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NAIC update: 2023 Summer National Meeting

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The National Association of Insurance Commissioners (NAIC) hosted its 2023 Summer National Meeting in Seattle, August 12–16, 2023. Important topics included the use and governance of artificial intelligence for equitable outcomes, the tricky business of crafting customer privacy guardrails, the growing challenges of availability and affordability insurance protections under fast-accelerating climate change and relentless perils, which could impact economic stability in some regions, and a potential revamp of the solvency oversight framework as the NAIC takes a holistic approach to standards and considerations involving insurance capital requirements. Insurance supervisors will be reassessing how they measure capital standards and/or the methods used for such assessments at both the state and international level.

Introduction

Seattle sits on an earthquake fault zone that poses the potential for very serious seismic activity—in fact, the Seattle area has hosted three different earthquake types over its geological history: crustal, intraplate, and megathrust quakes.[1]

However, during the summer national meeting of the National Association of Insurance Commissioners (NAIC) in the city on Puget Sound in mid-August 2023, despite being located in an area of potential seismic activity, insurance regulators and the NAIC's many stakeholders enjoyed stable footing on solid ground without major rifts or disruption.

While Earth remained quiet, the air temperature soared, with Seattle's uncharacteristically hot summer weather making headlines while the NAIC meeting was underway. However, regulators were focused on grieving and addressing the needs of policyholders from the latest weather tragedy—the devasting, deadly Hawaii wildfires—during their stay.[2]

Under the leadership of NAIC President Chlora Lindley-Myers, who had advocated for a year of CALM, policy work continued apace, as regulators listened patiently—and yes, calmly—to industry, academics, and consumer advocates expressing urgency and concern in a rapidly evolving world where dramatic shifts in weather and advancing technology are shaking up the way insurers do business.[3]

Insurance regulators appear cognizant of the pressures and tension that can occasionally erupt beneath the surface but kept any fissures from overtaking discussions during the many meeting sessions. Chair of the NAIC's Innovation, Cybersecurity and Technology (H) Committee Kathleen Birrane, also the Maryland insurance commissioner, characterized NAIC Chair Katie Johnson as being the "absolute epitome of grace under fire" for her leadership during the Privacy Protections Working Group (PPWG) sessions.

By and large, insurance regulators are adhering to their tried-and-true statutory guideposts in the current landscape to deal with the onslaught of tectonic changes, as utilization of artificial intelligence (AI) in daily life balloons and those "one in a lifetime" weather headlines that appear almost monthly now pressure existing norms. They will continue to do so in every aspect of insurance, from marketing to underwriting to claims settlement.[4]

As a key example, the H Committee's *Exposure Draft of the Model Bulletin on the Use of Algorithms, Predictive Models, and AI Systems by Insurers* (AI Model Bulletin), which will undergo changes based on input from stakeholders, "starts with the premise that existing state laws apply," as Birrane reminded attendees.[5]

Rather than wait for federal data collection to gather information on climate risk vulnerabilities in certain markets to begin, the NAIC is moving ahead with its own data collection and data template development, using the existing state-based insurance system to fill in the gaps.

At a Federal Advisory Committee on Insurance (FACI) meeting on September 26, more than a month after the announcement of the NAIC's efforts, and discussion of collaboration between the two data collection initiatives, it was clear that the efforts would not be combined, at least for now. Federal Insurance Office (FIO) Director Steven Seitz said FIO needs a more detailed view of property markets, and it understands the NAIC is going forward with its process, as FIO intends to go forward with its own. Expect varied and detailed requests for homeowners insurance and property data in the coming months.[6]

"NAIC members believe the state insurance departments have both the expertise and necessary regulatory authority to gather, analyze, and utilize data about their unique market conditions and meet the needs of policyholders," the NAIC stated in its August 16 announcement during the meeting. Lest there be any doubt, the NAIC asserted that it is state regulators who are best positioned to lead the work in identifying new coverage gaps and availability and affordability issues, citing state regulators' ability to receive accurate and meaningful data.

The NAIC efforts to keep policy developed and on terra firma while anticipating future needs, whether in AI, climate risk mitigation partnerships, or financial investment oversight frameworks, was a hallmark of the Seattle meeting. We highlight a few of the ongoing works from the NAIC, including information governance, climate risk, and solvency oversight.

Information governance: Privacy protections, big data, and AI

Privacy protection model draft experiences continuing tremors

The gathering, use, and effects of an exponentially increasing amount of data, where more information breeds its own data subsets, provides insurers with opportunities as regulators strive to construct guardrails to protect consumers in the form of proposed model laws or bulletins. This dynamic, even amid a world of overlapping cyber and data frameworks, informed much of the work and sometimes spirited discussions at the NAIC meeting.

The PPWG public session on August 13 followed a regulator-only session centered around the development of a new model law that is not quite within grasp due to ongoing concerns around sharing of the information.

The collaborative process to come up with a workable model draft is ongoing. Virginia's Katie Johnson made it clear there has been no shortage of meetings since the spring national meeting in Louisville, but concluded that the PPWG needs more time to engage the public on a model draft due to the "sheer volume of comments and sheer number of calls" among regulators and stakeholders in response to the version 1.2 of the draft model.

Johnson said the group asked the parent H committee for an extension for the proposed Consumer Insurance Data Privacy Model #674, with a new redlined version to be exposed for four to six weeks at some point in the future. "It is too important a project to rush," Johnson said during the meeting.

Concerns voiced by interested parties and even other state regulators include issues with limiting data sharing, confusion on its terms, and worries about its costs to the business of insurance.

Consumer advocates worried that the opt-out language would allow consumers' information to be shared to the furthest extent the law allows and argued that consent instead needs to be constructed as an opt-in.

Representatives from both P&C insurance and life insurance trade groups expressed worries about a conflicting patchwork of rules that would be overly complex and a burden to insurers and not harmonize with other privacy frameworks, including the federal Gramm-Leach-Bliley Act, adding to what they termed comprehensive and extensive feedback already submitted in comment letters.[7]

Specific areas that still need a lot of work, according to these representatives, deal with the draft model's approach to retention and deletion as well as correction of data, joint marketing, and opt-in/opt-out language.

