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NAIC Life and Health Actuarial (Technical) Task Force – Life Valuation Issues Survey of the States

By Mark Peavy (NAIC/SSO)

On January 4, 1999, two questions on life valuation issues were sent to all state insurance departments on behalf of the NAIC Life and Health Actuarial (Technical) Task Force. This article contains the responses submitted by 20 states as of February 4, 1999.

NAIC Electronic Commerce and Regulation Working Group

By Teresa Walker (NAIC/SSO)

This newly formed working group will evaluate methods by which the Internet and other means of electronic commerce can be used to increase efficiencies in the regulation of insurance and make specific recommendations by the 1999 Fall National Meeting.

Resources for Members & Staff Available Through the NAIC Research Library

By Deborah Scott (NAIC/SSO)

In the Research Library, we process an average of 700 requests per month for NAIC members and support staff; state, federal, and international government agencies and legislators; insurance industry companies, agencies, and associations; law firms, consultants, consumers, and even students.

Insurance and the 106th Congress

By Ray Spudeck (NAIC/SSO)

A survey of the Thomas register at the Library of Congress shows 50 pending pieces of legislation that in one way or another impact the insurance industry and its current regulation.

The NAIC Report on Profitability: Considering an Alternative Calculation Methodology

By NAIC Staff

The NAIC Profitability Working Group of the Statistical Technical Task Force is considering a proposal to use an alternative methodology for calculating formulas in the NAIC Report on Profitability By Line and By State.

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by Mark Peavy (NAIC/SSO)

On January 4, 1999, I sent the following two questions to all state insurance departments on behalf of the NAIC Life and Health Actuarial (Technical) Task Force. As of February 4, 1999, 20 states had submitted responses (which are shown in Appendices 1 and 2).

1) **The Standard Valuation Law does not specify a mortality table for use in the valuation of group life insurance. Instead, use is restricted to "tables approved by the commissioner." Does your state require that particular mortality tables be used in the valuation of group life insurance? If "yes," what table or tables are required?**

2) **Section 4b of the Standard Valuation Law provides for dynamic interest rates based on differing risk characteristics of policies. Section 4b. C.1.(c)(iii) allows for an increase of .05 to the weighting factor for annuities "that do not guarantee interest on considerations received more than one year after issue." Section 4b.C.1.(c)(iv) defines the guarantee duration as "the number of years for which the contract guarantees interest rates in excess of the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years." The question that has been raised is whether the word "guarantee" in 4b.C.1.(c)(iii) refers to any guarantee, or only guarantees in excess of the long-term life rate. Does your state prohibit the use of the .05 addition to the weighting factor when any guarantee is provided, or do you allow use of the additional .05 for guarantees of less than the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years?**

The responses to both questions covered a wide range of positions. Many of the answers had multiple aspects to them, so in the following summaries a state may fall into more than one category. It should also be noted that the summaries below include excerpts of the responses from the states. The actual responses themselves should be reviewed in determining a particular state's position.

Responses to Question #1

Nine states responded by saying that they have no specific valuation table requirements for group life insurance: Arkansas, Idaho, Maine, Minnesota, Montana, New Hampshire, Pennsylvania, South Carolina and Wyoming. Only four states indicated that they have explicitly codified requirements relative to valuation tables for group life. California stated that it requires the use of the American Men Ultimate Table at 3.5% or other tables as may be approved by the commissioner; no other tables have yet been approved. Louisiana requires the use of the American Men Ultimate Table at 3.5% for rate guarantees of five years or less, and the American Experience Table at 4% for guarantees in excess of 5 years. These requirements only apply to persons who are not residents of the continental United States or who are not subject to the Standard Nonforfeiture Law. Louisiana also indicated that its law requires "for other group life CRVM on tables approved by the Commissioner." Missouri indicated that "the 60 CSG is required (200-1.140)." Florida noted that it has explicit statutory requirements only for credit life. Other states might also have explicit requirements for credit life that they did not report. Florida also stated that the department "accepts the 1960 CSG and 1958 and 1980 CSO tables for valuation of group life reserves."

The remaining states do not appear to have formal codified requirements, although they did specify certain preferences. Mississippi indicated that the 1960 CSG is required, but did not indicate if this is a codified mandate. Virginia said, "the required tables are those approved for ordinary life valuation or those specifically constructed for group (i.e., 1960 CSG). But no list of tables has been established." Connecticut indicated that "in all but a few minor instances, statutory reserves are calculated using the CSO Tables applicable to individual business at issue or the 1960 CSG." Oregon stated, "We look for use of the group life table." New Jersey indicated that "tables are approved on a case by case basis." Washington said, "While not set forth in our rules for mortality tables adopted after 1980, the recognized and accepted (= "approved") table is the 1960 CSG Table." It was further noted that the American Men Ultimate Table and the 1941 CSO Table have also been accepted. Alabama stated that its department has no explicit requirement, but that the actuary is required to defend his/her choice.

Responses to Question #2

Five states indicated that they interpret the Standard Valuation Law to preclude the use of the additional .05 weighting factor when there is any guarantee: Alabama, Florida, Mississippi, New Jersey and Washington. Seven states indicated that only guarantees in excess of the long-term life rate would preclude use of the additional .05: Arkansas, California, Connecticut, Missouri, New Hampshire, Pennsylvania, and Virginia. Idaho, Maine, Minnesota and South Carolina indicated that their departments have taken no position on this issue, although South Carolina did state, "it appears that the word 'guarantee' in 4b.C.1.(c)(iii) refers to any guarantee on considerations received more than one year after issue or purchase." Two states (Oregon and Montana) quoted from their law without further explanation. Louisiana stated "the additional .05 may be used, if the reserves are valued on an issue year basis and the guarantee of interest includes considerations received more than one year after issue or purchase. RS 22:163B(3)(c)(iii)c. The additional .05 is prohibited for other annuities with interest rate guarantees. RS 22:163B(3)(c)(iii)d." Wyoming stated the following: "Not prohibited under Group Life Statute in Wyoming."

Individual State Responses to Question #1 As of February 4, 1999

1) The Standard Valuation Law does not specify a mortality table for use in the valuation of group life insurance. Instead, use is restricted to "tables approved by the commissioner." Does your state require that particular mortality tables be used in the valuation of group life insurance? If "yes," what table or tables are required?

AL No, we do not mandate a valuation mortality table for group life insurance. However, the valuation actuary should consider the characteristics of the "group" (Is it more like individual insurance than true group? What about underwriting?) before deciding on the appropriate valuation mortality – and be prepared to justify the table used.

AR No

CA One section of our law specifies the American Men Ultimate Table of Mortality at 3.5% while another more recent section uses the "tables as may be approved by the commissioner" language. California has not, to my knowledge, officially adopted any such tables.

CT Our domestic companies all value group life liabilities on mortality tables that have been approved as minimum standards for other life contingent reserve calculations. In all but a few minor instances, statutory reserves are calculated using the CSO tables applicable to individual business at issue or the 1960 CSG and have been deemed acceptable on audit.

