

Questions:

1	<p>Do you agree with the IAIS' plan for the development of liquidity metrics for monitoring? If not, please explain what changes you recommend and why.</p>
	<p>Insurance Europe is supportive of the Holistic Framework for Systemic Risk, which represents a significant improvement on the previous entity-based approach.</p> <p>It is noted that the development of an exposure-based liquidity metric is intended as an ancillary indicator as part of the Individual Insurer Monitoring (IIM). However, given that it is a simple factor-based measure, Insurance Europe considers that the nature of the proposed Insurance Liquidity Ratio (ILR) would have limited value as a reliable ancillary indicator that would achieve the IAIS's stated aims, i.e. to facilitate the monitoring of potential vulnerabilities, risk drivers, and trends in the global insurance industry's liquidity risk. In particular, it would be inappropriate to apply the ILR beyond the Global Monitoring Exercise (GME) for the purposes of micro-prudential regulation.</p> <p>As the IAIS has itself noted in its Application Paper on Liquidity Risk Management, liquidity risk is company and scenario specific. The weaknesses of the proposed "exposure approach" include a loss of information on mismatches between liquidity needs and sources as well as being less risk sensitive. A thorough understanding of liquidity sources and needs is required to understand insurers individual liquidity risk profiles which a blunt factor-based ILR would fail to do.</p> <p>Liquidity risk is important for insurers and accordingly, it is well managed due to the business model (ie an inverted production cycle), existing regulatory provisions and insurers' integrated approach to liquidity and risk management. Further, insurance groups have established liquidity risk management practices and liquidity frameworks tailored to the characteristics and nature of their business. These internally developed frameworks have already considered the actual liquidity profile of the business and provide better accuracy than a crude bucketing of assets and, more notably, liabilities.</p> <p>While a standardised liquidity ratio may make sense in the banking industry given its business profile and heightened liquidity risk, it is inappropriate for the insurance sector given that there is much lower liquidity risk and the dependence on individual liquidity profiles of different businesses and the scenarios where they may be vulnerable. Because of this liquidity risk needs to be supervised and assessed as part of an insurer's wider ERM framework.</p>

	<p>The IAIS's application paper on Liquidity Risk Management sets out guidance to supervisors on the assessment of insurers' liquidity risk management processes and the effectiveness of their implementation. This should help supervisors arrive at an informed view of the liquidity risk of an individual insurer.</p> <p>In anticipation of Phase 2 of the IAIS work on developing liquidity metrics, Insurance Europe highlights that many of the issues raised in this response will be relevant a liquidity metric which use companies' cashflow projections. Furthermore, standardising cashflows for comparability purposes may produce results not considered economically relevant for participants and would likely result in a disproportionate operational burden relative to the objective of the ancillary indicator.</p> <p>To avoid an unjustified increase of burden on firms, either directly through Phase 2, or indirectly if Phase 1 leads to inaccurate conclusions, Insurance Europe proposes that the IAIS instead leverages on existing internal liquidity framework and promote industry best practices.</p> <p>Please note that, our specific responses to Q2-Q27 are not an endorsement of the ILR. As explained in response to Q1, we consider the proposed ILR to have limited value as an appropriate indicator.</p>
2	<p>Should the IAIS consider any other approaches or alternatives when developing liquidity metrics? If so, please explain.</p>
	<p>No. Given the company and scenario specific nature of liquidity risk, supervision of insurers' liquidity risk management, an assessment of their dedicated liquidity models/analysis is the most efficient way of understanding liquidity risks in the insurance sector.</p>
3	<p>Should the IAIS develop additional liquidity metrics that examine other time horizons? If so, how should these metrics differ from the proposed metric?</p>
	<p>No. As mentioned above a one-fits all liquidity metric in general is deemed to not fulfil the stated objectives. Therefore, adding additional metrics would not resolve this shortcoming and a metric which uses a one-year time horizon would therefore be sufficient. The development of additional liquidity metrics is not necessary.</p>
4	<p>Do you agree with the exclusion of separate accounts from the ILR? If not, how should separate accounts be incorporated?</p>
	<p>Separate accounts should be considered in isolation. This should be a focus of supervision rather than any liquidity metric. However, liquidity risk measures should reflect any requirement for shareholder funds to provide capital / liquidity support to policyholder funds in a time of stress.</p>

