NAMIC® ADVOCACY

THE STATE RATING STATUTES AND CONSTITUTIONAL POLICYMAKING:

CAUSATION AND DISPARATE IMPACT STANDARDS IN NAIC'S DRAFT WHITE PAPER

NAT SHAPO
Partner
Katten Muchin Rosenman LLP

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ISSUE ANALYSIS

NAT SHAPO

Nat Shapo is a partner at Katten Muchin Rosenman LLP with an insurance litigation, regulatory, and public policy practice. He served four years as the director of the Illinois Department of Insurance, where he was elected four times to the NAIC executive committee, twice as a national officer. He has been a lecturer in law at the University of Chicago Law School, and he has a BA and a JD, both with honors, from the University of Chicago. He has testified frequently in many forums, including Congress, the National Association of Insurance Commissioners, and the National Council of Insurance Legislators, regarding rate regulation and unfair discrimination.

For more information about this NAMIC Issue Analysis please visit www.namic.org/issues/our-positions or contact:

Jon Bergner
jbergner@namic.org
202.580.6751

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INTRODUCTION/SUMMARY

The National Association of Insurance Commissioners' Casualty Actuarial and Statistical (C) Task Force's (CASTF) draft Regulatory Review of Predictive Models White Paper fails to demonstrate the need for a transformative regulatory response to modern underwriting. Yet it directs regulators to require a showing of causation/intuitiveness for, and to apply a disparate impact/proxy variable standard to, all rating factors — major changes to established norms, with no basis in controlling law, which cannot be instituted by white paper.

The White Paper explains that "predictive models ... use statistics to predict outcomes" and "estimate ... expected value of ... loss" — but this is not a new way of classifying risk. Its caricature of "data mining" practices as "cherry-picking ... spurious ... results" that "churn up ... simply random non-meaningful correlations" misrepresents typical insurer vetting and risk evaluation methods.[1]

The White Paper grafts causation onto state rating statutes: "[T]hroughout this white paper, the regulator asks the modeler to go beyond correlation and document their basic, causal understanding of how variables ... are related to risk" by requiring an "explanation ... beyond demonstrating correlation."

This isn't the law. Courts applying statutory prohibitions on unfair discrimination judge "the equitableness of a rating factor by its predictive accuracy"; reject the standard of "a causal connection to expected losses"; and further instruct that "assessing risks of future ... costs on an actuarial basis cannot be prohibited." This is "fair discrimination": Safer risks pay more accurate, lower premiums based on their cost to insure, and pairing price with risk promotes insurer solvency – both essential consumer protection concerns.

Correlation, not causation, is the cornerstone of actuarial justification. Actuarial authorities turn on whether "the variation in ... anticipated experience correlates to the risk characteristic," and explain that, because "the categorization of variables as 'causal' or 'non-causal' is ambiguous[,] ... correlated variables provide more accurate premiums and are thus more desirable."

The White Paper directs reviewers to "obtain a complete data dictionary including ... each ... proxy variable" and to identify "concerns related to ... proxies for prohibited variables." This implements a disparate impact standard for unintentional discrimination, in conflict with the NAIC's stated legal position that "'disparate impact theory' ... overthrows state laws ... that allow ... neutral underwriting guidelines."

The White Paper likely constitutes an unpromulgated regulation under state Administrative Procedure Acts, which require administrative rulemaking for each "standard, directive or statement of general applicability which effectuates or interprets law or policy."

Prevailing law establishes an objective correlation standard, supplemented by legislative bans or limits on specific rating factors. Although a previous NAIC committee studying causation stated that, "as public policy issues, questions regarding discriminatory practices should be determined in the public forum of the legislature," the White Paper directs regulators to claim these subjective political judgments for themselves.

[1] Citations to all authorities quoted in this introductory section are found in the body of the paper below.

I. THE RELEVANT PROVISIONS OF THE CASTF WHITE PAPER

A. THE WHITE PAPER DOES NOT IDENTIFY NEW BUSINESS PRACTICES THAT CAUSE HARM

The White Paper fails to successfully identify the kind and degree of qualitatively new business practices, and corresponding consumer harm, that could reasonably justify and necessitate the sorts of extensive and material changes to established state rate regulation practices proposed therein.

Under the suggestive heading, "do regulators need best practices to review predictive models," the White Paper defines "predictive model" as "a set of models that use statistics to predict outcomes. When applied to insurance, the model is chosen to estimate the probability or expected value of an outcome given a set amount of input data; for example, models can predict the frequency of loss, the severity of loss, or the pure premium." CASTF White Paper, Oct. 15 Draft (hereafter "White Paper"), p. 3. This is a description of traditional underwriting — not of a radical new practice that demands aggressive regulatory reforms in response.

The White Paper criticizes "generalized linear models" that "became vogue" because, in comparison to "univariate models," they are "not always intuitive, and the relationship to costs may be difficult to explain." Id. But GLMs have been used for some time; univariate rating factors do not have causal relationships to loss, see p. 7-8; and many longstanding univariate variables are unintuitive — like marital status, see p. 11-12.

