

**Questionnaire on the assessment of the expected impact of implementing proposed reforms to the framework for liquidity risk management for insurers**

**Background and context**

Liquidity risk is the risk that an insurer, although solvent, may not be able to meet its financial obligations when they are due without incurring significant costs. This risk can arise from a number of activities that insurers may engage in, such as derivative contracts, which are used to hedge market risk but can introduce liquidity risk in the form of margin and collateral calls, securities lending transactions if funds received are reinvested in illiquid assets, and where illiquid assets back liquid liabilities.

To ascertain the potential impact of implementing the revised FSI 6 Liquidity Risk Management Standard, the PA is soliciting stakeholder inputs through this questionnaire and the accompanying quantitative impact study (QIS) templates. The responses received from all interested persons as part of this process will be considered, together with any further or other comments that may be received from interested persons on the framework when the PA finalises the proposed amendments to the liquidity risk management standard for insurers.

Information gathered through this questionnaire will be treated with strict confidentiality and only utilised for the purpose indicated above (i.e. to assess the impact of the proposed framework on insurers).

Non-life insurers operating in South Africa must complete the questionnaire and accompanying QIS templates. All life insurers operating in South Africa must complete the questionnaire and the cost of implementation (TAB 4) and derivatives tabs (TAB 5) of the accompanying QIS template. Completed questionnaires and templates must be submitted to RSD-ALM@resbank.co.za for the attention of Pierre Mananga by COB, 31 July 2024.

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| **General: Please note the purpose of the questions below is to field test the insurers’ capabilities in line with the PA’s intended proposals to amend the tab LIQ and FSI 6 liquidity risk management standard for insurers. Therefore, when completing the below, please refer to the respective sections on the quantitative assessment to see the corresponding proposals.** |

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| **Information on responding institution** | |
| **Name of institution** |  |
| **Name and position of the respondent** |  |

**Part 1: proposed amended return liquidity risk**

1. **Reporting both business as usual and stressed cash flows**

The cumulative net cash flow mismatch is one of the principal tools used to measure the insurer’s liquidity strain. Insurers shall construct the required cumulative net cash flow mismatch by classifying all relevant cash flows in time horizons according to their receipt or payment dates. The cumulative cash flow mismatch:

1. Measures the insurer’s exposure to liquidity risk by focusing on cash inflows and outflows in given time horizons.

For some items, the date on which the cash flow will occur is less certain; therefore, assumptions about when these will occur are necessary in determining the cash flows. Some business-as-usual cash flows will differ in timing and quantum as a result of stressed conditions; therefore, the stressed cash flows are required to capture this difference in the cash flows.

1. **Please provide your insurers business as usual and stressed cash flow forecast for the next 12 months. Please respond by completing the attached Excel template, TAB 1- Business as Usual and TAB 2-Stressed cash flows.**

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| * 1. **Please explain your insurer’s view on the proposed reporting of a business-as-usual and stressed cash flow projection.** | Response: |
| * 1. **What are the main advantages and disadvantages of reporting business as usual and stressed cash flows?** | Response: |
| * 1. **Do you foresee any challenges reporting business as usual and stressed cash flows? Please elaborate.** | Response: |

1. **Insurance Liquidity Ratio**

The insurance liquidity ratio is the ratio of the total available liquidity to stressed liquidity requirements. An insurer's stress tests should include a range of severe but plausible scenarios, covering short-term and protracted macroeconomic, sector-wide, and idiosyncratic events and a combination that appropriately reflects its business's distinctive features.

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| 1. **Does your insurer hold a portfolio of high-quality liquid assets to cover any liquidity gap in a particular time horizon, both benign and stressed conditions? Please expand on this.** | Response: |
| 1. **What do you see as the main benefits of reporting the ILR?** | Response: |
| 1. **Do you foresee any disadvantages or challenges of reporting the ILR?** | Response: |

1. **Liquidity risk exposure from the use of derivatives.**

Some derivatives contracts require collateral or a margin to be posted for mark-to-market movements in the value of the contract. These derivatives, used to hedge market risk arising from investments and liabilities, introduce potential liquidity risk on the insurer’s balance sheet. A significant macroeconomic shock could trigger calls for additional margins or collateral, resulting in a liquidity risk event.

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| 1. **What derivative contracts is your insurer exposed to that require collateral and margin calls to be posted for mark-to-market movements? Please report the amount of the derivative exposure by type. Provide your response by completing the attached Excel template, TAB 5- Derivatives exposures.** | Response:[2. Insurance Liquidity Risk quantitative assessment\_PA.xlsx](file:///\\SRV06900\BSD-Share\RiskSpecialistFunction\Supervision\Assets%20and%20Liabilities%20Management\Insurance\FSI%206%20Updated\PWG\2.%20Insurance%20Liquidity%20Risk%20quantitative%20assessment_PA.xlsx) |
| 1. **How does your insurer estimate the liquidity risk of derivative exposures?** | Response: |

1. **Exposure to illiquid assets backing liquid liabilities**

Some products offered by insurers contain provisions whereby a policyholder can withdraw cash from the policy with little notice or penalty. Where insurers do not adequately match such liabilities with sufficient liquid assets, this may lead to a liquidity shortage in certain circumstances and ultimately trigger fire sales.

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| 1. **What proportion of your liquid liabilities are backed by illiquid assets?** | Response: |
| 1. **Describe your approach to managing the liquidity risk that may arise from the mismatch between liquid liabilities and illiquid assets?** | Response: |

1. **Securities lending transactions**

If funds received are reinvested in illiquid assets, sudden recalls of these funds could force the insurer to sell assets. In a stressed market, these sales could impact the insurer's creditworthiness, triggering more collateral demands and leading to a price spiral as the lender sells assets to meet collateral needs.

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| 1. **Does your insurer conduct securities lending transactions? Please report the size (R’000) of the securities lending business.** | Response: |
| 1. **How does your insurer monitor and assess the liquidity risk from conducting securities lending?** | Response: |

1. **Contingency Funding Plan**

Contingency funding planning assists the insurer in addressing stress situations where its liquid assets are insufficient or unexpectedly become illiquid. Planning should include actions that the insurer could realistically take to ensure that liquidity sources are sufficient to maintain normal operations and continue to meet the insurer’s financial obligations, including collateral needs, under stress.

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| 1. **Does your insurer have a contingency funding plan to address stress situations where liquid assets are insufficient or unexpectedly become illiquid?** | Response: |
| 1. **What are the main benefits of having a contingency funding plan in place?** | Response: |
| 1. **Do you foresee any disadvantages or challenges of implementing a contingency funding plan?** | Response |

1. **Part 3: Liquidity Risk Management Proposals**

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| 1. **Does your insurer foresee any challenges in implementing the above proposals? Please elaborate.** | Response: |
| 1. **Are there any other issues or suggestions you would like to bring to the PA's attention?** | Response: |