

**PRINCIPLES OF STATE INSURANCE**  
**UNFAIR DISCRIMINATION LAW**

**Thoughts Regarding  
NAIC And NCOIL Policymaking**

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Nov. 11, 2020

## INTRODUCTION/EXECUTIVE SUMMARY

The NAIC and NCOIL's recent engagement of the question of what constitutes unfair discrimination under state insurance codes<sup>1</sup> implicates several fundamental substantive and procedural questions. Although this paper disagrees with some aspects of their proposals, I emphasize my belief that the intentions of NAIC, NCOIL, and their members are consistent with the finest traditions of these groups, and of the term "public service."

Based on my experience,<sup>2</sup> I respectfully submit, for the consideration of policymakers and regulators, that the following core principles govern the application of the unfairly discriminatory prong of the state rating laws:<sup>3</sup>

1. The unfair discrimination statutes resulted from the 1945 McCarran-Ferguson Act's direction to the states to implement cost-based pricing requirements for insurer discrimination practices. Senator McCarran explained that his "bill would...prevent...unjust discrimination"; it did so, the NAIC explained, by requiring the states to pass laws patterned after "the rationale of" the Robinson-Patman Anti-Discrimination Act, a consumer protection law under which, "if the costs are the same, the seller cannot discriminate price."<sup>4</sup>
2. "In insurance," the NAIC explained to the Supreme Court, "*discrimination* is not necessarily a negative term so much as a descriptive one." Courts recognize that "the insurance commissioner is instructed to eliminate unfair discrimination, whereas" general civil rights laws "prohibit all discrimination." The "reason for the different standards" is that, since "insurance...always involves discrimination based on statistical differences and actuarial tables," the "legislature specifically intended...to only prohibit *unfair* discrimination in the sale of insurance policies." Courts thus hold

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<sup>1</sup> Including but not necessarily limited to the NAIC Casualty Actuarial and Statistical (C) Task Force, Regulatory Review of Predictive Models White Paper; the NAIC Artificial Intelligence Working Group Principles on Artificial Intelligence; the NAIC Special (EX) Committee on Race and Insurance; the NCOIL Resolution Urging the National Association of Insurance Commissioners To Refrain from Intruding on the Constitutional Role of State Legislators, July 1, 2020; and the NCOIL Special Committee on Race in Insurance, announced Sept. 25, 2020.

<sup>2</sup> I have worked on these issues for twenty years as a regulator and lawyer, including testimony in Congress, NAIC, and other public forums. While I have worked with clients with respect to the issues discussed in this paper, this analysis is my own.

<sup>3</sup> Following the McCarran-Ferguson Act of 1945, "every state...adopted both fire and casualty insurance rating laws," the "great majority" of which "were patterned after the Commissioners-All Industry model bills," which include the core requirement that "rates shall not be excessive, inadequate or unfairly discriminatory." Hanson, Dineen, and Johnson, Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business, National Association of Insurance Commissioners (1974) p. 30-31.

<sup>4</sup> Quotations in this executive summary are taken from the body of the paper; citations are found therein.

that “the basic principle underlying statutes governing underwriting practices” is “fair discrimination,” under which “the most equitable classification factors are those that are the most actuarially sound,” with “persons of substantially the same risk...grouped together.”

3. State legislatures create discrete statutory exceptions to this core rule—that actuarially justified risk classification is fair discrimination—when a factor’s social unfairness is determined after extensive study to exceed the benefits of its predictive value. This includes prohibitions, such as the common ban on the use of race, religion, and national origin; and tailored restrictions, such as the nuanced laws patterned on NCOIL’s Model Act Regarding Use Of Credit Information In Personal Insurance.
4. This basic construct—a two-step, under which the core rule of cost-based, actuarially justified, “fairly discriminatory” pricing is subject to limited, enumerated legislative overrides based on social considerations—has served the public interest since 1945. Automobile and homeowners insurance are mandatory products (by government and lenders) sold by private companies which must match price with risk to be solvent.<sup>5</sup> Stable carriers provide affordable, available coverage to policy holders across the country in every demographic, supplemented by only very small residual markets.
5. There is no third step. A neutral factor’s disproportionate impact on a protected class does not constitute unfair discrimination under any controlling state insurance law. Regarding disparate impact, NAIC told the Supreme Court: “The ‘disparate impact’ approach...overthrows state laws....that allow insurers to use rationally based, neutral underwriting guidelines.”
6. Actuarial justification is determined by a rating factor’s predictive value, not a subjective causation standard. As the American Academy of Actuaries explained to NAIC: “Any finding of causality...is a statement of theory or conjecture...Causality is not a requirement for any element in a risk classification system.”
7. NAIC has consistently rejected proposals incompatible with substantive (cost-based pricing standard) and procedural (exceptions made factor-by-factor) norms. In the 1970s, it voted down a “task force[’s] recommend[ation]...of criteria such as causality, reliability, social acceptability, and incentive value in judging the reasonableness of a classification system.” In the 2000s, it rejected causality and disparate impact standards with respect to credit scoring. And its 2018 proceedings include a Missouri regulatory report debunking a false media assertion that “minority communities were surcharged

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<sup>5</sup> Because in my experience most of the discussions around these questions take place with respect to property casualty insurance, this analysis generally focuses on those lines. My basic arguments, however, could also apply to life, health, and other lines.

relative to risk”; the Department’s careful study concluded the opposite—“higher rates for urban areas seem to be entirely accounted for by higher payouts.”

8. NAIC has recognized that, “as public policy issues, questions regarding discriminatory practices should be determined in the public forum of the legislature.” Such lawmaking has always focused on whether specific factors are socially unacceptable. Under this precedent NAIC and NCOIL can study purportedly unfair risk classes to determine their objective predictive value; whether their use is subjectively unfair; and whether the latter outweighs the former so much so that remedial model legislation is needed.
9. Cost-based pricing is an essential regulatory standard for the sound oversight of a business based on predictability. Limited, reasonable, socially necessary deviations from this core rule do not undermine this fundamental norm, so long as the exceptions are clearly established by statute.
10. Insurers must efficiently classify risk and regulators must consistently apply clear rules. These policy goals are met by applying one sweeping, objective standard (cost-based pricing) to every rating factor, supplemented by discrete, enumerated exceptions. By contrast, layering on to the evaluation of every factor a second, sweeping, subjective standard—such as causation or disparate impact—would inject untenable uncertainty into, and fundamentally undermine, carriers’ sound and beneficial classification of risk.

