

National Association of Insurance Commissioners

Financial Report
December 31, 2018

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RSM US LLP

Independent Auditor's Report

Honorable Members
National Association of Insurance Commissioners

Report on the Financial Statements

We have audited the accompanying financial statements of the National Association of Insurance Commissioners (the NAIC), which comprise the statements of financial position as of December 31, 2018 and 2017, the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the NAIC as of December 31, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

RSM US LLP

Kansas City, Missouri
March 13, 2019

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National Association of Insurance Commissioners

**Statements of Financial Position
December 31, 2018 and 2017**

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 13,310,382	\$ 15,696,221
Accounts receivable, less allowance for doubtful accounts of 2018—\$1,070,423 and 2017—\$1,820,818	9,391,863	10,892,252
Interest receivable	87,767	74,877
Incentive receivable (Note 5)	225,856	213,073
Prepaid expenses	2,770,419	3,069,176
Inventories	51,562	51,077
Investments (Note 3)	108,088,481	111,445,384
Total current assets	133,926,330	141,442,060
Operating note receivable (Note 7)	3,376,116	3,301,071
Incentive receivable (Note 5)	762,185	988,042
Property and equipment, net (Note 4)	20,554,064	23,258,276
Total assets	\$ 158,618,695	\$ 168,989,449
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 1,951,084	\$ 1,735,255
Accrued expenses and other current liabilities	13,382,458	16,148,702
Deferred revenue	3,807,620	3,538,240
Total current liabilities	19,141,162	21,422,197
Deferred lease incentive (Note 5)	7,315,962	8,668,314
Deferred pension liability (Note 6)	1,173,918	5,092,788
Total liabilities	27,631,042	35,183,299
Net assets:		
Without donor restrictions:		
Allocated	129,145,307	131,799,822
Unallocated	1,842,346	2,006,328
Total net assets	130,987,653	133,806,150
Total liabilities and net assets	\$ 158,618,695	\$ 168,989,449

See notes to financial statements.

National Association of Insurance Commissioners

**Statements of Activities
Years Ended December 31, 2018 and 2017**

	2018	2017
Revenues:		
Member assessments	\$ 2,108,678	\$ 2,110,636
Database fees	29,750,827	28,734,510
Publications and insurance data products	16,059,955	16,025,983
Valuation services	26,918,340	26,532,364
Transaction filing fees	10,752,404	10,253,060
National meeting registration fees	2,192,250	1,897,260
Education and training	749,045	668,609
Administrative services/license fees	17,166,364	15,718,898
Other	43,601	65,944
Total revenues	105,741,464	102,007,264
Expenses:		
Salaries	50,241,679	48,022,001
Temporary personnel	592,540	464,983
Employee benefits	14,247,392	14,152,714
Professional services	7,215,644	11,207,401
Computer services	6,016,851	2,776,270
Travel	5,024,078	4,568,529
Occupancy	3,926,466	3,813,737
Equipment rental and maintenance	5,424,574	3,951,631
Depreciation and amortization	4,435,747	5,283,667
Insurance	454,215	492,980
Supplies	1,798,073	1,750,138
Printing expense	88,681	141,667
Meetings	3,766,042	2,937,125
Education and training	60,992	164,550
Grant and zone	1,530,867	1,404,399
Other expenses	631,128	410,968
Total expenses	105,454,969	101,542,760
Changes in net assets before investment income (loss) and pension adjustment	286,495	464,504
Net investment income (loss) (Note 3)	(3,183,386)	11,174,483
Changes in net assets before pension adjustment	(2,896,891)	11,638,987
Pension adjustment	78,394	2,904,688
Changes in net assets without donor restrictions	(2,818,497)	14,543,675
Net assets, beginning of year	133,806,150	119,262,475
Net assets, end of year	\$ 130,987,653	\$ 133,806,150

See notes to financial statements.

