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Answers of the European Financial Congress[1] in relation to the European Insurance and Occupational Pensions Authority's consultation on liquidity risk management plans - Solvency II Review [2]

Methodology for preparing the answers

The answers were prepared in the following stages:

Stage 1

A group of experts from the Polish financial sector were invited to participate in the survey. They received selected extracts of the EIOPA's consultation document and the consultation questions translated into Polish. The experts were guaranteed anonymity.

Stage 2

Responses were obtained from over a dozen experts representing:

- insurance firms
- consulting firms,
- the academia.

Stage 3

All the responses were collected, anonymised and the survey project coordinators prepared a draft synthesis of opinions submitted by the experts. The draft synthesis was sent to the experts participating in the survey with the request to propose modifications and additions as well as marking the passages they did not agree with.

Step 4

On the basis of the responses received, the final version of the European Financial Congress' answers was prepared. The final version of the answers was translated into English and submitted to the EIOPA.

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[1] The European Financial Congress www.efcongress.com is an independent think tank focusing on economic and financial issues. Its goal is to engage in debate on the security and stability of the financial systems as well as sustainable economic growth of the European Union and Poland. The EFC is run by the Centrum Myśli Strategicznych. The EFC Project dedicated to insurance is EFC Insurance: Sales, Innovations, Risks https://www.efcongress.com/usir/

[2] https://www.eiopa.europa.eu/document/download/236fbcae-afdd-4392-8fa0-d1c7336938a2_en?filename=08.3_EIOPA-BoS-24-320_CP%20on%20RTS%20on%20liquidity%20risk%20management%20plans.pdf&prefLang=pl

Answers of the European Financial Congress to consultation questions

Q. 1
Do you have general comments on the consultation paper?

YES

Please provide your general comments on the consultation paper.

The Polish insurance market has demonstrated high stability and resilience towards liquidity risk, even in the face of recent catastrophic events such as the COVID-19 pandemic, the war in Ukraine and recent flood. This stability is reflected in the relatively high solvency ratios of Polish insurance companies, and ability to meet contractual obligations in timely manner, indicating a robust market that has not been adversely affected by these crises.

Moreover, according to the current Solvency II Directive, insurance companies are required to incorporate liquidity risk into their management systems. In practice, this means that insurance companies have liquidity risk management policies and conduct regular analyses within the IMMMR and ORSA systems. Insurance companies recognize the importance of liquidity risk and actively manage it, conducting regular analyses to ensure they are adequately prepared for potential liquidity challenges.

The new regulation introduces additional requirements that could be burdensome for insurance companies. These include more detailed and frequent reporting obligations, such as quarterly updates of cash flow projections under baseline and stress scenarios. In has to be noted that generally, the liquidity risk profile of insurance companies is stable and does not change frequently.

Taking the above into account, it should be noted that the new requirements may increase operational costs and administrative burdens, potentially impacting the competitiveness of the market. The regulation's stringent demands could limit the flexibility of insurance companies to manage their risk profiles effectively, thereby affecting their overall market position, while the overall assessment of liquidity risk remains moderate.

The imposition of a 12 billion euro threshold for all insurance companies is considered unjustified and lacks sufficient rationale. This threshold is based on financial stability reporting guidelines, but its value is not adequately explained. The Polish market, in particular, finds this threshold debatable as only one life and one non-life insurance company meet this criterion. It has been noted that it is possible to include entities not meeting the quantitative criteria based on qualitative criteria such as scale and complexity. Notwithstanding the above, the necessity for medium and long-term liquidity risk management plans should be justified by local supervisory authorities and should be primarily directed towards institutions for which liquidity risk is significant. The introduction of provisions allowing national supervisory authorities to adjust requirements to the specifics of the local market, while maintaining compliance with EU guidelines should be considered.

Lastly, it should be noted that if risk management plans are prepared at the group level and adequately consider subsidiaries, there should be no need for plans at the individual company level.

Background and rationale

Q. 2
Do you have comments on the following sections in section 1 with background and rationale?

		Yes	No
1.1	Amendments to the Solvency II Directive		x
1.2	Mandate for draft regulatory technical standards		x
1.3	Current requirements on liquidity risk management		x
1.4	Principle-based and proportionate approach	x	
1.5	Detailed explanation of the draft RTS	x	

Please provide your comments on indivudual sections

1.4. Principle-based and proportionate approach

The proposed regulation emphasizes a principles-based and proportionality approach, which is generally advisable. In the same time it remains unclear how this principle will be effectively applied by local regulatory authorities.

