

AI Regulation and Risk Management

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Overview

- Artificial intelligence (AI) refers to a machine-based system that can, for a given set of human-defined objectives, generate output such as predictions, recommendations, or decisions influencing real or virtual environments.
 - May perform functions normally associated with human intelligence (such as reasoning, learning and self-improvement)
- Generative artificial intelligence is a type of AI that generates content in the form of data, text, images, sounds or video





Overview

- The data that fuels AI can come from many sources, such as social media, wearable trackers, telematics devices, public records, purchasing history and credit information
- One of the things that makes AI so powerful is that it enables researchers to discover previously unknown connections...
 - Between an ocean of data points
 - Outcomes that the researchers care about
- Applications: medical research, employment decisions, lending, insurance and more



Why are Insurers Investing in AI?

For insurers, artificial intelligence can facilitate better:

✓ Marketing, customer service and customer engagement	✓ Claims decisions
✓ Underwriting	✓ Utilization management
✓ Rating	✓ Fraud detection

In addition, generative AI can improve operational efficiencies and enable personnel to focus on higher value activities



Potential Concerns About AI

Many regulators, policymakers and consumer advocates have expressed concern about:

Accuracy, validity
and reliability

Unintended
“algorithmic
discrimination”

Lack of
transparency/
explainability

Privacy

Safety/
extinction

- In addition, the use of generative AI raises concerns about confidentiality and infringement of intellectual property rights
- As a result, insurers that use AI may be exposed to regulatory, litigation and reputational risk





Algorithmic Discrimination

“Algorithmic discrimination refers to instances when automated systems contribute to unjustified different treatment or impacts disfavoring people based on their actual or perceived race, color, ethnicity, sex (including based on pregnancy, childbirth, and related conditions; gender identity; intersex status; and sexual orientation), religion, age, national origin, limited English proficiency, disability, veteran status, genetic information, or any other classification protected by law.”

Executive Order 14091 of February 16, 2023



Evolving Regulatory Response: NAIC Model Bulletin

- Lays out regulatory expectations for insurers that use AI Systems.
 - “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.
- Requires that insurers adopt governance/ risk management framework.
- Encourages testing for unfair discrimination.



Evolving Regulatory Response: NAIC Model Bulletin

- Focuses on decisions and actions impacting consumers
- Reminds insurers that decisions may not be inaccurate, arbitrary, capricious or unfairly discriminatory (undefined)
- Encourages a risk-based approach to governance
 - Does not prescribe specific practices
 - Should be commensurate with the risk of adverse consumer outcomes and the degree of potential harm
- Imposes annual reporting requirements



Evolving Regulatory Response: NAIC Model Bulletin

- Bulletin was adopted unanimously by NAIC at Fall National Meeting on 12.4.23
- States will adopt (or not) as they see fit; some states may take more aggressive action
- Has already changed the insurance regulatory landscape with respect to AI
- More to come from NAIC



Evolving Regulatory Response: CO

- Unlike the NAIC bulletin, which focuses on AI Systems, Colorado legislation enacted in 2021 focuses on insurers' use of external consumer data and information sources (ECDIS).
 - ECDIS includes credit scores, social media habits, purchasing habits, court records and more.
- 2023 regulation requires life insurers using ECDIS to establish a risk-based governance and risk management framework to determine whether such use results in unfair discrimination with respect to race. (Applies to individual life insurance only.)
- A draft regulation would require life insurers to test for unfair discrimination.



Evolving Regulatory Response: CO

- Colorado approach and NAIC bulletin have much in common
- Some important differences
 - ECDIS v. AI Systems
 - Prescriptive v. ostensibly non-prescriptive
 - Approach to unfair discrimination
- Next up in Colorado: auto insurance and health insurance



Evolving Regulatory Response: NY

- New York DFS issued proposed circular letter regarding use of AI Systems and ECDIS in underwriting and pricing
- Draws heavily on NAIC bulletin and Colorado governance reg, but includes elements not found in either
 - Actuarial validity/intuitive relationship
 - No proxies for protected status
 - Less discriminatory alternatives
 - Testing using multiple statistical metrics
 - Transparency
 - Internal audit





A word about state legislation...



Colorado's AI Law

- On May 17, 2024, Colorado Governor Jared Polis signed Senate Bill 24-205, making Colorado the first state to require developers and deployers of high-risk AI systems to exercise reasonable care to prevent algorithmic discrimination.
- The new law applies to AI systems that make (or are a substantial factor in making) consequential decisions regarding education, employment, lending/financial services, essential government services, healthcare, housing, legal services and insurance.
- However, insurers subject to subject to SB 169 and any rules adopted by the Commissioner are deemed to be in full compliance.