National Association of Insurance Commissioners

Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Changes in net assets without donor restrictions	\$ (2,818,497)	\$ 14,543,675
Adjustments to reconcile changes in net assets without donor restrictions to net cash provided by operating activities:		
Interest income included in operating note receivable	(75,045)	(73,375)
Depreciation and amortization	4,435,747	5,283,667
Net realized and unrealized losses (gains) on investments	6,352,170	(8,968,351)
Loss on sale of property and equipment	16,775	26,944
Changes in operating assets and liabilities:		
Accounts receivable, net	1,500,389	(2,296,972)
Incentive receivable	213,074	201,012
Interest receivable	(12,890)	(5,798)
Prepaid expenses	298,757	135,647
Inventories	(485)	46,199
Accounts payable	215,829	(1,845,154)
Accrued expenses and other current liabilities	(2,766,244)	4,981,202
Deferred revenue	269,380	(2,531,171)
Deferred lease incentive	(1,352,352)	(1,352,351)
Deferred pension liability	(3,918,870)	(551,249)
Net cash provided by operating activities	2,357,738	7,593,925
Cash flows from investing activities:		
Purchase of property and equipment	(1,748,310)	(1,575,185)
Purchase of investments	(31,143,253)	(29,366,928)
Proceeds from disposition of investments	28,147,986	28,496,212
Net cash used in investing activities	(4,743,577)	(2,445,901)
Net (decrease) increase in cash and cash equivalents	(2,385,839)	5,148,024
Cash and cash equivalents:		
Beginning of year	15,696,221	10,548,197
End of year	\$ 13,310,382	\$ 15,696,221

See notes to financial statements.

National Association of Insurance Commissioners

Notes to Financial Statements

Note 1. Nature of Operations and Summary of Significant Accounting Policies

Nature of operations: The National Association of Insurance Commissioners (the NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer reviews, and coordinate their regulatory oversight. The NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. The NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the United States.

Basis of accounting and presentation: The financial statements of the NAIC have been prepared on the accrual basis of accounting. During 2018, the NAIC adopted Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new standard changes presentation and disclosure requirements with the intention of helping nonprofits provide more relevant information about their resources to donors, grantors, creditors and other financial statement users. This pronouncement decreases the number of net asset classes from three to two. The new classes are net assets without donor restrictions and net assets with donor restrictions. The changes in this new standard have been reflected in the financial statements for the years ended December 31, 2018 and 2017.

Cash and cash equivalents: The NAIC considers all liquid investments with original maturities of one year or less to be cash equivalents. At December 31, 2018 and 2017, cash equivalents consisted of money market funds and discount notes. The NAIC, at times, maintains deposits with banks in excess of the insured limits, but has not experienced any losses in such accounts.

Accounts receivable: Accounts receivable are stated at the amounts billed to customers. The NAIC provides an allowance for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Past-due accounts are periodically reviewed by management. Delinquent and/or uncollectible receivables are written off based on individual credit evaluation and specific circumstances of the customer.

Inventory pricing: Inventories are stated at the lower of cost, determined by the first-in, first-out (FIFO) method, or market.

Investments: The NAIC carries its investments at their estimated fair values. Unrealized gains and losses are included in the change in net assets in the accompanying financial statements.

Investments may be exposed to various risks, such as interest rate, market and credit risks. As a result, it is at least reasonably possible that changes in risks in the near term could affect investment balances, and those effects could be significant.

Fair value of financial instruments: The following methods and assumptions were used to estimate the fair value of each class of the NAIC's financial instruments at December 31, 2018 and 2017:

Cash and cash equivalents: The carrying amount approximates fair value because of the short maturity of these instruments.

Investment securities, except alternative investments: The fair values of fixed-income and domestic and international equity investments are based on quoted market prices at the reporting date for those or similar investments. A portion of the fixed-income investments is valued based on quoted prices for similar instruments in active markets.

National Association of Insurance Commissioners

Notes to Financial Statements

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Alternative investments: The NAIC reports the fair value of alternative investments using the practical expedient. The practical expedient allows for the use of net asset value (NAV), either as reported by the investee fund or as adjusted by the NAIC based on various factors.

Fair value measurements: Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in its principal market, or in the absence of a principal market, the most advantageous market for the investment or liability. The NAIC accounts for its investments at fair value. In accordance with the guidance, the NAIC has categorized its investments based on the priority of the inputs to the valuation technique, which gives the highest priority to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Quoted prices for identical instruments traded in active markets

Level 2: Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, or derived from inputs that are observable

Level 3: Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer or broker trade transactions; Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities

Investments and concentrations of credit risk: Financial instruments that potentially subject the NAIC to significant concentrations of credit risk consist principally of cash and investments. The NAIC maintains deposits in financial institutions in excess of federally insured limits. Management monitors the soundness of these financial institutions and believes the NAIC's risk is negligible.

