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Insurance Europe’s response to EIOPA's consultation on supervising the liquidity risk management of IORPs

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Questions to stakeholders

Consultation Paper on the draft Opinion on the supervision of liquidity risk management of IORPs

> **Q1.** *The draft Opinion aims to be consistent with the FSB’s proposed policy recommendations to enhance the liquidity preparedness of non-bank market participants. However, the draft Opinion covers all sources of liquidity risks within its scope rather than only liquidity risk relating to margin and collateral calls. Do you agree that the draft Opinion takes a comprehensive approach to liquidity risk of IORPs?*

- Yes

Please explain.

Insurance Europe agrees that the draft Opinion should take a comprehensive approach to liquidity risk of Institutions for Occupational Retirement Provision (IORPs). At the same time, (re)insurers believe that the existing regulatory framework already allows to adequately address the sources of liquidity risks highlighted in the paper. Financial Stability Board (FSB)’s recommendations should correctly reflect the framework, including its requirements and definitions.

In more detail:

Insurance Europe acknowledges that the 2022 pension schemes crisis in the United Kingdom has raised concerns regarding potential liquidity risks within the IORPs sector, the adequacy of current liquidity risk management, and the supervisory practices within the EU.

However, in those Member States where existing regulations, along with their implementation, already provide for a comprehensive approach to the management of all relevant risks, including liquidity risks, the measures proposed in the consultation paper may not be necessary or suitable.

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More specifically, Article 25 of the IORP II Directive already requires IORPs to establish effective risk management systems, including measures to identify, measure, monitor, manage and report on various risks, including liquidity risk. According to these rules, IORPs must tailor their risk management practices to their specific size, nature, scale and complexity. This requirement includes assessing their liquidity risks and implementing strategies to mitigate them.

Moreover, the IORP II Directive already requires IORPs to conduct Own Risk Assessments (ORAs), which provide a comprehensive approach to managing liquidity risks, as outlined in Article 28. This involves evaluating and analysing the IORP's risk profile and risk-bearing capacity, including liquidity risks. The risk-management system of IORPs shall cover, in a manner that is proportionate to their size and internal organisation, as well as to the size, nature, scale and complexity of their activities, risks which can occur in IORPs. That system shall also cover, with similar modalities, risks occurring in undertakings to which tasks or activities of an IORP have been outsourced, at least in concerning the liquidity and concentration risk management.

Furthermore, the National Authorities of some jurisdictions, such as Germany's BaFin, have already clarified that ORAs must include detailed liquidity planning for the following year. This involves identifying and considering external factors that could materially impact the IORP's financing requirements or available funds. Such factors may include economic conditions, legal and regulatory changes, tax implications, market dynamics, and technological advancements.

Given these existing regulatory requirements, Insurance Europe believes that the sources of material liquidity risk identified in section 3.6 of the consultation paper are already adequately addressed by the governance and risk management frameworks of IORPs in these jurisdictions.

Finally, it is important to ensure that the FSB recommendations take into account, and can interact effectively, with the European and national regulations definitions and requirements, including with the proportionality principle as it is stated by the IORP II directive.

Q2. *Do you agree with the definitions of 'liquidity risk' and 'material liquidity risks' in paragraphs 3.1 and 3.2?*

- Yes

Please explain your answer and provide any suggestions to improve the definitions

Insurance Europe agrees with the definitions of "liquidity risk" and "material liquidity risks" included in paragraphs 3.1 and 3.2 of the draft opinion paper.

Indeed, national regulatory frameworks, which encompass provisions for IORPs, generally define "liquidity risk" as the risk that an insurance or reinsurance company may not be able to realise its investments and other assets in a timely manner to fulfil its financial obligations.

It is crucial to ensure that any proposed definition of liquidity risk aligns with both national and European regulatory frameworks. This includes referencing to:

- the Solvency II Directive, which can be applicable to IORPs that are part of insurance groups; or
- dedicated prudential rules at the national level, in accordance with the IORP II Directive, incorporating additional national specificities.

In both cases, IORPs are mandated to implement robust risk management practices, including measures to identify, measure, monitor, manage, and report on liquidity risk, including the performance of stress tests.

