

# Locke Lord QuickStudy: NY DFS Jumps on the AI Bandwagon by Issuing Proposed Guidance to New York Licensed Insurers Relating to Underwriting

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On January 17, 2024, the New York Department of Financial Services (“NYDFS”) exposed for comment a proposed circular letter regarding “Use of Artificial Intelligence Systems and External Consumer Data and Information Sources in Insurance Underwriting and Policy” (the “Proposed NY AI Guidance”). It sets forth the NYDFS’ expectations for insurers using emerging technologies. NYDFS has requested comments be submitted by March 17, 2024.<sup>[1]</sup>

The Proposed NY AI Guidance touches on many of the same principles as the NAIC Model Bulletin: Use of Algorithmic, Predictive Models, and Artificial Intelligence Systems By Insurers (the “NAIC AI Model Bulletin”) as well as the recently adopted Colorado regulation on “Guidance and Risk Management Framework Requirements For Life Insurers’ Use External Consumer Data and Information Sources, Algorithms, and Predictive Models,”<sup>[2]</sup> and the proposed Colorado regulation “Concerning Quantitative Testing of External Consumer Data And Information Sources, Algorithms, and Predictive Models Used for Life Insurance Underwriting for Unfairly Discriminatory Outcomes” (together, the “Colorado Regulations”). The Proposed NY AI Guidance would apply to “all insurers authorized to write insurance in New York State, licensed fraternal benefit societies, and the New York State Fund” and focuses on uses of “ECDIS, artificial intelligence systems and other predictive models” in the *underwriting and pricing* processes of insurance policies and annuities.

The Proposed NY AI Guidance explicitly states that, while the guidance is not intended to address “phases of the insurance product lifecycle other than underwriting and pricing,” it also states that the guidance is “not intended to provide an exhaustive list of potential issues that could arise from the use of ECDIS and AIS and is not intended to suggest that an insurer’s due diligence in assessing ECDIS and AIS should be limited to the concerns enumerated” in the guidance. Further, the Proposed NY AI Guidance reinforces its authority to audit and examine an insurer’s use of ECDIS and AIS under existing insurance and market conduct examination laws.

## **Key Definitions**

The Proposed NY AI Guidance uses some familiar terms despite having different definitions. For example, like the Colorado Regulations, the Proposed NY AI Guidance uses the term External Consumer Data and Information Sources (“ECDIS”). However, the definition is not identical to Colorado’s albeit they are conceptually similar. NYDFS defines ECDIS as:

data or information used – in whole or in part – to supplement traditional medical, property or casualty underwriting or pricing, as proxy for traditional medical, property or casualty underwriting or pricing, or to establish ‘lifestyle indicators’ that may contribute to an underwriting or pricing assessment of any application for insurance coverage.<sup>[3]</sup>

Similarly, the Proposed NY AI Guidance uses the term Artificial Intelligence Systems (“AIS”) like the NAIC AI Model Bulletin, but NYDFS again uses a different definition which is similar in concept. AIS is defined by the NYDFS as:

any machine-based system designed to perform functions normally associated with human intelligence, such as reasoning, learning, and self-improvement, that is used – in whole or in part – to supplement traditional medical, property or casualty underwriting or pricing, as a proxy for traditional medical, property or casualty underwriting or pricing, or to establish ‘lifestyle indicators’ that may contribute to an underwriting or pricing assessment of an applicant for insurance coverage.

The NYDFS’ definitions appear to be simpler; however, as states continue to adopt their own guidance and regulations, insurers will have to grapple with whether the differences in definitions are intentional or different without a distinction.

### **AI Principles**

The Proposed NY AI Guidance covers the same general principals as those covered in the NAIC AI Model Bulletin and the Colorado Regulations. Generally, the Proposed NY AI Guidance covers (1) Fairness Principles; (2) Governance and Risk Management; and (3) Transparency. Under Fairness Principles, NYDFS addresses the need to avoid unfair discrimination when using ECDIS and that it be supported by generally accepted actuarial standards.