FL The Department accepts the 1960 CSG and 1958 and 1980 CSO tables for valuation of group life reserves. No specific tables are required, except as follows for credit insurance (including group credit life):

625.131 Credit life and disability policies, special reserve bases.

(2) As to single-premium credit life insurance policies, the insurer shall establish and maintain reserves which are not less than the value, at the valuation date, of the risk for the unexpired portion of the period for which the premium has been paid as computed on the basis of the Commissioners' 1980 Standard Ordinary Mortality Table and 3.5 percent interest. In lieu of the foregoing basis, reserves based upon unearned gross premiums may be used at the option of the insurer.

625.121 Standard Valuation Law; life insurance (5)(g) For group life insurance, life insurance issued on the substandard basis, and other special benefits, such tables as may be approved by the department as being sufficient with relation to the benefits provided by such policies.

ID Idaho does not require that any particular mortality tables be used in the valuation of group life insurance. Idaho has adopted the NAIC Model Law without modifications with respect to this definition.

LA For policies on persons not residents of the continental United States or not subject to the standard nonforfeiture law:
Rates guaranteed 5 years or less – American Men Ultimate Table at 3.5%
Rates guaranteed more than 5 years – American Experience at 4% [RS 22:162B and 163A(1)]

For other group life, CRVM on tables approved by the commissioner:
Prior to 09/07/79 at 4% or calendar year statutory interest rate
On and after 09/07/79 at 4.5% or calendar year statutory interest rate. [RS 22:163B(1)]

ME No

MN No explicit position taken by the department on this question.

MO Group Insurance: the 1960 CSG is required (200-1.140)

MS Yes - 1960 CSG

MT No; the Montana code annotated (MCA) designates the mortality tables "for group life insurance ... the tables as may be approved by the commissioner." (33-2-523, MCA). We have nothing in our regulations prescribing such a table.

NH The NH Standard Valuation Law does not specify a mortality table for use in the valuation of group life insurance. Instead, use is restricted to "tables approved by the commissioner." No specific table is required.

NJ We do not require the use of particular tables in the valuation of group life insurance. Tables are approved on a case-by-case basis and depend on the nature of the business. For example, the 1980 CSO Table may be appropriate if the business is individually underwritten.

OR Oregon valuation law refers to tables approved by the director. We look for use of the group life table.

PA Pennsylvania does not require a particular mortality table in the valuation of group life insurance.

SC No

VA Yes. Required tables are those approved for ordinary life valuation or those specifically constructed for group (i.e. 1960 CSG Table). But no list of tables has been established from which the valuation table must be chosen.

WA In Washington, group life insurance is not considered standard ordinary life insurance. While not set forth in our rules for mortality tables adopted after 1980, the recognized and accepted (= "approved") table is the 1960 CSG Table. The American Men Ultimate table and the 1941 CSO Table have also been accepted for the valuation of group life insurance under Washington law.

WY No, a particular table is not specified. We require an actuarial memorandum that discloses which table is being used.

Individual State Responses to Question #2 As of February 4, 1999

2) Section 4b of the Standard Valuation Law provides for dynamic interest rates based on differing risk characteristics of policies. Section 4b. C.1.(c)(iii) allows for an increase of .05 to the weighting factor for annuities "that do not guarantee interest on considerations received more than one year after issue." Section 4b.C.1.(c)(iv) defines the guarantee duration as "the number of years for which the contract guarantees interest rates in excess of the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years." The question that has been raised is whether the word "guarantee" in 4b.C.1.(c)(iii) refers to any guarantee, or only guarantees in excess of the long-term life rate. Does your state prohibit the use of the .05 addition to the weighting factor when any guarantee is provided, or do you allow use of the additional .05 for guarantees of less than the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years?

AL We take a literal interpretation of the SVL on this one. Any guarantee in excess of one year would preclude the use of a factor .05 more than the norm in calculating the weighting factor.

AR We would consider only a guarantee in excess of the long-term life rate.

CA We would allow the use of the additional .05 for guarantees of less than the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years.

CT We interpret the word "guarantee" in 4b(C)(1)(c)(iii) to mean "guarantees in excess of the long-term life rate."

FL The phrase "guarantee duration" as defined in the Standard Valuation Law (and as discussed in the 1981 *NAIC Proceedings* Vol. II, pp. 849-50) seems clearly distinguished from the existence of a guarantee on future considerations. The additional factor for valuation seems inappropriate if the insurer guarantees (non-zero) interest on future considerations, including a rate (such as 3 percent) which is lower than the long-term life valuation rate.

So reserves for FPDAs with 3 percent guarantees which are valued on an issue-year basis must use 5 percent, not 5.25 percent, for 1998 issues, even if the contract guarantees 4.5 percent or less after the first five years.

ID We do not have a staff actuary to consider the guarantees; therefore, we cannot answer that question since the question has not been raised in the past.

LA The additional .05 may be used, if the reserves are valued on an issue year basis and the guarantee of interest includes considerations received more than one year after issue or purchase. RS 22:163B(3)(c)(iii)c

The additional .05 is prohibited for other annuities with interest rate guarantees. RS 22:163B(3)(c)(iii)d

ME This issue has not arisen in Maine.

MN No explicit position taken by the department on this question.

MO The use of the extra .05 is based on guarantees in excess of the long-term life rate.

MS We prohibit the use of the .05 addition when any guarantee is provided.

MT Here is what the MCA says:

33-2-528(1)(c)(iii):
"For annuities and guaranteed interest contracts valued on an issue year basis, other than those without cash settlement options, that do not guarantee interest on considerations received more than 1 year after issue or purchase and for annuities and guaranteed interest contracts valued on a change-in-fund basis that do not guarantee interest rates on considerations received more than 12 months beyond the valuation date, the factors set forth in subsection (1)(c)(i) or derived in subsection (1)(c)(ii) increased by: .05"

33-2-528(c)(2):
"For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, the guarantee duration is the number of years for which the contract guarantees interest rates in excess of the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of 20 years. For other annuities without cash settlement options and for guaranteed interest contracts without cash settlement options, the guarantee duration is the number of years from the date of issue or date of purchase to the date annuity benefits are scheduled to commence."

NH Section 4b of the NH Standard Valuation Law allows use of the additional .05 for guarantees of less than the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years.

NJ New Jersey interprets the word "guarantee" to refer to any guarantee on considerations received more than one year after issue and not just guarantees in excess of the long-term life rate. We would not permit the use of the .05 addition to the weighting factor when any guarantee is provided.

OR ORS 733.310(3)(iii) For annuities and guaranteed interest contracts valued on issue year basis, other than those with no cash settlement options that do not guarantee interest on considerations received more than one year after issue.

733.310(3)(iv) For annuities with cash settlement options, the guaranteed duration is the number of years. Since these two sections refer to differing types of annuities, we would interpret allowing additional .05 when there is no guarantee on considerations received more than one year.

PA Pennsylvania allows use of the additional .05 for guarantees of less than the calendar year statutory valuation rate for life insurance policies with a guarantee duration in excess of 20 years. My recollection is that this issue was discussed in a study note of several years past.

SC South Carolina has not addressed this issue. However, it appears that the word "guarantee" in 4b.C.1.(c)(iii) refers to any guarantee on considerations received more than one year after issue or purchase.

VA Use of the additional .05 to the weighting factor is allowed for guarantees of less than the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of 20 years.