Colorado's AI Law

- If developers of high-risk AI systems are in compliance with the obligations enumerated in the law, they are afforded a rebuttable presumption that they used reasonable care to protect consumers from known or reasonably foreseeable risks of algorithmic discrimination.
- Businesses deploying high-risk AI systems must also use reasonable care to prevent algorithmic discrimination. Among other things, deployers are required to implement a risk management policy and program to govern the deployment of the high-risk AI system.
 - Also, extensive impact assessment and transparency requirements
- Colorado AG is vested with exclusive enforcement authority, and there is no private right of action.
- The law goes into effect on February 1, 2026.



Evolving Regulatory Response: Federal



White House



Equal Employment
Opportunity Commission



Congress



Securities and Exchange Commission



Department of Health
and Human Services



Department of Justice



Federal Trade Commission



National Institute of Standards
and Technology



Consumer Financial
Protection Bureau



National Telecommunications and
Information Administration



Executive Order 14110 (10.30.2023)

- Builds upon voluntary commitments, the Blueprint for an AI Bill of Rights and the NIST AI Risk Management Framework
- Calls for a coordinated approach across all federal departments and agencies
- Establishes 8 guiding principles and priorities

Safety and security	Employee rights and opportunities	Consumer protections	Federal government's own use of AI
Innovation, competition and collaboration	Equity and civil rights	Privacy	U.S. leadership



Executive Order 14110 (10.30.2023)

- The EO is sprawling and ambitious and will have far-reaching effects
- Impacts on insurance industry will be both direct and indirect
 - Insurers that do business with the federal government may be expected to adopt AI governance and risk management practices that are consistent with those implemented by the federal agencies.
 - Technical guidance to be developed by the newly formed U.S. Artificial Intelligence Safety Institute (including on how to identify and mitigate algorithmic discrimination) could be embraced by one or more states in the insurance context.
 - Insurers that use AI in the employment context will be required to comply with guidance to be developed by the EEOC.



Executive Order Implementation

- **HUD Guidance on Digital Advertising:** Addresses application of the Fair Housing Act to the advertising of housing, credit and other real estate-related transactions (like homeowners insurance). Does a nice job of explaining how advertising through digital platforms can result in unintentional discrimination and includes a few recommendations for mitigating that possibility.
- **HHS Rule on Patient Care Decision Support Tools:** Requires providers and health insurers to take steps to identify and mitigate discrimination when they use AI and other forms of decision support tools for patient care.
- **NIST Draft Guidance:** Addresses generative AI risks and mitigation, the reduction of threats to data that is used to train AI systems, and the development of global AI standards.





A word about litigation...



Mitigating Potential Risk

- To mitigate their regulatory, litigation and reputational risk, organizations that use artificial intelligence or algorithmic decision-making should:
 - Stay on top of the evolving regulatory expectations, litigation and media reports
 - Implement a risk management framework that takes those developments into account
 - Consider testing for algorithmic discrimination even if not legally required





