Presentation to NAIC SCORI Workstream 3

American Academy *of* Actuaries

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December 1, 2021

Actuarial Professionalism - Code of Professional Conduct

*Precept 1: An Actuary shall act honestly, with integrity and competence, **and in a manner to fulfill the profession's responsibility to the public** and to uphold the reputation of the actuarial profession.*

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Actuarial Professionalism—ASOPs

- Actuarial Standard of Practice (ASOP) No. 12, Risk Classification
  - Provides perspective of concept of “fairness” in insurance rates
  - Rates within a risk classification system would only be considered equitable (or fair) if differences in rates reflect material differences in expected cost for risk characteristics.
  - This is demonstrated if it can be shown that the experience ***correlates*** to the risk characteristic.
- ASOP No. 23, Data Quality
- ASOP No. 53, Estimating Future Costs for Prospective P/C Risk Transfer and Risk Retention
- ASOP No. 56, Modeling
- Other ASOPs

P/C Racial Equity Task Force

- Mission: To provide independent actuarial perspective to inform public policy makers on issues related to racial equity in insurance practices as they relate to property and casualty insurance.
- Recent Activities
  - Comment Letters to NAIC SCORI
  - Comment Letter to NCOIL
  - Letter regarding Colorado Bill on Unfair Discrimination
  - Contributed to Auto Committee Comment Letter to FIO on Auto Affordability
- Potential Upcoming Publications
  - Issue Brief on Protected Class Data Collection
  - Discussion Brief on Causation and Correlation Topics

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Defining the Key Terms

- CAS' work is useful research for the NAIC in determining definitions, and the Academy will consider this research in its future work.
- Focus will be on three key terms
  - Unfair discrimination
  - Proxy discrimination
  - Additional Term: Disproportionate impact

Key Term: Unfair Discrimination

- Recommendation: Maintain the existing definition of unfair discrimination as an actuarial and regulatory construct.
- Consistent with actuarial standards and principles.
  - CAS Statement of Principles: A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.
  - ASOP 12 Risk Classification: Rates within a risk classification system would be considered equitable if differences in rates reflect material differences in expected cost for risk characteristics.
- Codified in most state laws.
- Well-understood by regulators and industry.
- **Example:** Blue cars charged higher rates without evidence that the expected costs were higher.

- Regarding Protected Classes:
  - State laws differ regarding prohibitions on the use of protected class information in rating.
  - May consider harmonizing definitions of prohibited discrimination (e.g. protected classes)

Key Term: Proxy Discrimination

- Recommendation: Address proxy discrimination regardless of intention within the evaluation of Disproportionate Impact
- NCOIL model law addresses intentional proxy discrimination
  - *… "Proxy Discrimination" means the intentional substitution of a neutral factor for a factor based on race, color, creed, national origin, or sexual orientation* ***for the purpose of discriminating against a consumer*** *to prevent that consumer from obtaining insurance or obtaining a preferred or more advantageous rate due to that consumer's race, color, creed, national origin, or sexual orientation."*
- NAIC's Artificial Intelligence Principles includes "unintended consequences" when considering proxy discrimination
  - *"Consistent with the risk-based foundation of insurance, 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. AI systems should not be designed to harm or deceive people and should be implemented in a manner that* ***avoids harmful or unintended consequences*** *and corrects and remediates for such consequences when they occur."*
- **Example:** Blue cars charged higher rates because expected costs were higher. Proxy discrimination may exist if most blue cars are primarily purchased by members of a protected class. Whether or not a company deliberately chose to charge more for blue cars because of the effect on the protected class could be difficult to prove.

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Key Term: Disproportionate Impact

- Recommendation: Focus efforts on methods to assess Disproportionate Impact.
- American Academy of Actuaries in 2002, Use of Credit History for Personal Lines of Insurance, defined Disproportionate Impact as “a rating tool that results in higher or lower rates, on average, for a protected class, controlling for distributional differences.”
  - https://www.actuary.org/sites/default/files/pdf/casualty/credit_dec02.pdf
- “Controlling for distributional differences” is key to this definition.
- Include tests for proxy discrimination regardless of intent.
- **Example:** A company’s overall automobile rating plan produces higher rates for a protected class, after controlling for distributional differences. More investigation needed to mitigate any disproportionate impact.

Future Considerations: Methods for Assessing Disproportionate Impact

- Actuaries have tools to assist regulators in assessing Disproportionate Impact
- Many different approaches…no silver bullet
- Statistical methods will help us make more informed decisions to identify, address, and mitigate disproportionate impact