Insurance Europe response to IAIS consultation on liquidity metrics: Phase 2

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Questions

Q1. *Do you agree with the IAIS' general objective and contemplated usage for the liquidity metrics? If not, please explain your rationale.*

- Yes

Kindly refer to Insurance Europe's response to Question 67 "General comments" to gain the context in which the answers to detailed/ individual questions are provided.

Insurance Europe recognises that liquidity risk is a component of the International Association of Insurance Supervisors' (IAIS) holistic framework and that ancillary indicators may prove useful in helping to identify trends in insurance sector liquidity.

Liquidity risk management is not only a well established and fundamental aspect of insurer's risk management: it is also increasingly embedded in regulatory requirements across the world — including in the context of the ongoing Solvency II review in Europe.

The internal liquidity risk management framework of an individual company is, and remains, the best basis for microprudential supervision, as it allows companies and supervisors to focus on the specificities of its business model.

In addition, liquidity risk is limited in the insurance sector compared to banking: although there were examples of a few cases where liquidity was a problem in insurance in the past, it should be recognised that those cases were still very limited.
Even from a macroprudential perspective, liquidity risk can and indeed has been tested as part of stress test exercises (eg the European Insurance and Occupational Pensions Authority (EIOPA) 2021 stress test exercise in Europe, which clearly demonstrated a lack of liquidity issues), so the supervisory community should be mindful of already existing tools and also the conclusions drawn from applying them.

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The IAIS must therefore strike an appropriate balance between the objective of monitoring liquidity trends at a macro level and the reporting effort placed on companies subject to the global monitoring exercise (GME).
Insurance Europe appreciates the fact that the IAIS does not intend to use the liquidity metrics as "a binding regulatory requirement", but rather "as a monitoring tool to gather information that will help identify trends in insurer and insurance sector liquidity".

Nevertheless, it is important to recognise that any metric developed by the IAIS for the purpose of the GME is not suitable for the purposes of microprudential supervision, which instead must be based on company-specific analysis and frameworks and can't be standardised at global level.

Insurance Europe considers the implementation of the Exposure Approach (EA) metric as an ancillary indicator as part of the IAIS GME as better suited than the CPA in this context. The design of the EA liquidity metric should align to this macroprudential objective by not being overengineered and remaining as simple as possible to avoid being lulled into spurious accuracy.

Q2. *Do you want to propose an additional liquidity metric in addition to three metrics mentioned in this section? If yes, please describe a proposed metrics.*

- No

Insurance Europe supports the development and implementation of a single metric, not of several different metrics.

Q3. *Do you know any public database with liquidity related data relevant for the development of liquidity metrics (either on a company level or on a jurisdictional level)?*

- No

Insurance Europe is not aware of a public database focused on liquidity. A number of elements relevant for a liquidity analysis can, however, be retrieved from existing jurisdictional reporting which the IAIS and its membership could explore as part of the Sector Wide Monitoring.

Q4. *Is there a need to develop supplementary liquidity metrics solely for separate accounts for both EA and CPA? If not, provide suggestions how the IAIS should monitor liquidity related to separate accounts (united-linked products) for both EA and CPA?*

- No

It is not necessary to develop supplementary liquidity metrics for separate accounts for the purpose of the ancillary indicators in the context of the GME.

Although liquidity risk within separate accounts is borne by the policyholder, the shareholder still has a duty to the policyholder and is subsequently required to step in to support the policyholder in a time of severe liquidity stress.
Liquidity risks arising from separate accounts are, however, considerations for liquidity risk management at a micro-prudential level and are best addressed as part of ongoing national supervision. As previously stated, a standardised liquidity metric is not a suitable approach to provide a complete understanding of the liquidity risk profiles of individual insurers.

Q5. *Do you prefer to collect data and calculate liquidity metrics using fungible liquidity pools approach instead of the current enterprise approach for both EA and CPA? If yes, please provide ideas on approaches to the group-wide aggregation of results.*

- No

The additional complexity of implementing this approach for an ancillary indicator which aims to "help identity trends in insurance-sector liquidity" is not expected to be commensurate with the additional insights it could bring.

Insurance Europe recognises that implicitly assuming unlimited fungibility of liquidity may not be a perfect approach, but considers it suitable for the purpose of the IAIS ancillary indicators. Implementing an approach which attempts to reflect fungible liquidity pools is likely to lead to illusionary benefits and/or spurious accuracy.

Q6. *Does the current enterprise approach lead to significant shortcomings of the liquidity monitoring? If yes, describe these shortcomings and limitations.*

- No

The current enterprise approach does not necessarily capture all features liquidity management: for example, where liquidity pools exist. It is, however, appropriate for the monitoring of liquidity trends at a macro level.

