THE REGULATORS ARE COMING
NAIC AI BULLETIN AND BEST PRACTICES

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SEPTEMBER 10, 2024

INTRO/OVERVIEW

- NAIC Action and Development of Model AI Bulletin
- What is the Bulletin?
  - Key Concepts/Definitions
  - Insurance Regulatory Authority
  - AIS Program Expectations
  - Regulatory Examinations
- Best Practices and Conclusions

NAIC AND AI

- 2019, the NAIC Big Data and Artificial Intelligence (H) Working Group was established to study the development of AI, its use in the insurance sector, and its impact on consumer protection and privacy, marketplace dynamics, and the state-based insurance regulatory framework.
- 2020 the Working Group developed the ***National Association of Insurance Commissioners (NAIC) Principles on Artificial Intelligence (AI)***:
  - Fair and Ethical
  - Accountable
  - Compliant
  - Transparent
  - Secure, Safe and Robust
- 2021, the Working Group began surveying insurers to learn:
  - (1) how AI and machine learning techniques are currently being used and
  - (2) what governance and risk management controls are in place.

NAIC AI SURVEY RESULTS – HOME INSURANCE – AUGUST 10, 2023

- 70% (136 out of 194) of companies that completed the survey currently use, plan to use, or plan to explore using AI / ML.

Table 3: Companies with Models (in Use or Under Construction) by Company Operation Area

Company Operation Area[1]	Number and Percentage of Companies							
	In Use		Research, Proof of Concept, Prototype		Not Using		Total	
	#	%	#	%	#	%	#	%
Rating	68	35	21	11	105	54	194	100
Underwriting	91	47	29	15	74	38	194	100
Claims	104	54	13	7	77	40	194	100
Fraud Detection	81	42	26	13	87	45	194	100
Marketing	92	47	11	6	91	47	194	100
Loss Prevention	28	14	6	3	160	82	194	100
Other	5	3	11	6	178	92	194	100

NAIC AI SURVEY RESULTS – PRIVATE PASSENGER AUTO INSURANCE – DECEMBER 8, 2022

- 88.6% (169 out of 193) of companies that completed the survey currently use, plan to use, or plan to explore using AI / ML.