"Our members think there is significant work left to do on this draft to become a workable model. Some of that includes overly broad and prescriptive provisions regarding retention sharing of information; the inclusion of a requirement to annually review all consumers' personal information in the licensee's possession, which is logistically unfeasible; and requirements for notice contents and delivery that are unworkable, among several others," said Shelby Schoensee, director, Cyber & Counsel, for American Property Casualty Insurance Association (APCIA).[8]

"We can find new trains, more modern trains, that are run on those train tracks, but we don't need to rip out the tracks in order to modernize and bolster the privacy regime," said Wes Bissett, senior counsel for Independent Insurance Agents & Brokers of America (IIABA). "We see a pathway here for success on this … the ultimate goal is uniformity. If the model is adopted and doesn't really go anywhere on the state level, that doesn't benefit anyone and frankly harms your credibility on Capitol Hill … We absolutely want to prevent that."

PPWG member and Kansas Insurance Department's Director of Consumer Assistance Division LeAnn Crow remarked that the model as redrafted, despite the many hours spent on it, would not be passed by the state legislature in Kansas, and limiting data sharing could harm or take away benefits from consumers. "We have only heard strong opposition" to the policy language exposed, she said. This opposition is multifaceted and consistent regarding that the model is fundamentally flawed, she warned. The concern of state legislative resistance was shared by some other states.

Johnson welcomed more input and said it would be helpful to be specific to help fix the myriad issues. Much more dialogue in the coming months is guaranteed due to the breadth of issues and depth of concern with the ramifications of any new consumer privacy standard, and it is not as likely that a new draft will be forwarded to the parent H committee at the fall national meeting in Orlando.

Big data/AI: Keep a human in the loop

The Big Data Working Group under the H Committee featured a packed room early Sunday morning for a session that included a rousing presentation from Deloitte & Touche LLP on AI. The presenters delved into generative AI's current and emerging capabilities and its risks and limitations, including addressing any inherent bias, ethical use, and dealing with so-called hallucinations or outputs that do not reflect reality.[9]

Opportunities such as leveraging AI to better reach underserved markets and closing the protection gap also emerged during the discussion.[10]

Deloitte & Touche LLP Advisory Managing Director David Sherwood informed attendees that there are three key areas where Deloitte practitioners are seeing generative AI used: in text, in audio, and in their code. Insurers often have legacy systems that are running the old code and companies can use generative AI to review it and develop new code.

Sherwood said it's unlikely that insurers will be developing their own generative AI but are obviously leveraging the technology itself internally and bringing it into their technology stack. They are leveraging it internally, or using third-party data in certain areas where they lack their own, Sherwood explained. "Obviously that brings concern about privacy or whether they [third parties] will be leveraging your data, perhaps without your knowledge; so again, it's about the governance and controls that face into that," Sherwood said.

Both Sherwood and co-presenter Casey Kacirek reiterated the need for a "human in the loop," or human supervision, during the training of models and monitoring of outputs to make sure the training data is not biased unintentionally against a demographic or protected class of people. This involves periodic monitoring and guardrail controls to make sure the model has outputs consistent with its original design, with tools for fine-tuning if they drift, Kacirek noted. Human supervision will to be able to recognize that a claim is off or doesn't fit the standard, so it gets kicked out for human review, Kacirek said. Personnel can return to the model and retrain and build in guardrails, a process that is not static but continues as warranted. She suggested the possibility for periodic audits of the data.[11]

Key regulators on the Big Data Working Group expressed interest and engaged in further discussion with the presenters on issues around transparency and explainability, potential for overreliance on the data, and upskilling employees. Rhode Island Superintendent and Chair of the Big Data Working Group Beth Dwyer said she could not emphasize enough from a regulator's perspective the importance of the insurer understanding the data models it is using and being able to explain it to regulators. "The worst thing that can happen," she said is the licensee tells regulators that they really don't know how it works and tells them "it's just what comes out of the algorithm," Dwyer said. Parent H Committee Chair Birrane and others expounded on the concept of explainability in the case of an adverse decision or a delay for consumers—regulators want to know if insurers have the ability to drill down and be able to share what is driving the delay or the adverse decision.[12]

Attendees heard that out of the 194 home insurance companies surveyed in 10 participating states by the Big Data Working Group and NAIC staff, about 70% either plan to use, plan to explore using, or are already using AI/machine learning (ML) in their operations. This is not as high as the 88% in the private passenger auto survey, according to the summary delivered by Vermont Commissioner Kevin Gaffney. The highest percentage use is for claims, including subrogation claims triage and evaluating images of loss, followed closely by underwriting and marketing, fraud, for rating, and lastly, for loss prevention.[13]

Preventing unfair discrimination in AI models: NAIC's answer with model bulletin

The parent committee—Innovation, Cybersecurity, and Technology Committee—of these ongoing efforts on privacy and algorithmic oversight met in the afternoon of August 13 to adopt the reports of its working groups, to discuss the required extension to the Privacy Protections model draft, and to hear commentary in advance of submitted formal comments on the AI Model Bulletin.[14]

Regulators and consumer advocates broached the subject of future additional policy to address testing for biased outcomes, but regulators appeared to put a pin in it, for now.[15]

H Committee Chair Birrane, in presenting an overview of the draft bulletin first unveiled July 17, underscored the principles-based nature of the document, noting it is an interpretive bulletin rather than a model law or regulation, based on a consensus that saw 22 states' participation in the document's drafting.[16]

One of her main points was on the recognition of practical limitations in the bulletin's focus on governance.

It starts with the premise that existing state laws apply, Birrane said. She pointed out that, with respect to third parties, the bulletin places responsibilities on insurers as the licensees to conduct appropriate due diligence with respect to third parties and AI model vendors.

Insurers would hold third parties responsible rather than having insurance departments directly regulating licensed third parties, Birrane emphasized.

According to the draft bulletin language: "Third-party data and model vendors and AI system developers [are] to have and maintain an AIS (Artificial Intelligence System) program commensurate with the standards expected of the Insurer."

The 11-page draft model has four sections: introduction, background, and legislative authority; definitions; regulatory guidance and expectations; and regulatory oversight and examination considerations.

Birrane characterized section four as "critical" because it addresses responsible AI development and its continued use by insurers, and sets expectation that insurers will establish meaningful governance and risk management policies and procedures.

Specifically, an insurer can expect to be asked about its governance framework, risk management, and internal controls, as well as questions regarding any specific model, AI system, or its application, and requests for a range of information and/or documentation, according to the draft model.

Stakeholder comments varied, with industry expressing support in anticipation of more fine-tuning of language, such as insurers' oversight of third-party vendors—a marked contrast from the Consumer Privacy Protections draft model—and consumer advocates pressing for a more robust tool, with testing requirements built into it.

"Notably, we have concerns about certain definitions and the imposition of impractical oversight and contractual oversight on third-party vendors. The requirement on third-party vendors, in particular, will be challenging for smaller to midsize companies throughout the country," said Brian Bayerle, chief life actuary of the American Council of Life Insurers (ACLI).