## **ANALYSIS OF STATE UNFAIR DISCRIMINATION LAW**

### **The unfair discrimination statutes are intended by Congress and the state legislatures to implement cost-based pricing requirements.**

Uniformity in state regulation is generally not achieved without a coercive mandate driven by Congress—such as, in recent decades, the creation of the state accreditation system for financial regulation<sup>6</sup> and certain producer licensing initiatives<sup>7</sup>.

The most substantial and influential uniformity in state regulation, however, dates back to 1945, when the federal McCarran-Ferguson Act of 1945 established the modern system of rating and trade practice oversight.

Although McCarran-Ferguson is best known for its structural component (state primacy and reverse preemption<sup>8</sup>), its most extensively debated provision was its substantive, limited antitrust exemption.<sup>9</sup>

This protection was made applicable to the extent that the states occupied the field—an aggressive incentive to force vigorous state regulation of trade practices.<sup>10</sup> Most well-

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<sup>6</sup> The accreditation system was crafted in the 1990s as a defense to the House Commerce Committee’s threat of federal regulation following its criticisms of lack of standards, uniformity, and coordination in state solvency regulation.

<sup>7</sup> Such as those driven by the NARAB provisions in Acts of Congress passed in 1999 and 2015.

<sup>8</sup> See 15 U.S.C. 1011 (“Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to [that] regulation...by the several States.”); 15 U.S.C. 1012 (“The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business....No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance...unless such Act specifically relates to the business of insurance.”).

<sup>9</sup> See 15 U.S.C. 1012(b) (“Provided, That after June 30, 1948, the...Sherman Act, and...as amended,...the Clayton Act [this includes the Robinson-Patman Anti-Discrimination Act, which amended the Clayton Act], and...the Federal Trade Commission Act..., shall be applicable to the business of insurance to the extent that such business is not regulated by State law.”); 15 U.S.C. 1013(a) (“Until June 30, 1948,...the Sherman Act, and...the Clayton Act, and...the Federal Trade Commission Act..., and...the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance.”).

<sup>10</sup> Congress used a carrot and stick approach, *see supra*, note 9. It disabled the antitrust laws for three years, then made them “applicable to the business of insurance to the extent that such business is not regulated by State law.” 15 U.S.C. 1012(b). This was explicitly intended to force the states to pass rating and trade practices laws to occupy the field. Such an approach was described by the main broker of the compromise that passed McCarran-Ferguson, Sen. O’Mahoney, as “an invitation to legislate in good faith,” 91 Cong. Rec. 1486-1487, and was in practice a “formulation of a federal public policy [of] real regulation of insurance rate making at the state level,” Spencer L. Kimball & Ronald N. Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 Mich. L. Rev. 545, 566 (1957-58). See also 91 Cong.

known is that the “excessive” and “inadequate” prongs of the state rating laws mostly disable the Sherman Act’s application to insurance.<sup>11</sup>

Forgotten to history, however, is the genesis of the rating laws’ “unfairly discriminatory” prong: Congress—by making the Robinson-Patman Anti-Discrimination Act specifically applicable to insurance if the states failed to occupy its field—established a national policy of cost-based insurance pricing.<sup>12</sup> Such purpose was clear when several Members successfully objected to exempting insurance from Robinson-Patman’s cost-based pricing requirements.<sup>13</sup>

Senator McCarran described the “feeling in the Congress that the Federal legislature has a positive responsibility to see to it that there is adequate regulation of insurance...by the...States”—including “afford[ing] the public protection...against discrimination.”<sup>14</sup> And the NAIC concluded that “the very fact that the Robinson-Patman Act is specifically mentioned in [McCarran] is a clear indication that Congress intended its provisions to apply to the insurance business.”<sup>15</sup>

NAIC discerned Congress’ intended purpose as the “enactment in each State—either as an integral part of the rating law or independently—of statutes prohibiting unfair rate

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Rec.1478 (Sen. McCarran) (“[T]he states are advised and warned that they have a moratorium of 3 years during which they may bring themselves into compliance by way of regulation.”).

<sup>11</sup> See, e.g., 1946 NAIC Proc. 100-101 (Joint Report of the Committee on Federal Legislation and the Committee on Rates and Rating Organizations) (“It is the consensus that although the industry is confronted with the impact of these four [antitrust] Acts, the major problem centers around the Sherman Act, and if satisfactory rating bills can be passed in the several States, one of our most difficult problems will be solved.”); Joseph Bauer, “Application of the Antitrust Laws to the Activities of Insurance Companies,” 63 N.C.L.Rev. 431, 444 (1984-1985) (explaining that the Supreme Court “concluded that the Act’s purpose was to allow insurance companies to...work cooperatively, particularly in the area of rate-setting, under the supervision of state authorities and thereby engage in joint activities that otherwise would be unlawful under the Sherman Act”);

<sup>12</sup> The brief history of this issue presented herein summarizes a more detailed treatment provided by NCOIL in its comment letter to the Department of Housing and Urban Development regarding rulemaking under the Fair Housing Act, found in its entirety at <http://ncoil.org/wp-content/uploads/2020/02/NCOIL-HUD-Comment-Letter-10-11-19.pdf>.

<sup>13</sup> See, e.g., 91 Cong. Rec. 1027-1028 (Feb. 12, 1945) (Rep. Cochran) (“If you look at section 3 of the bill you will find that it exempts all the business of insurance companies...from the...Robinson-Patman Act....I will not vote for the bill as...reported...unless section 3 is stricken.”); 91 Cong. Rec. 1092 (Feb. 14, 1945) (Rep. Kefauver) (“I doubt...Members...should...permanently exempt insurance from...the...Robinson-Patman Act.”).

