NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Date: February 3, 2022

To: All NAIC Members and Interested Parties

From: Dean Cameron, Idaho Director of Insurance and NAIC President
Michael Consedine, NAIC Chief Executive Officer
Andy Beal, NAIC Chief Operating Officer and Chief Legal Officer
Jim Woody, NAIC Chief Financial Officer

Re: Summary of Comments on the Proposed SERFF Modernization – 2022 Transition Stages Fiscal Impact Statement

In response to the Executive (EX) Committee's and Internal Administration (EX1) Subcommittee's request for comment on the SERFF Modernization – 2022 Transition Stages Fiscal Impact Statement, the NAIC received one comment letter on the proposed fiscal after it was released for public comment on January 14, 2022, from the American Property Casualty Insurance Association (APCIA) (Attachment One).

This memorandum summarizes the letter's comments and includes the NAIC's response to each comment. The NAIC appreciates APCIA's insight and the opportunity to provide greater details into the SERFF Modernization initiative and the resulting fee change.

Clarification regarding Assessment of Transaction Fees

1. APCIA asked for clarification regarding the fee increase to $17 being per company per filing. APCIA indicated the current wording in the fiscal may not be clear to all industry members that the fee increase, effective May 1, 2022, would be at that level.

NAIC Response: The NAIC has charged the SERFF transaction fee at a per company per filing level since the system was launched 22 years ago. The fiscal does not contemplate changing the methodology as to how the transaction fees are charged. Rather, it simplifies the approach by removing the volume discounting so that all transactions are charged at the same flat rate, regardless of filing trends or company size, as efficiencies are not gained in SERFF by volume filings.

Transaction Fee Revenue Usage

2. APCIA requested NAIC provide a fuller explanation as to the intended usage of the SERFF fees, specifically whether the fees are intended to cover related expenses and be a break-even proposition or were intended to generate revenue that could be utilized to fund unrelated NAIC initiatives. The organization noted NAIC's net assets as documented within the 2020 Annual Report were $166.7 million and suggested prior collected SERFF transaction fees contributed to those net assets.

NAIC Response: The proposed fiscal is the first of three modernization fiscals to be submitted for the membership's consideration with funding expected to cost approximately $20 million over the next three years. A portion of these expenses, for consulting and professional services, will be capitalized and recognized over the life of the platform, which for accounting purposes is set at 10 years. Annual support, maintenance, and staffing costs for additional headcount to be requested in the next two fiscals are projected to be $3.5 to $4.4 million, per year, by the end of the 10 years. The capitalized expense as well as the additional maintenance, staffing, and support costs over that 10-year period is expected to be $60 million. Much of the expense is due to new technologies that will be utilized in the modernized platform, including tools for machine learning, robotics process automation, and document management capabilities.

The $17 fee was set based on historical average transactions per year and the resulting average transaction fee, given the standard rate and three volume discounts. With the differential being used to fund the initiative, the $17 transaction fee starting in May 2022 will allow the NAIC to break even by the end of the 10 years. The 10-year financial analysis assumed no growth in transactions with annual CPI-U rates averaging 2% (the CPI-U at year-end 2019 was 2.2% and was 1.7% at year-end 2020). The net present value of the initiative over the 10 years will result in an underrun to the NAIC of $681,000, using a conservative discount rate of 5%.

It is important to note that, outside of this proposed fee differential, NAIC revenue received for its products and services are used to support all NAIC initiatives. The NAIC does not typically utilize revenues collected from one platform for that platform's sole benefit. Were the NAIC to do so, the vast majority of the membership's initiatives would go unfunded as only a handful of departments at the NAIC have products and services that generate revenue. Therefore, the average fee historically earned from each SERFF transaction has been used to fund initiatives outside of the current SERFF platform. That being said, as noted above, the differential from the $17 fee is expected to cover the modernization initiatives' anticipated expenses over the long term.

Timing of the Fee Increase

3. In the comment letter APCIA explained insurers typically budget for current year expenses within the previous calendar year and therefore were not expecting an increase beyond the $0.25 per transaction outlined in the NAIC's 2022 proposed budget.

NAIC Response: The NAIC recognizes that the timing of this proposed fiscal may not have allowed insurers to budget the proposed increase and appreciates APCIA's position. However, the NAIC has been transparent about its intention to change the pricing to cover expenses related to the modernized

platform from the beginning stages of the project. Within the first fiscal related to the SERFF Modernization in April 2021, the NAIC said the pricing structure would be revised with the next fiscal, as noted on page 4: "This phase of the project does not contemplate additional revenue. However, a fiscal for the next stage of the project will encompass a modified revenue structure commensurate with the value of the system and services provided."

