National Association of Insurance Commissioners

Date: 02/02/21

Conference Call

INTERNATIONAL INSURANCE RELATIONS (G) COMMITTEE
Wednesday, February 3, 2021
3:00 p.m. Eastern

ROLL CALL

Gary Anderson, Chair	Massachusetts	Kathleen A. Birrane	Maryland
Bruce R. Ramge, Vice Chair	Nebraska	Anita G. Fox	Michigan
Evan G. Daniels	Arizona	Chlora Lindley-Myers	Missouri
Andrew N. Mais	Connecticut	Marlene Caride	New Jersey
Karima M. Woods	District of Columbia	Andrew R. Stolfi	Oregon
David Altmaier	Florida	Jessica K. Altman	Pennsylvania
Doug Ommen	Iowa	Raymond G. Farmer	South Carolina
James J. Donelon	Louisiana		

NAIC Support Staff: Ryan Workman/Nikhail Nigam

AGENDA

1. Discuss NAIC Comments on the IAIS Draft Application Paper on Resolution Powers and Planning and Consultation on the Development of Liquidity Metrics —*Commissioner Anderson (MA)* — Attachment A

2. Adjournment

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Attachment A

February 2, 2021

IAIS Draft Application Paper on Resolution Powers and Planning – *NAIC Draft Comments*

Section/Paragraph	Comment
16	(editorial) Such a situation generally occurs when ~~to~~ a troubled insurer ~~that~~ is no longer viable, or is likely to be no longer viable, and has no reasonable prospect of returning to viability in its current form.
20	(editorial) This however does not mean that policyholders will be fully protected under all circumstances and does not exclude the possibility that losses could be absorbed by policyholders, to the extent they are not covered by PPSs or other mechanisms.
22	(editorial) Finally, resolution should seek to minimise any ~~the~~ reliance on public funding.
27	Box 1, first sub-bullet, there should be a semi-colon rather than a period at the end of the bulleted text, for consistency.
32	Table 3 – some of the bullets are not capitalized, they should be capitalized for consistency.
32	(editorial) While some resolution powers could be allocated to more than one group, this grouping ~~is purely aimed at facilitating the reading by avoiding~~ avoids repetition in describing the powers and their benefits and uses.
66	(editorial) The resolution authority may want to consider whether policyholder premiums should be adjusted post-write-down to reflect the write-down of their liabilities. The ~~the~~ resolution authority should consider both protected and unprotected policyholders in line with the levels of protection provided to policyholders in their jurisdiction by the PPS, if applicable.
86	The second bullet states: "The existence of a PPS may affect timing of liquidation" The paper should provide more explanation of how a PPS can affect the timing of liquidation.
100	Suggest the procedures for effectuating the NCWOL principle include the potential impact of a PPS.
103	Second sentence, change "staggered" to "proportional" for alignment with section heading.
108	First bullet in second set of bullets – recommend this be written in US dollars for consistency with other IAIS documents.
111	Add a semi-colon after the last bullet in the first set of bullets for consistency.
114	(editorial) An analysis of the impact of the failure of the insurance group on other parts of the financial system, or on the real economy, including the identification of any financial and economic functions that need to be continued to achieve the resolution objectives;
115	Include the following edits to improve clarity and grammatical flow: "In such cases, the group-wide supervisor and/or resolution authority should provide oversight, review and non-objection or approval of the resolution plan. ~~including a~~ The process ~~that~~ should require ~~requires~~ correction of any deficiencies."
139	Include the following edits to improve clarity and grammatical flow: "In such cases, the group-wide supervisor and/or resolution authority should provide oversight, review and non-objection or approval of the resolution plan. ~~including a~~ The process ~~that~~ should require ~~requires~~ correction of any deficiencies."
Annex	The Annex contains examples of legislation in four jurisdictions. It would be helpful to provide a more in-depth discussion of these laws, and how they function.

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IAIS Development of Liquidity Metrics: Phase 1 – Exposure Approach – *NAIC Draft Comments*

	Question / Response
1	Do you agree with the IAIS' plan for the development of liquidity metrics for monitoring? If not, please explain what changes you recommend and why. Yes, several metrics may achieve the same goal and be comparable.
2	Should the IAIS consider any other approaches or alternatives when developing liquidity metrics? If so, please explain. No. We are happy to see the plan includes development of a company projection approach in Phase 2.
3	Should the IAIS develop additional liquidity metrics that examine other time horizons? If so, how should these metrics differ from the proposed metric? Phase 2 should consider other time horizons.
4	Do you agree with the exclusion of separate accounts from the ILR? If not, how should separate accounts be incorporated? Yes. However, we agree further metrics should be considered in the future. For certain products, the IAIS should review any potential residual risk in the general account.
5	Do you agree with the proposed factors for liquidity sources? If not, please explain. No, we feel the asset factors are too low. We suggest they be based on empirical evidence such as market size, daily average trading volumes, and price volatility to determine appropriate factors, especially as the asset categories relate to each other. Absent empirical evidence, we are hesitant to recommend a percentage, but look to the factors used by S&P as a logical starting point. In addition, the IAIS should take into account if the insurer has a diversified asset portfolio across business sectors. If an insurer's investments have been concentrated on certain business sectors such as energy or financial services and not well diversified, then an overall haircut adjustment may be warranted.
6	Do you agree with the treatment of investment funds? If not, please explain and suggest an alternative treatment. Yes, we agree to exclude them, but should review periodically if that is appropriate based on market conditions.
7	Do you agree with the treatment of premiums? If not, please explain how premiums and excluded expenses should be treated in the ILR. Yes. However, premiums, expenses and other cash flow items should be considered in Phase 2 development of a liquidity metric.
8	How should instruments issued by financial institutions be treated within the ILR? We agree with the plan to assess the treatment of instruments issued by financial institutions in 2021. We recommend the assessment include a study of historical defaults, loss given defaults and correlation with a broad market downturn of these instruments compared to other issuer categories to determine if there is any empirical evidence to suggest treating them differently.