WA RCW 48.74.030(3)(d)(iii)(C) allows for an increase of .05 to the weighting factor for annuities "valued on an issue year basis other than those with no cash settlement options which do not guarantee interest rates on considerations received more than twelve months beyond the valuation date." The .05 is not allowed otherwise. That is, an interest rate guarantee (such as 3 percent) greater than zero percent is an interest rate guarantee.

WY Not prohibited under Group Life Statute in Wyoming.

NAIC Electronic Commerce and Regulation Working Group

by Teresa Walker (NAIC/SSO)

Introduction

The NAIC Electronic Commerce and Regulation Working Group was formed by the NAIC (EX) Special Committee on Regulatory Re-engineering at the 1998 Spring National Meeting of the NAIC. The newly formed working group was given the following charge:

> Evaluate methods by which the Internet and other means of electronic commerce can be used to increase efficiencies in the regulation of insurance and make specific recommendations by the 1999 Fall National Meeting. Develop specific recommendations to update and, where appropriate, harmonize state laws, regulations and procedural requirements governing the insurance industry: to facilitate the use of beneficial electronic commerce by insurers; to allow continuous improvement in cost/quality of access, delivery and administration of insurance products and services; and to maintain or improve appropriate consumer protections.

Chaired by Craig Travis, Assistant Commissioner of the California Department of Insurance, the current working group members include: Arkansas, California, Delaware, District of Columbia, Indiana, Maine, Maryland, Nebraska, New York, North Carolina, Oregon and Utah. There is also a large listing of interested parties from the insurance industry that participate in the working group. The current members of the working group feel very strongly about the issues that they are working to resolve. They highly encourage all states and interested industry representatives to participate in the meetings.

State and Industry Surveys

During 1998, the working group prepared a survey to be completed by the state insurance departments to gather more information on current conditions and direction of the states regarding electronic commerce. The state survey (Figure 1) was placed on the NAIC web site and was the first NAIC survey to be collected via the Internet. Once the responses began to come in, the working group decided that it would be helpful also to have input from the insurance industry. At that time, the state survey was modified and again placed on the NAIC web site for completion by both insurers and insurance producers (Figure 2). The results from both surveys proved to be helpful in finding direction for the working group to move forward. The state survey results are too voluminous to be presented in this article. However, a summary of the insurer/producer survey results is presented in Figure 3.

Working Group Issues

After much discussion, the working group has identified a list of impediments to electronic commerce in regard to insurance transactions and the regulation of the insurance industry. The working group is addressing these issues through an issues paper. The issues paper is currently being distributed for further drafting. Upon adoption, the issues paper will be submitted to the parent committee. The issues paper gives examples of impediments, definitions of terms, and suggested resolution to the impediments. The suggested resolutions include repeal of state laws and regulations, change in definitional interpretation, and revision of state laws, regulations and procedures. Following are areas discussed in the working group issues paper:

- Countersignature requirements and other non-resident solicitation restrictions
- Signature requirements
- Delivery of documents
- Format of documents
- Electronic payments
- Records retention
- Disclosure of license status
- Advertising
- Compensation
- Code and regulation clean-up
- Proof of coverage
- Privacy issues

The working group is also developing a state assessment tool that is intended to be used by state regulators to assist them in eliminating impediments to electronic commerce in their state. The tool will be in a format that will allow states to check off areas where they have examined their state laws, regulations and procedures and have corrected or verified that there are no longer impediments.

Other NAIC Initiatives

The NAIC has many committees, task forces and working groups discussing and dealing with issues related to electronic commerce in the insurance industry. To avoid duplicate efforts, the working group is encouraging communication and teamwork between the various groups and projects. Following are a few examples of the NAIC projects currently under way that include electronic commerce issues:

- Producer Information Network (PIN)
- System for Electronic Rate and Form Filings (SERFF)
- Agent Licensing Initiative
- Y2K
- NAIC White Paper: *The Marketing of Insurance Over the Internet*
- Various NAIC Model Laws

Conclusion

To be added to the interested parties list or to receive additional information about the Electronic Commerce and Regulation Working Group, please contact Teresa Walker at the NAIC by e-mail at twalker@naic.org or by phone at (816) 889-6818.

Figure 1

Electronic Commerce & Regulation Working Group
State Survey

1. What elements do you consider to be included in the definition of "electronic commerce"?

2. Disclosure Standards

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited. Should specific disclosure standards be developed? Should regulatory guidelines be developed? Is voluntary participation by the industry sufficient?
C. If you feel that no action is warranted for this item, please explain why.

3. Records Retention Requirements

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

4. Electronic Signature Requirements

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions, including the elimination of signature requirements, that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

5. Countersignature Requirements

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

6. Advertising Requirements

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

7. Verification/Validation of Various Documents/Acts

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

8. Regulator Contacts

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

9. Binders

A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

10. Prohibitions or Restrictions Against Mandatory Electronic Payments or Payment by Credit Card
A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

11. Consumer Education Efforts
A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

12. Rates & Forms
A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

13. Consumer Complaint Handling
A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

14. Insurance Department Internet Sites
A. Please identify any action already under way in your state to address this item.
B. Please explain any actions that you believe should or should not be taken to ensure that the use of electronic commerce, as it relates to this item, is not unduly inhibited.
C. If you feel that no action is warranted for this item, please explain why.

15. Please identify, and rank in order of importance, any other issues relative to electronic commerce and regulatory efficiencies that you feel need to be addressed by the working group to alleviate barriers to electronic commerce and/or streamline the regulation of insurance using available or emerging technologies.

Figure 2

Electronic Commerce & Regulation Working Group
Insurance Industry Survey

1. Please identify whether you are responding on behalf of an insurer or an insurance producer. Producer includes both brokers and agents.
   A. Insurer
   B. Producer

Disclosure Standards: This refers to state laws or regulations that require insurers and producers to inform consumers where the insurer or producer is licensed to transact insurance. For example, on the Internet, this disclosure might be provided in a clear, easy to understand manner, perhaps on a web site's main page or off a link from the main page.

2A. Please identify the choice that best describes the action taken by your organization to address this item.
   A. No action
   B. Our web site lists applicable insurer and/or producer state licensing information.
   C. Our web site contains links to the state of domicile Department of Insurance web site, which lists state licensing information for insurers and/or producers.
   D. Insurer and/or producer disclosure of licensing information is not required by the state of domicile Department of Insurance.
   E. None of the above
   F. No response

2B. Should specific disclosure standards be developed?
   A. Yes
   B. No
   C. No opinion
   D. No response

2C. If specific disclosure standards were developed, do you think that voluntary participation by the insurance industry would be sufficient?
   A. Yes
   B. No
   C. We do not think that standards are necessary
   D. No response

2D. Do you consider differing standards for each state to be a barrier to your use of electronic commerce to service your customers?
   A. Yes
   B. No
   C. No opinion
   D. No response

Records Retention Requirements: This refers to the elimination of requirements that records be maintained in a paper format, by insurers, producers or regulators, and the development of other standards necessary to allow for the electronic retention of records.

3A. Please identify the choice that best describes the action taken by your organization to address this item.

