January 21, 2021

Dr. Victoria Saporta
Chairperson
Mr. Jonathan Dixon
Secretary General
International Association of Insurance Supervisors (IAIS)
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: IAIS Public Consultation Document – Development of Liquidity Metrics: Phase 2

Dear Dr. Saporta and Mr. Dixon:

The Institute of International Finance (IIF) and its insurance members appreciate the opportunity to comment on the *IAIS Public Consultation Document – Development of Liquidity Metrics: Phase 2* (Second Liquidity Metrics Consultation). On February 4, 2021, the IIF commented on the IAIS's consultation on the *IAIS Public Consultation Document: Development of Liquidity Metrics: Phase 1 – Exposure Approach* (the First Liquidity Metrics Consultation). Some of the key themes of our response to the First Liquidity Metrics Consultation are reemphasized here, as they are also relevant to the discussion of the Second Liquidity Metrics Consultation.

Overarching Comments

The IIF and its insurance members generally believe that liquidity risk management and liquidity stress testing is and should remain a bespoke exercise conducted by insurers with supervisory review and oversight. A standardized approach to liquidity risk management is not consistent with the highly individualized nature of liquidity risk and liquidity risk management across the insurance industry. Each insurance group, as well as each of the entities within the group, has a different liquidity risk profile and liquidity dynamics, which are not readily amenable to standardized analysis. Internationally active insurance groups generally use internal models that are designed and continually refined to reflect the risk profile and dynamics of the group and its constituent entities. Given the complex and bespoke nature of liquidity management, it is not amenable to a single approach. Rather, insurers consider their individual business model and structure, the particular conditions to which they are exposed, the likely time horizons and consequences of various scenarios for both the company and its policyholders, and the resources and management actions that are available to address those scenarios.

Notwithstanding, we acknowledge the importance of liquidity risk monitoring for the IAIS as part of the finalization of the Holistic Framework for the Assessment of Systemic Risk in the Insurance Sector (Holistic Framework). IAIS macroprudential liquidity monitoring should be a sector-wide supervisory monitoring exercise that is tied to the transmission channels in the Holistic Framework (particularly, the asset liquidation transmission channel) and driven by jurisdictional supervisors' collective view of potential sources of liquidity stress in the insurance sector. A simple Exposure Approach (EA) metric, such as the

Insurance Liquidity Ratio (ILR), can function as a high-level macroprudential sector-wide monitoring tool for assessing changes in overall industry liquidity over time and as a possible signal of impending liquidity stress or other macroprudential developments. However, in order to avoid the creation of an illusory precision and to reduce the likelihood of false positives and negatives, the use of the ILR should avoid a simple aggregation or summation of liquidity sources and needs and should be accompanied by a broader qualitative analysis conducted at the jurisdictional level. Results of the jurisdictional qualitative analyses could be shared within the appropriate committees and working groups of the IAIS.

We stress that aggregate liquidity metrics, including the EA/ILR, should not be used for microprudential oversight, as these measures fail to consider many of the relevant facets of liquidity management in insurance. Importantly, aggregate metrics overlook the time dimension of liquidity risk management and do not provide a forward-looking view of liquidity risk. The use of aggregate metrics in microprudential supervision would be at odds with existing liquidity regimes and approaches to liquidity risk management among insurers. A microprudential use of EA metrics could lead supervisors to rely on misleading indicators of liquidity strength or weakness, with negative consequences for the supervision of insurers.

We question the need for multiple liquidity metrics, given that it is well acknowledged that liquidity pressures among insurance undertakings are considerably lower than those experienced by banking organizations. Moreover, as noted in the IAIS's recent *Global Insurance Market Report* (GIMAR), insurers' cash positions generally increased, liquidity buffers were strengthened, and liquidity contingency planning has been enhanced.

The IAIS has other tools at its disposal that can help develop a macroprudential view of insurance sector liquidity. In addition to the aforementioned qualitative analyses, GIMAR thematic reviews provide a vehicle for IAIS members to share insights into sector-wide developments. The IAIS's Macroprudential Committee and working groups can conduct sectoral deep dive reviews of any liquidity developments that raise concerns among members. IAIS members would then be equipped to review these issues in the context of individual insurers under their jurisdiction as and to the extent appropriate.

Company Projection Approach

The Company Projection Approach (CPA) may be appropriate for implementation in certain IAIS member jurisdictions and may complement certain insurers' existing in-house liquidity risk management approaches, but this should ultimately be a decision by the insurer on how to best set up its own liquidity monitoring. In turn, decisions regarding liquidity monitoring will be business line and business model dependent.

