



NAIC Update: Spring Meeting 2023 in Louisville

Remaining calm in
a fast-changing world

Center for
**Regulatory
Strategy**
US

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Introduction

The National Association of Insurance Commissioners (NAIC) gathered in Louisville during a gusty spring week during March Madness (the final rounds of college basketball), which had descended upon the city where no policy stances were settled for long before they were carried away by the winds of another approach or point of view.

In her opening session address at the spring meeting, NAIC President Chlora Lindley-Myers underscored the tone of a dynamic, unsettled landscape by noting the world of global uncertainty we inhabit, where the insurance landscape is changing at an accelerated pace. Through the volatility, turmoil, and ever-widening areas of scrutiny, she urged her signature acronym CALM. “This year is the year of CALM,” a play on her initials, first name, middle name, maiden name, and married name. CALM stands for C (Communicate, Collaborate, Colleagues); A (Accountability, Alert, Action); L (Learn, Listen); M (Mentoring and Methodology), as she had noted previously.¹

Half a dozen or more commissioners who had recently taken their post were greeted in a welcome video, while a final, poignant goodbye was said and public service recognition was given to former Hawaii Insurance Commissioner Colin Hayashida, who passed away in late February. Shortly before the meeting started, then-NAIC CEO Michael Consedine announced his departure effective April 30, with Andy Beal to take the reins as acting CEO. Consedine was recognized for his leadership and dedication during the pandemic—helping guide the organization through strategic planning—and his guidance was crucial when some organizations faced their “most challenging” international issues weeks before the meeting was convened: turmoil roiled the financial services sector as regional banks tottered and failed, which triggered government intervention.

The NAIC is seeking new avenues, and it will be searching for a new leader as it assesses its internal executive organizational structure.

Lindley-Myers made it very clear that, despite the winds of change, the NAIC has a strong foundation with its blueprint of *State Ahead*—which is now segueing to the next phase—the three-year strategic plan, *State Connected*. The plan has focus areas that range from member connectivity and data analytics, to technology and training, to NAIC operations and corporate governance.² She said she was excited to build on a long legacy of excellence as the NAIC kicked off the new initiative.

The 2023 president and Missouri insurance commissioner highlighted in depth the six top areas that will receive the NAIC’s attention and focus for the year.³

It should come as no surprise that the top priority continues to be financial oversight and transparency, said Lindley-Myers. This focus is even more important now, especially given the economic climate the country faces. “We need to maintain our vigilance to ensure that companies are not only able to remain solvent and pay their claims when times are good, but they’re also making sound investment choices and safeguarding their ability to remain solvent when we have economic challenges ... stability is essential and remains a high priority,” Lindley-Myers said.⁴

Another key priority falls under the umbrella of data/artificial intelligence (AI), cybersecurity, and innovation, as concern for cybersecurity grows worldwide and as the demand for cyber insurance continues to grow, Lindley-Myers remarked. This is also affected by international issues such as the Russia-Ukraine conflict, supply chain interruptions, and volatility in banking and the insurance marketplace.

“How companies are managing their third-party risk is now something that is on our radar,” said the NAIC president. She warned that the outsourcing of certain functions and services by companies to third parties “does not absolve them of their responsibility.”

Beyond cybersecurity, other fast-emerging technology issues such as AI are getting attention from the NAIC and its members, and efforts might soon be accelerating. While AI and other technologies can represent advancements in the industry, the NAIC president acknowledged. Regulators must also be mindful of “potential pitfalls” that come along with these advancements. “We want to see product innovation, but we also need to protect a consumer against potential problems such as predictive modeling, price algorithms, and AI, which may affect people of color or underrepresented groups,” Lindley-Myers said.

In her address to attendees, the NAIC president also described the priorities of managing long-term care insurance rates and reduced benefit options, where the organization will try to transition to an actuarial review framework to create a consistent regulatory environment by working with the industry.

Marketing of insurance products is another key area, and Lindley-Myers referred (again) to amending the NAIC’s Unfair Trade Practices Act (#880) while ensuring organizations stay up to date on deceptive practices to keep consumers safe and markets stable. To that end, the NAIC’s Improper Marketing of Health Insurance (D) Working Group, under the Market Regulation Consumer Affairs, will seek to broaden the model law to help consumers by overseeing health insurance lead generators to target unfair trade practices.⁵

In addressing the priority of race, diversity, and inclusion in insurance, the NAIC is “taking major steps” to close the protection gap and looking at ways to make financial inclusion a priority to meet the needs of a varied consumer population with products for all. Industry practices that have the potential to disadvantage protected groups are also under scrutiny, as well as reaching all people with affordable, fairly priced, and available insurance products—another key initiative under Lindley-Myers. “Our customers are varied, our products are varied, our services are varied, and we should meet that,” she said.

Climate risk, natural catastrophe, and resiliency received final billing in the president’s speech. “Last but not least,” as Lindley-Myers put it when introducing the topic. Each commissioner in every state has a list of natural disasters with which they are dealing, from flooding to droughts, tornadoes to hurricanes, wildfires to earthquakes, she said. She pointed out that our news feeds are full of an increasing number of natural catastrophes. The NAIC wants to build awareness while reducing the negative impact on consumers of these events through consumer education campaigns—reducing the coverage gap.

“In a world filled with global uncertainty, challenges, and divisions, our commitment to support one another fuels our progress, growth, and effectiveness,” Lindley-Myers said.

“CALM will help guide us as we address the many issues ahead of us. The work we have before us is important and complex. We will not always agree on the solutions or the path forward, but I know we will work together to find the right path. To pivot where we need to and abandon what no longer works. We’ll be calm and collegial,” she said.



Big (and bigger) data: Privacy and use concerns coalesce

All aspects of the future of data collection, handling, and storage are under review by the NAIC as technology advances, and stakes remain high for measuring risk and treating current consumers ethically and fairly. One of the thorniest issues that regulators are tracking in several forums is that of the relationship to third-party vendors and their data.⁶ Regulators are looking to ensure fairness, outcomes without bias, and data safety in a world where these vendors are not regulated as licensees by state insurance departments as their users are.

Industry participants and consumer advocates pushed, sometimes strenuously, for changes to the exposure draft of the new NAIC privacy model.⁷ Dubbed #674, the model addresses transparency, data minimization, data review, disclosures, and accountability for third-party vendors. It is a modernization of two previous privacy model acts (#670 and #672). But stakeholders from across different lines of insurance told regulators that major portions need to be rewritten even as a consumer advocate expressed strong support for going forward with an insurance privacy model that gets ahead of all other industries.

The model has quite a way to go before this draft is workable, said Shelby Schoensee, representing the American Property Casualty Insurance Association (APCIA). She said APCIA will be actively engaged in future discussions to balance the need for consumer protection and for insurers to be able to provide their products and services in a workable way—finding the right balance between appropriate oversight and operational flexibility.

The following issues were identified by participants:

- Consent for overseas data sharing
- Overly broad provisions on marketing that would interfere with or even prevent joint marketing business models
- Requirements for third-party oversight
- Consumer disclosures
- Inclusion of a private right of action
- Opt-in provisions
- The number and nature of privacy notice requirements
- Data deletion requirements
- Treatment of a consumer's personal information used in actuarial studies and research activities that could bar actuarial science's functionality in risk management and business operations to be used.⁸

Signaling that the interactive process to hammer out a new model draft will be lengthy, if constructive, Maine Bureau of Insurance General Counsel Bob Wake told industry commenters that the decision to get rid of the joint marketing exception was intentional. "Why is joint marketing so precious that you should do it even over the consumer's objection?" Wake asked the industry participants. He said he looked forward to hearing stakeholders' arguments.

One academic consumer advocate pointed out that personal information is abused daily, third-party service providers need to be held to the same standards as licensees, and regulators need to be able to levy serious penalties to protect consumers.

