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Artificial Intelligence (AI) state of play  
in insurance regulation

Developments as of March 2023

Center for  
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# The NAIC

The National Association of Insurance Commissioners (NAIC) first planted a flag in the ground more than two-and-a-half years ago with its broad, inaugural “Principles on Artificial Intelligence (AI)” document but is only now beginning to build up its commitment to its principles.<sup>1</sup>

The NAIC’s August 2020 principles, adopted unanimously by membership, are based on the global Organisation for Economic Co-operation and Development’s (OECD) AI principles—to date, 42 countries have adopted. They cleave to high-level principles of accountability, fairness, transparency, and safe and secure outputs, tenets assembled under the acronym “FACTS” (Fair and Ethical; Accountable; Compliant; Transparent, and Secure/Safe/Robust). This adoption sets the regulatory tone for insurers taking ownership of their AI data, models processes, and mistakes. Their risk management approach should be systematic and apply to each phase of the AI stage continuously, and obviously it should adhere to existing laws and regulations, according to the document.

To drive home its intent, the NAIC referenced the creation of new frameworks and guidance regarding insurers’ responsible data and AI as a regulatory priority for 2023 in February.<sup>2</sup>

Insurance regulators want oversight and expect insurers to manage AI risk. One element that state insurance commissioners have been underscoring in their state bulletins has been the principle that the external and internal data, predictive modeling, and machine learning (ML) that form a conclusion reached by AI on an insurance coverage outcome should be kept by the company and be furnished to insurance commissioners respective to applicable state laws. Additionally, lack of intent is not an excuse for noncompliance and outputs of bias from predictive models. Indeed, the NAIC principles hold that AI actors should be responsible for the creation, implementation, and impact of their outputs or systems.

The risk of unfair discrimination is mentioned three times within the FACTS outline as an uncompliant outcome that must be safeguarded against in AI systems used by insurers.<sup>3</sup>

What follows are the NAIC’s five key AI principles:<sup>4</sup>

- 01. Fair and ethical:** AI actors should respect the rule of law throughout the AI life cycle. AI actors should proactively engage in responsible stewardship of trustworthy AI in pursuit of beneficial outcomes for consumers and to avoid proxy discrimination against protected classes.
- 02. Accountable:** AI actors should be accountable for ensuring that AI systems operate in compliance with these principles consistent with the actors’ roles, within the appropriate context and evolving technologies. Companies must maintain a retention of data system supporting final AI outcome.
- 03. Compliant:** AI actors must have the knowledge and resources in place to comply with all applicable insurance laws and regulations, and compliance is required whether violations would be intentional or unintentional.
- 04. Transparent:** AI actors must have the ability to protect confidentiality of proprietary algorithms and demonstrate adherence to individual state law and regulations in all states where AI is deployed. Regulators and consumers should have a way to inquire about, review, and seek recourse for AI-driven insurance decisions in an easy to understand presentation.
- 05. Secure/safe/robust:** AI systems should be robust, secure, and safe throughout the entire life cycle in conditions of normal or reasonably foreseeable use; AI actors should ensure a reasonable level of traceability in relation to data sets, processes, and decisions made during the AI system life cycle.

By late 2022, the NAIC and some state insurance departments had forged ahead beyond the wider principles to try to put some measures in place to address bias and unfair discrimination from AI and, in some cases, potentially construct an enforcement regime around it.

At the NAIC level, the head of the powerful and expansive Innovation, Cybersecurity and Technology (H) Committee announced an effort, which it referred to as an action of membership, to develop and adopt a regulatory framework for the use of AI, to be articulated in the form of a model bulletin. H Committee Chair Kathleen Birrane (Maryland’s insurance commissioner) pointed out that many members feel strongly that current underwriting and rating standards as well as unfair trade and settlement practices apply to

AI use. Thus, the new framework will be designed to be principles-based and not prescriptive and to also serve as guidance at a high level and not hammer out specific cases and applications for use—at least, for now.

“We don’t always agree about everything, or have same political focus but I never cease to be amazed about how we can put aside differences and come together and work cooperatively and collaboratively and quickly on issues that are of real importance to our job to protect consumers with respect to the insurance industry,” Birrane said at the December 2022 NAIC Fall National Meeting in Tampa, making it clear the NAIC is unified on addressing AI bias in depth.

What we expect from this NAIC effort, according to commentary by Birrane at the December meeting:

- **Who:** Work on drafting the model interpretive bulletin will be done by H Committee through the Collaboration Forum and its many NAIC working groups that comprise the collaboration forum to draft a model interpretive bulletin. All NAIC members are welcome to participate.