To maintain continuity of the initiative, it was important to retain the current outside vendor to begin the transition stages in early 2022, in order to deploy the full platform by year-end 2024. This continuity will ensure greater success during the transition stages and prevent a loss of momentum and expertise gained during the pilot. Having experienced consultants familiar with SERFF and involved in the development of the modernization plan and pilot will allow the project to provide value to the membership and industry as quickly as possible, as outlined more fully in the Initiatives Benefits section of the fiscal.

Transaction Fee Revenue Reported in 2019

4. The NAIC's 2020 Annual Report listed Transaction filing fees (page 40) of $11.5 million in 2019. APCIA noted this is significantly higher than the $4.4 million budgeted for "usage fees" as outlined in a copy of the 2019 proposed budget given to the SERFF Advisory Board in late 2018. The NAIC was asked to explain the large difference between these numbers.

NAIC Response: The approved 2019 budget for SERFF transaction fees was $4.4 million. Overall, the NAIC received transaction fees of over $11 million in 2019, as reported in the 2020 Annual Report. The NAIC categorizes four software platforms' transaction fees together as "Transaction Filing Fees" for the purposes of reporting simplification. However, the NAIC's annual budget published each year breaks down this category between the SERFF platform ($4.6m), SERFF data hosting and integration services ($483k); the OPT*ins* application for collecting premium taxes and surplus lines filings ($1.1m), the State Based System (SBS) collection of Continuing Education and other related fees ($4.4m), and the International Insurer Department (IID) applications ($856k). The 2022 budget has $15.7 million for Transaction Filing Fees of which $5.2 million is for SERFF transaction fees.

Clarification on Financials in the Fiscal

5. The financials on page 8 of the proposed fiscal impact statement provided the revenue, expenses, and capital associated with the modernization initiative. APCIA notes that total SERFF revenue was not included and provided some estimations as to what the total SERFF revenue would be with the new pricing, using an assumed 550,000 transactions and CPI-U rate increase. It suggested revised financials be provided accordingly.

NAIC Response: As mentioned above, SERFF transaction fees are used to support NAIC initiatives beyond the rates and forms filings platform. The NAIC has been transparent that revenues collected within a particular cost center such as SERFF is needed to support the membership's full body of work and internal operational and infrastructure projects such as the migration of NAIC systems to the Cloud and the setup and administration of an enterprise data platform. Therefore, the average fee currently earned for SERFF transactions – as well as previously collected transaction fees – will continue to be used to fund initiatives beyond the current SERFF platform. The differential, however, will be utilized solely for the modernization

initiatives' expenses, including support over the life of the platform. The financials presented in the fiscal are related solely to the modernization and represent the dollar amounts that will be added to the NAIC's 2022 budget upon approval of the fiscal.

Usage of CPI-U

6. The fiscal includes annual increases to the proposed $17 transaction fee based on the previous year's CPI-U as published by the Bureau of Labor Statistics. APCIA expressed uncertainty as to how the CPI-U would correlate to the cost of modernizing SERFF, citing concern over a 2021 CPI-U of 7%.

NAIC Response: The use of the core CPI-U excluding food and energy, as published by the U.S. Department of Labor, Bureau of Labor Statistics, has been applied to the cap for NAIC's database filing fees since 2017. Below is a table sourced from the BLS showing the annual CPI-U since 2011, which has been on average 1.95% during this time period. The core CPI-U is considered the most appropriate economic measure to use for annual increase as it removes food and energy, thus making it a less volatile economic metric, but a metric that generally represents changes within the economy. The 7% CPI-U cited by APCIA includes food and energy in the calculation. The BLS website as of January 27, 2022, indicated the core CPI-U less food and energy as being 3.6% in 2021.

CPI-U Year-End	Core CPI-U % change*
2021	3.6%
2020	1.7%
2019	2.2%
2018	2.1%
2017	1.8%
2016	1.7%
2015	1.8%
2014	2.1%
2013	1.7%
2012	1.0%
2011	1.7%
Average	1.95%

*As published by the U.S. Department of Labor, Bureau of Labor Statistics; see http://www.bls.gov/.

