

Draft date: 7/26/2024

Virtual Meeting

THIRD-PARTY DATA AND MODELS (H) TASK FORCE

Tuesday, July 30, 2024

9:00 a.m. – 10:00 a.m. PT / 10:00 – 11:00 a.m. MT / 11:00 a.m. – 12:00 p.m. CT / 12:00 – 1:00 p.m. ET

ROLL CALL

| | | | |
|---------------------------------|-------------|--------------------------|----------------|
| Michael Conway, Chair | Colorado | Kevin P. Beagan | Massachusetts |
| Michael Yaworsky, Vice Chair | Florida | Grace Arnold | Minnesota |
| Mark Fowler | Alabama | Chlora Lindley-Myers | Missouri |
| Lori K. Wing-Heier | Alaska | Scott Kipper | Nevada |
| Barbara D. Richardson | Arizona | D.J. Bettencourt | New Hampshire |
| Ricardo Lara | California | Adrienne A. Harris | New York |
| Andrew N. Mais | Connecticut | Jon Godfread | North Dakota |
| Gordon I. Ito | Hawaii | Judith L. French | Ohio |
| Dean L. Cameron | Idaho | Michael Humphreys | Pennsylvania |
| Ann Gillespie | Illinois | Elizabeth Kelleher Dwyer | Rhode Island |
| Doug Ommen | Iowa | Michael Wise | South Carolina |
| Vicki Schmidt | Kansas | Cassie Brown | Texas |
| Timothy J. Temple | Louisiana | Kevin Gaffney | Vermont |
| Robert L. Carey | Maine | Nathan Houdek | Wisconsin |
| Joy Y. Hatchette | Maryland | | |

NAIC Support Staff: Kris DeFrain/Scott Sobel

AGENDA

1. Hear Presentations about U.S. Risk-Based Regulatory Frameworks Attachment
 - Financial Analysis and Examination including ORSA – Jack Broccoli (CT)
 - Market Analysis and Examination – Jo LeDuc (MO)
 - Colorado’s “Trust but Verify” Approach – Jason Lapham (CO)
2. Discuss Any Other Matters Brought Before the Task Force
—*Commissioner Michael Conway, Chair*
3. Adjournment

Overview of Risk-Focused Surveillance Approach to Solvency Monitoring

Presentation to NAIC Third Party Data and Models (H) Task Force
July 30, 2024

Jack Broccoli - Assistant Deputy Commissioner of Financial Analysis and Licensing
Connecticut Insurance Department

Risk-Focused Surveillance

- Primary goal is to identify and assess risks in insurers' operations and utilize those assessments to formulate ongoing surveillance plans
 - Assists regulators in concentrating efforts on high-risk insurers
 - Company prioritization process
 - Also assists regulators in focusing efforts on the riskiest areas of an insurer's operations
 - Individual risk assessments

Risk-Focused vs. Traditional

| Risk-Focused Surveillance | Traditional Surveillance |
|----------------------------------|---------------------------------|
| Flexible | Structured |
| Self-directed | Checklist directed |
| Customized | Standardized |
| Unique/Distinct | Uniform |
| Risk-focused | Variance and compliance focused |
| Prospective | Retrospective |

Company Prioritization

- Companies assigned a priority rating to ensure effective oversight
- Rating criteria include both quantitative and qualitative elements
 - Results of NAIC Prioritization Tools assist with quantitative elements
- Each state assigns priority rating for their own domestic insurers
 - Shared with other states through Insurer Profile Summary reports
- Prioritization reviewed and updated regularly (at least annually)
 - Change in priority rating requires detailed rationale and supervisory sign-off

Company Prioritization

- **Priority 1 (Troubled)** - The highest priority insurers from a solvency monitoring perspective, based on significant financial solvency risks.
- **Priority 2 (Priority)** - High priority insurers that are not yet considered troubled but may become so if recent trends or unfavorable metrics are not addressed.
- **Priority 3 (Non-Priority)** - Moderate priority insurers that indicate some need for additional monitoring.
- **Priority 4 (Non-Priority)** - Lower priority insurers that are fundamentally sound, not overly complex and/or nationally significant, and don't currently indicate a need for additional monitoring.

