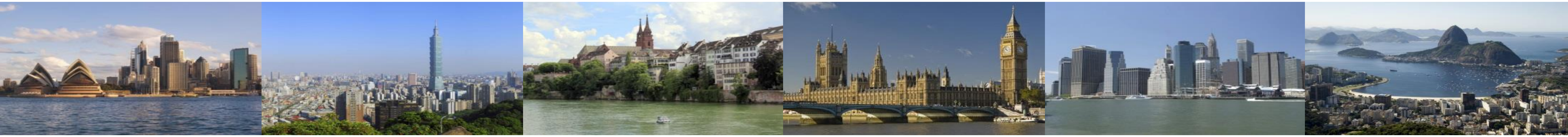
IAIS

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Public background session

30 November 2020

13.30 – 15.00 CET



Development of Liquidity Metrics: Phase 1 – Exposure Approach

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Global Monitoring Exercise and ancillary indicators

- Global Monitoring Exercise (GME) – one of the key elements of the IAIS Holistic Framework for the assessment and mitigation of systemic risk in the global insurance sector (adopted in November 2019)
- Global Monitoring Exercise serves:
  - to assess global insurance market trends and developments and
  - to detect the possible build-up of systemic risk in the global insurance sector.
- This includes an annual assessment by the IAIS of potential systemic risk arising from sector-wide trends with regard to specific activities and exposures, but also the possible concentration of systemic risks at an individual insurer level (using an updated assessment methodology) arising from these activities and exposures
- To further aid the assessment of systemic risk in the global insurance sector, the IAIS can make use of ancillary indicators in its analysis
- Ancillary indicators are used in the context of the IIM exercise and do not affect the total individual quantitative score. However, they may provide additional context that can inform the overall assessment. Liquidity metrics are potential ancillary indicators

Liquidity metrics and the two-phase approach

- Paragraph 58 of the November 2019 GME document states: “The IAIS is currently developing liquidity metrics. These liquidity metrics will serve as a tool for the IAIS to assess insurers’ liquidity exposures. They will not be a binding requirement, but rather a monitoring tool, and will help identify trends in insurer and insurance-sector liquidity. The IAIS plans to consult on metrics for liquidity monitoring in 2020 and 2021.”
- The IAIS has split the development of liquidity metrics into two phases:
  - During Phase 1, the IAIS will develop an Insurance Liquidity Ratio (ILR), which will use an exposure approach (EA) and is further defined in this current public consultation document;
  - During Phase 2, the IAIS will develop other liquidity metrics, including a company projection (CP) approach. The CP approach utilises insurers’ projections of cash flows to assess liquidity risk.
- The current public consultation focuses on one metric, an Insurance Liquidity Ratio, the IAIS has developed as an ancillary indicator for the monitoring of liquidity risk
- During 2021, the IAIS will also work to further develop other liquidity metrics (eg a company-projection approach) for monitoring. The IAIS plans to consult on these other metrics in autumn 2021
- The IAIS plans to finalise a set of liquidity monitoring metrics in 2022

Exposure Approach and Company Projection Approach

Description and comparison

- The Exposure Approach (EA), for example an Insurance Liquidity Ratio (ILR), applies factors to balance sheet items and off-balance sheet exposures to measure liquidity risk
- The Company Projection (CP) approach utilizes insurers' projections of cash flows to assess liquidity risk.

Exposure approach		**Company Projection approach**	
Strengths	Weaknesses	Strengths	Weaknesses
• Better comparability • Simplicity • Less burden (many inputs already available) • Transparent	• Less risk sensitive • Loss of information on mismatches between liquidity needs and sources	• More risk sensitive • Additional information about timing mismatches between liquidity need and sources	• More complicated • Decreased comparability due to differences in assumptions across companies • Less transparent • More burdensome

Insurance Liquidity Ratio (ILR)

- The ILR is the ratio of an insurer's liquidity sources and needs over a one-year assumed liquidity stress:

$$\text{Insurance Liquidity Ratio (ILR)} = \frac{\text{Liquidity Sources}}{\text{Liquidity Needs}}$$

- The IAIS chose initially to focus on a one-year stress horizon as insurers are relatively less vulnerable to liquidity stresses that resolve over shorter horizons.
- Some of the largest drivers of insurer liquidity needs, such as policyholder surrenders and catastrophe payments, would result in cash flows that are spread over months or years instead of hours or days
- The ILR focuses on an insurer's general accounts. Liquidity risk within separate accounts is borne by the policyholder, rather than the insurer. The IAIS may develop separate metrics for monitoring in a future period to capture any potential risk from these products