The White Paper suggests that insurers commonly utilize "a purely 'cookbook' approach to statistics" involving the development of classifications based on "a p-value near .05 taken by itself"; "'cherry-picking promising findings, also known by such terms as data dredging, significance chasing...and p-hacking' ... lead[ing] to a spurious excess of statistically significant results"; and the failure to attempt to weed out "'false positives' ... [that] will inevitably churn up numerous associations between variables that are simply random, non-meaningful correlations resulting purely from chance." White Paper at 36-37.[2]

This caricature is belied by the substantial protocols insurers deploy to prevent use of false positives as rating factors. Such further vetting is in carriers' own, and their insureds', vital interest: Bogus "data mining" mismatches price and risk, undermines solvency, and alienates better risks.[3]

[2] The White Paper's rhetoric here is concerning. It dismissively criticizes the industry for "The apparent disregard of causality that seems common among practitioners of data mining techniques," p. 37, even though causality is not an established regulatory standard. And its assertion that "causality forms the basis of the standard model of all natural and social sciences," id., is unsupported by any citation to authority and conflicts with the rules controlling the relevant topic - insurance unfair discrimination law.

[3] See, e.g., Federal Trade Commission Report to Congress, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," July 2007, p. 8 ("Insurance companies have a strong economic incentive to try to predict risk as accurately as possible. ... If an insurance company is able to predict risk better than its competitors, it can identify consumers who currently are paying more than they should based on the risk they pose, and target these consumers by offering a slightly lower price. Thus, developing and using better risk prediction methods is an important form of competition among insurance companies.").

B. EROSION OF THE ESTABLISHED CORRELATION STANDARD

The White Paper's "Other Considerations" section admits that "discuss[ing] correlation vs causality" is "beyond the scope of this paper, as well as CASTF's current charges." Id. at 35-36. Yet it concedes that the White Paper nonetheless comprehensively directs causality regulation. See id. p. 36 ("Throughout this white paper, the regulator asks the modeler to go beyond correlation and document their basic, causal understanding of how variables used in a model or rating plan are related to risk."); id. ("This white paper, in general, establishes that a rating/modeled variable should not only be correlated to expected costs but that there should be a rational explanation as to why the correlation exists."); id. ("A correlation alone is not the final arbiter of the validity of findings, but causal understanding can be employed to assess which correlations may be entirely due to chance, what are non-causal relationships, and which are most likely to be enduring causal relationships. ... [T] he paper does ask the modeler to provide their understanding of these relationships.").

Examples of such directions given to regulators "throughout this white paper" include:

- "Do Regulators Need Best Practices To Review Predictive Models," Section III, p. 3 (expressing preference for the use of "methods ... considered intuitive and easy to demonstrate the relationship to costs (loss and/or expense)," as opposed to those that "are not always intuitive.").
- "Predictive Models — Information For Regulatory Review/Building The Model," Section VII, p. 15 ("Obtain a rational explanation for why an increase in each predictor variable should increase or decrease frequency, severity, loss costs, expenses, or any element or characteristic being predicted. The explanation should go beyond demonstrating correlation. Considering possible causation is relevant, but proving causation is neither practical nor expected. If no rational explanation can be provided, greater scrutiny may be appropriate. For example, the regulator should look for unfamiliar predictor variables and, if found, the regulator should seek to understand the rational connection that variable has to increasing or decreasing the target variable.").
- "Predictive Models — Information For Regulatory Review/The Filed Rating Plan," Section VII, p. 20 ("Obtain a narrative regarding how the characteristics/rating variables included in the filed rating plan relate to the risk of insurance loss (or expense) for the type of insurance product being priced. The narrative should include a discussion of the relevance each characteristic/rating variable has on consumer behavior that would lead to a difference in risk of loss (or expense). The narrative should include a logical and intuitive relationship to cost.")

Because the last cited provision is an "Importance to Regulator's Review Level 2" item ("this information is necessary to continue the review of all but the most basic models," id. at 7), the White Paper is essentially demanding that virtually all rate filings provide affirmative causation justification for every rating factor.

C. APPLICATION OF THE DISPARATE IMPACT STANDARD

The White Paper contains a series of provisions instructing regulators to identify and regulate proxy variables. See p. 15 (establishing as a Level 1 requirement ("information ... necessary to begin the review," p. 7) that the reviewer "obtain a complete data dictionary, including the names, types, definitions and uses of each predictor variable, offset variable, control variable, proxy variable...."); p. 32 (adding to the Product Filing Review Handbook's questions used to determine if "there [is] unfair discrimination" the question, "If predictive models are used in the rating plan, are there concerns related to input variables that are prohibited or proxies for prohibited variables?"); p. 44 (defining "proxy variable" as "any characteristic that indirectly captures the effect of another characteristic whether or not that characteristic is used in the insurer's rating plan.").

