

Recent developments in New York State's regulation of insurance | Viewpoint

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VIEWPOINT
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DFS issues final circular letter providing guidance on use of artificial intelligence in insurance underwriting, pricing

In February 2024, we wrote about the New York State Department of Financial Services (DFS) issuing a Proposed Circular Letter regarding the use of artificial intelligence (AI) and external consumer data information sources (ECDIS) in the underwriting and pricing of insurance. DFS's Proposed Circular Letter expressed concern that although AI tools may simplify or expedite the underwriting process, such tools "may reflect systemic biases" and could have potential adverse effects or discriminatory outcomes. DFS set forth several proposed fairness principles to guide the use of AI in underwriting so that insurers

could avoid discriminatory impacts and design their procedures for using AI and ECDIS to prevent unfair or unlawful discrimination.

DFS invited comments and feedback regarding its Proposed Circular Letter and received submissions from insurers, trade associations, universities and interested members of the public. In response to that feedback, DFS issued a Final Circular Letter on July 11, 2024, to identify DFS's expectations that insurers develop and manage policies for their use of AI and ECDIS in a manner that complies with all applicable state and federal laws, does not make coverage decisions based on an applicant's membership in a protected class, and does not result in unfair discrimination.

After discussing the purpose and background of the Final Circular Letter, DFS set forth Fairness Principles, as well as guidelines for Governance and Risk Management and Transparency.

Fairness principles

The guiding principle set forth in

the Final Circular Letter is that insurers should not use AI or ECDIS unless they can establish that the data is not based on any protected class and does not result in any unfair discrimination. Insurers are responsible for complying with anti-discrimination laws, and an insurer should not use ECDIS or AI in its underwriting process if it would have disproportionate adverse effects on a protected class.

DFS suggests that insurers need to be able to demonstrate that ECDIS are supported by generally accepted actuarial standards such that there is a clear statistical link between the variables used and the relevant risk of the insured. DFS also provides a three-step model for assessing whether an underwriting or pricing guideline derived from AI or ECDIS unfairly discriminates.

Governance and risk management

DFS's Final Circular Letter also sets forth guidelines for governance and risk management. The insurer's board of di-

rectors must provide oversight of the insurer's activities, such as establishing appropriate lines of reporting for delegated tasks, including the development and management of AI tools and the use of ECDIS.

Insurers should develop formal written policies for the use of AI, setting forth clearly defined roles and responsibilities, as well as monitoring, reporting, and training requirements. Insurers should also have an internal audit function that is appropriately engaged with the insurer's use of AI and ECDIS. And insurers are responsible for the use of AI tools and ECDIS, even when deployed by third-party vendors.

Transparency

DFS notes that disclosure is an essential mechanism to aid insurance applicants in identifying and correcting any incorrect data used in underwriting and pricing decisions. To that end, notices to insureds should indicate whether the insurer uses AI in its underwriting or pricing process or uses data about the applicant from third-party vendors and that the applicant may request information about the specific data that resulted in the underwriting or pricing decision.

The full text of DFS's Final Circular Letter is available at www.dfs.ny.gov/industry-guidance/circular-letters/cl2024-07.

[dfs.ny.gov/industry-guidance/circular-letters/cl2024-07](http://www.dfs.ny.gov/industry-guidance/circular-letters/cl2024-07).

Affordable housing underwriting and rating

In 2022, DFS published a report on increases in insurance premiums and unavailable coverage for affordable housing in New York. After surveying authorized property and casualty insurers regarding how they use information about government-subsidized housing units, DFS worked with the legislature to propose new legislation to prohibit insurers from inquiring about, or making decisions based on, a property's status as affordable housing.

In April 20, 2024, Governor Kathy Hochul signed into law New York Insurance Law § 3462, a new provision which provides that insurers writing policies for residential real property in New York State may not inquire about an application; cancel, refuse to issue, refuse to renew, or increase the premium of a policy; or exclude, limit, restrict or reduce coverage under a policy based on the following:

- The residential building contains dwelling units that must be affordable to residents at a specific income level pursuant to a statute, regulation, restrictive

declaration, or regulatory agreement with a local, state or federal government entity.

- The real property owner or tenants of such residential building or the shareholders of a cooperative housing corporation receive rental assistance provided by a local, state or federal government entity, including, but not limited to, the receipt of federal vouchers issued under Section 8 of the United States Housing Act of 1937 (42 U.S.C. § 1437f).

- The level or source of income of the tenants of the residential building or the shareholders of a cooperative housing corporation.

- Whether such residential building is owned by a limited-equity cooperative, owned by a public housing authority, or owned by a cooperative housing corporation.

DFS issued a Circular Letter on June 24, 2024, summarizing the new legislation. The letter is available at www.dfs.ny.gov/industry-guidance/circular-letters/cl2024-06.

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