Where needed, the enterprise approach can be complemented through assessment of the individual insurer's internal liquidity risk management frameworks in order to better assess risks such as liquidity fungibility.

Q7. *Do you agree with the proposal to include capital instruments in the CPA and EA metrics calculations as described in this section? If not, please provide rationale and alternative suggestions.*

- Yes

Capital instruments make up part of the balance sheet and therefore it would be appropriate to include them in the EA metric (contrary to internal operations that would be neutral from a liquidity perspective at the enterprise level).

Cashflows relating to capital instruments over the proposed timeframes could be material and so should likewise be considered within the Cashflow Projection Approach (CPA) metric, if it is further investigated.

It should be clearly defined which capital instruments are to be included and, for the CPA approach, there should be the possibility of applying discretion to the payment of dividend in the stressed scenario.

Q8. *Do you prefer the detailed method for inclusion of capital instruments in the ILR calculation as described in this section? If not, please provide rationale.*

- No

Insurance Europe supports the use of the simplified approach which should be sufficient given the macroprudential focus of the proposed metrics.

Q9. *Do you agree with the above described CPA to calculate the baseline cash flow projection, to apply the liquidity stress test and then to evaluate its impact and potential application of haircuts on assets? If not, please explain and provide suggestions.*

- No

Despite the fact that Insurance Europe does not support further development of the CPA in this context, the approach seems at first sight logical: ie start with cashflow projections, stress the cashflows, evaluate, and if negative stresses cashflows, then decide how to manage the gap by using the liquidity buffer.

It is, however, not clear whether the IAIS intends to use historical cashflows or projected cashflows. The consultation papers notes that cashflows would be "derived from cash flow statements" (Page 17) and based on "easily validated data…mostly publicly available across jurisdictions" (Page 25). This suggests a reference to historic cash flows and not to projected forward looking cashflows.

This could make the result too dependent to the previous year's situation, particularly in the case of a very negative calendar year, and not akin to a real "projection approach".

For the 30 days and 90 days' time horizons, it is not explained how the cash flows would be derived (eg on a proportional share of yearly cash flows, disregarding any seasonality?).

In addition, it should be noted that the haircuts applied to liquidity sources would not be calibrated in accordance with the proposed scenario, which creates a lack of consistency in the approach (see Question 12).

Q10. *Do you agree with the proposal to perform the CPA at the holding company level? If not, please explain and provide suggestions.*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, the CPA approach performed at the holding company level permits a consolidated macro view of liquidity. If relevant, it can be complemented by an assessment of insurers' internal liquidity risk management frameworks on a case by case basis: for example, in order to assess risks at the level of fungible liquidity pools.

Q11. *Are there any other categories of cash inflows or outflows that should be added that were not captured by the cash flow statement, such as asset management activities?*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, a change in the form of collateral arrangements could be considered: eg by replacing pledged assets with other tools.

If the CPA is based on fungible liquidity pools, internal dividends between fungible liquidity pools could be included. Depending on the severity of the respective stress scenario and own risk tolerances, internal group support might still be an option (possibly after applying haircuts).

In addition, projected asset management charges from the policyholder funds should be recognised within the defined timeframes.

Q12. *Do you agree with using haircuts from the ILR for assets to be applied if there is a cash flow deficit? If not, provide your explanation and suggestions.*

- No

If a negative cash flow is recognised in a stress situation, the IAIS should first consider whether the insurer has other means to avoid the sale of any assets: for example, the use of committed credit lines, intragroup liquidity etc. Only if these are depleted and a deficit still exists, should the IAIS assess the deficit against the haircutted asset value.

While the use of consistent haircuts between the Insurance Liquidity Ratio (ILR) and CPA approaches would reduce reporting burden, it seems to create an inconsistency (or potentially double counting) between the stresses applied to the cashflows and those applied to the assets. The haircuts applied to liquidity sources would not be calibrated in accordance with the proposed scenario.

As noted in section 3.2.4, the haircuts represent both the insurers' ability to sell the assets and the fall in value of the assets before liquidation. Section 2.4, which outlines the market scenarios of the liquidity stress test (LST), seems to suggest, however, that the assets should be stressed by the adverse market parameters included in Table 4.

It is not clear if the asset values should be stressed in the LST.

- If they are to be stressed in the LST, the comparison of any liquidity deficit with the haircutted assets would effectively be double counting.
- If they are not to be stressed in the LST, then there would be inconsistency between the stress factors applied to the cashflows (via the LST) and those implicit in the haircuts. It also raises the question of what the purpose is of the market parameters in Table 4.

Finally, haircuts should only be used in the stress scenarios and not in the base line.