- **What:** The components of the interpretive bulletin are an introduction and background authority, definitional section, regulatory expectations for the use of AI for insurers including governance, enterprise risk management expectations, and a section on regulatory oversight and examination standards, which would address market conduct, financial rate filings, and similar areas.
- **When:** Robust conversations are expected throughout the drafting and exposure process, with perhaps some provisional elements of the bulletin open for comment by the Spring National Meeting in Louisville in late March and at subsequent interim and national meetings thereafter.

Meanwhile, AI oversight activity at the state level is forging ahead, with laws in place or contemplated, to bulletins from insurance commissioners asserting their authority under multiple state and federal laws. In some instances, progression toward a legal framework and implementation have surpassed the NAIC’s directives and gained nationwide attention from the industry. A recent Colorado stakeholder session had hundreds of participants from across the industry and consumer advocacy arenas.<sup>5</sup> Some key state actions, with more anticipated, are described next.

# The states

## Colorado

Colorado is on the frontier of the AI bias legal framework for insurers, and even with an almost two-year-old law, Colorado is methodically crafting a regulatory framework for initial implementation and later testing and enforcement/compliance protocols.

In the first of its kind, state law SB21-169 was enacted in July 2021 but not slated to go into effect until 2023, at the earliest, after a sometimes tense legislative gestation period.<sup>6</sup> The law provides for stakeholder meetings led by the insurance commissioner and his staff to address specific lines of insurance and their accompanying specific practices such as marketing, underwriting, and claims management before final rule adoption on the protocols and demonstration methods insurers must use to test and show regulators that their use of big data is not unfairly discriminating against consumers, according to the Colorado Division of Insurance.<sup>7</sup>

The law and its initial draft regulation zeroing in on life insurers is comprehensive and exacting, as industry weighing in on calls have also expressed. Colorado now prohibits an insurer from using any external consumer data and information source, algorithm, or predictive model that unfairly discriminates against an individual based on an individual's race, color, national or ethnic origin, religion, sex, sexual orientation, disability, gender identity, or gender expression.<sup>8</sup> It encompasses a data source or an information source that is used by an insurer to supplement or supplant traditional underwriting factors to include credit scores, social media habits, purchasing habits, home ownership, educational attainment, licensures, civil judgments, court records, occupation that does not have a direct relationship to mortality, morbidity or longevity risk, and any insurance risk scores derived by the insurer or third party from a similar information source, according to the draft regulation.<sup>9</sup>

Entitled *Restrict Insurers' Use of External Consumer Data*, the law has several requirements beyond the oversight and enforcement of the typical unfair discrimination standard found throughout the state-based system. In addition, the law is undergoing a lengthy implementation process with stakeholder sessions for different lines of insurance, to establish regulations for governance principles, and then, down the road, testing, with yearlong compliance phase-in periods after the regulation becomes effective. After the effective date, reports will be due every two years that demonstrate compliance with a host of documentation and reporting requirements.<sup>10</sup>

The rubber is meeting the road on the development of regulations through stakeholder video meetings, and consultations continue, with the life industry at bat first for an algorithm and predictive model governance regulation. Health and Property & Casualty (P&C) lines will be next, although Colorado Insurance Commissioner Mike Conway indicated on a Feb. 7, 2023, call with industry and consumer advocates that the now-drafted governance practices for life insurers will likely be generally applicable to other lines of insurers and will look similar.

Currently, a draft regulation for governance principles for life insurers' use of AI models has been drafted and has forged ahead with industry comments. Insurers that are using external data, as well as algorithms and/or predictive models using this external data, must submit a report demonstrating compliance with the major portions of the regulation one year following its effective date.



Carriers then must also submit a report every two years to the Division of Insurance detailing their AI/predictive modeling inventory, changes to governance and risk framework, and their effect on the use of external data and algorithmic models, with risks related to the use of these models detected and steps taken to mitigate them.

Requirements on maintaining an active and detailed inventory of all external data, algorithms, and predictive models in use must be inventoried and annually reviewed, with changes actively tracked and managed, according to the draft regulation.

Insurers must also maintain comprehensive documentation on all manner of their external data use. This includes descriptions of the testing conducted to detect unfair discrimination in insurance practices resulting from the use of external data, algorithms, and predictive models. It also includes the methodology, assumptions, results, and steps taken to address disproportionate negative outcomes.

Bias testing protocols, when the time arrives to address these after the governance regulations are implemented, will likely be different between lines of insurance. For now, the Division's regulations will initially only address and analyze racial discrimination or bias in underwriting until there is a method of ascertaining or inferring membership in other protected classes, according to Conway. The method to infer race discussed by regulators is based on the Bayesian Improved First Name Surname and Geocoding (BIFSG) method, developed by the RAND Corp.<sup>11</sup>

During the February 7 call around the sensitive practice of data collection, Conway predicted that, in five years, companies will be asking the Division to collect data.

