GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

24 January 2022

Response to IAIS consultation on the development of liquidity metrics — Phase 2

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

No. GFIA recognises the importance of liquidity risk management and the monitoring of that risk within the global insurance industry and supports the implementation of the Holistic Framework for Systemic Risk. GFIA is supportive of the IAIS' objective to develop a liquidity metric(s) to serve as a monitoring tool for the IAIS to help identify material trends in insurance sector liquidity.

However, the liquidity metrics, as currently formulated, should not be used "to assess insurers' liquidity exposure", as they do not adequately reflect the actual liquidity characteristics of individual insurance liabilities.

It is also important that the metrics are recognised as only being appropriate to be applied at global level. They should not translate into regulatory requirements for individual jurisdictions.

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. The proposed metrics already provide more than sufficient coverage for monitoring liquidity risk within the insurance industry.

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.

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. Any monitoring of separate accounts should be a focus of supervision rather than any liquidity metric and should be excluded.

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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 fungible liquidity pools approach may have relatively high-risk sensitivity, but in light of the low systemic risk in the insurance sector, GFIA does not consider that the additional reporting and calculation burdens required would be justified for a macro-level monitoring exercise.

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 (EA) does not capture all the features of how liquidity is managed and reported in the real world.

However, the updated EA approach is likely to be sufficient to provide a simplified "early warning" system to identify liquidity risks at the macro-prudential level.

While the company projection approach (CPA) has some merit in certain jurisdictions, it is expected to create a significantly greater operational and reporting burden for insurers with a little additional benefit.

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.

No. Cashflows relating to capital instruments over the proposed timeframes could be material and could be considered within the CPA metric.

However, GFIA does not consider it worthwhile including capital adjustments to the liquidity needs in the EA approach.

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. As noted above, GFIA does not consider there to be significant additional value in including capital elements in the insurance liquidity ratio (ILR). The detailed method should be avoided due to the additional reporting burden it would entail with no clear additional benefit.

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 proposal to assess the CPA over three different time horizons would create an unnecessarily high burden and should be avoided.

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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 combined adverse scenario that is based on the most likely, onerous market event for the insurance sector is appropriate.

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

Yes. GFIA supports the inclusion of financials in the liquidity sources and treating them with the same weights as non-financials. Haircuts on liquid assets should be used only in the stressed scenarios and not in the baseline.

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

Yes. GFIA supports the inclusion of investment funds (mutual, ETF and MMF) as liquidity sources.

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 appear extremely conservative. Table 6 does not seem to be the source for this proposal.

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. The most adverse stress impact from the Basel Committee on Banking Supervision (BCBS) proposal has been adopted, which significantly deviates from haircuts used by rating agencies and observable market data.

GFIA considers that they are rather conservative compared to the criteria of global rating agencies. As with sovereigns, it may be possible to consider setting the factors depending on the rating.

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

No. GFIA considers the proposed haircuts to be overly conservative.

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 the value of underlying instruments they already overstate 1-in-200-year shocks proposed in regulatory capital models.

Although GFIA agrees with the inclusion of factors for common equity, it would like to know the rationale for setting the factors (eg, that other evaluation organisations use similar calculations and approaches).

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

No. GFIA considers the factors for liquid ETFs, liquid mutual funds, and MMFs to be too low. The factors should be set to reflect the liquidity of the underlying asset.

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. In GFIA's view, the factors for undrawn credit lines are far too low, in particular in the cases where credit lines are with strong international banks, long-term and ready for execution. Such factors need to be considered in the calibration of the factors.

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

No.

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.

Yes. As noted in response to Question 1, GFIA supports the development of liquidity metrics as a tool to identify material directional changes in industry liquidity risk in the global insurance sector. If the desired use of the ILR is "to assess insurers' liquidity exposure", then more detailed factors are needed to reasonably reflect the actual nature of liquidity risk across different products.

In this context, GFIA also supports the principle of proportionality and regional differences for recalibration, and certain member jurisdictions believe that the economic penalty and time-restraint assessment metrics are oversimplified and that their comments have not been reflected in the IAIS documents.

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

No. Consideration of non-life insurance claims and expenses, which are factors that are likely to fluctuate, may lead to results that do not match the actual situation. Therefore, GFIA supports the method of assuming that cash inflows (such as premiums) and cash outflows (such as claims and operating expenses) offset each other.

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

No. Factors for reinsurance recoverables should be related to the rating quality of the reinsurer(s). Many insurance undertakings have strategic reinsurance partners with strong credit ratings.

With regard to the factors to be applied on actual figures at year-end close, GFIA would like to confirm that these should cover reinsurance recoveries already incurred in terms of claim paid. (While there are exceptional cases when insurance companies do not have the right to claim reinsurance at the time of accumulating technical provision and incurred but not reported (IBNR) reserves.)

The factors should be based on the rating and creditworthiness of reinsurers, as factors set at 50% and 12.5% are considered to be very high when assuming there are reinsurers with high credit ratings.

Three to six months is the normal cycle for reinsurance recoveries. It is therefore inappropriate to set the factor at 0% for amounts recovered during this period. A review of the period categories and factors should be considered.

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 OTC and CCP contracts the 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.

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.

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. GFIA does not consider the benefits of developing multiple liquidity metrics to be necessary given the limited amount of liquidity risk inherent in the insurance industry.

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

Yes. GFIA supports the use of a single liquidity metric for liquidity risk monitoring at a macroprudential level given the limited amount of liquidity risk inherent in the insurance industry.

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

GFIA welcomes the opportunity to engage with the IAIS on its work on liquidity metrics.

It recognises the importance of liquidity risk management and the monitoring of that risk within the global insurance industry and supports the implementation of the Holistic Framework for Systemic Risk. GFIA is supportive of the IAIS' objective to develop a liquidity metric(s) to serve as a monitoring tool for the IAIS to help identify material trends in insurance sector liquidity.

Liquidity risk is important for insurers, but it is well managed due to the business model, existing regulatory provisions and insurers' integrated approach to liquidity and risk management. Furthermore, 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 each business, which is highly individual.

The overall level of liquidity risk in the insurance sector is significantly lower than that in the banking sector.

GFIA supports the development of liquidity metrics for macroprudential monitoring that are proportionate to the overall liquidity risk inherent in the insurance sector. Standardised liquidity metrics should not aim to cater for the full range of business models, liquidity risk profiles and product and asset mixes in the global insurance market.

In GFIA's view, the IAIS should aim to develop a simple liquidity metric that achieves the objective of identifying material changes in liquidity risk. Despite its shortcomings, on which GFIA has previously commented, the ILR does have the advantages of being a simple and relatively easy to implement metric for macroprudential monitoring. However, it should be accepted that it should not be used "to assess insurers' liquidity exposure", as it does not adequately reflect the actual liquidity characteristics of individual insurance liabilities.

Where liquidity risks are identified, supervisors can engage with companies to gain a better understanding of any liquidity issues through assessment of insurers' internal liquidity management plans and liquidity frameworks which are already in place.

GFIA recognises that, for some markets, the company projection approach provides greater risk sensitivity and insights into risk exposures. However, GFIA is concerned that it would create unjustified operational burdens for some business models and jurisdictions.

The development of multiple metrics risks creates significant additional reporting and operational burdens without commensurate benefit and should be avoided.

GFIA encourages the IAIS to continue stakeholder engagement in further developing the metric(s).

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About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 43 member associations and 1 observer associations the interests of insurers and reinsurers in 66 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than $4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.