Impact of Company Prioritization

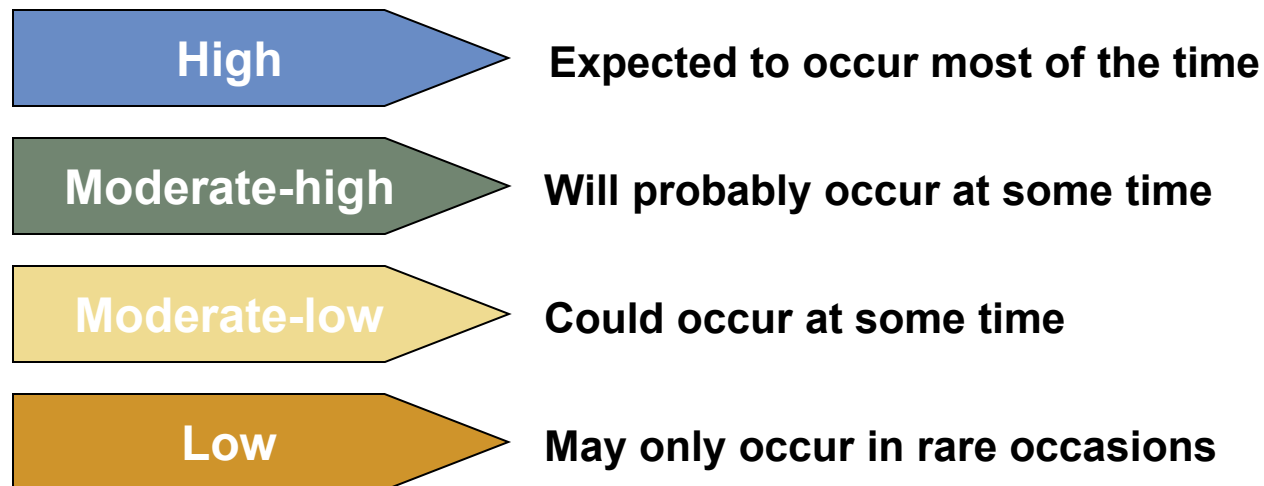
- Higher priority companies subject to increased depth of supervision
 - More frequent on-site, full-scope examinations
 - Potentially offset or supplemented by limited-scope examinations
 - Increased timeliness and frequency of off-site financial analysis
 - Earlier analysis due dates and full quarterly analysis for priority companies
 - Greater depth of review
 - Often more individual risks identified, and greater detail in risk investigation and testing

Individual Risk Assessment

- Regulators encouraged to identify and assess an insurer's exposure to various risks that could impact their solvency position
 - Focus on both current and prospective issues
- Branded risk classifications generally used as framework for identification
 - Credit Risk, Legal Risk, Pricing/Underwriting Risk, Strategic Risk, etc.
- Risk assessment process varies by function (analysis vs. exam)
 - Both functions assess risk levels to determine depth of review/testing to be performed

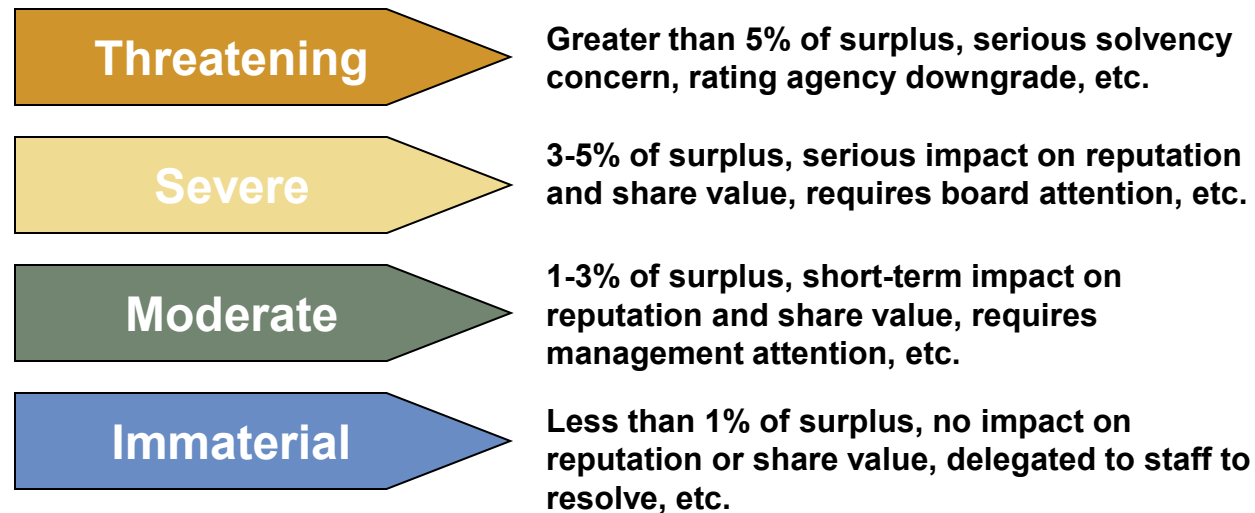
Individual Risk Assessment - Likelihood of Occurrence

