Draft Pending Adoption

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Financial Stability (EX) Task Force
Conference Call
February 26, 2020

The Financial Stability (EX) Task Force met via conference call Feb. 26, 2020. The following Task Force members participated: Marlene Caride, Chair (NJ); Eric A. Cioppa, Vice Chair, represented by Vanessa Sullivan (ME); Ricardo Lara represented by Kim Hudson (CA); Andrew N. Mais represented by Kathy Belfi (CT); Karima M. Woods (DC); David Altmaier (FL); Doug Ommen represented by Mike Yanacheak (IA); Robert H. Muriel represented by Vincent Tsang (IL); Gary Anderson represented by John Turchi (MA); Chlora Lindley-Myers represented by John Rehagen (MO); Bruce R. Ramge represented by Justin Schrader (NE); Andrew R. Stolfi (OR); Jessica K. Altman represented by Joe DiMemmo (PA); and Kent Sullivan represented by Mike Boerner (TX).

1. **Heard Opening Remarks**

Commissioner Caride said that materials for consideration and discussion for this conference call were sent by email to member, interested state insurance regulator and interested party distribution lists for the Task Force and the Subgroup, but are also available on the Task Force’s web page at [www.naic.org](http://www.naic.org).

2. **Received a Notice of Adoption of the Liquidity Assessment (EX) Subgroup, the Subgroup’s Charges, and the Subgroup’s Chair and Members**

Commissioner Caride noted that the Task Force adopted the Liquidity Assessment (EX) Subgroup, the Subgroup’s charges, and the Subgroup’s chair and members via e-vote (Attachment A).

3. **Received Comments on the Draft 2019 LST Framework**

Commissioner Caride said that a copy of the comment letters on the draft 2019 liquidity stress test (LST) framework was included in the information distributed for this conference call (Attachment B). She noted that the Liquidity Assessment (EX) Subgroup’s study group has vetted all the comment letters and is in the process of taking appropriate action to address these comments. She added that the Task Force and Subgroup will receive a revised draft 2019 LST Framework soon.

Ms. Hudson made a motion, seconded by Mr. Rehagen, to receive a copy of the comment letters ([see NAIC Proceedings – Fall 2019, Financial Stability (EX) Task Force](http://www.naic.org)). The motion passed unanimously.

4. **Received Comments on a Request to Join the Financial Condition (E) Committee in Opening Holding Company Models**

Commissioner Caride asked to receive comments on the Task Force’s proposed request to join the Financial Condition (E) Committee in opening the holding company models outlined in a letter from the Task Force and one comment letter submitted by the American Council of Life Insurers (ACLI) (Attachment C). Mr. Tsang made a motion, seconded by Mr. Yanacheak, to receive the ACLI comment letter ([see NAIC Proceedings – Fall 2019, Financial Stability (EX) Task Force, Attachment D](http://www.naic.org)). The motion passed unanimously.

Commissioner Caride explained that although the current 2019 LST utilizes exam authority, the Task Force needs to address regulatory authority and confidentiality protections for the long term in a more specific manner. She added that the Executive (EX) Committee already approved at the 2019 Fall National Meeting a request from the Group Capital Calculation (E) Working Group to open the holding company models to accomplish regulatory authority and confidentiality protections for the group capital calculation (GCC), so joining that request is more efficient given the difficulties involved in making changes to model laws and having those implemented across the states. Commissioner Caride noted that there were no objections to the proposed request letter received from Task Force members or other interested state insurance regulators.

Commissioner Caride summarized the main points of the ACLI comment letter:

1) The ACLI said further consideration and feedback on the appropriate placement is merited. Commissioner Caride
responded that the proposed process would allow those discussions and considerations in the event that the holding company models are deemed appropriate and provide state insurance regulators with the ability to move forward. She added that if deemed not appropriate, the Task Force would still have worked through some of the language concerns that would apply to work on a different existing model or the creation of a new model.