The period for informal comments on the draft algorithm and predictive model governance regulation was extended by the Division and closed March 7.<sup>12</sup>

Under the Colorado law, insurers must create and maintain a risk management framework that is reasonably designed to determine whether the insurer's use of external data sources unfairly discriminates against individuals based on the above criteria.

Initially, the regime will focus on race and use a method for inferring race. Other protected classes identified in the law are not easily able to be identified and would likely require data collection from insurers, which is not yet required but could be in the future, according to regulator-stakeholder discussions.<sup>13</sup>

The insurance industry has been highly engaged in discussions, and some have suggested that the draft for governance for life insurers is not truly a principles-based approach for governance or risk management as it has too high a level of specificity and there is so much detail in the reporting and documentation requirements.<sup>14</sup>

In short, the Colorado rules, once adopted, must require each insurer to take the following actions with the insurance commissioner:

- Report information concerning the external data sources used by the insurer in the development and implementation of algorithms and predictive models specific to insurance lines/products;
- Explain the manner in which the insurer uses external data sources;
- Establish and maintain a risk management framework that is reasonably designed to determine, to the extent practicable, whether the insurer's use of external data sources unfairly discriminates against individuals based on the protected classes identified by the legislation;
- Assess the results of the risk management framework;
- Take actions to minimize the risk of unfair discrimination, which includes ongoing monitoring; and
- Attest that a risk management framework has been implemented appropriately on a continuous basis (to be performed by the insurer's Chief Risk Officer).

The rules must include provisions for insurers as they work to craft the new framework. These are:

- A reasonable period of time for insurers to remedy any unfairly discriminatory impact in an external data source; and
- The ability of insurers to use external data sources that have been previously assessed by the division of insurance and found not to be unfairly discriminatory.<sup>15</sup>

## District of Columbia (DC)

Another first among the 50 states and jurisdictions that make up the US state insurance system is the District of Columbia Department of Insurance, Securities and Banking (DISB), which proposed an insurance application/quote data call to evaluate unintentional bias and then figure out if laws and regulations are needed to address findings.<sup>16</sup>

“The review of the data will seek to identify and address unintentional bias, if any, with a focus on race and ethnicity,” DISB stated November 30, 2022, in its request for comment.<sup>17</sup> Comments were due in January 2023. The due date for the data call is April 28, 2023, according to the data call template.<sup>18</sup>

Once the data is gathered, the analysis will determine what criteria will be used as control variables. To initiate the data call, DISB issued a market conduct examination warrant in mid-February for all insurance groups doing private passenger auto business in DC. The period under examination is the period starting January 1, 2019, through the date of the warrant, February 17, 2023.

DISB partnered with the algorithmic risk consulting firm O’Neil Risk Consulting and Algorithmic Auditing (ORCAA) as of June 2022, after Insurance Commissioner Karima Woods determined that data was needed to address insurers’ use of underwriting factors that might result in unintentional bias.<sup>19</sup> The initial work will review only private passenger auto insurance and its use of non-driving factors.<sup>20</sup>

DISB has stated that the review and final results of its study could result in additional filing requirements for future rate filings that would be implemented after an appropriate transition period, and legislative changes to address insurers’ use of certain factors in their underwriting and rating practices if it is determined that such factors have led to unintentional bias.

The review process will not require:

- Public disclosure of any company-specific data collected as part of this initiative.
- Insurers to collect or hold any race/ethnicity data about its applicants or customers.

Insurers’ comment letters note that, while “unfair discrimination” is statutorily defined, “bias” is not, and DISB will need to clarify its terms and establish a legal basis for collecting, disclosing, and assessing

data—and even expressed concern about damage to the market and solvency considerations if comparative risk cannot be applied. Unfair discrimination prohibits charging different rates to people with similar risk profiles differently, trade associations argued, raising questions about the individual data points that will become part of the data call and whether DC should go it alone or coordinate with other jurisdictions and experts in the insurance application and quotation process.<sup>21</sup>

Additionally, states are issuing bulletins that are sometimes broad and sometimes very specific, as in a case-by-case approach.



## California

A June 30, 2022, bulletin was issued by Commissioner Ricardo Lara to California's \$371 billion insurance industry to "remind all insurance companies and licensees of their obligation to market and issue insurance, charge premiums, investigate suspected fraud, and pay insurance claims in a manner that treats all similarly-situated persons alike" and warned that reliance on algorithms could result in denials and worse outcomes for protected classes, such as race, gender, or disability status.<sup>22</sup>

Specifically, Lara ordered that insurance companies and other licensees must avoid both conscious and unconscious bias or discrimination that "can and often does result from the use of artificial intelligence, as well as other forms of 'Big Data' ... when marketing, rating, underwriting, processing claims, or investigating suspected fraud relating to any insurance transaction that impacts California residents, businesses, and policyholders."

