IAIS Consultation

Print view of your comments on "Development of Liquidity Metrics: Phase 2" - Date: 21.01.2022, Time: 21:15

Organisation	International Actuarial Association
Jurisdiction	International
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Treat my comments as confidential	No

	Question
	Q1 Do you agree with the IAIS' general objective and contemplated usage for the liquidity metrics? If not, please explain your rationale.
Answer	Yes
Answer Comment	The IAA agrees with the IAIS's overall objective to monitor liquidity risk, but do not believe that developing liquidity metrics is the right approach. Our observation is that most past liquidity events in the insurance industry were the result of certain products or practices in place for certain insurance groups, rather than due to systemic aspects of the industry itself. Therefore, the IAA believes that the exposure-based methods and metrics that look at overall balance sheet accounts are likely to be inconsistent with the source of the risk. Furthermore, in the IAA's view, introducing the three metrics proposed, CPA, ILR and a company own metric, seem disproportionate and leads to an extra reporting burden for (re)insurers. There is also a risk that using a single approach for liquidity risk could lead to (re)insurers to manage the liquidity position in the same way, thereby increasing concentrations, and as a consequence systemic risk. Instead, the IAA recommends focussing on the identification of activities and products that could materially increase liquidity risk, and then the investigation the prevalence of such activities and products within the industry. The IAA suggests that such activities and products that contain material liquidity risk could be first identified via supervisory college discussions and reviews of ORSA reports. If a liquidity metric were to be used, the IAA would suggest that it is used for macroprudential purposes and not for assessing the liquidity risk position of an individual (re)insurer.
	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.
Answer	No
Answer Comment	As mentioned in our response to Q1, the IAA proposes the identification of the activities and products that are most susceptible to liquidity risk instead of the approaches proposed. There already exist metrics that address future company risks, including liquidity: • ORSA • IMF Financial Sector Assessment Program • Individual company ERM and risk management functions, including projections of future financial condition. The IAA does not believe that the IAIS's introduction of an additional metric is likely to improve appreciably liquidity risk assessment.
	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)?

Answer	
	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?
Answer	

	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.
Answer	No
Answer Comment	As stated in the paper, the aim is to provide a monitoring tool for gathering information that will help identify trends in insurer and insurance sector liquidity. The IAA believes that neither EA nor CPA is capable of providing a full picture. Both approaches address known sources of liquidity risk only. (This is a shortfall of every standardised approach.) They fail to address new upcoming, unknown sources of liquidity. Usually there are management procedures available to deal with well-known risks, the higher danger lies in the area of unknown risks. Non-standard activities of insurance groups have the potential to generate new sources of liquidity risk and so the IAA that such activities need to be identified and the liquidity risk potential analysed

	Q6 Does the current enterprise approach lead to significant shortcomings of the liquidity monitoring? If yes, describe these shortcomings and limitations.
Answer	Yes
Answer Comment	The IAA's view is that it does. The biggest shortcoming is that this approach ignores the source of most liquidity issues that insurance groups have experienced in the past. Those liquidity risk events were not due to systemic risk within the industry but instead were due to systemic risk for certain activities and products. By focusing on groups but not activities the current enterprise approach is looking in the wrong place for these risks.

	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.
Answer	No
Answer Comment	The IAA agrees that any evaluation of liquidity risk has to include capital flows, but we think that the static approach suggested may well not produce useful results. Over the timeframes suggested (one quarter or one year), insurance enterprises would be expected to take certain (management) actions to address any emerging potential liquidity risk. That could include actions such as slowing down cash outflows (including new asset purchases, new investments, new products, etc.) and generating new cash sources.

	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.
Answer	No
Answer Comment	See Q7 response.

	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.
Answer	No

Answer Comment

Consistent with our response to Q7, the IAA sees the proposed approach as assuming a static operation for insurers that (incorrectly) assumes no adjustment by management to the new environment. The IAA believes the evaluation of the proposed approach cannot be fully evaluated without knowing the details, which were only discussed later in the document. The IAA's view is that the CPA approach is flawed as it continues to make fixed assumptions as to cash inflows/outflows in a year for an insurer based on balance sheet or income statement metrics - with no recognition of whether the enterprise has been growing or shrinking (or in a stable steady state), whether the assets have a remaining maturity of one or 30 years, or any other business or regulatory differences.