The probability or likelihood that the risk will occur or would prevent a process or activity from attaining its objectives



Individual Risk Assessment - Magnitude of Impact

Potential impact/potential materiality of a risk



Individual Risk Assessment - Other Factors

- **Risk Velocity/Speed of Onset** - The time it takes for a risk event to occur and for the company to feel its effects
- **Risk Trend** - The direction in which a risk is moving over time
- **Risk Connectivity** - The concept that various risks are interconnected and can affect one another
- **Risk Mitigation/Controls** - Process used to reduce likelihood of and exposure to a risk

Own Risk & Solvency Assessment ("ORSA")

Section I - Description of ERM Framework

- Risk Culture and Governance
- Risk Identification and Prioritization
- Risk Appetite, Tolerances and Limits
- Risk Management and Controls
- Risk Reporting and Communication

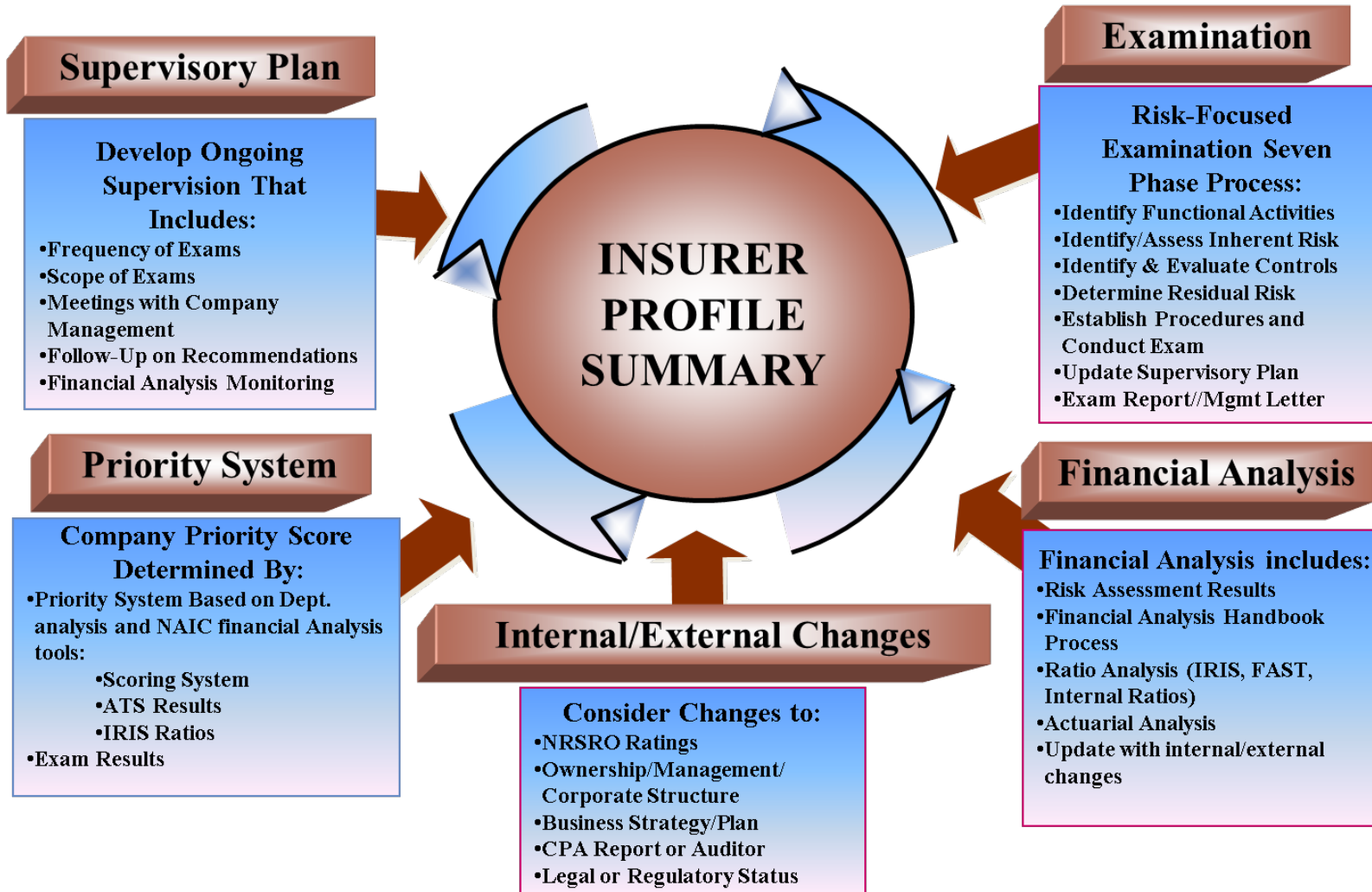
Section II - Insurer Assessment of Risk Exposures