California said that the increased use of AI, algorithms, and big data use had resulted in an increase in consumer complaints both in the state and elsewhere.

California is taking action as well as issuing statements to guide behavior. The California Department of Insurance is investigating or has investigated examples of potential bias and alleged unfair discrimination in many lines of insurance resulting from the use of technology and data, the bulletin warned, citing unfairly flagging certain ZIP codes for claims investigations resulting in allegedly unreasonable and unfair treatment.

Bulletin 2022-05 mandates that when insurers use complex algorithms in a declination, limitation, premium increase, or other adverse action, the specific reason or reasons must be provided. Lara stated that the California Department of Insurance can examine insurers within the scope of market conduct exams to scrutinize marketing, rating, claim, and underwriting criteria, programs, algorithms, and models and take disciplinary action, if necessary.

Lara appears to be concerned about the collection and use of biometric data obtained through facial recognition technology to influence whether to pay or deny claims.

"The use of these models and data often lack a sufficient actuarial nexus to the risk of loss and have the potential to have an unfairly discriminatory impact on consumers. Even under circumstances where these models and data may suggest an actuarial nexus to risk of loss, unless a specific law expressly states otherwise, discrimination against protected classes of individuals is categorically and unconditionally prohibited," the bulletin states.



## Connecticut

Connecticut Commissioner Andrew Mais been taking steps to review practices related to AI to guard against possible misuse and discrimination. The Connecticut Insurance Department (CID) is employing the NAIC's AI framework in doing so. The CID issued press releases in 2021 on its intentions and, in 2022, issued a formal notice to insurers that they must be in compliance with federal and state anti-discrimination laws even as it is supportive of the industry's use of technological advances and opportunities for both consumers and business efficiency.<sup>23</sup> In doing so, Connecticut also reminded insurers that it can require both insurers and third-party vendors and developers to provide it access to data used to build the predictive models used in all rate, form, and underwriting filings. The authority allows access to data from insurance carriers and third-party data vendors, model developers, and bureaus in all filings since 2021.

In the April 2022 notice, the CID required insurers to certify their compliance with applicable anti-discrimination laws.

The CID also identified potential regulatory concerns with respect to internal data deployment, internal data governance processes, and big data/AI/predictive model risk management and compliance in the company, from inventorying to evaluating for quality.

In October 2022, the CID and Mais took the extra step toward AI oversight by consolidating all actuarial and data science functions within a single unit to improve regulatory oversight of AI, big data, and machine learning to protect consumers and keep tabs on the industry. The division will be led by Wanchin Chou, assistant deputy commissioner and chief actuary.<sup>24</sup>

