

Adverse Disparate Impact AND Insurance

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Adverse Impact

- ❑ Originated in housing and employment cases
- ❑ **Unintentional** form of discrimination
- ❑ Identical standards or procedures are applied to everyone, leading to significant differences in outcomes
- ❑ Adverse impact not necessarily illegal

Disparate Treatment

- ❑ **Intentional** discrimination against protected groups
- ❑ Disparate treatment of protected groups is illegal
- ❑ Courts have not accepted a showing of disparate impact as proof of unfair discrimination/disparate treatment



Adverse Impact

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Disproportionate Impact

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Disparate Impact

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Disparate Treatment

Griggs v. Duke Power

(1971 U. S. Supreme Court)

- ❑ Seminal disparate impact case, first reference to disparate impact
- ❑ Established that discriminatory **effect** was the issue and that lack of discriminatory **intent** did not matter
- ❑ Provided “business necessity” as the yardstick for assessing legality

Civil Rights Act of 1991

- Codified language from Griggs
- Tolerance of disparate impact if there is a demonstration of both job relatedness and business necessity

General Outline of Disparate Impact Cases

- ❑ Establish existence of adverse, disparate impact
- ❑ Establish significance of disparate impact
- ❑ Establish business necessity
- ❑ Establish existence of alternate procedures that can accomplish same business need with less adverse impact

NAACP v. American Family

(Wisconsin Seventh Circuit, 1992)

- ❑ Alleged violation of Fair Housing Act
- ❑ Alleged higher rates for homeowners in racial minority neighborhoods
- ❑ Alleged inferior coverages in racial minority neighborhoods
- ❑ Court distinguished between disparate treatment and disparate impact
- ❑ Court said risk discrimination is not race discrimination

DeHoyos v. Allstate

(Texas, Fifth Circuit, 2003)

- ❑ Alleged racial disparate impact because of use of credit-based insurance scores
- ❑ Court ruled McCarran-Ferguson did not preempt application of FHA
- ❑ U.S. Supreme Court refused to review
- ❑ Case settled without decision on disparate impact

Other Insurance Cases

- ❑ Canady, et al v. Allstate, et al (Missouri)
 - Alleged unfairly discriminatory rates due to disparate impact by territory
- ❑ Melder v. Allstate (Louisiana)
 - Alleged that credit-based insurance scores disparately impact on low-income and minority neighborhoods
- ❑ Schermer, et al v. State Farm Fire (Minnesota)
 - Alleged that discounts for upgraded utilities unfairly discriminatory because the effect on older homes disparately affected low-income and minority neighborhoods
- ❑ Amos, et al v. GEICO (Minnesota)
 - Alleged that underwriting factors of occupation and education level disparately impacted racial minorities because of higher rates
- ❑ Toledo Fair Housing v. American Family (Ohio)
 - Alleged that inferior coverage disparately impacts minority neighborhoods

FTC Study

- ❑ Found credit-based insurance scores were predictive of auto losses
- ❑ Found a small “proxy” effect
- ❑ Proxy finding opens door for charges of disparate impact

Unfairly Discriminatory Rates

“An insurance rate structure will be considered to be unfairly discriminatory..., if allowing for practical limitations, there are premium differences that do not correspond to expected losses and average expenses or if there are expected average cost differences that are not reflected in premium differences.”

Professor C. Arthur Williams, Jr.

Conflict in Definitions

- ❑ “Unfairly discriminatory” refers to rates and underwriting factors that are not cost-based
- ❑ Disparate impact not related to underlying costs
- ❑ Every risk factor has potential for disparate impact if distribution of insureds is not constant across all risk classes

Disparate Impact Exists If Distribution of Insureds Is Not Perfectly Constant Across All Classes of Insureds

| | <u>Majority Class</u> | <u>Minority Class</u> |
|----------------|-----------------------|-----------------------|
| # Insureds | 100 | 60 |
| High Rate | \$200 | \$200 |
| # Insureds | 100 | 40 |
| Low Rate | \$100 | \$100 |
| Total Insureds | 200 | 100 |
| Avg. Rate | \$150 | \$160 |

Application of Disparate Impact to Insurance

- ❑ Will even a slight degree of disparate impact be tolerated for insurance?
- ❑ How will practical significance of any disparate impact be measured?

Role of an Actuary

- ❑ Measure potential disparate impact
- ❑ Determine significance or practical importance of the disparate impact
- ❑ Establish the business necessity of the risk factor by showing its power to predict the propensity for loss
- ❑ Identify reasonable alternatives, if any

Recommended Business Practices

- ❑ Be aware that being cost-based is no longer the sole consideration and that every risk factor is in danger of prohibition
- ❑ Establish in your records that your sole intent is to measure risk
- ❑ Recommend against gathering data to measure disparate impact
- ❑ Be careful with discussions concerning substitute risk factors
- ❑ Retain a lawyer competent in ratemaking and underwriting issues