	<p>There are also some accounts, such as operational cash accounts, that are owned by the shareholder but are used to pay claims / receive premiums for policyholder funds. Therefore, consideration of the intra-fund receivables and payables is needed.</p>
5	<p>Do you agree with the proposed factors for liquidity sources? If not, please explain.</p> <p>No. The proposal for liquidity bucketing with prescribed haircuts would result in an over simplified view of the actual liquidity of the assets, and therefore may lead to erroneous interpretations from the ILR.</p> <p>Haircuts should depend on a number of factors, including the nature and time horizon of the stress scenario and whether an insurer would actually need to liquidate these assets under the stress scenario.</p> <p>However, it is worth reiterating that haircuts are unlikely to reflect the true liquidity situation. Global insurance Groups operating in multiple regions and jurisdictions have a globally diversified investment portfolio paired with broad access to markets and market players.</p> <p>Further, the IAIS should consider that the liquidity risk profile of banks and insurers differ and that insurers are less exposed to short term liquidity stresses due to the characteristics of their liabilities. As stated in the consultation, “For the treatment of assets, the IAIS relied most heavily on bank regulations”.</p> <p>It should be noted that under a 1 year timeframe, it should be possible to recognise the liquidity for more tangible assets than those that are listed in the table. The longer timeframe ensures buyers can usually be found for those assets without creating operational or financial friction caused by the sale process, meaning that haircuts applied to the assets should only be in relation to the fall in asset price due to the stress.</p> <p>Insurance Europe also highlights its support for the appropriate recognition of time deposits as a source of liquidity.</p>
6	<p>Do you agree with the treatment of investment funds? If not, please explain and suggest an alternative treatment.</p> <p>No, investment funds should be included reflecting the liquidity of the underlying assets and any liquidity-specific features of the individual funds (eg. lock-in periods).</p>

7	Do you agree with the treatment of premiums? If not, please explain how premiums and excluded expenses should be treated in the ILR.
	The approach appears to be broadly reasonable. However, the question should also be asked whether these cashflows should be treated on a gross basis as opposed to a net basis.
8	How should instruments issued by financial institutions be treated within the ILR?
	<p>Instruments issued by financial institutions should be included in any liquidity metric in a consistent approach with non-financial institution instruments, ie. taking into consideration their quality and the time horizon.</p> <p>It is recognised that when assessing liquidity under stress there may be scenario specificities which influence the availability of financial institution instruments, but these should only be considered within the given scenario and not result in pre-exclusion.</p>
9	Do you agree with the inclusion of certain encumbered assets as liquidity sources within the ILR or should the IAIS alternatively exclude these encumbered assets and measure certain the related liquidity needs on a net basis? Should any additional liquidity needs be included in the calculation because encumbered assets are included as a liquidity source?
	The basis for liquidity resources and liquidity needs should be consistent.
10	Do you agree with the treatment of liquidity risk from surrenders and withdrawals from insurance products in the ILR? If not, please explain how this could be improved.
	<p>No. The approach focusing only on economic penalty and time restraints is too simplistic, and therefore unlikely to reflect the individual characteristics of insurers' liquidity risk or enable meaningful interpretations to be drawn from the ILR.</p> <p>The IAIS acknowledge that policyholders' behaviours are based on the complex interaction of many factors. We do not consider that only picking on two of these factors that are measurable through the IIM data will provide a representative view.</p> <p>Although the proposed treatment appears straightforward in theory, practically it could be very labour intensive to extract the source data, therefore prompting the question as to whether the pros outweigh the cons for calculating a number that would not be used for any other purpose.</p>