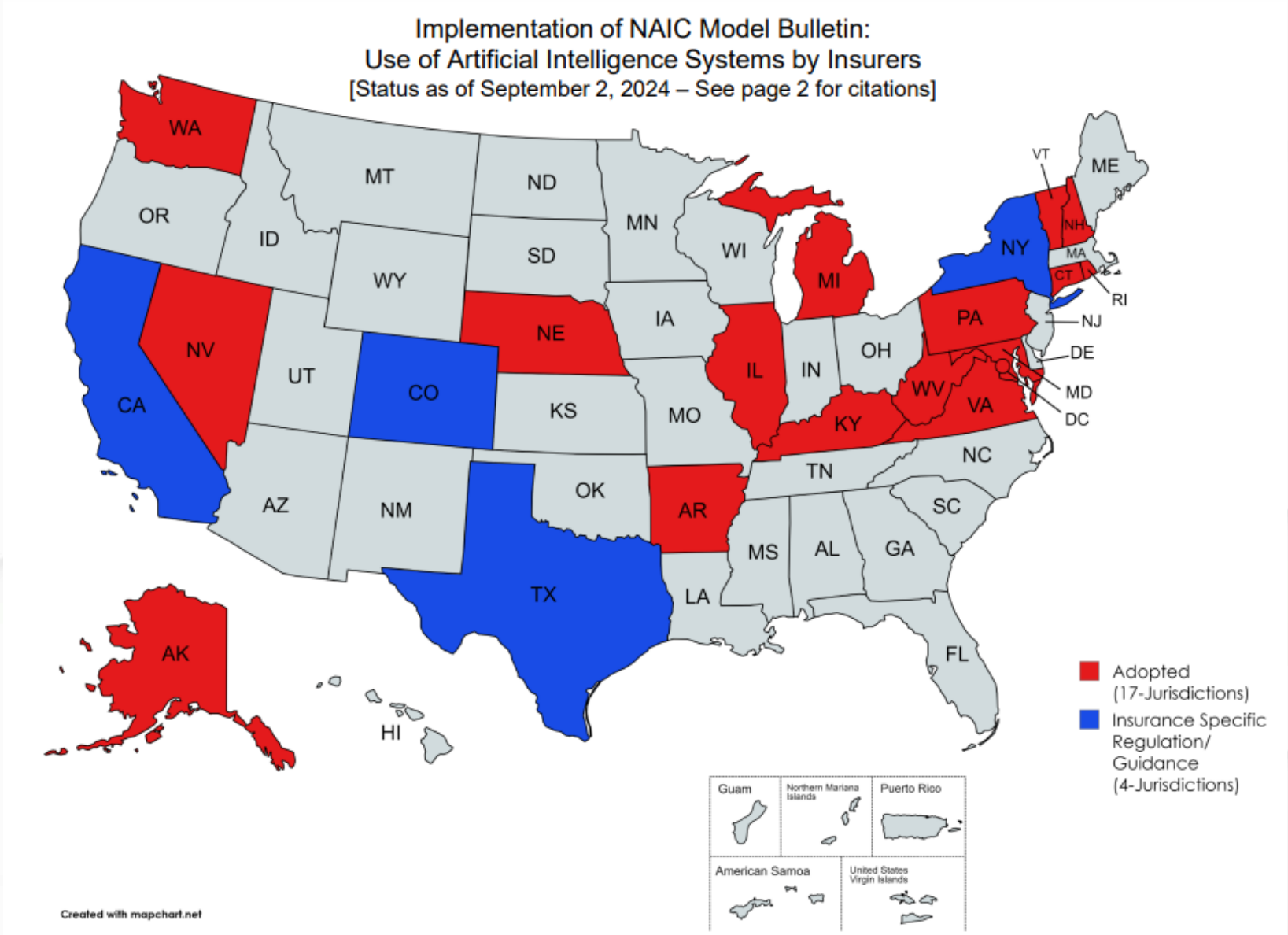
Table 3: Companies with Models in Use or Under Construction by Company Operation Area

Company Operation Area[1]	Number and Percentage of Companies							
	In Use		Under Construction [2]		None (N/A)		Total	
	#	%	#	%	#	%	#	%
Rating	52	27%	25	13%	116	60%	193	100%
Underwriting	34	18	25	13	134	69	193	100
Claims	135	70	20	10	38	20	193	100
Fraud Detection	95	49	17	9	81	42	193	100
Marketing	96	50	7	4	90	47	193	100
Loss Prevention	3	2	25	13	165	85	193	100

NAIC AND AI

- In 2022, the Innovation, Cybersecurity and Technology (H) Committee was charged with developing a model bulletin to set forth the expectations regarding the usage of AI by insurance companies.
- December 2023, NAIC adopted the Model Bulletin on Use of Artificial Intelligence Systems by Insurers.
  - AI Systems – Regulatory Guidance and Expectations –
    - Sets forth the department's "expectations as to how insurers will govern the development/acquisition and use of certain AI technologies"
  - Regulatory Oversight and Examination Considerations –
    - The Bulletin "advises Insurers of the type of information and documentation that the department may request during an investigation or examination of any Insurer regarding its use of such technologies and AI Systems."

ADOPTION OF NAIC AI BULLETIN (OR OTHER REGS/GUIDANCE)



This map represents state action or pending state action addressing the topic of the model. This map does not reflect a determination as to whether the pending or enacted legislation contains all elements of the model or whether a state meets any applicable accreditation standards. See the reference list on the next page.

