

**Management's Discussion and Analysis
December 31, 2010**

This discussion and analysis of the financial performance of the National Association of Insurance Commissioners (NAIC) provides management's overview of the financial activities for the year ended December 31, 2010. While the NAIC's 2010 Annual Report includes information on the actual financial results of the organization, this report provides management's analysis of the organization's financial performance in relation to the annual budget and mid-2010 financials projections.

Budget Performance

The NAIC produced a 2010 operating margin of \$2,833,391, compared to the budgeted net operating margin of \$899,646. When including investment income, the NAIC produced total net revenues of \$9.2 million. The table below illustrates key components of the NAIC's 2010 financial results. In summary:

- Operational revenues performed above budget \$169,071 (0.2%) and within 1.5% of the published 2010 target. Operating expenses yielded savings of \$1,764,675 (2.5%) from budget and performed within \$196,708 (.3%) of the published 2010 target. As a result, NAIC operations exceeded budget expectations by \$1.9 million and performed within \$1.3 million (1.8%) of the projections published in mid-2010.
- The NAIC investment portfolio produced net gains generating investment income of \$6,376,866, exceeding its \$1,433,388 budget by \$4.9 million.
- The structured securities project was a significant component of the NAIC's financial results through December 31, 2010. The NAIC billed \$5,977,080 of structured security assessments to the industry in 2010, and earned \$795,600 from the sale of December 31, 2009 RMBS data in early 2010, resulting in total project revenues of \$6,772,680. The NAIC incurred \$6,236,656 in direct expenses and \$576,270 in indirect expenses to support the 2010 project, reducing the December 31, 2009 net assets of \$1,858,926 to \$1,818,680 at December 31, 2010. The indirect cost of NAIC staff support to this project in 2009 and 2010 have been allocated to this project in the amount of \$395,511 and \$576,270, respectively.
- The NAIC experienced a \$444,997 net asset adjustment relating to its defined benefit pension plan at December 31, 2010. This adjustment resulted from (1) the reducing discount rate environment in 2010, which impacts the present value of future benefit liabilities, and (2) an update and improvement in mortality assumptions, partially offset by an increase in the value of the assets held in the plan from improved market performance in 2010.
- Overall, and as a result of each of the above components, the NAIC generated an increase in net assets of \$8.7 million.

**Management's Discussion and Analysis
December 31, 2010**

	2010 Actual	2010 Budget	Variance from Budget at 12/31/10	2010 Target Published in 2011 Budget Proposal	Variance from Target at 12/31/10	% Variance from Target
Operating Revenues	\$ 72,705,362	\$ 72,536,291	\$ 169,071	\$ 71,614,188	\$ 1,091,174	1.5%
Operating Expenses	69,871,971	71,636,646	(1,764,675)	70,068,679	(196,708)	-0.3%
Operating Margin	2,833,391	899,645	1,933,746	1,545,509	1,287,882	1.8%
Investment Income	6,376,866	1,433,388	4,943,478	1,258,795	5,118,071	
Structured Securities Revenues	6,772,680	-	6,772,680	7,001,100	(228,420)	
Structured Securities Expenses	(6,236,656)	-	(6,236,656)	(7,314,504)	1,077,848	
Indirect Structured Securities Expenses	(576,270)	-	(576,270)	(374,047)	(202,223)	
Margin Before Pension Adjustment	9,170,011	2,333,033	6,836,978	2,116,853	7,053,158	
Pension Adjustment	(444,997)	-	(444,997)	-	(444,997)	
Total Change in Net Assets	<u>\$ 8,725,014</u>	<u>\$ 2,333,033</u>	<u>\$ 6,391,981</u>	<u>\$ 2,116,853</u>	<u>\$ 6,608,161</u>	

Net Assets

NAIC net assets were impacted significantly by 2008 investment downturns, with the operating reserve reducing to \$48.4 million at December 31, 2008, from \$59.6 million at December 31, 2007, taking the total operating reserve from 89.6% to 67.6%, respectively, and reducing the liquid operating reserve from 69.9% to 52.3%, respectively. Actual results for 2009, excluding the impact of the structured securities project, increased net assets to \$57.2 million at December 31, 2009, improving the total operating reserve to 79.9% and the liquid operating reserve to 68.7%. Actual results in 2010, excluding the impact of the structured securities project, increased net assets to \$66.0 million at December 31, 2010, improving the total operating reserve to 87.5% and the liquid operating reserve to 79.3%.

Historical Perspective

The NAIC budget and annual operating expenditures are very carefully managed by NAIC senior management, the Internal Administration (EX1) Subcommittee, the Executive (EX) Committee and the entire membership. NAIC resources are continually evaluated and aligned with important and priority membership services, systems, products and data that serve as the backbone of a complex variety of regulatory programs and tools. Management believes this is evident in NAIC expense management, where cumulative expense variances from 2005 to 2010 totaled \$3.6 million in savings. Put in perspective, over the \$390.3 million of budgeted operating revenues and \$389.9 million of budgeted operating expenses from 2005 to 2010, the NAIC generated an additional 1.2% of revenue and expense savings of 0.9% – statistics management believes demonstrate discipline, accountability, staff management and membership leadership to manage NAIC budgets. Further, key drivers of such variances in each year are disclosed and described in each fiscal year's budget documentation.

Management appreciates the opportunity to present this discussion and analysis to the NAIC membership and the general public, and believes it provides useful information regarding the NAIC's budget and financial projections, which are not already included in the 2010 Annual Report. The NAIC's 2011 budget also provides a comprehensive and useful review of the NAIC's business and financial plan for the upcoming fiscal year and can be found at http://www.naic.org/about_budget.htm. Please feel free to contact Brady Kelley, Chief Financial and Business Strategy Officer, at (816) 783-8004 should you have any questions or need additional information.