We believe that the CPA does not lend itself to global application given the diversity of markets and the asset and liability composition of insurers in different markets. For example, while a CPA may be a useful tool for assessing liquidity risk in long duration lines of business, it is not well suited to the analysis of liquidity risk in many property and casualty and asset management business lines, given differences in the duration of assets and liabilities across business lines. We also believe that broad application of the CPA across insurance business lines and markets could produce misleading false positives and negatives which could trigger supervisory actions that hinder, rather than support, strong risk management practices. Given these limitations, we do not support the IAIS using the CPA as a global macroprudential tool.

Finalization of the Exposure Approach

A focus on liquidity needs and sources at the group level would only be appropriate if the liquidity is managed at a group level, which is not necessarily the case. If liquidity is managed at the legal entity level, a group level analysis would not only be difficult to calculate but may provide false signals as to the liquidity strength or weakness of individual insurers within the group.

Overall, liquidity risk management practices among insurers depend critically upon the insurer's lines of business and product mix. A 'one-size-fits-all' approach to liquidity metrics does not reflect this heterogeneity of insurers' liquidity risk management and could lead to 'herding' behavior and associated concentration risks if insurers are incentivized to invest in the same types of assets to meet liquidity targets.

For instance, a number of less liquid sources are actually well suited to match long-term liabilities but are unduly penalized under certain circumstances under the IAIS's proposed treatment. The IAIS should recognize the inherent limitations of standardized discounts, which cannot and do not reflect different and changing liquidity dynamics over time and among companies. This inappropriate penalization of some liquidity sources and the use of standardized discounts could contribute to concentration risks as mentioned above. This treatment could also lead to the development of unwarranted 'fire sale' scenarios that are extremely unlikely to manifest in the insurance sector and may result in inappropriate policy or supervisory reactions that would impede effective liquidity risk management.

We believe that the factors and related discounts for liquidity sources depend on a particular insurer's products, the terms and conditions on which those products are offered to the market, and how particular assets respond to market movements in terms of liquidity and/or spread widening. Standardized discounts are incapable of reflecting the unique combinations of products, terms and conditions across insurance markets.

With respect to particular discounts, while we welcome the inclusion of committed lines of credit in liquidity sources, we believe that the proposed discount is inappropriately high. Committed lines of credit are legally binding contractual commitments by banks that provide a strong source of liquidity support to insurers. The proposed discount could discourage the use of lines of credit as a contingency planning tool, to the detriment of sound liquidity risk management.

With respect to liquidity needs, we believe that lapse sensitivity is very idiosyncratic and not amenable to a standardized approach. Economic penalties (which we note are not permitted in some markets) are not the main drivers of lapse risk and the use of this indicator would not capture the full range of market dynamics and other factors (e.g. tax impacts) that are greater contributors to the likelihood of policy lapses. More importantly, the use of this indicator will lead to misleading false positives and negatives as to sector liquidity needs and the penalties of up to 50% mass lapse are overly conservative for many products.

We find that the addition of a factor for operational and cyber risk to be arbitrary and unsupported by evidence. We respectfully suggest that the treatment of operational and cyber risk needs further study and deliberation before finalizing a factor.

We would like to confirm that the IAIS's EA does not necessarily require a liability liquidity bucketing approach but, rather allows for greater flexibility for a wide range of company approaches to liquidity risk management. In particular, we encourage the IAIS to adopt a more flexible approach to the impact of

economic penalties on liability liquidity, as well as the surrender rates for retail and institutional products (Tables 7 through 9).

Other Liquidity Metrics

As noted above, internationally active insurance groups generally use internal models that are designed and continually refined to reflect the risk profile and dynamics of the group and its constituent entities. The listing of nine specific aspects in own liquidity metrics could hamper the development of insurers' bespoke internal models by appearing to prescribe certain required elements of those models. Moreover, a 'laundry list' of other liquidity metrics may lead some external stakeholders to adopt a tick-box approach when reviewing and assessing individual companies' or groups' liquidity risk management. Whether a particular metric is appropriate and meaningful depends upon the company's lines of business, business model and overall approach to liquidity risk management.

We appreciate the opportunity to comment on this consultation. The IIF believes that the topic of liquidity risk management is one that would benefit from extensive dialogue and discussion among regulatory and industry experts before an approach is finalized. We would be pleased to facilitate this dialogue among IAIS members and the insurance members of the IIF.

Respectfully submitted,

Mary Frances Monroe