

New York Regulator Issues Proposed AI Guidance for Insurers

The proposed guidance notes the potential risks of discriminatory, inaccurate, and arbitrary decision-making.

Key Points:

- Insurance regulators are increasingly coalescing around general principles for regulation of artificial intelligence systems (AIS). These principles include a focus on (i) comprehensive governance processes regarding the use of AIS, (ii) the datasets that provide the foundation for AIS, and (iii) existing laws and regulations regarding unlawful discrimination and claims handling.
- A proposed circular letter from the New York State Department of Financial Services is the latest movement by regulators in this regard, and contains important considerations for the insurance industry.

On January 17, 2024, the New York State Department of Financial Services (DFS) issued for public comment a proposed circular letter on the use of AIS and external data sources by New York-authorized insurers (the Proposed Circular Letter). The Proposed Circular Letter supplements the DFS's Insurance Circular Letter No. 1 (January 18, 2019) (the 2019 Circular Letter), which addressed the use of external consumer data and information sources in underwriting for life insurance and is representative of part of a trend of increased scrutiny by regulators and legislators on the role of artificial intelligence in the insurance industry.

The Proposed Circular Letter observes that insurers have increasingly relied on external consumer data and information sources (ECDIS) and AIS for more efficient and accurate underwriting and pricing processes. These benefits, however, are weighed against the potential risks of discriminatory, inaccurate, and arbitrary decision-making.

Although the Proposed Circular Letter does not create new rules applicable to New York-authorized insurers, it does clarify how existing laws and regulations will be applied to insurers that use ECDIS and AIS. As a result of these clarifications, insurers that do business in New York may need to modify certain aspects of their business practices and compliance regimes. The Proposed Circular Letter expressly states that it neither provides an exhaustive list of potential issues arising from an insurer's use of ECDIS or AIS nor addresses an insurance product's life cycle beyond underwriting and pricing.

Further, although insurers are ultimately responsible for all aspects of compliance with such laws, the DFS's view on these matters is relevant in a material way for vendors as well, as insurers frequently outsource certain tasks to vendors that employ AIS. Further, the emphasis of affirmative corporate governance regarding AIS indicates that the DFS will not consider the novelty of AIS to be a defense against a breach by insurers, as the DFS will expect advance consideration of such issues.

The Proposed Circular Letter contains four broad categories of issues: (1) unfair and unlawful discrimination; (2) governance and risk management; (3) transparency; and (4) clarifications on the 2019 Circular Letter.

1. Unfair and Unlawful Discrimination

As with the use of any other underwriting and pricing factor, an insurer should be able to demonstrate that its use of ECDIS satisfies generally accepted actuarial standards of practice, is based on actual or reasonably anticipated experience, and does not unlawfully discriminate — directly or on a proxy basis — against protected classes. In the Proposed Circular Letter, the DFS posits that an insurer should not use ECDIS or AIS in underwriting or pricing unless the insurer has determined, through a comprehensive assessment, that such usages do not collect or employ criteria that would constitute unfair or unlawful discrimination or otherwise result in an unfair trade practice.

To ensure that an insurer's use of ECDIS or AIS does not result in discriminatory or otherwise unlawful pricing or underwriting, the Proposed Circular Letter sets forth certain compliance obligations that the DFS will expect of a New York-authorized insurer, including:

- documenting the processes and reasoning behind an insurer's testing methodologies and analysis for unfair or unlawful discrimination "commensurate with the insurer's use of ECDIS and AIS and the complexity and materiality of such ECDIS and AIS";
- testing and analyzing the potential for unfair or unlawful discrimination prior to putting AIS into production "and on a regular cadence thereafter," including when there are material updates or changes to the ECDIS or AIS;
- using multiple statistical metrics to evaluate data and model outputs to ensure a comprehensive understanding and assessment of the potential for unfair or unlawful discrimination; and
- maintaining a qualitative assessment of unfair or unlawful discrimination, whereby an insurer can explain, at all times, how its AIS operates and how ECDIS is used in the risk analysis.