The level of detail specified in the RTS is considered excessive. For instance, the detailed breakdown of liquidity sources and requirements under normal and stress conditions, as well as the extensive documentation requirements, can be seen as burdensome (articles 5 to 8).

1.5 Detailed explanation of the draft RTS

The introduction of a liquidity coverage ratio developed by EIOPA as a common liquidity risk indicator for all insurance and reinsurance companies may not be entirely appropriate. This is because the indicator might not be fully comparable across different companies due to individual differences in the approaches to assumed scenarios and stress tests for their insurance portfolios. The proposed indicator has been compared to commonly used liquidity ratios for banks, which are based on standardized liquidity stresses. However, the plans described in the RTS should be based on individual scenarios and stresses appropriate for each insurance company. This could lead to challenges in achieving comparability of the indicator between insurance companies. Therefore, the introduction of a uniform liquidity indicator for insurance and reinsurance companies may not be the most effective approach and could potentially lead to inaccurate conclusions.

The new regulations may be considered as an excessive burden to the entities. First, the entities are required to carry out cash flow projections under stressed conditions, while the current requirements in Art. 259 (3) do not explicitly state that (only stress tests and scenario analyses are required). Second, according to the new regulation, the entities need to perform the full projections each quarter, while currently the plans are usually performed once a year and every quarter only the

deviations to the plan are analyzed without the necessity to update the full plan based on the new data.

In the case of insurance groups that include banks within their structure, these banks should be excluded from the quantitative thresholds as well as the analysis and content of liquidity plans. This is due to the significantly higher exposure of the banking sector to liquidity risk and the separate liquidity risk management requirements introduced by the EBA and local supervisory authorities for the banking sector.

Q. 3

Do you have any other comments on the background and rationale section?

YES

Please provide your other comments on the background and rationale section.

Upon reviewing the background and rationale section of the document, it appears that liquidity risk issues from banking or investment activities has been transferred to the insurance perspective. This is justified in the context of life insurance with a significant investment component, but it does not correspond, for example, to property and casualty insurance activities. Therefore, it seems that liquidity risk issues should be regulated differently for life insurance and non-life insurance sectors.

For P&C business the materialization of liquidity risk is secondary to other risks and exacerbates their impact on the financial situation of the company Therefore, liquidity risk should not be analyzed based on current cash flows alone, as this does not capture the essence of the risk. Instead, it should be analyzed in the context of extraordinary events arising from scenarios defined in the SCR or in the context of business continuity or IRRD requirements.

For example, it is possible that an insurance company with a balance sheet total of 4bn EUR insures a catastrophic event resulting in an insurance claim of 2 bn EUR as companies transfer risk through reinsurance, retaining only a fraction of the primary risk. However, in this case we can identify two liquidity-related issues: 1. the need to pay the claim at a different time than the potential reinsurance payout, and 2. the reinsurance company's ability to cover the risk. The first issue can lead to an increase in the claim value (interest) or the need to liquidate assets at a loss. The second issue is similar. In summary, the balance sheet before and after the event may not indicate a liquidity problem, but the issue can exist in reality. Such situations are largely overlooked in the document, and the proposed factor analysis may distort potential real risk.

Therefore, liquidity risk should not only focus on a balance sheet approach but also on an approach derived from the SCR (MVBS after shock) and scenario-based approaches analyzed within the framework of financial and operational business continuity.

Draft technical standards

<u>Proportionality</u>

Q. 4
Do you agree that the draft technical standards achieve a proportionate implementation of the liquidity risk management plans?

NO

Please provide suggestions to achieve a more proportionate approach.

Consistent comments on thresholds and scope of RTS as described in the response to question1.

<u>Recitals</u>

Q. 5
Do you have comments on the following recitals in section 2?

	Yes	No
Recital 1		X
Recital 2		X
Recital 3	X	
Recital 4		X
Recital 5	X	
Recital 6		X
Recital 7		X
Recital 8		X
Recital 9		X
Recital10	X	
Recital 11		X
Recital 12		X
Recital 13		X
Recital 14		X
Recital 15		X
Recital 16		X

Please provide your comments on individual recitals

General comment to preamble
In the preamble, only recital 6 indicates the consequential nature of liquidity risk, which in insurance companies (particularly non-life) is triggered by events of different nature. In the remaining parts, the preamble places a strong emphasis on macroeconomic factors, which from the perspective of non-life insurance companies are of secondary importance. However, we recognize that the macroeconomic factors can be important for life insurance sector, in particular for products with significant investment component. Therefore, the opinion expressed in the response to question 3 that liquidity risk issues should be regulated differently for life insurance and non-life insurance sectors remains valid.