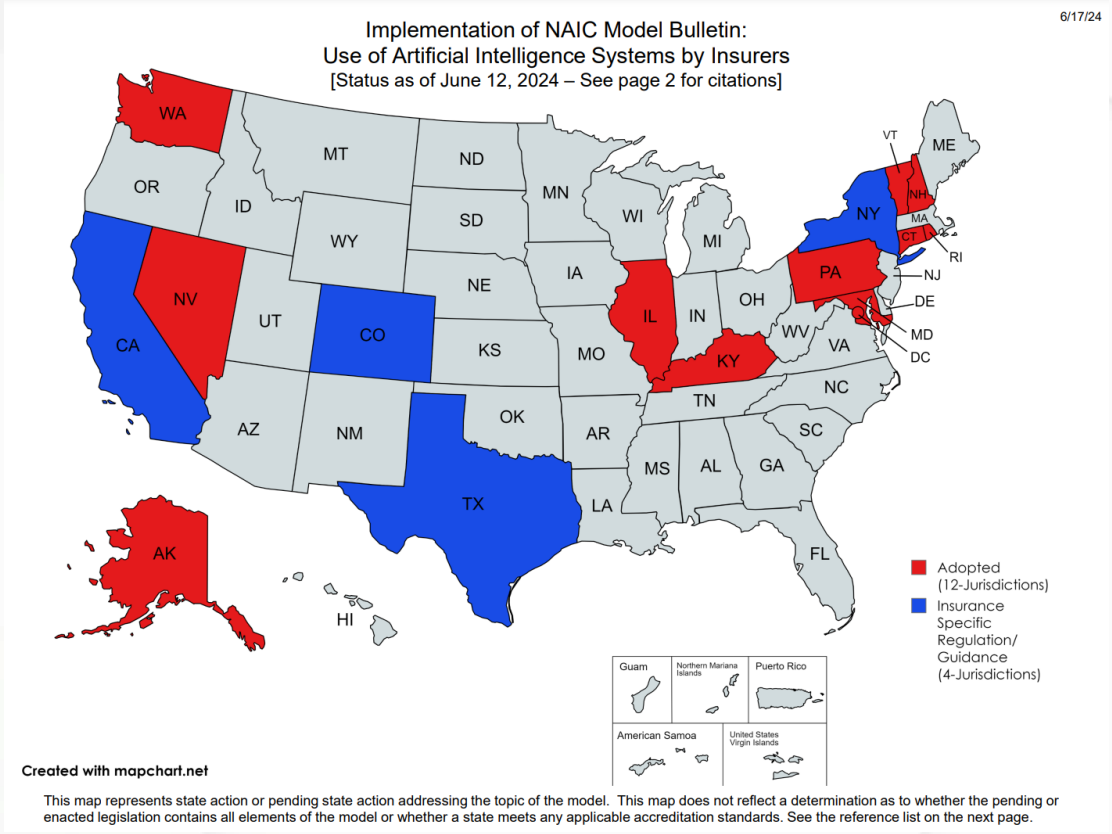
GODFREY KAHN

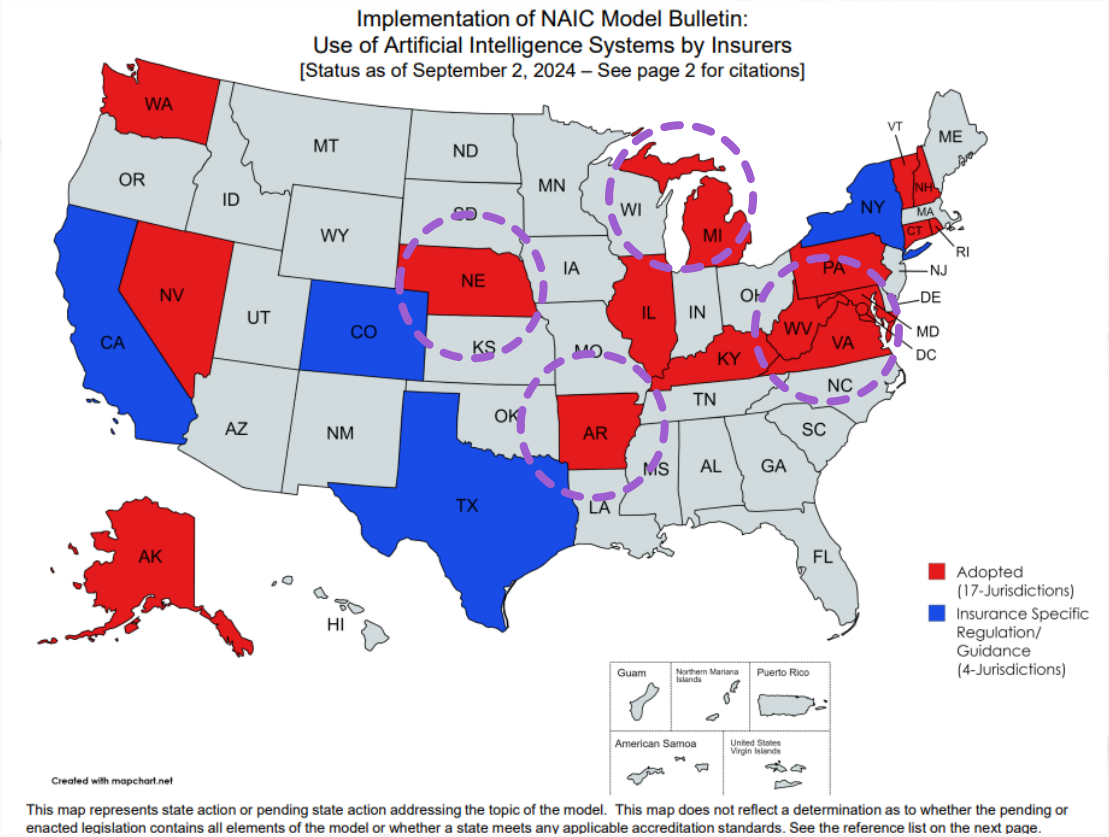
ADOPTION CONTINUES

June 12, 2024

+5 States Adopted
AR, MI, NE, VA, WV

September 2, 2024





GODFREY & KAHN

WHAT IS THE NAIC BULLETIN?

"Neither binding law nor regulation"

REY KAHN

WHAT IS THE NAIC BULLETIN?

- **Don't use AI to violate existing insurance regulations**:
  - Issued "to remind all insurers that hold certificates of authority to do business in this state that decisions or actions impacting consumers that are made or supported by advanced analytical and computational technologies, including AI Systems, ***must comply with all applicable insurance laws and regulations***."
- **Develop an AIS Program to ensure compliance**:
  - "all Insurers authorized to do business in this state are ***expected*** to develop, implement, and maintain a written program ("AIS Program") for the responsible use of AI Systems that make, or support decisions related to regulated insurance practices."
- **Expect regulatory inquiries**:
  - "Regardless of the existence or scope of a written AIS Program, in the context of an investigation or market conduct action, ***an Insurer can expect to be asked about its development, deployment and use of AI Systems***, or any specific Predictive Model, AI System or application and its outcomes (including Adverse Consumer Outcomes) from the use of those AI Systems, as well as any other information or documentation deemed relevant by the Department."

KEY DEFINITIONS

- "AI System"
  - is a machine-based system that can, for a given set of objectives, generate outputs such as predictions, recommendations, content (such as text, images, videos, or sounds), or other output influencing decisions made in real or virtual environments. AI Systems are designed to operate with varying levels of autonomy.
- "Generative Artificial Intelligence (Generative AI)"
  - refers to a class of AI Systems that generate content in the form of data, text, images, sounds, or video, that is similar to, but not a direct copy of, pre-existing data or content.
- "Machine Learning (ML)"
  - Refers to a field within artificial intelligence that focuses on the ability of computers to learn from provided data without being explicitly programmed.

WHAT IS AI?

"In its simplest form, artificial intelligence is a field that combines computer science and robust datasets to enable problem-solving."

