



# Liquidity Management for Insurers – delivering financial performance while responding to regulatory requirements

James Henshall-Howard



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# Liquidity Management

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1. The way in which liquidity is managed has direct commercial implications for any business. This becomes particularly applicable when regulatory requirements are introduced.
2. Regulatory requirements should not be a box ticking exercise but rather an opportunity to continue evolving the liquidity management continuum in a manner that delivers real value.

# Liquidity Management

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Liquidity management – roles players and types of liquidity

International case studies

Liquidity management continuum and risk preparedness

The evolving role of an enterprise-wide treasury function

Closing remarks



## South Africa finance minister's departure drives rand down to all-time low

Currency at weakest ever rate against US dollar and share prices fall after Jacob Zuma removes Nhlanhla Nene with no explanation

The surprise departure of South Africa's finance minister has driven the country's currency to an all-time low and led to share falls in the share prices of companies listed on the Johannesburg Stock Exchange, Africa's second largest stock market.

The political fallout from the resignation of Nene on Thursday in Pretoria led to a slump in Investec's shares.

Economists at Capgemini said the move "advocate of fiscal conservatism" and "will lead to higher yields on government bonds."

While London-listed Anglo American was hard hit, so was the JSE's top performer, the JSE 100, which fell 13.5%.

"The sell-off in South African stocks is a sign of things to come," Citi said. The sell-off of the rand against the dollar hit a record low of 18.5 cents to the dollar.

## QE comes to SA as Reserve Bank steps in to provide liquidity to the market

Patrick Lawlor | Content editor

The SA Reserve Bank (SARB) on Wednesday adopted new measures to support liquidity in the local market. We look at the implications of the SARB's undertaking to make unlimited purchases of SA government bonds across the yield curve.



Commodities

## REFILE-South Africa suspends use of Land Bank debt as collateral after default

Chicago Fed Letter, No. 480, June 2023

Crossref

## UK Pension Market Stress in 2022—Why It Happened and Implications for the U.S.

## UK gilt selloff triggers pension cash calls in first big test since 2022 crisis

By Carolyn Cohn and Iain Withers

January 10, 2025 7:56 PM GMT+2 · Updated 4 months ago



UK pension funds have been forced to pay longer-dated gilts by selling up long-term gilts through the use of derivative contracts. Both of these approaches require the pension funds to mark-to-market losses with their lenders or derivative market counterparties. Dramatically higher September 2022 generated large mark-to-market losses for pension funds that, combined with volatility, triggered large margin calls.

Pension funds met the liquidity demands of margin calls by selling assets—primarily gilts, of which they held 28% of the market.<sup>1</sup> These sales by the pension funds contributed to additional price declines and a catalyst for even further selling of their gilts, according to the deputy governor of financial stability at the Bank of England. Only a direct intervention by the Bank of England that set up a temporary gilt program on September 28 eventually stabilized prices.

World Business Markets Sustainability Legal Breakingviews Technology Investigat

## Property and casualty insurers' shares slump as hurricane season losses mount

By Manya Saini



### MARKETS

# Insurance stocks sell off sharply as potential losses tied to LA wildfires increase

PUBLISHED FRI, JAN 10 2025-9:24 AM EST | UPDATED FRI, JAN 10 2025-2:42 PM EST

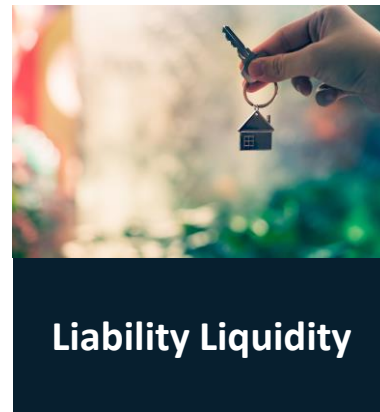
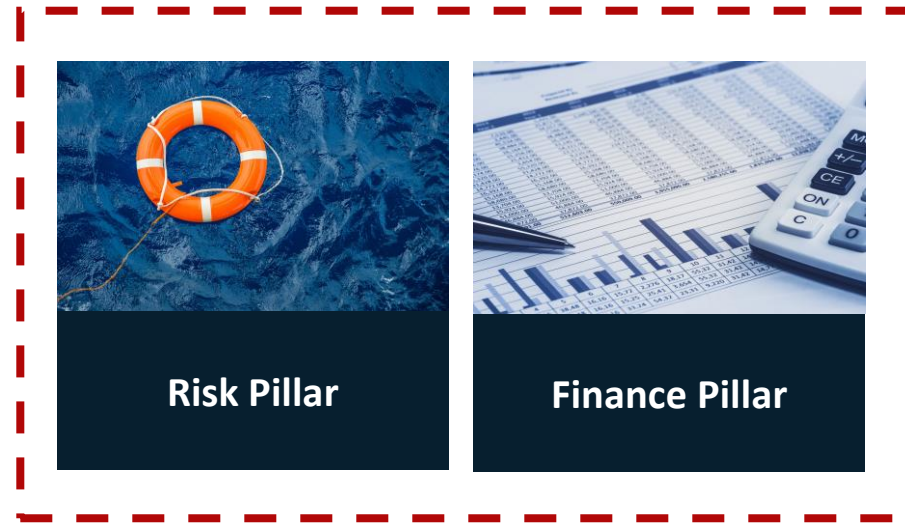