Other industry stakeholders such as Wes Bissett, representing the Independent Insurance Agents & Brokers of America (IIABA), expressed surprise and concern with the nature of the draft. It would "dramatically restructure the privacy framework that would only apply to one sector of the business world," he said, adding that he had "a hard time seeing state legislatures adopting this." He expressed concern about the provisions that would impinge on consumer relationships and the legitimate interest agents have in preserving information and access to data.

"It's a draft that needs significant work in our view, not modest changes or wordsmithing—but in some cases, wholesale revisions," Bissett said.

Members of the National Association of Mutual Insurance Companies (NAMIC) asked that data minimization deletion requirements not be so prescriptive, said Cate Paolino.

Privacy Protections (H) Working Group Chair Katie Johnson of the Virginia Bureau of Insurance said the model was drafted early on as a way to "put a stake in the ground on a lot of places," knowing that it would require input later. Since the working group lacked input early on, she said, it went ahead with a draft that will now be subject to a revised workplan that will extend the date to which the model will be sent to the parent committee, the Innovation, Cybersecurity, and Technology (H) Committee. "We got you talking to us, and for that, we're grateful because we need your input," Johnson said. This detailed new workplan includes biweekly meetings to discuss the draft along with a two-day in-person meeting in June to talk through more complex issues, she said.⁹ The new draft is now anticipated to be sent to H Committee by the fall meeting in late November.

There are those who expressed support for a federal solution. “I wish that the federal government would provide greater protection of my personal information,” said consumer representative Dr. Harold Ting. Although he said it was unlikely to happen due to business models of companies, he supported the model draft because it has clear standards for protecting consumer privacy. He went on to say, “NAIC has an opportunity to advance personal protection measures now that are never going to be enacted for all industries,” especially at a time when the insurance industry model is not based on selling and sharing consumer data.

Ting also expressed support for having a privacy model that would hold third-party service providers to the same standards as licensees. This issue of third-party products as well as the service providers’ relationships with insurers is coalescing into an area of broad and strong focus among regulators—not only in the privacy working group but across others.

Stakeholders expressed concerns with both the content and processes for third-party service provider contracts, outlined in the privacy model draft. When it comes to the content of a third-party agreement, incorporating state privacy laws isn’t practical because some laws are not relevant to vendors and laws also change, NAMIC’s Paolino noted. She asked the regulators to consider volume. There would be hundreds or thousands of service agreements in play, and obtaining contract changing would be a massive project, she said.

Third-party data service provider relationships and oversight remain as sticky issues

The Big Data and AI (H) Working Group dove into the third-party vendor issue as part of its Workstream Two, which addresses regulatory oversight queries insurance supervisors can employ to ask insurers about both the predictive models and data. In the draft, the questions are separated into three sections with questions to pose to insurers about their own models, the use of third-party models and their data inputs, as well as the use of third-party data.¹⁰

The questions are meant to be a starting point for discussion and engagement with interested parties. As insurers develop governance procedures and this information is shared with regulators, “this work will continue to evolve,” Iowa Commissioner Doug Ommen said.

He indicated that further work will be done on the outline. Stakeholders wanted to know how regulatory guidance from the Accelerated Underwriting (A) Working Group and prospective guidance that might be included in the forthcoming AI guidance

bulletin under the parent committee would be coordinated with a system to monitor the use of third-party data and model vendors. One participant wanted assurance that big data, AI, and third-party workstreams across the various working groups were well-coordinated. Ommen’s overview shed light on how the group views the ongoing process and interactions among regulators, and with the industry as a dynamic one that will continue to gain shape and form.

The Iowa commissioner noted that subject-matter experts (SMEs) assembled for Workstream Two were asked last year, based on information from the prior private passenger survey recommendations, about the feasibility of a library or registry of third-party data or model vendors with known AI applications or uses in the business of insurance. They were also asked to contemplate a potentially appropriate regulatory framework to monitor and oversee the industry use of third-party data and model vendors, according to Ommen.



Interest in the issue and feedback was very high, with one veteran trade group representative noting that he had received more questions from his member companies than ever before.

Industry participants in general expressed concern about confidentiality and data security if regulators were to collect and store information on the models, the potential for a risk-based approach that would create an enormous amount of work and be a burden to smaller or midsize companies, the potential for the creation of new laws rather than principles-based guidance, and redundancies in financial examinations.

No one wants the insurance department or anyone else to be a target for state actors or cybercriminals who would gain profit by stealing the information, said Scott Harrison, co-founder of the American InsurTech Council (AITC), also representing the National Alliance of Life Companies (NALC) before the NAIC at this session.

Big Data and AI (H) Working Group Chair and Rhode Island Banking and Insurance Superintendent Beth Dwyer remarked that she had never seen a state insurance department data leak in her 30 years in regulatory oversight, and she remains confident that there will not be a leak and that a state's examination authority will keep data confidential. She also assured participants that there was coordination on the various overlapping aspects of contemplated, or potential, oversight of data use and other regulatory initiatives between the working group and the parent H committee, and this coordination is overseen in "incredible detail."

Still, longtime consumer advocate Birny Birnbaum from the Center for Economic Justice expressed concern that no mechanism for review of narrative descriptions and feedback exists on gathered answers to the proposed questions. A better approach, he said, would shift analytics to outcomes and ask the insurers to produce data and data sources without having to figure out definitions of their components or waiting until a consumer is harmed.

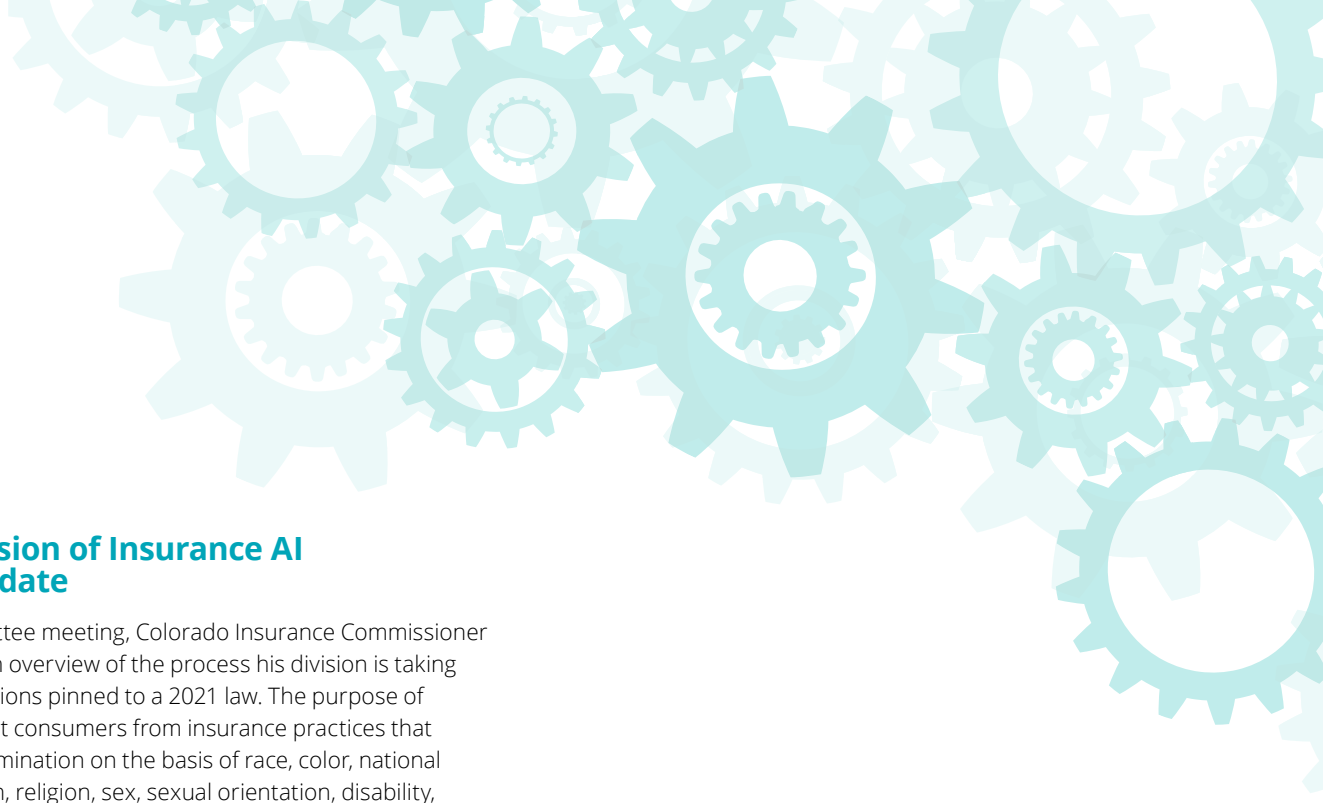
Dave Snyder, a policy executive with the Washington-based APCIA, remarked during the meeting that the issue of testing is "highly complicated" and that his association feels that testing should not be embedded in the regulatory work now. Even the most advanced state on this issue has yet to even issue proposed regulations (in the property casualty lines), Snyder said. He posed questions back at the working group, asking what would be tested, precisely, and to what standard, as well as the issue of what data is available and whether it should be collected by and from a private insurance company with reputational risk. Snyder asked, "How much is too much of a relationship to a protected party, for example," adding that there is a "whole series of very, very difficult regulatory industry and