– IBM.com

KEY DEFINITIONS

- "Model Drift"
  - refers to the decay of a model's performance over time arising from underlying changes such as the definitions, distributions, and/or statistical properties between the data used to train the model and the data on which it is deployed.
- "Predictive Model"
  - refers to the mining of historic data using algorithms and/or machine learning to identify patterns and predict outcomes that can be used to make or support the making of decisions.
- "Adverse Consumer Outcome"
  - refers to a decision by an Insurer that is subject to ***insurance regulatory standards enforced by the Department*** that adversely impacts the consumer in a manner that violates those standards.
- "Degree of Potential Harm to Consumers"
  - Refers to the severity of adverse economic impact that a consumer might experience as a result of an Adverse Consumer Outcome.

EXISTING INSURANCE REGULATORY AUTHORITY

- "Actions taken by insurers in the state must not violate applicable law, regardless of the methods the Insurer used to determine or support its actions."
- "Insurers are expected to adopt practices, including governance frameworks and risk management protocols, that are designed to ensure that the use of AI Systems does not result in violation of unfair trade practices or unfair claims settlement practices."
- Unfair Trade Practices Model Act (#880):
  - The Unfair Trade Practices Act (UTPA), regulates trade practices in insurance by defining and prohibiting practices that constitute ***unfair methods of competition*** or ***unfair or deceptive acts and practices***
- Unfair Claims Settlement Practices Model Act (#900):
  - The Unfair Claims Settlement Practices Act, (UCSPA), sets forth standards for the ***investigation and disposition of claims*** arising under policies or certificates of insurance issued to residents of the applicable state.
    - "committed flagrantly and in conscious disregard" or "committed with such frequency to indicate a general business practice"

EXISTING INSURANCE REGULATORY AUTHORITY

- Property and Casualty Model Rating Law (#1780):
  - The Property and Casualty Model Rating Law, requires that property/casualty (P/C) insurance rates not be excessive, inadequate, or unfairly discriminatory.
- The requirements apply regardless of the methodology that the Insurer used to develop rates, rating rules, and rating plans subject to those provisions.
- Insurers are responsible for assuring that rates, rating rules, and rating plans that are developed using AI techniques and Predictive Models that rely on data and Machine Learning ***do not result in excessive, inadequate, or unfairly discriminatory insurance rates***.

EXISTING INSURANCE REGULATORY AUTHORITY

- Corporate Governance Annual Disclosure Model Act(#305):
  - The Corporate Governance Annual Disclosure Act (CGAD), requires Insurers to report on governance practices and to provide a summary of the Insurer's corporate governance structure, policies, and practices. The content, form, and filing requirements for CGAD information are set forth in the Corporate Governance Annual Disclosure Model Regulation (#306) (CGAD-R).
- "The requirements of CGAD and CGAD-R apply to elements of the Insurer's corporate governance framework that address the Insurer's use of AI Systems to support actions decisions that impact consumers."
- *Is this still "guidance"?*
  - CGAD generally applies to the "governance framework and practices" and the "structure" (i.e., committees, board duties, nomination committees, senior management appointment and supervision).
  - Also includes the process by which board/committees/senior management "ensure an appropriate amount of oversight to the critical risk areas impacting the insurer's business activities."
  - Recommendation: CGAD should address AI in a manner consistent with CGAD filing; more corporate governance process, less substance.

EXISTING INSURANCE REGULATORY AUTHORITY

- Market Conduct Surveillance Model Law (#693):
  - The Market Conduct Surveillance Model Law establishes the framework for market conduct actions (e.g., consumer complaints, market analysis, targeted examinations).
- An Insurer's conduct in the state, including its use of AI Systems to make or support actions and decisions that impact consumers, is subject to investigation, including market conduct actions.
- Broad authority to request reports and information.
  - ***Expect inquiries from insurance regulators.***

