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|  | **Financial Analysis Handbook**  **2021 Annual / 2022 Quarterly** |
| VI.C. Group-Wide Supervision – Insurance Holding Company System Analysis Guidance (Lead State) | |

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**Liquidity Stress Test**

In 2021 the NAIC Executive Committee and Plenary adopted revisions to the *Insurance Holding Company System Model Act* (Model #440) that introduce a new filing requirement for a Liquidity Stress Test (LST). While insurer and insurer groups within the scope of the LST will submit required filings in 2021 under states’ examination authority, states are beginning the process of adopting Model #440 amendments into state laws. Additional lead state and non-lead state guidance will be developed in future years as regulators gain experience reviewing the LST filing.

**Scope Criteria and LST Framework**

* The Scope Criteria for insurers or insurance groups required to perform and file the LST and the instructions for the filings are outlined in the *NAIC 2020 Liquidity Stress Test Framework* which is located on the Financial Stability (E) Task Force webpage of the NAIC’s Website at: <https://content.naic.org/cmte_e_financial_stability_tf.htm>. Once an insurance group with two or more life insurers triggers the Scope Criteria for a specific year, then the LST is performed at the legal entity insurer level within the group. Results are aggregated at the group level.
* Property/Casualty and Health: Although the property/casualty and health insurers are not subject to the scope criteria in 2021, if a property/casualty or health legal entity insurer is deemed to pose material liquidity risk to a U.S. group that triggered the scope criteria in a future year, then the property/casualty and health legal entity insurer within the group will perform the LST.

**Regulatory Goals of the LST per the *NAIC 2020 Liquidity Stress Test Framework***

The primary goal of the LST, and the specific stress scenarios utilized, are:

* First, for macroprudential uses – to allow the Financial Stability (E) Task Force to identify amounts of asset sales by insurers that could impact the markets under stressed environments. Thus, the selected stress scenarios are consciously focused on industry‐wide stresses – those that can impact many insurers within a similar timeframe.
* Second, the liquidity stress testing is also meant to assist regulators in their micro prudential supervision, in the context of being helpful for domiciliary and lead state regulators to better understand liquidity stress testing programs at those legal entities insurers and insurance groups. The LST requires filing of reporting templates and other narrative disclosures referenced in the LST Framework to be submitted to the lead state by September 30.

**Non-Lead State Reliance on the Lead State Analysis of LST**

* The LST must be reviewed by the lead state and significant findings should be incorporated into the GPS branded risk assessments.
* To reduce duplication, non-lead domestic states may rely on the analysis work performed by the lead state.
* Because the LST is performed at a legal entity insurer level and aggregated on an insurance group level, if material risks and concerns are identified for a legal entity insurer, the lead state should communicate those concerns to the non-lead domestic state.
* While the LST filing may provide good insights into a legal entity insurer’s assumptions, processes and worst case stress scenario results; a domestic state’s assessment of liquidity risk for the legal entity insurer should not rely solely on the LST. It is acceptable that a legal entity insurer may have its own liquidity stress test scenarios and manage liquidity differently from what is reported for the LST.

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1. Liquidity: Evaluate the insurance holding company’s liquidity and document any negative trends and overall strength.

Liquidity Risk—e.g., assessment of cash flow trends; cash and short-term investments held; indications of liquidity shortfalls reflected in quantitative ratios (i.e,. liquidity ratio); liquidity needs for high surrender activity impacted by economic changes; liquidity needs created by catastrophic events; liquidity requirements for future debt payments; available lines of credit; stress testing.

***Procedure #11***assists analysts in evaluating the liquidity of the group. Liquidity is important for any type of organization, but can be more important for others, including certain insurers or types of insurers who may have products or other aspects of their business plan that make them susceptible to immediate withdrawals. Having said that, most insurers’ cash flows are predictable, and it is an area that insurance regulation or business practices already address, including asset/liability matching required for life/annuity writers and the maintenance of very liquid assets. But this procedure requires an analysis that can generally only be conducted through understanding information developed by the group, which may be available through the risk-focused examination or otherwise requested by analysts. Updated information may be best obtained in the periodic meeting with the group as discussed within Section VI.F. Own Risk and Solvency Assessment (ORSA) Procedures, unless the group is more susceptible to immediate withdrawals, in which case analysts may want to obtain/discuss the issue with the group sooner. Generally, issues impacting liquidity that are identified through holding company analysis should be presented within the Liquidity Risk classification of branded risk assessments.

1. Liquidity Stress Test (LST):
   1. If the insurance group is subject to the requirements to perform and file an LST, review and determine if any concerns or material risks exist regarding the liquidity of the insurance group or any of its insurance legal entities performing the LST.
   2. If concerns or material risks are identified, consider requesting further explanation from the insurance group about its liquidity risk management framework and internal liquidity stress tests.

***Procedure #12:*** The procedure instructs the analyst to review the results of the stress test scenarios included in the Liquidity Stress Test (LST) filing to supplement the assessment of the insurance group’s overall liquidity. Because the LST is performed at a legal entity level and risks are aggregated for the group, assess if the results of the LST identifies material risks at the insurance legal entity that should be included in the analysis and/or communicated to the non-lead state domestic state insurance regulator.

The instructions for the LST filings are outlined in the *NAIC 2020 Liquidity Stress Test Framework* which is located on the Financial Stability (E) Task Force webpage of the NAIC’s Website at: <https://content.naic.org/cmte_e_financial_stability_tf.htm>.