2) The ACLI said liquidity risk is not exclusively a group level issue, so the Insurance Holding Company System Regulatory Act (#440) may not be the most logical mechanism. Commissioner Caride agreed that liquidity risk is not exclusively a group level issue, since it can be considered at the legal entity or the group level, as well as from a macro-prudential view across the entire insurance industry. She added that the liquidity stress testing results are for our macro-prudential needs and are intended to be submitted at the group level to the lead state supervisor, which supports the concept of the holding company models. She said that the current work of the Task Force does not address legal entity liquidity risk concerns, but if in the future specific legal entity liquidity risk initiatives arise, then appropriate vehicles for such work will be considered based on legal entity models.

3) The ACLI said the core components of the liquidity stress testing framework have not been finalized or approved, thus addressing regulatory authority and confidentiality protections may be premature. Commissioner Caride noted that the scope criteria have been adopted and the insurance groups identified, so the key concepts of the liquidity stress testing are known. She added that state insurance regulators know there are specific requirements for liquidity stress testing that will not be appropriate for a model law or regulation, so regardless of whether one set of metrics or another is adopted for the severely adverse economic stress scenario of the 2019 liquidity stress testing framework, regulatory authority and confidentiality protections must be established.

4) The ACLI said that several different NAIC workstreams, rather than the GCC, may lead to additional revisions to the holding company models, and it may be more appropriate to make separate changes to these models. Commissioner Caride disagreed with the ACLI’s conclusion. She pointed to a criticism regarding the states’ ability to react in a timely manner, particularly on a nationwide basis as a result of the states having different legislative dynamics. She added that NAIC members and their staff are challenged to utilize legislative resources in a judicious and efficient manner, while still accomplishing regulatory priorities. She said that coordinating different revisions to the same model laws would be beneficial. However, she stressed that the Task Force is not locked into ultimately implementing our regulatory authority and confidentiality needs in the holding company models with this request to the Financial Condition (E) Committee. She added that if the deliberations indicate that those models will not work well, state insurance regulators can still pivot to another existing model or to creating a new model.

Commissioner Caride asked if any members had any of their own responses to make regarding the ACLI comments or any comments that are different from her responses. Hearing none, Mr. Boerner made a motion, seconded by Commissioner Altmaier, to send the request letter to the Financial Condition (E) Committee (see NAIC Proceedings – Fall 2019, Financial Stability (EX) Task Force, Attachment E). The motion passed unanimously.

Having no further business, the Financial Stability (EX) Task Force adjourned.
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Financial Stability (EX) Task Force
Austin, Texas
December 9, 2019

The Financial Stability (EX) Task Force met in Austin, TX, Dec. 9, 2019. The following Task Force members participated: Marlene Caride, Chair (NJ); Eric A. Cioppa, Vice Chair (ME); Andrew N. Mais and Kathy Belfi (CT); David Altmaier and Ray Spudeck (FL); Doug Ommen represented by Jim Armstrong (IA); Dean L. Cameron represented by Nathan Faragher (ID); Gary Anderson (MA); Chlora Lindley-Myers represented by John Rehagen (MO); Bruce R. Ramge represented by Justin Schrader (NE); Jessica Altman represented by Kim Rankin (PA); Raymond G. Farmer (SC); Hodgen Mainda and Trey Hancock (TN); Kent Sullivan represented by Mike Boerner and James Kennedy (TX); and Scott A. White represented by Doug Stolte (VA).

1. **Adopted its Summer National Meeting Minutes**

   Commissioner Altmaier made a motion, seconded by Director Farmer, to adopt the Task Force’s Aug. 5 minutes (see NAIC Proceedings – Summer 2019, Financial Stability (EX) Task Force). The motion passed.

2. **Adopted the Nov. 26 Minutes of the Liquidity Assessment (EX) Subgroup**

   Mr. Schrader made a motion, seconded by Commissioner Altmaier, to adopt the Subgroup’s Nov. 26 minutes (Attachment One). The motion passed.

3. **Heard an Update on FSOC Developments**

   Superintendent Cioppa reported that since the Summer National Meeting, the Financial Stability Oversight Council (FSOC) has met three times. During last week’s meeting, the FSOC approved the final revisions to the Nonbank Designations guidance. He summarized that the final version, like the initial proposal, prioritizes an activities-based approach to the identification and mitigation of risks to financial stability. He added that the new guidance also makes changes to the designations process, including increasing transparency around the process. He also said that there is now a clearer off-ramp to designation, with both a pre-designation off-ramp and a robust post-designation off-ramp.

