INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

Public Consultation on the Development of Liquidity Metrics: Phase 1 – Exposure Approach

Thank you for your interest in the public consultation on the Development of Liquidity Metrics: Phase 1 – Exposure Approach. The Consultation Tool is available on the IAIS website from Monday 9 November 2020 and the deadline for submitting comments is Sunday 7 February 2021.

Please do not submit this document to the IAIS. All responses to the Consultation Document must be made via the Consultation Tool to enable those responses to be considered.

Questions:

1	Do you agree with the IAIS' plan for the development of liquidity metrics for monitoring? If not, please explain what changes you recommend and why. **We agree that liquidity can be a key risk, both in relation to individual insurers and systemically. We support the IAIS's plan to develop liquidity metrics that reflect characteristics of liquidity sources and requirements and that can be used by supervisors to show the systemic environment in their jurisdictions. We believe that a single liquidity metric, as proposed in this consultation paper, can be a useful and expedient tool for sector wide liquidity monitoring.** **However, we believe an ILR should also be useful for individual insurer monitoring, but the current design has shortcomings in identifying potential liquidity problems and liquidity sources in any particular insurer. Each insurer's circumstances are different and should be examined individually by its supervisor. The proposed ILR has a prescriptive methodology that may not be adequate for supervisors to use for each insurer.** **A key consideration that we believe should receive more emphasis is that there are different circumstances that could trigger liquidity problems for insurers. A liquidity problem that is a result of an insurer's idiosyncratic circumstances can create financial effects that might be mitigated by a range of available remedies. However, a more systemic liquidity crisis might result in insurers having fewer potential remedies. Understanding the type of liquidity crisis is key to assessing what liquidity needs might arise and what liquidity sources might be available.** **Additional specific comments are made in response to some of the questions later in this document.**
2	Should the IAIS consider any other approaches or alternatives when developing liquidity metrics? If so, please explain. **This consultation paper should be aimed at providing guidance to supervisors on how to judge the robustness of an insurer's liquidity management. This**

	would be better served by the use of scenario testing for liquidity management, as described/required by ICP 16. The supervisor could constrain liquidity risk by advising insurers about best practices. **An alternative to calculating a metric (such as a ratio as proposed by this paper) is to show available liquidity and required liquidity, and their difference, as monetary amounts. Each of these amounts can be shown by component. A single ratio seems too simplistic for such a complex risk element.** **A specific point in this section of the consultation paper notes that the IIM will be computed on an "enterprise-wide basis." At the time of a liquidity crisis, it should not be presumed that any liquid assets would be fungible across separate jurisdictions. Liquidity risk should be measured separately by company/subsidiary and by jurisdiction.**
3	Should the IAIS develop additional liquidity metrics that examine other time horizons? If so, how should these metrics differ from the proposed metric? **We consider a one-year time horizon to be appropriate. Specific comments on the metrics are included in responses to some of the questions later in this document.**
4	Do you agree with the exclusion of separate accounts from the ILR? If not, how should separate accounts be incorporated? **We agree that separate accounts can be excluded from the ILR. If there are any guarantees of minimum returns on the separate accounts, they will be held in the general account of the insurer and will be subject to cash flow requirements.**
5	Do you agree with the proposed factors for liquidity sources? If not, please explain. **The factors appear to be arbitrary and will not be appropriate in all circumstances in all jurisdictions. The appropriateness of the size of the factors would depend on whether the insurer has an idiosyncratic liquidity problem (in which case the factors are conservative and could all be 100%) or whether there is a systemic market crisis (in which case the factors could all**

	be too high). Judging an insurer's liquidity management should depend on its specific circumstances. **If factors are to be used, they should be a function of similar factors already being used, such as those in the ICS or the large rating agencies. This would simplify reporting requirements and reconciliation of results.**
6	Do you agree with the treatment of investment funds? If not, please explain and suggest an alternative treatment. **If investment funds could cause liquidity risk, as is mentioned in the paper, then they should be included in the analysis.**
7	Do you agree with the treatment of premiums? If not, please explain how premiums and excluded expenses should be treated in the ILR. **We agree with the proposed treatment.**
8	How should instruments issued by financial institutions be treated within the ILR? **No opinion on this question.**
9	Do you agree with the inclusion of certain encumbered assets as liquidity sources within the ILR or should the IAIS alternatively exclude these encumbered assets and measure the related liquidity needs on a net basis? Should any additional liquidity needs be included in the calculation because encumbered assets are included as a liquidity source? **No opinion on this question.**
10	Do you agree with the treatment of liquidity risk from surrenders and withdrawals from insurance products in the ILR? If not, please explain how this could be improved. **We agree with the paper's treatment in general. However, there could be additional risks given the specific circumstances of an insurer. An example is the case of General American where a decrease in a rating by an external agency caused a very large pension client to have to immediately withdraw their funds, but the liquidity for this was not available. Special material**