<sup>14</sup> Pat McCarran, “Insurance as Commerce—After Four Years,” 23 Notre Dame L.Rev. 299, 303, 306 (1948). See also 91 Cong. Rec. 1483 (Sen. Radcliffe) (“[T]he States would have certain opportunities to regulate....If they should attempt to enact any laws which would permit...unjust discrimination, this bill would intervene and prevent.”).

<sup>15</sup> Address of NAIC President Robert E. Dineen, 1947 NAIC Proc. 297.

discrimination.”<sup>16</sup> This meant state codification of Robinson-Patman’s prohibition against “discriminat[ing] in price between different purchasers of commodities of like grade and quality.”<sup>17</sup>

New York Superintendent/NAIC President Robert Dineen explained that “the rationale of” the “Robinson-Patman Act, the All-Industry [NAIC Model] Bills and the New York rating law” is “generally the same, namely, that where varying prices on the same articles are quoted to different buyers...the seller should be able to establish that the variations in price are fair and reasonable.”<sup>18</sup> His predecessor as NAIC president declared that “no state legislation should prevent the economic non-discriminatory rating of risks....There should be no unfair discrimination.”<sup>19</sup> And NAIC’s landmark 1974 rate regulation treatise found that, under both Robinson-Patman and the state unfair discrimination statutes, “if the costs are the same, the seller cannot discriminate price.”<sup>20</sup>

In order to ensure their jurisdiction over insurer discrimination practices—rather than Federal Trade Commission enforcement of Robinson-Patman—the states promptly passed substantively identical rating laws, including an “unfairly discriminatory” prong, in the three year window provided by Congress to incentivize such activity.<sup>21</sup>

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<sup>16</sup> Report of NAIC Robinson-Patman Act Subcommittee, 1947 NAIC Proc. 187-188.

<sup>17</sup> Robinson-Patman Anti-Discrimination Act, 15 U.S.C. 13(a). *See also* 1946 NAIC Proc. 127 (Memorandum of NAIC Casualty and Surety Rating Bill and Fire and Inland Marine Rating Bill Drafting Committee) (“[T]he Robinson-Patman Act, a portion of which will be applicable to the insurance business after January 1, 1948, expressly prohibits price differentials by reason of volume or size unless supported by adequate cost figures.”).

<sup>18</sup> Speech of Sept. 21, 1948, quoted in Stone and Campbell, “Insurance and the Robinson-Patman Act,” 1949 *Ins. L.J.* 553, 564 (1949).

<sup>19</sup> Speech of NAIC president James McCormack, 1946 Proc. 212-213.

<sup>20</sup> Hanson, Dineen, and Johnson, “Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business,” at 440 (1974 National Association of Insurance Commissioners).

<sup>21</sup> *See, e.g., Karlin v. Zalta*, 154 Cal.App.3d 953, 967 (1984) (“There ensued precipitate state action to implement the McCarran Act and by 1950 every state had enacted rate regulatory legislation.”); *Pac. Fire Rating Bur. v. Ins. Co. of N. Am.*, 83 Ariz. 369, 371 (1958) (“Because the federal antitrust laws were, by Public Law 15...made inapplicable to insurance only to the extent that the business was regulated by state law, each state proceeded to enact a rate law.”); *Ins. Co. of N. Am. v. Com’r. of Ins.*, 327 Mass. 745, 748 (1951) (“During the period of delay thus afforded [McCarran moratorium], model laws were prepared by the [NAIC]....These have now been adopted with few changes in almost every State.”).

## **The Unfair Discrimination Statutes Require Actuarially Justified, Predictive, Cost-Based, Fairly Discriminatory Pricing.**

Although the word “discrimination” usually connotes unfair bias, its meaning in insurance is clinical: Carriers assign insureds to “classes” determined by risk of loss. For instance, insurers do not test individuals’ driving skills but rather rely on the predictive power of group characteristics (age, gender, moving violations, credit history, etc.).

Thus the NAIC explained to the United States Supreme Court: “In insurance, discrimination is not necessarily a negative term so much as a descriptive one.” NAIC Friend of the Court Brief to the U.S. Supreme Court, *Nationwide Mut. Ins. Co. v. Cisneros* (1996 WL 33467770). *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.”).

High courts understand and apply this rule, under which otherwise unacceptable stereotyping is condoned—and required—by insurance law. *See, e.g., Thompson v. IDS Life Ins. Co.*, 274 Or. 649, 654 (1976) (“The Insurance Commissioner is instructed to eliminate unfair discrimination, whereas the Public Accommodations Act prohibits *all* discrimination. The reason for the different standards...is that insurance...always involves discrimination...based on statistical differences and actuarial tables. The legislature specifically intended...to only prohibit *unfair* discrimination in the sale of insurance policies.” (Italics in original.)).

Generally, our law, policies, and mores are offended by pegging individuals with the general characteristics of groups in which they happen to be members. For instance, there are safe young and old drivers, and reckless fifty year olds. But on the whole those ages predict a much different outcome, and private insurance can only work if insurers construct actuarial classes that match price with risk.

Thus “unfair discrimination” and “class” are terms of art with specific meaning. *See, e.g., Ins. Com'r v. Engelman*, 345 Md. 402, 413 (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.”).

Actuarial justification and predictive accuracy is the lodestar of the unfair discrimination statutes. *See, e.g., 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.”).



This is cost-based pricing. See *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.”).

The more accurate the discrimination, the more fair the grouping—and the better the legal footing. 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.’...[T]he 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.”).

### **Accuracy In Predicting Loss, Not Causation, Is The Controlling Standard.**

Consensus case law—applying the statutory standard<sup>22</sup> of predictive, actuarial justification to achieve cost-based pricing—instructs that correlation, not causation, is determinative.

For instance, when the Florida commissioner attempted to ban sex, marital status, and scholastic achievement based on a lack of causation, the appellate court flatly rejected his argument that “a rating factor will be deemed unfairly discriminatory and inequitable unless it has a causal connection to expected losses”; applied the rule 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.” *Dept. of Ins. v. Ins. Services Ofc.*, 434 So.2d 908, 912-913 (Fla. App. 1983).

The Kentucky appellate court applied the same correlation 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).

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<sup>22</sup> 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.”); 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.”); La. Rev. Stat. 22:1452(C)(25) (“‘Unfairly discriminatory’...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.”).