consumer protection questions raised by mixing in the testing issues with what we are trying to do here, which is establishing a baseline of information that regulators have about what the insurance industry is doing."

- The working group planned to circulate a revised draft of regulatory questions by the end of May.
- A report on the working group's survey that went to homeowner insurers on their AI/machine learning (ML) use and what governance and risk management controls are being put in place will be issued at the summer national meeting. The AI/ML life insurance survey was set to be sent to life insurance companies with more than \$250 million in premiums on all individual policies in 2021; term writers that have issued policies on more than 10,000 lives; or specifically selected insurance technology (InsurTech) companies by the end of March, with responses due by the end of May. The formal call letter consisted of 192 companies, according to updates from the Big Data and AI (H) Working Group. The work expands on the anecdotal information regulators had received without more granular information from companies, according to Dwyer.

Even as more specific work progresses, all eyes are on the status of the model bulletin on AI, which is meant to provide regulatory guidance on the use of AI. Maryland Insurance Commissioner Kathleen Birrane said it would be principles-based and rooted in existing statutory law, with no plans at this time to regulate third parties. She said that drafters have "moved apace," with four sections well underway, and a goal or hope to have a draft by early summer. The four sections include an introduction; definitions; regulatory expectations (which has the largest drafting group and includes Birrane); and regulatory oversight and examination.





Colorado Division of Insurance AI regulation update

During the H Committee meeting, Colorado Insurance Commissioner Mike Conway gave an overview of the process his division is taking in developing regulations pinned to a 2021 law. The purpose of SB21-169 is to protect consumers from insurance practices that result in unfair discrimination on the basis of race, color, national origin or ethnic origin, religion, sex, sexual orientation, disability, gender identity, or gender expression—including through the use of big data—and holds them accountable for testing their data systems, including external consumer data and information sources, algorithms, and predictive models. It is the first law in the nation specifically pinned to the use of AI/ML and its potential for unfairly biased outcomes.¹¹

Draft regulations for a framework of requirements for the use of algorithms, predictive models, and external data by life/health insurers were exposed in February, and work was set to begin on private passenger auto insurance, with the sector's first of ongoing stakeholder meetings for the Colorado Unfair Discrimination in Insurance Practices occurring shortly after the NAIC meeting, on April 6.¹² Meetings for the draft life insurance regulation also are continuing. Conway said, based on comments, the Division would be making some changes to its draft regulations, and it has had conversations with stakeholders.¹³ Conway noted that he would like to keep the dialogue open, but warned attendees about "unproductive conversations" that frustrate the process, with insurers primed to take heed.

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Market risk examined after Q1 bank upheaval

The spring meeting was convened shortly after the collapse of Silicon Valley Bank on March 10. Accompanying interventions and rescues of some regional US banks further pushed the evolving financial institution market risk concerns into the mix of discussion items at the forum. In various sessions, the industry talked with regulators about whether interest rate issues of affected banks could have an impact on the insurance industry in any material way—and discussed disintermediation risk, where rising interest rates lead to declining bond values. The underlying sentiment expressed by regulators was controlled optimism about the financial stability of the sector.

Participants at the meeting discussed whether higher interest rates could become a driver of annuity surrender experience, especially when the new money rate exceeds what is being credited by a certain percentage.

Discussions got underway on the first day of the conference. Life actuaries Fred Andersen of the Minnesota Department of Commerce and R. Dale Hall of the Society of Actuaries (SOA) engaged and presented in tandem on the impact of the rising interest rate environment during the Life Actuarial Task Force (LATF) session at the outset of the spring national meeting. Andersen noted that his slide deck was prepared before the bank failures. But he sought to reassure attendees and fellow regulators that there are multiple safeguards in place to reduce the chances of a substantial increase in annuity surrenders, therefore limiting the impact of the negative aspect of rising rates and falling values of bonds held.

In seeking to differentiate between life insurance and what has happened with some banks, Andersen discussed product features that halt withdrawals on demand, surrenderable contracts that still have attractive long-term guarantees to keep policyholders sticking around, and oversight by regulators who have invested in macroprudential oversight of liquidity risk and capital requirement oversight. Because of that, companies often have multiple times the amount of capital required actually available, and in general, most life insurers have robust liquidity management strategies in place, according to Andersen.

One regulatory project underway, as described by Andersen during the LATF meeting, is the work of Financial Condition (E) Committee in overseeing the development and implementation of a liquidity stress test to analyze the results of such a scenario where a life insurer would need to sell bonds with unrealized losses to meet cash demands. This would need an array of factors to trigger a situation, but it would arise if a company that is investing for the long term may not be able to reinvest and take advantage of rising rates. So a

person with an annuity paying 3% to 4% returns would figure they could pay the surrender charge and go elsewhere and get 5%—or a better deal somewhere else—creating potential losses for the insurer. He sought to reassure on overall industry risk by noting that he has reviewed the asset adequacy of hundreds of companies over the years, and they had assumed a robust level of dynamic lapses, so the vulnerabilities had been tested over time.

Andersen raised the issue of dynamic annuity lapses amid rising interest rates with Treasury rates at a 15-year peak, as LATF prepared to delve into the issues further in a roundtable on the impact of rising interest rates with insurance company participants during the daylong LATF session.

Meanwhile, in the Risk-Based Capital Investment Risk and Evaluation Working Group (RBC IR&E WG), an insurance company executive with structured product investment experience representing a group of life insurers discussed market risk as part of his commentary on a regulatory proposal for developing interim RBC factors for collateralized loan obligations (CLOs).¹⁴

The life insurance company executive pointed to the “vulnerable” state of the economy, with banks going under and governments orchestrating interventions to contain any contagion, as a reason for the NAIC to take action in a timely way with RBC factors for these structured securities.

Some states are expected to go beyond reviewing the financial statements that the NAIC might collect on liabilities, subject to early cash-outs due to low surrender charges by canvassing or surveying their domestic companies on specifics on their current and potential annuity surrenders.

