Workplace pensions offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often “not-for-profit” and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

Contact:
PensionsEurope
Koningsstraat 97, rue Royale – 1000 Brussels
Belgium
Tel: +32 (0)2 289 14 14 – Fax: +32 (0) 289 14 15

[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Iceland, Norway, Switzerland.