Each IORP has a unique liquidity risk profile, influenced by factors such as the nature and volume of illiquid assets, as well as the characteristics of its liabilities (including potential early redemptions). These specific factors should be considered when formulating a comprehensive definition of liquidity risk.

Q3. *The draft Opinion specifies that NCAs should gather relevant derivative data to assess liquidity risk exposures of IORPs. Are you aware of any issues or obstacles for IORPs:*

in collecting derivative data from asset managers to monitor and assess liquidity risks in relation to margin and collateral calls;

- No

(additional information not included in the response to the EC website because possible only in case of positive answer)

Insurance Europe is not aware of issues or obstacles for IORPs in gathering such data. The insurance industry notes that the minimum requirements for the business organisation of IORPs already include regulations governing outsourcing and other service relationships. Therefore, no significant challenges in obtaining the necessary data in the event of a liquidity risk are anticipated. However, this does not diminish the importance of establishing clear guidelines for the monitoring and assessment of liquidity risk. Please refer to the response to the following question for further details.

in reporting relevant derivative data to NCAs?

- No

(additional information not included in the response to the EC website because possible only in case of positive answer)

Insurance Europe is not aware of relevant issues or obstacle for IORPs in gathering such data, either. However, the industry notes that the collection of detailed data on derivative positions can be time-consuming and costly for IORPs. Therefore, such data collection should be triggered only when the ORA identifies material liquidity risks related to these positions. A one-size-fits-all approach to data collection, without considering the specific risk profile of each IORP, could impose unnecessary burdens. In cases where a national supervisory authority identifies significant liquidity risks, they can utilise intensified supervisory measures, including additional reporting requirements for the affected IORP. To maintain proportionality and avoid unnecessary regulatory burdens, it is essential to focus data collection efforts on IORPs with material liquidity risk exposures.

If 'yes', please explain.

Q4. *The draft Opinion envisages a two-step approach. IORPs should first assess whether they are exposed to material liquidity risk and, if so, integrate liquidity risk in their system of governance and risk-management system, including an assessment in their own-risk assessment (ORA). Do you agree with this two-step approach?*

- Yes

Please explain.

Insurance Europe agrees with the proposed two-step approach, which is already implemented in certain jurisdictions, such as Germany. However, the insurance industry emphasises the importance of tailoring the assessment and approach to the specific liquidity risk exposure of each IORP. A one-size-fits-all approach may not be suitable for all institutions.

Q5. *The draft Opinion provides in paragraph 3.6 suggestions for possible sources of liquidity risk that IORPs are exposed to. Are you aware of any other sources of liquidity risk that should in your view be explicitly addressed?*

- No

Please explain your answer.

Insurance Europe is not aware of any other sources of liquidity risk that should be explicitly addressed

Q6. *Do you agree that IORPs with material liquidity risk exposures should establish a contingency plan to deal with liquidity stress, as expected in paragraphs 3.8-3.10?*

- Yes

If 'no', please explain why and provide any suggestions on what other measures IORPs would put in place. (additional information not included in the response to the EC website because possible only in case of negative answer)

Insurance Europe agrees that contingency planning is an essential component of effective liquidity risk management. In many jurisdictions, including Germany, IORPs are already required to develop contingency plans as part of their overall risk management framework. These plans typically address a range of potential risks, including liquidity risks. When an IORP is identified as having significant liquidity risks, national supervisory authorities, such as BaFin in Germany, can impose intensified supervisory measures, which may include requirements for more detailed contingency planning. It is important to ensure that contingency plans are tailored to the specific risk profile of each IORP and comply with relevant EU and national regulations.

Q7. *The draft Opinion provides in paragraph 3.12 that IORPs should define their own liquidity risk indicators for day-to-day risk management. Subsequently two examples of commonly used risk indicators (liquidity coverage ratio & excess liquidity indicator) are suggested. Are you aware of any other liquidity risk indicators that are commonly used by IORPs?*

- Yes

If 'yes', please explain.

Insurance Europe believes that IORPs play a crucial role in the long-term financing of the EU economy and in providing secure retirement benefits (as outlined in Recital 8 of the IORP II Directive). To fulfil this role effectively, IORPs require a sufficient degree of investment flexibility.