- High level summary of quantitative and qualitative assessments of risk exposure in both normal and stressed environments

Section III - Assessment of Risk Capital and Prospective Solvency

- Discussion of Capital Metric(s) Used
- Group Risk Capital (GRC) - By Risk and In Aggregate
- Impact of Diversification Benefit
- Available Capital
- Excess Capital
- Impact of Stresses on GRC
- Governance and Validation
- Prospective Solvency Assessment

Risk Assessment Tracking and Communication



Conclusion

- Risk-Focused Surveillance allows for efficient and effective allocation of regulatory resources in company monitoring
 - Assists regulators in concentrating efforts on high-risk insurers
 - Company prioritization process
 - Also assists regulators in focusing efforts on the riskiest areas of an insurer's operations
 - Individual risk assessments
- Approach may be applied to other areas of insurance regulation
 - Modifications may be necessary to account for different risk exposures
 - For example, focus on factors relevant to privacy protection and preventing unfair discrimination

Questions



Market Analysis Framework

Third-Party Data and Models (H) Task Force

July 30, 2024



DCI

Missouri Department of Commerce & Insurance

Agenda

- Market Analysis Goals
- Market Analysis Process
- Baseline Analysis
- Level 1 Analysis
- Level 2 Analysis
- Continuum of Market Actions
- Questions

Market Analysis Goals

- Increase Effectiveness
 - Ability to Identify Market Conduct Issues
 - Identify Issues Across the Market
- Increase Efficiency
 - Focusing Resources
 - Less Costly
 - Less Intrusive
- Improve Uniformity
 - Collaboratively Developed Tools
 - Increased Transparency
- Improve Collaboration
 - NAIC Centralized Tools Accessible to Regulators in Other Jurisdictions
 - Improved Analysis Tools & Techniques Through Common Framework

Market Analysis Process

- Standardized Framework
- Market Regulation Handbook
- Process
 - Baseline
 - Level 1
 - Level 2
 - Continuum

Baseline Analysis

- Standardized Starting Point for Routine Analysis
- Line of Business Specific
- Broad Market Comparison
- Data Centric
 - Financial Annual Statement
 - Complaint Database System (CDS)
 - Regulatory Information Retrieval System (RIRS)
 - Market Action Tracking System (MATS)
 - Market Conduct Annual Statement (MCAS)

Level 1 Analysis

- Second Step in Routine Process
- Individual Company Reviews
- Guided Analysis of:
 - Company Operations
 - Financial Ratios
 - Regulatory Actions
 - Market Conduct Continuum Activity
 - Premiums
 - Market Share
 - Loss and Expense Ratios
 - Resisted or Unpaid Claims
 - Complaints
 - Market Conduct Annual Statement

Level 2 Analysis

- Final Step of Routine Analysis

- Extremely Detailed Review

- Consumer Complaints
- Continuum Activity
- Examinations
- Interdepartmental Communications
- Market Analysis
- Regulatory Actions
- Insurance Department Filings
- Dispute Resolution Activity
- Financial Analysis
- Financial Rating Agencies

- Geographic Analysis
- Human Resource Department
- Internet/World Wide Web
- Legal Information
- NAIC Bulletin Boards
- Other Governmental/Quasi-Governmental Agencies
- Product Licensing
- State Mandated Items
- Trade Publications & Other Media Sources
- Voluntary Accreditation/Certification Programs

Continuum of Market Actions

- Options for Responding to Identified Issue/Concern
- Guiding Principles
 - Appropriate
 - Cost-effective
 - Timely
 - Least Intrusive
- Factors Considered in Selecting a Response
 - Consumers
 - Regulator
 - Company

QUESTIONS

Jo A. LeDuc, CIE, MCM, CPCU, FLMI, AIDA

Director, Insurance Market Regulation Division

Missouri Department of Commerce & Insurance

Jo.LeDuc@insurance.mo.gov



DCI

Connect with DCI.



