

Primer on US Regulation of InsurTech Applications

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In the United States, the insurance industry is regulated by the individual states. To assist in uniformity, the National Association of Insurance Commissioners (NAIC)¹ meets three times a year to review and propose model laws and assess emerging issues. Historically, they have done this by topic:

- A. A Committee - Life Insurance and Annuities
- B. B Committee - Health Insurance and Managed Care
- C. C Committee - Property and Casualty Insurance
- D. D Committee - Market Regulation and Consumer Affairs
- E. E Committee - Financial Condition
- F. F Committee - Financial Regulation Standards and Accreditation
- G. G Committee - International Insurance Relations

Each Committee reports to the overarching Executive Committee, which leads the NAIC Plenary session composed of each state's Commissioner, which is held at each tri-annual meeting.

¹ More about the NAIC: <https://content.naic.org/about>

Caveat and Disclaimer

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Traditional Process

Recommended model law changes are a long, difficult, and laborious process that must typically start with:

- A working group, created to tackle an issue under a parent committee (letter committees A to G mentioned above), makes recommendations to their parent committee based on a process that includes an initial exposure followed by a comment period, then likely revisions adopted for a new exposure period. This may take one to three years to accomplish.
- Since the state representative members of a working group may or may not have a representative on the parent Committee, this means that when the parent Committee assesses and debates the recommendation, it may or may not go to the Executive Committee. This parent Committee will also need to make recommendations based on their exposure/comment period process.
- The Executive Committee will manage the plenary sessions where model laws will be approved (or not) by all state insurance commissioners.
- BUT the insurance commissioners have no legislative authority. While they might recommend an NAIC model law be adopted in their state, state legislators are usually very sensitive to executive offices “making laws” without legislative actions. Thus, in many cases, model laws agreed to by the NAIC may only have a modest number of states that actually adopt those model laws. The few that have almost universally consistent adoption include:
 - Standard Valuation Law
 - Unfair Trade Practices Act
 - Unfair Claim Settlement Practices Model Act
 - Property and Casualty Model Rating Law

After the NAIC model law is approved by the Executive Committee, individual state legislatures are encouraged to adopt it in their respective states. In the case of the Standard Valuation Law, after enough states approved the model law, it became a requirement for a state to be accredited as meeting baseline standards of solvency regulation, particularly with respect to the regulation of multi-state insurers. Most other model laws do not have that kind of “persuasive” mechanism.

Expedited Process

To move faster, the NAIC can:

- Create a work group that reports directly to the Executive Committee.
- Create a new committee as was done a few years ago when the NAIC formed an H Committee to focus on Innovation, Cybersecurity & Technology.
- Use accreditation (wherein a state’s annual financial statements for its domiciled insurance companies will only be accepted by other states if the statement is prepared and meets the requirements of the Standard Valuation Law). In this case, it has allowed the use of an NAIC central decision-making authority to ensure uniformity in specific requirements.
- Provide “clarifications” of what is meant by already universally, or nearly universally, adopted model laws.

Current Proposed NAIC AI Oversight

Pursuant to its charge, in July, the H Committee released a draft bulletin for public comment. The intent of the bulletin is to create an expedited, uniform expectation, based on already adopted NAIC Model Laws, that insurance companies (including third-party vendors) must have available for states to review the documentation of the governance process used for all insurance company decisions based on the use of artificial intelligence systems (where AI systems are defined very broadly).

Key points in the July bulletin exposure draft included:

- Based on their authority under two laws (the Unfair Trade & Claim Settlement Practices Acts), states can ask companies for documentation of their AI governance systems that impact consumers.
- The documentation requirements are based on the Corporate Governance Annual Disclosure Model Act and also apply to external data sources.
- A reminder that the P&C Model Rating Law requires that rates not be excessive, inadequate or unfairly discriminate.

Many industry and consumer groups did submit comments², along with the American Academy of Actuaries. The Academy comment letter focused on the need to clarify the expected desired distinction between regulatory transparency as to actual company practices versus regulatory enforcement of specific regulations. It is the intended purpose of the H Committee bulletin to follow the spirit of the Own Risk and Solvency Assessment (ORSA) requirement³ of the NAIC, which requires a company to share how it identifies, measures and manages its risks without any mandate concerning which risks should or should not be included or how they should be measured. In addition, the comment letter mentioned that, for actuaries that work in the AI space, there are standards⁴ that address risk classification⁵, data quality⁶, actuarial communications⁷ and modeling⁸.

² https://content.naic.org/cmte_h.htm for a description of the committee, its meeting materials, exposure drafts and documents. The page provides instructions on how to submit comments.

³ <https://content.naic.org/cipr-topics/own-risk-and-solvency-assessment-orsa>

⁴ Indeed, a qualified actuary is bound by a code of conduct (<https://www.actuary.org/content/code-professional-conduct>), and guidance is available (<http://www.actuarialstandardsboard.org/standards-of-practice/>). A departure from said guidance needs to be justified.

⁵ <http://www.actuarialstandardsboard.org/asops/risk-classification-practice-areas/>

⁶ <http://www.actuarialstandardsboard.org/asops/data-quality/>

⁷ <http://www.actuarialstandardsboard.org/asops/actuarial-communications/>

⁸ <http://www.actuarialstandardsboard.org/asops/modeling-3/>

Next Steps and Open Questions

The next steps on the topic are:

- Await next exposure draft of H Committee sometime in October or early November 2023.
- Invite comments from industry, professional and consumer representatives.
- Possible approval of a bulletin in early December by the NAIC – more likely by March 2024.

However, open questions remain:

- Some desire more explicit requirements that may be impractical or limit innovation and, while they may also allow safe harbor practices, they will require adoption by state legislatures to become effective.
- Reliance on principles solely may mean a wide variance of expectations across 50+ jurisdictions that will perform market conduct exams.
- Companies and startups need to be aware that the regulators will likely push for appropriate governance and documentation in 2024.

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