Q13. *Do you prefer to collect and analyse only high-level cash flow projections, ie. aggregate cash inflows and outflows of the three categories mentioned above? If yes, provide your clarification.*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, for the purpose of an ancillary indicator the collection of high-level cash flow projections should be adequate.

Q14. *Do you prefer to collect and analyse the underlying cash inflows and outflows as listed in Annex 2? Note that this option provides more accuracy at the cost of a higher reporting burden. If yes, explain your reasoning.*

- No

See response to Question 13. There should be a balance between the granularity needed to achieve reasonable accuracy and operational effort. A company should be able to decide which factors have the most impact on the liquidity risk.

Q15. *Do you have any suggestions for changes or additions to the inflows and outflows as listed in Annex 2?*

- N/A

Q16. *Do you agree with the proposed main types of cash outflows as specified in this section? If not, please provide clarification and suggestions for other outflows that should be considered.*

- Yes

The main types of cash outflows are suitable. The following changes should, however, be considered if the IAIS does pursue the CP approach.

(1) Securities lending can be used for fixed income instruments, not just equity stock holdings.
(2) Money market funds are a distinct category of fund.
(3) Life insurance policies can create the same types of liquidity risks as annuities, albeit to a lesser degree typically.

Q17. *Do you agree with the three proposed time horizons (30 days, 90 days and 1-year) for the CPA? If not, please explain and provide your suggestions.*

- No

The use of three time horizons is overly complex for the purpose of the IAIS liquidity monitoring tool in the context of the Individual Insurer Monitoring (IIM). If the IAIS does pursue the CPA approach, then a single time horizon of one year would be a reasonable approach.

Q18. *Do you think the investing section of the cash flow statement should be stressed in the LST? Would you add or subtract certain investing cash inflows or outflows as listed in Annex 2?*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, volatility in collateral margin calls is a key liquidity risk, and so this sensitivity should be reflected in any stressed liquidity metric. Likewise, there is a potential that, in a time of stress, a counterparty default could occur leading to reduced "investing inflows" being received.

Q19. *Do you think the operating section of the cash flow statement should be stressed in the LST? Would you add or subtract certain operating cash inflows or outflows as listed in Annex 2?*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, a liquidity stress on claims could manifest itself in the form of mass lapse risk and pandemic risk. This is likely to play out over a one year period but could materially increase the operating outflows of an insurer.

It is important to consider the LST for the different financial sectors. As mentioned in the consultation paper, liquidity characteristics differ between banks and insurers, and this must be taken into account.

Q20. *Do you think the financing section of the cash flow statement should be stressed in the LST? Would you add or subtract certain financing cash inflows or outflows as listed in Annex 2?*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, all inflows could be stressed in the LST. Care must be taken, however, not to double count the stress applied as some inflows, such as dividends from subsidiaries, and capital contributions will have been quantified based on a stress view already. Moreover, intercompany flows should be removed if a group consolidated approach is followed.

Defined management actions, for example, cancellation of share buy-back or dividends, could also be included to have a more economic approach to the LST impact. Given the purpose of the CPA, it is not, however, clear if this additional complexity is justified and would provide significant additional insights.

Q21. *Do you agree with the selected adverse liquidity stress scenario? If not, provide clarification.*

- Yes

Despite the fact that Insurance Europe does not support further development of the CPA in this context, in theory, this represents a plausible economic downturn.

As noted in Section 2.4 of the consultation paper, the design of the scenario may not, however, reflect the most stressed condition for some legal entity insurers, or even groups, and is therefore unlikely to be equally appropriate for each single insurance company. It would not, therefore, be appropriate to use this scenario for microprudential supervisory purposes.

Additionally, it is unclear how some of the parameter changes would impact the reported flows: for example, the unemployment rate, GDP growth etc.

Q22. *Do you want to propose a different liquidity stress scenario? If yes, provide its detailed parameters.*

- No

Insurance Europe would, however, highlight that the proposed scenario is banking focused and that there are other scenarios which would potentially be more suitable for testing (life) insurance company liquidity risks.

Q23. *Do you agree with the proposed adverse GDP and market parameters? If not, provide clarification and suggestions.*

- N/A

Q24. *Do you agree that CPA adverse scenario should contain adverse parameters related to insurance liabilities? If yes, do you have any suggestions for adverse parameters for cash outflows related to insurance liabilities?*

- Yes

Some adverse movements in insurance liabilities might be triggered by an economic downturn but this relationship is not straightforward to justify (in the context of an adverse economic scenario eg for natural/man made catastrophes). It is possible that some outflows could increase, but would not be as high as a scenario triggered by company specific reputational issues. Adverse parameters for cash outflows would need to be mindful of how liability risk exposure differs across companies: for example, by differentiating by product types (eg with-profit and non-profit business).