Bayerle acknowledged that the ACLI believes the draft allows life insurers to utilize such technologies to meet consumer demands for an easier, less intrusive underwriting process while advancing the objective to eliminate unfair discrimination for consumers.

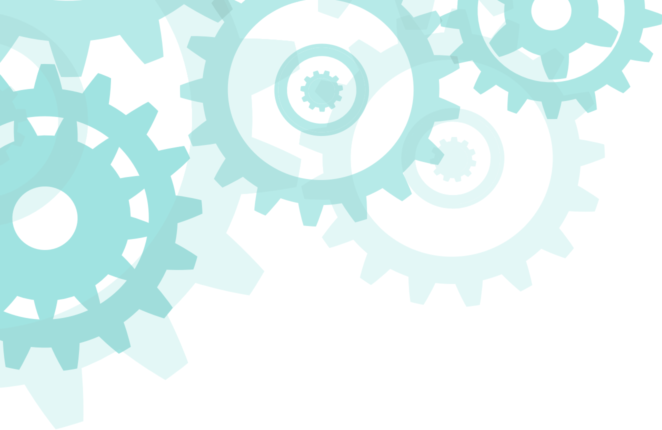
American InsurTech Council cofounder and principal J.P. Wieske said the group believes "this is exactly the right framework and exactly the right way to go," adding that AI is just another tool used by insurers. However, he called for a tightening of definitions.

Another industry representative said the bulletin should be grounded in the National Institute of Standards and Technology's (NIST) AI risk management framework, which includes accountability, security and safety, privacy, confidentiality, and bias mitigation.[17]

Dave Snyder, vice president and counsel for APCIA, said the draft bulletin's language reflects the "current reality in terms of the ability of data and the undesirability of obtaining certain types of data despite the request of other parties." He added that the property casualty trade group would be concerned with suggesting the collection of data that the public simply does not want insurers to collect or use. He also cautioned on third-party vendor directives on behalf of member companies of all sizes.

Snyder offered that APCIA thinks the overall approach is foundationally right and lauded the "Herculean task and the groundbreaking effort of the group" that produced the draft, which prioritized governance and the rule of law.

However, consumer advocates termed the model draft's language "too tentative" and said there were missed opportunities in not expanding on the expectations of AI principles beyond what was adopted in 2020.[18]



Michael DeLong, research and advocacy associate for the Consumer Federation of America, noted that consumer groups have long been concerned with the potential for unfair discrimination generated by insurers' use of data that is unfairly biased and could cause racial discrimination. The draft bulletin offers no guidance on how to implement the AI principles and how to ensure compliance with existing laws, DeLong charged. "The draft bulletin tells insurers what they already know: AI applications must comply with the law, and insurers should have oversight over the AI applications," DeLong lamented. After invoking the murder of George Floyd and recognition that there must be change against inherent bias and institutional racism, DeLong asserted that the draft "doesn't respond to the challenges and promises made three years ago … It doesn't expand on the AI principles or reflect any specific guidance to any NAIC committees and working groups."

Regulators weighed in on the potential for future bias testing and, with it, the need to address further how insurers are specifically dealing with the oversight of third parties.

Colorado Insurance Commissioner Mike Conway warned that the third-party vendor aspect is going to become very, very important if regulators develop a testing methodology, which he said he thinks they will. He said it will be very important for companies to be able to respond to regulators when they are told they need to fix a problem that these future testing outcomes have revealed with their third-party vendor. Conway urged insurance groups to respond to Pennsylvania Insurance Commissioner Mike Humphries' request during the session that touched upon this.

Conway is overseeing the creation of rulemaking stemming from 2021 legislation, which requires insurers to reveal their big data/ AI testing protocol to the Colorado Division of Insurance bias testing protocols to make sure the outcomes do not result in unfair discrimination against protected classes.[19]

Birrane, after hearing comments, noted that the bulletin is a draft, "not a perfect document."

As far as next steps, Birrane planned on a regulator-only meeting to discuss the input and other considerations, with a second draft of the bulletin potentially coming in early fall, although it was not exposed at the time of this publication.

Climate risk challenges and adaptations

Moving from safe operating spaces into danger zones

The topic of climate change and risk has become a permanent fixture in the discussions at the NAIC, as each meeting is often preceded by a climate crisis among the 56 states and territories. In Seattle, regulators and attendees mourned the deadly Hawaii wildfire days earlier, even as the death tolls were climbing while presenters shared scenarios of increased danger.[20]

Still, some regulators—through discussing their work in community/industry partnerships—strove to present success stories in mitigating damage and hardening properties from storms, floods, and fires.

"Humankind is no longer in a safe operating space," said ASU Global Futures Vice Provost Dr. Peter Schlosser.[21] He added that the world is seeing more extremes and recalled the extreme heat warning in Seattle during the conference, where temperatures held in the 90s. Still, the delegation from Louisiana and Texas had left temperatures of 105°F and higher back home.[22]

During his Climate and Resiliency Task Force presentation, Dr. Schlosser acknowledged that renewables were increasing but couldn't make up for the energy increase from people.

Steven Rothstein, managing director for Ceres Accelerator for Sustainable Capital Markets, discussed recent climate reports tallying the 357 natural disasters since 1980 that have caused more than $1 billion in damages.[23]

Rothstein presented a few reports during the task force session, including a report on inclusive insurance and the needs of families of color. He also presented on the Ceres July 2023 report,[24] which represents a joint undertaking by the nonprofit. Ceres has worked with the NAIC for more than a dozen years and with California Department of Insurance to review, analyze, and present findings from insurance company responses to the NAIC 2021 Climate Disclosure Survey, which is aligned with the Task Force on Climate-related Financial Disclosures (TCFD) framework for climate risk disclosure.

The research showed that among the four TCFD pillars, the responses to risk management and strategy were the strongest, both in terms of number of reports and details on such exercises as integration of climate risk into enterprise risk management, product design for cleaner technology, and identification of specific climate risks.

The July report revealed that insurers are actively engaged with diverse strategies and offering a variety of new products to aid risk reduction or promoting support of clean technology through discounts, endorsements, and the like.

The report acknowledged what many consumers are experiencing how catastrophic events, such as wildfires and hurricanes, are becoming more severe in many places, making insurance necessary but coverage more challenging to obtain.