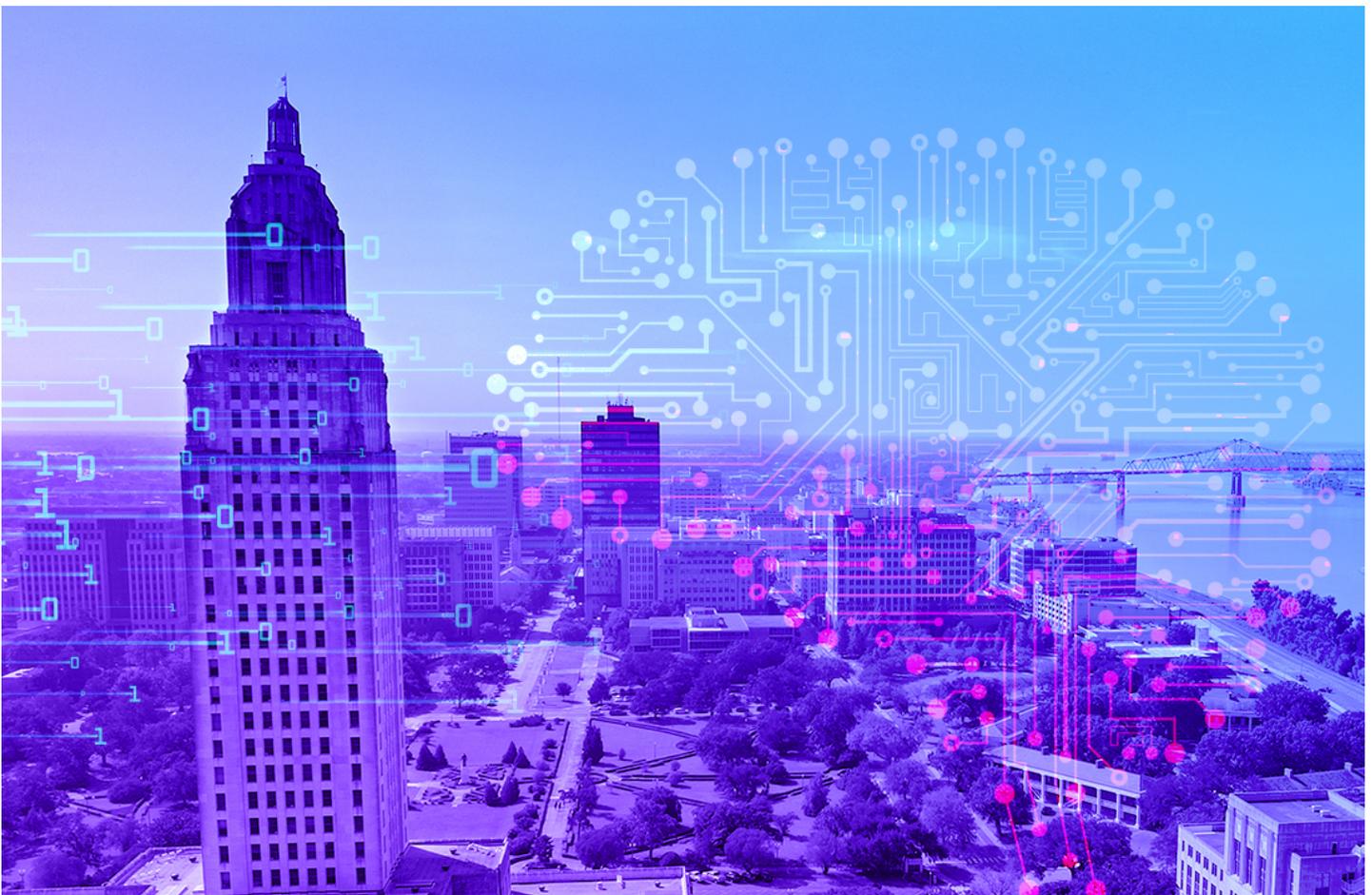


## Louisiana

Louisiana already has had a vivid example of big data skewing results and creating adverse incomes, causing the insurance commissioner to act.<sup>25</sup>

Commissioner Jim Donelon weighed in with a bulletin on January 25, 2023, to remind all carriers who write property insurance coverage in Louisiana to follow a state statute that all policyholders have a right to be treated fairly. The bulletin stemmed from a specific case involving third-party data sources that resulted in property insurance declinations based on negative crime scores in a certain small city and parish.

At issue was the crime database used by the third parties. The database reflected a much higher proportion of crime by area due to activity within an enclosed state penitentiary, which adversely affected citizens in the area seeking property coverage. The third-party data companies that calculate underwriting crime scores using the FBI crime database reported an “F” rating for the town of St. Francisville and West Feliciana Parish. However, the criminal activity reflects inmate-on-inmate crimes within the walls of the Angola State Penitentiary, which doesn’t accurately reflect crime risks in St. Francisville and other areas of West Feliciana Parish outside of the prison, Donelon clarified in the bulletin. The commissioner instructed all insurers writing in the area to consider this and treat policyholders fairly—and to not be beholden to the vendor data in this instance.



## New York

Back in 2019, the New York Department of Financial Services (NYDFS) issued a circular letter prohibiting a life insurer from using an external data source, algorithm, or predictive model for underwriting or rating purposes unless the insurer can show that the source is not based in any way on a protected class. It also must adhere to unfair discrimination regulations in the use of its data.

The NYDFS cited state insurance law, executive law, general business law, and the federal Civil Rights Act, which protects against discrimination for certain classes of individuals. Protected classes include race, color, creed, national origin, status as a victim of domestic violence, past lawful travel, or sexual orientation in any manner.<sup>26</sup>

Like other regulators, New York expressed significant concern about a lack of transparency for consumers and lack of regulatory oversight and consumer protections among the third-party purveyors of data and predictive models.

Thus, insurers must provide the reason or reasons for denying policies, limiting them, charging different or higher rates, or making underwriting decisions that are adverse to the consumer if the data that fed these decisions comes from external data sources or predictive models. The specific source of the information upon which the insurer based its decision is also required to be disclosed.

External data sources do not include a motor vehicle report or criminal history searches. Criminal history only includes past convictions or pending criminal matters. It does not include prior arrests, pleas, or imprisonment for which an individual was not convicted of any crime; or civil dispute history such as appearances in housing court, civil litigation, liens, or bankruptcy, the NYDFS stated.

