Memo

To: Tim Mullen, NAIC Director of Market Regulation

From: John Humphries, Dave Heppen, and Debbie Rosenberg - Risk & Regulatory Consulting, LLC

Date: January 12, 2018

Subject: RRC Response to the NAIC Big Data (EX) Working Group regarding the *Regulatory Framework – Proposed Structure and Issues for Discussion*

Risk & Regulatory Consulting, LLC ("RRC" or "we") supports the efforts of the Big Data (EX) Working Group ("Working Group") to outline a process for determining whether changes to the current regulatory framework are needed to address the use of consumer and non-insurance data, and if so what form these changes should take. We have reviewed the discussion document and offer the following comments for your consideration. We would be glad to answer any questions, and we appreciate the opportunity to offer our comments.

We appreciate the efforts of the Working Group to thoughtfully consider the far reaching implications of new data sources that are available for policy rating. The data that is now available is far beyond that envisioned when current rating laws were drafted, and as time progresses there will be other available data that has not been considered to date. As such, innovative regulatory approaches are needed to address the impact of new sources of rating data on consumer insurance pricing. The work of this group will impact insurers, regulators and, most importantly, consumers, for decades to come.

We strongly endorse the Working Group's desire to, "balance consumer protection with industry innovation." Both consumer protections and industry innovation are critically important in any regulatory approach that is developed.

With this background we suggest:

- The Working Group should identify all variables currently being used in rating models to ensure that these variables are not only in compliance with current state law and statutory guidance but will also represent good public policy for the future. Special attention must be paid to rating variables that could serve as a proxy for variables already prohibited or not in keeping with desired public policy. For instance, some variables such as occupation could be used in a manner to serve as a proxy for race, creed, national origin, or the religion of the insured. The Working Group may need to consider not only proposed rating variables at face value but also require analysis to confirm there is not significant correlation to prohibited factors or outcomes. One potential approach is a periodic survey of the rating variables that are currently in use. Such a survey ideally would be as broad as possible. The survey could assist regulators in gaining an understanding of changes in commonly used rating variables as well as less frequently used variables. This in turn could suggest areas for further study by the Working Group.

- In addition, as the ability to segment data continues to grow, there is risk that the resulting classes will be defined in narrow terms that could also inadvertently become proxies for prohibited rating characteristics. Understanding the changing characteristics of rating groups as segmentation refinement continues to develop will be an important challenge for regulators. Analysis of the variables being used, both now and in the future, could help regulators better understand this potential issue.

- Similar to Nevada Regulatory Activity Bulletin 17-001 included in Attachment B, statutory guidance should include language that broadly defines underwriting rules and rating models based upon the ultimate effect on premium paid by an insured. Tier rating, company placement within a group of affiliates, or other similar rating structures should not be allowed to circumvent rating prohibitions or guidance.

- Provisions to ensure the accuracy of input data for rating models will be critically important, and should be considered as part of the regulatory process. The risk of inaccurate internal policy data is already mitigated by a series of internal controls and processes that are reviewed by both internal/external audit and confirmed during periodic statutory examinations. As new rating variables from new data sources including external vendors become key factors in determining the premium charged to consumers, then the accuracy of this data should also be protected by appropriate controls and readily available for review during audits and statutory examinations.

With these suggestions in mind, we strongly support regulatory facilitation of improvements to rating methodologies. The regulatory framework should encourage research into continued development of modeling techniques and rating variables that allow for:

- Improvements in the accuracy of pricing
- Reductions in subsidizations of individual rating groups
- Encouragement of safer behavior through the use of improved ability to reflect such behaviors in pricing

The Working Group has succeeded to date in providing a forum for input from regulatory, consumer, and industry perspectives in furthering these goals. We encourage continuation down this path.