Such rulings are consistent with actuarial standards. ASOP 12 (Risk Classification) explicitly rejects causation and embraces correlation: “[I]t 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.” Also: “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.” *Id.*

The Casualty Actuarial Society’s Foundations of Casualty Actuarial Science (4th edition, CAS 2001) instructs that, “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* p. 295 (“The most important consideration is that the rating variables have an objective definition. There should be little ambiguity.”).

Authorities also frequently employ terms, phrases, and descriptions that actuaries use interchangeably with correlation. The Casualty Actuarial Society’s 1988 Statement of Principles Regarding Property and Casualty Insurance Ratemaking explains that the rating laws require “an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.”<sup>23</sup> 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),” 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.” These formulations rely on terms—like “predictive” and “expected losses”—grounded in statistical correlation.

Leading actuarial authorities conclude that causative factors are subjective, unquantifiable, and impractical: “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.” CAS Foundations, p. 295. By contrast, “The actual rating variables, age, gender, and marital status, may be proxies for the underlying sources of cost variation. Maturity might be more accurate variable, but it is not practical.” *Id.* Immaturity might be causative, but is too subjective to be a rating factor; objective factors like age and gender are not causative, but provide measurable, efficient, reliable, cost-based pricing.

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<sup>23</sup> *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.”).

As the American Academy of Actuaries explained to NAIC during its review of credit-based insurance scores, even the most traditional casualty rating factors have no causal nexus to risk: “Causality is not a requirement for any element in a risk classification system. For example...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.”<sup>24</sup>

### **Legislatures Restrict The Use Of Some Actuarially Justified Rating Factors Based On Social Considerations.**

The core unfair discrimination principle, as intended by Congress and by the drafters of the model rating laws adopted in the states, is cost-based pricing. Actuarially justified risk classification is fair discrimination; rating factors that are not actuarially sound are unfairly discriminatory.

From time to time, however, when risk classes produce outcomes seen by the public as socially unacceptable, state legislators will consider restricting such factors’ use if their review establishes that classifying risk in this manner, though actuarially fair, is unacceptably politically unfair. Such a review involves policy judgments about costs and benefits that are the core competence of elected policymakers.

From time to time this leads to statutory modifications to the state unfair discrimination laws, often based on NAIC and NCOIL models. These include complete prohibitions on the use of some factors for any risk classification purpose; prohibitions on using some factors as a basis for denying coverage; prohibitions on using some factors as the sole basis for risk classification decisions; and other nuanced restrictions on how certain risk classification tools can and cannot be used.

The factors for which legislatures have grafted social fairness components over the basic actuarial unfair discrimination principle include, but are not limited to, race, religion, national origin, sexual orientation, disability, sex, marital status, gender status, domestic violence and stalking victims, foreign travel, housing construction and age, residential

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<sup>24</sup> American Academy of Actuaries, *The Use of Credit History for Personal Lines of Insurance: Report to the NAIC*, Nov. 15, 2002, p. 29. *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.”).

territory, genetic characteristics, scholastic achievement, and credit-based insurance scores.<sup>25</sup>

**Statutes That Protect Discrete Classes Restrict Direct Discrimination Based On Those Classes, Not Disparate Impact On A Protected Class Caused By A Neutral Factor.**

Membership in a statutorily protected class—insureds who are Black,<sup>26</sup> people who have traveled to Israel,<sup>27</sup> consumers who have low credit scores caused by medical bills,<sup>28</sup> etc.—protects insureds from direct discrimination based on membership in that class. Because the state unfair discrimination statutes contain no language regarding discriminatory effect (rather than intent), a facially neutral factor which disparately impacts members of a protected class is not illegal.

This rule of disparate impact was recently reiterated by the U.S. Supreme Court. *See Tex. Dept. Housing and Comm. Affairs v. Inclusive Comm. Proj., Inc.*, 135 S.Ct. 2507, 2518 (2015) (statutes are “construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of actors”).

This has been the law for decades. *See, e.g., Smith v. Jackson*, 544 U.S. 228, 236 (2005) (recognizing disparate impact when statute’s “text focuses on the *effects* of the action on the employee rather than the motivation for the action of the employer” (italics in original)); *Washington v. Davis*, 426 U.S. 229, 242 (explaining that a civil rights “law, neutral on its face and serving ends otherwise within the power of government to pursue,” is not triggered “simply because it may effect a greater proportion of one race than another”).

State unfair discrimination laws typically use the statutory phrase, “based on,”<sup>29</sup> which plainly encompasses “the mindset of actors,” and not “the consequences of actions.” In order to discriminate “based on” these factors, carriers would have to know whether

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<sup>25</sup> *See, e.g.,* NAIC Model 880 (Unfair Trade Practices Act); NAIC Model 1775 (Property and Casualty Model Rating Law); NCOIL Model Act Regarding Use of Credit Information in Personal Insurance; Fla. Stat. 626.9541; Minn.Stat. 72A.20; Ill. Stat. 215-5/155.17.

<sup>26</sup> Or others based on race, *see* NAIC Model 1775 (Property and Casualty Model Rating Law) (“No risk classification...may be based on race....”).

<sup>27</sup> Or other foreign travel, *see* Fla. Stat. 626.9541(1)(dd) (“Life insurance limitations based on past foreign travel experience or future foreign travel plans”).

<sup>28</sup> *See* NCOIL Model Act Regarding Use of Credit Information in Personal Insurance, Sect. 5(H) (prohibiting “us[ing]...as a negative factor in any...methodology...collection accounts with a medical industry code”).

<sup>29</sup> *See, e.g.,* La. Rev. Stat. 22:1452(C)(25) (prohibiting discrimination “based on race, color, creed, or national origin”); Nev. Rev. Stat. 686B.060 (“classifications may not be based on race, color, creed, national origin, sexual orientation or gender identity or expression”); Minn. Stat. 70A.05 (“Classifications may not be based on race, color, creed or national origin.”).

individual insureds were members of protected classes—information they do not collect, avoid attempting to ascertain, and are prohibited from knowing by some laws.

