NAIC Macroprudential Risk Assessment

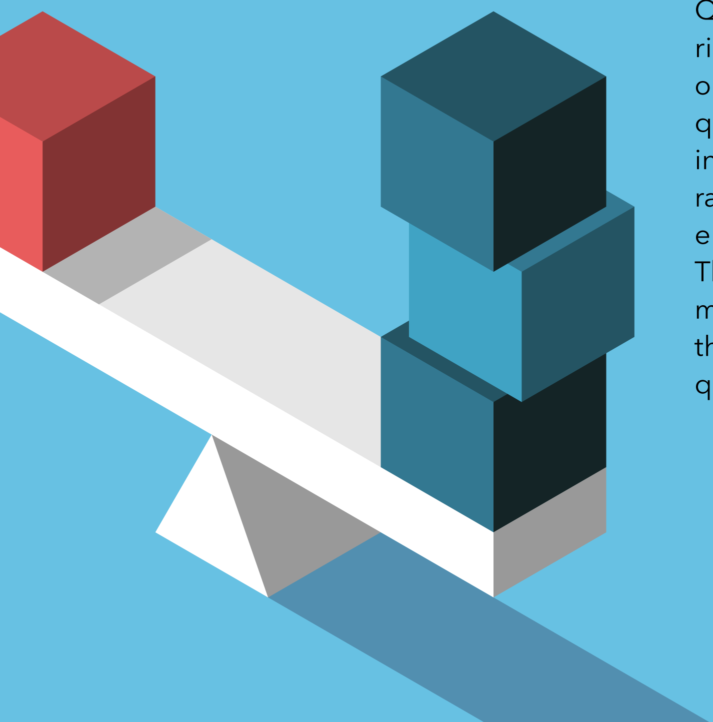
Overview

The Macroprudential (E) Working Group was charged with the development, implementation, and maintenance of a Macroprudential Risk Assessment system. This project is a logical extension of the NAIC's Macroprudential Initiative (MPI). The Macroprudential Risk Assessment is also a key component of the NAIC's overall Macroprudential Supervision that enhances state insurance regulators' ability to monitor industry trends from a macroprudential perspective. This document summarizes the process to conduct the Macroprudential Risk Assessment.

A key objective of the NAIC's Macroprudential Risk Assessment is to identify and assess industry-wide insurance risks. The proactive identification of risks allows state insurance regulators to consider and incorporate, as needed, various macroprudential surveillance measures across the insurance sector. The risk dashboard tools developed in this process may provide valuable insight to state insurance regulators, the industry, and the public about activities that may pose systemic risk or threaten U.S. financial stability. The NAIC's membership on the Financial Stability Oversight Council (FSOC) provides a forum to communicate and monitor such systemic risks or activities.

The NAIC uses the same definition of systemic risk as the International Monetary Fund (IMF), Bank for International Settlements (BIS), and Financial Stability Board (FSB) for the Macroprudential Risk Assessment process. That definition is "a risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy."

The NAIC's Macroprudential Risk Assessment is designed to incorporate both quantitative and qualitative assessment factors to facilitate the identification of key risk exposures. Quantitative factors can be used to track and measure risk exposures by establishing key risk indicators for ongoing monitoring and objective assessment. In addition, qualitative factors may be used to supplement the risk indicators by incorporating information from a broader range of sources into the risk assessment process to identify emerging issues and industry trends for consideration. The risk dashboard primarily considers inward risks but may also consider outward risks. This document describes the steps to review and consider both quantitative and qualitative factors.



Quantitative Review

In conducting a quantitative assessment, NAIC staff and state insurance regulators will identify, aggregate, and track the performance of targeted insurance industry and macroeconomic risk indicators on a biannual basis. Targeted indicators are classified within established risk assessment categories to facilitate both the assessment process and presentation of results. Risk indicators are sourced from aggregated NAIC Annual Statement data, as well as public data sources, and are reviewed and updated as needed to quantify emerging material risk exposures. Industry exposures and indicators are aggregated/presented in a manner that logically fits the measured risk exposure under evaluation (i.e., by line of business, product type, legal structure, etc.). Careful consideration will also be given to the historical data that best provides context necessary to evaluate the exposure.

Risk Assessment Categories *(subject to ongoing review and adjustment)*:

1. **Macroeconomic –** This category assesses the potential impact of macroeconomic factors affecting the broader economy, with a focus on those most likely to impact the insurance industry.
2. **Interconnectedness –** This category assesses the impact of interconnectedness with other financial sectors on the overall financial stability of the insurance industry.
3. **Capitalization & Reputation –** This category assesses the overall capitalization of the insurance industry, as well as how perceptions of financial strength (including ratings and outlooks) could affect industry performance.
4. **Underwriting & Profitability –** This category assesses the exposure of the insurance industry to risks associated with insurance underwriting performance, reserve development, and overall profitability.
5. **Credit –** This category assesses the exposure of the insurance industry to the risk that amounts collected or collectible by insurers are less than those contractually due (i.e., debt securities, reinsurance recoverable, and other counterparties).
6. **Market –** This category assesses the exposure of the insurance industry to the risk that changes in interest rates and/or prices adversely affect the value of investments and liabilities.
7. **Liquidity –** This category assesses the exposure of the insurance industry to the risk that insurers are unable to meet financial obligations (i.e., cash demands) as they become due without incurring unacceptable losses.
8. **Other –** This category assesses the exposure of the insurance industry to other key risks that do not fit into the above categories, which could include operational and strategic risk exposures.