As the White Paper defines and uses the term, a proxy variable may not be used if it has a disparate impact resulting in non-intentional discrimination against a protected social class (race, religion, or national origin in most insurance codes).

II. ANALYSIS OF THE WHITE PAPER UNDER CONTROLLING LAW AND PUBLIC POLICY

A. STATE RATING STATUTES REQUIRE CORRELATION, NOT CAUSALITY

The White Paper explains that it "consciously exclude[s] ... discussion" of ASOPs, Actuarial Standards Of Practice, because they "do not supersede state laws" and are "a floor, not a ceiling, for regulatory actuaries who also need to consider state laws and public policy concerns." White Paper at 36.

Such a negative approach to the ASOPs in a CASTF document is ironic: CASTF's "Regulatory Guidance on Property and Casualty Statutory Statements of Actuarial Opinion" instructs that "one expectation of regulators clearly presented in the Instructions is that the Actuarial Opinion, AOS, and supporting Actuarial Report and work papers be consistent with relevant Actuarial Standards of Practice (ASOPs)."[4]

Regardless, the White Paper's implication that state laws provide more support for a causation standard than the ASOPs is not well-founded: We are aware of no controlling law recognizing causation as a relevant factor in the evaluation of whether rating methods are unfairly discriminatory.

For instance, in Dept. of Ins. v. Ins. Services Ofc., 434 So.2d 908, 912-913 (Fla. App. 1983), with respect to the rating factors of sex, marital status, and scholastic achievement — accurate but non-intuitive risk predictors with no causal relationship to loss — the court rejected the regulator's contention that "a rating factor will be deemed unfairly discriminatory and inequitable unless it has a causal connection to expected losses"; affirmed the hearing officer's finding that "the most equitable classification factors are those that are the most actuarially sound"; and approvingly noted that the department had "historically ... measure[d] the equitableness of a rating factor by its predictive accuracy."[5]

[4] https://content.naic.org/sites/default/files/inline-files/Regulatory%20Guidance%202019%2010-25-19_0.pdf

[5] The court's rejection of the Florida regulator's attack on non-intuitive factors based on purported lack of causality followed the NAIC's rejection of a 1979 proposal calling for the elimination of automobile insurance classifications based on sex or marital status, as discussed further below, infra, p. 12.

"Predictive accuracy" is the lodestar of the state unfair discrimination laws, which have not been interpreted as requiring a showing of causation. For instance, the New York appellate court held that an "underwriting practice that is valid in reasonably assessing risks of future ... costs on an actuarial basis cannot be prohibited by" regulators applying the unfair discrimination standard: "Such an underwriting practice is not unfair, inequitable, misleading or discriminatory. Indeed ... appropriate classification of risks is sanctioned and encouraged throughout the Insurance Law." Health Ins. Assn. of Am. v. Corcoran, 154 A.D.2d 61, 69 (N.Y. App. 1990).

Under this objective rule, "The premium rate must be correlated to loss experience. It is necessary for the insurance companies (and the Commissioner) to rely principally upon statistical data and a projected premium-loss ratio." Louisville Auto. Club v. Dept. of Ins., 384 S.W.2d 75, 78 (Ky. App. 1964). This correlation standard tying premiums to actuarially projected losses is the consensus rule.[6]

Such case law reflects the plain language of the state rate statutes, which do not encompass causation. See La. Rev. Stat. 22:1452(C)(25) ("'Unfairly discriminatory' means not capable of being actuarially justified or based on race, color, creed, or national origin. It does not refer to rates that produce differences in premiums for policyholders with different loss exposures, so long as the rate is actuarially justified and reflects such differences with reasonable accuracy."). This is the essence of unfair discrimination regulation: a core requirement of actuarial justification, with some factors further prohibited or restricted based on social considerations.

All relevant authority follows this basic construct. See also La. Rev. Stat. 22:1454(B) ("Basic rate factors. Due consideration shall be given to past and prospective loss and expense experience.... Classification ... Classification rates may be modified ... in accordance with rating plans ... which establish standards for measuring probable variations in hazards or expenses, or both."); Ins. Services Ofc. v. Com'r of Ins., 381 So.2d 515, 517 (La. App. 1979) (because "there exists a sound statistical basis for using classifications based on age and sex in fixing insurance rates," even though these are "factors over which the driver has no control," and "although there is discrimination against the good, young driver," it "is not unfair or unreasonable.").