Functionality to be Delivered in Modernized Platform

7. APCIA expressed the expectation that the modernization effort would set SERFF on a viable platform for many years to come and that the industry would expect to see incremental improvements to continue for years beyond the re-platform. Included in the comment letter were specific mention of increased user configurability (reports, timeout features, and a filing status dashboard), the ability to re-order filed forms, and the improvements to the filing cloning processes. APCIA asked the NAIC to confirm its plans to include this functionality in the modernized platform.

NAIC Response: While the modernization initiative will begin its discovery phase to finalize business requirements in the early months of 2022, the NAIC can confirm that the increased user configurability, the ability to re-order filed forms, and the improvements to the filing cloning processes mentioned in the APCIA comment letter are planned for the new platform. While the timeout feature will remain in the application for security purposes, the new design is expected to invoke the timeout less frequently by bringing user tools into SERFF rather than porting the user out of SERFF to use a tool. The overarching goal of the modernization will be for the users of the platform to gain operational efficiencies, while taking advantage of technology and innovation opportunities available today and to build flexibility into the design such that SERFF is prepared to integrate future capabilities.

Timeline Considerations regarding the New Fee

8. APCIA noted the timeline for the transition stages slated property and casualty filers moving to the new platform near year-end 2023. It also noted that the capital consulting for T3.1-2022, which slates the move of the Insurance Compact, were over $3 million. The organization asked if consideration was given to different transaction fees for different lines of business to ensure that those filers who will see benefits earlier pay for those benefits without subsidization from other segments of the insurance industry.

NAIC Response: The NAIC understands APCIA's position; however, it is important to note that the development work done within initial stages of the transition will benefit all filers in the long term. Although the Insurance Compact will begin using the new platform sooner than other filers, the platform work done during that phase will be utilized for all subsequent phases and cannot be considered solely for the Insurance Compact's benefit. In addition, the search and reporting improvements to be done in the first two stages will be of benefit to all filers, as that work will occur within the legacy platform.

Concluding Comments

The NAIC appreciates APCIA's comments. These were considered and discussed by the Executive Committee further on February 3; however, a decision was made to move forward with the fiscal as proposed.

NAIC leadership, as well as NAIC senior management, appreciates the opportunity to publicly present the proposed fiscal and respond to questions and/or comments raised by interested parties. State insurance regulators, supported by the NAIC, are committed to protecting policyholders as well as ensuring the financial solvency of the insurance industry in a cost-effective and financially prudent manner. The NAIC continuously seeks opportunities to prudentially manage its operating costs while providing world-class support to its members, regulators, interested parties, and insurance customers.

Attachment One

January 26, 2022

Jim Woody
Chief Financial Officer, NAIC
NAIC Central Office
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

VIA Electronic Mail: jwoody@naic.org

RE: SERFF – Proposed Fiscal Impact Statement Intended to Provide Funding to Modernize the NAIC's SERFF Platform

Dear Mr. Woody:

The American Property Casualty Insurance Association (APCIA)[1] appreciates the opportunity to provide comments on the proposed fiscal impact statement intended to provide funding to modernize the NAIC's SERFF platform.

APCIA recognizes the need to modernize the existing SERFF platform through which insurers submit rate and form filings for consideration by the various states and territories that comprise the NAIC membership. However, APCIA members have some significant concerns with the proposed fiscal impact statement.

At the very least, APCIA strongly suggests that the NAIC rewrite and republish the industry fee change section in order to transparently represent that the filing fees are increasing to $17 per company per filing. The current wording lacks the detail necessary for all industry members to understand that the fees will be nearly three (3) times higher beginning on May 1, 2022. This is a very significant increase for all SERFF users, but particularly for any filings with more than one underwriting company.

APCIA respectfully requests a more fulsome explanation of the NAIC's ultimate intentions regarding SERFF fees. Are SERFF fees intended to cover related expenses and be a break-even proposition or are these fees intended more to generate revenue that can be utilized to fund unrelated NAIC initiatives?

Insurers typically budget for the current year (2022) in the 2nd or 3rd quarter of the previous year (2021). On January 1, 2022, SERFF filing fees increased by $0.25 per company for all pricing tiers. Introducing a mid-year increase of close to 150% over the January 1, 2022 transaction fee could not have been

[1] The American Property Casualty Insurance Association (APCIA) is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions-protecting families, communities, and businesses in the U.S. and across the globe.

