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July 16, 2018

Justin Schrader
Chair, Liquidity Assessment (EX) Subgroup
National Association of Insurance Commissioners

Re: Scope Considerations for Liquidity Stress Test and Design Elements: Considerations for Liquidity Stress Test

Mr. Schrader,

The Macroprudential Task Force (MPTF) of the American Academy of Actuaries[1] offers initial comments to the questions contained in the June 25 conference call material of the National Association of Insurance Commissioners (NAIC) Liquidity Assessment (EX) Subgroup (LASG). Creating an effective framework for liquidity stress testing requires sound technical input, and the MPTF looks forward to contributing to the initiative.

The MPTF believes that conclusions about scope, approach, and other design elements are a function of the objective(s) of the exercise and the desired timetable for completing the development work. Both elements merit further clarification by the LASG.

Regarding objectives, the conference call materials point to objectives that are both sector-wide and individual. The materials state that the primary objective is "to understand how large life insurers react to a common liquidity stress and assess the potential implications of their collective reactions for the financial sector…." Assessing the implications of a liquidity stress on the broader financial sector, however, is a challenging and possibly unrealistic aspiration. The materials also mention more practicable objectives of assessing sector-wide vulnerabilities and the liquidity exposures of individual insurers.

The MPTF notes that sector-wide impacts are a sum of individual impacts. Accordingly, consideration should be given toward first developing a sound stress testing framework for individual insurers upon which a sector-wide framework can be built. Regardless, clarification of the objectives would help avoid circumstances in which the chosen approach is not fit for purpose.

[1] The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Regarding the desired timetable, the conference call material is silent. The MPTF believes that the optimal approach is related to the available development time. If more development time is available, a more rigorous approach can be pursued.

These two overarching considerations—objectives and timetable—guide the MPTF's responses to a selected subset of the questions, as provided below.

Scope Questions:

1. **Should scoping for large life insurers that are subject to liquidity stress testing be based on both size and activities or on activities alone?**

   The MPTF suggests that the appropriate scope is a function of the objectives. Assessing liquidity implications from a sector-wide perspective may require a broader scope than assessing the impact of liquidity on individual insurers. If individual insurer objectives are pursued, the MPTF believes that stress testing should be applied to companies that are at risk of a material liquidity event.

3. **Would you recommend changes to the list of activities that could cause potential liquidity risk mentioned below?**

   Activities that expose the firms to liquidity risk could include, among others:

   - Fixed and indexed annuities
   - Derivatives
   - Securities lending
   - Repurchase agreements
   - Borrowed money that includes commercial papers, letters of credit, etc.
   - Funding agreements and guaranteed interest contracts (GICs)

The MPTF suggests expanding the points above to describe how activity related to each of the above product or asset class might contribute to a liquidity shortfall. The MPTF believes that liquidity must be assessed holistically, considering liquidity needs, liquidity sources, triggering events, and management or regulatory actions.

Design Element Questions:

1. **Is the proposed cash-flow approach preferable over a balance sheet-based approach?**

   The MPTF notes that each approach has strengths and weaknesses. The rigor of a cash flow approach may result in more meaningful information but is likely to be time consuming to develop. A balance sheet approach can be put in place more quickly than a cash flow approach, but is likely to be less informative. Again, clarification of the objectives and timetable will guide the selection of an approach that is fit for purpose.

2. Have the most salient design elements been identified for initial decision-making?

The appropriate design elements are a function of the chosen approach, which, in turn, is a function of the objectives and timetable, as noted above.

4. Will the inputs to and outputs from the exercise as described above provide information sufficient to achieve the stated objectives?

The MPTF believes that this question is relevant and appropriate. It can be answered more conclusively after the objectives and timetable are clarified and after the scope, approach, and design elements are determined based on the objectives and timetable.

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The Macroprudential Task Force looks forward to discussing these comments further and working with the Liquidity Assessment Subgroup on the development of a liquidity stress test. If you have any questions, please contact Ian Trepanier, life policy analyst at the American Academy of Actuaries, (trepanier@actuary.org).

Sincerely,

Jeff Johnson, MAAA, FSA
Chairperson, Macroprudential Task Force
American Academy of Actuaries