CONSUMER CLASS LITIGATION

- Insurance: Focused on Claims Denials
  - Homeowners: *Huskey v. State Farm* (N.D. Ill.)
    - Theory: racial disparities in automated claims denials, violating Fair Housing Act
    - Status: motion to dismiss denied; in discovery
  - Health: *Cigna* (E.D. Cal., D. Conn.); *Humana* (W.D. Ky.); *United* (D. Minn.)
    - Theory: automated claims denial, without or against physician review, violates state statutes, good faith, and/or terms of insurance contract
    - Status: pending motions to dismiss
- Other:
  - Antitrust (hotel-room price fixing by casinos using a shared pricing algo)
  - Discrimination in mortgage lending (*Wells Fargo*); employment decisions (*iTutorGroup*)
  - Accidental/wrongful denial or reduction of public benefits (*Zynda v. Zimmer; Barry v. Lyon*)

DAIL (Database of AI Litigation; George Washington University): https://blogs.gwu.edu/law-eti/ai-litigation-database/

SECTION 3 – AIS PROGRAM GUIDANCE AND EXPECTATIONS

- Decisions subject to regulatory oversight that are made by Insurers using AI Systems must comply with the legal and regulatory standards that apply to those decisions, including unfair trade practice laws. These standards require, at a minimum, that decisions made by Insurers are not inaccurate, arbitrary, capricious, or unfairly discriminatory.
- Compliance with these standards is required regardless of the tools and methods Insurers use to make such decisions.
- Consistent therewith, all Insurers authorized to do business in this state are ***expected*** to develop, implement, and maintain a ***written*** program (an "AIS Program") for the responsible use of AI Systems that make, or support decisions related to regulated insurance practices.
- Four Sections:
  - 1) General Guidelines
  - 2) Governance
  - 3) Risk Management and Internal Controls
  - 4) Third-Party AI Systems and Data

AIS PROGRAM GENERAL GUIDELINES

- An Insurer's AIS Program should be designed to:
  - Mitigate the risk of "Adverse Consumer Outcomes'
  - Address governance, risk management controls, and internal audit functions
  - Include Board oversight, accountability
  - Tailored to and proportionate with use and reliance on AI and AI Systems – commensurate with degree of potential harm to consumers
  - May be part of Enterprise Risk Management; NIST AI Risk Management Framework Version 1.0.
  - Address AI Systems "across the insurance life cycle" and specifically "with respect to regulated insurance practices."
  - Include "processes and procedures providing ***notice*** to impacted consumers that AI Systems are in use and provide access to appropriate levels of information based on the phase of the insurance life cycle in which AI Systems are being used."

AI SYSTEM GOVERNANCE

- Governance framework for oversight of AI Systems used by the Insurer. Either new internal governance structure or reliance on existing structures.
- Should prioritize “transparency, fairness and accountability in the design and implementation of the AI Systems.”
- Documentation of compliance with the AIS Program (with Regulatory Oversight/Examination in mind).
- Governance Accountability Structure
  - Use of committees across business units
  - Scope of responsibility, authority, changes of command, and decisional hierarchies
  - Independence of decision-makers and “lines of defense” at successive stages of the AI System life cycle.
  - Monitoring, auditing, escalation, and reporting protocols and requirements.
  - Training and ongoing supervision

WHAT IS AI GOVERNANCE?

"AI Governance translates espoused ethical principles and good data science practice into repeatable, reliable, repositories of evidence about the risks and benefits of AI."

CREATING AI SYSTEM GOVERNANCE

Align all stakeholders including business teams, legal and privacy teams from the beginning on strategy, risk tolerance, and desired outcomes