	circumstances have to be addressed separately by an insurer and its supervisor.
11	How should the IAIS capture liquidity needs from policy loans? Should these be incorporated into the ILR or be an alternative metric? **If policy loans are material, then they should be included. This depends on the circumstances of each individual insurer.**
12	Do you agree with the factors applied to retail insurance products being half of the factors applied to institutional products? How should the factors applied to retail and institutional policies differ? **No opinion on this question.**
13	Do you agree with the treatment of unearned premiums in the ILR? If not, how can it be improved? **No opinion on this question.**
14	Should the IAIS apply standardised factors to insurers projected ultimate catastrophe losses or rely on company projections for the speed of catastrophe payments and reinsurance recoveries? **Company projections should be used since the speed of payments would vary by an insurer's circumstances.**
15	Do you agree with the proposed treatment of catastrophe insurance claims? If not, how can it be improved? **No opinion on this question.**
16	Should the proposed treatment of deposit liabilities include more or less granularity? If so, what additional dimensions (eg the presence of an effective deposit insurance scheme) should be captured or left out? **If the deposit liabilities are in an insurer's bank subsidiary, they should be considered separately. See the comments to question 2 above.**
17	Should the proposed factors be modified? If so, please explain how and why.

	Actual experience should be used if available.
18	Should insurance contracts without significant exposure to insurance events be captured by these factors, or included with other policyholder liabilities? **They should be included in other policyholder liabilities.**
19	Do you agree with the treatment of derivatives? If not, please explain and suggest an alternative treatment. **The proposed standardized factors in respect of derivatives do not sufficiently recognize the differences in the risk profile amongst insurers and consequently differences in their hedging needs and derivative portfolios. Such analysis of derivatives should be based on each insurer's circumstances.**
20	How should the ILR treat debt with financial covenants that may be triggered under stress? **We do not propose there should be a general rule. Each insurer's circumstances should be analyzed separately where there are material financial covenants.**
21	How should the ILR assess potential liquidity needs from a downgrade? **If there are potential material liquidity risks from a downgrade, the circumstances should be analyzed separately.**
22	Do you agree with the discussed limitations and mitigations of the ILR? What other limitations should the IAIS consider and how can these be mitigated when the IAIS monitors liquidity risk? **No opinion on this question.**
23	General comments on the Public Consultation Document on the Development of Liquidity Metrics: Phase 1 – Exposure Approach **A liquidity ratio, as proposed by this paper, is too simplistic for a complex liquidity analysis. It is a point in time number that does not include:** • **An insurer's risk management operations;**

	• Systemic vs. idiosyncratic liquidity crises; • Differences in separate jurisdictions; • Differences in product characteristics between companies and between jurisdictions; and • Differences in timing for liquidity needs and liquidity availability. An ILR would also not address any interactions between liquidity and capital. In some cases, the sales of assets used as liquidity sources (with the assumed haircuts) may exhaust the insurer's capital resources. In other cases a weak financial position may in fact deteriorate the illiquidity, which would not be captured by the ILR. While ideally these risks could be looked at jointly, this would add significant complexity, and supervisors typically look at these risks separately using different tools. The use of company liquidity availability and requirements within a company-specific projection gives a better early indicator of potential risk. ICP 16 describes and prescribes this type of scenario testing for risks, specifically including liquidity risk. Liquidity risk is specifically addressed in ICP 16, 16.1.1, 16.1.b, 16.9.1, 16.9.a, 16.9.d. As noted in an earlier answer, this consultation paper's proposed standardized liquidity monitoring using a standardized single ratio is too simplistic to provide any real value to supervisors and adds costs for both the insurers and the supervisors. The use of insurer-specific risk modelling as required by ICP 16 gives superior risk management early warning.