This two-step — objective predictive accuracy, supplemented by subjective protection of legislatively determined, discrete classes even if they correlate to risk — is the norm. See, e.g., Nev. Rev. Stat. 686B.050(4) ("One rate is unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the difference in expected losses and expenses."); Nev. Rev. Stat. 686B.060(1) ("Due consideration shall be given to past and prospective loss and expense experience. ... Risks may be classified in any reasonable way for the establishment of rates and minimum premiums, except that classifications may not be based on race, color, creed, national origin, sexual orientation or gender identity or expression.").[7]

[6] See, e.g., Telles v. Com'r of Ins., 574 N.E.2d 359, 361-362 (Mass. 1991) ("The statutory pattern which deals with insurance regulation authorizes insurers to 'discriminate fairly.' [Citation omitted.] We stated ... that the basic principle underlying statutes governing underwriting practices is that insurers have the right to classify risks and to elect not to insure risks if the discrimination is fair. ... The intended result of the ... process is that persons of substantially the same risk will be grouped together.' [Citation omitted.] ... [The unfair discrimination statutes] illustrate the principle that insureds must be treated in accordance with their risk classification. ... This statutory scheme requires the commissioner to treat equally insureds who are of the same risk classification. This may result in fair discrimination.); Doukas v. Met. Life Ins. Co., 950 F.Supp. 422, 429 (D.N.H. 1996) ("[T]he insurance practice must either be based on actuarial data or on the company's actual or reasonably anticipated experience relating to the risk involved."); Ins. Com'r v. Engelman, 692 A.2d 474, 480 (Md. 1997) ("Unfair discrimination, as the term is employed by the Insurance Code, means discrimination among insureds of the same class based upon something other than actuarial risk."); Hardware Mut. Cas. Co. v. Premo, 217 A.2d 698, 704 (Conn. 1966) ("The effect of the Act is to permit the filing of a rating plan in which the individual insurer's judgment as to the expense provisions of a particular risk, or the probable hazards of a particular risk, may reflect the expected cost to the insurer of providing the coverage for that risk and, in turn, the amount of premium to be charged the insured.").

[7] Such statutes are common. See, e.g., Minn. Stat. 70A.04 ("One rate is unfairly discriminatory in relation to another if it clearly fails to reflect equitably the differences in expected losses, expenses and the degree of risk."); Minn. Stat. 70A.05 ("Risks may be classified by any reasonable method for the establishment of rates and minimum premiums. Classifications may not be based on race, color, creed or national origin.").

The White Paper would wither these statutory presumptions favoring rates that correlate with risk by attaching an affirmative requirement that insurers proffer a showing of causality for every rating factor.

B. ACTUARIAL AUTHORITIES REQUIRE CORRELATION, NOT CAUSALITY

In following the "rule of thumb ... that prices are not unfairly discriminatory when consumers are charged different amounts that are actuarially justified (or justified based on risk/cost)," the NAIC Product Filing Review Handbook (Aug. 2016) quotes the Casualty Actuarial Society's 1988 Statement of Principles Regarding Property and Casualty Insurance Ratemaking: "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." Id. at 27, 12.[8]

Actuarial authorities consistently follow these principles. For instance, ASOP 25 (Credibility Procedures) defines "credibility" as "a measure of the predictive value in a given application that the actuary attaches to a particular set of data ('predictive' is used here in the statistical sense and not in the sense of predicting the future)," ASOP 25, Sect. 2.1; and "risk classification system" as "a system used to assign risks to groups based upon the expected cost or benefit of the coverage or services provided," id. Sect. 2.6.

ASOP 12 (Risk Classification) explains that "it is not necessary for the actuary to establish a cause and effect relationship between the risk characteristic and expected outcome in order to use a specific risk characteristic." ASOP 12, Sect. 3.2.2. The White Paper criticizes "filers who cite" this language "while omitting the leading phrase 'while the actuary should select risk characteristics that are related to expected outcomes,'" White Paper at 36.

But the White Paper itself omits ASOP 12's clear explanation of what the quoted "leading phrase" means: "The actuary should select risk characteristics that are related to expected outcomes. A relationship between a risk characteristic and an expected outcome, such as cost, is demonstrated if it can be shown that the variation in actual or reasonably anticipated experience **correlates to** the risk characteristic." ASOP 12, Sect. 3.2.1 (emphasis added). Thus even the language quoted by the White Paper in support of its position plainly follows the controlling correlation standard.

The first authority listed by the NAIC Product Filing Review Handbook as "recommended ... background reading" is the Casualty Actuarial Society's Foundations of Casualty Actuarial Science (4th edition, CAS 2001), which instructs that causation is too subjective to replace correlation. "Unfortunately, ... the categorization of variables as 'causal' or 'non-causal' is ambiguous.... [C]orrelated variables provide more accurate premiums and are thus more desirable.... Eliminating correlated noncausal variables may produce a less accurate rating system." CAS Foundations, p. 298; see also id. at 295 ("The most important consideration is that the rating variables have an objective definition. There should be little ambiguity.").

CAS's Foundations further explains that the concept of causation is inapposite to proper underwriting because causal factors are unquantifiable, subjective, and not useful: "For example, automobile insurance underwriters often talk of 'maturity' and 'responsibility' as important criteria for youthful drivers. These are difficult to define objectively and to apply consistently." Id.

[8] See also NAIC Product Filing Review Handbook at 12 ("'Unfairly discriminatory' is a concept often based on 'cost based pricing,' with the key word being 'unfairly.' For example, charging different prices to a man vs. a woman is discriminatory; however, it is only unfairly discriminatory if it cannot be reasonably explained by differences in expected costs.").