Because it is inconsistent with the state unfair discrimination statutes, NAIC has officially opposed disparate impact theory.<sup>30</sup> See NAIC Friend of the Court Brief to the U.S. Supreme Court, *Nationwide Mut. Ins. Co. v. Cisneros* (1996 WL 33467770) (“The ‘disparate impact’ approach...overthrow[s] state laws...that allow insurers to use rationally based, neutral underwriting guidelines.”).<sup>31</sup>

The state laws governing insurer discrimination practices trace a straightforward two-step: The core cost-based pricing standard is applied; then exceptions for classes requiring special, social protection, even if actuarially justified, are enumerated by the legislature.

There is no third step. Protected class status does not extend to instances where other, neutral factors heavily impact the protected class. State insurance doctrine does not recognize any form of disparate impact or proxy discrimination based on statistical correlation<sup>32</sup>—not by statute, case law, or legal authority of any other kind.

### **More Precise Risk Prediction Means Better, Fairer Prices Offered By Solvent Companies.**

Controlling law—requiring fair discrimination, establishing correlation over causation, and rejecting disparate impact standards—reflects fundamental policy judgments about what constitutes the public interest. 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...requires the commissioner to treat equally insureds who are of the same risk classification. This may result in ‘fair discrimination.’”).

Requiring insurers to strive for accurate, “fair,” classification of insureds reflects a social consensus that correlating risk with price creates good incentives and equitable results. See, e.g., *Casualty Actuarial Society, Foundations of Actuarial Science* (4<sup>th</sup> Ed. 2001), p. 293-294 (“[W]hen insurers can identify costs more accurately, they can compete more

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<sup>30</sup> NAIC models use language of intent, not effect. 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.” (Emphasis added.)).

<sup>31</sup> 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. NAIC’s brief is directly relevant here, though, because it unequivocally asserted that the state rating unfair discrimination laws do not recognize disparate impact liability.

<sup>32</sup> The term “proxy discrimination” is often referred to by those who seek to regulate it as a “subset of disparate impact.” See, e.g., Prince and Schwarcz, *Proxy Discrimination in the Age of Artificial Intelligence and Big Data*, Iowa L.Rev., Vol. 105 (2020), p. 1257.

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.”).

Correlating price to risk protects solvency, the ultimate aim of insurance regulation. *See* NAIC Supreme Court brief, *supra* (“rationally based, neutral risk selection criteria...promote[ ] insurer solvency through appropriate risk classification and accurate pricing of insurance”); ASOP 12, Appdx. 1 (“Risk classification has been a fundamental part of actuarial practice since the beginning of the profession....[I]gnoring...differences in risk characteristics was dramatically illustrated by the failure of the nineteenth-century...societies, where life insurance was provided at rates that disregarded age....Risk classification...protect[s] the soundness of the system.”).

Deviating from cost-based pricing thus undermines financial regulation and fair policyholder treatment: “Of concern to state regulators is that improper underwriting can result in the following circumstances...An insurer could become insolvent....An insured or potential insured could be improperly discriminated against.” NAIC Brief, *supra*.

## **NAIC And NCOIL Workstreams And The Cost-Based Pricing Standard.**

### *NAIC Artificial Intelligence Working Group/Proxy Discrimination:*

The NAIC, in Aug, 2020, adopted Principles on Artificial Intelligence,<sup>33</sup> including the instruction that “AI actors should proactively...avoid proxy discrimination against protected classes.”

“Proxy discrimination” is not defined, but the Artificial Intelligence Working Group’s deliberations are instructive. It was argued that “a rating variable ha[ving] to do with the age...of the house...can be shown...to discriminate against minority communities,” and that regulators should use a proxy discrimination standard to “challenge[ ] an insurer to find a better alternative to the age...of the home...[s]uch as the condition of the roof and/or the condition and age of the wiring.”<sup>34</sup>

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[https://content.naic.org/sites/default/files/inline-files/AI%20principles%20as%20Adopted%20by%20the%20TF\\_0807.pdf](https://content.naic.org/sites/default/files/inline-files/AI%20principles%20as%20Adopted%20by%20the%20TF_0807.pdf)

<sup>34</sup> This argument, put forth by the chair of the AIWG, concluded that “it would make more sense to use the variables; the roof and/or the condition and age of the wiring rather than a broad variable such as the age of the house,” and, with respect to cost-based pricing, called for “examining these processes to identify unintentional and unnecessary discriminatory effects on protected classes.” [https://content.naic.org/sites/default/files/national\\_meeting/ND\\_Summary\\_of\\_AI\\_Principles.pdf/](https://content.naic.org/sites/default/files/national_meeting/ND_Summary_of_AI_Principles.pdf/).

It is this paper’s position that regulators and policymakers are always within their rights to consider whether a rating factor is socially unfair. In fact, before the AIWG’s efforts this year, NAIC had already done so with respect to age of the house. *See* NAIC Model Unfair Trade Practices Act, Sect. 4(G)(4) (defining, as unfair discrimination, “refusing to insure, refusing to renew, canceling or limiting the amount of insurance coverage...solely because of the age of the residential property”).

Considering rating factors on their own individual merits is effective public policy. Insurers can efficiently classify and manage risk for the benefit of policyholders if the regulatory exceptions to cost-based pricing are carefully identified and discretely and clearly defined by statute. I respectfully suggest, however, that a tool which provides regulators an open-ended mandate to, with respect to every risk classification method, “challenge,” and pressure insurers to replace, a facially neutral, actuarially justified rating factor with “a better alternative” is too subjective and potentially destabilizing.

This does not imply that the Working Group and the NAIC operated in anything but utmost good faith. On the contrary, their desire to contribute to a just society is palpable. This paper argues, however, that legislation targeted to factors identified and demonstrated to be problematic provides better, clearer direction to both regulated entities and their regulators than a rule which charges regulators with trying to determine—for every facially neutral rating factor—when a risk classification method has crossed the undefined line of “be[ing] shown...to discriminate against minority communities.”

The NAIC’s prior admonition—that “disparate impact...overthrows state laws...that allow insurers to use rationally based, neutral underwriting guidelines”—should control.

