

Date: November 30, 2020

To: All NAIC Members and Interested Parties

From: Commissioner David Altmaier, NAIC President-Elect
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 NAIC 2021 Budget

The NAIC's annual budget and related process is transparent and subject to several layers of review and approval including NAIC Senior Staff, NAIC Officers, and the NAIC Executive (EX) Committee and Internal Administration (EX1) Subcommittee. In addition, the proposed budget is exposed publicly for review and comment by interested parties before the proposed budget is presented to NAIC membership for final approval.

The proposed NAIC 2021 budget was released for public review on Wednesday, October 28 and a briefing with interested parties was held on Wednesday, November 4. Written comments to the NAIC CFO were due on Friday, November 20, and no comments were received on the proposed 2021 budget.

The NAIC's proposed 2021 budget includes total revenues (including investment income) of \$119.0 million and total expenses of \$127.2 million, which represents a 1.1 percent increase and 1.5 percent increase, respectively, from the 2020 budget. Included in the proposed budget are four Fiscal Impact Statements (Fiscals) with associated expenses of \$2.1 million. Overall, the proposed 2021 budget results in a reduction in Net Assets of \$8.2 million – an overview of key elements of the budget is attached (Attachment One).

The next step in the budget process is a Public Hearing which will be held on Wednesday, December 2nd – participation instructions for the Public Hearing can be accessed at on the NAIC About Budget page (https://content.naic.org/about_budget.htm).

If you have any questions about the proposed 2021 budget or process, please contact Jim Woody, NAIC CFO, at jwoody@naic.org.

Executive Summary NAIC 2021 Budget



National Association of Insurance Commissioners

About the NAIC

The National Association of Insurance Commissioners (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 activities. NAIC staff supports these efforts and represents the collective domestic and international views of state insurance regulators.

NAIC members, together with the central resources of the association, form the national system of state-based insurance regulation in the U.S. NAIC members are elected or appointed state government officials who, along with their departments and staff, regulate the conduct of insurance companies and agents/brokers in their respective jurisdictions.

The NAIC's annual budget supports the many valuable services and benefits provided to state insurance regulators, insurance consumers, and the insurance industry. Each year, the budget is developed with the goal of enabling the membership to accomplish its key strategic priorities.

The year 2020 has seen a number of surprises, not least of which was a global pandemic. Natural disasters ranged from devastating hurricanes to historic wildfires. Civil unrest highlighted unresolved issues of importance to society. These issues and more have had an impact to the insurance industry, and through it all, the NAIC has sought to provide leadership, resources, and a path forward.

Naturally, the year 2021 will also bring surprises. Yet as the world moves toward an unknown future, having a plan in place to address key issues and provide guidance and direction is crucial. Over the past three years, the NAIC has utilized its strategic plan, *State Ahead*, as a compass. The plan articulated a comprehensive vision for the future of state insurance regulation and outlined how the NAIC could help the membership stay ahead of the curve in a rapidly evolving marketplace. Although the original intent was to expand the plan in 2021 as *State Ahead 2.0*, the vast number of surprises this year required NAIC leadership to carry several initiatives from the plan into 2021, so that attention could be focused on the response to the pandemic, natural disasters, and social issues that came to the forefront in 2020.

As a result, the 2021 budget continues to incorporate funding for several key initiatives from *State Ahead*, particularly completing the migration of applications to the Cloud, the build out of the centralized data warehouse and its governance, and the development of business intelligence dashboards for market regulatory oversight. The budget demonstrates a firm commitment to support technology advancements and the continuing modernization of insurance regulation in areas such as innovation, cybersecurity, and international standard-setting.

The budget also continues the NAIC's commitment to support the variety of programs, products, and services in the financial solvency and market regulatory arenas. The NAIC offers a wide range of publications, data, and information systems; accreditation reviews; and many other

services to assist state insurance regulators in achieving their fundamental insurance regulatory goals in a timely and cost-effective manner.