"As we've seen, increasing climate risk is causing these challenges for insurance availability and affordability in pretty much all our states," said California Insurance Commissioner Ricardo Lara, co-chair of the Climate and Resiliency Task Force. Lara said pre-disaster mitigation but noted that new approaches to insurance coverage itself are needed so people are not left behind without adequate protection.

Rothstein noted the report on inclusive insurance published earlier in the year detailed 14 recommendations for action that stakeholders from the federal government, state regulators, local governments, and the private sector can undertake to create a more inclusive system. The report's recommended actions include subsidizing disaster insurance for low-income households, providing insurance consultations to low-income households, reforming claim contestation procedures, providing discounts for disaster mitigation, and mandating disaster coverage backed by a federal reinsurance.[25]

Catastrophe risk endeavors

Some of the efforts on risk mitigation were the focus of discussion during the Catastrophe Insurance (C) Working Group meeting, which held a joint session with the NAIC/FEMA Advisory Group on August 13.[26]

"With the changing weather patterns and increased damage due to storms, companies not wanting to, or able to, write in certain areas, some states have had better luck than others in getting mitigation programs through their legislatures," noted Catastrophe Insurance Working Group Chair Cynthia Amann of Missouri. The group called on Alabama, Louisiana, and Minnesota regulators to touch upon the highlights of their programs so that other states might learn from them.

Alabama Insurance Commissioner Mark Fowler discussed during the meeting how the legislation-created "Strengthen Alabama Homes" program, now more than a decade old in the state, makes grants to Alabama residents to fortify their homes against wind damage to certain standards, and how alliances with nonprofits, academics, and partnerships—plus the city of Birmingham and a major life insurer—have been formed to help in underserved neighborhoods.[27] "By end of the fiscal year, we [Alabama Insurance Department] will have granted $62.5 million … and fortified more than 6,300 homes in the state of Alabama," Fowler stated.

Alabama has worked with Louisiana and Minnesota to help them start programs similar to his state's program and said that 11 states are looking to establish them.

Louisiana Insurance Commissioner Jim Donelon touted funding in his state for resilient construction and how efforts had paid off, with homes built to fortified standards undamaged during two hurricanes with 150+ mph winds this decade.

Regulators acknowledged to consumer representatives that it's going to take a while for the market to react to strengthening homes and mitigation efforts and that the work is long term as is the time horizon to change the economics.

"Maybe when we get 20% of homes in Mobile and Baldwin counties, which are our coastal counties, fortified, then, possibly we're going to see some reaction in the market in coastal communities," Fowler said. "We are now in 35 counties in Alabama in fortifying homes," he said.

Funding for resilience and retrofitting homes, and building firewise or other such fortified communities, is an ongoing issue and requires coordination, outreach, education, planning, and sometimes new laws, agreed presenters, nonprofits, and others.[28]

Some vented about working with the Federal Emergency Management Administration (FEMA) during catastrophes and emphasized the need to strengthen the states' relationships and information sharing with agents so consumers could get the information they need and get help during the worst time of their lives.

The working group has a subset of members drafting a Catastrophe Modeling Primer, a project underway this year with several sections having been drafted since the spring national meeting. The NAIC stated that the drafting group hopes to complete the draft before the Fall national meeting.

From the solvency oversight watchtower

Modernization of the SVO planned

While perhaps not earthshaking, a new proposal on a key NAIC office has the potential to alter the insurance solvency oversight system.

In a world where investment strategies by insurers are changing in more complex ways—and will always change and grow to adapt to macroeconomic forces—the NAIC has sought to scrutinize the investments themselves for their impact on insurers' financial solvency. However, now the NAIC is scrutinizing its investment risk assessment division, the Securities Valuation Office (SVO), in an effort to modernize its role and capabilities in line with what it states is "more complex and asset-intensive insurer business strategies."[29]

This new undertaking should be a "primary focus" of the NAIC, according to financial regulators, with an SVO overhaul that would need the help of an external consultant or resource for its design and implementation.

Financial Condition E Committee Chair Beth Dwyer, Rhode Island's banking and insurance superintendent, introduced the new "Framework for Regulation of Insurer Investments – A Holistic Review" on August 15, 2023.[30] The framework was drafted by a small group of ad hoc committee members and has been exposed for comments, which were due October 9, 2023. Discussion should flow into the rest of the year and into 2024 on this new, overarching approach to rethinking the NAIC's solvency mechanisms through its investment and credit analysis arm.

Financial regulators decided that the SVO lacks tools to provide due diligence and assessment over the use and effectiveness of credit rating providers (CRPs) for filing exempt securities and has been "blindly reliant on these CRPs."

This issue, among others, has garnered a great deal of public attention over the past couple years, as the framework acknowledged by noting that its "recent initiatives to address gaps in the regulatory framework for insurer investments have received much attention by a variety of stakeholders."

Because of this perceived lack of tools, the Financial Condition Committee is proposing a new, stronger governance structure for the SVO to address the CRPs' evaluations, according to the document.

The Financial Condition Committee says a reimagined, holistic SVO would keep using CRPs but eliminate or reduce its blind reliance on them under a new, robust due diligence framework.

This reimagined SVO would have new risk analysis capabilities "to better support the risk-focused approach to supervision, at both a micro- and macro-prudential level," according to the memo describing it.[31]

"It is both inefficient and impractical for the SVO to effectively replicate the capabilities of CRPs on a large scale … Rather, the SVO should focus primarily on holistic due diligence around CRP usage," the draft framework states.

The Holistic Review draft also outlined proposals to modernize the roles and capabilities of the SVO, with an eye toward assessing constancy of capital assessment and treatment even as certain investment initiatives continue to roll forward in separate solvency oversight workstreams.

Comprehensive approach for investment oversight embraced

Regulators on the committee voiced their support, indicating encouragement for the creation of a new framework from key committee members. One state regulator and committee member from Missouri said the NAIC needs this type of ability given the increasing complexity of investments and stated difficulties in making a determination by themselves how risky they are. Another from Indiana said the changes would bring "peace of mind" and give the SVO the resources they need without having a "knee-jerk reaction" to issues when they arise.

"At the most basic level, the question has arisen—what is the most effective use of regulatory resources in the modern environment of insurance regulation for investments?" the memo asks.

"This framework provides for future vision of what regulators seek," said Carrie Mears, chair of the Valuation of Securities Task Force and chief investment specialist at the Iowa Insurance Division. She acknowledged many of the outlined initiatives will be costly and will take some time but that the framework looks beyond the immediate financial cycles and allows financial regulators to be "thoughtful and deliberative."