In an investigation, the NYDFS had found that the use of external data sources in underwriting has the “strong potential to mask the forms of discrimination” prohibited by its laws. “Many of these external data sources use geographical data (including community-level mortality, addiction, or smoking data), homeownership data, credit information, educational attainment, licensures, civil judgments and court records, which all have the potential to reflect disguised and illegal race-based underwriting,” the NYDFS stated in its circular letter.<sup>27</sup>

It also warned against predictive models that cull data from consumers’ retail purchase history; actions and appearances on social media, internet, or mobile activity; geographic location tracking; and even condition and type of an applicant’s electronic device as potentially having a disparate impact on the protected classes as identified in New York and federal law.



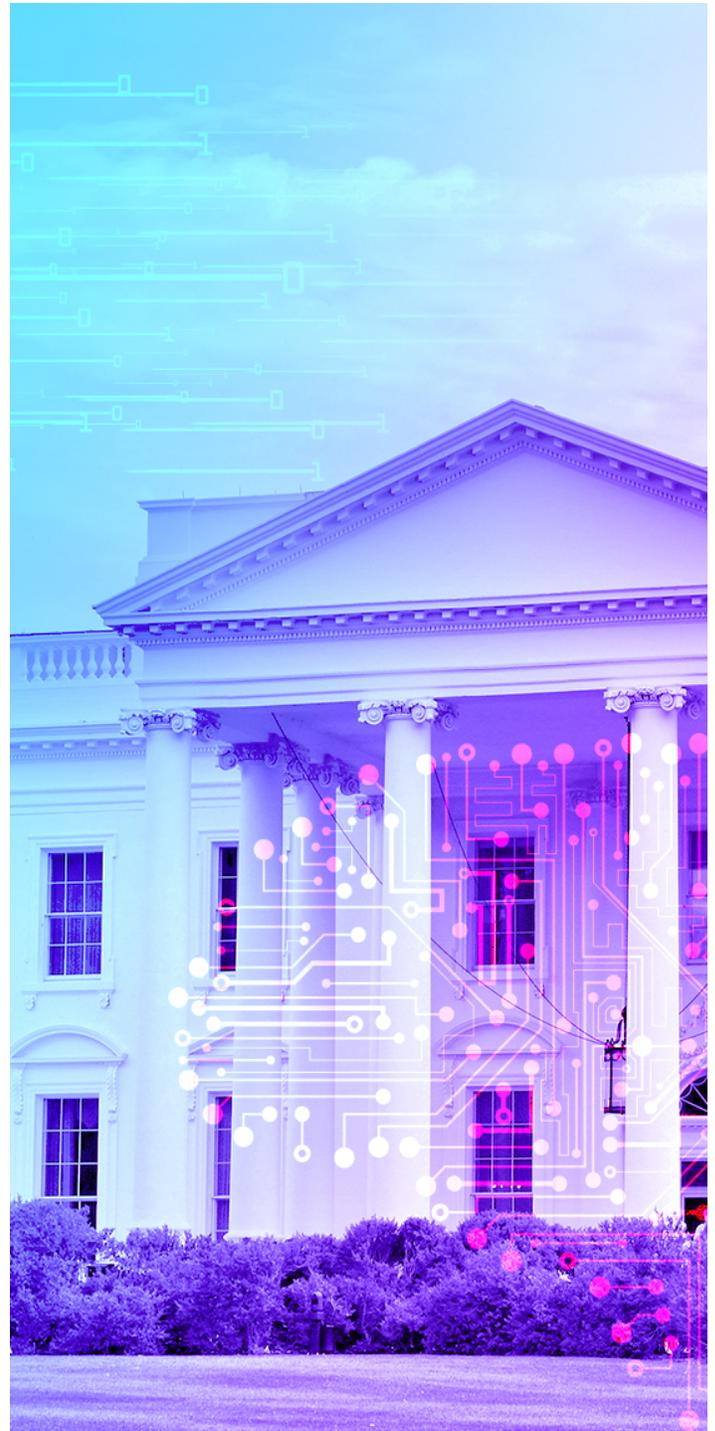
# The White House

At the federal level, the White House has issued a Blueprint for an AI Bill of Rights (AIBoR). The White House Office of Science and Technology Policy (OSTP) released the AIBoR in October 2022. While it is not enforceable, it provides guidance to organizations as they automate their systems with the latest technological advancements.<sup>28</sup> The blueprint has five principles.<sup>29</sup> They are:

01. Safe and effective systems
02. Algorithmic discrimination protections
03. Data privacy
04. Notice and explanation
05. Human alternatives, consideration, and fallback

The blueprint's section on algorithmic discrimination protections defines discrimination as when automated systems contribute to unjustified different treatment or impacts disfavoring people based on their race, color, ethnicity, sex (including pregnancy, childbirth, and related medical conditions, gender identity, intersex status, and sexual orientation), religion, age, national origin, disability, veteran status, genetic information, or any other classification protected by law. Life insurers, of course, do weigh health and sex in underwriting policies (smoking behaviors, height, weight, gender, for one), but the blueprint does refer to specific circumstances.<sup>30</sup> Auto insurers also factor in gender/sex in many states.<sup>31</sup> The White House calls for protections that should be proactive, equitable, and part of the design and development of systems, with protocols for disparity testing, mitigation, impact assessment disclosure of issues when relevant, and organizational oversight.