2. Governance and Risk Management

Existing regulations require an insurer to "adopt a corporate governance framework that shall be appropriate for the nature, scale, and complexity of the insurer." The Proposed Circular Letter clarifies that this framework should provide for "appropriate oversight" of an insurer's use of ECDIS and AIS. To this end, the Proposed Circular Letter sets forth the following obligations that the DFS will expect of New York-authorized insurers, including:

- delegating specific duties and authorities related to the management of ECDIS and AIS to specific committees and senior management;
- ensuring the relevant operation areas of the insurer are appropriately engaged, which may require the creation a cross-functional management committee with representatives from key function areas

(e.g., legal, compliance, risk management, product development, underwriting, actuarial, and data science, as appropriate);

- formalizing the development and management of ECDIS and AIS in written policies and procedures consistent with the Proposed Circular Letter and reviewing these policies and procedures at least annually in order to keep current with changes in the insurer's use of ECDIS and AIS and industry best practices;
- maintaining comprehensive documentation of the insurer's use of all AIS, including all ECDIS relied on for such AIS, whether developed internally or supplied by third parties;
- ensuring the internal audit function is appropriately engaged with the insurer's use of ECDIS and AIS consistent with the insurer's financial, operational, and compliance risks; and
- developing written standards, policies, procedures, and protocols for the acquisition, use of, or reliance on ECDIS and AIS developed or deployed by a third-party vendor.

This emphasis on good corporate governance has parallels with the DFS's groundbreaking 2015 Cybersecurity Regulation, which similarly elevated cybersecurity considerations as a matter of corporate governance.

3. Transparency

The Proposed Circular Letter underscores that an insurer that uses ECDIS and AIS remains obligated to satisfy certain transparency requirements under existing law. For example, non-commercial and certain commercial property and casualty policies require the specific basis or reason to be provided to the insured in writing in the event of a cancellation, nonrenewal, or conditional renewal. Various transparency requirements also exist with respect to other lines of business. An insurer's use of ECDIS or AIS does not abrogate these general obligations.

4. Clarifications on the 2019 Circular Letter

The Proposed Circular Letter addresses certain language from the 2019 Circular Letter, which focused on the use of external data sources in underwriting for life insurance. The 2019 Circular Letter stated that "[a]n adverse underwriting decision would include the inability of an applicant to utilize an expedited, accelerated or algorithmic underwriting process in lieu of a traditional medical underwriting." The Proposed Circular Letter clarifies that this sentence was intended to only address the issue of disclosure and not raise any other implications of an adverse underwriting decision.

More specifically, the Proposed Circular Letter states that insurers should disclose any objective threshold criteria used for an accelerated underwriting process to a prospective insured prior to the policy application. (Internal proprietary guidelines do not apply if the prospective insured was never aware of the existence of such internal standards.) Further, if the insurer determines that an prospective insured will not be approved for insurance and can only obtain insurance by submitting to the traditional underwriting process, the prospective insured "has the right to know why."

Conclusion

The Proposed Circular Letter comes on the heels of the recent enactment of Colorado's first-in-the-nation regulation on the use of artificial intelligence by authorized life insurers as well as the issuance of a model bulletin last month from the National Association of Insurance Commissioners (NAIC) that

covers many of the same issues raised in the Proposed Circular Letter. The use of artificial intelligence and related technologies in the insurance industry is an issue to which regulators, legislators, and the NAIC are increasingly attentive to, and we expect increased scrutiny on insurers and other market participants in the coming years. Indeed, the Proposed Circular Letter expressly states that the DFS may audit and examine an insurer's use of ECDIS and AIS as part of the DFS's existing market conduct examination authority. We expect that the DFS, as well as regulators throughout the country, will increasingly focus on how insurers use artificial intelligence and how such usages comply with existing, or in some cases new, laws and regulations.

The DFS requests feedback from interested parties on the Proposed Circular Letter by March 17, 2024.

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