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9	Do you agree with the inclusion of certain encumbered assets as liquidity sources within the ILR or should the IAIS alternatively exclude these encumbered assets and measure certain the related liquidity needs on a net basis? Should any additional liquidity needs be included in the calculation because encumbered assets are included as a liquidity source? We believe encumbered assets should be included in the ratio as a liquidity source as long as the cash received in connection with the securities financing transaction is also included as a liquidity source and the liability to return the cash is included as a liquidity need in the denominator of the ratio. We believe treatment of collateral (i.e., cash, investment funds, or securities issued by financial institutions) should be applied consistently for different securities financing transactions.
10	Do you agree with the treatment of liquidity risk from surrenders and withdrawals from insurance products in the ILR? If not, please explain how this could be improved. We agree and support the plan for the IAIS to conduct further sensitivity analysis on these factors in 2021. The IAIS may need to consider impact of non-catastrophic, but significant random fluctuation of insurance experience such as higher than expected death and health claims from COVID 19.
11	How should the IAIS capture liquidity needs from policy loans? Should these be incorporated into the ILR or be an alternative metric? If policy loans are included, then care must be taken to avoid overcounting surrender, withdrawal, and loan on the same policy.
12	Do you agree with the factors applied to retail insurance products being half of the factors applied to institutional products? How should the factors applied to retail and institutional policies differ? We agree and support the plan for the IAIS to conduct further sensitivity analysis on these factors in 2021, but see no statistical evidence that supports 50% factor to be applied as a difference between retail and institutional policyholders. The IAIS should study historical surrender rates to derive appropriate factors. Given regional differences in insurance products, regional factors may need to be developed.
13	Do you agree with the treatment of unearned premiums in the ILR? If not, how can it be improved? Yes.
14	Should the IAIS apply standardised factors to insurers projected ultimate catastrophe losses or rely on company projections for the speed of catastrophe payments and reinsurance recoveries? We recommend using the companies 1/250 PML or 1/100 PML as an alternative.
15	Do you agree with the proposed treatment of catastrophe insurance claims? If not, how can it be improved? Yes, we agree.
16	Should the proposed treatment of deposit liabilities include more or less granularity? If so, what additional dimensions (eg the presence of an effective deposit insurance scheme) should be captured or left out? We agree with the proposed treatment, with a less granular approach preferred.
17	Should the proposed factors be modified? If so, please explain how and why.

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	No, they look appropriate
18	Should insurance contracts without significant exposure to insurance events be captured by these factors, or included with other policyholder liabilities? Yes, we believe such contracts warrant being captured by these factors and not just captured by other policyholder liabilities as the purpose is to capture the entire liquidity risk to insurer. For example, the exposure of the insurer to guaranteed investment contracts with no insurance riders attached to the contract should be captured.
19	Do you agree with the treatment of derivatives? If not, please explain and suggest an alternative treatment. Yes.
20	How should the ILR treat debt with financial covenants that may be triggered under stress? We believe that treating all (100%) of the category as being called, not rolled or not available under stress is too conservative. All debt that is short-term (i.e. commercial paper or long-term debt with maturity of less than a year) should be included. The stress event should be clearly defined. Any debt with covenants or collateral calls that are triggered by that specific stress event should only be included if there are provisions in the financial contracts that exclude them from the jurisdiction's bankruptcy code. The 100% factor on LT Debt appears too high as it is highly unlikely all the debt would be accelerated at once.
21	How should the ILR assess potential liquidity needs from a downgrade? We agree with 100% of the category affected by the downgrade, but "downgrade" needs to be clearly defined. We believe that a credit rating downgrade of the holding company of significant magnitude that triggers debt covenants and posting of higher collateral requirements for derivatives, securities lending, and repurchase agreements would be appropriate as a definition. In contrast, an insurers' underlying debt or subsidiaries as well as investments are subject to frequent up and downgrades and thus should be excluded.
22	Do you agree with the discussed limitations and mitigations of the ILR? What other limitations should the IAIS consider and how can these be mitigated when the IAIS monitors liquidity risk? Yes. The paper describes only one approximate measure of liquidity risk and such risk may be measured better with a cash flow approach, to be developed in Phase 2. Currently, renewal premiums, future claims from in force business and new business are not included. As these factors may affect the insurer's liquidity position, one caveat of the current metric is that it will require more analysis of the insurer, on an on-going basis, by the IAIS and the supervisor. Another issue the IAIS should consider is how to differentiate between a resolution with an orderly run-off, which will typically result in all claims being paid, and a liquidation due to a lack of liquidity.
23	General comments on the Public Consultation Document on the Development of Liquidity Metrics: Phase 1 – Exposure Approach None.