State regulators also moved to create an amendment to the NAIC’s Purposes and Procedures (P&P) Manual that would “promptly” remove financial institutions closed or placed into receivership from its list of qualified financial institutions. This list, which requires updating, refers to financial institutions that can serve as issuers of letters of credit that insurers can utilize in support of reinsurance. The measure was passed by e-vote on April 21, 2023.¹⁵

Insurance industry investments delicately divide the industry, regulators

Discussion around measuring, analyzing, and possibly applying more capital requirements to some life insurance investments continued to fuel robust discussion at the spring meeting as the treatment of structured securities remains under regulatory heavy scrutiny.

The RBC IR&E WG, under its parent Financial Condition (E) Committee, is crafting interim RBC charges for residual tranches of structured securities, including CLOs, by striving to find the right balance to prevent regulatory arbitrage while still allowing a market for investments.

While the concern at first was CLOs, some key state regulators have repeatedly circled back to the issue of regulatory arbitrage among some investments, and they want to address it. The matter gained urgency during the spring meeting in Louisville because of the economic backdrop, with recent bank failures, higher interest rates, and recession fears.

Working Group Chair Phil Barlow, a longtime life actuary and associate commissioner for the District of Columbia Department of Insurance, Securities and Banking (DISB), repeatedly referred to the charge from the parent committee, the Financial Condition (E) Committee, to look at residual tranches for all types of structured assets, not just CLOs. The methodology applied to CLOs, which was a leading point of discussion in recent NAIC meetings, would be applicable to other kinds of assets, he explained.¹⁶ Barlow made it clear that he would need to bring something back to the parent committee even as he recognizes that the data was still coming in from year-end filings because his group was given a mandate to develop some interim RBC charge.

It is clear that regulators intend to bring change, given the concerns that formed the working group chaired by Barlow, with its mandate to develop RBC guardrails for structured securities.

The issue is complicated by the fact that there are groups with different stances on the treatment of residual tranches and the interim RBC factor that should be assigned. Some representatives of a coalition of life companies argued for at least 45% RBC factor citing highly leveraged positions pinned to the underlying collateral; some regulators and companies are more in line with a 30% RBC factor; and some called for more analysis of the data and questioned the urgency of the application of such an interim factor while waiting for more data to come in.¹⁷

The coalitions of companies, with various company executives taking the lead in public forums to represent the postures of each group, demonstrated the controversy of the matter as accusations of regulatory arbitrage were made without citing any individual insurers or specific data. Some industry and company executives said they sought to reduce RBC arbitrage in securitized assets and that their position was supported by historical data and addressed regulatory capital risk-weighting objectives. They maintained that residual tranches and public equities do not have the same risk profile, so they should be treated differently. Others argued increasing the RBC factor was not supported by any data and there was no proven increased solvency risk from the structured securities.

Some state regulators want to attend to risk by installing capital charges expeditiously before there is a chance for great losses, according to discussions during the open meetings in Louisville.

In the RBC IR&E WG, which is under the umbrella of the Financial Condition (E) Committee, Doug Stolte, deputy commissioner for the Virginia Bureau of Insurance, said he is in favor of an interim solution because he thinks there is concentration risk in the market. He said that although he doesn't know what the right charge is for these residuals, he believes they need a charge as the economy seems to be faltering. Stolte compared the residuals to a binary outcome in a baseball play—you either hit a home run or you're out.

Others also voiced support for increased capital charges and speedy regulatory attention to the investments. Dale Bruggeman, a risk assessor for the Ohio Department of Insurance, said he had no problem looking at the data and waiting until a little bit later to make a permanent choice on a charge. But an interim charge should come sooner rather than later because getting in the wrong place for the wrong company would not be a good choice, he added. He described previous situations in past decades of problematic concentration of risk that came as a surprise to the sector.

About a month after the Louisville meeting, a public NAIC video conference call of the RBC IR&E WG was held. The meeting was in accordance with a timeline for adopting a structural change by the end of April, and it adopted the factors that would go into that charge by the end of June.¹⁸

During the video call, Virginia's Stolte reiterated that he was in strong support of an interim solution and underscored the point that RBC is a regulatory tool, and it was "incumbent" on regulators to act with the way the economy was "faltering."

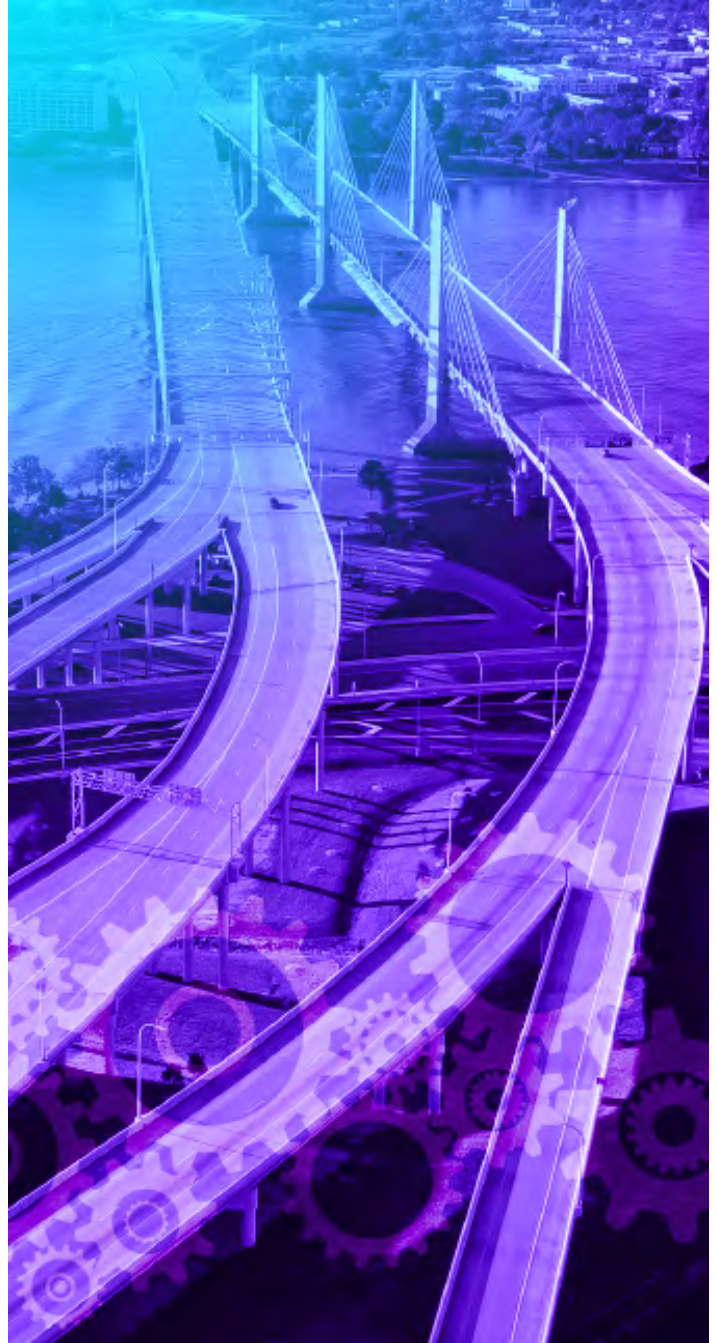
The group decided to expose a 45% RBC charge for all residual tranches identified in insurers' financial statements because of the arbitrage going on in the investments, as Andersen, Minnesota's chief life actuary, put it on the call. He said that regulators can take a fresh look at the RBC framework when the longer-term investment modeling project occurs under the NAIC's structured security work.

There seems to be "some consensus that 45% RBC charge is where we are heading," Barlow said.¹⁹ Acknowledging that he doesn't know if that is the case, he offered that it would be a good idea to expose the proposed factor to start fashioning a final factor even as a regulator from Indiana suggested the group start with something in the range of 30% to 45% as a factor.