555 12th Street, NW, Suite 550, Washington, DC 20004 | 202-828-7100
444 North Capitol Street NW, Suite 801, Washington, DC 20001 | 202-639-0490
8700 W. Bryn Mawr Avenue, Suite 1200S, Chicago, IL 60631-3512 | 847-297-7800

anticipated and is not a small amount for most insurance carrier filing departments that can be absorbed without significant strain elsewhere within their budget.

The 2020 NAIC Annual Report (https://content.naic.org/sites/default/files/annual_report_2020.pdf) shows NAIC net assets are approximately $166.7 million. It should be noted that SERFF transaction fees collected over the last 20+ years contributed to those net assets. The capital expenditure for this IT initiative should be sourced by the prior SERFF revenue, not new SERFF revenue. If transaction fees are increased in the near term to fund this project, the fees should be significantly reduced once the initial capital purchase ($5.7 million) is recouped in 3 years.

Transaction filing fees shown on Page 40 of the 2020 NAIC Annual Report are $11.5 million in 2019. This is significantly higher than the $4.4 million budgeted "usage fees" in the attached 2019 SERFF Budget Fiscal. APCIA's understanding is that the Usage Fees in the 2019 SERFF Fiscal represent the SERFF Transaction Fees. Can NAIC explain the difference in Transaction Filing Fees in the NAIC Annual Statement and the "Usage Fees" in the NAIC Budget Fiscal? Clearly, the NAIC Annual Report includes actual fees and the 2019 Fiscal is budgeted, but the large difference must be attributable to something else.

When reviewing the financials on Page 8 of the proposed fiscal impact statement, the revenue line only includes the revenue **differential**, not total SERFF revenue. SERFF has 550,000 transactions. Total SERFF revenue should be shown as $9.35 million per year for 2023 and beyond (increasing at the CPI-U rate each year). Total revenue for 2022 is probably closer to $8 million since the $17 rate does not go into effect until 5/1/22. APCIA suggests this portion of the proposal be reworked to reflect total anticipated revenue and not only the revenue differential as it is now reported. This would provide a more complete picture of the revenue generated through SERFF transaction fees.

The proposal includes annual increases to the proposed $17 per filing transaction fee based on the previous year's CPI-U as published by the Bureau of Labor Statistics. It is unclear how the CPI-U, which measures the changes in the price of a basket of goods and services purchased by urban consumers, is correlated to the cost of maintaining, or even modernizing, SERFF. The CPI-U for 2021, for instance, was 7%. To first increase fees mid-year close to 150%, and subsequently plan to increase annually based on CPI-U seems very aggressive.

All of these SERFF fee increases occur at a time of falling cloud storage costs, falling software development costs and users being accustomed to iterative improvements to applications that do not create such significant financial and on-boarding disruptions. Understanding the Modernization effort includes (and needs) a re-platform, the disruption and multiple year implementation is somewhat unavoidable. APCIA would expect, however, that the Modernization effort would set SERFF on a viable platform for many years to come and that the industry should expect to see incremental improvements to continue for years beyond the re-platform.

On the re-platform features, many of the items listed are welcomed – regulators and industry have been requesting many of these changes for years. For the items listed around Industry user experience, APCIA would want to confirm the following items are included:

- **Increased user configurability including reports, timeout features, and filing status dashboard**
  - *Billing export, ability to select more than one month;*
  - *Would like other options available to tailor a search; for example: search by form/rate/rule, filing type.*
- **Ability to re-order filed forms:**
  - *Ability to move forms on draft filing up or down in bulk order.*
- **Improvements to Filing Cloning:**
  - *Ability to clone paper filings;*
  - *Ability to clone from an external filing to a paper filing and vice versa.*

The proposed fiscal indicates that P&C filers will see no enhancements to their user experience before the end of 2023, yet their transactions fees will be significantly increased under the proposal in May 2022. Also, the proposed fiscal shows that the Capital Consulting T3.1-2022 (Insurance Compact) costs are over $3 million on page 8. Was consideration given to different transaction fees for different lines of business to ensure that those filers who will see benefits earlier pay for those benefits without subsidization from other segments of the insurance industry? Perhaps, increases in transaction fees should be more closely aligned with benefits to different segments of the industry and the IT costs associated with providing those benefits, and when they will be seen by industry?

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Thank you for the opportunity to provide comments. If you have any questions or would like to discuss any of our comments further, please let us know.

Respectfully Submitted,

Lisa Brown
Sr. Director, Market Conduct and Counsel