Alternative investments are redeemable with the fund at net asset value under the original terms of the partnership and/or subscription agreements. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future, in accordance with the fund agreements. Due to the nature of the investments held by the funds, changes in market conditions and the economic environment may significantly impact the net asset value of the funds and, consequently, the fair value of the NAIC's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is therefore reasonably possible that if the NAIC were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.

Property and equipment: Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

National Association of Insurance Commissioners

Notes to Financial Statements

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

The cost of internally developed software is expensed until the technological feasibility of the software has been established. Thereafter, all software development costs are capitalized until such time as the product is available for general release to customers. The development costs of enhancements that extend the life or improve the marketability of the original product are capitalized. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, anticipated future revenues, estimated economic life, and changes in software and hardware technologies. The cost of capitalized software is amortized on the straight-line method over the products' estimated useful lives.

	<u>Estimated Useful Lives</u>
Furniture and equipment	5-13 years
Computer and related equipment	3 years
Computer software	3-10 years
Leasehold improvements	10-13 years

Uses of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of accounting for revenues: Revenues are recognized as follows:

- Database fee revenue is recognized in the month the annual statement filing is due.
- Publications and insurance data products revenue is recognized when the product is shipped to the customer.
- Valuation services and transaction filing fee revenue is recognized when the service or filing has been performed.
- License fees consist of revenue earned from a related party for the use of the NAIC's producer data. Administrative services consist of revenues earned from related parties for administrative services and the use of the NAIC's facilities and equipment. Revenue from administrative services/license fees is recognized as revenue when the services are performed and when the use of the NAIC's assets occurs, in accordance with the terms contained in written agreements in effect with related parties.
- Revenue from fees for member assessments apply to an assessment fiscal year ended April 30, and are recorded in the calendar year assessed as receivables and deferred revenue. At December 31 of each year, one-third of the assessments are accounted for as deferred revenue.

Income taxes: The NAIC has been granted exemption from income taxes by the Internal Revenue Service under the provisions of section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the NAIC is subject to federal income tax on any unrelated business taxable income.

National Association of Insurance Commissioners

Notes to Financial Statements

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Uncertain tax positions, if any, are recorded in accordance with *FASB Accounting Standards Codification* (ASC) Topic 740, Income Taxes. ASC 740 requires the recognition of a liability for tax positions taken that do not meet the more-likely-than-not standard that the position will be sustained upon examination by the taxing authorities. There is no liability for uncertain tax positions recorded at December 31, 2018 or 2017.

Net assets: The NAIC operating reserve is based on a liquid reserve, defined as total net assets, less net property and equipment, as a percentage of the future year's budgeted operating expenses. On July 7, 2015, following a comprehensive review by an outside consultant to reflect the NAIC's current operating environment, the NAIC adopted a target liquid reserve range of 83.4 percent to 108.2 percent. Net assets are allocated by the Executive (EX) Committee and Internal Administration (EX1) Subcommittee as a function of the budgeting process. As of December 31, 2018 and 2017, net assets were fully allocated, with the exception of an amount maintained as unallocated equal to 1.5 percent of the next year's projected net assets. The unallocated balance will be used to fund priority initiatives that may arise in the next year.

Pension plan: The Compensation-Retirement Benefits topic of the ASC requires employers to recognize on their statements of financial position a liability and/or an asset equal to the underfunded or overfunded status of their defined benefit pension and other postretirement benefit plans. The funded status that the NAIC has reported on the statements of financial position under the topic is measured as the difference between the fair value of plan assets and the benefit obligation.

Functional expenses: The Not-for-Profit Entities topic of the ASC requires nonprofit organizations to disclose expenses by functional classification. The NAIC presents expenses only by their natural classification in the December 31, 2018 and 2017, statements of activities, as there is only one program (member services) with multiple service offerings. Therefore, management does not allocate expenses between program and supporting expenses. Management believes that disclosing expenses by function is insignificant to the financial statements taken as a whole and, therefore, does not apply the provision of the topic as it relates to the disclosure of expenses by functional classification.