Yun Li  
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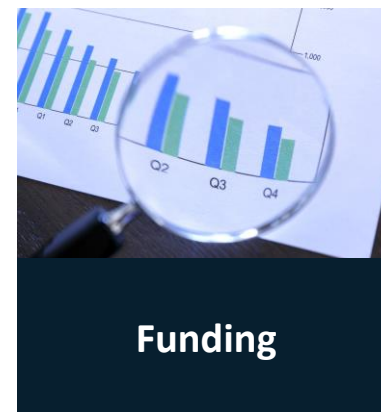


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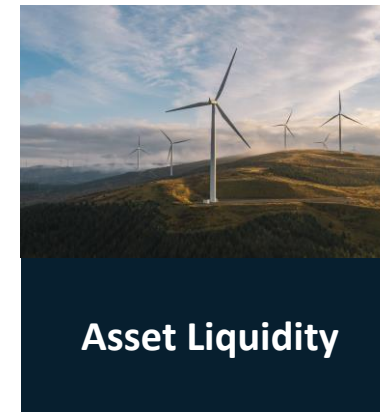
# Liquidity management – bringing the pieces together



Insurer  
Products  
(Commercial  
terms)

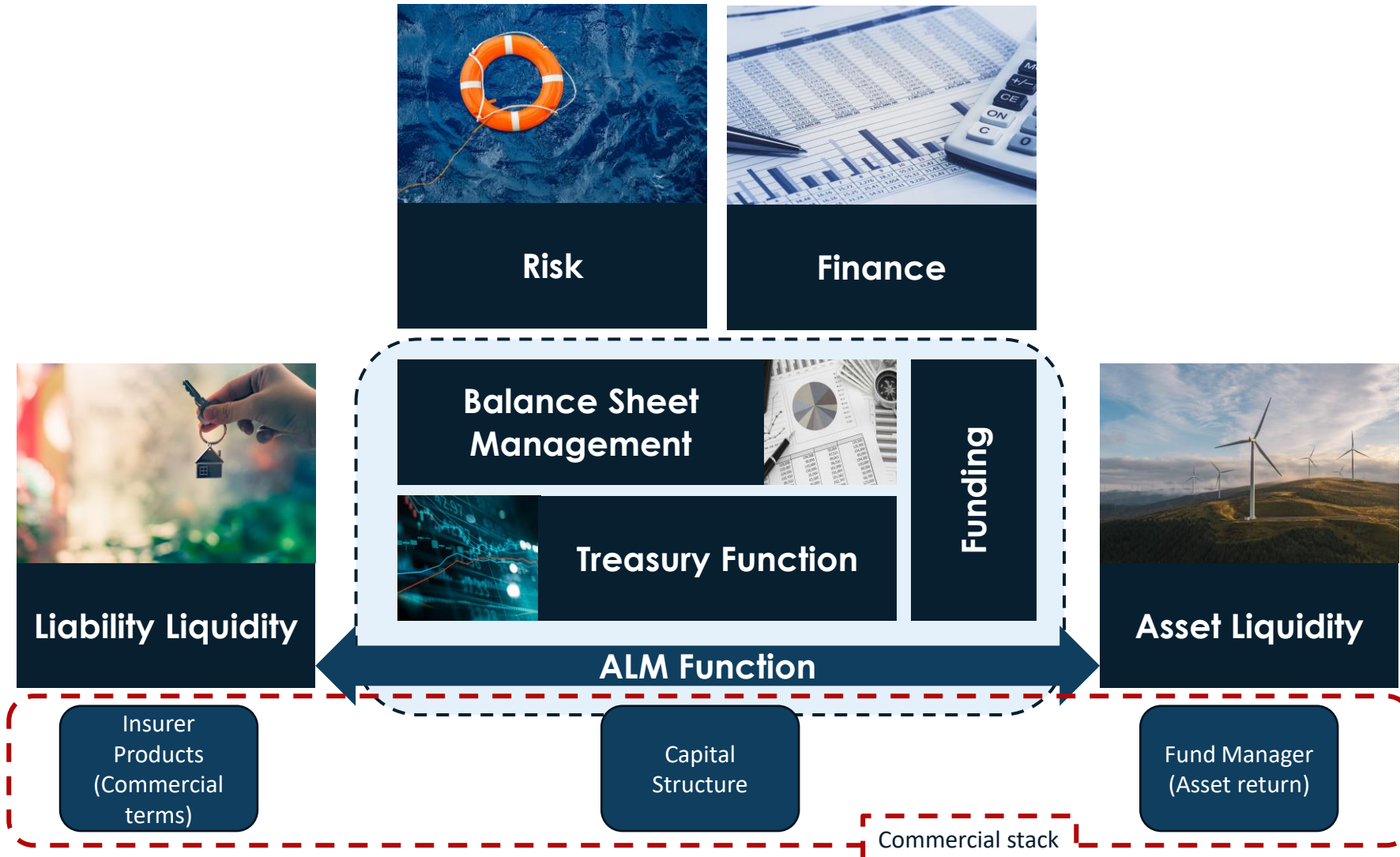


Capital  
Structure



Fund Manager  
(Asset return)

# Liquidity management – bringing the pieces together



# Liquidity management – bringing the pieces together



## Risk Management

Risk (& regulatory) led BSM and treasury activities – liquidity risk, portfolio market risk, credit risk



Risk



Finance



Liability Liquidity

Balance Sheet Management



Funding

Treasury Function



ALM Function



Asset Liquidity

# Liquidity management – bringing the pieces together



**Risk**



**Finance**

## Financial Performance

Finance led BSM and treasury activities: e.g. funding, working capital, strategy execution, forex (enterprise-wide market risk management), funds transfer pricing, surplus liquidity management (HQLA), cash forecasting, asset strategy funding (repos) implementation.