Dwyer and Mears made clear that valuation of securities efforts already underway would continue apace, making it clear that the new document would be significant. These are detailed as follows:[32]

- **The proposal to modify risk-based capital (RBC) under the RBC Investment Risk and Evaluation (R&E) Working Group.** Of significance, the full NAIC adopted a change to the Life RBC formula in its plenary session August 16, after much discussion over the past few months on the size of factors. The change will require residual tranches of structured securities to receive a 30% factor for year-end 2023 RBC filings and a 45% factor for year-end 2024 RBC filings. The change will apply sectorwide to any firm with such investments, no matter its size, the NAIC stated. It also noted that the RBC R&E Working Group could potentially adjust the factor up or down, based on additional supporting information. The NAIC took the opportunity in a press release to note that its work is consistent with the NAIC members' regulatory priority to protect policyholders by boosting oversight of "the increasingly opaque investment structures favored by some insurers" and underscored its need to regulate for insurance solvency and marketplace stability as a core tenet to state insurance regulation by state commissioners**.** It indicated the estimated change in the RBC ratio of the life insurance companies that own residual investments is expected to be "very small."[33]

- **Modeling collateralized loan obligations (CLOs) beginning in December 2024 in the SVO financial modeling process.** The Valuation of Securities (VOS) Task Force can then initiate and approve the assignment of NAIC Designation Categories to CLOs modeled to eliminate what they see as RBC arbitrage.[34]

- **SVO's ability to challenge credit rating from exempt security.** Back in March, the VOS Task Force directed the SVO staff to draft a distinct process on how it would recommend challenging an NAIC Designation assigned from a CRP rating in the so-called filing exemption process. The Task Force work would establish these processes.

Stakeholders in various meetings within the VOS and Capital Adequacy Task Forces have been pressing for a clear definition of what is meant by an NAIC designation through different processes and reasons for proposed changes to the NAIC designation, which are constructed to reflect the probability of default and should reflect tail risk.

Insurers are pushing for a consistent framework across asset classes with rating agencies and the SVO having clearly defined roles on how capital amounts are determined and set in the insurance industry.

The SVO framework as it is developed should provide a template for these myriad discussions going forward.[35]

The Financial Condition Committee has been working on its approach to holistically examine reserves and capital by overseeing the creation of a new group called the Generator of Economic Scenarios Subgroup under the Life RBC Working Group and the Life Actuarial Task Force. As discussed in a July 19 meeting, according to the minutes, the new subgroup, to be chaired by Iowa and vice-chaired by Ohio regulators, will be supporting the implementation of a scenario generator for use in statutory reserve and capital calculations. It will also be monitoring the economic scenario governance framework, reviewing material economic scenario generator updates and key economic conditions and metrics.[36]

International: AM awaits its day in the sun

On the global front, solvency oversight pencils have been sharpened. The International Association of Insurance Supervisors (IAIS) is readying for the anticipated comparability assessment process for the United States' alternative methodology vis-à-vis the international capital standard (ICS) for internationally active insurance groups (IAIGs).

Beginning in September 2023, the IAIS will have embarked on an assessment of whether the United States' approach, termed Aggregation Method (AM), provided comparable outcomes to the ICS with a final decision on comparability to be made in 2024, according to Gary Anderson, chair of the NAIC International Insurance (G) Committee and Massachusetts insurance commissioner. The analysis will use a provisional AM and the candidate ICS, reflecting any revisions made in the data collections and public consultations on candidate ICS.

The goal of the AM is to "leverage legal entity reported available and required capital to produce a measure of group capital adequacy," according to the NAIC.[37]

"We expect the comparability assessment to be based on a robust technical, evidence-based analysis," Anderson said. The NAIC also drafted a document describing the provisional AM that is being used in the comparability assessment before the process begins for which it was seeking comment by September 1, 2023.[38]

The IAIS has conducted two public consultations to the AM, including the release of draft criteria to assess whether the AM provides comparable outcomes to the ICS. After workshops specific to the AM, the financial criteria of the comparability assessment was published in March. The NAIC responded to them by stating it was "confident that these criteria provide a viable and fair path forward for the AM to be deemed an outcome-equivalent approach for implementation of the ICS."[39]

The international standard-setting body also released public consultation of a candidate version of the ICS ahead of its adoption as a Prescribed Capital Requirement (PCR) for IAIGs in late June 2024. The consultation solicits input from stakeholders to support an economic impact assessment of the ICS.

Anderson said that over the years, the collection of the AM data has expanded to include 21 insurance companies from five countries, demonstrating a commitment to a group capital approach that embeds the "wisdom and analysis" underlying each jurisdiction's capital requirements "and allows for a nuanced handling for business models," particularly for long-term life insurance, which has been difficult to handle in a standardized approach to group capital.

The draft NAIC AM document describes the principles for the AM approach, a provisional AM that will serve as the basis for comparison to the candidate ICS during the comparability assessment and steps planned for the finalization of the AM, including further analysis on scalars and a decision on a final methodology that delivers comparable outcomes to the ICS.

The document, *Provisional AM for use in the comparability assessment,*[40] and other aspects of the ICS development are expected to be discussed at the 2023 IAIS Annual Conference, which will take place in Tokyo on November 9–10, 2023, during a panel on the ICS, following the consultation launched in June. Implementation of the global standard is expected to be adopted in December 2024, according to the IAIS.[41]

NAIC health care update: Summer 2023

The 2023 Summer National Meeting of the Health Insurance and Managed Care (B) Committee continued to focus on those persistent issues across the health plan environment, and at the forefront, addressing health care disparities by increasing access to quality care.[42]

A topic recently permeating (B) Committee meetings is prior authorizations. Sometimes referred to as prior approval, prior authorizations are a health plan cost-control process through which health care providers must obtain advance approval before a specific health care service is provided to the patient to qualify for coverage by the health plan. Despite often driving cost savings at the health plan, prior authorizations are often viewed by health care providers and patients as a barrier to accessing appropriate, quality health care.[43]

For instance, around 1 in 36 children has been identified with autism in the United States according to the Centers for Disease Control (CDC).[44] However, there are also an estimated 5 million adults living with autism.[45] Applied behavior analysis (ABA) therapy is a scientifically proven, common treatment for autism.[46] Though this therapy is a commonly approved treatment for children, adult treatment is oftentimes constrained for adults through mental health prior-authorization requirements. ABA is just one example.

