

Comments of Harvey Rosenfield, Consumer Watchdog

Workshop: Examining Bias and Discrimination in the Insurance Industry

California Department of Insurance

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The insurance industry's use of technologies such as algorithms, models, artificial intelligence, and machine learning to unfairly discriminate against Californians is a serious threat to the integrity, transparency and stability of California's insurance marketplace – and a violation of California law. That's why Consumer Watchdog welcomes this inquiry – and why our non-profit organization has continuously fought to stop insurance industry practices and proposals that seek the Department's blessing for abuses that the voters made illegal in 1988, long before the advent of massively powerful computers and the theft of personal data made it possible for insurers to engage in far more sophisticated forms of discrimination.

Back then, insurance companies relied on zip codes to avoid offering insurance, or overcharge people, based on their race, religion, gender or occupation. The pernicious practices of redlining and territorial rating were outlawed by provisions of Proposition 103 that require auto, home and business insurance rates and premiums to be empirically justified through a transparent, public process before the Department of Insurance that guarantees the public the right to scrutinize and object to violations of these voter-enacted protections. (Insurance Code sections 1861.01, 1861.02, 1861.05, 1861.07, 1861.10.) As the notice of this workshop states, today “California law prohibits discrimination in insurance ratemaking, claims handling practices, accepting insurance applications, and when canceling or nonrenewing insurance policies.” It says the Insurance Commissioner “is committed to preventing unfair practices targeting Californians, regardless of income level or ZIP code, and to ensuring consumer protections are upheld under California's laws.” Yet since the passage of Proposition 103, and through today, many insurance companies doing business in California continue to engage in discriminatory practices, often with little or no consequences. Here are four disturbing and ongoing examples.

1. Wealth and race-based auto insurance surcharges. Over the objection of Consumer Watchdog and other citizen organizations, the Department of Insurance has at least since 2007 permitted insurance companies to base motorists' auto insurance premiums on their occupation and education levels – unauthorized rating factors that are obvious surrogates for race and income. In a study it published on September 19, 2019, the agency itself acknowledged that automobile insurers' use of targeted “affinity marketing” programs to reward professionals and those with post-high school educational degrees with lower prices “disproportionately and adversely impact[s] drivers residing in ZIP codes: 1. With lower per capita incomes; 2. With lower levels of educational attainment; and 3. With a lower percentage of Non-Hispanic White population.”¹ Requiring middle and low income Californians to pay more for auto insurance in order to subsidize the wealthy is precisely

¹ See California Department of Insurance, Investigatory Hearing on the Use of Group Rating in Private Passenger Automobile Insurance [Sept. 17, 2019], http://www.insurance.ca.gov/0400-news/0200-studies-reports/upload/CDI-Affinity-Group-Hearing-Powerpoint-9_17_19_Public.pdf.)

the kind of systemic and discriminatory income and race-based system that this workshop proposes to address. Consumer Watchdog has repeatedly objected to approval of rate increases by companies utilizing affinity marketing systems – including Allstate, Farmers, Mercury, Interinsurance Exchange of the Auto Club, and GEICO.² In February 2019, one month after Commissioner Lara took office, Consumer Watchdog and ten community and civil rights organizations petitioned him to ban the use of occupation and education to set premiums.³ But the Department continues to allow insurance companies to do so. Apart from an investigatory hearing and two public workshops like this one – the last one held over a year and a half ago in March 2021 –the Commissioner has taken no further action to stop the discriminatory overcharges that are built into this marketing scheme.

2. Telematics. Under Proposition 103, insurance companies must set auto insurance premiums based on factors that are within a motorist’s control and can be objectively verified, principally their driving safety record, the number of miles they drive each year, and how many years of driving experience they have had. (Insurance Code section 1861.02.) The voters greatly suppressed the historic use of a person’s zip code, a practice known as territorial rating. Now, insurance companies are demanding to be allowed to base auto insurance premiums on computer *projections* of a motorist’s risk of getting into an accident based on a person’s “geo-location,” where and what time of day they drive, how and when a person applies the brakes, as well as a potential multitude of other unknown factors based on the vast trove of unverified personal data that is collected as people shop, research and interact online. At the other end of the transaction, insurance companies aim to turn their policyholders’ private information into a new source of profits, by selling data about their customers’ driving and shopping habits back to Wall Street data collectors and advertisers.

Claiming that their “telematics” algorithms are trade secrets, the insurance companies want to evade another cardinal principle of California law: that insurance companies must open their books and justify every method and manner by which they set rates, including the algorithms and models that purport to predict a person’s future likelihood of getting into an accident. (Section 1861.07.) Telematics shifts the insurance rate-making process from one that can be analyzed and verified to an arbitrary “smart black box” system –in which the legitimacy of prices and underwriting practices can never be confirmed.