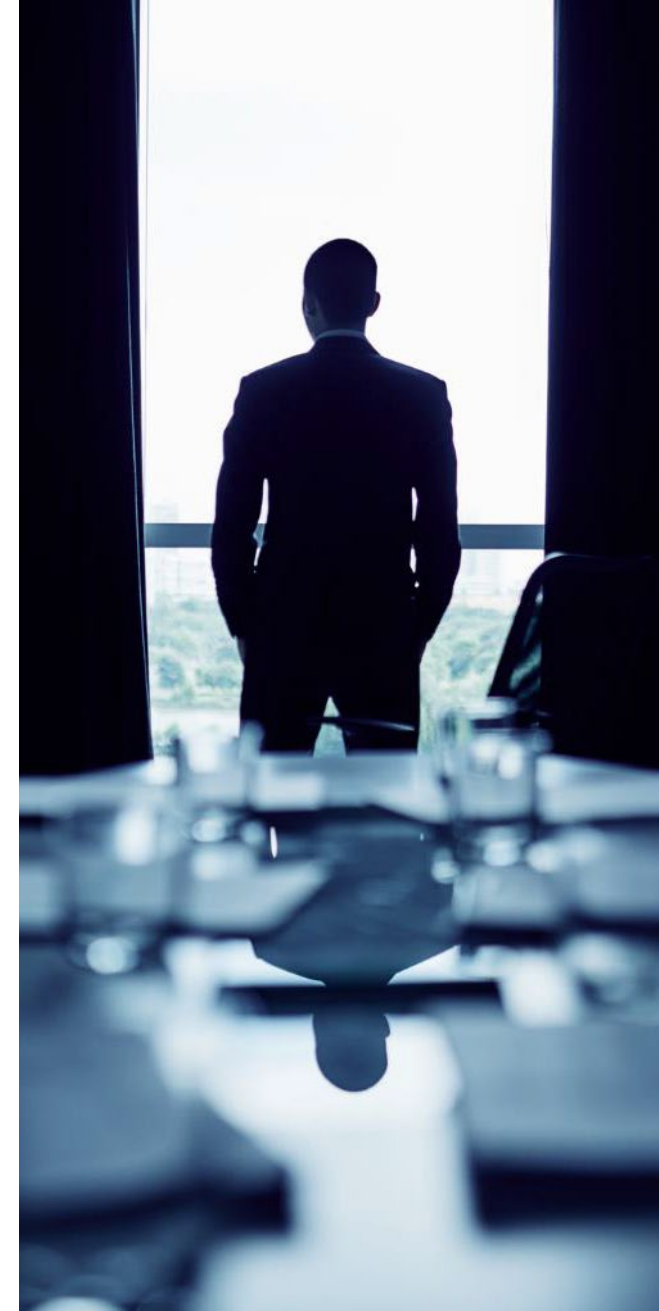
Risk Management Goal: Have a Good Story to Tell

- Organizations that use AI and algorithmic models to make important decisions should strive to have a good story to tell.
- The story should demonstrate that the organization...
 - Appreciates the concerns associated with AI;
 - Takes those concerns seriously; and
 - Has exercised reasonable care in identifying, managing and mitigating the risk of negative impacts.



Risk Management: Evolving Guidance

- NIST AI Risk Management Framework and accompanying playbook
 - Lays out suggested actions and encourages organizations to decide which ones make the most sense for them
 - Received a big boost from executive order
- Colorado Division of Insurance governance regulation
 - Mandates a number of suggestions found in NIST playbook
- NAIC model bulletin
 - Non-prescriptive, but has significant overlap with Colorado reg
- New York proposed circular
 - Builds on the above



Basic Risk Management Framework

A risk management framework should be an extension of the organization's ERM and compliance programs

✓ High level principles	✓ Training and supervision
✓ Cross-functional, multi-disciplinary governance committee	✓ Monitoring/auditing, testing* and corrective action
✓ Written policies and procedures	✓ Appropriate involvement by senior management and Board
✓ Clear assignment of responsibility and accountability	✓ Documentation

* Testing will be required in CO and NY, is encouraged by NAIC



Governance Committee

Assemble a multidisciplinary team that represents the organization's relevant departments



Legal



Underwriting



Risk Management



Compliance



Marketing



Internal Audit



Actuarial



Data Scientists



Other Affected Departments

Diversity of committee is critical

Should be sufficiently diverse so as to include views and perspectives of historically underrepresented populations; may be the only way to avoid blind spots



Basic Approach

- Institutionalize critical thinking
- Create and maintain inventory of AI system and external data sources being used or developed
- Understand the objective of each and how it will be used
- Identify potential risks for each AI system and external data source
- For each identified risk, assess the severity of the potential harm and how likely it is to occur
- Identify and implement appropriate safeguards, including humans in the loop





Third Party Vendors

- Insurance regulators don't have jurisdiction over third-party data brokers and AI vendors
- As a result, regulators expect insurers to make sure that data and AI purchased from third parties are compliant
- Due diligence, contractual safeguards, monitoring and possible testing





Closing Thoughts

- Risk management efforts should be proportional to the potential harm and its likelihood of occurring
- Should cover every stage of the AI life cycle
- No one-size-fits-all approach
- Need to reevaluate the framework periodically in light of regulatory developments and evolving practices
- No compliance program is perfect
- Remember the goal: have a good story to tell that demonstrates an understanding of the risks and reasonable efforts to mitigate them



Some Things to Think About

Questions about your data

- Is it complete and representative of the affected population?
- Is it accurate?
- Is it up to date?
- Does it reflect historical/ societal discrimination?
- Are we entitled to use it?

Questions about your algorithm

- Is it reliably accurate?
- Can the results be explained?
- Does it rely on prohibited factors (i.e., race, gender, religion) or factors that could be seen as proxies?
- Can it morph over time?