A. No action
B. State of domicile does not require that records be kept in a paper format
C. We use microfiche, imaging system, or other paperless records retention system
D. Both B and C
E. None of the above
F. No response

3B. Do you agree that requirements in state laws or regulations that specify the retention of records in paper are a barrier to your use of electronic commerce to service your customers?

A. Yes
B. No
C. No opinion
D. No response

Electronic Signature Requirements: This refers to the implementation of laws or regulations that recognize electronic signatures as having the same force and effect as wet (hand written) signatures.

4A. Please identify the choice that best describes the action taken by your organization to address this item.

A. No action
B. We use electronic signatures where state law allows
C. We do not use electronic signatures
D. None of the above
E. No response

4B. Are you in favor of the use of electronic signatures?

A. Yes
B. No
C. No opinion
D. No response

4C. Do you consider state laws or regulations requiring wet signatures to be a barrier to your use of electronic commerce to service your customers?

A. Yes
B. No
C. No opinion
D. No response

4D. If states were to adopt differing standards for the use of electronic signatures, would you consider that to be a barrier to your use of electronic commerce to service your customers?

A. Yes
B. No
C. No opinion
D. No response

Countersignature and Accompaniment Requirements: This refers to the elimination of producer countersignature and accompaniment (i.e., laws requiring that a licensed resident agent “accompany” a licensed non-resident agent during the non-resident’s solicitation) requirements.

5A. Should states eliminate countersignature requirements?

A. Yes

B. No
C. No opinion
D. No response

5B. Should states eliminate accompaniment requirements and other unique restrictions on the activities of licensed non-resident agents?
A. Yes
B. No
C. No opinion
D. No response

Advertising Requirements: This refers to a state's regulation of advertisements and the revision of laws or regulations that reference "paper," "printed" or "written" advertisements.

6A. Please identify the choice that best describes the action taken by your organization to address this item.
A. We currently apply all laws that are applicable to "paper" advertisements to our electronic commerce advertising.
B. We currently advertise under the definition of electronic commerce, but do not apply laws pertaining to "paper" advertisements to our electronic commerce advertising.
C. We currently do not advertise under the definition of electronic commerce.
D. None of the above
E. No response

6B. Do you consider the lack of advertising requirements in state laws or regulations that mention electronic advertisements to be a barrier to your use of electronic commerce to service your customers?
A. Yes
B. No
C. No opinion
D. No response

6C. If states were to adopt differing standards for review of electronic advertising materials, would you consider that to be a barrier to your use of electronic commerce to service your customers?
A. Yes
B. No
C. No opinion
D. No response

Verification/Validation of Various Documents/Acts: This refers to the ability to verify or validate the electronic transmission or issuance of various documents, such as insurance contracts, rejections, proof of coverage or policyholder notices, including the language, contents and format of the document transmitted.

7A. Please identify the choice that best describes the action taken by your organization to address this item.
A. No action
B. We have put or are putting systems in place that we feel provide appropriate verifications and validations.
C. No response

7B. Do you agree that this is an area that needs to be addressed by insurance regulators or the legislatures?
A. Yes

B. No
C. No opinion
D. No response

Regulator Contacts: This refers to any requirement that a separate contact be made available within each admitted insurer for questions relating to electronic commerce and/or Internet transactions. This also refers to the maintenance of e-mail addresses and URLs in your database.

8A. Does your company have an employee that is specifically assigned as a contact for questions regarding electronic commerce and/or Internet transactions?
A. Yes
B. No
C. No response

8B. Should insurer contact information (e-mail address and URL) be added to the NAIC financial statement data along with other insurer contact information?
A. Yes
B. No
C. No response

8C. Do you maintain your own database of e-mail addresses and URLs for your agents/producers?
A. Yes
B. No
C. No response

Binders: This refers to the electronic issuance of binders, any special formatting requirements and whether an electronic confirmation constitutes a binder.

9A. Do you issue electronic binders, or otherwise bind policy coverage on-line?
A. Yes
B. No
C. No response

9B. Do you agree that an electronic confirmation constitutes a binder?
A. Yes
B. No
C. No response

9C. Do you agree that electronic binders should be allowed?
A. Yes
B. No
C. No response

9D. Do you consider the lack of standards in state laws or regulations regarding electronic binders to be a barrier to your use of electronic commerce to service your customers?
A. Yes
B. No
C. No opinion
D. No response

9E. If states were to adopt differing standards for electronic binders, would you consider that to be a barrier to your use of electronic commerce to service your customers?
A. Yes
B. No

C. No opinion
D. No response

Prohibitions or Restrictions Against Mandatory Electronic Payments or Payment by Credit Card: This refers to state laws or regulations that prohibit or restrict electronic payments or payments by credit card. This can include payments to or from consumers, insurers, producers or regulators.

10A. Should electronic payments to or from consumers, insurers, producers or regulators be allowed?
A. Yes
B. No
C. No opinion
D. No response

10B. If you agree that electronic payments should be allowed, then do you think that standards should be established for this process?
A. Yes
B. No
C. No opinion
D. No response

10C. Do you currently accept electronic forms of payment?
A. Yes
B. No
C. No response

10D. If states were to adopt different standards for electronic payments, would you consider that to be a barrier to your use of electronic commerce to service your customers?
A. Yes
B. No
C. No opinion
D. No response

Consumer Education Efforts: This refers to consumer education efforts being taken, or that should be taken, by state regulators, the NAIC, consumer representatives or the industry relative to the use of electronic commerce by the insurance industry.

11A. Please identify the choice that best describes the actions taken by your organization to address this item.
A. No action
B. We currently provide general educational materials to consumers on our web site.
C. We currently provide specific insurance advice on our web site.
D. We provide brochures containing information on how to access our web site and how to use the serv ices provided on our web site.
E. Other
F. No response

11B. Do you believe that states should develop standards for consumer education efforts using electronic means?
A. Yes
B. No
C. No opinion

D. No response

11C. If states were to adopt different standards for consumer education efforts using electronic means, would you consider that to he a barrier to your use of electronic commerce to service your customers?
A. Yes
B. No
C. No opinion
D. No response

Rates and Forms: This refers to requirements that rates and forms be filed on paper and whether states should permit the electronic filing of rates and forms, similar to the System for Electronic Rate and Form Filing (SERFF).

12A. Are you familiar with the System for Electronic Rate and Form Filing (SERFF)?
A. Yes
B. No
C. No response

12B. Should insurers be allowed to file rates and forms electronically?
A. Yes
B. No
C. No opinion
D. No response

12C. Should insurers be required to file rates and forms electronically?
A. Yes
B. No
C. No opinion
D. No response

Consumer Complaint Handling: This refers to how industry is using electronic transmissions/ communications to resolve consumer complaints.