An alignment with other scenarios used in other contexts (internal scenarios, the Own Risk and Solvency Assessment (ORSA) etc) could also be envisaged.

Q25. *Do you want to add other variables and parameters into the adverse liquidity stress?*

- No

Q26. *Do you prefer to have several targeted stressed scenarios/projections (in comparison to the currently proposed one combined adverse scenario)?*

- No

Each company is likely to have its own company specific targeted stress scenarios and, for macroprudential supervisory purposes, the proposal to simply have a single combine adverse scenario that is based on a plausible, onerous market event for the insurance sector is appropriate.

Q27. *Do you believe the selected adverse liquidity scenario is relevant to the countries you operate in? If not, what would be the relevant stresses for the countries you operate in?*

- Yes

Q28. *Do you agree with the summary of benefits and limitations of the CPA? If not, please provide some clarification.*

- Yes

It is not desirable to materially further extend the amount and granularity of the data collected in the IIM data collect exercise. The liquidity crisis experienced by AIG is a very specific example, related to "non-traditional" activities (eg credit default swaps (CDS)).

In principle, in most jurisdictions' derivatives may only be used for either efficient portfolio management or risk mitigation purposes, and trading derivative portfolios is generally not allowed. Under several prudential regimes, such as Solvency II, any off balance sheet activities which generate negative impact on the own funds in the wake of stresses are accounted for. This limitation, as mentioned by the IAIS, will be very specific and mostly common for a single insurer or group. For such a small number, a tailormade solution should be made to capture all the risks, if deemed appropriate. There is no need for a generalised approach as the off balance sheet will be captured.

Q29. *Do you agree with the consideration of differences in liquidity profiles of life insurers, non-life insurers and reinsurers in the ILR liquidity needs factors? If not, please explain and provide your suggestions.*

- Yes

Liquidity profiles within the liquidity sector differ greatly, and therefore some sort of segregation in the ILR liquidity needs factors is required to ensure effective monitoring of the industry. The three proposed liquidity profiles appear to be reasonable: ie life insurers, non-life insurers and reinsurers.

The IAIS emphasises the "risk of failure of reinsurer to pay on time" for non-life insurers, which leads to the application of crude liquidity need factors for reinsurance recoveries and on ceded one year cat payments. However, in Section 2.5, for the CPA, the IAIS states that in the insurance business model the "inability to pay claims is rare".

The factors should reflect the fact that many insurance undertakings have strategic reinsurance partners with strong credit ratings. See Question 49 for further feedback.

Q30. *Do you agree with the use of two time horizons for the EA: 1-year and 3-month time horizons? If not, please explain and provide your suggestions.*

- No

A single time horizon of one year is sufficient to achieve the objective of the ancillary indicator.

The three month time horizon is unnecessary as it is unlikely to provide any more meaningful insight than the one year horizon.

Q31. *Do you prefer to calculate 3-month time horizon similarly to the BCBS' LCR, ie. 3-month ILR liquidity sources (as defined in the Table 5) will be divided by net 3-month cash outflows (a difference between cash outflows and inflows from all operating, financing and funding activities as defined in the Chapter 2)? If not provide your comments.*

- N/A

Q32. *Do you agree with the proposed approach to financials? If not, please explain and provide your suggestions.*

- Yes

Insurance Europe supports the inclusion of financials in the liquidity sources and applying the same weights as non-financials. (Please also note the other feedback regarding proposed weights/haircuts.) Haircuts on liquid assets should be used only in the stressed scenarios and not in the base line.

Q33. *Do you agree with the proposed approach to investment funds? If not, please explain and provide your suggestions.*

- Yes

Insurance Europe supports including investment funds (mutual, exchange-traded funds (ETFs) and money market funds (MMF)) as liquidity sources.

The IAIS definition of a liquid investment fund "traded at the liquid and active market every working day and has not changed by more than 40% during a 30 day calendar period" seems somewhat arbitrary and is noted to be relatively prudent.

Q34. *Do you agree with the proposed factors for sovereign/PSE/GSE debt instruments? If not, please explain and provide your suggestions.*

- No

The haircuts for investment grade sovereigns seem to be extremely conservative.

The source/justification for the factors has not been provided. Insurance Europe notes that the factors represent both the fall in the asset price over the period and the ability to sell the assets.

It is unclear why sovereigns in local currencies are considered to be less liquid or to suffer a greater fall in price in the implicit stress scenario.

Public sector entities (PSE) should be treated similar to sovereign bonds if these are part of the governmental structure in a jurisdiction. The liquidity will depend on the liquidity of the country where the PSE is localised.