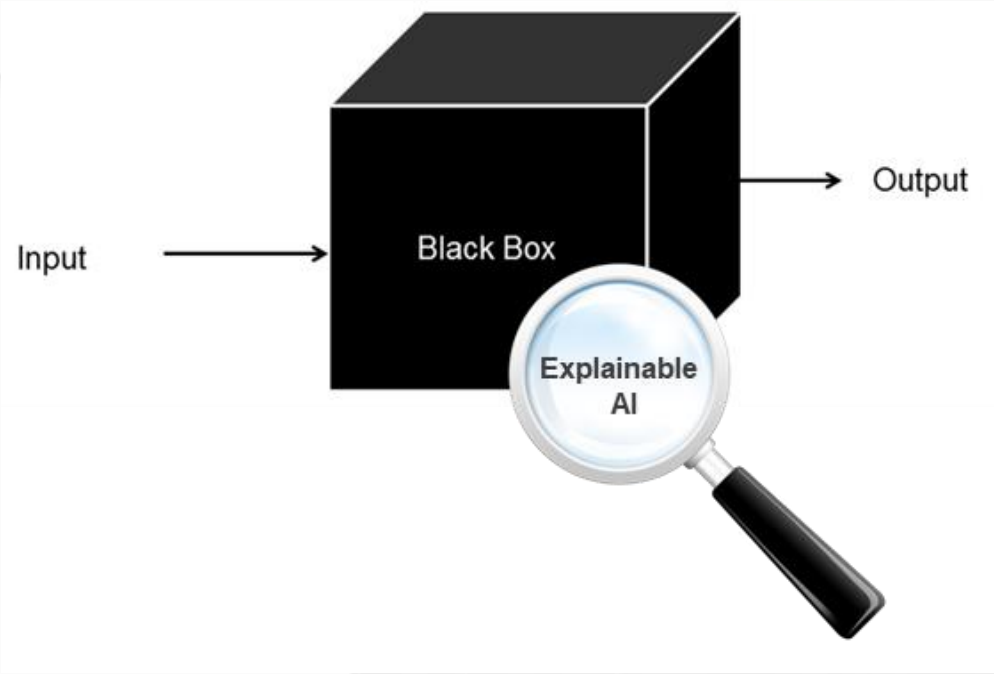
Identify guiding principles and standards at the outset

Understand data sources and data flows by creating a data catalogue

Measure and monitor AI outcomes, maintaining documentation throughout

TRANSPARENCY, FAIRNESS, ACCOUNTABILITY

- Understand how the AI model makes decisions
- Understand the reasoning behind the decisions
- Confirm the decisions are mathematically provable



RISK MANAGEMENT AND INTERNAL CONTROLS

- Document "risk identification, mitigation, and management framework and internal controls for AI Systems generally and at each stage of AI System life cycle."
- Data practices and accountability procedures (data currency, lineage, quality, integrity, bias analysis and minimization, and suitability.
- Validating, testing, retesting to assess AI System outputs.
  - Validation can take the form of "comparing model performance on unseen data available at the time of model development to the performance observed on data post-implementation, measuring against expert review, or other methods."
- Data and record retention.

RISK ASSESSMENT

- Business Risk
  - Compliance with laws
  - Bias and discrimination
  - Reputational damage
  - Opaque decision making
  - Lack of human oversight
  - Ethical use
  - Liability for harm caused by AI
- Security Risk
  - Vulnerability to attack
- Operational Risk
  - Data corruption
  - High costs
- Privacy Risk
  - Data repurposing

VALIDATING, TESTING, RETESTING TO ASSESS AI SYSTEM

- Documentation is Key
- Continuous Evaluation
  - Is the AI making decisions we expect it to make?
  - Is the AI making accurate decisions?
  - Is the AI making repeatable and reliable decisions?
  - Is the AI making discriminatory decisions?
  - Test for documented risks
  - Test with unseen data
  - Test with edge data

THIRD-PARTY AI SYSTEMS AND DATA

- AIS Program should address Insurer's process for acquiring, using or relying on (i) third-party data to develop AI Systems and (ii) AI Systems developed by a third party.
- Standards, policies, procedures and protocols relating to:
  - Due diligence and methods used by the Insurer to assess the third party and its data or AI Systems to ensure that made or supported from such AI Systems that could lead to Adverse Consumer Outcomes will meet the legal standards imposed on the Insurer itself.
  - Where appropriate and available, terms in contracts with third parties that:
    - Provide audit rights and/or entitle the Insurer to receive audit reports by qualified auditing entities.
    - Require the third party to cooperate with the Insurer with regard to regulatory inquiries and investigations related to the Insurer's use of third-party products or services.