**Liability Liquidity**

**Balance Sheet Management**



**Treasury Function**



**Funding**

**ALM Function**



**Asset Liquidity**

# Liquidity management – bringing the pieces together



## Liability Liquidity

- Surrenders
- Lapses
- Catastrophic loss event
- Concentration

## Slower onset of liquidity risk

Product design and life stage of products plays a key role in the level of liquidity risk:

- Financial guarantees
- Fixed vs. variable
- Deferral phase vs payout phase



## Asset Liquidity

- Asset characteristics (asset class, listing status, term to maturity)
- Alternative assets
- Credit events
- Asset yield strategies & liquid asset

## Rapid onset of liquidity risk

**2022)**

- Other yield enhancement activities (**Securities lending – AIG 2008**)
- Asset to liability matching Collateral eligibility
- Cash vs. liquidity



International case study



## 48 Insurers 20 Countries

### Capital & Liquidity Stress Exercise

Intensifying geopolitical risk scenario - knock-on impacts such as steepening yield curves, tighter capital market conditions, widening of credit spreads and sovereign bond and debt sustainability concerns.

Participants calculated their post stress capital and liquidity positions in two ways:

- (1) fixed balance sheet approach, and
- (2) constrained balance sheet approach.

*The former only allowing embedded management actions and the latter permitting insurers to implement reactive management actions to the various shocks.*

#### Stress Scenarios

The liquidity and the capital components shared a common scenario, however, the application of the shocks, data collection, assessment and disclosure differ between the two components. The application of the shocks were applied in a manner that accounted for the way risk manifests in the respective components.

Capital Component	Liquidity Component
<ul style="list-style-type: none"> <li>• Combined scenarios with Market and Insurance specific shocks</li> <li>• Approach:                             <ul style="list-style-type: none"> <li>• Instantaneous shocks</li> <li>• Fixed balance sheet (no reactive Management Actions)</li> <li>• Constrained balance sheet (with guided reactive Management Actions)</li> </ul> </li> <li>• Metrics:                             <ul style="list-style-type: none"> <li>• Balance sheet based (Excess of Assets over Liabilities)</li> <li>• Solvency based (OF, SCR)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Approach:                             <ul style="list-style-type: none"> <li>• Instantaneous shocks</li> <li>• Fixed balance sheet (no reactive Management Actions)</li> <li>• Constrained balance sheet (with guided reactive Management Actions)</li> <li>• Stylised flow based evaluation</li> <li>• Stock based evaluation</li> </ul> </li> <li>• Time Horizon:                             <ul style="list-style-type: none"> <li>• 90 days</li> </ul> </li> <li>• Metrics:                             <ul style="list-style-type: none"> <li>• Liquidity sources / Liquidity needs</li> </ul> </li> </ul>

Figure 2: Insurance specific shocks and their application

Shock	Life	Non-life
Mass lapse	$X_{C,L}$	
Cost of claims	$X_{C,L(\text{health SLT})}$	$X_{C,L}$
Expenses	$X_{C,L}$	$X_{C,L}$
Reinsurance recoverables/receivables	$X_L$	$X_L$
Reduction in written premia	$X_L$	$X_L$

C=capital component; L=liquidity component

EIOPA adopted a **2-step approach** where step 1 was to apply market shocks and step 2 a set of insurance specific shocks to be applied to the business lines that are most affected by the proposed scenario.



# Case Study 1: The European Insurance and Occupational Pensions Authority (EIOPA) 2024 Capital and Liquidity Stress Test Exercise