Support of the Membership

The mission of the NAIC is to assist the state insurance regulators in serving the public interest and achieving its goals of protecting the public interest; promoting a competitive marketplace; facilitating the fair and equitable treatment of insurance customers; ensuring the reliability, solvency, and financial stability of insurers; and supporting and improving state insurance regulation. Leveraging NAIC technology solutions, regulatory tools, and staff resources allow member states to achieve these goals at a significant cost savings. Without these options, many systems would be cost-prohibitive for the states to implement on their own. Without membership in the NAIC, the amount of state funding required to provide or access similar types of services and data the NAIC provides — often at no extra charge — would far exceed what a state pays in member dues to the NAIC.

A Focus on Consumers

The NAIC provides a multi-channel approach to reach and assist consumers in making informed decisions on insurance matters. These multi-pronged marketing communications campaigns include items like consumer insights, a consumer section on naic.org, mobile apps, and targeted social campaigns. In 2021, naic.org will be updated to enable consumers and regulators to better navigate NAIC resources.

Valuable Products and Services

The NAIC seeks to support its mission through a wide variety of products and services offered to both the insurance industry and state regulators. NAIC web-based systems automate, standardize, and streamline regulatory processes by transmitting data and facilitating regulatory transactions between insurers, consumers, and state insurance regulators.

By the Numbers

NAIC products and services make life easier.

- ▶ **Life Policy Locator** – 175,006 requests received from inception in Nov. 2016 through year-end 2019, with 60,247 located life insurance policies for a total claims amount of more than \$821 million
- ▶ **System for Electronic Rates & Forms Filing (SERFF)** – 577,165 transactions processed in 2019
- ▶ **Online Premium Tax for Insurance (OPTins)** – 139,313 transactions processed in 2019
- ▶ **State Based Systems (SBS)** – back-office services licensed to 32 jurisdictions in 2020
- ▶ **Professional Designation Program** – 1,310 designations awarded since the program's inception in October 2006 through year-end 2019
- ▶ **Center for Insurance Policy and Research (CIPR) Key Research Issues** – 180 briefs currently available online including NAIC key initiatives and topics ranging from cybersecurity and innovation to natural catastrophe risk and resiliency

The NAIC is committed to maintaining and enhancing these systems to provide high-quality service to all stakeholders. The 2021 budget includes four technology-based fiscals, which represent initiatives to incorporate cutting-edge technology to improve decision-making and analysis, build out the data infrastructure, eliminate redundant processes, and improve data quality.

Building the Budget

The NAIC strives for transparency in its budget process as well as in its operations. The budget process gets underway in the spring each year, when department managers evaluate current-year revenues and expenses in order to assess the year-end picture, then propose a budget for the following year based on their operational objectives and member initiatives. Managers carefully focus on variances between the current year's budget and projected results and anticipated business needs for the coming year. This process includes a review of all projects, products, programs, services, committee charges, and technology initiatives in light of the NAIC's mission and the membership's strategic priorities, particularly those outlined in *State Ahead*. NAIC senior management reviews each department budget in detail with its division director to adjust according to the strategic and financial needs of the association and ultimately consolidates all requests into a single, comprehensive budget.

Following the extensive development and internal review process, the budget is presented to the NAIC Officers, the Executive (EX) Committee and Internal Administration (EX1) Subcommittee, and the full NAIC membership before being released for public review and comment. To ensure transparency, a public hearing is held to receive public comments before final consideration and adoption by the NAIC Executive (EX) Committee and Plenary.

Expected Results for 2020

Based on actual operating results (before adding investment income) through June 30, 2020, the NAIC projects a net negative operating margin of \$3.6 million compared to a budgeted net negative operating margin of \$10.8 million, an improvement of nearly \$7.2 million. Investment income is projected to be \$3.0 million, resulting in a net asset decrease of nearly \$591,000. As a result of the COVID-19 pandemic, 2020 was an unusual year resulting in the cancellation of most in-person meetings causing travel, meetings, and Grant/Zone to be significantly lower than budget.

2020: Year Three of State Ahead

State Ahead includes 91 key initiatives. By year end, 60 projects will be completed, or 66%.

2020: Transforming

By the end of 2020, the NAIC will be positioned to provide its members with new analytics, technology, and tools to more effectively regulate their markets.

Several initiatives outlined in the *State Ahead* blueprint resulted in fiscal impact statements for 2020. These fiscals were made available for public comment in advance of membership consideration, approval, and incorporation into the 2020 budget.

