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# Do Property-Liability Insurers Create Liquidity? Evidence from South Africa

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<sup>1</sup> **Note:** The findings from this working paper does not in any way reflect the views of the Development Finance Centre (DEFIC). The views are only representative of the authors.



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# Do Property-Liability Insurers Create Liquidity? Evidence from South Africa

Abdul Latif Alhassan and Nicholas Biekpe

## Abstract

This paper examines the liquidity creation behaviour and its determining factors in the property-liability insurance market in South Africa. Using annual data on 76 insurers from 2007 to 2014, the paper employs the three-stage approach of Berger and Bowman (2009) to estimate liquidity creation. The results suggest that property-liability insurers are characterized by liquidity de-creation to reflect the reverse production function of insurers whereby insurers transform illiquid liabilities in premium reserves to liquid assets in investable securities. The findings indicate that the total liquidity of R1.02 billion de-created in 2014 was mainly driven by large insurers compared with small and medium-sized insurers. On average, approximately R0.89 billion of liquidity was de-created, representing 17.10% of total industry assets. The results of panel regression analysis provide evidence in support of the 'risk-absorption' hypothesis which suggests that low levels of capital increases liquidity de-creation. The paper also document evidence to suggest that reducing firm size and reinsurance usage are associated with high levels of liquidity de-creation in the market. The implications of the findings for policy are discussed.

**Keywords:** Liquidity | Capital | Insurance | Africa |