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Question: "How should liquidity be maintained when using derivatives in investment strategies?"

Answers:

Answer 1:

Liquidity must be maintained in full at all times in the event of an obligation to sell derivatives, especially when cash settlement is mandatory for underlyings that cannot be physically delivered. This is crucial for ensuring that the necessary liquidity is available to fulfill the obligations associated with derivative transactions.

Answer 2:

To manage and report on investments in derivatives effectively, insurance companies must adhere to several critical practices according to the FINMA Circular 2016/5:
Management of Derivative Investments

Risk Mitigation: Derivatives should be used primarily for hedging risks associated with the assets or obligations of the insurance company or for efficient management of investments.

Limitation on Risk Exposure: The usage of derivatives must not expose the company to risks that exceed its capacity or the scope of its business operations.

Coverage Requirements: All potential obligations arising from derivative transactions must be fully covered at all times. This coverage can be either through the underlying assets or liquidity to ensure that the company can meet its derivative obligations without fail.

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