Recent accounting pronouncements: In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance is intended to improve comparability of accounting treatment for revenue recognition across geographies and industries, and to provide more useful information to financial statement readers through enhanced disclosure requirements. It replaces industry-specific guidance with a principles-based approach for revenue recognition, and is a step toward convergence of U.S. GAAP and International Financial Reporting Standards. In general, it requires revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU, as deferred one year by ASU No. 2015-14, is effective for annual reporting periods beginning after December 15, 2018. Therefore, this ASU will be effective for the NAIC for the fiscal year ending December 31, 2019. The ASU permits the use of either of two methods: a full retrospective or a retrospective with the cumulative effect and additional disclosures. Management has not yet selected a transition method, as the NAIC is currently evaluating the impact of the new standard on its sources of support and financial statements, and is reviewing its revenue recognition policies and processes for any necessary amendments.

National Association of Insurance Commissioners

Notes to Financial Statements

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in ASC Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal year 2020. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The NAIC is currently evaluating the impact of the pending adoption of the new standard on the financial statements.

Note 2. Liquidity and Availability of Resources

The NAIC regularly monitors liquidity required to meet its annual operating needs and other contractual commitments while also striving to maximize the return on investment of its funds not required for annual operations. As of December 31, 2018, the following financial assets are available to meet annual operating needs of the 2019 fiscal year:

Financial assets at year-end:	
Cash and cash equivalents	\$ 13,310,382
Accounts receivable, net	9,391,863
Interest receivable	87,767
Inventories	51,562
Investments (Note 3)	108,088,481
Total financial assets	<u>\$ 130,930,055</u>

The NAIC has various sources of liquidity at its disposal, including cash and cash equivalents, accounts receivable, inventory and marketable debt and equity securities. See Note 3 for information about the NAIC's investments.

Note 3. Investments and Investment Income

	2018		2017	
	Cost	Fair Value	Cost	Fair Value
Government bonds	\$ 7,111,045	\$ 7,105,826	\$ 5,651,046	\$ 5,523,968
Corporate bonds	7,029,684	6,845,191	7,894,713	7,794,354
Fixed-income mutual funds	33,831,764	32,630,206	40,831,095	42,961,893
Foreign fixed-income funds	7,703,393	6,929,606	5,953,378	5,600,807
Domestic equity mutual funds	8,433,861	10,443,016	-	-
Common stock:				
Industrials	1,123,080	1,416,117	1,093,024	2,085,029
Consumer discretionary	5,724,109	5,721,040	1,656,873	2,595,468
Financials	2,982,194	3,918,329	1,869,165	3,676,604
Information technology	3,673,018	6,889,536	3,529,935	6,558,328
Other industries	14,676,729	16,221,381	14,494,614	20,814,118
Foreign common stock	131,447	389,565	215,809	589,600
Foreign equity mutual funds	7,161,472	7,911,979	6,062,445	7,884,635
Alternative equity funds	1,402,733	1,666,689	4,548,750	5,360,580
	<u>\$ 100,984,529</u>	<u>\$ 108,088,481</u>	<u>\$ 93,800,847</u>	<u>\$ 111,445,384</u>

National Association of Insurance Commissioners

Notes to Financial Statements

Note 3. Investments and Investment Income (Continued)

Total net investment income (loss) comprises the following:

	<u>2018</u>	<u>2017</u>
Interest and dividend income	\$ 3,512,095	\$ 2,710,513
Net realized gains	4,188,414	1,821,160
Net unrealized (losses) gains	(10,540,584)	7,147,190
Investment manager fees	(343,311)	(504,380)
	<u>\$ (3,183,386)</u>	<u>\$ 11,174,483</u>

The following tables summarize the valuation of financial instruments measured at fair value on a recurring basis, segregated by the general classification of such instruments pursuant to the valuation hierarchy:

	<u>December 31, 2018</u>			
	<u>Total</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Government bonds	\$ 7,105,826	\$ -	\$ 7,105,826	\$ -
Corporate bonds	6,845,191	-	6,845,191	-
Fixed-income mutual funds	32,630,206	32,630,206	-	-
Foreign fixed-income funds	6,929,606	6,929,606	-	-
Domestic equity mutual funds	10,443,016	10,443,016	-	-
Common stock:				
Industrials	1,416,117	1,416,117	-	-
Consumer discretionary	5,721,040	5,721,040	-	-
Financials	3,918,329	3,918,329	-	-
Information technology	6,889,536	6,889,536	-	-
Other industries	16,221,381	16,221,381	-	-
Foreign common stock	389,565	389,565	-	-
Foreign equity mutual funds	7,911,979	7,911,979	-	-
	<u>106,421,792</u>	<u>\$ 92,470,775</u>	<u>\$ 13,951,017</u>	<u>\$ -</u>
Investments measured at net asset value:				
Alternative equity hedge funds	1,666,689			
Total investments	<u>\$ 108,088,481</u>			

National Association of Insurance Commissioners

Notes to Financial Statements

Note 3. Investments and Investment Income (Continued)

	December 31, 2017			
	Total Fair Value	Level 1	Level 2	Level 3
Government bonds	\$ 5,523,968	\$ -	\$ 5,523,968	\$ -
Corporate bonds	7,794,354	-	7,794,354	-
Fixed-income mutual funds	42,961,893	42,961,893	-	-
Foreign fixed-income funds	5,600,807	5,600,807	-	-
Common stock:				
Industrials	2,085,029	2,085,029	-	-
Consumer discretionary	2,595,468	2,595,468	-	-
Financials	3,676,604	3,676,604	-	-
Information technology	6,558,328	6,558,328	-	-
Other industries	20,814,118	20,814,118	-	-
Foreign common stock	589,600	589,600	-	-
Foreign equity mutual funds	7,884,635	7,884,635	-	-
	<u>106,084,804</u>	<u>\$ 92,766,482</u>	<u>\$ 13,318,322</u>	<u>\$ -</u>
Investments measured at net asset value:				
Alternative equity hedge funds	<u>5,360,580</u>			
Total investments	<u>\$ 111,445,384</u>			

	Alternative Equity Funds	
	2018	2017
Total gains (losses), included in earnings attributable to the change in unrealized gains (losses), net, relating to financial instruments still held	<u>\$ (30,348)</u>	<u>\$ 62,726</u>

The following table sets forth additional disclosures of the NAIC's investments whose fair value is estimated using NAV per share (or its equivalent) as of December 31, 2018 and 2017:

Investment	Fair Value at December 31		Unfunded Commitment	Redemption Frequency	Redemption Notice Period
	2018	2017			
Alternative equity funds (A)	<u>\$ 1,666,689</u>	<u>\$ 5,360,580</u>	<u>\$ -</u>	Quarterly	95 days

(A) This fund aims to generate consistent absolute returns by investing in assets with a diversified group of investment managers through managed account structures or in the private investment funds sponsored by investment managers (collectively, hedge fund managers or hedge funds).

National Association of Insurance Commissioners

Notes to Financial Statements

Note 4. Property and Equipment

Property and equipment at December 31, 2018 and 2017, consisted of the following:

	<u>2018</u>	<u>2017</u>
Furniture and equipment	\$ 5,533,555	\$ 5,434,403
Computer and related equipment	8,849,445	11,889,771
Computer software	31,221,347	36,108,993
Leasehold improvements	16,869,256	16,774,497
	<u>62,473,603</u>	<u>70,207,664</u>
Less accumulated depreciation and amortization	41,919,539	46,949,388
	<u>\$ 20,554,064</u>	<u>\$ 23,258,276</u>

Note 5. Operating Leases

The NAIC leases its office space in Kansas City, New York and Washington, D.C. under noncancelable operating leases. Certain parts of the agreements contain escalation clauses providing increased rentals based on maintenance, utility and tax increases. The NAIC also leases certain office equipment under noncancelable operating leases, which expire at various dates through 2021. The accompanying financial statements reflect rent expense on the straight-line method over the terms of the leases. Total rental expenses under all leases for the years ended December 31, 2018 and 2017, were \$2,747,822 and \$2,729,000, respectively.

The Kansas City office space lease includes various lease incentives, free rent and scheduled rent increases. The lessor agreed to pay the NAIC base rental differential payments totaling \$2,390,571 plus 6 percent interest over the course of the initial lease term. Annual payments of \$285,140 are being made to the NAIC through fiscal year 2022. The outstanding noncurrent principal balance of this receivable is reported as an incentive receivable on the statements of financial position and had a balance of \$762,185 and \$988,042 as of December 31, 2018 and 2017, respectively. This outstanding receivable is being recognized in the statements of activities on a straight-line basis over the life of the lease and is included in the deferred lease incentive described below.