Some in the industry pressed for sensitivity or impact testing on the solvency of particular residual tranches or even identifying companies that were using arbitrage rather than using RBC, which was termed a "blunt instrument" for all companies. The Working Group adopted the structural change for the sensitivity test, but it will have to be reviewed by the Capital Adequacy Task Force.²⁰

In other securities subgroups, state regulators discussed modernizing the Securities Valuation Office (SVO) and investing in enhancements to its existing systems to collect more market data for bond investments to better assess securities' overall risk. It would provide more information for examination analysis and encourage capital adequacy, according to comments made by Iowa Division of Insurance Chief Investment specialist Carrie Mears during a discussion at the spring meeting. She was reporting on measures from the Valuation of Securities (VOS) Task Force, of which she is the chair, to the Capital Adequacy Task Force.

The NAIC also created a CLO ad hoc group under the Structured Securities Group's umbrella, where participants from the industry and regulators can "dig into" the modeling process and aid in the development of RBC capital factors. The group's active participants consist of a small group of company representatives and regulators, and it will run proxy deals through different stress scenarios. The ad hoc meetings had kicked off by mid-April and were working apace.



Consumer protections: Progress witnessed—but additional safeguards requested

At the spring meeting, the NAIC in plenary session adopted revisions to two Actuarial Guidelines (AG): the Life Illustrations Model Regulation Index-Universal Life (IUL) policies sold on or after December 14, 2020 (AG 49), and the Nonforfeiture Requirements for Index-Linked Variable Annuity Products (AG 54).

However, some believe the NAIC's work is not done with regard to policy illustrations.

The NAIC explained that after the 2020 adoption of AG 49, state insurance regulators expressed concern with illustrations on new products that showed more favorable returns than the traditional S&P 500 index. The revisions require insurers to provide additional disclosures and side-by-side comparison illustrations, limit policy loan leverage, and provide guidance on the maximum crediting rate and earned interest shown for policies. Regulators believe that the revisions will improve illustrations for IULs and other registered index-linked annuities products with uncapped volatility-controlled funds and a fixed bonus, they wrote.

As a background, regulators noticed that life insurers were issuing annuity products with credits based on the performance of certain indexes that they did not directly invest in and noted that the policy illustrations showed non-benchmark indexes in a more favorable manner than benchmark indexes, particularly for products with uncapped volatility-controlled funds and a fixed bonus.²¹

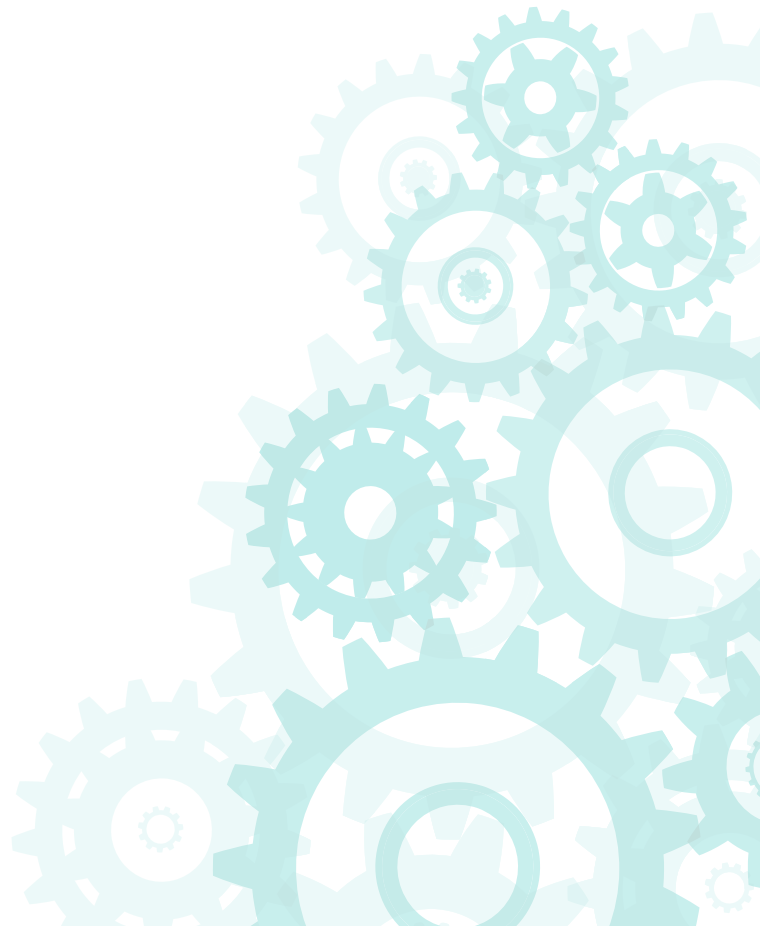
Consumer advocates raised concerns with illustrations in general at a couple of sessions, including the Life Insurance and Annuities (A) Committee, which adopted the revisions to AG 49, and the Consumer Liaison Committee.

Dick Weber, a life insurance consumer advocate, recommended reopening the Life Insurance Illustration Model. In a presentation before the Consumer Liaison Committee, he said that consumer challenge of policy illustrations for universal life is very significant and it cannot truly reflect long-term likelihoods, which matter when policyholders are expecting death benefits. He expressed concern that most customers do not see or know about the possibilities of increased charges and expenses, as well as cash accumulation fluctuations that are not apparent in the current illustrations for universal life policies. Illustrations are not projections, Weber said.²²

Consumer advocate Birny Birnbaum from the Center for Economic Justice raised concerns in both the Life and Consumer Liaison Committees. He suggested regulators look at current illustrations that are being used to sell IULs. These run 60 to 100 pages and

"are indecipherable," he alleged. If you have 7% rate of return over 40 years, everyone becomes a multimillionaire, he said, but he knows of a consumer who put in more than \$600,000 and now has nothing left. "They are bereft," he said. Anything you can do to have the A Committee take up that charge would be appreciated, he urged regulators.

Texas Department of Insurance actuary Rachel Hemphill, chair of LATF, noted that the AG 49 revisions had just made it through the layers of approval process, but she expects the life insurance actuarial subgroup to have more discussions on the matter in the future. Hemphill had noted that the adopted revisions were "quick-fix" edits and were made to address a pressing issue, but an IUL Illustration Subgroup will continue to discuss and take on wider improvements in the long term as they continue to oversee the use of policy illustrations, according to minutes from the A Committee meeting.²³



Climate risk capabilities become a core NAIC offering

The NAIC has set up its Catastrophe Modeling Center of Excellence (COE) with the goal of providing the same level of technical expertise and tools that the industry has at its disposal. NAIC's Center for Insurance Policy and Research (CIPR) Director Jeff Czajkowski gave a high-level overview of the catastrophe risk modeling work underway at the COE, with Jennifer Gardner, catastrophe risk and resilience research manager for CIPR.

The COE, which grew out of the technology workstream of the task force, is now fully operational and staffed with catastrophe risk modeling and resilience subject-matter experts, according to the update given during the task force meeting. It has entered into agreements with seven catastrophe modelers and added technical documentation to an online file-sharing site it has established. All regulators who want to obtain access must sign a data use agreement. The COE is trying to enhance access to more states and wants regulators to reach out. The COE is developing a course on the use of catastrophe models, which will be rolled out soon. It is also interacting with International Society of Catastrophe Managers (ISCM).

The COE is now developing tools, such as catastrophe/peril model cards that outline which model vendors have a model relative to that peril. The cards provide details on that model, which can be used for a rate and form filing for regulators. It is starting with severe convective storms, as this peril can cause losses in so many different areas, and then it will start on wildfires and some of the other perils as well, Gardner noted. The COE has already surveyed a couple of zones, and it is developing a compendium of actions and legislation that would impede or require the use of a model. It has also been working with the Colorado Division of Insurance to identify potential resources that could be developed by catastrophe model vendors to support risk assessment and could be used to support legislative initiatives or regulatory initiatives, especially in the aftermath of the Marshall Fire that devastated Boulder County. Gardner told assembled insurance regulators that the COE is looking forward to developing tools and resources for other states as well.