The (B) Committee actively engages with interested parties, who typically represent the health care provider community as well as consumers at (B) Committee meetings. During the 2023 Summer National Meeting, these interested parties discussed patient and consumer experiences with prior authorization requirements that are broadly applied across health care services and can include pharmaceuticals, diagnostic imaging, physical therapy, and occupational therapy, among numerous others, resulting in barriers to quality health care. Current prior authorization practices can result in undesirable patient outcomes, increased health care provider burden, and increased health care costs due to redundant doctor visits and worsened health conditions caused by previously avoided or unauthorized health care.

However, federal and state legislators are taking action to reform the prior authorization process.

In December 2022, the Centers for Medicare & Medicaid Services (CMS) Advancing Interoperability and Improving Prior Authorization Processes Proposed Rule (CMS-0057-P) was published.[47] CMS is currently evaluating the public response for inclusion in a final rule.

Per CMS: "This proposed rule emphasizes the need to improve health information exchange to achieve appropriate and necessary access to complete health records for patients, healthcare providers, and payers. This proposed rule also focuses on efforts to improve prior authorization processes through policies and technology, to help ensure that patients remain at the center of their own care. The rule enhances certain policies … and adds several new provisions to increase data sharing and reduce overall payer, healthcare provider, and patient burden through proposed improvements to prior authorization practices."[48]

In addition to federal and state legislators, health plans play a pivotal role in improving the current prior authorization process by reducing or refining historical prior authorization requirements that hinder the ability of patients to secure quality health care.[49]

There are opportunities for health plans, in conjunction with their regulators, to identify solutions. For example, available prior authorization data can provide insight related to the services most frequently subject to prior authorization; the relative approval rates for specific procedures; and the time it takes to approve or deny specific procedures. This information can be used to potentially reduce the time spent on prior authorizations or to alleviate burdens on the health care provider, patients, and consumers.

In a developing industry trend, health plans have begun acting on prior authorization reform. Several health plans across the country have announced plans to ease prior authorization requirements for medical procedures and surgeries. Despite these steps taken, there remain opportunities for transparency, education, and collaboration to eliminate barriers to quality health care.

Explore more on the ongoing insurance accounting work and any new changes in the "NAIC accounting update" on the following pages.

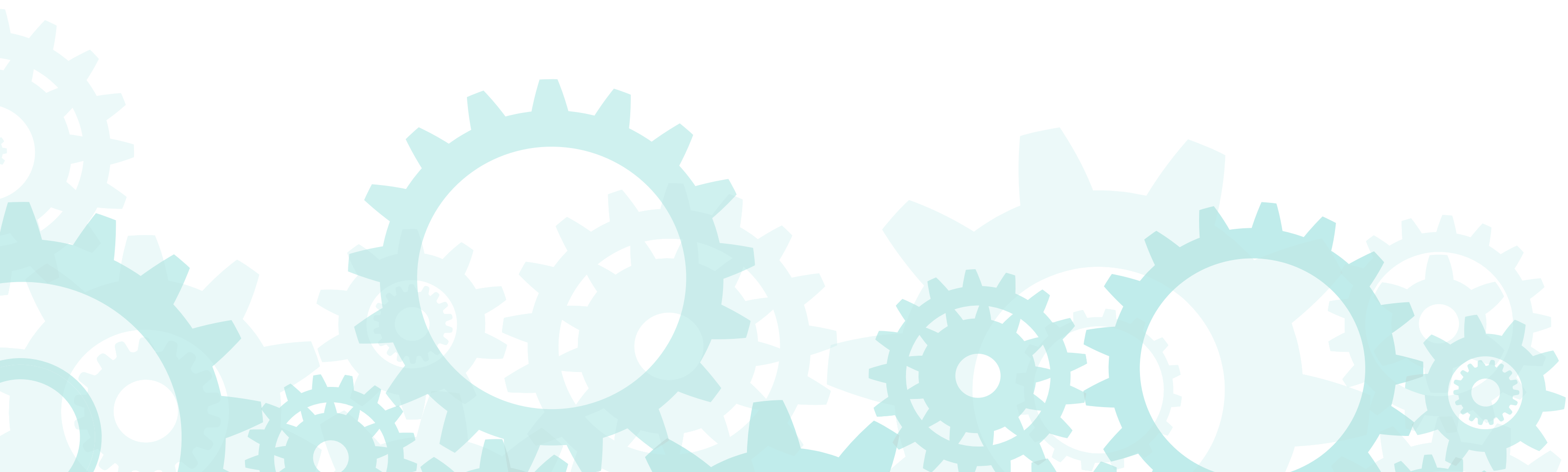
NAIC accounting update

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 adopted the following new SAP concepts during the 2023 Summer National Meeting.

Ref#	Title	Sector	Revisions adopted	F/S impact	Disclosure	Effective date
2019-21	**SSAP No. 26R—Bonds** **SSAP No. 43R—Asset-Backed Securities** **SSAP No. 21R—Other Admitted Assets**	P&C Life Health	The Working Group adopted new SAP concepts to Statement of Statutory Accounting Principle (SSAP) No. 26R—Bonds and SSAP No. 43R—Asset-Backed Securities, for the new principles-based definition, as well as various SSAPs to reflect the revised definition and/or references. • 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**. BLANKS PROPOSAL: Schedule BA Reporting • Revised reporting lines and columns to capture debt securities that do not meet the updated definition of bonds. • Notice to the Valuation of Securities (E) Task Force and the Capital Adequacy (E) Task Force.	Y	Y	2025



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

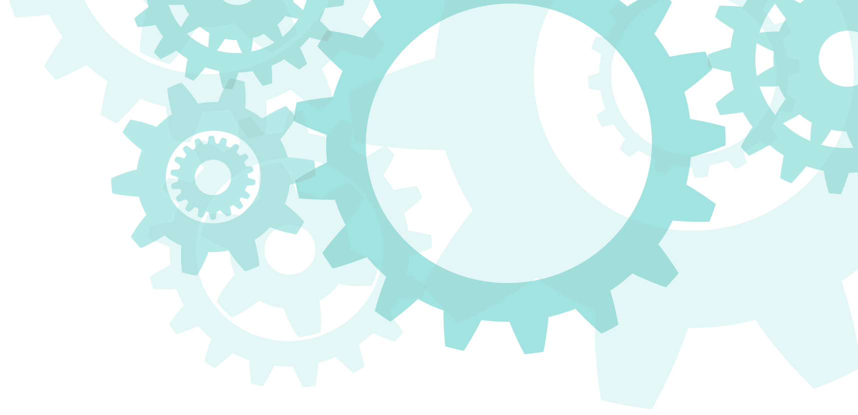
Ref#	Title	Sector	Revisions adopted	F/S impact	Disclosure	Effective date
2022-01	**SSAP No. 5R—Liabilities, Contingen-cies and Impairments of Assets**	P&C Life Health	Adopted an issue paper and SAP clarification related to the definition of liabilities included in US Generally Accepted Accounting Principles (GAAP) Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements aligning the definition of a liability between US GAAP and SAP. An additional clarification was also adopted to note that guidance in SSAP No. 5R regarding the definition of a liability is applicable unless other authoritative SAP provides more topic-specific contradictory guidance.	Y	N	2023
2023-06	**SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items**	P&C Life Health	Adopted revisions to explicitly reject Accounting Standards Update (ASU) 2021-10, Government Assistance and the grant and contribution model of accounting, but incorporated disclosures regarding government assistance.	N	Y	2023