Liquidity Sources

Insurance Liquidity Ratio (ILR)

- The table below identifies significant sources of liquidity considered for inclusion in the ILR (factors are subject to further analysis an refinements):

Factors	Liquidity Sources in the ILR	Rows
100%	Cash	9.4.a
100%	Sovereigns rated AA- and above	9.5.1
100%	Sovereigns in local currency	9.5.2
85%	Sovereigns rated A- and above	9.5.3
85%	GSE securities senior to preferred shares rated above A-	9.5.7a and 9.5.7b
70%	Investment-grade covered bonds	9.5.4
70%	Investment-grade public sector entity debt	9.5.8
70%	Investment-grade corporate debt securities	9.5.5
50%	Common equity	9.5.6

Liquidity Needs

Insurance Liquidity Ratio (ILR)

- For liquidity needs, the ILR would primarily leverage prior IAIS work on systemic risk identification
- Liquidity needs may be divided into the following categories:
  - Insurance Liquidity Needs
    - Liability Surrenders
    - Unearned Premiums
    - Catastrophe Claim Payments
  - Non-Insurance Liquidity Needs
    - Bank deposits and contingent funding
    - Derivatives
    - Other Funding Liabilities and potential liquidity needs

QUESTIONS

Application Paper on Resolution Powers and Planning

Alex Hart, Chair of the Resolution Working Group

IAIS Application Papers

- The IAIS, as the Global Standard Setting Body for insurance supervision, develops supervisory material and supporting material

- Supervisory material:
  - Insurance Core Principles (ICPs), which apply to all insurers in all jurisdictions
  - ComFrame, which focuses on the group-wide supervision of Internationally Active Insurance Groups (IAIGs)

- Supporting material:
  - Application Papers
  - Issues Papers
  - These supporting materials do not create new standards

- Role of the proportionality principle

IAIS work on Recovery and Resolution

Relevant Supervisory Material

- ICP 12 (Exit from the Market and Resolution) and ComFrame integrated in it lays out the resolution framework for insurers, including the resolution powers, resolution planning and management information systems.

- Standard ICP 16.15 and ComFrame integrated in it include requirements for recovery plans
    - In November 2019, the IAIS adopted an Application Paper on Recovery Planning

- ICP 25 (Supervisory Cooperation and Coordination) and ComFrame integrated in it provide requirements for crisis preparation & management, including a requirement to have in place crisis management groups for IAIGs.

Application Paper on Resolution Powers and Planning

Structure of the Paper

- Objectives and concepts of resolution
- Concepts around point of non-viability and entry into resolution
- Resolution powers
- Resolution planning
- Resolvability assessments
- Coordination and cooperation among involved authorities.

Application Paper on Resolution Powers and Planning

Zooming in on… resolution powers

Resolution powers have been grouped as follows:

- Taking control
- Prohibition of certain payments and transfers
- Withdrawal of licence to write new business and placement into run-off
- Restructuring mechanisms
- Suspension of Rights
- Liquidation
- Specific powers required for IAIGs

Application Paper on Resolution Powers and Planning

Zooming in on… resolution planning

Objective of resolution planning:

- To identify in advance options for resolving all or part(s) of an insurer with the ultimate aim to be better prepared for resolution. It serves as a guide to resolution authorities for achieving an orderly resolution in situations where recovery measures are no longer feasible or have been unsuccessful.

The Paper provides concrete examples for decisions around the scope of the requirement, and the application of proportionality

The Paper provides guidance around the key elements of a plan

- An executive summary, including the resolvability assessment
- A description of the group, including on the legal structure, financial and operational dependencies
- A trigger framework for entry into resolution
- An analysis of the impact of the failure on other parts of the financial system and/or on the real economy
- A description of the preferred resolution strategy
- An operational plan for the implementation of the resolution strategy;
- A description of the governance for resolution planning and resolution process;
- A communication strategy
- An analysis of the impact on the PPS (if applicable)

QUESTIONS

Next steps

Development of Liquidity Metrics: Phase 1 – Exposure Approach

- Feedback is invited by **7 February 2021 24.00 CET (Basel time)**.
- The feedback will be taken into account while the IAIS continues its work on developing (a set of) liquidity monitoring metrics.

Application Paper on Resolution Powers and Planning

- Feedback on this draft Application Paper is invited by **Friday 5 February 2021 24:00 CET (Basel time)**.
- The final Paper is expected to be published along with a Resolution of Comments document, around mid-2021.

Only comments provided via the IAIS consultation tool will be considered