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NAIC International Insurance Realtions (G) Committee
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We'd like to offer the following comments:

The proposed Insurance Liquidity Ratio (ILR) for Phase 1 has serious flaws and the NAIC should point these out in its response. The flaws are:

- **The use of only balance sheet values when looking at "Liquidity Sources" and "Liquidity Needs" over a one-year time horizon.** Liquidity sources over a one-year time horizon include premiums, investment income and investment maturities, even before consideration of asset sales. By focusing solely on the balance sheet the IAIS proposal is looking only at asset sales. Liquidity needs (claim liability runoff, new claims, expenses) offset some of those sources, but the degree to which that happens varies materially by company. Those that are in runoff or partial runoff (such as via exit of a long-tail line) might expect needs to consume most of the sources. Those that are going concerns or start-ups would expect sources to be greater (possible much greater) than needs, generating high levels of positive operating cash flows. In short, the use of only an exposure-based approach is materially inconsistent with a one-year time horizon.
    - We note that the Q22 response partially reflects this issue, but from a life insurance perspective as it makes no mention of the payout in the next 12 months of current claim liabilities, and focuses on "in force" business. We believe that response is insufficient as a result.
- **The use of only enterprise-wide calculations**. The use of only enterprise-wide calculations ignores the location of the liquidity sources vs. the needs. The paper points out on page 24 that the location of the funds matters, yet this is ignored in the design of the ratio. As a result, the proposed ILR is likely to propose false negatives (i.e., indicate that no liquidity concerns exist) in situations where liquidity concerns do exist.
- **Ignoring asset duration in its evaluation of liquidity sources.** In evaluating the degree to which asset values are available as liquidity sources, no reflection is made of the asset maturity. We believe that assets maturing in a shorter time frame would be more fully realizable in a crisis than those maturing in a longer timeframe.
- **Treatment of unearned premium as a liquidity need based partly on an archaic case study, and using an inadequately defined classification inconsistent with the available data.** The proposal would treat a certain portion of unearned premiums as a liquidity need, based partly on a 1933 case study for a surety insurer based in New York. A case study from 87 years ago is not relevant, given the changes in the environment (consumer, regulatory, financial, legal) since then. The proposed factors also vary for "retail" versus "institutional". Such a classification is not sufficiently defined nor captured in the data for U.S. property/casualty insurers for it to be usable.
- **The catastrophe scenario is overly conservative with regard to the percent payout for an extreme event.** For property/casualty coverages affected by a catastrophe, the

larger the event the slower the payout. The 1-in-250 year scenario suggested would be larger than any recent event, and the largest recent events have payouts of over 12 months. Assuming that the event did not occur on January 1, the scenario suggested would have a payout of less than 12 months, making the suggested approach even more conservative. The result is an estimated liquidity need that is unrealistic. In addition, the longer the return period forecasted by catastrophe models, the more uncertain (if not speculative) the estimates become, making the quantification of this need unreliable.

Suggested edits to the NAIC response:

- Question 1 – Answer "*No, as we believe that operating cashflow also needs to be considered, not just balance sheet values. In addition, we advise against enterprise-wide approaches that assume full fungibility of funds within a group."*
- Question 2 – Answer "*Yes. We recommend recognizing operating cash flow consistent with the chosen time horizon, and investigating the use of entity-specific ratios rather than enterprise-wide ratios."*
- Question 3 – Modify the currently proposed answer to add consideration of asset maturity and trading volumes over a period more consistent with the chosen time horizon.
- Question 7 – Answer "*No. We believe that recent historic operating cash flows should be reflected in the calculation. Such an approach is more consistent with the chosen time horizon, and reflects how many non-life insurers that do not have callable liabilities are currently managed*."
- Question 13 – Answer "We are not ready to agree or disagree until more information is collected with regard to recent situations. We do not believe the 1933 case study is sufficiently relevant to current times and, in addition, believe that the retail vs. institutional split proposed is not feasible or sufficiently defined for the U.S. property/casualty market."
- Question 15 – Answer "*No, as the percentage payout (i.e., 100%) is faster than that observed from the most extreme events in the relatively recent past. We also believe that catastrophe models are more reliable the shorter the return period, and conversely less reliable the longer the return period, such that estimates using a 1-in-250 year return period may not be sufficiently reliable. We recommend looking at percentage payouts within the year of occurrence from recent events, as well as investigating the reliability of catastrophe estimates for longer return periods. (The latter might be accomplished by comparison of various model estimates for various return periods.)*"
- Question 19 – We believe that the proposed approach to derivatives is overly conservative, and recommend that the NAIC response reflect its experience with AIG's derivatives during the 2008 financial crisis.