Liquidity Preparedness for Margin and Collateral Calls: Consultation report

Response to Consultation

American Council of Life Insurers ("ACLI")

1. **Does the outlined approach identify all key causes of some non-bank market participant's inadequate liquidity preparedness with respect to spikes in margin and collateral calls during times of stress? Are there any sector specific causes that should be considered?**

   The consultative report does not contain compelling evidence to support the assertion that life insurers, as non-bank financial institutions, lack liquidity preparedness and internal controls to manage in times of stress. U.S. life insurers have been managing liquidity through existing state-based regulations and guidelines from the National Association of Insurance Commissioners ("NAIC"), including liquidity stress testing. For regulators seeking to apply these recommendations, we suggest analyzing the existing requirements for life insurers—including IAIS standards and related requirements in individual jurisdictions—to ensure there are no redundancies.

2. **Is the scope of the proposed policy recommendations appropriate?**

   We believe a flexible, principle-based approach is appropriate for life insurers' unique business models. We want to point out that the IAIS has developed liquidity risk management standards—including Insurance Core Principle 16 for governance and liquidity metrics in the form of the Insurance Liquidity Ratio and the Company Projection Approach for liquidity stress testing related to margining and collateral. When interpreting the scope of the recommendations, we encourage regulators with jurisdiction over life insurers to consider the comprehensive unique regulatory requirements applicable to life insurers to reduce any unintended consequences to liquidity or conflicts with existing regulation. We believe the NAIC has developed an exemplary model for monitoring liquidity risk that can be utilized by other jurisdictions.

3. **Is the focus of the FSB's policy recommendations on liquidity risk management and governance, stress testing and scenario design and collateral management practices appropriate? Are there any other areas the FSB should consider?**

   Yes, this seems comprehensive. We would note, however, that insurance companies may be countercyclical relative to banks and other NBFI sectors, which may be procyclical. Life insurers are long-term investors, and need assets to match our long-term liabilities.

Therefore, our risk management considerations and related regulations are very different from banks and other short-term focused financial institutions/activities, especially when considering the economic environment. As a result, margin demands and collateral calls for many life insurance companies decrease in a risk-off environment (decreasing interest rates and equity markets), while increasing in a risk-on environment (increasing interest rates and equity markets). To that end, we are cautious about potential efforts to harmonize regulations across sectors and caution regulators across jurisdictions against becoming too prescriptive for both specific industry and firms' risk management practices.

4. **Is the approach to proportionality and materiality clear for all non-bank market participants?**

5. **Section 3.1 sets out key elements of a liquidity risk management framework to identify, monitor and manage liquidity risk exposures arising from margin and collateral calls. Are these sufficiently clear for all non-bank market participants?**

   We support the recommendations, and they are sufficiently clear for life insurers.

   The US-state based system has a clear liquidity risk management framework in place to support the life insurance industry. First and foremost, we have robust reserving requirements that accompany our liabilities as well as risk-based capital ("RBC") requirements for our underlying assets and related hedging activities that reflect the long-term nature of our business. The NAIC's Liquidity Stress Test Framework for Life Insurers—now in its fourth year of implementation—sets out assumptions and embeds information on derivatives. In addition, life insurers have been supportive of allowing a range of non-cash collateral types to be eligible for satisfying variation margin ("VM") and initial margin ("IM") requirements. Life insurers also use NAIC's Enterprise Risk Management ("ERM") framework to monitor and manage liquidity risks. As financial end-users hedging market risks that exist on our balance sheets, being able to post non-cash collateral directly, without the need to employ other liquidity measures such as repos or selling assets for cash, is extremely beneficial to meeting the potential liquidity requirements associated with OTC Derivative positions. We are supportive of the recommendation that firms consider providing flexibility in bilaterally agreed acceptable collateral. We would also be supportive of a structure where new collateral types could potentially be added to the list of eligible collateral types under the WGMR framework and national regulations with appropriate haircuts, particularly to satisfy IM requirements. Because the liquidity risk profile is different from not only industry to industry, but from firm to firm, we support a principle-based approach.

6. **Are the recommendations on liquidity stress testing and scenario design with respect to margin and collateral calls clear and sufficiently specified?**

   We are supportive of the FSB's emphasis on the importance of liquidity stress testing. When it comes to scenario design, there will be differentiation across the NBFI sector. Scenarios should be customized at the industry and firm levels. Any recommendations should consider the IAIS's own liquidity metrics and related standards—which have been in place for two years—as well as jurisdictional specific approaches (i.e., NAIC's own liquidity stress testing and related requirements), as they are specifically tailored for life insurance considerations.

7. **Are there any jurisdictional or sector-specific differences that are not accounted for in the recommendations?**

   We support the International Swaps And Derivatives Association ("ISDA")'s comments that caution against a unified approach to stress-testing for liquidity risk in the NBFI sector.

8. **Collateral readiness at the right time, quality and location is a critical aspect of effective liquidity preparedness for spikes in margin and collateral calls to mitigate the risk of having to liquidate collateral under stressed market conditions. Do the FSB's recommendations in Section 3.3 address all key elements required to be effective in mitigating liquidity risk arising from margin and collateral calls?**

   We support the recommendations and add that expanding the eligible collateral set would improve flexibility on the use of collateral which may mitigate liquidity problems. We note that current reforms like clearing mandates have impacts on liquidity. Regulators should consider liquidity impacts on market participants if they consider expanding clearing mandates as this heightens the need for cash collateral.

9. **Are there any material challenges to collateral management practices that some non-bank market participants may face that should be considered?**

   We would ask that regulators consider a significant phase-in compliance period to accompany principles for liquidity management. Similar to the transition from LIBOR to SOFR, market participants should be leading that transition and should be consulted on the timeframe based on the size or activities of the participant.

   If you have any additional comments, please provide them below.

   N/A

Submitted to the Financial Stability Board via online form

June 17, 2024

Questions

Section 1

1. Does the outlined approach identify all key causes of some non-bank market participant's inadequate liquidity preparedness with respect to spikes in margin and collateral calls during times of stress? Are there any sector specific causes that should be considered?

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2. Is the scope of the proposed policy recommendations appropriate?

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4. Is the approach to proportionality and materiality clear for all non-bank market participants?

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Best,

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