April 1, 2021

Mr. Todd Sells, Director
Financial Regulatory Policy & Data
tsells@naic.org

Re: Financial Stability (E) Task Force 2020 Liquidity Stress Test Framework Exposure

Dear Mr. Sells:

Thank you for the opportunity to submit comments on behalf of the American Council of Life Insurers (ACLI) related to the exposed framework document for the 2020 Liquidity Stress Test (LST) Framework. The points below are intended as high-level observations that will hopefully help inform the Financial Stability (E) Task Force on industry issues before approving the final LST Framework.

A. Comments about the exposed LST framework document

1. The source of the Baseline scenario should be identified consistently (Section 4.1 and Section 5.1.2)

The exposed document appears to identify inconsistently the source of the Baseline scenario, most notably the economic assumptions within that scenario. We understand that the intent is for insurers to use their internal Baseline scenarios and assumptions, and the language of Section 4.1 is consistent with this intent. The references to the Fed's Baseline scenario in Section 5.1.2, however, create potential confusion. We believe that the references to the Fed's Baseline scenario are intended solely to determine the degree of stress within the Adverse scenario. Assuming that this is the case, we recommend appropriate clarifications within Section 5.1.2 and Annex 2i.

2. A provision permitting prudent modeling simplifications should be added (Section 5)

For both the Adverse scenario and the Interest Rate Spike scenario, we request that regulators explicitly allow for a simplification whereby shocks may be reflected on day 1 of the stress period vs. at specific points in time during the stress period if the practice can be demonstrated or reasonably assumed to be more conservative.

3. The degree of stress within the Adverse scenario should be described consistently (Section 5.1)

The exposed document appears to characterize inconsistently the degree of stress to be applied under the Adverse scenario. In a couple of places, the level of stress is characterized as akin to the 2007-09 financial crisis. Our understanding, which is outlined in Section 5.1.2 and Annex 2i, is that regulators desire to utilize the 2017 Fed CCAR Adverse scenario, which applies a more moderated degree of stress. We would appreciate clarifications where appropriate and a single, harmonized approach to the Adverse scenario within the framework document.

4. **To promote consistency, the prescribed Fed-generated scenario stress should be translated into basis point shocks (Section 5.1.2)**

Section 5.1.2 requires insurers to run the Adverse liquidity stress scenario using specific values from the Fed's stress-testing exercise for banks. It is our understanding that the intent is: (1) for the companies to use internal baselines for the Baseline scenario and (2) for the direction and magnitude of the Adverse stress scenario to be consistent with that of the prescribed Fed-generated scenario as measured from the original scenario date, and the direction and magnitude of the Adverse stress scenario would be applied to the Baseline scenario. We believe that the relevant economic and regulatory prescribed assumptions should be translated into basis point shocks to ensure more uniformity in insurers' interpretations of the stressed economic environment.

We understand that regulators have suggested that the projected path of ten-year Treasury rates should be translated to quarterly percentage increases, with a 10 bps minimum increase. Although this guidance is helpful, we have questions about the appropriateness of extending this construct to a variety of metrics. Overall, it would be helpful to establish a process that ensures that the Adverse stress scenario is constructed and applied consistently across the industry. We would be pleased to offer our assistance in this process.

5. **A provision directing companies to produce assumptions consistent with stated Moody's values should be added for asset classes not covered by Moody's (Sections 5.1.7, 5.1.8, 5.1.9)**

Sections 5.1.7, 5.1.8 and 5.1.9 refer to Moody's tables for use in determining credit migrations, defaults, and recoveries. Other asset classes (structured credit, CMBS, MBS, other ABS, etc.) are not explicitly addressed. The framework document should more clearly direct companies to create "own" assumptions consistent with the Moody's tables. This may be related to the requested clarification of "illustrative value" (see 9c, below).

6. **Detailed specifications for the "What If" modification of the Adverse scenario should be provided (Section 5.1.10)**

Section 5.1.10 describes the "What If" modification of the Adverse scenario. The exposed framework document indicates that the "What If" modification "allows for insurers to use established funding commitments" including existing Federal Home Loan Bank (FHLB) commitments. It further allows the rollover of expiring facilities "but eliminates the ability of the insurer to access additional/extraordinary internal and external funding sources to satisfy any liquidity deficiency under stress." We understand that, since the exposure, regulators would like to alter the "What If" modification to limit all external funding sources, including existing

FHLB obligations and rollovers, and to prohibit any internal extraordinary transactions to make the scenario more stressful.

We urge the regulators to reconsider this approach and, instead, maintain the language as drafted in the current framework exposure. Our view is that the suggested treatment of existing FHLB obligations, which would eliminate one of the primary tools that insurers have established to manage liquidity stresses, is not plausible even under a severe stress. Further, we believe all internal funding mechanisms, including extraordinary actions, should be allowed to the extent regulatory approval is not required, as that is how internal transfers would realistically play out during a crisis.

7. The requirement to provide the insurer's worst-case scenario information should be eliminated in future reporting (Section 5.3)

Section 5.3 requires insurers to provide a narrative of their most severe internal liquidity stress scenario. We observe that companies will have provided essentially the same information on or before June 1st via the COVID-19 special reporting, but we understand the desire of regulators to have this information through the cashflow template at the group level for educational purposes. After this year, the educational purpose will have been largely fulfilled and regulators should consider that many companies provide information on their binding scenario(s) to their domestic regulators through ORSA and other means. We ask that this requirement be eliminated in future reporting after this year.