By contrast, "The actual rating variables, age, gender, and marital status, may be proxies for the underlying sources of cost variation. Maturity might be a more accurate variable, but it is not practical." Id. Immaturity can cause losses, but age, gender, and marital status cannot. The former characteristic might be causative, but is too subjective to be a rating factor; the latter, objective, factors are not causative but comport with industry practice and legal requirements.

Actuarial leaders applied these same principles — rejecting causation in favor of correlation — to credit scoring in the 2000s. When asked by the NAIC to "provide guidelines/parameters on how the NAIC could conduct a study of credit scoring, including suggestions on how the NAIC could determine ... causality," the American Academy of Actuaries declined because it found causality irrelevant. See AAA, The Use of Credit History for Personal Lines of Insurance: Report to the NAIC, Nov. 15, 2002, p. 28 ("The Risk Classification Subcommittee does not recommend that the NAIC conduct a study to determine if there is a causal relationship between credit history and future insurance claims experience, because in our opinion it would not be possible to prove a causal relationship. The NAIC could conduct a study to evaluate the strength of any statistical relationships between credit history and insurance claims experience. In the subcommittee's opinion, **any finding of causality in any context or field of study is a statement of a theory or conjecture** based on the observation that there is a strong statistical relationship between the 'cause' and the 'effect.'" (Emphasis added.)).

The AAA credit scoring report cut to the heart of the matter: Even the most basic rating factors are not causative. See id. at 29 ("Causality is not a requirement for any element in a risk classification system. For example, drivers with past accidents and driving violations have been shown to have higher rates of accidents in the future, and therefore driving record is a useful and commonly accepted element of risk classification systems for automobile insurance. However, histories of past accidents and violations do not cause drivers to have more accidents. The rating practice that does exist is based on the fact that, as a group, drivers who have been accident-prone in the past are likely to be accident-prone in the future.").[9]

[9] See also Michael Walters, Risk Classification Standards, found in CAS Proceedings, May 1981 ("Merit rating in auto insurance is almost totally non-causal. The fact that an insured has been involved in a past accident does not behaviorally cause him to get in the next one or even to have become a worse driver. And yet the same critics of current rating cite past accident record as an ideal rating variable.").

C. DISPARATE IMPACT IS NOT CONTROLLING LAW

The White Paper's definition of a "proxy variable" as "any characteristic that indirectly captures the effect of another characteristic whether or not that characteristic is used in the insurer's rating plan," and its instructions to include "each ... proxy variable" in a "complete data dictionary," and to question whether factors used "are prohibited or proxies for prohibited variables," White Paper at 44, 15, 32, would establish a disparate impact standard not recognized under state unfair discrimination law.

State insurance codes typically prohibit discrimination "based on" protected class status, such as race.[10] Insurers do not use classifications "based on" protected classes. In order to discriminate "based on" these factors, carriers would have to know whether individual insureds were members of these protected classes — information insurers do not collect and avoid attempting to ascertain.

Courts applying anti-discrimination law recognize disparate impact only when the relevant statute includes language evincing an intent to deviate from the default rule, which prohibits only intentional discrimination. See, e.g., Tex. Dept. Housing and Comm. Affairs v. Inclusive Comm. Proj., Inc., 135 S.Ct. 2507, 2518 (2015) ("[A]ntidiscrimination laws must be construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of actors.").

The "text" of state unfair discrimination laws do not reference "the consequences of" risk classification practices with respect to protected social classes.[11] The statutory phrase "based on" plainly encompasses "just the mindset of actors," and not the effects of their conduct.

NAIC models also prohibit intentional discrimination "based upon" protected social class status. See NAIC Model #1775, Property and Casualty Model Rating Law, Section 5(A)(4)(b) ("No risk classification ... may be based upon race, creed, national origin or the religion of the insured.").

That is why the NAIC's legal position of record opposes disparate impact theory. See NAIC Friend of the Court Brief to the U.S. Supreme Court, Nationwide Mut. Ins. Co. v. Cisneros (1996 WL 33467770) ("Ohio laws permit and encourage the use of rationally based, neutral risk selection criteria. ... This promotes insurer solvency through appropriate risk classification and accurate pricing of insurance. ... The 'disparate impact' approach ... means that a facially neutral rule that disproportionately excludes members of a protected class can violate the Fair Housing Act even though the alleged violator was not motivated by discriminatory intent. ... [This] overthrow[s] state laws ... that allow insurers to use rationally based, neutral underwriting guidelines.").[12]

[10] See, e.g., La. Rev. Stat. 22:1452(C)(25) ("'Unfairly discriminatory' means not capable of being actuarially justified or based on race, color, creed, or national origin."); Nev. Rev. Stat. 686B.060 ("Risks may be classified in any reasonable way for the establishment of rates and minimum premiums, except that classifications may not be based on race, color, creed, national origin, sexual orientation or gender identity or expression."); Minn. Stat. 70A.05 ("Risks may be classified by any reasonable method for the establishment of rates and minimum premiums. Classifications may not be based on race, color, creed or national origin.").