The COE is also working with other groups on grant programs focused on risk mitigation and resiliency efforts.

Louisiana Insurance Commissioner and Task Force Co-Vice Chair Jim Donelon heartily endorsed the efforts of the COE. Demonstrating a unifying spirit at the conclusion of the meeting after the remarks about state legislative activity challenging environmental, social, and governance (ESG) measures, Task Force Co-Chair Ricardo Lara,

California's insurance commissioner, heartily thanked Donelon for leadership efforts in helping to develop the COE and praised the NAIC membership for rising above the politicizing climate to instead working together on climate risk challenges.

The NAIC was squarely positioned in a listening mode in the early spring meeting as outside groups representing other organizations gave presentations on perils, consumer gaps in coverage, climate issues, and scenario analysis. For example, during the Climate and Resiliency Task Force meeting, the Canadian Council of Insurance Regulators discussed Canadian flood risk using flood models, while Catastrophe Risk Subgroup attendees were given a primer on the physical science of climate change projections, probabilities, and scenario modeling by various vendors and demonstrating their capabilities.²⁴

The NAIC is also collecting data on the private flood insurance market and will provide updates later. International and federal efforts around climate risk were also highlighted during NAIC sessions. The International Association of Insurance Supervisors (IAIS) recently launched a public consultation—one of three planned consultations over the next year and a half on work they have planned on climate risk. The NAIC staff encouraged stakeholders to look at the public consultation with its high-level questions launched in early March, and it is looking at corporate governance and risk management. The ongoing US-EU dialogue project is having a public stakeholder event in June in Seattle at the conclusion of the IAIS Global Seminar.

Protection coverage gaps in the face of climate risk were emphasized in particular during the meeting of the International Insurance Relations (G) Committee.

Chair Gary Anderson, the Massachusetts insurance commissioner noted that the IAIS recently began a Protection Gaps Task Force, which is due to deliver a report on natural catastrophe protection gaps at the IAIS annual meeting in November. He pointed to other organizations focused on the topic as well, leading into a presentation by insurance trade association representatives on a downloadable report by the Global Federation of Insurance Associations (GFIA).²⁵ While the report focused on protection gaps worldwide in four areas (pensions, cyber, health, and natural catastrophes) and recommendations for bridging them, the industry representatives and regulators engaged heavily on the natural catastrophe protection gap in their discussions. The report acknowledges that both insurance companies and the government are players in addressing the protection gap, ideally through a holistic approach, which garnered questions from regulators.

In determining whether there's a gap, "Is it based on lack of access to coverage or lack of take-up of coverage?" asked Dean Cameron, NAIC former president and Idaho insurance director.

"I think it's both," replied Dennis Burke of the Reinsurance Association of America (RAA). Cameron followed up by noting that the report addressed issues that regulators or the government might do to mitigate those protection gaps but wondered if there is a component of it that says to the industry, "here are things we should be doing as an industry to reduce those gaps."

Burke replied that to a certain extent, the report was outward-looking and to a lesser extent it is focused on the risk takers of the world, insurers and insurance-type equivalents. Part of the need is how you deliver insurance policies to people who don't have a post office address, Burke responded.

Burke and his fellow presenter, APCIA's Snyder, also discussed better building codes, proper inspections, where to build and building back better after an event as a mitigation factor, sustainable FAIR plans, and developments that are driving the severity of the protection gaps. He also advocated via the report the use of recycled and green products when risk appropriate. The GFIA report recommendations on protection gaps for climate is an international consensus on government, industry, and societal roles in dealing with the challenges of natural catastrophes. The first report recommendation centers on education, for starters. Consumers don't fully appreciate the risk from natural catastrophes, he warned. People are underinsured or the value of insurance is underappreciated, not recognized, or ignored, Burke said, bluntly referencing the threat of the New Madrid and Pacific earthquake faults as a major protection gap in the United States. He said he hoped that education will help close the protection gap before another event occurs.²⁶

Meanwhile, NAIC Climate Task Force staff said it was still waiting to hear from the Federal Insurance Office (FIO) on its planned climate report (first noticed in the Federal Register in 2021), which is supposed to help identify gaps in the supervision of climate insurance oversight. The staff that shared it had a productive meeting with FIO after it had sent a letter that expressed concern about its climate-related risk data call proposal issued in October 2022.²⁷

Amid all the plans for future assessments, reviews and analysis came from commenters expressing concerns about "political polarization" potentially leading to undercutting a diverse business model involving climate risk considerations of companies and states. Consumer advocate Birnbaum cited growing efforts under the guise of ESG factors or scores that could ban insurers from considering climate risk in their investment, exposure, and/or underwriting risk. It would cause a "serious degradation" of insurers' risk management capabilities and regulators' ability to protect consumers, among other potential threats to other state insurance regulatory authorities and insurance risk management.



Looking forward

The NAIC Summer Meeting in Seattle August 12–16, 2023, should firm up some of the positions among the committees. As the committees build up their capabilities, research, and processing of input from stakeholders, some states may venture out beyond the confines of model laws to adopt and implement their own regulations and statutes on such pressing topics as data applications and use of AI, consumer protection, climate risk disclosures and mitigation, macroeconomic issues affecting insurers, investment risk, and consumer issues surrounding data privacy and marketing. The NAIC's role will continue to be at the center of the ever-developing insurance ecosystem in the United States, so maintaining a clear eye into the deliberations and processes of the standard-setting organization is key to positioning any insurance company in the years ahead.



NAIC accounting update

This section of the NAIC Update focuses on accounting and reporting changes discussed, adopted, or exposed by the Statutory Accounting Principles (E) Working Group (SAPWG), the Accounting Practices and Procedures (E) Task Force, and the Financial Condition (E) Committee during the 2023 Spring National Meeting. New Statutory Accounting Principles (SAP) concepts (formerly known as substantive changes), which are changes in accounting principles or method of applying the principles, have explicit effective dates as documented below. All SAP clarifications (formerly known as *nonsubstantive* changes), which are changes that clarify existing accounting principles, are effective upon adoption unless otherwise noted.

Statutory Accounting Principles Working Group

Current developments: The SAPWG did not adopt any new SAP concepts during the 2023 Spring National Meeting.

Current developments: The SAPWG adopted the following SAP clarification items as final during the 2023 Spring National Meeting and Interim Meetings.