Recital 48 of the IORP II Directive recognises this need and aims to ensure an appropriate level of investment freedom for IORPs. As long-term investors with relatively low liquidity needs, IORPs are well-positioned to invest in illiquid assets, such as unlisted equities and other long-term instruments that are not traded on regulated markets, multilateral trading facilities (MTFs) or organised trading facilities (OTFs) within prudent limits.

To maximise returns and mitigate risks, IORPs should be allowed to diversify their portfolios internationally. This includes investing in equities denominated in foreign currencies and other long-term assets, provided that such investments are made prudently and in the best interests of members and beneficiaries.

Q8. *Do you agree that IORPs with material liquidity risk exposures should establish and maintain a clearly defined liquidity risk tolerance statement approved by the management or supervisory body of the IORP, as expected in paragraph 3.14?*

- No

If 'no', please explain why not and provide any suggestions on alternative practices used by IORPs.

Insurance Europe agrees with the fundamental objective of assessing liquidity risks, but also believes that existing regulatory frameworks, such as intensified national competent authority (NCA) supervision, provide sufficient tools to address material liquidity risks. A new, specific liquidity risk tolerance level is therefore unnecessary.

National supervisors and IORPs should have the flexibility to tailor their approach to specific cases and market conditions. This includes:

- Identifying sources of material liquidity risk and associated timescales: IORPs assess their own exposures and capacity to cover risks within defined timeframes.
- Calibrating stress tests: Stress tests are specific to each IORP, considering real exposure, nature of risk and existing risk management tools.
- Selecting appropriate liquidity risk hedging tools: The choice of hedging tools depends on the IORP's risk profile and the illiquid nature of assets and liabilities. Global risk hedging strategies, including diversification and mobilisation of liquid assets, may be effective solutions.

Q9. *The draft Opinion prescribes in paragraph 3.15-3.16 that IORPs should regularly review and update their liquidity risk-management system. What would in your view be appropriate triggers and minimum requirements for such a review?*

Insurance Europe believes that the frequency of ORAs should be tailored to the specific liquidity risk profile of each IORP. While a regular review is essential, the exact frequency may vary depending on the real liquidity risk exposure of each IORP.

Q10. Do you agree that IORPs should perform stress tests and scenario analysis covering all material sources of liquidity risk, and assess the impact of a range of severe, but plausible liquidity stresses, as expected in paragraphs 3.17-3.20?

- No

Please explain and provide any suggestions on the proposed minimum requirements for the stress tests and scenario analysis.

Insurance Europe agrees with the fundamental objective of assessing liquidity risks, but also advocates for a risk-based approach to stress testing and scenario analysis for IORPs.

IORPs should conduct tests that are tailored to their specific risk profiles, avoiding unnecessary burdens. National supervisors should have the flexibility to require appropriate tests and analyses based on the individual circumstances of each IORP.

For instance, a one-size-fits-all approach, such as requiring stress tests based on derivative liquidity risks for all IORPs, would be unnecessary for institutions without significant derivative exposures.

Q11. *Do you agree that IORPs should maintain an adequate buffer of liquid assets to cover any shortfall of incoming relative to outgoing cash flows, also under severe but plausible stress conditions, as expected in paragraphs 3.21-3.23?*

- Yes

Please explain and provide any suggestions on the conditions imposed on the liquid assets in paragraph 3.22 and 3.23.

Insurance Europe agrees that IORPs should maintain an adequate buffer of liquid assets to cover any shortfall of incoming cash flows relative to outgoing cash flows, and highlights that each IORP's specific exposure to liquidity risk and its capacity to manage it should be considered.

The appropriate margin of liquid assets should be determined on a case-by-case basis, taking into account:

- the level of exposure to liquidity risk;
- the nature and liquidity of assets;
- the nature of liabilities; and
- the IORP's capacity to manage liquidity risk.

Each IORP is best positioned to calibrate its own liquidity risk management framework, considering its unique circumstances and risk profile.

Within the same market, IORPs may have diverse profiles and require tailored approaches, including different liquidity thresholds.