Selected market and insurance shocks

Negative 10yr yield +200bps in days; and Covid 10yr yield +270bps in weeks

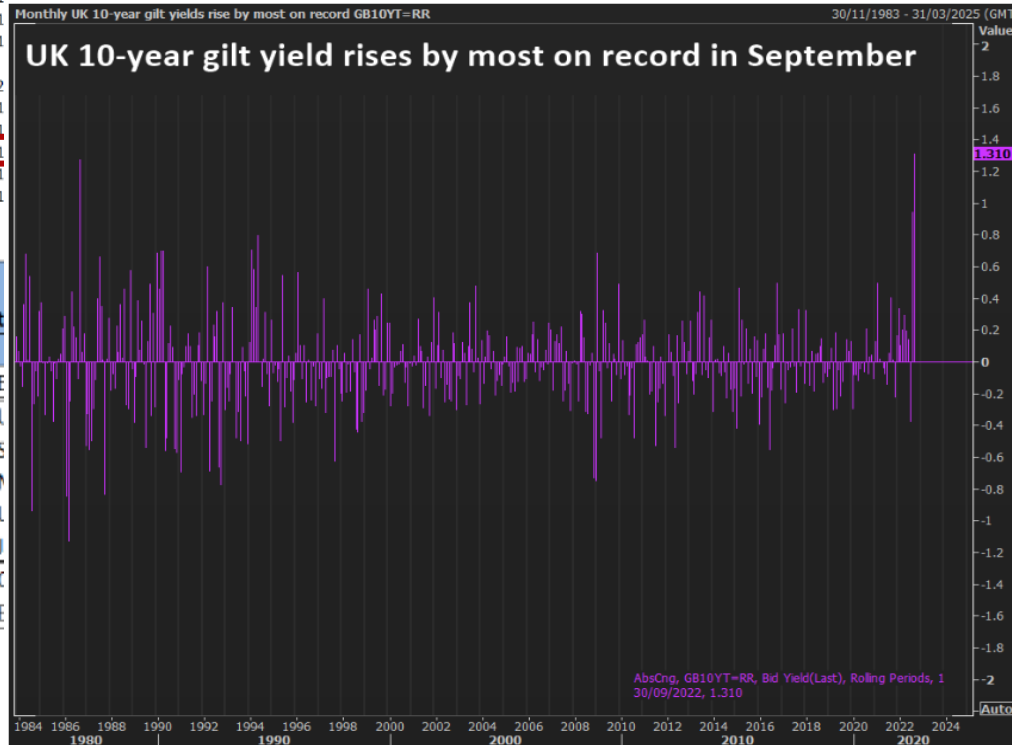
		TRADING ECONOMICS						
CZ	Czech Republic	71						
DK	Denmark	40						
EE	Estonia	60						
FI	Finland	62	63	69	77	81	84	84
FR	France	45	47	54	66	69	72	72
DE	Germany	36	38	44	54	57	60	60
GR	Greece	110	114	127	149	152	156	156
HU	Hungary	99	103	116	138	142	145	145
IE	Ireland	55	57	62	70	73	77	77
IT	Italy	96	101	114	136	139	142	142
LV	Latvia	92	97	110	129	132	135	135
LT	Lithuania	96	100	113	135	138	142	142
LU	Luxembourg	48	51	58	69	72	75	75
MT	Malta	89	91	98	109	113	116	116
NL	Netherlands	44	46	53	65	68	71	71
PL	Poland	95	99	111	132	135	138	138
PT	Portugal	85	87	92	101	104	108	108
RO	Romania	99	103	116	139	142	145	145
SK	Slovakia	80	81	85	91	94	97	97
SI	Slovenia	84	86	91	100	103	106	106
ES	Spain	92	96	108	127	130	134	134
SE	Sweden	60	62	67	76	79	82	82
EA (weighted averages)	EA (weighted averages)	60	63	71	84	87	90	90
EU (weighted averages)	EU (weighted averages)	62	65	73	87	90	93	93
UK	United Kingdom	78	79	81	84	88	91	91
CH	Switzerland	43	45	51	61	64	67	67
NO	Norway	50	52	57	65	68	71	71
IS	Iceland	62	65	73	87	90	93	93
BR	Brazil	236	240	252	272	275	278	278
US	United States	45	47	55	68	72	75	75
JP	Japan	41	43	48	56	59	62	62
Other advanced economies	Other advanced economies	53	55	60	70	73	76	76
Emerging markets	Emerging markets	171	177	194	222	226	229	229

		Shocks to swaps absolute changes (basis points)										
Country/region	Currency	1Y	2Y	3Y	5Y	7Y	10Y	15Y	20Y	25Y	30Y	
EA	EUR	177	177	177	177	177	177	177	177	177	177	
BG	BGN	2										
CZ	CZK	1										
HU	HUF	2										
RO	RON	2										
PL	PLN	1										
DK	DKK	1										
CH	CHF	1										
NO	NOK	1										
SE	SEK	1										
UK	GBP	1										
AU	AUD	1										
CA	CAD	1										
CN	CNY	1										
HK	HKD	1										
JP	JPY	1										
MX	MXN	2										
NZ	NZD	1										
SG	SGD	1										
ZA	ZAR	1										
KR	KRW	1										
US	USD	1										

## UK 10-year bonds see record monthly fall after fiscal upset

By David Milliken

September 30, 2022 6:20 PM GMT+2 · Updated 3 years ago



Shocks to stock prices relat	
Country/region	
EU	
UK	
CH	
NO	
US	
JP	
Other advanced economies	
Emerging markets	

Bookmark icon, Font size icon (Aa), Share icon

Value	77
13	46
79	77
75	72
40	137
52	51

Previous discontinuance

20%

or without guarantees shall be considered.