Ref#	Title	Sector	Revisions adopted	F/S impact	Disclosure	Effective date
2022-15	SSAP No. 25— Affiliates and Other Related Parties	P&C Life Health	Clarification as to when an investment is considered an affiliated investment and reported on the “parent, subsidiaries and affiliates” reporting lines in the investment schedules. Any invested asset held by a reporting entity that is issued by an affiliated entity, or that includes the obligations of an affiliated entity, is an affiliated investment. Also recommends clarification in the annual statement instructions.	Y	Y	2023
2022-17	SSAP No. 34— Investment Income Due and Accrued	P&C Life Health	Enhance reporting of interest income on Schedule D-1-1: Bonds by adding disclosure in Note 7 of the annual statement. - Expands disclosures, with data capturing: - Gross, non-admitted and admitted amounts for interest income due and accrued. - Aggregate deferred interest. - Cumulative amounts of paid-in-kind (PIK) interest included in the current principal balances.	N	Y	2023

Ref#	Title	Sector	Revisions adopted	F/S impact	Disclosure	Effective date
2022-16	SSAP No. 100R—Fair Value	P&C Life Health	Adopted <i>ASU 2022-03</i>, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions. • Provide clarity in situations involving equity securities that have restrictions related to the sale of the asset. • Modification rejects the US GAAP disclosure but captured as a restricted asset per <i>SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures</i>.	Y	Y	2023
2022-18	SSAP No. 105R—Working Capital Finance Investments	P&C Life Health	Rejected <i>ASU 2022-04</i>, Liabilities—Supplier Finance Programs (Subtopic 405-50) Disclosure of Supplier Finance Program Obligations. • As insurance reporting entities are generally not the buyers (obligors) of supplier finance programs, the disclosures in <i>ASU 2022-04</i> are not relevant. • Reporting entities that invest in working capital finance programs are the providers of capital (investors), not the buyers (obligors) of such programs.	N	N	2023



The SAPWG exposed the following items for written comments by interested parties:

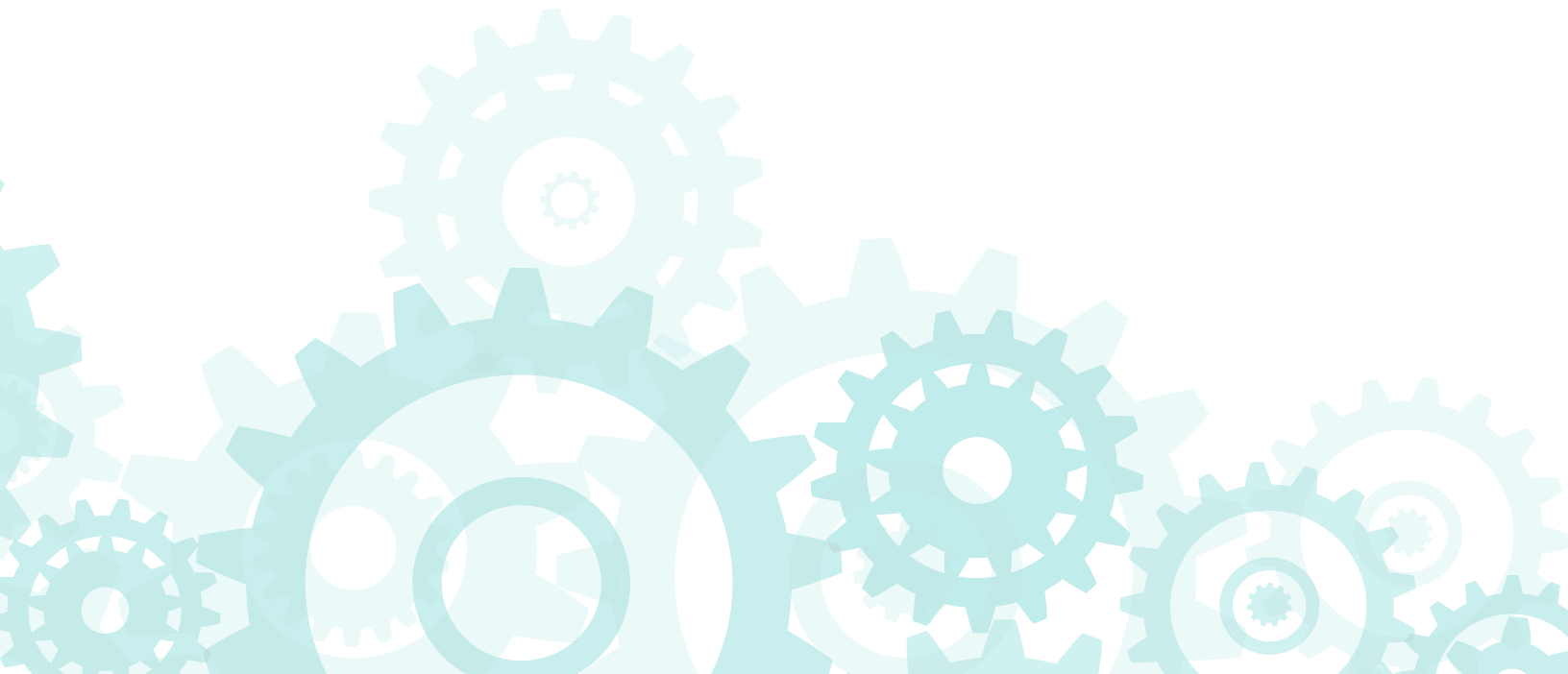
Ref#	Title	Sector	Amendments exposed	F/S impact	Disclosure	Effective date
2019-21	SSAP No. 26R—Bonds SSAP No. 43R—Loan-Backed and Structured Securities SSAP No. 21R—Other Admitted Assets	P&C Life Health	PROPOSED NEW SAP CONCEPT The Working Group exposed the following: • Updated Bond Definition • Updated Issue Paper • <i>SSAP No. 26R—Bonds</i> • <i>SSAP No. 43R—Asset-Backed Securities</i> • Bond Proposal Reporting Revisions Overall, the Working Group is separating bonds from asset-backed securities in both the SSAPs and the investment schedules. To be reported on Schedule D, investments must comply with the definition of a bond (issuer credit obligation) or an asset-backed security. The proposed bond definition is as follows: <i>A bond shall be defined as any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security.</i> Investments that are NOT within the scope of the proposed revisions to SSAP No. 26R and SSAP 43R will likely be moved to Schedule BA: Other Long-Term Invested Assets. Exposed changes include: • Exceptions for nominal interest rate adjustments when determining whether a security represents a creditor relationship. • Guidance for residual tranches excluded from SSAP No. 43R and moved to SSAP No. 21R. • Proposed effective date is January 1, 2025, and is to be applied prospectively. • Prior-year comparative disclosures shall not be restated in the 2025 disclosures. • Clarifying that assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify at the time of transition. • Schedule BA classifications and instructions for debt securities that do not qualify as bonds.	Y	Y	TBD

Ref#	Title	Sector	Amendments exposed	F/S impact	Disclosure	Effective date
2022-01	SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets	P&C Life Health	PROPOSED SAP CLARIFICATION Re-exposed the issue paper related to the definition of liabilities related to newly adopted US GAAP in <i>Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements</i>. Re-exposure provides interested parties time to analyze individual SSAPs and provide further comment. Updates to the exposure include revisions that defer to topic-specific SSAP guidance that varies from the liability definition.	TBD	TBD	TBD
2022-11	SSAP No. 21R—Other Admitted Assets	P&C Life Health	PROPOSED SAP CLARIFICATION - Proposed revision clarifies that collateral loans must be collateralized by admitted invested assets. - Proposed revisions also clarify that <i>SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies</i> type investments must have an audit to serve as collateral for collateral loans.	Y	TBD	TBD
2023-06	SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items	P&C Life Health	Exposed proposed revisions to explicitly reject <i>ASU 2021-10, Government Assistance</i> and the grant and contribution model, but incorporate disclosures regarding government assistance.	N	Y	TBD
2023-02	SSAP No. 43R—Loan-Backed and Structured Securities	P&C Life Health	PROPOSED SAP CLARIFICATION Exposed revisions to the summarized financial modeling guidance reflecting changes adopted by the Valuation of Securities (E) Task Force to include collateralized loan obligations (CLOs). The methodology to model CLOs is still being developed by the NAIC Securities Valuation Office.	TBD	TBD	TBD