Then, on January 26, 2023, the National Institute of Standards and Technology (NIST) released a guidance document for an AI risk management framework for voluntary use by any organization designing or offering AI systems.<sup>32</sup>



# Company checklist/securing a robust and compliant AI future

While AI bias testing protocols have not yet been standardized or developed for review at the regulatory level, it is only a matter of time before the market develops these capabilities, and dynamic systems that provide continuous monitoring of data also provide enough data for testing. As Deloitte has noted, the White House blueprint is but the “ latest governmental call to action for organizations to proactively protect the American public as they embrace innovation through automation and AI (and) ... can set the tone for the inevitable future legislation.”<sup>33</sup>

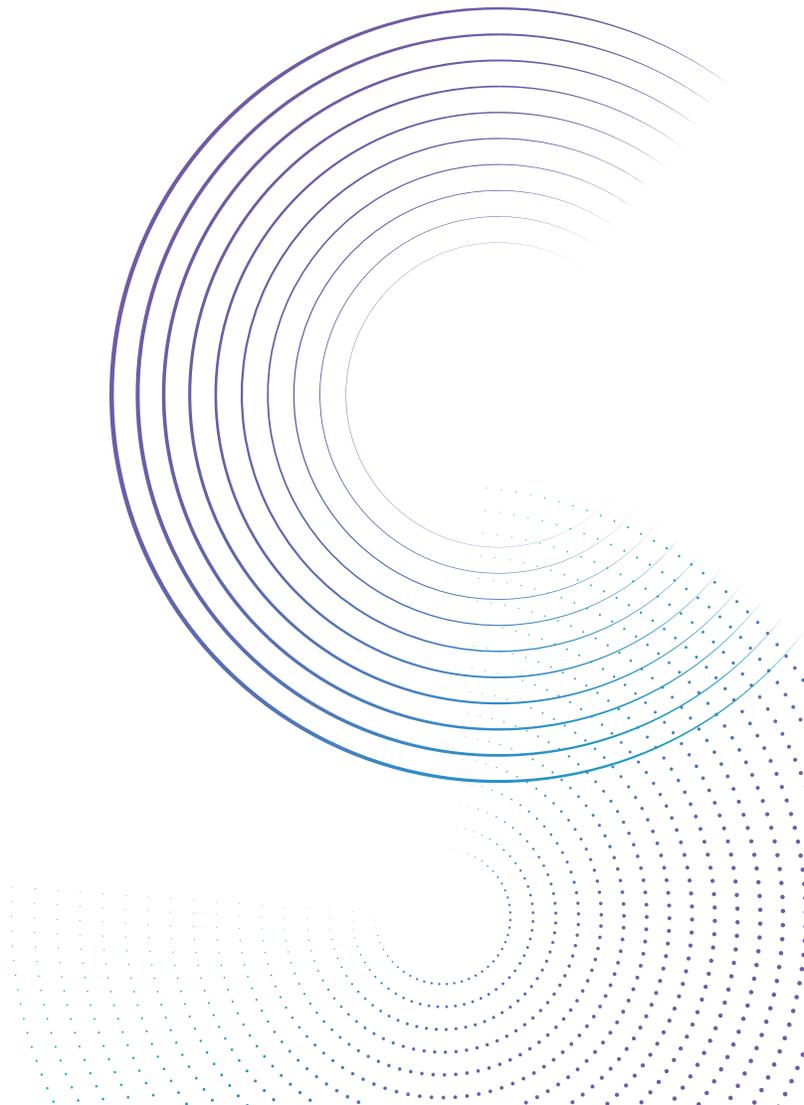
While many insurance underwriting processes and even laws don't allow for the collection of data on race, ethnicity, country of origin, and other attributes of protected classes against which harm or bias can be measured, some third parties and regulators are trying to apply systems to infer such information. More data collection from state and even federal regulators is possible in the long term.

