FINANCIAL STABILITY (EX) TASK FORCE

Draft: 8/12/20

Financial Stability (EX) Task Force
Virtual Summer National Meeting
August 5, 2020

The Financial Stability (EX) Task Force met via conference call. The following Task Force members participated: Marlene Caride, Chair (NJ); Eric A. Cioppa, Vice Chair (ME); Alan McClain represented by Mel Anderson (AK); Ricardo Lara represented by Kim Hudson (CA); Andrew N. Mais represented by Kathy Belfi (CT); Karima Woods represented by Philip Barlow (DC); David Altmaier represented by Susanne Murphy (FL); Doug Ommen (IA); Robert H. Muriel represented by Vincent Tsang and Kevin Fry (IL); Gary Anderson (MA); Chlora Lindley-Myers represented by John Rehagen (MO); Bruce R. Ramge represented by Justin Schrader (NE); Linda A. Lacewell represented by Martha Lees (NY); Jessica Altman (PA); and Kent Sullivan represented by Mike Boerner and James Kennedy (TX).

1. Adopted its Feb. 26, 2020, and 2019 Fall National Meeting Minutes

The Task Force met Feb. 26, 2020, and Dec. 9, 2019. During its Feb. 26 meeting, the Task Force took the following action: 1) announced reappointment of the Liquidity Assessment (EX) Subgroup; 2) discussed comments received on the draft 2019 liquidity stress test framework; and 3) discussed comments received on a request to join the Financial Condition (E) Committee in opening holding company models.

Superintendent Cioppa made a motion, seconded by Ms. Belfi, to adopt the Task Force's Feb. 26, 2020, and Dec. 9, 2019 minutes (*see NAIC Proceedings – Fall 2019, Financial Stability (EX) Task Force*). The motion passed.

2. Heard an Update on FSOC Developments

Superintendent Cioppa reported that since the 2019 Fall National Meeting, the Financial Stability Oversight Council (FSOC) has met three times with a primary focus on the COVID-19 pandemic and the related economic crisis. On March 26, the FSOC met in executive session to discuss COVID-19 and non-bank mortgage origination and in open session to discuss developments related to COVID-19. He added that during the open session, he reported on the work of state insurance regulators in response to the crisis, noting that the insurance sector remains strong but that the impact of the low interest rate environment on life and annuity writers, as well as the issues surrounding business interruption coverage, are being monitored. On May 14, the FSOC met in closed session to discuss regulators' response to COVID-19 and received an update on the work of the Nonbank Mortgage Liquidity Task Force. Finally, the FSOC met July 14 to hear an update on an activities-based review of the secondary mortgage market and to receive an update on the Federal Reserve's stress tests, including additional COVID-19 focused analysis.

3. Received an Update from the Liquidity Assessment (EX) Subgroup on Progress in Achieving its Deliverables related to Liquidity Stress Testing

Mr. Schrader reported that via an e-vote effective April 17, the Task Force adopted a motion to pause the work on the 2019 Liquidity Stress Test (LST) and instead adopted a new 2020 charge for the Subgroup to address an American Council of Life Insurer's (ACLI) proposal to focus on macroprudential information regarding how the insurance sector is navigating market conditions due to the economic impact of the pandemic. The Subgroup's study group has established a scope of 23 companies for a quantitative and qualitative data collection with respect to liquidity. He added that the data collection consists of Phase I, which is qualitative data based on first-quarter financials, and Phase II, which is qualitative and quantitative data on second-quarter financials. He said that the deadline for Phase I was July 15, and the deadline for Phase II is Aug. 31. Mr. Schrader noted that results from both phases will be used to refine the study group's prior work of developing the 2019 LST. He said that a pandemic in conjunction with an economic stress will now be considered for the postponed LST.

4. 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 Macroprudential Initiative (MPI) but with some delay due to the impact of COVID-19. The Receivership and Insolvency (E) Task Force will request comments and further consider key provisions that states should adopt into states' receivership and guaranty fund laws and regulations. He added that earlier this year, the Receivership and Insolvency (E) Task Force and Financial Condition (E) Committee adopted a Request for NAIC Model Law Development, which, if adopted by the Executive (EX) Committee, the Receivership Law (E) Working Group will develop recommendations within the *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450) to ensure the continuation of essential services to an insurer in receivership by affiliated entities in a group.

Mr. Kennedy reported that the Receivership and Insolvency (E) Task Force found that a bridge institution might be useful in a receivership to address 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. Therefore, a possible solution is to explore if a bridge can be established under regulatory oversight before receivership to address early termination of QFCs.

Mr. Kennedy added that at the 2019 Fall National Meeting, the Executive (EX) Committee and Plenary adopted revisions to the *Guideline for Stay on Termination of Netting Arrangements and Qualified Financial Contracts* (#1556) and at this Summer National Meeting, the Receivership and Insolvency (E) Task Force plans to adopt amendments to the Receiver's Handbook to address federal taxes and federal releases. He also reported that the International Association of Insurance Supervisors (IAIS) will be meeting virtually in September to finalize the *Application Paper on Resolution Planning*.