*NCOIL And Proxy Discrimination:*

NCOIL has charged its newly created Special Committee on Race in Insurance Underwriting with “taking testimony, discussing, and defining the term ‘proxy discrimination’—an undefined term that has been used by many when discussing insurance rating, and has even been included in regulatory-related documents.”<sup>35</sup>

“Proxy discrimination,” like disparate impact, is a term not found in any NAIC or NCOIL model or state insurance statute, administrative code, case law, or other relevant controlling authority. Its most prominent use is in the NAIC guidance document discussed above, which by its own terms recites that its principles “do not carry the weight of law.” I respectfully suggest that a phrase which does “not...impose any legal liability,” as conceded by NAIC in the Principles themselves, requires no legislative definition.

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<sup>35</sup> <http://ncoil.org/2020/09/25/ncoil-announces-creation-of-special-committee-on-race-in-insurance-underwriting/>

Traditional policymaking procedures followed by individual legislatures and NCOIL begin with fact gathering and analysis around a purportedly unfair business practice, in order to determine whether such insurer conduct poses a problem in need of a remedy. To date, no evidence has been produced to support the notion that insurers have used neutral factors with the intent and for the purpose of classifying insureds by protected class rather than by risk. Thus “proxy discrimination” is not a problem demanding a regulatory response.

The Special Committee’s charge also includes “discussing the wisdom of certain rating factors being used in insurance underwriting, such as zip code, and level of education.” This part of the charge is notable for at least two reasons. First, it does not assume the necessity of a remedy to the issue under consideration, but rather calls for study before deciding whether to take action<sup>36</sup>—the most effective course of action.

Second, it conforms to the conventional approach of pursuing social fairness in insurance risk classification through evaluation of *specific* factors identified as requiring particular scrutiny, rather than through the application—on top of risk-based pricing—of a new, sweeping standard to *every* rating factor.

NCOIL’s “30 Day Materials,” published Nov. 9, 2020, in advance of its December meeting, include proposed amendments to the Property/Casualty Insurance Modernization Act which declare “proxy discrimination” to be a form of prohibited unfair discrimination, and which define the term.

Adoption of a “proxy discrimination” definition that incorporates any element of disparate impact (effects rather than intent)—a legal theory which NAIC correctly warned “overthrows state laws...that allow insurers to use rationally based, neutral underwriting guidelines”—would radically depart from the successful regulatory regime of “state jurisdiction over insurance as established by the McCarran-Ferguson Act,” which NCOIL’s mission statement is explicitly designed “to preserve.”<sup>37</sup>

NCOIL staff’s proposed definition for discussion purposes is a deliberative and thoughtful effort to avoid such a result: “‘Proxy discrimination’ means the intentional substitution of a neutral factor for a factor based on race, color, creed, national origin, or sexual orientation for the purpose of discriminating against a consumer to prevent that consumer from obtaining insurance or obtaining a preferred or more advantageous rate due to the

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<sup>36</sup> With respect to territorial rating, such study should include a thorough review of the recent Missouri Department of Insurance report, discussed further below, *see* note 49 and accompanying text, which concluded: “Higher rates for urban areas seem to be entirely accounted for by higher payouts. This conclusion is entirely consistent with numerous DIFP studies over the last two decades.”

<sup>37</sup> <http://ncoil.org/history-purpose/>



consumer’s race, color, creed, national origin, or sexual orientation.”<sup>38</sup> This reads as an attempt to plainly create a true intent standard for proxy discrimination—distinguishable from, and with no lines blurred with respect to, disparate impact.

Thus should NCOIL conclude that it must define and prohibit proxy discrimination (which this paper argues is unnecessary), its staff’s definition in the 30 Day Materials provides a reasonable, good faith starting point for the crafting of a careful and meticulous definition that meets NCOIL’s stated goals.

*The NAIC CASTF “Rational Explanation” Standard:*

The Sept. 9, 2020, version of the NAIC Casualty Actuarial and Statistical Task Force’s Regulatory Review of Predictive Models White Paper,<sup>39</sup> adopted by the Task Force on Sept. 15, directs rate filing reviewers to, as a “best practice”:

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 may be 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 connection that variable has to increasing or decreasing the target variable.

“Rational explanation” is a defined term:

**Rational Explanation** – A “rational explanation” refers to a plausible narrative connecting the variable and/or treatment in question with real-world circumstances or behaviors that contribute to the risk of insurance loss in a manner that is readily understandable to a consumer or other educated layperson. A “rational explanation” does not require strict proof of causality but should establish a sufficient degree of confidence that the variable and/or treatment selected are not obscure, irrelevant, or arbitrary.

A “rational explanation” can assist the regulator in explaining an approved rating treatment if challenged by a consumer, legislator, or the media. Furthermore, a “rational explanation” can increase the regulator’s confidence

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<sup>38</sup> NCOIL Staff Draft Strawman Proposed Language Defining Proxy Discrimination for the NCOIL Property/Casualty Insurance Modernization Act, found at <http://ncoil.org/wp-content/uploads/2020/11/Tampa-30-Day-Materials-1.pdf>.

<sup>39</sup> Casualty Actuarial and Statistical (C) Task Force, Regulatory Review of Predictive Models White Paper, Draft, 6/12/2020. Available at [https://content.naic.org/cmtc\\_c\\_catf.htm](https://content.naic.org/cmtc_c_catf.htm).

that a statistical correlation identified by the insurer is not spurious, temporary, or limited to the specific datasets analyzed by the insurer.<sup>40</sup>

Since the white paper's best practices are presented as "an effective method of...solving...the problem [of]...determin[ing] [whether] predictive models...are compliant with state laws,"<sup>41</sup> NAIC is proffering as a legal standard the requirement of a "rational explanation" under the unfair discrimination statutes. But CASTF's definition of "rational explanation" is inconsistent with these code provisions.

The first paragraph of the "rational explanation" definition imposes an affirmative obligation on filers to proffer a "plausible narrative" that "connect[s] the variable...with real-world circumstances or behaviors that contribute to the risk of insurance loss." This is a causation standard.

That the definition recites that it does not require "strict proof of causality" only underscores that some level of "causality" is an implied requirement—just not "strict...causality." In this case, compliance is judged by the variable being "not obscure, irrelevant, or arbitrary"—open-ended, non-defined terms necessitating the application of substantial regulatory subjectivity.