THIRD-PARTY AI SYSTEMS AND DATA

- AIS Program should address verification of third-party compliance with contractual and regulatory requirements (where applicable).
- Expect examination or investigation inquiries relating to:
  - Due diligence conducted on third parties and their data, models or AI Systems.
  - Contracts with third-party vendors (including terms relating to representations and warranties, data security and privacy, data sourcing, IP rights, confidentiality and disclosures, and/or cooperation with regulators.
  - Audits and confirmation processes performed regarding third-party compliance and contractual/ or regulatory obligations
  - Documentation pertaining to validation, testing, and auditing.

VENDOR MANAGEMENT POLICIES

- **Due Diligence**
  - What data was used to train the model?
  - Where did the data come from?
  - Does the company have sufficient rights to use the data?
  - How does the model make decisions?
  - Has the model been tested, will it be continuously tested, and can you provide the documentation?
  - Who owns the inputs, outputs and model?
- **Contract Terms**
  - Auditing rights and ongoing testing obligations
  - Indemnification for violations of law, including privacy laws, and IP infringement
  - Reps and warranties regarding the data
  - Sufficient carve outs to the limitation of liability with regard to security and confidentiality
  - Security requirements around protecting inputs, outputs and the model itself
  - Responsibilities in the case of a data breach

PREDICTIVE MODELS

- Governance expected to specifically address process and procedures for "designing, developing, verifying, deploying, using updating, and monitoring Predictive Models"
- Description of methods used to detect and address errors, performance issues, outliers, or unfair discrimination in the insurance practices resulting from the use of the Predictive Model.
- Management and oversight of Predictive Models, including:
  - Inventories and descriptions of the Predictive Models
  - Detailed documentation of the development and use
  - Assessments regarding interoperability, repeatability, robustness, regular tuning, reproducibility, traceability, model drift, and auditability.
- Narrative description of the model's intended goals and objectives and how the model is developed and validated to ensure that the AI Systems that rely on such models correctly and efficiently predict or implement those goals and objectives

SECTION 4 – REGULATORY OVERSIGHT AND EXAMINATION CONSIDERATIONS

- "Regardless of the existence or scope of a written AIS Program, in the context of an investigation or market conduct action, an Insurer can ***expect to be asked*** about its development, deployment, and use of AI Systems, or any specific Predictive Model, AI System or application and its outcomes (including Adverse Consumer Outcomes) from the use of those AI Systems, as well as any other information or documentation deemed relevant by the Department."

SECTION 4 – REGULATORY OVERSIGHT AND EXAMINATION CONSIDERATIONS

- Insurers should expect those inquiries to include (but not be limited to) the Insurer's governance framework, risk management, and internal controls.
- Also expect inquiries regarding specific models, AI Systems, and numerous specific types of information and documentation relating to:
  - AI Program (e.g., written program; evidence of adoption; fit/tailoring; further AI adoption, development, validation and oversight; and data privacy).
  - Third-party due diligence (pre-use, monitoring, auditing).
  - Evidence of implementation and compliance with AIS Program (including in specific facts of given complaint or circumstance).
  - Consumer notifications?

SUMMARY

- ***Be on notice*** – Regulators are very interested in use of AI by insurance companies. Anticipate regulator inquiries at every opportunity.
- ***Develop a written AIS Program and be prepared to show your work*** – NAIC Bulletin outlines expectations for the AIS Program. When deviating, be prepared to communicate alternative processes or functional compliance.
- ***Prioritize areas with greatest nexus to potential Adverse Consumer Outcomes*** (i.e., violations of existing law).
- ***Monitor how insurance departments are using the AI Bulletin*** - Is it interpreted as a guidance document or a functional requirement? Is any enforcement action relating to a specific violation of an existing statute or regulation?

THANK YOU

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