The Liquidity Assessment (EX) Subgroup of the Financial Stability (EX) Task Force met via conference call Nov. 26, 2019. The following Task Force members participated: Justin Schrader, Chair (NE); Kathy Belfi (CT); Philip Barlow (DC); Carrie Mears (IA); Bruce Sartain and Vincent Tsang (IL); Bill Carmello (NY); and Mike Boerner (TX). Also participating was: John Rehagen (MO).

1. Discuss its Progress on the Liquidity Stress Test Proposal

Mr. Schrader stated that a draft of the 2019 liquidity stress test proposal will be jointly exposed for a 60-day public comment period by the Financial Stability (EX) Task Force and the Subgroup during the Task Force’s Dec. 9 meeting at the Fall National Meeting.

Mr. Schrader noted that the draft 2019 liquidity stress test proposal does not address all aspects of liquidity risk concerns, but rather focuses on key risks from the 2019 stress test results to further refine the methodology. Mr. Schrader highlighted the key design element recommendations made since the last Task Force meeting at the Summer National Meeting.

Mr. Schrader said that for the 2019 liquidity stress test, a baseline normal operations scenario, two liquidity stress scenarios and an insurer-specific information request should be required. For each stress scenario, there will be a state insurance regulator-provided narrative and state insurance regulator-prescribed assumptions that must be used in the insurer’s internal modeling. For these stress scenarios, there will be company assumptions to be generated and used by the insurer based upon the state insurance regulator-provided narrative and state insurance regulator-prescribed assumptions that exist.

The first liquidity stress test is a Severely Adverse Scenario, where market conditions are similar to the 2008 financial crisis. The state insurance regulator prescribed narrative and assumptions are primarily extracted from the Federal Reserve Board’s Supervisory Scenarios for Annual Stress Tests Required under the Stress Testing Rule of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act. He said that additionally, there is a “what if” modification to the Severely Adverse Scenario that limits the insurer to curing any liquidity deficiency through expected asset sales amounts. He clarified that under that assumption, there are no internal and external funding sources to satisfy any liquidity deficiency under stress such as no new FHLB draws or holding company contributions. Mr. Schrader added that the values of assumptions such as market capacity, swaption volatility, structured spreads, swap spreads and credit default assumptions being suggested in the draft exposure document will be finalized in the first quarter of 2020 and to also reflect an update from the Federal Reserve Board.

Mr. Schrader said the second liquidity stress test is a scenario that contemplates whether an interest rate spike, equities decrease and credit spread stress exist. Additionally, the nationally recognized statistical rating organization (NRSRO) insurance industry outlook goes from stable to negative with many insurers experiencing a downgrade. A “what if” modification to this stress scenario is also required. State insurance regulators see value in performing a Sovereign Debt stress scenario but are not ready to implement it for the 2019 liquidity stress test. This stress scenario and “what if” modification will accomplish some of the dynamics that would be included in a Sovereign Debt stress, and state insurance regulators will utilize those results to build out a Sovereign Debt stress scenario in the future. The “what-if” modification to this stress scenario includes the state insurance regulator-provided narrative and all state insurance regulator-prescribed assumptions as per above except that instead of a decrease in equities, insurers should assume an increase in equities. Additionally, no credit spread stress should be assumed.

Mr. Schrader noted that for the insurer-specific information request, state insurance regulators also require the insurers to report their severe worst-case stress scenario in a detailed narrative, including any assumptions needed for state insurance regulators to gain greater insight to the drivers of liquidity risk for specific insurers and to inform future prescribed stress scenarios.

Mr. Schrader explained that if the insurer reported a liquidity deficiency, where liquidity uses exceed sources, then the insurer would need to disclose in the reporting templates the expected asset sales involved with meeting that short fall. He added that the insurer will be requested to provide:

- The expected asset sales amounts generated by the system prior to any review or modification by the portfolio manager.
The final expected asset sales amounts after review or modification by portfolio manager.

Mr. Schrader mentioned that the holding company and life insurance legal entities in the group are required to perform the stress tests. For the remaining non-life insurance and non-insurance legal entities within the group, those with material liquidity risks should be required to perform the stress tests. He mentioned that the definition of materiality should be flexible, based on the insurer’s Own Risk and Solvency Assessment (ORSA) and internal liquidity stress testing. He also mentioned that based on the results of the 2019 initial stress test exercise, the Subgroup will determine if additional materiality criteria should be developed to help ensure better comparability among insurers.

As to the next steps, Mr. Schrader noted that the study group still needs to address other types of disclosures to be captured in the 2019 liquidity stress test results—for example, some of the key company assumptions utilized by the insurers. These disclosures will be finalized in the first quarter of 2020.

Mr. Schrader mentioned that the timing of the 2019 liquidity stress test is proposed to be early third quarter of 2020.

Mr. Schrader mentioned that subsequent to insurer reporting of liquidity stress testing results and aggregation of data, the Subgroup will also focus on the mapping of industry aggregated sales to market data. The NAIC aims to compare the aggregated results against various benchmarks, potentially including normal and/or stressed trading volumes and asset values for various asset classes, to determine the impact such sales may have on the capital markets in times of stress. Findings from this analysis may also inform expected asset sale assumptions utilized in future runs of the liquidity stress test. As part of its macroprudential surveillance, state insurance regulators and/or the NAIC may reach out to other regulatory agencies to discuss aggregate results that may affect other regulated industries such as banks, securities brokers and asset managers. State insurance regulators may also coordinate with other agencies to identify appropriate and perhaps coordinated action they may take to prevent or minimize the effect large asset sales may have on the financial markets and overall economy.

Mr. Schrader said that for the 2019 liquidity stress test exercise, lead state insurance regulators will utilize their examination authority to collect the reporting results from insurers identified by the scope criteria to ensure confidentiality. He added that the Task Force will be developing a long-term solution to confidentiality, possibly in coordination with the needs from the group capital calculation (GCC) project.

Mr. Tsang (IL) asked if an executive summary to the draft exposure document would be good to have to better understand the purpose, to which Mr. Schrader responded that the background section of the document covers this aspect.

Mr. Rehagen (MO) asked for a confirmation of which firms are on the list based on the scope criteria. Mr. Schrader responded that 23 firms are in the scope, noting that he had checked with all lead state insurance regulators if those firms were informed.

Having no further business, the Liquidity Assessment (EX) Subgroup adjourned.