

Liquidity risk is an important focus for insurers but is not area of regulatory concern, because the insurance business model already limits the exposure and because insurers actively assess and manage liquidity as needed and have a large range of sources of liquidity to do so. There are also already regulatory requirements in place requiring them to manage liquidity

- The vast majority of insurance undertakings are only exposed to moderate liquidity risk. One important reason for this is that insurers have an inverted production cycle; they receive and invest premium income before they need to pay claims, benefits and expenses. The claims and expenses at portfolio level are generally stable and predictable. This naturally lessens any liquidity strains.
- For insurance companies, liquidity risk is a short-term risk. Future requirements for cash as liability falls due are an ALM risk and not liquidity risk. Both of these risks are managed by insurers on an ongoing basis.
- Insurers deal with liquidity risk by actively assessing and managing liquidity. They have a range of sources of liquidity that allow them to manage both normal variation and rare extreme deviations from their short term cashflow planning. These include
 - New premium flow
 - Maturing investments and income from investments (dividends, rental income and interest payments)
 - Liquid assets including cash, shares, bonds – and insurers have a great deal of flexibility over which assets they would sell and so are able to avoid fire sales that could mean realising losses that are expected to be temporary due to market turmoil
 - Re-insurance
 - Committed credit lines
 - Intra-group liquidity
- The need for liquidity is limited by the predictability and/or long-term nature of liabilities but also due to the impact of mitigating factors on customer behaviour such as penalties imposed for early surrender either by the insurer and/or through taxation rules.
- Finally, especially in markets where mass lapse is a theoretical possibility, supervisors typically have powers to prevent mass lapses and this has been used successfully to mitigate potentially negative effects. Such powers of stay and prevention are supported precisely because they can eliminate residual theoretical concerns about liquidity risk.

Liquidity risk should not be addressed through increased solvency requirements. Liquidity is complementary to solvency and needs to be assessed in parallel. Liquidity should also not be incorporated into the liability valuation. Instead it should be addressed via appropriate and proportionate Pillar II and III requirements. For most insurers with usually quite moderate liquidity risks Solvency II already takes liquidity risk adequately into account:

- There are a number of existing Solvency II requirements relating to liquidity risk management and reporting. These include Article 44 (Risk Management), Article 77 (use of MA and VA) and Article 132 (Prudent Person Principle) of the Solvency II Directive and Article 260 (Risk Management) and Article 295 (SFCR requirements) of the Delegated Acts.
- Insurers also already submit a significant amount of data to EIOPA via the QRTs which should provide the majority of the data required to monitor systemic liquidity risk.
- EU-wide, standardised liquidity stress tests are not expected to provide significant additional value or insights to the data which is already available to supervisors and regulators. If standardised liquidity stress tests are to be used, they should be well designed and calibrated and take a holistic view which includes the mitigating factors and all sources of liquidity.

It should also be recognised that the solvency capital requirements under Solvency II include scenarios which overlap with those that can trigger a potential need for short-term liquidity such as mass lapses. Therefore, the risk that certain events can trigger the need to pay out liabilities sooner than expected, and under which some of the liabilities cannot be discounted, is already accounted for in the overall Solvency II framework.

- Additional capital is therefore already held and there is no need to develop new requirements related to liquidity in the valuation of the liabilities – in fact to do so would be double counting.

Liquidity stress testing is already undertaken by companies as part of their existing liquidity and risk management processes and widely reported upon within the ORSA. However, it is recognised that some additional appropriate and proportionate Pillar II and III requirements could provide clearer assurance that this is the case.

- For example, the following could be considered in case of special liquidity risks:
 - including explicit liquidity stress testing as part of the ORSA, where relevant.
 - the proportionate introduction of liquidity risk management plans (LRMPs).
- It is vital that liquidity, like solvency, is assessed on a holistic basis with any liquidity reporting taking into account both the liquidity of assets and liabilities, the interaction between these and all the sources of liquidity listed above. Elements such as penalties, taxes and powers to prevent mass lapses must all be taken into account in the assessment of any liquidity needs.
- Proportionality should be a key principle in the development of any additional liquidity risk requirements. Undertakings with very limited liquidity risks (eg annuity or unit-linked business), there should be no new requirements.