11	How should the IAIS capture liquidity needs from policy loans? Should these be incorporated into the ILR or be an alternative metric?
12	Do you agree with the factors applied to retail insurance products being half of the factors applied to institutional products? How should the factors applied to retail and institutional policies differ?
	No. The double weighting factors for institutional business is a purely theoretical assumption which is not justified with any supporting analysis or documentation. See also response to question 10.
13	Do you agree with the treatment of unearned premiums in the ILR? If not, how can it be improved?
14	Should the IAIS apply standardised factors to insurers projected ultimate catastrophe losses or rely on company projections for the speed of catastrophe payments and reinsurance recoveries?
	There is no need to consider a lower factor for reinsurance recoveries capturing potential risk arising from exposure to the reinsurer counterparty.
15	Do you agree with the proposed treatment of catastrophe insurance claims? If not, how can it be improved?
	The IAIS has not justified why it would be appropriate to use a scenario based on a 1 in 250 years global event across all non-life insurance perils. This confidence level is more conservative than the severest prudential solvency regimes.
16	Should the proposed treatment of deposit liabilities include more or less granularity? If so, what additional dimensions (eg the presence of an effective deposit insurance scheme) should be captured or left out?
	Deposit taking forms a significant part of banking activity and therefore a significant part of the risks relating to that sector. This is not the case for insurance companies as most insurers do not control a licensed banking subsidiary, and activities are funded via other means. Therefore, deposit holdings are minimal, and treatment within the ILR should be proportionate to the recognized risk. If an insurer has a licensed banking subsidiary, the liquidity risk management will be monitored by the banking regulatory bodies.
17	Should the proposed factors be modified? If so, please explain how and why.

18	Should insurance contracts without significant exposure to insurance events be captured by these factors, or included with other policyholder liabilities?
19	Do you agree with the treatment of derivatives? If not, please explain and suggest an alternative treatment.
	<p>The trading setup, volume and derivatives usage between sell and buy side (insurance) is completely different. Therefore, the BCBS approach used for banks, is not be suitable for insurance companies.</p> <p>The ratio is more reflective of the balance sheet and the funding requirements as opposed to liquidity and cashflows. As a liquidity metric, the ILR should focus on applying a defined liquidity stress to the derivatives held by the insurer at that moment in time, in order to calculate the additional collateral that needs to be posted.</p> <p>For this reason, liquidity risk measures generally consider a more risk-based approach, such as VaR or by applying prescribed hikes in market risk parameters against the sensitivities / market value of the derivative portfolio.</p>
20	How should the ILR treat debt with financial covenants that may be triggered under stress?
21	How should the ILR assess potential liquidity needs from a downgrade?
	<p>Potential collateral requirements at different downgrade levels can be faced through different options, e.g. the use of letter of credits from third parties, and the negotiation of different collateral provisions is possible as well. Therefore, a 100% weighting factor on related exposures to derive potential liquidity needs is not realistic.</p> <p>With regard to ILR Funding Liability Factors (Table 8), it is not realistic to assume a 25% weighting factor on “Pledged contingent funding including credit facilities” based on ROW 12.1 of the IIM – this row correspond to all commitments given, including the significant (gross) amounts of pledged assets that are common in the insurance industry. The IAIS does not provide any justification for this factor (“investors are assumed to exercise any options that would shorten the maturity of outstanding debt or draw upon any contingent funding the insurer provides”). A pledged asset is not a form of contingent funding. Furthermore, this approach would be biased as it does not consider any commitment received (e.g. received pledged assets).</p>

	<p>A liquidity risk measure should consider all contracts that have clauses requiring the posting of additional collateral, drawdown of contingent facilities, or early repayment of existing liabilities upon downgrade by a recognised credit rating organisation. A liquidity risk measure should recognise a percentage of this additional collateral or cash outflow depending on the stress applied. Care needs to be taken to ensure that there is no double counting with calculating derivative risk.</p>
22	<p>Do you agree with the discussed limitations and mitigations of the ILR? What other limitations should the IAIS consider and how can these be mitigated when the IAIS monitors liquidity risk?</p>
	<p>Please refer to our answer to Question 1. The limitations of the proposed ILR are such that it would have limited value as a reliable ancillary indicator that would achieve the aims the IAIS has stated, as it could provide an unreliable signal as to the strength or weakness of individual insurers' liquidity risk.</p> <p>Given that the IAIS acknowledge that it would have limitations and would be required to be supplemented with supervisory judgement the ILR as proposed would seem to have limited value.</p> <p>We acknowledge the limitations noted within the consultation paper and point out the fact that they greatly outweigh (in significance and not just in number) the points of mitigation. The main point of mitigation seems to be the fact that the IAIS will supplement the ILR with other supervisory judgements and the use of additional metrics. This demonstrates that a standardised approach does not necessarily work well to assess liquidity risk and firm-specific liquidity risk frameworks are a better basis for supervisory dialogue. This point is also very relevant indeed for the approach outlined in Phase 2.</p>
23	<p>General comments on the Public Consultation Document on the Development of Liquidity Metrics: Phase 1 – Exposure Approach</p>