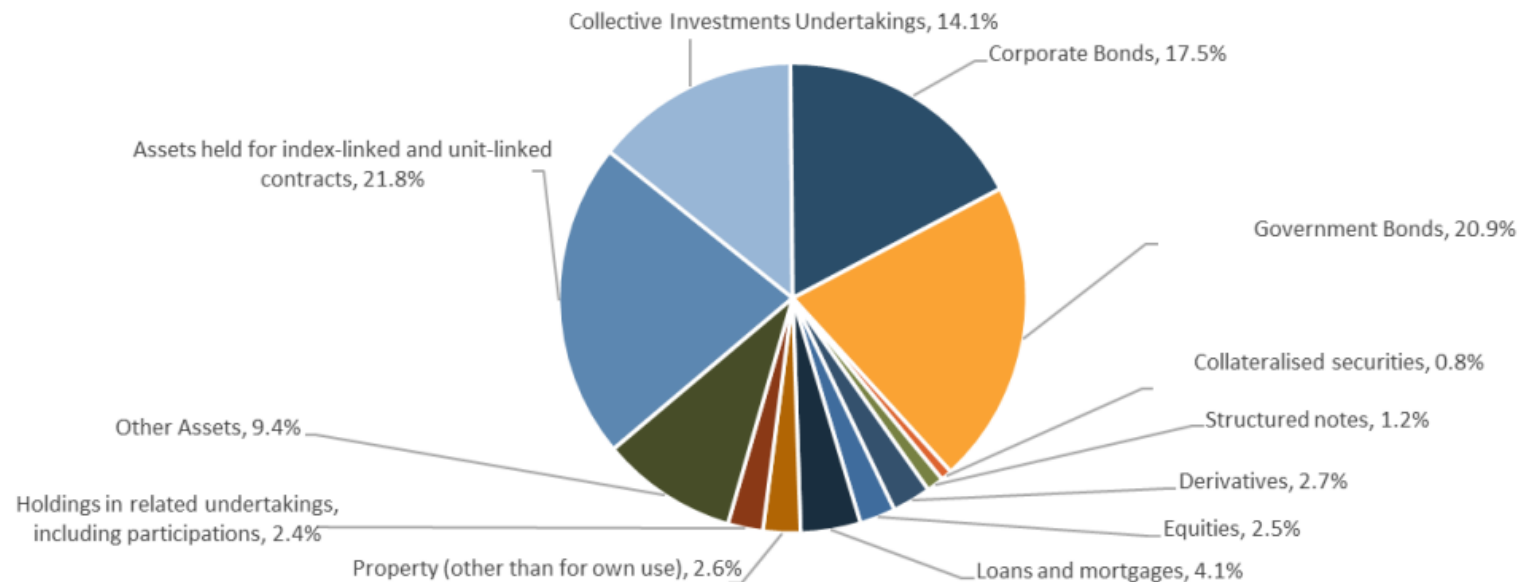
Products such as term insurance, annuities (deferral or pay-out phase), disability insurance and health insurance should be excluded.



## Stress results on liquidity:

- **Material liquidity outflows** which insurers could not fully cover with their cash holdings
- **Insurers had to liquidate part of their liquid assets EUR 305.6 billion** (usually net buyers of c. EUR 93 billion) under the constrained balance sheet approach
- Higher outflows due to surrenders and claims inflation
- Lower inflows caused by the cut in premium payments and reinsurance inflows
- Resulted in a net technical outflow of €314 billion

Figure 5: Aggregate asset composition of the stress test participants in the baseline





01

### Phase 1: Exposure Approach (EA) - Public Consultation (PC) 2020

IAIS developed version 1 of Insurance Liquidity Ratio (ILR) using an EA calculation based on PC 2020 weights/factors

### Phase 2: Development of Liquidity Metrics – Public Consultation (PC) 2021

IAIS implemented feedback received during the interim PC 2020 and updated the EA methodology and calculation of the ILR.

02

### Insurance Liquidity Ratio (ILR)

- EA applies factors to balance sheet items and off-balance sheet exposures to measure liquidity risk.
- IAIS leverages current and prior work on systemic risk assessment to develop the ILR.
- **ILR is the ratio of an insurer's liquidity sources and needs over a selected time horizon of an assumed liquidity stress.**
- IAIS considers a short-term and longer-term time horizon to prudently monitor liquidity risks (based on comments received from Phase 1):
  1. 1-year time horizon (the main time horizon)
  2. 3-month time horizon (the supplementary time horizon)