[11] The U.S. Department of Housing and Urban Development has promulgated a rule applying disparate impact to homeowners' insurers. The rule, which is currently under litigation, is irrelevant to the White Paper: This federal agency, HUD, implements the federal Fair Housing Act, not the distinguishable state unfair discrimination statutes enforced by NAIC member state insurance departments.

[12] The NAIC brief was submitted with respect to the question of disparate impact liability under the federal Fair Housing Act, which is not within the jurisdiction of state insurance departments, see supra, note 11. NAIC's brief is directly relevant here because it unequivocally asserted that the state rating laws – the statutes which the White Paper seeks to aid state form reviewers in enforcing – do not recognize disparate impact liability.

III. THE LEGAL LIMITS OF POLICYMAKING BY WHITE PAPER

A. STATE APA RULEMAKING REQUIREMENTS

By instructing regulators to implement new legal standards of causation and disparate impact, the White Paper, if adopted, would likely make its and the Product Filing Review Handbook's[13] use in the states an unpromulgated rule.

State Administrative Procedure Acts require that statements of general applicability implementing substantive policy and/or constituting agency practice must be adopted via formal notice and comment rulemaking. See, e.g., Nev. Rev. Stat. 233B.038(1)(a) ("'Regulation' means ... [a]n agency rule, standard, directive or statement of general applicability which effectuates or interprets law or policy, or describes the organization, procedure or practice requirements of an agency.").

The White Paper's purpose is to "hopefully ... help[ ] bring more consistency to the art of reviewing predictive models within a rate filing" by "identify[ing] best practices ... and provid[ing] state guidance," White Paper, p. 2, and is thus on its face intended to serve as a "standard, directive or statement of general applicability."[14]

The White Paper defines "best practice" as an "effective method of problem solving. The 'problem' regulators want to solve is probably better posed as seeking an answer to this question: How can regulators determine that predictive models, as used in rate filings, are compliant with state laws and regulations?" Id. at 2.

[13] Section VIII of the White Paper, Proposed Changes to the Product Filing Review Handbook, inserts numerous references to the White Paper into the Handbook. See, e.g., White Paper, p. 30 ("To assist the regulator in following each best practice, [CASTF] created a white paper titled Regulatory Review of Predictive Models. The paper contains a list of information elements and considerations that should be useful during the review of a model underlying a rating plan."); id. at 28 ("NAIC has developed a white paper for guidance."); id. at 32 ("The CASTF white paper, Regulatory Review of Predictive Models, documents questions a regulator may want to ask when reviewing a model."); id. at 33 (adding the white paper to the Handbook's list of "recommended reading"); id. ("Summary" of Handbook chapter concludes with new dot point referencing "best practices ... provided in the CASTF white paper.").

[14] Statement of general applicability language is found throughout. See, e.g., White Paper at 2 ("[F]iling requirements and insurer presentations can be routinely organized to meet or exceed reviewers' needs and expectations."); id. at 4 ("Regulatory best practices need to ... provid[e] a baseline of analysis for regulators to review the referenced filings."); id. at 5 ("Best practices will help the regulator understand ... if the predictive model is compliant with state law."); id. ("Best practices can, also, make the regulator's review more consistent across state lines.").

Because the White Paper instructs that "complian[ce] with state laws and regulations" prohibiting unfair discrimination includes causation/intuitiveness and disparate impact/proxy variable standards,[15] its "statements of general applicability ... effectuate or interpret law or policy," thus meeting the plain language elements of a regulation and triggering the requirement of notice and comment rulemaking.

Case law bolsters this conclusion. See, e.g., Coury v. Whittlesea-Bell Lux. Limo., 721 P.2d 375, 377 (Nev. 1986) ("An agency makes a rule when it does nothing more than state its official position on how it interprets a requirement already provided for and how it proposes to administer its statutory function."); State Bd. of Equalization v. Sierra Pac. Pwr. Co., 634 P.2d 461, 465 (Nev. 1981) ("These formulae represent the official position of [the] Commission on how ... property ... will be assessed, and are pronouncements of what methods of assessment will be utilized ... [and] are in fact regulations").[16]

A core purpose of the White Paper is to "state ... official position[s] on how [a regulator] interprets a requirement already provided for" — the unfair discrimination prohibition. As "guidance to regulators who review predictive models and to insurance companies filing rating plans that incorporate predictive models," it declares regulatory "position[s] ... on how [rate filings] will be assessed, and are pronouncements of what methods ... will be utilized." It thus appears to implicate state rulemaking requirements.[17]

B. UNFAIR DISCRIMINATION POLICYMAKING MUST BE CODIFIED

Unfair discrimination public policy making is objectively straightforward: A presumption of legality based on a factor's predictive value may only be superseded by the legislature's political determination to prohibit or further restrict its use based on public policy considerations.