2023-13	**SSAP No. 34—Investment Income Due and Accrued**	P&C
		Life
		Health
			At the NAIC 2023 spring national meeting, the Working Group adopted disclosures that enhance reporting of interest income on *Schedule D-1-1: Bonds.*
			
			During this meeting, the Working Group adopted a revision to clarify the impact of paydowns and disposals on paid-in-kind (PIK) interest and related disclosures.
			
			• *No change in disclosure requirements.* Clarifications for consistent application of the disclosure.
			   · Identify PIK interest by lot and aggregate amounts by Committee on Uniform Security Identification Procedures (CUSIP)/ Private Placement Number (PPN) that increase original par value.
			   · Increases first applied to outstanding PIK interest.
			   · PRACTICAL EXPEDIENT—May calculate the cumulative amount of PIK interest by subtracting original principal/par value from the current principal/par value, but not less than $0.
				N	N	2023

Ref#	Title	Sector	Revisions adopted	F/S impact	Disclosure	Effective date
2023-02	**SSAP No. 43R—Loan-Backed and Structured Securities**	P&C Life Health	Adopted 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 being developed by the NAIC Securities Valuation Office.	N	N	2023

2023-07	**SSAP No. 104R—Share-Based Payments**
	
	SSAP No. 95—Nonmonetary Transactions
	
	SSAP No. 47—Uninsured Plans
		P&C
		Life
		Health
			The agenda item relates to *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.*
			
			• Adopted 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	2023

2023-05	**Interpretation (INT) 20-01: ASU 2020-04 and 2021-01—Reference Rate Reform**	P&C Life Health	The issuance of *ASU 2022-06, Reference Rate Reform (Topic 848)* 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. Adopted a revision to extend the date of nullification to December 31, 2024, consistent with US GAAP.	Y	N	2023



Ref#	Title	Sector	Revisions adopted	F/S impact	Disclosure	Effective date

2022-19	**SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve**
	
	INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve
		Life	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.
			
			Adopted INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve.
			
			• Provides optional, limited-time guidance, which allows the admittance of net negative (disallowed) IMR.
			  ◦ Must have risk-based capital greater than 300% authorized control level after an adjustment to total adjusted capital (TAC) that reflects a reduction to remove any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted net negative (disallowed) IMR.
			  ◦ Allowed up to 10% of adjusted capital and surplus (general account first, then separate account up to the threshold).
			  ◦ Automatically nullified, January 1, 2026, unless effective period is subsequently revised.
			  ◦ Disclosure memo will be provided to the Blanks (E) Working Group for posting on its website and will provide instructions for disclosure and attestation in the 2023 Annual Statement.
				Y	Y	2023

2023-08 2023-09 2023-10	**Appendix D—Nonapplicable GAAP Pronouncements**	P&C Life Health	The following US GAAP items were rejected as not applicable to statutory accounting: • *ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization and Miscellaneous Updates* • *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* • *ASU 2022-05, Transition for Sold Contracts*	N	N	NA

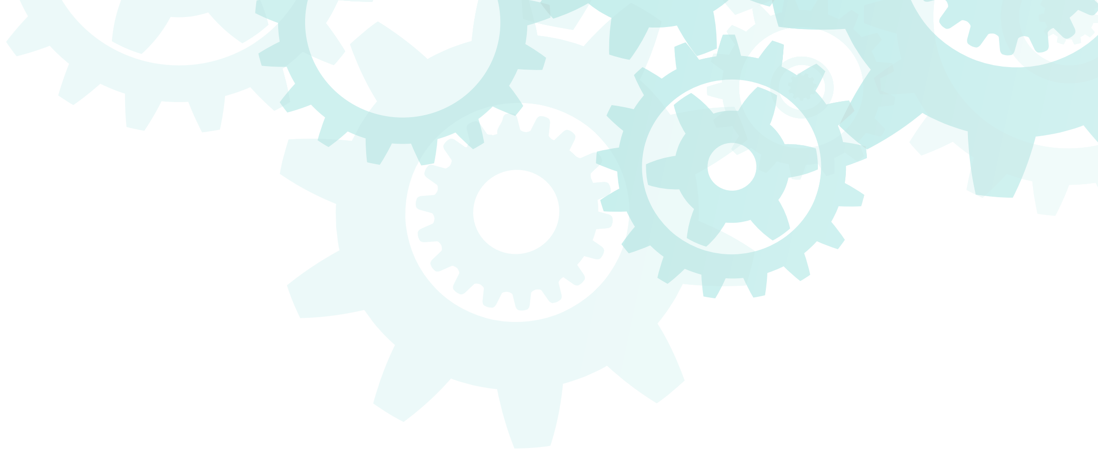
The SAPWG exposed the following items for written comments by interested parties:

Ref#	SSAP	Sec.	Revisions Exposed	F/S Impact	Disclosure	Effect. Date
2023-17	**SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments**	P&C Life Health	**Proposed New SAP Concept** Potential for collateral loans and other long-term invested assets to be designed to have the characteristics of a short-term investment but continually rolled over or replaced, resulting in continued reporting on *Schedule DA: Short-Term Investments* for multiple years. Proposed revisions further restrict what is considered a short-term investment. Under current guidance, some have inferred that any investment with a maturity of one year or less at the time of acquisition can be reported as a short-term investment. The proposal explicitly identifies the following security types and excludes them from being reported as a short-term investment: • Asset-backed securities; • All investments reported on *Schedule BA: Other Long-Term Invested Assets;* • Mortgage loans; and • Derivatives. Proposed effective date: January 1, 2025, to be consistent with new proposed bond definition.	Y	Y	TBD
2023-18	**SSAP No. 5R—Liabilities, Contingencies** **SSAP No. 92—Postretirement Benefits Other Than Pensions** **SSAP No. 102—Pensions** **SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities**	P&C Life Health	**Proposed SAP Clarification** Proposes to adopt, with modification, certain elements of *ASU 2016-19, Technical Corrections and Improvements.* Remainder to be rejected.	N	N	TBD