03

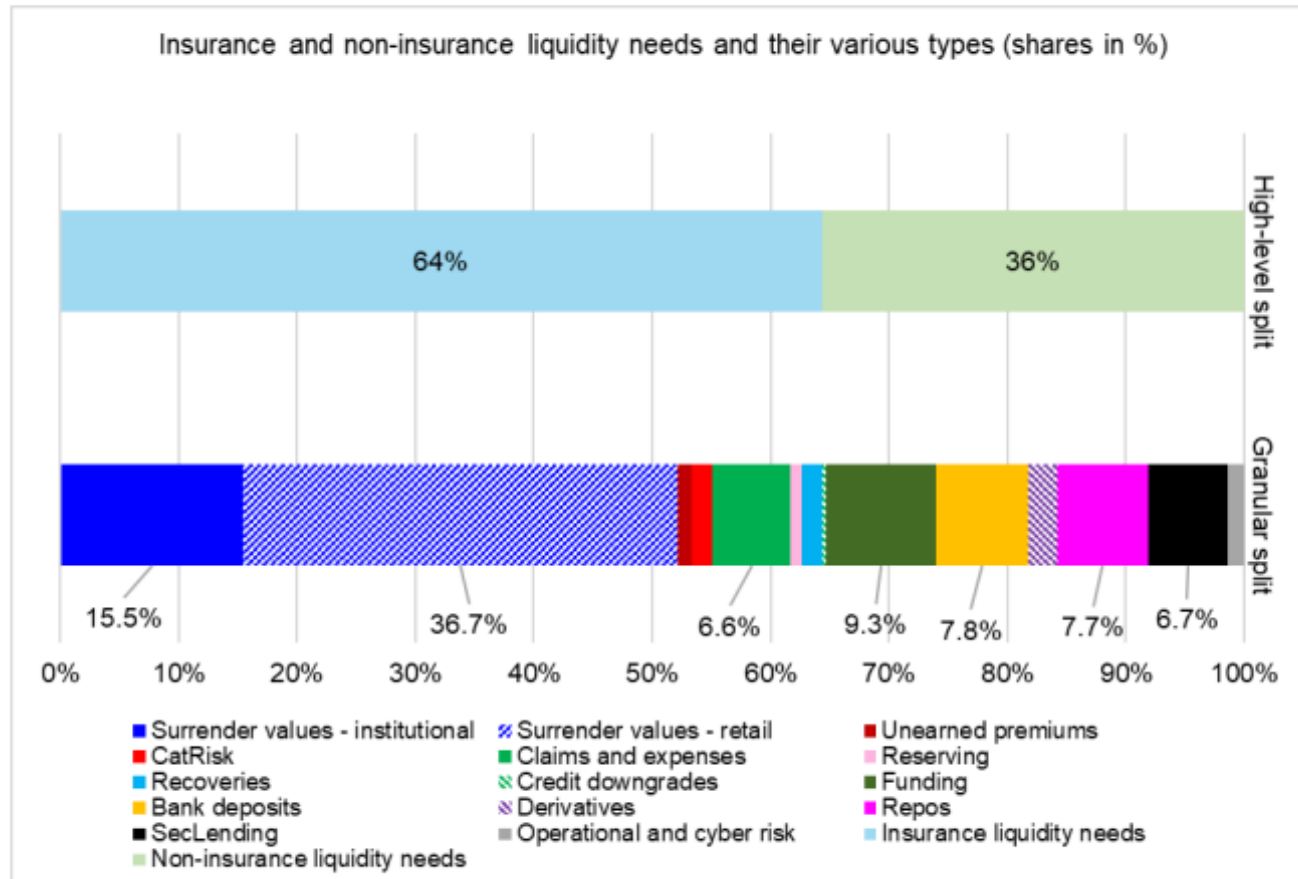
### Determining ILR parameters

- IAIS used multiple sources to determine ILR parameters such as approaches of insurance supervisors, rating agencies and bank supervisors.
- **For Liquidity Sources:** IAIS relied most heavily on bank regulations for treatment of assets. Although insurers are less exposed to liquidity shortfalls than banks, both sectors invest in certain similar asset classes.
- **For Liquidity Needs:** ILR would primarily leverage prior IAIS work on systemic risk identification. With enhanced liquidity needs of banks relative to insurers, bank supervisors have developed a range of tools over the last decade to assess and regulate liquidity risk. The IAIS utilizes lessons learned from these tools, especially for non-insurance liquidity needs.



The graph shows materiality (after applying the factors) of various categories of liquidity needs, using an updated version of the ILR methodology and weights following the feedback received in Phase 1.

**Figure 4 - ILR Liquidity needs using ILR 1Y factors (YE21)**



Source: IIM 2022 data collection

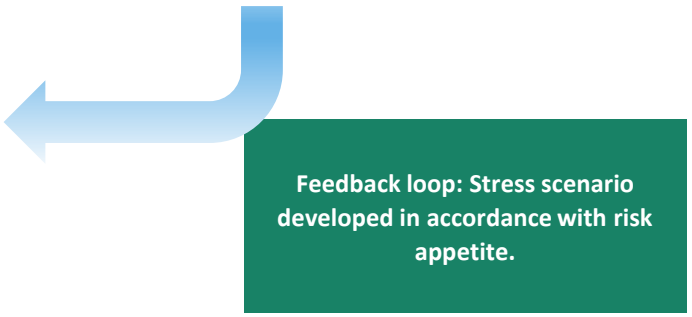
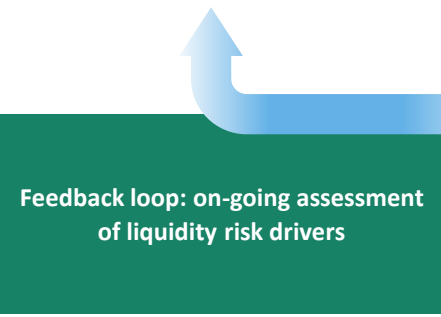
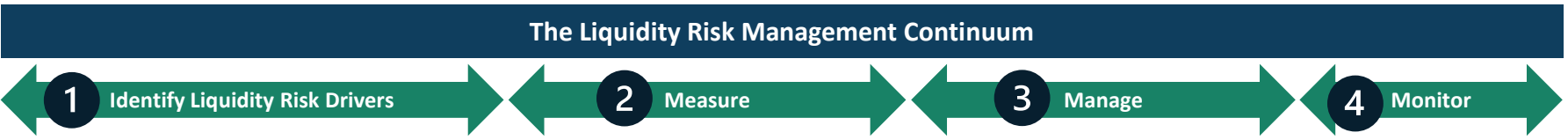


Liquidity management and risk preparedness



# Liquidity management and risk preparedness

Liquidity risk management is an iterative process that should be continually refined and adjusted to changing market conditions and changes to the business itself.