### **Third-Party Vendor Oversight**

Notably, the NYDFS states that insurers “may not rely solely on a vendor’s claim of non-discrimination or a proprietary third-party process to determine compliance with anti-discrimination laws.” Insurers should be aware of these issues when addressing indemnification language in third-party vendor contracts. Accordingly, insurers will need to ensure that their third-party vendor contracts provide the insurers with ample access to the third-party vendor’s tools, ECDIS or AIS to sufficiently understand what it is, what type of information is being used, how it is being used, and whether it complies with applicable laws. Additionally, insurers are responsible for third party vendor oversight including written policies and procedures, for reporting and remediating incorrect information identified by the insurer or reported to a third party. Moreover, “an insurer may not rely on the proprietary nature of a third-party vendor’s algorithmic processes to justify the lack of specificity in disclosures related to an adverse underwriting or pricing action.”

### **Documentation and Testing**

NYDFS also addresses the insurer’s need for:

- Documenting the processes and reasoning behind its testing methodologies and analysis of unfair discrimination;
- Conducting testing “prior to putting AIS into production and on a regular cadence thereafter;”
- Conducting Quantitative Assessments using multiple statistical metrics in evaluating data and model outputs; and
- Conducting Qualitative Assessments enabling the insurer “to explain, at all times, how the insurer’s AIS operates and to articulate the intuitive logical relationship between ECDIS and other model variables with an insured and potential insured’s individual risk.”

### **Governance and Risk Management Framework**

Like the NAIC AI Model Bulletin and the Colorado Regulations, an insurer’s governance and risk management framework is an integral piece for maintaining compliance as it implements and deploys ECDIS and AIS. The Proposed NY AI Guidance:

- References existing NY regulations (11 NYCRR Section 90.1. and 90.2) requiring insurers to have an appropriate corporate governance framework for the use of ECDIS and AIS to comply with applicable law;
- Delineates responsibility for oversight among the insurer’s board and senior management;
- Sets forth the need for policies, procedures and documentation reviewed and approved by the insurer’s board and senior management consistent with the insurer’s strategic vision and risk appetite.
- Addresses risk management and internal control expectations including stressing the importance of engaging the insurer’s internal audit function in “the insurer’s use of ECDIS and AIS consistent with the financial, operational and compliance risk.”

### **Clarification of Prior Circular Letter No. 1 (2019)**

Lastly, the Proposed NY AI Guidance discusses transparency in the form of disclosure and notice requirements; and expressly clarifies the disclosure requirements in the prior Circular Letter No. 1 (2019) “Use of external consumer data and information sources in underwriting for life insurance,” particularly in connection with accelerated underwriting for life insurance. For example, the consumer must be provided with a specific reason for refusal, limitation, or rate differential. The notice must include:

whether the insurer uses AIS in its underwriting or pricing process, (ii) whether the insurer uses data about the person obtained from external vendors, and (iii) that such person has a right to request information about the specific data that resulted in the underwriting or pricing decision, including contact information for making such request.

Additionally, the Proposed NY AI Guidance clarifies that the prior Circular Letter No. 1 (2019) requires that objective threshold criteria used in the accelerated underwriting process for life insurance must be disclosed to the consumer, and the consumer also must be informed of which objective threshold criteria was not met causing the applicant to be rejected from the accelerated process.

Currently, the Proposed NY AI Guidance is like the Proposed NAIC AI Model Bulletin in that it is only intended to provide guidance and is not expected to be an enacted law. In its current form, the Proposed NY AI Guidance is principles-based as opposed to prescriptive in nature.

Please reach out to your Locke Lord attorney for further information.

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[1] Comments should be submitted to [innovation@dfs.ny.gov](mailto:innovation@dfs.ny.gov). Please use “Proposed Circular on the use of AI and ECDIS in Insurance Underwriting and Pricing” in the subject line. Comments may be subject to public inspection and should not include any sensitive or confidential information.

[2] <sup>3</sup> CCR 702-10

[3] The ECDIS definition excludes MBI Group, Inc. member information exchange service, a motor vehicle report, or criminal history search.

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