Deferred lease incentives consist primarily of reimbursements for leasehold improvements, parking costs and moving costs. U.S. GAAP requires that the above items be recognized as a reduction of rental expense over the term of the lease. The unamortized balance in deferred lease incentive was \$7,315,962 and \$8,668,314 as of December 31, 2018 and 2017, respectively.

Future minimum lease payments at December 31, 2018, are as follows:

Years ending December 31:	
2019	\$ 4,367,364
2020	4,394,734
2021	4,411,109
2022	4,402,867
2023	4,461,792
Thereafter	3,563,041
Total future minimum lease payments	<u>\$ 25,600,907</u>

National Association of Insurance Commissioners

Notes to Financial Statements

Note 6. Employee Retirement Plans

The NAIC has a noncontributory defined benefit plan covering all employees with a hire date prior to January 1, 2000. As of December 31, 2012, accrued benefits for all active participants were frozen. The benefits are based on years of service and the employee's compensation prior to January 1, 2013.

The following table sets forth the plan's funding status, amount recognized in the NAIC's financial statements, and other required disclosures:

	<u>2018</u>	<u>2017</u>
Projected benefit obligation	\$ (48,007,199)	\$ (50,233,124)
Fair value of plan assets	46,833,281	45,140,336
Funded status of plan	<u>\$ (1,173,918)</u>	<u>\$ (5,092,788)</u>
Accrued benefit cost recognized in the statements of financial position	<u>\$ (1,173,918)</u>	<u>\$ (5,092,788)</u>
Accumulated benefit obligation	<u>\$ 48,007,199</u>	<u>\$ 50,233,124</u>
Employer contributions	<u>\$ 5,092,788</u>	<u>\$ -</u>
Plan settlements	<u>\$ -</u>	<u>\$ (2,025,485)</u>
Benefits paid	<u>\$ (1,252,868)</u>	<u>\$ (739,677)</u>
Interest cost	\$ 1,644,435	\$ 1,830,382
Return on plan assets	(2,756,080)	(2,431,436)
Amortization of net loss	2,363,957	2,561,984
Settlement loss recognized	-	392,509
Net pension cost	<u>\$ 1,252,312</u>	<u>\$ 2,353,439</u>

Weighted-average assumptions used to determine benefit obligations are as follows:

	<u>2018</u>	<u>2017</u>
Discount rate	4.21%	3.52%
Salary rate	N/A	N/A
Measurement date	December 31, 2018	December 31, 2017

Weighted-average assumptions used to determine net pension costs are as follows:

	<u>2018</u>	<u>2017</u>
Discount rate	3.52%	3.95%
Salary rate	N/A	N/A
Expected return on plan assets	6.00%	6.00%
Measurement date	December 31, 2018	December 31, 2017

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Notes to Financial Statements

Note 6. Employee Retirement Plans (Continued)

The expected rate of return on plan assets is determined by those assets' historical long-term investment performance, current asset allocation and estimates of future long-term returns by asset class.

The following is the plan's weighted-average asset allocation by asset category as of December 31, 2018 and 2017 (the measurement date of the plan assets):

	<u>2018</u>	<u>2017</u>
Equity securities	45.41%	52.44%
Debt securities	54.59%	47.56%

Plan assets are held by an insurance company, which invests the plan assets in accordance with the provisions of the plan agreement. The plan agreement permits investment in common stocks, corporate bonds, U.S. government securities and other specified investments, based on certain target allocation percentages. Asset allocation is primarily based on a strategy to provide stable earnings while still permitting the plan to recognize potentially higher returns through a limited investment in equity securities. Plan assets are rebalanced as necessary based upon the minimum and maximum restrictions set forth in the plan's investment policy statement. Plan assets are valued using Level 1 inputs and are based on unadjusted quoted market prices within active markets.

The benefits expected to be paid to participants over the next 10 years, as of December 31, 2018, are as follows:

Years ending December 31:	
2019	\$ 4,333,576
2020	4,298,986
2021	3,879,256
2022	3,636,000
2023	4,044,619
2024–2028	15,312,010
Total	<u>\$ 35,504,447</u>

The annual amount is actuarially calculated by the NAIC's independent consultant firm and represents the amount necessary to fully fund the actuarial accrued liability and normal cost of the plan.