Insurers should be mindful to start now or continue to:

- Stay aware of ongoing legislation, laws, and guidance frameworks in order to stay compliant.
- Build out a surveillance monitoring system with the capability to test AI outputs to ascertain whether unfair discrimination, already statutorily enforced, could be occurring—whether at the Zip code level or in greater detail.
- Evaluate the AI systems throughout the organization and with vendors on an ongoing basis.
- Be ready to respond without hesitation to consumer complaints, including those that will inevitably be made to state regulators, about potential bias with transparent, easily comprehended data processes, and be able to mitigate and address bias when it is identified.
- Construct a training regimen throughout the organization on AI use and through each part of the insurance transaction process it touches, whether internal or external. The CRO must have the backing of the governing executive suite and board, as this role will be expected to attest to the company's risk management framework on a continuous basis in at least one jurisdiction so far.
- Ensure that all business segments, from underwriting to marketing, are aligned on an ongoing basis with the

guiding principles of the NAIC and the White House, and operationalize every aspect of them with flexible systems that can acquire and incorporate new regulatory mandates as they are developed.

- Be ready to share information with customers on a timely basis and in clear language when an adverse decision such as a policy declination or higher rates is made based on AI data sets.
- Maintain strong oversight and communications with third-party vendors, as regulators are making insurers responsible for the predictive models and AI/ML outputs they produce, which are then incorporated into the insurer's decisions for current and potential policyholders.



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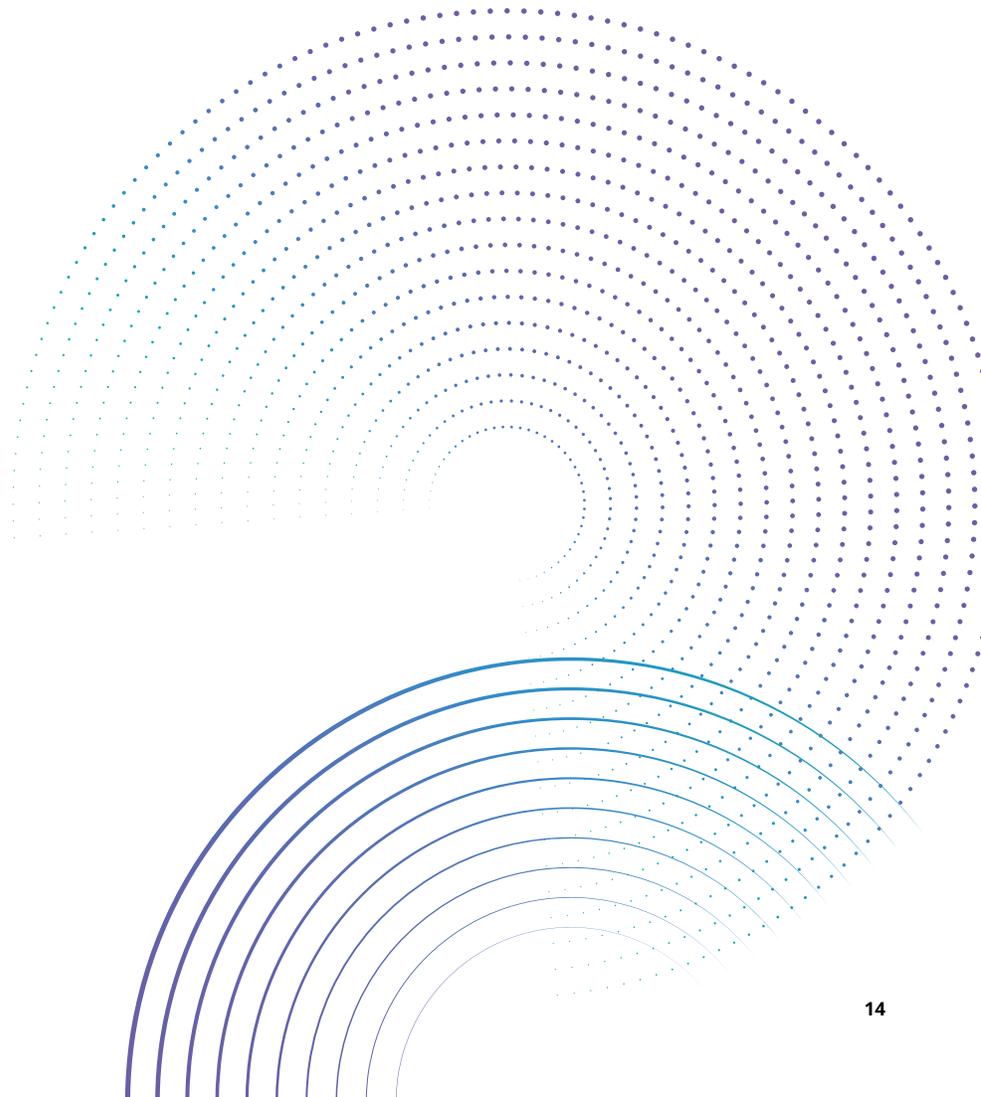
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# Center for Regulatory Strategy US

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