Q35. *Do you agree with the proposed factors for non-financial corporate debt instruments (including covered bonds)? If not, please explain and provide your suggestions.*

- No

The haircuts for non-financial corporate debt are extremely conservative. Actually, the most adverse stress impact from the Basel Committee of Banking Supervision (BCBS) proposal has been adopted, which significantly differentiates from haircuts used by rating agencies and observable market data.

The calibration of the haircuts should be based on/consistent with historical data. The haircuts proposed by the IAIS seem to be set rather arbitrary (also applicable to Questions 36 and 37).

The factors applied to non-financial corporate debt instruments should be based on the credit rating of the debt. The highest quality corporate bonds, with a rating of AA- or higher should receive a factor of at least 85%. High quality corporate bonds with a rating higher than BBB- (but less than AA-) should receive a factor of at least 50%. At the one year horizon point, asset prices should be less sensitive to sudden market movements and so propose higher factors to be used for the proposed time horizons.

Q36. *Do you agree with the proposed factors for financial corporate debt instruments? If not, please explain and provide your suggestions.*

- No

The haircuts are too conservative. The calibration of the haircuts should be based on historical market observations.

See answer to Question 35.

Q37. *Do you agree with the proposed factors for common equity (both financials and non-financials)? If not, please explain and provide your suggestions.*

- No

The haircuts are too conservative. With a 50% loss in value of underlying instruments they already overstate one in 200 year shocks proposed in regulatory capital models.

See answer to Q35.

Q38. *Do you agree with the proposed factors for selected liquid investment funds? If not, please explain and provide your suggestions.*

- No

Insurance Europe welcomes the fact that the ILR now recognises liquid investment funds as a source of liquidity. The factors applied to them for both time horizons do not, however, reflect true liquidity under a liquidity stress. It is unclear how the proposed haircuts have been derived. They are far too high, particularly given the definition of liquidity investment funds proposed by the IAIS: "a fund that is traded at the liquid and active market every working day and has not changed by more than 40% during a 30 calendar day period of significant stress".

Within both time horizons, all the underlying assets within the liquid funds are considered to be as liquid and just as realisable as the assets themselves. For highly liquid funds, the factors applied should therefore equate more to those assigned to sovereign/public sector entity debt instruments, as well as high credit rated corporate debt.

Q39. *Do you agree with the proposed factors for non-life premiums? If not, please explain and provide your suggestions.*

- No

The factor applied for the three months' time horizon is very low. A distinction could probably be made between non-life with a mandatory nature and those with a non-mandatory nature. The former should have a very much higher factor. For medical expense, for example, the factors should be close to 100%.

Q40. *Do you agree with the proposed factors for certificates of deposit and undrawn committed lines? If not, please explain and provide your suggestions.*

- No

The factors for undrawn committed lines are far too low (10% and 15%, respectively, for the two year time horizons), in particular in the cases where these lines are with strong international banks, long-term and ready for execution. Such factors need to be considered in the calibration of the factors.

Indeed these lines are bought to provide additional liquidity sources when needed. Undrawn committed lines may include material amounts of committed letters of credit that would be immediately and fully available to

collateralize losses, and of committed credit facilities with banks that could be immediately realised in cash (as bank counterparties are likely to be better rated than investment grade).

Committed facilities in cash should be considered as fully available as a liquidity source unless their time of disposal or maturity do not match the considered horizon.

Committed letters of credit should be considered as available as a liquidity source, if their maturity is matching the considered horizon, and with a limited haircut to reflect the fact that they can be used to provide collateral and alleviate liquidity needs in cash. The factors should be at least 50% at one year and 100% at three months. Indeed, and as observed during the subprime crisis and the liquidity freeze that occurred, it seems more appropriate to distinguish very short term paper from the longer ones.

Q41. *Do you agree with the proposed factors differentiation between 3-month and 1-year time horizons? If not, please explain and provide your suggestions.*

- Yes

Some differentiation might be considered. The IAIS should, however, be very careful in selecting the factors to avoid making the choice of factors too subjective.

Q42. *Do you think any additional relevant liquidity source should be considered in the ILR calculation? If yes, please explain and provide your suggestions.*

- Yes

In the (re)insurance business model, pledged assets to ceding companies can be used as a liquidity source when claims arise. It is, therefore, simplistic and very penalizing to exclude them across the board from liquidity sources, just because they are "pledged, explicitly or implicitly, to secure … any transaction". In the reporting of Row 9.5 (Liquidity of invested assets), it should be possible to include certain encumbered assets, if they are pledged to the benefit of policyholders or ceding companies to secure the capacity to pay future claims when they arise. This approach is even more justified as in the EA, it is suggested to include claims as a liquidity need.