5. Heard an Update on Collateralized Loan Obligation (CLO) Stress Tests

Eric Kolchinsky (NAIC) reported that equity markets continue to stabilize and have staged a comeback with year-to-date (YTD) return on nonaffiliated publicly traded common stocks being down by about 15% as of June 30. He added that the negative performance is driven primarily by insurer holdings of energy stocks. He also reported that the amount of bonds that have been downgraded to below investment grade has been minimal. He added that total NAIC 1 and NAIC 2 designation holdings have only decreased from approximately 95% to 93% from year-end 2019 to June 2020. Mr. Kolchinsky said that collateralized loan obligations (CLOs) continue to be a growing asset class for U.S. insurers, increasing 18% from $130 billion at year-end 2018 to $158 billion at year-end 2019. He noted that the NAIC was able to model $119 billion in several stress test scenarios. He concluded that NAIC CLO stress tests have determined that COVID-related scenarios will have a minor impact on the vast bulk of CLO-holding insurers. However, he cautioned that significant CLO exposures relative to capital and surplus, and concentrated exposures to atypical securities, are potential risks (particularly in a stressed environment) for several medium to small insurers.

6. Heard an Update on the IAIS

Tim Nauheimer (NAIC) reported that the IAIS has adopted a framework for a holistic approach to assessing and mitigating systemic risk, which recognizes that systemic risk can arise both from sector-wide trends with regard to specific activities and exposures, as well as from a concentration of these activities and exposures in individual insurers. He added that the IAIS Macroprudential Monitoring Working Group (MMWG) oversees many of the holistic initiatives, including the global monitoring exercise (GME) that consists of individual insurer monitoring (IIM) and sector-wide monitoring (SWM).

Mr. Nauheimer reported that the IAIS launched its eighth annual IIM exercise in March, but the exercise was reduced to a targeted COVID-19 data collection with both a quantitative section and a qualitative section. He added that there are 58 insurers participating worldwide, including 16 U.S. insurers that are submitting data quarterly on a best effort basis. He also reported that the IAIS launched its annual SWM exercise in March, but the exercise was also reduced to a targeted COVID-19 data collection with both a quantitative and qualitative section. He added that the NAIC has been providing quarterly SWM data to the IAIS. He said that the IAIS, in consultation with the Financial Stability Board (FSB), agreed that reporting to the FSB on the outcomes of the 2020 GME will be postponed by one year to October 2021. He concluded that common themes from the GME include: 1) the potential materialization of credit risk in insurers' investment portfolio; 2) the impact of the low interest rate environment; 3) insurance sector interconnectedness; 4) business interruption; 5) operational resilience; and 6) cyber risk. He added that the IAIS is also developing a global risk dashboard with data from the GME.

Mr. Nauheimer also reported that the Macro-prudential Supervision Working Group (MSWG) has completed and exposed the application paper on liquidity risk management and is preparing for a second public consultation in November. Additionally, MSWG began drafting the Macroprudential Supervision Application Paper to provide guidance on Insurance Core Principle (ICP) 24. He added that the IAIS is also conducting a baseline assessment questionnaire for the implementation of the holistic framework, which focuses on ICPs and IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) standards adopted in November 2019. He said that the proposed NAIC staff survey responses were forwarded to Financial Stability (EX) Task Force members and interested regulators for review on July 27 and will be submitted jointly with the Federal Reserve and the Federal Insurance Office (FIO) to the IAIS.

He said that some of the work of the NAIC's MPI has been delayed in order to provide relief to industry and members. He added that while the NAIC continues to work on a U.S. risk dashboard, the work has been paused to establish interim COVID risk dashboards for the property, life and health sectors, which will assist regulators in prioritizing the myriad of COVID issues that were occurring rapidly in April.

7. Heard an Update on LIBOR

Mr. Nauheimer reported that the Task Force monitors London Interbank Offered Rate (LIBOR)-related matters to assess if there are any issues that may significantly affect financial stability. He added that NAIC staff are also ex officio members of the Alternative Reference Rates Committee (ARRC), which is a group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York to help ensure a successful transition from U.S. dollar LIBOR to the secured overnight financing rate (SOFR). He identified several issues:

- Insurers were looking for safe harbor language from the NAIC and states to hold basis swaps in their derivatives portfolio. In response, the Financial Condition (E) Committee issued a letter on June 12 alerting insurers of its support of those swaps being deemed permissible derivative investments up to one year past the cutover.
- Some life reserving and accounting issues need to be addressed by the NAIC but pose no threat to financial stability.

8. Discussed Exposure Comments for the Draft Revisions to Model #440

Todd Sells (NAIC) reported that two comment letters were received by the Subgroup for the draft revisions to Model #440:

- The Texas Department of Insurance's (DOI) comment letter suggests: 1) to incorporate the separate confidentiality section 8.2 into the original section 8 of Model #440 as occurred for the Group Capital Calculation; 2) to consider the Liquidity Stress Test an additional type of enterprise risk filing; 3) to define scope criteria in the definitions section; and 4) to ensure the NAIC Liquidity Stress Test Framework for a given year is completed in advance enough to allow states to adopt it and for insurers in scope to meet the requirements.
- The ACLI's comment letter suggests modifications to the draft confidentiality provisions, but recognized their specific edits may not be valid if the Texas DOI's recommendation to collapse the draft section 8.2 into the original section 8 of Model #440.

Mr. Sells concluded that the Subgroup intends to address these comments and provide a set of proposed revisions to Model #440 for the Task Force to expose and finalize.

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

W:\national meetings\2020\summer\tf\financialstability\8-5FSTFmin.docx