Rating based on a protected class — such as race, religion, and national origin (expanded in some jurisdictions to include other groups) — is prohibited. Other factors that implicate social concerns are sometimes not prohibited but further restricted, as with credit scoring: The widely adopted National Council of Insurance Legislators Model Act Regarding Use Of Credit Information In Personal Insurance imposes additional regulatory requirements in areas of established concern, including consumers with no credit information; freshness of scores; erroneous scores; collections involving medical bills; and some extraordinary life circumstances.

This law is made by legislatures and interpreted by courts. Executive branch regulators whose constitutional duty it is to apply the law may provide further guidance through notice and comment rulemaking that follows an authorizing statute. But the

[15] See White Paper at 15 ("Obtain a complete data dictionary, including the names, types, definitions and uses of each ... proxy variable."); id. ("Obtain a rational explanation for why an increase in each predictor variable should increase or decrease ... loss costs.... The explanation should go beyond demonstrating correlation."); id. at 20 ("Obtain a narrative ... [that] include[s] a discussion of the ... logical and intuitive relationship to cost."); id. at 32 ("Is there unfair discrimination?... If predictive models are used ... are there concerns related to input variables that are ... proxies for prohibited variables?"); id. at 36 ("Throughout this white paper, the regulator asks the modeler to go beyond correlation and document their basic, causal understanding of how variables ... are related to risk.").

[16] This statute and case law are typical. See, e.g., La. Rev. Stat. 49:951(6) ("'Rule' means each agency statement, guide, or requirement for conduct or action ... which has general applicability and the effect of implementing or interpreting substantive law or policy, or which prescribes the procedure or practice requirements of the agency."); Liberty Mut. Ins. Co. v. La. Ins. Rating Com'n, 696 So.2d 1021, 1026 (La. App. 1997) (Bulletin was a rule because it had "the effect of interpreting LIRC's substantive policy regarding the use of wrap-up policies ... [and] sets forth ... substantive criteria which must be considered in the filing of any insurer."); Minn. Stat. 14.02(4) ("'Rule' means every agency statement of general applicability and future effect ... adopted to implement or make specific the law enforced or administered by that agency or to govern its ... procedure."); Sa-Ag., Inc. v. Minn. Dept. of Transp., 447 N.W.2d 1, 4 (Minn. App. 1989) ("If the addendum goes beyond announcing the statutory requirements, and actually includes an interpretation of the statute, then it is in fact a rule, and subject to the rulemaking process.").

[17] The White Paper's recitations that regulators must apply their own statutes provides no safe harbor. The White Paper explicitly seeks to solve the problem of how to "determine that predictive models, as used in rate filings, are compliant with state laws and regulations," White Paper at 2, and it repeatedly stresses its goal of bringing about "consistency," id., in that endeavor – which are basic activities that require rulemaking, as discussed herein.

White Paper as conceived and currently constituted — directing regulators to apply unestablished causation and disparate impact standards without a statutory basis — would shift policymaking authority from legislatures to form reviewers.

The NAIC has previously avoided asserting such lawmaking power. When the Rates and Ratings Procedures Task Force of the late 1970s proposed banning "the continued use of sex and marital status for purposes of classifying automobile insurance risks," it offered "amendments to the NAIC model rating laws ... to prohibit the use of classifications based on these factors" – because, "as public policy issues, questions regarding discriminatory practices should be determined in the public forum of the legislature." 1979 NAIC Proc. Vol. I at 913-914.[18]

The NAIC Plenary rejected the task force's proposals based on the prevailing view, expressed by the Maryland commissioner, in making his motion against the Task Force's proposals, that they were not "sound regulatory policy" in comparison to longstanding unfair discrimination rules, under which "the law requires ... a company to prove by objective proof that rate increases are justified."[19] 1979 NAIC Proc. Vol. II at 25-26.

That the NAIC rejected the prior task force's attempt to change unfair discrimination law is instructive. How the task force articulated its position within the context of traditional unfair discrimination law is also highly relevant: "To summarize ..., it is argued that public policy considerations require more adequate justification ... than simple statistical correlation with loss; ... [T]he task force recommends consideration of criteria such as causality, reliability, social acceptability, and incentive value in judging the reasonableness of a classification system." 1979 NAIC Proc. Vol. I at 912.[20]

The Task Force thus explicitly conceded that established law requires objective, "simple statistical correlation with loss" – and that, because causality and other subjective measures of "social acceptability" depart from this core rule, legislation was required to achieve its regulatory goals.[21]

Since such legislation has never passed, the basic standard of "simple statistical correlation with loss" remains controlling law. We thus respectfully suggest that CASTF cannot establish causality and/or other social acceptability standards today — and upend the prevailing statutory correlation standard — via interpretive white paper.