Recital 3
Consistent comments on thresholds and scope of RTS as described in the response to question1.

Recital 5
Considering the stance expressed in point 1, in case the proposed changes move towards additional requirements in the area of liquidity risk reporting for insurance entities, the comparability should be one of the main areas considered by the regulation. It has been acknowledged that the proposed changes are intended to ensure the comparability of analyses conducted by entities, which has been reflected by a suggested common plan structure. Nevertheless, it should be considered whether, in addition to the common structure, other required elements of the analysis should be clearly defined (e.g., the definition of liquid assets, proposals for mandatory shocks, the level of haircuts on the side of liquid assets, etc.).

Recital 10
The requirement of updating short-term plans every three months seems unfeasible and overly burdensome. It has to be noted that crucial analyses interconnected with plan preparation such as ORSA and the comprehensive calculation of SCR are performed once a year.

Articles

Q. 6
Do you have comments on the following articles in section 2?

	Yes	No
Art.1 Criteria for liquidity risk management plan over the medium and long term	X	
Art.2 Time horizon of the liquidity analysis	X	
Art.3 Structure, including Annex I	X	
Art.4 Assumptions underlying the projections	X	
Art.5 Cash flow projections	X	
Art.6 Buffers of liquid assets	X	
Art.7 Liquidity risk indicators	X	
Art.8 Overall assessment of liquidity risk		X
Art.9 Frequency of update of the liquidity risk management plan	X	
Art.10 Content and frequency of update of liquidity risk management plans at group level	X	
Art.11 Risk concentration and intragroup transactions		X
Art.12 Entry into force		X

Please provide your comments on individual articles:

Art. 1
The proposed 12 billion EUR threshold for liquidity risk reporting lacks clear justification and could create significant disparities between markets or cause

changes in the entities subject to the requirement due to market valuation fluctuations. A more qualitative, risk-based approach is recommended. Supervisory authorities should have the discretion to decide on liquidity risk requirements based on individual exposure towards liquidity risk.

For groups, it is unclear whether subsidiaries are subject to medium and long-term analysis if the group exceeds the threshold. The article should be amended to clarify that subsidiaries under group supervision are only subject to analysis if the threshold is exceeded at the entity level or, preferably, as suggested before a more qualitative, risk-based approach should be considered

Moreover, It is unclear what approach should be used by large financial groups that include both banks and insurance companies. In the case of such structure banks should be excluded from the quantitative thresholds as well as the analysis and content of liquidity plans. This is due to the significantly higher exposure of the banking sector to liquidity risk and the separate liquidity risk management requirements introduced by the EBA and local supervisory authorities for the banking sector.

Re point 3 It is unclear how the exposure of insurance and reinsurance undertakings and groups to liquidity risk should be included in the financial plan. Should there be alternative financial plans under different stress scenarios?

Art 2.
It is unclear how to interpret the following requirement and how this should be done in practice : „following the starting date of the projections until the point in time when the liquidity risk exposures of the insurance or reinsurance undertaking are not material."

Art 3.
It can be considered whether the structure of the liquidity management plan should include a section describing potential management actions of the insurance company in the event of a liquidity issues.

Art 4.
It should be considered whether the regulation should mandate specific shocks as a required minimum to ensure comparability. Moreover, the probability of the shocks could be included in the point 2 also to ensure comparability of results.

Art 5.
There is a lack of a clear definition of "liquid assets," which could lead to misunderstandings with regulators and unequal interpretations between countries. For example, it is not clear whether government bonds are considered liquid or not, or whether other assets are considered fully or partially liquid. Additionally, the statement in point 5, that positive/incoming flows should be gross excluding the conversion of liquid asset buffers into liquidity, is ambiguous and should be rephrased to avoid interpretation issues. Therefore, as stated in the response to Recital 5 of preamble it should be considered whether, in addition to the common structure, other required elements of the analysis should be clearly defined (e.g., the definition of liquid assets, proposals for mandatory shocks, the level of haircuts on the side of liquid assets, etc.).

Article 5 requires the inclusion of minimum elements in cash flow analyses, which seems to contradict the principles of proportionality and risk-based approach.

Immaterial elements should not be considered. Specifically, the level of detail required in points (g) to (j) of paragraph 4 is not appropriate for a minimum list of mandatory items and is not proportional in case of low level of liquidity risk.

Finally, It is unclear if the plan shall be aligned with the financial plan reported to the supervisory authority. Entities should have the flexibility to use the most current figures, even if they do not match the financial plan officially reported to the supervisory authority.