Qualitative Review and Research

In addition to quantitative analysis, the process of Macroprudential Risk Assessment uses various qualitative tools and resources to identify emerging risk exposures, market conditions, and industry activities that have the potential to impact the Macroprudential Risk Assessment. These tools and resources may include results of company surveillance efforts, industry news, and internal/external research, as well as insights from federal and international resources. By conducting ongoing study and research in these areas, topics for consideration in the overall macroeconomic risk assessment may be identified, as well as additional indicators for incorporation into the quantitative assessment. The qualitative assessment and research may also result in the identification of factors that could potentially influence the quantitative assessment of exposures discussed above.

Qualitative Review Sources *(subject to ongoing review and adjustment)*:

a. **Results of Microeconomic Surveillance –** Incorporation of findings and takeaways from the NAIC Financial Analysis (E) Working Group process, Own Risk and Solvency Assessment (ORSA) reviews, input from chief financial regulators, etc.

b. **Industry News –** Ongoing review and tracking of issues identified through a review of news feeds including rating agency reports and outlooks, industry periodicals, etc.

c. **Internal/External Research & Studies** – Ongoing review and consideration of research performed by the NAIC's Capital Markets Bureau (CMB), the NAIC's Center for Insurance Policy and Research (CIPR), rating agencies, and various external research agencies and sources (i.e., academics, *Journal of Insurance Regulation* [JIR], Insurance Information Institute [III]), etc.

d. **Federal Resources –** Review of information highlighted in FSOC reports and inquiries, Federal Reserve/Federal Insurance Office (FIO)/Office of Financial Research (OFR) reports, etc.

e. **International Resources –** Review of information highlighted in the International Association of Insurance Supervisors' (IAIS') Global Monitoring Exercise (GME) reports and other reports (i.e., Global Insurance Market Report [GIMAR]), FSB data and reports, IMF data and reports, etc.

Overall Conclusions and Presentation of Results

Insights from both the quantitative and qualitative reviews are aggregated to reach a baseline assessment of industry exposure to various macroprudential risks. The baseline assessment will then be evaluated, adjusted as needed, and approved by the Macroprudential (E) Working Group. The assessment considers how each risk aligns with the three transmission channels, identified by the FSOC as most likely to facilitate the transmission of risk across firms or markets. Those transmission channels are interconnectedness, asset liquidation, and critical function. The final assessment will consist of an overall level and trend for each risk category.

1. **Assessment Levels** – Assessment levels are documented on a four-tier scale consisting of High, Moderate-High, Moderate-Low, or Low. Assessments are based on current and historical risk indicators and expert judgment.

2. **Trend Levels** – Trend levels are documented on a five-tier scale consisting of Rapidly Increasing, Increasing, Static, Decreasing, or Rapidly Decreasing. Trends are based on the changes in risk indicators and expert judgment.

   The Macroprudential Risk Assessments are compiled and presented in a public report describing state insurance regulator views on risk exposures (i.e., risk dashboards), ongoing supervisory efforts to address exposures, and additional policy considerations in response to higher risk assessments, if warranted. The public report will also highlight specific quantitative and qualitative elements that support the overall assessments.

Use in Ongoing Macroprudential and Microprudential Surveillance

The results of the Macroprudential Risk Assessment process can be used by state insurance regulators for various purposes, including the identification of sector-wide risks and potential systemic risks within the financial system related to insurance sector activities. The risk dashboard may be used to identify interplays between industry-wide risks identified in the dashboard and individual insurer risk analysis.

State insurance regulators may also consider using the risk dashboard in a top-down, risk-focused, supervisory approach. Starting at the top with a sector-wide risk dashboard, state insurance regulators may wish to channel their supervisory resources towards identifying individual insurers who contribute to higher assessed sector-wide risks and potential systemic risk or activities. Further analysis may warrant additional supervision and oversight of select insurers. When monitoring an individual insurer, the state insurance regulator should be aware of the broader market in which the insurer operates to be able to better understand the context of certain risk factors. To assist state insurance regulators in this regard, the results may be used to complement the NAIC's Solvency Monitoring Risk Alert and act as a regulator-only supplement to NAIC handbooks for use in addressing risk exposures and industry trends in conducting financial analysis and examinations.

Macroprudential risks can also be presented to the Financial Stability (E) Task Force for general policy consideration, which could include the development of additional tasks, policies, practices, or disclosures to address sector-wide risk exposures. In addition, assessments could be shared with federal and international regulators for broader financial sector and macroprudential surveillance purposes.