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

Answer

No

Answer Comment

The IAA does not believe that this will always make sense. The reasonableness of this assumption will vary by legal jurisdiction. Where a legal jurisdiction provides the holding company (or supervisor of the holding company) the authority to force actions by its subsidiaries then calculating the CPA at the holding company level may be reasonable, but where (and to the extent that) supervisors of the subsidiaries can prevent such actions (I.e., cash flows from the subsidiary to the holding company or affiliate) without their approval, the suggested approach would not reflect reality and so would not be recommended.

The proposed approach assumes that funds are fully fungible across all the companies in the group. This would not be useful from a supervisory point of view. If an individual company were to experience a liquidity problem, a local supervisor may well ring-fence the assets in that jurisdiction so as to protect the local policyholders and creditor. In a crisis, funds may well not be fungible. This would happen whether the company is operating using subsidiary or branch operations. A possible alternative to a group basis is for the supervisor to test for liquidity at the main insurance company at the head of the group and not assume that funds in a subsidiary are fungible up to the parent company.

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?

Answer

Yes

Answer Comment

While not necessarily a separate category, potential management actions affecting both cash inflows and outflows need to be reflected in order to obtain a reasonable evaluation of liquidity risk.

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.

Answer

No

Answer Comment

While some haircut may make sense, the IAA does not agree with the suggested haircuts as they seem overly simplified and overly conservative. As one example, the haircuts suggested for investment grade debt (table 5) do not reflect the remaining maturity of the debt. It is likely that the haircut in the market in a stressed situation would be a function of when the instrument matures, with those with shorter duration having less of a haircut than those with a longer duration. It is not clear how the currently proposed haircuts were calculated, but they seem to assume assets of extremely long duration.

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.

Answer

No

Answer Comment

The IAA's view is that such a high-level approach would only make sense if the industry was inherently susceptible to material liquidity risk. Given the IAA believes that only certain activities and/or products contain such material liquidity risk, the IAA's view is that the high-level approach is inappropriate (as it does not allow for adjustment to the extent that such high-risk activities do or do not exist).

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.

Answer

Yes

Answer Comment

Yes, but with a focus on high liquidity risk activities or products as identified first by a supervisory college or ORSA report review, and then with a focus on those activities/products rather than a focus on entire enterprises.

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

Answer

Yes

Answer Comment

There needs to be allowance for management actions, for reinsurance agreements that allow for netting of cash flows (such that cash outflows to the reinsurer can be netted with inflows from the reinsurer), and agreements that allow for timely receipt of the reinsurance recoveries. The IAA has observed that reinsurance payment is more timely where an ongoing business relationship exists or is assumed to exist, and the proposed makes no reflection of that.

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.

Answer

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.

Answer

No

Answer Comment

The IAA believes that for most insurance enterprises the 30 day time horizon is too short. That is because many claims (particularly for non-life) can take over a month for settlement, especially if the legal court system is involved. For some types of claims even 90 days is too short.

The 30-day time horizon would show the effects of an immediate cash flow crisis. The 90-day time horizon would show mitigation efforts, such as raising new capital/loans, selling subs, etc. The 1-year assessment should already be covered in a company's ERM risk management function and ORSA projections, and do not need to be duplicated.

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?

Answer

Yes

Answer Comment

The treatment of the investing section needs to consider management actions (e.g., stockpiling cash as signs of an impending or possible future cash flow become apparent). For example, some non-life companies providing coverage for North American storms that typically occur mid-calendar year have been known to adjust their levels of cash during the year. As such, year-end balances would ignore such management actions throughout the year.

The paper deals with liquidity from assets already in the company's funds. It does not mention the possible problems resulting from selling existing assets and thus unbalancing the company's ALM. This may have effects on the size of technical provisions and the

	company's resulting weakened statutory financial position.

	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?
Answer	Yes
Answer Comment	The proposal makes no allowance for whether an insurer has been growing or is in partial runoff when evaluating operating cash flow (pre and post stress). The IAA sees this as a significant flaw in the analysis. Any such stress suggested needs to reflect the situation of an insurer with regard to historic growth or runoff, as that facet materially affects expected operating cash flow and the potential for stressed operating cash flows.

	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?
Answer	Yes
Answer Comment	As mentioned earlier, all cash flows should reflect potential management actions and those activities/products that create liquidity risk.