Ref#	SSAP	Sec.	Revisions Exposed	F/S Impact	Disclosure	Effect. Date
2023-14	**SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve**	Life	**Proposed New SAP Concept** This item is the broader long-term project to address accounting and reporting for asset valuation reserve (AVR) and IMR.	Y	Y	TBD
2022-11	**SSAP No. 20—Nonadmitted Assets** **SSAP No. 21R—Other Admitted Assets**	P&C Life Health	**Proposed SAP Clarification** Re-exposed proposed revisions to clarify that collateral loans must be collateralized by admitted invested assets. Proposed revisions also clarify that *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* type investments must have an audit to serve as collateral for collateral loans. Latest element of the exposure based on industry comment letters centers on the basis for collateral valuation when the collateral is an investment subject to SSAP No. 48. The Working Group is exploring fair value measurements of the collateral assets as an alternative to net equity value.	Y	TBD	TBD

2019-21	**SSAP No. 21R—Other Admitted Assets**	P&C
		Life
		Health
			Proposed SAP Clarification
			
			This item relates to the principles-based bond definition. Exposed revisions as follows:
			• Clarifies accounting and reporting requirements for:
			    · Debt securities that do not meet the updated definition of bonds.
			    · Measurement of residual interests in such securities.
			        – Requires a lower of "adjusted cost" or fair value measurement method with no amortization or accretion and no changes based on changes in cash flow expectations other than for temporary impairment.
				Y	N	TBD

Ref#	SSAP	Sec.	Revisions Exposed	F/S Impact	Disclosure	Effect. Date
2023-12	**SSAP No. 43R—Loan-Backed and Structured Securities**	P&C Life Health	**Proposed SAP Clarification** Previously, the Working Group defined the concept of residual interests and concluded they do not qualify for reporting as bonds. Ultimately, residual interests are reported on *Schedule BA: Other Long-Term Invested Assets.* This agenda item clarifies that all forms of residual interests, even those structured as limited partnerships, joint ventures, or other equity fund investments, which fall within the SSAP No. 43R definition are to be reported on Schedule BA. The Working Group desires this clarification to be effective for year-end 2023 reporting. A separate agenda item was also exposed to recommend additional reporting categories for Schedule BA to capture the various forms of residual interests (2023-16).	Y	Y	2023
2023-22	**SSAP No. 54—Individual and Group Accident and Health Contracts**	P&C Life Health	**Proposed SAP Clarification** Exposed revisions to clarify that the gross premium valuation and cash flow testing are both required if indicated. An example was also exposed.	Y	N	TBD
2023-21	**SSAP No. 92—Postretirement Benefits Other Than Pensions** **SSAP No. 102—Pensions**	P&C Life Health	**Proposed SAP Clarification** Exposed revisions to remove the transition guidance related to initial adoption in both SSAPs.	N	N	TBD



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<tr><th>Ref#</th><th>SSAP</th><th>Sec.</th><th>Revisions Exposed</th><th>F/S Impact</th><th>Disclosure</th><th>Effect. Date</th></tr>
<tr><td>2022-12</td><td>INT 03-02: Modification to an Existing Intercompany Pooling Arrangement</td><td>P&C
Life
Health</td><td>Proposed SAP Clarification

Re-exposed, this agenda item proposes to nullify INT 03-02, which is an interpretation of the following SSAPs:
• SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance
• SSAP No. 62R—Property and Casualty Reinsurance
• SSAP No. 63—Underwriting Pools

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 SSAP No. 25—Affiliates and Other Related Parties.

As such, the Working Group is considering nullification of INT 03-02.</td><td>Y</td><td>N</td><td>TBD</td></tr>
<tr><td>2022-14</td><td>SSAP No. 93—Low Income Housing Tax Credit Property Investments

SSAP No. 94R—Transferable and Non-Transferable State Tax Credits</td><td>P&C
Life
Health</td><td>PROPOSED NEW SAP CONCEPT

Relates to the New Market Tax Credits (NMTC) 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.

The Financial Accounting Standards Board (FASB) adopted guidance allowing the application of the proportional amortization method for these structures that are currently used for Low-Income Housing Tax Credits (LIHTC).

The current proposal considers a revision expanding SSAP No. 93 to other qualifying tax equity investments.

This item has the potential to impact annual statement disclosures and Risk-Based Capital.

The proposed revisions to SSAP No. 94R—Transferable and Non-Transferable State Tax Credits are to include both federal and state tax credits.</td><td>Y</td><td>TBD</td><td>TBD</td></tr>
</table>

Ref#	SSAP	Sec.	Revisions Exposed	F/S Impact	Disclosure	Effect. Date
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. Revised INT 2022-02 exposed to address issues for third quarter 2022 through third quarter 2023 reporting. The CAMT presents several accounting challenges, including treatment of tax sharing agreements, consideration regarding the CAMT deferred tax asset (DTA) in the statutory valuation allowance, and the treatment of CAMT DTAs in the overall DTA admissibility calculation. Exposure of *INT 23-03T: Corporate Alternative Minimum Tax Guidance*, which requires assessment of potential valuation allowance and admission of DTA to adhere to existing guidance in *SSAP No. 101—Income Taxes,* including admission by offset by deferred tax liabilities under paragraph 11c of SSAP No. 101.	Y	Y	TBD
2023-19 2023-20	**Appendix D—Nonapplicable GAAP Pronouncements**	P&C Life Health	**Proposed SAP Clarification** Exposed rejection of the following US GAAP guidance updates as not applicable to statutory accounting: • *ASU 2018-09*—Codification Improvements • *ASU 2020-10*—Codification Improvements	N	N	TBD

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

Ref#	Title	Sec.	Description	F/S Impact	Disclosure	Effect. Date
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. Expectation is to move accounting guidance included in the annual statement instructions to an applicable statement of statutory accounting principle.	N	N	TBD
2023-15	**Annual Statement Instructions**	Life Health	**Annual Statement Instruction Recommendation** The core principle of the IMR and the AVR is that interest-related losses go to IMR, and non-interest-related losses go to AVR. This agenda recommends a correction to the instructions that appear to direct an entity to allocate non-interest-related losses to IMR rather than correctly to the AVR. Exposed a proposal to the Blanks (E) Working Group, which recommends removing the guidance that appears to permit the allocation of non-interest-related losses to IMR.	Y	Y	TBD

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