The background of the slide features a faded image of the Colorado State Capitol building, a large classical structure with a prominent dome, situated behind a well-manicured garden with various plants and trees.

Colorado Division of Insurance

Senate Bill 21-169, Governance and Risk Management, and Regulatory Oversight

NAIC Third-Party Data and Models (H) Task Force
July 30, 2024



Agenda

- Overview of SB21-169
- Life Insurance Stakeholder Process and Survey: Lessons Learned
- Regulation 10-1-1: Life Insurer Governance and Risk Management Framework Requirements and Reporting
- Draft Life Insurance Underwriting Quantitative Testing Regulation



Goal of SB21-169

- Protect Colorado consumers from insurance practices that result in unfair discrimination on the *basis of race, color, national or ethnic origin, religion, sex, sexual orientation, disability, gender identity, or gender expression*
- Focuses on outcomes
- Not on individual factors or model variables



Applicability of SB21-169

- Insurers that use external consumer data and information sources (“ECDIS”) as well as algorithms and predictive models that use ECDIS including life, auto, homeowners, and health insurance
- By insurance practice, i.e., Marketing, Underwriting, Pricing, Utilization Management, Reimbursement Methodologies, and Claims Management



SB21-169 Insurer Requirements

- Establish a risk management framework
- Quantitatively test whether any ECDIS, and/or algorithms and predictive models utilizing ECDIS, result in unfairly discriminatory outcomes

SB21-169 Stakeholder Engagement Process

- Prior to the adoption of rules, the statute requires the Division engage in a stakeholder process with carriers, producers, consumer representatives, and other interested parties by **type of insurance and insurance practice**
- Conducted a survey of life insurers regarding current risk management and governance practices related to the use ECDIS, algorithms, and predictive models
- A wide range of insurer preparedness with insurers in various stages of developing their governance and risk management processes

Life Insurance Survey: Lessons Learned

- Multi-disciplinary, cross-functional team
- Clearly defined roles and responsibilities for evaluating data and models and developing risk mitigation measures
- Comprehensive and detailed documentation of policies and procedures as well as thorough record keeping
- Bifurcated approach to address the required risk management framework and testing components contemplated by SB21-169 through two regulations



Rulemaking/Implementation

- Adopted the first regulation and drafted a second
- Governance and Risk Management Framework, Reg 10-1-1
 - Effective November 14, 2023
- Quantitative testing for unfair discrimination in life insurance underwriting
 - Exposed for comment September 28, 2023

Colorado Insurance Regulation 10-1-1

Life Insurer Governance and Risk Management Requirements

- Board oversight and senior management accountability
- Cross-functional governance group with clearly defined roles and responsibilities
- Inventory of all algorithms and predictive models, their purpose, and outputs
- Documented ongoing monitoring of predictive model performance including accounting for model drift
- Documented roles and responsibilities for the design, development, testing, deployment, use, and monitoring

Colorado Insurance Regulation 10-1-1

Life Insurer Governance and Risk Management Requirements

- Documented process for selecting third-party predictive models and third-party vendors that supply ECDIS, algorithms, and/or predictive models
- Insurers that use third-party vendors remain responsible for ensuring requirements are met including the production of any documents or information the Division deems necessary to ensure compliance
- Documented means for assessing and prioritizing risk

Colorado Insurance Regulation 10-1-1 Verification

- Insurers that do not use ECDIS, or algorithms and/or predictive models that use ECDIS, must submit an attestation annually
- Insurers that use ECDIS, or algorithms and/or predictive models that use ECDIS, were required to submit an interim report by June 1, 2024
- Insurers that use ECDIS, and algorithms and/or predictive models that use ECDIS, must submit a report by December 1, 2024 demonstrating compliance or corrective action plan

Colorado Insurance Regulation 10-1-1

Verification

- Regular reporting to demonstrate compliance
 - Serve as tools for continuous verification of compliance, allowing the Division to monitor adherence to the regulation
 - Through regular submissions and attestations, insurers provide external validation of their compliance efforts
- Progress and compliance reports help identify any issues or areas needing improvement, ensuring prompt action to rectify potential discrimination or non-compliance

Draft Life Insurance Underwriting Quantitative Testing Regulation

- Required for insurers that use ECDIS as well as algorithms and predictive models that use ECDIS
- Limited to testing for unfairly discriminatory outcomes based on race and ethnicity
- Similar Regulation 10-1-1 by establishing a quantitative testing protocol while also requiring insurers submit a report to the Division indicating the results of the testing and any necessary remediation



Thank You