Q43. *Do you prefer to conduct a detailed recalibration of factors for surrender values based on historical surrender rates of participating insurers? Such a recalibration would be a substantial reporting burden.*

- No

The use of simplified factors to measure the illiquidity of insurance liabilities is a crude approach. While recalibration may slightly improve the risk sensitivity of the calculations, it is unlikely to result an improvement which would justify substantial additional reporting burden foreseen by the IAIS.

Q44. *Do you agree with the proposed 3-month time horizon factors? If not, provide your explanation and suggestions.*

- No

See answer 43.

Q45. *Do you agree with the proposed factors for non-life claims and expenses? If not, please explain and provide your suggestions.*

- N/A

Q46. *Do you agree that life premiums, claims and expenses are currently not included in the ILR? If not, please provide clarification.*

- Yes

Insurance Europe supports the proposal that life premiums, claims and expenses not be included in the ILR. This simplifies the approach.

The basis of exclusion is that premiums charged on policies are designed to at least cover the Net Present Value (NPV) of expected claims over the life of the policy, plus administrative costs relating to running the policy. The longer nature of life policies ensures sufficient cash generation through the long-term investment of the premiums received. These investment instruments are considered elsewhere in the ILR.

Q47. *Do you agree with the proposed factors for reserving risk? If not, please explain and provide your suggestions.*

- No

Reserving risk is not a liquidity topic. A potential increase of reserves does not constitute a direct cash need and should be seen as a risk capital topic. The category should therefore be eliminated.

As it stands, the proposed parameter is unsuitable and would potentially equate to a significant number. Currently, there is no justification behind the proposed factor of 2.5% and so this appears arbitrary.

Q48. *Do you agree with the proposed factors for unearned premiums? If not, please explain and provide your suggestions.*

- N/A

Q49. *Do you agree with the proposed approach for reinsurance recoveries? If not, please explain and provide your suggestions.*

- No

Factors for reinsurance recoveries/receivables should be related to the rating quality of the reinsurer(s). Many insurance undertakings have strategic reinsurance partners with strong credit ratings.

Furthermore, reinsurance programs or retrocessions are generally spread among a diversified pool of reinsurers. The proposed factors are far too severe.

In addition, for cat payments, the same factors are applied separately on ceded cat payments (paid within one year of the start of the catastrophe scenario) – 12,5% on a three month horizon and 50% for the one year

horizon. The previous comment applies in the same way to these proposed factors (they are too severe and the strong rating and diversification of reinsurers should be reflected in the factors).

Q50. *Do you agree with the refined factors for catastrophe claim payments? If not, please explain and provide your suggestions.*

- No

Sub-component 2 / net cat payments seem to be obsolete. Events which have incurred in previous years should have already been reserved and respective sources should be available. In this context, there will be a double counting with the reserving risk liquidity needs.

In addition, for cat payments, the same factors are applied separately on ceded cat payments (paid within one year of the start of the catastrophe scenario) – 12,5% on a three month horizon and 50% for the one year horizon. The previous comment apply in the same way to these proposed factors (they are too severe and the strong rating and diversification of reinsurers should be reflected in the factors).

Q51. *Do you prefer a standardized 1/250 PML scenario to be applied for catastrophe claim payments? If yes, provide your suggestions for such a scenario. The current proposal counts with 1/250 PML scenario calculated using insurers' own projections and stress-testing.*

- No

The 1/250 years event assumption seems too conservative. It also deviates from current regulatory capitalization stress calibrations. Climate change effects will be at least to some extent already considered in well-maintained loss models.

Q52. *Do you agree with the IAIS proposal to consider DGS in the ILR factors for bank deposits? Please provide your comments and suggestions.*

- Yes

Q53. *Do you agree with the 3-month time horizon ILR factors for bank deposits? If not, provide your comments and suggestions.*

- N/A

Q54. *Do you agree that there is currently no liquidity need considered for the non-financial type of business that some insurance groups may conduct? If not, please provide your suggestions.*

- Yes

Deposit holdings are minimal, and treatment within liquidity risk measures should be proportionate to the recognised risk. Deposit type products would be assessed using the factors for insurance products.

Q55. *Do you agree with the inclusion of derivative assets into the ILR Liquidity Sources? If not, please explain and provide your clarification. If yes, provide your suggestions on factors for such derivative assets.*

- Yes

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.

The definition of derivative netting sets might be misleading for insurers as they generally have derivative assets & liabilities within a netting set. Based on this and as for all over the counter (OTC) and Central Clearing Party (CCP) contracts daily t+0 Variation Margin (VM) exchange is used, the Mark-to-Market is in principle zero.

It might be more reasonable to exclude daily settled netting sets in general, otherwise one has to take derivative assets (positive VM cashflows) into account as the ILR should also be adjusted for any Eligible Cash Variation Margin.