Ref#	Title	Sector	Amendments exposed	F/S impact	Disclosure	Effective date
2023-07	SSAP No. 104R—Share-Based Payments SSAP No. 95—Nonmonetary Transactions SSAP No. 47—Uninsured Plans	P&C Life Health	PROPOSED SAP CLARIFICATION The agenda item relates to <i>ASU 2019-08, Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606); Codification Improvements—Share-Based Consideration Payable to a Customer</i> . Exposed proposed revisions: - Adoption, with modification, to include share-based consideration payable to customers in SSAP No. 104R. - Update the related guidance in SSAP No. 95 for convertible instruments granted to non-employees. - Rejection of Topic 606 guidance included in the ASU in SSAP No. 47.	Y	N	TBD
2022-12	INT 03-02: Modification to an Existing Intercompany Pooling Arrangement	P&C Life Health	PROPOSED SAP CLARIFICATION Re-exposed, this agenda item proposes to nullify INT 03-02, which is an interpretation of the following SSAPs: <i>SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance</i> <i>SSAP No. 62R—Property and Casualty Reinsurance</i> <i>SSAP No. 63—Underwriting Pools</i> This interpretation requires transferred assets and liabilities among affiliates in conjunction with the execution of a new reinsurance agreement(s) that substantively modifies the existing intercompany pooling arrangement to be valued at book value for assets and statutory value for liabilities. Valuation at book or statutory value for transfers between affiliates and related parties is inconsistent with <i>SSAP No. 25—Affiliates and Other Related Parties</i> . As such, the Working Group is considering nullification of the interpretation.	Y	N	TBD



Ref#	Title	Sector	Amendments exposed	F/S impact	Disclosure	Effective date
2023-05	INT 20-01: ASU 2020-04 and 2021-01—Reference Rate Reform	P&C Life Health	PROPOSED SAP CLARIFICATION The issuance of ASU 2022-06, <i>Reference Rate Reform (Topic 848)</i> extends the sunset date of the reference rate reform ASUs to December 31, 2024. After this date, entities will no longer be able to apply the optional expedient to allow the change in reference rates to be considered a continuance of the existing contract. Exposed a proposal to extend the date of nullification to December 31, 2024, consistent with US GAAP.	Y	N	TBD
2023-01	Review Annual Statement Instructions for Accounting Guidance	P&C Life Health	PROPOSED SAP CLARIFICATION The agenda item relates to a new project to review the annual (and quarterly) statement instructions to identify statutory accounting guidance. The expectation is to move accounting guidance included in the annual statement instructions to an applicable statement of statutory accounting principle.	N	N	TBD



Ref#	Title	Sector	Amendments exposed	F/S impact	Disclosure	Effective date
2023-03	C-2 Mortality Risk Note	Life	PROPOSED SAP CLARIFICATION <i>SSAP No. 51R—Life Contracts; SSAP No. 59—Credit Life and Accident and Health Insurance Contracts; and SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance.</i> Life Risk-Based Capital (E) Working Group is currently working on modifications to the C-2 mortality risk charges along with the American Academy of Actuaries. Changes include structural updates to assign the same factors to group permanent life as individual permanent life for policies with and without pricing flexibility. - Requires linkage of financial statement information (proposed footnotes to the annual statement) that will be linked to the C-2 mortality risk updates. - The Blanks (E) Working Group will be exposing the same proposed footnote revisions. - Proposed effective date: December 31, 2023.	N	Y	TBD
2023-11EP	Editorial Updates to the NAIC Accounting Practices and Procedures Manual	P&C Life Health	Wording and reference corrections.	N	N	TBD
2023-08 2023-09 2023-10	Appendix D—Nonapplicable GAAP Pronouncements	P&C Life Health	The Working Group exposed the following US GAAP guidance for rejection as not applicable: <i>ASU 2019-07, Codification Updates to SEC Sections</i> <i>ASU 2020-09, Codification Updates to SEC Sections</i> <i>ASU 2022-05, Transition for Sold Contracts</i>	N	N	TBD

The SAPWG also took the following actions, received updates, and provided direction to NAIC staff on the following items:

Ref#	Title	Sector	Description	F/S impact	Disclosure	Effective date
2022-14	Revised or New SSAP	P&C Life Health	PROPOSED NEW SAP CONCEPT Relates to the New Market Tax Credits (NMTCT) Program established by Congress in December 2000. - Permits receipt of non-refundable tax credit against federal income taxes for making equity investments in financial intermediaries (corporations or partnerships). - States have enacted similar programs. FASB has a current project evaluating the application of the proportional amortization method for these structures that is currently used for Low-Income Housing Tax Credits (LIHTC). Current proposal considers a new SSAP or a revision to SSAP No. 93—<i>Low Income Housing Tax Credit Property Investments</i>. The Working Group directed the development accounting guidance for expanding SSAP No. 93 to other qualifying tax equity investments. This item has the potential to impact annual statement disclosures and Risk-Based Capital. A review of SSAP No. 94R—<i>Transferable and Non-Transferable State Tax Credits</i> will also occur during this project.	Y	TBD	TBD
2023-04	Corporate Alternative Minimum Tax Guidance	P&C Life Health	PROPOSED SAP CLARIFICATION The Inflation Reduction Act was enacted in 2022 and included a new corporate alternative minimum tax (CAMT), which goes into effect for 2023 tax years. INT 2022-02 was issued previously to address immediate issues for the third quarter 2022 through first quarter 2023 reporting. NOTE: During the interim period, the Working Group re-exposed the interpretation extending the effectiveness through the second quarter of 2023. The CAMT presents several accounting challenges, including treatment of tax sharing agreements, consideration regarding the CAMT DTA in the statutory valuation allowance, and the treatment of CAMT DTAs in the overall DTA admissibility calculation. The Working Group has directed NAIC staff to work with industry on developing guidance for reporting of the CAMT.	Y	Y	TBD

Ref#	Title	Sector	Description	F/S impact	Disclosure	Effective date
2022-19	SSAP No. 7— Asset Valuation Reserve and Interest Maintenance Reserve	P&C Life Health	PROPOSED NEW SAP CONCEPT Rising interest rates have created an increased likelihood for insurers to move into a negative interest maintenance reserve (IMR) position for realized losses reserved for and amortized into income over time. Current guidance requires nonadmission of a negative IMR position and reporting on the exhibit of nonadmitted assets. The Working Group: - Issued a referral to the Life Actuarial (A) Task Force for consideration of the asset adequacy implications: (1) reporting template; (2) if negative IMR admitted, inclusion in asset adequacy testing; (3) cash flow and liquidity stress test considerations; (4) impacts of excessive withdrawal considerations; and (5) assumptions for any guardrails for assumptions of asset adequacy testing. - Issued a referral to the Capital Adequacy (E) Task Force recommending the elimination of any admitted net negative IMR for total adjusted capital and sensitivity testing with and without. - Noted that the tentative interpretation will apply to the current 2023 period and a long-term solution will be discussed for subsequent reporting periods. Exposed a tentative interpretation, 23-01T: Net Negative (Disallowed) Interest Maintenance Reserve. Highlights of the interpretation include: - RBC greater than 300%, admission of negative IMR is limited to 5% of adjusted capital and surplus - Only for rebalancing-type sales and immediate purchases of investments carried at amortized cost - Derivative losses related to derivatives reported at fair value allocated to IMR and not associated with effective hedging are not included for negative IMR admission consideration - Not applicable to separate account IMR - Any admitted negative IMR is reported as a write-in to miscellaneous other-than-invested assets with the credit to special surplus - Disclosures: - Derivative gains/losses related to derivatives reported at fair value and allocated to IMR must disclose the unamortized impact to IMR separately between gains and losses - Detailed note of the following amounts: - Gross negative IMR - Negative IMR admitted - Negative IMR nonadmitted - Adjusted capital and surplus - Percentage of adjusted capital and surplus associated with admitted negative IMR	Y	Y	TBD
2017-33	SSAP No. 86— Derivatives	P&C Life Health	Adopted an issue paper related to ASU 2017-12, <i>Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities</i> outlining the elements addressed in statutory accounting. When the issue paper is adopted, this agenda item will be disposed.	N	N	NA

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