Art 6.
It is unclear how a buffer of liquid assets should be identified, in particular: when it is considered sufficient (from both a quantitative and qualitative perspective), and how it should be included in the plan. Additionally, it is not clear whether subsequent plans should maintain consistency in the identification of the buffer (i.e., a buffer identified in one quarter should still exist in the following quarter). More transparent regulation of such a buffer would help avoid divergent interpretations at the local and international levels. Please see comments to article 5 above and Recital 5 on more precise definitions for required elements of the analysis.

Art 7.
The liquidity coverage indicator developed by EIOPA, intended as a common liquidity risk indicator for all insurance and reinsurance companies, is unjustified because it will not be comparable due to individual differences in the approach to assumed scenarios and stress tests for the insurance portfolio. Unlike standardized liquidity stress indicators used for banks, the plans described in the RTS should be based on individual scenarios and stresses appropriate for each insurance company, leading to non-comparability of the indicator. Additionally, the liquidity coverage indicator conflicts with the narrative nature of liquidity risk management plans, risking the reduction of plans to a single measure of liquidity position assessed by the proposed indicator.

To summarize, the industry opposes a single liquidity coverage indicator due to the diverse nature of the operations of individual insurance/reinsurance companies. Therefore, one indicator should not form the basis for comparing insurance companies.

Art 9.
Due to the short-term nature of liquidity risk, supervisory requirements for conducting medium and long-term analyses should be limited to exceptional cases and thoroughly justified.

Short-term plans should only require annual updates or updates if there is a significant change in the liquidity profile of the insurance company. Requiring quarterly updates when there are no apparent indications of a change in this risk profile is contrary to the principle of proportionality. Therefore, the quarterly frequency of updates and reporting of the short-term plan seems excessive when there are no apparent liquidity risks and will increase reporting burdens and result in additional excessive costs.

Art. 10
Under the current approach set forth in the SII Directive, subsidiaries may follow a top-down approach. In the wording of the article, it is not clear whether this applies for the proposed liquidity management plan in the RTS. At the same time, however,

it should be emphasized that the RTS does not force the use of a group liquidity management plan and a subsidiary can execute the plan on an individual level. Also missing is a requirement to document conflicts of interest between group entities in liquidity management.

Q. 7
Do you have any other comments on the draft technical standards in section 2?

NO

***Annex I*: Impact assessment**

Policy issues

Q. 8
Do you have comments on the analysis of the following policy issues?

	Yes	No
Policy issue A	X	
Polisy issue B	X	

Please provide your comments on the analysis of policy issue A and policy issue B

Policy issue A
Comment consistent with the response to question 1 : The imposition of a 12 billion euro threshold for all insurance companies is considered unjustified and lacks sufficient rationale. This threshold is based on financial stability reporting guidelines, but its value is not adequately explained. The Polish market, in particular, finds this threshold debatable as only one life and one non-life insurance company meet this criterion. It has been noted that it is possible to include entities not meeting the quantitative criteria based on qualitative criteria such as scale and complexity. Notwithstanding the above, the necessity for medium and long-term liquidity risk management plans should be justified by local supervisory authorities and should be primarily directed towards institutions for which liquidity risk is significant. The introduction of provisions allowing national supervisory authorities to adjust requirements to the specifics of the local market, while maintaining compliance with EU guidelines should be considered.

Policy issue B
Consistent with the response to question 1 and 5 recital 5: Primarily it has to be noted that the new requirements may increase operational costs and administrative burdens, potentially impacting the competitiveness of the market. The regulation's stringent demands could limit the flexibility of insurance companies to manage their risk profiles effectively, thereby affecting their overall market position, while the overall assessment of liquidity risk remains moderate.

Notwithstanding the above, in case the proposed changes move towards additional requirements in the area of liquidity risk reporting for insurance entities, the

comparability should be one of the main areas considered by the regulation. It has been acknowledged that the proposed changes are intended to ensure the comparability of analyses conducted by entities, which has been reflected by a suggested common plan structure. Nevertheless, it should be considered whether, in addition to the common structure, other required elements of the analysis should be clearly defined (e.g., the definition of liquid assets, proposals for mandatory shocks, the level of haircuts on the side of liquid assets, etc.).

Other comments :

Q. 9
Do you have any other comments on the impact assessment in Annex I?

YES

Please provide your other comments on the impact assessment in Annex I.

Additional regulatory requirements imposed on the insurance industry may result in higher operational costs which may translate to higher costs for customers and potentially impact the competitiveness of the European insurance market.

Any other comments

Q. 10
Do you have any other comments on the consultation paper?

NO