Commissioner Lara endorsed telematics in a closed-door speech to the insurance industry shortly after taking office,⁴ and insurance companies have stated publicly that they have

² <https://www.consumerwatchdog.org/insurance/consumer-watchdog-calls-insurance-commissioner-lara-reject-mercurys-job-based-insurance>; <https://www.consumerwatchdog.org/insurance/consumer-watchdog-challenges-202-million-auto-club-insurance-rate-increase-job-based>; <https://www.consumerwatchdog.org/insurance/consumer-watchdog-challenges-268-million-geico-auto-insurance-rate-hike-job-and-education>; <https://www.consumerwatchdog.org/insurance/commissioner-lara-should-reject-farmers-auto-insurance-rate-hikes-and-stop-surcharges>

³ <https://www.consumerwatchdog.org/insurance/community-groups-petition-california-insurance-commissioner-ricardo-lara-ban-use>

⁴ Marinucci and White, “Lara Tells Insurers He’s ‘Receptive’ to Their Ideas, Including Vehicle Data Use,” Politico, July 29, 2019.

met with Insurance Commissioner Lara and that he supports their efforts.⁵ The Commissioner has since tweeted he will protect Californians privacy. The Commissioner must respect and enforce the law.

3. Price Optimization. Starting in the mid-2000's, insurance companies began relying on Big Data to research the intimate details of the behavior of their customers. Through this process, they learned that some policyholders are willing to tolerate modest increases in their premiums more than other customers. The economists' buzz word for this is "price optimization." Companies that "optimize" their premiums charge some customers more than they should – sometimes just a few dollars more. But these dollars add up.

As a Bulletin issued by the Commissioner in 2015 confirms,⁶ price optimization is unlawful in California and other states, where premiums must be set based on objective criteria and data related to risk, not whether a particular person will stomach a rate increase. A four year administrative inquiry before the Department uncovered evidence that Farmers had engaged in price optimization in California.⁷ Farmers ultimately settled a class action lawsuit with its customers; but the Department failed to issue any penalties against the company. In a similar investigation now underway before the Department, Consumer Watchdog's expert concluded that Allstate, the state's third largest auto insurance company, has also engaged in price optimization in California, overcharging its best customers by approximately \$1 billion since 2012.⁸ That case is set for an administrative trial before CDI for November 9, 2022.

California law authorizes the Commissioner to levy penalties of up to \$10,000 for each person who was overcharged or discriminated against in violation of Proposition 103. Such penalties, in an amount reflective of the gravity of the violations, are necessary to both punish wrongdoers and deter other insurance companies from engaging in similar behavior. To police the California marketplace and deter such wrongdoing, the Commissioner must require Allstate to pay penalties commensurate with the gravity of the overcharges.

4. Homeowner Wildfire Risk Scores. Just as insurance companies are attempting to move from historically objective, verifiable estimates of a motorist's likelihood of getting into an accident to subjective, arbitrary and secret software algorithms, the companies that insure people's homes have begun using models and algorithms that set a homeowner's "wildfire risk score" to determine whether a person is eligible to buy insurance and if so, the price they will be required to pay. If, according to the algorithm, a particular homeowner's wildfire risk score is too high, the insurance company will refuse to sell them a policy, or nonrenew them. Each company deploys its own scoring system, often

⁵ Consumer Watchdog, "Connected Cars and The Threat to Your Privacy," March 2022.

⁶ <https://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/bulletin-notices-commiss-opinion/upload/PriceOptimization.pdf>

⁷ <https://www.consumerwatchdog.org/courtroom/farmers-insurance-caught-overcharging-its-most-loyal-customers-violation-proposition-103>

⁸ <https://www.consumerwatchdog.org/courtroom/case-update-allstate-price-optimization>; see also <https://themarkup.org/allstates-algorithm/2022/02/01/newly-public-documents-allege-allstate-overcharged-loyal-california-customers-1-billion>

based on software sold by third parties, which claim their models are trade secrets. Hundreds of thousands of Californians have lost their home insurance based on wildfire scores. Interestingly, while the insurers want to use software models to predict wildfire claims and determine homeowners' premiums, the companies claim they can't predict the reduction in risk when a homeowner takes actions to protect their property against wildfire – often at a substantial cost. In February, the Department proposed a regulation that would prevent insurance companies from using algorithms and models to set overall rates, and *require* companies to offer homeowners wildfire mitigation discounts – two important measures. But it left intact the private algorithmic scoring system that insurance companies can use to deny coverage altogether.⁹

We urge the Commissioner to reject the glittery hype and facile promises proffered by the insurance companies and Big Data firms seeking a regulatory windfall at the expense of California consumers. The promoters of Artificial Intelligence, algorithms and Machine Learning contend that every advance in technology improves our lives. That's proven to be a myth. These technologies are the product of human engineers working primarily for large corporations. Their clandestine decisions on the choice of data to input and the algorithms and models that manipulate the data would allow Insurance companies to cloak old-school discrimination in a phony aura of technological infallibility.

California law is clear: insurance rates and practices that unfairly discriminate are *illegal*. What is needed now in California is *enforcement of the law*.

⁹ <https://www.consumerwatchdog.org/insurance/insurance-commissioner-laras-regulation-preserves-loophole-letting-insurers-ignore>