Final

Summary of Comments
From the American Academy of Actuaries' Liquidity Work Group
On the State of New York Insurance Department's
Circular Letter No. XX (2002)

January 10, 2002

Background

The American Academy of Actuaries' Life Liquidity Work Group (Work Group) reviewed the draft of the State of New York Insurance Department's (Department) Circular Letter XX (2002).

The comments below represent the thoughts of the Work Group as a whole, and do not necessarily represent any individual's opinion or the opinion of their employer.

Overview

The Work Group recognizes that liquidity is an important facet to risk management, and supports the Department in its efforts to assess stress liquidity risk. Circular Letter 33 (2000) was considered to be the best tool offered to date in this area. There are, however, a few points that the Work Group would like to comment on regarding the changes as shown in Circular Letter XX (2002).

Specific Comments

1. Attachment to Circular Letter No. XX: The initial question, which compares cash demand to available cash, is a critical question in that it triggers the requirements to complete Tables One and Two and to complete questions 6 through 11. Because it is so important, it must measure exactly what the Department is concerned about and its terms must be clearly defined so that all companies answer consistently. As the question appears on the current draft, it raises two issues.

    - First, the term "cash demand" is unclear. Questions can arise concerning (a) the predictability of the demand and (b) the intended time horizon. The term "demand" often implies that the control of the cash outflow is in the hands of the customers, not the company. If this is the case, then scheduled maturities should be excluded from the analysis.

      Once maturities are excluded, the question of time horizon needs to be addressed. Funding agreements with seven-day puts seem to fit the idea of "cash demand", but funding agreements with one-year puts do not.

- Second, the set of assets included in the test should be consistent with the definition of "cash demand." If "cash demand" excludes scheduled maturities and has a very short time horizon, then a comparison to cash plus United States Government Treasury Securities may be reasonable (although United States Government agencies are also extremely liquid as are AAA public bonds). However, if "cash demand" includes scheduled maturity payments for a period of, for example, six months, we think the Department should consider adding other liquid assets (including other government bonds, such as those issued by the State of New York) and known asset inflows to the cash resources. If the definition of "cash demand" is significantly different from "cash", the test will not produce the desired screening.

2. Table Two: The Work Group thinks that the lines showing, "Investments maturing within x months", should include known sinking fund payments and coupon income, since these cash flows are as predictable as maturities.

3. Question 6: This question might pose difficulties for companies because calculating the market value of liabilities is not necessarily straightforward and therefore may not be available in a timely manner. The Work Group requests that small companies and companies with a formal liquidity plan be exempt from this question.

4. Questions 7 and 9: The Work Group believes that question 7 is essentially addressed by one of the Notes to the Financial Statements in the National Association of Insurance Commissioners (NAIC) Annual Statement Blank (number 27, concerning variable annuities with guaranteed living benefits) and could possibly be eliminated. The Work Group also thinks that questions 7 and 9 could be combined and could follow the format of Note # 27, expanding it to include equity-indexed plans and a catchall such as the question in 9.b. Question 9.c. would not need to be changed.

5. Question 10: Since book value equals market value for public equities, it is unclear why both are requested. The Work Group recommends asking for market value only.

As the Circular Letter XX stands now, the Work Group thinks that it is likely that many companies, who did not need to answer questions 11 through 16 of Circular Letter 33, will be required to answer them as questions 6 through 11. This may cause administrative burdens that may not have been intended by the Department. The required response date of April 1, 2002 will also add to this problem.

Summary

The Work Group realizes that liquidity risk management is both very important to the health of the insurance industry and very complex to assess. We look forward to continuing to work with the Department on this topic.

If you have any questions on these comments, please contact the chair of the Academy's Life Liquidity Work Group, Donna Claire, at (631) 269-1501, or the vice chair, Laura Rosenthal, at (617) 572-8565.