13A. Please identify the choice that best describes the actions taken by your organization to address this item.
A. No action
B. Our web site allows consumers to send questions and complaints to our offices for review.
C. We provide our e-mail address and web site address on policies and/or other documentation sent to insureds for more convenient communication of questions and complaints.
D. Other
E. No response

14. Please provide any comments or concerns that you have about other areas of electronic commerce that you feel were not discussed in this survey:

Figure 3

Summary of the Electronic Commerce & Regulation Working Group Insurance Industry Survey Responses

	Insurer						Producer					
Question	A	B	C	D	E	F	A	B	C	D	E	F
1A	26						19					
2A	2	8	0	3	8	5	4	3	0	1	6	5
2B	13	11	2	0			14	2	3	0		
2C	17	3	5	1			8	8	1	2		
2D	24	2	0	0			15	3	1	0		
3A	1	2	7	7	4	5	1	0	7	1	8	2
3B	23	3	0	0			13	5	0	1		
4A	6	5	10	3	2		3	5	9	2	0	
4B	25	0	1	0			16	3	0	0		
4C	24	1	1	0			13	6	0	0		
4D	25	1	0	0			14	2	2	1		
5A	23	0	3	0			13	5	1	0		
5B	25	0	1	0			12	5	1	1		
6A	20	0	2	1	3		6	1	9	1	2	
6B	3	19	2	2			3	7	5	4		
6C	25	1	0	0			14	1	1	3		
7A	8	15	3				7	6	6			
7B	11	11	3	1			11	5	1	2		
8A	10	14	2				8	8	3			
8B	15	6	5				14	2	3			
8C	14	7	5				8	3	8			
9A	6	15	5				7	11	1			
9B	17	1	8				13	3	3			
9C	22	1	3				17	1	1			
9D	9	13	1	3			9	4	2	4		
9E	23	1	0	2			16	0	1	2		
10A	25	0	1	0			19	0	0	0		
10B	9	12	2	3			11	6	1	1		
10C	15	9	2				5	13	1			
10D	25	1	0	0			16	1	1	1		
11A	4	15	1	1	2	3	5	5	1	4	1	3
11B	3	18	5	0			9	7	3	0		
11C	24	1	1	0			13	4	1	1		
12A	21	4	1				4	12	3			
12B	25	0	1	0			19	0	0	0		
12C	2	20	3	1			8	9	1	1		
13A	1	14	5	4	2		5	3	6	2	3	

Resources for Members & Staff Available Through the NAIC Research Library

by Deborah Scott (NAIC/SSO)

Basic research is part of "doing the job" in our industry. When you search for information to find out what is new, what other departments encounter, or to discover best practices covering your area, you are doing research. We live and work in an information economy and an industry dependent on complete, accurately presented information.

In the Research Library, we process an average of 700 requests per month for NAIC members and support staff; state, federal, and international government agencies and legislators; insurance industry companies, agencies, and associations; law firms, consultants, consumers, and even students. For our diverse customer base, we use a variety of resources. We are able to share **Corporate ResourceNet (CRN)** with you through a contract arrangement with our vendor, EBSCO.

CRN is a reference service that combines information from more than 4,000 searchable sources, a directory covering more than 200,000 companies and 80,000 hand-selected Web links with a Web-based interface. Anyone in any of our support staff offices or 55 regulatory department offices may use this product FREE of charge. **CRN** was officially rolled out to the states on January 11, 1999, as "Collectanea."

CRN is ready for your use and is present on our web site in three places: Under the Library header of "Help & Support", the Library header of "Products & Services" and under "What's New."

Click on: "**Corporate ResourceNet**." You will be connected to a login screen.

Each state has an individual ID and password, enabling us to track usage. You will insert the appropriate login and password in the boxes, as prompted by the screen. All words are to be entered in lowercase, with no spaces. State Insurance Department usernames and passwords were sent in January and again in March when the service was updated.

Get in and have a look around CRN

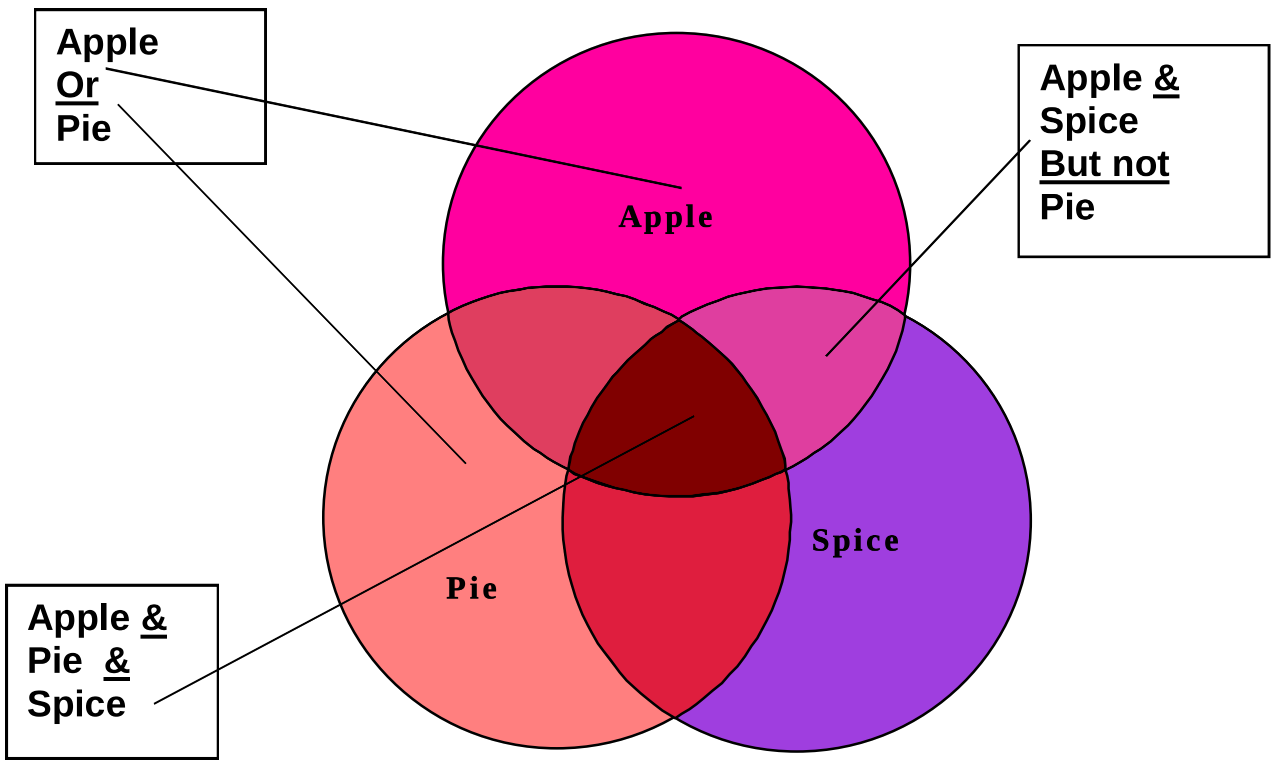
This is a simple reference tool for everyone to use to augment our library services and put some organized resources at your desk. The **periodical collection** has six subsets. You can search the entire collection of sources or focus on smaller, specialized collections. The **company directory** features company profile pages linked to both the company directory and hyperlinked company names in the articles. Company pages offer data licensed from Dun & Bradstreet, Disclosure Incorporated and Thomas Register. More than 200,000 U.S. public and private companies are covered.

How to Search

Search for articles and company information using natural language or Boolean searching, as well as keyword search all fields in the database—including full text, charts and graphs. Results can be e-mailed, downloaded or printed with options to print selected articles, print the entire article or just portions of selected text.