Q56. *Do you agree with the current IAIS proposal to include only cash collateral into the Eligible Cash Variation Margin? If not, provide your comments and suggestions.*

- No

Other highly liquid assets provided as collateral should also be included.

In addition, as for OTC initial margin (IM) pledging of cash collateral is feasible, at least for an IM bridge, this case should be taken into account also for the ILR factors.

Q57. *Do you agree with the 3-month time horizon ILR treatment of and factors for derivatives? If not, provide your comments and suggestions.*

- N/A

Q58. *Do you agree with the floor as proposed by the IAIS to protect a level-playing field for all insurers? If not, provide your comments and suggestions.*

- Yes

Although applying a floor would artificially "fix the data gap" and ensure a punitive derivative stress at all times, but the derived figure using the floor may not reflect the true derivative risk.

Q59. *Do you agree with the proposed approach to securities lending transactions and repurchase agreements including the factors? If not, provide your comments and suggestions.*

- N/A

Q60. *Do you agree with the 3-month time horizon ILR factors for other funding liabilities and potential liquidity needs? If not, provide your comments and suggestions.*

- No

Regarding pledged contingent funding including credit facilities, it is not reasonable to apply a factor on those to derive a liquidity need, whereas as the same time pledged assets are subtracted from the liquidity sources.

In the (re)insurance business model, pledged assets to ceding companies can be used as a liquidity source when claims arise. It is, therefore, simplistic and very penalizing to exclude them across the board from liquidity sources, just because they are "pledged, explicitly or implicitly, to secure … any transaction". In the reporting of Row 9.5 (Liquidity of invested assets), it should be possible to include certain encumbered assets if they are pledged to the benefit of policyholders or ceding companies to secure the capacity to pay future claims when they arise. This approach is even more justified as in the EA, it is suggested to include claims as a liquidity source.

Pledged contingent funding, including credit facilities, can represent material amounts and the proposed factors 12,5% and 25% appear in any case too high.

The ILR also includes, as a liquidity need, any potential payments as a result of a credit downgrade.

Assuming a low materiality of this type of liquidity needs, the IAIS "decided to keep its approach unchanged" and recommends considering the worst case results out of three scenarios is applied: two notches, to BB+, or to C.

In the previous "Liquidity Metrics Calculation", however, the IAIS had only tested the "two notches scenario" (referring to Row 33.F.1 of the IIM template) and not the three scenarios mentioned in the IIM template to "report the maximum value of any additional payments". Actually, scenarios based on a deterioration to the "Junk" category (Speculative) are not really applicable.

Insurance Europe takes the view that the related liquidity need would not be immaterial with as severe an assumption as a downgrade to the Non-Investment Grade category, be it Speculative (BB+) or Highly Speculative (C). It is not, however, realistic to disregard the current rating of an insurer when applying a stress on its rating and a deterioration to the Speculative category should not be considered as a realistic worst case (an insurer or reinsurer would not be able to further conduct business with such a Speculative rating). The stress should rely on a realistic deterioration expressed as a number of notches (two notches).

In addition, it should be made clear that the rating downgrade should not lead to a double counting of any liquidity needs already reflected through the factor applied on "off-balance sheet or contingent financial liabilities to third parties".

Finally, it should be noted that, even in the case of a stress, there is no reason for a bank to request an early repayment of a debt.

Q61. *Do you agree with the proposed factors for operational and cyber risk? If not, please explain and suggest an alternative treatment.*

- No

The factors should be backed by historical data and loss experience. A factor of 5% of total GWPs is far too high to represent three month and one year "potential liquidity needs related to sudden operational or cyber related

events". Operational risk is already considered in the calculation of Solvency II capital requirements, which is a more suitable approach than considering it as a source of liquidity needs.

Indeed, operational risk can create a risk to business operations but has a weak connection with material liquidity needs, especially on a short-term basis. For instance, a cyber-attack can create business interruptions and potential loss of business, or a leak of sensitive data, but is not a driver for material liquidity needs.

A more reasonable calibration of potential liquidity needs related to sudden operational and cyber related events would be 1% of written premiums, if relying on premiums.

Dependence between cyber losses and GWP may have limitations. For example, bigger companies would have larger resources and investments in information security.

Q62. *Did the IAIS omit any other material type of insurance, non-insurance or operational liquidity needs that should be considered in the ILR calculation? If yes, provide your suggestions.*

- No

Q63. *Do you agree with the description of aspects of other liquidity metrics provided in Section 4?*

- No

This description is not a comprehensive discussion of the use of own liquidity metrics and its benefit for the insurer's own management and monitoring of liquidity risk, but only a presentation of nine specific aspects that are "easier to consider in own liquidity metrics".