Such subjective standards are contrary to the controlling, objective correlation standard, including the CAS Foundations' instructions that "the categorization of variables as 'causal' or 'non-causal' is ambiguous"; that "correlated variables provide more accurate premiums"; and that, because the "most important consideration is that the rating variables have an objective definition," there "should be little ambiguity."

Ambiguity, however, is the necessary result of CASTF's definition of "rational explanation," which elevates subjective political opinion over actuarial science as a regulatory standard: The first paragraph instructs that the use of a rating factor must be "readily understandable to a consumer or other educated layperson"; the second paragraph elaborates that the goal of a regulatory decision is to be able to "explain[ ] an approv[al]" to "a consumer, legislator, or the media."

### **NAIC Has Repeatedly Concluded That Sweeping Disparate Impact And Causality Standards Would Not Protect Consumers.**

The NAIC 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," based on the stated rationale that "public policy considerations require

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<sup>40</sup> CASTF white paper, p. 46.

<sup>41</sup> CASTF white paper, p. 2.

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.”<sup>42</sup>

The task force argued that “It is important to recognize that statistical parameters often fail to address important social and public policy considerations regarding the rating process.”<sup>43</sup> The NAIC Plenary rejected the task force’s aggressive recommendations 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.”<sup>44</sup>

As discussed above, in 1996, the NAIC expressed to the Supreme Court its formal position that, because “state laws that prohibit unfair discrimination in insurance...allow the use of rationally based, neutral risk selection techniques that promote the solvency of insurers,” the use of “‘disparate impact’ theory’...overthrows state laws” and “punish[es]...insurers...even though they were merely using...guidelines permitted and encouraged under state law.” 1996 WL 33467770.

In the 2000s, questions of causality and disparate impact were repeatedly debated with respect to credit-based insurance scoring. NAIC abandoned a causality inquiry when, in response to NAIC’s request that the American Academy of Actuaries “provide guidelines/parameters on how the NAIC could conduct a study of credit scoring, including suggestions on how the NAIC could determine...causality,” AAA responded that it could not do so “because in our opinion it would not be possible to prove a causal relationship,” for the reason that “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.’”<sup>45</sup>

Similarly, NAIC repeatedly rejected the viability of a disparate impact standard during its credit scoring debates. As described in the 2001 report of the Public Hearing on the Use of Credit Information in the Underwriting and Rating Process,<sup>46</sup> NAIC refused to adopt the

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<sup>42</sup> 1979 NAIC Proc. Vol. I at 912.

<sup>43</sup> 1979 NAIC Proc. Vol. I at 911

<sup>44</sup> 1979 NAIC Proc. Vol. II at 25-26. 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.

<sup>45</sup> American Academy of Actuaries, *The Use of Credit History for Personal Lines of Insurance: Report to the NAIC*, Nov. 15, 2002, p. 28.

<sup>46</sup> *See* 2001 WL 34898564.

position that “credit scores may have a disparate impact on protected classes of individuals and...if there is a disparate impact the use of credit scores should be banned.” The NAIC studied the same topic at length in 2003, choosing not to take action on a “proposed disparate impact credit scoring study.”<sup>47</sup>

During the 2001 deliberations, the chair of the Market Conduct Committee asked a simple threshold question of critics who asserted that insurers use new predictive tools for the purpose of disadvantaging minorities: “Why [would] companies...use credit scores if they do not work”? This is a practical, common sense formulation of the issue. Insurers are prohibited by law and business practice from knowing the protected class status of their insureds. They have no financial incentive to group insureds for the purpose of identifying protected classes rather than risk. Do they go out of their way to do so anyway?

Pro Publica insinuated that they do in an inflammatory series of articles asserting that “Minority neighborhoods pay higher car insurance premiums than white areas with the same risk.” These stories concluded that “many of the disparities in auto insurance prices between minority and white neighborhoods are wider than differences in risk can explain”—allegedly “a form of redlining,” featuring overcharges of “on average 30 percent in zip codes where most residents are minorities.”<sup>48</sup>

The NAIC Proceedings contain a detailed, thorough report, by the Missouri Department of Insurance, Financial Institutions and Professional Registration’s veteran research manager, concluding that Pro Publica’s reports were plagued by “methodological deficiencies that produced erroneous conclusions,” causing “dissemination of conclusions regarding race-based pricing that are simply unambiguously wrong.”

The Missouri study found no evidence for the “claim[ ] that pricing differences were not...justified by actual risk, and that minority communities were surcharged relative to risk,” and concluded the exact opposite: “Higher rates for urban areas seem to be entirely accounted for by higher payouts. This conclusion is entirely consistent with numerous DIFP studies over the last two decades.”<sup>49</sup>

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<sup>47</sup> See Credit Scoring Working Group minutes, Sept. 15, 2003, 2003 NAIC Proc. 3<sup>rd</sup> Qtr. P. 431 et seq.

<sup>48</sup> <https://www.propublica.org/article/minority-neighborhoods-higher-car-insurance-premiums-methodology>; <https://www.propublica.org/article/minority-neighborhoods-higher-car-insurance-premiums-white-areas-same-risk>.

<sup>49</sup> Memorandum dated July 23, 2018, to Auto Insurance Working Group, from Brent Kabler, Research Manager, Missouri Dept. of Insurance, Financial Institutions and Professional Registration, attaching DIFP report entitled “Private passenger automobile insurance/A review of the market in Missouri,” found in Auto Insurance (C/D) Working Group minutes.

## **Legal Standards Governing Insurer Discrimination Practices Are Made, And Can Only Be Properly Changed, By Statute.**

When the NAIC 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.”<sup>50</sup>

The task force correctly recognized that unfair discrimination standards are statutory. Thus it explained that, while NAIC debated whether to propose new model legislation, and until such measures were adopted in the states, “statistically justified sex and marital status rating classification should be permitted to remain in use until specifically prohibited by legislative action.”<sup>51</sup>

The task force described the law it wanted to change as the objective standard of “simple statistical correlation with loss.” Because the task force’s preferred standards of causality and other subjective measures of “social acceptability” departed from this core rule, legislation was required to achieve these regulatory goals.<sup>52</sup> Thus even an NAIC task force that wanted to upend key risk classification practices recognized that the most it could do was recommend such changes to legislatures.