Additional information regarding 2020 projected variances is included throughout the detailed footnotes of the budget.

2021: State Ahead remains a focus

Several key projects will carry into 2021 as the transforming phase continues.

Cloud Migrations, Data Asset Management, Macroprudential Surveillance Tools, Enhanced Financial Reporting & Risk Assessment, among others.

2021 Budget

The 2021 budget demonstrates NAIC's continued strong focus on prudent financial management, which is critically important in these unprecedented times. The 2021 budget also assumes in-person meetings will be held again starting in the first quarter.

The 2021 NAIC operating budget (before adding investment income) reflects revenues of \$117.2 million

and expenses of \$127.2 million, which represent a 2.4% and a 1.5% increase, respectively, from the 2020 budget, resulting in \$10.0 million in projected expenses over revenues. Viewed in relation to the 2020 projected totals which were significantly impacted by the pandemic, the 2021 budget represents operating revenue increase of 4.1% and operating expense increase of 9.4%. Additional information about the 2021 budget is included throughout the detailed footnotes of the budget.

A fiscal impact statement (fiscal) is prepared for new or existing NAIC initiatives with revenue, expense, or capital impacts of \$100,000 or more either in the current budget or within the following few years' budgets or requires more than 1,150 hours of internal technical resources to accomplish. Each fiscal includes a detailed description of the initiative; impact on key stakeholders; financial and operational impact of the initiative; and an assessment of the risks. The total financial impact of the four fiscals included in the 2021 budget is \$2.1 million in expenses with no associated revenues. Additional information about each initiative is included in the various fiscal sections of the budget.

The 2021 budget includes \$1.8 million in investment income from the NAIC's Long-Term Investment Portfolio. Investment income is composed of interest and dividends earned reduced by investment management fees – investment gains and losses are not projected nor included in the budget.

Combining budgeted results from operations with budgeted investment income, the 2021 budget has a reduction in net assets of \$8.2 million.

Preparing for the Unknown

The budget includes all known activities anticipated to occur in 2021. However, as 2020 has proven to be a year that deviated from the expected, situations will likely arise during 2021 that require additional funding. In such an event, a funding request is prepared and presented to the Executive (EX) Committee and Internal Administration (EX1) Subcommittee for consideration. Funding for any approved project comes from the Regulatory Modernization and Initiatives Fund, established in 2005 to manage requests that

2021 Fiscal Impact Statements

- ▶ **Artificial Intelligence and Machine Learning for Financial Analysis** – proposes to utilize an external consultant with expertise in AI and predictive analysis to assist NAIC staff in improving the accuracy of the NAIC Scoring System for life and accident & health insurers, which is a key financial analysis solvency tool used by regulators to identify and assess potential financial risks and to prioritize financial surveillance efforts.
 - 2021 expense of \$150K
- ▶ **Enterprise Data Asset Management** – continues to build-out the new Enterprise Data Platform in AWS and adds new tools and technologies to modernize the NAIC's data capabilities in areas such as data movement, data quality, data preparation, and data science. Advanced data users at state insurance departments will gain efficiencies in their data work and gain more powerful insights from their analyses, while less technical users will be empowered to perform some of their own data discovery and analysis.
 - 2021 expense of \$1.4M
- ▶ **MCAS/FDR Separation** – due to the growth of MCAS filings from the initial four lines of business in 2014 to nine lines of business in 2021, this project will address the growing complexity of the MCAS system relying on the FDR system. This project will allow the MCAS system to operate independently of the FDR system and reduce work across multiple NAIC departments when setting up annual data validations and MCAS scorecard ratios. Eliminating system dependencies and simplifying internal work processes will provide for more efficient use of NAIC resources to meet the needs of the NAIC Members.
 - 2021 expense of \$266K; 2022 expense of \$134K
- ▶ **SERFF Plan Management Enhancements** – these updates will streamline processes supporting data collection related to the Patient Protection and Affordable Care Act. The resulting process will require less NAIC staff support and improve data quality as well as simplify the process for insurance companies.
 - 2021 Expense of \$292K

arise following the adoption and implementation of an annual budget. The Fund is based on 1.5% of the NAIC's projected consolidated net assets as of December 31, 2021, or \$2.1 million with the inclusion of fiscals.