   Superintendent Cioppa praised the new framework, which he said represents a sensible shift in approach and is consistent with approaches the NAIC has been advocating for the past several years. He added that the FSOC’s annual report is now available on the FSOC website.

4. **Exposed the Proposed 2019 NAIC Liquidity Stress Test Framework**

   Mr. Schrader reported that state insurance regulators have been working diligently toward delivering an initial proposal of a 2019 liquidity stress test and is pleased that today they are in a position to do just that. He 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 will be required. For each stress scenario, there will be a regulator-provided narrative for companies to use in their internal modeling. The assumptions underlying the modeled narrative will be a combination of regulator prescribed assumptions and company specific assumptions, the latter of which must be consistent with the prescribed narrative.

   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 Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule. He said there is also 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 Federal Home Loan Bank (FHLB).
draws or holding company contributions.

Mr. Schrader said the second liquidity stress test is a scenario that includes an interest rate spike, a market-wide decrease in equities and a credit spread stress. 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 changing the equities decrease to an increase and removing the credit spread stress to this stress scenario is also required. He noted that while some elements of this narrative would also be relevant for performing a Sovereign Debt stress scenario, state insurance regulators are not ready to implement it for the 2019 liquidity stress test.

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 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 shortfall. 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. Additionally, non-life insurance and non-insurance legal entities within the group with material liquidity risks should also 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.

Mr. Schrader noted that subsequent to insurer reporting of liquidity stress testing results and aggregation of data, the Liquidity Assessment (EX) 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.

Mr. Schrader requested that the Task Force, together with the Liquidity Assessment (EX) Subgroup, expose the proposed 2019 NAIC Liquidity Stress Test Framework for a 60-day public comment period ending Feb. 10, 2020.

Mr. Schrader made a motion, seconded by Ms. Belfi, to expose the proposed 2019 NAIC Liquidity Stress Test Framework jointly by the Task Force and the Subgroup for a 60-day public comment period (Attachment Two). The motion passed.

5. Received an Update from the Receivership and Insolvency (E) Task Force on its Work to Address the Financial Stability (EX) Task Force’s Referral Letter to Undertake Analysis Relevant to the MPI

Mr. Kennedy reported that the Receivership and Insolvency (E) Task Force continues to work to address the Financial Stability (EX) Task Force’s referral letter to undertake an analysis of resolution and recovery concerns important to financial stability as part of the Macropuidential Initiative (MPI). He said the current Insurer Receivership Model Act (#555) substantially conforms with the International Association of Insurance Supervisors’ (IAIS) Insurance Core Principles (ICPs) and its Common Framework for the Supervision on Internationally Active Insurance Groups (ComFrame), as well as the Financial Stability Board’s (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions.

Mr. Kennedy cautioned that most states have laws based on prior NAIC models, so the NAIC will encourage adoption, including a request to amend the Financial Regulation Standards and Accreditation Program. He also noted that a bridge institution might be useful in a receivership to address an early termination on qualified financial contracts (QFCs) but would require the use of a temporary stay on termination rights, which is prohibited in many states.

Mr. Kennedy added that the Receivership Model Law (E) Working Group will explore if a bridge could be implemented under regulatory oversight before receivership to address the early termination of QFCs. He also reported that the Financial Condition (E) Committee has adopted amendments to the Guideline for Stay on Termination of Netting Agreements and
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Qualified Financial Contracts (#1556), which will be considered for adoption by the Executive (EX) Committee and Plenary at this national meeting.

6. **Heard an Update on CLO Stress Tests**

Eric Kolchinsky (NAIC) reported that the stress thesis is based on the concern about U.S. insurer holdings of collateralized loan obligations (CLOs) that stem from lax underwriting on the underlying leveraged loans. He added that the loose underwriting falls into three areas: covenant-lite; lack of subordination; and weaker earnings before interest, tax, depreciation and amortization (EBITDA) multiples. He concluded that these developments will result in substantially lower recovery rates on leveraged loans during the next recession. He forecast that loan recoveries will deteriorate from the historical norms to levels comparable to unsecured debt. He added that recovery stresses were run in both historical and moderately stressful default environments.