Appendix A: Colorado (a closer look)



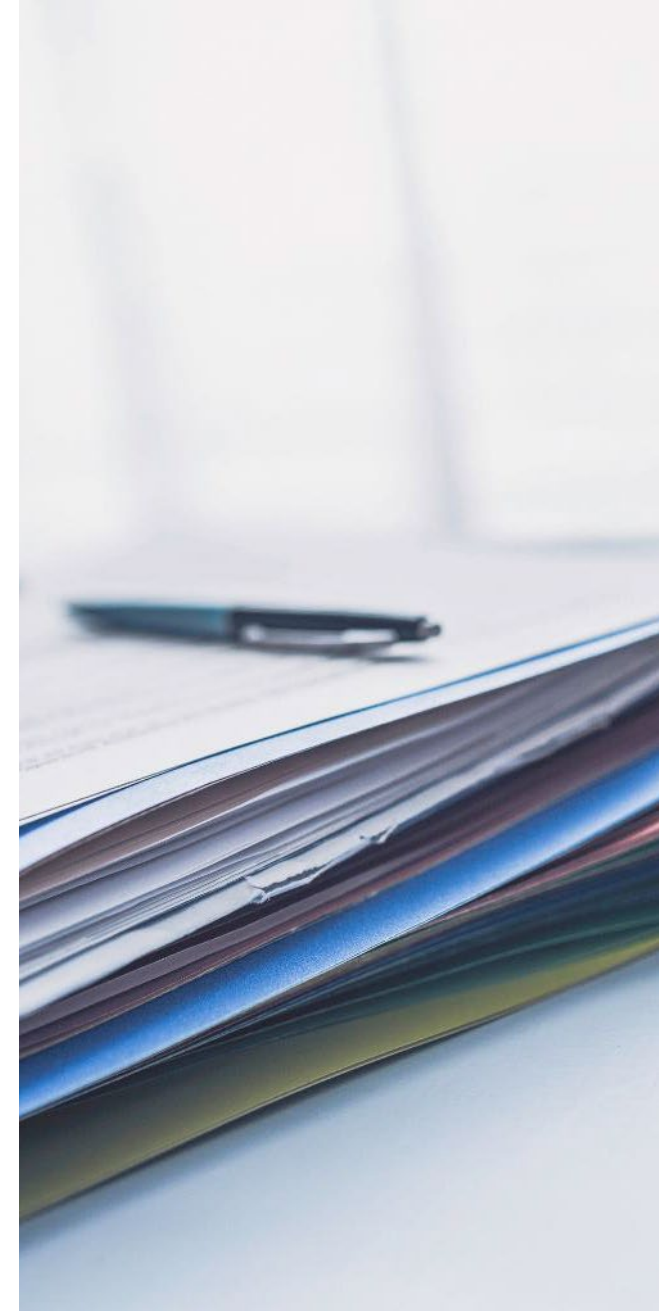
Colorado SB21-169 (2021)

- Directs the commissioner to adopt rules that would establish a means by which an insurer can demonstrate, to the extent practicable, that it has tested whether its use of external consumer data (including in connection with algorithms or predictive models) unfairly discriminates based on membership in a protected class
- The rules must require that each insurer adopt a risk management framework (or something similar) and submit periodic reports to the commissioner
- The rules must be tailored to specific types of insurance and specific insurance practices



Colorado SB21-169 (2021)

- The legislation does not:
 - Require insurers to collect demographic information from applicants or policyholders regarding membership in a protected class
 - Prohibit the use of medical, family history, occupational, disability or behavioral information related to a specific individual that has a direct relationship to mortality, morbidity or longevity risk
 - Prohibit the use of traditional underwriting factors being used for the exclusive purpose of determining insurable interest or eligibility for coverage



Colorado Governance Regulation

- Adopted on 9.21.23, the regulation sets forth governance requirements for life insurers that use (i) external consumer data and information sources (ECDIS); or (ii) algorithms or predictive models that use ECDIS
- The regulation requires life insurers using ECDIS (or algorithms/predictive models employing ECDIS) to establish a risk-based governance and risk management framework to determine whether such use in any insurance practice results in unfair discrimination with respect to race



Required Components of Framework

- ✓ Documented governing principles
- ✓ Rubric for assessing and prioritizing risks with appropriate consideration given to consumer impact
- ✓ Oversight by board of directors or appropriate board committee
- ✓ Senior management responsibility and accountability
- ✓ Cross-functional governance group
- ✓ Written policies and processes, including assigned roles and responsibilities
- ✓ Ongoing supervision and training for relevant personnel
- ✓ Process for addressing consumer complaints and inquiries