Ensuring Financial Stability

The NAIC's operating reserve is designed to ensure the financial stability of the NAIC in the event of emerging business risks and uncertainties and to absorb new priority initiatives pursued by NAIC membership. The association's reserve status is of paramount consideration in the budgeting process, as is strong and prudent financial management of the NAIC's assets.

Operating Reserve	
2019 Audited	104.9%
2020 Projected	104.9%
2021 Proposed	100.6%

In July 2015, the Executive (EX) Committee and Internal Administration (EX1) Subcommittee approved a report from an independent financial advisory firm which established the NAIC's liquid operating reserve target range of 83.4% to 108.2%. This range was the result of a comprehensive review of current and future identified risks and an evaluation of comparable organizations. This report recognized the increased level of uncertainty facing the NAIC and anticipated future investments which would be required to enhance the association's information technology and technical infrastructure, which is represented by many elements of the 2021 budget.

Contact Information

The NAIC appreciates the opportunity to present this 2021 budget and believes it provides a comprehensive review of the NAIC's business and financial operations for the current and upcoming fiscal year. A summary of the 2021 budget's key components is included in the budget overview.

Please feel free to contact Jim Woody, Chief Financial Officer, at (816) 783-8015, or Carol Thompson, Senior Controller, at (816) 783-8038, should you have any questions or need additional information.