If you are not familiar with the terms "natural language" or "Boolean," they describe two ways to enter your search question. "Natural language" means you can enter a question or phrase, just the way you would speak it. The search engine will sort out the important and unique terms and run around the database gathering articles that contain those terms. "Boolean" searching is a little more precise because you are telling the search engine how you want your important terms to be found. You can use qualifiers such as "and," "or," "not" to specify how you want the terms included or valued for your search. Some examples are illustrated below.

A natural language version of these search-es is the **phrase "spices used in apple pie"**. The search engine will still select the words apple, pie and spice as the unique words.



However, you will have to supply all the discrimination by scanning all hits for the ones that come closest to your meaning. By using these simple strategies, you can use Corporate ResourceNet to:

- Research and apply specific business strategies within your industry
- Conduct research on market trends
- Explore possibilities for new products and services
- Access information about companies instantly
- Conduct background research on potential and current vendors

Advantages to using a resource such as Corporate ResourceNet, rather than random surfing on the net are:

- Information is organized and indexed for retrieval
- Information is from verified sources
- Date of latest update is readily available
- A wide variety of resources is gathered into one tool

An important feature for once-in-a-while users is the **help** available within the program as a **tutorial**, an **index** of topics, or **examples** to demonstrate whatever method you select from the first search screen. **Help** is available every step of the way, as you check results, select articles to read, print, e-mail or download. For help outside of the database:

- For **USERNAME/PASSWORD questions or search structure questions,** contact the NAIC **Research Library** by phone: 816-374-7175; fax: 816-889-4446; or web site: reslib@server.naic.org.

- **TECHNICAL questions**: Find answers to commonly asked technical questions 24 hours a day on the web site at **http://www.epnet.com**. Contact Technical Support via e-mail at **eptech@epnet.com** or by phone at **(800)-758-5995**. (Technical Support staff is available for calls Monday through Friday from 7 a.m. to 7 p.m. & Saturday and Sunday 9 a.m. to 5 p.m. All times U.S. Eastern Standard.)

Insurance and the 106th Congress

by Ray Spudeck

Although still early in the legislative season, the 106th Congress is showing considerable enthusiasm in proposing insurance related legislation. A survey of the Thomas register at the Library of Congress shows 50 pending pieces of legislation that in one way or another impact the insurance industry and its current regulation. While some of these bills are primarily designed to address “housekeeping” details regarding existing Federal policies, employees, and programs, others are designed to increase either the presence of or regulatory reach of the Federal government. Legislation is being proposed that would alter the structure of insurance markets and regulation in the areas of financial services regulation, catastrophe risk management and insurance, automobile insurance, managed health care, and crop insurance. The purpose of this article is to provide a review of some of the more controversial proposed legislation relating to insurance regulation in these areas.

Financial Services Regulation

The most visible piece of legislation impacting insurance legislation, of course, is H.R. 10, the Financial Services Modernization bill. Proposed to make firms in the US financial system more competitive in the global marketplace, the bill is designed to remove the last vestiges of the Glass-Steagall Act. On March 23, 1999, the bill was referred to the House Committee on Banking and Financial Services. Senator Phil Gramm has recently reiterated that he would not allow the bill through the Senate if it retained existing language maintaining and extending the Community Reinvestment Act (CRA).

Rep. Jesse L. Jackson, Jr. has introduced H.R. 1429, officially titled “A bill to establish a program under the Secretary of Housing and Urban Development to eliminate redlining in the insurance business.” The intent of the bill is, as the name implies, to eliminate alleged redlining in the insurance industry. The Bill was referred to the House Committee on Banking and Financial Services on April 15, 1999.

Catastrophe Risk

Rep. Rick Lazio, along with 75 cosponsors, has introduced H.R. 21 titled “A bill to establish a Federal program to provide reinsurance for State disaster insurance programs. The bill’s short tile is “Homeowners’ Insurance Availability Act of 1999.” If passed, the bill directs the Secretary of Treasury to carry out a program to make reinsurance coverage available for purchase by eligible state programs and private insurers and reinsurers via auction. The program is not to displace private insurance and is designed to be short term in existence, lasting only ten years, with the possibility of another five year extension.

The bill was referred to the House Committee on Banking and Financial Services on January 6, 1999, where it was referred to the Subcommittee on Housing and Community Opportunity.

Rep. Tillie Fowler has introduced H.R. 707, officially titled “A bill to amend the Robert T. Stafford Disaster Relief and Emergency Assistance Act to authorize a program for predisaster mitigation, to streamline the administration of disaster relief, to control the Federal costs of disaster assistance, and for other purposes.” The short title is “Disaster Mitigation and Cost Reduction Act of 1999 Robert T. Stafford Disaster Relief and Emergency Assistance Act.” As the name suggests, the bill offers new rules and processes for predisaster hazard mitigation programs and offers new processes for streamlining and reducing the cost of the program. The bill was passed by the House on March 3, 1999 by a 415-2 vote and on March 4, 1999 was received in the Senate, read twice and referred to the Committee on Environment and Public Works. A similar early bill was H.R. 533, sponsored by Rep. Sherwood L. Boehlert. The Senate version of the bill S. 583 was read twice and referred to the Senate Committee on Environment and Public Works on March 10, 1999.

Rep. Patsy T. Mink has introduced H.R. 48, officially titled "A bill to provide for a Federal program of insurance against the risk of catastrophic earthquakes, volcanic eruptions, and hurricanes, and for other purposes." The short title is "Earthquake, Volcanic Eruption and Hurricane Hazards Insurance Act of 1999." The bill would require the Director of FEMA to identify earthquake- volcanic eruption- and hurricane-prone states and areas and would create the Earthquake, Volcanic Eruption, and Hurricane Loss Mitigation Advisory Committee to develop loss-reduction criteria for state and local land use and management ordinances, building codes and other measures. FEMA would then be directed to provide national coverage for residential property in these areas.

On February 2, 1999, the bill was referred to the House Committee on Banking and Financial Services for a period to be determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned. It was also referred to the Subcommittee on Housing and Community Opportunity on February 2, 1999. On February 19, 1999 the bill was referred to the House Subcommittee on Basic Research.

Automobile Insurance

Rep. Patsy T. Mink is sponsoring H.R. 644 titled "A bill to establish requirements for the cancellation of automobile insurance policies." The bill is cosponsored by Reps. Barbara Lee and Bob Filner. The bill would prohibit states from authorizing the sale of automobile insurance unless it was subject to cancellation in accordance with the requirements of the Act.

Under the Act, cancellation would only be allowed under three conditions: 1) written cancellation notice is given to the insured at least 180 days before the cancellation; 2) the named insured's drivers license was suspended or revoked, or; 3) the insured has been convicted of, or forfeited bail for, and action connected with operating a motor vehicle that constitutes grounds for license suspension or revocation.

The bill was referred to the House Committee on Commerce on February 9, 1999 and then referred to the Subcommittees on Finance and Hazardous Materials on February 24, 1999.

Health Care

Over a hundred pieces of legislation reagarding health care are currently pending in the 106th Congress. Many of those are designed to modify current federal programs and regulations. A few, on the other hand could have a new impact on state insurance regulation.