# Liquidity management and risk preparedness



?

Is the current governance framework for liquidity risk management adequate for identifying, assessing, managing, reporting and mitigating all liquidity risk within the business?

?

Is there an established and up-to-date liquidity risk management policy?

?

Is the risk appetite statement up to date in terms of the review cycle and correctly reflective of the current operating environment and business?

?

Have adequate risk tolerances been established with consistent and robust mechanisms and tools to assess and monitor these tolerances?

?

Is there a contingency funding plan in place and is that plan adequate to comply with the Standard?

?

Has the contingency funding plan been tested within the last 12 months?

?

What are the requirements and best practice for adequate contingency funding plan testing?

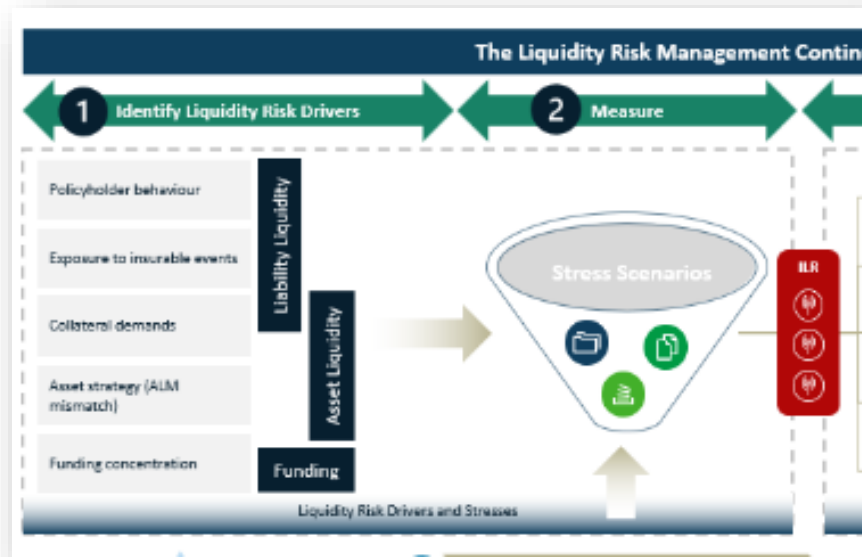
# Liquidity Management

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**The evolving role of an enterprise-wide treasury function**

# Coordinating liquidity management



$$\text{ILR} = \frac{\text{Adjusted HQLA}}{\text{Net Stressed Cash Flows}}$$

# The evolving role of the Treasury Function



Greater accuracy and efficiency in liquidity risk identification and measurement

## Enterprise –wide standardisation

- ✓ Liquidity Management Policy
- ✓ Liquidity risk measurement methodology

More precise EWI and limit setting allowing greater opportunity to optimise the HQLA portfolio