**2021 BUDGET WITH FISCAL IMPACT STATEMENTS
REVENUE AND EXPENSE BY LINE**

Description	Reference	2020					2021 Budget	2021				
		2019		2020		Projected Variance		Increase (Decrease) from 2020 Budget	%	Increase (Decrease) from 2020 Projected		
		Actual	6/30/2020 Actual	12/31/2020 Projected	2020 Budget			2020 Budget	%	2020 Budget	%	
Member Assessments	R1	\$2,109,455	\$1,055,363	\$2,110,951	\$2,110,953	(\$2)	\$2,114,816	\$3,863	0.2%	\$3,865	0.2%	
Database Fees	R2	31,003,712	32,001,173	31,995,475	31,776,882	218,593	32,416,728	639,846	2.0%	421,253	1.3%	
Publications and Insurance Data Products	R3	16,618,257	11,402,490	17,026,183	16,867,844	158,339	17,048,190	180,346	1.1%	22,006	0.1%	
Valuation Services	R4	29,321,356	8,968,077	28,347,014	27,977,053	369,961	28,743,095	766,042	2.7%	396,081	1.4%	
Transaction Filing Fees	R5	11,503,240	6,527,411	13,021,994	12,711,651	310,343	14,312,075	1,600,424	12.6%	1,290,081	9.9%	
National Meetings, NAIC Events, and Interim Meetings	R6	2,856,154		1,020,494	2,923,648	(1,903,154)	2,805,910	(117,738)	-4.0%	1,785,416	175.0%	
Education and Training	R7	312,180	134,275	388,290	400,740	(12,450)	365,663	(35,077)	-8.8%	(22,627)	-5.8%	
Administrative Services and License Fees	R8	19,524,587	9,481,751	18,650,205	19,646,917	(996,712)	19,320,684	(326,233)	-1.7%	670,479	3.6%	
Other	R9	94,186	7,667	90,630	90,400	230	97,900	7,500	8.3%	7,270	8.0%	
Total Operating Revenues		113,343,127	69,578,207	112,651,236	114,506,088	(1,854,852)	117,225,061	2,718,973	2.4%	4,573,824	4.1%	
Salaries	E1	52,745,464	28,356,282	56,857,324	55,339,393	1,517,931	58,140,344	2,800,950	5.1%	1,283,020	2.3%	
Temporary Personnel	E2	649,631	302,984	734,654	611,936	122,718	946,257	334,321	54.6%	211,603	28.8%	
Payroll Taxes	E3	3,562,849	2,207,766	3,903,689	3,636,130	267,559	4,053,328	417,198	11.5%	149,639	3.8%	
Employee Benefits	E4	11,488,647	5,576,726	11,985,410	12,285,356	(299,946)	12,809,259	523,903	4.3%	823,849	6.9%	
Employee Development	E5	807,066	324,865	712,123	804,191	(92,068)	905,414	101,223	12.6%	193,291	27.1%	
Professional Services	E6	15,459,313	5,820,618	17,140,020	17,501,997	(361,978)	15,109,061	(2,392,936)	-13.7%	(2,030,959)	-11.8%	
Computer Services	E7	4,688,443	2,353,668	4,895,269	5,765,128	(869,859)	5,357,891	(407,237)	-7.1%	462,622	9.5%	
Travel	E8	4,988,672	507,454	957,310	5,264,192	(4,306,883)	4,912,182	(352,011)	-6.7%	3,954,872	413.1%	
Occupancy and Rental	E9	4,487,226	2,271,579	4,558,513	4,561,327	(2,814)	4,685,737	124,410	2.7%	127,224	2.8%	
Computer Hardware and Software Maintenance	E10	5,311,455	2,952,219	5,846,218	6,033,208	(186,990)	6,367,834	334,626	5.5%	521,616	8.9%	
Depreciation and Amortization	E11	4,042,165	2,027,056	4,064,893	4,140,587	(75,694)	4,245,378	104,791	2.5%	180,485	4.4%	
Operational	E12	1,864,736	700,191	1,547,033	1,790,279	(243,245)	1,651,247	(139,032)	-7.8%	104,213	6.7%	
Library Reference Materials	E13	334,441	155,233	317,233	332,487	(15,254)	336,213	3,726	1.1%	18,980	6.0%	
Printing and Production	E14	81,091	7,773	57,603	71,022	(13,418)	53,113	(17,909)	-25.2%	(4,491)	-7.8%	
National Meetings, NAIC Events, and Interim Meetings	E15	3,698,417	391,421	851,004	4,133,484	(3,282,480)	3,773,522	(359,962)	-8.7%	2,922,518	343.4%	
Education and Training	E16	131,737	18,111	96,967	121,404	(115,437)	272,638	60,234	28.4%	175,671	181.2%	
Grant and Zone	E17	1,509,915	79,702	643,974	1,676,730	(1,032,756)	2,409,072	732,342	43.7%	1,765,098	274.1%	
Other	E18	1,572,995	903,787	1,084,389	1,140,642	(56,253)	1,152,660	12,018	1.1%	68,271	6.3%	
Total Operating Expenses		117,424,263	54,957,436	116,253,627	125,300,494	(9,046,866)	127,181,150	1,880,656	1.5%	10,927,522	9.4%	
Revenues Over/(Under) Expenses before Investment Income		(4,081,136)	14,620,771	(3,602,391)	(10,794,406)	7,192,015	(9,956,089)	838,317		(6,353,698)		
Investment Income	II1	18,030,413	(3,413,916)	3,011,752	3,153,072	(141,320)	1,759,818	(1,393,254)		(1,251,934)		
Revenues Over/(Under) Expenses		\$13,949,277	\$11,206,856	(\$590,639)	(\$7,641,334)	\$7,050,695	(\$8,196,271)	(\$554,937)		(\$7,605,632)		

A detailed analysis of each line item is included in the Revenue Detail, Expense Detail, and Investment Income Detail sections.



**2021 BUDGET
FISCAL IMPACT STATEMENTS**

<u>Fiscal Impact Number</u>	<u>Description</u>	2021 Budget			Net Impact 2021 Budget
		Capital Expenditures	Revenues	Expenses	
	Total Revenues Over/(Under) Expenses Before Fiscals and Investment Income	\$1,495,281	\$117,225,061	\$125,073,350	(\$7,848,289)
1	Artificial Intelligence and Machine Learning for Financial Analysis			150,000	(150,000)
2	Enterprise Data Asset Management			1,400,000	(1,400,000)
3	MCAS/FDR Separation			266,000	(266,000)
4	SERFF Plan Management Enhancements			291,800	(291,800)
	Total Fiscal Revenues Over/(Under) Expenses			2,107,800	(2,107,800)
	Investment Income			1,759,818	1,759,818
	Total Revenues Over/(Under) Expenses	<u>\$1,495,281</u>	<u>\$118,984,879</u>	<u>\$127,181,150</u>	<u>(\$8,196,271)</u>