[18] See also 1979 NAIC Proc. Vol. I at 914 ("The task force therefore recommends that ... statistically justified sex and marital status rating classification should be permitted to remain in use until specifically prohibited by legislative action.").

[19] The commissioner elaborated on why he opposed straying from the controlling correlation standard: "[W]e're ... talking about a situation where automobile insurance premiums in Maryland under the adoption of this premise would be raised because a person is female despite lack of actuarial justification. In Maryland that is illegal. We're talking about raising auto insurance premiums for a person because he or she is married despite a clear lack of positive actuarial justification therefore. In Maryland that is illegal." 1979 NAIC Proc. Vol. II at 26.

[20] See also 1979 NAIC Proc. Vol. I at 911 ("It is important to recognize that statistical parameters often fail to address important social and public policy considerations regarding the rating process.").

[21] NAIC did not ultimately seek such legislation because the Plenary did not adopt the task force's recommended amendments to the model rating laws. The instructive point with respect to the current CASTF draft white paper is that the Rates and Rating Procedure Task Force in 1979 recognized, correctly, that the imposition of unfair discrimination standards requiring more than "simple statistical correlation with loss" can only be effectuated via legislation - a point just as true today as it was in 1979.

IV. MORE PRECISE RISK PREDICTION MEANS BETTER, FAIRER PRICES OFFERED BY SOLVENT COMPANIES

Correlation is the controlling law of insurance discrimination. See, e.g., Telles v. Com'r of Ins., 574 N.E.2d 359, 361-362 (Mass. 1991), supra note 6 ("The statutory pattern which deals with insurance regulation ... requires the commissioner to treat equally insureds who are of the same risk classification. This may result in 'fair discrimination.'").

Imposing causation and/or disparate impact rules directly impedes this statutory duty "to treat equally insureds who are of the same risk classification" — which as the 1970s NAIC Rating Task Force recognized, is traditionally judged by "simple statistical correlation with loss," supra, p. 12. Deviating from correlation standards reduces risk classification accuracy, in conflict with the "fair discrimination" requirement.

The policy rationale for requiring insurers to strive for the most accurate, "fair," risk classification is a social consensus that correlating risk with price is equitable and creates good incentivizes for insurers. See Casualty Actuarial Society, Foundations of Actuarial Science (4th Ed. 2001), p. 293-294 ("[W]hen insurers can identify costs more accurately, they can compete more successfully. ... Another reason for the importance of accuracy is fairness. ... [It is] fair ... to pay ... the costs of the goods and services provided. ... This concept is often called 'actuarial fairness' and it is based on the workings of a market economy.").

Put more simply, accurate risk classification protects insurer solvency and produces fairer prices for better risks.[22] Safer insureds pay lower premiums because they are less likely to cause losses. This sound and considered public policy choice controls, absent specific legislative direction to the contrary.

The concepts discussed herein, therefore, are not legal niceties. They represent norms of fairness and proper policymaking that tangibly benefit insurance consumers. The White Paper would fundamentally undermine this well-established and successful regime.

[22] See also Actuarial Standards Board, Actuarial Standard of Practice No. 12 (Risk Classification), Appendix 1 (Background and Current Practices), ("Risk classification has been a fundamental part of actuarial practice since the beginning of the profession. The financial distress and inequity that can result from ignoring the impact of differences in risk characteristics was dramatically illustrated by the failure of the nineteenth-century assessment societies, where life insurance was provided at rates that disregarded age. ... Risk classification is generally used to treat participants with similar risk characteristics in a consistent manner, to permit economic incentives to operate and thereby encourage widespread availability of coverage, and to protect the soundness of the system.").

CONCLUSION

Actuarially justified insurer discrimination practices are fair and legal, overridden only by special protections applicable to particular rating factors.

Requiring a general showing of causation for every factor in a rate filing shifts presumptions away from the controlling correlation standard. Such new policy governing how regulators apply their insurance codes can and should only be established via statutes passed by elected legislatures.[23]

Analyzing the effects on protected classes of facially neutral rating factors under an unintentional disparate impact standard similarly undermines controlling unfair discrimination law.

We respectfully suggest that the White Paper unnecessarily and without a grounded legal or factual basis directly conflicts with these core pillars of the regulatory state, and thus should be either withdrawn or substantially amended to remedy these paramount substantive and procedural concerns.

[23] The White Paper asserts that "discussion of the rational, logical, or plausible relationships of individual risk attributes to the risk of insurance loss ... is crucial ... as new predictive models are being developed. ... We, as insurance professionals, cannot insulate ourselves from participation in the conceptual discourse." P. 36. No one could dispute that CASTF experts and the NAIC and its members are necessary participants in public policy discourse around big data and predictive analysis, but the manner of such policymaking is dictated by state constitutions and administrative procedure statutes, which do not allow legal standards to be established in the manner intended by the White Paper.

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

3601 Vincennes Road | Indianapolis, IN 46268 | 317.875.5250
20 F Street, NW, Suite 510 | Washington, D.C. 20001 | 202.628.1558

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