## **Unfair Discrimination Lawmaking Should Be Done Factor-By-Factor, Not By Disparate Impact Standard.**

The Center for Economic Justice’s influential recent publications<sup>53</sup> astutely suggest that only legislation can establish a disparate impact standard. CEJ explained that “NAIC

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<sup>50</sup> 1979 NAIC Proc. Vol. I at 913-914.

<sup>51</sup> 1979 NAIC Proc. Vol. I at 914.

<sup>52</sup> 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 current NAIC guidance documents 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.

<sup>53</sup> Call to Insurers and Insurance Regulators, June 18, 2020, available at <https://consumerfed.org/wp-content/uploads/2020/06/CEJs-Call-on-Insurers-and-Regulators-to-Address-Systemic-Bias-and-Inherent-Racism-in-Insurance.pdf>; Insurance Consumer Protection Issues Resulting From, Or Heightened By COVID-19, June 19, 2020, available at [https://content.naic.org/sites/default/files/call\\_materials/Slideshow\\_Consumer%5B1%5D.pdf](https://content.naic.org/sites/default/files/call_materials/Slideshow_Consumer%5B1%5D.pdf); Comments to the NAIC Artificial Intelligence Working Group, June 28, 2020, available at [https://content.naic.org/sites/default/files/call\\_materials/CEJ%20Comments.pdf](https://content.naic.org/sites/default/files/call_materials/CEJ%20Comments.pdf)

model laws and state statutes do not explicitly recognize disparate impact as unfair discrimination against protected classes. Further, there are no requirements...to identify and minimize such proxy discrimination within the overall cost-based pricing framework.”<sup>54</sup>

This accurate observation is consistent with the legal rule that disparate impact is not a viable legal concept under statutes that, like the state insurance unfair discrimination laws, do not articulate an intent to encompass indirect discrimination. *See, e.g., Tex. Dept. Housing and Comm. Affairs v. Inclusive Comm. Proj., Inc.*, 135 S.Ct. 2507, 2518 (2015); *Smith v. Jackson*, 544 U.S. 228, 236 (2005); *Washington v. Davis*, 426 U.S. 229, 242, discussed, *supra*, p. 12.

Thus CEJ’s Call to Insurers and Insurance Regulators correctly advocates that, in order to reach its goal of “explicit recognition of disparate impact as unfair discrimination against protected classes in insurance...to minimize this proxy discrimination,” a necessary “mechanism[ ] to accomplish” such a result “is straightforward”: “Development of, and implementation by the states, through the National Association of Insurance Commissioners (NAIC) of a model law...including recognition of disparate impact as unfair discrimination.”

CEJ is correct that disparate impact is not prohibited by current law, and that statutory changes are the appropriate method of effectuating social justice in insurer discrimination practices. The question becomes: To effectuate social justice, what type of legislation should be considered—imposition of a sweeping statutory disparate impact/proxy discrimination standard to all rating factors, or the evaluation and prohibition or restriction of individual risk classification methods identified as potentially socially unfair?

Implementation of the first option, a disparate impact standard, would be the most radical measure adopted in the history of American insurance regulation, and would undermine, if not threaten the viability of, the private insurance market that delivers the bulk of the homeowners and automobile insurance in the United States. Core regulatory standards require these insurers to develop and use accurate predictors of loss.

As the NAIC explained to the U.S. Supreme Court, “For insurance *fair* discrimination is not only permitted, but necessary” because it “promotes insurer solvency through appropriate risk classification and accurate pricing of insurance.” Disparate impact regulation—where “a facially neutral rule that disproportionately excludes members of a protected class...even though...not motivated by discriminatory intent” can be found illegal—“overthrows state laws...that allow insurers to use rationally based, neutral underwriting guidelines.” *Id.*

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<sup>54</sup> Insurance Consumer Protection Issues Resulting From, Or Heightened By COVID-19, June 19, 2020, slide 13.

Social justice can be pursued by caring public officials without “overthrowing” the state unfair discrimination statutes. The established method of policymaking under the successful McCarran-Ferguson regime offers a proven method of bringing accountability and fairness to insurer discrimination practices: Social fairness review of classifications identified as potentially problematic.

For instance, CEJ provides several examples of what it says are risk classification “practices...shown to discriminate unfairly against protected classes, generally, and Black Americans, specifically,” including “criminal history scores...bas[ed]” on “complaints filed with courts.” This, CEJ argues, is unfair because a Dept. of Justice study of policing in Ferguson, Mo., found a “disproportionate burden on African Americans [that] cannot be explained by any difference in the rate at which people of different races violate the law”—but “rather,” by “at least in part,...unlawful bias against and stereotypes against African Americans.”<sup>55</sup>

If NAIC or NCOIL members believe that “criminal history scores,” or any of the other purportedly suspect factors identified in the CEJ paper, or any other factors identified by the NAIC, NCOIL, or their stakeholders, merit inquiry, they can and should review their fairness. Doing so would require careful deliberative study, during which all relevant stakeholders express their viewpoints and arguments, and policymakers apply appropriate and vigorous due diligence and vetting, rather than political preconceptions.

Should this process yield a conclusion that a social fairness norm was implicated, and a public policy judgment that the social unfairness resulting from the use of a particular rating factor outweighs in that instance the prevailing public policy of “fair discrimination” as judged by predictive value, then NAIC or NCOIL could propose model legislative language prohibiting or restricting that classification method.

In following the precedent of this time-honored approach, NAIC and/or NCOIL—in a process infused with legitimacy, and without upending the basic foundations of the insurance enterprise and its regulatory norms—could tangibly and effectively contribute to the cause of just and fair treatment of American citizens. This would be of no small import, since, as the U.S. Supreme Court has explained, insurance “touches the home, the family, and the occupation or the business of almost every person in the United States.”<sup>56</sup>

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<sup>55</sup> CEJ comments to Artificial Intelligence Working Group, *supra*, note 53.

<sup>56</sup> *U.S. v. South-Eastern Underwriters*, 322 U.S. 533, 540 (1944).