Required Components of Framework

- ✓ Detailed inventory of ECDIS, algorithms and predictive models
- ✓ Documented description of material changes to ECDIS, algorithms and predictive models
- ✓ Description of testing conducted to detect unfair discrimination
- ✓ Ongoing monitoring of performance of algorithms and predictive models
- ✓ Selection process for third-party vendors



Timing

- By June 1, 2024, insurers using ECDIS, algorithms or predictive models were required to submit a report summarizing their progress towards complying with the regulation
- By December 1, 2024, and annually thereafter, insurers must submit a narrative report summarizing their compliance with the regulation
- Officer must attest to compliance



Appendix B: Further Reading and Viewing



Insurance

- [California bulletin](#) (2022)
- [California workshop invitation](#) (2022)
- [Colorado SB21-169](#) (2021)
- [Colorado governance regulation](#) (2023)
- [District of Columbia notice](#) (2022)
- [NAIC principles on AI](#) (2020)
- [NAIC AI model bulletin](#) (2023)
- [NAIC model bulletin state adoption map](#) (2024)
- [NCOIL resolution](#) (2021)
- [New York Circular Letter \(proposed\)](#) (2024)
- [New York Insurance Circular Letter No. 1](#) (2019)



Federal Activity

- [CFPB Circular 2022-03](#) (2022)
- [CFPB interpretive rule regarding digital marketers](#) (2022)
- [DOJ settlement with Meta over algorithmic bias](#) (2022)
- [DOJ statement regarding implementation of Meta settlement](#) (2023)
- [DOJ statement of interest in SafeRent case](#) (2023)
- [EEOC guidance regarding AI and Americans with Disabilities Act](#) (2022)
- [Executive Order 14091 regarding algorithmic discrimination](#) (2023)
- [Executive Order 14110 regarding AI](#) (2023)
- [FTC Advance Notice of Proposed Rulemaking](#) (2022)



Federal Activity

- [FTC report to Congress over use of AI to combat online harms \(2022\)](#)
- [FTC issues warning about generative AI \(2023\)](#)
- [HHS rule regarding algorithm transparency \(2023\)](#)
- [HHS rule on patient care decision support tools \(2024\)](#)
- [HHS Trustworthy AI Playbook \(2021\)](#)
- [HUD guidance on digital advertising \(2024\)](#)
- [Joint statement of CFPB, FTC, EEOC and DOJ \(2023\)](#)
- [NIST AI Risk Management Framework \(2023\)](#)
- [NLRB general counsel memo \(2022\)](#)



Federal Activity

- [NTIA request for comment on AI accountability](#) (2023)
- [OMB memorandum to federal agencies regarding AI](#) (2024)
- [Office of Science and Technology request for information](#) (2023)
- [SEC proposed rule regarding predictive data analytics](#) (2023)
- [White House Blueprint for an AI Bill of Rights](#) (2022)



International Activity

- [OECD Principles on A.I.](#) (2019)
- [EU AI Act](#) (2024)
- [EU proposed AI Liability Directive](#) (2022)
- [U.S.-EU Trade and Technology Council Inaugural Joint Statement](#) (2021)
- [United Nations AI resolution](#) (2024)



Other

- [AlphaGo](#) (2016)
- [Weapons of Math Destruction](#) (2016)
- [Coded Bias](#) (2020)
- [The American College paper on AI, ethics and life insurance](#) (2021)
- [Algorithmic Bias Playbook](#) (2021)
- [Algorithmic Bias Safeguards for Workforce](#) (2022)





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Trusted by industry and regulators alike, Scott helps insurance clients capitalize on opportunities and address regulatory and legal issues related to artificial intelligence, big data and algorithms.

- Scott helps clients stay on top of the emerging standards and regulations that will govern AI. There's a lot going on, at every level.
- Scott helps clients implement a risk management framework and minimize their risk of regulatory, litigation and reputational exposure. Effective risk management calls for a holistic, multi-disciplinary approach throughout the AI life cycle.
- Working with the firm's data consulting subsidiary, Scott uses his first-hand knowledge of evolving regulatory standards to help insurers assess their algorithms for unintended discrimination. It's important, cutting-edge work.
- At the request of the NAIC, Scott has briefed the nation's top insurance regulators regarding AI on multiple occasions, including in closed-door sessions. Most recently, he has briefed insurance regulators on how insurers can employ AI risk management and governance to mitigate their regulatory, litigation and reputation risk.