$$ILR = \frac{\text{Adjusted HQLA}}{\text{Net Stressed Cash Flows}}$$

## Enterprise –wide standardisation

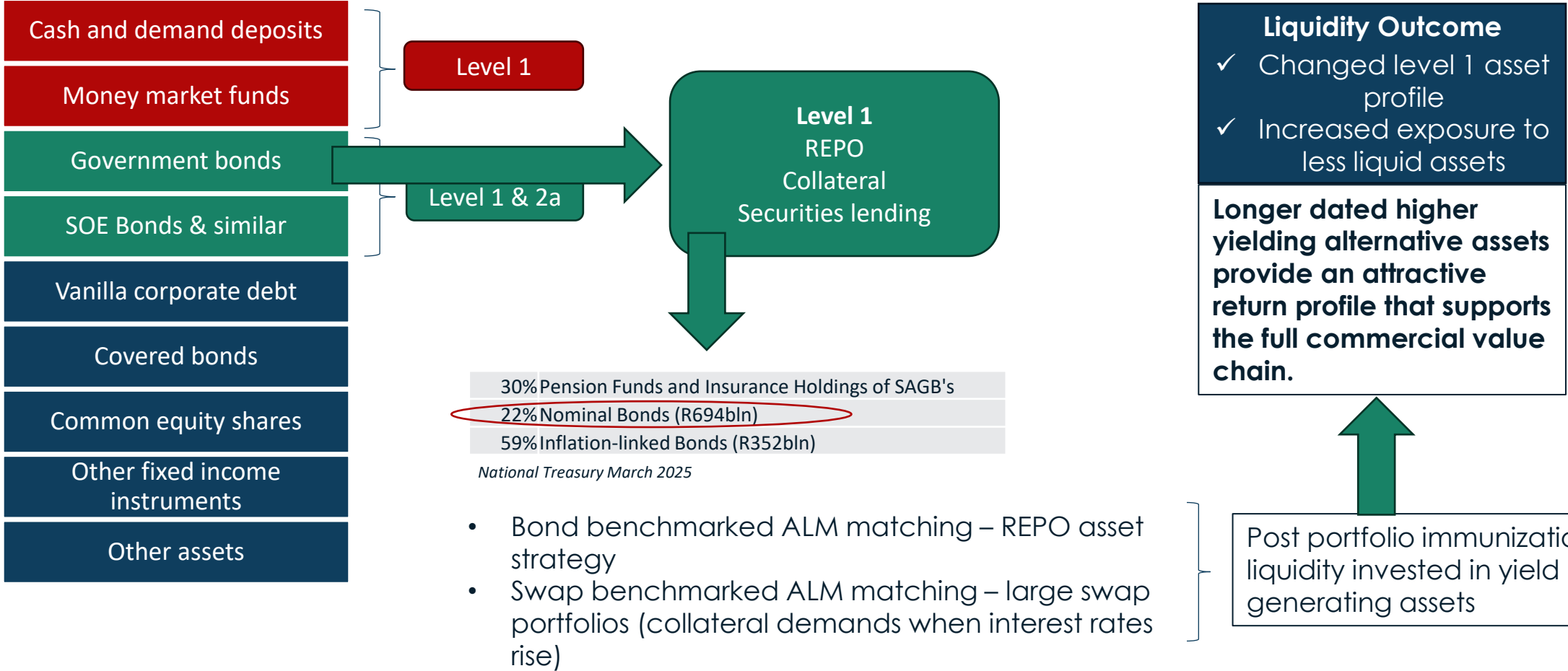
- ✓ HQLA portfolio management standards

- ✓ Direct management vs. Mandate
- ✓ Diversification
- ✓ Liquidity stress response coordination (asset sales to CFP)
- ✓ Cash yield opportunity (sweeping/pooling)
- ✓ Liquidity facilities
- ✓ HQLA fungibility
- ✓ Funding management
- ✓ Liquid asset leverage
- ✓ Pricing for HQLA
- ✓ Granularity (level 1)
- ✓ Automation



# The evolving role of the Treasury Function

## Liquid asset leverage and the rise of alternative investments

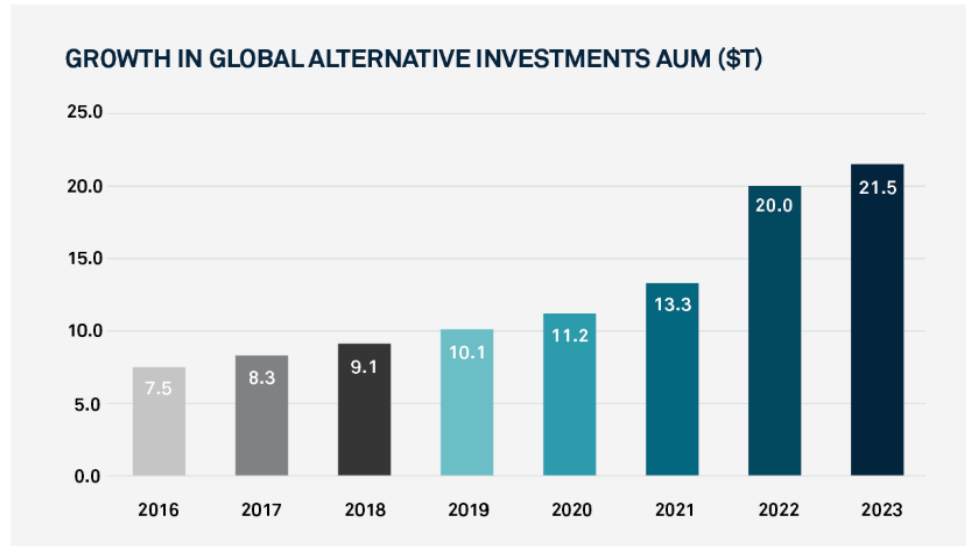


# The evolving role of the Treasury Function



Search for yield and rise of alternative investments – is this the next liquidity crisis?

**FIGURE 1: CONTINUED GROWTH IN GLOBAL ALTERNATIVE ASSETS AND REGISTERED FUNDS**



**BNY** January 21, 2025

INSURANCE

## Insurers' Big Bet On Alternative Investments

APRIL 6, 2025



Author: Andrew Osterland

✕ f in ✉

Faced with low yields, insurers are deepening ties with private equity and asset managers, turning to alternative investments amid regulatory headwinds.

Life insurance companies used to be conservative investors.

**GLOBAL  
FINANCE**

# Liquidity Management

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Closing remarks

# Closing remarks



- ✓ Effective liquidity management requires input from a wide range of role-players, making standardisation an imperative
- ✓ Changing regulatory requirements presents an opportunity to enhance liquidity risk management practices and drive for greater efficiency (it is not just about risk management)
- ✓ Cash matters – cash management efficiency is critical
- ✓ HQLA portfolio management is multi-layered and requires an appropriately resourced function capable of balancing risk and yield generation (cost minimisation)
- ✓ Searching for yield in alternatives – consideration for when the music stops



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Thank you

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