Senators Jack Reed and Ron Wyden have introduced S. 496, offically titled "A bill to provide for the establishment of assistance program for health insurance consumers." The short title is the "Health Care Consumer Assistance Act." Under the bill, The Secretary of Health and Human Services is charged to award grants to states to enable states to enter into contracts for the establishment of consumer assistance programs designed to assist consumers of health insurance in understanding their rights, responsibilities and choices among health insurance products.

The bill was read twice and referred to the Senate Committee on HELP on March 2, 1999.

Crop Insurance

Rep. Larry Combest sponsored H.R. 1212 titled "A bill to protect producers of agricultural commodities who applied for a Crop Revenue Coverage PLUS supplemental endorsement for the 1999 crop year." The bill was passed by the House on March 23, 1999. It was received by the Senate on March 24, and passed in the Senate by unanimous consent on March 25 (as S.756). Sent to the White House, the President signed the bill on April 1, 1999 at which time it became Public Law No: 106-7.

The Law allows eligible producers who obtained supplemental coverage under the

CRCPLUS program a period of time (not to extend past April 12, 1999) during which they may:

1) obtain from any approved insurance provider a level of coverage for the commodity originally applied for under the CRCPLUS endorsement that is equal to or less than the level of federally reinsured coverage that the producer applied from the insurance provider that offered the CRCPLUS endorsement, and;
2) transfer to any approved insurance provider any federally reinsured coverage provided for other agricultural commodities of the producer by the same insurance provider that offered the CRCPLUS endorsement.

Senator Pat Roberts is sponsoring S.529 titled "A bill to amend the Federal Crop Insurance Act to improve crop insurance coverage, to make structural changes to the Federal Crop Insurance Corporation and the Risk Management Agency, and for other purposes." The short title is "Crop Insurance Act for the 21st Century." The bill was introduced on March 3, 1999 where it was read twice and referred to the Committee on Agriculture.

Under the provisions of the bill, provisions of the existing Act are modified with respect to changes in the payment of portion of premium by the Corporation, assigned yields and definitions of assigned yields, multiyear disaster actual production history adjustment measurements and techniques, increases in coverage policy, and livestock insurance. A rating methodologies pilot program is called for. The bill also modifies the nature and makeup of the Agency's Board, management, and fee schedules.

The bill was read twice and referred to the Senate Committee on Agriculture on March 4, 1999.

The NAIC Report on Profitability: Considering an Alternative Calculation Methodology

by NAIC Staff

The NAIC Profitability Working Group of the Statistical Technical Task Force is considering a proposal to use an alternative methodology for calculating formulas in the *NAIC Report on Profitability By Line and By State.* This report combines by line and by state calendar year data from the "Exhibit of Premiums and Losses By State" (Page 15 (Statutory Page 14) of the Property/Casualty Annual Statement) with by line data from the Insurance Expense Exhibit (IEE) and certain other pages of the annual statement to develop estimates of insurer profits on insurance transactions and to insurer "Return on Net Worth" aggregated by line and by state. The report also shows the various components of estimated profits including:

- premiums earned;
- losses incurred;
- loss adjustment expense;
- general expenses;
- selling expenses;
- taxes, licenses and fees;
- dividends to policyholders;
- underwriting profits;
- investment income;
- and federal income taxes

Formulas in Report Calculated on an *Aggregate Basis*–Current Methodology

The current methodology creates a single insurance "entity" from all property/casualty insurers that file annual statements and exhibits with the NAIC, by aggregating all raw data elements. It then performs a single set of formula calculations on this "Aggregated Entity" to arrive at the dollar amounts used in the report. However, most companies do not restrict their operations to writing a single line of business in a single state. Accordingly, the by line and by state profitability analysis is built in part, on allocations of financial data reflecting multi-line and multi-state operations.

Therein lies a significant concern associated with this methodology. Aggregating the data for all companies prior to performing any calculations results in industrywide ratios that are applied to all states and lines. However, not all companies participate in all markets. Therefore, to the extent that the experience of those companies that actually participate in the market for a particular line in a particular state differs from industrywide experience, distortions in the actual profitability in the state will exist.

Formula Calculations on a *Group-by Group* Basis–Proposed Alternative Methodology

The proposed alternative methodology performs the report's formula calculations on a *group-by-group* basis, using combined annual statement data, where available, to develop dollar amounts for each insurer group or for each individual company not part of a group. The dollar amounts of each group or individual company are then summed to arrive at the final dollar amounts used in the report. The proposed change deals with the internal aggregation of data and development of dollar amounts. These internal aggregation changes would be transparent; that is, a year to year comparison of the formulas may not indicate any significant differences. The change, however, is significant because rather than using a countrywide adjustment factor to allocate the effects of affiliate businesses for example, group- by-group calculations in the new version would be more accurate.

The following items are currently reported by company by state and used in the report:

- premiums written
- premiums earned
- dividends to policy holders
- unearned premium reserves
- losses incurred
- losses unpaid
- direct allocated loss adjustment expense incurred
- allocated loss adjustment expense reserves unpaid
- commissions and brokerage expenses;
- taxes licenses and fees

Data that are not reported by state are allocated to each state according to the company's premiums, losses, or liabilities to estimate state results. This in effect "weights" the results by state as each company contributes only that amount which is reasonably attributable to a state and line. (Implicit in this allocation method is that expense ratios do not differ among the states, a situation that is not likely.)

There are two extreme situations: 1) a company does not write a particular line in a state resulting in no amount being allocated to that state and line and 2) a company writes one hundred percent of its business in a particular state resulting in the entire amount being allocated to that state and that state only. All other states would be unaffected in the second example. Most companies will fall somewhere in between. In the event that state amounts exceed equivalent countrywide amounts (for whatever reason), the ultimate ratio of state to countrywide amounts may be limited to a maximum of one.

Examples 1 and 2 illustrate the differences in the two methodologies. The data used in the examples focus on the development of the IEE or other acquisition expense portion of the Selling Expense amounts for the Other Liability, line 14 (as defined in the profitability report). Limiting the population to two observations in these examples does not diminish their usefulness in demonstrating the differences between options. It should be noted that Company A has nearly a 15% market share versus a less than .5% share for Company B.

Issues that Need to be Resolved to Produce the Group-by-Group Report

The actual production of a meaningful report developed on the proposed alternative basis has yet to be completed due to various data, formula and technical issues. Major programming changes necessary to produce the alternative Profitability Report were completed in 1998 along with the conversion of the NAIC's database from the mainframe to a client-server format. Although much of the programming necessary to produce the Profitability Report on the alternative basis has been put into place, several technical issues still need to be resolved such as the development of programming to handle averaging of prior and current year data, where applicable. The composition of companies in combined annual statements can and do change from one year to the next. Members are considering several programming methods to deal with report formula calculations that require the averaging of two years of annual statement data. The members are looking at the pros and cons of various approaches for adjusting results for one or both of the data years and the results produced by each approach. It is agreed that, although there is no way to create an exact match of group compositions from year to year, it would be preferable to maintain the current reporting year group compositions, to the extent possible, and to apply any adjustments, (particularly subtractions to group totals) to the prior year data. Also, as might be expected, a report that utilizes the proposed methodology requires a significantly greater amount of time to run due to the considerably greater number of calculations performed. This hampers effective and timely analysis of preliminary results.