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

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

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

	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?
Answer	

	Q25 Do you want to add other variables and parameters into the adverse liquidity stress scenario? If yes, provide suggestions.
Answer	

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

	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?
Answer	

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

	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.
Answer	
	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.
Answer	
	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.
Answer	
	Q32 Do you agree with the proposed approach to financials? If not, please explain and provide your suggestions.
Answer	
	Q33 Do you agree with the proposed approach to investment funds? If not, please explain and provide your suggestions.
Answer	
	Q34 Do you agree with the proposed factors for sovereign/PSE/GSE debt instruments? If not, please explain and provide your suggestions.
Answer	
	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.
Answer	
	Q36 Do you agree with the proposed factors for financial corporate debt instruments? If not, please explain and provide your suggestions.
Answer	
	Q37 Do you agree with the proposed factors for common equity (both financials and non-financials)? If not, please explain and provide your suggestions.
Answer	
	Q38 Do you agree with the proposed factors for selected liquid investment funds? If not, please explain and provide your suggestions.
Answer	
	Q39 Do you agree with the proposed factors for non-life premiums? If not, please explain and provide your suggestions.
Answer	
	Q40 Do you agree with the proposed factors for certificates of deposit and undrawn committed lines? If not, please explain and provide your suggestions.
Answer	
	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.

Answer	
	Q42 Do you think any additional relevant liquidity source should be considered in the ILR calculation? If yes, please explain and provide your suggestions.
Answer	
	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.
Answer	
	Q44 Do you agree with the proposed 3-month time horizon factors? If not, provide your explanation and suggestions.
Answer	
	Q45 Do you agree with the proposed factors for non-life claims and expenses? If not, please explain and provide your suggestions.
Answer	
	Q46 Do you agree that life premiums, claims and expenses are currently not included in the ILR? If not, please provide clarification.
Answer	
	Q47 Do you agree with the proposed factors for reserving risk? If not, please explain and provide your suggestions.
Answer	No
Answer Comment	The IAA does not believe that there is a significant risk of liquidity issues from reserving, as in general, reserves are set prudently and can be released as required to meet claims payments.
	Q48 Do you agree with the proposed factors for unearned premiums? If not, please explain and provide your suggestions.
Answer	
	Q49 Do you agree with the proposed approach for reinsurance recoveries? If not, please explain and provide your suggestions.
Answer	
	Q50 Do you agree with the refined factors for catastrophe claim payments? If not, please explain and provide your suggestions.
Answer	
	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.
Answer	
	Q52 Do you agree with the IAIS proposal to consider DGS in the ILR factors for bank deposits? Please provide your comments and suggestions.
Answer	

	Q53 Do you agree with the 3-month time horizon ILR factors for bank deposits? If not, provide your comments and suggestions.
Answer	
	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.
Answer	
	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.
Answer	
	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.
Answer	
	Q57 Do you agree with the 3-month time horizon ILR treatment of and factors for derivatives? If not, provide your comments and suggestions.
Answer	
	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.
Answer	
	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.
Answer	
	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.
Answer	
	Q61 Do you agree with the proposed factors for operational and cyber risk? If not, please explain and suggest an alternative treatment.
Answer	
	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.
Answer	
	Q63 Do you agree with the description of aspects of other liquidity metrics provided in Section 4?
Answer	
	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.
Answer	
	Q65 Do you prefer a set of liquidity metrics for liquidity risk monitoring purposes? If not, provide clarification.

Answer	
	Q66 Do you prefer a single liquidity metric (eg. ILR or CPA metrics) for liquidity risk monitoring purposes? If not, provide clarification.
Answer	
	Q67 General comments on the Public Consultation Document on the Development of Liquidity Metrics: Phase 2
Answer	As the IAA commented in response to Q1, the IAA's recommendation is to focus on the identification of activities and products that could materially increase liquidity risk, and then investigate the prevalence of such activities and products within the industry, rather than develop a suite of liquidity metrics. If overall the likelihood of a "liquidity event" is low, then there is a lot of work done to collate and analyse such metrics when a better approach might be first to identify (e.g. through supervisory colleges) those Groups where there is more likelihood of a liquidity event because of their structure/business model. The IAA suggests that such activities and products that contain material liquidity risk could be first identified via supervisory college discussions and reviews of ORSA reports, rather than developing distinct metrics