8. Reporting for the What If modification of the Adverse scenario should be clarified (Section 7)

For the "What If" modification of the Adverse scenario, the framework document is currently unclear as to which reporting templates are to be submitted and whether they are to be submitted at the legal entity or group level. Our understanding is that regulators want only the asset sales template at the group level. Assuming that our understanding is correct, we would appreciate appropriate clarifications within the framework document.

9. Other desired clarifications, corrections, and confirmations

a. Section 2.2, Time Horizons, includes the following statement: "We do acknowledge liquidity risk may exist in shorter time horizons, but this is viewed as a cash management/Treasury function as part of the daily operations of individual insurers that would not affect the industry as a whole. ~~Many insurers do have shorter term time horizons (7-days for example) as part of their internal liquidity stress testing framework. A 7-day time horizon may be appropriately applied to specifically 'identified activities' within an entity, such as posting collateral.~~"

   We recommend removing the struck-through language as the NAIC has determined that a 7-day time horizon is inappropriate. The IAIS reached the same conclusion in their liquidity consultation.

b. In Section 4.1, Baseline Assumptions for Cash Flows, language in the framework document reads, "These cash flow projections should be consistent with those used for internal financial planning and analysis (FP&A), risk management, etc." We recognize the value of having consistency between assumptions in the Baseline scenario and assumptions that are used for internal purposes. However, we think the current language is overly specific in identifying the models with which the Baseline scenario should be consistent. We suggest the following clarification: “These cash flow projections should be consistent with those used for internal baseline liquidity forecasts, such as those used for financial planning and analysis (FP&A), risk management, etc.”

c. In Section 5, Introduction, the term “Illustrative value” is used in the following sentence: "If there is no specific value included in the 2020 LST Framework and instead there is an illustrative value, the company should use a value consistent with the illustrative value.” This term is not used elsewhere in the framework document and should be clarified or modified.

d. In Section 5.1.2, our understanding is that the intent is to use Q4 2020 actuals, with the first projection quarter being Q1 2021.This should be updated accordingly.

e. In Section 6, Available and Expected Asset Sales, new language in the framework reads “Regulators expect robust disclosures around the chief investment officer’s assumptions and decisions on expected asset sales.” Although we recognize the value of the involvement of senior investment professionals in the LST, we do not think it is necessary to require the involvement of a specific individual. We would appreciate more generic language on this topic, such as “the company’s assumptions…” or “the investment team’s assumptions…” or “the chief investment officer or CIO delegate’s assumptions…”.

f. In Section 7, the reporting instructions should expressly indicate the scenarios for which the cash flow sources and uses templates are required. It is our understanding that the templates would be required for the Baseline scenario, for the Adverse scenario, and for the Interest Rate Spike scenario at both the individual entity level and the group level and for the “Worst Case” scenario at the group level only. As noted above, it would not be required for the “What If” modification of the Adverse scenario.

g. In Section 7, we do not understand why certain boxes are greyed out in the Liquidity Sources and Uses template.

h. The Section 7 description of the narrative requirements of internal stress testing systems and processes should be aligned with Section 2.3. Section 2.3 indicates that "insurers should provide a narrative description of their internal liquidity stress testing system and processes, including for example their materiality thresholds for stressed cash flows *and methodology for converting foreign currencies to US dollars* (see Section 7 Reporting)" [emphasis added]. The italicized portion of the sentence above is not found in the corresponding bullet in Section 7. More generally, our understanding is that regulators would like, where appropriate, to have some understanding of how FX rates are used in internal processes. We think that is appropriate and would not support mandated currency conversions.

i. In Section 7, we request confirmation of the required practices around margin and collateral. For margin, the Sources and Uses template includes Initial Margin (IM) and Variation (VM) as a source. We request confirmation of this intent, noting that it is inconsistent with some internal practices, which exclude all margin received from sources unless trades are settled. For collateral, the reporting templates exclude “Other Collateral Received” (Sources) and “Other Collateral Sent” (Uses), and we would appreciate clarification and confirmation that non-cash collateral is to be excluded from the reporting templates.

j. Annex 1 outlines the original scope criteria with annual statement references. While these criteria are relevant for the current exercise, it may be appropriate to update the references for future iterations of the LST.

Account Balances	Threshold in $B "greater than"	Reference to 2020 NAIC life/fraternal annual financial statement blank
Fixed and Indexed Annuities	25	Analysis of Increase in Annuity Reserves Page: 7.3 Analysis of Increase in Reserves During the Year – Individual Annuities Line: 15 – Reserve December 31, current year Columns: 2 – Fixed Annuities; 3 – Indexed Annuities + Page: 7.4 Analysis of Increase in Reserves During the Year – Group Annuities Line: 15 – Reserve December 31, current year Columns: 2 – Fixed Annuities; 3 – Indexed Annuities

k. Annex 2iii provides both placeholder categories and references for structured spreads. ACLI's recommendation will be forthcoming. Once these are finalized, Annex 2iii should be updated.

B. Recommended Baseline and Adverse stress spreads for structured credit instruments

Section 5.1.4 directs the industry to recommend year-end Baseline structured spreads. There is also a need to include uniform structured spreads for the Adverse stress scenario. ACLI is still developing a recommendation, and we aim to deliver a proposal in the coming weeks.

C. Conclusion

We believe that the LST framework may require a fair amount of refinement, even after it is "finalized" at the end of April. **We recommend establishing a Q&A process whereby questions can be submitted and addressed throughout the course of the 2021 exercise.** We look forward to working collaboratively as issues emerge, and as we look to the development of the 2022 LST.

Again, we thank you for the opportunity to submit these comments and we look forward to discussing further.

Sincerely,

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