July 28, 2022

KARIMA WOODS, COMMISIONER

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF INSURANCE, SECURITIES & BANKING

Dear Commissioner,

Thank you for the opportunity to comment on your important initiative to explore the UNINTENTIONAL BIAS IN AUTOMOBILE INSURANCE.

Let me begin by introducing myself briefly. I have been an advisor in the risk pooling ecosystem for 34+ years. I grew up in the technology stack but developed a passion for risk sharing in its many shapes and forms. While I am not an actuary, I have a deep understanding of what goes into pricing risk. I recently retired in April and looking for opportunities to influence dialogs that involve risk pools. The topic is becoming even more crucial given societal, technological, and environmental trends.

The core of my belief is that each participant in a risk pool has two interests – the first as a consumer and the second as a stakeholder in the risk pool itself. Both are important but the second is often overlooked. For risk pooling to work each participant must trust that they are paying.a fair premium for the risk that is transferred – and that others are also paying an equitable premium for the risk they transfer. Note I have not explicitly discussed the insurer or the agent – I think of the risk pool as an entity of its own. Sometimes insurers are good stewards of the risk pool and sometimes they are not. Agents can support or undermine the risk pool as well.

A fair premium has two components – it reflects the risk (actuarial equity) and it abides by the established rules around acceptable discrimination (societal equity). I am using discrimination in its broadest sense – intentionally – because risk pooling requires us to statistically discriminate and differentiate risk. There is and should be much debate around what constitutes a fair discriminant – some believe that anything that predicts loss is fair game, others believe that the weighting must tilt towards factors you can control. My belief is somewhere in the middle. Government owns those boundaries – based on the objectives we are trying to accomplish, in alignment with established principles, and based on a rich understanding of the risk pooling dynamic fed by data.

Incentives are an important element of the risk pooling equation. Those who pay more for their auto insurance than their risk deserves are more likely to leave the risk pool – shopping can help reveal this – but those that pay too little are less likely to adopt lower risk behaviors. As a participant – we can all pay more for our risk transfer if the pool is unfairly managed – with underpaying riskier drivers staying and overpaying lower risk drivers leaving disproportionately.

In addition to suggesting the above framing, I have three suggestions for your effort:

1. **Consider both societal and actuarial equity.** Getting the social equity 'right' but disrupting the actuarial equity can threaten the health of the system. Getting the actuarial equity 'right' and the social equity wrong defeats some important collective goals. I believe neither form of equity is all-or-nothing – so it's a question of achieving an acceptable and sustainable balance. Even with the best of intent, actuaries cannot eliminate all actuarial subsidy in a rate plan. Some degree of social inequity is also likely. Processes need to be in place to make sure neither gets excessive.

2. **Open the aperture to include the process and insurance product**. Beyond price, insurance has to work for everyone. The process can include unintentional bias (e.g. down payment requirements can discriminate against lower income people or fees charged more frequently) Each risk pool has a different composition. A risk pool has "learned" its rating plan throughout its history. Bias is statistically "learned" -- and it is hard to unlearn. Substantial dislocations can occur when these factors are not considered. Even the product design might include some unintentional bias -- mandatory coverages not required by law that certain customer groups do not want or need. Education – understanding risk transfer – plays a role. Branding and distribution can too. The claim side of the equation should be considered as well. There are a subset of lawyers and doctors who are exploiting the same people unintentional bias is likely impacting. It is an important factor in the cost of risk pooling.

3. **Consider fairness with recognition that the participant in the risk pool is sharing other people's risk.** In the direct role as a party transferring risk they want coverage that meets their needs at fair prices. In the indirect role as a stakeholder in the risk pool they are in a sense paying other peoples losses. That is what we hope. Any rating factor that one cannot directly control has an element of unfairness to it when it drives insurance prices higher. But defining 'control' can be tricky. As a risk pool stakeholder, we want to see others pay their cost of risk.

And we want the risk pool to be well managed. Otherwise our rates will go up as the total loss of the portfolio increases.

I have worked across many different jurisdictions and that experience leads me to believe that state based regulation makes good sense because it allows for the expression of different value systems and behaviors. More litigious localities can have risk transfer opportunities that can make sense. Low litigation localities as well. Automobile insurance is of course at the forefront and amplifies these differences.

I hope in your examination you explicitly integrate the need for social subsidies (e.g. for lower income households) with actuarial soundness and the alignment of incentives. I have seen first hand that when liability minimums are too expensive and coverage limits inadequate the problem shifts to the rest of the risk pool. Unintentional bias is just one form of unfairness in risk pooling – it should not be considered in a vacuum.

Please let me know if I can be of any assistance in your initiative. Equity and fairness are crucial ingredients of sustainable risk pooling – which is becoming more important in our society as risk is increasing on a number of fronts.

SINCERELY,

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RISK POOLING ADVOCATE

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