Mr. Kolchinsky said that about 85% of CLOs outstanding were modeled in three scenarios, which is approximately $527 billion. He noted that insurance companies hold a total of $130 billion of CLOs based on year-end 2018 data, which was published in the NAIC’s Special Report, “U.S. Insurers’ Exposure to CLOs,” on June 19, 2019. He added that these exposures were classified into five categories:

- Mapped and modeled “normal” ($96 billion)
- Mapped and modeled “atypical” ($1 billion)
- Ready to map ($6 billion)
- Out of scope ($12 billion)
- Need information ($15 billion)

Mr. Kolchinsky concluded that, based on results, CLOs do not appear to be a significant risk to the insurance sector as a whole, but a few companies have concentrated investments in combo notes, which are securities that pay off quickly in good times but take significant losses in stressed environments. He reported that NAIC staff has requested that the Valuation of Securities (E) Task Force exclude combo notes from filing exemption treatment because their risk is not captured by ratings.

7. **Heard an Update on Macroprudential Surveillance**

Mr. Nauheimer reported that the IAIS has adopted a framework for a holistic approach to assessing and mitigating systemic risk in the insurance sector, with implementation beginning in 2020. He summarized that the holistic framework consists of the following elements:

- An enhanced set of supervisory policy measures for macroprudential purposes.
- The global monitoring exercise that is both individual and sector wide.
- Mechanisms to allow for a collective assessment of potential global systemic risk and a coordinated supervisory response.
- An assessment by the IAIS of the consistent implementation of the enhanced supervisory policy measures and powers of intervention.

He also reported that the IAIS Macro-prudential Surveillance Working Group (MPSWG) will be disbanded and two new groups will be formed in its place. They are the “Macroprudential Monitoring Working Group” or MMWG and the “Macroprudential Supervision Working Group” or MSWG. The work related to macroprudential supervision will move to the MSWG. In the immediate future the MSWG will be tasked with developing and finalizing two application papers: The Application Paper on Liquidity Risk Management; and the macroprudential supervision paper to support implementation of ICP 24 – Macroprudential Surveillance and Insurance Supervision.

Mr. Nauheimer reported that the IAIS issued the Application Paper on Liquidity Risk Management for public consultation with comments due by Jan. 18, 2020, and he encouraged interested parties to submit comments before the deadline. He also said the FSB has accepted the IAIS recommendation to suspend global systemically important insurer (G-SII) identification and, in 2022, the FSB will consider whether to discontinue or re-establish an annual identification of G-SIIs.

Mr. Nauheimer also reported that as the IAIS takes a deeper dive into the Holistic Framework’s domestic impact with its four key elements and numerous workstreams, the NAIC is reviewing any areas where state insurance regulators may want to ramp up work in progress and/or bring new proposals forward under the domestic Macroprudential initiatives. Many initiatives updated earlier in the meeting such as the Liquidity Stress Testing and Resolution initiatives address Holistic Framework workstreams. The creation of a U.S. risk assessment is another example of a relatively new initiative motivated
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by the Holistic Framework.

8. **Received a Response from the Valuation Analysis (E) Working Group Regarding the Academy's ESGs**

Todd Sells (NAIC) reported that the Task Force received a status report regarding Commissioner Caride’s request to the Valuation Analysis (E) Working Group (VAWG) to assess a potential concern related to economic scenario generators (ESGs) developed by the American Academy of Actuaries (Academy). The VAWG’s status report is included in a memo dated Nov. 27 (Attachment Three). Mr. Boerner summarized the report and indicated the VAWG will continue addressing issues of concern. He added that though the process of implementing a new ESG is expected to take several years once a vendor has been selected, the Life Actuarial (A) Task Force (LATF) is pursuing an aggressive timeline. The details can be found on a report posted on the LATF’s NAIC webpage.

Having no further business, the Financial Stability (EX) Task Force adjourned.

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