The NAIC provides a defined contribution 401(a) plan (Plan B) that covers substantially all employees with one year or more of service. Each year, the Executive (EX) Committee and Internal Administration (EX1) Subcommittee determine the contribution for the next year. The NAIC matched up to 5.5 percent of compensation of employees who contributed to Plan B and contributed 3.0 percent of all employees' compensation in 2018 and 2017. The pension expense related to Plan B for the years ended December 31, 2018 and 2017, was \$3,400,168 and \$3,244,927, respectively.

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Notes to Financial Statements

Note 7. Related-Party Transactions

The NAIC and the National Insurance Producer Registry (NIPR) executed a License and Services Agreement (the Agreement) effective January 1, 2012, for an initial term of five years. The Agreement was renewed for an additional one-year period ending December 31, 2017. The terms of the Agreement provide for (1) a 38 percent license fee for NIPR to use the NAIC's producer data; (2) the reimbursement of the actual cost of services, facilities and equipment provided by the NAIC to NIPR; and (3) the reimbursement of system usage fees related to ongoing infrastructure costs for NIPR.

In December 2017, the NAIC and NIPR finalized a new License and Services Agreement (the Agreement) effective January 1, 2018. The term of the agreement is five years. Terms in the new Agreement retained the 38 percent fee for NIPR to use the NAIC's producer data and reimbursement of the actual cost of services, facilities and equipment provided. System usage fees for 2018 forward have been replaced with reimbursement of actual expenses.

The total amount of revenue recognized during the year and amount owed at year-end from NIPR are as follows:

	<u>2018</u>	<u>2017</u>
Administrative services provided by the NAIC	<u>\$ 1,847,701</u>	<u>\$ 1,312,451</u>
License fee	<u>\$ 15,187,412</u>	<u>\$ 13,981,511</u>
System usage fee	<u>\$ -</u>	<u>\$ 299,936</u>
Amounts payable to the NAIC	<u>\$ 1,807,831</u>	<u>\$ 1,450,456</u>

Effective June 2007, the NAIC entered into a service agreement with the Interstate Insurance Product Regulation Commission (the IIPRC), whereby the NAIC provides certain administrative services to the IIPRC. The NAIC received an administrative fee of \$125,000 for both of the years ended December 31, 2018 and 2017. The IIPRC also pays an annual license and maintenance fee in the amount of \$25,000 for the use of the NAIC's System for Electronic Rate and Form Filing (SERFF). The NAIC also has an operating note receivable due from the IIPRC. Repayment of principal and interest is deferred until certain operating performance measures are met by the IIPRC. Additionally, certain expenses are paid on behalf of, and reimbursed by, the IIPRC.

The total amount of revenue recognized during the year and amounts owed at year-end from the IIPRC are as follows:

	<u>2018</u>	<u>2017</u>
Administrative services provided by the NAIC	<u>\$ 125,000</u>	<u>\$ 125,000</u>
License fee paid to the NAIC	<u>\$ 25,000</u>	<u>\$ 25,000</u>
Amounts payable to the NAIC	<u>\$ 36,536</u>	<u>\$ 31,294</u>
Note payable to the NAIC	<u>\$ 3,376,116</u>	<u>\$ 3,301,071</u>

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Notes to Financial Statements

Note 7. Related Party Transactions (Continued)

During 2018, a line of credit in the amount of \$100,000 to be used by the IIPRC was executed. No amounts were drawn on the line of credit during the year. Management of the IIPRC does not plan to request a line of credit during 2019.

Note 8. Contingencies

The NAIC is, from time to time, subject to claims and lawsuits arising in the ordinary course of business. Although the ultimate disposition of such proceedings is not presently determinable, management does not currently believe the ultimate resolution of these matters will have a material adverse effect on the financial condition, results of operations, or cash flows of the NAIC.

Note 9. Subsequent Events

Management has performed an evaluation of events that have occurred subsequent to December 31, 2018, through March 13, 2019. There have been no events that occurred during such period that would require disclosure in these financial statements or would be required to be recognized in the financial statements as of or for the year ended December 31, 2018.