Foremost among the data issues requiring resolution are some major data limitations to accurately producing some of the report's results. These data limitations include missing exhibits, inconsistent reporting and the limited ability to historically track group compositions, particularly prior year data used to calculate "Return on Net Worth". The reason for this is that the NAIC database is not designed to maintain and to track meaningful group historical information. In the current methodology, historical groupings have been created manually using combined annual statements, but the information is available back to 1990 only. Accordingly, the NAIC database cannot be used exclusively to identify companies within groups in the years 1986, (when the federal tax formula was revised to reflect provisions of Tax Reform Act of 1986) through 1989. In a "group-by-group" report this information is necessary in order to perform report calculations in 1998, for example, using the tax formula carried through from 1987, on groups that are consistent in make-up throughout the years. One critical determination that needs to be made deals with the handling of data for those companies that fail the screening for a minimal set of data. One proposed approach is to simply omit the data. The second is to aggregate data from the "orphan" companies into a single "artificial" entity.

Members of the working group will also need to develop an appropriate method of dealing with anomalies that result when calculations are performed on a group-by-group basis rather than in the aggregate. In the various areas where anomalies occur, decisions will be required regarding what to do about them, particularly in the creation of the "Return on Net Worth" column due to various ratios that must be calculated first. For example, with regard to the development of the surplus ratio and the investment gain ratio, adjustment factors that are currently developed and used on an aggregate basis will need to be revised since such factors would not be appropriate for individual groups or stand-alone companies.

Several ways in which to deal with these anomalous results include capping results or applying a prorated industry-wide factor by company in the development of certain ratios, such as the deferred tax ratio used in the overall formula for "Return on Net Worth". Members need to decide also whether to use one factor for each state, or to develop adjustment factors using the actual ratio of companies in a combined statement and a countrywide ratio for companies not in a combined statement. (Note: It has been suggested that with regard to the deferred tax calculation, an industry average could be applied in the development of the deferred tax ratio each year until the NAIC codification of annual statement information is complete and companies will be required to report an actual deferred tax figure.)

Despite these concerns, and the difficulties encountered in trying to resolve them, working group members agree that the proposed methodology is the technically more desirable approach. The group remains open to input from others in the report's development and invite that input at future meetings of the Profitability Working Group. Further information on the alternative methodologies for developing the *NAIC Report on Profitability* is available by contacting Jim Bugenhagen, Research Associate at the NAIC. He can be reached by telephone at 816/374-7276 or by e-mail at jbugenha@naic.org. Copies of the report are available through the NAIC Publications Department.

Example 1

Current Methodology
By Aggregated Company and Aggregated Line Illustration

The complete formula for Column 5, Selling Expenses is as follows:

5. Selling Expenses

{(Page 15, Column 12 x (Page 15, Column 3/Page 15, Column 2)) + **(IEE, Part III, Column 14 x (Page 15, Column 3/IEE, Part III, Column 1)**}.

Only development of the amount for that portion of the formula appearing in bold type is examined.

	Page 15 Premiums Earned	IEE Premiums Written	IEE Other Acquisition Expense
Company A			
Other Liability, line 17	$5,446,767	$139,654,000	$5,289,000
Products Liability, line 18	5,454	19,450,000	1,168,000
Company B			
Other Liability, line 17	$109,828	$200,240,000	$1,902,000
Products Liability, line 18	6,708	37,626,000	367,000

Step 1. All data elements are summed prior to any manipulation. This results in the following figures:

Report Line 14			
Other Liability	$5,568,757	$396,970,000	$8,726,000

Step 2. To arrive at a dollar amount, results produced in Step 1 are substituted into the following formula:

Other Acquisition Expense = (IEE, Part III, Column 14 x (Page 15, Column 3/IEE, Part III, Column 1)}
where IEE Part III, Column 14 = IEE Other Acquisition Expense
and Page 15, Column 3 = Page 15 Premiums Earned
and IEE, Part III, Column 1 = IEE Premiums Written.

This methodology, which is currently in place, generates an expense figure of about $122,410 or roughly 2.2% of premiums earned. The actual ratio is .02198. In contrast, the result in percent of premiums earned in Example 2, nearly at 4.0% significantly exceeds that observed here. The actual expense ratio for the Example 2 option is .03993. It is quite apparent that significant differences exist between the discriminate weighting in Example 2 and the indiscriminate weighting in the current methodology.

Example 2

Proposed Methodology
By Group and Aggregated Line Illustration

The complete formula for Column 5, Selling Expenses is as follows:

5. Selling Expenses

{(Page 15, Column 12 x (Page 15, Column 3/Page 14, Column 2)) + **(IEE, Part III, Column 14 x (Page 15, Column 3/IEE, Part III, Column 1)**}.

Only development of the amount for that portion of the formula appearing in bold type is examined.

	Page 15 Premiums Earned	IEE Premiums Written	IEE Other Acquisition Expense
Company A			
Other Liability, line 17	$5,446,767	$139,654,000	$5,289,000
Products Liability, line 18	5,454	19,450,000	1,168,000
Company B			
Other Liability, line 17	$109,828	$200,240,000	$1,902,000
Products Liability, line 18	6,708	37,626,000	367,000

Step 1. All data elements for the lines of business in the report are summed as in Option 1 prior to any manipulation. However, this is where the similarity ends. Data is segregated for each company rather than summed as in Option 1 to arrive at a single set of ratios. Each company has dollar amounts developed independently using its own set of raw data. In this example, we now have two sets of data each unique to the company. This results in the following figures:

Company A			
Other Liability	$5,452,221	$159,104,000	$6,457,000
Company B			
Other Liability	$116,536	$237,866,000	$2,269,000

Step 2. To arrive at a dollar amount, results produced in Step 1 are substituted into the following formula:

Other Acquisition Expense = {(IEE, Part III, Column 14 x (Page 15, Column 3/IEE, Part III, Column 1)}

where IEE Part III, Column 14 = IEE Other Acquisition Expense
and Page 15, Column 3 = Page 15 Premiums Earned
and IEE, Part III, Column 1 = IEE Premiums Written.

This step is performed as many times as there are companies, and dollar amounts are saved for each company. In this example, Company A with state premiums representing 3.4% of its countrywide business and an acquisition expense ratio of .04058 contributes about $221,270 to the development of the state specific ratio. Company B, with state premiums representing only .049% of its countrywide business and an acquisition expense ratio of .00954 contributes only about $1,112 to ratio development. The development of expense dollars in this manner, the proportion of statewide to countrywide business, conceivably results in the report being more reflective of the actual experience in that state.

Step 3. Individual company amounts are then summed to arrive at the final dollar amount. In this example, the amount comes to $222,382, which represents nearly 4% of premiums earned, a figure significantly higher than that in Example 1. The actual ratio is .03993.

Another feature of this approach is that first performs a test to determine whether to include a company as part of the population. The program provides for the “screening” of company data to determine whether the data should be included in a particular state or line. For example, to be included in the report a company must have filed a valid annual statement, state page(s) and IEE for the reporting year. Profitability Report lines of business consisting of multiple state page lines would continue to be grouped prior to any testing or calculations.

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