The IAIS is concerned by the risk of limited comparability that the use of own liquidity metrics would entail for the purpose of its monitoring of the insurance industry's liquidity risk. If the IAIS is not considering the use of own liquidity metric as the right monitoring tool in the context of the IIM, it is superfluous to open a discussion on a limited number of specific topics that might come up when an insurer is developing an own liquidity metric.

Insurers will continue to use own liquidity metrics for the sake of liquidity risk management and might consider different aspects and group specificities when developing these metrics.

Q64. *Do you want to propose any other liquidity metric for liquidity risk monitoring that is not mentioned in sections 2, 3 and 4 of this document? If yes, please elaborate on its calculation and data requirements.*

- No

Q65. *Do you prefer a set of liquidity metrics for liquidity risk monitoring purposes? If not, provide clarification.*

- No

A single metric is preferable, as noted in the response to Question 66.

Q66. *Do you prefer a single liquidity metric (eg. ILR or CPA metrics) for liquidity risk monitoring purposes? If not, provide clarification.*

- Yes

A single liquidity metric is preferable.

Although the CPA has technical merit, significant development and ongoing maintenance work would be required. It needs additional development for non-life and non-US economies. In addition, the proposed scenario may not be an adequate stress for many insurers. For purposes of sector-wide monitoring, the extensive development and reporting burdens of this approach do not appear to justify the reporting burden. The IAIS appears to be committed to using the ILR, and an additional approach that is distinct from the ILR is unwelcome.

IAIS should focus on one meaningful metric. Increasing the number of metrics does not compensate their shortcomings, but rather increases confusion and burdens with the danger of relying on inappropriate indicators.

Q67. *General comments on the Public Consultation Document on the Development of Liquidity Metrics: Phase 2*

Insurance Europe welcomes the opportunity to engage with the IAIS on the development of liquidity metrics and the efforts made by the IAIS.

Insurance Europe acknowledges the IAIS' objective of developing a liquidity metric to act as a tool to facilitate monitoring of the industry at a macro level. The IAIS notes that the metric is intended to help it "highlight potential vulnerabilities, risk drivers and trends" in both individual insurers and the insurance sector". This is important context, because it correctly implies that the proposed metrics cannot do more than signal areas that may merit further investigation. The IAIS and its membership must recognise that the proposed metric is only appropriate to apply at a global level for sector-wide monitoring of potential trends and vulnerabilities for macroprudential considerations.

It should also be clearly accepted that microprudential supervision of liquidity risk must be based on company-specific analysis and frameworks which can't be standardised at global level. The macro prudential toolbox should not translate into binding regulatory requirements for individual firms, consistent with IAIS' stated intention. Insurance business models and liquidity risk profiles vary significantly, and from the perspective of the supervision of an individual insurer, the starting point of the supervisory dialogue should rather be the company-specific internal liquidity risk management framework.

Insurance Europe supports the implementation of the proposed Exposure Approach (EA) which it considers to be the most appropriate candidate metric for global macro liquidity risk monitoring. Insurance Europe acknowledges that there are some shortcomings of such an approach but considers these acceptable for the purposes of macroprudential monitoring.

For IAIS' global exercise, Insurance Europe supports the development and implementation of a single metric, assessed under a single time horizon. As the various metrics are intended to be an ancillary (supporting) indicator for monitoring, the burden of developing and maintaining three different approaches and seven plus different metrics (ie two sets of factors for EA, three time periods for CPA, and, at minimum, the two current metrics under "other liquidity metrics") is unjustified and unnecessary. It is likely that the use of multiple metrics will lead to confusion, not clarity. In addition, the various metrics proposed do not clearly relate to one another, as the underlying assumptions are inconsistent. If multiple metrics were to be proposed, the IAIS should demonstrate that it intends to use them in a cohesive way.

The design of the liquidity metric should align to its macroprudential objective. Attempting to address the shortcomings of the metrics to accommodate all business models will result in overengineering which will create spurious accuracy and unnecessary regulatory burden.

Insurance Europe recognises the efforts made by the IAIS to develop the cashflow projection approach. As the CPA relies on a prescriptive "one size fits all" list of stress parameters which are not suitable for each individual insurer, it cannot, however, replace internally developed metrics used to manage liquidity and would create additional work and a parallel calculation without material benefits. It should also be noted that the haircuts applied to liquidity sources would not be calibrated in accordance with the proposed scenario, which creates a lack of consistency in the approach.

Going forward. Detailed specification of the EA (or any other metric the IAIS retains) should be subject to a dedicated consultation. For instance, it is noted that various calibrations and contemplated downgrade options appear too extreme or not in line with the realities of insurance markets.

Please note that the responses provided to Questions 9-28 should not be interpreted as being supportive of the CPA approach.