While some countries, such as Germany, benefit from specific regulatory frameworks that mitigate certain liquidity risks, all IORPs should prioritise liquidity risk management by maintaining adequate liquid asset buffers and conducting stress tests.

The optimal level of liquidity buffers varies significantly based on an IORP's specific risk profile and exposure to liquidity risks.

Q12. *Do you agree that IORPs with material liquidity risk exposures should periodically test their liquidity contingency plan through simulation exercises in order to ensure operational readiness, as expected in paragraphs 3.24-3.26?*

- Yes

Please explain and provide any suggestions on the conditions imposed on the periodical testing.

Insurance Europe agrees that IORPs should test their liquidity contingency plan through simulation exercises.

In some countries, such as Germany, the ORA, and its BaFin-supervised implementation already provides a robust framework for monitoring liquidity risks.

A one-size-fits-all approach to liquidity risk management may not be appropriate for all IORPs. It is essential to allow flexibility at IORP level.

Q13. *To prevent operational lags in fulfilling margin requirements, do you agree that IORPs should ensure that investment funds to which IORPs have outsourced the management of derivative instruments should hold sufficient buffers of liquid assets to cover margin calls in times of market stress?*

- No

Should this apply to all outsourced derivative arrangements or only a specific subset, considering for example segregated accounts/mandates versus multi-client/pooled funds and AIF versus UCITS funds?

Please explain.

Although Insurance Europe agrees on the objective of preventing operational lags in fulfilling margin requirements, it believes that it is crucial to consider the overall impact of sectorial regulatory requirements on IORPs, including bilateral agreements with investment funds. It is equally important to avoid creating an uneven regulatory playing field between IORPs and their providers.

In the EU, alternative investment funds (AIF) and undertakings for collective investment in transferable securities (UCITS) are subject to stringent regulations under Directives 2011/61/EU and 2009/65/EC, respectively. Recent amendments to these directives have introduced liquidity management tools to mitigate liquidity risks. Additionally, ESMA's 2020 guidelines on liquidity stress testing require fund managers, depositaries, and NCAs to conduct stress tests that explicitly consider the impact of margin calls for derivatives.

Given these existing regulatory measures, the industry does not believe that further regulatory action is necessary.

Q14. *Do the expectations put forward in the draft Opinion achieve a proportionate approach to liquidity risk management of IORPs?*

- No

If not, please provide your suggestions to improve proportionality of the draft Opinion.

Insurance Europe supports the stated objectives but emphasises the importance of a proportionate approach, as outlined in the technical advice. It is crucial to consider the specific risk profile of each IORP when assessing and managing liquidity risks.

The insurance industry believes that existing regulations adequately address these requirements. IORPs have already identified and are managing these risks, taking into account their individual risk profiles.

Focusing solely on liquidity issues, as proposed in the EIOPA draft opinion, is not a proportionate approach. A more holistic approach, as set out by ORA and its implementation and supervision in Germany, is preferable, considering the potential for various risk factors to impact IORP liquidity.

Q15. *Do you agree that the Impact Assessment in Annex I provides a balanced view of the costs and benefits of the relevant policy issues in the draft Opinion?*

- No

Please explain and provide any suggestions.

Insurance Europe does not agree with that. See previous answers for more information.

Q16. *Do you agree with the definitions of 'liquidity risk' and 'material liquidity risks' in paragraphs 3.1 and 3.2?*

- Yes

If yes, please provide these other comments?

Insurance Europe acknowledges the insights provided by BaFin, which highlighted that in Germany no single IORP has ever experienced a liquidity shortfall (paragraph 43 of the consultation paper). German IORPs typically use few derivatives and, during the low interest rate phase, they utilised illiquid markets to achieve sufficient yields to meet their obligations. While higher interest rates may present certain challenges with illiquid markets, German IORPs hold substantial quantities of highly liquid assets. Furthermore, potential risks, including liquidity risks, are well-documented and supervised by BaFin. In summary, the liquidity risk for IORPs in Germany is relatively moderate.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out over €1 000bn annually — or €2.8bn a day — in claims, directly employ more than 920 000 people and invest over €10.6trn in the economy.